FRAUD ON THE MARKET GETS A MINITRIAL: *EISEN* THROUGH *IN RE IPO*

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ABSTRACT

Securities class actions involve contested pretrial hearings to determine the proper class of plaintiffs. The certification decision often affects the outcome of a case because defendants usually settle if the class is certified, whereas plaintiffs usually abandon the case without trial if certification is denied. Courts disagree, however, over the appropriate class certification procedure. Courts that emphasize efficiency invoke Eisen v. Carlisle & Jacquelin *to preclude considering substantive issues during the pretrial hearing. Courts that emphasize the importance of determining the correct class during the pretrial stage follow* General Telephone Co. of the Southwest v. Falcon *and allow parties to introduce evidence going to the merits of the case. Certification procedures based on* Eisen *or* Falcon *often appear in securities class actions, which litigants usually bring under Rule 10b-5 and base on the fraud-on-the-market theory.* Eisen*'s and* Falcon*'s holdings influence securities class actions because courts rely on them to determine the proper class certification procedure. This Note argues that the apparent tension between the two cases has provided courts with the flexibility to consider just the right amount of evidence during class certification proceedings, permitting them to efficiently certify the proper class.*

INTRODUCTION

Since the early 1980s, opposing attorneys have used *Eisen v. Carlisle & Jacquelin*[1] and *General Telephone Co. of the Southwest v.*

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1. Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974).

Falcon[2] to battle over the proper class certification process in securities class action lawsuits. In one corner, *Eisen* focuses on the interest of efficiency, holding that courts should not use a certification determination as a pretext for disposing of a plaintiff's claim on the merits.[3] Courts following this approach do not consider substantive issues at the certification stage and instead resolve these issues only after full discovery.[4] In the other corner, in *Falcon*, the Supreme Court emphasized the important effect the class certification decision could have on the outcome of a case and held that courts may go beyond the pleadings and consider relevant evidence on the merits during class certification proceedings.[5] Courts following this approach may examine all facts relevant to a class certification decision.[6] Under Rule 23 of the Federal Rules of Civil Procedure, which provides guidelines for class actions, courts must certify classes of plaintiffs seeking to file a class action lawsuit.[7] *Eisen* and *Falcon* greatly impact securities class actions because courts use these contrasting holdings to determine the proper class certification procedure. Given that parties normally either settle class actions if the class is certified or abandon the case without trial if class certification is denied, how courts decide certification often determines the case's outcome.[8] A court's approach to class certification, therefore, has a significant economic impact; the average class action settlement in 2007 was over $33 million.[9]

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2. Gen. Tel. Co. of the Sw. v. Falcon, 457 U.S. 147 (1982).

3. *Eisen*, 417 U.S. at 177, 185.

4. *See id.* 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."); *see also, e.g.*, *In re* Visa Check/MasterMoney Antitrust Litig., 280 F.3d 124, 135 (2d Cir. 2001) ("[A] motion for class certification is not an occasion for examination of the merits of the case." (quoting Caridad v. Metro-North Commuter R.R., 191 F.3d 283, 291 (2d Cir. 1999))).

5. *See Falcon*, 457 U.S. at 160 ("[T]he class determination generally involves considerations that are enmeshed in the factual and legal issues comprising the plaintiff's cause of action." (quoting Coopers & Lybrand v. Livesay, 437 U.S. 463, 469 (1978))).

6. *Id.*; *see also, e.g.*, Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 259 F.3d 154, 167–69 (3d Cir. 2001) (following this approach).

7. *See infra* note 28.

8. *See, e.g.*, *Newton*, 259 F.3d at 164 (suggesting that a certification denial can end the case and a successful certification can coerce settlement). *But see* Charles Silver, *"We're Scared to Death": Class Certification and Blackmail*, 78 N.Y.U. L. REV. 1357, 1357 (2003) (rebutting the assertion that "class actions force defendants into 'blackmail settlements'" (quoting Henry Friendly, C.J., United States Court of Appeals for the Second Circuit)).

