11-1684-cv

United States Court of Appeals
for the Second Circuit

BOILERMAKER BLACKSMITH NATIONAL PENSION TRUST,
NEW JERSEY CARPENTERS VACATION FUND,
on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

v.

(*caption continued on inside cover*)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF DEFENDANTS-APPELLEES

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HARBORVIEW MORTGAGE LOAN TRUST 2006-4, HARBORVIEW MORTGAGE LOAN TRUST 2006-5, HARBORVIEW MORTGAGE LOAN TRUST 2006-9, FITCH RATINGS, RBS HOLDINGS USA INC., RBS ACCEPTANCE INC., RBS FINANCIAL PRODUCTS INC., RBS FINANCIAL PRODUCTS INC., RBS SECURITIES INC.,

Defendants,

THE ROYAL BANK OF SCOTLAND GROUP, PLC, GREENWICH CAPITAL HOLDINGS, INC., GREENWICH CAPITAL ACCEPTANCE, INC., GREENWICH CAPITAL MARKETS, INC., GREENWICH CAPITAL FINANCIAL PRODUCTS, INC., ROBERT J. MCGINNIS, CAROL P. MATHIS, JOSEPH N. WALSH, III, JOHN C. ANDERSON, JAMES C. ESPOSITO, MOODY'S INVESTORS SERVICE, INCORPORATED, THE MCGRAW-HILL COMPANIES, INC., RBS SECURITIES, INC., FKA GREENWICH CAPITAL MARKETS, INC., DBA RBS GREENWICH CAPITAL,

Defendants-Appellees.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, *Amicus Curiae* Securities Industry and Financial Markets Association hereby certifies that it 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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INTEREST OF *AMICUS CURIAE*

The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the United States regional member of the Global Financial Markets Association.

SIFMA regularly files *amicus curiae* briefs in cases that raise legal issues of vital concern to the participants in the securities industry. SIFMA has appeared as *amicus curiae* in many cases involving issues arising under the federal securities laws, including *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011); *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011); *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010); *Merck & Co. v. Reynolds*, 130 S. Ct. 1784 (2010); *Jones v. Harris Associates L.P.*, 130 S. Ct. 1418 (2010); and *Willow Creek Capital Partners v. UBS Securities LLC*, No. 11-122 (2d Cir.) (pending).[1]

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[1] No counsel for a party authored this brief in whole or in part; and no such counsel or any party made a monetary contribution intended to fund the preparation or submission of this brief. No person or entity, other than *amicus* and its counsel, made a monetary contribution intended to fund its preparation or submission.

This case involves important issues regarding the standards under which private securities claims can be appropriately adjudicated as class actions. A decision to certify a class exerts enormous and undue settlement pressure on a defendant, even one with a meritorious defense. *See Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 165 (3d Cir. 2001) ("certifying the class may place unwarranted or hydraulic pressure to settle on defendants"); Fed. R. Civ. P. 23(f) advisory committee's note to the 1998 amendments ("An order granting certification . . . may force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability."). The *in terrorem* effect of class actions is especially acute in private securities cases. *See* H.R. Rep. No. 104-369, at 26 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 731 ("In . . . examples of abusive and manipulative securities litigation, innocent parties are often forced to pay exorbitant 'settlements.'"); Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497, 523 (1991) (concluding that "the merits did not affect the settlement amounts").

These issues are directly relevant to SIFMA's mission of promoting the fairness and strength of the financial services industry. Resolution of these issues could have a profound effect on SIFMA's members.

SUMMARY OF ARGUMENT

Plaintiffs contend that all securities cases are presumptively appropriate for class treatment. The Supreme Court, however, has observed that only "certain" securities cases will satisfy the requirements for class certification, *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 626 (1997), and recently reiterated that class treatment is an "exception." *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2550 (2011). The proponent of class certification always has the burden of proving compliance with the requirements of Rule 23. *Id.* at 2551.

In this case, Plaintiffs did not carry their burden of satisfying the predominance and superiority requirements of Rule 23(b)(3) because the nature of the securities at issue will necessitate a host of individualized determinations that are inimical to collective adjudication. The District Court properly considered the unique attributes of mortgage pass-through certificates in determining that the proposed class action would require "significant individualized evidence on, among other things, each purchaser's knowledge and damages" and that "[t]he necessity of hearing all this individualized evidence defeats the requisite superiority of class treatment." (SPA-13).

In an attempt to salvage their proposed class, Plaintiffs would have this Court adopt a "legal standard" that assumes class certification is "the norm for claims under the Securities Act" and imposes on the Defendants at the class

certification stage the burden of proving the merits of their investor knowledge defense with "clear evidence demonstrating that there was widespread knowledge of the specific alleged [*i.e.*, unproven] misstatements." Plaintiffs-Appellants' Brief ("Ps' Br.") at 27 (Dkt. 43).

Plaintiffs' proposed legal standard is unsupportable because it reverses the parties' burdens on class certification. It is Plaintiffs' burden to demonstrate that a proposed class satisfies all the requirements of Rule 23, not the Defendants' burden to disprove Plaintiffs' presumed compliance with Rule 23. *See Wal-Mart*, 131 S. Ct. at 2551.

