UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

NANCY GEORGE, ROBERT GEORGE AND RANDALL WHITMAN, on behalf of themselves and all others similarly situated

Plaintiffs,

-v-

CHINA AUTOMOTIVE SYSTEMS, INC., HANLIN CHEN, QIZHOU WU, XIE LIPING, WONG TSE YIU, WANG SHAOBO, YU SHENGBING, and SCHWARTZ LEVITSKY FELDMAN LLP,

Defendants.

11 Civ. 7533 (KBF)

MEMORANDUM DECISION & ORDER

KATHERINE B. FORREST, District Judge:

On July 3, 2013, this Court issued an Order & Opinion denying class certification in the above-referenced securities litigation. The Court found, inter alia, that plaintiffs failed to meet the elements of Rule 23's adequacy, typicality and predominance requirements. Of particular importance for the instant decision, the Court found that plaintiffs failed to demonstrate by a preponderance of the evidence that the China Automotive Systems Inc.'s ("China Automotive") securities at issue traded in an efficient market, rebutting any presumption of reliance. (7/3/13 Order at 3, 16-20, ECF No. 127.) Accordingly, the Court found that plaintiffs had failed to show that common issues of fact predominated as to the element of reliance.

On December 6, 2013, plaintiffs moved for preliminary approval of both a settlement with Schwartz Levitsky Feldman LLP, a former auditor for China

Automotive, and certification of a proposed settlement class. (See ECF No. 34.) The definition of "Settlement Class" in the motion now before the Court mirrors that as to which the Court denied certification on July 3, 2013. (Compare Lead Plaintiffs' Memorandum of Law in Support of Motion for Class Certification ("Pls.' Class Mem.") at 1, Jan. 15, 2013, ECF No. 82 with [Proposed] Order of Preliminary Approval of Proposed Settlement at 5-6, Dec. 6, 2013, ECF No. 135-2.)

The issue before this Court is an important one: whether this Court, having found as a factual matter following an evidentiary hearing that plaintiffs failed to make a sufficient showing that the securities at issue traded in an efficient market – and thus are not entitled to a presumption of reliance for purposes of class certification – are nonetheless now entitled to certification of that same class for settlement purposes.

The settling parties in this matter assert that the Second Circuit has already answered this question in the affirmative, citing In re American International Group, Inc. Securities Litigation, 689 F.3d 229 (2d Cir. 2012). This Court disagrees with the Settling Parties' reading of American International. Placing the facts of the case and motion now before this Court against the controlling case law, including American International, the Court declines to approve the proposed Settlement Class.

LEGAL FRAMEWORK

The law is clear, and the settling parties do not dispute, that in determining whether a class may be certified for settlement purposes, a Rule 23 analysis is

required. Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 621 (1997) ("The safeguards provided by the Rule 23(a) and (b) class-qualifying criteria . . . are not impractical impediments – checks shorn of utility – in the settlement context."); American Int'l, 689 F.3d at 238 ("Before approving a class settlement agreement, a district court must first determine whether the requirements for class certification in Rule 23(a) and (b) have been satisfied.") (citations omitted).

Pursuant to Rule 23(a), the court must determine whether a proposed class satisfies four requirements: (1) numerosity; (2) commonality; (3) typicality; and (4) adequacy of representation. Fed. R. Civ. P. 23(a); American Int'l, 689 F.3d at 238. Under Rule 23(b)(3), a class may be certified if "the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Fed. R. Civ. P. 23(b)(3); see also American Int'l, 689 F.3d at 238. This latter requirement is referred to in shorthand as the "predominance requirement."

For settlement purposes, if the requirements of Rule 23(a) and (b) are satisfied, the court must then determine whether the proposed settlement agreement is "fair, reasonable, and adequate" pursuant to the requirements of Rule 23(e). Fed. R. Civ. P. 23(e); see also American Int'l, 689 F.3d at 238.

