03-9350

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE WORLDCOM, INC. SECURITIES LITIGATION

ALAN G. HEVESI, COMPTROLLER OF THE STATE OF NEW YORK, AS ADMINISTRATIVE HEAD OF THE NEW YORK STATE AND LOCAL RETIREMENT SYSTEMS AND AS TRUSTEE OF THE NEW YORK STATE

(For Continuation of Captions See Inside Cover and Following Pages)

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

BRIEF OF LEAD PLAINTIFF-APPELLEE ALAN G. HEVESI, COMPTROLLER OF THE STATE OF NEW YORK, AS ADMINISTRATIVE HEAD OF THE NEW YORK STATE AND LOCAL RETIREMENT SYSTEMS AND AS TRUSTEE OF THE NEW YORK STATE COMMON RETIREMENT FUND

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NO. 03-9359 *(Continuation of Caption)*

COMMON RETIREMENT FUND, THE FRESNO COUNTY EMPLOYEES RETIREMENT ASSOCIATION, THE COUNTY OF FRESNO, CALIFORNIA, AND HGK ASSET MANAGEMENT, INC., ON BEHALF OF PURCHASERS AND ACQUIRERS OF ALL PUBLICLY TRADED SECURITIES OF WORLDCOM, INC., DURING THE PERIOD BEGINNING APRIL 29, 1999, THROUGH AND INCLUDING JUNE 25, 2002

Plaintiffs-Appellees

v.

CITIGROUP INC., CITIGROUP GLOBAL MARKETS INC. F/K/A SALOMON SMITH BARNEY INC. AND JACK GRUBMAN,

Defendants-Appellants.

BERNARD EBBERS, SCOTT SULLIVAN, DAVID MYERS, BUFORD YATES, JR., JAMCES C. ALLEN, JUDITH AREEN, CARL J. AYCOCK, MAX E. BOBBITT, FRANCESCO GALESI, CLIFFORD L. ALEXANDER, JR., STILES A. KELLETT, JR., GORDON S. MACKLIN, JOHN A. PORTER, BERT C. ROBERTS, JR., JOHN W. SIDGMORE, LAWRENCE C. TUCKER, ARTHUR ANDERSEN LLP, J.P. MORGAN CHASE & CO., BANC OF AMERICA SECURITIES LLC, DEUTSCHE BANK SECURITIES INC., CHASE SECURITIES INC., LEHMAN BROTHERS INC., BLAYLOCK & PARTNERS, L.P., CREDIT SUISSE FIRST BOSTON CORP., GOLDMAN SACHS & CO., UBS WARBURG LLC, ABN/AMRO INC., UTENDAHL CAPITAL, TOKYO-MITSUBISHI INTERNATIONAL LPC, WESTDEUTSCHE LANDESBANK GIROZENTRALE, BNP PARIBAS SECURITIES CORP., CABOTO HOLDING SIM S.P.A., FLEET SECURITIES, INC., AND MIZUHO INTERNATIONAL PLC,

Defendants.

STATEMENT PURSUANT TO RULE 26.1

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, counsel for Plaintiffs-Appellees states as follows:

1. The New York State Common Retirement Fund is not a corporate party.

2. The Fresno County Employees Retirement Association is not a corporate party.

3. The County of Fresno, California is not a corporate party.

4. HGK Asset Management, Inc. has no parent corporation and no publicly held corporation owns 10% or more of its stock.

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PRELIMINARY STATEMENT

The District Court (Cote, J.) properly applied well-settled principles of Fed. R. Civ. P. 23 and securities law jurisprudence to conclude that this consolidated action satisfied the requirements for certification of the proposed class. None of the arguments raised on appeal demonstrates that Judge Cote erred in the slightest – let alone abused her discretion in addressing the class motion.

This is especially so concerning the principal issue presented on appeal – whether analysts should be exempt from the fraud-on-the-market presumption of *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988), and its progeny, which rests on the well-settled hypothesis that "[b]ecause most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations … may be presumed for purposes of a Rule 10b-5 action." *See also In re Ames Dept. Stores, Inc., Stock Litig*., 991 F.2d 953, 967 (2d Cir. 1993). The District Court correctly rejected the invitation of Salomon Smith Barney, Inc. ("Salomon" or "SSB"), Jack Grubman, and Citigroup, Inc. (together, the "Salomon Defendants" or "Appellants") to create an unprecedented exception for analysts, who are specifically paid to disseminate information into the marketplace with the intent to influence the purchase or sale of a company's securities. Though Appellants argue that the District Court erred as a matter of law, they provided the District Court no legal authority for the remarkable notion that the fraud-on-the-market theory should exclude analysts' statements from the mix of

information that influences investors, and they have not cured this deficiency in their appellate brief.

The Salomon Defendants also side-step the many factual underpinnings of the District Court's ruling. The District Court noted that they ignored virtually every allegation of the complaint it had previously held amply satisfied the heightened pleading standards of the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 743 ("PSLRA"), as well as evidence submitted on the class motion. Those allegations, buttressed by that evidence, show that Salomon's analyst Grubman was a *de facto* insider who knowingly and/or recklessly made materially false statements about WorldCom's financial health to a market that considered him the analyst who, according to an article appended to the Salomon Defendants' expert report, could "move billions of dollars into or out of a stock with just one research report." SPA-32, n.44. The Salomon Defendants failed to acknowledge Grubman's role as the pre-eminent telecommunications analyst; failed to provide any explanation why Salomon paid Grubman $20 million annually if his reports were irrelevant to the market; and failed to explain why Grubman issued numerous reports urging investors to purchase WorldCom stock if his views were not likely to influence investors. SPA-31. Applying the "common sense and probability" standard of *Basic* to the ample record, the District Court reasonably, and correctly, concluded that the presumption was applicable. SPA-31-32.

Upon closer examination, Appellants' quarrel is not so much with how the District Court applied *Basic* but with *Basic* itself. They seek to disparage that seminal decision, casting it as a mere 4-2 decision and adding footnotes presumably intended to suggest that it would be decided differently if it were decided by today's Supreme Court (or Appellants' preferred economists). SSB Br. at 1-2 & n.1, 21 n.15. But *Basic* is hardly the tenuous authority Appellants claim: it remains binding precedent that is repeatedly cited in subsequent decisions. *See, e.g., DiRienzo v. Philip Services Corp.*, 294 F.3d 21, 33 (2d Cir.) ("The fraud-on-the-market theory itself illustrates investors' reliance on accurate and complete information") , *cert. denied*, 537 U.S. 1028 (2002); *DeMarco v. Robertson Stephens Inc.*, 2004 WL 51232 (S.D.N.Y. Jan. 9, 2004).

Although they seek to portray the class certification order as an unprecedented anomaly, it is Appellants who seek to rewrite the law. Numerous district courts in this Circuit, including the District Court below, have considered whether the fraud-on-the-market doctrine applies to material public statements made by securities analysts about the companies they cover, and every court has unequivocally held that it does. *See, e.g., In re WRT Energy Sec. Litig.*, 1997 WL 576023 (S.D.N.Y. Sept. 15, 1997) (Keenan, J.), *vacated and remanded on other grounds*, 75 Fed. Appx. 839 (2d Cir. 2003); *In re Credit Suisse First Boston Corp. Sec. Litig.*, 1998 WL 734365 (S.D.N.Y. Oct. 20, 1998) (Koeltl, J.); *Robertson Stephens*, 2004 WL 51232, at *7 (Lynch, J.); *Demarco v. Lehman Brothers Inc.*, 2004 WL 602668, *3 (S.D.N.Y. March 29, 2004) (Rakoff, J.). In

stark contrast, Appellants not cited a single decision by *any* court holding to the contrary. As Judge Lynch recently held:

> An underwriter … that has a research department engaged in the business of analyzing companies in order to disseminate to the investing public information and opinions about specific securities clearly intends that the market take into account its recommendations to buy or sell such securities. It is axiomatic that prices in an open market reflect supply and demand, and it is disingenuous, to say the least, for defendants to now argue that their published purchase recommendations are somehow excluded from the information available to market actors when valuing securities.

Robertson Stephens, 2004 WL 51232, at *7.

Faced with this case law, the Salomon Defendants try to create the impression that the Class will be unmanageable because individual issues will supposedly predominate over common issues. They claim that because they will seek to rebut the presumption of reliance, thousands of mini-trials will be required, thereby overwhelming the common issues of fact and law found by the District Court. SSB Br. at 49-56. As Lead Plaintiff demonstrates below, this argument is nonsense. These same arguments could be made by *any* defendant, including an issuer. While defendants in *any* securities class action may attempt at trial to rebut the fraud-on-the-market theory of reliance, the presumption is rebutted "by showing the inapplicability of the fraud-on-the-market theory (*i.e.*, because the relevant securities market is not an 'efficient' market) and does not require a myriad of individual determinations." *Dunnigan v. Metropolitan Life Ins. Co.*, 214 F.R.D. 125, 140 n. 12 (S.D.N.Y. 2003); *accord RMED Int'l, Inc. v. Sloan's Supermarkets, Inc.*, 185 F.Supp.2d 389, 404 (S.D.N.Y. 2002). If

Appellants – who have never contended that the market for WorldCom securities was inefficient – were correct that they are entitled to rebut the presumption by holding mini-trials on each class member's reliance on a particular statement, it would effectively render that doctrine a nullity.

Appellants also overreach in arguing that there are differences in the extent and duration of market influence when the speaker of false statements is an analyst and not an issuer. SSB Br. at 24-31. According to Appellants, because a company's false statements were bound to distort the market price and do so "throughout the class period until they were corrected," the Supreme Court adopted the fraud-on-the-market presumption in *Basic* for issuers *alone*. *Id*. at 24. But *Basic* did not limits its analysis, and instead specifically noted that whether misrepresentations caused a price distortion and could keep an "information-hungry" market misinformed throughout a class period, were matters for trial. 485 U.S. at 248, 249 n.29.