Moreover, the predominance and superiority inquiries under Rule 23(b)(3) require a court to assess how a proposed class action case will be tried on the merits, not which party is likely to prevail at trial. Plaintiffs do not, and cannot, explain how investor knowledge could be anything but an individualized inquiry in the circumstances of this case. Indeed, the record is devoid of any plausible trial plan under which either the claims or defenses could be effectively adjudicated on a classwide basis. Individual mini-trials to present and consider individualized evidence cannot be avoided, and it is those individualized inquiries that the District Court properly considered in holding that Plaintiffs had failed to satisfy the predominance and superiority requirements of Rule 23(b)(3).

The District Court's Order denying Plaintiffs' motion for class certification should be affirmed.

ARGUMENT

I. CLASS CERTIFICATION IS NOT THE "NORM"

Contrary to Plaintiffs' assertion that class certification should be regarded as the "norm" (Ps' Br. at 27), the Supreme Court has long made clear that "[t]he class action is 'an *exception* to the usual rule that litigation is conducted by and on behalf of the individual named parties only.'" *Wal-Mart*, 131 S. Ct. at 2550 (quoting *Califano v. Yamasaki*, 442 U.S. 682, 700-01 (1979) (emphasis supplied)). Thus, class action status is not to be granted without a "rigorous analysis." *In re Initial Pub. Offering Sec. Litig.*, 471 F.3d 24, 33 (2d Cir. 2006) ("*IPO*"), (quoting *Gen. Tel. Co. v. Falcon*, 457 U.S. 147, 161 (1982)), *reh'g denied*, 483 F.3d 70 (2d Cir. 2007).

To obtain class certification, a plaintiff must demonstrate not only that there are common issues – *i.e.*, "the *capacity* of a classwide proceeding to generate common *answers* apt to drive the resolution of the litigation," *Wal-Mart*, 131 S. Ct. at 2551 (emphasis in original) (citation omitted) – to satisfy the commonality requirement of Rule 23(a)(2), but that "common answers" will predominate over individual answers to satisfy the predominance requirement of Rule 23(b)(3).

The predominance requirement is "far more demanding" than Rule 23(a)'s commonality requirement. *Amchem*, 521 U.S. at 624. Thus, "courts frequently have found that the requirement was not met where, notwithstanding the presence of common legal and factual issues that satisfy the commonality requirement, the resolution of individual claims for relief would require individualized inquiries." *Dunnigan v. Metro. Life Ins. Co.*, 214 F.R.D. 125, 138 (S.D.N.Y. 2003).

The Rules Enabling Act, 28 U.S.C. § 2072(b), precludes application of procedural rules (including Rule 23) in a way that would modify the applicable substantive law, and ensures that the claim elements and defenses that would have to be proved in an individual action must also be proved in a class action. In other words, if a plaintiff has a burden of proving a claim element in an individual case, he cannot be relieved of that burden in a class action, *Hohider v. United Parcel Serv., Inc.*, 574 F.3d 169, 184-85, 196-98 (3d Cir. 2009); and, if the defendant has a statutory defense in an individual action, he cannot be precluded from presenting that defense in a class action. *See Wal-Mart*, 131 S. Ct. at 2561.

Thus, in assessing a proposed class action, a court may not ignore individualized claim elements or defenses. Where, as here, individual inquiries cannot be avoided, courts have repeatedly denied class certification for failure to satisfy the predominance and superiority requirements of Rule 23(b)(3). *See McLaughlin v. Am. Tobacco Co.*, 522 F.3d 215, 223-34 (2d Cir. 2008); *IPO*, 471

F.3d at 42-45; *Berks Cnty. Emps.' Ret. Fund v. First Am. Corp.*, 734 F. Supp. 2d 533, 536-41 (S.D.N.Y. 2010); *Ruggles v. WellPoint, Inc.*, 272 F.R.D 320, 341 (N.D.N.Y. 2011); *Dunnigan*, 214 F.R.D. at 139-42.

II. THE DISTRICT COURT PROPERLY CONSIDERED THE UNIQUE ATTRIBUTES OF MORTGAGE PASS-THROUGH CERTIFICATES IN DETERMINING THAT PLAINTIFFS HAD FAILED TO MEET THEIR BURDEN UNDER RULE 23(b)(3)

In arguing that "no securities class action could ever be certified under Rule 23" if the District Court's Order is affirmed (Ps' Br. at 2), Plaintiffs erroneously presume that all securities (and all lawsuits involving securities) are the same.[2] They are not. There are many different types of securities, and a "one size fits all" approach for the class certification analysis in every securities case is inconsistent with both the federal securities laws and Rule 23, neither of which authorizes "automatic" certification in securities cases. On the contrary, the Supreme Court recently reiterated that securities cases, like all federal civil actions, must comply with Rule 23. *See Wal-Mart*, 131 S. Ct. at 2552 n.6; *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2184 (2011). Given the wide range of securities in the market – from common stock of public companies trading on established

[2] *See also* Brief of The National Association of Shareholder and Consumer Attorneys ("NASCAT Br.") at 2 (Dkt. 60-2) ("[I]f this holding stands it could largely extinguish the ability of investors to maintain securities actions."); Brief of The Council of Institutional Investors at 4 (Dkt. 69-2) ("Th[e] decision would effectively preclude any securities class from being certified.").

exchanges to structured finance products trading in individually negotiated transactions – the circumstances of each case, including the characteristics of the securities at issue, must be separately examined.