9. STEPHANIE PLANCICH, BRIAN SAXTON & SVETLANA STARYKH, NERA ECON. CONSULTING, RECENT TRENDS IN SHAREHOLDER CLASS ACTIONS: FILINGS RETURN TO 2005

In re Visa Check/MasterMoney Antitrust Litigation[10] provides a good example of class determination and its potential effect on the outcome of a case. In that case, merchants and trade associations accused Visa and MasterCard of conspiring to monopolize the debit-card market and charge excessive fees.[11] The Second Circuit followed *Eisen*[12] and certified a class consisting of "all persons and business entities who have accepted Visa and/or MasterCard credit cards"[13] without allowing the parties to introduce evidence relating to the merits of the case during the class certification proceeding.[14] The dissent's warning that a possibly erroneous certification order may "coerce settlement"[15] was consistent with the final result in this case, as the defendants settled before a verdict[16] after the circuit court affirmed in favor of certification.[17] The Third Circuit later took an approach similar to *Falcon*'s, holding that "[i]n reviewing a motion for class certification, a preliminary inquiry into the merits is sometimes necessary to determine whether the alleged claims can be properly resolved as a class action."[18] Despite court uncertainty over the proper scope of review when certifying class actions, this Note argues that the conflicting approaches the Supreme Court has endorsed coexist usefully and provide lower courts with the flexibility they need to balance judicial economy against fully developing disputed issues.

The divergence in class certification often appears in class actions involving securities fraud, which litigants usually bring under Rule 10b-5 and base on the fraud-on-the-market theory. Rule 10b-5 prohibits any fraudulent statement or omission in connection with the

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LEVELS AS SUBPRIME CASES TAKE OFF; AVERAGE SETTLEMENTS HIT NEW HIGH 9 (2007), *available at* http://www.nera.com/image/BRO_Recent_Trends_12-07_web_3_FINAL.pdf.

10. *In re* Visa Check/MasterMoney Antitrust Litig., 280 F.3d 124 (2d Cir. 2001).

11. *Id.* at 129–31.

12. *Id.* at 133.

13. *Id.* at 131 (quoting the plaintiffs' motion).

14. *Id.* at 135.

15. *Id.* at 148 (Jacobs, J., dissenting) ("Rule 23(f) was adopted in part to alleviate the danger that an erroneous 'order granting certification' may force a defendant 'to settle rather than incur the costs of defending a class action and run the risk of ruinous liability.'" (quoting FED R. CIV. P. 23 advisory committee's note)).

16. Robert B. McCaw & Robert W. Trenchard, *Bring in the Experts*, N.Y.L.J., Aug. 20, 2007, at S4.

17. *In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d at 145.

18. Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 259 F.3d 154, 168 (3d Cir. 2001).

purchase or sale of any security[19] and remains one of the broadest bases for bringing an action alleging fraud in a securities transaction.[20] The fraud-on-the-market theory facilitates Rule 10b-5 class actions by stating that individual plaintiffs need not be personally aware of the defendant's fraudulent statements or omissions.[21]

This Note explores how courts resolve conflicting interests that arise when deciding whether to grant certification of a class asserting claims under Rule 10b-5. Part I discusses *Eisen* and *Falcon*'s differing approaches to class certification under Rule 23 and the fraud-on-the-market theory, which has given rise to cases that have enunciated the *Eisen-Falcon* tension. Part II shows how the evolution of Rule 10b-5 class action litigation has affected class certification. As Rule 10b-5 cases have increasingly involved complex market efficiency analyses and required more expert testimony, judges have enjoyed greater discretion to decide what evidence to consider during class certification. Part III looks in detail at securities class actions that have been decided since the enactment of the Private Securities Litigation Reform Act of 1995 (PSLRA),[22] focusing on the synthesis of *Eisen* and *Falcon* achieved in *In re PolyMedica Corp. Securities Litigation*[23] and *In re Initial Public Offerings Securities Litigation*.[24] Part IV concludes that the apparent tension between the two lines of cases has served as an important resource for courts, providing

19. 17 C.F.R. § 240.10b-5 (2008). Courts have recognized a private remedy for violating Rule 10b-5. *E.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975). This private litigation is "'a most effective weapon in the enforcement' of the securities laws and . . . 'a necessary supplement to Commission action.'" Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 310 (1985) (quoting J.I. Chase Co. v. Borak, 377 U.S. 426, 432 (1964)).

20. *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 11 n.7 (1971) (stating that Section 10(b) and Rule 10b-5 "prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception" (quoting A. T. Brod & Co. v. Perlow, 375 F.2d 393, 397 (2d Cir. 1967))). Following the enactment of the Securities Litigation Uniform Standards Act of 1998 (SLUSA), Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.), these provisions may be the sole means for investors redressing their injuries through a class action. *See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 126 S. Ct. 1503, 1507 (2006) (interpreting statutory federal preemption of state law securities claims broadly).

