16-463

In the United States Court of Appeals for the Second Circuit

PETROLEO BRASILEIRO S.A. PETROBRAS, PRICEWATERHOUSECOOPERS AUDITORES INDEPENDENTES, BB SECURITIES LTD., THEODORE MARSHALL HELMS, PETROBRAS GLOBAL FINANCE B.V., PETROBRAS AMERICA INC., CITIGROUP GLOBAL MARKETS INC.,

(caption continued on inside cover)

On Petition for Permission to Appeal from an Order of the United States District Court for the Southern District of New York Granting Class Certification

BRIEF OF AMICUS CURIAE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF PETITION OF DEFENDANTS-PETITIONERS FOR PERMISSION TO APPEAL PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 23(f)

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ITAU BBA USA SECURITIES, INC., J.P.MORGAN SECURITIES LLC, MORGAN STANLEY & CO. LLC, MITSUBISHI UFJ SECURITIES (USA), INC., HSBC SECURITIES (USA) INC., MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED, STANDARD CHARTERED BANK, BANK OF CHINA (HONG KONG) LIMITED, BANCO BRADESCO BBI S.A., BANCA IMI, S.P.A., SCOTIA CAPITAL (USA) INC.,

Defendants-Petitioners,

– V. –

UNIVERSITIES SUPERANNUATION SCHEME LIMITED, UNION ASSET MANAGEMENT HOLDING AG, EMPLOYEES RETIREMENT SYSTEM OF THE STATE OF HAWAII, NORTH CAROLINA DEPARTMENT OF STATE TREASURER,

Plaintiffs-Respondents.

Corporate Disclosure Statement

Pursuant to Local Rule 26.1, the Securities Industry and Financial Markets Association hereby states that it has no parent corporation and that no publicly held corporation owns 10% 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.[1] Its 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 market. It regularly files *amicus curiae* briefs in cases raising issues of vital concern to securities industry participants, including *Morrison* v. *National Australia Bank Ltd.*, 561 U.S. 247 (2010).

Background and Summary of Argument

The District Court's class certification order has wide-ranging implications for $85 trillion of debt securities currently outstanding, which predominantly trade in the "over-the-counter" (OTC) market. The difficulty of determining which transactions in those markets are subject to the U.S. securities laws—which, under the Supreme Court and this Court's decisions, turns on individualized assessments of whether each transaction by each potential class member was "domestic"—precludes the requisite findings that a class of investors

[1] Pursuant to Fed. R. App. P. 29(c)(5), SIFMA states that no party's counsel authored this brief in whole or in part and that no party or party's counsel, or any other person, other than amici or their counsel, contributed money that was intended to fund the preparation or submission of this brief.

in those securities is ascertainable and that common questions predominate. Deferring resolution of those issues, as the Court did below, is inconsistent with Rule 23 and means that—given the dynamics of class action litigation—the issue may never be decided. Such lingering indeterminacy is not only unfair to defendants, but in practical effect exposes issuers and underwriters to the liability and damages risk of transactions to which the U.S. securities laws do not apply.

Argument

I. The District Court's Order Has Wide-Ranging Implications for the Entire $85 Trillion Debt Market

The securities at issue here are among the approximately $85 trillion of debt securities currently outstanding.[2] While debt securities are sometimes *listed* (or *approved* for trading) on exchanges, they generally are not actually *traded* on exchanges.[3] In such circumstances, *Morrison* teaches that the federal securities laws apply only to "domestic transactions." 561 U.S. at 267. This Court has held that, to qualify as a "domestic transaction," the plaintiff must show that

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[2] SIFMA, *2015 Fact Book* 74, 93 (Sept. 30, 2015), *available at* http://www.sifma.org/factbook/ (hereinafter "Fact Book").

[3] *See, e.g.*, Juan Carlos Gozzi et al., *How Firms Use Corporate Bond Markets under Financial Globalization*, 58 J. of Banking & Fin. 532, 535 n.11 (2015). Mere *listing*, without *trading*, is insufficient for the federal securities laws to apply. *See, e.g.*, *City of Pontiac Policemen's & Firemen's Ret. Sys.* v. *UBS AG*, 752 F.3d 173, 179-80 (2d Cir. 2014) (rejecting "listing theory"); *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 527-31 (S.D.N.Y. 2011) (collecting cases).

