16-1914-cv

United States Court of Appeals

for the

Second Circuit

UNIVERSITIES SUPERANNUATION SCHEME LIMITED,
EMPLOYEES RETIREMENT SYSTEM OF THE STATE OF HAWAII,
NORTH CAROLINA DEPARTMENT OF STATE TREASURER,

Plaintiffs-Appellees,

(For Continuation of Caption See Inside Cover)

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

REDACTED
REPLY BRIEF OF DEFENDANTS-APPELLANTS PETRÓLEO BRASILEIRO S.A. – PETROBRAS, PETROBRAS GLOBAL FINANCE B.V., PETROBRAS AMERICA INC., AND THEODORE MARSHALL HELMS

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and on behalf of all others similarly situated, JONATHAN MESSING, individually and on behalf of all others similarly situated, CITY OF PROVIDENCE, individually and on behalf of all others similarly situated, UNION ASSET MANAGEMENT HOLDING AG,

Plaintiffs,

– v. –

PETRÓLEO BRASILEIRO S.A. PETROBRAS, BB SECURITIES LTD., MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED, BANK OF CHINA (HONG KONG) LIMITED, BANCA IMI, S.P.A., SCOTIA CAPITAL (USA) INC., THEODORE MARSHALL HELMS, PETROBRAS GLOBAL FINANCE B.V., PETROBRAS AMERICA INC., CITIGROUP GLOBAL MARKETS INC., ITAU BBA USA SECURITIES, INC., J.P. MORGAN SECURITIES LLC, MORGAN STANLEY & CO. LLC, MITSUBISHI UFJ SECURITIES (USA), INC., HSBC SECURITIES (USA) INC., STANDARD CHARTERED BANK, BANCO BRADESCO BBI S.A.,

Defendants-Appellants,

JOSE SERGIO GABRIELLI, SILVIO SINEDINO PINHEIRO, PAULO ROBERTO COSTA, JOSE CARLOS COSENZA, RENATO DE SOUZA DUQUE, GUILLHERME DE OLIVEIRA ESTRELLA, JOSE MIRANDA FORMIGL FILHO, MARIA DAS GRACAS SILVA FOSTER, ALMIR GUILHERME BARBASSA, MARIANGELA MOINTEIRO TIZATTO, JOSUE CHRISTIANO GOME DA SILVA, DANIEL LIMA DE OLIVEIRA, JOSE RAIMUNDO BRANDA PEREIRA, SERVIO TULIO DA ROSA TINOCO, PAULO JOSE ALVES, GUSTAVO TARDIN BARBOSA, ALEXANDRE QUINTAO FERNANDES, MARCOS ANTONIO ZACARIAS, CORNELIS FRANCISCUS JOZE LOOMAN, JP MORGAN SECURITIES LLC, PRICEWATERHOUSECOOPERS AUDITORES INDEPENDENTES,

Defendants.

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PRELIMINARY STATEMENT

Plaintiffs' Opposition is based on the faulty premise that Petrobras has already been found to have committed securities fraud. Decades ago, however, this Court stressed that questions of class certification "must be considered not simply in the halcyon context of a large recovery which plaintiff visualizes but in those of a judgment for the defendants or a plaintiffs' judgment or a settlement deemed to be inadequate." *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 996 (2d Cir. 1975) (Friendly, J.). Here, the Brazilian courts and prosecutors have concluded that Petrobras is not a perpetrator, but rather one of several victims of an unlawful scheme by Brazilian construction companies that colluded to win Brazilian construction bids and kick back money to Brazilian politicians, political parties, and a small group of former Petrobras executives whom they corrupted.

Petrobras made no false statements, much less ones that investors would rely on to their detriment. Once prosecutors uncovered the well-concealed scheme—long after the corrupted executives left—the Company immediately began cooperating with Brazilian authorities as an assistant to the prosecution to recover for itself the funds stolen from it. And Petrobras's security-holders were injured, if at all, only derivatively. Yet, in numerous ways, the Certification Order makes it prohibitively risky for these issues ever to be addressed and deprives Petrobras of its rights to present such defenses. The Certification Order would also effectively

eliminate Plaintiffs' burden to prove reliance and domestic purchases at trial. It should be reversed.

ARGUMENT

I. PLAINTIFFS FAILED TO SATISFY THEIR BURDEN UNDER *BASIC*

A. Plaintiffs Cannot Satisfy *Basic* Without Direct Evidence Demonstrating Market Efficiency

Plaintiffs distort the test for reliance under the fraud-on-the-market theory. *See* PbBr. 18–21. *Halliburton II* explained that "[p]rice impact"—not market efficiency *vel non*—is "an essential precondition for any Rule 10b-5 class action." *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2416 (2014) ("*Halliburton II*"). "Under *Basic*'s fraud-on-the-market theory, market efficiency and the other prerequisites for invoking the presumption constitute an *indirect* way of showing price impact." *Id.* at 2415 (emphasis added). This Court and the Supreme Court have made clear, however, that market efficiency itself cannot be demonstrated only by *indirect* evidence, piling presumption on top of presumption. PbBr. 18–19. Plaintiffs must provide *direct* evidence *demonstrating* market efficiency in order to enjoy an inference of price impact and therefore obtain *Basic*'s presumption of reliance. Indeed, empirical evidence of cause and effect is the "most important" factor in proving market efficiency; it goes to "the essence of an efficient market and the foundation for the fraud on the market theory," and

without "demonstrat[ing]" cause and effect, "it is difficult" to find market efficiency. *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, 546 F.3d 196, 207 (2d Cir. 2008); PbBr. 18–19 n.5. "Without proof of [market efficiency], the fraud-on-the-market theory underlying the presumption completely collapses." *Halliburton II*, 134 S. Ct. at 2416.

