No. 09-517

In the Supreme Court of the United States

PACIFIC INVESTMENT MANAGEMENT COMPANY LLC AND PIMCO FUNDS,

Petitioners,

v.

RICHARD HERSHEY, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY TO BRIEF IN OPPOSITION

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INTRODUCTION

The Seventh Circuit's decision in this case fundamentally alters the gateway standards governing the all-important class certification determination in a way that not only conflicts with decisions of this Court and other circuits, but overwhelmingly favors class action plaintiffs. Indeed, in just the few months since the Seventh Circuit's ruling, plaintiffs already have been "ma[king] much"[1] of the decision in arguing for class certification. Respondents—who believe that "more" class actions are "needed" and suggest that the "'hydraulic pressure'" that class certification places on defendants to settle is "'more myth than reality,'" Opp.37-38—have thrown up everything they can in an attempt to divert this Court's attention from the undeniably important questions presented. But upon analysis, respondents' litany of objections only underscores the need for plenary review.

Moreover, in many respects the brief in opposition is most remarkable for what it does not say. For example, respondents do not deny that the Seventh Circuit placed on *defendants* the burden of demonstrating that certification of this overbroad class was improper. That ruling directly conflicts with decisions of this Court and other circuits, Pet.17-21, and respondents do not defend it. And, as *amicus* DRI has explained (at 13), "[i]t goes without saying that plaintiffs in the Seventh Circuit will take full advantage of this shift"—and "already are doing so."

Respondents also do not defend the Seventh Circuit's remarkable holding that a class may be drawn

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[1] *Reed v. Advocate Health Care*, No. 06 C 3337, 2009 U.S. Dist. LEXIS 89576, at *21 n.7 (N.D. Ill. Sept. 28, 2009).

so broadly that it embraces numerous members who actually *benefited* from the alleged misconduct. Instead, they suggest that this issue is not presented because *all* class members purportedly were injured. Opp.19-27. That contention fails as a matter of fact and law. But it is also beside the point. The Seventh Circuit decided this case based on the premise that the class *does* contain numerous members who were uninjured "net gainers" and squarely held that the certification of such a class was proper under Rule 23. Pet.App.12a-13a. That holding directly conflicts with the decisions of other circuits and merits review.

Respondents also do not seriously defend the Seventh Circuit's holding that obvious inherent conflicts of interest within a class can be disregarded at the class certification stage. Instead, they posit that many lower courts routinely ignore intra-class conflicts to promote use of the class-action device (Opp.30-36)—in direct contravention of this Court's decision in *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 613 (1997). That admission simply underscores why this Court's review is necessary.

ARGUMENT

1. As explained in the petition, this case presents several fundamental issues concerning the standards governing the class certification decision—the pivotal event in most class actions. Respondents do not even attempt to defend the Seventh Circuit's ruling that *defendants* bore the burden of proof to establish that certification was not warranted. Pet.App.14a. That ruling directly conflicts with decisions of this Court and other circuits. Pet.20-21. And as *amicus* DRI explains, that reallocation of the burden of proof—along with the court of appeals' related failure to subject the

certification request to the requisite "rigorous analysis," *Gen. Tel. Co. of the Sw. v. Falcon*, 457 U.S. 147, 161 (1982); *see* Pet.17-20—"fundamentally alters the Rule 23 certification process." DRI Br.13-14.

As to the Seventh Circuit's failure to insist on the requisite inquiry before certification, respondents assert that the "'circuits agree'" that "'a searching inquiry regarding the Rule 23 criteria'" is required. Opp.28; *see also* Opp.29-30. But the cases cited by respondents simply underscore the conflict created by the decision below, which affirmed class certification based solely on unproven allegations and the court's own speculation and armchair economics, Pet.19-20—and then wrongly put the burden on defendants to prove that certification was not warranted.

2. Nor do respondents seriously defend the Seventh Circuit's remarkable ruling that Rule 23 permits the certification of a class drawn so broadly that it encompasses numerous members who not only were not injured by—but actually *benefited* from—the alleged misconduct. Pet.App.12a-14a.