Because the scrutiny of a proposed Rule 23(b)(3) class includes an assessment of how the merits of a case will be tried, a "case-specific analysis" is required for each proposed Rule 23(b)(3) class. *Castano v. Am. Tobacco Co.*, 84 F.3d 734, 744-45 (5th Cir.1996) ("Absent knowledge of how [the case at issue] would actually be tried, however, it was impossible for the court to know whether the common issues would be a significant portion of the individual trials."). The Supreme Court has observed that only "certain" securities cases will satisfy the Rule 23(b)(3) predominance requirement. *Amchem*, 521 U.S. at 625.

One way to conceptualize the core question on appeal, therefore, is what kinds of securities cases are *not* appropriate for class treatment? And the answer, which ought not to be controversial, is that cases not involving traditional corporate securities require a particularly "rigorous analysis." *Falcon*, 457 U.S. at 161.

Here, as the District Court recognized, and as explained below, the distinguishing characteristics of mortgage pass-through certificates render class certification inappropriate.

A. Asset-Backed Securities, Such As The Mortgage Pass-Through Certificates At Issue In This Case, Are Very Different From Traditional Corporate Securities

The mortgage pass-through certificates at issue in this case are a type of asset-backed security ("ABS"). The SEC has established a "separate framework for the registration and reporting of asset-backed securities due to differences between asset-backed securities and other securities." *Asset-Backed Securities*, Securities Act Release No. 33-8518, 70 Fed. Reg. 1506, 1507 (Jan. 7, 2005).

Securitization refers to structured financing transactions in which companies (for example, mortgage loan originators) sell assets (for example, mortgage loans) to a trust, which, in turn, issues securities that are backed by the assets. *See generally* RONALD S. BOROD, SECURITIZATION, ASSET BACKED AND MORTGAGE BACKED SECURITIES, 1-3 (3d ed. 1991). "In the mortgage market, securitization converts mortgages to mortgage-backed securities." Richard J. Rosen, *The Role of Securitization in Mortgage Lending* (Fed. Res. Bank of Chi., Chi. Fed. Letter No. 244, 2004) at 1.

Unlike with traditional corporate securities, the value of ABS does not depend on the profitability of its issuer:

> Asset-backed securities are securities that are backed by a discrete pool of self-liquidating financial assets. Asset-backed securitization is a financing technique in which financial assets, in many cases themselves less liquid, are pooled and converted into instruments that may be offered and sold in the capital markets. In a basic securitization structure, an entity, often a financial institution and

> commonly known as a "sponsor," originates or otherwise acquires a pool of financial assets, such as mortgage loans, either directly or through an affiliate. It then sells the financial assets, again either directly or through an affiliate, to a specially created investment vehicle that issues securities "backed" or supported by those financial assets, which securities are "asset-backed securities." Payment on the asset-backed securities depends primarily on the cash flows generated by the assets in the underlying pool and other rights designed to assure timely payment, such as liquidity facilities, guarantees or other features generally known as credit enhancements. The structure of asset-backed securities is intended, among other things, to insulate ABS investors from the corporate credit risk of the sponsor that originated or acquired the financial assets.

Asset-Backed Securities, 70 Fed. Reg. at 1508.

Thus, "there is essentially no business or management of the issuing entity" to describe in offerings of ABS, and "GAAP financial information about the issuing entity generally does not provide useful information." *Id.* at 1511. "Instead, information about the transaction structure and the characteristics and quality of the asset pool and servicing is often what is most important to investors" in ABS. *Id.* at 1508.

"ABS transactions often involve multiple classes of securities, or tranches, with complex formulas for the calculation and distribution of the cash flows." *Id.* at 1511. *See also City of Ann Arbor Emps.' Ret. Sys. v. Citigroup Mortg. Loan Trust Inc.*, 703 F. Supp. 2d 253, 255-56 (E.D.N.Y. 2010) ("Interests in trusts are often grouped into different sections or 'tranches,' with different levels of risk."). "In addition to creating internal credit enhancement or support for more senior

classes, these structures allow the cash flows from the asset pool to be packaged into securities designed to provide returns with specific risk and timing characteristics." *Asset-Backed Securities*, 70 Fed. Reg. at 1511. Indeed, one of the primary innovations of ABS is that it allows investors to request the creation of securities tailored to their specific needs.

Given the "complex" structures "designed to provide returns with specific risk and timing characteristics," ABS are typically "not marketed to retail investors." *Id.* Instead, "[t]he predominant purchasers of asset-backed securities . . . are institutional investors, including financial institutions, pension funds, insurance companies, mutual funds and money managers" that negotiate and make large investments in ABS tailored to their specific investment needs. *Id.*

B. Mortgage Pass-Through Certificates Are Unlike Traditional Corporate Securities In Many Respects

Plaintiffs in this case seek certification of a single class consisting of investors in any of 39 different tranches of mortgage pass-through certificates issued in an April 2006 offering and an October 2007 offering.

Mortgage pass-through certificates differ from traditional corporate securities in many respects.

