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05-3349-CV

United States Court of Appeals FOR THE SECOND CIRCUIT

IN RE: INITIAL PUBLIC OFFERING SECURITIES LITIGATION

JOHN G. MILES, SASWATA BASU, MICHAEL HUFF, SEAN ROONEY, KRIKOR KASBARIAN, STATHIS PAPPAS, JAMES COLLINS, DIANE COLLINS, JOSEPH ZHEN, ZITTO INVESTMENTS, J. CHRIS ROWE, VASANTHAKUMAR GANGAIAH, FREDERICK HENDERSON, BARRY LEMBERG, ANITA BUDICH, SPIROS GIANOS, MARY JANE GIANOS AND HARALD ZAGODA,

Plaintiffs-Appellees,

— v. —

MERRILL LYNCH & Co., INC., GOLDMAN, SACHS & Co., MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED, CREDIT SUISSE FIRST BOSTON LLC, ROBERTSON STEPHENS, INC., MORGAN STANLEY & Co., INCORPORATED, BEAR STEARNS & Co., INC., THE BEAR STEARNS COMPANIES, INC., J.P. MORGAN SECURITIES INC., DEUTSCHE BANK SECURITIES, INC., (F/K/A DEUTSCHE BANC ALEX. BROWN, INC., DB ALEX. BROWN LLC AND BT ALEX. BROWN INCORPORATED), LEHMAN BROTHERS, INC., SG COWEN SECURITIES CORP., (N/K/A COWEN AND COMPANY, LLC), RBC DAIN RAUSCHER, INC. (F/K/A DAIN RAUSCHER, INC.) AND PRUDENTIAL SECURITIES, INCORPORATED,

Defendants-Appellants.

BRIEF FOR DEFENDANT-APPELLANT UNDERWRITERS IN RESPONSE TO PLAINTIFFS-APPELLEES' PETITION FOR REHEARING

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

February 7, 2007

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TABLE OF ABBREVIATIONS

A- ____	Joint Appendix
CA- ____	Confidential Appendix
Exchange Act	Securities Exchange Act of 1934, 48 Stat. 891, as amended
IPO	Initial Public Offering
Pet. ____	Plaintiffs' Petition for Rehearing and Rehearing <i>En Banc</i> , dated January 5, 2007
SEC	Securities and Exchange Commission
Securities Act	Securities Act of 1933, 48 Stat. 74, as amended
SPA- ____	Special Appendix
UD Reply ____	Reply Brief for Defendant-Appellant Underwriters Seeking Reversal of Class Certification, dated January 27, 2006
Underwriter Defendants	The underwriters named as defendants in one or more of the 309 coordinated actions in <i>In re Initial Public Offering Securities Litigation</i> , 21 MC 92 (SAS)

PRELIMINARY STATEMENT

The panel correctly concluded that plaintiffs' core allegations and admissions concerning widespread knowledge of an alleged market manipulation scheme, in which thousands of institutional and individual investors supposedly participated, preclude class certification in these cases. The knowledge allegations and admissions require innumerable individual, investor-by-investor inquiries so that the predominance requirement of Rule 23 can never be satisfied. At the same time, the panel correctly held that widespread investor knowledge, as a matter of law, precludes invocation of the *Basic* presumption of reliance, as investor knowledge of a fraud is the antithesis of investor reliance. Without the *Basic* presumption, reliance must be proven subjectively, investor-by-investor, for untold thousands of investors.

There is no reason to revisit the conclusion that these putative classes can never be certified. Because plaintiffs' allegations and admissions about knowledge and participation are central to the theory of their cases and will pervade any record, the outcome can never change.

In their petition, plaintiffs do not deal squarely with the problem of investor knowledge or its centrality to the panel's decision.¹ Instead,

¹ In accordance with the panel's order, this response addresses only the arguments made by plaintiffs in Sections II and III of their petition in support of panel rehearing under Fed. R. App. P. 40.

plaintiffs isolate—and misstate—other aspects of the decision as if there were no knowledge problem at all. So, for example, plaintiffs primarily attack the decision for saying that the market for IPO shares “can never be efficient” (Pet. 12), even though the decision never says that. In these cases, whether or when markets for IPO shares might otherwise theoretically attain efficiency did not require resolution because plaintiffs asserted that price inflation endured throughout the lengthy class periods despite widespread knowledge—an assertion irreconcilably at odds with market efficiency. *See Miles v. Merrill Lynch & Co.*, 471 F.3d 24, 43 (2d Cir. 2006).

