The Unjustified Judicial Creation of Class Certification Merits Trials in Securities Fraud Actions

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THE UNJUSTIFIED JUDICIAL CREATION OF CLASS CERTIFICATION MERITS TRIALS IN SECURITIES FRAUD ACTIONS

Michael J. Kaufman*
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I. INTRODUCTION

The class action device is vital to deterring securities fraud and remedying its victims, who almost never suffer losses sufficient to justify an individual suit. Nonetheless, the federal courts have begun to convert the class certification process into a premature trial on the merits, thereby precluding victims of securities fraud from pursuing otherwise valid claims of financial wrongdoing. In particular, in a series of important decisions, the federal courts have required plaintiffs to prove the essential elements of their securities fraud claims at the preliminary class certification stage.

This Article demonstrates why this trend should end. The judicial creation of class certification merits trials in securities fraud cases is inconsistent with the federal securities laws and Supreme Court precedent. Moreover, judicial resolution of the merits of a securities fraud claim at the class certification threshold infringes on the Seventh Amendment right to trial by jury. Nor can class certification merits trials be excused by any legitimate policy concerns. The harm purportedly averted by these trials is illusory. The supposed threat that class certification and post-certification discovery costs will produce in terrorem settlements is unfounded and illogical. Finally, this Article concludes that the harm caused by class certification merits trials is substantial. This new procedure will over-deter the very type of private securities fraud actions that both supplement Securities and Exchange Commission enforcement

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actions and compensate victims for losses caused by securities fraud.

II. CERTIFYING A SECURITIES CLASS ACTION

This Part provides a brief overview of the requirements to certify a securities class action under Federal Rule of Civil Procedure 23. Next, this Part discusses the essential elements of a securities fraud case. Understanding these elements is necessary as plaintiffs must establish a commonality and predominance of such elements to become a certifiable class. 7 The elements of loss causation and the fraud-on-the-market presumption of reliance are of particular importance. Last, this Part examines the emerging standard by which courts determine if a class action should be certified, namely what kind of “resolution” of the issues is required.

A. Certifying a Class: Rule 23

Securities litigation usually takes the form of a class action because the class action device makes uneconomic actions economical to bring as a class. 2 Not only do securities actions typically take the form of class actions, securities class actions are the largest single category of class action. 3 Most class actions turn on class certification: its grant or denial typically results in either settlement or dismissal. 4 Securities class actions must meet the requirements of both Rule 23(a) and Rule 23(b). 5 Rule 23(a) has four elements: (1) numerosity, (2) commonality, (3) typicality, and (4) adequacy. 6

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7. Fed. R. Civ. P. 23(a). Numerosity requires that the class be so large that joinder of all members is impracticable. In re Micron Techs., Inc. Sec. Litig., 247 F.R.D. 627, 632 (D. Idaho 2007). As a rule of thumb, numerosity is presumed where the class would have at least forty members. Lapin v. Goldman Sachs & Co., 254 F.R.D. 168, 175 (S.D.N.Y. 2008). For "securities fraud class actions relating to publicly owned and nationally listed corporations, the numerosity requirement may be satisfied by showing that a large number of shares were outstanding and traded during the relevant period." Id. (quoting In re Vivendi Universal, S.A., 242 F.R.D. 76, 84 (S.D.N.Y. 2007)). Next, there must be questions of fact and law com-
The threshold for meeting Rule 23(a) is not considered demanding.\footnote{Gene & Gene LLC v. BioPay LLC, 541 F.3d 318, 325 (5th Cir. 2008) (assuming Rule 23(a) is met).} Once Rule 23(a) has been satisfied, the class must be maintainable under either Rule 23(b)(1), (b)(2), or (b)(3).\footnote{Fed. R. Civ. P. 23(b).} Rule 23(b)(1) class actions are maintainable if either (1) the defendant is at risk of inconsistent adjudication or (2) the class members are fighting over a limited fund.\footnote{Id. at 326–27.} Rule 23(b)(2) class actions are maintainable if the class seeks solely injunctive relief.\footnote{Id. at 326.} Last, Rule 23(b)(3) class actions are maintainable if questions of law and fact common to the members of the class predominate over any questions affecting only individual members.\footnote{Id. at 176.} The predominance requirement is similar to the commonality requirement; however, it is considered far more demanding.\footnote{Id. at 326.} The predominance requirement mandates that a court consider how a trial on the merits would be conducted if it certified the class.\footnote{Id.} This requires that the court: (1) identify outcome determinative issues, (2) assess which of these issues will predominate, and (3) then determine whether the issues are common to the class.\footnote{Id.} In addition, Rule 23(b)(3) requires that the class action be more advantageous, or superior, than alternative methods of adjudication.\footnote{Id. at 186–87.} In general, securities suits easily satisfy the superiority requirement as they involve economic injury on a large number of persons geographically dispersed.\footnote{Id.}
dispositive issues for securities class actions are often whether common issues of loss causation or reliance predominate.

B. Proving a Securities Fraud Case and the Elements of Loss Causation and Reliance

At the class certification stage, the plaintiff must show that each element of his claim will be satisfied using generalized proof applicable to all class members.\(^\text{18}\) Securities fraud actions brought under § 10 of the Securities Exchange Act\(^\text{19}\) and the Securities and Exchange Commission’s Rule 10b-5\(^\text{20}\) allow a private plaintiff to recover damages caused by an act or omission resulting in fraud or deceit in connection with the purchase or sale of any security.\(^\text{21}\) To state a cause of action under Rule 10b-5, a plaintiff must allege and prove six elements: (1) that the defendant made a material misrepresentation or omission, (2) that the defendant acted with

\(^{18}\) Id. at 181.

\(^{19}\) Securities Exchange Act of 1934 § 10, 15 U.S.C. § 78j (2006) ("It shall be unlawful for any person . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.").

\(^{20}\) 17 C.F.R. § 240.10b-5 (1997). Rule 10b-5 is construed to contain an implied private right of action. See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976); Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971). Chief Judge Frank H. Easterbrook of the United States Court of Appeals for the Seventh Circuit recently implied in a speech on challenges in reading statutes that current judicial philosophy would have warranted against inferring a private right of action absent a specific legislative directive to do so; rather, such enforcement should be left to governmental agencies.

If Congress enacts a rule and commits enforcement to an agency, no judge these days takes the line of J.I. Case Co. v. Borak, 377 U.S. 426 (1964), and says: "Well, we could get more enforcement by creating a private right of action too." If the deal lacks a private right of action, that's conclusive.

Judges see that laws have both costs and benefits. A private right of action may produce more of the benefit—but at more cost in litigation, and if litigation leads to errors then the costs of errors may be high too. A sensible compromise may be to create a right but limit enforcement to agencies.


\(^{21}\) 17 C.F.R. § 240.10b-5.
scienter or a wrongful state of mind, (3) that the material misrepresentation or omission was made in connection with the purchase or sale of a security, (4) that the plaintiff relied on the material misrepresentation, (5) that the plaintiff suffered an economic loss as a result, and (6) that the material misrepresentation actually caused the loss.

Usually the key to defeating class certification is to show that individual issues of loss causation or reliance predominate. Loss causation refers to the direct causal link between the misstatement and the economic loss, and is an essential element of Rule 10b-5 liability. Reliance is also an essential element for Rule 10b-5 liability because it proves the requisite causal connection between a defendant's misrepresentation and the injury. In the Supreme Court's most recent securities fraud case, Stoneridge, the Court noted that there are two instances where a rebuttable presumption of reliance exists: (1) if there is an omission of a material fact by one with a duty to disclose and (2) if the statements at issue become public.

The presumption of a plaintiff's reliance when the statements at issue become public is called the "fraud-on-the-market" presumption, or the Basic presumption. The rationale for this rule is that all

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22. Scienter is a mental state embracing intent to deceive, manipulate, or defraud. Ernst & Ernst, 425 U.S. at 185 n.1. Currently, there are three different ways to establish scienter: (1) plaintiffs can state a claim by pleading either (a) motive and opportunity or (b) strong circumstantial evidence of recklessness or conscious misbehavior, Novak v. Kasaks, 216 F.3d 300, 309–10 (2d Cir. 2000); (2) plaintiffs can state a claim by pleading facts showing (a) simple recklessness or (b) a motive to commit fraud and opportunity, In re Silicon Graphics, Inc. Sec. Litig., 183 F.3d 970, 974 (9th Cir. 1999); and (3) plaintiffs can state a claim by pleading enough facts that establish altogether a strong inference of scienter, see, e.g., Ottmann v. Hangar Orthopedic Group, Inc., 353 F.3d 338, 345 (4th Cir. 2003); Helwig v. Vencor, Inc., 251 F.3d 540, 550–52 (6th Cir. 2000). Scienter also must be established with a "strong inference." 15 U.S.C. § 78u-4(b)(2) (2006). The Supreme Court recently clarified that this strong inference requirement mandates a holistic assessment whereby courts weigh both culpable and nonculpable inferences on a Rule 12(b)(6) motion. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 322–24 (2007).


24. Jonathan Eisenberg, Beyond the Basics: Seventy-five Defenses Securities Litigators Need to Know, 62 BUS. LAW. 1281, 1297 (2007); see also Ryan v. Flowserve Corp., 245 F.R.D. 560, 567 (N.D. Tex. 2007) (stating that transforming an individual securities fraud action into a class action through Rule 23(b)(3)'s predominance factor hinges on whether the plaintiffs' can utilize the fraud-on-the-market presumption to establish blanket reliance).


27. Id.
public information is reflected in the market price of the security, and hence it can be assumed that an investor who buys or sells stock at the market price relies upon false statements made publicly. Thus, reliance will be presumed if the plaintiff can show: (1) that the defendant made public material misstatements, (2) that the defendant's shares were traded in an efficient market, and (3) that the plaintiffs traded shares between the time the misrepresentations were made and the time the truth was revealed. This presumption, however, cuts both ways. Defendants can embrace the Basic presumption at the class certification stage and later turn the presumption to their advantage by successfully arguing that the market was indeed efficient, and thus "reflect[ed] all available information in securities pricing, including information from nonissuer sources that questions, contradicts, or corrects the issuer's misrepresentation."

C. Reaching the Merits to Resolve a Class Certification Motion

Granting class certification is within the discretion of the lower court, exercised within the constraints of Rule 23. It is an abuse of discretion for a lower court to erroneously apply the law to class certification.

The Second Circuit recently joined a majority of the other circuits by abandoning its requirement that plaintiffs only make "some showing" of compliance with Rule 23's requirements. Pre-

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29. Eisenberg, supra note 24, at 1323.
30. Whether a market is an "efficient" market depends on certain factors, including: (1) the average trading volume; (2) the number of securities analysts following the stock; (3) the number of market makers; (3) whether a company is entitled to file a registration statement for trading; and (5) certain evidence of a cause and effect relationship between news and stock-price changes. In re Nature's Sunshine Prods. Inc. Sec. Litig., 251 F.R.D. 656, 662 (D. Utah 2008). The most important factor is whether the plaintiff can empirically demonstrate that stock prices regularly rose or fell in response to market information. Id. at 663-64.
33. Oscar Private Equity Invs., 487 F.3d at 264 (citing Gulf Oil v. Bernard, 452 U.S. 89, 100 (1981)).
34. Id. (citing Feder v. Elec. Data Sys., 429 F.3d 125, 129 (5th Cir. 2005)).
viously, the Second Circuit prohibited the weighing of merits on a Rule 23 hearing. Now, the Second Circuit states that specific Rule 23 requirements must be fully established, regardless whether this assessment overlaps with the merits, and requires a “definitive assessment” of Rule 23 requirements. The other circuit courts generally agree with this approach and require that a court resolve disputes concerning the facts of the case to determine if certification is appropriate.

Nonetheless, the Second Circuit cautioned that Rule 23 hearings should not extend into protracted mini-trials, stating:

To avoid the risk that a Rule 23 hearing will extend into a protracted mini-trial of substantial portions of the underlying litigation, a district judge must be accorded considerable discretion to limit both discovery and the extent of the hearing on Rule 23 requirements. But even with some limits on discovery and the extent of the hearing, the district judge must receive enough evidence, by affidavits, documents, or testimony, to be satisfied that each Rule 23 requirement has been met.

Thus, the emerging view among the circuits is that district courts must consider evidence which goes to the requirements of Rule 23 even if it affects the underlying merits of the case; the court should not assess any aspect of the merits unrelated to a Rule 23 requirement. However, as Part III and Part IV demonstrate, despite the Second Circuit’s concern that motions for class certification should not progress into mini-trials, securities class plaintiffs are now required to establish more and more of the merits of their claim at the Rule 23 stage.

474 (2d Cir. 2008). Ultimately the district court erroneously adopted the “some showing” standard. Id. at 212.
37. In re Initial Public Offering, 471 F.3d at 33. For a full discussion of the circuit’s relative approach to weighing merits and considering evidence on a motion for class certification, see Davis, supra note 5.
38. In re Initial Public Offering, 471 F.3d at 41.
39. See, e.g., In re Polymedica Corp. Sec. Litig., 432 F.3d 1, 6 (1st Cir. 2005); Unger v. Amedisys Inc., 401 F.3d 316, 321 (5th Cir. 2005); Blades v. Monsanto Co., 400 F.3d 562, 575 (8th Cir. 2005); Gariety v. Grant Thornton, LLP, 568 F.3d 356, 366 (4th Cir. 2004); Newton v. Merill Lynch, Pierce, Fenner & Smith, Inc., 259 F.3d 154, 166–68 (3d Cir. 2001); Szabo v. Bridgeport Machs., Inc., 249 F.3d 672, 676 (7th Cir. 2001); Love v. Turlington, 733 F.2d 1562, 1564 (11th Cir. 1984).
40. In re Initial Public Offering, 471 F.3d at 41.
III. Newly Erected Barriers Require Class Plaintiffs To Establish Essential Elements of Their Securities Fraud Claims at the Class Certification Stage

"To be successful, a securities class-action plaintiff must thread the eye of a needle made smaller and smaller over the years by judicial decree and congressional action." Indeed, the courts are now in the process of erecting merits barriers to certifying a private securities fraud class action. This growing trend requires plaintiffs to establish more and more of their securities fraud claims on a Rule 23 hearing. For instance, the Fifth Circuit denies plaintiffs the reliance presumption in Rule 23 hearings absent a showing of loss causation by a preponderance of the evidence. The Second Circuit has similarly followed suit by providing plaintiffs with a reliance presumption, but mandating defendants be given an opportunity to contest this. In essence, what the Second Circuit gave with one hand, it took back with the other. As this Article shows, by providing defendants with an opportunity to rebut the classwide presumption of reliance before class certification, the Second Circuit has followed the Fifth Circuit's lead in orchestrating Rule 23 trials on the merits.