Appellants are also unhappy that the District Court hewed to the fundamental jurisprudence governing consideration of class motions, including this Court's oft-repeated caution that district courts are not to resolve disputed issues of fact that go to the underlying merits when considering class certification. *In re Visa Check/MasterMoney Antitrust Litig*., 280 F.3d 124, 134-35 (2d Cir. 2001); *Caridad v. Metro-North Commuter R.R.*, 191 F.3d 283, 291 (2d Cir. 1999). For example, Appellants argue that other factors (including the so-called market "bubble") caused plaintiffs' losses; that institutional investors did not rely on Grubman's reports; and that

Grubman did nothing other than repeat what WorldCom said. Each of these contentions raises fact issues that are inappropriate to resolve at the class stage. Further, viewing the extensive record as a whole, the District Court concluded that for purposes of the class motion Lead Plaintiff had adduced sufficient detailed factual allegations to support each claim against the Salomon Defendants.[1]

Finally, the District Court did not abuse its discretion in rejecting Appellants' plea that certification of this class would subject them to unfair settlement pressure. This is no strike suit. The case is being prosecuted by the second largest public pension fund in the Nation. The Salomon Defendants include an analyst who agreed to pay a record $15

[1] Appellants have broadened their attack on the decision below to include reference to post-certification developments such as the February 2004 publication of the third and final report of the bankruptcy examiner ("Examiner") and the March 2004 guilty plea of WorldCom's former CFO. Leaving aside whether these subsequent developments have any bearing on the District Court's October 2003 certification decision, Appellants cite such matters at their peril. As discovery has continued to unfold, Salomon was recently forced to concede that certain highly probative materials were not produced to the Examiner. Further, Lead Plaintiff has adduced additional compelling evidence demonstrating: (1) Grubman fraudulently manipulated the underlying financial analyses he used to value WorldCom stock to maintain falsely inflated target prices for the stock and justify a "buy" rating, even though WorldCom's performance did not satisfy Salomon's own criteria to earn such a rating; and (2) the most senior officers of Salomon privately acknowledged that its investment bankers successfully pressured its analysts to avoid negative ratings, and that providing accurate stock ratings conflicted with Salomon's paramount goal of securing investment banking business, and not giving true and accurate information to investors. While Lead Plaintiff does not believe that weighing the merits (or the underlying evidence in support) of the claims is necessary or appropriate when considering whether the District Court acted within its discretion in certifying the Class, it is constrained to respond to Appellants' entirely inappropriate argument. Absent an affirmative disavowal in Appellants' reply of any reliance on the Examiner's report, Lead Plaintiff will seek leave to supplement the record with the materials described above.

million fine and suffer a lifetime ban from the securities industry for issuing false and misleading analyst reports, and Salomon itself, which paid a record $400 million fine for its corrupt use of ostensibly independent and objective research to curry favor with prospective investment banking clients. The claims against these defendants were sustained as having satisfied the exacting pleading standards of the PSLRA. If the claims lack evidentiary support as the Salomon Defendants contend, they will be disposed of at summary judgment.

The District Court's class ruling was proper and should be affirmed in all respects.

COUNTER-STATEMENT OF THE ISSUES PRESENTED

1. Did the District Court act within its discretion when it rejected the invitation to create an unprecedented "analyst exception" to the fraud-on-the-market presumption of *Basic Inc. v. Levinson* and its progeny for Salomon and its influential telecommunications analyst Jack Grubman, whom Salomon paid $20 million annually to influence investment decisions of investors in WorldCom and other companies?

2. Did the District Court act within its discretion when, after examining each issue Appellants claimed would require thousands of mini-trials, it concluded that they had neither rebutted any applicable presumption of reliance nor shown that individual issues would predominate?

3. Did the District Court act within its discretion when, having previously determined that the Complaint's allegations of fraud as to Grubman and Salomon amply satisfied the heightened pleading standards of the PSLRA, it concluded that the fact-intensive issues presented by Appellants were appropriately reserved for trial and provided no basis to deny class certification?

COUNTER-STATEMENT OF THE CASE

This litigation arises from the largest corporate scandal in history, a fraud that inflicted billions of dollars of damage across a broad swath of the investing public and triggered the largest bankruptcy in American history. The scores of resulting actions brought by defrauded investors were transferred by the J.P.M.D.L. to the Southern District of New York, assigned to Judge Cote, and consolidated under the caption *In re WorldCom, Inc. Securities Litigation*. On August 15, 2002, the District Court appointed the New York State Common Retirement Fund ("NYSCRF"), which had lost over $300 million as a result of its purchases of WorldCom securities, as Lead Plaintiff for the prospective class. On October 11, 2002, the NYSCRF filed a Consolidated Class Action Complaint (A-163-335, "Complaint") and, on August 1, 2003, a First Amended Class Action Complaint (A-406-662, "Amended Complaint").

The District Court's opinion sets forth the identity of the defendants in this Action and the various claims asserted against them. *See* SPA-9, 12; *see also In re WorldCom, Inc. Sec. Litig.*, 294 F.Supp.2d 392, 398-406 (S.D.N.Y. 2003). Of particular relevance to this appeal, the claims against the Salomon Defendants consist of Securities Act claims based on Salomon's position as a lead underwriter for WorldCom's $5 billion May 2000 bond offering and $11.8 billion May 2001 bond offering (together, the "Offerings"), the latter of which was the largest in American history, and Exchange Act claims based on the registration statements for the Offerings and the reports issued by Salomon and Grubman during the class period. This appeal does not seek to overturn

the District Court's certification of the case with respect to any Securities Act or Exchange Act claims asserted against defendants other than Appellants.[2]

A. The Motion to Dismiss

The Salomon Defendants and other defendants named in the Complaint moved for dismissal under Fed. R. Civ. P. 12(b)(6).[3] The Salomon Defendants raised three primary arguments in support of their motion to dismiss the Exchange Act claims: (1) the Complaint's allegations failed to satisfy the requirements of the PSLRA and Fed. R. Civ. P. 9(b), particularly concerning whether Grubman had knowingly or recklessly issued false and misleading statements; (2) there were insufficient allegations demonstrating that concealment of an illicit *quid pro quo* arrangement with WorldCom and certain WorldCom insiders caused a loss to any investors; and (3) the Salomon Defendants could not be liable for failure to disclose the illicit relationship because they disclosed all that was required of them under NASD and NYSE rules. Notably, the Salomon Defendants did *not* raise any issue concerning the materiality of Grubman's

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[2] Certain underwriter defendants, including Salomon, sought interlocutory review of the District Court's ruling certifying the class for Counts IV and V. That motion was denied by this Court on December 31, 2003.

[3] Prior to filing its motion to dismiss, Salomon moved to sever the Exchange Act claims (Counts IX, X and XI) from the Securities Act claims brought against Salomon in connection with the Offerings (Counts IV and V). The District Court denied that motion, holding that the operative facts implicated in all of these counts were inextricably woven such that litigating them in one proceeding would be fair and serve judicial economy. *In re WorldCom, Inc. Sec. Litig.*, 2003 WL 1563412, at *3-5 (S.D.N.Y. March 25, 2003).

statements; nor did they raise any issue concerning the propriety of applying the fraud-on-the-market presumption of *Basic* to an analyst's statements.

On May 19, 2003, the District Court denied the Salomon Defendants' motion to dismiss in its entirety. *See* 294 F. Supp.2d at 424-31. Of particular significance here, the District Court held:

> The Complaint sufficiently alleges scienter with respect to the analyst reports, not only for the failure to disclose the *quid pro quo* relationship [between Salomon and WorldCom] but also for the misrepresentations concerning WorldCom's financial condition. There are also sufficient allegations that Grubman and SSB knew enough about WorldCom's actual financial condition to understand that their descriptions of that condition in the analyst reports were false and misleading.

Id. at 425.

Among the "detailed and abundant" allegations cited by the District Court were the unusually close relationship between Grubman and WorldCom on which he was reporting, including attendance at board meetings where two of WorldCom's most significant acquisition candidates were discussed, and "strong circumstantial evidence that Grubman changed his analytical model for valuing WorldCom – and WorldCom alone among the companies be covered – to camouflage WorldCom's faltering business." *Id*.

The District Court concluded that Lead Plaintiff had sufficiently alleged particularized facts showing "that at a minimum, Grubman was not functioning as an independent analyst, but had been corrupted, and withheld from his readers his serious concerns about the accuracy of the WorldCom financial information that he was

conveying to them and about the reliability of his advice to them." *Id*. at 427. The District Court further noted that many of the arguments (and materials) presented by the Salomon Defendants were more properly submitted with a motion for summary judgment or at trial. *Id*. at 427 n.25, 430, 432.

B. The Motion for Class Certification

Pursuant to Rule 23's directive that class certification be determined as soon as practicable, the District Court directed Lead Plaintiff to file its motion for class certification within two weeks of the decision on the motions to dismiss, namely, by June 4, 2003. The District Court permitted defendants to seek discovery of Lead Plaintiff and the three named plaintiffs even before the motion was filed.[4] *See* A-38, item 232 (Order of May 19, 2003). The parties thereafter conducted extensive discovery, and the class motion was fully submitted on October 10, 2003. Among the voluminous materials submitted to the District Court were competing expert reports from Salomon's loss causation expert, Dr. Robert Comment, who asserted that Lead Plaintiff had not demonstrated a causal link between Grubman's statements and WorldCom's stock price (A-774-839, A-4388-4403), and Lead Plaintiff's expert, Frank Torchio, who concluded that Grubman's reports did have a statistically significant impact on WorldCom's stock price during the class period (A-3902-3967), as well as

[4] The Complaint included three additional named plaintiffs (Fresno County Employees Retirement Association ("FCERA"), the County of Fresno and HGK Asset Management, Inc.) that had purchased bonds in the Offerings.

declarations appending deposition transcripts and hundreds of news articles and other items. (A-840-1650, A-1651-3311, A-3446-4365).

On October 24, 2003, the District Court certified the class of all persons and entities who acquired publicly traded securities of WorldCom from April 29, 1999 through June 25, 2002, and were injured thereby ("the class"). SPA-8-9, 39. The District Court certified the class with respect to

all claims in the Complaint, including the claims against the Salomon Defendants based on the registration statements for the Offerings (Counts IV, V, IX and part of XI) as well as analyst reports issued by Salomon and Grubman (Counts X and part of XI). The present appeal concerns only Counts IX, X and XI.