Plaintiffs only half-heartedly argue that courts can rely on non-empirical factors. They do not dispute that the district court's ruling would have the effect for every large, well-covered company of shifting the burden to show lack of price impact and thus lack of reliance—the element that "ensures that there is a proper connection between a defendant's misrepresentation and a plaintiff's injury," *id.* at 2407—at the class-certification stage and, because the presumption operates identically at the certification and merits stages, *id.* at 2415, 2417, also at trial.[1] Plaintiffs also do not dispute that *Halliburton II* drew a distinction between "direct" evidence necessary to prove market efficiency and "indirect" evidence sufficient to give rise to a presumption of price impact. PbBr. 18. They offer no answer to the uncertainty and unpredictability that using indirect factors to prove market

[1] Plaintiffs have misleadingly suggested that plaintiffs generally prove price impact at trial in connection with loss causation. *In re Petrobras Sec. Litig.*, 16-463-cv, ECF No. 102 (Apr. 22, 2016). But Plaintiffs here rely on the materialization-of-the-risk theory of loss, which does not measure price impact of the alleged misrepresentation. *Ludlow v. BP, P.L.C.*, 800 F.3d 674, 690 (5th Cir. 2015).

efficiency injects into Section 10(b) litigation. There are no benchmarks for their application, and no guidance on how to weigh the presence of some factors and the absence of others (other than just counting them up, on the false assumption that they are of equal weight). Rather, their application is entirely subjective, as the court's analysis here showed. PbBr. 21–22.

Finally, Plaintiffs do not dispute that the court recognized the non-empirical, indirect factors upon which it relied did not constitute *direct evidence* of efficiency, SPA-32: (1) the articles Feinstein himself cites—including FDT—make this clear, PbBr. 20 n.6; (2) the non-empirical factors are just proxies for a company being "large" and "do not directly [examine or] address whether the market price [of a company] reflects public information, which is the issue at the core of ... the efficient market hypothesis," *In re Fed. Home Loan Mortg. Corp. (Freddie Mac) Sec. Litig.*, 281 F.R.D. 174, 178 (S.D.N.Y. 2012); and (3) a "large cross section" of even large companies can and do trade *in*efficiently. PbBr. 19–21. Indeed, Gompers *and* Feinstein agree that *only* an empirical study can "demonstrate" market efficiency, and that the indirect factors at best are "indicators" of efficiency. *Id*. 19–20.[2] "[C]ourts effectively require a plaintiff to provide a methodologically

[2] Although Plaintiffs claim Gompers "completely ignored these factors," Opp'n 43, he explained at length why they are not sufficient to show market efficiency and why no financial economist would rely upon them to demonstrate it. A-3637–39. The Financial Economists *amici* fully agree. PbEcon.Br. 5 ("*Amici*

sound event study to" prove market efficiency. Stanford Note 1209.[3] Because the indirect factors are merely "indicia of efficiency," event studies "are the primary test of efficiency." *Id.* at 1218. Moreover, as a term of art, an "efficient market" should be defined consistently with financial economics, PbBr. 23, and financial economists reject these indirect factors as being relevant to identifying such markets. PbEcon.Br. 2, 4–6.[4]

B. Plaintiffs' Novel and Flawed Test Did Not Satisfy *Basic*

Plaintiffs' primary arguments that "directionality [need not] be part of a market efficiency analysis" and that an "irrational" market can be efficient misread *Halliburton II*. Opp'n 41, 48. *Halliburton II* did not hold that a market can be

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and, they believe, financial economists more generally would not rely on any of these factors in assessing whether a particular securities market operated efficiently.").

[3] Plaintiffs wrongly contend that "[e]ven before *Halliburton II*, circuit courts consistently embraced this type of evidence as compelling indicia of market efficiency." Opp'n 42–43 & n.26 (citing cases). Those opinions either refuse to require use of indirect factors or explain that they are not an exhaustive list of factors relevant to efficiency. Moreover, all are pre-*Halliburton II* and merely note that indirect factors *may* be relevant as *indicia* of market efficiency; none holds that they are, alone or collectively, sufficient to *demonstrate* or *prove* efficiency.

[4] Plaintiffs rely on Judge Scheindlin's decisions in *Carpenters Pension Trust Fund of St. Louis v. Barclays PLC*, 310 F.R.D. 69 (S.D.N.Y. 2015) and *Strougo v. Barclays PLC*, 312 F.R.D. 307 (S.D.N.Y. 2016). But this Court granted review of *Strougo* and neither decision grappled with these issues. Further, even *Carpenters* held that "when defendants present evidence of lack of price impact or that the market was inefficient," as here, "an event study or other rebuttal evidence is required." 310 F.R.D. at 86.