In Amchem Products, Inc. v. Windsor, the Supreme Court held that in the context of a settlement class, a court need not be concerned with whether the case, if it proceeded to trial, would present intractable management problems because

"the proposal is that there be no trial." 521 U.S. at 620. "But other specifications of the Rule – those designed to protect absentees by blocking unwarranted or overbroad class definitions – demand undiluted, even heightened, attention in the settlement context." Id. Concerning the claims of individuals who allegedly were exposed to asbestos, the Court stated: "The benefits [plaintiffs] might gain from the establishment of a grand-scale compensation scheme is a matter fit for legislative consideration, but it is not pertinent to the predominance inquiry. That inquiry trains on the legal or factual questions that qualify each class members' case as a genuine controversy, questions that preexist any settlement." Id. at 622-23. "Federal courts . . . lack authority to substitute for Rule 23's certification criteria a standard never adopted – that if a settlement is 'fair,' then certification is proper." Id. at 622.

Rule 23 "does not set forth a mere pleading standard." Wal-Mart Stores, Inc. v. Dukes, – U.S. – , 131 S.Ct. 5241, 2551-52 (2011). The Supreme Court has repeatedly emphasized that "it 'may be necessary for the court to probe behind the pleadings before coming to rest on the certification question,'" Comcast Corp. v. Behrend, – U.S. – , 133 S.Ct. 1426, 1432 (2013) (quoting Wal-Mart Stores, Inc., 131 S.Ct. at 2551-52)), and "[s]uch an analysis will frequently entail 'overlap with the merits of the plaintiff's underlying claim.'" Id. (quoting Wal-Mart Stores, Inc., 131 S.Ct. at 2551).

The Supreme Court has made clear that "'[r]eliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of

action.'" Erica P. John Fund, Inc. v. Halliburton Co., – U.S. – , 131 S.Ct. 2179, 2184 (2011) (quoting Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 159 (2008)) (explaining that in securities class action cases, the determination as to whether Rule 23 has been met often turns on the issue of whether there is sufficient evidence that plaintiffs relied on a defendant's misrepresentation, so as to give rise to a cause of action under Section 10(b)). Evidence of reliance "ensures that there is a proper 'connection between a defendant's misrepresentation and a plaintiff's injury.'" Id. (quoting Basic, Inc. v. Levinson, 485 U.S. 224, 243 (1988)). In Halliburton, a case involving class certification for purposes of settlement, the Court noted that a plaintiff unaware of the misstatement – or not entitled to a presumption of reliance on the market's awareness – cannot establish a claim. Id.

The relationship between the Rule 23(b)(3) "predominance" requirement and the Section 10(b) reliance requirement is therefore a straightforward one: all plaintiffs must have been able to rely on an efficient market (to obtain the benefit of a presumption), or must have individually relied on the alleged misstatements or omissions in order to have a claim. As the Supreme Court said in Amchem, a plaintiff must have a genuine controversy. This question preexists any settlement. See Amchem, 521 U.S. at 622-23. At the class certification stage, reliance itself need not be proven; however, plaintiffs must share a common way of proving reliance; thus making common issues of fact as to reliance predominate over individual ones. See Halliburton Co., 131 S.Ct. at 2184 (recognizing reliance as an essential element of a § 10(b) private cause of action).

At oral argument on this motion, counsel for plaintiffs argued that to require predominance as to reliance at this stage is equivalent to requiring that plaintiffs show "materiality" as to a misstatement at the class certification stage and that the Supreme Court has clearly held this is not so. Amgen, Inc. v. Connecticut Retirement Plans & Trust Funds, – U.S. – , 133 S.Ct. 1184, 1196-97 (2013). This is an incorrect analogy. By definition, a Section 10(b) claim raises the same allegedly material misstatements of fact for all plaintiffs. That is, for instance, whether a particular statement in a Form 10-K was false when made and whether it was material to the investors. Questions of materiality do not involve individualized inquiries. Id. at 1195-96 (explaining that "'[t]he question of materiality . . . is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor,' materiality can be proved through evidence common to the class. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 445 (1976). Consequently materiality is a 'common question[n]' for purposes of Rule 23(b)(3). Basic, 485 U.S. at 242."). In such a situation, issues of law and fact clearly predominate over individual ones. But whether individual stockholders, among the thousands or millions of different stockholders, can share proof of reliance is a separate question. An answer in the negative suggests a lack of predominance on this issue. In Basic, the Supreme Court provided one possible route to an affirmative answer to such an inquiry: market efficiency – subject to rebuttal.

