UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE INITIAL PUBLIC OFFERING SECURITIES LITIGATION	21 MC 92 (SAS)
This document relates to: 01 Civ. 0242; 01 Civ. 3857; 01 Civ. 6001; 01 Civ. 7048; 01 Civ. 8404; 01 Civ. 9417	**FILE UNDER SEAL**

REPLY MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS' MOTION FOR CLASS CERTIFICATION IN SIX FOCUS CASES

March 28, 2008

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TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1

ARGUMENT 3

I. DEFENDANTS' PARTICIPATION IN DECEPTIVE AND MANIPULATIVE CONDUCT CAN BE ESTABLISHED CLASSWIDE 3

II. RELIANCE CAN BE ESTABLISHED CLASSWIDE 5

A. Transaction Causation for Manipulative Conduct 12

1. Artificial Inflation 12

a. Defendants' Analyses Ignore Relevant Features of the Pre-Open 13

b. Defendants Improperly Examine Aftermarket Trading Divorced from the Scheme 18

c. Analyst Reports Must Be Considered in the Context of the Overall Scheme 27

2. Reliance on Market Price 28

3. Issuers are Responsible for the Effects of the Manipulations 29

B. Transaction Causation for Omissions and Misstatements 30

1. Materiality 30

2. Market Efficiency 31

3. *Affiliated Ute* 40

C. Individualized Issues are Not Created by the Possibility of Actual Knowledge 41

1. First Amended Complaints 42

2. Other Evidence 45

3. Interrogatory Answers 49

4. Media and Internet Chat Rooms 54

5. Expert Testimony and Academic Articles 59

D. Loss Causation 61

1. The Index Method Properly Accounts for any Intervening Causes 64

2. Plaintiffs' Evidence is Not the Result of Selection Bias............... 68

3. Other Aspects of the Index Approach.. 69

E. Plaintiffs' Allegations are Not Inconsistent With Market Efficiency........72

III. THE PUTATIVE CLASS MEMBERS' CLAIMS ARE TIMELY.......................73

IV. ASCERTAINABILITY 74

V. RULE 23(C)(4) CERTIFICATION IS APPROPRIATE 75

VI. PLAINTIFFS' PROPOSED SECTION 11 CLASSES ARE CONSISTENT WITH THIS COURT'S HOLDING ON TRACING 77

VII. VARIOUS ASPECTS OF DEFENDANTS' EXPERT REPORTS SHOULD BE STRICKEN FROM THE RECORD...78

A. Defendants' References to "Non-Litigated IPOs" Should Be Stricken.....78

B. Defendants' Experts Offer Legal Conclusions 79

C. Defendants' Experts Opine on Lay Matters...81

CONCLUSION... 82

TABLE OF AUTHORITIES

Page

FEDERAL CASES

60223 Trust v. Goldman, Sachs & Co.,
No. 03-3548, 2007 WL 4326730 (S.D.N.Y. Dec. 4, 2007) 11

ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.,
493 F.3d 87 (2d Cir. 2007)....................7, 9, 61

Affiliated Ute Citizens v. United States,
406 U.S. 128 (1972)....................40

Akerman v. Oryx Commc'ns, Inc.,
810 F.2d 336 (2d Cir. 1987)....................63

Ambrosini v. Labarraque,
101 F.3d 129 (D.C. Cir. 1996)....................67

Andrews v. Metro. North Commuter R.R. Co.,
882 F.2d 705 (2d Cir. 1989)....................79, 81

In re Apple Computer Sec. Litig.,
886 F.2d 1109 (9th Cir. 1989)....................72

In re Atl. Fin. Fed. Sec. Litig.,
No. 89-0645, 1990 WL 188927 (E.D. Pa. Nov. 28, 1990)....................71

Basic, Inc. v. Levinson,
485 U.S. 224 (1988).................... *passim*

In re Bearingpoint, Inc. Sec. Litig.,
232 F.R.D. 534 (E.D. Va. 2006)....................69

Bellefonte Re Ins. Co. v. Argonaut Ins. Co.,
757 F.2d 523 (2d Cir. 1985)....................48

Black v. Finantra Capital, Inc.,
418 F.3d 203 (2d Cir. 2005)....................8, 10

Blackie v. Barrack,
524 F.2d 891 (9th Cir. 1975)....................5, 29, 41

Blyden v. Mancusi,
186 F.3d 252 (2d Cir. 1999)....................76, 77

Cammer v. Bloom,
711 F. Supp. 1264 (D.N.J. 1989) 9, 34

Castellano v. Young & Rubicam, Inc.,
257 F.3d 171 (2d Cir. 2001)..67

In re Cendant Corp. Sec. Litig.,
109 F. Supp. 2d 235 (D.N.J. 2000) 25

In re Chiang,
385 F.3d 256 (3d Cir. 2004)..73

Coplin v. United States,
88 F.2d 652 (9th Cir. 1937) 27

Crane v. Consol. Rail Corp.,
731 F.2d 1042 (2d Cir. 1984)..77

Darquea v. Jarden Corp.,
No. 06-722, 2008 WL 622811 (S.D.N.Y. Mar. 6, 2008)...30

In re Data Access Sys. Sec. Litig.,
103 F.R.D. 130 (D.N.J. 1984)..55, 56

DeMarco v. Lehman Bros.,
222 F.R.D. 243 (S.D.N.Y. 2004) 27

DiLeo v. Ernst & Young,
901 F.2d 624 (7th Cir. 1990) 57

Doft & Co. v. Travelocity.com Inc.,
No. 19734, 2004 WL 1152338 (Del. Ch. May 21, 2004) 33

Dolphin & Bradbury, Inc. v. SEC,
512 F.3d 634 (D.C. Cir. 2008) 31

Dorchester Investors v. Peak Trends Trust,
No. 99-4696, 2002 WL 272404 (S.D.N.Y. Feb. 26, 2002)..71

Dura Pharms., Inc. v. Broudo,
544 U.S. 336 (2005)..66

Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.,
343 F.3d 189 (2d Cir. 2003)..68

Fisher v. Plessey Co.,
103 F.R.D. 150 (S.D.N.Y. 1984) 30

Freeman v. Laventhol & Horwath,
915 F.2d 193 (6th Cir. 1990) 10

Futura Dev. Corp. v. Centex Corp.,
761 F.2d 33 (1st Cir. 1985) 6, 9, 35

Ganino v. Citizens Utils. Co.,
228 F.3d 154 (2d Cir. 2000) 72

In re Genesisintermedia, Inc. Sec. Litig.,
No. 01-9024, 2007 WL 1953475 (N.D. Cal. June 28, 2007) 10

Glassman v. Computervision Corp.,
90 F.3d 617 (9th Cir. 1996) 6

Green v. Wolf Corp.,
406 F.2d 291 (2d Cir. 1968) 76

Gurary v. Winehouse,
190 F.3d 37 (2d Cir. 1999) 7

Hevesi v. Citigroup, Inc.,
366 F.3d 70 (2d Cir. 2004) 6, 10

Hunt v. Enzo Biochem, Inc.,
530 F. Supp. 2d 580 (S.D.N.Y. 2008) 61

In re Initial Public Offering Sec. Litig.,
227 F.R.D. 65 (S.D.N.Y 2004) .... *passim*

In re Initial Public Offering Sec. Litig.,
241 F. Supp. 2d 281 (S.D.N.Y. 2003) .... *passim*

In re Initial Public Offering Sec. Litig.,
297 F. Supp. 2d 668 (S.D.N.Y. 2003) .... *passim*

In re Initial Pub. Offering Sec. Litig.,
No. 21 MC 92, 2004 WL 3015304 (S.D.N.Y. Dec. 27, 2004) 57, 58, 73

In re Initial Pub. Offering Sec. Litig.,
No. 21 MC 92, 2007 WL 2609585 (S.D.N.Y. Aug. 30, 2007) 73

In re Initial Pub. Offering Sec. Litig.,
No. 21 MC 92, slip op. (S.D.N.Y. Mar. 26, 2008) .... *passim*

Jahn v. Equine Servs., PSC,
233 F.3d 382 (6th Cir. 2000) 67

Kavowras v. N.Y. Times,
328 F.3d 50 (2d Cir. 2003)..27

La Grasta v. First Union Sec., Inc.,
358 F.3d 840 (11th Cir. 2004) 57

Lentell v. Merrill Lynch,
396 F.3d 161 (2d Cir. 2005)..56, 64, 65, 72

Levitt v. Bear Stearns & Co.,
340 F.3d 94, 101 (2d Cir. 2003)..72

In re Linerboard Antitrust Litig.,
305 F.3d 145 (3d Cir. 2002)..41

Liu v. Credit Suisse First Boston Corp.,
383 F. Supp. 2d 566 (S.D.N.Y. 2005)..61

Malletier v. Dooney & Bourke, Inc.,
525 F. Supp. 2d 558 (S.D.N.Y. 2007)..81

Marx & Co. v. Diners' Club, Inc.,
550 F.2d 505 (2d Cir. 1977)..79

In re Micron Techs., Inc. Sec. Litig.,
247 F.R.D. 627 (D. Idaho 2007) 30

Miles v. Merrill Lynch,
471 F.3d 24 (2d Cir. 2006)..10, 41

In re NYSE Specialists Sec. Litig.,
503 F.3d 89 (2d Cir. 2007)..11

In re Nassau County Strip Search Cases,
461 F.3d 219 (2d Cir. 2006)..75

Nathan Gordon Trust v. Northgate Exploration Ltd.,
148 F.R.D. 105 (S.D.N.Y. 1993) 71, 73

Newman v. Warnaco Group, Inc.,
335 F.3d 187 (2d Cir. 2003)..56, 57

Newsome v. McCabe,
319 F.3d 301 (7th Cir. 2003) 5

Newton v. Merrill Lynch, Pierce, Fenner & Smith,
259 F.3d 154 (3d Cir. 2001)..41

O2 Micro Int'l v. Monolithic Power Sys., Inc.,
467 F.3d 1355 (Fed. Cir. 2006)....54

Oscar Private Equity Invs. v. Allegiance Telecom, Inc.,
487 F.3d 261 (5th Cir. 2007)....30

In re Oxford Health Plans, Inc. Sec. Litig.,
191 F.R.D. 369 (S.D.N.Y. 2000)....71, 73

Peil v. Speiser,
806 F.2d 1154 (3d Cir. 1986)....8

In re Pfizer, Inc. Sec. Litig.,
-- F. Supp. 2d --, 2008 WL 540120 (S.D.N.Y. Feb. 28, 2008)....58, 59

In re PolyMedica Corp. Sec. Litig.,
432 F.3d 1 (1st Cir. 2005)....6, 8, 32, 40

In re Rent-Way Sec. Litig.,
218 F.R.D. 101 (W.D. Pa. 2003)....66, 69

Rezzonico v. H & R Block, Inc.,
182 F.3d 144 (2d Cir. 1999)....74

Robinson v. Metro-North Commuter R.R. Co.,
267 F.3d 147 (2d Cir. 2001)....76

Rosenberg v. Hano,
121 F.2d 818 (3d Cir. 1941)....27

In re SCOR Holding (Switzerland) AG Litig.,
-- F. Supp. 2d --, 2008 WL 608606 (S.D.N.Y. Mar. 6, 2008)....32

Semerenko v. Cendant Corp.,
223 F.3d 165 (3d Cir. 2000)....55, 66

Simon v. Philip Morris Inc.,
200 F.R.D. 21 (E.D.N.Y. 2001)....77

Sirota v. Solitron Devices, Inc.,
673 F.2d 566 (2d Cir. 1982)....71, 73

Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc.,
No. 05-1898, 2006 WL 2161887 (S.D.N.Y. Aug. 1, 2006)....8, 28

Tellabs, Inc. v. Makor Issues & Rights, Ltd.,
127 S. Ct. 2499 (2007)....57

Thiessen v. GE Capital Corp.,
267 F.3d 1095 (10th Cir. 2001) 41

United States v. Bilzerian,
926 F.2d 1285 (2d Cir. 1991)..79

United States v. Feliciano,
223 F.3d 102 (2d Cir. 2000)..79

In re VeriFone Sec. Litig. ,
784 F. Supp. 1471 (N.D. Cal. 1992) 6

In re VisaCheck/Mastermoney Antitrust Litig.,
280 F.3d 124 (2d Cir. 2001)..41

Wagner v. Barrick Gold Corp.,
No. 03-4302, 2008 WL 465115 (S.D.N.Y. Feb. 15, 2008)...30

Waste Mgmt. Holdings v. Mowbray,
208 F.3d 288 (1st Cir. 2000) 41

West v. Prudential Sec., Inc.,
282 F.3d 935 (7th Cir. 2002) 21

Wielgos v. Commonwealth Edison Co.,
892 F.2d 509 (7th Cir. 1989) 6, 61

In re Williams Sec. Litig.,
496 F. Supp. 2d 1195 (N.D. Okla. 2007)...65

In re WorldCom, Inc. Sec. Litig.,
219 F.R.D. 267 (S.D.N.Y. 2003) 71

In re Xcelera.com Sec. Litig.,
430 F.3d 503 (1st Cir. 2005)...36, 37

Zedner v. United States,
547 U.S. 489 (2006)...75

DOCKETED CASES

SEC v. CSFB,
02 CV 90 (D.D.C. Jan. 22, 2002)...47

SEC v. Goldman Sachs,
05 Civ. 853 (S.D.N.Y. Jan. 25, 2005)..47

SEC v. J.P. Morgan Sec.,
03 CV 2028 (D.D.C. Oct. 1, 2003) 47

SEC v. Morgan Stanley,
05 CV 166 (D.D.C. Jan. 25, 2005), *available at* http://www.sec.gov/litigation/complaints/comp19050.pdf....27, 47

SEC v. Robertson Stephens,
03 CV 21 (D.D.C. Jan. 9, 2003)....47

OTHER FEDERAL MATERIALS

Fed. R. Civ. P. 33(a)(2)....54

15 U.S.C. § 78u-4(e)....38

Fed. R. Civ. P. 23....76

H.R. Rep. No. 73-1383, pt. 2 (1934)....26

Report of the Securities and Exchange Commission Concerning the Hot Issues Markets (August 1984)....26

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S.D.N.Y. Loc. Civ. R. 33.3....54

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U.S. Const. amend. VII....76

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8A Wright & Miller, *Federal Practice & Procedure* § 2181 (2d ed. 2008)....54

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Restatement (Second) of Torts (1977)...66, 67

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Steven S. Gensler, *Bifurcation Unbound*,
75 Wash. L. Rev. 705 (2000)...77

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40 U. Kan. L. Rev. 325 (1992) 79

Was IPO Frenzy Rigged?,
available at http://www.cbsnews.com/stories/2002/11/13/60II/printable 529225.shtml........49

PRELIMINARY STATEMENT

Plaintiffs have adduced substantial evidence demonstrating that their claims are subject to classwide proof and thus should be certified pursuant to Rule 23 of the Federal Rules of Civil Procedure. For example, Plaintiffs have shown that illegal tie-in agreements enabled Underwriters to inflate bidding in the pre-open bid session, resulting in inflated market prices. Plaintiffs have shown that the manipulated stocks underperformed market benchmarks, and that stocks with the greatest artificial inflation experienced the greatest underperformance. Plaintiffs have also shown that because each of the Focus Case stocks was heavily traded, sponsored by reputable underwriters, and the subject of heavy news and analyst coverage, investors in the aftermarket were likely to have believed that the prices at which they traded were the result of natural market forces. Plaintiffs have also shown that by standard economic measures, the market prices of the Focus Case stocks readily incorporated available information, and thus the stocks traded efficiently for purposes of the fraud-on-the-market doctrine.

Though Defendants' experts claim that other bidders played important roles in the pre-open session, none of Defendants' experts even measured the relationship between the lead underwriter's bids and the aftermarket trading prices. Defendants contend that the Focus Case stocks did not perform differently from "comparable" companies, but fail to acknowledge that their "comparable" companies have since either been proved to have been trading at artificially inflated prices, or at least bear a significant risk of having been tainted by the same manipulative conduct alleged in the Focus Cases. Defendants eschew standard measures of market efficiency and instead offer their own alternative measurements that not only result in various conflicting conclusions, but also in the highly implausible assertion that Plaintiffs have not submitted evidence that any of the Focus Case stocks traded efficiently at any time during the entire length of their class periods.

Defendants also rely on misleading portrayals of Plaintiffs' allegations, answers to contention interrogatories and internet chatter to suggest that knowledge of their scheme was so widespread that individual issues of reliance predominate over common issues. They would have this Court ignore that Plaintiffs' newly-defined classes exclude those who were in a position to learn of the scheme directly from the perpetrators. They would have this Court ignore the testimony of seventeen plaintiffs who all have said that they traded in ignorance of the scheme. And they would have this Court ignore the testimony of their own employees, repeated under oath both in this case and to government regulators, that they did not know of the scheme and did not communicate it to anyone.

In sum, this case is not nearly as complex as Defendants suggest. Plaintiffs allege that Defendants made the initial demand for the Focus Case stocks seem much higher than it actually was and, as a result, induced investors to buy at inflated prices. Plaintiffs claim that as the manipulation ceased and events revealed that the companies' businesses were not nearly as strong as their initial valuation suggested, stock prices fell. Thus, the manipulative scheme described, and the damage wrought by the scheme, represent exactly what Congress, the Securities & Exchange Commission, and the courts have sought to prevent since the passage of the Securities Act of 1933 and the Securities Exchange Act of 1934.

Defendants attempt to muddy these intuitive concepts. Defendants purport to see no relationship between a stock's inflated valuation on its first day of trading, and that stock's eventual decline, often amidst news of disastrous business problems. Defendants argue that courts must adopt definitions of market efficiency that – their own experts concede – would preclude claims for market manipulation in all cases. Defendants claim that it is "implausible" that tie-in agreements could have actually inflated market prices, while ignoring the obvious

point that it is far more implausible that Defendants would have invested enormous time and effort over a period of years to create and enforce a manipulative scheme without ever noticing that their efforts were having no effect. And, most relevant to this Court's analysis, the vast majority of Defendants' challenges to Plaintiffs' evidence apply *classwide*. For these reasons, Plaintiffs' motion for class certification should be granted.[1]

ARGUMENT

I. DEFENDANTS' PARTICIPATION IN DECEPTIVE AND MANIPULATIVE CONDUCT CAN BE ESTABLISHED CLASSWIDE

Plaintiffs allege that Defendants engaged in a scheme to inflate the prices of the Focus Case stocks by: (1) conditioning allocations on agreements to purchase in the aftermarket or to pay undisclosed compensation to Underwriters; (2) issuing false analyst reports; and (3) failing to disclose the scheme in the prospectuses of each of the Focus Cases. Each aspect of this scheme can be proved classwide.

As an initial matter, it is plain that the misleading analyst reports and the deficiencies in the prospectuses were identical in each of the Focus Cases. Therefore, the existence of these documents, and their misleading nature, are classwide issues. In a similar vein, the existence of tie-in agreements and associated orders and trades will also be identical for each class member. Even if an investor sought to bring an individual claim, that investor would be required to identify tie-in agreements and tainted orders.

Plaintiffs will prove the existence of tie-in agreements on a classwide basis with documentary evidence and testimony. Additionally, Professor Daniel R. Fischel has shown that

[1] Issuers contend that proceedings against iXL are barred by bankruptcy proceedings. Issuer Br. 25. This Court has determined that the bankruptcy court's order "has no connection" to this action. *See In re Initial Pub. Offering Sec. Litig.*, No. 21 MC 92, slip op. at 52 (S.D.N.Y. March 26, 2008). Issuers have offered the Court no reason to alter its conclusion.

circumstantial evidence may contribute to a finding of the existence of tie-in agreements and tie-in trades. *See* Second Supplemental Report of Daniel R. Fischel, dated September 27, 2007 ("Second Supp. Rep.") ¶ 32; Second Rebuttal Report of Daniel R. Fischel, dated March 20, 2008 ("Second Rebuttal Rep.") ¶ 30. Thus, Fischel's evidence, in addition to other evidence developed by Plaintiffs, will be used to establish the existence of tie-in agreements and to identify tainted trades.

Though Defendants do not dispute that the existence and falsity of analyst reports and registration statements are amenable to classwide treatment, they repeatedly insist that Plaintiffs have failed to identify a method for proving the existence of tie-in agreements and tie-in trading. *See, e.g.*, Issuer Br. 9. Defendants err by assuming that Fischel's report represents the sole evidence that Plaintiffs propose to introduce to establish the existence of the tie-in agreements and associated trading. Defendants ignore obvious sources of evidence such as documents noting the agreements and testimony from the persons involved. Indeed, in the Amended Master Allegations, Plaintiffs identify numerous investors who say they were induced to enter tie-in agreements as a condition of receiving allocations. Siebott Decl. (Vol. 3) (Amended Master Allegations ("AMA")) ¶ 37. Thus, Defendants' challenges to Fischel's reports as insufficient *by themselves* to prove that any particular agreements were reached, or that any particular trades were the result of a tie-in agreement, are beside the point.

