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,

(*For Continuation of Caption See Inside Cover)*

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

AMICUS CURIAE BRIEF OF THE CHAMBER OF COMMERCE
OF THE UNITED STATES OF AMERICA
IN SUPPORT OF DEFENDANTS-APPELLANTS

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INTERNATIONAL EQUITY FUND, ABERDEEN GLOBAL EMERGING 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 Rules 26.1 and 29(c) of the Federal Rules of Appellate Procedure, *amicus* states as follows:

The Chamber of Commerce of the United States of America has no parent company. No publicly held company owns 10% or more of its stock.

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INTEREST OF *AMICUS CURIAE*[1]

The Chamber of Commerce of the United States of America ("the Chamber") is the world's largest business federation. The Chamber represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry, from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. The Chamber thus regularly files *amicus curiae* briefs in cases raising issues of concern to the Nation's business community, including in securities cases.

The Chamber has a strong interest in this important case. Many of the Chamber's members are companies subject to U.S. securities laws who are adversely affected by the district court's decision relieving Plaintiffs of their burden to provide direct evidence of market efficiency before receiving the *Basic* presumption of reliance. Those members (and those who are exposed to other types of class action litigation) are likewise adversely affected by

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[1] Pursuant to Fed. R. App. P. 29(c), *amicus curiae* states that no counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amicus curiae*, its members, or its counsel made a monetary contribution intended to fund its preparation or submission. All parties have consented to the filing of this brief.

the district court's decision relieving plaintiffs of their burden to demonstrate that the proposed class was ascertainable—*i.e.*, defined by objective criteria that are administratively feasible and allow for the identification of members without a mini-hearing on the merits of each case. In addition, the Chamber has long been concerned about the costs that class-action lawsuits—including, in particular, securities class actions—impose on the American economy. To that end, the Chamber regularly files *amicus curiae* briefs in various class action appeals, including in *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014) ("*Halliburton II*") and *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010).

SUMMARY OF ARGUMENT

Time and again, the Supreme Court and this Court have stressed that "Rule 23 does not set forth a mere pleading standard," *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 350 (2011), and so a district court must perform "rigorous analysis" to ensure it "receive[s] enough evidence, by affidavits, documents, or testimony, to be satisfied that each Rule 23 requirement has been met," *In re Initial Pub. Offerings Secs. Litig.*, 471 F.3d 24, 37, 41 (2d Cir. 2006). The district court below failed to follow these instructions in at least two critical respects.

First, the district court applied a presumption of reliance under *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), even though Plaintiffs failed to present direct evidence of an efficient market in the securities at issue. A cause-and-effect relationship between unexpected news and the market price is the essence of an efficient market. By instead relying on "indirect factors" of market efficiency, the district court eviscerated the foundation of the fraud-on-the-market theory underlying the *Basic* presumption. Because the presumption relieves plaintiffs of the burden they otherwise carry to show reliance on alleged misleading information, this Court should be particularly vigilant to prevent the kind of shortcut taken below.

Second, the district court failed to follow this Court's instruction to certify a class only when the plaintiff proves that the class is "defined by objective criteria that are administratively feasible" and its members can be identified without "a mini-hearing on the merits of each case." *Brecher v. Republic of Argentina*, 806 F.3d 22, 24-25 (2d Cir. 2015). This "ascertainability" requirement is essential to ensure that certification of a class does not deprive a defendant or absent class members of their due process rights. Because Plaintiffs failed to prove that they can identify at the class-certification stage whether a security was acquired through a "domestic transaction," the district court improperly certified the class.

These two errors are not foot faults. They are fundamental departures from precedent. If left uncorrected, the court's market-efficiency error would eliminate the reliance element and make class certification a near certainty in the vast majority of securities class actions; the court's ascertainability holding would effectively eliminate a defendant's right to present (and prove) every available defense. The business community already faces enormous challenges from dubious class-action litigation, in the securities context and elsewhere. Upholding the district court's decision would embolden plaintiffs to bring even more questionable claims that are disconnected from real culpability and allow them to extort settlements using the threat of massive class-wide damages. The district court's decision should be vacated.

ARGUMENT

I. The District Court Improperly Applied the *Basic* Presumption of Reliance.

A. Plaintiffs Bear the Burden of Proving Every Element of the Rule 23 Analysis, Including Predominance.

As the Supreme Court has cautioned, the class action remains "an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only." *Comcast Corp. v. Behrend*, 133 S. Ct. 1426, 1432 (2013). Certification of a class is appropriate only when "questions of law or fact common to class members predominate over any

questions affecting only individual members" and when class litigation "is superior to other available methods for fairly and efficiently adjudicating the controversy." Fed. R. Civ. P. 23(b)(3).