First, each offering of mortgage pass-through certificates is backed by a distinct mortgage pool that is often further subdivided into smaller loan groups. A-259, 430. The loans may be "originated by different companies, by different

underwriting officers, and valued by different appraisers. Moreover, the loan groups could be comprised of different types of loan products, *e.g.*, first lien loans, second lien loans, fixed rate loans, and adjustable rate loans. The term length of the loans could also differ." *Me. State Ret. Sys. v. Countrywide Fin. Corp.*, 2011 WL 4389689, at *7 (C.D. Cal. May 5, 2011) ("*Countrywide*").

Second, each offering is structured to address different risk appetites and is comprised of multiple distinct tranches of mortgage pass-through certificates that each represents a different investment opportunity. A-256-71, 426, 430-39. Indeed, "[t]he very point of pooling mortgages and creating tranches is to create different securities whose credit and risk profiles attract different purchasers." *In re Washington Mut. Mortgage-Backed Sec. Litig.*, 2011 WL 5027725, at *2 (W.D. Wash. Oct. 21, 2011) ("*WaMu*").

Third, different tranches of mortgage pass-through certificates within the same offering are often backed by different loans in different loan groups. *See* A-259, 430; *Countrywide*, 2011 WL 4389689, at *5 (explaining that mortgage pass-through certificate tranches are "often backed by different loans than other tranches in the same MBS offering").

Fourth, each tranche is a separately traded security, with its own unique CUSIP identifier, original principal note balance, interest rate, credit rating, payment rights, and priority for receiving distributions of cash flows. A-256-71,

426, 430-39; *WaMu*, 2011 WL 5027725, at *1 ("Each tranche is an individual security in which investors could buy certificates."); *Countrywide*, 2011 WL 4389689, at *5 ("The Court agrees that each tranche, or Certificate, is indisputably a separate security."); Peter H. Hammer, *The Credit Crisis and Subprime Litigation: How Fraud Without Motive "Makes Little Economic Sense"*, 1 U. Puerto Rico Bus. L.J. 103, 109-11 (2010). Thus, each investor in an offering of mortgage pass-through certificates is differently situated based on the particular tranche that it purchased:

> The variety in terms of type of loan products, length of the term, credit rating and interest rate, existed at the tranche level to allow each investor to choose the characteristics of the security that best matched its needs. Some investors forwent the opportunity for a higher return and chose safer investments, such as the most senior tranches. Other investors decided the riskiest tranches met their needs. In all cases, each tranche provided a different investment opportunity with unique characteristics.

Countrywide, 2011 WL 4389689, at *7.

Fifth, each offering of mortgage pass-through certificates has its own unique prospectus supplement containing distinct disclosures about the different tranches and the particular loans backing the different tranches. *See* A-254-55, 366, 371-406, 497-99, 502-29; *Countrywide*, 2011 WL 4389689, at *7.

Sixth, mortgage pass-through certificates are typically not marketed to the public at large. *See Asset-Backed Securities*, 70 Fed. Reg. at 1511. Instead, they are sold in individually "negotiated transactions" at "varying prices to be

determined at the time of sale." A-254, 424. The "predominant purchasers" of mortgage pass-through certificates are "institutional investors" who typically make large investments. *Asset-Backed Securities*, 70 Fed. Reg. at 1511.

Seventh, mortgage pass-through certificates do not trade on a national exchange or other transparent, efficient market and are thus generally viewed as long-term investments. Indeed, the offering documents here expressly disclaimed any secondary market for the mortgage pass-through certificates. *See* A-447.

Eighth, for each trust that holds mortgage loans and issues mortgage pass-through certificates, there are monthly reports that "detail the payment and performance of the financial assets [*i.e.*, the mortgage loans] in the asset pool and payments on the securities [*i.e.*, the mortgage pass-through certificates]." *Asset-Backed Securities*, 70 Fed. Reg. at 1511. Thus, there is updated performance data available to later investors. A-333, 521-23.

C. The Distinguishing Characteristics Of Mortgage Pass-Through Certificates Render Class Certification Particularly Inappropriate

Given the unique attributes of mortgage pass-through certificates, the District Court properly concluded that "[w]ere I to certify the proposed classes the Court would have to hear significant individualized evidence on, among other things, each purchaser's knowledge and damages." (SPA-13). Indeed, there are

no "common *answers*" for the claims or defenses in the action. *Wal-Mart*, 131 S. Ct. at 2551 (emphasis in original).

1. No "Common Answers" For Claims

Plaintiffs' proposed class lumps investors in 39 different tranches together based on allegedly "identical" misrepresentations (Ps' Br. at 10), but there are no "common answers" for Plaintiffs' claims. Indeed, because different tranches are backed by *different* collateral in *different* loan pools and/or *different* loan groups, the answer to whether underwriting guidelines were followed for the collateral backing one certificate is not the same for all certificates:

> Because the loan groups backing the Certificates differed from tranche to tranche, the statements regarding underwriting and credit characteristics found in the prospectus supplements for those MBS deals were essentially different statements for each tranche . . . . In other words, an alleged misstatement as to the origination practices with respect to one loan group backing a particular tranche would not necessarily constitute a misstatement as to a different loan group backing a different tranche. . . . [A]ny alleged injury flowing from an alleged misstatement as to one tranche would not necessarily constitute injury to purchasers of different tranches.

