16-1914

In the 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,

(caption continued on inside cover)

On 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 DEFENDANTS-APPELLANTS

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MARKETS EQUITY FUND, ABERDEEN GLOBAL ETHICAL WORLD EQUITY FUND, ABERDEEN GLOBAL RESPONSIBLE WORLD EQUITY FUND, ABERDEEN GLOBAL WORLD EQUITY DIVIDEND FUND, ABERDEEN GLOBAL WORLD EQUITY FUND, ABERDEEN GLOBAL WORLD RESOURCES EQUITY FUND, ABERDEEN EMERGING MARKETS EQUITY FUND, ABERDEEN ETHICAL WORLD EQUITY FUND, ABERDEEN MULTI-ASSET FUND, ABERDEEN WORLD EQUITY FUND, ABERDEEN LATIN AMERICA EQUITY FUND, INC., AAAID EQUITY PORTFOLIO, ALBERTA TEACHERS RETIREMENT FUND, AON HEWITT INVESTMENT CONSULTING, INC., AURION INTERNATIONAL DAILY EQUITY FUND, BELL ALIANT REGIONAL COMMUNICATIONS INC., BMO GLOBAL EQUITY CLASS, CITY OF ALBANY PENSION PLAN, DESJARDINS DIVIDEND INCOME FUND, DESJARDINS EMERGING MARKETS FUND, DESJARDINS GLOBAL ALL CAPITAL EQUITY FUND, DESJARDINS OVERSEAS EQUITY VALUE FUND, DEVON COUNTY COUNCIL GLOBAL EMERGING MARKET FUND, DEVON COUNTY COUNCIL GLOBAL EQUITY FUND, DGIA EMERGING MARKETS EQUITY FUND L.P., ERIE INSURANCE EXCHANGE, FIRST TRUST/ABERDEEN EMERGING OPPORTUNITY FUND, GE UK PENSION COMMON INVESTMENT FUND, HAPSHIRE COUNTY COUNCIL GLOBAL EQUITY PORTFOLIO, LONDON BOROUGH OF HOUNSLOW SUPPERANNUATION FUND, MACKENZIE UNIVERSAL SUSTAINABLE OPPORTUNITIES CLASS, MARSHFIELD CLINIC, MOTHER THERESA CARE AND MISSION TRUST, MOTHER THERESA CARE AND MISSION TRUST, MTR CORPORATION LIMITED RETIREMENT SCHEME, MYRIA ASSET MANAGEMENT EMERGENCE, NATIONAL PENSION SERVICE, NPS TRUST ACTIVE 14, OHIO PUBLIC EMPLOYEES RETIREMENT SYSTEM, WASHINGTON STATE INVESTMENT BOARD, ABERDEEN LATIN AMERICAN INCOME FUND LIMITED, ABERDEEN GLOBAL EX JAPAN PENSION FUND PPIT, FS INTERNATIONAL EQUITY MOTHER FUND, NN INVESTMENT PARTNERS B.V., acting in the capacity of management company of the mutual fund NN Global Equity Fund and in the capacity of management company of the mutual fund NN Institutioneel Dividend Aandelen Fonds, NN INVESTMENT PARTNERS LUXEMBOURG S.A., acting in the capacity of management company SICAV and its Sub-Funds and NN (L) SICAV, for and on behalf of NN (L) Emerging Markets High Dividend, NN (L) FIRST, AURA CAPITAL LTD., WGI EMERGING MARKETS FUND, LLC, BILL AND MELINDA GATES FOUNDATION TRUST, BOARD OF REGENTS OF THE UNIVERSITY OF TEXAS SYSTEM, TRUSTEES OF THE

ESTATE OF BERNICE PAUAHI BISHOP, LOUIS KENNEDY, individually and on behalf of all others similarly situated, KEN NGO, individually 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.

Corporate Disclosure Statement

Pursuant to Local Rule 26.1, the Securities Industry and Financial Markets Association 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] SIFMA has U.S.-based members who do business abroad, have branches abroad, and/or have non-U.S.-based customers. It also has non-U.S.-based members who have non-U.S.-based customers. 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 market. It regularly files amicus curiae briefs in cases raising issues of vital concern to securities industry participants. This case involves important issues concerning standards for class certification in private securities actions and the extraterritoriality of the U.S. securities laws, which are directly relevant to SIFMA's mission.

Background and Summary of Argument

The District Court erred in certifying two classes defined to include "domestic transactions" in Petrobras's debt securities, which trade in the "over-the-counter" (OTC) market. It is common ground that the federal securities laws do

[1] All parties have consented to the filing of this brief. No party's counsel authored this brief in whole or in part, and no person, other than amici or their counsel, contributed money that was intended to fund the preparation or submission of this brief.

not apply to all trades in the OTC market because OTC trades do not occur on U.S. exchanges. Rather, the federal securities laws apply only to OTC trades in which irrevocable liability is incurred in the U.S. or in which title is transferred in the U.S., and only to the extent that the totality of the facts and circumstances of each trade is not predominantly foreign.