Nor do Defendants' challenges undermine the strength of Fischel's reports as a whole. In reaching his conclusions about other aspects of Plaintiffs' claims, Fischel relied upon lists of tainted allocants and trades provided by Plaintiffs. Second Rebuttal Rep. ¶ 31 n.61. Even at trial, experts may assume facts and reach conclusions based on those facts, and those

assumptions may be probed at trial. *See Newsome v. McCabe*, 319 F.3d 301, 306 (7th Cir. 2003).

Moreover, Defendants' criticisms of Fischel are flawed on their own terms. Defendants claim, for example, that Fischel's methods are unreliable because not all tainted allocants are shown to have engaged in tie-in trades in the aftermarket. Issuer Br. 10. But Plaintiffs have not alleged that all allocants engaged in tie-in trades. Siebott Decl. (Vol. 3) (AMA) ¶¶ 32-35. As Fischel has shown, Plaintiffs will be able to establish that the mere existence of the tie-in agreements – even if they did not result in executed orders – enabled Underwriters to inflate bidding in the pre-open session before each IPO. Second Rebuttal Rep. ¶ 34.[2]

II. RELIANCE CAN BE ESTABLISHED CLASSWIDE

In a traditional fraud claim, proof of reliance satisfies the element of causation. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 243 (1988) (explaining that reliance "provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury"). Thus, the plaintiff establishes that the misconduct caused her losses by showing that a misrepresentation was material, and that the plaintiff acted on that misrepresentation. *See, e.g.*, *Blackie v. Barrack*, 524 F.2d 891, 906 (9th Cir. 1975). In many securities transactions, however, the plaintiff does not personally hear or read the false statement; in those cases, the fraud-on-the-market doctrine and the efficient markets hypothesis are used to satisfy the element of causation.

The fraud-on-the-market doctrine rests on the basic principle that when a market is sufficiently well-developed, stock prices reflect various traders' judgments about the value of the

[2] The fact that some tainted allocants may have willingly purchased shares in the aftermarket after the prices dropped substantially does not negate this. *See* Expert Report of René M. Stulz, dated December 21, 2007 ("Stulz") ¶ 109. Such evidence has no bearing on the critical question whether these allocants agreed to or purchased shares at much higher prices in exchange for receiving allocations.

company, based on available information. *See In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 8-10 (1st Cir. 2005). It is this principle, which has been recognized since before the passage of the Securities Act of 1933 and the Securities Exchange Act of 1934, that allows markets to function; investors are willing to buy and sell stocks with relative ease, and markets stay liquid, because investors trust that the prices themselves serve as a type of disclosure about the underlying security, sparing them the burden of performing copious research prior to every transaction. *See* Adolf A. Berle, *Liability for Stock Market Manipulation*, 31 Colum. L. Rev. 264, 268-70 (1931) (recognizing that trading patterns and stock prices reflected available public information, and that false statements would be reflected in market prices); *see also Futura Dev. Corp. v. Centex Corp.*, 761 F.2d 33, 40 (1st Cir. 1985) (Exchange Act intended to "restor[e] investor's confidence in financial markets" and "reduc[e] transaction costs associated with a caveat-investor rule"). These prices generated by a developed market are said to represent investors' judgments about the future performance of the firm. *See Glassman v. Computervision Corp.*, 90 F.3d 617, 626 (9th Cir. 1996) (prices reflect expected future performance (citing *In re VeriFone Sec. Litig*., 784 F. Supp. 1471, 1479 (N.D. Cal. 1992), *aff'd*, 11 F.3d 865 (9th Cir. 1993)); *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 514 (7th Cir. 1989) ("Investors value securities because of beliefs about how firms will do tomorrow, not because of how they did yesterday.").

Thus, if a plaintiff purchases a security at market price, the plaintiff is afforded the benefit of two legal presumptions that may be used to satisfy the element of causation in a fraud claim: first, that any publicly-available false statements were incorporated into the market price, and second, that the plaintiff purchased at the market price in the expectation that the price reflected publicly available information. *See Hevesi v. Citigroup, Inc.*, 366 F.3d 70, 77 (2d Cir.

2004). The market is thus said to be "acting as the unpaid agent of the investor, informing him that given all the information available to it, the value of the stock is worth the market price." *Basic*, 485 U.S. at 244. Reliance is satisfied because the plaintiff has shown that the market price was affected by the fraud, and that the plaintiff trusted the market price to represent the unmanipulated judgment of various traders.

Once the plaintiff has invoked these presumptions, the defendant may seek to rebut them. For example, the defendant may attempt to show that the plaintiff did not, in fact, rely upon the market price as a reflection of available information, or may attempt to show that even though the market was operating efficiently, some factor prevented the false information from influencing the stock price. *Basic*, 485 U.S. at 248-49.

Moreover, because the efficient markets hypothesis is such an underpinning of the securities markets, fraud may be accomplished by taking advantage of the efficient market directly. Rather than making a specific false statement concerning a particular area of company operations, a defendant may seek to defraud by artificially influencing the stock price via manipulative conduct. In that situation, the investor is fooled into believing "that prices at which they purchase and sell securities are determined by the natural interplay of supply and demand," and, thus, represent the market's actual judgment as to the worth of the security. *See ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 100 (2d Cir. 2007) (quoting *Gurary v. Winehouse*, 190 F.3d 37, 45 (2d Cir. 1999)). Under such circumstances, the plaintiff does not seek or receive a legal presumption that the fraudulent conduct influenced stock prices; instead, the plaintiff bears the burden of proving that prices were affected. *See Basic*, 485 U.S. at 244 (the presumption that misconduct has affected stock prices applies to situations involving "the dissemination of material misrepresentations or withholding of material information" (quoting

Peil v. Speiser, 806 F. 2d 1154, 1161 (3d Cir. 1986)). However, the plaintiff still receives the benefit of the presumption that any stock purchases were made in the expectation that the market price was validly set. *See Black v. Finantra Capital*, *Inc.*, 418 F.3d 203, 209 (2d Cir. 2005).

Because plaintiffs employing the fraud-on-the-market doctrine do so for the particular purpose of satisfying an element of a legal claim, they need only make a showing sufficient to satisfy that element. Thus, in false statement cases, they need only show that the market was "informationally efficient," in the sense that stock prices reflected available information *rapidly*. *See PolyMedica*, 432 F.3d at 16. They need not, by contrast, show that the market *accurately* absorbed available information, such that prices represented a correct picture of the "fundamental value" of the company. *PolyMedica*, 432 F.3d at 16; *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc.*, No. 05-1898, 2006 WL 2161887, at *6 n.75 (S.D.N.Y. Aug. 1, 2006). Though many economists may find it useful, for their own work, to examine market efficiency in terms of whether the markets have reached "accurate" judgments about a security's value, for the purposes of a *legal* claim, the only question is "whether a market processes information in such a way as to justify investor reliance, not whether the stock price paid or received by investors was 'correct' in the fundamental value sense." *PolyMedica*, 432 F.3d at 16.[3]

The situation is similar when a plaintiff advances a market manipulation claim. In that instance, the plaintiff does not seek, or receive, a presumption that a false statement influenced the market. Instead, the plaintiff bears the burden of proving that the conduct affected the market

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[3] Even Defendants' experts agree that markets are not simply "efficient" or "inefficient;" they are evaluated on a sliding scale, depending on the purpose of the inquiry. *See* Pfleiderer Tr. at 91:5-94:5; *see also* Bessembinder Tr. at 148:6-149:4. In this case, the purpose of the inquiry is whether the markets were efficient enough to satisfy the element of causation in a fraud case.

price. Thus, to establish reliance – and thus satisfy the legal element of causation -- it is unnecessary even to show that the market was informationally efficient; whether it was, or was not, is irrelevant to the plaintiff's claim. The only relevant issue is that purchasers "reli[ed] *on an assumption of an efficient market* free of manipulation." *ATSI*, 493 F.3d at 101 (emphasis added). And because the average investor cannot seriously be expected to conduct an event study or examine the factors developed in *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989) before trading – indeed, any requirement that they do so would undermine the Exchange Act's goal to "reduc[e] transaction costs associated with a caveat-investor rule," *Futura Dev. Corp.*, 761 F.2d at 40 – such investors must be accorded a presumption of reliance on market price when they demonstrate that the market possessed such indicators of efficiency as to reasonably induce reliance.

This is, in fact, precisely what one of the Defendants' experts, Professor Bradford Cornell, has recently recommended. Recognizing the distinction between *Basic's* two presumptions – that false statements affect market prices, and that investors rely on the integrity of market prices – Cornell has written that "Reliance on the integrity of the market price is sensibly presumed, we argue, if the market bears enough *hallmarks of efficiency* that investors, mindful of the costs they would incur if they went out and conducted their own research into stock values, reasonably could decide instead to treat the market's prices as indicative of fair value." Cornell & Rutten, *Market Efficiency, Crashes, and Securities Litigation*, 81 Tul. L. Rev. 443, 449 (2006) (emphasis added). Indeed, it could hardly be otherwise, for "it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in a crooked crap game?" *Basic*, 485 U.S. at 246-47.

Defendants falsely claim that Plaintiffs are seeking a "reduced" reliance standard. UW Br. 38. On the contrary, Plaintiffs' reasoning leads to a *higher* standard for manipulation claims. In a false-statement case, plaintiffs need not demonstrate that the statements influenced market prices at all; that fact is presumed once plaintiffs have proved the existence of an efficient market and the presence of a materially false statement. *See Basic*, 485 U.S. at 247; *Hevesi*, 366 F.3d at 77. By contrast, in a manipulation case, the plaintiff must actually show at trial, on the merits, that the manipulation influenced prices. *Black*, 418 F.3d at 209. Thus, plaintiffs in manipulation cases actually have a higher burden, even if they need not prove that the market in which they traded was informationally efficient.[4]

Contrary to Defendants' claim, *In re Genesisintermedia, Inc. Securities Litigation*, No. 01-9024, 2007 WL 1953475 (N.D. Cal. June 28, 2007) does not reject Plaintiffs' interpretation of *Basic* and actually supports Plaintiffs' reasoning. In that case, even though it was undisputed that the market was *inefficient*, the court was still willing to accept that the plaintiffs had purchased in reliance on the integrity of the market price. *See id.* at *13. The plaintiffs' claims were rejected because, given the facts of that case, in the absence of market efficiency, they were unable to show that the misrepresentations and misconduct actually affected the market price. *See id*. Thus, the *Genesisintermedia* court properly drew a distinction between the presumption that purchasers *rely* on market price, and the presumption that prices are affected by fraud, and

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[4] This is not inconsistent with the Second Circuit's holding in *Miles v. Merrill Lynch*, 471 F.3d 24 (2d Cir. 2006) ("*Miles I*"), because the *Miles* Court never ruled on Plaintiffs' manipulation claims. 471 F.3d at 43. At most, as discussed in Part II.B.2, *infra*, *Miles I* held that the offering price for shares is not generated by an efficient market, and therefore that these prices may not be reasonably relied upon. *Miles I*, 471 F.3d at 42 (citing *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 199 (6th Cir. 1990)). However, Plaintiffs are not seeking a presumption that they relied on offering prices; they are only seeking a presumption that they relied on aftermarket prices.

explained that, given those particular facts, it was appropriate to apply the former presumption in an inefficient market, but not the latter.

Similarly, Defendants' argument that *Basic* only applies to issuer statements is both wrong and beside the point. UW Br. 33. Whether the defendant happens to be an issuer or happens to be an underwriter is irrelevant to the general presumption that investors purchasing on the open market do so with the expectation that prices reflect available information. And, with respect to *Basic*'s first presumption – that false statements affect market prices – the Second Circuit has made clear that the presumption applies to many different entities, including "underwriters, brokers, bankers, and non-issuer sellers." *In re NYSE Specialists Sec. Litig.*, 503 F.3d 89, 102 (2d Cir. 2007); *see 60223 Trust v. Goldman, Sachs & Co.*, No. 03-3548, 2007 WL 4326730, at *9 (S.D.N.Y. Dec. 4, 2007) ("*Basic* itself did not specifically limit the presumption to issuers.").

Finally, Underwriters seek refuge in *Basic*'s holding that:

> if petitioners could show that the "market makers" were privy to the truth . . ., and thus that the market price would not have been affected by their misrepresentations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone.

485 U.S. at 248. From this, they conclude that Underwriters' own knowledge of wrongdoing must necessarily have eliminated any artificial inflation. UW Br. 27-28. However, in *Basic*, the unstated assumption was that the market makers were not themselves part of the fraud; the Court was envisioning that independent market makers use their knowledge of the truth to correct for fraudulent information, so that the market price would never be inflated in the first place. *See Basic*, 485 U.S. at 248. Here, Plaintiffs allege that the Underwriter market makers were aware of the scheme but, intentionally, did *not* set appropriate prices. Thus, market makers' awareness of the fraud did not eliminate any artificial inflation.

A. Transaction Causation for Manipulative Conduct

As explained above, in the fraud-on-the-market context, the element of causation may be satisfied if the plaintiff shows: (a) the market price was affected by the fraud; and (b) investors purchased with the reasonable expectation that the market price reflected publicly available information. Here, Plaintiffs have shown that they can prove the effects of Defendants' manipulative conduct on a classwide basis, and that class members are entitled to the presumption that they purchased in the reasonable expectation that market prices reflected available information. Though Fischel has stated that the "economic evidence" supporting plaintiffs' claims is "much weaker" for iXL than for the other Focus Cases, Second Rebuttal Rep. ¶ 1 n.3, this conclusion goes to the merits, and does not affect Plaintiffs' ability to prove their claims classwide. Thus, Plaintiffs have satisfied their Rule 23 burden.

1. Artificial Inflation

As Plaintiffs explained in their Brief in Support of Class Certification, artificial inflation can be established on a classwide basis. In previous reports, Fischel showed that in each of the Focus Cases, the lead underwriter's first bid in the premarket was substantially above the offer price, that the lead underwriter's bidding guided the bidding of other market participants, and that the lead underwriter's first bid contributed a substantial amount to the stock's opening price. *See* Second Supp. Rep. ¶ 30; Supplemental Report of Daniel R. Fischel, dated July 12, 2004 ("Supp. Rep.") ¶¶ 9, 12. As Fischel explains – and as Defendants' experts concede – the lead underwriter's bidding in the pre-open session is necessarily based on its assessment of demand as a result of the offering process. Second Supp. Rep. ¶ 29; Ready Tr. at 121:10-123:6. Thus, because the "demand" generated during the offering process in these cases was artificially created through illegal tie-in agreements, each of the Focus Case stocks opened (and closed at the end of the first day of trading) at prices far higher than they would have absent the

manipulation. That higher price, in turn, was understood by the market as an indicator of demand, and influenced future trading. Class Cert Br. at 39.

In his Second Rebuttal Report, Fischel has documented the influence that the lead underwriter had on the opening price of each IPO through its conduct in the pre-open bid session. Fischel has supplemented his earlier findings first by showing that the lead underwriter's first bid was invariably above that of any other market maker for each of the Focus Cases, and then by performing a regression analysis of the relationship between the lead underwriter's first bid and first-day returns across all of the litigation IPOs. In this manner, Fischel documents a powerful statistical correlation between the lead underwriter's first bid and the first day returns. *See* Second Rebuttal Rep. ¶¶ 22-27 & Ex. A. These correlations exist regardless of whether the lead underwriter's first bid was, in fact, the first bid of the pre-open session. *Id.* ¶¶ 22-23, 26. By contrast, the first bid of the session – if not made by the lead underwriter – has little influence on first day returns. ***Id.*** ¶ 23 & n.54. For these reasons, Underwriters are simply wrong when they claim that there is "no known scientific method to establish a particular pre-open bid's influence on subsequent bids." UW Br. 43. Fischel, and the authorities on which he relies, show that there is indeed a method of demonstrating the impact of the lead underwriter's first bid on first day returns. Moreover, in this and in previous reports, Fischel has also shown that the tainted orders placed by allocants in the aftermarket continued to support and reinforce the inflated opening prices with substantial aftermarket trading and limit orders. *See* Second Rebuttal Rep. Ex. C; Second Supp. Rep. Ex. G.

a. Defendants' Analyses Ignore Relevant Features of the Pre-Open

Defendants offer a number of criticisms of Fischel's approach, none of which have acceptance in the economic literature and many of which contradict their own experts' previous

work.[5] For example, Underwriters argue that pre-open sessions are merely "cheap talk" that cannot influence future trading. Expert Report of Maureen O'Hara, dated December 21, 2007 ("O'Hara") ¶ 25. In fact, Fischel cites to the relevant academic literature documenting that pre-open sessions communicate critical information to investors and are highly efficient mechanisms for "price discovery," signaling valuable information about pending order flow. *See* Second Supp. Rep. ¶ 48; Second Rebuttal Rep. ¶ 16 n.39. Indeed, Defendants' experts agree that pre-open sessions are critical mechanisms for communicating information to the market: Professor Christopher Spatt co-authored a study of the Paris Bourse in which he concluded that pre-open sessions significantly increased the informational content of the opening price sessions. *See* B. Biais, P. Hillion & C. Spatt, *Price Discovery and Learning During the Pre-opening Period in the Paris Bourse*, 107 J. Pol. Econ. 1218 (1999). Notably, Spatt observed that his findings for the Bourse were similar to those observed in NASDAQ trading, citing with approval one of the very studies on which Fischel relies. *See* Second Rebuttal Rep. ¶ 16 n.39. Professor Maureen O'Hara, too, admitted in her deposition that underwriters send important signals regarding expected demand during the pre-open session, and that pre-open sessions communicate important information to the market. O'Hara Tr. at 157:17-158:11 (agreeing that "the lead underwriter's initial bid during the pre-opening can have an *important impact* on the initial returns") (emphasis added); *see also id.* at 104:16-24.

[5] Defendants' experts apparently were misinformed as to Plaintiffs' actual allegations. Professor Barry, for example, appeared to be operating under the false impression that Plaintiffs are seeking a presumption that manipulative conduct affected stock prices. Expert Report of Christopher B. Barry in the Matter of iXL Enterprises, dated December 20, 2007 ("Barry") ¶ 52. To the contrary, as explained above, Plaintiffs intend to prove that the conduct had such an effect and do not seek any such presumption.

Cornell's analysis confirms that the pre-open sessions had important informational content. As he observes, for both litigated and nonlitigated IPOs, most of the first day price increases from offer to closing occurred during the pre-open session. Expert Report of Bradford Cornell (Corrected), dated March 4, 2008 ("Cornell") ¶ 26 & Ex. 10. This fact alone shows that the market accepted the information generated during the pre-open. *See* Second Rebuttal Rep. ¶ 16 n.39. In his deposition, Cornell elaborated on this point by explaining that when the pre-open session produces a high opening price, "enough information is conveyed in the pre-open to make it clear to dealers that there's a very large demand for the stock and a price significantly above the offer price would be required to clear the market." Cornell Tr. at 147:25-148:10; *id.* at 150:8-14 (pre-open period "conveys information among dealers and other major market participants regarding how many shares would be bid or offered at various prices"). Cornell's testimony and report, in conjunction with Fischel's statistical evidence of the impact of the lead underwriter's first bid, flatly contradict Underwriters' claim that there is no way to demonstrate a causal connection between lead underwriting bidding in the pre-open and inflation in the aftermarket. UW Br. 44.

Defendants next insist that the Underwriters had no particular influence on the pre-open session. They cite a number of alternative statistics, such as the fact that in some cases the lead underwriter did not offer the first bid, or the fact that wholesalers not alleged to be part of the scheme had a number of retail orders. UW Br. 44. The first and most obvious answer to Defendants is that the influence, or not, of the Underwriters over the pre-open session is unquestionably a classwide issue, and Defendants have not argued otherwise. More critically, *none* of Defendants' experts even purports to examine the relationship between the amount of the lead underwriter's first bid and the opening price. *See, e.g.*, O'Hara Tr. at 168:11-20; Ready Tr.

at 119:7-120:13.[6] In other words, Defendants' experts have not even *measured* the variable that is actually relevant to this litigation. Defendants' alternative findings – that there were a number of wholesaler bids, or that the lead underwriter did not always have the inside bid – simply do not answer the relevant question: were the Underwriters able to parlay their illegal tie-in agreements into an artificial opening price for each stock? Fischel shows that the Underwriters' pre-open conduct had an enormous impact on the opening price, and none of Defendants' experts has even attempted to dispute Fischel's statistical analysis on this point.[7] Finally, as with the existence of tie-in arrangements, evidence on this point need not be limited to Fischel's statistical analysis. Plaintiffs can depose actual participants in the bidding session, or employees of the lead underwriters, to address the lead underwriter's influence and the orders that fueled the bidding.