"irrevocable liability was incurred or that title was transferred within the United States."[4] To determine where irrevocable liability was incurred, courts must consider a wide array of information, such as "facts concerning the formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money." *Absolute Activist*, 677 F.3d at 70. The District Court's failure to recognize the difficulty of identifying domestic transactions in the debt securities context has troubling implications for all debt issuers and underwriters.

The bonds purchased by lead plaintiffs here are "global bonds," which are designed to be easily tradeable across geographic markets and have become the "debt instrument of choice for large corporate issuers."[5] Cross-border debt transactions are commonplace. In 2014 alone, non-U.S. persons traded $2.1 trillion of debt issued in the U.S.; and U.S. persons traded $9.3 trillion of debt issued abroad. Fact Book at 79, 81. According to Thomson Reuters and Bloomberg data, more than $10 trillion of global bonds, in more than 7,000

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[4] *Absolute Activist Value Master Fund Ltd.* v. *Ficeto*, 677 F.3d 60, 62 (2d Cir. 2012). Here, the District Court correctly rejected the argument that title was transferred in the United States. *In re Petrobras Sec. Litig.*, No. 14-9662, 2015 WL 9266983, at *3-4 (S.D.N.Y. Dec. 20, 2015).

[5] Lubomir Petrasek, *Multimarket Trading and Corporate Bond Liquidity*, 36 J. of Banking & Fin. 2110, 2110-12 (2012); *see, e.g.*, Darius P. Miller & John J. Puthenpurackal, *Security Fungibility and the Cost of Capital: Evidence from Global Bonds*, 40 J. of Fin. & Quantitative Analysis 849, 849-55 (2005).

offerings, have been issued since 2005. Such bonds were issued by corporations from at least 32 countries, from Australia to Venezuela.[6]

The market for bonds—both in an initial offering and in OTC trading—is increasingly globalized, and the facts relevant to a typical transaction will often involve both domestic and foreign elements. The dealers that place and trade these bonds, and the investors that buy them, are located both in the U.S. and abroad.[7] In the OTC aftermarket, a bond initially distributed through a foreign offering may subsequently change hands in a "domestic" transaction, just as a bond initially distributed through a domestic offering may be traded in a foreign transaction. Accordingly, in the OTC market there are many possible permutations of domestic and foreign contacts. For example, a U.S. investor with a foreign account may, through a foreign broker, trade with a foreign investor with a U.S. account. Nor is the traditional OTC market the only way to trade. Investors now also have the option to utilize various alternative trading systems, such as anonymized "dark pools" and "e-trading" platforms. When these automated

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[6] These countries are: Australia, Austria, Belgium, Bermuda, Brazil, Canada, China, Colombia, Finland, France, Germany, Hong Kong, Ivory Coast, Jamaica, Japan, Luxembourg, Mexico, the Netherlands, Panama, Peru, Philippines, Poland, Republic of Ireland, South Korea, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States, Uruguay, and Venezuela.

[7] Petrasek, *supra* n.5, at 2111-12; Miller & Puthenpurackal, *supra* n.5, at 852-53.

platforms match orders between geographically diverse and anonymized parties, there is no easy, or uniform, answer to the question of *where* the trade occurred.[8]

II. Review Is Merited to Address Whether the District Court Erred in Finding Ascertainability and Predominance Notwithstanding the Need to Consider the Totality of the Circumstances of Each Transaction by Each Potential Class Member

Rule 23(b)(3)'s requirement that questions common to the class "predominate" is not satisfied where the threshold issue of the applicability of the federal securities laws depends upon complex, individualized proof. In addition, Rule 23 includes an implied requirement of "ascertainability," i.e., a requirement that class membership be "sufficiently definite and readily identifiable." This requirement is not satisfied where, as here, a "mini-hearing on the merits" is necessary to determine class membership.[9]

A. *Absolute Activist* and *Parkcentral* Require Careful Consideration of All Facts and Circumstances to Determine Whether the Federal Securities Laws Apply

The facts relevant under *Absolute Activist* may point in different directions, and even if all such facts are known, there is no simple rule of decision.

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[8] *See* Laura Benitez & Alex Chambers, *Which Corporate Trading Bond Platforms Are Lost Causes?*, Reuters (Feb. 13, 2015, 8:42 AM) (noting that there are dozens of e-trading platforms, which typically feature an "all-to-all" trading model), http://www.reuters.com/article/bond-etrading-idUSL6N0VG2CC20150213.