Importantly, "Rule 23 does not set forth a mere pleading standard," and a party seeking class certification "must affirmatively demonstrate [its] compliance with the Rule—that is, [it] must be prepared to prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc." *Dukes*, 564 U.S. at 350 (emphasis in original). The plaintiffs carry the burden of proof with respect to every Rule 23 requirement, and a district court abuses its discretion when it fails to conduct the "rigorous analysis" that Rule 23 requires. *Comcast Corp.*, 133 S. Ct. at 1432.

This burden of proof is no different for the "predominance" requirement under Rule 23(b)(3). The predominance inquiry is not satisfied unless "a proposed class is 'sufficiently cohesive to warrant adjudication by representation.'" *Amgen Inc. v. Conn. Ret. Plans & Tr. Funds*, 133 S. Ct. 1184, 1196 (2013) (quoting *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 623 (1997)). Class-wide issues predominate only when legal or factual questions can be resolved "through generalized proof" and are "more substantial than the issues subject only to individualized proof." *In re U.S. Foodservice Inc. Pricing Litig.*, 729 F.3d 108, 118 (2d Cir. 2013). "The

requirement's purpose is to ensure that the class will be certified only when it would achieve economies of time, effort, and expense, and promote uniformity of decision as to persons similarly situated, without sacrificing procedural fairness or bringing about other undesirable results." *Myers v. Hertz Corp.*, 624 F.3d 537, 547 (2d Cir. 2010) (citation and alteration omitted).

B. To Receive the *Basic* Presumption of Reliance, Plaintiffs Must Present Direct Evidence of Market Efficiency at the Class Certification Stage.

Before certifying a class, plaintiffs must prove that "questions of law or fact common to class members predominate" in their underlying cause of action—in this case, under Section 10(b) of the Exchange Act and Rule 10b-5. *See Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804, 809 (2011) ("*Halliburton I*"). Section 10(b) and Rule 10b-5 "prohibit making any material misstatement or omission in connection with the purchase or sale of any security." *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2407 (2014) ("*Halliburton II*"). To recover damages for violations of these provisions, plaintiffs must prove "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4)

reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Id*.

The reliance element is a critical component of this cause of action because it "ensures that there is a proper connection between a defendant's misrepresentation and a plaintiff's injury." *Amgen*, 133 S. Ct. at 1192 (citation omitted). "The traditional (and most direct) way for a plaintiff to demonstrate reliance is by showing that he was aware of a company's statement and engaged in a relevant transaction—*e.g.*, purchasing common stock—based on that specific misrepresentation." *Halliburton I*, 563 U.S. at 809.

In *Basic Inc. v. Levinson*, however, the Supreme Court held that "securities fraud plaintiffs can in certain circumstances satisfy the reliance element of a Rule 10b-5 action by invoking a rebuttable presumption of reliance, rather than proving direct reliance on a misrepresentation." *Halliburton II*, 134 S. Ct. at 2408 (citing *Basic*, 485 U.S. at 246-47). The Court based that presumption on what is known as the "fraud-on-the-market" theory, which holds that "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." *Basic*, 485 U.S. at 246.

The *Basic* presumption is premised on "price impact"—*i.e.*, "whether the alleged misrepresentations affected the market price in the first place." *Halliburton I*, 563 U.S. at 814. "In the absence of price impact, *Basic*'s fraud-on-the-market theory and presumption of reliance collapse." *Halliburton II*, 134 S. Ct. at 2414. "The fundamental premise underlying the presumption is that an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction." *Id*. (citation omitted). "If it was not, then there is no grounding for any contention that the investor indirectly relied on that misrepresentation through his reliance on the integrity of the market price." *Id*. (citation omitted).

For the *Basic* presumption to apply, plaintiffs must show: "(1) that the alleged misrepresentations were publicly known, (2) that they were material, (3) that the stock traded in an efficient market, and (4) that the plaintiff traded the stock between the time the misrepresentations were made and when the truth was revealed." *Halliburton II*, 134 S. Ct. at 2408. To prove market efficiency, "the most important" factor to consider is *direct* evidence of cause and effect—*i.e.*, a causal relationship between unexpected news and the market price. *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, 546 F.3d 196, 207 (2d Cir. 2008). "[I]n an efficient market,

all publicly available information is rapidly incorporated into, and thus transmitted to investors through, the market price." *Amgen*, 133 S. Ct. at 1195. As a result, "[e]vidence that unexpected corporate events or financial releases cause an immediate response in the price of a security" is "the essence of an efficient market and the foundation for the fraud on the market theory." *Teamsters Local 445 Freight Div. Pension Fund*, 546 F.3d at 207. "Without the demonstration of such a causal relationship, it is difficult to presume that the market will integrate the release of material information about a security into its price." *Id*.