21. Basic Inc. v. Levinson, 485 U.S. 224, 241–42, 250 (1988).

22. Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.).

23. *In re* PolyMedica Corp. Sec. Litig., 432 F.3d 1 (1st Cir. 2005).

24. *In re* Initial Pub. Offerings Sec. Litig., 471 F.3d 24 (2d Cir. 2006).

flexibility for deciding issues in securities class actions that a simple, bright-line rule could not have resolved.

I. THE *EISEN-FALCON* FRAMEWORK AND FRAUD ON THE MARKET

The holdings in *Eisen* and *Falcon* play an important role in securities class actions because courts rely on them for guidance when determining the proper class certification procedure. This Part describes Rule 23's class certification procedures under *Eisen*'s and *Falcon*'s differing interpretations. These differences are most evident in class actions involving the fraud-on-the-market theory, which was developed in *Basic Inc. v. Levinson*.[25] This Part explores the rise of the fraud-on-the-market theory in securities class actions and reviews how courts apply *Eisen* and *Falcon* to these cases.

A. Class Certification Procedures under Eisen *and* Falcon

Rule 23 of the Federal Rules of Civil Procedure permits multiple plaintiffs to "aggregate their claims in a manner that makes litigation cost-beneficial."[26] Rule 23 is a specialized area of federal procedure that involves a number of unique, overlapping, and sometimes conflicting rules and judicial doctrines. For a case to proceed as a class action, the court must certify "at an early practicable time"[27] that the class meets the requirements of Rule 23.[28] Therefore, courts must

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25. Basic Inc. v. Levinson, 485 U.S. 224, 229, 241–49 (1988).

26. Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 FLA. L. REV. 71, 75 (2007).

27. FED. R. CIV. P. 23(c)(1).

28. *Id.* To certify a class of plaintiffs, Rule 23 requires that

> (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

Id. 23(a). In addition, at least one of three additional conditions in Rule 23(b)(1) through (3) must be met. Parties seeking certification must show either that (1) adjudicating individual actions might create inconsistent standards or impair the rights of nonparties to protect their interests, (2) injunctive relief is appropriate for the class, or (3) common questions of law or fact predominate over questions affecting individual class members (the "predominance requirement") and the class action is a superior method for adjudicating the controversy (the "superiority requirement"). *Id.* 23(b)(1)–(3). Rule 23(b)(3), which requires in part that common questions of law or fact predominate over questions affecting individual class members, is the most common ground on which classes of shareholders seek certification in federal securities cases. Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455, 461 (2006) ("Certification of shareholder fraud cases is almost always sought under FRCP 23(b)(3) . . . ."). The primary remedy plaintiffs seek in securities law class actions is often monetary damages, whereas (b)(1) and (b)(2) are intended for other purposes.

hold class certification hearings prior to full trials on the merits. *Eisen* and *Falcon* both interpreted Rule 23 and provided contrasting procedures for class certification hearings.

Eisen v. Carlisle & Jacquelin involved a class action alleging antitrust and securities law violations arising from pricing practices of securities brokers in odd-lot transactions.[29] Morton Eisen charged two brokerage firms with monopolizing odd-lot trading and charging excessive fees.[30] The brokerage firms allegedly "controlled ninety-nine percent of the odd-lot business [and] illegally fixed the odd-lot differential charged to the investing public at an excessive level in violation of the federal antitrust laws."[31] In 1972, the trial court determined that the plaintiff was "more than likely" to prevail and therefore allocated 90 percent of the cost of giving notice of the action to the approximately six million prospective class members to the defendant.[32] In 1973, the court of appeals "ordered the suit dismissed as a class action."[33] In 1974, the Supreme Court upheld the court of appeals, deciding that a trial court should not conduct "a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action."[34] This approach is sometimes called the "*Eisen* rule."[35]

The Court stated two reasons for the *Eisen* rule. First, it found no authority in Rule 23 for a merits inquiry at the certification stage, stating that the inquiry would be "directly contrary to the command of subdivision (c)(1)" that the class determination occur "[a]s soon as practicable"[36] after the action commences.[37] Second, it feared that

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See Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 564 (2d Cir. 1968) ("Subsection (b)(2) was never intended to cover cases like the instant one where the primary claim is for damages, but it is only applicable where the relief sought is exclusively or predominantly injunctive or declaratory."), *vacated*, 417 U.S. 156 (1974); Crasto v. Estate of Kaskel, 63 F.R.D. 18, 21 (S.D.N.Y. 1974) ("Numerous courts have held that class actions under the securities laws are not appropriate for class action treatment under (b)(1).").