efficient when it reacts irrationally or in the absence of evidence that the security moves in the correct direction in response to new, material news. The language upon which Plaintiffs rely is from the portion of the opinion in which the Court declined to eliminate the *Basic* presumption entirely based on studies showing "public information is often not incorporated immediately (much less rationally) into market prices" of certain securities. Opp'n 39 (quoting *Halliburton II*, 134 S. Ct. at 2409). Yet the studies at issue addressed different theories of efficiency—weak, semi-strong, and strong—that all assumed that, for a market to be efficient, the security must react to news in a directionally appropriate manner and differed only in their views of what *types* of information were impacted into market prices and how fast. *See, e.g.*, Lynn 655 n.25 (cited in *Basic Inc. v. Levinson*, 485 U.S. 224, 247 n.26 (1988)). The Court held that it need not "adopt any particular theory of how quickly and completely publicly available information is reflected in market price." *Halliburton II*, 134 S. Ct. at 2410. It did *not* hold that a particular security that moved irrationally or in the wrong direction could be found to trade in an efficient market. It stated: "[t]hat the ... price of a stock may be inaccurate does not detract from the fact that *false statements affect it, and cause loss*," which is "all that *Basic* requires." *Id.* (emphasis added). The only way that a false

statement can "cause loss" is if, all else equal, the statement inflates the price in response to false positive information.[5]

When crossed, even Feinstein agreed. A-5090–91. So have many courts when examining this precise issue.[6] And financial economists agree too. A-1962; PbEcon.Br. 9–10 ("[E]conomists agree that in an efficient market ... prices will ... move in an expected direction."). In the absence of evidence of directionally appropriate movements, therefore, there is no support for invoking the *Basic* presumption.

Plaintiffs and the trial court thus are wrong that directionality is tantamount to "fundamental efficiency" or "perfect or nearly perfect *ex ante* prediction of magnitude, direction, and correctness of stock-price reactions to new information." Opp'n 47. Fundamental efficiency requires that prices conform to a particular

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[5] Plaintiffs complain that non-fraud news may also move trading prices. Opp'n 51–52. But a basic element of event studies is to address confounding news in order to examine how the specific disclosure studied moved the price. A-3648; A-4081; A-3297, 3327; A-3957, 3963.

[6] *See Carpenters*, 310 F.R.D. at 90 (crediting event study where "on each of the fifteen days studied, the price moved in the direction ... expected"); *Freddie Mac*, 281 F.R.D. at 180 (noting inclusion of certain days in event study was improper "because price movements were in the wrong direction given the news"); *IBEW Local 90 Pension Fund v. Deutsche Bank AG*, No. 11 Civ. 4209 (KBF), 2013 WL 5815472, at *21–22 (S.D.N.Y. Oct. 29, 2013) (finding plaintiffs failed to prove market efficiency and crediting Gompers' criticism that plaintiffs' expert did not consider "whether price movements were directionally appropriate").

pricing model. A-4070; A-5000, 5002.[7] The FDT test is not deficient because it fails to show fundamental efficiency; it is deficient because it fails to require movement in the right direction—a definitional prerequisite to market efficiency—and can be satisfied when, as here, prices do not consistently move in the predicted direction, such as identical bonds moving in statistically significant amounts but in *opposite directions* on the same days. A-3669–70; A-4994, 5001–02. Moreover, while *Halliburton II* held that the "modest premise" underlying *Basic* does not require movement to any "precise degree"—meaning it does not require perfect *ex ante* prediction of the magnitude or correctness of stock-price reactions to new news—it most definitely requires movement in the right direction. *Halliburton II*, 134 S. Ct. at 2410.[8] Moreover, an event study that measures directionality is not "a nearly impossible task." Opp'n 48. Such event studies have been conducted by plaintiffs' experts for decades, A-5082, and are backed by a considerable body of literature explaining, *inter alia*, how to—objectively—select event dates in order to

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[7] Gompers testified only that market efficiency requires that "markets respond appropriately in a positive way to good news and negatively to bad news," A-3958—which is precisely the relevant definition, and the one Feinstein himself used. A-1962.

[8] *Halliburton II*'s use of the phrase "modest premise," Opp'n 39, was derived from the financial economists' *amicus*, which stated that the efficient-market hypothesis is based on "the *modest assumption* that prices move reasonably promptly *in a predictable direction* in response to favorable or unfavorable public information." *HII*Econ.Br. 11 (emphases added); PbBr. 25, 27.

properly test whether prices react in response to unexpected material news by moving in a predicted direction—the definition of an efficient market. *See* A-5250; A-3640–41, 3642; MacKinlay 35.

Plaintiffs do not dispute that FDT fails to show directionality. That FDT uses a common statistical tool, a "z-test," says nothing about whether satisfying it means that a security *trades in an efficient market*. PbBr. 29. The only source that even addresses that issue—and the sole source Feinstein identified as the basis for using the FDT test here, A-3217–18—is a 2004 law review article. But neither it nor the FDT test has ever been cited in any finance journal, much less one peer-reviewed,[9] and the FDT authors acknowledge that FDT "is a threshold step, not a sufficient condition, to show that a stock traded in an efficient market." FDT 122; *see Freddie Mac*, 281 F.R.D. at 180 (FDT is a "threshold step" insufficient "to show that a stock traded in an efficient market."). So did an FDT author in later testimony. *Forsta AP-Fonden v. St. Jude Med. Inc.*, 312 F.R.D. 511, 521 (D. Minn. 2015) (Tabak stated FDT "is a threshold test for market efficiency and does not directly prove it."); PbBr 29–30. Indeed, the Opposition largely relies on

[9] Plaintiffs found only one journal that mentions FDT—another law review article, written by plaintiffs-side experts. And all it said was that the FDT test was "a related but less powerful test" than the one those authors proposed. Hartzmark & Seyhun 461 n.118. The only new finance text Plaintiffs cite never even mentions "market efficiency," much less FDT. McWilliams & McWilliams 1.