As Defendants argued below, a class definition based on "domestic transactions" does not satisfy Rule 23's requirements of ascertainability, predominance, or manageability. Deferring resolution of those issues, as the District Court did, is inconsistent with Rule 23, incompatible with the relevant substantive law, and prejudicial to Defendants and to absent class members.

By including "domestic transactions" in the class definitions, the District Court deferred determining which transactions would be the subject of the class-wide adjudication until after a jury determines whether Petrobras made actionable misstatements. Then, if Defendants lose, Defendants will liable to all investors who are determined, through what the District Court called a "bureaucratic" post-verdict claims administration process, to have purchased in "domestic transactions." Such a "process" would require individual discovery and individual mini-trials in order to comport with the applicable substantive law and the Rules Enabling Act, which prohibits use of the class action device in a way that effectively alters substantive law. The class here, however, is far too numerous for

complete evidentiary mini-trials to be consistent with the predominance and manageability requirements. If on the other hand, Defendants win, there will be no claims to process and the *res judicata* effect of the verdict will be determined in separate future litigations in forums unknown.

The District Court also erred by relying on an incorrect test of market efficiency to conclude that Plaintiffs were entitled to a presumption of reliance. It used evidence of market inefficiency to support a finding that the market was efficient, thus eliminating the connection between defendant's misrepresentation and plaintiff's injury that the reliance element must supply. That error permitted class certification even though Plaintiff cannot demonstrate reliance based on evidence common to the class. That error undercut the essential premise for application of the fraud-on-the-market theory.

Argument

I. The Certified Classes of Securities Purchasers in "Domestic Transactions" Fail the Ascertainability, Predominance, and Superiority Requirements

The District Court's error involves both the substantive law of *Morrison*, as applied to the OTC market for debt securities, and the procedural requirements of Rule 23. The realities of that market and its recordkeeping practices are such that the requisites of Rule 23 cannot be satisfied by a class defined to include all "domestic transactions."

A. *Morrison*'s "Domestic Transaction" Test

The Supreme Court's decision in *Morrison* v. *National Australia Bank Ltd.*, 561 U.S. 247, 267 (2010), teaches that the federal securities laws apply only to (i) transactions on U.S. securities exchanges and (ii) "domestic transactions in other securities." Petrobras's debt securities do not trade on a U.S. exchange. The federal securities laws thus apply only to those transactions in Petrobras's debt securities that are "domestic."

To plead and prove a "domestic transaction," a plaintiff must show that "irrevocable liability was incurred or that title was transferred within the United States." *Absolute Activist Value Master Fund Ltd.* v. *Ficeto*, 677 F.3d 60, 62 (2d Cir. 2012).[2] "Irrevocable liability" refers to the "meeting of the minds of the parties" to the securities transaction, in the "'classic contractual sense.'" *Id.* at 68 (quoting *Radiation Dynamics, Inc.* v. *Goldmuntz*, 464 F.2d 876, 891 (2d Cir. 1972)). To determine where irrevocable liability was incurred, courts must consider a wide array of information, including but not limited to "facts concerning the formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money." *Id.* at 70.

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[2] Here, in ruling on Defendants' motion to dismiss, the District Court correctly held that title to the global notes was never transferred. *In re Petrobras Sec. Litig.*, No. 14 Civ. 9662, 2015 WL 9266983, at *3-4 (S.D.N.Y. Dec. 20, 2015). Thus, only the "irrevocable liability" prong of the *Absolute Activist* test was at issue on the class certification order.

Absolute Activist and this Court's cases applying it do not identify any particular fact that is alone sufficient to make a transaction domestic. For example, a transaction is not domestic, without more, just because the issuer is a U.S. resident, the investor is a U.S. resident, the investor placed a purchase order in the U.S., the dealer is in the U.S., the security is issued and registered in the U.S., or the investor wired funds to the U.S. *See Loginovskaya* v. *Batratchenko*, 764 F.3d 266, 274-75 (2d Cir. 2014); *City of Pontiac Policemen's & Firemen's Ret. Sys.* v. *UBS AG*, 752 F.3d 173, 181-82 & n.33 (2d Cir. 2014); *Absolute Activist*, 677 F.3d at 68-70. As a result, applying the domestic transaction test is "fact specific and often 'does not admit of an easy answer.'" *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)).

Satisfying the *Absolute Activist* test is necessary but not sufficient for the federal securities laws to apply. Even if a transaction is deemed domestic under *Absolute Activist*, the totality of the facts and circumstances of the claim can be "so predominantly foreign" that the application of the securities laws would be impermissibly extraterritorial. *Parkcentral Global Hub Ltd.* v. *Porsche Auto. Holdings SE*, 763 F.3d 198, 216 (2d Cir. 2014) (per curiam).

In sum, this Court's precedents require "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." *Id.* at 217. Since there are "innumerable" circumstances relevant to the extraterritoriality analysis, this Court has not adopted "a comprehensive rule or set of rules." *Id*. This Court specifically declined to "proffer a test that will *reliably determine* when a particular invocation of § 10(b) will be deemed appropriately domestic or impermissibly extraterritorial." *Id.* (emphasis added). Rather, the Court has adopted a "flexible, multi-factor analysis." *Id.* at 219 (Leval, J., concurring).