In opposing certification, Appellants argued that it was unreasonable to apply the *Basic* presumption of reliance to analysts because they are not likely to influence market prices; that Lead Plaintiff had failed to prove loss causation; and that the "conflict of interest" claim (as characterized by Salomon) could not proceed because the market had long been aware that Grubman was a conflicted analyst. In rejecting Salomon's arguments, the District Court noted that they "emerge[d] from several false premises." *First*, as the District Court had previously found in rejecting the severance motion, "there is no conflict of interest 'claim,' and there is no separate complicity 'claim.'" SPA-30. Rather, the *quid pro quo* relationship was integral to the allegations that both Grubman and Salomon made false statements because it explained why the Salomon Defendants "were willing to misrepresent WorldCom's financial condition to the public, both through Registration Statements and through the analyst reports." *Id*. *Second*, the District Court rejected the argument that Lead Plaintiff had to prove reliance on the failure to disclose the illicit relationship between Salomon and WorldCom, holding that reliance is presumed if an omission is material. *Id*., citing *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972).

Third, the District Court found that the Salomon Defendants' arguments were "dependent on highly contested facts," and ignored "the detailed allegations in the Amended Complaint in favor of their own selective presentation of facts and argument." SPA-30.[5] For instance, the Salomon Defendants argued: (1) because no regulator had asserted that Salomon or Grubman knew of or participated in the fraud at WorldCom, Lead Plaintiff would not succeed in showing they were participants; (2) Grubman's reports could not have affected the price of WorldCom's securities since he was a mere analyst (and only one of thirty-five reporting on WorldCom); and (3) the market was already saturated with disclosures about Grubman's conflicted relationship with WorldCom. The District Court rejected these arguments based on the facts alleged in the Amended Complaint and evidence submitted in connection with the class motion, and ruled, consistent with this Circuit's precedents, that "[t]he motion for class certification is simply not the correct forum to resolve hotly contested factual disputes." SPA-31.

The District Court also properly rejected the principal argument raised on this appeal, namely, that the fraud-on-the-market presumption cannot be applied to analysts

[5] The decision to certify the class was made by reference to the Amended Complaint, which was filed August 1, 2003, and added, *inter alia*, further detailed allegations regarding the conduct of Salomon and Grubman, and the illicit relationship between and among Salomon, Grubman, Citigroup, WorldCom and WorldCom's CEO Bernard Ebbers. The District Court considered these additional facts relevant to the class certification determination, noting the Salomon Defendants' "fact-bound arguments" and stating "it has been helpful to have the detailed allegations against the SSB defendants in the amended pleading." SPA-31, n.41.

generally or to Grubman's reports in particular. Specifically addressing the competing expert reports, the District Court stated:

> SSB contends that intervening factors, specifically the collapse of the telecommunications sector and WorldCom's own disclosure of its accounting fraud, cause the plaintiff's losses. Although this argument may be more apt as a summary judgment argument addressed to the plaintiffs' burden to show loss causation, SSB now argues that this evidence will in fact rebut the presumption of reliance at trial. Needless to say, the plaintiffs have a very different view of the relevant data and what it shows. If this should in fact be treated as an argument concerning reliance, then it is one that applies equally to the entire class and does not demonstrate the existence of individual issues or overcome the predominance of the common issues. Moreover, the SSB defendants have not sufficiently shown that Dr. Comment's analysis will succeed in rebutting the presumption of reliance such that it is appropriate to conclude that there will be no such presumption available at trial and that individual issues will come to predominate over common ones.

SPA-31-32. Consistent with the rulings in *Caridad*, 191 F.3d at 292-93, and *Visa Check*, 280 F.3d at 134-35, the District Court declined to decide which side's expert a jury would find more persuasive, properly leaving that dispute for trial. SPA-32.[6]

Finally, as to the argument that certifying the class would unfairly coerce the Salomon Defendants to settle, the District Court recounted that the claims had survived a motion to dismiss, and that these defendants had not shown that certification was improper or a violation of their rights. The District Court found that this case "is not a strike suit filed by professional plaintiffs in order to coerce a settlement unfairly from the defendants." SPA-38-39.

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[6] The District Court also rejected the arguments that common issues would be overwhelmed by individualized issues on matters such as loss causation and statute of limitations. SPA-34-36.

COUNTER-STATEMENT OF THE FACTS

A. Jack Grubman, Salomon and WorldCom.

The story of WorldCom cannot be told without explaining the role that Salomon and Grubman, Salomon's premier telecommunications analyst, played in the rise and fall of what once was America's second largest long-distance provider. Until his resignation from Salomon in August 2002, Grubman was the most influential telecommunications analyst in the country, and one of the most powerful men on Wall Street. SPA-11. As *Time* reported in August 2002, "every big investor knew Grubman was the 'ax', the one man who could make or break any stock in the [telecom] industry with a thumbs-up or thumb-down." *Id*. In May 2000, *Business Week* reported that Grubman "can move billions of dollars into or out of a stock with just one research report," *id.*, and Grubman himself boasted that through his research reports he was "sculpting the [telecom] industry." A-506-07, A-4096. Grubman's influence was so pervasive that Salomon specifically solicited prospective investment banking clients by promising them that Grubman would "support" the stock with favorable research reports if they retained Salomon as their investment banker. A-4111.

Fueled by Grubman's research reports, by the late 1990's Salomon had become the pre-eminent investment banking firm in the telecom industry, collecting fees of approximately $1 billion for investment banking services provided to the telecom industry between 1997 and 2001. SPA-11. During this same time period, WorldCom became Salomon's most important investment banking client, paying Salomon over

$100 million over the course of twenty-three transactions. *Id*. Grubman made about $20 million annually, tied in large part to the income Salomon derived from his involvement in its investment banking transactions. *Id.*

In exchange for WorldCom's lucrative investment banking business, Grubman issued a series of unrelentingly positive research reports about WorldCom. In the face of a declining telecom market, Grubman consistently urged investors to "load up the truck" and be "massively aggressive" buyers of WorldCom stock, admonishing "any investor who does not take advantage of current prices to buy every share of WCOM they can should seriously think about another vocation." A-516-21. Lead Plaintiff alleges that these reports, which were publicly disseminated to the market, artificially inflated the price of WorldCom stock. A-522-26, A-530, A-648.

While the Salomon Defendants portray Grubman as somehow indistinguishable from the many analysts who followed WorldCom, that assertion is flatly contradicted by the allegations of the Amended Complaint and the record presented to the District Court. *E.g.*, SPA-31 & 33 n.46. Indeed, on numerous occasions during the class period, market commentators and respected financial publications specifically attributed significant changes in WorldCom's stock price to Grubman's reports.

Grubman's influence was derived in large part from the fact that investors – including large institutional investors – viewed him as a WorldCom insider, who had unparalleled access to WorldCom's CEO and CFO and to material, non-public information. Grubman attended WorldCom board meetings – unprecedented for an

analyst – and served as WorldCom's financial advisor on the most significant transactions in its history – the merger with MCI in 1998 and the proposed merger with Sprint in 1999. A-514-15. And Grubman held as much sway with WorldCom senior management as he did with investors. For example, when WorldCom was considering acquiring Nextel Communications, Grubman left a voicemail for WorldCom's CFO, Scott Sullivan, advising him not to acquire Nextel. A-508. Two days later, WorldCom announced it was terminating the discussions. *Id.* Grubman even took the extraordinary step of helping WorldCom's CEO Ebbers script statements he would make to investors during quarterly investor conference calls – and Grubman intentionally asked management "softball" questions during these calls (which he cleared with management to make sure he got "the right answer"). *See, e.g.*, A-526-30, A-649-50. Thus, notwithstanding SEC Regulation FD (cited at SSB Br. at 27-28, as "proof" that Grubman merely commented on publicly-available information), Grubman and his team routinely sought and received access to non-public financial information from senior WorldCom officers. A-534-35.

B. The Salomon Defendants' Fraudulent Scheme.

As was ultimately revealed, Grubman's positive reports about telecommunication companies were part of a fraudulent scheme that the New York State Attorney General called "commercial bribery." To obtain WorldCom's coveted investment banking fees, Appellants enticed WorldCom's executives with (1) hundreds of thousands of risk-free shares in "hot" IPOs, which Salomon knew would be worth millions to these executives

(A-499-503); (2) over one-half billion dollars worth of loans to Ebbers, with a material portion being secured by Ebbers' holdings of WorldCom stock (A-538-48); and (3) a guarantee of favorable analyst reports issued by Grubman to boost the value of the Company's stock price. SPA-11.[7]

Notwithstanding that the conflicts that pervaded the Grubman/Salomon/Citigroup-Ebbers/WorldCom relationship compromised the objectivity and integrity of Salomon's reports about WorldCom and the registration statements issued in connection with the May 2000 and May 2001 Offerings, the highly material facts concerning this illicit *quid pro quo*

[7] Ebbers received allocations of hot IPO shares on over twenty occasions between 1995 and 2000, realizing over $11.5 million in proceeds. A-502. CFO Sullivan and WorldCom director Stiles Kellett also received material amounts of hot IPO shares. *Id*. Citibank loaned Ebbers approximately $53 million in 1999 secured by Ebbers' WorldCom stock, and, around the same time, Travelers Insurance Company, a Citigroup company, loaned a shell company owned by Ebbers one half billion dollars, and became equity partners with WorldCom's CEO in his timber business. A-541-48. Grubman was involved in the loans and IPO allocations to Ebbers. A-508-09, A-548.

relationship were never disclosed to investors, who relied on the integrity of the market price for WorldCom that was inflated by Grubman's positive ratings. A-499.

At the same time Salomon was assuring investors that its analysts were providing independent objective and unbiased reports investors could rely upon in reaching investment decisions, A-504, Salomon's senior management was acknowledging internally that the integrity and objectivity of its research department had been compromised by the drive for investment banking business. John Hoffmann, Salomon's former Director of Global Equity Research, informed Salomon's then-CEO there was a "legitimate concern" about the objectivity of Salomon's analysts and a "rising issue of research integrity" and a "basic inherent conflict" between investment banking and research. A-505-06. In a February 2001 memorandum, Hoffmann reported that the head of Salomon's broker division had called Salomon's research "basically worthless." A-506. Grubman himself acknowledged in emails to his supervisors in July 2001 that "most of our banking clients are going to zero and you know I wanted to downgrade them months ago but got huge pushback from banking," and around May 2001 told a colleague that "[i]f anything the record shows we support our banking clients too well and too long." A-509. Indeed, in late 1999, Grubman altered his valuation model in order to obscure WorldCom's deteriorating financial condition, A-531, and he continued to publish glowing reports on WorldCom, even though he knew that its business was deteriorating and the company was not the consistent "buy" he said it was. A-522.