literature never discussed by Feinstein, Opp'n 44, none of which supports the notion that directionality is irrelevant to efficiency.[10] While Plaintiffs tout that Feinstein was one of several "testifying experts" who submitted an *amicus* brief in *Halliburton II* that embraced the z-test, Opp'n 45, they omit that the brief was written by Plaintiffs' counsel in this case, and no court has ever cited it. PbBr. 29.[11] Indeed, many of the cases Plaintiffs cite to "show" that satisfaction of FDT means a market is efficient employ it to show *in*efficiency. PbBr. 26 & n.7.[12]

After relying on the FDT test below, Plaintiffs cannot now reverse course and support the Certification Order by pointing to Feinstein's after-the-fact attempt to show directionality. The court gave that attempt only "limited weight"—far

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[10] Plaintiffs refer to *uncited* medical research and FDA clinical trials. Opp'n 44. But to say the FDA would not care about the *direction* of the results with respect to the people in its trials is to argue that the agency would be indifferent as to whether a drug cured or killed people, A-5272–73, a risible proposition.

[11] Plaintiffs also string cite a series of cases which, they claim, used FDT to find market efficiency, Opp'n 45, but just ignore why those cases do not mean what Plaintiffs claim—as Defendants previously explained. *See* PbBr. 26 n.7. The only other cases they cite, *In re NII Holdings, Inc. Sec. Litig.*, 311 F.R.D. 401 (E.D. Va. 2015) and *Smilovits v. First Solar, Inc.*, 295 F.R.D. 423 (D. Ariz. 2013), do not address the arguments raised here.

[12] The district court also did not address how FDT could be valid when, following its protocols, two experts can come to opposite conclusions based on the same evidence. PbBr. 31–32; *cf. Zenith Elecs. Corp. v. WH-TV Broad. Corp.*, 395 F.3d 416, 419 (7th Cir. 2005) ("An expert must offer good reason to think that his approach produces an accurate estimate using professional methods, and this estimate must be testable. Someone else using the same data and methods must be able to replicate the result.").

from the preponderance necessary to satisfy Rule 23. SPA-41; *see Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 350 (2011). And Feinstein himself admitted that *ex post* evaluation of analyst reports is "backwards," "doesn't prove anything," and is a "violation of the event study rules and a violation of scientific principles." PbBr. 28 n.8; *see* PbEcon.Br. 10–11 n.10. Moreover, while the Opposition pretends that Defendants simply disagreed with how Feinstein characterized Petrobras news on two dates, the court found that Feinstein had "mischaracterized" those dates. A-6021. It also found it was "difficult to assess whether ... these two dates are anomalous or indicative of wider deficiencies in Feinstein's directionality testing." A-6021–22.

Ultimately, Plaintiffs rely on the contention that it is "utterly implausible ... that Petrobras's securities remained unaffected by the disclosure of the massive fraud." Opp'n 50. But Plaintiffs must prove market efficiency, not assume it. If efficiency is as obvious as they claim, it is not too much to ask that they do so in the conventional manner that *Halliburton II* contemplates and finance theory requires—through evidence showing cause and effect.[13]

[13] *duPont v. Brady*, Opp'n 57–58, shifted the burden to defendants because in omission cases it is "impossible to demonstrate reliance." 828 F.2d 75, 78 (2d Cir. 1987). But Plaintiffs can prove market efficiency and price impact in a misrepresentation case like this one. *Halliburton II*, 134 S. Ct. at 2412. Plaintiffs simply chose not to try.

C. The Evidence Severed the Cause and Effect Link

Plaintiffs do not dispute that the district court never considered—as it was required to—whether the substantial evidence offered by Defendants could support a reasonable fact-finder in concluding that Plaintiffs had not shown market efficiency and thus, indirectly, price impact, shifting the burden back to Plaintiffs to *prove* price impact. *Basic*, 485 U.S. at 248; *Halliburton II*, 134 S. Ct. at 2408; PbBr. 30–35.[14] Instead, Plaintiffs offer a series of meritless responses.

First, although Feinstein has never been a "day trader," Opp'n 51–52, for decades he had no trouble agreeing that the "vast majority" of event dates have to show statistically significant residual returns in order for a market to be efficient, and employing standard methodologies to account for confounding news. PbBr. 30–31. Here, fewer than one-third of Feinstein's event dates showed statistical significance. *Id.* Prices thus did not "generally" move in response to new, material information. *FreddieMac*, 281 F.R.D. at 180–81.

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[14] Plaintiffs mistakenly argue that Rule 301 places the burden of persuasion on Defendants. The current rule is clear: "the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption" but not "the burden of persuasion," and there is no "federal statute or [rule] that provides otherwise." Fed. R. Evid. 301. Unspoken "congressional intent," Opp'n 54–55, is not sufficient. The Supreme Court has made clear that courts must apply the letter of Section 10(b). *See Stoneridge Inv. Partners, LLC v. Sci.-Atlanta*, 552 U.S. 148, 165 (2008). Under these standards, it was Plaintiffs—and not Defendants—who had the burden "to perform their own event study to demonstrate ... price impact." Opp'n 54.

Second, similar bonds moved in statistically significant *opposite* directions. PbBr. 33. The court noted this evidence, and that "Feinstein did not address" it, and accordingly gave Feinstein's bond-directionality analysis "little weight." SPA-41. Plaintiffs do not address this evidence, which shows inefficiency. Opp'n 53.