Defendants also maintain that the pre-open was "chaotic" during the class periods, featuring numerous "locked" and "crossed" quotes and prompting the NASDAQ to lengthen the

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[6] This is why O'Hara's criticisms of Fischel's method are so wide of the mark. O'Hara finds that during the pre-open session, the lead underwriter in VA Linux was at the "inside" bid a much lower percentage of the time than the lead underwriter in Corvis. O'Hara ¶ 51. From this, she concludes that VA Linux's higher first-day "pop" cannot be explained by lead underwriter conduct during the pre-open. However, O'Hara ignores the relevant metric; the relevant metric is not whether the lead underwriter maintained the inside bid, but is instead the amount of the lead underwriter's first bid. As it turns out, the lead underwriter's first bid in VA Linux was nearly *seven times* the offer price; in Corvis, by contrast, the lead underwriter's first bid doubled the offering price. These bids make it quite clear why VA Linux experienced a greater first-day price increase than Corvis. *See* Second Rebuttal Rep. Ex. B.

[7] Significantly, in her report, O'Hara claimed that the literature relied on by Fischel "does not support his theory that pre-opening quoting generated aftermarket inflation in the Focus Case stocks," O'Hara ¶ 27. In particular, she wrote in her report that a study cited by Fischel concluded that it is "*primarily wholesalers, not the lead underwriter*, who drive the evolution of the pricing." *Id.* ¶ 28 (emphasis added). At her deposition, however, O'Hara was forced to concede that the article actually concluded "lead underwriting quoting behavior appeared to explain first day returns with some statistical significance." O'Hara Tr. at 144:22-145:19.

pre-open bid session. UW Br. 45. As Fischel points out, however, “locking” and “crossing” in pre-open sessions are actually potent mechanisms of price discovery because they send important signals about order flow. *See* Second Rebuttal Rep. ¶ 16 n.39. Moreover, whatever the significance of these purportedly “chaotic” pre-opens, the only issues relevant to this Motion are whether it can be shown, on a classwide basis, that Underwriters influenced the pre-open with bids backed by illicit agreements, and whether it can be shown, on a classwide basis, that those bids resulted in artificially inflated stock prices. The characterization of “chaos” – which ignores the importance of crossed and locked bids as a communicative device – elides the relevant point that because pre-open sessions have such importance in market functioning, the opening prices (supported by aftermarket tie-in orders) influenced the market, regardless of any surrounding “chaos” that may have generated them.

O’Hara offers the alternative explanation that Underwriters’ revisions to the offer price over the course of the pre-IPO period caused the Focus Case stocks to open at high prices. O’Hara ¶ 54. Fischel has shown that though offer price revisions are correlated with first-day returns, they do not have nearly the influence over first-day returns as does the lead underwriter’s first bid in the pre-open session. *See* Second Rebuttal Rep. ¶ 25 & n.56. Moreover, offer price revisions are not an alternative explanation for the first day price increases: as Fischel points out, offer price revisions over the course of the pre-IPO period are an important signal to the market that initial demand is high. *See* Second Rebuttal Rep. ¶ 21 n.51. Thus, once again, it was the illegal tie-in agreements that allowed Underwriters to send such signals – resulting in increased interest from other market participants – and to back those signals up with follow-up tie-in trades in the aftermarket.

Defendants' expert Allan W. Kleidon contends that the high initial returns of Sycamore can be explained by Morgan Stanley's "conservative" offer price. Expert Report of Allan W. Kleidon, PhD, dated December 20, 2007 ("Kleidon") ¶¶ 17-19. He claims that the offer price was selected by comparing Sycamore to the trading multiples of "comparable companies" underwritten by Morgan Stanley, in the expectation that Sycamore would perform similarly in the aftermarket. *Id.* at 18. The problem with Kleidon's analysis is that these comparable companies – Juniper, Redback, Brocade, and Copper Mountain -- are all included in this litigation, and their trading prices are all alleged to have been tainted by manipulation. Thus, far from demonstrating that Sycamore's high initial returns were a result of conservatism in offer price, Kleidon's report merely establishes that Morgan Stanley was skilled at predicting the types of price increases it could expect as a result of tie-in agreements. Moreover, Kleidon's claim that the offer price was carefully selected through a comparables analysis based on fundamental value is belied by the fact that Morgan Stanley repeatedly revised the offer price upward in the period leading to the IPO. *See* Second Rebuttal Rep. ¶ 36 n.72.[8]

b. Defendants Improperly Examine Aftermarket Trading Divorced from the Scheme

Defendants also dispute Fischel's examination of tie-in trades, insisting that the impact of each allegedly laddered trade must be examined individually, and that the effect of any such

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[8] Defendants also offer the "alternative" explanation that high initial returns were due to the existence of an internet "bubble," or investor enthusiasm. *See, e.g.*, Cornell ¶ 16. As Plaintiffs explain below, Defendants' own experts acknowledge significant disagreement over whether a "bubble" even existed. *See* Part II.B.2, *infra*. Additionally, as Fischel explains, to the extent that any investor "exuberance" was the result of Defendants' *own* manipulations of large numbers of IPOs, it is not an alternative explanation at all, but a natural result of the fraud. Second Rebuttal Rep. ¶ 36; *see also* Part II.D.1, *infra*. In any event, it is hardly surprising that Defendants dispute that their manipulations caused artificial inflation, but the choice between competing explanations must be made a jury; the only question at this time is whether the issue can be resolved classwide.

laddered trading would quickly dissipate. UW Br. 47-48, 51-52. Defendants once again misconstrue the scheme: Plaintiffs have not alleged that all allocants who entered into tie-in agreements actually executed trades in the aftermarket. Rather, as the evidence demonstrates, allocants often placed limit orders at particular prices that went unexecuted if the stock was trading above the specified price level. Second Supp. Rep. Ex. G. These orders not only allowed Underwriters to boost bidding in the pre-open session, but also provided support for prices in the secondary market. *See* Second Supp. Rep. ¶ 31; Rebuttal Report of Daniel R. Fischel, dated April 15, 2004 ("Rebuttal Rep.") ¶ 10 n.6; *see also* O'Hara Tr. at 313:25-316:2 (conceding that unexecuted limit orders may influence prices). Indeed, Kleidon concedes that after Sycamore opened at a price higher than the one at which allocants had agreed to purchase, there were no immediate tie-in trades and, as a result, Sycamore's stock price dropped. Kleidon ¶¶ 66-68. Far from undermining Fischel's conclusions, these facts help establish that tie-in trades in the aftermarket provided support for the inflated opening prices generated in the pre-open bid session. When the tie-in trades were not forthcoming, stock prices dropped.

Additionally, as Fischel explains, Defendants' proposed method of examining laddered trades – as individual incidents, rather than as a cumulative pattern that includes trading that influenced other purchasers – has not been adopted in *any* academic study. *See* Second Rebuttal Rep. ¶ 41. By contrast, Fischel has cited four papers studying laddered trades, *all* of which consider the broad impact laddering has on prices without studying the fleeting effects of each individual trade. *Id.* ¶ 41 n.86. Indeed, in other contexts, Defendants' experts have acknowledged that the influence of particular trades must be gauged on a macro level: in their study of how insider trading impacts market prices, Cornell and Sirri explicitly stated that such effects "can be documented on a day-by-day basis, but *not* on the basis of a trade-by-trade

analysis." Bradford E. Cornell & Erik R. Sirri, *The Reaction of Investors and Stock Prices to Insider Trading*, 47 J. Fin. 1031, 1045, 1053-54 (July 1992); *see* Second Rebuttal Rep. ¶ 41 n.87. The article concludes that a total of 38 "tippees" were able to significantly impact the price and liquidity of a particular stock solely by trading on the basis of inside information. Cornell Tr. at 275:20-282:12. Spatt, as well, cites with approval an article documenting the macro effect of insider trading on stock prices. *See* Expert Report of Chester Spatt, dated December 19, 2007 ("Spatt") ¶ 23. This article eschews a trade-by-trade analysis in favor of a larger examination of trading relative to stock price movements. *See* Second Rebuttal Rep. ¶ 41 n.87.[9]

The reason a trade-by-trade analysis is inappropriate is that it does not fully reflect the fact that laddered trades, like insider trades, send informational signals to other market participants, who then revise their own estimates of the security's worth and make their own purchases. *See* Rebuttal Rep. ¶ 10; Supp. Rep. ¶ 36. Though Defendants, using their narrow trade-by-trade analysis, insist that any effect of a laddered trade would only have been fleeting at best, *e.g.*, Issuer Br. 15, their analyses are based on studies of *uninformed* traders, whose orders are then counterbalanced by the orders of more informed traders. *See, e.g.*, Expert Report of Hendrik Bessembinder, dated December 19, 2007 ("Bessembinder") ¶¶ 25, 30-31; Cornell ¶¶ 82-83; Expert Report of Paul Pfleiderer in the Matter of iXL Enterprises, dated December 19, 2007 ("Pfleiderer") ¶¶ 37-38.[10] Defense experts argue that in an unmanipulated market, the orders of

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[9] Kleidon, together with Professor Matthew Spiegel, also argue that the scheme could not have worked because the price increases would be reversed when the ladderer sought to sell his or her stock, thus preventing the ladderer from earning a profit. However, as Fischel has previously stated, the profits in this case did not accrue to ladderers from the price increases cause by the laddered trades; the profits came from the difference between the offer price and the aftermarket price. Second Rebuttal Rep. ¶¶ 15 n.8.

[10] Spiegel, along with Professors René M. Stulz and Hendrik Bessembinder, all cite the same article, Chordia, Roll, & Subrahmanyam, *Evidence on the Speed of Convergence to Market*

uninformed traders may be counterbalanced when the market witnesses a lack of follow-on trading or confirmatory information. Issuer Br. 15-16. Here, however, the scheme was designed precisely to send that confirmatory information – the pre-open session and opening price signaled to the market the level of demand; laddered trades over a period of days, coming from multiple traders, provided additional (false) information regarding demand; and Underwriters' captive analysts provided additional market support.[11] Rebuttal Rep. ¶ 16. And, because of the uncertainty regarding the future of technology stocks, other market participants were not in a position to second-guess those signals, particularly when the true business potential of these companies would not be revealed for several months or years. *See* Second Rebuttal Rep. ¶¶ 15-16. In this manner, the scheme was able to keep stock prices afloat for prolonged periods.[12]

Efficiency, 76 J. Fin. Econ. 271 (2005), for the proposition that order imbalances are quickly reversed. Stulz ¶ 21; Report of Matthew Spiegel, dated December 20, 2007 ("Spiegel") ¶ 26; Bessembinder ¶ 31. That article explicitly describes the subjects of its study as "irrational," "naïve," and "quirk[y]" individual investors who pursue ineffective trading strategies. Chordia, Roll, & Subrahmanyam, *supra*, at 272-73; *see also* Bessembinder ¶¶ 28-31 (discussing the article in the context of uninformed trading).

[11] In fact, O'Hara conceded in her deposition that the average investor has no way to distinguish informed trades from uninformed trades. O'Hara Tr. at 177:14-25; *see also* Bessembinder Tr. at 200:3-9**.**

[12] Relying on *West v. Prudential Securities, Inc.*, 282 F.3d 935 (7th Cir. 2002), Underwriters argue that "no mechanism" explains how trading on private information could inflate stock prices. This is surprising, because Spatt argues that this is precisely what occurs when insiders drive up stock prices with their trades. Spatt ¶ 23; Second Rebuttal Rep. ¶ 41 n.87 (explaining that the article cited by Spatt concludes that the market is able to detect, and react to, the presence of an "informed" trader, even when there has been no actual leak of information). In any event, as Plaintiffs explained in their Opposition to Defendants' Motion to Dismiss, *West* simply has no relevance here. *See* MTD Opp. at 38-39. In that case, the Seventh Circuit refused to *presume* that a handful of trades had affected stock prices, and, with the burden of proof placed on plaintiffs, found their particular expert evidence insufficient. *See* 282 F.3d at 38-39. Here, Plaintiffs do not seek a *presumption* that manipulative trading inflated stock prices – as explained above, they will bear the burden of proving artificial inflation – and the expert evidence they offer as to how they will prove such effects is far more extensive than the expert evidence rejected in *West.*

Moreover, Defendants' claim that informed traders would quickly arbitrage away any order imbalances is, itself, internally inconsistent. In the context of their market efficiency examinations, Defendants repeatedly insist that during the period from 1998 to 2000, arbitrageurs *were not* correcting order imbalances for technology stocks "because the risks were great and difficult to hedge against." Barry ¶ 26; *see also* Expert Report of Paul A. Gompers, dated December 21, 1007 ("Gompers") ¶ 83. In other words, because the futures of these companies were so uncertain, arbitrageurs, like the rest of the market, simply could not determine whether the order imbalances represented informed or uninformed trading. Thus, if arbitrageurs – by Defendants' own argument – chose not to "correct" order imbalances, there is no reason to believe that artificial inflation would have disappeared within minutes or days.[13]

Evidence concerning *informed*, rather than *uninformed*, trading supports Plaintiffs' position. Price changes caused by insider trading were discussed above; additionally, defense expert Spiegel identifies a study involving potentially informed, rather than uninformed, trading. Spiegel ¶ 25. He cites the article, Chordia & Subrahmanyam, *Order Imbalance and Individual Stock Returns: Theory and Evidence*, 72 J. Fin. Econ. 485 (2004), for the proposition that price changes caused by large purchases are reversed by arbitrageurs within days. *Id.* at ¶ 25. In fact, as Spiegel admitted in his deposition, the article concludes that arbitrage does not alleviate all of the price alteration; instead, these trades by potentially informed purchasers cause lingering changes to stock prices. Spiegel Tr. at 126:23-130:11. Moreover, that article was based on the assumption that the informed traders in question were intentionally *trying* to minimize the price

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[13] This also explains why, contrary to Cornell's opinion, the scheme may well have focused on technology stocks. Cornell ¶ 11. Technology stocks, in particular, with their uncertain future, and private, proprietary information regarding the technologies at issue, may have been difficult to value, thus making them susceptible to this form of manipulation.

impact of their trades, and that market makers were unaware of when the traders would place their orders or in what amounts. Spiegel Tr. at 115:22-119:24, 123:16-124:3. Here, of course, the exact opposite is true: Plaintiffs allege that the scheme was intended to manipulate prices, and that the market makers who were privy to the scheme knew what orders to expect.

For similar reasons, Defendants are wrong to argue that sales by the ladderers would necessarily move stock prices back to their uninflated levels. Issuer Br. 17. Once again, this simplistic analysis fails to take into account the various other factors that contributed to the artificial inflation, including the boost from the pre-open session and the false analyst reports. As Fischel explained, sales will only pressure stock prices downward if they are perceived as informed, Rebuttal Rep. ¶ 18; here, there is no reason to believe that they would have so been perceived, particularly when, unlike the laddered trades, sales would not have been coordinated among various allocants. Moreover, as explained in one of the articles on which Fischel relies, because laddering increases investor interest and thus demand for a security, "ladderers can exploit the additional demand when they unwind their positions." G. Hao, *Laddering in Initial Public Offerings*, 85 J. Fin. Econ. 102, 112 (2007). Indeed, Bessembinder has previously testified that manipulative trading can, in fact, have a prolonged effect on market prices, particularly when that trading is perceived as "informed" by other investors. Bessembinder Tr. at 104:11-105:5.

Defendants are also misguided when they criticize Fischel for concluding that VA Linux experienced a greater first-day price increase than other Focus Case stocks, even though there is evidence of fewer laddered trades in VA Linux. UW Br. 46. First of all, this analysis again ignores the fact that even tie-in agreements that did not result in aftermarket trades contributed to first-day price increases. But more importantly, the manipulative conduct cannot be divorced

from the underlying fundamentals of the company; the two factors work in tandem to influence investor perceptions. So, just as a positive statement about revenues may have a different effect on the prices of General Electric than on the prices of Google, so too the manipulative conduct may have a different effect on VA Linux stock than on Corvis stock. Indeed, this is exactly what Fischel explains: in a "cold" IPO, where investor interest is not as great, laddered trades *increase*. *See* Second Rebuttal Rep. ¶ 1 n.6. This is because allocants commit to purchase at varying price levels, and lower trading prices are more likely to trigger the agreements to purchase. Additionally, laddering increases simply because a "cold" IPO requires more artificial support to keep price levels high. *See id.*

In a similar vein, and contrary to Defendants' contentions, *see, e.g.*, Issuer Br. 12, Fischel has shown that his method is sensitive to the volume of tie-in agreements. As Defendants point out, much of the demand for iXL stock came from retail allocants who are not alleged to have participated in the scheme, and the lead underwriter price targets for iXL were lower than those of other analysts. Pfleiderer ¶¶ 53, 63, 102. Unsurprisingly, then, the iXL lead underwriter's first bid showed the smallest improvement over the offer price of any of the Focus Case stocks, and iXL exhibited the lowest amount of aftermarket tie-in trading, the lowest first day price increase, and the least amount of underperformance over the course of its class period. *See* Supp. Rep. Exs. G, H; Second Supp. Rep. Ex. C.[14]

Fischel is also not required to provide a methodology for calculating the precise amount of artificial inflation caused by each tie-in agreement across each of the Focus Cases. Issuer Br. 11-12. As explained above, Fischel proposes to prove that the tie-in agreements inflated stock

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[14] Significantly, of the six Focus Cases, iXL was the only one selected by Defendants; the others were selected by Plaintiffs.

prices. It is only the *degree* of inflation, and its rate of dissipation, that will be determined in part by examining stock performance over time. This is not unusual; in fraud-on-the-market cases, whether based on false statements or based on manipulation, it is common to determine the degree of artificial inflation caused by the misconduct by ascertaining the true value of the stock at the end of the class period when the artificial inflation has been removed, and then using that information to calculate the degree of artificial inflation in the stock's price at the beginning of the class period. *See In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d 235, 270 (D.N.J. 2000). Moreover, as is equally unremarkable, Fischel has proposed an event study method that would examine expected returns on the date of the IPO. Rebuttal Rep. ¶ 7. However, because of the market forces involved, Plaintiffs are never expected to provide a methodology that actually will *predict* how much artificial inflation will be caused by any particular fraudulent act.

Defendants additionally contend that tie-in trading by allocants was not sufficiently vigorous to have caused the increases from offer price to trading price. UW Br. 46. However, Defendants routinely conduct their analyses of tie-in trading in a vacuum, without reference to the substantial boost created by the pre-open session. *See, e.g.*, Cornell ¶ 57 (explicitly stating that he is analyzing laddered trades without regard to the pre-open session); Bessembinder Tr. at 107:19-108:3 (did not consider impact of pre-open); Stulz ¶¶ 28-57 (explicitly distinguishing his analysis of the pre-open from his analysis of laddered trades in the aftermarket). Such an approach is fundamentally flawed because, as explained above, the pre-open provided a substantial amount of information to the market, and helped create the illusion that the laddered trades represented valuable information. Moreover, as Fischel points out, Defendants' calculations regarding the number of tie-in trades are based on their own idiosyncratic definition

of taint; rather than use the trades identified by Plaintiffs as tainted, Defendants use their own, more restricted, definition. *See* Second Rebuttal Rep. ¶ 31.

Finally, Defendants' insistence that laddered trades could only have resulted in fleeting market impact is simply implausible and contrary to the great weight of authority. In addition to the academic studies cited by Fischel, *see* Second Rebuttal Rep. ¶ 1 n.4, Congress, the courts, and the SEC have previously concluded that such manipulative schemes *do* have significant effects on trading prices. In the legislative history for the Exchange Act, Congress was concerned about "the conscious marking up of prices to make investors believe that there is a constantly increasing demand for stocks at higher prices." H.R. Rep. No. 73-1383, pt. 2, at 10 (1934). In 1963, the SEC found that illicit tie-ins had contributed to extraordinary rises in first day trading prices of new issues during a "hot issue" market that ran from 1959 to 1961. *See* U.S. SEC, Report of the Special Study of the Securities Markets, H.R. Doc. No. 88-95, at 520-22 (1st Sess. 1963). A 1984 SEC report, following another "hot issue" market, concluded that tie-in arrangements "stimulate[] demand for a hot issue in the aftermarket, thereby facilitating the process by which stock prices rise to a premium." Report of the Securities and Exchange Commission Concerning the Hot Issues Markets, at 37-38 (August 1984). In 2002, then-SEC Chair Harvey Pitt requested that the NASD and the NYSE review IPO abuses, singling out tie-ins as a practice that "distort[ed] the market for these securities." NYSE/NASD IPO Advisory Committee Report and Recommendations, at A-2 (May 2003), *available at* http://www.finra.org/web/groups/rules_regs/documents/rules_regs/p010373.pdf. The resulting report by the blue-ribbon advisory committee, made up of academics and market professionals, among others, confirmed that "laddering" practices had that effect, *id.* at 6, a conclusion adopted by the SEC in Release No. 34-51500. The SEC found that tie-in arrangements and "laddering"

practices "tend to: (1) create offering demand; (2) cause artificial aftermarket price escalation; and (3) erode market integrity" and that investors "would not know that the aftermarket demand had been stimulated by the underwriters' unlawful conduct." *Id.* at 8. Courts, too, have recognized that intentionally manipulative trading can inflate prices. *See, e.g.*, *Rosenberg v. Hano*, 121 F.2d 818, 820 (3d Cir. 1941); *Coplin v. United States*, 88 F.2d 652, 662-64 (9th Cir. 1937). Thus, it has been widely recognized that laddering practices of the type alleged in the complaint do, in fact, result in significant distortions to market prices.[15]

c. Analyst Reports Must Be Considered in the Context of the Overall Scheme

Underwriters also attack Fischel's analysis of analyst reports, arguing that a jury would have to assess the impact of each analyst report while excluding the effects of other market events. UW Br. 53-54. However, Underwriters ignore that this is not a case premised solely on analyst reports; to the contrary, this is a case premised on a larger scheme of manipulative behavior.[16] The analysts were just one portion of the scheme, and their function was to keep the

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[15] Complaints filed by the SEC contain allegations demonstrating that even *Underwriters themselves* believed that aftermarket laddering affected stock prices. *E.g., SEC v. Morgan Stanley*, No. 05 CV 166, ¶ 57 (D.D.C. Jan. 25, 2005), *available at* http://www.sec.gov/litigation/ complaints /comp19050.pdf ("Morgan Stanley obtained aftermarket interest from customers at increasing prices that were well above the IPO price range to attempt to induce aftermarket orders and purchases at prices higher than the IPO price. A syndicate manager explained to an IPO company's management 'that aftermarket interest from IPO customers was a factor that could cause the stock to trade up in the aftermarket.'"). This Court may judicially notice publicly filed documents. *See Kavowras v. N.Y. Times*, 328 F.3d 50, 57 (2d Cir. 2003).