B. Rule 23's Requirements of Ascertainability and Predominance

A class cannot be certified unless plaintiff proves and the district court determines, after a rigorous analysis, that class membership is ascertainable by objective criteria that are administratively feasible, *Brecher* v. *Republic of Argentina*, 806 F.3d 22, 24-25 (2d Cir. 2015); that common questions predominate over individual ones, Fed. R. Civ. P. 23(b)(3); and that the class action is "superior to other available methods" of adjudicating the controversy, after considering, among other things, the "likely difficulties in managing a class action," *id*.

Ascertainability serves the purposes of: (i) reducing administrative burdens, consistent with the efficiencies the class action device is supposed to deliver; (ii) protecting absent class members by facilitating proper notice, including for the purpose of opting out; and (iii) protecting defendants' due process rights, including the right to challenge each claimant's class membership and the practical

ability to bind all class members in the event of a defense verdict. *Carrera* v. *Bayer Corp.*, 727 F.3d 300, 305-06 (3d Cir. 2013) (citing *Marcus* v. *BMW of N. Am., LLC*, 687 F.3d 583, 593 (3d Cir. 2012)).

Similarly, predominance and superiority seek to ensure that a class action will "'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.'" *Amchem Prods., Inc.* v. *Windsor*, 521 U.S. 591, 615 (1997) (quoting Fed. R. Civ. P. 23(b) advisory committee's note to 1966 amendment). Predominance is a "vital prescription" that "tests whether proposed classes are sufficiently cohesive to warrant adjudication by representation." *Id.* at 623.

C. The Nature of the Market for OTC Debt Securities

There is no tension between the principles of *Morrison* and Rule 23 in the typical securities class action, which would concern securities traded on a U.S. exchange. Rather, the incompatibility of *Morrison* with class treatment here arises from the characteristics of the market for "over the counter" (OTC) debt securities.

There are currently approximately $85 trillion of debt securities outstanding.[3] While debt securities are sometimes *listed* (or *approved* for trading)

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

on exchanges, debt securities generally are not actually *traded* on exchanges.[4] Rather, debt securities generally trade OTC. Investors who wish to purchase bonds OTC generally place orders with dealers, who in turn will either match an order with an offer from another investor or sell the bonds from their own inventories.

The bonds at issue here are "global bonds," which are bonds with custody and clearing arrangements that make them easily tradeable across geographic markets.[5] Global bonds have become the "debt instrument of choice for large corporate issuers."[6] According to Thomson Reuters and Bloomberg data, more than $10 trillion of global bonds, in more than 7,000 offerings, have been issued since 2005. Such bonds were issued by corporations from at least 32 countries, from Australia to Venezuela.[7]

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[4] *See, e.g.*, Juan Carlos Gozzi et al., *How Firms Use Corporate Bond Markets under Financial Globalization*, 58 J. 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*, 752 F.3d at 179-80 (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).

[5] *See* Richard A. Brealey et al., *Principles of Corporate Finance* 598 (10th ed. 2011).

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

[7] 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,

Over time, the same security may change hands in both domestic and foreign transactions. A bond initially distributed through a foreign transaction may subsequently be sold in a domestic aftermarket transaction, just as a bond initially distributed through a domestic transaction may be traded in a foreign aftermarket transaction. For that reason, it is generally not possible to isolate any subset of a tradeable security that would have been traded only in domestic transactions or that would never have been traded in domestic transactions.

The geographic facts relevant to a particular OTC transaction often will not be limited to a single country. Cross-border debt transactions are commonplace.[8] The dealers that place and trade these bonds, and the investors that buy them, are located both in the U.S. and abroad.[9] And both the dealers and investors may be headquartered in one place, while conducting their relevant operations from other places. Similarly, the securities accounts in which the bonds are held by the buyer and seller, and the bank accounts from purchase price is paid and received, may be located either in the U.S. or abroad. There are consequently

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Philippines, Poland, Republic of Ireland, South Korea, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States, Uruguay, and Venezuela.

[8] 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.

[9] Petrasek, *supra* n.6, at 2111-12; Miller & Puthenpurackal, *supra* n.6, at 852-53.

many possible permutations of relevant contacts that could be either domestic or foreign.

Defining and isolating a single "transaction" may require "matching" closely related buys and sells. For example, one investor may buy 100 units of a bond from a dealer contemporaneously with another investor selling 100 units of the bond to that dealer. A qualitative decision must be made as to whether—for purposes of the extraterritoriality analysis—these are two separate transactions or one unified transaction. Indeed, there may be multiple investors buying and selling contemporaneously, or almost contemporaneously, and complex evidentiary issues can therefore arise concerning which purchases should be matched with which sales. In short, given the industry practice of booking securities trades on a net basis, matching can sometimes be more of an art than a science. *See Brecher*, 806 F.3d at 26 & n.4.[10]

Investors typically do not know whether their trades are domestic. Each participant in an OTC trade only knows the identity of the other participants with whom it is directly communicating. When talking to a dealer, an investor typically does not know whether the dealer is trading for its own account or

[10] *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.").