Third, that the repeat of old news (previously reported to the market) caused statistically significant price movements, as Feinstein found, also shows inefficiency. PbBr. 33. That Feinstein later found price movements when the earlier news was reported, Opp'n 53–54, is a side-show: The relevant inquiry is how an efficient market could react to *stale* news.

Fourth, the NERA study Plaintiffs tout, Opp'n 48, 50–51, was never put before the district court, and in any event is irrelevant: It is no surprise that announcements only of *unexpected* earnings would, in an efficient market, produce statistically significant residual returns, and even then, only when the earnings surprise is a substantial deviation from what was expected.[15]

Having produced evidence of *in*efficiency sufficient to "support a reasonable jury finding of the nonexistence of the presumed fact," *ITC Ltd. v. Punchgini, Inc.*,

[15] Moreover, that the FDT test was satisfied in this case in the face of substantial evidence of market *in*efficiency reinforces its author's warning that "there are clear examples" where "a market can exhibit some form of inefficiency but still pass the FDT test." Tabak (2010) 7; PbBr. 30–33.

482 F.3d 135, 149 (2d Cir. 2007), Defendants therefore "sever[ed] the [price impact] link," *Basic*, 485 U.S. at 248, and the burden shifted to Plaintiffs to establish price impact.

II. PLAINTIFFS FAILED TO ESTABLISH ASCERTAINABILITY, PREDOMINANCE, AND SUPERIORITY

A. The Certification Order Violates Ascertainability

1. The Class Is Not Ascertainable

Plaintiffs simply ignore that under this Court's standards for ascertainability they must *prove* that the proposed class is: "[(1)] defined by objective criteria that are [(2)] administratively feasible and [(3)] when identifying its members would not require a mini-hearing on the merits of each case." *Brecher v. Republic of Argentina*, 806 F.3d 22, 24–25 (2d Cir. 2015). Only then will the court be able to provide notice reasonably designed to inform absent class members of their rights, PbBr. 37, and provide defendants with a clear understanding at the beginning of the suit of "the number of parties to whom [they] may ultimately be liable," *Siskind v. Sperry Ret. Program*, 47 F.3d 498, 503 (2d Cir. 1995), and the certainty and finality that comes from a judgment at litigation-end that binds all class members. *Marcus v. BMW of N. Am., LLC*, 687 F.3d 583, 593 (3d Cir. 2012).

The court's Order certifying a worldwide class of aftermarket purchasers of Petrobras Notes flunked ascertainability. This Court's precedents establish that there is no "test that will reliably determine when a particular invocation of § 10(b)

will be deemed appropriately domestic or impermissibly extraterritorial," and thus courts must pay "careful attention to the facts of each case." *Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F.3d 198, 217 (2d Cir. 2014); *see Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 68, 70 (2d Cir. 2012) (*Morrison*'s "transactional test" considers "the point at which ... there was a meeting of the minds" based on specific "facts."); *United States v. Vilar*, 729 F.3d 62, 77–78 & n.11 (2d Cir. 2013) (considering individualized facts such as location where investment documents were executed and correspondence and testimony demonstrating a party's location); *see also Butler v. United States*, 992 F. Supp. 2d 165, 176 (E.D.N.Y. 2014) (*Morrison*'s "inquiry is fact specific and often does not admit of an easy answer."). *Morrison*'s test cannot be satisfied by readily established factors, including "residency or citizenship" of the purchaser or "the location of the broker" in the United States, or that the securities were "heavily marketed in the United States and that United States investors were harmed by the defendants' action." *Absolute Activist*, 677 F.3d at 68–70. Moreover, Petrobras is a foreign state-owned company whose Notes were offered and traded (and which thus faces exposure) across four continents. Here, there is "no easy, or uniform answer to the question of *where* [a] trade occurred," and "various records held by various institutions" worldwide may be relevant to—but not dispositive of—the *Morrison* inquiry in this case. SIFMABr. 12, 14.

Before it became expedient for them to claim otherwise, Plaintiffs themselves represented to the SEC that "determining whether a transaction occurred domestically can prove difficult," including because "institutions increasingly trade large blocks of securities off-exchange in private markets known as 'dark pools'" and "investors typically do not know which exchange their order is directed through, assuming it even occurs on an exchange." PbBr. 8 n.3. Even today, their *amicus* posits that absent class members must "prove their claims through evidence that, while feasible to analyze, will be *expensive and time-consuming to obtain, thus increasing the administrative burden and expense*," which "will be multiplied many times over for institutional investors, which are likely to engage in large volumes of trades." Bd.Admin.Br. 20 (emphasis added).

While Plaintiffs assert that they succeeded in satisfying *Morrison* on their "first try" to supply "transactional details," Opp'n 19, this attempt followed several unsuccessful ones and, even then, Plaintiffs offered *no* documentary evidence from *any* purchaser in the aftermarket *anywhere* that showed a domestic purchase.