A. The Federal Court Trend: Securities Class Action Rule 23 Trials on the Merits

The Fifth and Second Circuits have turned a motion for class certification into a trial-like forum where plaintiffs are required to

42. Alaska Elec. Pension Fund v. Flowserve Corp., 572 F.3d 221, 235 (5th Cir. 2009) (per curiam with former Justice O'Connor sitting by special designation).
43. See Coffee & Paulovic, supra note 4, at 196 (discussing the trend of stricter standards at the Rule 23 stage for securities class actions); see also Matthew L. Mustokoff, Fraud Not on the Market: Rebutting the Presumption of Classwide Reliance Twenty Years After Basic Inc. v. Levinson, 4 Hastings Bus. L.J. 225, 226 (2008) ("In a wave of recent decisions, the courts have made it tougher for plaintiffs to demonstrate that a particular security trades in an efficient market for purposes of triggering the classwide presumption of reliance.... [A principal reason for this trend is that] the courts have interpreted Federal Rule of Civil Procedure 23... more stringently in recent years."); cf. Joanne Doroshov, Gordon Gekko Justice Makes a Comeback, 132 Recorder 56 (Mar. 21, 2008) (arguing the Supreme Court in Stoneridge ushered in an era whereby shareholders are more vulnerable and the integrity of American markets more exposed than in decades).
44. Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 266 (5th Cir. 2007); see also Alaska Elec. Pension Fund, 572 F.3d at 233-34.
45. In re Salomon Analyst Metromedia Litig., 544 F.3d 474, 485 (2d Cir. 2008).
prove the merits of their case.\textsuperscript{46} \textit{Oscar} imposed a loss causation obstacle that plaintiffs have to overcome at the class certification stage.\textsuperscript{47} The Second Circuit in \textit{In re Salomon} added the fraud-on-the-market presumption to the list as well. While the Second Circuit provides plaintiffs with an initial presumption of reliance through the fraud-on-the-market theory, by mandating that defendants be given an opportunity to rebut this presumption, it has transformed a Rule 23 hearing into a trial on the reliance issue as well.

1. The Fifth Circuit Increases the Role of Rule 23 Hearings: Loss Causation

\textit{Oscar} requires that plaintiffs establish loss causation at the class certification stage. The Fifth Circuit's decision in \textit{Oscar} applying the loss causation requirement in class certification is a formidable obstacle in the way of plaintiffs' class certification.\textsuperscript{48}

One principal effect of the \textit{Oscar} decision is to relieve defendants of the burden of rebutting market efficiency . . . . By identifying loss causation as a "fraud-on-the-market" prerequisite, \textit{Oscar} shifts the burden to plaintiffs to prove loss causation. Moreover, the decision requires plaintiffs to come forward with proof of loss causation on a motion for class certification, earlier than has been typical in fraud-on-the-market cases.\textsuperscript{49}

\textsuperscript{46} See \textit{Oscar Private Equity Invs.,} 487 F.3d at 266; \textit{In re Salomon Analyst Metromedia Litig.,} 544 F.3d at 485-86; see also Samuel H. Rudman, 'Oscar': Misinterpretation of Fraud-on-the-Market Theory, N.Y.L.J., July 17, 2008, at 3 (stating that \textit{Oscar} is in direct conflict with controlling Supreme Court precedent and erroneously creates a new certification requirement by placing a burden on plaintiffs to prove the merits of their case before trial).

\textsuperscript{47} Rudman, supra note 46. Since its inception, the Fifth Circuit has taken \textit{Oscar} even further. Originally the Fifth Circuit's decision was understood as applying only to cases of multiple negative disclosures. See Fener v. Belo Corp., 560 F. Supp. 2d at 506-08 (N.D. Tex. 2008) (applying \textit{Oscar}'s loss causation requirement to a plaintiff's motion for class certification and finding a lack of loss causation because not all multiple negative disclosures were shown to be substantially related to the fraud); David Jacobson, 5th Circuit's 'Oscar' Ruling, Nat'l L.J., Sept. 24, 2007, at 14. However, now the Fifth Circuit has applied this requirement to cases of single disclosures as well. Luksin v. Intervoice-Brite, Inc., No. 06-11251, 2008 WL 104275 (5th Cir. Jan. 8, 2008); see also Ryan v. Flowserve Corp., 245 F.R.D. 560, 568-69 (N.D. Tex. 2007) (applying \textit{Dura}'s loss causation requirement on a motion for class certification to a case involving only a single disclosure).

\textsuperscript{48} Jacobson, supra note 47. The \textit{Oscar} decision has been referred to as "the penultimate step to repudiation of the fraud-on-the-market presumption." H. Peter Haveles, 'Oscar': Nearing the End of Fraud-on-the-Market Theory?, N.Y.L.J., Sept. 27, 2007, at 4.

\textsuperscript{49} Jacobson, supra note 47; see also Coffee & Paulovic, supra note 8, at 200 (stating that while \textit{Oscar} may not mandate mini-trials, it remains an open question to what extent courts must go to find Rule 23's requirements to be established).
a. The Oscar Case and the District Court

Allegiance Telecom Inc. ("Allegiance") was a publicly traded, national telecommunications company. In April 2001, Allegiance released its first quarter financial results which indicated that it had outperformed analysts' estimates, raising the stock price by nine percent. Again in the second and third quarters, Allegiance released results indicating it surpassed earnings expectations. Then in February 2002, Allegiance released its fourth quarter financial results, which fell short of analysts' earnings estimates. The stock price then fell twenty-eight percent.

Oscar Private Equity Investments filed suit in the Northern District of Texas alleging Allegiance violated §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5. The plaintiffs alleged that Allegiance fraudulently misrepresented its line-installation count in its first three quarterly announcements for 2001. As a result, the plaintiffs asserted they purchased Allegiance shares at an artificially inflated price. When Allegiance released its correction, the plaintiffs alleged they were injured because of the resulting stock decline.

The plaintiffs moved to certify a class of all individuals who purchased Allegiance shares between its first and fourth quarter releases. The district court certified the class, specifically allowing the plaintiffs to establish a rebuttable, class-wide presumption of reliance through the fraud-on-the-market theory.

b. The Fifth Circuit Modifies the Law

The Fifth Circuit, however, vacated the proposed class "for want of any showing that the market reacted to the corrective disclosure." Instead, the Fifth Circuit insisted that class certification be

50. Oscar Private Equity Invs., 487 F.3d at 262.
51. Id. at 263.
52. Id.
53. Id. Allegiance missed its revenue covenants, which put its credit lines in default, ultimately forcing Allegiance into bankruptcy. Id.
54. Id.
55. Id. at 262.
56. Id. at 263.
57. Id.
58. Id.
59. Id.
60. Id.
61. Id. at 262. The dissent characterized the majority's holding as a "breathtaking revision of securities class action procedure that eviscerates Basic's fraud-on-the-market
supported by a showing of loss causation. The Fifth Circuit initially noted that the Supreme Court’s Basic decision provided the circuits “room to develop its own fraud-on-the-market rules.”

Thus, the Fifth Circuit required more than proof of a material misstatement; rather, the court required that “the misstatement actually moved the market.” According to the court, a plaintiff must establish loss causation to trigger the fraud-on-the-market presumption by a preponderance of the evidence.

The Circuit required: (1) that the misstatement actually move the market to prove loss causation, (2) that a plaintiff must establish loss causation in order to be entitled to the fraud-on-the-market presumption, (3) that the plaintiff must establish this by a preponderance of the evidence, and (4) that all this must be done on a motion for class certification.

The court ruled that the plaintiff must establish loss causation on a motion for class certification with an opinion primarily driven by policy concerns. The Fifth Circuit stated, “We cannot ignore the presumption, creates a split from other circuits by requiring mini-trials on the merits of cases at the class certification stage, and effectively overrules legitimately binding circuit precedents.” Id. at 272 (Dennis, J., dissenting).

62. Id. at 262.
63. Id. at 264 (internal citations omitted).
64. Id. at 265. But see In re Salomon Analyst Metromedia Litig., 544 F.3d 474, 482-83 (2d Cir. 2008) (rejecting this “actually moved” language).

[R]eliance—even in a fraud-on-the-market case—is distinct from the element of loss causation. The Court in Basic declared that plaintiffs must also demonstrate the requisite causal connection between a defendant’s misrepresentation and the plaintiff’s injury. The causal connection required is that the defendants’ misstatements or omissions created a quantifiable disparity between the transaction price and the true value of the securities on the date of the transaction. That particular causal connection can be broken by defendants by showing that the market price would not have been affected by their misrepresentations. Reliance requires proof that defendants’ misrepresentations or omissions influenced plaintiffs’ decision whether to invest at all. As developed by the Supreme Court in Basic, and as ultimately codified by Congress in the PSLRA, loss causation is proof that these misrepresentations or omissions created a measurable difference between the price which plaintiffs actually paid for their securities and the price that they would have paid in the absence of those misrepresentations or omissions.

Id. at 38 (internal citations and quotations omitted).
66. Oscar Private Equity Invs., 487 F.3d at 266.
in terrorem power of certification." According to the court, there was no "sound reason" to leave the loss causation determination for a later stage in the litigation because it involves little discovery and little proof. "Its 'proof' is drawn from public data and public filings . . . It is largely an empirical judgment that can be made [at class certification] as well as later in the litigation." Ultimately the court, after weighing all the evidence—expert reports both for and against the plaintiff—decided that the factual conclusion drawn by the plaintiff's expert was "untenable" and loss causation was not established.

The dissent in the Oscar decision summarized the majority holding as a "breathtaking revision of securities class action procedure that eviscerates Basic's fraud-on-the-market presumption . . . [and] creates a split from other circuits by requiring mini-trials on the merits of cases at the class certification stage."  

2. The Second Circuit Continues the Trend of Rule 23 Trials: Reliance and Rebutting the Basic Presumption

In In re Salomon, the Second Circuit was the first to jump on the Oscar bandwagon. While not requiring that plaintiffs initially come forward with their loss causation and reliance evidence, by requiring that the defendant be given an opportunity to rebut the evidence that courts should be mindful of the extraordinary leverage plaintiffs have once they file a securities class action. Id. Interestingly, the Fifth Circuit subsequently reaffirmed Oscar's holding but drew attention to a competing and opposing policy of promoting private rights of action. Alaska Elec. Pension Fund, 572 F.3d at 234–35.

This "empirical judgment" is based on an expert's opinion and a properly performed regression analysis. However, a recent study by Esther Bruegger and Frederick Dunbar of NERA Economic Consulting finds that regression analyses can be exploited to estimate what the effect of the truth would have been had it been disclosed at the time it was concealed, and that there comes a point where arbitrary allocations are made. Esther Bruegger & Frederick C. Dunbar, Estimating Financial Fraud Damages with Response Coefficients, 35 J. Corp. L. (forthcoming 2009) (on file with the University of Michigan Journal of Law Reform).
reliance presumption, plaintiffs must eventually set forth their evidence at a Rule 23 hearing. Thus, the practical effect will be the same: the plaintiffs must establish that they are entitled to the presumption with persuasive evidence, not merely sufficient evidence.

a. The Grubman Fallout and the District Court Decision

The plaintiffs in \textit{In re Salomon} brought a securities fraud action under § 10(b) and Rule 10b-5 against Citicorp USA, Inc., Salomon Smith Barney, Inc., Citigroup, Inc., and Smith Barney analyst Jack Grubman.\textsuperscript{73} The plaintiffs alleged that the defendants violated the securities laws by issuing and disseminating research analyst reports on Metromedia that contained materially false and misleading statements and omissions of material fact to attract business from Metromedia for Smith Barney's investment banking division.\textsuperscript{74} This, according to the plaintiffs, would increase Grubman's personal compensation.\textsuperscript{75}

The district court held that, for the research reports issued between March 8 and July 25, 2001, the complaint pleaded fraud with sufficient particularity to withstand the defendants' motion to dismiss.\textsuperscript{76} The plaintiffs alleged that Grubman's reports omitted or
misstated material facts regarding a credit facility that Citicorp USA was to provide Metromedia. The plaintiffs alleged, however, that this facility suffered numerous problems and delays over the next seven months. Despite these mounting difficulties, Grubman did not reveal the trouble and instead touted the Metromedia-Citicorp USA deal. The court determined that Grubman became obligated to reveal this information when he chose to provide some information about the credit facility.

The plaintiffs then moved to certify a class of plaintiffs who bought Metromedia stock during this time. The district court granted the plaintiffs' motion, finding that the class satisfied both Rule 23(a) and 23(b)’s requirements. The plaintiffs brought their motion for class certification under Rule 23(b)(3), which requires that questions of fact and law predominate over any questions affecting individual members. The defendants, offering no evidence or expert testimony, contended that the individual questions of reliance would predominate, thus making class certification improper. The plaintiffs then invoked the fraud-on-the-market presumption to demonstrate class-wide reliance.

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77. *In re Salomon Analyst Metromedia Litig.*, 544 F.3d at 477.
78. *Id.*
79. *Id.* at 477.
80. *Id.*
81. *Id.* at 477.
82. *Id.*
83. *Id.* at 476–78.
84. *Id.*
85. *Id.*
86. *Id.* at 478. The plaintiffs presented two alternative arguments to the defendants’ reliance-based challenge: (1) because the case involves omissions, they are relieved altogether of the obligation to prove reliance or (2) even if reliance is required for their claim, reliance by all class members may be presumed under the Basic presumption. *In re Salomon Analyst Metromedia Litig.*, 236 F.R.D. 208, 218 (S.D.N.Y. 2006). The district court disagreed with the plaintiffs’ argument that reliance was not required. *Id.* The district court held that the allegations did not present a case primarily involving a failure to disclose and therefore the plaintiffs were not in a difficult position to prove reliance on a mere non-disclosure. *Id.* at 219.
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defendants retorted that the presumption could not be invoked in actions against research analysts. The district court, however, applied the presumption. The district court found that the three required elements of the fraud-on-the-market presumption were all met as well. However, the district court refused to allow the defendants an opportunity to present rebuttal evidence until a later stage in the litigation.

b. The Second Circuit Gives Defendants the Chance to Respond

The Second Circuit was faced with three issues on appeal: (1) whether the fraud-on-the-market presumption applies to suits against analysts or other non-issuers, (2) whether plaintiffs must make a heightened showing that misrepresentations had an "actual impact on market price" to invoke the fraud-on-the-market presumption, and (3) whether the defendants must be afforded an opportunity to rebut the fraud-on-the-market presumption before class certification.

i. The Fraud-on-the-Market Presumption Applies to Non-Issuers

Relying heavily on the Supreme Court's Basic decision, the Second Circuit rejected the argument that the fraud-on-the-market presumption applies only to issuers. The court reasoned that:

[T]he Basic Court did not so limit its holding and its logic counsels against doing so. The reason is simple: the premise of Basic is that, in an efficient market, share prices reflect "all publicly available information, and, hence, any material misrepresentations." It thus does not matter, for purposes of establishing entitlement to the presumption, whether the

87. In re Salomon Analyst Metromedia Litig., 544 F.3d at 478. The defendants likewise opposed certification, arguing that proposed representatives were inadequate and atypical. In re Salomon Analyst Metromedia Litig., 236 F.R.D. at 211.
88. In re Salomon Analyst Metromedia Litig., 544 F.3d at 478.
89. Id.
90. Id. at 479.
91. Id. at 480.
92. Id. at 481.
misinformation was transmitted by an issuer, an analyst, or anyone else.93

In addition, the Second Circuit invoked the controversial94 Stoneridge decision to maintain that the fraud-on-the-market presumption applies if the deceptive acts were communicated to the public, regardless of the speaker's position in the company.95

ii. A Heightened Showing Is Not Required: Rejecting Oscar?

Second, the Second Circuit addressed "whether plaintiffs alleging securities fraud against research analysts must make a heightened evidentiary showing in order to benefit from the fraud-on-the-market presumption."96 The defendants argued that the plaintiff must demonstrate that the misrepresentations had a measurable effect on the stock price.97 The Second Circuit disagreed, holding that the question of materiality must be viewed by a "reasonable investor" standard rather than in terms of "actual impact on the market price."98 The court stated the concept as follows:

93. Id. (internal citations omitted); see also In re Credit Suisse-AOL Sec. Litig., 253 F.R.D. 17, 28–29 (D. Mass. 2008) (applying Basic to a 10b-5 action against an analyst).


