13-420-cv

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE LEHMAN BROTHERS SECURITIES AND ERISA LITIGATION

MOHAN ANANDA, RICHARD BARRETT, ED DAVIS, NEEL DUNCAN, RICK FLEISCHMAN, NICK C. FOTINOS, STEPHEN GOTT, DAVID KOTZ, BARBARA MOSKOWITZ, GASTROENTEROLOGY ASSOCIATES PROFIT SHARING TRUST FBO CHARLES M. BROOKS M.D., RONALD PROFILI, LAWRENCE ROSE, JOE ROTTMAN, SHEA-EDWARDS LIMITED PARTNERSHIP, ARTHUR SIMONS, JUAN TOLOSA, DAVID WANG, GRACE WANG, and MIRIAM WOLF,

Plaintiffs-Respondents,

-v.-

UBS FINANCIAL SERVICES INC.,

Defendant-Petitioner.

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

On Petition From an Order Granting Class Certification Entered on January 23, 2013
By the United States District Court for the Southern District of New York
Case Nos. 09 MD 2017, 08 Civ. 5523 (LAK)

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Rule 26.1 CORPORATE DISCLOSURE STATEMENT

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.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

STATEMENT OF IDENTITY AND 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 has offices in New York and Washington, D.C., and is the United States regional member of the Global Financial Markets Association.

SIFMA and its diverse members have a strong interest in this Rule 23(f) petition seeking review of the District Court's January 23, 2013 class certification ruling (the "Order"), which raises important issues regarding the standards under which private securities claims can be certified as class actions.[1] SIFMA submits this brief in support of Petitioner because the District Court's decision to certify a class of claimants under § 11 of the Securities Act, despite the predominance of individual questions concerning putative class members' knowledge, undermines Second Circuit precedent and expands the class action device beyond what Rule 23 permits. These issues are directly relevant to SIFMA's mission of promoting the

[1] In accordance with Local Rule 29.1(b), no party's counsel authored this brief in whole or in part, no party's counsel contributed money that was intended to fund preparing or submitting this brief, and no other individual or entity contributed money that was intended to fund preparing or submitting this brief.

fairness and strength of the financial services industry. Resolution of these issues may well have a significant effect on SIFMA's members.[2]

INTRODUCTION AND SUMMARY OF ARGUMENT

Clear standards governing use of the class action device in federal securities actions are of fundamental importance to all securities industry participants. Guidance from this Court and the Supreme Court on the application of those standards promotes consistency in the rulings of district court judges tasked with deciding class certification motions in securities actions day in and day out. The District Court's Order in the instant action undermines the rulings of this Court and the Supreme Court on a fundamental aspect of class certification law, specifically, whether the disparate knowledge of investors concerning alleged misstatements raises individualized issues potentially defeating certification of a class of claimants under § 11 of the Securities Act.

According to the District Court's ruling, a different approach to class certification applies (and here requires a different result) when investors' knowledge is raised as an affirmative defense to a § 11 claim, as compared to when

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[2] SIFMA regularly files *amicus curiae* briefs on legal issues arising under the federal securities laws that are of vital concern to participants in the securities industry. These cases include *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. Nat'l Australia Bank Ltd.*, 130 S. Ct. 2869 (2010); *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (2010); *Jones v. Harris Assocs. L.P.*, 130 S. Ct. 1418 (2010); *Willow Creek Capital Partners v. UBS Sec. LLC*, No. 11-122 (2d Cir.) (pending); and *New Jersey Carpenters Vacation v. RALI*, 477 Fed.Appx. 809 (2d Cir. 2012).

investors' lack of knowledge is presented as an element of plaintiffs' claims under § 12. This holding was legal error. Having denied class certification of plaintiffs' § 12 claims because individualized questions concerning investors' knowledge predominate over common issues, certification of plaintiffs' § 11 claims should have been denied too based on the same individualized knowledge questions.

The District Court's Order confounds this Court's class certification precedents—in particular its seminal decision in *In re IPO Sec. Litig.*, 471 F.3d 24 (2d Cir. 2006) ("*In re IPO*")—which held that individualized inquiries concerning putative class members' knowledge are equally relevant to the Rule 23(b)(3) determination of whether common issues predominate over investor-specific issues, regardless of whether such knowledge relates to an affirmative defense or to an element of plaintiffs' claim. In a direct challenge to the prevailing law in this Circuit, the District Court's Order contends that *In re IPO* and other precedents "rest on their unique facts and have been persuasively distinguished by courts in this District in subsequent opinions." Order at 6 n. 13. This alone warrants immediate appellate review of the District Court's Order.