[16] Even if this were a case based purely on analyst reports, such idiosyncratic inquiries would not be necessary. Underwriters rely on *DeMarco v. Lehman Brothers*, 222 F.R.D. 243 (S.D.N.Y. 2004), in which the court held that the plaintiffs would only benefit from the fraud-on-the-market doctrine if they showed that the "analyst's statements materially impacted the market price." *Id.* at 247. This standard represents a misreading of *Basic*. As explained above, the fraud-on-the-market doctrine, as defined in *Basic*, consists of two presumptions: that false statements affect prices of stock trading in an efficient market, and that investors rely on market price when trading. 485 U.S. at 247. By refusing to presume market impact from the allegedly false

stock price afloat and prevent dissipation of the artificial inflation. Thus, as this Court previously concluded, their impact must be assessed through an overall review of the rate of dissipation of artificial inflation. *See In re Initial Pub. Offering Sec. Litig.*, 227 F.R.D. 65, 111 n. 351 (S.D.N.Y. 2004) ("*IPO III*").[17]

2. Reliance on Market Price

As explained further below, *see* Part II.B.2, *infra*, Plaintiffs have demonstrated that each of the Focus Case stocks traded in an efficient market throughout the class periods. However, even if these markets were not perfectly efficient, investors were unlikely to have known that fact; thus, they are still entitled to the presumption of reasonable reliance.

The Focus Case stocks all traded on the NASDAQ – a fact that usually connotes efficiency both according to courts and Defendants' own experts. *See IPO III*, 227 F.R.D. at 107 n.324 (citing cases); Barry Tr. at 220:12-222:12; Cornell Tr. at 235:17-236:13 (describing NASDAQ as "developed"). They were highly liquid which, again, is a strong indicator of efficiency, *see Bombardier,* 2006 WL 2161887, at *6, and were the subject of heavy news coverage, *see* O'Hara Tr. at 256:11-259:9. These facts should be sufficient to trigger a presumption that investors reasonably believed that the market prices of each of the stocks reflected available information. Indeed, Bessembinder agrees that each of the Focus Case stocks "actively traded in liquid markets, and were regularly analyzed by investment professionals who

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statements, the *DeMarco* court was, in fact, rejecting the first *Basic* presumption. In this way, the *DeMarco* court employed a standard more akin to that appropriate for a manipulation case.

[17] Interestingly, despite Defendants' insistence that the scheme could not have resulted in prolonged artificial inflation, Barry cited in his report – and enthusiastically endorsed – a book called *A Random Walk Down Wall Street* by Burton G. Malkiel. Barry ¶ 13; Barry Tr. at 330:5-14. That book concludes that the false analyst reports at issue in this litigation kept stock prices afloat during the class periods. Barry Tr. at 332:14-336:23.

considered fundamental indicators of value." Bessembinder ¶ 32. Because the average investor cannot possibly be expected to conduct a detailed analysis under *Cammer* before trading, these facts should be sufficient to trigger the presumption that investors trusted the market price of the stock.

Defendants offer no real reason why an average investor should not be presumed to have relied on market prices when these characteristics are present. Though Defendants insist that actual efficiency must exist before an investor may be presumed to rely on market prices, UW Br. 38, nowhere do they explain how the average investor, at the moment he or she makes a purchase, is to distinguish between an efficient market and one that merely appears to be efficient.[18]

3. Issuers are Responsible for the Effects of the Manipulations

Just as they argued in connection with their recent motions to dismiss, Issuers insist that they are only responsible for the false statements and omissions in the prospectuses, and that therefore the effects of these statements must be considered independently of the effects of any manipulation. Issuer Br. 4-5. This Court has already held that the consequences of the deficiencies in the prospectuses must be assessed in tandem with the effects of the manipulation.

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[18] Stulz argues that investors who placed orders during the pre-open session, prior to the commencement of trading, cannot be said to have relied on market price. Stulz ¶ 55. However, the mere fact that these investors placed orders prior to the commencement of trading does not mean they did not rely on the integrity of the market; to the contrary, by placing orders to purchase at market prices, they indicated that they expected that these stocks would trade efficiently and that prices generated by the open market would be fair ones. These investors can establish that the fraud caused their losses because they paid artificially-inflated prices as a result of the manipulation; if there had been no manipulation, they would have purchased shares at much lower prices. *See Basic*, 485 U.S. at 245 (fraud-on-the-market theory provides the same "causal nexus" as does common law reliance (quoting *Blackie*, 524 F.2d at 908)). In any event, even if persons who placed orders prior to the commencement of trading are deemed not to have relied on market price, such purchases can easily be excluded from the class definition.

See In re Initial Pub. Offering Sec. Litig., 297 F. Supp. 2d 668, 675 (S.D.N.Y. 2003) ("*IPO II*"); *IPO III*, 227 F.R.D. at 111 n.352. The Issuers are alleged to have intentionally or recklessly misstated or omitted facts they were legally required to disclose; they are therefore responsible for the harm that followed, even if they did not personally enter into tie-in agreements or require that others do.

B. Transaction Causation for Omissions and Misstatements

1. Materiality

As explained above, Plaintiffs are entitled to a presumption that materially false statements and omissions affect the prices of securities trading in an efficient market. In this case, Plaintiffs have alleged that the prospectuses omitted critical information not only regarding the manipulative scheme, but also regarding the kickbacks to Underwriters. Because the materiality, or not, of these statements is unquestionably susceptible to classwide treatment, *see Fisher v. Plessey Co.*, 103 F.R.D. 150, 155 (S.D.N.Y. 1984) (citing cases), Plaintiffs have satisfied their burden under Rule 23.

Ignoring these fundamental principles, Defendants instead insist that Plaintiffs bear some kind of burden to "prove" that the undisclosed facts were material to investors or inflated stock prices. Issuer Br. 21-22; UW Br. 35-36. Issuers argue that, under the Fifth Circuit's decision in *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007), plaintiffs bear the burden at class certification of proving that false statements have had an impact on market prices. Issuer Br. at 21-22. However, *Oscar Private Equity* has been squarely rejected by courts outside the Fifth Circuit as inconsistent with *Basic*. *See Darquea v. Jarden Corp.*, No. 06-722, 2008 WL 622811, at *4 (S.D.N.Y. Mar. 6, 2008); *Wagner v. Barrick Gold Corp.*, No. 03-4302, 2008 WL 465115, at *6 (S.D.N.Y. Feb. 15, 2008); *In re Micron Techs., Inc. Sec. Litig.*, 247 F.R.D. 627, 634 (D. Idaho 2007); *cf. Oscar Private Equity*, 487 F.3d at 272

(Dennis, J., dissenting) ("the majority departs drastically from the Supreme Court's decision in *Basic*"). Defendants have cited no case requiring a court to assess materiality at the class certification stage.

In any event, this Court has already held that the misstatements and omissions in the prospectuses were material to investors. *See In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 379-80 (S.D.N.Y. 2003) ("*IPO I*"). As Plaintiffs explained in their Brief in Support of Class Certification at 45-46, had investors known that Underwriters intended to make astronomical profits through kickbacks and tie-in agreements, they would have doubted the diligence and quality of the underwriting. *See Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 641 (D.C. Cir. 2008) (investors rely on the "reputation, integrity, independence, and expertise" of the underwriter during an offering).[19] One of Defendants' own experts concedes that the quality of the underwriter serves an important signaling function of investment quality in connection with an IPO. *See* O'Hara Tr. at 76:2-15.[20]

2. Market Efficiency

As this Court recently held, *Miles I* does not mandate a finding that the secondary markets for the Focus Case stocks were inefficient. *See IPO V* (slip op.) at 38. This Court also noted that the fact that the stocks traded on the NASDAQ, and were the subject of heavy analyst

[19] As Plaintiffs explained in their Brief in Support of Class Certification, underwriter status serves as an important signaling function to the market of the quality of the new issue. *See* Class Cert. Br. 45 & n.15.

[20] Issuers also make the disingenuous argument that facts concerning the scheme would not be "material" to investors because they do not concern "the company and its business." Issuer Br. 23 (quoting *Basic*, 485 U.S. at 241-42). As Plaintiffs explained above, the manipulative scheme was designed to fool investors into believing that the market valued the company, and viewed its business prospects, more positively than was actually the case. Obviously, these facts directly concern the company and its business.

and media coverage, were "particularly probative" of efficiency, and that any further determination would have to be made by the trier of fact. *See id.* at 41-42. This Court additionally noted that the *Cammer* test for efficiency is widely used and frequently endorsed by courts. *See id.* at 39 n.132. As Plaintiffs previously explained, using the *Cammer* test, Fischel's analysis shows that the Focus Case stocks traded efficiently throughout the class periods. *See* Class Cert. Br. 46-53.[21] They have thus met any burden necessary for this stage of litigation, and any further dispute on this score may be resolved by a jury.

Rather than refute Fischel's determinations under *Cammer*, Defendants instead offer their own tests for market efficiency. First, many of Defendants' experts examine efficiency with an eye not just to whether prices rapidly reflected material information, but also to whether such information was incorporated *accurately*. *See*, *e.g.*, Gompers ¶¶ 23-25.[22] Relying on such analyses, Defendants reach the highly implausible conclusion that there is no evidence that the

[21] In *In re SCOR Holding (Switzerland) AG Litigation*, -- F. Supp. 2d --, 2008 WL 608606 (S.D.N.Y. Mar. 6, 2008), the court also refused to interpret *Miles I* to mean that the quiet period is inefficient as a matter of law. *See id.* at *15. In that case, however, the court adopted a "presumption" that markets are not efficient during the quiet period. *See id.* In so doing, the court relied on SEC releases, dating from the 1980s, explaining that the 25-day quiet period was a "prophylactic" measure intended to ensure that new issues would not be manipulated during a time when markets were still reacting to new information. *See id.* The *SCOR* court's reliance on these releases to adopt a presumption that makes it *harder*, not *easier*, to prove fraud is ironic, given that the purpose of the quiet period is to protect investors. Moreover, one of the releases on which the *SCOR* court relied explicitly stated that the SEC proposals "would in no way diminish responsibility and potential liability to investors for such practices under the antifraud provisions of the securities laws." Prospectus Delivery During Quiet Period, Securities Act Release No. 6682, 37 S.E.C. Docket 260, 1986 WL 703857, at *4 (Dec. 18, 1986). In any event, regardless of the correctness of the *SCOR* presumption, the court explicitly held that the presumption could be rebutted if the *Cammer* test was satisfied. *See* 2008 WL 608606, at *15-16. Because Plaintiffs have satisfied the *Cammer* test, even under the *SCOR* court's analysis, they have demonstrated that the markets in these cases were efficient.

[22] As explained above, the proper inquiry is not whether the market properly valued the securities, but whether the market absorbed available information. *See PolyMedica*, 432 F.3d at 16.

markets for *any* of the Focus Cases became efficient at any time during the class periods – which lasted from 5 months to 18 months – despite what Defendants concede was extensive analyst attention and high-volume trading. UW Br. 28-32. As explained above, because the efficiency inquiry in a securities fraud claim is meant only to determine whether it is reasonable to presume that a particular false statement affected market prices, Defendants' far more elaborate and controversial methodologies should be rejected.

The defense experts' focus on whether markets properly *valued* the stocks, rather than on whether markets absorbed relevant information, infects most of their analyses. For example, Gompers' entire examination of Sycamore is premised on his rejection of informational efficiency as the appropriate metric. Gompers ¶¶ 23-25, 27. Instead, he constructs a "discounted cash flow" model that purports to demonstrate that the market for Sycamore stock was inefficient *because* Sycamore was overvalued. Gompers ¶ 134.[23] Plaintiffs do not dispute that Sycamore stock was overvalued during the Class Period; however, that fact is not a sign of inefficiency, but a sign of *fraud*: the stock was overvalued because investors accepted market signals in the form of pricing and trading patterns as an indicator of Sycamore's worth. *See* Second Rebuttal Rep. ¶ 15 n.34.

Other defense experts, as well, frame their inquiry in terms of fundamental value. Spatt, for example, explicitly rejects the *Cammer* factors and repeatedly refuses to distinguish between informational efficiency and fundamental value efficiency. *See* Spatt Tr. at 57:17-59:17; 63:5-64:6; 66:22-67:15; *see also* Spatt ¶ 33 ("hot" offerings trade inefficiently because they are difficult to value). Cornell writes that "because Plaintiffs allege that the IPO stock prices were

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[23] Notably, Gompers's "discounted cash flow" model was rejected in *Doft & Co. v. Travelocity.com Inc.*, No. 19734, 2004 WL 1152338 (Del. Ch. May 21, 2004). *See* Gompers Tr. at 103:18-106:24.

driven away from fundamental values by tie-in aftermarket share purchases, they are also alleging that the market is by definition inefficient." Cornell ¶ 76; *see id.* ¶ 80. Cornell thus illustrates the problem with an efficiency analysis that focuses on accurate absorption of information; if this approach were to be accepted, it would single-handedly wipe out the investor protections built in to the Exchange Act. For that reason alone, an analysis anchored in "accuracy" or "fundamental value" is flatly incompatible with the legal standards for assessing efficiency in the context of a manipulation claim.

These experts' focus on fundamental value leads them to examine numerous factors that are not identified in *Cammer* and, in some cases, are flatly inconsistent with *Cammer*. So, for example, although *Cammer* directs courts to look to trading volume as evidence of efficiency, Spatt argues that high volume is a sign of *inefficiency* because it reflects disagreement as to a stock's *value*. Spatt ¶ 30. And although *Cammer* takes the presence of several market makers as a sign of efficiency, Spatt concludes that the presence of multiple market makers suggests inefficient differences in valuation. *Id.* ¶ 32.[24] Barry opines that if an issuer is ineligible to file an S-3 statement solely because it has not issued reports under the Securities Act for at least a year, that fact should count against efficiency – because, in his view, stocks traded for less than a

[24] The *Cammer* factors also direct courts to consider the presence of arbitrageurs as an indicator of efficiency. *See Cammer*, 711 F. Supp. at 1286-87. Though Defendants' experts contend there was little arbitrage for IPO stocks, that factor alone does not establish that the market was inefficient. As Fischel points out, studies of IPO markets show that even without arbitrage, stocks rapidly incorporate available information. Second Rebuttal Rep. ¶ 14. Notably, Spatt argues that the active presence of arbitrageurs suggests inefficiency, not efficiency. Spatt ¶ 32. O'Hara contends that there was too *much* opportunity for arbitrage in the Focus Cases for the market to have been efficient, O'Hara ¶¶ 31-32, although she concedes she is unaware of any investors actually earning any profits from the arbitrage opportunities she identifies, *see* O'Hara Tr. at 164:10-17. She also concedes that her own data was likely flawed due to minute lags in trade reporting. O'Hara ¶ 34. In any event, O'Hara identifies these opportunities only for fleeting moments in the first few minutes of trading. O'Hara ¶ 31.

year cannot be *accurately* valued. Barry ¶ 12; Barry Tr. at 308:3-309:19. However, *Cammer* holds that if ineligibility results solely from failing to meet timing requirements, but the company is eligible in other respects, that fact should *support* a finding of efficiency. *See Cammer*, 711 F. Supp. at 1285.[25] *Cammer* directs courts to consider whether markets react to new information; Spatt, however, insists that reactions could be a sign of *inefficiency* if such reactions connote that the markets failed to *accurately* anticipate the new information. Spatt ¶ 33; *see also* Gompers ¶¶ 54-55 (concluding that certain information, though new, should have been anticipated by the market and that market reaction was therefore a sign of inefficiency). Defense experts also focus on the existence of "lock ups," which, they claim, made too few shares available to the public. Barry ¶ 30; Spatt ¶ 34. Fischel addressed this issue in his Efficiency Report, *e.g.*, ¶¶ 27, 50, 68, but, it also should be noted, if lock up agreements were held to preclude a finding of efficiency, the public would almost never be able to rely on stock prices for several months after any IPO. Such a holding would, once again, undermine Congress's goal of "restoring investor's confidence in financial markets" with the passage of the Exchange Act. *Futura Dev. Corp.*, 761 F.2d at 40.

Some of defendants' experts also opine that the market was inefficient because, on occasion, prices moved in the absence of identifiable new information. *See, e.g.*, Barry ¶ 29; Gompers ¶¶ 69-78. But – as even Barry concedes – stock prices often move in response to factors that cannot be readily identified by researchers. *See* Second Rebuttal Rep. ¶ 10 n.18;

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[25] Barry states in his report that the yearlong reporting requirement for S-3 Registration reflects the "SEC's judgment that the market for a stock of a company new to public reporting is not as efficient as that of a more seasoned issuer," citing Securities Act Release No. 6235 (Sept. 2, 1980). Barry ¶ 12. At his deposition, Barry could not identify any such finding in the release cited, and conceded that his statement, and the unverified citation, had been provided to him by the consultant group Cornerstone. Barry Tr. at 303:5-307:12.

Barry Tr. at 221:13-222:2. Price movements may represent reactions to a *lack* of expected information, or may represent reactions to the movements of other stocks, or may simply reflect trading based on *private* information. *See* Second Rebuttal Rep. ¶ 10; Cornell Tr. at 194:4-195:10, 300:3-21; O'Hara Tr. at 103:23-104:10. Indeed, because it is by now so well-established that stock prices frequently move in the absence of identifiable new information, if complete lack of movement in the absence of identifiable information were deemed a sign of market inefficiency, no stock would ever be found to trade efficiently ever again.

Even when purporting to apply the *Cammer* factors, Defendants' experts are improperly preoccupied with "accurate" valuation. For instance, though Barry purports to distinguish between the two inquiries, he actually intertwines his analysis of informational efficiency with an analysis of fundamental value. *See* Barry ¶ 16; Barry Tr. at 234:25-237:2 (volatility in pricing suggests inefficiency because it reflects incorrect valuations or disagreement). Nothing in the concept of informational efficiency requires that all traders make the same value judgments based on the information they have available. Second Rebuttal Rep. ¶ 19 n.49. Stulz claims that Plaintiffs have not shown the market for Firepond was efficient in the first 25 of trading because of the lack of analyst reports. He explains that in an efficient market, "stock price equals the present value of the future cash flows that will accrue to shareholders," ¶ 22, and explains that analyst reports "provide the market with information that is valuable in setting an efficient stock price." Stulz ¶ 65. However, informational efficiency only requires that prices reflect publicly available information – it does not require that any particular level of information be made available.