Countrywide, 2011 WL 4389689, at *7.[3]

[3] The *Countrywide* court addressed as a matter of first impression "whether the Plaintiffs have standing to sue on behalf of investors who purchased different Certificates in the same public offerings – *i.e.*, different tranches offered pursuant to the same prospectus supplement – in which Plaintiffs purchased." 2011 WL 4389689, at *3-4 & n.10. After "careful consideration" of the distinguishing characteristics of mortgage pass-through certificates, the court held that standing is limited to those tranches in an offering from which a plaintiff purchased certificates. *Id.* at *4-8. The *WaMu* court likewise reviewed

A proposed class action involving investors in multiple different tranches of mortgage pass-through certificates is thus far different from a proposed class action comprised of investors in a traditional corporate security such as common stock. Whereas class treatment may be appropriate in a case involving investors in "a large number of shares [of common stock] traded publicly in an established market," *In re Deutsche Telekom AG Sec. Litig.*, 229 F. Supp. 2d 277, 280 (S.D.N.Y. 2002), because the investors are concerned about the same thing (the publicly available information about the issuer's financial performance), class treatment is not appropriate in a case encompassing investors in multiple different tranches of mortgage pass-through certificates because the investors are concerned about the characteristics and performance of the different loans backing their different tranches of certificates.

Because the distinct securities for which Plaintiffs seek class certification are backed by *different* collateral, there are no "common answers" on liability or damages for the proposed class. *Wal-Mart*, 131 S. Ct. at 2551. *See also City of Ann Arbor*, 703 F. Supp. 2d at 260 ("Plaintiffs must be able to prove falsity with respect to statements, or omissions regarding the mortgages in which they

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the distinguishing characteristics of mortgage pass-through certificates and concluded that "Plaintiffs' standing is . . . limited only to those tranches in which they actually purchased certificates." *WaMu*, 2011 WL 5027725, at *2.

purchased interests. Those statements will inevitably require reference to particular pools of mortgages contained in particular securities.").

2. No "Common Answers" For Defenses

There are also no "common answers" for the defenses in the action. The proposed class is comprised primarily of "large, institutional and sophisticated investors," including "pension funds" and "hedge funds and mutual funds" (SPA-12, 13) that acquired certificates through individually negotiated transactions. A-254, 424. *See also Asset-Backed Securities*, 70 Fed. Reg. at 1511.

Because of the typically large and long-term nature of investments in mortgage pass-through certificates, the institutional investors and their advisors undertook significant independent research, investigation, and analyses. For example, Western Asset Management Company ("WAMCO"), one of Plaintiffs' investment advisors, "testified that it was regular practice for its analysts to meet with mortgage originators." (SPA-10). "WAMCO's objective in these meetings was to understand what their underwriting guidelines were . . . [and] whether originators made any exceptions to their underwriting guidelines." *Id.* Thus, "it knew that loans could be originated with exceptions to loan underwriting guidelines, and it knew that such loans posed the increased risk of delinquencies and heightened losses." *Id.* WAMCO's documents "make clear that it had at least some awareness of the risk or type of conduct that is targeted in this lawsuit,"

including "deteriorating underwriting standards" that "allowed many borrowers to purchase homes that they cannot afford." *Id.* at 10-11.

Moreover, during the multi-year period covered by the proposed class,[4] "later purchasers would have been privy to information about increasing delinquency and foreclosure rates, as well as key ratings downgrades." (SPA-12). In addition, "more and more information became publicly available including reports of government actions or investigations, analyst reports, news items and raw data." *Id.* at 11. "This information cast increasing levels of doubt on whether the loans comprising mortgage backed securities were originated in conformity with appropriate guidelines and risk analyses." *Id*. *See In re Superior Offshore Int'l, Inc. Sec. Litig*., 2010 WL 2305742, at *5 (S.D. Tex. June 8, 2010) (denying class certification because "[a]s more information became available during the proposed class period, it became more likely that an individual purchaser of Superior's IPO shares had knowledge that would support the affirmative [knowledge] defense asserted by Defendants").

Because investors in mortgage pass-through certificates undertook significant independent research, investigation, and analyses relating to the very loan origination practices challenged by Plaintiffs, and were privy to different

[4] The proposed class encompasses investors who purchased at any time after the challenged offerings in 2006 and 2007.

information depending on when they purchased their certificates, there is, as the District Court found, a reasonable inference of investor knowledge that will require individualized inquiries.[5] *See IPO*, 471 F.3d at 44 n.14 (finding that individualized inquiries would be required where investor knowledge was "at least a reasonable inference").[6]

Plaintiffs denigrate the District Court's finding as "rest[ing] on the illogical inference that investment advisors and mutual funds who purportedly had

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[5] For traditional corporate securities like common stock, "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." *Basic Inc. v. Levinson*, 485 U.S. 224, 246 (1988). Because mortgage pass-through certificates do not trade on a developed, efficient market, there is no "market" reflection of material information for mortgage pass-through certificates. Instead, each investor must make his own assessment of the material information regarding, and value of, any given tranche of a mortgage pass-through certificate.