C. The District Court Improperly Granted the *Basic* Presumption of Reliance Without Any Direct Evidence of Market Efficiency.

The district court erred in granting class certification because it had no direct evidence that Petrobras securities were traded in an efficient market. The court mistakenly concluded that Plaintiffs were entitled to the *Basic* presumption of reliance without identifying *any* "empirical evidence of a cause and effect relationship between events and an immediate response in the price of the debt securities." Slip op. 31. Instead, the district court assumed that "indirect factors" pointed to a "large and well-functioning market for Petrobras securities" and that "common sense suggest[ed] that the market would materially react to material disclosures." *Id*. In the Court's

view, these factors "raise[d] the likelihood of an efficient market" and obviated any need for direct evidence of causation. *Id*. at 33.

This holding was error. Direct evidence of causality is necessary to determine whether a security is traded in an efficient market. This determination about market efficiency does not turn on a simple tally of the *Cammer* factors. *See Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989). This Court has been crystal clear: whether "unexpected corporate events or financial releases cause an immediate response in the price of a security" is "the *most important*" factor and "the essence of an efficient market and the foundation for the fraud on the market theory." *Teamsters Local 445 Freight Div. Pension Fund*, 546 F.3d at 207 (emphasis added and citations omitted). Indeed, the district court recognized that this was the law of the Second Circuit. Slip op. 32.

"Without the demonstration of such a causal relationship, it is difficult to presume that the market will integrate the release of material information about a security into its price." *Teamsters Local 445 Freight Div. Pension Fund*, 546 F.3d at 207; *see also In re Xcelera.com Sec. Litig.*, 430 F.3d 503, 512 (1st Cir. 2005) (Without "a historical cause-and-effect relationship between company disclosures and an immediate response in stock price … there is little assurance that information is being absorbed into the market

and reflected in its price."). An empirical study is essential for evaluating market efficiency. *See* Petrobras Defendants-Appellants Br. ("Petrobras Br.") 19-20. The district court's "indirect factors" were mere "indicators" of efficiency and insufficient standing alone to prove market efficiency. *See id.*; *see, e.g.*, *In re HealthSouth Corp. Sec. Litig.*, 261 F.R.D. 616, 633 (N.D. Ala. 2009).

Adopting the court's reasoning would eviscerate the reliance element in class action lawsuits. If the court's "indirect factors" were sufficient to find market efficiency, which then established reliance, then most, if not all, large companies would be potentially liable for any statement regardless whether investors actually relied on it. This would have the effect of making the securities laws into an insurance policy. *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 347-48 (2005) ("Such a rule would tend to transform a private securities action into a partial downside insurance policy."). Almost all large companies satisfy these "indirect factors," which include commonplace features such as heavy trading volume, analyst coverage, and market capitalization. Conversely, investors in smaller issuers or bond offerings would rarely benefit from the presumption. But the Supreme Court has never indicated that size can serve as a proxy for the existence of an efficient market. Indeed, this presumption would conflict with the empirical

evidence, which shows that securities of large companies trading on major exchanges often do trade inefficiently. *See* Petrobras Br. 19.

As Appellants' Brief explains well, *see* Petrobras Br. 22-34, the district court also shrugged off fundamental flaws in the quality of plaintiffs' expert, *see* Slip op. 32-44. In particular, the district court did not adequately address questions regarding the general reliability of its novel empirical test as a mechanism for testing market efficiency, and discounted the plaintiffs' expert's failure to account for the directionality of any price impact. *See, e.g.*, Slip op. 43 (acknowledging "the limited evidence of directionality" but concluding that it "is not fatal to plaintiffs' showing of market efficiency"). The district court thus relieved plaintiffs of their obligation "to *prove*" a cause-and-effect relationship between a company's material disclosures and its stock price. *Dukes*, 564 U.S. at 350. The district court needed to employ "rigorous analysis" in its review of the evidence. *Comcast Corp.*, 133 S. Ct. at 1432. The district court's emphasis on "indirect factors" and "common sense" fell short of this requirement, setting a dangerous precedent for class action litigation. *See infra* at 20-24.