In any event, the markets were not lacking for information during the quiet period. News reports may perform the same function as analyst reports, *see In re Xcelera.com Sec. Litig.*, 430

F.3d 503, 515, 516 (1st Cir. 2005) and Defendants' experts concede that in the first 25 days, the market was saturated with news items and relevant information about these companies. *See* O'Hara ¶ 63 ("barrage of relevant information") & O'Hara Tr. at 256:11-259:9; *see also* Expert Report of Professor Maureen O'Hara in the Matter of VA Linux and Corvis Corp., dated Feb. 23, 2004 ("O'Hara 2004 Rep.") ¶ 29 ("flood of news . . . at the time of the offering") & O'Hara Tr. at 350:7-352:18. There is simply no reason to believe that critical information was somehow made available without being reflected in stock prices; certainly, Defendants have not shown that the market *failed* to react to new information during the quiet period or during any time thereafter -- a far more critical indicator of whether stock prices reflected public information.[26]

Defendants' preoccupation with analysts in the first 25 days directly contradicts other parts of their analyses. For example, even while insisting that analysts are necessary to spread information, Stulz ¶ 65, Defendants' experts claim that several analyst reports contained no new information and thus should not have had any effect on market price (or contributed to market efficiency). *See, e.g.*, Barry Tr. at 234:4-24. Defendants even go so far as to claim that the markets were "slow" to react if they took mere *hours* to respond to new information – Stulz ¶¶ 71, 74; Barry ¶ 38; Gompers ¶ 51 – but if market analysts are, in fact, as critical as Defendants claim in spreading information, a few hours' reaction time can hardly be surprising, as it would take at least that long for analysts to draft reports, distribute them, and for those reports to be read and digested by investors. In fact, Barry concedes that in an efficient market, different types of information will be incorporated into stock prices at different speeds (but, because he also requires that such information be incorporated "accurately," he provides no guidance to a

[26] Cornell conceded at his deposition that Engage stock did react quickly to new information. Cornell Tr. at 265:15-266:13.

court as to how to assess rapidity for the purposes of a fraud-on-the-market analysis). Barry Tr. at 206:9-212:18; *see also* Gompers ¶¶ 40-42, 50 (news must be incorporated "accurately" into stock prices).[27] In any event, as Fischel points out, it is well-recognized that efficient markets often take hours to respond to new information, and may continue to respond to information the day after it initially becomes available. Second Rebuttal Rep. ¶ 12 & n.22.[28]

Defendants' focus on analysts during the quiet period is also puzzling in light of their other positions. Defendants repeatedly insist that because analysts do not "relay[] important information," the market does not rely upon them or react to their reports. UW Br. 33-34. Defendants cannot have it both ways: either analyst reports contribute valuable information to the market, or they do not. In any event, contrary to the defense experts' arguments, the reports identified by Fischel, as well as various news items, did, in fact, contain novel information that could have caused the price changes. *See* Second Rebuttal Rep. ¶ 12 & n.23.[29]

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[27] Barry, adhering to his "fundamental value" definition of efficiency, also states that not all news reports will contribute to efficiency; in an efficiency inquiry, he suggests that each article be examined to determine whether the opinions expressed are correct or incorrect. Barry Tr. at 278:14-281:8.

[28] Congress itself has recognized that stocks may take time to fully incorporate new information even in an efficient market. In 1995, Congress passed the PSLRA, which includes a statutory ninety-day "lookback" period that limits damages in situations where a stock price "crashes" in response to an announcement but later rebounds. *See* 15 U.S.C. § 78u-4(e). The lookback provision was based upon an article that opines that markets may overreact to bad news and take time to adjust, all while maintaining "informational efficiency." Baruch Lev & Meiring de Villiers, *Stock Price Crashes and 10b-5 Damages: A Legal*, *Economic*, *and Policy Analysis*, 47 Stan. L. Rev. 7, 21 (1994); *see* S. Rep. No. 104-98, at 20 & n.58 (1995), *as reprinted in* 1995 U.S.C.C.A.N. 679, 699 (citing the article as a basis for the lookback provision). Thus, in endorsing the article and codifying its suggestions, Congress expressed its belief that even efficient markets may take as long as *three months* to respond fully to new information.

[29] Defendants' own experts, in their academic writings, have implicitly recognized this point by examining the impact on stock prices many hours (or days) following the announcements. *See* Stulz Tr. at 274:23-277:25; 281:5-282:3; Second Rebuttal Rep. ¶ 12 & n.22.

Finally, several of Defendants' experts argue that because the class periods occurred during an internet "bubble" – defined as a period when prices deviated from fundamental values, Pfleiderer Tr. at 104:20-105:10 – all of the ordinary signs of efficiency must be disregarded, or taken as signs of *inefficiency*. *See* Barry Tr. at 261:20-266-8; Spatt ¶¶ 29, 33. According to these experts, if a "bubble" is deemed to exist, high volume of trading, multiple market makers, and the attention of analysts and reporters must all be taken as signs of inefficiency. UW Br. 32. At the same time, however, Defendants' own experts concede that there is disagreement among economists whether a "bubble" even existed during the class period, *see* Barry Tr. at 354:13-355:19; Pfleiderer Tr. at 106:12-107:8; Spiegel Tr. at 138:22-140:2; Stulz Tr. at 325:25-327:6; Cornell Tr. at 91:19-92:13.

As should be plain, if the analyses advanced by Defendants' experts were accepted, they would radically destabilize the efficiency inquiry. News items would have to be assessed for the "correctness" of their opinions as well as the "correctness" of stock price reaction before efficiency could be determined; analyst reports might, or might not, contribute to a finding of efficiency; high volume trading might, or might not, contribute to a finding of efficiency; multiple market makers would be a sign of efficiency, except for situations when they would be a sign of *in*efficiency; arbitrage would be a sign of efficiency except when it is not; market movements in response to new information would show efficiency or would show inefficiency; the mere fact that a plaintiff advanced a market manipulation allegation at all would act as a concession of inefficiency (and, in Defendants' view, would result in dismissal for failure to state a claim); and courts would be required to determine whether there was in fact a "bubble" – something that Defendants' experts concede is a highly debatable conclusion even years later – which itself would be defined as a period during which stock prices depart from fundamental

valuation. This chaos is precisely what the *PolyMedica* court hoped to avoid when it rejected "fundamental value" as the governing definition of efficiency. *PolyMedica*, 432 F.3d at 16-17. Accordingly, this Court should adhere to the *Cammer* factor test, which, as explained in Plaintiffs' Brief in Support of Class Certification, demonstrates the efficiency of each of the Focus Case stocks. *See* Class Cert Br. 46-53.[30]

3. *Affiliated Ute*

Underwriters contend that even though *Miles I* did not address the applicability of *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), it is now the "law of the case" that *Affiliated Ute* does not apply because of the Second Circuit's finding that individual issues predominate. UW Br. 36. This is simply not true.

As explained in Part II.C, *infra*, now that the knowledge allegations have been amended, the class definition altered, and certain aspects of the record have been clarified, *Miles I*'s conclusion that individual issues predominate is no longer applicable. Like the fraud-on-the-market presumptions, the *Affiliate Ute* presumption is rebuttable; *Miles I*'s holding regarding individual issues did not concern whether a presumption may be applied at all, but only whether individual issues were likely to predominate upon rebuttal.

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[30] Defense experts' focus on fundamental value efficiency, rather than informational efficiency, also infects their criticism of other aspects of Fischel's reports. For instance, Stulz claims that the article "Laddering in Initial Public Offerings," on which Fischel relies, makes assumptions inconsistent with market efficiency because it posits that "an increase in demand for the IPO stock due to laddering increases the price regardless of the 'true' value of the IPO firm." Stulz ¶ 90. Thus, like Cornell, Stulz appears to believe that a market in which prices diverge from "fundamental value" is necessarily an inefficient one – a concept that is flatly incompatible with the standards adopted by Congress, the courts, and the SEC. Gompers, too, errs when he criticizes the article for reasoning that as a stock is more heavily traded, more information is sought and made publicly available. *See* Gompers ¶ 98. As explained above, informational efficiency does not require that any absolute amount of information be made available; there is simply nothing inconsistent, or surprising, about the notion that the market seeks out more information about active stocks.

This Court has already determined that the *Affiliated Ute* presumption applies to Plaintiffs' claims based on the prospectus omissions, *see IPO III*, 227 F.R.D. at 105-06, and that decision remains undisturbed by the Second Circuit. Defendants have offered no reason why this Court should reconsider that holding.

C. Individualized Issues are Not Created by the Possibility of Actual Knowledge

The mere possibility of individualized defenses (including defenses of knowledge) will not defeat certification. *See In re VisaCheck/Mastermoney Antitrust Litig.*, 280 F.3d 124,138 (2d Cir. 2001); *Waste Mgmt. Holdings v. Mowbray*, 208 F.3d 288, 296 (1st Cir. 2000); *Thiessen v. GE Capital Corp.*, 267 F.3d 1095, 1107 (10th Cir. 2001); *In re Linerboard Antitrust Litig.*, 305 F.3d 145 (3d Cir. 2002). The Supreme Court in *Basic* acknowledged that some investors may have had actual knowledge of the fraud without suggesting that that possibility alone would defeat certification. *Basic*, 485 U.S. at 249; *see also Blackie*, 524 F.2d at 906 n.22; *cf. Newton v. Merrill Lynch, Pierce, Fenner & Smith*, 259 F.3d 154, 176 (3d Cir. 2001) ("While it seems apparent that some class members likely knew of defendants' practice, this knowledge does not necessarily invalidate the presumption [of reliance].").

Nothing in *Miles I* holds to the contrary.[31] There, the Second Circuit was primarily concerned that inclusion in the class of "initial IPO allocants, who were required to purchase in the aftermarket," would lead individual questions of reliance to predominate over common ones. *Miles I*, 471 F.3d at 43. As this Court recognized, this reading of *Miles I* is supported by *Miles II*. *IPO V* (slip op.) at 38. The Defendants would like this Court to ignore that the institutional

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[31] It is ironic that Defendants contend that the holding of *Miles I* regarding widespread knowledge is "law of the case" when they themselves concede that one of the factual bases for that ruling – that Plaintiffs had purportedly identified 11,000 diverse entities that engaged in tie-in agreements or paid undisclosed compensation – is no longer accurate even by their count. *See* UW Br. at 21 (interrogatory answers listed "11,000 (now 6,000) institutions and individuals").

allocants in more than 800 IPOs from 1997 through 2000 have been defined out of the proposed classes, and thus, that the investors most likely to have learned of the scheme are no longer relevant to the predominance inquiry. Instead, rehashing the same convoluted reading of Plaintiffs' now-inoperative first amended complaints, the same fuzzy counting of Plaintiffs' interrogatory answers, and the same scattered and vague media reports, Defendants again assert that "widespread knowledge precludes class treatment." UW Br. at 13. They argue that information about their scheme must have been known widely because the Defendants employed so many people, and they rely on the deposition testimony of several of their employees to show that so many people "in a position to know moved to new positions," spreading knowledge of the scheme throughout the industry. The evidence, however, tells a different story.

1. First Amended Complaints

The Defendants argue, again, that Plaintiffs' first amended complaints evidence widespread knowledge. Assessing the evidentiary weight of the first amended complaints, however, cannot be divorced from the record, and the record shows that the first amended complaints are consistent with the second amended complaint allegations that aftermarket purchasers traded in ignorance of the scheme. The second amended pleadings merely clarify Plaintiffs' allegations to ensure they are afforded the meaning that Plaintiffs have always intended and that this Court has repeatedly recognized.

In 2002, on their first Rule 12(b)(6) motion to dismiss, Defendants argued that "the pleadings allege on their face 'common knowledge' of the alleged misrepresentation," 2 Und. Mem. (2002) at 9. Specifically, Underwriters pointed to certain paragraphs of the Master Allegations that purportedly alleged that the fraudulent schemes were "common knowledge," MA ¶ 30, and that there was an "industry-wide understanding" about their existence, *id.* ¶ 31.

In November 2002, during oral argument on the motion to dismiss, counsel for Plaintiffs explained, and the Court understood, that Plaintiffs were not alleging that Underwriters' scheme was widely known to retail investors. *See* Declaration of Christian Siebott in Support of Plaintiffs' Motion for Class Certification in Six Focus Cases, filed Sep. 27, 2007 ("Siebott Decl.") (Vol. 1) Ex. B (11/1/2002 Tr. at 29-32, 64:12-20, 79:9-14). As this Court recapped the discussion, "Plaintiffs' Liaison Counsel[] stated that the pleadings were intended to allege that the ones who knew were the ones 'who benefited from the continuing enterprise that we are alleging was illegal [*i.e.*, customers who entered into Tie-in Agreements].'" *IPO I*, 241 F. Supp. 2d at 346 n.74 (*quoting* 11/01/02 Tr. at 31).

Rejecting Underwriters' argument and according the complaints a "fair reading," the Court held that there had been "no concession that investors *in the aftermarket – i.e.*, the Plaintiffs in these cases – knew about this scheme." *Id.* at 345-46 (emphasis in original); *accord id.* at 376 n.139. The Court explained:

> The Underwriters' argument would only have merit if the Complaints had alleged that the scheme was common knowledge among all investors. But not only is there no such allegation, such an allegation would not be reasonable given that investors who buy stock in the initial allocation generally have more knowledge of the IPO process than investors who purchase stock in the aftermarket. Indeed, the SEC has long defended the importance of securities law on the ground that investors in the aftermarket have a much lower level of sophistication and knowledge about the IPO process than initial purchasers. *See, e.g.*, SEC Special Study at 556 (arguing that disclosure provisions of the Securities Act are particularly important because "persons who bought in the after-market often [are] less sophisticated [than customers who received original allotments] and more susceptible to the allure of publicity and rumor about 'hot issues.'"); SEC Hot Issues Report at 9 (same).

Id. at 346.

Underwriters' straw man resurfaced on the motion for class certification. Again pointing to paragraphs 30 and 31 of the Master Allegations, Underwriters complained that "[i]dentifying claimants with knowledge would be a massive undertaking in light of plaintiffs' assertion that

thousands of [investors] participated in the alleged manipulation in hundreds of offerings." Defendants' Class Certification Sur-Reply at 5. And again, counsel for Plaintiffs explained the allegations in no uncertain terms: "What was intended was certain customers. . . . [W]e did not allege that all of them – we didn't say all. We never said all. And it was never intended to mean all. And every time we've argued this in the past we pointed out to the Court that it was a relatively small number of those." Siebott Decl. (Vol. 1) Ex. E (6/17/2004 Tr. at 64:14-24).

In the 2004 decision granting class certification, this Court again read Plaintiffs' allegations, not as Underwriters had recast them, but as Plaintiffs intended:

> Defendants' concerns are unfounded. *First*, a close look at these paragraphs is absolutely necessary in view of defendants' argument. Paragraph 30 reveals that the allegation is only that "investors [who are allocants] have noted that...." Thus, the pleading is not that "everyone knew of the scheme" but rather that some allocants "noted" that certain information was common knowledge. This is not a judicial admission by plaintiffs that "everyone knew of the scheme."
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> * * *
>
> The same is true of paragraph 31. The paragraph begins with the words "this industry-wide understanding." This raises the question-to what does the word "this" refer? The natural reading is that it refers back to the immediate prior paragraph so that "this industry-wide understanding" is that investors who paid undisclosed compensation and agreed to purchase in the aftermarket received allocations. Paragraph 31 merely pleads that the underwriters made it known that those who paid undisclosed compensation and agreed to purchase stock in the aftermarket received allocations - not that such investors were aware of an illegal scheme to inflate stock prices.

IPO III, 227 F.R.D. at 101. The Court also took note of Plaintiffs' counsel's explanations of the intent of the allegations:

> *Finally*, plaintiffs' counsel has explained that, contrary to defendants' assertions that the scheme was "common knowledge" and "invariably communicated" to allocation-seekers, only a limited population of allocants actually paid undisclosed compensation or consummated tie-in agreements:
>
> > MR. WEISS: We're not saying that all allocants were subjected to this kind of requirement for laddering and kickbacks. There's a certain small universe, but we say that the universe was sufficient to be able to doctor this market and to create huge additional compensation that was

> undisclosed for these underwriters; a scheme, information that was never disclosed by ... the defendants throughout the class period. The population of those allocants who participated is a relatively small population....
>
> [Transcript of 6/17/04 Hearing] at 54:10-19. This position is more consistent with information gleaned through the discovery process than is the notion that every customer who ever expressed an interest in an allocation somehow became privy to the alleged scheme. *See* Plaintiffs' Reply at 47 ("[T]he uncontroverted testimony of all 17 [named] Plaintiffs [several of whom received allocations] is that each was entirely ignorant of the manipulation when each purchased his or her shares.").

Id. at 102 n.296. In short, the record is replete with instances in which Plaintiffs' counsel explained what was intended by the complaint allegations with respect to knowledge. Thus, as an evidentiary matter, the first amended complaints support Plaintiffs' assertion that knowledge was not widespread.

2. Other Evidence

Defendants assert that despite "six years of discovery," there is no "evidence that knowledge did not spread." UW Br. at 15. In fact, the evidence that aftermarket purchasers did not have knowledge of the scheme is overwhelming. First, every one of the proposed class representatives who was deposed testified that they traded in ignorance of the scheme. *See* Class Cert. Br. at 12-25. Second, none of the Defendants' employees deposed in these cases has explicitly testified that they knew, or communicated to anyone, about the scheme. Siebott Reply Decl. (Vol. 2) Exs. 1-102. The Underwriter Defendants cite to eleven of their employees' depositions to show that employees sometimes switched jobs. *See* Shane Decl. ¶¶ 28, 29. They ignore that these employees never admitted knowing anything or communicating anything about the scheme. Siebott Reply Decl. (Vol. 2) Exs. 1-102. For instance, Michael Smith, who moved from Lehman Brothers to Bank of America Securities during the class period, was asked if he communicated with anyone at Bank of America about the scheme. Siebott Reply Decl. (Vol. 2) Ex. 87 at 572-73. He replied "no." *Id.* Indeed, nearly every one of Defendants' employees

deposed in these cases – more than 100 in all – has been asked an identical series of questions about communicating the scheme to others. For example, one such question asked of Smith was:

> Did you communicate with anyone at [Underwriter Defendant], in words or substance, about requiring customers to buy IPO shares in the aftermarket in exchange for an allocation in any securities offering?

E.g., *id.* at 572.[32] Invariably, the deponents have testified under oath that they did not communicate about the scheme to anyone from other banks. So, while the Defendants would like this Court to credit their speculation that knowledge of the scheme must have spread far and wide along with their employees, the actual evidence shows that the scheme was not widely communicated (either that, or more than a hundred of Defendants' deponents have testified untruthfully).

Still other evidence shows that knowledge of the scheme was not as widespread as the Defendants say. Credit Suisse, for example, has maintained that the scheme, for which it paid the largest fine ever imposed by the SEC ($100 million), was known only to three or four of its "22,044" employees. *See, e.g.*, Siebott Reply Decl. (Vol. 1) Ex. 1 (*Schmidt v. Credit Suisse First Boston Corp.*, JAMS Case No. 1100043649, Memorandum of Points and Authorities in Support of Motion for Summary Judgment or Summary Adjudication, Dec. 3, 2005). David Brodsky, Credit Suisse's general counsel to the Americas during much of the class period, told Credit Suisse's investigators in June 2001 that although he learned of an outsized commission payment in exchange for a VA Linux allocation in December 1999, he believed at the time that it was an "isolated incident." Siebott Reply Decl. (Vol. 1) Ex. 2 (Credit Suisse interview memorandum). Again, either knowledge of the scheme was contained, or some of Credit Suisse's employees

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[32] This series of questions has been asked of nearly every deponent in this case by counsel for underwriter defendants. The questions invariably cover both tie-in agreements and undisclosed compensation.

have lied. Either way, there is simply no evidence that knowledge of the scheme was so widespread – even among bank employees – that individual questions of reliance predominate over common ones for class members.

Likewise, the SEC brought charges against several Underwriter Defendants for requiring allocants to either engage in tie-in agreements or pay undisclosed compensation in exchange for IPO allocations during the class periods.[33] During its investigations, the SEC staff (in conjunction with NYSE and the NASDR) interviewed hundreds of people about allocation practices. Very rarely, at least as reflected in the transcripts reviewed by Plaintiffs' counsel, did an employee of the Underwriter Defendants admit to conduct resembling Plaintiffs' allegations. So again, either the Defendants' employees routinely lied under oath to investigators or knowledge of the schemes was contained; either way, there is no evidence that knowledge of the scheme was pervasive.

In addition, in their answers to the complaint, every one of the Underwriter Defendants denied the allegation that allocants "have noted that it was common knowledge that the clients who were forced to pay Undisclosed Compensation . . . and who agreed to purchase on the aftermarket received allocations in IPOs." *E.g.*, Siebott Reply Decl. (Vol. 3) Ex. 9, (Answer of Defendant Credit Suisse First Boston LLC to Master Allegations) ¶ 30 ("denies the allegations contained in paragraph 30 of the Master Allegations that relate to CSFB"); *see also id*. Exs. 1-40. And the Underwriter Defendants uniformly stated that they did not possess sufficient knowledge to either admit or deny whether the alleged misconduct occurred at other banks. The

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[33] *See SEC v. Goldman Sachs*, 05 Civ. 853 (S.D.N.Y. Jan. 25, 2005); *SEC v. Morgan Stanley*, 05 CV 166 (D.D.C. Jan. 25, 2005); *SEC v. J.P. Morgan Sec*., 03 CV 2028 (D.D.C. Oct. 1, 2003); *SEC v. Robertson Stephens*, 03 CV 21 (D.D.C. Jan. 9, 2003); *SEC v. CSFB*, 02 CV 90 (D.D.C. Jan. 22, 2002).

Defendants' pleadings are thus inconsistent with their continual assertions that knowledge of the scheme was widespread and that industry professionals spread knowledge of the scheme from bank to bank as they changed jobs. Unless withdrawn or amended, the defendants' pleadings are binding judicial admissions. *See IPO I*, 241 F. Supp. 2d at 324 (citing *Bellefonte Re Ins. Co. v. Argonaut Ins. Co*., 757 F.2d 523, 528 (2d Cir. 1985)) ("[a] party's assertion of fact in a pleading is a judicial admission by which it normally is bound throughout the course of the proceeding"); *IPO V* (slip op.) at 26 n.96.