C. The Fraud is Revealed.

On April 21, 2002, Grubman finally did what his own financial models indicated he should have done long before – downgrade WorldCom from "Buy" to "Neutral." A-524-25. The market's reaction was swift and severe: WorldCom lost a third of its value on the first trading day after the downgrade and another fifteen percent the following day, on record volume. *Id*. The financial media specifically attributed investors' mass exodus from WorldCom to Grubman's move. *Id*. On June 24, 2002, Grubman again downgraded WorldCom, from "Neutral" to "Underperform." *Id*. Once again, the stock reacted dramatically, falling 25% on the next trading day, and once again, the financial press cited Grubman as the reason for the drop. *Id.*

On June 25, 2002, WorldCom announced that an internal audit had uncovered $3.8 billion in improperly recorded earnings and that WorldCom would restate its financial statements for 2001 and the first quarter of 2002. A-524. The following day, the SEC filed a complaint against accusing WorldCom of fraud. On June 27, the House Committee on Financial Services announced it would hold hearings on the events surrounding WorldCom's announcement. *Id*. At those hearings, Grubman was questioned about his role in WorldCom's collapse, and notably feigned ignorance of the hot IPO allocations provided to Ebbers. *Id.* On July 21, 2002, WorldCom filed for bankruptcy protection under Chapter 11 – the largest bankruptcy in United States history. A-413. Former WorldCom CFO Sullivan was indicted for fraud on August 28, 2002, and four other senior WorldCom employees thereafter pled guilty to multiple

felonies, including securities fraud and conspiracy to commit securities fraud. A-413-15.

Salomon announced Grubman's resignation on August 16, 2002. A-430. On April 28, 2003, Salomon agreed to a settlement of claims involving its research practices brought by the SEC and several State and market regulators. As part of the settlement, Citigroup agreed to pay $400 million. In a similar settlement, Grubman agreed to pay $15 million and accept a life-time ban from the securities industry.[8]

SUMMARY OF ARGUMENT

The central thrust of the current appeal is predicated not upon some issue of class certification, but rather an attempt to utilize Rule 23(f) to mount an interlocutory attack upon the District Court's substantive rulings on Lead Plaintiff's claims. Reduced to its essentials, this appeal argues that the District Court committed a substantive error of law in sustaining the Complaint and concluding, following *Basic* and *Affiliated Ute*, that the presumption of investor reliance upon false public statements in an efficient market for securities applies to the knowing and reckless false public statements of analysts. As shown below, however, the District Court properly rejected Appellants' request to create an unprecedented and unsupportable "analyst exception" to the fraud-on-the-market presumption established in *Basic*.

[8] April 28, 2003 Joint Press Release: Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking, *available at* http://www.sec.gov/news/press/2003-54.htm.

Appellants also quarrel with the District Court's findings that common questions of fact exist and predominate in this case and warrant

certification of the class. As shown below, however, those findings, which are entitled to great deference, were amply supported by the allegations in the Amended Complaint, as well as evidence submitted on the class motion and Lead Plaintiff's expert analysis.

The District Court's class certification decision is well-supported by the law in this Circuit and the record submitted below, does not in any way constitute an abuse of its broad discretion on class certification issues, and should not be disturbed here.

STANDARD OF REVIEW

A district court's grant of a motion for class certification is reviewed under a deferential standard. *Visa Check*, 280 F.3d at 132. "Provided that the District Court has applied the proper legal standards in deciding whether to certify a class, its decision may only be overturned if it constitutes an abuse of discretion." *Caridad*, 191 F.3d at 291; *Visa Check*, 280 F.3d at 132.

This Court has expressed its "longstanding view that the District Court is often in the best position to assess the propriety of the class and has the ability, pursuant to Rule 23(c)(4)(B), to alter or modify the class, create subclasses, and decertify the class whenever warranted." *In re Sumitomo Copper Litig.*, 262 F.3d 134, 139 (2d Cir. 2001). Accordingly, the Court is more deferential to the district court where, as here, class certification was granted. *Caridad*, 191 F.3d at 291-92.

ARGUMENT

The District Court applied the proper standard for determining Lead Plaintiff's class motion. Before certifying a class, a district court must be persuaded, "after a

rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied." *Caridad,* 191 F.3d at 291, *quoting General Telephone Co. v. Falcon*, 457 U.S. 147, 157 n.13 (1982). However, this is "not an occasion for examination of the merits of the case" and does not mean that a plaintiff must prove its claims to prevail. *Visa Check*, 280 F.3d 124, 135. To the contrary, "nothing in either the language or history of Rule 23 … gives a court any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action." *Caridad,* 191 F.3d at 291, *quoting Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974).

Further, while a district court may consider expert testimony, it "may not weigh conflicting expert evidence or engage in 'statistical dueling' of experts." *VISA Check*, 280 F.3d at 135; *Caridad*, 191 F.3d at 292. The relevance of expert testimony at the class certification stage is to demonstrate the existence or absence of common questions, and not whether an expert will ultimately be persuasive at trial. *Caridad*, 191 F.3d at 292-293.

I. THE DISTRICT COURT PROPERLY APPLIED THE PRESUMPTION OF RELIANCE BASED UPON FRAUD-ON-THE-MARKET AND MATERIAL OMISSIONS.

A. Applying the Fraud-on-the-Market Presumption to Certify Claims Against the Salomon Defendants for Knowingly False Statements is Consistent with Precedent, Common Sense, and the Record.

1. This appeal constitutes an unwarranted assault on *Basic*'s fraud-on-the-market doctrine.

The Salomon Defendants and their ally, the Securities Industries Association ("SIA"), would have this Court believe that it is writing on a blank slate – or at least one

with significant gaps – in addressing the contours of the fraud-on-the-market doctrine. Each appellate brief spills considerable ink arguing the merits of the doctrine and the associated efficient capital market hypothesis. After paying lip service to *Basic*, Appellants argue that *Basic* was decided when this hypothesis was "close to its zenith" in acceptance among economists and that a "large body of economic literature" criticizes the doctrine.[9] SSB Br. at 21-22 n.15. SIA is even bolder in citing a report prepared by a senior vice president and a senior consultant of the firm that assisted the underwriter defendants in opposing class certification in this case, which, not surprisingly, concludes that "the presumption of reliance under *Basic* is no longer valid." SIA Br. at 18-19. In effect, the Salomon Defendants and SIA seek to use this Rule 23(f) appeal to rewrite decades of judicial history and effectively undo, or at least severely curtail, the Supreme Court's decision in *Basic*.

The case law does not support Appellants' assertions. In recent years numerous courts, including this Court, have endorsed the fraud-on-the-market doctrine as reflecting the "investors' reliance on accurate and complete information." *DiRienzo v. Philip Services Corp*., 294 F.3d at 33; *see also Ames Dept. Stores*, 991 F.2d at 967 ("the fraud-on-the-market theory is premised on the notion that fraud can be committed by

[9] It should be noted that the efficient capital market hypothesis retains substantial academic support. *See, e.g.*, Burton G. Malkiel, *The Efficient Market Hypothesis and Its Critics*, 17 Journal of Economic Perspectives 59-82 (Winter 2003); Mark Rubinstein, *Rational markets: Yes or no? The affirmative case*, 57 Financial Analysts Journal 15-29 (May-June 2001).

any means of disseminating false information into the market on which a reasonable investor would rely") (emphasis added).

2. No court has limited *Basic* to statements of issuers or their officers or held that analysts' statements cannot give rise to fraud-on-the-market.

The essence of the fraud-on-the-market theory is that in an open and developed securities market, the price of a security is determined by all available material information. The market acts as the unpaid agent of the investor, informing him that, given all of the available information, the value of the stock is worth its current market price. Therefore, if the market is affected by materially misleading public statements, this will defraud investors who purchase the stock, even if the purchasers do not rely directly on the misstatements, because the price they pay will be based in part on the misinformation. *Basic*, 485 U.S. at 241-44. The Supreme Court reasoned that "an investor's reliance on *any* public material misrepresentations … may be presumed for purposes of a Rule 10b-5 action." *Id.* at 246-47 (emphasis added).

Nothing in *Basic* or subsequent decisions interpreting it suggests that its analysis, as well as the underlying considerations of fairness, public policy and judicial economy, are limited to cases brought against corporate issuers or their officers. *Id*. at 244-47; *see also Fine v. American Solar King Corp*., 919 F.2d 290, 298-99 (5th Cir. 1990) (accountants); *Cromer Finance Ltd. v. Berger*, 205 F.R.D. 113, 128-30 (S.D.N.Y. 2001) (same); *In re Union Carbide Corp. Consumer Products Business Sec. Litig*., 676 F.Supp. 458, 465-71 (S.D.N.Y. 1987) (investment banking and accounting firms).

These policy considerations were clearly understood by the District Court here, which precisely followed both this Court's and the Supreme Court's embrace of the fraud-on-the-market presumption of reliance. SPA-24.

Both the Salomon Defendants and SIA seek to immunize analysts from liability for knowing misrepresentations, even though they are in the very business of issuing publicly disseminated reports and encouraging investors to act upon them. A-4141. Notwithstanding *Basic*'s express approval of the fraud-on-the-market doctrine, 485 U.S. at 246-47, Appellants contend that the presumption of reliance must be limited to only statements of issuers or their officers, and cannot be applied to analysts who act in concert with them. SSB Br. at 24-33; *see also* SIA Br. at 11-19.