[6] Plaintiffs assert that *IPO* established a bright-line rule requiring defendants at the class certification stage to produce "clear evidence demonstrating that there was widespread [investor] knowledge of the specific alleged misstatements." Ps' Br. at 25. *IPO* established no such rule. In *IPO*, the "Plaintiffs' own allegations" reflected investor knowledge of "aftermarket purchase requirements," but "not necessarily [of] the indirect scheme to defraud investors by artificially driving up securities prices." 471 F.3d at 43-44 & n.14. Even in the absence of allegations (or proof) of widespread knowledge of the price-inflation scheme, this Court found that the district court had erred in finding that individualized inquiries of investor knowledge would not be required because there was "at least a reasonable inference" of investor knowledge that "a requirement to purchase in the aftermarket would artificially inflate securities prices." *Id*. Here, as in *IPO*, there is "at least a reasonable inference" of investor knowledge of the underwriting practices in question that will require individualized inquiries.

heightened investment knowledge of mortgage-backed securities would have purchased the Bonds . . . knowing that the mortgage collateral . . . ha[d] not been originated pursuant to the stated underwriting guidelines." Ps' Br. at 49.

Plaintiffs ignore, however, that there was an unprecedented expansion of the residential real estate market during which housing prices had consistently increased for years.[7] Prior to the collapse of the residential real estate market, many believed that home prices would continue to rise or at least not fall. *See* Michael Comiskey and Pawan Madhogarhia, *Unraveling the Financial Crisis of 2008*, Political Science and Politics (April 2009); *The Financial Crisis and the Role of Federal Regulators: Hearing Before the H. Comm. on Government Oversight and Reform*, 110th Cong. 17 (2008) (statement of Alan Greenspan, former Chairman of the Federal Reserve Board).

Moreover, Plaintiffs ignore that the underwriting practices for the underlying mortgage loans were openly permissive[8] and that the offerings of mortgage pass-

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[7] *See* S&P/Case-Shiller Home Price Indices, *available at* http://www.standardandpoors.com/indices/sp-case-shiller-home-price-indices/en/us/?indexId=spusa-cashpidff--p-us---- (last accessed on Nov. 10, 2011).

[8] For example, the Harborview Series 2006-4 prospectus supplement explained that "[t]he borrower is not required to disclose any income information for some mortgage loans originated under [the originator's] Reduced Documentation Program . . . " and that "[u]nder the No Income/No Asset Documentation Program, no documentation relating to a prospective borrower's income, employment or assets is required. . . . " A-340.

through certificates were structured to address different risk appetites. *See Countrywide,* 2011 WL 4389689, at *7. Investors who wanted additional protection, for example, could acquire senior tranches that were supported by credit enhancement mechanisms or insured. *See* A-386-87, 498.

Thus, there was nothing "illogical" about the District Court's ruling. Ps' Br. at 49. The District Court made the reasonable determination that "relevant individual issues exist concerning the level of knowledge possessed by different putative class members" (SPA-12) because investors (i) were aware that the stated underwriting guidelines for underlying mortgage loans were permissive on their face; (ii) undertook significant independent research, investigation, and analyses relating to the very loan origination practices challenged by Plaintiffs, including direct in-person meetings with the loan originators themselves; (iii) did so during a time in which many believed that home prices would continue to rise or at least not fall; (iv) could negotiate for and purchase certificates that were tailored to their risk tolerances; and (v) were privy to different information on the performance of the loans and the tranches depending on when they purchased.

3. In The Absence Of "Common Answers," Class Action Treatment Is Not Superior

The Supreme Court has warned against reflexively granting class action treatment because it "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." *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 476 (1978). *See also CE Design Ltd. v. King Architectural Metals, Inc.*, 637 F.3d 721, 723 (7th Cir. 2011) ("Certification as a class action can coerce a defendant into settling on highly disadvantageous terms regardless of the merits of the suit.").

Here, the potential *in terrorem* effect is particularly acute because Plaintiffs propose to lump investors in 39 different securities together in order to press aggregate claims relating to over $3 billion in securities. *See IPO*, 471 F.3d at 38 n.9 (noting "the enormous settlement pressure often arising from certification"); *Castano*, 84 F.3d at 746 ("Class certification magnifies and strengthens the number of unmeritorious claims. Aggregation of claims also makes it more likely that a defendant will be found liable and results in significantly higher damages.").

As demonstrated above, however, there are no "common answers" for either the claims or defenses in the proposed blunderbuss class. Indeed, the record is devoid of any plausible trial plan under which the claims and defenses could be effectively adjudicated on a classwide basis. *See Wachtel ex rel. Jesse v. Guardian Life Ins. Co. of Am.*, 453 F.3d 179, 186 n.7 (3d Cir. 2007) (noting that presentation of pre-certification "trial plans" is an "advisable practice" because "a clear and complete statement of the claims, issues, or defenses to be treated on a class basis will shed light on a district court's numerosity, commonality, typicality, and predominance analysis under Rule 23(a) and (b)"); Fed. R. Civ. P. 23(c)(1)

advisory committee's note to the 2003 amendments (noting "critical need" at the Rule 23 stage to "determine how the case will be tried" and that "[a]n increasing number of courts require a party requesting class certification to present a 'trial plan' that describes the issues likely to be presented at trial and tests whether they are susceptible of class-wide proof").