To the extent that plaintiffs address the knowledge issue, they still ignore the crux of the decision’s reasoning. Plaintiffs pretend that the knowledge problem arises out of *published* materials, which the decision barely mentioned, rather than out of the *direct dealings* between the defendants and thousands of IPO allocation recipients, which the decision expressly recognized as the core of plaintiffs’ case. Plaintiffs also belatedly contend there might be some way to satisfy the “ascertainability” requirement, despite plaintiffs’ own intent-based definition of the “Undisclosed Compensation” investors allegedly paid. Only in the last three pages of the thirty-page petition do plaintiffs mention knowledge or participation among allocation recipients, and even there plaintiffs argue only that it was “factual error” to say that there

were numerous recipients in the know. The facts before the panel, however, were plaintiffs' own allegations and discovery responses. The decision properly treated those as binding admissions. Plaintiffs thus are left arguing about alternative ways to slice their own numbers or to explore investor intent, but plaintiffs do not deny that the number is in the "thousands," and would require countless subjective, investor-by-investor inquiries that preclude both an ascertainability and a predominance finding under Rule 23.

No matter how plaintiffs slice it, the flaw lies not in the decision's treatment of plaintiffs' claims, but in the claims themselves. Because of plaintiffs' allegations and admissions, this litigation is "bristling with individual questions" and, under settled law, is profoundly unsuitable for class treatment. *Miles*, 471 F.3d at 44. Each of three grounds—knowledge, reliance and ascertainability—is alone sufficient to justify the panel's decision. Accordingly, neither rehearing nor remand could serve any purpose.

ARGUMENT

I. PANEL REHEARING IS NOT WARRANTED.

Federal Rule of Appellate Procedure 40(a) provides that a petition for panel rehearing "must state with particularity each point of law or fact that the petitioner believes the court has overlooked or misapprehended." Consequently, "[i]t should go without saying that a petition for rehearing

should not be filed simply to reargue matters already argued unsuccessfully in the original appeal proceedings. . . .” Charles A. Wright *et al.*, 16A *Federal Practice & Procedure 3d* § 3986.1 (2006). “[A] petition for rehearing is not a brief on the merits,” *United States v. Molina-Tarazon*, 285 F.3d 807, 808 (9th Cir. 2002), and plaintiffs’ attempt to “reargue [their] case anew” “under the guise of a petition for rehearing” should be denied. *Anderson v. Knox*, 300 F.2d 296, 297 (9th Cir. 1962).²

II. THE PANEL’S CONCLUSION THAT INDIVIDUAL ISSUES PREDOMINATE RESTS ON SETTLED LAW AND “PLAINTIFFS’ OWN ALLEGATIONS AND EVIDENCE.”

A. “Individual Questions” Preclude Certification.

Plaintiffs say that “allowing the possibility of knowledge to defeat certification is in tension with [other cases] and represents a sharp break with prior jurisprudence.” (Pet. 25.) This reargument is incorrect. Because the law is clear in this and other Circuits that class treatment is impermissible where

² Rehearing *en banc* also is “not favored,” Fed. R. App. P. 35(a), especially where, as here, the panel decision harmonizes this Court’s decisions on class certification with the approach of six sister Circuits (the Third, Fourth, Fifth, Seventh, Eighth and Eleventh), and is fully consistent with this Circuit’s precedents as well. Under the proper standards for class certification, the panel’s unanimous and thorough opinion makes clear that plaintiffs’ own admissions and allegations create individual issues of knowledge and reliance that defeat predominance. This case-specific conclusion does not merit *en banc* review.

plaintiffs' allegations require numerous subjective or individualized determinations, there is no reason to revisit this conclusion.