29. *Eisen,* 417 U.S. at 159–60.

30. *Id.* at 160.

31. Brief of Petitioner at 8, *Eisen*, 417 U.S. 156 (No. 73-203), 1973 WL 172430.

32. *Eisen*, 417 U.S. at 168 (quoting Eisen v. Carlisle & Jacquelin, 54 F.R.D. 565, 567 (S.D.N.Y. 1972)).

33. *Id.* at 169.

34. *Id.* at 177.

35. *See, e.g.*, O'Neil v. Appel, 165 F.R.D. 479, 495 (W.D. Mich. 1996) (using the term "*Eisen* rule").

36. *Eisen*, 417 U.S. at 178. The "as soon as practicable" requirement was introduced into Rule 23 in 1966 to prevent a situation in which putative class members in a particular class action would know the outcome of the case before having to choose whether to opt in. *See* Am.

defendants could suffer prejudice from a preliminary proceeding that determined a merits issue without the protections of "traditional rules and procedures applicable to civil trials."[38] This preliminary decision could "color the subsequent proceedings and place an unfair burden on the defendant."[39] Therefore, *Eisen* aimed to maximize efficiency by preventing courts from reaching the merits during a separate, preliminary minitrial before the parties have developed their cases.

If applied too literally and broadly, the *Eisen* rule could impede the adjudicative process. "In some cases, federal judges invoke the rule to ignore merits-related evidence and to facilitate certification. In other cases, judges profess fidelity to the rule while selectively violating it in practice. The result is a patchwork of discretionary decisions difficult to justify on principled grounds."[40] Recognizing the importance of certification decisions, some courts have refused to base decisions on inadequate records unless the parties have the opportunity to argue the merits.[41]

General Telephone Co. of the Southwest v. Falcon definitively rejected reaching the merits prematurely. *Falcon* was an employment discrimination suit brought on behalf of a class of people who were

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Pipe & Constr. Co. v. Utah, 414 U.S. 538, 547 (1974) ("[T]he potential for so-called 'one-way intervention' [] aroused considerable criticism upon the ground that it was unfair to allow members of a class to benefit from a favorable judgment without subjecting themselves to the binding effect of an unfavorable one. The 1966 amendments were designed . . . to assure [*sic*] that members of the class would be identified before trial on the merits and would be bound by all subsequent orders and judgments." (footnote omitted)).

37. *Eisen*, 417 U.S. at 177–78.

38. *Id.* at 178.

39. *Id.*

40. Robert G. Bone & David S. Evans, *Class Certification and the Substantive Merits*, 51 DUKE L.J. 1251, 1254 (2002).

41. *See, e.g.*, Shelton v. Pargo, 582 F.2d 1298, 1312 (4th Cir. 1978) ("An intelligent decision on class certification requires 'at least a preliminary exploration of the merits' of the plaintiff's claim." (quoting ARTHUR R. MILLER, AN OVERVIEW ON FEDERAL CLASS ACTIONS: PAST, PRESENT AND FUTURE 15 (1977))). Commentators have expressed three different criticisms of the *Eisen* rule. *See* Bone & Evans, *supra* note 40, at 1319 ("[A] careful examination of the costs and benefits favors abolishing the rule and replacing it with a rigorous review of the evidence and a preliminary evaluation of the merits at the certification stage."); Bartlett H. McGuire, *The Death Knell for* Eisen*: Why the Class Action Analysis Should Include an Assessment of the Merits*, 168 F.R.D. 366, 403 (1996) ("For more than two decades, the Supreme Court's dictum in *Eisen* has made it difficult for the courts to assess the merits in the course of their class action analyses."); Geoffrey P. Miller, *Review of the Merits in Class Action Certification*, 33 HOFSTRA L. REV. 51, 87 (2004) ("The strong-form interpretation of *Eisen*, under which a trial court may not conduct a reasoned inquiry into merits issues as they relate to class certification, cannot be justified under any plausible analysis of public policy.").