Plaintiffs' new argument that "deposition testimony" demonstrates that certain funds' "secondary market transactions were domestic," Opp'n 36–37, only makes Defendants' point. Even Plaintiffs' chosen witnesses were unable to testify that the losses they suffered on any individual Petrobras security could be traced *based on records* to a domestic, aftermarket purchase. *See, e.g.*, CSA-12

[redacted]; *id.* 14–15 [redacted]. If it takes transaction-specific testimony of this ambiguous nature to even suggest there was a domestic purchase, that shows determining class membership is not administratively feasible without individualized hearings. Indeed, if it were appropriate to consider such evidence, the testimony from individual plaintiffs and their investment advisors demonstrates that the records accessible to Defendants or absent class members would not permit them to trace a particular loss to a domestic aftermarket transaction in Petrobras Notes.[16]

Moreover, even if there were relevant records, Plaintiffs and their *amici* admit—as the record showed—that any such records here would be held by "third parties and intermediaries," Opp'n 20, and "expensive and time-consuming to obtain," Bd.Admin.Br. 20. Indeed, when Defendants sought discovery relevant to *Morrison* below, even large funds represented by counsel refused because it called

[16] *See* SA-1689–91 (introducing testimony); SA-1700–01; 1707; 1709–12; 1715–20; 1725–29; 1734–45; 1753–55; 1759–72; 1777–82; 1788; 1793–97; 1803–05; 1811–19; 1824–27; 1833–39; 1845–53; 1858–61; 1867–68; 1873–75; 1880; 1886–90.

"for the disclosure of information not within [their] possession, custody or control, or otherwise require[d] [them] to seek information solely in the possession, custody or control of non-parties." SA-1474–75; PbBr. 40 n.13 (noting plaintiff INKA's admission "that documentation regarding the location of their purchases is held by third-party investment managers").[17] If investors represented by counsel could not provide that information in U.S. discovery, it is inconceivable that unrepresented investors could readily obtain the information necessary to determine whether to opt-out. Nor could Defendants determine—without mini-hearings in foreign courts based on uncertain discovery—if a foreign claim were barred by the U.S. class judgment. PbBr. 43–44.

The cases Plaintiffs cite cannot overcome these difficulties. Opp'n 14, 22, 32. Each involved a determination of class membership based upon a simple, mechanical inquiry using objective proof, often in the hands of the defendants or absent class members themselves. Many do not even address ascertainability. For instance, the continuous-holder class members in *Seijas v. Republic of Argentina*, Opp'n 14, were clearly ascertainable because an investor typically knows when it

[17] Class Plaintiffs made similar objections when Defendants sought *Morrison*-related discovery. A-6051 ("[A]bsent class members, many of whom are unsophisticated investors with little legal background and unfamiliar with the U.S. legal system, would have substantial difficulty" with the "long and arduous" process of responding regarding the domestic nature of Notes transactions.).

acquired a bond and whether it sold it. 606 F.3d 53 (2d Cir. 2010). The determination of such facts is "largely ministerial." Nat'lConf.Br. 25.

By contrast, the "prospective class members," *id.* at 16, here resemble those in *Brecher* itself, who could not tell without trial involving third-party records and perhaps testimony whether the bonds they held were purchased from someone who opted out of the class or not. 806 F.3d at 26. Even if notice could be provided and "beneficial interests could be traced," the difficulties in establishing transactional details for global notes traded throughout the world rendered the class insufficiently "definite to allow ready identification of the ... persons who will be bound by the judgment." *Id.* at 25–26; PbBr. 38.

It is no answer to claim that transactions through domestic market makers/dealers satisfy *Morrison*. *SEC. v. Ficeto*, 839 F. Supp. 2d 1101, 1106 (C.D. Cal. 2011), Opp'n 21, is not the law of this Circuit. Even if they do, the point highlights Defendants' arguments: Petrobras's market makers are "both domestic and foreign," Opp'n 20—and even domestic entities often have foreign offices and affiliates, *see* A-7123–24—and Plaintiffs offer no means for an unrepresented investor (much less for Defendants or a foreign court) to determine which of the "over fifty" market makers, Opp'n 20, to approach in the wild-goose chase to determine whether a transaction was or was not domestic.

Plaintiffs' *amici* themselves refute the argument that Defendants' potential exposure is the sole province of Rule 23(a)'s numerosity requirement. *Compare* Opp'n 28 *with* Nat'lConf.Br. 21 (noting that ascertainability addresses "the outer bounds of a class"). Defendants are entitled to understand at the beginning of the suit "the number of parties to whom [they] may ultimately be liable," *Siskind*, 47 F.3d at 503, and to "identify the stakes of the case so that [they] may choose their litigation strategies accordingly." *Bieneman v. Chicago*, 838 F.2d 962, 963 (7th Cir. 1988); PbBr. 41–42. Yet, under Plaintiffs' approach, Defendants would not know until it is too late whether the class numbers forty or forty million. PbBr. 41–42.

Ultimately, the flaw in Plaintiffs' argument is its myopic perspective that, at the claims stage, "claimants will either be able to show ... that they purchased the relevant Petrobras Notes in domestic transactions, or they won't." Opp'n 28. Under the Certification Order, any putative plaintiff could await the outcome of trial to determine whether to be bound. Assuming a Plaintiffs' verdict, it would be prohibitively expensive, or extraordinarily time-consuming, for Defendants to object on *Morrison* grounds to each individual investor's participation. Assuming a defense verdict—which means there would be no claims process at all—or a Plaintiffs' verdict deemed inadequate, it would be even more "expensive and time-consuming," Bd.Admin.Br. 20, if it were even possible, for Defendants and foreign

courts to enforce the district court's judgment. Defendants' concerns with a "fail-safe" class definition are thus no mere "quibble." Opp'n 31; *see* PbBr. 42–44.