In the circumstances currently before the Court, and in the face of a finding that the Basic presumption is not here applicable, plaintiffs are left without a

method of sharing proof on the important factual issue of reliance. That requires denial of the proposed Settlement Class.

ANALYSIS

In American International, plaintiffs sued American International Group, Inc. ("AIG") and various other corporate and individual defendants, including the General Reinsurance Corporation and individuals associated thereto (the "Gen Re defendants"). American Int'l, 689 F.3d at 232-33. The claim was essentially that AIG and the Gen Re defendants violated Section 10(b) by entering into a $500 million sham reinsurance transaction "designed to mislead the market and artificially increase AIG's share price." Id. at 233.

Plaintiffs moved to certify a class action, relying on the fraud-on-the-market presumption to satisfy the predominance requirement for reliance. Id. at 234. In response, the Gen Re defendants filed a motion for judgment on the pleadings. The issue raised was whether a Section 10(b) claim could proceed "against a counterparty to a deceptive transaction with an issuer of stock where the existence of the transaction and the counterparty's participation in it is disclosed to the market by the issuer, but not by the counterparty." Id. at 235-36.

Plaintiffs and the Gen Re defendants then reached a $72 million settlement, which they submitted to the district court for approval. Id. at 236. Prior to deciding the pending settlement, the court held an evidentiary hearing for the motion for class certification – Gen Re did not participate in light of its pending settlement.

Id.[1] The court denied the motion for class certification; with respect to the Gen Re defendants, the court held that the fraud-on-the-market presumption did not apply because plaintiffs failed to "establish[] or even [plead] that the Gen Re [d]efendants made any public misstatement or omission with regard to AIG . . . ." Id. The court then denied the motion for approval of the settlement as moot because of its class certification decision. Id.

Following the court's decision, the settling parties again sought approval of their proposed settlement – they argued that because the reliance issue would not pose a manageability problem at trial (because they were not going to trial anymore), the settlement should be approved. Id. at 236-37. The court rejected this argument, holding that it could not "'dispense with the requirement of proving the application of the fraud-on-the-market presumption when certifying a class for settlement purposes,'" and again stating that the Gen Re defendants could not prevail on their motion for judgment on the pleadings because "'none of the Gen Re [d]efendants made any public statement or took any action regarding AIG stock' that could be relied upon." Id. at 237.

In vacating and remanding the district court's decision, the Second Circuit focused primarily on the issue of manageability. The court reiterated that because manageability is not an issue for settlement classes, courts must take that fact into consideration in deciding whether predominance is satisfied: "[T]he existence of a

[1] In the matter currently before this Court, the settling defendant, Schwartz Levitsky Feldman LLP, did participate in the motion for class certification – by opposing certification. (ECF No. 91.)

settlement that eliminates manageability problems can alter the outcome of the predominance analysis." Id. at 242 (citation omitted). The court further held that "a Section 10(b) settlement class's failure to satisfy the fraud-on-the-market presumption does not necessarily preclude a finding of predominance." 689 F.3d at 242 ("Where a Section 10(b) settlement class would otherwise satisfy the predominance requirement, the fact that the plaintiff class is unable to invoke the presumption, without more, is no obstacle to certification.").[2]

Additionally, the court advised the district court on remand to pay "particular attention" to issues beyond fraud-on-the-market, including: whether any members of the class may have had viable state law claims that would be released by the settlement; whether variations in state law may cause class members' interests to diverge; and whether there were legitimate objectors to the proposed settlement class. Id. at 243.

Reading the American International decision in light of the unique factual and procedural circumstances at issue there, and pursuant to the relevant Supreme Court precedent, it is evident that the Second Circuit was focused on ensuring that district courts engage in a sufficiently thorough analysis of the various issues and interests in play in Rule 23 settlement class certifications – and that that be an analytically distinct inquiry from that involved in certification of a litigation class.

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[2] The Second Circuit also stated: "We hold that, under Amchem, a securities fraud class's failure to satisfy the fraud-on-the-market presumption primarily threatens class certification by creating 'intractable management problems' at trial. Because settlement eliminates the need for trial, a settlement class ordinarily need not demonstrate that the fraud-on-the-market presumption applies to its claims in order to satisfy the predominance requirement." American Int'l, 689 F.3d at 232.