denied promotions based on their national origin.[42] General Telephone hired Mariano S. Falcon through a special recruitment program for minorities.[43] Falcon accepted two promotions but refused a third promotion.[44] He later applied for a different position but was denied in favor of several white employees with less seniority.[45] Falcon filed a claim, alleging that he was "passed over for promotion because of his national origin and that [General Telephone's] promotion policy operated against Mexican-Americans as a class."[46] In 1978, the district court certified a class of Mexican-American applicants at General Telephone,[47] and in 1980 the court of appeals upheld the certification order.[48] Reversing the certification order, the Supreme Court in 1982 found that if the issues are not

> plain enough from the pleadings to determine whether the interests of the absent parties are fairly encompassed within the named plaintiff's claim . . . [it is] necessary for the court to probe behind the pleadings before coming to rest on the certification question. . . . [A]ctual, not presumed, conformance with Rule 23(a) remains . . . indispensable.[49]

Courts could certify a class only if the "trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied."[50] Therefore, *Falcon*'s justification was based on ensuring the correct outcome of the class certification decision.

Courts have managed to balance *Eisen* and *Falcon*'s two independent demands by requiring an "[i]ntertwining of class action inquiry with merits inquiry."[51] Courts have dealt with the advantages and disadvantages of the *Eisen* rule pragmatically and flexibly. Although they have sometimes refused to hold a "mini-trial[] into the merits," courts have developed class certification evidentiary procedures.[52] Courts have provided a "full opportunity to develop a record containing all the facts pertaining to the suggested class and its

42. Gen. Tel. Co. of the Sw. v. Falcon, 457 U.S. 147, 150 (1982).
43. *Id.* at 149.
44. *Id.*
45. *Id.*
46. *Id.*
47. *Id.* at 152.
48. *Id.* at 155.
49. *Id.* at 160 (footnote omitted) (citation omitted).
50. *Id.* at 161.
51. Stastny v. S. Bell Tel. & Tel. Co., 628 F.2d 267, 274–75 (4th Cir. 1980).
52. *Id.* at 275.

representatives,"[53] which can include preparation of memoranda,[54] affidavits,[55] discovery,[56] and hearings.[57] Such procedures are not always necessary in Rule 23 determinations;[58] however, the failure to use one when necessary[59] is a reversible error.[60] In summary, courts have varied their application of Rule 23 depending on the facts of particular cases.

B. Rule 10b-5 and Fraud on the Market

The *Eisen-Falcon* framework is especially important to cases in which the class certification hearing is complicated and potentially requires an inquiry into the merits of the case. Cases involving Rule 10b-5 often include these complications. The Securities and Exchange Commission (SEC), acting under Section 10(b) of the Securities Exchange Act of 1934,[61] promulgated Rule 10b-5, which makes it unlawful for any person "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to

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53. Int'l Woodworkers of Am. v. Chesapeake Bay Plywood Corp., 659 F.2d 1259, 1268 (4th Cir. 1981).

54. *See* Crawford v. W. Elec. Co., 614 F.2d 1300, 1304 (5th Cir. 1980) (indicating that the district court considered memoranda both parties had submitted when deciding the class certification issue).

55. *See* Chateau de Ville Prods., Inc. v. Tams-Witmark Music Library, Inc., 586 F.2d 962, 964 (2d Cir. 1978) (finding a three-and-a-half page affidavit inadequate).

56. Sirota v. Solitron Devices, Inc., 673 F.2d 566, 571 (2d Cir. 1982); *Stastny*, 628 F.2d at 277 n.16 (explaining that the judge's discovery orders can help in Rule 23 determinations); *Chateau de Ville Prods.*, 586 F.2d at 966 (holding that a failure to allow discovery when "substantial factual issues relevant to certification" exist was improper).

57. Albertson's, Inc. v. Amalgamated Sugar Co., 503 F.2d 459, 461 (10th Cir. 1974).

58. *See, e.g.*, *Int'l Woodworkers of Am.*, 659 F.2d at 1268 (stating that trial courts do not need to conduct a hearing to decide every class certification motion). Some opinions have suggested that there were rules either requiring, Gore v. Turner, 563 F.2d 159, 165 (5th Cir. 1977), or prohibiting, Shelter Realty Corp. v. Allied Maint. Corp., 574 F.2d 656, 661 n.15 (2d Cir. 1978), inquiries into certification. The better reading of *Eisen* and the cases that invoke its rule, however, is that courts must require inquiries only to the extent the record for a certification determination is inadequate.