96. In re Salomon Analyst Metromedia Litig., 544 F.3d at 476. The Second Circuit noted that it was poised to address this issue earlier in 2004 in Hevesi v. Citigroup, Inc., 366 F.3d 70 (2d Cir. 2004), but that appeal was never heard on its merits.

97. In re Salomon Analyst Metromedia Litig., 544 F.3d at 482.

98. Id. at 482–83. A plaintiff can demonstrate fraud actually moved the stock price by showing either (1) an increase in price after the release of a false positive news or (2) a decrease in stock price after a corrective disclosure. See Nathenson v. Zonagen, Inc., 267 F.3d 400, 418–19 (5th Cir. 2001).
[I]f plaintiffs can show that the alleged misrepresentation was material and publicly transmitted into a well-developed market, then reliance will be presumed, for if a reasonable investor would think that the information would have significantly altered the total mix of information, then it may be presumed that, in an efficient market, investors would have taken the omitted information into account, thereby affecting market price. 99

Thus rejecting Oscar’s overall holding, the Second Circuit held that the burden is properly placed on the defendants at the rebuttal stage and not on the plaintiffs. 100 To hold otherwise, according to the Second Circuit, would eviscerate the presumption of reliance. 101

The defendants also argued that a heightened standard was necessary to deter frivolous suits against non-issuers. 102 The court rejected this argument, reasoning that there were already sufficient safeguards in place to prevent plaintiffs from suing any person who makes public statements about a company. 103 For instance, the court noted that the materiality requirement, the fact that defendants can rebut the presumption of reliance, and the fact that predictions or opinions are generally not actionable all act as safeguards against vexatious litigation. 104

99. In re Salomon Analyst Metromedia Litig., 544 F.3d at 483 (internal citations and quotations omitted).

100. Id. at 485. However, lower courts have begun to confuse In re Salomon with Oscar. See, e.g., In re Metro. Sec. Litig., No. CV-04-25-FVS, 2008 WL 5102303, at *2 n.2 (E.D. Wash. Nov. 25, 2008) (citing Salomon and stating that “[t]he defendants have made the decision to wait until later to litigate loss causation.”).


102. Id. at 484. “The structure of this analysis does not vary according to the identity of the speaker.” Id. However, the court noted an important caveat to this broad statement: the identity of the speaker may be significant in that it effects what a reasonable investor would rely upon. Id. at 484 n.8. For instance, it is clearly reasonable to rely on misstatements made by the CEO of the defrauding company, while the same is not true about relying on statements made by a relatively obscure comment posted on a website.

103. Id. at 484. The defendants phrased their fear as, “if no heightened test is applied in suits against non-issuers, any person who posts material misstatements about a company on the internet could end up a defendant in a Rule 10b-5 action.” Id.

104. Id. at 484. One commentator has identified over seventy-five defenses available in a securities fraud action. See Eisenberg, supra note 24, at 1281–83. Thus, one thing the defense bar need not worry about is the absence of any colorable defense.
iii. The Defendants Must Be Afforded an Opportunity to Rebut the Fraud-on-the-Market Presumption: Embracing the Rule 23 Trial Trend?

Finally, the Second Circuit mandated that trial courts make a "definitive assessment" of the Rule 23 requirements. This requires that the court consider all evidence and resolve factual disputes. While the Second Circuit cautioned that a Rule 23 hearing should not extend into a mini-trial, it nevertheless required that the court receive enough "evidence, by affidavits, documents, or testimony, to be satisfied that each Rule 23 requirement has been met." The In re Salomon court effectively held that this definitive assessment could not be made without determining whether the defendants can rebut the presumption at the class certification stage. A successful rebuttal defeats class certification. Despite the fact that there was "no dispute," that the market was efficient, and that the statements were public, the Second Circuit still required that the defendant be given a chance to refute the presumption. Ultimately, because the court failed to afford the defendants a chance to rebut the presumption, the Second Circuit vacated class certification and remanded.

B. The Significance of Loss Causation and an Opportunity to Rebut the Fraud-on-the-Market Presumption

Generally, the key to defeating class certification is to show that individual issues of reliance or loss causation predominate. Reliance and loss causation are essential elements for § 10(b) and Rule

105. In re Salomon Analyst Metromedia Litig., 544 F.3d at 484.
106. Id.
107. Id. at 486 (internal citation omitted).
108. Id. at 485.
109. Id. The Second Circuit cited Oscar to support the proposition that because a defendant's rebuttal will defeat certification, the court must afford the defendant an opportunity to rebut the presumption before class certification. Id.
110. Id.
111. Id. at 486. The court noted that even though the defendants did not have or offer any evidence, that error may have been the result of confusion over the law, and should not be held against them. Id. at 485.
112. Eisenberg, supra note 24, at 1297; see also Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 270 (5th Cir. 2007) (contesting the validity of the expert's report to establish loss causation); Ryan v. Flowserve Corp., 245 F.R.D. 560, 567 (N.D. Tex. 2007) (stating that transforming an individual securities fraud action into a class action through Rule 23(b)(3)'s predominance factor hinges on whether the plaintiffs' can utilize the fraud-on-the-market presumption to establish blanket reliance).
10b-5 liability because they establish the requisite causal connection between a defendant's misrepresentation and the injury.\textsuperscript{113}

\textit{In re Salomon} has continued \textit{Oscar}'s overall trend of transforming motions for class certification into trials on the merits. \textit{Oscar} flatly required a plaintiff to establish loss causation by a preponderance of the evidence and \textit{In re Salomon} further required that courts actually resolve contested issues concerning reliance at the class certification stage. By requiring that trial courts give the defendant an opportunity to respond, \textit{In re Salomon} has in practice converted the fraud-on-the-market presumption into a bursting bubble presumption at the class certification stage.

1. Resolving the Battle of the Experts to Determine Reliance and Loss Causation

The Second Circuit and the Fifth Circuit require that courts definitively assess Rule 23 issues.\textsuperscript{114} This definitive assessment requires the resolution of contested issues of fact.\textsuperscript{115} Defendants commonly contest issues of reliance and loss causation through expert testimony.\textsuperscript{116} The Second Circuit has now mandated that defendants be given a chance to do this at class certification;\textsuperscript{117} the Fifth Circuit requires a plaintiff to establish loss causation by a \textit{preponderance of the evidence} at class certification.\textsuperscript{118} Thus, in the battle of the experts that will inevitably result, the plaintiffs must establish that their evidence of reliance and loss causation relating to the fraud-on-the-market presumption is not just sufficient, but persuasive at the class certification stage.\textsuperscript{119}

\begin{itemize}
\item \textsuperscript{114} \textit{Oscar Private Equity Invs.}, 487 F.3d at 268; \textit{In re Initial Pub. Offerings Sec. Litig.}, 471 F.3d 24, 41 (2d Cir. 2006).
\item \textsuperscript{115} \textit{In re Initial Pub. Offerings Sec. Litig.}, 471 F.3d at 41.
\item \textsuperscript{116} Michael J. Kaufman, \textit{Class Certification Proceedings Involving Securities Fraud Experts, in Expert Witnesses: Securities Cases} § 3:5 (2008); see also 1 Joseph M. McLaughlin, McLaughlin on \textit{Class Actions: Law and Practice} § 3:13 (5th ed. 2009).
\item \textsuperscript{117} \textit{In re Salomon Analyst Metromedia Litig.}, 544 F.3d 474, 486 (2d Cir. 2008).
\item \textsuperscript{118} \textit{Oscar Private Equity Invs.}, 487 F.3d at 269; Rudman, supra note 46, at 8 ("\textit{Oscar} focuses less on whether the requirements of Rule 23 can be met and, instead, turns class certification into a determination of whether loss causation can be proved.").
\item \textsuperscript{119} \textit{In re Salomon Analyst Metromedia Litig.}, 544 F.3d at 480 (citing Heerwagen v. Clear Channel Commc'ns, 455 F.3d 219 (2d Cir. 2006)). A plaintiff's failure to rebut a defendant's expert may result in the court denying the plaintiff the benefit of the fraud-on-the-market presumption. See \textit{In re Zonagen}, Inc. Sec. Litig., 322 F. Supp. 2d 764, 781 (S.D. Tex. 2003).
\end{itemize}
In particular, the *In re Salomon* court was not faced with whether the market was efficient—something the plaintiff must show before he is entitled to the fraud-on-the-market presumption. Rather, the question before the court was one of causation. The Second Circuit muddied two distinct inquiries: (1) whether the plaintiff may take advantage of the presumption of reliance and (2) whether the plaintiff has proven reliance. This confusion is problematic because only the former is needed for class certification. However, the Second Circuit required that the defendant be given an opportunity to rebut the latter issue at class certification. This explicit directive for courts to engage in the battle of the experts contravenes the longstanding and traditional deference courts have employed in considering expert submissions on class certification.

2. Fraud-on-the-Market Presumption: A Bursting Bubble Theory at the Rule 23 Stage

Under the Fifth Circuit’s “preponderance of the evidence” and the Second Circuit’s “required opportunity to respond” approaches, the fraud-on-the-market presumption has been converted into a weak “bursting bubble” presumption. Once the defendant offers some evidence to rebut the presumption of the fraud-on-the-market theory, the presumption disappears and the plaintiff must then come forward with enough evidence for the court to conclude that the plaintiff has satisfied Rule 23. Given that defendants usually attempt to rebut this presumption regard-

120. *In re Salomon Analyst Metromedia Litig.*, 544 F.3d at 485 (stating that there was “no dispute that [the] stock was actively traded on an open, developed, and generally efficient securities market” and that it was beyond “any dispute that the alleged misrepresentations were publicly made.” (internal quotations and citations omitted)).


122. Id. at *9.

123. Id. The availability of the fraud-on-the-market theory is not a merits inquiry; reliance is. Id.

124. *In re Salomon Analyst Metromedia Litig.*, 544 F.3d at 485.

125. McLaughlin, supra note 116 (stating that “[c]ourts have long approached their consideration of expert submissions on class certification with substantial restraint.”).

126. *In re Salomon Analyst Metromedia Litig.*, 544 F.3d at 486. A bursting bubble theory holds that once the presumed facts have been contradicted, the presumption disappears. BLACK'S LAW DICTIONARY 211 (8th ed. 1999); see also Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 274 (5th Cir. 2007) (Dennis, J., dissenting) (stating that giving the defendant the right of rebuttal recharacterizes the Basic presumption as a “bursting bubble” presumption, e.g., one that “disappears if anything to the contrary is placed before the court.”) (citation omitted)).
less whether the plaintiff offers evidence in support of the *Basic* presumption, the plaintiff must in practice come forward with enough evidence to persuade.\(^{127}\) Thus, just as *Oscar* requires that the plaintiff first establish loss causation by a preponderance of the evidence at the Rule 23 stage, *Salomon* has the practical effect of requiring a plaintiff to overcome the defendant's evidence and establish the fraud-on-the-market presumption at the Rule 23 stage.\(^ {128}\)

### IV. THIS JUDICIAL TREND IS INCONSISTENT WITH THE FEDERAL SECURITIES LAWS, SUPREME COURT PRECEDENT, AND THE CONSTITUTIONAL RIGHT TO TRIAL BY JURY

As this Part shows, the trend of creating Rule 23 merits trials impedes the litigation of meritorious securities fraud cases. This judicial design is inconsistent with the federal securities laws,\(^ {129}\) contradictory to applicable Supreme Court precedent,\(^ {130}\) and incompatible with the Seventh Amendment right to a jury trial.\(^ {131}\)

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\(^{128}\) As two coauthors explain, the "split" between the Second and Fifth Circuits is illusory:

> Although the burden of showing no price impact in the Second Circuit is on defendants, both sides will be forced to address loss causation in detail at the class certification stage. Inevitably, defendants will rely on experts armed with event studies in order to sever the link between the misrepresentation and the price of the security in issue, essentially disproving loss causation as would normally be done at the summary judgment or trial stage.

> Faced with such evidence, plaintiffs will clearly need to present their own evidence that the misrepresentations in issue did move the market in order to avoid losing the fraud-on-the-market presumption.


\(^{129}\) See *infra* Part IV.A (arguing that the federal court trend is inconsistent with the Private Securities Litigation Reform Act).

\(^{130}\) See *infra* Part IV.B (demonstrating that the Supreme Court's decisions in *Eisen* and *Basic* preclude resolution of loss causation and reliance at the Rule 23 stage).

\(^{131}\) See *infra* Part IV.C (showing how resolving issues of loss causation and reliance at the Rule 23 stage denies parties their Seventh Amendment right to have issues decided by a jury and may implicate collateral estoppel issues as well).
Securities fraud class actions brought under Rule 10b-5 allow a private plaintiff to recover damages caused by an act or omission resulting in fraud or deceit in connection with the purchase or sale of any security.132 However, in the 1990s, Congress perceived a threat to the stability of the American financial markets from these Rule 10b-5 actions and, in response, passed the Private Securities Litigation Reform Act of 1995 ("PSLRA").133

Through the enactment of the PSLRA, Congress sought to encourage the voluntary disclosure of information by corporate issuers, empower investors rather than their lawyers, and encourage plaintiffs’ lawyers to pursue valid claims.134 Specifically, Congress wanted to encourage valid claims, but prevent in terrorem settlements.135 In terrorem settlements are settlements a defendant enters into for fear of costly litigation.136

To prevent in terrorem settlements and curb perceived abuses of the 10b-5 action,137 Congress imposed a variety of procedural barri-


133. In 1994, when the Republicans won control of Congress, they passed the PSLRA as part of their "Contract with America." ALSTON & BIRD, LLP, Private Securities Litigation Reform Act—Major Developments and Issues, in SECURITIES LITIGATION: FORMS AND ANALYSIS § 1:2 (Thomson West 2009).


135. S. REP. No. 104-98, at 6 (1995), as reprinted in 1995 U.S.C.C.A.N. 679, 685 ("The dynamics of private securities litigation create powerful incentives to settle .... Many such actions are brought on the basis of their settlement value. The settlement value to defendants turns more on the expected costs of defense than the merits of the underlying claim.").

136. In terrorem is Latin meaning "in order to frighten." BLACK'S LAW DICTIONARY 839 (8th ed. 1999).

ers to securities fraud actions, including a heightened pleading requirement. Congress did not, however, enact any barrier to class certification. As this Part shows, a heightened standard for class certification is contrary to the PSLRA because: (1) numerous other procedural provisions, contained in both the Federal Rules of Civil Procedure and the PSLRA, address the *in terrorem* threat and abusive practices, and (2) Congress addressed securities class actions in the PSLRA, and refrained from implementing any heightened class certification standard despite being capable of doing so. This evidences Congress’s intent not to apply a heightened standard.

1. Other Procedural and PSLRA Provisions Address *In Terrorem* Threats and Abusive Practices

The Supreme Court and Congress have already enacted and endorsed mechanisms to address the costs of securities litigation and the concern of *in terrorem* securities class actions. A heightened securities class certification standard is not among them.