In *Moore v. PaineWebber, Inc.*, 306 F.3d 1247, 1256 (2d Cir. 2002), this Court affirmed the denial of class certification where the claims were based on individually varying sales pitches used by defendants' brokers. *Moore*, like the panel's decision, is consistent with a long line of authority from other Circuits deeming class treatment improper where the nature of plaintiffs' allegations makes numerous individualized inquiries unavoidable.³

The individualized issues in these cases far surpass those in *Moore*, or in any other case denying class certification on predominance grounds. This multitude mandates the panel's conclusion that classes can never be certified. Cases cited by plaintiffs (Pet. 25) are not to the contrary.

³ See *Moore*, 306 F.3d at 1253-56 (collecting cases); *Zimmerman v. Bell*, 800 F.2d 386, 390 (4th Cir. 1986) (precluding class certification where "the extent of knowledge . . . will vary from shareholder to shareholder"); *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331, 340-44 (4th Cir. 1998); *Sprague v. Gen. Motors Corp.*, 133 F.3d 388, 398 (6th Cir. 1998) (en banc); *Johnston v. HBO Film Mgmt., Inc.*, 265 F.3d 178, 190 (3d Cir. 2001) (individual issues "overwhelmed" common ones because discussions "varied from customer-to-customer"); 5 James W. Moore *et al.*, *Moore's Federal Practice*, § 23.45[5][a][ii][A], at 23-218 (3d ed. 2005) (common issues do not predominate where "class members may have had varied sources and amounts of information apart from the nondisclosures of the defendants"); see also *West v. Prudential Sec., Inc.*, 282 F.3d 935, 937 (7th Cir. 2002) ("[O]ral frauds have not been allowed to proceed as class actions, for the details of the deceit differ from victim to victim, and the nature of the loss also may be statement-specific.").

Each involved just a handful of class members with individual timeliness or damage calculation issues, rather than thousands with individualized liability issues. See *In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d 124, 139 (2d Cir. 2001) (determination of liability left only “some individualized damage issues”); *Waste Mgmt. Holdings, Inc. v. Mowbray*, 208 F.3d 288, 296 (1st Cir. 2000) (limitations defense involved 13 transactions); *Thiessen v. Gen. Elec. Capital Corp.*, 267 F.3d 1095, 1101, 1107 (10th Cir. 2001) (individual defenses manageable with only 23 class members); *In re Linerboard Antitrust Litig.*, 305 F.3d 145, 157, 163 (3d Cir. 2002) (relatively small number of transactions and primarily common issues on limitations defense).⁴

Because “[t]he undisputed, established facts can only support one inescapable conclusion,” remand would be “only a hollow ritual” that would

⁴ Contrary to plaintiffs’ suggestion that the panel “misstated the elements of claims brought under section 11 of the Securities Act” by “writing that plaintiffs have the burden of proving ‘lack of knowledge’” (Pet. 23 n.14), the panel correctly stated that under section 11, which expressly bars claims by investors who “knew of [the alleged] untruth or omission,” 15 U.S.C. § 77k(a), plaintiffs “must show lack of knowledge to recover,” not because this is an “element” of the claim but because purchaser knowledge is an affirmative defense under the statute, and these cases bring that affirmative defense very much into play. 471 F.3d at 43. This Court has made clear that the predominance inquiry looks to the proof that will be entered at trial in light of substantive law, including “both the claims and defenses.” *Visa Check*, 280 F.3d at 138; see also *Thorn v. Jefferson-Pilot Life Ins. Co.*, 445 F.3d 311, 320-24 (4th Cir. 2006) (individualized knowledge-based defenses preclude certification); *Manual for Complex Litigation (Fourth)* § 21.142 (2006) (predominance analysis includes “claims, issues and defenses”).

“subject the parties and the courts to further delays and expense.” *In re Holloway*, 955 F.2d 1008, 1015 (5th Cir. 1992). The panel correctly recognized remand would be futile. *See A.J. Canfield Co. v. Honickman*, 808 F.2d 291, 307 (3d Cir. 1986) (where district court fails “to apply the correct legal standard,” appeals court “need not remand if the record permits only one resolution of the factual issue”); *West*, 282 F.3d at 938-39 (same).

