11-1683-cv

United States Court of Appeals

for the

Second Circuit

NEW JERSEY CARPENTERS HEALTH FUND, On behalf of itself and all others similarly situated, NEW JERSEY CARPENTERS VACATION FUND, BOILERMAKER BLACKSMITH NATIONAL PENSION TRUST, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

– v. –

RALI SERIES 2006-QO1 TRUST, RALI SERIES 2006-QO2 TRUST, RALI SERIES 2006-QO3 TRUST, RALI SERIES 2006 QO4 TRUST, RALI SERIES 2006-QO5 TRUST, RALI SERIES 2006-QO6 TRUST, RALI SERIES 2006-QO7 TRUST, RALI SERIES 2006-QO10 TRUST, RALI SERIES 2007-QO1 TRUST, RALI SERIES 2007-QO2 TRUST, RALI SERIES 2007-QO3 TRUST, RALI SERIES 2007-QO4 TRUST, RALI SERIES 2007-QO5 TRUST, GOLDMAN SACHS & COMPANY, CITIGROUP GLOBAL MARKETS INCORPORATED, UBS SECURITIES, LLC,

Defendants-Appellees.

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

BRIEF OF *AMICUS CURIAE* THE NATIONAL ASSOCIATION OF SHAREHOLDER AND CONSUMER ATTORNEYS

DANIEL P. CHIPLOCK
LIEFF CABRASER HEIMANN & BERNSTEIN, LLP
Attorneys for Amicus Curiae
250 Hudson Street, 8th Fl.
New York, New York 10013
(212) 355-9500

DISCLOSURE STATEMENT

The National Association of Shareholder and Consumer Attorneys is not a corporate party within the meaning of Federal Rule of Appellate Procedure 26.1.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

INTEREST OF AMICUS CURIAE

The National Association of Shareholder and Consumer Attorneys ("NASCAT") is a nonprofit membership organization founded in 1988. NASCAT's member law firms represent both institutional and individual investors in securities fraud and shareholder derivative cases throughout the United States. NASCAT and its members are committed to representing victims of corporate abuse, fraud and white collar criminal activity in cases with the potential to advance the state of the law, educate the public, modify corporate behavior, and improve access to justice and compensation for those who have suffered injury at the hands of corporate wrongdoers. NASCAT advocates the principled interpretation and application of the federal securities laws to protect investors from manipulative and deceptive practices, and to ensure this nation's capital markets operate fairly and efficiently.[1]

Comprised of attorneys whose practice focuses in substantial part on the application of the federal securities laws, NASCAT has a deeply-rooted interest in the central issue this case presents. NASCAT agrees with

[1] Counsel for NASCAT represent that no counsel for a party authored this brief in whole or in part and no one other than NASCAT, its members or its counsel made a monetary contribution to the preparation or submission of this brief.

Plaintiffs-Appellants' arguments and writes separately to highlight the broad implications of the district court's holding.

Specifically, if this holding stands it could largely extinguish the ability of investors to maintain securities class actions, as most securities classes are comprised, at least in part, of PSLRA-favored institutional investors that (through themselves or their financial advisors) may have more, or different sources of, knowledge about the industries in which they invest than other investors. This is particularly problematic where, as here, defendants have offered no evidence that any class member actually knew of the falsity of the relevant statements, instead offering nothing more than speculation that plaintiffs may have known of the falsity. Given the enormous burdens of bringing individual suits under the securities laws, without the possibility of a class action the vast majority of investors will forego any recovery because of the difficulties and expense of proceeding alone.

This result contravenes two long-settled policy principles. First, since Congress favored institutional investors as lead plaintiffs in enacting the PSLRA, we know Congress believed that class actions would proceed more effectively with institutional lead plaintiffs, even though these class members may well have specialized expertise and knowledge not available

to ordinary investors. Second, in enacting the Securities Act of 1933, Congress recognized the importance of allowing investors in offerings to maintain and recover on their claims; the policies favoring these claims are evident in the lack of a scienter requirement under Section 11. *Herman & Maclean v. Huddleston*, 459 U.S. 375, 382 (U.S. 1983) (noting the "minimal burden on a plaintiff" bringing this claim).