II. The District Court Misapplied the Ascertainability Requirement.

A. Ascertainability Is a Fundamental Prerequisite to Class Certification.

"The fundamental requisite of due process of law is the opportunity to be heard." *Grannis v. Ordean*, 234 U.S. 385, 394 (1914). Due process requires not only that a plaintiff prove every element of his claim, but also that a defendant be given "'an opportunity to present every available defense.'" *Lindsey v. Normet*, 405 U.S. 56, 66 (1972) (quoting *Am. Sur. Co. v. Baldwin*, 287 U.S. 156, 168 (1932)). A defendant does not forfeit any of these rights in the class action setting. *See Deposit Guar. Nat'l Bank v. Roper*, 445 U.S. 326, 332 (1980). The class action is merely a *procedural* device that is "ancillary to the litigation of substantive claims." *Id.*; *see also* 28 U.S.C. § 2072 ("[R]ules of practice and procedure … shall not abridge, enlarge or modify any substantive right.").

In line with Rule 23, the Rules Enabling Act, and principles of due process, this Court has recognized an "implied requirement of ascertainability in Rule 23 of the Federal Rules of Civil Procedure." *Brecher*, 806 F.3d at 24. This ascertainability requirement flows directly from, and is compelled by, Rule 23(b)(3).

Specifically, a class is "ascertainable" only when "defined by objective criteria that are administratively feasible and when identifying its

members would not require a mini-hearing on the merits of each case." *Id*. at 24-25. If deciding the claims of a class will eventually "devolve into numerous mini-trials," a putative class action cannot satisfy the predominance or superiority requirements of Rule 23. *Marcus v. BMW of N. America, LLC*, 687 F.3d 583, 606 (3d Cir. 2012). As with other Rule 23 requirements, the plaintiff "bears the burden of establishing by a preponderance of the evidence" that the ascertainability requirements have been met. *Myers*, 624 F.3d at 547.

The ascertainability requirement is a critical mechanism for ensuring that a class certification does not deprive a defendant of his due process rights. By insisting on the "easy identification of class members," *Marcus*, 687 F.3d at 593, the ascertainability requirement protects both plaintiffs and defendants alike. It protects plaintiffs by ensuring that they have fair notice of whether they are included in the class (and thus a fair opportunity to opt out of the class). *See Carrera v. Bayer Corp.*, 727 F.3d 300, 307 (3d Cir. 2013). And it protects defendants "by ensuring that those persons who will be bound by the final judgment are clearly identifiable." *Marcus*, 687 F.3d at 593. Without this protection, defendants likely would be forced to engage in "satellite litigation … over who was in the class in the first place." *Id*. Ascertainability further "eliminates serious administrative burdens that are

incongruous with the efficiencies expected in a class action" by insisting that the process of identifying class members consistent with due process will not become bogged down in "extensive and individualized fact-finding or 'mini-trials.'" *Id*.

B. The District Court Misapplied the Ascertainability Requirement.

Defendants argued that the district court would need to conduct individualized, fact-specific inquiries to determine whether the transactions at issue were "domestic" under *Morrison v. National Australia Bank Ltd*., 561 U.S. 247 (2010). The district court rejected this argument, finding that restricting the class in this way would "cut off purchasers who have valid claims under *Morrison*'s second prong, which holds that the securities laws apply to securities purchased in 'domestic transactions.'" Slip op. 22. The Court also felt confident that evaluating whether an individual had purchased the security through a "domestic transaction" would be administratively feasible, and so a "court, a putative class member, or a claims administrator" would, in the future, be able "to determine whether a claim satisfies *Morrison*." *Id*. at 23.

The district court erred in multiple respects. To begin, the certified class was not "defined by objective criteria that are administratively feasible" and does not allow for the identification of members without "a

mini-hearing on the merits of each case." *Brecher*, 806 F.3d at 24-25. These principles apply to claims based on securities fraud—just as they do to claims based on consumer fraud, contract law, and other laws. The Supreme Court in *Morrison* held, after employing a presumption that federal law is not meant to have extraterritorial effect, that Section 10(b) applies only to "[1] transactions in securities listed on domestic exchanges, and [2] domestic transactions in other securities." *Morrison*, 561 U.S. at 267.