B. The Panel Relied on Plaintiffs’ Admissions About “Widespread Knowledge.”

The panel correctly concluded that plaintiffs’ allegations of extensive knowledge and participation preclude predominance under Rule 23. As the panel reasoned, not only would individual inquiries be necessary to exclude the thousands of investors that plaintiffs alleged participated in the scheme, but “the exclusion of full participants from the class does nothing to lessen the broad extent of knowledge of the scheme throughout the community of market participants and watchers, and it is this widespread knowledge that would precipitate individual inquiries as to the knowledge of each member of the class” *Miles*, 471 F.3d at 44.

Plaintiffs respond that in so holding the panel improperly engaged in “speculation” because media reports lacked “public acknowledgement that the IPOs of the *specific stocks* in the six cases were manipulated.” (Pet. 21.) But the panel did not speculate about the possible effect of media reports;

rather, it referred expressly to plaintiffs' assertions concerning the number of investors with knowledge. Before even mentioning a single media report, the panel expressly referred to (i) plaintiffs' interrogatory responses listing more than 11,000 alleged participants in the scheme, 471 F.3d at 43 & n.13; (ii) plaintiffs' allegation that "more than 900 IPOs" were "manipulated by aftermarket purchase requirements," *id.* at 43; and (iii) the inescapable conclusion that where thousands of entities receiving allocations allegedly knew about these "requirements," so would at least one employee of each such entity, adding up to "thousands of people employed by the institutional investors," *id.* Likewise, just after mentioning media reports, the panel expressly referred to plaintiffs' claims (i) that "it was common knowledge that the clients who were forced to pay Undisclosed Compensation to the underwriters . . . and who agreed to purchase in the aftermarket received allocations in IPOs" (A-1137; SPA-91-92), and (ii) that "[t]his industry-wide understanding" was "invariably communicated between [the underwriters] and customers seeking the allocation," (A-1137-38; SPA-92; *see also Miles*, 471 F.3d at 43). The panel also stressed the undisputed, large number of allocants in just one of the focus case offerings (Engage), 471 F.3d at 43, a fact that plaintiffs never mention.

The panel’s reliance on plaintiffs’ admissions fully justifies its decision not to remand for further class certification proceedings. This decision accords with this Court’s longstanding recognition that a litigant can “plead himself out of court” through judicial admissions. *Official Comm. of the Unsecured Creditors of Color Tile, Inc. v. Coopers & Lybrand, LLP*, 322 F.3d 147, 167 (2d Cir. 2003); *see also Pegram v. Herdrich*, 530 U.S. 211, 230 & n.10 (2000). Assertions in pleadings and interrogatory responses bind parties “throughout the course of the proceeding.” *Bellefonte Re Ins. Co. v. Argonaut Ins. Co.*, 757 F.2d 523, 528 (2d Cir. 1985). Indeed, in *Heerwagen v. Clear Channel Communications*, 435 F.3d 219 (2d Cir. 2006), plaintiff’s admissions, including in pleadings, deposition testimony and expert reports, justified the holding that no further discovery or proceedings could remedy the consequences of those admissions. 435 F.3d at 234. The panel correctly concluded that the same outcome is required here.

There was no “factual error” in the panel’s recitation of plaintiffs’ pleadings and other admissions of record.⁵ (Pet. 26-27.) Plaintiffs say that the decision “seems to conclude, without the benefit of a complete record, that

⁵ Contrary to plaintiffs’ assertion (Pet. 26 n.19), plaintiffs’ lengthy interrogatory responses were part of the record considered by the district court and are part of the record on appeal (*see* CA-68-442). During the pendency of the appeal, plaintiffs amended and expanded these responses to a list of more than 5,000 printed pages (*see* UD Reply 9 n.2).

each of the 11,000 names” in plaintiffs’ interrogatory responses “is a distinct entity.” (Pet. 27.) But the decision does not parse the potential interrelationships among these entities, and in any event does not place particular importance on the number 11,000. Instead, the decision relies only on “thousands of people” or entities, noting that the “defendants assert” that the number alleged by plaintiffs is 11,000, and that plaintiffs did not disagree. 471 F.3d at 43 n.13. But the precise number of participants is not critical to the panel’s decision, which recognized that the universe of investors with knowledge would necessarily be larger. *Id.* at 43. The 11,000 figure was itself the result of defendants’ conservative count (which had eliminated 10,000 investors based on their similar, but not identical, names). (UD Reply 9 n.2, 11.)