There is still other evidence that the scheme was not widely known to aftermarket purchasers. The SEC issued Staff Legal Bulletin No. 10 ("SLB 10") in August 2000 because it had "become aware of complaints that . . . some underwriters have required their customers to agree to buy additional shares in the aftermarket as a condition to being allocated shares in the distribution (*i.e.*, "tie-in" agreements)." Contrary to evidencing widespread knowledge of the scheme, as the Defendants have asserted, *see* UW Br. at 12, SLB 10 states that "[s]olicitations and tie-in agreements for aftermarket purchases are manipulative" because "*traders in the aftermarket will not know* that the aftermarket demand, which may appear to validate the offering price, has been stimulated by the distribution participants." *Id.* (emphasis added). Other examples include the sworn testimony of David W. Tice of David W. Tice Associates, Inc. before Congress in 2001:

> Michael Sola, portfolio manager for T. Rowe Price's Developing Technology Fund, explained to USA Today [May 25, 2001] how the game was played. He said that "['p]eople know the higher they say they are willing to buy the stock (in the after market), the bigger the allocation [of the IPO shares] they are going to get.'" But why should we care that these practices are going on? Aren't institutions making money for their clients? Yes, but they are doing so at the expense of individual investors and at the risk of corrupting the capital allocation system. . . . In fact, the IPO game in effect transferred wealth from individual investors to large institutions, management of the companies going public, and the venture capitalists who got out before the game ended. . . . While some institutions were selling stocks on the first day of trading, and other

> institutions and insiders reduced positions as the speculation continued, *individuals were often left holding the bag. They had been led to believe these stocks were to be held for the long term.*

Analyzing the Analysts: Are Investors Getting Unbiased Research from Wall Street: Hearing Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the H. Comm. on Financial Services (Statement of David W. Tice, David W. Tice & Associates, Inc.), 2001 WL 670802 (F.D.C.H.).

The Underwriters again cite to vague media reports to support their argument that knowledge of the scheme must have been widespread. They ignore the specific media reports that show the exact opposite. For example, a 60 Minutes report on November 13, 2002 quoted one IPO insider:

> Blythe Berents' job was to sell IPO shares for the brokerage firm of Hambrecht & Quist in Boston. A 10-year professional on Wall Street, she said she saw prices artificially inflated in insider deals between the firm and some of its clients. She said the firm was involved in launching up to seven new stocks a week and pushing up prices artificially was standard. "Yeah, it was a game," she says. "*And the retail investor really got left in the dark.*"

Was IPO Frenzy Rigged?, *available at* http://www.cbsnews.com/stories/2002/11/13/60II/printable529225.shtml (last visited Mar. 26, 2008) (emphasis added).

The evidence leaves little doubt. Aftermarket purchasers and retail allocants knew nothing about the scheme.

3. Interrogatory Answers

Once again, the Underwriter Defendants rely on Plaintiffs' answers to certain contention interrogatories to show that knowledge of their scheme was so widespread, individual issues of reliance predominate over common ones. When the Underwriters' supposedly "conservative count" is parsed, however, it is clear that the interrogatory answers are useless in assessing the extent of knowledge among aftermarket purchasers.

The Defendants assert that one set of Plaintiffs' preliminary answers to their contention interrogatories lists 11,000 (now 6,000) "diverse investors" who were required or induced to enter into tie-in agreements or pay undisclosed compensation in exchange for IPO allocations. UW Br. at 13. Another interrogatory answer, according to the Defendants, lists "more than 1,800 institutions" that entered into tie-in agreements with the five lead Underwriter Defendants in the six Focus Cases. *Id.* These raw numbers are very important to the Defendants because, they say, their sheer magnitude demonstrates the spread of knowledge about their scheme, necessitating individual inquiries to ascertain reliance and knowledge among class members. The problem, for the Defendants, is that their counts – 11,000 (now 6,000) and 1,800 "diverse investors" – are neither accurate nor meaningful.[34]

Plaintiffs have always disputed the Defendants' assertion that there were "11,000 (now 6,000)" unique names listed in the preliminary interrogatory answers. *See* Plaintiffs-Appellees' Reply Mem. of Law in Support of Motion to Strike Extra-Record Material at 2 n.1, *Miles v. Merrill Lynch*, No. 05-3349-cv (2d Cir. June 1, 2006); Petition for Rehearing and Rehearing En Banc at 3-4, *Miles v. Merrill Lynch*, No. 05-3349-cv (2d Cir. Jan. 5, 2007); Plaintiffs' Mem. of Law in Opposition to the Issuer and Underwriter Defs. Motions to Dismiss at 49. To this day, no one but the Defendants know how they derived "11,000 (now 6,000)" and the Underwriters have never disclosed their list of 11,000. The interrogatory answers are not, and never were intended to be, a list of unique entities that engaged in tie-in agreements or paid undisclosed

[34] The Defendants assert that Plaintiffs' "quietly dropped" some names from the preliminary interrogatory answers "without explanation." The not-so-subtle implication is that Plaintiffs deviously reduced the number of names to evade *Miles I*. *See also* UW Br. at 8. That charge is unfounded and misleading. Plaintiffs "cut back" the interrogatory answers *before Miles I,* and the smaller number is almost entirely attributable to reducing duplication in the lists. *See* Declaration of Thomas Burt in Support of Plaintiffs' Motion for Class Certification in Six Focus Cases ("Burt Decl.").

compensation. It is, rather, a list of specific transactions, each one associated with whatever account identifier Plaintiffs can link to it. It could, for instance, list an account name, a variation on a name, or an account number. Many of the accounts, even accounts with dissimilar names, are related. Thus, assessing the number of unique entities, for the purpose of gauging the extent of knowledge, cannot be accomplished by just counting entries or names from top to bottom. Determining even an approximate number of "diverse entities" – as the Defendants purport to have done – would involve tracking the account data of various entities across various unrelated sources. Matching names and accounts within a single bank is very difficult; doing so across multiple banks, and across time, is even more so. And the task is made even more difficult by the Defendants' recalcitrance in providing mapping and linking data. After Special Master Capra compelled disclosure of some mapping and linking data, Plaintiffs were finally able to account for some duplication within individual banks' records; thus the amended interrogatory responses reflect many fewer distinct names than before (by the Defendants' count, it was reduced from 11,000 to 6,000). The deduping exercise proves that the preliminary interrogatory responses are, as Plaintiffs have always maintained, an unreliable measure of the number of allocants forced to participate in the Defendants' scheme, at least until discovery on the issue is complete.

By way of illustration, in the larger preliminary interrogatory answers supplied to Goldman Sachs, in response to question 1(a), there is one "United Caoital" [sic] transaction listed, thirty-four "United Capital" transactions, thirty-four "United Capital (UCG)" transactions, one "United Capital 003-00599-8" transaction, one "United Capital G" transaction, thirteen "United Capital Group LP" transactions, and ten "United Capital Opportunistic" transactions. In response to question 2(a), there are an additional ninety-four transactions among the diverse

“United Capital” names. There are still more “United Capital” entity transactions listed for other banks. The Underwriter Defendants have not disclosed if they counted all those “United Capital” transactions as 188 entities, 94 entities, 7 entities, 1 entity, or some other number. Because the Underwriters have neglected to supply their pared-down list, there is no way for Plaintiffs or this Court to check.

The Defendants nevertheless maintain that their counts are “highly conservative” because of their unilateral efforts to reduce duplication in the lists. Shane Decl. (Vol. 3) ¶ 15. As stated, while Underwriters have not submitted their “11,000 (now 6,000)” list, a glimpse at the Defendants’ purportedly deduped list of those with tie-in agreements in the Focus Cases (the 1800 list) reveals how shoddy their efforts were, even by their own criteria. *Id.*, Ex. 38. For instance, the Defendants said that they “eliminate[ed] investor names where the name, on its face, indicated a potential relationship to other named investors,” *id*. ¶¶ 15, 20, yet the supposedly deduped list includes two AAL entities, two Abbey, two Aberdeen, two ABN Amro, three ADIG, three Advantus, two Aegon, three AGF, three AIG, four AIM, two Alex Brown & Sons, three Allianz, two Allied, two Alpine, two American Capital, and four American Express – and that’s just on the first page, *id.* Ex. 38. Both “United Capital (UCG)” and “United Capital Management” are listed, and therefore counted as two entities, even though they both are in fact controlled by one man. The Underwriters made *no* effort to eliminate duplication where names are dissimilar, even where *they know* the entities are related and should not be double-counted. So, for example, at least twenty-eight of the entities are related to one Anthony Bruan. The Underwriters certainly know that the twenty-eight are related, because they listed them as related (along with 174 other Bruan entities) when they subpoenaed Mr. Bruan. *See* Siebott Reply Decl. (Vol. 1) Ex. 4 (Bruan Subpoena). Other instances abound. The Underwriters count five entities

separately that are controlled by one Andrew Siegel. The Underwriters know the five are related, because he supplied the Underwriters with a list of his business concerns pursuant to a subpoena. And the Underwriters count two entities, "Capstar Holdings" and "Capstar Investment Mgmt," that are controlled by one Chris Rule. The Underwriters know the two are related, because they deposed Mr. Rule and asked him about both. *E.g.*, Siebott Reply Decl. (Vol. 1) Ex. 5 (C. Rule Tr. at 13, 35).

Notably, the Defendants' count of those listed in the broader interrogatory answers, which yielded 11,000 (now 6,000) names by their count, purportedly excluded names that "appeared to reflect a relationship to an Underwriter Defendant." *Id.* ¶ 15.[35] But when the Underwriters deduped the smaller list, those pertaining to tie-in agreements, they did not exclude such names. Thus, among the 1,800 investors (by Defendants' count) who entered into tie-in agreements in the Focus Cases, there are three Bear Stearns entities, one Goldman Sachs, four Credit Suisse, five Merrill Lynch, five Morgan Stanley and two Dean Witter, to name just some that are obviously related to Underwriter Defendants. The fact is that the Defendants' counts are anything but conservative, are derived from suspect criteria and specious efforts to reduce duplications, and serve only to mislead. In sum, there is nothing telling about their counts, or any counts, until there is a full and honest effort, after complete discovery, to reduce the duplication of names.

The Defendants have repeatedly distorted the preliminary interrogatory answers with dubious counting before both this Court and the Second Circuit. Beginning with their appellate reply brief, the Defendants introduced the interrogatory answers (which were not, of course, part

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[35] One might think that the Underwriter Defendants would know which of those listed *actually* had a relationship to an Underwriter Defendant.

of the record on class certification) and represented that there were "11,000 market-makers, institutions and individuals" listed. They did not disclose how the count was derived, that the list was riddled with duplication of names, that the answers were not yet binding, or that their count was disputed. The Second Circuit was in fact misled and accepted the 11,000 figure at face value, saying that it was "uncontradicted." The Defendants have twice repeated the ploy, relying on their counts in support of their Rule 12(b)(6) motion to dismiss and now in opposition to class certification. Such dissembling should not be countenanced.

Typically, answers to contention interrogatories are postponed until the close of discovery. Fed. R. Civ. P. 33(a)(2); S.D.N.Y. Loc. Civ. R. 33.3; *O2 Micro Int'l v. Monolithic Power Sys., Inc.*, 467 F.3d 1355, 1365 (Fed. Cir. 2006), and, as the parties agreed here, are not binding while discovery is ongoing, 8A Wright & Miller, *Federal Practice & Procedure* § 2181 (2d ed. 2008) (courts should allow amendments to contention interrogatories as parties complete their investigations and develop a full understanding of the case). This Court directed that Plaintiffs provide preliminary answers to the interrogatories, to be periodically updated, because the Defendants said they needed them to target discovery of allocants. The Defendants, however, abused this Court's latitude, and have instead represented the interrogatory answers to be something they are not. It is, therefore, respectfully submitted that the interrogatory answers to date should be stricken, and answers should not be required, as with contention interrogatories generally, until the close of discovery.

4. Media and Internet Chat Rooms

Defendants argue that publicly available information, specifically a handful of media reports and three anonymous internet "chat room" posts, reflect widespread knowledge about their scheme and created opportunities for prospective class members to learn that the Focus

Case stocks were manipulated.[36] The Defendants' contention begs two questions: 1) whether publicly available information creates individual issues that predominate over common ones, and 2) whether the publicly available information, even if read by class members, is sufficient to defeat the presumption of reliance. The answer to both questions is "no," and *Miles I* did not hold otherwise.[37]

A defendant may rebut the presumption of reliance in a securities fraud case by, among other ways, showing "that the investor knew, or had reason to know, that the misrepresentations were in fact false." *Semerenko v. Cendant Corp.*, 223 F.3d 165, 179 n.8 (3d Cir. 2000). It is still true, as this Court stated in 2004, that "the question of whether publicly available information would have made any reader aware of the allegations here presents an important class-wide common issue." *IPO III*, 227 F.R.D. at 110 (internal quotation omitted). "Furthermore, differences among class members in terms of access to publicly available information (*e.g.*, whether certain investors actually saw all publicized materials, or whether they had access to sophisticated investment advice in interpreting the releases) are insufficient to defeat certification or rebut plaintiffs' presumed reliance." *Id.* at 110-11; *In re Data Access Sys. Sec. Litig.*, 103

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[36] Though Defendants have made this argument many times, they rely on two media reports they have not previously relied upon. The articles, with ominous titles like "The Great Internet IPO Scam" and "Fund Adviser Censured for IPO Gifts," have nothing to do with the Focus Case stocks, laddering, tie-in agreements, kickbacks, undisclosed compensation, excessive commissions, analyst misconduct, or, for that matter, price manipulation. They are about "spinning."

[37] The *Miles* court suggested that two media reports contributed to the predominance of individual questions over common ones with respect to reliance when viewed in conjunction with many other factors, including its reading of Plaintiffs' first amended complaints, its misapprehension that the interrogatory answers actually listed 11,000 "distinct entities," and a broad class definition that included institutional allocants who were in a position to learn of the scheme. The *Miles* court did not hold, as the Defendants suggest, that the media reports were, in and of themselves, sufficient to rebut the presumption that open market purchasers rely upon market price.

F.R.D. 130, 139 (D.N.J. 1984), *rev'd on other grounds*, 643 F.2d 1537 (3d Cir. 1988) ("There will always be some individuals who read the financial statements directly, others who read secondary analyses . . . and many others who relied on the advice of stockbrokers or friends. If defendants' argument were to prevail that factual differences of this nature were sufficient to defeat class action certification, there could never be a class action of securities purchasers."). Consequently, the few public sources relied on by the Defendants do not create a predominance of individual issues of reliance.

That said, even if read by class members, the publicly available sources relied on the defendants are not sufficient to give investors "reason to *know*" that the Focus Case stock prices are inflated, rendering reliance on market price unreasonable as a matter of law.

The standard for rebutting the presumption of reliance through a showing of knowledge is akin to that required to trigger inquiry notice for statute of limitations purposes. *See IPO III,* 227 F.R.D. at 96 ("Defendants may also choose to challenge the rebuttable presumption of reliance with respect to any individual class representative on the grounds that some publication (*e.g.*, the MSNBC article or the SEC Bulletin) placed her on inquiry notice of the alleged scheme."). Both require a showing that the Plaintiffs had access to enough information to reveal the fraud. Thus, in considering whether certain publicly available information is enough to rebut the presumption of reliance, inquiry notice cases are instructive.

In *Lentell v. Merrill Lynch,* 396 F.3d 161, 170-71 (2d Cir. 2005), the Second Circuit held that inquiry notice cannot be triggered by media reports that either pre-date an offering or do not mention the specific company at issue. Rather, "'the triggering . . . data must be such that it relates *directly* to the misrepresentations and omissions the Plaintiffs allege in their action against the defendants.'" *Id.* at 168 (*quoting Newman v. Warnaco Group, Inc.*, 335 F.3d 187,

193 (2d Cir. 2003)). Available information must establish "a probability, not a possibility" of fraud. *Newman,* 335 F.3d at 194. "Inquiry notice exists only when uncontroverted evidence irrefutably demonstrates when plaintiff discovered or should have discovered the fraudulent conduct." *In re Initial Pub. Offering Sec. Litig.*, No. 21 MC 92, 2004 WL 3015304, at *2 (S.D.N.Y. Dec. 27, 2004) ("*IPO IV*") (internal quotation omitted). The *Lentell* court observed that if a vague press account sufficed to trigger inquiry notice, then the same account would necessarily "sustain a claim for securities fraud." 396 F.3d at 171 (Before inquiry notice is triggered by public information, "the level of particularity in pleading required by the PSLRA is such that inquiry notice can be established only where the triggering data, relates *directly* to the misrepresentations and omissions' alleged."); *see also La Grasta v. First Union Sec., Inc.*, 358 F.3d 840, 846 (11th Cir. 2004) (finding earliest inquiry notice of stock analyst's conflict of interest to be a published interview in which she referenced the conflict with respect to the specific security). This, the court said, would be incompatible with the congressional intent of the PSLRA "to deter strike suits." *Id.* In other words, in the securities fraud context, inquiry notice is triggered only when publicly available information contains enough particularity to satisfy the pleading standard if relied upon in a complaint. Thus, consistent with the Second Circuit's reasoning, the publicly available information must reveal the "who, what, when, where, and how" of the fraud, *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990), and give rise to a strong inference of scienter that is both "cogent and at least as compelling as any opposing inference of nonfraudulent intent," *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2504-05 (2007).

In determining whether the public information cited by Defendants is sufficient to rebut the presumption of reliance by a showing of actual knowledge, the Court may simply ask: if

Plaintiffs relied upon and pleaded only the information available in the public sources cited by Defendants, would the allegations satisfy Rule 9(b) and the PSLRA? The answer is no.

Even before *Lentell*, this Court held that an article that fails to mention the stock at issue, and contains denial from the named Underwriters, was insufficiently detailed to trigger inquiry notice. *See IPO IV*, 2004 WL 3015304, at *4. This Court most recently held that the very articles and other publicly available information relied on by the Defendants to rebut the presumption of reliance were insufficient to trigger inquiry notice for statute of limitations purposes. *IPO V* (slip op.) at 50. It follows that the publicly available information the Defendants rely on now, which also fails to name a single Focus Case stock and contains a denial, is insufficiently detailed to rebut the presumption of reliance. The MSNBC.com opinion piece by Chris Byron names none of the Focus Case stocks, and names just one Underwriter Defendant (which is quoted denying the conduct). The CNBC broadcast, an interview of Chris Byron, does not name any stock or underwriter. Likewise, the SEC Staff Legal Bulletin No. 10 merely states that the SEC had "become aware of complaints" of tie-in agreements; it did not indicate whether those reports were substantiated, let alone name a specific stock that may have been manipulated or investment bank that may have been involved. SEC Staff Legal Bulletin No. 10, 2000 SEC No-Act. LEXIS 820 (Aug. 25, 2000). In fact, it was only after the end of the class periods that either the SEC or the NASDR brought their first enforcement actions relating to the IPO allocation practices that are the subject of this litigation. And the anonymous internet posts are not only vague, they are patently unreliable.[38] *In re Pfizer, Inc. Sec. Litig.*, -- F. Supp.

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[38] Defendants' own experts agree that statements in chat rooms are too "noisy" to be of any informational value. O'Hara Tr. at 353:22-354:14. A glimpse at the kind of chat room comments that litter the Yahoo! Finance message boards shows why. "The whole market is manipulated by weasels" said justwonderingal on December 6, 2000. Shane Decl. Ex. 16 at 4.

2d --, 2008 WL 540120 (S.D.N.Y. Feb. 28, 2008) (holding anonymous blog post insufficiently reliable to form basis for PSLRA complaint allegation). Thus, even if read by class members, the MSNBC.com opinion piece, the CNBC broadcast, the Staff Legal Bulletin, or the anonymous message board posts, individual issues of reliance will not predominate over common ones, because even together, the publicly available information is not sufficiently particular to rebut the presumption of reliance by a showing of knowledge.

Defendants also seem to argue that the three anonymous internet "chat room" postings that describe tie-in agreements, along with their bald assertion that the internet in 1999-2000 "bubbled" with allegations of manipulation generally, somehow evince widespread knowledge of the particular fraud alleged in these cases. *See* Shane Decl. ¶ 24. To the contrary, the rarity of remarks describing tie-in agreements – just three from among millions of postings – demonstrates the opposite. Indeed, the Defendants say that anonymous posters used the word "manipulation" nearly 100,000 times on *Yahoo!* message boards during the class period, UW Br. 19, but they point to none that also describe anything resembling the scheme alleged in these cases. Consequently, even if it were a reliable measure, based on the evidence presented by Defendants themselves, it seems that *very* few internet chat room visitors in 1999-2000 knew anything about tie-in agreements.