The District Court – noting that Appellants cited no supporting legal authority for "this remarkable assertion" – rejected the argument and concluded that there is no legal barrier to applying the fraud-on-the-market doctrine to Section 10(b) claims against an analyst. SPA-31. This ruling was amply supported. *See Credit Suisse First Boston Corp.*, 1998 WL 734365 at *8 (Koeltl, J.) (applying fraud-on-the-market to analyst reports); *WRT Energy*, 1997 WL 576023 at *11 (Keenan, J.) (it "is not beyond doubt at this stage of the action that the analyst reports, which typically are widely available and followed closely by investors, influenced the market"). *See also In re Initial Public Offering Sec. Litig.*, 241 F.Supp.2d 281, 359-60, 377-78 (S.D.N.Y. 2003) (Scheindlin, J.) (sustaining Rule 10b-5 claims against underwriters who made material

misrepresentations and issued fraudulent recommendations in their analyst reports to manipulate after-market stock prices).

Subsequent decisions have not only adhered to Judge Cote's view, they have also expressly endorsed her reasoning. In *Lehman Bros.*, 2004 WL 602668 at *3, Judge Rakoff wrote: "This Court agrees [with the rationale of the District Court in *WorldCom*], and therefore declines to exempt the research reports here in question – whose very purpose was to advise Lehman's readers to buy stock in a company … for which Lehman also acted as investment banker … from the reach of the fraud-on-the-market presumption."

And in *Robertson Stephens*, where plaintiffs alleged that the defendant brokerage firm manipulated the price of a company's stock by disseminating analyst reports advising investors to purchase the stock at a time when the brokerage firm believed the stock to be overvalued, Judge Lynch rejected that firm's argument that the fraud-on-the-market theory applies only to misrepresentations by corporate insiders, and not to statements published in analyst reports:

> [D]efendants do not cite a single case holding or even suggesting that the fraud-on-the-market theory extends only to misrepresentations made by individuals presumed to possess inside knowledge.
>
> Nor do the economic principles underlying the doctrine support that assertion, since efficient market theory does not exclude non-insider information from the mix of information factored into share price.
>
> An underwriter like [defendant] that has a research department engaged in the business of analyzing companies in order to disseminate to the public information and opinions about specific securities clearly intends that the market take into account its recommendations to buy or sell such securities.

> It is axiomatic that prices in an open market reflect supply and demand, and *it is disingenuous, to say the least, for defendants to now argue that their published purchase recommendations are somehow excluded from the information available to market actors when valuing securities.*

2004 WL 51232 at *6-7 (emphasis added).

Thus, far from being the anomalous decision characterized by Appellants, Judge Cote's ruling lies comfortably within the applicable jurisprudence.

B. The Salomon Defendants Failed to Establish that the Presumption of Reliance Under the Fraud-on-the-Market Doctrine Does Not Apply Here.

Lacking any supporting legal precedent, the Salomon Defendants and SIA offer a number of subordinate arguments, all predicated upon disputed questions of fact (or economic theory) that are properly reserved for trial, to defeat the presumption of reliance here. Each was considered and properly rejected below.

1. The fraud-on-the-market theory does not devalue statements according to the identity of the speaker.

Appellants and SIA contend that anything stated by an analyst "lacks the information value of factual assertions and the unique authority of the issuer's voice" and, therefore, it is not consistent with "common sense and probability" to apply the presumption of reliance to analyst statements. SSB Br. at 26; SIA Br. at 12-13. However, nothing in *Basic* established an ordinal ranking of sources of public information in an efficient market for securities. In fact, *Basic* directly rejected the suggestion that a court should prejudge the informational value of particular statements based upon the identity of the speaker before applying the presumption of reliance:

> We need not determine by adjudication what economists and social scientists have debated through the use of sophisticated statistical analysis and the application of economic theory. For purposes of accepting the presumption of reliance in this case, we need only believe that *market professionals generally consider most publicly announced material statements about companies*, thereby affecting stock market prices.

485 U.S. at 246 n.24 (emphasis added).

At trial, Lead Plaintiff will have ample basis to argue that Grubman's statements were *no less* influential than WorldCom's (since Grubman was viewed as a *de facto* insider) or even *more* influential (given his reputation as the "ax" who could make or break a telecom stock).

2. Lead Plaintiff made a sufficient showing that Grubman influenced the market for WorldCom securities.

Even if Appellants were correct that a plaintiff must make some showing at the class certification stage that the fraud-on-the-market method for asserting reliance can be applied to a claim against a defendant, Lead Plaintiff satisfied that standard.[10]

The Salomon Defendants attempt to undercut that showing by claiming that Grubman was merely one of many analysts who followed WorldCom, and that his exhortations to investors about WorldCom did not inflate its stock price. As the District

[10] The case law is clear that issues of reliance are *not* sufficient to defeat class certification. *Kamerman v. Ockap Corp.*, 112 F.R.D. 195, 198 (S.D.N.Y. 1986); *In re Gulf Oil/Cities Service Tender Offer Litig.*, 112 F.R.D. 383, 389 (S.D.N.Y. 1986). As for Appellants' effort to discredit *Green v. Wolf Corp.*, 406 F.2d 291, 301 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969), which held that district courts should certify securities actions *even if* reliance involved individual issues, it is clear in this Circuit and elsewhere that courts continue to rely on that precedent. *Schenek v. FSI Futures, Inc.*, 1998 U.S. Dist. LEXIS 11562, * 13 (S.D.N.Y. July 28, 1998).

Court found, however, the argument "ignore[s] virtually every allegation in the lengthy Amended Complaint (as well as evidence uncovered through discovery and submitted in support of this motion)." SPA-31. Specifically, Lead Plaintiff alleged – and submitted supporting evidence – that Grubman was the most influential analyst in the entire telecom sector and one of the most powerful men on Wall Street. *See* A-506-07, A-4043-46, A-4150-51. Grubman had unparalleled access to company insiders and to non-public information, which distinguished him from other analysts and lent extra weight to his reports. A-1025-26, A-4095-105. Grubman was so influential that Salomon enticed prospective investment banking clients by promising them favorable research reports by Grubman, *see* A-4111, and ownership of WorldCom stock in the Salomon Smith Barney retail system increased by almost 700% in one year because of Grubman's buy recommendations. A-4141-42.

The Amended Complaint further alleges, and Lead Plaintiff's expert analysis confirms, that WorldCom's stock rose or fell in response to Grubman's reports, and there were numerous instances where changes in WorldCom's stock price were specifically attributed to Grubman by sophisticated and knowledgeable market commentators. A-522-25, A-4045-46, A-4141-42, A-4143, A-4144-45. Indeed, on both instances near the end of the class period when Grubman reduced his WorldCom rating, the price of WorldCom stock fell dramatically in response. A-524-25, A-4141a-41b.

In addition to relying on the detailed factual allegations in the Amended Complaint and the articles submitted to the District Court, Lead Plaintiff also retained Frank C. Torchio, the president of Forensic Economics, Inc., to evaluate the impact Grubman's reports had on the market. Mr. Torchio stated as a general matter that analysts' statements can and do move the market price of securities:

> Wall Street analysts are generally considered an important source of information on the companies they cover. Analysts develop special expertise in analyzing and projecting the economic performance of the companies. They write detailed reports that are distributed and communicated to investors, they publicly disclose earnings forecasts and future price targets, and rate the stock.

A-3915-16. Mr. Torchio added:

> When analysts revise their forecasts of future earnings upwards, on average stock prices rise. When they cut their earnings forecasts, on average stock prices fall. Likewise, when they revise their stock recommendations upward, say from 'neutral' to 'buy,' on average stock prices rise. When analysts cut their stock recommendations from say 'buy' to 'sell,' on average the stock prices of these firms fall.

A-3916 n.17.

Mr. Torchio also conducted an event study through which he sought to measure the impact of new information contained in Grubman's reports on the price of WorldCom stock. A-3909-10, A-3913-15. Mr. Torchio determined that there were eighteen instances (or "events") during the class period where Grubman's reports contained new or "unanticipated" information. A-3913. He defined such events to include those instances where Grubman either changed his rating or price target for WorldCom, or where contemporaneous news stories or market commentary indicated

that there was a change in the total mix of information in the market because of Grubman. A-3912-13. Mr. Torchio analyzed these eighteen events using a regression model to factor out unrelated causes, and determined that when Grubman's reports contained "unanticipated" information, they had a statistically significant impact on the price of WorldCom stock. He concluded that there was a 99% probability that the changes in WorldCom's stock price that occurred after these eighteen events were caused by Grubman. A-3914.[11]

The Salomon Defendants challenged Mr. Torchio's conclusions in their surreply brief and in a surreply declaration of their expert, and argued that his analysis was flawed in certain respects. The District Court carefully considered both sides' expert reports and, based on its review of all the submissions, found, *inter alia*: (a) the motion for class certification "is simply not the correct forum to resolve hotly contested factual disputes"; and (b) the Salomon Defendants "have not sufficiently shown that Dr. Comment's analysis will succeed in rebutting the presumption of reliance such that it is appropriate to conclude that there will be no such presumption available at trial and that individual issues will come to predominate over common ones." SPA-31–32. These determinations were made using the correct legal standard, and are entitled to deference

[11] One of Mr. Torchio's criticisms of the report submitted by the Salomon Defendants' expert, Robert Comment, was that Dr. Comment's analysis did not distinguish the Grubman reports that contained new information from the many Grubman reports that merely reiterated old information, which had the effect of skewing the "results" reported in Dr. Comment's initial report. A-3912.

under the abuse of discretion standard. They may not be overturned on the record before this Court.

3. Questions concerning the impact of Grubman's statements on the price of WorldCom's stock are questions of fact to be resolved at trial.

The Salomon Defendants' argument that "it is impossible to know whether any price effect that may have followed dissemination of [Grubman's] reports was caused by his opinions or instead by his repetition of WorldCom's misstatements" (SSB Br. at 25-26), is simply a variant of the loss causation issue presented by any claim of securities fraud, namely, what injuries were caused by the defendant's false statement. Indeed, defendants in securities class actions often argue that (a) other, non-fraudulent statements (or statements made by other entities) caused the inflation in the price of the stock, and/or (b) loss causation is not established because the price of the stock fell not in response to the disclosure of the alleged misrepresentation, but for other reasons.