SUMMARY OF ARGUMENT

A core question presented by this appeal is: where defendants rely on the assertion of affirmative defenses to defeat class certification, can they simply make "some showing" that the predominance and superiority requirements of Rule 23(b) have not been met, or must they be held to the same evidentiary standards that plaintiffs are held to under this Court's ruling in *In re Initial Public Offering Securities Litigation*, 471 F.3d 24, 41-42 (2d Cir. 2006) ("IPO")?

Rule 23 requires that district courts must review defendants' arguments against certification with the same critical eye that they review plaintiffs' arguments in favor of certification. A court cannot refuse to certify a class simply on the basis of mere speculation or "some showing" by defendants that certain plaintiffs might be subject to an affirmative defense.

In this case, plaintiffs' claims easily satisfy any *prima facie* burden of showing predominating common issues – plaintiffs bought on the same offering, plaintiffs suffered from the same nondisclosures and false statements, and plaintiffs were injured thereby. In turn, defendants arguably could have shown that common issues do not predominate if they had produced evidence that a sufficient number of individual class members purchased the securities despite knowing that the misstatements and omissions at issue in the case were false or misleading.

As a review of the district court's decision makes evident, however, defendants utterly failed to produce such evidence. Even in the light most favorable to defendants, the record does not contain sufficient evidence that a trier of fact could find that any individual class member actually knew of the truth. On the contrary, at most the evidence defendants put forward suggests that certain class members perhaps could have known the truth because of their knowledge of mortgage-backed securities and the ability and resources to monitor investments in those securities. Whether plaintiffs could have, or even should have, known of the truth does not deprive them of a claim: only actual knowledge of the specific misleading statement or omission in the offering documents is sufficient to defeat liability under the Securities Act claims asserted. Since there is no evidence of actual

knowledge of any class member, the district court erred in refusing to certify a class.

Further, even assuming *arguendo* that defendants had produced sufficient evidence from which a jury could reasonably conclude that one or two class members had actual knowledge, that does not mean that the predominance and superiority requirements of Rule 23 have been defeated. Instead, the district court has available case management techniques, including re-defining the class to exclude the class members with actual knowledge, that allow the case to proceed on a classwide basis.

DISCUSSSION

The plaintiffs' claims in this action were brought under, *inter alia*, Section 11 of the Securities Act of 1933 ("Securities Act"), which imposes liability where a registration statement contains misrepresentations or omissions of material fact. 15 U.S.C. §77k. Unlike Section 10(b) of the Exchange Act, Section 11 "places a relatively minimal burden on a plaintiff." *Herman & Maclean*, 459 U.S. at 382. "Liability against the issuer of a security is ***virtually absolute***, even for innocent misstatements." *Id*. at 381-82 (emphasis added).

Section 11 provides for recovery to the plaintiff "unless it is *proved* that at the time of such acquisition he *knew* of such untruth or omission." 15

U.S.C. § 77k (emphasis added). Thus, to establish the affirmative defense, a defendant must prove that a class member had actual knowledge of the untruth or omission at the time of the acquisition; whether a class member was sophisticated or had more resources available to learn the truth is irrelevant under the statute's express language. In other words, a plaintiff's actual knowledge is an affirmative defense for the defendant, but a plaintiff's failure to discover the misstatements and omissions is not.

A. The Evidentiary Burden With Respect to Affirmative Defenses Must Be On Defendants

The initial question for this court is which party has the burden of showing whether there is (in)sufficient evidence supporting the assertion of affirmative defense to defeat class certification. NASCAT recognizes that the plaintiff has the burden of establishing the prerequisites for class certification, *In re Flag Telecom Holdings, Ltd. Securities Litigation,* 574 F.3d 29, 34-35 (2d Cir. 2009), and that plaintiffs must show that "that more 'substantial' aspects of th[e] litigation will be susceptible to generalized proof for all class members than any individualized issues," *Myers v. Hertz Corp*., 624 F.3d 537, 551 (2d Cir. 2010), but plaintiffs here have satisfied this burden with regard to their case in chief – the offering statements are the same and the omissions or false statements are the same across the class.