First, the securities class action procedure, absent heightened class certification, provides a defendant ample defenses against a securities claim. At the pleading stage, Congress heightened the standard by requiring that the plaintiff allege a "strong inference" of scienter. This has proven to be an increasingly potent defense after the Supreme Court’s decision in *Tellabs Inc. v. Makor Issues & Rights*, where defendants can challenge whether a plaintiff's allegations give rise to a strong inference of scienter with a 12(b)(6) motion and the lower courts must weigh both culpable and non-culpable inferences. The lower federal courts have since used

goals of the PSLRA are: (1) to reduce the costs that securities actions impose on the capital markets by discouraging the filing of non-meritorious suits, (2) reducing litigation risk for high technology issuers, and (3) reducing the race to the courthouse door whereby class actions are filed soon after a significant stock price declines). But see *Tellabs*, 551 U.S. at 332 (Scalia, J., concurring) (arguing the report of a single committee of a single House does not express the will of Congress).

138. See Perino, supra note 137, at 925 (noting that the pleading requirement actually has three components: (1) a specificity requirement, (2) a particularity requirement for complaints pled on information and belief, and (3) the strong inference requirement).


140. *Tellabs*, 551 U.S. at 324; John M. Wunderlich, Note, *Tellabs Inc. v. Makor Issues & Rights*, Ltd.: *The Weighing Game*, 39 Loy. U. Chi. L.J. 613, 662-70 (2008) (showing that *Tellabs* will result in the increased dismissal of securities fraud claims because it unjustifiably heightens the pleading requirement); see also *In re ProQuest Sec. Litig.*, 527 F. Supp. 2d 728, 747 (E.D. Mich. 2007) (stating *Tellabs* requires "a mini-trial on the merits"). One prominent securities litigator has stated that his firm spent $150,000 just on a single response to a motion to dismiss. Terry Carter, *How Lawyers Enabled the Meltdown and How They Might Have
Tellabs to perform a mini-trial on the merits at the 12(b)(6) stage.\textsuperscript{141} In addition to this heady 12(b)(6) weapon, the defense can easily later seek decertification if additional facts come out during discovery.\textsuperscript{142} Even at the trial stage, a defendant can move for summary judgment and for judgment as a matter of law.\textsuperscript{143} In fact, the majority of dismissals are granted between the first ruling on a motion to dismiss, but before a ruling on summary judgment.\textsuperscript{144} All these procedural devices remove the resolution of the case from the jury’s discretion and serve to weed out meritless claims.

Second, prudent defense attorneys have a variety of cost-saving mechanisms that they should employ. For instance, Congress enacted a stay of discovery provision in the PSLRA, which enables courts to stay discovery pending a 12(b)(6) motion to dismiss.\textsuperscript{145} Aggressive use of case management facilitates pre-trial disposi-


\textsuperscript{143} FED. R. CIV. P. 56 (summary judgment); FED. R. CIV. P. 50 (judgment as a matter of law).

\textsuperscript{144} CORNERSTONE RESEARCH, supra note 141, at 16.

\textsuperscript{145} 15 U.S.C. § 78u-4(b)(3)(B) (2006). Along the same lines, the federal rules inherently provide judges with broad discretion to manage discovery. See FED. R. CIV. P. 26(a). Perhaps a better approach to discovery control would be for courts to vigorously analyze whether these requests violate Rule 11’s requirement that the motion is not “presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation.” FED. R. CIV. P. 11(b)(1) (emphasis added); FED. R. CIV. P. 37; FDIC v. Maxxam, Inc., 523 F.3d 566, 589 (5th Cir. 2008) (stating that a court is empowered to sanction a party who prosecutes a case in a manner to delay and increase the costs of defense pursuant to its inherent power, Rule 11, and Rule 37); see also Jim McElhaney, The Judicial Counter-Punch, A.B.A.J., Oct. 2008, at 28, 29 (illustrating a trial court’s effective use of Rule 11 to curb frivolous discovery). Moreover, changing the judicial approach to discovery sanctions from sanctioning only the most disgusting and despicable litigation conduct to sanctioning even boorish and wasteful conduct may effectuate a change in discovery practice. Charles Yablon, Essay, Stupid Lawyer Tricks: An Essay on Discovery Abuse, 96 COLUM. L. REV. 1618, 1641 (1996).
The Unjustified Judicial Creation

Defendants should take advantage of this and propose reasonable discovery schedules and stage limitations.

Third, Congress also enacted specific provisions in the PSLRA to alleviate the concern of in terrorem settlement. For example, in addition to heightened pleading and a discovery stay, the PSLRA requires courts to engage in a Rule 11 review to sanction and discourage those that file frivolous claims. The PSLRA also replaced joint and several liability with a proportionate liability scheme to alleviate pressures to settle.

Despite these options, one would likely respond that litigation still exposes defendants to the risk that a jury will fail to recognize the frivolity of the plaintiff's claim and come down against the law-abiding corporate defendant. This argument ignores the abundance of defenses, both legal and procedural, defendants


147. 15 U.S.C. § 78u-4(c)(1)-(2) (2006). This provision, however, is currently underutilized; courts should engage in a more thorough review, impose sanctions, as well as fee shifting, to combat any economic incentive to file frivolous suits. Wunderlich, supra note 140, at 668-69.


149. See Evans, supra note 3, at 36 ("Class actions can put a gun to the head of companies. Maybe the company will win, but maybe they will get a verdict that will kill them."); Robert E. Litman, U.S. Chamber of Commerce Inst. for Legal Reform, Through Their Eyes: How Foreign Investors View and React to the U.S. Legal System 13 (2007) (on file with the University of Michigan Journal of Law Reform), available at www.instituteforlegalreform.com/get_ilr_doc.php?id=1059 (stating that "some defendants can feel financially pressured to settle even if they have done nothing wrong, believing it not to be worth betting their companies on a subsequent mistaken jury verdict that can be difficult to overturn on an appeal."). Certainly our nation's founders did not express such distrust of our jury system. See U.S. Const. amend. VII; see also John Guinther, The Jury in America 30 (1988) (discussing the importance of the jury as a bedrock of our governmental structure). In addition, securities fraud trials are extraordinarily rare. Stephanie Plancich & Svetlana Stariksh, NERA Econ. Consulting, 2008 Trends in Securities Class Actions 7 (2008) (on file with the University of Michigan Journal of Law Reform), available at http://www.nera.com/image/Recent_Trends_Report_12-08.pdf ("[O]nly four of the cases filed in 2000 have gone to trial, and all settled with at least one defendant during the trial."). In fact, securities fraud class actions go to verdict so seldom that damage issues prove to be novel and difficult. See Jeffrey M. Goldman, Avoiding Blurred Lines: The Computation of Damages in Rule 10b-5 Securities Class Action Lawsuits in the Ninth Circuit and a Proposal for a More Sensible System, 2 Hastings Bus. L.J. 261, 261-62 (2006). Moreover, "lack of faith in jury capability is based on untested (and somewhat elitist) assumptions about lay people and would require case-by-case line drawing that would be burdensome, if not impossible, and subject the jury trial right to the subjective judgments of individual judges." Miller, supra note 146, at 1106.
have in a securities action. In fact, one commentator has been able to catalogue over seventy-five distinct defenses to a securities claim. Even further, if the defendant goes to trial, the plaintiff must establish all the elements of his claim by a preponderance of the evidence; the defense has a legitimate chance at defending against liability. It is interesting to note that the last time a plaintiff procured a securities class action verdict was seven years ago, in 2002. Thus, the risk that jurors will run amok is an insufficient basis to justify imposing a rigorous class certification standard whereby plaintiffs must establish loss causation and defendants must be afforded opportunity for rebuttal of reliance.

2. Congress Did Not Establish a Heightened Class Certification Standard in the PSLRA

Had Congress wished to heighten the class certification standard under the PSLRA, it would have done so. However, Congress re-
frained from enhancing the barrier to class certification in the PSLRA. Instead, the PSLRA implemented numerous other comprehensive class action reforms to address concerns. For example, Congress made the following changes as they pertain to securities class actions:

- Lead plaintiffs must show independence from class action attorneys.
- The first plaintiff to file a class action complaint must provide notice to members of the purported class within twenty days.
- Within ninety days of notice, the court must consider and resolve motions by class members to serve as the lead plaintiff.
- Once a lead plaintiff is selected, the lead plaintiff may select and retain class counsel subject to the court's approval.
- Class members must receive notice of any settlement which includes the amount of the proposed settlement distribution determined in the aggregate and on an average per share basis.
- The selected class counsel must identify and explain fees and expenses to be included in the settlement.

sion alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." (emphasis added)).

156. Rice, supra note 148, at 329–35.
157. Lead plaintiffs must disavow having purchased the securities at the direction of plaintiff's counsel to participate in the class action. 15 U.S.C. § 78u-4(a)(2). Additionally, no person can be a lead plaintiff in more than five securities class actions during any three-year period without the express permission of the court. 15 U.S.C. § 77z-1(a)(3)(B)(vi) (2006) ("Except as the court may otherwise permit, consistent with the purposes of this section, a person may be a lead plaintiff, or an officer, director, or fiduciary of a lead plaintiff, in no more than 5 securities class actions brought as plaintiff class actions pursuant to the Federal Rules of Civil Procedure during any 3-year period.").
159. 15 U.S.C. § 78u-4(a)(3)(B)(i) ("Not later than 90 days after the date on which a notice is published . . . the court shall consider any motion made by a purported class member in response to the notice, including any motion by a class member who is not individually named as a plaintiff in the complaint or complaints, and shall appoint as lead plaintiff the member . . . of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members . . . .").
160. 15 U.S.C. § 78u-4(a)(3)(B)(v) ("The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class.").
Despite Congress's comprehensive attention to the securities class action, it is telling that Congress did not change the class certification standard.

Moreover, "the PSLRA enacts significant, heightened pleading requirements for private securities fraud claims," yet a heightened class certification standard or an alteration of Rule 23 is not among them. "The statute requires plaintiffs to allege with particularity defendants' misrepresentations and omissions, together with a statement of reasons why they are misleading. In addition, the statute requires plaintiffs to plead with particularity facts which give rise to a 'strong inference' that defendants made their misstatements or omissions with the requisite state of mind." These heightened standards do not mention class certification, loss causation, or reliance at all. More importantly, the loss causation section of the PSLRA refers only to the burden of proof at trial. Thus, the statutory canon of construction expressio unius est exclusio alterius compels the conclusion. This canon has been used quite authoritatively by those interpreting the Federal Rules of Civil Procedure. Congress's expression of a heightened standard for pleading scienter implies the exclusion of a heightened standard for loss causation and reliance. It is plain that Congress did not intend to heighten the securities class certification standard. Instead, alternative procedures were a sufficient safeguard for frivolous claims while preserving plaintiffs' ability to bring meritorious suits. However, the judicial decision to raise the class certification standard has made it easier for defendants to mislead investors, thwarting the primary goal of the securities laws—implementing a philosophy of full disclosure.

164. Id. at 22.
166. See Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit, 507 U.S. 163, 168 (1993) (using the canon of construction expressio unius est exclusio alterius to refine the liberal pleading requirements of Rule 8(a) and the heightened pleading requirements of Rule 9(b)).
167. Not only did Congress specifically refrain from heightening the loss causation pleading standard, but the Supreme Court in Dura Pharms., Inc. v. Broudo, 544 U.S. 336 (2005), also refrained from doing so. See Matthew L. Fry, Pleading and Proving Loss Causation in Fraud-on-the-Market-Based Securities Suits Post-Dura Pharmaceuticals, 36 SEC. REG. L.J. 31 (2008).
168. Rudman, supra note 46.
B. The Judicial Creation of Rule 23 Merits Trials
Contradicts Supreme Court Precedent

In addition, the judicial creation of Rule 23 trials for securities fraud claims is directly contrary to applicable Supreme Court precedent.\(^{169}\) In Eisen v. Carlisle & Jacquelin, the Supreme Court held that merits issues are reserved for trial and are not to be decided on a Rule 23 certification motion.\(^{170}\) Even more specifically, the Supreme Court has unequivocally stated in Basic v. Levinson that the fraud-on-the-market presumption is rebuttable at trial.\(^{171}\) Thus, requiring plaintiffs to establish merits-related issues, such as loss causation and reliance, at the Rule 23 stage is irreconcilable with Supreme Court precedent.

1. Eisen v. Carlisle: No Merits Inquiries on Class Certification

The Court in Eisen was clear that courts do not have any authority under Rule 23 to conduct a preliminary inquiry into the merits of a suit in determining whether to maintain an action as a class action.\(^{172}\) In Eisen, the Supreme Court explained that a merits inquiry on class certification contravenes Rule 23 because it allows a plaintiff to secure the benefit of a class action without first satisfying its requirements and that it may deny defendants traditional rules and procedures applicable to civil trials.\(^{173}\) The Court further reasoned that the inquiry on a Rule 23 motion is not whether the

\(^{169}\) See In re LDK Solar Sec. Litig., 255 F.R.D. 519, 530 (N.D. Cal. 2009) (stating that Oscar injects a merits inquiry into the class-certification inquiry through the back door and that it is in no small tension with the Supreme Court’s Basic decision); Schleicher v. Wendt, No. 1:02-cv-1332-DHF-TAB, 2009 WL 761157, at *26-27 (S.D. Ind. Mar. 20, 2009) (stating that Oscar runs contrary to Supreme Court precedent). The federal circuit courts of appeal appear to be "boiling the frog." See Posner, supra note 140, at 277 (a term borrowed by Judge Richard Posner to describe how Supreme Court Justices gradually extinguish prior unloved precedents from Justice Alito’s plurality opinion in Hein v. Freedom From Religion Found., Inc., 551 U.S. 587 (2007)).


\(^{172}\) Eisen, 417 U.S. at 177 ("We find nothing in either the language or history of Rule 23 that 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."). In Eisen, a class action was brought against certain brokerage firms trading on the New York Stock Exchange alleging violations of both antitrust and securities laws. Id. at 160. The district court certified a class of over two million persons. Id. at 166. The district court then conducted a preliminary hearing on the merits and after determining that the plaintiff was more than likely to prevail at trial, imposed ninety-percent of the costs of serving notice on the class on the defendant. Id. at 168. The Court of Appeals for the Second Circuit reversed and stated that the district court had no authority to hold a preliminary hearing on the merits. Id. at 169.

\(^{173}\) Id. at 177-78.
plaintiff has stated a cause of action or whether he will prevail on the merits; rather, the issue is whether the requirements of Rule 23 are met. Thus, both Oscar and In re Salomon contravene the clear holding of Eisen.

2. Basic v. Levinson: The Fraud-on-the-Market Presumption Is Rebuttable at Trial

Similarly, the trend of allowing rebuttal of the fraud-on-the-market presumption at the class certification stage cuts against the precedent set forth in Basic. In Basic, the Supreme Court established that the fraud-on-the-market presumption of reliance is a rebuttable presumption, no doubt. However, the relevant inquiry is when is this presumption rebuttable? The Supreme Court in Basic provides the answer: at trial. The Basic Court specifically left issues of loss causation and the fraud-on-the-market presumption for trial. The Supreme Court stated:

[I]f, despite petitioners' allegedly fraudulent attempt to manipulate market price, news of the merger discussions credibly entered the market and dissipated the effects of the misstatements, those who traded Basic shares after the corrective statements would have no direct or indirect connection with the fraud.

... We note there may be a certain incongruity between the assumption that Basic shares are traded on a well-developed, efficient, and information-hungry market, and the allegation that such a market could remain misinformed, and its valuation of Basic shares depressed ... on the basis of the three public statements. Proof of that sort is a matter for trial, throughout which the District Court retains the authority to amend the certification order as may be appropriate.