[9] *Johnson* v. *Nextel Commc'ns Inc.*, 780 F.3d 128, 148 (2d Cir. 2015); *Brecher* v. *Republic of Arg.*, 806 F.3d 22, 25 (2d Cir. 2015).

For example, it is not enough, standing alone, that the issuer is a U.S. resident, that the investor is a U.S. resident, that the investor placed a purchase order in the U.S., that the broker is in the U.S., that the security is issued and registered in the U.S., or that the investor wired funds to the U.S.[10] As a result, applying the domestic transaction test is "fact specific and often 'does not admit of an easy answer.'"[11]

Even the *Absolute Activist* test is not the end of the analysis. Even if a transaction is domestic, the claim may still be "so predominantly foreign as to be impermissibly extraterritorial."[12] *Parkcentral* requires "careful attention to the facts of each case," which cannot be "perfunctorily applied to other cases based on the perceived similarity of a few facts." 763 F.3d at 217. Since there could be "innumerable" relevant circumstances, this Court expressly declined to adopt "a comprehensive rule or set of rules." *Id.*

B. The Individualized Evidence Necessary to Apply *Absolute Activist* and *Parkcentral* to Each Transaction by Each Class Member Is Difficult to Obtain and Evaluate

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[10] *See Loginovskaya* v. *Batratchenko*, 764 F.3d 266, 274-75 (2d Cir. 2014); *City of Pontiac*, 752 F.3d at 181-82 & n.33; *Absolute Activist*, 677 F.3d at 68-70.

[11] *Butler* v. *United States*, 992 F. Supp. 2d 165, 176 (E.D.N.Y. 2014) (quoting *Morrison*, 561 U.S. at 281 (Stevens, J., concurring)); s*ee* Richard D. Bernstein et al., *Closing Time: You Don't Have to Go Home, But You Can't Stay Here*, 67 Bus. Law. 957, 963-64 (2012) (noting that the *Absolute Activist* test is "fact-intensive" and raises "thorny issues").

[12] *Parkcentral Global Hub Ltd.* v. *Porsche Auto. Holdings SE*, 763 F.3d 198, 216 (2d Cir. 2014) (per curiam).

The "domestic transaction" analysis required by *Absolute Activist* and *Parkcentral* cannot be performed on a class-wide basis with class-wide evidence. Rather, these standards require individualized consideration of each transaction by each potential class member. The District Court dismissed the argument that this posed an obstacle to class certification, asserting that the relevant facts were "highly likely to be documented in a form susceptible to the bureaucratic process."[13] This observation is at odds with the reality of the OTC market. Dealers are not required by SEC or FINRA to maintain, and they do not maintain, records of whether a transaction is "domestic" under *Morrison*.[14] Nor do trade confirmations indicate this. *See, e.g.*, *In re Petrobras Sec. Litig.*, No. 14-CV-9662, ECF No. 269-10. Trades are typically negotiated informally, over the telephone or instant electronic message.[15] Dealers do not keep records of the sequence of "offer and acceptance," or of the locations of the ultimate offeror and offeree.[16] Nor can a dealer know whether it is trading with the agent of an undisclosed principal,

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[13] *In re Petrobras Sec. Litig.*, No. 14-CV-9662, 2016 WL 413122, at *8 (S.D.N.Y. Feb. 2, 2016).

[14] *See* 17 C.F.R. §§ 240.17a-3, 240.17a-4 (SEC recordkeeping rules); FINRA Rule 6730(c) (data required to be reported to TRACE).

[15] *See* SIFMA Asset Management Group, *Best Execution Guidelines for Fixed-Income Securities* 8, 10 (updated Sept. 2008), *available at* http://www.sifma.org/issues/item.aspx?id=21333.

[16] *See* Bernstein et al., *supra* n.11, at 964 (noting the ambiguity of how *Absolute Activist* would apply to an offer made in the U.S. and accepted abroad, or an offer made abroad and accepted in the U.S.).

including an agent who, after the fact, may allocate the trade to one or more of its principals.[17] Defendants do not always have, and cannot obtain from non-parties, the information necessary even to approximate the volume of domestic transactions within classes such as this one.