whether there is a counterparty investor on the "other side" of the trade. And dealers often trade with agents, such as investment advisors, without knowing the identities of their principals. Indeed, an investment advisor typically has trading authority over multiple accounts, and the advisor may decide to which account to allocate the trade only after the fact.[11]

Nor is the traditional OTC market the only way to trade. Investors now also have the option to utilize various alternative trading systems. The volume of corporate bonds traded over electronic trading platforms has more than doubled over the past five years.[12] There are a number of different platforms that operate according to distinct trading protocols. Some permit an investor to enter into direct buy and sell transactions with one particular dealer. Others connect investors with multiple dealers. *Id*. at 81. Still other platforms, called "all-to-all," allow investors to trade with dealers or directly with other investors. *Id.* at 84. There are also different levels of transparency. Some platforms, known as "dark platforms" or "dark pools," allow parties to trade directly with each other while

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

[12] Morten Bech et al., *Hanging Up The Phone – Electronic Trading in Fixed Income Markets and Its Implications*, BIS Quarterly Review, Mar. 2016, at 84, *available at* http://www.bis.org/publ/qtrpdf/r_qt1603h.pdf.

withholding their identities so that neither party knows the counterparty with whom it is trading. *Id.* at 83.

In short, given the realities of this market, there is often no easy, or uniform, answer to the question of *where* the trade occurred.

D. The Nature of Recordkeeping for OTC Transactions

Although the District Court recognized the need for objective records from which a list of class members could eventually be compiled, it simply assumed the existence of such records. The District Court asserted that "whether a transaction was domestic" is "highly likely to be documented in a form susceptible to the bureaucratic process." *In re Petrobras Sec. Litig.*, 312 F.R.D. 354, 364 (S.D.N.Y. 2016). The District Court further asserted that a claims administrator could decide this issue from a "discrete, objective record routinely produced by the modern financial system." *Id.* These assertions are 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 stating whether a transaction is "domestic" under *Morrison*.[13] Nor are dealers required to tell their customers whether a trade was "domestic." Dealers' records of many facts relevant to *Morrison* will not be readily accessible

[13] *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).

and may not exist at all. A typical trade confirmation, for example, will include neither an ultimate determination of domesticity under *Morrison* nor all the key facts. *See, e.g.*, *In re Petrobras Sec. Litig.*, No. 14 Civ. 9662 ("Dist. Ct. Dkt."), ECF No. 269-10 (example of a trade confirmation); *id.* at ECF No. 539, at 5 n.1 (S.D.N.Y. Mar. 25, 2016) (holding that an opt-out plaintiff's trade confirmations did "not provide any material locative details"). Reconstructing the circumstances of particular trades—beyond those recited in the confirmation—is burdensome. Trades are typically negotiated informally, over the telephone or via instant electronic message.[14] For example, the sequence of "offer and acceptance" (and the locations of the offeror and offeree) may matter under *Morrison*.[15] Determining this information, if possible at all, would frequently require a voluminous collection and review of electronic communications and/or (if recorded)[16] phone calls.

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[14] *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.

[15] *See* Richard D. Bernstein et al., *Closing Time: You Don't Have to Go Home, But You Can't Stay Here*, 67 Bus. Law. 957, 964 (2012) (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.).

[16] As authorized by Dodd-Frank, the CFTC requires swap dealers to record oral communications with customers. *See* 17 C.F.R. § 23.202. The SEC has not imposed similar regulations in the OTC market.

While there is no single record that conclusively answers the *Morrison* question, there are various records held by various institutions that may be relevant. But these records are hardly, as the District Court supposed, "susceptible to the bureaucratic process." *Petrobras*, 312 F.R.D. at 364. It may be possible to piece together facts such as the domicile of the investor and dealer, the location of the relevant personnel, and the location of the securities accounts and bank accounts. But even if and when all those facts are known, there is no simple rule of decision to apply. *See supra*, pp. 4-6.

E. *Morrison* Cannot Be Applied to an Entire Class of OTC Debt Transactions Consistent with Rule 23

The domestic transaction test mandated under substantive law cannot be applied to OTC debt transactions on a class-wide basis with class-wide evidence. Instead, fact-intensive, individualized determinations would be necessary to apply *Absolute Activist* and *Parkcentral*, first, to all potential class members to determine who is actually a class member, and then, to all transactions by those class members to determine which are domestic. For a class of the size at issue here, the need for such "individualized mini-hearings" (*Brecher*, 806 F.3d at 26) precludes findings of ascertainability or predominance. As a result, no "domestic transaction" class should have been certified.

The District Court did not find that individualized mini-hearings could be avoided. Rather, the District Court simply asserted that the determinations would be feasible because the District Court had previously decided motions to dismiss based on *Morrison*. *See Petrobras*, 312 F.R.D. at 364. But the fact that the *Morrison* issue is capable of being decided does not mean that a class definition may turn on that antecedent legal conclusion.[17] Moreover, class membership will eventually have to be proven, not just alleged sufficiently to survive a motion to dismiss. That will require discovery, including non-party discovery, followed by motions for summary judgment and/or trials. Mini-trials of that sort in this case would be incompatible with the requirements of Rule 23.