This statement by the Supreme Court has been correctly interpreted to mean that the defendant's rebuttal burden to show that the market price was not affected by the misrepresentation is a

174. Id. at 178 (citing Miller v. Mackey Int'l, 452 F.2d 424 (5th Cir. 1971)).
176. Basic, 485 U.S. at 248.
177. Id. at 248-49 & n.29 (emphasis added).
matter for trial. In other words, a defense of “non-reliance” is a matter for trial. A battle of the experts is not required at the Rule 23 stage.

3. The Rebuttal Opportunity Is at Trial

An approach consistent with Supreme Court precedent requires only that all other questions be common to the class once the plaintiff makes a showing that the fraud-on-the-market presumption attaches. The relevant question at the Rule 23 stage is only whether the plaintiff’s expert’s methodology will apply to the entire class.

The reason for this, as explained in Eisen, is simple: “the question is not whether the plaintiff or plaintiffs have stated a cause of action or will prevail on the merits, but rather whether the requirements of Rule 23 are met.” The issue is a procedural one: whether questions raised by the litigation would be most efficiently addressed as a class rather than on an individual basis. Thus, “to require [a] plaintiff to show more . . . would conflate the issue of whether common issues will dominate the merits decision with the merits decision itself.” A defendant’s arguments, even if substantial, do not address the purposes of Rule 23.

In sum, the approach Eisen and Basic demand, and that certain district courts already abide by, is that once the plaintiff establishes reliance and that the fraud-on-the-market presumption applies, the class should be certified.

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178. Kaplan v. Rose, 49 F.3d 1363, 1378 n.3 (9th Cir. 1994); In re Micron Techs., Inc. Sec. Litig., 247 F.R.D. 627, 634 (D. Idaho 2007) (citing Basic, 485 U.S. at 249 n.29). The defendant must do more than just raise questions to sever the link connecting the fraud-on-the-market theory. In re Micron Techs., 247 F.R.D. at 634.

179. Rudman, supra note 46.


183. In re Salomon Analyst Metromedia Litig., 236 F.R.D. 208, 223 (S.D.N.Y. 2006). Interestingly, the very “question of whether individual traits on the reliance issue are necessary is itself a question that is common to the whole class.” 3 Thomas Lee Hazen, Treasise on the Law of Securities Regulation § 12.10[5] (5th ed. 2005).

184. In re Credit Suisse-AOL Sec. Litig., 253 F.R.D. at 29 (internal quotation omitted).

185. Id.


187. In fact, defendants may be better off embracing the Basic presumption at the class certification stage and later turn the presumption to their advantage. Bradford Cornell & R. Gregory Morgan, Using Finance Theory to Measure Damages in Fraud on the Market Cases, 37
While a court must still analyze whether the plaintiff has established that he is initially entitled to the presumption, the defendant’s opportunity to refute this presumption is reserved for trial, and it is not appropriate on a class certification motion. As the district court in In re Salomon correctly noted, “if the evidence at trial or on summary judgment indicates that the alleged misrepresentations . . . did not affect the value of [the company’s] shares during the class period, Basic would not apply.” In addition, “[a]t trial or on summary judgment, defendants’ argument regarding the reports’ effect (or lack of effect) on market price will also be relevant to the question of loss causation.”

C. The Judicial Creation of Class Certification Merits Trials Is Incompatible With the Seventh Amendment to the Constitution

The federal courts’ creation of class certification merits trials also impermissibly infringes on plaintiffs’ Seventh Amendment right to a jury trial. The Seventh Amendment provides that in suits at common law, the right of a trial by jury shall be preserved.

UCLA L. Rev. 883, 919 (1990). For example, defendants may successfully argue that the market was indeed efficient, “reflect[ing] all available information in securities pricing, including information from nonissuer sources that questions, contradicts, or corrects the issuer’s misrepresentation.” Id. at 919 (citing cases where the fraud-on-the-market theory has worked against plaintiffs).

188. The availability of the presumption is not a merits issue, thus warranting an analysis as to whether the market was efficient. Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc., No. 05-CV-01898, 2006 WL 2161887, at *9-10 (S.D.N.Y. Aug. 1, 2006). However, “whether the plaintiff may take advantage of the presumption of reliance (through either Affiliated Ute or Basic) and whether the plaintiff has proven reliance are distinct inquiries.” Id. at *9 (emphasis in original).

189. In re Salomon Analyst Metromedia Litig., 236 F.R.D. 208, 223 (S.D.N.Y. 2006); see also HAZEN, supra note 183, § 12.10[5] (stating “the proper approach is to let the litigation continue as a class action until it becomes apparent that the common issues no longer predominate.”).

190. In re Salomon Analyst Metromedia Litig., 236 F.R.D. at 223 n.11.

191. A Seventh Amendment challenge was raised by the plaintiffs in Cammer v. Bloom, 711 F. Supp. 1264, 1289 (D.N.J. 1989). The plaintiffs claimed that evidence as to the presumption of the fraud-on-the-market theory would have to be reexamined by a second jury and that this infringed on their rights to have a single jury decide all the factual issues of the case. Id. The Cammer court addressed only whether the determination of a presumption infringes on the Seventh Amendment. Id. at 1289-91 (stating that a presumption is a rule of evidence and signifies a ruling of law). The Cammer court did not address whether an actual determination of loss causation, as in Oscar, infringes on the Seventh Amendment.

192. U.S. Const. amend. VII. The Seventh Amendment ensures citizenship by preserving “an active role for citizens in the administration of both civil and criminal justice.” GASS R. SUNSTEIN, THE SECOND BILL OF RIGHTS: FDR’S UNFINISHED REVOLUTION AND WHY WE
The right to a jury trial is not absolute and current Supreme Court jurisprudence concerning “the Seventh Amendment require[s] only the preservation of the substance of the English common law jury trial [as it existed] in 1791.” In the English common law, juries decided only questions of fact and not questions of law. Therefore, presently, questions of fact are reserved for the jury, not the court.

Noted scholar Suja A. Thomas has written extensively on the Seventh Amendment implications of procedural devices such as the motion to dismiss and the motion for summary judgment. According to Thomas, the framework for determining the constitutionality of procedural devices in light of Seventh Amendment concerns is as follows: (1) “under the common law, only the jury or the parties determine the facts,” (2) a court determines “the sufficiency of the evidence only after a jury trial,” and even then, if evidence is believed to be insufficient, the court orders a new trial, and (3) “a jury decide[s] a case with any evidence, however improbable.” Rule 23 must fit within the confines of the Seventh Amendment. The judicial creation of merits barriers to class certification is inconsistent with the Seventh Amendment.

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196. In re Peterson, 253 U.S. 300, 310 (1920) (“[U]ltimate determination of issues of fact by the jury [should] not [be] interfered with.”); Walker v. N.M. & S. Pac. R.R. Co., 165 U.S. 593, 596 (1897) (issues of fact in common-law actions are to be settled by the jury).


198. Thomas, Summary Judgment, supra note 193, at 180 (“Third, a jury would decide a case that had any evidence, however improbable that evidence was, unless the moving party admitted the facts and conclusions . . . .”).
Under Oscar, when plaintiffs move to certify a class, they must establish loss causation by a preponderance of the evidence.\textsuperscript{199} Under In re Salomon, once plaintiffs set forth evidence to establish the fraud-on-the-market presumption on a class certification motion, the defendant invariably presents rebuttal evidence\textsuperscript{200} and the court must resolve whether the plaintiffs have established loss causation on a Rule 23 motion. This resolution of the merits is inconsistent with the Seventh Amendment. According to Thomas, the common law only allowed a judge to consider the sufficiency of the evidence after a jury trial and verdict.\textsuperscript{201} Even a court only considering the reasonableness of inferences drawn from the evidence presented contravenes common law procedures, which require the judge to accept all allegations of the party as true, regardless of the improbability of those allegations.\textsuperscript{202} Resolving a battle of the experts concerning loss causation and reliance falls within the jury's province to listen, weigh, accept, or reject expert testimony.\textsuperscript{203} Indeed,

[T]here is a significant difference between allowing a judge to dispose of a case by applying a determinative legal principle to undisputed facts and allowing a judge to decide a factual issue because he or she believes the evidence allows only one conclusion. A judge always decides the former. As to the latter, if one or more facts are in dispute or different inferences may

\textsuperscript{199} Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 272 (5th Cir. 2007) (Dennis, J., dissenting) (stating that the majority holds that plaintiffs must prove loss causation "by a preponderance of all admissible evidence").

\textsuperscript{200} In re Salomon Analyst Metromedia Litig., 544 F.3d 474, 485 (2d Cir. 2008).

\textsuperscript{201} Thomas, Summary Judgment, supra note 193, at 161. Even then, where a judge found insufficient evidence, another jury would decide the second case, and not the original judge.

\textsuperscript{202} Id. at 159. This stricter approach would hold even the Seventh Circuit's standard unconstitutional. See Makor Issues & Rights, Ltd. v. Tellabs, Inc., 437 F.3d 588, 602 (7th Cir. 2006), vacated, Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007) (advocating a reasonableness standard).

\textsuperscript{203} Lapin v. Goldman Sachs & Co., 254 F.R.D. 168, 186 (S.D.N.Y. 2008); see Miller, supra note 146, at 1104. Professor Miller notes:

[Consider] the case of expert witnesses to fact. What is their function? It is just this, of judging facts. They are called in because they are men of skill and can interpret phenomena which other men cannot, or cannot safely interpret. . . . It is perfectly well settled in our law that such opinions or judgments are merely those of a witness, they are to aid the jury or the judge of fact, and not to bind them; the final judgment is for the jury, and, unquestionably, the judgment is one of fact.

\textit{Id.} at 1104 n.622 (citing James B. Thayer, "Law and Fact" in Jury Trials, 4 HARV. L. REV. 147, 154–55 (1890)).
be drawn from undisputed facts, a jury should be allowed to find for either party. 204

This is the case with loss causation 205 and reliance—at best, different inferences can be drawn from undisputed facts. The Oscar decision is a perfect case in point: the Fifth Circuit weighed competing expert theories and rejected the plaintiffs' expert's conclusion as "untenable." 206

Even those that argue for a more limited view of the Seventh Amendment in securities fraud litigation recognize that the Fifth Circuit in Oscar overstepped its role at the class certification stage. For example, Richard A. Nagareda argues that issues of aggregate proof, such as event studies in securities fraud litigation which demonstrate fatal dissimilarities, should be determined as a matter of law by the judge at the class certification stage, yet he still acknowledges that Oscar was incorrect as a ruling on class certification. 207 By finding facts concerning loss causation and reliance, this mini-trial on a motion for class certification intrudes on plaintiffs' right to trial by jury. Furthermore, the Seventh Amendment concerns raised by a resolution of the merits at the class certification stage are apparent when one considers the issues of collateral estoppel and issue preclusion. Collateral estoppel "bar[s] a party from relitigating an issue determined against that party in an earlier action." 208 In Bridgestone/Firestone Inc., the Seventh Circuit stated that, "[a]lthough claim preclusion (res judicata) depends on a final judgment, issue preclusion (collateral estoppel) does not."

The Seventh Circuit has held that a class certification decision is collateral estoppel for future class certification motions filed by members of the class. 209 Thus, collateral estoppel works for issues resolved by the court on class certification even if they are resolved

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204. Id. at 1091–92. Abrogating the Seventh Amendment cannot be justified for securities class actions on the basis of efficiency and cost; instead the Seventh Amendment gives a jury the power to decide cases that cannot be eliminated by Congress or the courts. Thomas, Motion to Dismiss, supra note 140, at 1887. Perhaps this hostility toward the Seventh Amendment merely represents the judiciary's hostility toward direct democracy. See Posner, supra note 140, at 329.


210. Id. at 768–69.
only as part of the class certification stage. The judicial creation of merits trials at the class certification stage for securities actions compounds this problem by precluding class plaintiffs from litigating merits issues such as reliance and causation in later suits without a trial by jury.

This end run around the right to a trial by jury is inconsistent with Supreme Court precedent. The class action was originally a device in equity. The Supreme Court held in *Beacon Theatres, Inc. v. Westover* that a federal court could not make findings in an equitable proceeding (i.e., a class certification decision) that would be collateral estoppel in a later action at law. The consequences of collateral estoppel can be dire for both defendants and plaintiffs: “[i]t can be invoked offensively ... to preclude litigation of an issue that was decided favorably ... in a prior action. Or, it can be used defensively ... to preclude relitigation of an issue that was decided in his favor in a prior suit.” If the doctrine of collateral estoppel did not apply to the factual findings on loss causation and reliance, the same evidence would have to be assessed again, resulting in a duplication of efforts. Thus, the Rule 23 analysis removes facts from the jury’s purview, violating the plaintiff’s Seventh Amendment right to a jury trial.

A recent decision from the Fifth Circuit in *Alaska Electrical Pension Fund v. Flowserve Corp.* recognizes the Seventh Amendment concerns expressed by this Article and tries to address that issue. However, its reasoning only underscores the problem. The *Flowserve* court reaffirmed that the plaintiffs “bore the burden of

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211. *Id.* at 768. This Rule 23 analysis is comparable to a Rule 12(b)(6) analysis advanced under *Tellabs* where courts must weigh competing inferences and select among them. *Tellabs, Inc. v. Makor Issues & Rights*, Ltd., 551 U.S. 308, 323 (2007). The Supreme Court has recognized that procedural dismissals based on Rule 12(b)(6) constitute judgments on the merits for purposes of collateral estoppel. A. Benjamin Spencer, *Civil Procedure: A Contemporary Approach* 925 (2d ed. 2007) (citing *Federated Dep’t Stores, Inc. v. Moitie*, 452 U.S. 394, 399 n.3 (1981)). Thus, just as a determination on a 12(b)(6) motion constitutes a judgment on the merits, so too does the courts’ determination on a Rule 23 analysis. The proceeding need not be a full adjudicatory proceeding for the doctrine of collateral estoppel to apply. *Jack H. Friedenthal et al., Civil Procedure: Cases and Materials* 1292 (10th ed. 2009).

212. *Hansberry v. Lee*, 311 U.S. 32, 41 (1940) (“The class suit was an invention of equity to enable it to proceed to a decree in suits where the number of those interested in the subject of the litigation is so great that their joinder as parties in conformity to the usual rules of procedure is impracticable.”).


214. Friedenthal, *supra* note 211, at 1273. Also, findings of loss causation and reliance at the class certification stage may constitute the law of the case, and bind the parties to those determinations. Spencer, *supra* note 211, at 948 (citing *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 815–16 (1988)).

215. 572 F.3d 221 (5th Cir. 2009) (per curiam). Former Justice O’Connor sat on the panel by designation.
establishing loss causation by a preponderance of the evidence in order to obtain certification of its proposed class. Yet, as this Article shows and as the Flowserve court's own reliance on cases like Eisen and Oscar demonstrates, that reaffirmation is based on an erroneous view of the requirements of Rule 23 at the class certification stage. The court accuses the plaintiffs of conflating issues of loss causation at the class certification stage with that issue on the merits, but it is the court that erroneously conflates those issues. As this Article shows, Supreme Court precedent governing Rule 23 and the federal securities laws do not justify requiring plaintiffs to prove any merits issue, such as loss causation, by a preponderance of the evidence at the class certification stage. The Flowserve court repeats this fundamental error.

