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THE SECOND CIRCUIT CLARIFIES THE STANDARD GOVERNING MOTIONS FOR CLASS CERTIFICATION

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On December 5, 2006, the United States Court of Appeals for the Second Circuit issued a landmark decision with wide-ranging effects in private securities litigation. Until now, the legal standard governing motions for class certification under Federal Rule of Civil Procedure 23 was an unsettled issue in the Second Circuit, where many securities class actions are brought. The uncertainty had led many trial courts to apply a lenient burden of proof when considering any merits-related class action requirements, much to the benefit of plaintiffs. No longer—the court's opinion in *In re: Initial Public Offering Securities* Litigation clarified the standards for class certification and rejected lesser standards of proof for class action prerequisites that happen to be merits-related. A significant victory for defendants, the opinion aligns the Second Circuit with most other federal courts of appeals and increases the evidentiary burden for plaintiffs seeking class certification, a critical event in any securities class action.

A well-known case concerning Wall Street's biggest names, *In re*: *IPO Securities Litigation* involves consolidated class action claims by thousands of investors against numerous underwriters, issuers, and executives in connection with a series of IPOs. The district court granted, in part, the plaintiffs' class certification motion, concluding that they had made "some showing" that the requirements of Rule 23 were satisfied. In particular, the court rejected the defendants' challenge to the plaintiffs' "fraud-on-the-market"

theory, concluding that the plaintiffs had made "some showing" of market efficiency, which was all that was required.

The Second Circuit reversed. Articulating an argument that securities litigation defendants had been making for years, the court opined that lower courts had been misinterpreting Supreme Court precedent, *Eisen v. Carlisle & Jacquelin*, to forbid an inquiry into the merits of the case, even where the merits related to a requirement for class certification. The court also disagreed that merits-related class requirements could be explored but satisfied with simply "some showing." A district court may only certify a class if it is persuaded that each of the individual requirements of Rule 23 are satisfied, after considering all the evidence and resolving any necessary factual questions. Held the court, "[t]he obligation to make such determinations 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."

Accordingly, the court reversed the district court's certification of a class in the *IPO* cases. The court held that the plaintiffs had not sufficiently established that the market for the relevant securities was "efficient," which eliminated the "fraud-on-the-market" presumption of reliance and introduced predominating individual reliance issues into the case. The court also held that the plaintiffs had not ruled out individual issues of lack of knowledge.

In summary, the standard for class certification adopted by the Second Circuit in its recent opinion aligns it with most other federal circuits. Plaintiffs must now do more than make "some showing" that the requirements of Rule 23(a) and (b)(3) are met—they must establish the relevant facts so the court can ascertain whether the applicable legal standard is satisfied, even if it requires the court to consider an issue that goes to the merits of the case.

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