Additionally, the court focused on the point that while fraud-on-the-market is relevant to the issue of predominance in a Section 10(b) claim, it is not the end of that analysis. In determining whether certification of a settlement class is appropriate, a court must carefully consider the strictures of Rule 23 as a whole, as well as the various interests in play; with respect to predominance, a court must look beyond merely whether the fraud-on-the-market presumption was satisfied at the litigation class certification stage.[3] Id. at 243. In short, nothing in American International eliminates the requirement of a Rule 23(b)(3) analysis in the context of the proposed Settlement Class here, nor mandates that predominance necessarily be found present whenever a settlement of a Section 10(b) claim is presented, nor holds that showing that common issues predominate as to reliance is always unnecessary in the context of a proposed settlement class. Indeed, that would be contrary to the Supreme Court precedent cited above.

After extensive submissions and an evidentiary hearing, this Court denied plaintiffs' motion for certification of a litigation class because, inter alia, plaintiffs failed to prove they were entitled to Basic's presumption of reliance. Plaintiffs offered no other way to show reliance in some common manner – indeed, they have

[3] The court explained "that there may be circumstances in which it will be appropriate for a court to determine, in its analysis of class certification, whether the fraud-on-the-market presumption applies to the claims of a settlement class. For example, if there appear to be conflicts within the class, with some members who could satisfy the presumption and others who cannot, a district court may need to address the applicability of the presumption in order to make findings with respect to the adequacy of representation or predominance, or to evaluate whether subclasses are necessary." American Int'l, 689 F.3d at 243 (internal citations omitted).

not further attempted to show reliance at all. In particular, this Court found that plaintiffs failed to show that the securities at issue traded in an efficient market: the five analyses conducted by Kenneth N. Kotz, a Vice President of Forensic Economics in Rochester, New York, were insufficient to support a finding that the securities at issue traded in an efficient market – four of the five were not event studies, and the one that most closely approximated such a study suffered from serious methodological flaws. The Court found Kotz unable to explain or defend his methodological approach; his tests failed to provide a reasonable basis that the market in which the securities traded was efficient. (Indeed, the Court found that Kotz's results actually indicated market inefficiency.)

In light of that ruling, while plaintiffs were not precluded from seeking certification of a settlement class, see American Int'l, 689 F.3d at 242-44, they nonetheless had to do something to fix this issue – they have failed to do so. See Halliburton, 131 S.Ct. at 2184 ("Reliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of action.") (internal quotation marks and citation omitted); see also Amgen, Inc., 133 S.Ct. at 1192.[4]

[4] The American International court was careful to state that while fraud-on-the-market is not required for purposes of settlement class certification, predominance is an essential element. See American Int'l, 689 F.3d at 232 ("Because settlement eliminates the need for trial, a settlement class ordinarily need not demonstrate that the fraud-on-the-market presumption applies to its claims in order to satisfy the predominance requirement."). If Rule 23(b)(3) were read to relate solely to manageability issues, and manageability issues are irrelevant for a settlement class, then Rule 23(b)(3) would correspondingly be irrelevant to a settlement class.

At no point during this litigation, including most significantly after the Court's ruling on class certification for litigation purposes, did plaintiffs sufficiently support predominance by showing that the question of reliance can be demonstrated on a representative (e.g. class) basis. If this Court were to certify the proposed settlement class in light of the evidentiary findings it previously made and without anything more from plaintiffs, it would effectively allow plaintiffs who potentially did not rely on materials setting forth the alleged misstatements to collect from the settlement fund. Similar to the concern expressed in Amchem, doing so would prevent those plaintiffs with real claims from obtaining the maximum amount to which they may be entitled.

Accordingly, the parties' request for approval of the settlement class must be denied.

CONCLUSION

For the reasons set forth above, the Court hereby DENIES the parties' request for certification of the Settlement Class and approval of the settlement. The parties are reminded that they are to appear for a telephonic status conference on **February 20, 2014** at **1:30 P.M.**

The Supreme Court has made it clear that this is not the case, and American International is not to the contrary.

The Clerk of Court is hereby directed to terminate the motion at ECF No. 134.

SO ORDERED.

Dated: New York, New York
January 15, 2014

KATHERINE B. FORREST
United States District Judge