The District Court's application of *Morrison* to the named plaintiffs demonstrates this point. The four original lead plaintiffs submitted 20 exhibits, including trade confirmations, excerpts of trading records, and one affidavit, in an effort to establish that their claims were based on domestic transactions. *See* Dist. Ct. Dkt., ECF Nos. 269-8–269-28. And even on a record limited to the documents

[17] *See, e.g.*, *EQT Prods. Co.* v. *Adair*, 764 F.3d 347, 358-60 (4th Cir. 2014) (vacating certification of a class of gas estate owners because "resolving ownership based on land records can be a complicated and individualized process," plagued by "numerous heirship, intestacy, and title-defect issues"); *Davoll* v. *Webb*, 194 F.3d 1116, 1146-47 (10th Cir. 1999) (affirming denial of certification of a class of disabled police officers because "individualized inquiries" would have been required to apply the Americans with Disabilities Act's "statutory definition" of disability).

selected by the plaintiffs, the District Court found that two named plaintiffs (Union and USS) had failed to establish an actionable domestic transaction. *Petrobras*, 2015 WL 9266983, at *3.[18] Union profited from the documented transaction, and USS submitted records of a transfer from a U.S. affiliate, not a purchase. *Id.* The claims of the other two named plaintiffs (North Carolina and Hawaii) survived dismissal only because they purchased in the initial offering and therefore had evidence that the human traders on both sides of the transactions were physically in the U.S. at the time of the trades. *Id*. *2 & nn.5-6.

In securities cases, notwithstanding the common questions of falsity, materiality, scienter, and loss causation, the presence of even a single merits issue that requires individual mini-trials for each of the many class members will typically preclude class certification. *See, e.g.*, *Halliburton Co.* v. *Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2416 (2014) ("*Halliburton II*") (noting that predominance would not be satisfied if "'[e]ach plaintiff would have to prove

[18] Similarly, the District Court dismissed the bond claims in five opt-out actions in the same MDL for failure to allege a domestic transaction. *In re Petrobras Sec. Litig.*, No. 14 Civ. 9662, 2016 WL 29229, at *2-3 (S.D.N.Y. Jan. 4, 2016); *see also* Dist. Ct. Dkt., ECF No. 539 (dismissing most of claims of another opt-out plaintiff, INKA, for failure to allege a domestic transaction). Some opt-out plaintiffs admitted difficulty in obtaining this information. *See, e.g.*, 2d Am. Compl. at ¶ 75, *Internationale Kapitalanlagegesellschaft mbH* v. *Petroleo Brasileiro S.A.*, No. 15 Civ. 6618, ECF No. 48 (S.D.N.Y. Jan. 29, 2016) (alleging that plaintiff had not received certain relevant documentation "held by [its] third-party investment managers").

reliance individually'" (citing *Basic Inc.* v. *Levinson*, 485 U.S. 224, 242 (1988))). Here, there are "thousands" of class members and potentially "billions" of dollars of transactions. *Petrobras*, 312 F.R.D. at 359. To define a class as those with "domestic transactions" is no more permissible than to define a class as those who actually relied. The need to conduct mini-trials concerning even a single individual question millions of times will cause individual questions to predominate and preclude a determination of manageability. And depriving Defendants of their ability to litigate the facts relevant to *Morrison* would be incompatible with *Absolute Activist*, *Parkcentral*, and the Rules Enabling Act, 28 U.S.C. § 2702(b).

II. Deferring the *Morrison* Issue Until After Class Certification Undermines the Polices of *Morrison*

Deferring the *Morrison* issue until after class certification (and, here, until after trial on the merits) undermines the policies underlying *Morrison*. By that time, the mischief of interfering with foreign securities regulation—including the regulation of "what discovery is available in litigation" and "what individual actions may be joined in a single suit," *Morrison*, 561 U.S. at 269—will already be accomplished. In practice, this approach resurrects the evil of the United States as "the Shangri–La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets." *Id*. at 270.

Under the District Court's approach, a "domestic transactions" class can be certified so long as one named plaintiff who purchased in a domestic transaction can be identified. The actual size and composition of that class will be determined only, if ever, after liability is determined. Indeed, here, the only domestic transactions by the lead plaintiffs for the Exchange Act Class involve Petrobras' ADRs. *See Petrobras*, 312 F.R.D. at 360. Lead plaintiffs have not alleged even a single domestic transaction in Petrobras's global notes.

The District Court's approach is particularly perverse for underwriters. The Underwriter Defendants here are named only on the Section 11 claim for the two series of bonds within the Securities Act Class. The Underwriter Defendants have no liability for Petrobras's ADRs, which are its only securities traded on a U.S. exchange. The District Court's class certification error has not just subjected the Underwriter Defendants to a broader class than they would otherwise face. But for the District Court's error, the Underwriter Defendants would be exposed only to individual actions, not a class action.

If this approach takes hold, it logically follows that underwriters would want to be compensated for the risks, which would detract from the benefits that global notes deliver to issuers and investors. Under the District Court's approach, each underwriter will be dragged into a U.S. class action, no matter how carefully it ensures that none of its underwriting transactions are domestic. This is

because if an underwriter has Section 11 liability with respect to certain aftermarket transactions,[19] which it cannot prevent from being domestic, then it cannot avoid liability even if it makes no domestic initial placements.