Plaintiffs' conspicuous failure to present a trial plan underscores that "[t]he specter of adjudicating plaintiffs' claims at trial is, at the very least, daunting." *Newton*, 259 F.3d at 192. Because there is no common proof for the claims of, and defenses against, the investors in the 39 different securities, there would have to be a series of mini-trials to present and consider individualized evidence. "The necessity of hearing all this individualized evidence defeats the requisite superiority of class treatment." (SPA-13). *See also Dunnigan*, 214 F.R.D. at 142 ("If a class were certified here, the Court would be required to conduct a series of mini-trials . . . . Under these circumstances, a class action is not a feasible, let alone superior, method for the fair, efficient, and manageable adjudication of the putative class's claims for interest.").

Moreover, the proposed class here is unlike those in common stock cases where there are many investors who made relatively modest investments. Because mortgage pass-through certificates are not sold on a national exchange or other transparent, efficient market, but are instead sold in individually "negotiated

transactions" with institutional investors and investment advisors, the proposed class is comprised of investors who made relatively large investments. As the District Court observed, these "large, institutional and sophisticated investors" have "the financial resources and incentive to pursue their own claims." (SPA-12).

All of the relevant factors thus confirm that class treatment would *not* be superior and that this case should *not* be an "exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only." *Wal-Mart*, 131 S. Ct. at 2550 (quotation marks omitted).

* * *

In presuming that class certification is the "norm" for securities actions (Ps' Br. at 27), Plaintiffs ignore the significant differences between mortgage pass-through certificates and traditional corporate securities and rely on cases involving facts and circumstances that are dissimilar and inapposite on their face. The District Court properly considered the distinguishing characteristics of mortgage pass-through certificates and determined that Plaintiffs had failed to satisfy both the predominance and superiority requirements of Rule 23(b)(3).

III. PLAINTIFFS' PROPOSED LEGAL STANDARD IMPROPERLY REVERSES THE PARTIES' BURDENS ON CLASS CERTIFICATION AND IS CONTRARY TO THE LAW

Plaintiffs have it backwards when they assert that class certification is the "norm" unless there is "clear evidence demonstrating that there was widespread

knowledge of the specific alleged misstatements." Ps' Br. at 27. It is Plaintiffs' burden to prove their compliance with Rule 23, not Defendants' burden to disprove presumed compliance with Rule 23: "Rule 23 does not set forth a mere pleading standard. A party seeking class certification must affirmatively demonstrate his compliance with the Rule – that is, he must be prepared to prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc." *Wal-Mart*, 131 S. Ct. at 2551 (emphasis in original).

A. It Is Plaintiffs' Burden To Prove Their Compliance With The Predominance Requirement Of Rule 23(b)(3), Not Defendants' Burden To Disprove Presumed Compliance With Rule 23(b)(3)

To comply with the predominance requirement of Rule 23(b)(3), Plaintiffs must prove, by a preponderance of the evidence, that "questions of law or fact common to class members predominate over *any* questions affecting only individual members." Fed. R. Civ. P. 23(b)(3) (emphasis supplied). Because "any" questions affecting individual members of a proposed class are relevant, both claims and defenses are relevant. Indeed, as this Court recently reiterated in affirming the denial of class certification, "courts must consider potential defenses in assessing the predominance requirement." *Myers v. Hertz Corp.*, 624 F.3d 537, 551 (2d Cir. 2010). *See also Waste Mgmt. Holdings, Inc. v. Mowbray*, 208 F.3d 288, 295 (1st Cir. 2000) (same); *Broussard v. Meineke Disc. Muffler Shops, Inc.*, 155 F.3d 331, 342 (4th Cir. 1998) (same).

In *Myers*, the plaintiffs brought claims on behalf of a putative class of Hertz station managers in New York for allegedly unpaid overtime wages guaranteed by the Fair Labor Standards Act ("FLSA"). 624 F.3d at 542, 546. Hertz asserted an affirmative defense based on an FLSA exemption that applies to persons employed in an "executive" capacity. *Id.* at 542, 551. Whether station managers were "executives" for purposes of the FLSA exemption depended on "the employees' actual job characteristics and duties." *Id.* at 548. While a number of courts had granted class certification in cases where the evidence showed that "the plaintiffs' jobs were similar in ways material to the establishment of the [FLSA] exemption criteria," the evidence in *Myers* showed that "the 'primary duties' of managers differ across [Hertz] locations." *Id.* at 549-50. Accordingly, this Court found that "it was not unreasonable for the district court to conclude . . . that Hertz's liability might require 'individual factual analysis' to resolve." *Id.* at 550.

In affirming the denial of class certification, the Court emphasized that "[t]here is no reason the district court ought to have given [Hertz's] 'defense' less weight in determining whether overall class certification would serve the goals of the predominance requirement" and reiterated that the purpose of Rule 23(b)(3) is to "ensure that the class will be certified only when it would achieve economies of time, effort, and expense, and promote uniformity of decision as to persons

similarly situated, without sacrificing procedural fairness or bringing about other undesirable results." *Id.* at 547, 551 (quotation and citation omitted).

Moreover, contrary to the assertions of Plaintiffs' *amici* that "a district court should presume that theoretical affirmative defenses will not predominate" and that "defendants must have the burden of establishing" that "affirmative defenses . . . will cause individual issues to predominate" (NASCAT Br. at 7), the Court made clear that it is the plaintiff's burden to prove its compliance with Rule 23(b)(3), not the defendant's burden to disprove presumed compliance with Rule 23(b)(3):

> While Hertz will ultimately bear the burden of proving the merits of its exemption [affirmative defense], plaintiffs must at this stage show that more "substantial" aspects of this litigation will be susceptible of generalized proof for all class members than any individualized issues.