As many courts have recognized, certification of a class significantly increases plaintiffs' ability to extract a settlement regardless of the merits of its claims. *See, e.g.*, *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"); *Coopers & Lybrand v. Livesay*, 98 S. Ct. 2454, 2462 (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 abandon a meritorious defense."). The likelihood of coerced settlement following class certification means that courts must apply a "rigorous analysis" in determining whether Rule 23's requirements are met. *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2551 (2011); *In re IPO*, 471 F.3d at 33.

The District Court's newly-minted approach to certification of § 11 and § 12 claims ignores the law of this Circuit and should be immediately reviewed and reversed by this Court. Allowing the Order to stand without immediate appellate review would create considerable uncertainty for plaintiffs and defendants alike regarding the standards governing certification of Securities Act claims.

ARGUMENT

Rule 23(f) permits appellate review of district court class certification rulings that present compelling questions of law that may otherwise go unreviewed. *See Hevesi v. Citigroup, Inc.*, 366 F.3d 70, 76 (2d Cir. 2004) (grounds for appeal include where "the certification order implicates a legal question about which there is a compelling need for immediate resolution."). Ultimately, it is within this Court's "broad discretion" whether to grant a Rule

23(f) petition for review. *Id* at 77. The District Court's Order presents exactly the kind of circumstance that Rule 23(f) was designed to address.

I. The District Court's Order Undermines Second Circuit Class Certification Law

In finding that individualized defenses to Securities Act § 11 claims "do not preclude class certification" because they are relevant "only to [the defendant's] affirmative defense," the District Court's decision is fundamentally at odds with, and undermines, the law of this Circuit regarding the significance to the Rule 23(b)(3) predominance analysis of putative class members' knowledge. Order at 4, 5. In *In re IPO*, this Court held that a class could not be certified where individual questions of class member knowledge concerning the alleged misstatements at issue, an affirmative defense to a § 11 claim, predominated over common class-wide issues. 471 F.3d at 43-44. In *New Jersey Carpenters Health Fund v. RALI*, 477 Fed.Appx. 809, 813 (2d Cir. 2012) ("*RALI*"), this Court upheld *IPO* in a summary affirmance of the district court's denial of class certification for both § 11 and §12(a)(2) claims where evidence of investors' knowledge "would require many individualized inquiries, outweighing the common issues in the case."[3]

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[3] While it was a summary affirmance, *RALI* has been cited in numerous district court decisions. *See, e.g.*, *In re Smart Techs., Inc. Shareholder Litig.*, No. 11 Civ. 7673, 2013 WL 139559 (S.D.N.Y. Jan. 11, 2013); *In re IndyMac Mortgage-Backed Sec. Litig.*, 286 F.R.D. 226 (S.D.N.Y. 2012); *Board of Trustees of So. California IBEW-NECA Defined Contribution Plan v. Bank of New York Mellon Corp.*, No. 09 Civ. 6273, 2012 WL 3578739 (S.D.N.Y. Aug. 16, 2012).

Knowledge issues are equally relevant to class certification whether raised as a defense to a § 11 claim or as an element of liability for a § 12 claim. In *Myers v. Hertz Corp.*, this Court held that "courts must consider potential defenses in considering the predominance requirement" and "there is no reason the district court ought to have given [defendant's] 'defense' less weight in determining whether overall class certification would serve the goals of the predominance requirement." 624 F.3d 537 at 551 (2d Cir. 2010). *See also RALI*, 477 Fed.Appx. at 813 n. 1 (in comparing the relevance of investors' knowledge to § 11 and § 12 claims, finding that any distinction as to which party bears the burden of proof at trial "does not change our analysis at the certification stage."). Indeed, this Court's denial of certification of a § 11 class in *In re IPO* was based on the need for individualized inquiries as to the knowledge of putative class members, confirming that investors' knowledge is equally relevant to the predominance requirement whether raised as an affirmative defense or as an element of plaintiffs' affirmative case. 471 F.3d at 43-44. *See also In re IPO Sec. Litig.*, 483 F.3d 70 (2d Cir. 2007) (denying rehearing and clarifying that knowledge is an affirmative defense under § 11 and lack of knowledge is an element of plaintiffs' claim under § 12(a)(2)).

As the Supreme Court held in *Wal-Mart*, the question is whether determining answers to individualized fact issues will predominate over common issues at trial. 131 S. Ct. at 2558. The predominance question does not turn on

which side bears the burden of proof at trial concerning investor knowledge; plaintiffs bear the burden of establishing that all elements of Rule 23(b)(3) are met, including predominance, regardless of which side bears the burden of proof on the merits as to any issue. Having concluded that plaintiffs "certainly have not carried their burden of persuasion as to the alleged predominance of common questions with respect to the Section 12(a)(2) claim" (Order at 6), the District Court applied an incorrect legal standard in reaching a different result as to certification of plaintiffs' § 11 claims merely because questions concerning investor knowledge were raised as an affirmative defense.