2. Plaintiffs' Arguments Are Inconsistent With *Morrison*

Plaintiffs do not argue that Judge Rakoff was right that certification was consistent with *Morrison* because some investors who purchased Notes did so domestically. They argue instead that he was wrong in concluding that *any* purchases of Notes were foreign. Plaintiffs and their *amici* take the extreme position that even "foreign investors, who may be deemed to have obtained their securities abroad" are entitled to the protection of the U.S. securities laws for a foreign-based fraud by a foreign company based on the fortuity that the company deposited a global note at DTC at some point in the distant past[18] and the note "never left the United States." Bd.Admin.Br. 20–21; Opp'n 22–27. Plaintiffs tellingly did not think of this argument when they told the SEC that the location of over-the-counter trades was not readily ascertainable. A-6203–23. Nor did they raise it in support of class certification below, or in any cross-appeal, and it is therefore procedurally foreclosed. *See* U.W.ReplyBr. 15–17. In any event, Plaintiffs' argument does not cure their ascertainability problems and is flagrantly inconsistent with *Morrison.*

[18] The notes on which the Exchange Act claims are based were deposited at DTC as far back as 2003. *See* A-2029.

Plaintiffs' *amici* assert that "the transfer of ownership for every trade [through DTC] unambiguously occurs only at a single designated time and location." Bd.Admin.Br. 8. However, not every sale of a security backed by a global note at DTC is accompanied by a transfer at DTC. If a broker sells a DTC-held security to a customer and has that security in its inventory, no DTC action is necessary. Nor is DTC action necessary if the broker transacts with a securities intermediary who has that security in its inventory. *See* A-4887–89. As the very source *amici* rely on explains, moreover, individual transactions are netted for settlement purposes with hundreds or thousands of other transactions on any given day, *see* A-4905, and thus it is impossible to say that any book entry at DTC represents the settlement of any particular trade.

Furthermore, transactions in securities backed by a global note at DTC are reflected in series of book entries between the ultimate purchaser and seller, who are most often not themselves DTC participants, but rather customers of brokers that are participants and thus have only a *pro rata* interest in securities held by DTC. *See* SEC Release; A-4887–89. If a customer holds securities through its broker, which in turns holds through DTC, that customer has a securities entitlement—which is "not … a specific property interest in any [particular] financial asset held by … the clearing corporation," U.C.C. § 8-102 cmt. 17—against the broker, but not DTC. *Id.* § 8-112 cmt. 3. And, even if a transaction in a

foreign security of a foreign company did lead to an entry at DTC, a court would have to analyze on the facts of the individual trade whether such a "minor domestic element" is outweighed by the "predominantly foreign" nature of the transaction. *Parkcentral*, 763 F.3d at 216.

More fundamentally, Plaintiffs' argument is flatly inconsistent with *Morrison* itself. "The stocks traded on domestic exchanges are actually immobilized at DTC." Bd.Admin.Br. 16. But Congress and *Morrison* stressed the "primacy of the domestic exchange." *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 267 (2010). Thus, as the district court concluded, "the entire thrust of *Morrison* and its progeny would be rendered nugatory if all DTC-settled transactions" were domestic, "not because they occurred on a domestic exchange but because they settled through the DTC." A-5182. Plaintiffs' approach also would re-introduce the very uncertainty and indeterminacy the Court eschewed in *Morrison*. The transfer of a beneficial interest involves a sequence of book-entry actions in *different* locations. Yet, Plaintiffs do not identify which link in this transactional chain is dispositive for *Morrison* purposes. A-4887–89.[19]

[19] Indeed, it was in response to this precise argument that Defendants made the statement, which Plaintiffs wrench from context, that *Absolute Activist* establishes "a single location" as the focus of its transactional test. Opp'n 6.

Absolute Activist itself requires either that irrevocable liability was incurred or that "*title* was transferred within the United States." 677 F.3d at 62 (emphasis added). The source it relied on to define "sale" makes clear that "beneficial interest" is a concept legally distinct from title. *Beneficial Interest*, *Black's Law Dictionary* (10th ed. 2014) ("A right or expectancy in something ... , *as opposed to legal title to that thing*."); *id.*, *Beneficial* ("Consisting in a right that derives from something *other than legal title*") (emphases added). *Morrison*, and this Court's interpretation of it, focuses on "the location of the securities *transaction*" itself, not on ancillary facts associated with the transaction or the security generally. *City of Pontiac v. UBS AG*, 752 F.3d 173, 180–81 (2d Cir. 2014). And, in *Loginovskaya v. Batratchenko*, this Court stressed that the transfer of an interest other than title is not sufficient under *Absolute Activist*. 764 F.3d 266, 274 (2d Cir. 2014).

Plaintiffs' remaining arguments are make-weights. They suggest that Defendants' position would deny entirely the class-action vehicle to persons with Securities Act claims who were injured by purchasing directly from U.S. underwriters. Opp'n 3–4, 37.[20] But that misconstrues Defendants' challenge to the

[20] It is telling that the only other U.S. activity Plaintiffs can identify is the Pasadena acquisition. Opp'n 4, 37. It occupies only some 15 paragraphs of a nearly 700-paragraph complaint, A-4627–30, 4724–29, it is not alleged to have anything to do with the cartel or to have resulted in a false financial entry, and Plaintiffs do not identify any improper activity in the U.S. in connection with the acquisition.