As a consequence, the court was then compelled to address the Seventh Amendment concern raised by improperly conflating class certification issues with the merits. It purports to relieve the Seventh Amendment concern by announcing that any overlap is “only coincidental” and that any judicial “findings in connection with a holding on class certification do not resolve loss-causation issues on the merits, even when—as here—the two issues are practically identical.” As a general matter, the court’s conclusion that class certification findings made by a judge cannot preclude plaintiffs from presenting those same issues to a jury for a finding on the merits seems to avoid the Seventh Amendment problem. Yet the court’s reasoning actually reinforces the Seventh Amendment concerns raised in this Article.

First, the court recognized that there would be a Seventh Amendment problem if a judge’s class certification findings precluded plaintiffs from re-litigating those same issues to a jury on the merits. Second, the only legal support for the court’s conclusion that no such issue preclusion can take place is its note that class certification findings can be “revised” and are not final. This turns the Basic presumption on its head: in Basic, the Supreme Court afforded the plaintiffs a presumption of reliance at the class certification stage and left it to the defendants to rebut at trial. Moreover, as previously shown, the idea that certification proceedings can later be “revised” has been

216. Id. at 229.
217. Id.
218. Id.
219. Id. at 233.
220. Id. at 228–29.
221. Id.
undermined by the Seventh Circuit's *In re Bridgestone/Firestone* decision, in which the court held that non-final judicial findings are in fact given preclusive collateral estoppel effect in certain circumstances. A judicial finding of no loss causation at the class certification stage, therefore, could very well preclude a plaintiff who is a member of a class from trial by jury on the merits of that issue. Third, as this Article points out, as a practical matter the decision to deny class certification precludes individual plaintiffs from continuing to prosecute their individual claims to a jury. Accordingly, the Fifth Circuit's recent *Flowserv* case exemplifies the constitutional and policy problems created by the continuation of the trend of federal courts improperly requiring plaintiffs to establish the merits of their securities fraud claims at the class certification stage. The most effective way to prevent those problems is to recognize that Rule 23 does not require plaintiffs to establish any essential elements of their securities fraud claims at the class certification stage.

V. RULE 23 TRIALS ARE UNSUPPORTED BY POLICY

Despite this trend's discord with the federal securities laws, Supreme Court precedent, and the Seventh Amendment, resolving merit disputes at the class certification stage lacks the justification of addressing any legitimate policy concern. As evidenced by the Supreme Court's recent *Stoneridge* decision, having a policy justification is exceedingly important in securities case law. In particular, as this Part demonstrates, the harm purportedly averted by the trend is illusory, whereas the harm caused is significant.

223. 333 F.3d 763, 767 (7th Cir. 2003).
The Rule 23 merits trial trend purports to address the same concern of legislators, judges, and many others that securities fraud class actions are frivolous, inefficient, and abusive. These concerns are illusory. Stricter standards for securities class actions are justified because too often defendants are forced in terrorem into settlement. In particular, the rigorous certification process is intended to deter abusive lawsuits. Through the enactment of the Private Securities Litigation Reform Act, Congress sought to combat perceived frivolous strike suits and combat abuse. S. Rep. No. 104-98, at 4 (1995), as reprinted in 1995 U.S.C.C.A.N. 679, 683; see also S. Rep. No. 104-98, at 5 (1995), as reprinted in 1995 U.S.C.C.A.N. 679, 684 (noting the system is being abused and misused); H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), as reprinted in 1995 U.S.C.C.A.N. 750, 730 (abusive practices include "(1) the routine filing of lawsuits against issuers ... whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability ..., (2) the targeting [of] deep pocket defendants ... and individuals who may be covered by insurance," (3) imposing burdensome discovery costs to push a settlement, and (4) class action manipulation).
requirement is primarily justified because of the \textit{in terrorem} threat class certification presents.\footnote{229}

Yet the prevention of \textit{in terrorem} class action settlements is too weak in theory and in fact to support the Rule 23 trend. First, the \textit{in terrorem} concept is illogical. Second, concerns about expensive class discovery do not warrant a heightened class certification standard. Third, mechanisms already in place—endorsed by Congress and the Supreme Court—mitigate the threat of frivolous securities class actions. Courts should utilize these devices more effectively rather than craft new, unendorsed, and unconstitutional devices.

1. The \textit{In Terrorem} Concept Is Illogical

The \textit{in terrorem} concept suffers from logical deficiencies. As an initial matter, to complain that defendants are forced into settlement ignores the well-settled judicial pillar that the law favors settlement of merited claims.\footnote{229} Further, whether a claim is “frivolous” is often no more than an untestable rhetorical assertion insufficient to deny investors a remedy for harmful conduct.\footnote{231} Nevertheless, even if there is verifiable evidence that plaintiffs bring frivolous securities class actions, a heightened barrier to class certification is not necessarily consistent with pragmatic business practices.

\textit{a. The Law Favors Settlement}

Those that presume the frivolity of securities class actions generally argue that these actions force defendants \textit{in terrorem} into settlement.\footnote{232} Absent the \textit{in terrorem} settlement concern, however,

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\begin{itemize}
\item \footnote{229}{See Oscar, 487 F.3d at 267; Recent Case, Securities Litigation—Class Certification—Fifth Circuit Holds that Plaintiffs Must Prove Loss Causation Before Being Certified as a Class, 121 Harv. L. Rev. 890, 890 (2008) (stating that courts have erected additional barriers to class certification in securities actions to guard defendants from settling frivolous claims). Despite the fact that this policy concern is insufficient to justify a rigorous standard, there is a competing policy concern that mandates against a rigorous standard: a rigorous standard can make it harder for victims to pursue smaller claims absent a class action device. Evans, supra note 3, at 1.}

\item \footnote{230}{See infra Part V.A.1.a.}

\item \footnote{231}{John C. Coffee, Jr., Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation, 106 Colum. L. Rev. 1534, 1556 n.5 (2006).}

\item \footnote{232}{See supra note 137 and accompanying text.}
\end{itemize}

The Unjustified Judicial Creation

there is no justification for a rigorous Rule 23 standard. To maintain that in terrorem settlements justify a rigorous class certification analysis requires that the plaintiff bring a frivolous claim. If the action is not frivolous, the defendants' entering into a settlement is in fact a good thing. Settlement compensates the injured party, spares both parties litigation costs, and promotes judicial economy. Class action suits readily lend themselves to compromise because of the difficulties of proof, the uncertainties of the outcome, and the typical length of the litigation. "There is an overriding public interest in settling and quieting litigation, and this is particularly true in class actions." Moreover, according to NERA Economic Consulting, plaintiffs are suffering higher losses, but there has been no corollary rise in the median settlement value. One may infer that settlement may be "cheaper" compensation for injured plaintiffs. The main problem with the in terrorem policy concern is that it is inapplicable where a claim has merit.

233. Instances of legitimate corporate fraud—as opposed to plaintiff fear mongering—are not unheard of. For example, Alan Greenspan, former Chairman of the Federal Reserve, noted that modern corporate accounting practices responsible for the Enron and Worldcom debacles provided corporate management with broad discretion "to favorably bias their results to the edge of outright fraud. Some clearly went over the line." ALAN GREENSPAN, THE AGE OF TURBULENCE 429 (Penguin Books 2008); see also BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (Penguin Group 2003) (chronicling the massive Enron accounting scandal).


237. Planich & Starykh, supra note 149, at 14 fig.15 (demonstrating that in 1996 the ratio between median investor losses and median settlement was 7.1%, but in 2008 the ratio is only 2.7%).

238. Should defendants and others still be heard to complain of litigation costs where the claim has merit, a very simple, yet often overlooked, response exists: "Why Not Tell the Truth?" Justice Brandeis observed that sunlight is a great disinfectant. If we focus on telling the truth, rather than obfuscating financial results, we can have the best of all worlds: an efficient market and minimal litigation." Murdock, supra note 227, at 568–69. Moreover, "[i]n a typical litigation scenario, the courts merely serve as a background for the bargaining between parties to reach a settlement. Thus, to single out settlements in securities litigation...
Perversely, under *Oscar*, *Flowserv*, and *Salomon*, injured investors asserting meritorious claims must now face a more rigorous class certification analysis without any reason for doing so. Even worse, absent class action status, injured investors may never bring the merited claim, deciding it is just not worth the effort despite the suffered wrong.

b. Concerns About “Frivolous” Claims are Unfounded and Untested.

Second, concerns in general about frivolous claims are unfounded and largely unverifiable. Proponents of securities class action reform claim that securities class actions cost millions of dollars in unnecessary legal expenses, and are often settled without regard to the merits solely to avoid the expense and risks of defending “frivolous” suits. See supra note 140, at 658. “Such claims, however, are based more on rhetoric than on empirical proof.” As John C. Coffee, Jr., securities law expert, states:

The true “strike suit” nuisance action, filed only because it was too expensive to defend, is, in this author’s judgment, a beast like the unicorn, more discussed than directly observed. Although small settlements may have been impelled in part by the high cost of defense, the corresponding observation is that the small damages in these cases also did not justify much effort on the plaintiff’s side. Neither side wanted to invest much effort in them—but this does not make them inherently frivolous. Similarly, the economic evidence that strike suits predominate also seems unpersuasive.

Even despite the logistical problem that there is little substantial means by which to respond to the mantra that “most class actions have little merit,” defendants also require plaintiffs to enter into strict confidentiality agreements before engaging in document production. Additionally, defendants require plaintiffs to return as nuisance-driven ignores the fact that most litigation is aimed at achieving settlement.”

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239. See supra note 149 and accompanying text.
241. Coffee, supra note 231, at 1536 n.5.
242. Hufford, supra note 240, at 637.
243. Id.
or destroy all such documents upon the conclusion of a case.\textsuperscript{244} Thus, plaintiffs' attorneys are generally unable to respond to vague public attacks on the validity of their suits by pointing to specific evidence of uncovered fraud.\textsuperscript{245}

c. Even if the Claim Is Frivolous, Pragmatic Business Practice Does Not Require Settlement of Frivolous Claims

Even if a plaintiff brings a claim that is frivolous or meritless, it is tenuous to contend that \textit{in terrorem} settlements mandate a stricter class certification analysis. For the fear of \textit{in terrorem} settlements to be legitimate, not only must a claim be meritless, but the costs of litigating must outweigh those of settling.\textsuperscript{246} There is little evidence that defendants invariably settle meritless claims to avoid the costs of litigation. Indeed, in deciding whether to litigate frivolous claims, a rational defendant may consider not only the costs of litigation and the probability of success, but also the potential long-range benefits it may derive from signaling its reputation for an unwillingness to settle these claims.\textsuperscript{247} Thus, in the long-run, litigating such a claim may turn out to be more cost-effective and a more pragmatic business solution for the defendant. In some cases, it would be shortsighted for a corporation to avoid immediate legal costs; it would be pragmatic to build a reputation as an "off-limits" nuisance target.\textsuperscript{248}

\footnotesize

\textsuperscript{244} \textit{Id.}

\textsuperscript{245} \textit{Id.}


\textsuperscript{247} RICHARD A. POSNER, \textit{ECONOMIC ANALYSIS OF LAW} 569–70 (6th ed. 2003) (discussing assorted variables that enter into settlement decisions, including probability of winning, precedential value from winning, and degrees of risk preference of the parties). Should a plaintiff bring a frivolous claim against a corporate defendant, it may even be in the best interest of the corporate defendant not to settle, but to litigate the case to the fullest extent possible. \textit{Cf.} Coffee, \textit{supra} note 241, at 1585 (concluding that litigation is often feigned, that adversaries skirmish over pretrial motions, but ultimately agree to settle to impose costs on the absent shareholders). Coffee also concludes that once securities litigation becomes more adversarial, then the SEC will be able to address the compensatory problem settlements pose. \textit{Id.} at 1585–86.

\textsuperscript{248} \textit{Cf.} RICHARD A. POSNER, \textit{LAW, PRAGMATISM, AND DEMOCRACY} 60–61 (2003) ("Pragmatic adjudication is not a synonym for ad hoc decisionmaking, that is, for always deciding a case in the way that will have the best immediate consequences without regard to possible future consequences. . . . 'Shortsighted' is not part of the definition of 'pragmatic.'"); \textit{see also} Posner, \textit{supra} note 140, at 239 (distinguishing sensible pragmatic adjudication from shortsighted pragmatists).
For example, consider the following scenario illustrated by Senator Robert Bennett in response to the President's veto of the PSLRA:

There is a lawyer in New York who watches [the Company], and whenever the compensation of the directors goes up for whatever reason, he automatically files a lawsuit . . . . [Legal counsel told the director:] "[T]his lawyer knows he will never win his suit. He knows we will never spend the money to take him to court. It would cost us about $500,000 to prosecute this suit and take him to court and win and it is cheaper for us to send him a $100,000 check to settle this . . . . [Director], you can be as outraged as you want to be, but our alternative is to prosecute this lawsuit, take him to court, beat him in court, see a $500,000 legal bill run up in the process." . . . [Later, this] lawyer decided to expand his practice and he started suing other companies . . . . One of the companies . . . looked at this and decided the time has come to put an end to it and . . . we can take this man to court and ruin him in his legal costs, trying to defend himself. So the system that had worked for the lawyer in one circumstance then turned against him . . . [T]hey ultimately did put a stop to it because when he was faced with actually proving his position in a court of law and running up the costs connected with that kind of litigation, the lawyer was finally forced to back down.249

What is missing from this story is how many times the Director's corporation made these payments to this New York lawyer. The answer is quite important: if the corporation made these payments more than five times, then it would have been more economically efficient to fight the case initially, putting him out of business and preventing future costs.

2. Concerns About Class Discovery Do Not Warrant a Heightened Standard for Securities Class Actions

Second, concerns about expensive class discovery do not warrant a heightened securities class certification standard. In general, discovery abuse is not as rampant as it is perceived to be. Moreover, discovery is a two-way street: both plaintiffs and defendants impose

costs and use discovery as a pressure tool. Finally, discovery serves a vital function in the legal system.

a. Concerns About Abusive Discovery are Based on Misperceptions.