II. The District Court's Order Prejudices Securities Act Defendants' Ability To Pursue Statutory Defenses

The District Court's ruling that issues concerning individual class members' knowledge can defeat certification of § 12 claims, but that the same issues do not defeat certification of § 11 claims, unfairly prejudices securities defendants' ability to pursue affirmative defenses relating to individual purchaser knowledge. By certifying a § 11 class notwithstanding its recognition that individualized inquiries will be required as to class members' knowledge, the District Court has, as a practical matter, eviscerated the defense because pursuing individualized inquiries as to every class member is impractical. Courts frequently circumscribe the ability of parties to take discovery of absent class members. *See, e.g.*, *Laborers Local 17 Health and Ben. Fund v. Morris*, No. 97 Civ. 4550, 1998 WL 241279, at *1

(S.D.N.Y. 1998) (requiring demonstration of a "clear need" for the discovery, that the requests be "narrowly tailored," and that it will not "impose undue burdens on the absent class members."); *see also Clark v. Universal Builders, Inc.*, 501 F.2d 324, 340 (7th Cir. 1974) (limiting discovery of absent class members). Where class members potentially number in the thousands (the record here indicates a potential class of 12,600), even if the Court permitted discovery of all or even a significant number of such class members, it would be practically impossible.

Prior rulings of this Court and the Supreme Court hold that certification of a class in circumstances that effectively prevent pursuit of statutory defenses is improper. *See Wal-Mart*, 131 S. Ct. at 2561 ("[A] class cannot be certified on the premise that [a defendant] will not be entitled to litigate its statutory defenses to individual claims."); *McLaughlin v. Am. Tobacco Co.*, 522 F.3d 215, 232 (2d Cir. 2008) ("[A]ctual injury cannot be presumed, and defendants have the right to raise individual defenses against each class member.") (quoting *Newton*, 259 F.3d at 191-92); *Malcolm v. Nat'l Gypsum Co.*, 995 F.2d 346, 350 (2d Cir. 1993) ("The systemic urge to aggregate litigation must not be allowed to trump our dedication to individual justice, and we must take care that each individual plaintiff's—and defendant's—case not be lost in the shadow of a towering mass litigation."). Certifying a class notwithstanding that individualized issues of investor knowledge predominate would unjustly curtail defendants' pursuit of statutory defenses.

III. The District Court's Order Runs Counter To The Purpose Of The Predominance Requirement And, If Allowed To Stand, Would Create Undue Burden And Uncertainty

Splitting the class treatment of § 11 and § 12 claims lacks logic and will increase the procedural burdens on parties litigating these kinds of claims, contrary to the interests of securities market participants. Under the District Court's ruling, investors in the securities at issue are members of a class for purposes of their § 11 claims, but, to the extent they wish to preserve and pursue any § 12 claims arising from the same facts, will be required to pursue their claims individually.

Avoiding such an impractical and illogical outcome is undoubtedly among the reasons why this Court has held that individualized questions of class member knowledge are just as relevant to the Rule 23(b)(3) predominance requirement when raised as an affirmative defense or as an element of plaintiffs' claims. To hold otherwise is to create a procedural inconsistency that will hinder, rather than help, the efficient and fair resolution of claims under the Securities Act, which frequently combine claims under both § 11 and § 12.

The purpose of Rule 23(b)'s "predominance" requirement 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." *Myers*, 624 F.3d at 547. The District Court's Order is at odds with every one of

these principles. If allowed to stand, the Order would require up to 12,600 mini-trials (the number of putative class members here) to determine knowledge on an individual class member basis, creating insurmountable manageability problems that preclude class treatment. It also aptly demonstrates why the predominance requirement exists in the first place—to avoid certification of such unwieldy class actions. Certification here also heightens the concern that defendants may be pressured to settle claims regardless of their merit.

In sum, the District Court's Order introduces significant uncertainties and represents a backward step in class certification jurisprudence in this Circuit. This Court's ruling in *In re IPO*, which represents the law of this Circuit regarding the role of affirmative defenses concerning investor knowledge in assessing predominance and class certification, and this Court's affirmation of *In re IPO* in recent decisions such as *RALI*, cannot be swept aside as being based on their "unique facts." Order at 6, n. 13. These issues will continue to be presented for resolution on class certification motions in many other actions. The District Court's Order reduces clarity for parties to putative Securities Act class actions, which is unhelpful to all securities industry participants, making it even more important that this Court accept the petition and review the District Court's Order.

CONCLUSION

For these reasons, this Court should grant the Rule 23(f) petition for permission to appeal.

Respectfully submitted,

Dated: New York, New York
February 13, 2013

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