5. Expert Testimony and Academic Articles

The Defendants also rely on expert testimony and a handful of academic articles to support their "widespread knowledge" hypothesis. Their experts conduct no analysis of who actually knew, or of how the information about the scheme might have spread; instead, they offer

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WallStreetTrickster informed Apple, Inc. (AAPL) investors that "ALIENS HAVE JAMMED ALL APPLES." Siebott Reply Decl. (Vol. 1) Ex. 6. Other investors might have read that Chris Byron is an "idiot," a "liar," a "curmudgeon," a "stupid ass," and a "rat bastard." *Id.*

mere speculation and conjecture. Indeed, these experts do little more than parrot the Defendants and offer nothing more than lay opinions. For instance, Kleidon speculates that "it was not just the allocants who had access to the information, but anyone who read any of a number of [unspecified] publications that widely publicized allegations about the conduct surrounding the IPOs." Kleidon ¶¶ 12–13. He cites to no data or other fact evidence to support his conclusion. Pfleiderer argumentatively states that "Plaintiffs also exclude retail allocants from the Exchange Act class, recognizing that those allocants too may have had knowledge of the alleged misconduct," and "[s]ales personnel relocating from one underwriter to another were able to transfer their knowledge of the scheme to the new firms" Pfleiderer ¶ 16 n.5; *see also* ¶¶ 4, 14-27, 41. Spatt likewise speculates that "knowledge of the alleged scheme would necessarily have been very broad," without conducting any analysis of his own, let alone one that draws upon his expertise. *E.g.*, Spatt ¶ 16. For the reasons discussed below, the opinions offered on knowledge by the Defendants' experts are not appropriate and should be stricken, and they also lack any factual foundation and are not credible.

To dress up his lay opinion on knowledge in experts' clothing, Spatt cites to several articles about the dissemination of information in markets. None of them concern knowledge of illegal information or significant proprietary information. Spatt Tr. at 78:18-25; 101:10-104:12. For instance, Spatt cites to two articles for the proposition that there is "considerable revelation of private information revealed by market anticipation of company announcements and insider trading." Spatt ¶ 23. But neither of the articles supports the assertion that information diffusion of inside information is widespread. The first discusses the effect of insider trading on market price; it does not discuss the dissemination of insider information at all, and in fact concludes that insider information does not leak. Lisa K. Meulbroek, *An Empirical Analysis of Illegal*

Insider Trading, 47 J. Fin. 1661 (Dec. 1992). The second likewise suggests that several "legal" factors contribute to the price run-up prior to corporate takeover announcements, and that the illegal dissemination of inside, proprietary information is insignificant. Gregg A. Jarrell and Annette B. Poulsen, *Stock Trading Before the Announcement of Tender Offers: Insider Trading or Market Anticipation?*, 5 J.L. Econ. & Org. 225 (Autumn 1989).

D. Loss Causation

As explained above, stock prices represent investor judgments as to the likely future performance of the security. *See Wielgos*, 892 F.2d at 514. Market manipulation schemes exploit this fact by "creating circumstantial evidence that positive information has entered the market," *Liu v. Credit Suisse First Boston Corp.*, 383 F. Supp. 2d 566, 579-80 (S.D.N.Y. 2005) (cited with approval in *ATSI*, 493 F.3d at 101), thus suggesting that informed investors have revised their judgments as to the stock's future performance upward. As Plaintiffs explained in their Class Cert. Brief at 57-60, the "risk" concealed by such conduct is that the manipulated stocks do not have the same potential for positive future performance as do the stocks of other (unmanipulated) companies with similar market features. In other words, because the market price has been manipulated, the risk is that the price is an unusually poor predictor of the security's future performance. The risk thus materializes when the manipulative conduct ceases and the stock performs below those of comparable companies as the market corrects for the original, false information. *See IPO II*, 297 F. Supp. 2d at 674. As even Defendants' experts concede, in this scenario, the mere *absence* of confirmatory "good" news -- even without an explicit corrective disclosure -- can cause artificial inflation to dissipate from a stock's price. *See* Stulz Tr. at 93:9-96:2; O'Hara Tr. at 102:14-103:4; Bessembinder ¶ 26; Pfleiderer ¶ 38; Cornell Tr. at 194:4-195:10, 300:3-21; *cf. Hunt v. Enzo Biochem, Inc.*, 530 F. Supp. 2d 580, 595 (S.D.N.Y. 2008) (applying Section 10(b) standards to common law claims; holding that a

company's failure to announce positive information anticipated by the market can act as a corrective disclosure); Berle, 31 Colum. L. Rev. at 270-71 (a record of trading activity "becomes an element in every subsequent appraisal, *at least for a period of time*" (emphasis added)).

Fischel proposes to measure market underperformance – and thus investor losses – by comparing the performance of the Focus Case stocks to an index of comparable companies. *See* Rebuttal Rep. ¶¶ 4-7; Supp. Rep. ¶¶ 20-24; Second Supp. Rep. ¶¶ 42-51. He has shown that the stocks did, in fact, underperform as compared to several market indices, although he has not settled on particular indices to be used at trial, which may vary from case to case. *See* Second Rebuttal Rep. ¶ 46. He has also shown in previous reports that stocks with the greatest amount of artificial inflation exhibited the most underperformance. Supp. Rep. ¶ 21. As this Court previously observed, the selection of an appropriate index is a matter that can be put to a jury, *see IPO III*, 227 F.R.D. at 115 n.378; the index *method*, however, provides a classwide basis for assessing losses.[39]

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[39] Defendants argue that comparisons may only legitimately be made using other non-litigation technology IPOs from the same period as "benchmarks." *See, e.g.*, Expert Report of Mark Ready (Corrected), dated March 12, 2008 ("Ready") ¶ 14; Cornell ¶¶ 10-11. They argue that these non-litigation technology IPOs perform similarly to the litigation IPOs, and conclude from this fact that the performances of the Focus Case IPOs were simply due to industry and market factors. However, as explained in Part VII.A, *infra*, such an analysis necessarily assumes that the other IPOs were not manipulated – a fact that has not been established. Indeed, Professor Mark Ready concedes he has not done any research to confirm that the "benchmark" IPOs he proposes were free of manipulation. Ready Tr. at 48:6-50:23. Similarly, Gompers proposes that the trajectory of Sycamore stock be compared to such companies as Nortel, Corvis, and Lucent – an analysis that, he contends, demonstrates that Sycamore's downward spiral was simply the result of factors affecting the entire industry. Gompers ¶ 124. However, it has since been established that Nortel and Lucent were engaged in massive accounting fraud. *See, e.g.*, *SEC Charges Four Former Senior Executives of Nortel Networks Corporation in Wide-Ranging Financial Fraud Scheme*, *available at* http://www.sec.gov/news/press/2007/2007-39.htm (Mar. 12, 2007); Christopher Stern, *SEC Charges Lucent Employees With Fraud*, Wash. Post, May 18, 2004, at E1. Corvis, of course, is another Focus Case stock. Thus, by arguing that there are similarities in the performance of Sycamore's stock and these other, demonstrably artificially-

Underwriters claim that in *Akerman v. Oryx Communications, Inc.*, 810 F.2d 336 (2d Cir. 1987), the Second Circuit rejected the use of comparable indices. This is simply not true – the Court actually endorsed the use of statistical correlation as part of a party's overall presentation. *See id.* at 342 n.2. Moreover, the Second Circuit's rejection of evidence in that particular case rested on various idiosyncratic factors, such as the failure to use an index that was sufficiently comparable to the relevant company, *see id.* at 343, and a failure to factor in the amount of time it would have taken for the market to react to certain information, *see id*. In addition, because *Akerman* was a false statement case, the Second Circuit faulted the index approach for failing to control for intervening factors. *See id*. As explained in Part II.D.1, *infra*, because a manipulation case differs from a false statement case, the range of potential intervening factors is much narrower, and Defendants have failed to identify anything that would qualify.

Underwriters also misinterpret *In re H.J. Meyers & Co.*, SEC Release No. ID-211, 2002 WL 1828078 (Aug. 9, 2002). There, the ALJ rejected the use of a comparable index as proof *of upward manipulation*. *See id.* at *44. The ALJ held that the mere fact that a stock declines past an index does not prove that the stock had been manipulated upward in the first place. *See id*. The ALJ did not consider – or reject – the use of comparable indices to prove *losses* after the effects of manipulative conduct were established by other evidence. Here, however, Plaintiffs will prove the effects of the manipulative conduct; the stock's decline is used in conjunction with that other evidence to establish loss causation, as this Court previously recognized. *See IPO III*, 227 F.R.D. at 113 (comparable index is a component of overall analysis). For the same reason,

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inflated securities, Gompers's report merely reinforces Plaintiffs' contention that the Sycamore price pattern was due to the dissipation of artificial inflation. Additionally, as Fischel points out, the trajectories of many of Defendants' proposed comparators do not, in fact, mirror those of the Focus Case stocks. Second Rebuttal Rep. ¶ 38 n.76.

Fischel's method does not "prove" that all NASDAQ stocks were artificially inflated at one time or another, as Bessembinder insists, Bessembinder ¶ 46, because Plaintiffs will still be required to show that Defendants artificially inflated stock prices in the first place.

1. The Index Method Properly Accounts for any Intervening Causes

Defendants argue that the index method is untenable because it attributes all underperformance to the original fraud, rather than teases out unrelated factors that may have been responsible for the poor performance. UW Br. 49-50. In so doing, Defendants ignore the *legal* basis of Plaintiffs' claims. Because the essence of the fraud was to fool the market as to the stock's future performance – as expressed through price – the "materialization of the concealed risk" occurred when the stock failed to live up to the false signals communicated by the artificial inflation. *See Lentell*, 396 F.3d at 173.

As this Court previously recognized, allegations of market manipulation differ from claims resting solely on false statements. *See IPO II*, 297 F. Supp. 2d at 674. False statements can concern many subjects, and may be very broad or very narrow; whether a concealed risk has, in fact, materialized, will require a fact-specific analysis of the particular risk that was concealed, as compared to events that are alleged to have caused the stock price to drop. *See Lentell*, 396 F.3d at 174. In a market manipulation claim, by contrast, the "fraud" is much broader – the defendant does not lie about a specific aspect of the company, but instead "tells" a much broader lie: The defendant misleads investors as to the market's overall judgment of the security's potential relative to other securities with comparable features. As a result, events that reveal that

judgment to have been flawed are, by definition, materializations of the risks. *See* Supp. Rep. ¶ 20 n.7.[40]

Seen in this light, the "unrelated" factors for which Defendants insist Fischel control are not unrelated at all – they are the very risks that, had the market priced the securities naturally, would likely have been taken into account. So, for example, had manipulation not occurred, Engage's stock price would have more accurately reflected the risk that it would "suffer[] departures of key executives," UW Br. 50 – or, to put it more simply, had Engage truly had the potential that its initial returns would have suggested, it would not ultimately have fallen into bankruptcy over the loss of three executives, or because of the other "setbacks" it experienced over its year and a half class period. Stocks fairly valued at $239.25-per-share should not experience a "clear failure" of their "business model[s]" a year and a half later. O'Hara 2004 Rep. ¶ 43. And though Kleidon argues that Sycamore's poor performance relative to an industry index simply reflects the fact that Sycamore responded "differently" to industry-wide events than did other companies, *see* Kleidon ¶ 92; *see also* Gompers ¶ 72 (noting that Sycamore reacted strongly to industry-wide events), this fact merely demonstrates that Sycamore's artificially-inflated market price did not reflect Sycamore's true fragility and vulnerability to those events.

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[40] Relying on *In re Williams Securities Litigation,* 496 F. Supp. 2d 1195 (N.D. Okla. 2007), Underwriters argue that, after *Dura*, courts may no longer "assume" loss causation from the fact of a stock price drop. UW Br. 45 n.25. Plaintiffs have previously explained that their theory of loss causation is perfectly consonant with *Dura* and with Second Circuit standards. *See* Class Cert. Br. 57-60; MTD Opp. Br. 50-55. Further, the *Williams* court apparently misunderstood the loss causation inquiry, for it held that in order to demonstrate "materialization of the [concealed] risk," plaintiffs would have to demonstrate the disclosure of "facts which expose the fraud or are at least indicative of the fraud." *Williams*, 496 F. Supp. 2d at 1265-66. The *Williams* court thus did not accept the Second Circuit's conclusion that loss causation may exist even when the market is unaware that a fraud has occurred, so long as the underlying concealed circumstance brought about the losses. *Lentell*, 396 F.3d at 173. In any event, the plaintiffs in *Williams* alleged a series of false statements; this Court has previously noted that proof of loss causation differs for manipulation cases. *See IPO II*, 297 F. Supp. 2d at 674.

As explained in the *Restatement (Second) of Torts* (1977) (cited with approval in *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 344 (2005)):

> [W]hen the financial condition of a corporation is misrepresented and it is subsequently driven into insolvency by reason of the depressed condition of an entire industry, which has no connection with the facts misrepresented, it may still be found that the misrepresentation was a legal cause of the recipient's loss, since it may appear that if the company had been in sound condition it would have survived the depression. . . .

Id. § 548A.[41] *See Semerenko*, 223 F.3d at 186 ("[N]ot every intervening event is sufficient to break the chain of causation. . . .").

Defense experts endorse the principle that poor company performance – or performance that does not justify the high trading price – will cause the dissipation of artificial inflation. They argue that manipulative trading will not have a prolonged effect on prices because informed traders, studying company fundamentals, will arbitrage away any inflation in prices unjustified by the company's fundamentals. *See, e.g.*, Bessembinder ¶¶ 25-30. As Stulz put it, changes in stock prices will persist "until the market receives a new signal that further revises the market's beliefs about the present value of the stock's future cash flow." Stulz ¶ 22.

That is precisely what Plaintiffs allege, albeit over a longer time period. Plaintiffs allege that because of the enormous resources Defendants poured into the scheme, as well as the sheer amount of manipulative information directed toward the market – in the form of laddered trades, an inflated opening price, and false analyst reports – and because of the general uncertainty regarding the actual future potential of internet stocks, Second Supp. Rep. ¶¶ 15-16, it took a

[41] Thus, despite Issuers' argument to the contrary (Issuer Br. 13), there is no "contradiction" between Fischel's attributing price movements both to fluctuations in levels of artificial inflation, and to news about the company. News about the company interacts with market expectations to alter the level of artificial inflation in the stock price. *Cf. In re Rent-Way Sec. Litig.*, 218 F.R.D. 101, 119 (W.D. Pa. 2003) ("[T]he degree of price inflation on any given day during the class period may well differ from the degree of inflation on a different day during the same period.").

longer period of time, as well as disclosures regarding actual corporate performance, before investors restored stock prices to their proper value.

Nor can the burst of any "internet bubble" be deemed an intervening cause. To the extent that any "bubble" existed, it was due to the fact that Defendants themselves created "irrational exuberance" by manipulating the prices of *at least* 309 new issues between 1998 and 2000, and potentially as many as 600 other new issues during the same time period that are not part of this litigation. *See* Siebott Decl. (Vol. 1), Ex. F (Amended Master Allegations), Ex. C; *IPO I*, 241 F. Supp. 2d at 388 n.168. As such, any "bubble" is not an "external and unforeseeable factor[]" that constitutes an intervening cause. *Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 190 (2d Cir. 2001); *see Restatement* § 548A cmt.b ("[T]here is no liability when the value of the stock goes down after the sale, *not in any way because of the misrepresented financial condition*, but as a result of some subsequent event that has *no connection* with or relation to its financial condition.") (emphasis added). Moreover, as explained above, Defendants' own experts concede that there is disagreement a "bubble" even existed. Indeed, as Fischel points out, Defendants' claims that the pricing patterns were the result of "irrationality" or "speculative excess" on the part of investors is flatly at odds with the high price targets issued by their own analysts. Second Rebuttal Rep. ¶ 36.

In any event, there is no requirement that preliminary expert reports at class certification rule out all alternative explanations. Even at trial the expert "need not eliminate all other possible causes of the injury. … 'The fact that several possible causes might remain 'uneliminated' . . . only goes to the accuracy of the conclusion, not to the soundness of the methodology.'" *Jahn v. Equine Servs., PSC*, 233 F.3d 382, 390 (6th Cir. 2000) (citing *Ambrosini v. Labarraque*, 101 F.3d 129, 140 (D.C. Cir. 1996)). Defendants are free to identify

any potentially intervening factors at later stages of litigation. *See Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 197 (2d Cir. 2003) (whether loss was "caused by an intervening event, like a general fall in the price of Internet stocks" is a "matter of proof at trial").

2. Plaintiffs' Evidence is Not the Result of Selection Bias

Defendants contend that the stock price trajectories documented by Fischel – and documented by the academic authorities on which he relies – are the result of selection bias in the cases Plaintiffs chose to litigate. UW Br. 43; Cornell ¶¶ 7-16. This argument simply ignores that Plaintiffs will still maintain the burden of proving that tie-ins influenced market prices, thus eliminating the contention that the initial price increases were the result of natural variations. Indeed, as explained above, Plaintiffs have already shown that Fischel's method is appropriately able to distinguish between cases with evidence of a large number of tie-ins and cases with a smaller number; in the case of iXL, where there is evidence of fewer tie-in agreements and laddered trading, Fischel has demonstrated the lowest first day price increase, and the lowest amount of long-term underperformance. Supp. Rep. Exs. G, H.[42]

Moreover, as Fischel explains, Defendants' claims of selection bias are internally inconsistent. Though they contend that Plaintiffs targeted companies with high initial returns and long-run underperformance, they also challenge Fischel's evidence by identifying companies within the litigated IPOs that do not share those features, and non-litigation IPOs that do have

[42] It is for this reason that Cornell's criticisms are flawed. Cornell attempts to undercut Plaintiffs' claims by noting that many of the litigated IPOs "lack the features that Fischel says are a basis for asserting they are part of the alleged scheme." Cornell ¶ 40. Not only is such an argument flatly inconsistent with selection bias, *see* Second Rebuttal Rep. ¶ 38, but it entirely ignores the fact that Plaintiffs have not yet obtained discovery in many of these cases and simply do not yet know how much evidence of misconduct will ultimately be revealed.

such features. These facts are simply inconsistent with selection bias. Second Rebuttal Rep. ¶ 38. Finally, the academic authorities on which Fischel relies use their own various methods for controlling for selection bias. Second Rebuttal Rep. ¶ 38 n.77; *see also* R. Aggarwal, A. Purnanandam, & G. Wu, *Underwriter Manipulation in Initial Public Offerings*, (working paper (2006)), at 4, *available at* http://bauer.uh.edu/wu/Papers/IPO_ladder.pdf.

3. Other Aspects of the Index Approach

Because each of the class periods persists for at least several months, it is not surprising or unusual that prices of the Focus Case stocks fluctuate relative to potential indices; indeed, in an actively traded market, it could hardly be otherwise. Fischel explains that his method can be adapted to deal with instances in which the Focus Case stocks outperform the selected index and thus appear to show increasing levels of artificial inflation. Second Rebuttal Rep. ¶ 46. First, as a general matter, it is widely accepted that artificial inflation levels may vary throughout a class period; thus, there is nothing inherently unusual about the fact that the index method may also yield varying levels of inflation. *See Rent-Way*, 218 F.R.D. at 119; *In re Bearingpoint, Inc. Sec. Litig.*, 232 F.R.D. 534, 544 (E.D. Va. 2006) (same).[43] Moreover, if there are any instances in which the index method would yield increases in artificial inflation deemed unattributable to the original fraud, inflation can simply be held constant on those dates. Second Rebuttal Rep. ¶ 46. So, for example, if Plaintiffs do not satisfy the Court that a particular increase was related to the original fraud (or, conversely, if Defendants can establish that a particular increase was not related to the fraud), the increases will simply not be deemed "artificial," but will instead be attributed to natural market movement. Of course, as Fischel explains, some increases may well

[43] In his previous testimony in the *Internet Law Library* case, Bessembinder also observed that even stock that had been artificially manipulated still fluctuated throughout the manipulation period. Bessembinder Tr. at 153:10-19.

be traceable to the original fraud – if, for example, the market overreacts to positive news, such as news of a secondary offering, because it deems that positive news to be related to earlier (artificially-inflated) company performance. In such cases, the increases may be included in calculations of artificial inflation. *Id.*

Defendants also object to the fact that Fischel has proposed to cap inflation as of the beginning of the class period, so that any increases in artificial inflation will not be deemed to exceed the levels on the first day. UW Br. 51 n.26. Defendants, bizarrely, are protesting a metric that *benefits* them. Because the bulk of the manipulative conduct is alleged to have occurred at the beginning of each class period, Fischel has merely proposed that the total amount of artificial inflation be measured at that point. He thus adopts the default position that even if artificial inflation levels fluctuate throughout the class periods, the total amount of inflation is unlikely to exceed the initial levels when the manipulative conduct was at its zenith. The cap thus represents the position that any apparent increases in artificial inflation that go beyond those initial levels are not "artificial" at all, but are instead due to natural market forces.[44] However, if this Court believes that some mid-class period increases in artificial inflation may be attributable to the original fraud, even when they exceed the levels seen at the beginning of the class periods, Fischel can eliminate the cap from his analysis.

Defendants next object to the selection of December 6, 2000 as the class period end date. As Fischel has explained, there is evidence suggesting that artificial inflation continued beyond that period; therefore, purchasers prior to that date were affected by the manipulation. Rebuttal Rep. ¶ 20; Second Supp. Rep. ¶ 25 For example, the Underwriters ceased supporting the Focus

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[44] In this way, the cap works in tandem with his proposed event study methodology analyzing predicted returns on the IPO date. Rebuttal Rep. ¶ 7.