Likewise, the panel did not “fail[] to appreciate” that plaintiffs’ allegations relate to all 309 consolidated actions, not just the six on appeal. (Pet. 26.) Rather, both the panel, 471 F.3d at 43-44, and the district court recognized that plaintiffs’ allegations of the involvement of thousands of investors in “more than 900 IPOs” over a multi-year period only exacerbates the problems of widespread knowledge because “an investor who has knowledge of the alleged fraud in one offering cannot erase that knowledge thereafter.” (SPA-97.) Plaintiffs’ allegations of an “industry-wide

understanding” that was “invariably communicated” to investors (A-1136-37) across more than 900 IPOs would not go away even if it were logical to divide the thousands of participants identified already by 309. And that many investors invested in multiple offerings only compounds the knowledge problem. Most importantly, if plaintiffs were correct for merits purposes that the alleged manipulation here was carried out by many, over many years, then it follows that too many knew for class certification purposes as well.

Finally, plaintiffs say (Pet. 28) that the panel failed “to determine which employees were informed, how many people they told and, most importantly, whether they knew of the totality of the scheme.” Plaintiffs likewise say (Pet. 27) that the panel “apparently believed that Plaintiffs alleged that *all* allocants—and all who sought allocations—were required to participate in the scheme,” when “[i]n fact, Plaintiffs claim only that *some* institutional allocants participated in the alleged scheme [] and each to varying degrees.” (Emphasis original; citation omitted.) This argument simply proves the panel’s point: the need to determine which of the thousands of allocants, employees and other investors had knowledge, and to assess each one’s degree of knowledge, is precisely why subjective and individualized issues overwhelm common ones in these cases.

C. The Panel Made No “Factual Errors” Regarding the “Distinct” Problem of “Ascertainability.”

As a “further example” of the many “individual questions” in the litigation, the panel pointed to the “ascertainment of which putative class members have ‘paid any undisclosed compensation to the allocating underwriter(s).’” 471 F.3d at 44 (quoting the district court, SPA-95). The panel explained that the definition of “Undisclosed Compensation” in the plaintiffs’ complaints depends on the “primary purpose” of the payment. *Id.* And where the alleged “Undisclosed Compensation” was in the form of purchases of securities in less-desired offerings, plaintiffs’ complaints were similarly subjective. *Id.* (quoting plaintiffs’ allegations). Based on plaintiffs’ allegations, therefore, the panel correctly concluded that “ascertaining each purchaser’s intent would require an individualized determination.” *Id.*

Plaintiffs contend that there was “factual error” in this ruling because “new evidence” and “records” about the alleged arrangements “greatly simplify the task of identifying undisclosed compensation.” (Pet. 29.) Putting aside that plaintiffs chose when to move for class certification and were given many chances by the district court to remedy their motion’s failings, the Underwriter Defendants are not aware of any “new evidence” or “records” that could somehow remove the need for individualized, subjective inquiries. Tellingly, plaintiffs chose not to bring this supposedly important “new

evidence” to the attention of the panel during the pendency of the appeal or even to identify or describe it with any specificity in their petition. Plaintiffs also fail to cite any authority for rehearing based on “new evidence” that remains unspecified. Because plaintiffs’ inherently subjective allegations about the intentions underlying thousands of investors’ trading activities could not be proved through “records” alone, there is no reason to revisit the conclusion that ascertainment, too, would require subjective investor-by-investor inquiries and therefore constitutes an independent and sufficient ground for the panel decision.

D. Widespread Investor Knowledge Precludes the Fraud-on-the-Market Presumption.

Because plaintiffs allege that many investors and other market participants knew about the scheme, the panel properly concluded that it would make no sense to “presume” that each investor relied on the existence of an efficient market under *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). This conclusion was required by *Basic* itself, which held reliance may not be presumed “if petitioner could show that the ‘market makers’ were privy to the truth” or if “news . . . credibly entered the market and dissipated the effects of the misstatements.”⁶ *Id.* at 248-49.