59. *See* Bradford v. Sears, Roebuck & Co., 673 F.2d 792, 795–96 (5th Cir. 1982) (explaining that a hearing usually is necessary "when a serious question of commonality, or any other essential element, is raised"). A court, however, could initiate such an inquiry on its own. *See, e.g.*, Blackie v. Barrack, 524 F.2d 891, 901 n.17 (9th Cir. 1975) ("Lacking [sufficient information to determine class certification,] the court may request the parties to supplement the pleadings with sufficient material to allow an informed judgment . . . .").

60. *See, e.g.*, *Chateau de Ville Prods.*, 586 F.2d at 966 (reversing the district court for prematurely certifying a class action after the trial court failed to develop a sufficient evidentiary record).

61. 15 U.S.C. § 78j(b) (2006).

make the statements made, in the light of the circumstances under which they were made, not misleading."[62] Although defendants can contest any element of the 10b-5 claim, defendants most frequently challenge plaintiffs' proof of reliance.[63] The reliance requirement assesses the connection between the defendant's misrepresentation or omission and the plaintiff's decision to buy or sell the defendant's security.[64] Because Rule 23 requires putative class plaintiffs to prove that potential defenses are common to all class members, defendants can argue that, without proof that every class member personally relied on the defendant's statement or omission, courts should refuse to certify proposed classes. Consequently, courts could reject nearly all proposed securities class actions under the reliance element.

When this problem first arose, many lower federal courts produced various formulations of the circumstances under which courts may dispense with proof that individual investors relied on the alleged misstatements or omissions in 10b-5 actions.[65] Economists then developed the efficient market theory to explain how information unknown to some investors affects the prices those investors pay for securities traded on securities markets.[66] According to this theory, securities traded on an efficient market incorporate all

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62. 17 C.F.R. § 240.10b-5 (2008).

63. Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005) ("[Rule 10b-5's] action's basic elements include: (1) *a material misrepresentation (or omission)*; (2) *scienter*, i.e., a wrongful state of mind; (3) *a connection with the purchase or sale of a security*; (4) *reliance*, often referred to . . . as 'transaction causation[]'; (5) *economic loss*; and (6) '*loss causation*,' i.e., a causal connection between the material misrepresentation and the loss." (citations omitted)).

64. The Court refined the concept of reliance under Rule 10b-5 in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972). In *Affiliated Ute*, the Court found proof of reliance unnecessary in a Rule 10b-5 action "involving primarily a failure to disclose." *Id.* at 153. The case involved Indian tribe members who had been induced to sell shares representing interests in tribal assets. *Id.* The Court found that certain employees of a bank transfer agent had a duty of disclosure regarding matters affecting share value. *Id.* The tribe members were not required to prove reliance on what might have been disclosed. *Id.* at 153–54. This decision produced a great divide between omission cases, in which courts presume reliance from the materiality of the omitted fact, and misstatement cases, in which no presumption arises. By relieving plaintiffs of the burden of proving individual reliance, courts have allowed the element of reliance to adapt to modern economic theories.

65. *See, e.g.*, Blackie v. Barrack, 524 F.2d 891, 908 (9th Cir. 1975) ("[The] causal nexus can be adequately established indirectly, by proof of materiality coupled with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock."). A description of these developments is set forth in Jeffrey L. Oldham, Comment, *Taking "Efficient Markets" out of the Fraud-on-the-Market Doctrine After the Private Securities Litigation Reform Act*, 97 NW. U. L. REV. 995, 1004–11 (2003).

66. Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 553 (1984).

publicly known information into their price.[67] In *Basic Inc. v. Levinson*, the Supreme Court decided that courts should apply the efficient market theory in securities cases:[68]

> The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements.[69]

The Court adopted a version of the theory that justifies a presumption of reliance[70] if the plaintiff shows certain factors, including "that the shares were traded on an efficient market."[71]

The issue of reliance arose in *Basic* as part of the district court's decision to certify a class of plaintiffs under Rule 23. The plaintiffs included shareholders who had sold their stock in the defendant corporation during a certain period, allegedly because they relied on prior fraudulent denials by management that the company was negotiating a prospective merger.[72] Affirming the district court's class certification decision, the Court agreed with the district court's assessment that the presumption of reliance provided a "practical

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67. *See* Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059, 1079 (1990) (arguing that the Supreme Court in *Basic* adopted the "all publicly known information" form of the fraud-on-the-market theory).