III. Deferring the *Morrison* Issue Until After Class Certification Is Prejudicial to Absent Class Members and to Defendants

A. Investors Are Prejudiced By Their Inability to Determine Whether They Are Class Members

Potential class members need to be able to determine for themselves, based on the content of the class notice and the information in their possession, whether or not they are members of the class.[20] In other words, upon receiving notice, the potential class members need to know what the legal term-of-art "domestic transaction" means and whether their own transactions qualify as domestic. For reasons already discussed, many potential class members will be unable to do that here.

Potential class members cannot wait until a claims administration process (which may never happen) to learn whether their own claims are being pursued by the class. Claims under the federal securities laws are subject to a

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

[20] *See In re Copper Antitrust Litig.*, 196 F.R.D. 348, 358 (W.D. Wis. 2000) (denying certification to class defined by terms of art that left "uncertainty of what transactions would be included").

statute of repose that is not tolled by the pendency of this class action. *See SRM Global Master Fund Ltd. P'ship* v. *Bear Stearns Cos.*, No. 14 Civ. 507, 2016 WL 3769735 (2d Cir. July 14, 2016). Potential class members need to be able to figure out whether they are in the class—and to make a decision about whether bring a separate action—at the time the class is certified.

B. Defendants' Due Process Rights Are Prejudiced by the Amorphous Nature and Size of the Certified Class

The District Court envisioned that the *Morrison* issues would be resolved in a "bureaucratic" post-verdict process involving a "claims administrator." *Petrobras*, 312 F.R.D. at 364. Such a process will occur only if Defendants settle or lose at trial. In the event of a verdict in favor of the class, absent investors will have every incentive to portray their transactions as "domestic" and to come forward with any evidence that supports that characterization.

In the event of a defense verdict, however, absent class members could file their own suits predicated on state and foreign law, in the jurisdictions of their choice around the world. The vagueness of the class definition, combined with the absent class members' lack of knowledge of the relevant facts, will cause even well-meaning class members to file such suits. These circumstances will also encourage gamesmanship. In subsequent collateral proceedings, to avoid the *res*

judicata effect of the class action, class members will have every incentive to portray their transactions as foreign and to come forward only with the evidence that supports that characterization. They are highly unlikely to "come forward to . . . establish membership in a class bound by an unfavorable verdict." *In re MTBE Prods. Liab. Litig.*, 209 F.R.D. 323, 348 (S.D.N.Y. 2002).[21] Defendants' ability to enforce a class verdict in their favor will depend on future decisions made by unknown courts applying the laws of the various forums in which the absent class members later choose to sue. Discovery on the issue of class membership may well be unavailable to Defendants.

Defendants cannot be assured that the class membership decisions reached in these collateral proceedings after a defense verdict will be the same as those that would have been reached by the District Court in the event of a verdict for the class. Thus, the class of persons who will bound by the *res judicata* effect of that judgment remains undefined. That deprives defendants of their right to "a victory no less broad than a defeat would have been." *Bersch* v. *Drexel Firestone,*

[21] *See also In re Paulsboro Derailment Cases*, No. 13 Civ. 784, 2014 WL 4162790, at *7 (D.N.J. Aug. 20, 2014) ("[A] showing that class members can be ascertained after trial at the claims administration phase will not suffice."); *In re Paxil Litig.*, 212 F.R.D. 539, 545 (C.D. Cal. 2003) (class cannot be certified if its "actual composition [is] only determinable at the conclusion of all proceedings").

Inc., 519 F.2d 974, 996 (2d Cir. 1975).[22] The ability of absent investors to claim the benefit of a verdict in favor of the class while avoiding the consequences of a defense verdict would essentially revive the historically unfair practice of "'one-way intervention'" that Rule 23 was intended to eliminate. *Brecher*, 806 F.3d at 26 (quoting *Am. Pipe & Constr. Co.* v. *Utah*, 414 U.S. 538, 547 (1974)).

Moreover, as a practical matter, very few securities class actions proceed after class certification.[23] Here, the inability of Defendants to estimate the proportion of domestic transactions within the OTC market will increase the "hydraulic pressure" to settle. *Hevesi* v. *Citigroup Inc.*, 366 F.3d 70, 80 (2d Cir. 2014).[24] Indeed, after certifying the class, the District Court also denied

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[22] *See Brecher*, 806 F.3d at 25 (holding that a class definition must "allow ready identification of the class or the persons who will be bound by the judgment"). This concern is grounded not only in Rule 23, but also in constitutional due process. *Karhu* v. *Vital Pharms., Inc.*, 621 F. App'x 945, 948-49 & n.3 (11th Cir. 2015); *see also Siskind* v. *Sperry Ret. Sys. Program,* 47 F.3d 498, 503 (2d Cir. 1995) ("[F]undamental fairness requires that a defendant . . . be told promptly the number of parties to whom it may ultimately be liable for monetary damages.").