⁶ Plaintiffs recognize that questions of knowledge and reliance are distinct (Pet. 2-3), but they ignore that each of these fact-specific inquiries

Plaintiffs do not address the panel’s additional distinct ground for ruling common proof of reliance unavailable in these cases: that to extend the fraud-on-the-market presumption to encompass the very different actors and the array of diverse activities at issue here would stretch the *Basic* paradigm beyond reasonable limits. This Court recognized in *Hevesi v. Citigroup Inc.*, 366 F.3d 70 (2d Cir. 2004), that the trial court had a duty to determine, prior to certification, whether the *Basic* presumption should be extended beyond “uniquely authoritative” statements by issuers, to reach other sources or statements, such as “opinions expressed by research analysts.” 366 F.3d at 79-80. Before extending the *Basic* presumption to new contexts, courts require at least a factual demonstration linking conduct to price movements. *See id.* at 77; *West*, 282 F.3d at 938-39; *DeMarco v. Lehman Bros., Inc.*, 222 F.R.D. 243, 247 (S.D.N.Y. 2004). Because the allegations here primarily relate to various trading arrangements, underwriter compensation, and analyst reports—not to any authoritative financial information disseminated by an issuer as in *Basic*—the panel correctly expressed doubt “whether the *Basic* presumption can be extended, beyond its original context, to tie-in trading, underwriter

independently supports the panel’s decision. For rehearing or *en banc* consideration to have any practical consequence, plaintiffs must argue that the panel erred with respect to *both* knowledge and reliance.

compensation, and analysts' reports." 471 F.3d at 43. Plaintiffs do not mention, let alone challenge, the panel's disciplined approach to *Basic*.

The panel also correctly declined to apply a presumption of reliance under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972). That presumption, conceived in a case involving no impersonal market and no market pricing, is applicable only to cases that "primarily" or exclusively involve omissions. 406 U.S. at 153.⁷ Moreover, because manipulation claims *always* involve some undisclosed conduct, if an *Affiliated Ute* presumption applies it would eliminate the reliance requirement altogether, an outcome at odds with this Court's decision in *Gurary v. Winehouse*, 190 F.3d 37, 44-45 (2d Cir. 1999). *See also Joseph v. Wiles*, 223 F.3d 1155, 1163 (10th Cir. 2000) (concealment cannot "transform [an] alleged malfeasance into an omission" under *Affiliated Ute* without "swallow[ing] the reliance requirement" entirely). *Affiliated Ute*, therefore, does "not even enter

⁷ E.g., *Starr v. Georgeson S'holder, Inc.*, 412 F.3d 103, 109 n.5 (2d Cir. 2005); *Wilson v. Comtech Telecomms. Corp.*, 648 F.2d 88, 93 (2d Cir. 1981); *Titan Group, Inc. v. Faggen*, 513 F.2d 234, 239 (2d Cir. 1975); *Joseph v. Wiles*, 223 F.3d 1155, 1162-63 (10th Cir. 2000); *Cox v. Collins*, 7 F.3d 394, 395-96 (4th Cir. 1993).

the case.” See *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 53 n.2 (1977) (Blackmun, J., concurring).⁸

In declining to extend a “presumption” of reliance to the unusual context of an allegedly widely-known scheme, the decision in no way implies that investors can never rely on “market integrity” and therefore “may not bring market manipulation claims at all.” (Pet. 19.) Instead, the decision makes clear that investors who lack knowledge of an alleged manipulation scheme may sometimes be said to have relied on “market integrity,” while those investors with knowledge cannot so rely. Further, the decision confirms that where many had knowledge, so that “‘market makers’ were privy to the truth,” reliance may not be presumed class-wide. *Basic*, 485 U.S. at 248. Nothing in this decision poses any threat to market manipulation claims in