As to the specific affirmative defense – actual knowledge – at issue here, we submit that the burden of showing that (i) evidence supports its assertion, and (ii) its assertion is inconsistent with class certification must fall on the defendant. First, there is no limit to the range of affirmative defenses that a creative defendant (and counsel) can assert; it is unreasonable to require plaintiffs to anticipate and pre-emptively negate every possible affirmative defense on a motion for class certification. Second, where, as here, there is no evidence that any class member is actually subject to any specific affirmative defense, a district court should presume that theoretical affirmative defenses will not predominate. This presumption is particularly reasonable here, where there is no common-sense reason to believe that any investor with actual knowledge of the truth would have invested in the securities at issue. Third, it is defendant's burden to prove the affirmative defense at trial, so that requiring defendant to meet an evidentiary burden at the time of class certification is reasonable.

A defendant cannot be permitted to defeat class certification merely by speculating that it will have an affirmative defense as to some class members. Thus, the defendant must have the burden of establishing, at minimum, that there is sufficient evidence supporting the assertion of affirmative defenses that will cause individual issues to predominate.

B. District Courts Cannot Rely On The "Some Showing" Standard in Evaluating Evidence Regarding Affirmative Defenses

The second question for this Court concerns by what standard a trial court must evaluate defendants' submissions. It is well-settled that district courts cannot merely speculate on class certification but, rather, must make findings and "resolve[] factual disputes relevant to each Rule 23 requirement." *Flag Telecom,* 574 F.3d at 34-35 (quoting *In re IPO,* 471 F.3d at 41). Consistent with the Court's instruction to resolve factual disputes where necessary to certify a class, several district courts in this Circuit have rightfully refused to deny class certification when a defendant offers nothing more than generalities or speculation concerning a potential affirmative defense. For example, in *In re Moody's Corp. Securities Litigation*, No. 07-8375, 2011 U.S. Dist. LEXIS 36023, at *28-29 (S.D.N.Y. Mar. 31, 2011), the court refused to deny class certification based merely on general market information, stating:

> What these [news] articles demonstrate over and over again is that the market was well aware of the potential for conflicts, but each time the rating agencies assured investors that the conflicts were either being managed or negligible. Moody's does not point to anything that rises to the same level of actual knowledge or, even a reasonable inference of such knowledge, that the market had in IPO, where tens of thousands of investors and institutions had actual knowledge of the after-market purchasing requirements and the media had reported on the exact scheme at issue. … Therefore, this argument does not

> rebut the Basic presumption, nor does it independently defeat [] class certification by demonstrating that individual questions predominate.

See also In re Monster Worldwide, Inc. Sec. Litig., 251 F.R.D. 132, 137 (S.D.N.Y. 2008) ("despite all of this speculation, Monster provides no direct evidence that any putative class member actually knew about option backdating at Monster before the scandal became public"); *Lapin v. Goldman Sachs & Co.*, 254 F.R.D. 168 (S.D.N.Y. 2008) (no evidence put forward by defendants that showed "that any potential class plaintiff – including investment banks…– had *actual* knowledge of, or participated in, any alleged fraud," and noting that, if this argument were permitted to succeed, defendants could "defeat class certification merely by citing comments by certain industry participants that note the potential for a type of fraud in the industry.").

Allowing a defendant to defeat class certification here based merely on speculation, innuendo, or vague generalities is particularly antagonistic to the policy of the PSLRA favoring institutional investors serving as class representatives. The very traits that make institutional investors desirable as lead plaintiffs – expertise, a strong financial interest, and the ability and resources to monitor investments and litigation – also means that they conceivably "could have known" things that ordinary small investors could

not have known. Even assuming *arguendo* that "could have known" is a relevant standard (which it is not), using the imposition of that standard without any evidentiary support as a basis to defeat class certification would make it virtually impossible to certify any class that includes institutional investors.

In this case, the district court erred by relying on speculation that some class members could have known, without any evidence that they actually did. The court did not even rely on "some evidence" of actual knowledge, a standard rejected by this Court in *IPO,* but instead on a new "some speculation" standard. This case highlights the impropriety of the "some speculation" standard, as its application was based on materials submitted by defendants that demonstrated nothing except that certain members of the class had some knowledge of mortgage-backed securities that exceeded the knowledge of other investors.