624 F.3d at 551.

The Fourth Circuit in *Thorn v. Jefferson-Pilot Life Insurance Co.*, 445 F.3d 311 (4th Cir. 2006), has likewise rejected the burden-shifting argument that Plaintiffs advance here. In *Thorn*, the plaintiffs argued that the district court had erred in denying class certification because the defendant had "failed to satisfy [its] burden of proving that its statute of limitations defense presents issues that must be decided on an individual basis." *Id.* at 321. The Fourth Circuit squarely rejected the plaintiffs' "assumption" that it was defendant's burden to disprove presumed compliance with Rule 23(b)(3), and made clear that it was the plaintiffs' burden to

present evidence demonstrating that the statute of limitations defense could be properly resolved in a class action proceeding:

> [W]e have stressed in case after case that it is *not the defendant* who bears the burden of showing that the proposed class does not comply with Rule 23, but that it *is the plaintiff* who bears the burden of showing that the class *does comply* with Rule 23. It is not enough, therefore, for Appellants to argue that Jefferson-Pilot failed to show that its statute of limitations defense presents individual issues. Instead, the record must affirmatively reveal that resolution of the statute of limitations defense on its merits may be accomplished on a class-wide basis.

Id. at 321-22 (emphasis in original).

Plaintiffs therefore have the "wrong legal standard." Ps' Br. at 24. It is not the Defendants' burden to disprove Plaintiffs' presumed compliance with Rule 23. Rather, Plaintiffs bear the burden of proving their compliance with each of the Rule 23 requirements by a preponderance of the evidence.

B. Plaintiffs Have Not Proven The Merits Of Their Misstatement Claims, But Would Have This Court Impose On Defendants The Incongruous Burden Of Proving The Merits Of Their Investor Knowledge Defense

Plaintiffs have not proven that there were any misstatements made in connection with the securities at issue. Yet, Plaintiffs would have this Court impose on Defendants at the class certification stage the burden of proving and prevailing on the merits of their knowledge defense with "clear evidence demonstrating that there was widespread knowledge of the specific alleged [*i.e.*, unproven] misstatements." Ps' Br. at 27.

What Plaintiffs misunderstand is that the predominance inquiry under Rule 23(b)(3) "requires the court to assess how the matter will be tried on the merits," not which party is likely to prevail at trial. *In re Wilborn*, 609 F.3d 748, 755 (5th Cir. 2010). Thus, "a district court must formulate some prediction as to how specific issues will play out in order to determine whether common or individual issues predominate in a given case." *In re New Motor Vehicles Can. Exp. Antitrust Litig.*, 522 F.3d 6, 20 (1st Cir. 2008). "The nature of the evidence that will suffice to resolve a question determines whether the question is common or individual." *Blades v. Monsanto Co.*, 400 F.3d 562, 566 (8th Cir. 2005). If the evidence needed for a claim or defense "varies from member to member, then it is an individual question." *Id.* "If the same evidence will suffice for each member[,] . . . then it becomes a common question." *Id.* *See also* Fed. R. Civ. P. 23(c)(1)(B) (requiring class certification order to define the "class claims, issues, or defenses").

In their 57-page brief, Plaintiffs never explain how investor knowledge could be anything but an individualized inquiry in the circumstances of this case. Instead, Plaintiffs apparently would have this Court require that Defendants prove their investor knowledge defense at the class certification stage with "clear evidence demonstrating that there was widespread knowledge of the specific alleged [*i.e.*, unproven] misstatements" (Ps' Br. at 27) or forever forego it. In *Wal-Mart*, however, the Supreme Court made clear that a defendant cannot be deprived

of its right to litigate a defense under the guise of Rule 23: "Because the Rules Enabling Act forbids Rule 23 to 'abridge, enlarge or modify any substantive right,' a class cannot be certified on the premise that Wal-Mart will not be entitled to litigate its statutory defenses to individual claims." *Wal-Mart*, 131 S. Ct. at 2561 (quoting 28 U.S.C. § 2072(b)). *See also Newton*, 259 F.3d at 192 ("defendants have the right to raise individual defenses against each class member").

Here, in light of the unusual characteristics of the mortgage-backed securities at issue, individualized inquiries on investor knowledge cannot be avoided, and it is those individualized inquiries, among others (SPA-13), that the District Court properly considered in holding that Plaintiffs had failed to satisfy the requirements of Rule 23(b)(3).

CONCLUSION

For all these reasons, this Court should affirm the District Court's Order denying Plaintiffs' motion for class certification.

Dated: November 10, 2011

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

The foregoing brief complies with the type-volume limitation of Federal Rules of Appellate Procedure 29(d) and 32(a)(7)(B) because it contains 6990 words, excluding those parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

The foregoing brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5) and the type-style requirements of Federal Rule of Appellate Procedure 32(a)(6) because it has been prepared in a proportionally spaced typeface, 14-point Times New Roman font, using Microsoft Word 2010.

Dated: November 10, 2011

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