Case stocks with positive analyst coverage shortly before, or shortly after, the end of each class period, and underperformance continued past the December 6 end date. Supp. Rep. ¶ 20; Second Rebuttal Rep. ¶ 43 n.94. At trial, Defendants are free to contest the class period end date and to argue that any artificial inflation completely dissipated much earlier; if Defendants prevail, the class period will be altered and the artificial inflation calculations adjusted accordingly. But the mere fact that there may be disputes about the date on which artificial inflation dissipated does not establish that individual issues predominate over common ones; indeed, courts frequently certify classes in the expectation that there may be disputes about whether the artificial inflation was removed from the stock at an earlier date. *See, e.g.*, *Sirota v. Solitron Devices, Inc.*, 673 F.2d 566, 572 (2d Cir. 1982) ["It would be improper for a district court to resolve substantial questions of fact going to the merits when deciding the scope or time limits of the class."]; *Dorchester Investors v. Peak Trends Trust*, No. 99-4696, 2002 WL 272404, at *5 (S.D.N.Y. Feb. 26, 2002); *In re WorldCom, Inc. Sec. Litig.*, 219 F.R.D. 267, 307 (S.D.N.Y. 2003); *In re Oxford Health Plans, Inc. Sec. Litig.*, 191 F.R.D. 369, 378 (S.D.N.Y. 2000); *Nathan Gordon Trust v. Northgate Exploration Ltd.*, 148 F.R.D. 105, 108 (S.D.N.Y. 1993); *In re Atl. Fin. Fed. Sec. Litig.*, No. 89-0645, 1990 WL 188927, at *2 (E.D. Pa. Nov. 28, 1990).

Finally, Defendants argue that an index calculation will yield periods of negative inflation or result in a finding of offer price inflation. UW Br. 51. These objections assume that Fischel will select a particular index and will apply it without any caps or other adjustments in response to appropriate factors. However, as Fischel explains, this is simply premature; his method will require careful selection and application of an appropriate index, not mechanical judgments as Defendants assume.

E. Plaintiffs' Allegations are Not Inconsistent With Market Efficiency

Defendants claim that, given what they deem to be the "widespread knowledge" of the scheme, the stocks could not have traded efficiently and remained inflated throughout the class periods. UW Br. 25; Issuer Br. 20. This is a variation on the "truth-on-the-market" defense. Truth-on-the-market is a corollary to the fraud-on-the-market doctrine, and it posits that in an efficient market, truthful information will counterbalance false information such that the false information will ultimately have no effect on a security's price. *See Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 168 (2d Cir. 2000); *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1115 (9th Cir. 1989).

However, as explained in Part II.C, *supra*, Plaintiffs do not allege, and there is no evidence, that there was widespread knowledge sufficient to bring stock prices down to their uninflated levels. Nor does *Miles I* hold to the contrary; as explained above, *Miles I* was explicitly premised on its interpretation of Plaintiffs' allegations in the FAC, and its mistaken view of the factual evidence. Now that the allegations the factual evidence have been clarified, there is no inconsistency between the level of knowledge documented in this case, market efficiency, and prolonged artificial inflation. Indeed, as explained above, what little disclosures did exist were so vague and contradictory that they were insufficient even to meet the standard for inquiry notice in a fraud claim – *i.e.*, they were insufficient to create circumstances that would "suggest to an investor of ordinary intelligence the probability that she has been defrauded." *Lentell*, 396 F.3d at 168 (quoting *Levitt v. Bear Stearns & Co.*, 340 F.3d 94, 101 (2d Cir. 2003)). Given that fact, the disclosures could not have been sufficient to counterbalance the fraud's effects.

In any event, the question whether knowledge is sufficiently widespread to deflate stock prices in an efficient market operates *classwide*. Even if Defendants are correct that market

participants were aware of the fraud and priced stocks accordingly, this would not present individual questions any more than fraud-on-the-market presents individual questions. The ultimate inquiry still would be whether stock prices were inflated. Similar issues arise in cases where defendants argue that a fraud became "known" to the market – thus deflating the stock price – prior to the class period end date chosen by the plaintiffs. *E.g.*, *Sirota*, 673 F.2d at 572. Courts extend the class period if there are genuine questions raised as to whether truthful information has eliminated inflation. *Oxford Health*, 191 F.R.D. at 378; *Nathan Gordon Trust*, 148 F.R.D. at 108. These courts do not suggest that the question raises *individual* issues, and Defendants have cited no case holding that a "truth-on-the-market" argument defeats certification.

Defendants also argue that the academic authorities on which Fischel relies assume the existence of an inefficient market. UW Br. 47. As Fischel explains, these authorities do no such thing; to the contrary, they are premised on information-hungry markets in which rational actors make value judgments given the data available. Second Rebuttal Rep. ¶¶ 17-19.

III. THE PUTATIVE CLASS MEMBERS' CLAIMS ARE TIMELY

Underwriters repeat the same statute of limitations arguments they unsuccessfully made in several previous motions, including their most recent motions to dismiss. Statute of limitations defenses are common to all class members, and resolving the defense on the merits is not appropriate in the context of class certification. *In re Chiang*, 385 F.3d 256 (3d Cir. 2004) (holding that a statute of limitations defense goes to the merits and hence is not an appropriate objection in the context of class certification). That said, as this Court has already held, Defendants' arguments have no merit, *IPO V* (slip op.) at 48-52; *In re Initial Pub. Offering Sec. Litig.*, No. 21 MC 92, 2007 WL 2609585, at *3 (S.D.N.Y. Aug. 30, 2007); *IPO IV*, 2004 WL 3015304. And pursuant to the law of the case doctrine, these issues should not be revisited

anyway. *Rezzonico v. H & R Block, Inc.*, 182 F.3d 144, 148 (2d Cir. 1999) ("[T]he doctrine [of law of the case] posits that when a court decides upon a rule of law, that decision should [generally] continue to govern the same issues in subsequent stages in the same case.").

IV. ASCERTAINABILITY

The Defendants assert that there are three barriers to ascertaining class members.

First, they say, it is nearly impossible to discern the allocation recipients in the 847 IPOs because "records sufficient to show many allocations resided solely with the 284 non-party underwriters in the 847 IPOs." UW Br. at 57-58. The class definitions, however, concern only allocants who received allocations "from any underwriter defendant." Surely the Underwriter Defendants have retained records sufficient to show who received their allocations.

Second, they say, "there is no uniform meaning of or source identifying an 'institutional pot' allocation." UW Br. at 58. Yet Underwriters *themselves* have distinguished retail and institutional pot allocants in this litigation and have premised discovery agreements and submissions to the Court upon the distinction. Examples are plenty. In the Focus Case Discovery Agreement, Underwriter Defendants agreed to produce (1) "a listing of [] sales representatives covering each of the *institutional pot allocant*s," (2) "documents contained within centrally-maintained indication-of-interest files or systems . . . sufficient to identify all requests for *institutional pot allocations*," and (3) "[w]ith respect to the allocants of Focus Case offering securities from the *institutional pot*, as well as institutional allocants from the retail portion of each offering . . . documents sufficient to show all trading in equity securities by the allocant. . . ." Siebott Reply Decl. (Vol. 1) Ex. 7. Underwriters renewed their agreement to produce institutional pot information in the Second Round Focus Case Discovery Agreement. Siebott Reply Decl. (Vol. 1) Ex. 8. In the Consent Order Concerning Plaintiffs' Fifth Request for Production of Documents, signed by Special Master Capra in February 2005, Underwriters

referred to institutional pots to *define* institutional allocants: "'institutional allocants' shall be construed to mean: a) all those entities listed in the Focus Case Underwriter's '*institutional pot lists*' . . . ." Siebott Reply Decl. (Vol. 1) Ex. 9. Underwriters have so often employed the term "institutional pot" in this litigation as a meaningful way to distinguish institutional and retail allocants, they ought to be estopped from even making the argument that its use in the class definition bars certification. *Zedner v. United States*, 547 U.S. 489, 504 (2006) ("'[W]here a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him.'").

Third, Defendants say, determining which investors received allocations and *from* which source is subjective because (1) "plaintiffs do not say what it means for an allocation to come 'from' an Underwriter Defendant," and (2) "Plaintiffs do not say what happens where an institutional investor maintains many subaccounts . . .and only one of these subaccounts has received a disqualifying IPO allocation." UW Br. at 59. As for the first point, the word "from" in the class definition was "used as a function word to indicate the source, cause, agent, or basis." Merrian-Webster. Employing the Defendants' own words, an investor receives its allocation *from* "whichever underwriter handles [the] allocation on behalf of all the underwriters in the syndicate." *Id.* As to the second point, Underwriters' concern about subaccounts is not an ascertainability problem: subaccounts will either be included in the exclusion or excluded from the exclusion – either way, the ascertainability of class membership is completely objective.

V. RULE 23(C)(4) CERTIFICATION IS APPROPRIATE

In *In re Nassau County Strip Search Cases*, 461 F.3d 219, 226 (2d Cir. 2006), the Second Circuit held that a "court may certify a class as to specific issues [pursuant to Rule 23(c)(4)]

regardless of whether the entire claim satisfies Rule 23(b)(3)." Defendants fault Plaintiffs for devoting many pages to Rules 23(a) and (b), yet only two paragraphs to Rule 23(c)(4). The criticism reflects a fundamental misapprehension about the interplay of Rules 23(a) & (b), and Rule 23(c)(4). Rule 23(c)(4) is merely a procedural device that permits a Rule 23(a) & (b) class to be certified for limited issues. Thus, a Rule 23(c)(4) class must satisfy all of the elements of Rule 23(b) with respect to the issue for which certification is sought. There is no "analysis" under Rule 23(c)(4) *per se*.

On the substance, the Defendants also argue that issue certification is only appropriate where certification is sought on "liability" and damages are left to individual trials. That is simply not so. The text of Rule 23(c)(4) suggests no such thing. Indeed, in *Green v. Wolf Corp.*, 406 F.2d 291, 301 (2d Cir. 1968), the Second Circuit held that individualized reliance determinations would not defeat certification of other issues. "We see no sound reason why the trial court, if it determines individual reliance is an essential element of the proof, cannot order separate trials on that particular issue, as on the question of damages, if necessary. The effective administration of 23(b)(3) will often require the use of the 'sensible device' of split trials." *Id.* at 301.

Defendants also complain that issue certification, to the extent it will require separate juries to examine different issues, may violate the Seventh Amendment's Re-examination Clause. The Re-examination Clause provides in relevant part that "no fact tried by a jury, shall be otherwise re-examined in any Court of the United States." U.S. Const. amend. VII. "Trying a bifurcated claim before separate juries does not run afoul of the Seventh Amendment, but a 'given [factual] issue may not be tried by different, successive juries.'" *Robinson v. Metro-North Commuter R.R. Co.*, 267 F.3d 147, 169 (2d Cir. 2001), quoting *Blyden v. Mancusi*, 186 F.3d 252,

268 (2d Cir. 1999). "'[A]voiding this calls for sound case management, not [outright] avoidance of the procedure. . . . First, the court needs to carefully define the roles of the two juries so that the first jury does not decide issues within the prerogative of the second jury. Second, the court must carefully craft the verdict form for the first jury so that the second jury knows what has been decided already. If the first jury makes sufficiently detailed findings, those findings are then akin to instructions for the second jury to follow." *Id.* (quoting Steven S. Gensler, *Bifurcation Unbound*, 75 Wash. L. Rev. 705, 736-37 (2000)); *see Simon v. Philip Morris Inc*., 200 F.R.D. 21, 36 (E.D.N.Y. 2001) (noting that "different issues can be submitted to different juries as long as they are not presented in a way that causes juror confusion or uncertainty"); Patrick Woolley, *Mass Tort Litigation and the Seventh Amendment Reexamination Clause,* 83 Iowa L. Rev. 499 (1998); *see generally Crane v. Consol. Rail Corp.*, 731 F.2d 1042, 1049-50 (2d Cir. 1984) (Friendly, J.) (discussing the use of special interrogatories to insulate various elements of a cause of action). Here, there is no reason a jury addressing classwide liability – that is, whether the Defendants engaged in the conduct alleged – would decide issues that would have to be reconsidered, or that could not be explained to, the juries deciding individual reliance issues, and the Defendants have not offered any.

VI. PLAINTIFFS' PROPOSED SECTION 11 CLASSES ARE CONSISTENT WITH THIS COURT'S HOLDING ON TRACING

Just as this Court held in connection with the first class certification motions, Plaintiffs' proposed section 11 classes "are appropriately limited to the periods between each IPO and the time when unregistered shares entered the market." *IPO III*, 227 F.R.D. at 120. *Miles* left the Court's ruling undisturbed, and there is no reason to revisit it now.

VII. VARIOUS ASPECTS OF DEFENDANTS' EXPERT REPORTS SHOULD BE STRICKEN FROM THE RECORD

A. Defendants' References to "Non-Litigated IPOs" Should Be Stricken

In connection with the first class certification motion, this Court precluded the Defendants from arguing that "the class definition does not adequately exclude investors who had knowledge of the fraudulent scheme through participation in 'the 'more than 900' IPOs that plaintiffs allege were manipulated as part of this purported industry wide scheme.'" *IPO III*, 227 F.R.D. at 104. That argument, the Court reasoned, was unfair because:

> defendants have vehemently opposed suggestions that they produce any discovery whatsoever with respect to any IPOs other than those consolidated here. Defendants may not now have it both ways; if plaintiffs do not obtain full discovery in the IPOs that are not in suit, then defendants are barred from making this argument. On the other hand, if defendants now believe that it would be beneficial to alter the boundaries of this case to give plaintiffs access to discovery in the approximately 600 remaining IPOs, this issue can be revisited.

Id. (footnote omitted). Defendants nevertheless again invoke IPOs beyond those in the coordinated litigation, without full discovery. Several of their experts, for instance, try to refute Fischel's analysis by comparing litigated IPOs to "non-litigated IPOs" from the same time period, resting on the assumption the non-litigated IPOs were not manipulated. *See* Cornell ¶¶ 5(b), 10-16, 18-21, 24-28, 38-39, 54, Exs. 3-7B, 9B, 10-12, 17, 21, App. 1; Gompers ¶¶ 99, 124, 126, Exs. 26, 28; Ready ¶¶ 11-16, 18, 23-25, 28-30, Exs. 2-6, 15, 17-18; Pfleiderer ¶¶ 6, 35, 55-56, 67, 81-82, Ex. 7. Without full discovery, Plaintiffs are unfairly disadvantaged in testing or countering these comparisons. Consequently, Defendants should not be permitted to rely on these arguments. Those portions of the expert reports that discuss such comparisons should be stricken, and the Defendants should be directed to submit reports with those portions redacted.

B. Defendants' Experts Offer Legal Conclusions

An expert may provide an opinion to help a jury or a judge understand a particular fact, but "he may not give testimony stating ultimate legal conclusions based on those facts." *United States v. Bilzerian,* 926 F.2d 1285, 1294 (2d Cir. 1991); *see also Andrews v. Metro North Commuter R.R. Co*., 882 F.2d 705, 708 (2d Cir. 1989) (holding that engineer's testimony that defendant was negligent was an improper legal conclusion). The rule prohibiting experts from providing their legal opinions or conclusions is "so well-established that it is often deemed a basic premise or assumption of evidence law a kind of axiomatic principle." Thomas E. Baker, *The Impropriety of Expert Witness Testimony on the Law*, 40 U. Kan. L. Rev. 325, 352 (1992); Note, *Expert Legal Testimony*, 97 Harv. L. Rev. 797, 797 (1984) (stating that "it remains black-letter law that expert legal testimony is not permissible.") (footnote omitted). Indeed, the Second Circuit "*requires* the exclusion of testimony [that] states a legal conclusion." *United States v. Feliciano*, 223 F.3d 102, 121 (2d Cir. 2000) (internal quotation marks and citation omitted) (alteration in original) (emphasis added); *see also Marx & Co. v. Diners' Club, Inc.*, 550 F.2d 505, 510 (2d Cir. 1977).

Several of the Defendants' expert reports provide legal opinions. Sometimes, the expert reports read like legal briefs and go on for paragraphs advancing nothing but rank advocacy. For instance, Kleidon opines that "Plaintiffs' new class definitions have not remedied the fundamental concerns raised by the Second Circuit related to the widespread knowledge about the alleged conduct by underwriters." Kleidon ¶ 4. He dedicates an entire section of his report to explaining to the Court that "Plaintiffs' New Amended Complaints and New Class Definitions Still Imply that Knowledge of the Alleged Scheme Was Widespread." Kleidon § IV (¶¶ 5-15). According to Kleidon, Plaintiffs' amended allegations and proposed class definitions "do not answer the questions raised by the Second Circuit about the widespread knowledge of the

scheme." Kleidon ¶ 7. Instructing the Court on what inferences it should draw from the exclusion of allocants in the proposed class definition, Kleidon explains that "Plaintiffs' new class definitions implicitly assume that all allocants or all institutional pot book allocants might have had knowledge of the scheme." Kleidon ¶ 7. Kleidon also reminds the Court that "numerous other market participants might have had knowledge about the alleged scheme as noted by the Second Circuit Decision," which he quotes at length. Kleidon ¶ 7. To assist the Court in reading the *Miles I* decision, Kleidon explains that, in his view, "[t]he Second Circuit emphasized that widespread knowledge still existed after excluding supposed participants in the alleged scheme." Kleidon ¶ 8. Apparently, according to Kleidon, to satisfy the Rule 23 predominance inquiry with respect to knowledge "it must be the case that none of the knowledge of the alleged scheme by any of the market participants aware of the alleged scheme was revealed to *any* of the members of the proposed classes." Kleidon ¶ 9. Kleidon also instructs the Court on matters of legal causation. For instance, according to Kleidon, "Plaintiffs do not specify any corrective disclosures when the truth of the alleged manipulative trading scheme was revealed to the market." Kleidon ¶ 89. And "[t]he use of the backcasting model adopted by Fischel is inconsistent with recent Court rulings," according to Kleidon; especially "*Robbins v. Koger* (cited favorably by *Dura*)." Kleidon ¶ 95. The comparable index approach has also "been rejected explicitly by the Court in *In re Williams Securities Litigation*," in the opinion of econometrician Kleidon. Kleidon ¶ 96; *see also* Kleidon ¶¶ 97-98.

Other experts offer legal opinions as well. Stulz states that one purpose of his report is to determine "the implications for class certification purposes of plaintiffs' allegations." Stulz ¶ 4.A. Cornell interprets *Dura* for the Court, Cornell ¶ 50; Pfleiderer offers his view of the Rule 23 predominance inquiry, Pfleiderer ¶ 27; and Gompers offers his opinion of the correct

interpretation of both *Cammer* and the First Circuit's *PolyMedica* decision, Gompers ¶¶ 16-27. All of these legal opinions should be stricken, and the Defendants should be required to submit corrected reports compliant with the rules of evidence.

C. Defendants' Experts Opine on Lay Matters

Expert opinions directed solely "to lay matters which a jury is capable of understanding and deciding without the expert's help" are inadmissible. *Andrews*, 882 F.2d at 708; *accord Malletier v. Dooney & Bourke, Inc.*, 525 F. Supp. 2d 558, 566 (S.D.N.Y. 2007). Despite this black letter principle, the Defendants' experts frequently opine on matters for which they have no expertise, and which lay persons are perfectly capable of grasping without their help. For instance, Kleidon speculates that it is "improbab[le] that any investor would agree to participate" in the alleged scheme and questions how far knowledge extends because "it was not just the allocants who had access to the information, but anyone who read any of a number of [unspecified] publications that widely publicized allegations about the conduct surrounding the IPOs." Kleidon ¶¶ 12–13. Pfleiderer and Spatt likewise discuss the extent and spread of knowledge of the scheme in a way that does not draw upon their fields of expertise. Pfleiderer ¶¶ 4, 14-27, 41; Spatt ¶¶ 8, 14-19. Cornell questions whether institutions would be motivated to participate in the alleged scheme, Cornell ¶ 89, and O'Hara baldly asserts that it is not reasonable to expect a sub-account to be motivated to participate in a "quid-pro-quo" arrangement of the parent account. O'Hara ¶ 82. And Stulz likewise draws conclusion regarding the spread of knowledge that are based on lay opinion. *E.g.*, Stulz ¶¶ 5, 7. He says that it "defies belief that employees would be aware of the alleged scheme but never talk about it with anybody outside their firms." Stulz ¶ 7. Stulz concludes that it is "impossible" for "putative class members to prove loss causation through common evidence," Stulz § III, and admits that "he knows of no economic methodology to identify those who did have . . . knowledge." Stulz ¶ 17. Indeed,

there is "no economic methodology" pertinent to the question of knowledge, and whether individual questions going to knowledge predominate over common ones for the purposes of Rule 23. There is, therefore, no basis for any of Defendants' experts to opine upon the matter. The offending portions of these expert reports should be stricken, and the Defendants should be required to submit corrected reports for the record.

CONCLUSION

For the reasons stated above and in Plaintiffs memorandum in support of class certification in six focus cases, Plaintiffs' motion for class certification should be granted.

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New York, New York

Respectfully submitted,

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