68. Basic Inc. v. Levinson, 485 U.S. 224, 247 (1988) ("Indeed, nearly every court that has considered the proposition has concluded that where materially misleading statements have been disseminated into an impersonal, well-developed market for securities, the reliance of individual plaintiffs on the integrity of the market price may be presumed.").

69. *Id.* at 241–42 (omission in original) (quoting Peil v. Speiser, 806 F.2d 1154, 1160 (3d Cir. 1986)).

70. *Id.* at 250. The presumption is rebuttable. *Id.*

71. *Id.* at 248 n.27. The Court quoted the Sixth Circuit opinion's assertion that, to secure the benefit of the presumption, the plaintiff must both allege and prove

> (1) that the defendant made public misrepresentations; (2) that the misrepresentations were material; (3) that the shares were traded on an efficient market; (4) that the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares; and (5) that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed.

Id. (quoting Levinson v. Basic Inc., 786 F.2d 741, 750 (6th Cir. 1986), *vacated and remanded*, 485 U.S. 224 (1988)). As this quotation suggests, the plaintiff carries the burden of proving these elements, consistent with the usual burden of proof in class certification matters. *See* Albertson's, Inc. v. Amalgamated Sugar Co., 503 F.2d 459, 463 (10th Cir. 1974) (stating that the party requesting a class action must show that Rule 23 requirements are satisfied).

72. *Basic*, 485 U.S. at 228.

resolution to the problem of balancing the substantive requirement of proof of reliance in securities cases against the procedural requisites of [Federal Rule of Civil Procedure] 23."[73]

Basic shows how proving reliance for a Rule 10b-5 claim and concurrently satisfying the various certification issues under Rule 23(b)(3) present problems for plaintiffs.[74] The district court noted that, if each member of the class had to prove reliance separately, "individual issues then would have overwhelmed the common ones."[75] This outcome, with many shareholders suffering losses too small to justify an individual suit but large enough in the aggregate for a group effort, would have created a "loophole" in the class action remedy.[76] In light of this concern, the Court's decision to adopt the fraud-on-the-market theory, permitting a common proof of reliance to satisfy the predominance requirement,[77] amounted to a "policy decision to promote the deterrence effect of private rights of action under the securities laws."[78]

The Supreme Court's adoption of the fraud-on-the-market theory in *Basic Inc. v. Levinson* removed a significant barrier to Rule 10b-5 class actions. Yet the opinion is not an unqualified endorsement of expanded access to federal remedies. The Court seemed content that lower courts would sort out substantive and procedural issues—including what proof plaintiffs must show to invoke the theory and whether *Eisen* limits the need to submit those proofs at the certification stage—on an *ad hoc* basis, even if the Court's lack of guidance permitted courts to turn away a substantial number of claims. Thus, the fundamental policy underlying *Basic* may be characterized as one favoring judicial flexibility and the exercise of

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73. *Id.* at 242 (alteration in original).

74. *See In re* Visa Check/MasterMoney Antitrust Litig., 280 F.3d 124, 136 (2d Cir. 2001) ("In order to meet the predominance requirement of Rule 23(b)(3), a plaintiff must establish that 'the issues in the class action that are subject to generalized proof, and thus applicable to the class as a whole, . . . predominate over those issues that are subject only to individualized proof.'" (omission in original) (quoting Rutstein v. Avis Rent-A-Car Sys., Inc., 211 F.3d 1228, 1233 (11th Cir. 2000))).

75. *Basic,* 485 U.S. at 242.

76. Dunbar & Heller, *supra* note 28, at 457; *see also* Priest v. Zayre Corp., 118 F.R.D. 552, 553–54 (D. Mass. 1988) ("Courts have expressed a general preference for class certification in securities fraud cases, based on a policy favoring enforcement of the federal securities laws, and recognition of the fact that class actions may be the only practicable means of enforcing investors' rights." (citations omitted)).

77. *Basic*, 485 U.S. at 242.