[23] *See* Svetlana Starykh & Stefan Boettrich, *Recent Trends in Securities Class Action Litigation: 2015 Full-Year Review* at 18, 38 (NERA Jan. 25, 2016), available at http://www.nera.com/content/dam/nera/publications/2016/2015_Securities_Trends_Report_NERA.pdf (finding that only 7.3% of defendants file motions for summary judgment and that only 0.3% of actions reach verdict or judgment).

[24] In a typical securities class action, a defendant estimates its exposure in the event of an adverse verdict based on known stock price movements and known trading volumes. The only unknown variables are which shares were traded at

Defendants' motion to pose narrowly tailored interrogatories concerning the *Morrison* issue to the recipients of the class notice. Dist. Ct. Dkt., ECF No. 428 (S.D.N.Y. Feb. 2, 2016). This decision compounded the unfairness of the class certification order for Defendants.

IV. Plaintiffs' Policy Arguments About the Need for Class Actions in the OTC Market Are Issues for Policymakers

In opposing Defendants' Rule 23(f) petition, Plaintiffs contended that Defendants' arguments would always preclude the certification of securities class actions in the OTC market and that their absence would be harmful to investors. Both premises are false and better addressed to policymakers than courts.

While classes that are defined as those purchasing in "domestic transactions" generally should not be certified, it is possible that more specific class definitions may be able to satisfy both the substantive requirements of *Morrison* and the procedural requirements of Rule 23. As this Court predicted in *Parkcentral*, courts may "eventually . . . develop a reasonable and consistent governing body of law on this elusive question." 763 F.3d at 217.

Moreover, the case for class actions in the OTC market is far less compelling than with the U.S. exchanges that are the primary focus of the federal securities laws. As the lead plaintiffs and opt-out plaintiffs here demonstrate, OTC

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which times. Here, there is the additional uncertainty of what transactions to the U.S. securities laws apply, which is not present in the typical case.

transactions often involve large dollar amounts and sophisticated investors.[25] Investors of this type are generally able to protect their own interests with individual actions. *See, e.g.*, *Pa. Pub. Sch. Emps.' Ret. Sys.* v. *Morgan Stanley & Co., Inc.*, 772 F.3d 111, 120 (2d Cir. 2014) (affirming denial of class certification where class was composed of "sophisticated" investors who had "millions of dollars at stake and were able to pursue their own claims").

But even if Plaintiffs' premises were correct, their arguments are better addressed to policymakers. *See Police & Fire Ret. Sys.* v. *IndyMac MBS, Inc.*, 721 F.3d 95, 109-10 (2d Cir. 2013) (rejecting plaintiffs' policy arguments about the "functioning of class action litigation" as "a problem that only Congress

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[25] *See* Compl. at App. B, *Skagen AS* v. *Petroleo Brasileiro S.A.*, No. 15 Civ. 2214, ECF No. 1-2 (S.D.N.Y. Mar. 23, 2015) (alleging purchases of more than $31 million of notes); 2d Am. Compl. at App., *N.Y.C. Emps.' Ret. Sys.* v. *Petroleo Brasileiro S.A.*, No. 15 Civ. 2192, ECF No. 59 (S.D.N.Y. Jan. 29, 2016) (alleging purchases of more than $134 million of notes); 2d Am. Compl. at App. A, B., *Transamerica Funds* v. *Petroleo Brasileiro S.A.*, No. 15 Civ. 3733, ECF No. 56-1–2 (S.D.N.Y. Jan. 29, 2016) (alleging purchases of more than $438 million of notes); 2d Am. Compl., *Internationale Kapitalanlagegesellschaft mbH* v. *Petroleo Brasileiro S.A.*, 15 Civ. 6618, ECF No. 48-2 (S.D.N.Y. Jan. 29, 2016) (alleging purchases of more than $420 million of notes); 2d Am. Compl. at App. A, *Lord Abbett Inv. Tr.* v. *Petroleo Brasileiro S.A.*, No. 15 Civ. 7615, ECF No. 93-1 (S.D.N.Y. Feb. 4, 2016) (alleging purchases of more than $170 million of notes); 2d Am. Compl. at App., *PIMCO Total Return Fund* v. *Petroleo Brasileiro S.A.,* No. 15 Civ. 8192 (S.D.N.Y. Jan. 29, 2016), ECF No. 65-1 (alleging purchases of more than $10.4 billion of notes); Am. Compl., 25-29, *Dodge & Cox Int'l Stock Fund* v. *Petroleo Brasileiro S.A.*, No. 15 Civ. 10111, ECF No. 57 (S.D.N.Y. Feb. 1, 2016) (alleging purchases of more than $590 million of notes).

can address"). This Court has already noted that "Congress and the Securities and Exchange Commission might be in a better position to craft broader rules in this area in light of their access to hearings, including the testimony of experts, their competence to make policy decisions, and their constitutionally and statutorily ordained roles as makers of law and rules." *Parkcentral*, 763 F.3d at 217. Section 929Y of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 directed the Staff of the SEC to study the post-*Morrison* state of the law, and the Staff completed that study in April 2012. In summarizing the application of *Morrison* to "off-exchange transactions," the Staff said that "[a]ll that can conclusively be said" is that the question is "fact-intensive" and that lower courts have been "struggling." Staff of the SEC, *Study on the Cross-Border Scope of the Private Right of Action Under Section 10(b) of the Securities Exchange Act of 1934*, at 33-34, 68 (Apr. 2012). The Staff set forth "four options for consideration to supplement and clarify the transactional test," *id*. at vii, but Congress has not yet adopted any of those options.