⁸ The other cases cited by plaintiffs (Pet. 23-24) as supposedly supporting a “presumption” not grounded in *Basic* remain inapposite. See, e.g., *Black v. Finantra Capital, Inc.*, 418 F.3d 203, 209 (2d Cir. 2005) (individual action where jury decided after trial that the investor relied on market pricing, not other factors); *Klay v. Humana, Inc.*, 382 F.3d 1241, 1256 (11th Cir. 2004) (RICO action where “the numerous factual issues relating to the conspiracy are common to all plaintiffs”); *Green v. Wolf Corp.*, 406 F.2d 291, 298 (2d Cir. 1968) (not addressing any reliance presumption and, as now prohibited by the 2003 Rule 23 amendments, tentatively certifying class because “if there is to be an error made, let it be in favor . . . for it is always subject to modification”); *Korn v. Franchard Corp.*, 456 F.2d 1206, 1213 (2d Cir. 1972) (relying on *Green*).

cases where knowledge of the alleged manipulation is not as widespread as plaintiffs say it was here.

III. THE PANEL CORRECTLY HELD THAT THE IPO SECURITIES DID NOT IMMEDIATELY TRADE IN EFFICIENT MARKETS.

Plaintiffs' attack on the panel's discussion of market efficiency for new issuances is similarly misguided. Plaintiffs primarily take issue with the idea that "the market for IPO shares can never be efficient." (Pet. 12.) The panel did not use the word "never." To the contrary, the panel observed that IPO markets generally are not efficient "[i]n the first place," that certain temporary conditions, such as the 25-day "quiet period," posed obstacles to immediate efficiency, and that plaintiffs' own allegations are fundamentally inconsistent with efficiency during the lengthy class periods alleged. 471 F.3d at 42-43.

There can be no dispute about the panel's ruling that shares issued in an IPO distribution—at a fixed price and to selected investors—are not issued in an efficient market. It is settled law that "[t]he fraud-on-the-market presumption can not logically apply when plaintiffs allege fraud in connection with an IPO, because in an IPO there is no well-developed market in the offered securities."⁹ 471 F.3d at 42 (quoting *Berwecky v. Bear, Stearns &*

⁹ Plaintiffs criticize the panel for being "confuse[d]" about the distinction between those who purchase directly at the offering price and those who

Co., 197 F.R.D. 65, 68 n.5 (S.D.N.Y. 2000)); *see also Freeman v. Laventhol & Horwath*, 915 F.2d 193, 199 (6th Cir. 1990) (Timbers, J., by designation) (“primary market for newly issued [securities] is not efficient or developed under any definition of these terms.”); *Peil v. Speiser*, 806 F.2d 1154, 1161 n.10 (3d Cir. 1986); *In re Keegan Mgmt. Co. Sec. Litig.*, 1991 WL 253003, at *3 (N.D. Cal. Sept. 10, 1991); *Gruber v. Price Waterhouse*, 776 F. Supp. 1044, 1052 (E.D. Pa. 1991).

Regarding the initial 25 days of trading, as the panel correctly observed, none of the factors ordinarily considered indicia of efficiency were operative. *See Cammer v. Bloom*, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989). Because the SEC mandates a post-IPO analyst “quiet period,” the market lacked not only “a significant number of reports by securities analysts,” but also fresh information from the issuer, until at least 25 days after each IPO. *See* 17 C.F.R. § 230.174(d). The handful of extra-record media articles cited by plaintiffs for the first time on rehearing (Pet. 15 n.7) do not qualify as “reports by securities analysts” and do not establish a “history of immediate

purchase after trading has begun. (Pet. 12-13.) The decision reflects no such confusion. In fact, plaintiffs have consistently disregarded the distinction themselves by taking the position that all purchasers are class members—no matter when they purchased—and all are equally entitled to a reliance presumption. (*See, e.g.*, A-2649 (proposed classes include IPO allocants); *see also* A-2446, A-2203-04, A-4208 (proposed class representatives include IPO allocants).)

movement of the stock price caused by unexpected corporate events or financial releases.” And about what is arguably most critical—whether the SEC recognizes efficiency by permitting short-form “S-3” registration—plaintiffs say nothing.¹⁰ Compare 17 C.F.R. § 239.11 with 17 C.F.R. § 239.13; see also 17 C.F.R. § 242.104 (permitting IPO aftermarket stabilizing transactions by underwriters). In the face of these strong indicia of inefficiency, plaintiffs cited no evidence at all to suggest that any of the markets in these six securities was efficient.