Moreover, Appellants are wrong in contending Lead Plaintiff cannot establish the effect of Grubman's statements on WorldCom's stock price. As noted above, an expert already opined that Grubman's reports had a statistically significant impact on WorldCom's stock price, and Lead Plaintiff will introduce expert testimony on this issue at trial.[12] Defendants will have the opportunity to conduct expert discovery and

[12] In addition, Lead Plaintiff has alleged that Grubman actually scripted certain WorldCom statements – which he then repeated and disseminated – that materially moved WorldCom's stock price. A-526-30.

challenge Lead Plaintiff's expert report at trial, where this issue would be appropriately adjudicated. *See Robertson Stephens*, 2004 WL 51232, at *7.

The Salomon Defendants and SIA further suggest that class certification is inappropriate because no single analyst's opinion can stand out for long from other information in the market, due to the effect of competing analysts' statements and other sources of information upon both the analyst and the market itself. SSB Br. at 28-31; SIA Br. at 13-15. That is also an issue of fact that may not be resolved at class certification. Moreover, the argument disregards the record here that establishes that Grubman played a unique and leading role influencing other analysts and the market itself. *See supra* at 18-21, 36-39, & *infra* at 43-44.[13]

Lead Plaintiff also tendered academic support for the conclusion that when analysts change their investment recommendations, these changes not only have an immediate and significant effect on the price of the securities, but that the impact of the recommendation lasts for months. *See* A-3998 at A-4017 ("there is strong evidence that

[13] This argument is similar to ones defendants have made for years in opposing class actions – that the effect of particular statements dissipates over time and that no class should be certified where there are many statements issued over a lengthy period of time – which have been rejected regularly by the courts. *See, e.g.*, *Blackie v. Barrack*, 524 F.2d 891, 902 (9th Cir. 1975) (court certifies class involving 45 separate documents over 27-month period); *In re Regal Communications Corp. Sec. Litig*., 1996 WL 411654, *3 (E.D. Pa. July 17, 1996) (it cannot be said as a matter of law that misstatements were dissipated or stale after 15 months); *Peil v. National Semiconductor Corp.*, 86 F.R.D. 357, 368 (E.D. Pa. 1980) (rejecting argument that the existence of different representations over an extensive time period precludes predominance of common issues); *see also In re Amerifirst Sec. Litig.*, 139 F.R.D. 423, 432-433 (S.D. Fla. 1991); *Weinberger v. Thornton*, 114 F.R.D. 599, 602-603 (S.D. Cal. 1986).

stock prices are significantly influenced by analysts' recommendation changes, not only at the immediate time of the announcement but also in subsequent months"); A-4027 at A-4032 (noting a "large and positive" differential in the month of an analyst's change of recommendation, which persists in the month after the change and, at a somewhat smaller amount, in the second month after the change. *See also* Jennifer Francis and Leonard Soffer, *The Relative Informativeness of Analysts' Stock Recommendations and Earnings Forecast Revisions*, 35 Journal of Accounting Research (Oct. 11, 1997).

In sum, the ultimate impact on WorldCom's stock price of Grubman's and Salomon's publication of false reports is an issue of fact for a jury to decide. *Robertson Stephens*, 2004 WL 51232, at *7; *In re Honeywell Int'l, Inc. Sec. Litig*., 211 F.R.D. 255, 264 (D.N.J. 2002); *In re Rent-Way Sec. Litig*., 218 F.R.D. 101, 117 (W.D. Pa. 2003). Rather than being a unique, individualized issue that precludes class certification, this issue is routine in securities actions and, as the District Court noted, common to the entire class. SPA-24.

4. The presence of institutional investors does not eliminate the presumption of reliance upon false statements provided by analysts.

As they did below, Appellants contend that fraud-on-the-market should not apply to an analyst's misstatements because "prices in the market for large capitalization stocks are mostly determined by the trading of institutional and other large sophisticated

investors" who do not rely on the opinions of analysts.[14] SSB Br. at 31-32; SIA Br. at 15-18. This argument, however, raises issues of fact for a jury to decide and further overlooks the substantial record establishing that institutional investors, including investment managers for the Lead Plaintiff and one of the Named Plaintiffs, took into consideration the ratings of "sell-side" analysts, including Grubman, in making their decision to purchase WorldCom stock. A-3650-51, A-3516.

Indeed, financial publications and the media routinely reported that large market participants highly valued Grubman's industry knowledge and unprecedented access to WorldCom's senior management, and flocked to hear his analysis. A-4045-46. More than **1000** financial analysts associated with large institutional investors or mutual funds regularly subscribed to Grubman's "blast" voicemails relating to WorldCom and other telecommunications companies. *See* A-4152-90. And many analysts or other employees of large institutional investors sought Grubman's inside analysis of major events affecting the company. *See, e.g.*, e-mails to Grubman collected at A-4191-202.

5. There is no "bubble" exception to the fraud-on-the-market theory.

[14] This argument ignores the general empirical evidence that even institutional investors trade on analysts' recommendations. *See* Xia Chen and Qiang Cheng, *Institutional Holdings and Analysts' Stock Recommendations,* University of British Columbia, working paper, page 4 (July 2003) ("we provide empirical evidence that institutional investors adjust their portfolios in response to stock recommendations. Thus as a whole, they are more important users of recommendations than individual investors").

The argument that the presumption of reliance cannot apply whenever the market can be shown to have the elements of a "bubble," SSB Br. at 32-33; SIA Br. at 18-19, was made without any supporting caselaw and is meritless. The fact that prices may have generally been inflated during part of the class period does not defeat the efficient capital market hypothesis or rebut the fraud-on-the-market presumption, particularly where, as here, Lead Plaintiff will argue at trial that Grubman was a principal contributor to the telecommunications "bubble."

Moreover, any argument that other factors, including general market conditions and the collapse of a "bubble" in telecommunications stocks, contributed to investors' losses, would itself be a class-wide issue and, to the extent it relates to damages, has no bearing on class certification. *VISA Check*, 280 F.3d at 137-41. These arguments involve issues of fact that cannot be determined now, and these issues – which can arise in virtually every securities class action – certainly do not prevent courts from certifying classes. *See Emergent Capital Investment Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 197 (2d Cir. 2003) (holding that argument that intervening factors caused investors' losses was "matter for proof a trial").

6. Applying the fraud-on-the-market presumption does not raise the specter of unrestrained liability on all public speakers.

In a final assault on *Basic*, Appellants contend that any decision sustaining the presumption of reliance on Grubman's analyst statements would entail similar presumptions for statements by journalists, newsletter writers, operators of internet sites,

and even cable television commentators. SSB Br. at 33. This straw man argument conveniently ignores the fact that the Salomon Defendants are charged not with failed prognostication, but with making knowing and reckless falsehoods about material facts. The Amended Complaint charges Grubman alone – out of all the analysts who covered WorldCom – with securities fraud, and does so based on detailed and well-founded allegations of fact. That is what this appeal concerns, not some theoretical nightmare of the Salomon Defendants' own creation.

C. The District Court Properly Applied the Presumption of Reliance for Material Omissions Under *Affiliated Ute*.

While never disputing that critical information concerning the Salomon Defendants' illicit *quid pro quo* relationship with WorldCom and its senior officers was never disclosed to the investing public, SPA-11, Appellants and SIA contend that the District Court erred in applying *Affiliated Ute*'s presumption of reliance on material omissions. SSB Br. at 47-49; SIA Br. at 19-23. Even assuming *arguendo* that this is an appropriate argument to make for purposes of a Rule 23(f) appeal, it does not withstand scrutiny.

As the District Court explained, because "the omissions and misrepresentations are alleged to be interdependent in their significance and effect" and Grubman's reports discussed WorldCom's financial condition rather than the existence and nature of the secret Salomon-Ebbers relationship, it was appropriate to presume reliance on these material omissions. SPA-30. Nothing the Salomon Defendants say in their appellate

brief alters this conclusion, especially since the same end result – a presumption of reliance – is reached for both material misrepresentations and material omissions.

SIA seeks to take this argument even further, contending that the entire doctrine of reliance upon material omissions approved by the Supreme Court in *Affiliated Ute* should not apply here – or in any other securities class action – where the defendants did not deal face-to-face with their victims. SIA Br. at 19-20. However, they cite no authority for this radical notion, and further ignore that there were no alternative sources of information that would have disclosed the secret relationship between the Salomon Defendants and Ebbers.[15]

D. The District Court Afforded the Parties All Appropriate Procedural Protections Consistent With the Mandate of Due Process and Rule 23.

The Salomon Defendants also assert a variety of procedural grievances about the process by which the District Court developed a record and decided the certification motion. SSB Br. at 38-47. These should be summarily rejected.

Even before Lead Plaintiff filed its certification motion and continuing thereafter, the District Court allowed defendants to undertake significant discovery concerning the class motion, obtaining production of thousands of documents, answers to

[15] SIA incorrectly claims that the alleged omissions here involve undisclosed motives, not omitted material facts, and that under the federal securities laws defendants have no obligation to make such disclosures. SIA Br. at 23. However, the cases cited, *Koppel v. 4987 Corp.*, 167 F.3d 125, 133-134 (2d Cir. 1999), and *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1, 5-6 (2d Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984), are inapposite because, among other reasons, they do not arise from Section 10(b) claims and do not address the presumption of reliance upon material omissions of fact in a Section 10(b) claim.

interrogatories, and depositions of witnesses from each of the named plaintiffs and several of their investment advisors. A-38, item 232 (Order of May 19, 2003). Defendants submitted 148 pages of briefs in opposition to the class motion, along with affidavits of two experts and three volumes of supporting exhibits. A-653-3311. Plaintiffs submitted a 117-page reply brief, along with an expert affidavit and two volumes of exhibits, A-3312-4365, and defendants opposing the certification submitted surreply briefs totaling 30 additional pages, along with a surreply declaration from each expert. A-4366-403. Having had a more than ample opportunity to make their points, including getting in the last word with a surreply on the motion, Appellants have no basis to assert a lack of due process.