Certification Order, A-5770–5804; the question here is whether a class can be certified for a boundless group of aftermarket traders in the absence of a record that either the size of that group, or the identity of its members, is ascertainable. Moreover, the Supreme Court has rejected such "parade of horribles" arguments. *Arthur Andersen LLP v. Carlisle*, 556 U.S. 624, 629 (2009). Petrobras is a foreign company whose securities were traded in numerous transactions across four continents, and the location of such transactions is not documented. And, to the extent the effect of *Morrison* is that aftermarket purchasers of global notes traded worldwide would be deprived of the class-action vehicle, that conclusion "no more eliminates those parties' right to pursue their statutory remedy (based on the 1934 Act) than did federal law before its adoption of the class action for legal relief in 1938." *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2311 (2013).[21] If Plaintiffs have a beef, they should raise it with the SEC or Congress, and not with this Court. *See Parkcentral*, 763 F.3d at 217; SIFMABr. 24–25.

[21] The Court need not distort Rule 23 to provide relief to those who purchased abroad. *See, e.g.*, *Morrison*U.K.Br. 37–39 ("It is not the case that adoption of a rule restraining extraterritorial application of Rule 10b-5 would … leave an enforcement void …. [Sovereign nations] should be allowed and expected to use their own well-developed legal and regulatory regimes to address alleged securities fraud."); ABBIBr. 11 (discussing Brazil's remedial scheme of securities regulation).

B. The Certification Order Violates Predominance and Superiority

Plaintiffs give short shrift to the district court's equally flawed conclusion that common issues predominate. Predominance is a "distinct" requirement, *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 45 (2d Cir. 2006), that requires a "close look," *Comcast v. Behrend*, 133 S. Ct. 1426, 1432–33 (2013), which the court below undisputedly did not take. *See* PbBr. 51.

Plaintiffs' *amici* attempt to assume away the problem by arguing that where issues regarding "class membership [can be] determined by a post-judgment administrative process," Nat'lConf.Br. 19, a class must be certified. That proves too much. Demonstrating a domestic transaction is a threshold requirement that each plaintiff must establish—and that Defendants have a due-process right to challenge based on discovery—to an Article III fact-finder before any judgment is entered. PbBr. 55; Opp'n 30; 28 U.S.C. § 2072(b); *accord McLaughlin v. Am. Tobacco Co.*, 522 F.3d 215, 231 (2d Cir. 2008); *Long Island Lighting Co. v. Barbash*, 779 F.2d 793, 795 (2d Cir. 1985). Unlike damages, whether each class member engaged in a domestic transaction cannot be determined administratively by application of a formula found by a jury "to a limited range of individual factual circumstances." Nat'lConf.Br. 25. Nor, unlike reliance in an efficient market, can Plaintiffs' burden be met on a classwide basis subject only to the rare instances

Defendants "attempt to pick off the occasional class member here or there." *Halliburton II*, 134 S. Ct. at 2412.

There was potentially a volume of millions (or more) in unique, over-the-counter transactions by persons Plaintiffs seek to represent executed by a variety of parties (from investors, to third-party investment managers, to broker/dealers) across a range of platforms (including telephone, electronic platforms, and dark pools). PbBr. 5; A-2196–2221. An investor who believes it purchased in the U.S. has the right to file an individual claim and obtain discovery to support that claim, just as Defendants have the right to notice and an opportunity to refute the claim. That is the "usual" way litigation is conducted, *Wal-Mart*, 564 U.S. at 348, and the way it is conducted when there are individualized issues of, *inter alia*, privity, causation, knowledge, limitations, or reliance that—like the domestic-transaction issue here—overwhelm common proof and defeat predominance. *See, e.g.*, *Halliburton II*, 134 S. Ct. 2398; *In re IPO*, 471 F.3d at 45; *Mazzei v. Money Store*, No. 15-2054, 2016 WL 3876518, at *8 (2d Cir. July 15, 2016) (lack of classwide proof on privity supported decertification); *UFCW Local 1776 v. Eli Lilly & Co.*, 620 F.3d 121, 133–36 (2d Cir. 2010) (reversing certification based on lack of generalized proof on causation); *Newton v. Merrill Lynch*, 259 F.3d 154, 187 (3d Cir. 2001) (The "Herculean task" of conducting individual inquiries, on a trade by trade basis, "involving hundreds of millions of transactions, counsels against

finding predominance."). It imposes no greater initial burden on an investor than would be required in a claims process.[22] Hundreds of investors already have brought claims in this litigation, seeking to benefit either from the efficiency of a joint trial or from the collateral-estoppel effects of that trial. What Plaintiffs cannot do is remove investors' obligation to prove domestic transactions or deprive Defendants of their rights to put investors to their proof or "to raise individual defenses," *McLaughlin*, 522 F.3d at 232, through misuse of the class-action vehicle.

[22] *Amici* cannot deny that *Morrison* itself guarantees "a slew of individual trials," Nat'lConf.Br. 9, in a case of this type, regardless of whether a class is certified. But this is no reason to compromise Defendants' due-process rights: as the district court demonstrated, it has tools to manage efficiently multi-party litigation. *See* Stay Denial; *see also Police & Fire Ret. Sys. of City of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95, 110 (2d Cir. 2013); Manual for Complex Litig., Fourth §§ 10.225, 20, 22 (discussing methods for managing multi-party litigations).

CONCLUSION

The Court should vacate the Certification Order.

Dated: New York, New York
September 8, 2016

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I hereby certify that:

1. This brief complies with Fed. R. App. P. 32(a)(7)(B)(i), because it contains 6,953 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. 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 this brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Times New Roman font.

/s/ Lewis J. Liman
Lewis J. Liman

Dated: New York, New York
September 8, 2016