In concluding that individual issues would predominate, the district court referred to evidence that certain class members met with mortgage originators, that certain class members were aware of general risks and trends, and that certain class members were sophisticated investors. Notably, however, the district court's decision does not refer to a shred of evidence that a single class member had actual knowledge of the misleading

statements and omissions at issue. Defendants were permitted to (and did in fact) take discovery of plaintiffs and their investment advisors, so the fact that they cannot point to any evidence of actual knowledge is telling.

Exactly how much evidence is sufficient to meet the burden of showing that an affirmative defense predominates need not be resolved by the Court in this case, because here defendants have utterly failed to show that there is any evidence that any class member actually knew of the truth. Without such evidence, this affirmative defense cannot survive summary judgment under Fed. R. Civ. P. 56, cannot reach a jury, and thus cannot create individual issues that would predominate at trial.

CONCLUSION

For the foregoing reasons, NASCAT submits that the Court should vacate the District Court's Judgment and reverse the District Court's denial of Plaintiffs' Class Certification Motion.

Dated: August 11, 2011

Respectfully submitted,

/s/ Daniel P. Chiplock
Daniel P. Chiplock
LIEFF, CABRASER, HEIMANN & BERNSTEIN, LLP
250 Hudson Street
8th Floor
New York, NY 10013-1413

Timothy N. Mathews
CHIMICLES & TIKELLIS LLP
361 W. Lancaster Ave
Haverford, PA 19041

Clifford S. Goodstein
MILBERG LLP
One Pennsylvania Plaza
49th Floor
New York, New York 10119

Attorneys for Amicus Curiae National Association of Shareholder and Consumer Attorneys

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, the foregoing brief is in 14-Point Times Roman proportional font and contains 2,338 words and thus is in compliance with the type-volume limitation set forth in Rule 32(a)(7)(B) of the Federal Rules of Appellate Procedure.

Dated: New York, New York
August 11, 2011

/s/ Daniel P. Chiplock
Attorney for Amicus Curiae National Association of Shareholder and Consumer Attorneys

STATE OF NEW YORK)
) ss.: **AFFIDAVIT OF**
COUNTY OF NEW YORK) **CM/ECF SERVICE**

I, Natasha S. Johnson, being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age.

On August 11, 2011

deponent served the within: **BRIEF OF *AMICUS CURIAE* THE NATIONAL ASSOCIATION OF SHAREHOLDER AND CONSUMER ATTORNEYS**

upon:

SEE ATTACHED LIST

via the CM/ECF Case Filing System. All counsel of record in this case are registered CM/ECF users. Filing and service were performed by direction of counsel.

Sworn to before me on August 11, 2011

MARIA MAISONET
Notary Public State of New York
No. 01MA6204360
Qualified in Bronx County
Commission Expires Apr. 20, 2013

Job # 237601

Service List:

Carpenter Lipps & Leland LLP
280 North High Street, Suite 1300
Columbus, OH 43215
(614) 365-4100

Lazare Potter & Giacovas LLP
950 Third Avenue, 15th Floor
New York, NY 10022
(212) 758-9300

Attorneys for Defendants-Appellees RALI Series 2006-QO1 through 2006-QO7 Trusts, RALI Series 2006-QO10 Trust, and RALI Series 2007-QO1 through 2007-QO5 Trusts

Fried, Frank, Harris, Shriver & Jacobson, LLP
One New York Plaza
New York, NY 10004
(212) 859-8000

Attorneys for Defendants-Appellees Goldman Sachs & Co., Citigroup Global Markets Incorporated, and UBS Securities, LLC.

SIMPSON THACHER & BARTLETT LLP
Attorneys for Defendants-Appellees
425 Lexington Avenue
New York, New York 10017
(212) 455-2000

COHEN MILSTEIN SELLERS & TOLL PLLC
Attorneys for Plaintiffs-Appellants
88 Pine Street, 14th Floor
New York, New York 10005
(212) 838-7797