The District Court's approach creates serious problems for underwriters as well as issuers. Typically, as here, all of the notes sold in a global bond offering, whether placed in the U.S. or abroad, are underwritten and issued pursuant to a common registration statement filed with the SEC.[18] Under some circumstances, for at least a limited period of time underwriters also have potential Securities Act liability with respect to secondary market transactions.[19] Although it will normally be possible to determine which sales in the *initial distribution* of such notes are "domestic" transactions, once secondary market trading begins, all notes trade in the same unitary global market. Given that secondary market transactions are recorded on a net basis by book entry, it will often be impossible

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[17] *See, e.g.*, *United States* v. *Litvak*, 30 F. Supp. 3d 143, 155 (D. Conn. 2014), *rev'd in part and vacated in part on other grounds*, 808 F.3d 160 (2d Cir. 2015) (noting that a broker could agree to a trade with an investment advisor without knowing the account to which the advisor will later allocate the trade).

[18] Miller & Puthenpurackal, *supra* n.5, at 851 & n.7.

[19] *See DeMaria* v. *Andersen*, 318 F.3d 170, 175-78 (2d Cir. 2003) (permitting § 11 claims by aftermarket purchasers who can "trace" their shares to an allegedly misleading registration statement).

to determine if a given secondary market trade that is traceable to a registered offering is "domestic" or not.[20]

As the District Court's prior ruling on the motion to dismiss demonstrates, the application of *Absolute Activist* and *Parkcentral* is far from bureaucratic. To establish that their claims were based on domestic transactions, the four original lead plaintiffs submitted 20 exhibits, including trade confirmations, excerpts of trading records, and one affidavit. *See* Dist. Ct. ECF Nos. 269-8 through 269-28. Even on a record that consisted only of documents selected by the plaintiffs-respondents (from their own records and those of their investment advisors), the District Court found that two named plaintiffs (Union and USS) had failed to establish a domestic transaction.[21]

III. Deferring the *Morrison* Issue Until After Class Certification Is Unfair to Defendants and Undermines *Morrison*

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[20] *See Brecher*, 806 F.3d at 26 & n.4 (illustrating this point with an example). *See also* UCC § 8-502 cmt. 2 ("Because securities trades are typically settled on a net basis by book-entry movements, it would ordinarily be impossible for anyone to trace the path of any particular security, no matter how the interest of parties who hold through intermediaries is described.").

[21] *In re Petrobras*, 2015 WL 9266983, at *3. Similarly, some of the "opt out" plaintiffs have admitted difficulty in obtaining this information. *See, e.g.*, Second Amended Complaint at ¶ 75, *Internationale Kapitalanlagegesellschaft* v. *Petroleo Brasileiro S.A.*, No. 15-6618, (S.D.N.Y. Jan. 29, 2016), ECF No. 48 (alleging that the documentation regarding the location of their purchases "is held by third-party investment managers" and that, despite suing nearly six months ago, they have "received varying amounts of documentation from its investment managers to date regarding the circumstances of individual trades").

It is no comfort that, after a trial, foreign transactions may eventually be excluded from the class. Ascertainability and predominance must be established *before* a class is certified. As a practical matter, very few securities class actions proceed after class certification. Thus, deferring the *Morrison* issue will most likely mean that it is never resolved. Indeterminate class definitions will prevent defendants from assessing the scope of their potential liability and place "hydraulic pressure" on them to settle.[22] It logically follows that underwriters would want to be compensated for these risks, which would undermine the benefits to issuers and investors of global notes.

Under the District Court's test, an enterprising lawyer could obtain a certification order covering all purchasers of a global security so long as he can identify just one or two persons who purchased domestically—with the actual size and composition of that class to be determined only (if ever) after a liability phase. Allowing class plaintiffs to postpone the *Morrison* inquiry until after trial, as a practical matter, would permit, indeed encourage, an end-run around *Morrison*.

Conclusion

Defendants-Petitioners' petition should be granted.[23]

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[22] *Hevesi* v. *Citigroup Inc.*, 366 F.3d 70, 80 (2d Cir. 2014).

[23] SIFMA agrees with defendants-petitioners that the District Court's presumption of reliance without empirical evidence of cause and effect, but rather based on a novel and unreliable test of market efficiency, also warrants review.

Dated: February 23, 2016

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 2,535 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point Times New Roman font.

Dated: February 23, 2016

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