This Court should not distort *Morrison* or Rule 23 for the purpose of facilitating class actions in the OTC market.

V. The District Court Improperly Credited the Results of Plaintiffs' Flawed Test of Market Efficiency

The District Court's ruling on the *Morrison* issue stacks the deck in favor of granting securities plaintiffs' class certification motions. So too does its holding that Plaintiffs had met their burden under *Basic Inc.* v. *Levinson,* 485 U.S. 224 (1988), of demonstrating market efficiency using the flawed FDT test.[26] In particular, by crediting the results of Plaintiffs' proffered FDT test, in which evidence of market *in*efficiency is taken to demonstrate its opposite, the District Court all but eliminated securities defendants' ability to rebut the *Basic* presumption of reliance at the class certification stage, in clear violation of binding Supreme Court precedent.

Recognizing the "practical consequences of an expansion" of liability under the federal securities laws—including "allow[ing] plaintiffs with weak claims to extort settlements from innocent companies," *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc*., 552 U.S. 148, 162-64 (2008)—the Supreme Court and this Court have, in ruling on claims under Section 10(b), sought a balance between appropriate enforcement of the law and weeding out non-meritorious suits. "No one sophisticated about markets believes that multiplying liability is

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[26] Plaintiffs' expert testimony relied on a test suggested in Paul Ferrillo, Frederick Dunbar & David Tabak, *The "Less Than" Efficient Capital Markets Hypothesis: Requiring More Proof From Plaintiffs in Fraud-on-the-Market Cases*, 78 St. John's L. Rev. 81 (2004) ("FDT").

free of cost." *SEC* v. *Tambone*, 597 F.3d 436, 452 (1st Cir. 2010) (Boudin, J., concurring). The costs of abusive class actions inevitably "get passed along to the public." *Id*. at 452-53. This is especially the case in securities class actions. *See SEC* v. *Tex. Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, J., concurring) (the costs of improperly certified securities class actions are "payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers"); Henry J. Friendly, *Federal Jurisdiction: A General View* 120 (1973) (class actions risk "recoveries that would ruin innocent shareholders or, what is more likely, . . . blackmail settlements").

In *Halliburton II*, the Supreme Court reaffirmed that defendants are entitled at the class certification stage to rebut the *Basic* presumption of reliance. The Court reasoned that the reliance element of securities fraud claims "ensures that there is a proper connection between a defendant's misrepresentation and a plaintiff's injury," 134 S. Ct. at 2407, which is necessary in order to respect "the careful limits on 10b-5 liability," *Stoneridge*, 552 U.S. at 157 (quoting *Cent. Bank of Denver* v. *First Interstate Bank of Denver*, 511 U.S. 164, 180 (1994)). Such a connection is premised on proof that material new information causes stock price movement in the appropriate direction—that is, that the price declines in response to bad news and increases in response to good news. Otherwise, there is no basis to conclude that any alleged misrepresentations caused stock price inflation, which

is the evidentiary basis for the *Basic* fraud-on-the-market theory. A market in which prices do not move in the direction indicated by the relevant disclosures is not efficient. And without proof that the security at issue traded in an efficient market, "the fraud-on-the-market theory underlying the [*Basic*] presumption completely collapses, rendering class certification inappropriate." *Id*. at 2416.

The FDT test is fatally flawed because it fails to consider the directionality of securities price movements. The test measures the *amount* of stock price movement, but ignores whether prices moved in the direction dictated by the news. Occasions on which a company's stock price increases in response to bad news, or decreases in response to good news, are persuasive evidence that the market is not efficient. Such occasions support a defendant's rebuttal of the fraud on the market theory. The District Court nevertheless incorrectly held that Plaintiffs could prove market efficiency even if Petrobras's security prices moved in the wrong direction in response to disclosures of new material information. It concluded that Plaintiffs had met their burden by showing that new information "generally affected" the price, even if the movement was in the wrong direction. 312 F.R.D. at 370.

In so doing, the District Court adopted a rule that would destroy the carefully crafted burden-shifting approach adopted by the Supreme Court in *Basic* and *Halliburton II*. Indeed, its rule stands that approach on its head. It goes

beyond excusing Plaintiffs from their burden of proving market efficiency—it takes evidence of market *in*efficiency and pretends that it demonstrates market efficiency. As a result, this ruling all but eliminates securities defendants' ability to rebut the *Basic* presumption at the class certification stage.

Conclusion

The District Court's class certification order should be reversed.

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Certificate of Compliance

I, Richard A. Rosen, attorney for amicus SIFMA, hereby certify that this brief conforms to the requirements of Fed. R. App. P. 29(d) and 32(a)(7) because this brief contains 6,926 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 in Times New Roman 14-point font.

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