Morrison's second inquiry—whether a "domestic transaction" has occurred—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). In particular, whether a "domestic transaction" has occurred turns on where "irrevocable liability was incurred" and where "title was passed within the United States." *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 68 (2d Cir. 2012). This is not a yes-or-no question with evidence of a methodology uniformly applicable to all (or even many) cases: the test for assessing these elements involves multiple factors, "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.[2]

[2] For those same reasons, the district court also erred in finding that common issues predominated over individualized ones. *See* Petrobras Br. 50-56.

As a result, Appellants could not determine at the class-certification stage even the approximate number of potential class members to which it might be liable, and potential plaintiffs will not receive adequate notice about whether they will or will not be members of the class.

Even worse, the district court postponed the necessary *Morrison* inquiries until the post-judgment phase—*after* determining liability. Resolving problems of ascertainability—and the facts necessary to determine a claim—cannot be deferred past the certification stage much less outsourced to claims administrators. The Supreme Court frequently has admonished that "a party seeking to maintain a class action 'must affirmatively demonstrate his compliance' with Rule 23" at the certification stage, and courts "must conduct a 'rigorous analysis' to determine whether" he has met that burden. *Comcast Corp.*, 133 S. Ct. at 1432-33 (quoting *Dukes*, 564 U.S. at 350-51). Ascertainability is unquestionably among the requirements that plaintiffs must "affirmatively demonstrate" at the class certification stage. *See supra* at 4-6. The question of ascertainability is a "threshold" one, and therefore must be answered *before* the application of the other Rule 23 requirements. *EQT Prod. Co. v. Adair*, 764 F.3d 347, 358 (4th Cir. 2014) ("We have repeatedly recognized that Rule 23 contains an implicit threshold requirement that the members of a proposed class be

'readily identifiable,'" *i.e.*, "an 'ascertainability' requirement.") Thus, although a plaintiff "need not be able to identify every class member at the time of certification, … if class members are impossible to identify without extensive and individualized fact-finding or 'mini-trials,' then a class action is inappropriate." *Id.* (citation omitted). Plaintiffs failed to do that here. *See* Petrobras Br. 38-39.

If the decision below stands and district courts are permitted to postpone ascertainability issues until a class is certified, then the reality is that such issues will rarely be resolved. Few defendants continue to litigate cases after classes are certified because, at that point, the pressure on defendants to settle is often overwhelming, even if the allegations lack merit. *See, e.g.*, *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 350 (2011) ("Faced with even a small chance of a devastating loss, defendants will be pressured into settling questionable claims" to avoid "the risk of 'in terrorem' settlements."); *Shady Grove Orthopedic Assocs. P.A. v. Allstate Ins. Co.*, 559 U.S. 393, 445 n.3 (2010) (Ginsburg, J., dissenting) ("A court's decision to certify a class … places pressure on the defendant to settle even unmeritorious claims."); Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 99 (2009) ("With vanishingly rare exception, class certification sets the litigation on a path

toward resolution by way of settlement, not full-fledged testing of the plaintiffs' case by trial."). The district court's "certify now, identify class members later" approach will force defendants to settle even if they have valid objections to putative class members' membership in the class, negating their right to raise "every available defense," *Lindsey*, 405 U.S. at 66 (quotation marks omitted).

In a litigated case, by contrast, under the district court's rule, there would be no judicial determination of these critical threshold questions and no opportunity for a defendant to cross-examine its accusers and to "litigate its … defenses to individual claims." *Dukes*, 564 U.S. at 367. No matter how complex the case or numerous the parties, a district court's reliance on a non-Article III entity to adjudicate fundamental issues amounts to "an abdication of the judicial function depriving the parties of a trial before the court on the basic issues involved in the litigation." *La Buy v. Howes Leather Co.*, 352 U.S. 249, 256 (1957).

In the end, by permitting plaintiffs to avoid proof of a "domestic transaction" under *Morrison*, the district court authorized individuals who may have no claims to participate in the class. This was improper and requires reversal.

III. The District Court's Decision Will Embolden Securities Plaintiffs to Pursue Marginal Claims on Behalf of Questionable Classes.

Left uncorrected, the district court's errors not only harm class action law generally. They would cause particular damage in securities class actions, making class certification a near certainty in the vast majority of those actions, while simultaneously depriving defendants of their rights to a defense. This outcome would embolden plaintiffs to bring insubstantial securities fraud claims that bear little relation to any real culpability and serve only to extract settlements by wielding the threat of overbroad class-wide damages.