1. The District Court was justified in relying upon the allegations of the Amended Complaint in deciding the motion.

The Salomon Defendants claim that the District Court was required, but failed, to "articulate what evidentiary showing, if any, it thought plaintiffs were required to make" concerning the *Basic* presumption, and improperly relied on the allegations in the Amended Complaint to find that Grubman's research reports may have influenced the price of WorldCom securities. SSB Br. at 38. However, the District Court did not rely exclusively upon the Amended Complaint; it also drew upon the substantial record of documents, depositions, and expert statements generated in class discovery.

Moreover, to the extent the District Court relied upon the Amended Complaint, it was reasonable to do so. Defendants' argument is predicated almost exclusively upon

cases from outside the Second Circuit, principally *Szabo v. Bridgeport Machines, Inc.*, 249 F.3d 672, 675 (7th Cir.), *cert. denied*, 534 U.S. 951 (2001), which involved very different fact situations, and ignores the rule in this Circuit that it is proper to accept the allegations of a complaint as true in deciding a class certification motion. *Shelter Realty Corp. v. Allied Maintenance Corp*., 574 F.2d 656, 661 n. 15 (2d Cir. 1978); *Green v. Wolf Corp*., 406 F.2d at 294 n.1. [16] Accordingly, district courts in this Circuit are entitled to rely upon a complaint's allegations to determine whether the criteria of Rule 23, including predominance of common questions, have been satisfied, *In re Nortel Networks Corp. Sec. Litig*., 2003 WL 22077464, *2 (S.D.N.Y. Sept. 8, 2003) (Berman, J.); *Bolanos v. Norwegian Cruise Lines Ltd*., 212 F.R.D. at 147-148, and Appellants have no basis to object on those grounds.

2. The rules of evidence do not narrowly restrict what a district court may consider on a certification motion.

The Salomon Defendants further complain that the District Court relied upon inadmissible allegations about Grubman in newspaper and magazine articles, as well as the prior settlement between Salomon and regulators.[17] SSB Br. at 43. However, on a motion for class certification "the evidentiary rules are not strictly applied and courts

[16] As a district court in this Circuit recently noted in *Bolanos v. Norwegian Cruise Lines Ltd*., 212 F.R.D. 144, 147, 155 n.9 (S.D.N.Y. 2002), *Szabo* "has not been adopted by the Second Circuit (or the District Courts within the Second Circuit)," and conflicts with existing Second Circuit precedent, *Shelter Realty v. Allied Maintenance*, 574 F.2d at 661 n.15.

can consider evidence that may not be admissible at trial." *Rockey v. Courtesy Motors, Inc.*, 199 F.R.D. 578, 582 (W.D. Mich. 2001). The purpose of the submissions is to determine whether there are common questions and whether they predominate, rather than to attempt to resolve underlying factual disputes. The District Court was justified in considering these submissions for that purpose.

3. Under established Second Circuit precedent, the District Court was not required to select which expert was more persuasive in order to decide the class motion.

Citing another Seventh Circuit case, *West v. Prudential Securities, Inc.*, 282 F.3d 935 (7th Cir. 2002), the Salomon Defendants argue that the District Court was required to decide which expert's analysis to accept in deciding the certification motion and could not simply conclude that each side made a colorable submission. SSB Br. at 41-42. This, too, flies in the face of this Circuit's precedents, which hold that a district court is *not* to choose between competing experts on a class motion. *VISA Check*, 280 F.3d at 134-35; *Caridad*, 191 F.3d at 291-92.[18] Indeed, even if the opposing party's critique of an expert report "may prove fatal at the merits stage," *Caridad*, 191 F.3d at

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[17] Although Appellants attack the District Court for citing newspaper and magazine articles, they fail to point out that they were the ones who first cited those articles in their papers opposing class certification. A-864-1650.

[18] While neither *VISA Check* nor *Caridad* were securities cases, and therefore did not involve the application of the presumption of reliance under *Basic* or *Affiliated Ute*, nothing in either decision suggests that these rulings would not apply here. This Court specifically granted interlocutory review of the class certification decision in *VISA Check* "to resolve the uncertainly regarding the proper standard for evaluating expert opinions at the class certification stage." 280 F.3d at 132 n.3. Having done so, the rulings set forth in *VISA Check* and *Caridad* apply here.

292, at the class stage the court reviews expert reports solely to "ensure that the basis of the expert opinion is not so flawed that it would be inadmissible as a matter of law" and not to decide "whether the evidence will ultimately be persuasive." *VISA Check*, 280 F.3d at 135. This is precisely what Judge Cote did here.

4. Class certification does not conflict with the Rules Enabling Act.

The argument that class certification conflicts with the Rules Enabling Act (SSB Br. at 49-50 & n.35) is totally lacking in merit and has been rejected by courts for nearly thirty years.

> Defendants contend that elimination of individual proof of subjective reliance alters and abridges their substantive rights in violation of the Rules Enabling Act, 28 U.S.C. § 2072. The obvious answer is that the standards of proof of causation we have set out apply to all fraud-on-the-market cases, individual as well as class actions. No interpretation of Rule 23 is involved, and the Rules Enabling Act limitation is not implicated.

Blackie v. Barrack, 524 F.2d at 908. *See also In re Eagle Computer Sec. Litig.*, 1986 WL 12574, at *10 (N.D. Cal. Mar. 31, 1986); *Stoller v.*

Baldwin-United Corp., 1985 WL 5809, *9 & n.7 (S.D. Ohio June 4, 1985).

5. Defendants' intention to assert a "truth-on-the-market" defense provides further support for class certification.

Appellants' further argument that their intention to offer a "truth-on-the-market" defense – positing that the investing public was aware of the conflicts, *quid pro quos*, IPO spinning, and other nefarious aspects of the Salomon/Grubman-WorldCom/Ebbers relationships – constitutes a reason why the class should not have been certified, is similarly unfounded in fact and law.

On the facts, there were at least four material aspects of the relationship between Salomon/Grubman-WorldCom/Ebbers that were not disclosed to investors: (1) Citigroup's hundreds of millions in loans to Ebbers, including a large debt secured by his WorldCom stock; (2) the equity partnership relationship between Salomon's corporate affiliate, Travelers, and an Ebbers affiliate in the timber business; (3) Salomon's practice of "spinning" hot IPO shares to Ebbers and other key WorldCom insiders; and (4) Salomon providing WorldCom with bullish research reports as a *quid pro quo* to obtain WorldCom's highly lucrative investment banking business.

The existence of the loans and Traveler's equity relationship with Ebbers, for instance, were revealed to the market only after the collapse of WorldCom, and only through the investigative efforts of counsel for the Lead Plaintiff. The public reaction to disclosure of these loans demonstrates both that the market considered this information significant, and that the market most certainly was *not* aware of the existence of these

loans prior to the collapse of WorldCom. A-4220, A-4221. Similarly, although Salomon contends that the practice of "spinning" was disclosed, it neglects to point out that in the very article it cites for this proposition – a November 12, 1997 *Wall Street Journal* article – Salomon admitted that this practice was illegal but *denied* that it engaged in spinning. A-936-41. And it was only in the summer of 2002 – through the congressional hearings after the class period – that Salomon's spinning of IPO shares to Ebbers and other WorldCom insiders was revealed.

Moreover, the market was not aware that Grubman was essentially a corrupt actor who had agreed to write positive research reports as part of a *quid pro quo* for investment banking business. Of the 189 articles cited below by Appellants below, only 11 mention Grubman by name. A-1002-41. The rest are broad articles discussing the securities industry in general or other analysts or firms. Most importantly, under any fair reading of these articles, it is clear that whatever they may have revealed about the securities industry in general, they just did not reveal the extent and nature of the extraordinary conflicts of interest between and among Grubman, Salomon, WorldCom and Ebbers.[19] In many of the articles, the Salomon Defendants *denied* the existence of

[19] Citing the series of *Merrill Lynch* decisions, Appellants argue that "there was widespread public awareness throughout the class period that … analysts may have conflicting interests" and, therefore, they should be exempted from the presumption of reliance. SSB Br. at 32. In fact, Judge Pollack explicitly recognized the distinction between the facts alleged in the *Merrill Lynch* complaint, and the facts in this case. *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*, 273 F.Supp.2d 351, 364 n.25 (S.D.N.Y. 2003). Unlike Lead Plaintiff here, the plaintiffs in *Merrill Lynch* did not identify any contradictory disclosures in the public articles cited by the defendants.

any conflicts of interest, eviscerating the very "truth-on-the-market" defense on which they now may seek to rely. For instance:

> "*There's no evidence of a conflict that I've ever seen*," said John Hoffman, the director of research at Smith Barney. "Especially at large retail firms such as ours, the quality-control pressure of ratings is higher because you certainly don't want to damage the firm's reputation. To inflate a rating to get a deal done is very shortsighted."

A-883-84 (emphasis added). *See also* A-893-99, 1008-09, 1016-109, 1025-35, 1331-35. In short, the market did not have knowledge about many of the material conflicts of interest that pervaded these relationships.

Appellants are also wrong as a matter of law. The "truth-on-the-market" defense is a matter uniquely appropriate for adjudication (a) by the trier of fact – here, the jury; and (b) on a class-wide basis. Success of a "truth-on-the-market" defense depends upon whether the true information was disseminated to *the market* with the intensity and credibility necessary to establish the defense, *see Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 167 (2d Cir. 2000)*; Provenz v. Miller*, 102 F.3d 1478, 1493 **(**9th Cir. 1996), *cert. denied*, 522 U.S. 808 (1997), which is an archetypal example of a common class-wide issue.

II. THE DISTRICT COURT PROPERLY CONCLUDED THAT CLASS CERTIFICATION IS BOTH MANAGEABLE AND SUPERIOR.

Moreover, unlike plaintiffs in *Merrill Lynch*, Lead Plaintiff here did not rely on generalized, vague allegations of undisclosed conflicts, but on particularized misrepresentations for the specific purpose of propping up WorldCom's stock price. Accordingly, as Judge Pollock recognized, the facts of *Merrill Lynch* are inapposite here.

A. Defendants' Right to Challenge Plaintiffs' Claims Does Not Defeat Class Certification.

In yet another argument that, if adopted, would preclude class certification in most, if not all, securities fraud cases, Appellants contend that, even if a presumption of reliance applies to Lead Plaintiff's fraud claims, they retain the right to individualized "mini-trials" for the purpose of attempting to: (1) rebut each class member's reliance upon their statements; and (2) establish that each member's claims are barred by the statute of limitations. SSB Br. at 49-50. SIA goes one giant leap further, claiming that there are a host of other individualized issues, including materiality, scienter and damages, that are subject to rebuttal on a transaction-by-transaction basis. SIA Br. at 24-27.