The Seventh Circuit acknowledged that the proposed class includes members who "were not injured at all," Pet.App.8a, and, indeed, "probably were net gainers from the alleged manipulation," Pet.App.12a, but held that fact to be legally irrelevant, Pet.App.10a. Of course, many classes may include some members who in the end cannot prove that they were injured. But the Seventh Circuit held that Rule 23 permits the certification of a class that includes numerous persons who, even accepting all allegations as true, cannot possibly have suffered injury because they *benefited* from the alleged wrongdoing. *See* Pet.11-12. That decision directly conflicts with the

decisions of other circuits barring "class certification where some class members derive[d] a net economic benefit from the very same conduct alleged to be wrongful." *Valley Drug Co. v. Geneva Pharms., Inc.*, 350 F.3d 1181, 1190 (11th Cir. 2003); *see* Pet.12-15.[2]

Certiorari is warranted to resolve that conflict. Certifying such an "overbroad" class not only unjustly increases the "pressure to settle" but contravenes the Rules Enabling Act and this Court's decisions (*e.g.*, *Amchem*, 521 U.S. at 613). *See* Pet.15-17. Indeed, as DRI has explained (at 4), the decision below "renders Rule 23 a vehicle for expanding substantive rights by permitting parties to participate in class actions, and obtain monetary or other relief, when they do not satisfy all of the essential requirements for asserting the underlying cause of action."

Respondents have no real response. Instead, they try to change the subject by taking issue with the "premise that there are 'uninjured' members in the class." Opp.19. But the Seventh Circuit decided that certification was proper based on that very premise. And other courts are already citing the Seventh Circuit's decision for the proposition that "[c]lass certification is not precluded simply because a class may include persons who have not been injured by the defendant's conduct." *Mims v. Stewart Title Guar. Co.*,

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[2] Respondents attempt to distinguish the supposedly "very different" facts of the conflicting *Valley Drug* decision. Opp.25-26. They argue that there plaintiffs constituting over half the class had cost-plus sales contracts which made them "net gainers" who benefited from defendants' antitrust overcharges. Yet the facts here are analogous because the record also shows that a majority of class members for whom there is data benefited from the alleged price manipulation. Pet.5,12.

No. 09-10127, 2009 U.S. App. LEXIS 26842, at *21-22 (5th Cir. Dec. 9, 2009); *see also, e.g., Allen v. Am. Honda Motor Co.*, No. 06 C 5932, 2009 U.S. Dist. LEXIS 115185, at *18 (N.D. Ill. Dec. 8, 2009) ("As the Seventh Circuit recently explained, 'a class will often include persons who have not been injured by the defendant's conduct ....'").[3] In deciding this case, the Court need only say—as it often does—that the court of appeals' decision was wrong as a matter of law based on its own terms.

Regardless, the record irrefutably shows that the Seventh Circuit's premise concerning uninjured class members was correct. *See* Pet.11-12. For example, respondents' own expert reports establish that class representative Hershey and "a majority of the class members for whom there is trading data in the record actually benefited from the alleged manipulation." Pet.5, 12. Respondents do not deny those points, and they therefore must be accepted. S. Ct. R. 15.2. Any remaining uncertainty just shines a spotlight on the fundamental problem—that the district court failed to engage in the requisite "rigorous analysis" before certification, which must include a genuine factual inquiry into the *extent* to which the class is overbroad. *See* Pet.17-20.

Respondents' real argument is legal, not factual. They argue that, regardless of which class members gained as a result of the alleged misconduct, *everyone* in the class suffered some abstract legal injury under

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[3] Class action plaintiffs are going even further and arguing that the decision below authorizes certification of classes containing "individuals without claims" at all. Pls.' Reply Mem., *Moss v. Cent. United Life Ins. Co.*, No. 09-4030-CV-C-NKL, 2009 WL 3639057 (W.D. Mo. Sept. 9, 2009) (citing decision below).

the CEA by virtue of having paid an artificially high price to liquidate a short position. Opp.20-22.[4] In certifying the class, the district court essentially adopted the same position. Pet.App.24a-27a. But the Seventh Circuit correctly rejected that theory, Pet.App.14a—and with good reason. It is flatly inconsistent with *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), which holds that economic harm must be determined by examining *both* sides of a financial transaction, and that a person who purchases stock at an artificially elevated price suffers no injury at all if he also *sells* that stock at a similarly inflated price. *Id.* at 342-43, 347; Pet.App.14a.

There is no plausible way to distinguish *Dura* here. Indeed, the requirement of proving economic loss is even more obvious here than in *Dura* because the underlying cause of action explicitly limits the class of potential plaintiffs to those who suffered "actual damages." 7 U.S.C. §25. And, as explained (Pet.3, 16), the history of the CEA's express cause of action underscores that Congress meant what it said.

