

DECEMBER 12, 2006

## The *In re Initial Public Offering Securities Litigation* class certification reversal: How far will the ripples spread?

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Last week, the United States Court of Appeals for the Second Circuit reversed class certification in six cases from the consolidated *In re Initial Public Offering Securities Litigation* actions. See 05-3349-cv, 2006 U.S. App. LEXIS 29859 (2d Cir. Dec. 5, 2006). While Plaintiffs in those cases will undoubtedly seek further appellate review, to the extent any of the Second Circuit's analytical approach to the standards for class certification survives, it will have a meaningful effect on cases well beyond the specific factual circumstances of the *In re IPO* litigation.

The *In re IPO* appeal involved six "focus cases" chosen by the parties out of the 310 consolidated class actions pending before Judge Shira Scheindlin in the United States District Court for the Southern District of New York. In 2004, Judge Scheindlin had granted Plaintiffs' motion for class certification in those six cases, noting that her decision would "provide strong guidance, if not dispositive effect" in the remaining 304 cases.<sup>1</sup> *In re IPO Sec. Litig.*, 27 F.R.D. 65, 73 (S.D.N.Y. 2004).

In granting class certification, Judge Scheindlin applied a standard that Plaintiffs needed only to make "some showing" of each of the elements for certification under Federal Rule of Civil Procedure 23. *Id.* at 93. In effect, the result was somewhat like a summary judgment decision: As long as Plaintiffs came forward with *prima facie* proof for each of the relevant Rule 23 elements, the court could decide in favor of Plaintiffs without actually resolving any contested issues.



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\* Nixon Peabody LLP represents an issuer Defendant in one of these underlying cases.

Judge Scheindlin's use of this "some showing" standard was based chiefly on language from *Caridad v. Metro-North Commuter R.R.*, 191 F.3d 283 (2d Cir. 1999). In that Title VII action, the Second Circuit had held that "class certification is not an occasion for examination of the merits of the case," and seemed to indicate that, therefore, a plaintiff needed only to make "some showing" on the issues relevant to class certification to prevail on a certification motion. *Id.* at 291-92. (In the *Caridad* case itself, the primary issue seemed to be whether the defendants' supposedly discriminatory policies had a common effect on the proposed class. *See id.*)

In its *In re IPO* opinion, however, the Second Circuit "disavowed" this implication from its earlier decision. 2006 U.S. App. LEXIS 29859, at \*53. It held instead that class certification requires "making determinations that each of the Rule 23 requirements has been met", *id.* at \*52, and that a court considering class certification *must* "resolve[] factual disputes relevant to each Rule 23 requirement", *id.*

To reach this result, the Second Circuit had to distinguish well-known cautionary language from the 1974 decision in *Eisen v. Carlisle and Jacquelin*, 417 U.S. 156, 177-78 (1974), where the Supreme Court had held that

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. Indeed, such a procedure contravenes the Rule by allowing a representative plaintiff to secure the benefits of a class action without first satisfying the requirements for it. He is thereby allowed to obtain a determination on the merits of the claims advanced on behalf of the class without any assurance that a class action may be maintained.

The Second Circuit, however, characterized the particular inquiry into the merits in *Eisen* as having "nothing to do with determining the requirements for class certification," *In re IPO Sec. Litig.*, 2006 U.S. App. LEXIS 29859, at \*26, and that a court's duty to resolve factual issues in class certification cannot be avoided "just because" the dispute in the context of the class certification "is identical to the issue of the merits", *id.* at \*54. The Second Circuit therefore held that *Eisen* should properly be understood "to preclude consideration of the merits *only* when a merits issue is unrelated to a Rule 23 requirement." *Id.* at \*50 (emphasis added). This means "there is no reason to lessen a district court's obligation to make a determination that every Rule 23 requirement is met before certifying a class just because of some or even full overlap of that requirement with a merits issue." *Id.* at \*51.

Applying this principle, the Second Circuit then reached five "conclusions" to guide trial court behavior in making decisions on class certification:

1. "[A] district judge may certify a class only after making determinations that each of the Rule 23 requirements has been met";
2. Such determinations can be made only if the judge resolves relevant "factual disputes" and "finds whatever underlying facts are relevant to a particular Rule 23 requirement have been established";

3. This obligation “is not lessened by overlap between a Rule 23 requirement and a merits issue, even a merits issue that is identical with a Rule 23 requirement”; but
4. “A district judge should not assess any aspect of the merits unrelated to a Rule 23 requirement”; and
5. A judge has “ample discretion to circumscribe both the extent of discovery concerning Rule 23 requirements and the extent of a hearing to determine whether such requirements are met.”

*Id.* at \*52-53.

Using this new test for the *In re IPO* appeal, the Second Circuit decided that, if Judge Scheindlin had properly considered the evidence before her, she would have concluded that individual questions of law or fact would clearly predominate over common questions in the six focus cases. As a result, Plaintiffs had failed to satisfy the requirements of Federal Rule of Civil Procedure 23(b).

The Second Circuit’s decision may curtail class treatment for some or all of the consolidated cases before Judge Scheindlin. Whether Plaintiffs’ counsel can salvage a class action approach remains to be seen. More interesting for clients who are not part of those cases, however, is what effect the Second Circuit’s decision may have elsewhere.

If the decision stands, we believe it will become a heavily cited opinion. At some point in almost every class action in which we represent a defendant, someone will mention to the court that a court is not permitted to “conduct an inquiry into the merits to the case”, *id.* at \*13 (quoting *Eisen*, 457 U.S. at 160-61). The *In re IPO* opinion provides ammunition to counter that comment. Sometimes this will help defendants oppose class certification because, as the Second Circuit noted “[e]very class action defendant wants its evidence disputing Rule 23 requirements considered in order to try to fend off the enormous settlement pressures arising from certification.” *Id.* at \*43 n.9. Plaintiffs, however, may well try to use the Second Circuit’s language to expand the scope of class certification discovery, arguing that, because the trial court must resolve factual issues relevant to certification even if those issues are “identical to an issue on the merits”, *see id.* at \*54, this means that discovery must expand beyond its narrowest ranges. (The Second Circuit addressed this concern only in the abstract by reiterating that a trial judge has “ample” discretion to limit discovery and any hearing on class certification. *Id.* at \*53.)

While both sides of a class certification battle may choose to use the Second Circuit’s language, one thing is clear: The opinion will not make class certification decisions easier for federal district court judges or for state court judges who look to federal decisions to guide their approach to class certification. A cynic may argue that because the amount of effort necessary to make a decision will probably now be greater, courts will be less likely to certify any class. Most courts, however, will probably struggle diligently with the opposing obligations to resolve all factual issues necessary for a class certification decision, even if those issues are “identical to an issue on the merits”, yet somehow at the same time try not to examine the merits. Such an exercise in hairsplitting is not, on average, likely to result in faster, cheaper, or more error-free class certification decisions.

We welcome your questions and comments. If you need assistance on any matter, please call or e-mail Christopher M. Mason ([cmason@nixonpeabody.com](mailto:cmason@nixonpeabody.com) 212-940-3017) or Paul J. Hall ([phall@nixonpeabody.com](mailto:phall@nixonpeabody.com) 415-984-8266) as the coordinating heads of our Class Action Defense practice across our substantive Litigation teams, or contact any of our partners listed below:

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