The argument that thousands of mini-trials are required to test every class member's reliance, thereby precluding class certification, has been uniformly rejected. *E.g., Green v. Wolf*, 406 F.2d at 301; *Sheftelman v. Jones*, 667 F. Supp. 859, 866-69 (N.D. Ga. 1987). In *Green*, this Court flatly rejected that argument because "[c]arried to its logical end, it would negate any attempted class action under Rule 10b-5, since the District Courts have recognized, reliance is an issue lurking in every 10b-5 action." 406 F.2d at 301. Indeed, as noted *supra* at 36, n.10, issues of reliance do not defeat class certification. Defendants offer no explanation or plausible argument as to why this Court should disregard this well-established precedent.

Appellants' related argument that individual issues relating to statute of limitations defenses defeat class certification should also be rejected. As stated in *See International Woodworkers of America, AFL-CIO, CLC v. Chesapeake Bay Plywood Corp.*, 659 F.2d 1259, 1270 (4th Cir. 1981) (citations omitted): "Courts passing upon motions for class certification have generally refused to consider the impact of such affirmative defenses as the statute of limitations on the potential representative's case." Indeed, courts "have been nearly unanimous … in holding that possible differences in the application of a statute of limitations to individual class members, including the named plaintiffs, do not preclude certification of a class action so long as the necessary commonality and, in a 23(b)(3) class action, predominance, are otherwise present." *In re Energy Systems Equipment Leasing Sec. Litig.*, 642 F. Supp. 718, 752-53 (E.D.N.Y. 1986) (citations omitted). *See also CV Reit, Inc. v. Levy*, 144 F.R.D. 690, 699 (S.D. Fla. 1992); *Gruber v. Price Waterhouse*, 117 F.R.D. 75, 80 (E.D. Pa. 1987).

The cases cited by Appellants and SIA in support of their argument that the right of rebuttal precludes class certification are inapplicable. Most arose outside the field of traditional securities fraud, and involve tobacco or other mass tort cases described as "immature torts" or other novel claims with great variations in both facts and applicable legal standards.[20] The handful of securities cases cited do not involve traditional fraud

[20] *See Castano v. American Tobacco Co.*, 84 F.3d 734, 737 (5th Cir. 1996); *Barnes v. American Tobacco Co.*, 161 F.3d 127 (3d Cir. 1998); *Badillo v. American Tobacco Co.*, 202 F.R.D. 261 (D. Nev. 2001); *Thompson v. American Tobacco Co., Inc.*, 189 F.R.D.

claims and specifically distinguish their facts from those where fraud-on-the-market applies.[21]

B. The Lack of a Viable Alternative to Class Certification Confirms the Superiority of Class Action Treatment.

The Salomon Defendants and SIA argue that the opportunity to file individual lawsuits or arbitration claims on behalf of investors establishes that there is a superior alternative to class certification. SSB Br. at 59; SIA Br. at 27-28. However, at present each class member's claims against all defendants can be tried in this one proceeding. Except for customers of Salomon, there would be no basis for any other class member to bring an arbitration claim against Salomon, and even Salomon's customers would have to separately sue the remaining defendants.

Nothing submitted by the Salomon Defendants or SIA establishes that separate suits or arbitrations constitute a viable alternative for all but the largest claimants. Each individual suit or arbitration would involve separate filing fees, not to mention the substantial expenditure required from both counsel and experts to prepare for hearing or trial. Even victims who lost part or all of their life savings may discover the unfortunate truth that even meritorious claims may be uneconomical to pursue. That, of course, is

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544 (D. Minn. 1999); *In re Rhone-Poulenc Rorer Inc.*, 51 F.3d 1293 (7th Cir.), *cert. denied*, 516 U.S. 867 (1995).

[21] *See, e.g.*, *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154 (3d Cir. 2001) (claim against broker-dealers for breaching duty to execute securities trades under most favorable terms reasonably available is not suitable for class certification where court found "sheer number of claims raising individual questions … is strikingly

one of the principal rationales underlying Rule 23, and its application to securities fraud actions has been understood as essential to enforcement of the Nation's securities laws.[22]

To require each class member to try his or her claim individually would multiply the proceedings and further deplete the resources available to compensate the victims of this fraud of historic proportions. That defendants, whose legal bills would be multiplied if every case were separately tried, are advocating this result speaks volumes about their true expectations, namely, that if certification were overturned, many if not most claimants would be forced to abandon their efforts to secure compensation and defendants' liability would be reduced accordingly.

C. Class Certification Will Not Unfairly Coerce Or Pressure Defendants To Settle This Litigation.

The Salomon Defendants also challenge the superiority of class proceedings – at least as they relate to what the Salomon Defendants characterize as the "complicity" allegations – on the ground that "plaintiffs' likelihood of success on the merits is

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similar" to mass tort case and specifically distinguished situation from fraud-on-the-market case where presumption of reliance applies).

[22] *See Maywalt v. Parker & Parsley Petroleum Co.*, 147 F.R.D. 51, 54 (S.D.N.Y. 1993) ("the Second Circuit … has explicitly noted its preference for class certification in securities cases and the importance of such certification for small securities purchasers located throughout the country."); H.R. Conf. Rep. 104-369 at 31 (1995) (legislative history of PSLRA) ("Private securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs.").

remote" and "certification of a class is likely to create extraordinary pressure to settle a claim that is baseless." SSB Br. at 5-7, 18-19, 57. SIA adopts an even more aggressive stance, characterizing Lead Plaintiff's efforts to recover from the Salomon Defendants for their role in the largest fraud in American history as an attempt to extract a "blackmail settlement." SIA Br. at 2-3, 9-10. This argument is without merit.

As a threshold matter, the Salomon Defendants' contention that the so-called "complicity" allegations must be analyzed in complete isolation from allegations that they failed to disclose the conflict of interests that infected their public statements about WorldCom, SSB Br. at 45-47, 56-57, disregards the District Court's repeated rulings that no such distinction can be drawn and that Lead Plaintiff has *not* made distinct "complicity" and "conflict of interest" claims. 2003 WL 1563412, at *1-3 ("no clear line can be drawn between the allegations concerning the SSB Group's analyst reports and SSB's role as an underwriter – in fact, the lead underwriter for at least two major WorldCom bond offerings."); *accord* SPA-30. Nothing the Salomon Defendants have said rebuts the conclusion that these allegations are inextricably intertwined.

Moreover, even if there were a distinct claim that Appellants felt was defensible at trial, the suggestion that this Court should overturn the certification order because one or more of the claims might be rejected by a jury is without merit. As stated in *Eisen v. Carlisle & Jacquelin*, 417 U.S. at 177, a court may not "conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class

action." Moreover, even if such an inquiry were required, the District Court *found* that each of Lead Plaintiff's claims is supported by substantial factual allegations.

Having tried to isolate and then disparage the "complicity" allegations, Appellants assert that the District Court's certification order creates unjust pressure to enter into "blackmail settlements" on weak or baseless claims without regard to their actual liability. SSB Br. at 5-6, 18-19, 57; SIA Br. at 2-3, 9-10. This argument has been explicitly repudiated in this Circuit. In *Visa Check*, this Court rejected the argument that "certification will coerce defendants into settlement," finding that "the effect of certification on parties' leverage in settlement negotiations is a fact of life for class action litigation. While the sheer size of the class in this case may enhance this effect, this alone cannot defeat an otherwise proper certification." 280 F.3d at 145. Indeed, in *Parker v. Time Warner Entertainment Co., L.P.*, 331 F.3d 13 (2d Cir. 2003), this Court vacated the district court's denial of class certification primarily on management grounds and the possibility that defendants would have been forced to pay "devastatingly large damages award out of all reasonable proportion to the actual harm suffered" by the twelve million class members. 331 F.3d at 21.[23]

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[23] The few cases cited by Appellants that have denied class certification on the basis of the possibility of "blackmail settlements" are worlds apart from the present case. *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293 (7th Cir. 1995), and *Castano v. American Tobacco*, 84 F.3d 734 (5th Cir. 1996), were both mass tort cases where the courts were rightly concerned with the virtual impossibility of the district court being able to apply the different liability standards of 50 states to each cause of action of the millions of class members. Indeed, the Supreme Court has recognized the distinction between mass

Finally, as the Salomon Defendants well know, this is not a strike suit. All claims asserted by Lead Plaintiff against the Salomon Defendants pursuant to the stringent pleading requirements of the PSLRA have been upheld, and substantial evidence of record already ties the actions of Salomon Defendants, including Grubman, into the overall fraud at WorldCom. Before the claims can be presented to a jury, they will likely face future motions for summary judgment, *Daubert* challenges and assorted motions *in limine.* In brief, it is not the class ruling that Appellants most fear; it is the validity of the claims against them combined with the massive damages their misconduct caused.

CONCLUSION

The Salomon Defendants have not demonstrated that the District Court abused its discretion or committed any legal error in certifying this class action on behalf of all of the defrauded investors in the largest reported

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tort cases where predominance issues often require denial of class certification and securities cases where predominance is satisfied. *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 624 (1997). Similarly, *Newton v. Merrill Lynch*, 259 F.3d at 189-190, would have involved proof of injury on an individualized basis, and the Court expressly distinguished that case from a fraud-on-the-market in which reliance and injury can be presumed.

fraud case in American history. Accordingly, the District Court's order should be affirmed in all respects.

Respectfully submitted,

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CERTIFICATION OF COMPLIANCE WITH RULE 32(A)(7)(B)

The undersigned counsel for plaintiffs-appellees certifies that the brief of plaintiffs-appellees complies with the type-volume limitation set forth in Fed. R. App. P. 32(a)(7)(B)(i) because this brief contains 13,964 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). In preparing this Certificate, I relied on the word-count program of Microsoft Word.

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Mark R. Rosen

Dated: April 12, 2004

CERTIFICATE OF SERVICE

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