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[4] Respondents suggest that petitioners waived an objection to the presence of uninjured traders in the class. Opp.3 n.2. But petitioners raised this issue from the outset, Opp. to Class Cert.4-10 (N.D. Ill. Docket No. 99), presented it to the Seventh Circuit, *see, e.g.*, Appellants' Br.34 (7th Cir. Sept. 15, 2008), and the Seventh Circuit squarely decided it, Pet.App.10a-14a. Nor did petitioners "concede[]" at oral argument that the class would be proper if limited to those who "opened short positions prior to May 9." Opp.12. When pressed at argument for a class definition that might pass muster, counsel suggested that a class of "traders who establish[ed] a short position before May 9, liquidated during the class period, *and did not otherwise trade* [would] essentially eliminate the net gainers and reduce the conflicts to a feasible level." 2009 WL 925914 (Apr. 1, 2009) (unofficial transcript). Such a class is far different than the one certified below. Pet.11-12.

In any event, this legal issue is also beside the point because, as noted, the Seventh Circuit's decision is based on the premise that the class includes numerous members who were uninjured. The court's conclusion that Rule 23 permits the certification of such an overbroad class warrants certiorari. *See* DRI Br.6-8.

3. Certiorari is also warranted to review the Seventh Circuit's decision that certification was proper despite the irrefutable fact that the class was beset by severe internal conflicts of interest—including class members who bought and sold opposite each other on the same days. Pet.21-30.[5] Respondents acknowledge that the conflicts problem has troubled the lower courts for decades. Opp.30-36; Pet.28-30. But they suggest that this case is not a suitable vehicle to address the issue.[6] They are wrong again.

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[5] Respondents' assertion that petitioners waived any objection to the "adequacy of class counsel" (Opp.16-17 & n.11) is beside the point. Petitioners' Rule 23(a)(4) argument hinges on the adequacy of the class *plaintiffs* as representatives of absent class members—an issue vigorously argued below, *see, e.g.*, Appellants' Br.41-48; Appellees' Br.46-51 (7th Cir. Nov. 14, 2008); Opp to Class Cert.10-17, and decided by the Seventh Circuit, Pet.App.15a-16a.

[6] The "matrix" (Opp.34-35) concocted by respondents is both irrelevant and unpersuasive. All but one of respondents' cases predate *Dura* and all rest on the erroneous premise that differences among plaintiffs were limited to variations in the amount of damages, rather than the fact of injury. The two S.D.N.Y. cases applied a class certification standard later rejected by the Second Circuit. *See In re IPO Sec. Litig.*, 471 F.3d 24, 35 & n.5 (2d Cir. 2006). And *In re Soybeans Futures Litigation*, Nos. 89 C 7009, 90 C 1138, 1993 U.S. Dist. LEXIS 18738, at *2 (N.D. Ill. Dec. 27, 1993), involved stipulated subclasses drawn because the court *rejected* the proposed class for reasons like those advanced by petitioners here.

This case is an ideal vehicle to address this important question. The undeniable facts present the conflicts problem in an unusually sharp form, Pet.23-24, yet the Seventh Circuit nevertheless squarely held that certification was proper without *any* inquiry into the extent of such conflicts, Pet.App.15a-16a.

Respondents suggest that, because this is a CEA case, it is factually distinguishable from contrary authority that prohibits certification in the face of obvious conflicts under antitrust, securities, or personal injury law, such as *Amchem*, 521 U.S. at 625-28, and *Valley Drug*, 350 F.3d at 1184-89. Opp.30-36. But the Seventh Circuit did not in any way rest its holding on the CEA. It announced a general principle applicable to *all* class certification decisions under Rule 23, and held that inquiry into the extent of intra-class conflicts at the class certification stage is "premature." Pet.App.16a. In so holding, the court relied on cases involving consumer finance, securities law, and employment discrimination. Pet.App.15a-16a.