The Supreme Court and this Court have repeatedly warned against the threat of abuse and unfair settlement pressures that often attend the class treatment of securities fraud claims. *See, e.g.*, *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 163 (2008) (noting that the "potential for uncertainty and disruption in a [securities fraud] lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies"); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975) (noting that securities class action litigation poses "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general"); *Hevesi v. Citigroup Inc.*, 366 F.3d 70, 80 (2d Cir. 2004) (noting

that "settlements in large class actions can be divorced from the parties' underlying legal positions" given the settlement pressure on defendants).

Given the costs of defending against such litigation and the potential for massive liability, settlement is a virtual certainty in cases that survive a motion to dismiss, regardless of merit, according to research by the Stanford Law School Securities Class Action Clearinghouse. *See* Stanford Clearinghouse, *Securities Class Action Filings: 2015 Year In Review* 12 (2016), http://goo.gl/Db3nSq (less than 1 percent of securities class action filings from 1997 to 2014 have reached a trial verdict). Such settlements often have more to do with the defendant's insurance limits than with the strength of the plaintiffs' claims. *See Schleicher v. Wendt*, 618 F.3d 679, 686 (7th Cir. 2010) (citing studies).

The targeting of defendants for securities lawsuits likewise often has little to do with the merits. Although the implied private right of action under Section 10(b) and Rule 10b-5 is intended to provide a remedy for investors who suffer genuine injury from securities fraud, securities class actions are routinely filed in the wake of almost any negative announcement by a company that corresponds to a stock price decline. Statistics from the Stanford Clearinghouse demonstrate that securities fraud suits often target particular industry sectors, in many cases ensnaring a large portion of the

publicly traded companies in a given industry. Stanford Clearinghouse, *Securities Class Action Filings: 2015 Year In Review*, *supra*, 18-19. For example, in 2015, new securities fraud class actions were filed against 2.6 percent of S&P 500 companies, but the figures were 10.3 percent for utilities companies and 7.5 percent for consumer staples companies. *Id*. Because securities fraud cases can take multiple years to resolve, the filing of a significant number of cases against an industry in one year can mire that industry in litigation for years to come.

Companies already face enormous pressure to settle securities class actions. Securities fraud class actions led to over $3 billion in settlements in 2015, with an average settlement of $38 million per case. *See* Stanford Clearinghouse, *Securities Class Action Settlements: 2015 Review and Analysis* 3 (2016), http://goo.gl/KPIl5y. Defense costs in these cases have been estimated to range from 25 to 35 percent of the settlement value. *See* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534, 1546 (2006). The district court's approach, if permitted to stand, would increase these burdens.

Such costs are not isolated to companies against which suits have been brought. They are spread to *all* U.S. public companies (and now, under

the district court's rule, to foreign companies), which must pay more for insurance, pay more to access capital, and be placed in a worse competitive position than their overseas counterparts. Indeed, these cases threaten the health of the U.S. economy—imposing huge costs on American businesses, investors, and employees while hurting the global competiveness of U.S. securities markets.

In addition to these costs, the district court's decision could have even greater economic consequences by spurring foreign issuers to turn to securities markets in other jurisdictions. The decision below, if affirmed, could discourage foreign global issuances involving the United States due to concerns about the risk of facing large U.S. class action lawsuits, even if most of the transactions occurred outside the United States.

These costs of excessive securities class actions are not offset by corresponding benefits in the form of effective fraud deterrence. *See* William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. Pa. L. Rev. 69, 72-73 (2011). In fact, most often the main result of settlements is a wealth transfer from one group of innocent shareholders to another—of course, with a healthy cut for the plaintiffs' lawyers. *See* Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 Ariz. L. Rev. 639, 648 n.43 (1996) ("[I]n the average

settlement, 68.2% comes from the insurer and 31.4% from the issuer, with only 0.4% coming from individual defendants.") (citation omitted).

At bottom, this Court should be mindful of the legal and economic burdens that flow from the district court's decision. Many in the business community are already deeply vulnerable to massive liability from insubstantial securities class actions. The Court should not increase this exposure by approving of the casual approach to class certification taken by the district court in this case.

CONCLUSION

For the foregoing reasons, this Court should vacate the decision of the district court.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), undersigned counsel certifies that this brief:

(i) complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B)(i) because it contains 5,048 words, including footnotes; and

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

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CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of July, 2016, a true and correct copy of the foregoing was filed with the Clerk of the United States Court of Appeals for the Second Circuit via the Court's CM/ECF system, which will send notice of such filing to all counsel who are registered CM/ECF users.

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