There is widespread sentiment that discovery is abusive and high discovery costs force defendants to settle. \(^\text{250}\) Nowhere is this misperception as visible as in securities class action litigation. Consider the colorful comparison of an article appearing in *The National Law Journal*: “Like ticks on a hound, the lawyering and lobbying classes are sucking billions from the economy that might otherwise be used for productive investment. And the public is getting plenty sore about it.” \(^\text{251}\)

While vivid anecdotes abound, \(^\text{252}\) empirical research about discovery in civil litigation has yielded results that differ from this conventional wisdom. \(^\text{253}\) The concern about abusive discovery practices rests on prevailing sentiments that discovery is excessive and abusive rather than on actual data. \(^\text{254}\) Most studies measuring the incidence of discovery survey only opinions, impressions, or


\[^{251}\text{Mullenix, Discovery in Disarray, supra note 250, at 1398 (citing Jonathan Racuh, The Parasite Economy, 24 Nat’l. Rev. 980, 980 (1992)).}\]

\[^{252}\text{Yablon, supra note 145, at 1618–20 (discussing the “smelly paper” discovery trick).}\]

\[^{253}\text{Thomas E. Willging et al., An Empirical Study of Discovery and Disclosure Practice Under the 1993 Federal Rule Amendments, 39 B.C. L. Rev. 525, 527 (1998). The discovery reform agenda is based on “questionable social science, cosmic anecdote, and pervasive, media-perpetrated myths.” Mullenix, Discovery in Disarray, supra note 250, at 1996 (internal quotations omitted). Discovery data has in fact remained constant over time. Mullenix, The Discovery Abuse Sequel, supra note 250, at 683.}\]

\[^{254}\text{Wunderlich, supra note 140, at 655. “[P]erceptions based on potentially unrepresentative experiences coalesced in a widely shared belief that discovery abuse was a pervasive and serious phenomena.” McKenna & Wiggins, supra note 250, at 787. “[P]roposals for discovery reform [are] . . . typically impelled by anecdotal evidence and rhetorical, but highly compelling, reports of discovery abuse.” Mullenix, The Discovery Abuse Sequel, supra note 250, at 684. Similarly, Professor Charles Yablon argues that discovery is misperceived as zealous advocacy. Yablon, supra note 145, at 1620. According to Yablon, this is due to the inherent tension between the cooperative nature of discovery and the adversarial nature of the litigation system. Id. at 1625. To remedy this over-zealous discovery advocacy, Professor Yablon suggests that courts treat lawyers much like a parent treats their kids on long car trips when they act up: tell them to “shut up and knock it off.” Id. at 1619. This approach would have the effect of deterring abusive discovery by making it “less fun.” Id. at 1640.}\]
billable hours. The Columbia Field Project study, the first major study into the actual effects of discovery practice, found that there was no widespread failing in the scope or availability of discovery. Likewise, a 1978 study by the Federal Judicial Center found that in fifty-three percent of cases no discovery was requested at all, and fewer than five percent of these cases had more than ten discovery requests. The Federal Judicial Center study found that in seventy-two percent of the cases there were no more than two discovery requests. Similarly, a study by the National Center for State Courts found that only forty-two percent of the cases in the sample group conducted discovery. Empirical data suggests that a majority of ordinary cases involve no discovery and that the majority of the cases that do conduct discovery generally involve only two discovery requests. Thus, abusive discovery is not widespread, rather what is widespread is the misperception that discovery is excessive and abused.

Admittedly, as a group, securities class action litigation suffers from higher discovery than the ordinary civil action. However, securities class actions alone do not suffer from this higher incidence of discovery. For example, copyright, patent, and trademark cases have higher discovery costs in general. In addition, trade regulation claims, tort claims, admiralty claims, contract cases, and antitrust cases all suffer from a higher volume of discov-


256. McKenna & Wiggins, supra note 250, at 786-87 (citing the Columbia Project field survey).


258. McKenna & Wiggins, supra note 250, at 790.


260. McKenna & Wiggins, supra note 250, at 790.

261. Wunderlich, supra note 140, at 655.

262. Willging, supra note 253, at 578.


264. Willging, supra note 253, at 552.
In all larger and more complex cases, discovery is used more intensely, consuming a dominating percentage of litigation resources. Thus, more extensive and intensive discovery is explained by the fact that in larger cases, the stakes are higher, and this is not necessarily indicative of abuse. There is more personal investment in the case. Hence, there tends to be more involvement in the discovery process, i.e., privileges are invoked more frequently and clients play a more active role in discovery matters.

In other words, higher incidences of discovery problems in larger class actions do not mean that more problems are likely to occur. Rather, a high incidence of discovery problems for larger cases may just indicate that there is plainly more discovery in those cases. And, notably, a high incidence of discovery abuse in all complex cases does not justify a heightened class certification standard for securities cases on their own.

b. Even if Discovery Costs are High in Securities Actions, This Does Not Lead A Fortiori to a Higher Class Certification Barrier

Even if data emerges that demonstrates that securities actions abound with high discovery costs more so than any other complex litigation, high discovery costs are to be expected in securities class actions that claim millions of dollars in investor losses. Discovery costs are proportional to parties' needs and the stakes in the case. One study found that the size of the amount at stake in the

265. Wunderlich, supra note 140, at 656.
266. McKenna & Wiggins, supra note 250, at 801. Larger and more complex cases also are more influenced by tactical decisions. Id. However, massive amounts of discovery presents a clichéd “chicken-or-the-egg” type problem: “[b]road discovery ... can contribute to ’megalitigation in part by unearthing evidence that supports claims by many.” Richard L. Marcus, Reassessing the Magnetic Pull of Megacases on Procedure, 51 DePaul L. Rev. 457, 470 (2001). Thus, whether a big case generates big discovery or whether big discovery generates a big case is an issue.
268. McKenna & Wiggins, supra note 250, at 801.
269. Marcus, supra note 266, at 470.
270. Id. at 471 n.60.
271. Willging, supra note 253, at 531. Indeed, the likelihood of discovery problems increased as the stakes, factual complexity, and contentiousness increased. Mullenix, The Discovery Abuse Sequel, supra note 250, at 685–86.
case had the strongest relationship to the total litigation costs more so than any other studied characteristic.\textsuperscript{272} Litigation in general is an interactive investment process that is influenced by actual and anticipated expenditures of both the litigant and the opponent.\textsuperscript{273} The high costs of securities litigation are not due to frivolous litigation or abusive discovery, but rather this symbiotic relationship.

Further, high discovery costs do not justify a heightened class certification barrier for the plaintiff. Courts have imposed barriers on plaintiffs because of discovery concerns, but “[d]efendants’ attorneys (58%) were more likely than plaintiffs’ attorneys (42%) to report that they had no problems [with disclosure or discovery in their case].”\textsuperscript{274} Consequently, plaintiffs have more problems with discovery than defendants. Discovery abuse is not a plaintiff-specific phenomenon. Just as plaintiffs may use discovery as a club to impose costs on defendants, defendants may use “dump-truck” discovery responses as a method of overwhelming the plaintiffs.\textsuperscript{275} As one commentator explained:

While companies claim that frivolous litigations result in unnecessary defense costs, what they fail to acknowledge is that frivolous defenses to valid claims have perhaps an even greater impact on the costs and delays inherent in litigation. Defense firms universally choose to file substantial motions to dismiss or for summary judgment, even for cases which clearly satisfy the pleading standards with valid underlying claims. Defense attorneys also oppose class certification even in the most routine situations and usually attempt to delay or stymie legitimate discovery efforts. As a result, cases involving even

\textsuperscript{272} Willging, supra note 253, at 532. Other factors studied included the percentage of litigation costs attributable to document production, the number of hours spent in depositions, the size of the law firm, the complexity and contentiousness of the case, and the type of the case. \textit{Id}. High stakes also influenced the length of the litigation: the higher the stakes, the longer the case lasted. \textit{Id}. at 533. In addition, securities litigation often involves the use of expert witnesses, requiring expert disclosure and discovery. Discovery relating to experts is the second most costly type of discovery. \textit{Id}. at 540. In addition, securities class action litigation is dominated by large firms. Costs for firms of more than eleven attorneys are “significantly” higher than costs from smaller firms, and this correlation is independent of complexity, contentiousness, or the amount at stake in the litigation. \textit{Id}. at 541. Moreover, clients that employ large firms generally have their own internal staff of lawyers, one of whose jobs is to keep down litigation costs. Yablon, supra note 145, at 1624 n.16.

\textsuperscript{273} Trubek, supra note 255, at 76, 77 (discussing the idea that litigation is an “investment of scarce resources to achieve a future result”); see also Patrick E. Higginbotham, \textit{Judge Robert A. Ainsworth, Jr. Memorial Lecture, Loyola University School of Law: So Why Do We Call Them Trial Courts?}, 55 S.M.U. L. REV. 1405, 1412 (2002) (saying that all decisions on whether to go to trial are based on cost concerns).

\textsuperscript{274} Willging, supra note 253, at 553.

\textsuperscript{275} Marcus, supra note 266, at 470.
The most obvious fraud take years to litigate and often result in settlements below what investors should, in all fairness, receive. In response to the argument that plaintiffs' firms file frivolous suits in order to "extort" settlements, it can just as easily be asserted that defendants delay litigation and file frivolous defenses in order to force plaintiffs to accept low settlements. 276

In addition to the fact that discovery abuse is likely to occur on both sides of the fence, there is some indication that a lengthened discovery process will actually benefit defendants. For example, studies find that "discovery is not cost-effective for all parties. . . . [F]or plaintiffs, increased lawyer time spent on discovery was associated with decreased measures of success. . . . [D]iscovery is less profitable for plaintiffs. The more days plaintiffs spent in discovery, the lower their recovery relative to expectations." 277

Similarly, discovery studies found that "cases with more discovery were actually less likely to settle." 278 The number of days spent in discovery was associated with increases in the number of disagreements between sides concerning factual and legal issues and with lower proportions of cases settling before trial. Cases where neither side engaged in discovery settled out of court in ninety-seven percent of cases. 279 Cases where both parties engaged in discovery settled in seventy-six percent of cases. 280 Thus, it is paradoxical to claim that high discovery costs force defendants to settle when higher incidences of discovery meant the parties were actually less likely to settle.

c. Discovery Promotes Merits Resolution

Finally, discovery plays an important role in resolving litigation on the merits. There is no dispute that defendants incur substantial costs defending against securities class actions. But the issue is not whether these defendants would have saved money by avoiding

276. Hufford, supra note 240, at 639; see also Mullenix, Discovery in Disarray, supra note 250, at 1401-02 ("(C)orporate defendants either withhold necessary evidence or inundate requesting plaintiffs with thousands of documents (in either instance, imposing extra cost, harassment, and delay on requesting plaintiffs). When discovery abuse occurs, it seems equally likely to be an attempt by a corporate defendant to bankrupt a plaintiff and to induce abandonment of the lawsuit as a plaintiff's attempt to harass a defendant.").

277. McKenna & Wiggins, supra note 250, at 795-96.

278. Id. at 796 (emphasis added).

279. Id.

280. Id.
litigation expenses; obviously they could have. "The real question is whether the benefits of a system that can adequately deter fraud outweigh the benefits of a system that discourages both frivolous and meritorious fraud suits." Discovery is designed to promote resolution of cases on the merits. Neither defendants nor plaintiffs could adequately assess the strength of their own claim or their opponent's claim absent discovery requests. And neither can the court adequately assess the strength of the claims absent discovery. Full access to evidence through open discovery ends trial by ambush and promotes settlement. Discovery is designed to facilitate a resolution on the merits.

B. The Harm Inflicted By the Rule 23 Merits Trial Trend Is Significant

Requiring plaintiffs to prove loss causation and reliance at class certification impedes meritorious actions unnecessarily. Not only do class actions serve the convenience of the parties and promote efficient judicial administration, private actions promote our market's integrity by supplementing otherwise deficient Securities and Exchange Commission ("SEC") enforcement. Private securities class actions also compensate harmed investors. Further,

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281. Hufford, supra note 240, at 636. Ultimately, whether discovery is "abusive" or "wasteful" may just be a matter of perspective. "[F]rom the judge's perspective the lawyers have wasted a lot of time and energy on useless papers and have gotten yelled at in the process. But from the plaintiff's counsel's perspective, plaintiff's deposition got postponed for at least two months while the lawyers drafted and served new interrogatories and answers, and that obviously felt like a victory, even if it had little impact on the ultimate outcome of the case." Yablon, supra note 145, at 1622.

282. Hufford, supra note 240, at 636 (emphasis omitted). Indeed, In re Stratosphere Corp. Sec. Litig., 1 F. Supp. 2d 1096 (D. Nev. 1998), provides a good illustration of the difference discovery can make: before discovery, the plaintiffs' initial complaint was dismissed, but after the benefit of discovery in a bankruptcy proceeding, the court granted leave to amend the complaint.

283. Wunderlich, supra note 150, at 658.

284. McKenna & Wiggins, supra note 250, at 785–86 (quoting Maurice Rosenberg, Federal Rules of Civil Procedure in Action: Assessing Their Impact, 137 U. Pa. L. Rev. 2197, 2198 (1989) ("Full access to the evidence would end trial by ambush and surprise. Open discovery would promote settlements; with both sides obliged to turn over all their important cards, secrets would disappear and realistic negotiations would occur.")).

285. See Rudman, supra note 46, at 8 ("The disadvantage that Oscar's holding causes to investors is evidenced by the decisions of the district courts in the Fifth Circuit that have followed Oscar's approach in requiring proof of loss causation at class certification. These district court decisions have led to premature dismissal of potentially meritorious claims, thereby leaving injured plaintiffs without possibility of recovery.").

heightening Rule 23 requirements for securities class actions may actually raise litigation costs for both plaintiffs and defendants.

1. Private Actions Supplement Otherwise Deficient SEC Actions

First, private causes of action are a critical means of support for the SEC's enforcement power. Private and public enforcement complement one another: both securities plaintiffs' attorneys and the SEC seek to recover damages on behalf of investors for violations of the securities laws. Private enforcement hence works in conjunction with SEC enforcement. Private securities class actions have been justified as a necessary supplement to SEC enforcement because it has become clear that the SEC cannot monitor the markets alone.

287. See, e.g., In re Seagate Tech. II Sec. Litig., 843 F. Supp. 1341, 1350 (N.D. Cal. 1994); Hufford, supra note 240, at 594. The risk of restricting shareholders' ability to combat fraud through private litigation becomes especially critical in light of the heavy burden already placed on regulators who cannot replace the efforts of private attorneys general. Hufford, supra note 240, at 638. Professor Amanda Rose insightfully proposes a new form of securities class action reform: SEC oversight of private actions. Amanda M. Rose, Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5, 108 COLUM. L. REV. 1301 (2008). While Professor Rose has undoubtedly articulated a new approach to reforming securities class actions—likely the most sound proposal of those currently out there—it is still unclear why securities class actions alone are in need of this reform.

Professor Rose justifies her oversight approach because securities class actions present problems of deterrence, compensation and market costs. Rose, supra note 286, at 1325–30. Nevertheless, these very same problems are present in medical malpractice cases, for example. There is an ongoing debate about how to adequately compensate a plaintiff for a broken arm or leg. See, e.g., John V. Jacoby, Patients At a Loss: Protecting Health Care Consumers Through Data Driven Quality Assurance, 45 U. KAN. L. REV. 705, 743–47 (1997). Similarly, medical malpractice actions are viewed as a poor deterrent, with many claiming that these negligence actions are not the result of any negligence, but rather routine medical treatment. See, e.g., Chandler Gregg, The Medical Malpractice Crisis: A Problem with No Answer?, 70 MO. L. REV. 307, 318 (2005). In addition, the medical malpractice cause of action is in turn claimed to be responsible for rising medical costs, see TOM BAKER, THE MEDICAL MALPRACTICE MYTH 1 (2005), just as the securities action is alleged to discourage investors and impair raising capital. Thus, before a more stringent standard for certifying securities class actions should be enacted, legislators and reformers should deeply question and consider what it is about securities class actions alone that necessitates such drastic reform.

288. Hufford, supra note 240, at 596; Luis A. Aguilar, Comm'n, Sec. Exch. Comm'n, Speech at North American Securities Administrators Association's Winter Enforcement Conference: Empowering the Markets Watchdog to Effect Real Results (Jan. 10, 2009) (transcript on file with the University of Michigan Journal of Law Reform) [hereinafter Aguilar, Empowering the Markets] ("The SEC's mission is very clear. It is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.").