The panel correctly recognized that plaintiffs’ own allegations are irreconcilably inconsistent with market efficiency at any time, even after the quiet period. Plaintiffs have insisted that the market for these IPO stocks remained inefficiently manipulated and inflated throughout the lengthy class periods and beyond. There is no need to apply the factors set forth in *Freeman* where plaintiffs have alleged that inflation remained embedded in the stocks for months or years despite “the dominant market maker” (A-1136), other market makers (A-2665, A-2862), and “institutional and retail investors” (A-1137) all sharing an “industry-wide understanding” (A-1137) of the alleged

¹⁰ The SEC has explained that its varied registration statement requirements, each with different disclosure items, are based on the view that securities of different ages do not trade in equally efficient markets. See, e.g., Securities Act Rel. No. 6235, 20 SEC Docket 1339 (Sept. 2, 1980), available at 1980 WL 20867, at *3 (1980).

scheme. As the panel put it, these assertions, if true, would “indicate the very antithesis of an efficient market.” 471 F.3d at 43.

In sum, plaintiffs had the burden of demonstrating that the market was efficient throughout the class periods plaintiffs picked. *See Bell v. Ascendant Solutions, Inc.*, 422 F.3d 307, 312-13 (5th Cir. 2005); *Gariety v. Grant Thornton, LLP*, 368 F.3d 356, 367-68 (4th Cir. 2004). It was their task to reconcile their market efficiency claim with their claims of initial as well as persistent price inflation and widespread knowledge of that inflation by the largest market participants. *See West*, 282 F.3d at 940 (denying class certification because *either* alleged manipulative trading could not have affected price in an efficient market *or*, if it did affect price, “the market . . . does not satisfy *Basic*’s efficiency requirement”). Because plaintiffs provided nothing to substantiate their efficiency claim and provided much to refute it, the panel correctly ruled that in these cases the IPO securities did not trade in an efficient market.

CONCLUSION

For the foregoing reasons, the petition should be denied.

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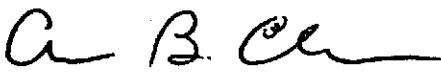
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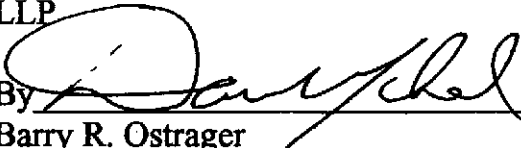
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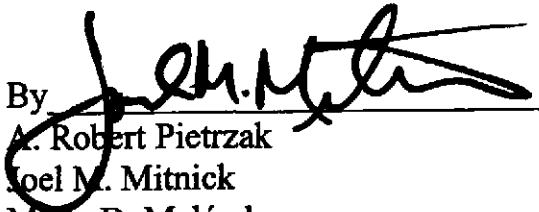
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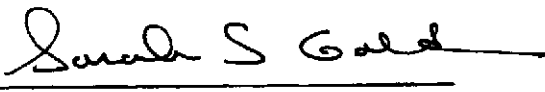
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Dated: February 7, 2007
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**CERTIFICATE OF COMPLIANCE WITH
SECOND CIRCUIT LOCAL RULE 32(A)(1)(E)**

Pursuant to Second Circuit Local Rule 32(a)(1)(E), the undersigned counsel for Defendants-Appellants hereby certifies that I have scanned for viruses the PDF version of the Brief for Defendant-Appellant Underwriters in Response to Plaintiffs-Appellees' Petition for Rehearing, docket number 05-3349-CV, that was submitted in this case on February 7, 2007, as an e-mail attachment to briefs@ca2.uscourts.gov, and that no viruses were detected.


Sara L. Manaugh

Dated: February 7, 2007

CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of February 2007, I caused true and accurate copies of the foregoing Brief for Defendant-Appellant Underwriters in Response to Plaintiffs-Appellees' Petition for Rehearing to be served upon the following:

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