The conflicts in this case relate to class members' starkly differing interests in proving the level of alleged price "artificiality" at particular times.[7] Price artificiality is also at the heart of most securities and antitrust cases. All of the same problems can arise, for

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[7] In a "Corrected" Brief in Opposition (at 40 n.21) filed more than a week late, respondents attempt to take issue—in a new footnote improperly added to the brief—with the petition's characterization of the obvious conflicts among class members. Respondents' untimely effort to supplement their response should be rejected, but in any event, any dispute over this issue further underscores the need for guidance on whether the district court was required to make findings on the extent of the intra-class conflict *before* certification. *See* Pet.27-29.

example, with a securities class defined so broadly that it includes "in and out" traders with conflicting interests in whether a particular public disclosure corrected pre-existing artificiality in the stock price. Accordingly, numerous courts have recognized that the CEA and the securities acts should be construed consistently wherever possible. *See, e.g., Leist v. Simplot*, 638 F.2d 283, 298 n.14 (2d Cir. 1980), *aff'd, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982); *FDIC v. UMIC, Inc.*, 136 F.3d 1375, 1384 n.4 (10th Cir. 1998); *Monieson v. CFTC*, 996 F.2d 852, 858-60 (7th Cir. 1993).

Respondents argue that purchaser/seller conflicts should be ignored in the interest of facilitating broad class certification and that the concerns identified in cases like *Valley Drug*, *Langbecker v. Electronic Data Sys. Corp.*, 476 F.3d 299 (5th Cir. 2007), and *In re Seagate Technology II Securities Litigation*, 843 F. Supp. 1341 (N.D. Cal. 1994), have been "discredited." Opp.30-33. Respondents are correct that the lower courts are divided on how to deal with intra-class conflicts at the certification stage. But that is precisely why this Court's review is needed.

As *Seagate* and its progeny have recognized, intra-class conflicts—including purchaser/seller conflicts like those present here—are directly relevant to several of Rule 23's criteria and often cannot be redressed in any practical way later (through "subclasses" or otherwise). And, as courts have held, a trial court should not certify a class in the face of such conflicts without *at least* "requir[ing] the named representatives to bring forth evidence ... that no fundamental conflict exists among the class members." *Valley Drug*, 350 F.3d at 1196; *see* Pet.27. The district court here refused to do

that, and the Seventh Circuit's decision likewise gives district courts the green light to ignore intra-class conflicts at the certification stage, rather than carefully to analyze their scope and significance.

4. Finally, respondents do not seriously contest the importance of the questions presented. Instead, they suggest that the particular type of claim underlying this class action makes it an unsuitable vehicle to resolve those issues. *See* Opp.36-39. That contention is clearly wrong. As DRI explains (at 2), the issues presented by this case "can have considerable, and even dispositive, impact in numerous types of class actions, including large-scale securities, antitrust, and commodities cases." *See id.* at 7-8 & nn.3-4. Even the early returns bear that out. Class plaintiffs and lower courts already are relying on the decision below in a wide variety of contexts.[8] And that makes perfect sense—the broad legal holdings reached by the

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[8] *See, e.g., Mims*, 2009 U.S. App. LEXIS 26842 (Real Estate Settlement Procedure Act); *Allen*, 2009 U.S. Dist. LEXIS 115185, at *18-19 (state law breach of express and implied warranties); *Reyher v. State Farm Mut. Auto. Ins. Co.*, No. 07-CV-4446, 2009 Colo. App. LEXIS 1968, at *22-23 (Colo. Ct. App. Dec. 24, 2009) (insurance law); and Respondents' Mem. of Law in Supp. of Mot. to Exclude Expert Opinion of Monica Noether, *In re Evanston Nw. Healthcare Corp. Antitrust Litig.*, No. 07-cv-4446, 2009 WL 4883940 (N.D. Ill. Dec. 14, 2009) (antitrust). Indeed, in *Evanston*, an antitrust case, respondents' counsel themselves invoked the decision below to argue that a report demonstrating "that a number of members of the proposed Class did not suffer any impact from the anti-competitive behavior" is irrelevant at the class certification stage. *Id.*

Seventh Circuit below on the standards governing class certification are in no way limited to the CEA.[9]

* * *

Adherence to proper procedural practice in class action litigation is extraordinarily important because of the enormous potential impact of class actions on defendants and the judicial system. The decision below unsettles the standards governing class certification in several fundamental respects. All the traditional criteria for certiorari are met, including "well-defined splits of authority," DRI Br.2-3, and this case is an excellent vehicle to provide long overdue guidance on the important and recurring questions presented. Certiorari, in short, is plainly warranted.

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[9] Respondents' reference to the "interlocutory" posture of this case is a red herring. Opp.1. The decision below represents the final word on whether certification was proper. Moreover, Rule 23(f) was added precisely to authorize interlocutory appeals of class certification orders because of the important interests at stake. *See* Fed. R. Civ. P. 23 advisory committee notes, 1998 Amendments.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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