Moreover, the SEC, as a government organization, is limited by bureaucratic barriers that do not limit private enforcement. Until recently, bureaucratic constraints caused SEC investigations and subpoenas to logjam. An additional vice of public enforcement—absent from private attorneys general—is that the SEC has been hampered in its role as an enforcement agency due to inadequate funding. The SEC is funded by annual appropriation, subjecting it to political pressures virtually year round. A stagnant SEC budget has had severe consequences. As one SEC Commissioner noted: "In the last few years, the Enforcement Division of the SEC
has been coping with less staff and fewer resources. This is clearly not what has been needed in a time of deregulation and clearly not what Congress had in mind when it enacted Sarbanes-Oxley . . . .

Indeed, by 2006, SEC staff turnover was at its highest level in five years and the amount of attorneys in well-staffed enforcement groups dwindled. 296 From 2005 to 2008, the total number of attorneys able to investigate fraud cases decreased by ten percent. 297 Similarly, the SEC's budget allocation has been relatively flat from 2005 to 2008. 298 Compare the SEC's budget with that of the FDIC:

With often less than $900 million in hand and approximately 3,500 staff, the SEC is tasked with regulating tens of thousands of entities including public companies, investment advisers, broker-dealers, transfer agents, exchanges, credit rating agencies, and several SROs. . . . [T]he FDIC has a staff of 5,000 to oversee 8,300 FDIC insured banks with a budget in the range from $1.2 to $2.2 billion dollars. Moreover, the FDIC is independently funded and thus, has control over its own budget and long term projects. 299

As of 2009, SEC Commissioners acknowledged that the SEC has been disempowered and the focus of the SEC has been on cases with little market reach. 300 Hence, private enforcement has emerged to fill the gap. A recent study from NERA Economic Consulting supports this conclusion, finding: "[M]ost SEC settlements do not parallel shareholder class actions. In 2007, only 22% of SEC settlements were with public companies or their employees and related to misstatements, and were therefore closely comparable to shareholder class actions."

Aside from bureaucratic barriers, there is now some support for the tentative hypothesis that SEC officials may not engage in truly impartial enforcement. 301 For example, a recent study concludes

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295. Aguilar, Empowering the Markets, supra note 288. The SEC has had to freeze hiring as well to keep pace with year-to-year expense increases. Id.
296. Id. (noting that enforcement groups composed of fifteen lawyers often had only seven or eight lawyers by 2006).
297. Id.
298. Id. (stating that the budget was $888 million in 2005, $888.1 in 2006, $881.6 in 2007, and $906 million in 2008).
299. Aguilar, Increasing Accountability, supra note 294.
300. Aguilar, Empowering the Markets, supra note 288 (calling for empowerment of enforcement staff and a concentration of resources on cases with greater market reach).
301. Larsen, supra note 227, at 7.
that the SEC pursued broker-dealer violations by initiating administrative proceedings, as opposed to civil lawsuits, because courts were a worse forum for finance professionals. In addition, in administrative cases, the study concludes that for the same violation and comparable levels of harm to investors, big firms and their employees are less likely to receive a ban from the securities industry when compared to small firms and their employees. The study then discredits the possibility that these enforcement disparities can be explained by the arguably better compliance systems larger firms have in place by finding that small and big firm violations for failing to supervise subordinates were virtually indistinguishable. Last, the study connects the enforcement disparity with post-SEC career trajectories of agency officials. As a result, the study concludes that SEC officials may be responding to future employment prospects by giving prospective employers favorable treatment.

The public/private partnership that has evolved leads to more comprehensive enforcement of the securities laws. Corporate officials will have a strong desire to avoid accusations of fraud, even if they come only in the form of a private securities lawsuit. Thus, private securities class actions empower an otherwise impotent class of harmed investors that may have been lost in the bureaucratic shuffle or self-serving aims of SEC officials.
2. Securities Class Actions Compensate Investor-Plaintiffs

Private securities class actions supplement SEC enforcement, but also compensate injured investors.

[W]ith more investment opportunities available, including increasingly complex financial products, and more investors relying on managers and other intermediaries, the need for honesty and integrity is greater than ever. Investor confidence has been badly shaken, and we need to reestablish stability by returning to the bedrock principle that the capital markets should be known for their integrity and honesty.311

Plaintiffs who are wronged in the market should have a remedy.

Despite the astounding losses securities class-action plaintiffs claim to have suffered,312 scholars critique securities class actions by claiming they serve no valid compensatory function.313 Judge Frank H. Easterbrook and Daniel R. Fischel have set out the seminal criticism of securities fraud class actions by claiming that active traders with diversified portfolios are as likely to be on the gaining side of a transaction tainted by securities fraud as on the losing side.314 In other words, an investor is equally likely to gain five dollars on account of fraud as to lose five dollars to fraud. Thus, diversified investors have no expected net losses from fraud

http://articles.latimes.com/2009/jan/20/business/B-investsuits20 ("To cut down on legal expenses and exert their power in numbers, investors are banding together in securities class-action lawsuits.").

311. Aguilar, Empowering the Markets, supra note 288. Chairman Mary L. Schapiro noted in a speech given in February:

Trillions of dollars of wealth have been lost. Our economy is in recession. And investor confidence has been badly shaken. Middle-class families who were relying on that nest egg to send a son or daughter to college or for a secure retirement now don’t know where to turn.

Schapiro, supra note 291. It has long been recognized by the courts as well that “the class action affords a large number of plaintiffs with relatively small claims a chance to obtain redress through aggregation.” In re Seagate Tech. II Sec. Litig., 843 F. Supp. 1341, 1350 (N.D. Cal. 1994).

312. According to a recent news report, 856 billion dollars. Trejos, supra note 310.


314. Frank H. Easterbrook & Daniel R. Fischel, Optimal Damages in Securities Cases, 52 U. CHI. L. REV. 611, 642 (1985). However, the fact that a large number of sophisticated, well-informed and profit-motivated institutional investors continue to actively participate in these cases indicates that these institutions believe that litigation is within their financial interest. LaCroix, supra note 263.
because their expected losses will match their expected gains.\textsuperscript{315} However, as Professor Alicia Davis Evans ascertains, “securities fraud can cause substantial injury to investors of all types. Compensation, therefore, is justified to make these investors whole.”\textsuperscript{316} Professor Evans first establishes that there is a fundamental asymmetry in a market’s reaction to fraudulent announcements.\textsuperscript{317} For gains and losses to be equivalent over time, according to Evans, an investor must find himself on the winning side of fraud-tainted trades more, by dollar volume, than the investor finds himself on the losing side because losses of investors on the losing side of trades tainted by fraud are more likely to exceed the gains of the investors on the winning side of these trades.\textsuperscript{318}

Second, according to Evans, even large, diversified investors are not immune to this asymmetry and can suffer substantial losses.\textsuperscript{319} Evans explains that the findings from a 2005 U.S. Chamber of Commerce Institute for Legal Reform indicate that it is possible for gains and losses to be significantly different for even large, diversified investors.\textsuperscript{317} Third, Evans clarifies that even losses of buy-and-hold investors are likely to exceed any gains from fraud because one must sell stocks with prices that are inflated by fraud as often as one buys stocks with prices that are inflated by fraud.\textsuperscript{320} Last, 

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Imagine the extreme case of the buy-and-hold investor that buys, but never sells (i.e., she holds the stocks in her portfolio until infinity). If this investor purchases a stock with a price that is inflated by fraud, the amount of this overpayment will never be recouped by a gain from selling a stock that also has an inflated price. This investor never sells. It is, of course, somewhat unrealistic to speak of an investor that never sells stock. Liquidity needs prompt virtually every investor to sell some stock eventually. However, the net buyer (rare seller) is not likely to have equivalent gains and losses from fraud. Thus, it is clear that this type of investor, who is following a rational investment strategy, is not going to be economically indifferent to the incidence of fraud.

\textit{Id.}
\end{minipage}
Evans notes that the portfolio theory only applies to diversified investors and that undiversified investors can suffer substantial harm from securities fraud. Thus, Evans concludes that because investors suffer an ascertainable wrong, there ought to be a remedy.

322. Evans, supra note 313, at 235–36. Ultimately, however, Evans goes on to argue that the securities class action (1) fails to provide meaningful compensation; (2) is largely ineffective; and (3) is too costly and complex to burden courts. Id. at 238–40.

Evans first claims that because insurers often are not willing to offer premiums that reach the level of harm complained of, adequate compensation is never obtained. Id. at 238. Evans, however, fails to address the fact that corporations can obtain insurance in layers, for example, insuring the first $100 million of loss, the next $100 million, and so on. See Tom Baker & Sean J. Griffith, How the Merits Matter: Directors’ and Officers’ Insurance and Securities Settlements, 157 U. Pa. L. Rev. 755, 809 (2009) (describing the insurance “tower”). Moreover, just because compensation may be inadequate in some ways is no reason to throw the baby out with the bath water. Additionally, insurance premiums, while they may be higher for financial services firms due to recent events, “for industries outside of financial services, it’s a completely different story.” Russ Banham, A Tale of Two Markets: Are Your D&O Premiums About to Soar? That Depends on Which Industry You’re In, CFO Mag., Apr. 1, 2009 (on file with the University of Michigan Journal of Law Reform), available at http://www.cfo.com/article.cfm/133568847?search. In fact, D&O insurance rates remain relatively flat in markets other than financial services. Id.

Second, Evans’ proposed “investor compensation fund” may in fact encourage, rather than discourage riskier or more fraudulent behavior. The investor compensation fund represents a form of social insurance for securities fraud. “[P]eople who are insured may choose to engage in more risky behavior as a result.” THOMAS SOWELL, APPLIED ECONOMICS: THINKING BEYOND STAGE ONE 154 (2008). While as a society we want to encourage risk-taking and innovation in business, it would be imprudent to encourage risk-taking that borders securities fraud. “Innovative” accounting is largely what led to the downfall of Enron. See MCLEAN & ELKIND, supra note 233.

Third, Evans also argues that private class actions are ineffective because they focus on larger cases and neglect smaller firms. Evans, supra note 313, at 239. Studies support this assertion, as a recent survey of SEC enforcement indicates that private actions do not overlap with SEC actions. Larsen, supra note 227, at 7 (“SEC settlements do not parallel shareholder class actions.” (emphasis added)). This is, in fact, a good thing: the SEC focuses on cases that private litigation may ignore and vice versa. This way, nobody is falling through the gaps.

Fourth, Evans argues that securities class actions are ineffective because the culpable parties are not required to pay anything in settlement. Evans, supra note 313, at 239; see also Chester S. Spatt, Chief Economist, Sec. & Exch. Comm’n, Remarks Before the American Economic Association: Penalties and Sanctions for Securities Fraud (Jan. 6, 2007) (transcript on file with the University of Michigan Journal of Law Reform) (stating that if settlement terms are restricted to prohibit executives from being indemnified, it would reduce their ability to settle claims). However, the relevant inquiry is whether the threat of private litigation raises the standard of conduct across the marketplace among all companies. LaCroix, supra note 263 (paraphrasing Professor Cox). This is difficult to measure, but
3. Raising Class Certification Barriers May Increase Litigation Costs

Finally, increasing securities class action barriers may contribute to rising securities litigation costs and rising settlement values. Consider the following:

(1) Congress enacted the PSLRA and its strong inference requirement in response to perceived abuses of discovery in securities litigation; (2) plaintiffs compensate for the higher risk of litigation, i.e., increased risk of dismissal as a result of the higher pleading standard, by bringing cases with larger damages; (3) thus, the cost of litigation, including discovery, as it is proportional to the size of the claim, rises; (4) then, these higher litigation costs are misperceived as abuses.\footnote{324}

This is precisely the problem with raising the class certification barrier as well. (1) The federal courts have heightened the class certification standard in response to perceived abuses by litigants.\footnote{325} (2) Plaintiffs will compensate for the higher risk of denial of class certification by bringing cases with larger damages.\footnote{326} (3) Discovery and pre-trial litigation costs, correlative with the amount of damages at issue, will rise when the amount of damages rises.\footnote{327} (4)

\footnote{324} the fact that U.S. markets generally are down less than other markets in the recent economic downturn indicates that these safeguards are doing their job. \textit{Id.}

Finally, Evans contends that securities litigation is costly and consumes judicial resources. Evans, \textit{supra} note 313, at 240. Nevertheless, cost is something largely controlled by the parties involved. See Yablon, \textit{supra} note 145, at 1624 n.16 (stating that clients have staff whose job it is to keep the costs of discovery down). Cases involving larger losses will involve larger costs. See \textit{supra} notes 271–276 and accompanying text. Evans herself acknowledges that an investor can suffer substantial losses. Evans, \textit{supra} note 313, at 228. Thus, substantial litigation costs are to be expected. Moreover, solely because securities actions take up judicial resources, it is no solution to fraud to remove the case from the court's purview.

\footnote{325} Wunderlich, \textit{supra} note 116, at 663 (citations omitted); \textit{see also} Rice, \textit{supra} note 148, at 285 ("[T]he comprehensive system of procedural hurdles and substantive limitations helps to explain why some smaller plaintiff firms with limited resources have apparently left the private class action securities arena. Such procedural requirements and the increased cost of maintaining class actions mean that plaintiff firms need greater resources in order to conduct pre-filing investigation and sophisticated motion practice.").

\footnote{326} Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 267 (5th Cir. 2007).

\footnote{327} \textit{See} Choi, \textit{supra} note 134, at 606–09 (describing statistics whereby plaintiffs compensate for the higher risk of dismissal because of a heightened pleading standard by bringing suits with higher damages); Perino, \textit{supra} note 137, at 941 (large settlements and fee awards since enactment of the PSLRA indicate continued incentive for attorneys to file securities class actions).

\textit{McKenna & Wiggins, supra} note 250, at 797 (finding that as a plaintiff's expected recovery rose, so did the medians of both defendant and plaintiff costs attributable to discovery).
These higher litigation costs will then be misperceived as abuses. To appreciate the implications of this concept, consider the concept as illustrated below:

In a roundabout fashion, federal courts may actually raise the very securities litigation costs they sought to avoid by heightening the class certification standard.

VI. Conclusion

[In our society that is growing in complexity there are bound to be innumerable people in common disasters, calamities, or ventures who would go begging for justice without the class action but who could with all regard to due process be protected by it. Some of these are consumers whose claims may seem de minimis but who alone have no practical recourse for either remuneration or injunctive relief. . . .

The class action is one of the few legal remedies the small claimant has against those who command the status quo. [The system should] strengthen his hand with the view of

328. See supra Part IV.A.2.
creating a system of law that dispenses justice to the lowly as well as to those liberally endowed with power and wealth.\textsuperscript{329}

Courts have not heeded this plea. This trend of conducting merits inquiries at the class certification stage neglects the small claimant. The trend flouts Congressional intent. Congress has already enacted significant devices to control the perceived \textit{in terrorem} threat that securities actions pose, and heightened class certification is not among them. Moreover, class certification merits inquiries contravene Supreme Court precedent. Specifically in the realm of securities litigation, the Supreme Court has held that the element of reliance is rebuttable at trial. Most problematic, Rule 23 merits inquiries abridge a class action plaintiff's constitutional right to a jury trial.

Not only is this Rule 23 trial trend devoid of any legal justification, it is bad policy and makes for bad law. "People who are trying to make a buck at the expense of investors need to know they are not welcome in the capital markets."\textsuperscript{330} Yet the Rule 23 trial trend currently underway by the federal courts fails to send this message.


\textsuperscript{330} Aguilar, Empowering the Markets, \textit{supra} note 288.