78. Dunbar & Heller, *supra* note 28, at 458.

sound discretion. The Supreme Court was likely aware of the many post-*Eisen*, pre-*Basic* lower court decisions applying the *Eisen* rule in a spirit of procedural pragmatism and flexibility. The Court likely expected that future trial courts would sometimes look at the case's merits when making certification decisions in fraud-on-the-market cases, as discussed in the following Part.

II. DEVELOPMENTS IN THE CLASS CERTIFICATION PROCEDURE SINCE *BASIC*

Basic increased lower courts' confusion over how much evidence to consider during class certification hearings. Because *Basic* did not explain how courts should evaluate plaintiffs' proof of fraud on the market, many courts have permitted a variety of evidence during certification hearings, often in the form of expert testimony and relevant market data. But courts have had to decide how to evaluate this evidence in light of *Eisen*'s prohibition on considering the merits of a case and *Falcon*'s encouragement of rigorous Rule 23 certification hearings.

This Part describes two events that have eroded the *Eisen* rule. First, amendments to Rule 23 appear to promote more litigation during class certification hearings. Second, the number of issues and the complexity of evidence needed to address those issues have progressively increased, leading courts to increasingly allow parties to introduce and challenge expert testimony. These changes stressed the *Eisen* rule, but courts have used *Falcon* to adjust to these pressures and to effectively give pretrial certification decisions greater prominence in Rule 10b-5 actions. Two further factors, however, have restrained *Falcon*'s applicability to prevent it from replacing the *Eisen* rule: Congress enacted legislation that placed burdens on class action plaintiffs, and the Supreme Court set tighter standards regarding the use of expert witnesses.

Two events have favored *Falcon* over *Eisen*, swinging the pendulum toward elaborate certification hearings. First, two amendments to Rule 23 invited courts to permit greater litigation during class certification hearings.[79] In 2003, the provision that class certification "may be conditional" was removed.[80] Without language permitting conditional class certification, courts cannot later modify

79. *In re* Initial Pub. Offerings Sec. Litig., 471 F.3d 24, 39 (2d Cir. 2006).

80. *Id.*

classes after certifying them, and so courts must be satisfied during hearings that they are certifying the right class. Additionally, the provision that courts should make class certification decisions "as soon as practicable" was replaced with a provision requiring the decision "at an early practicable time."[81] By providing courts some latitude when scheduling certification decisions, the amended rule potentially gives the parties more time to develop relevant evidence. Together, these amendments encourage greater litigation over class certification—putative class plaintiffs must be more persuasive when arguing that certification is proper, and courts may delay certification decisions to wait for more evidence.[82]

Second, the evidence necessary to prove the elements of Rule 10b-5 has become increasingly complex. The Supreme Court in *Basic* did not prescribe any single methodology for determining whether a market was efficient to invoke the fraud-on-the-market presumption.[83] Lower federal courts, fed by insights from academics,[84] have endorsed a variety of ways to determine market efficiency,[85] sometimes through excursions into economic theory or expansive factual inquiries that went far beyond what sufficed in *Basic*.[86] Thus, although *Basic* allowed a party to simply identify the market in which a stock traded as a sufficient basis for finding market efficiency,[87]

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81. *Id.*

82. *See id.* ("Two changes arguably combine to permit a more extensive inquiry into whether Rule 23 requirements are met than was previously appropriate.").

83. *See* Gariety v. Grant Thornton, LLP, 368 F.3d 356, 368 (4th Cir. 2004) ("[*Basic*] offers little guidance for determining whether a market is efficient.").

84. *See, e.g.*, Daniel R. Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 CORNELL L. REV. 907, 912 (1989) (listing, as factors to determine a security's market efficiency, whether the security is listed on a national exchange, whether it is actively traded, whether it is followed by market professionals, and whether the speed of its price adjusts to new information).

85. *See* Abell v. Potomac Ins. Co., 858 F.2d 1104, 1120 (5th Cir. 1988) ("*Basic* essentially allows each of the circuits room to develop its own fraud-on-the-market rules."), *vacated on other grounds*, 492 U.S. 914 (1989).

86. The dissent in *Basic* had warned of complications, fearing that, "with no staff economists, no experts schooled in the 'efficient-capital-market hypothesis,' [and] no ability to test the validity of empirical market studies, we are not well equipped to embrace novel constructions of a statute based on contemporary microeconomic theory." Basic Inc. v. Levinson, 485 U.S. 224, 253 (1988) (White, J., dissenting).

87. *See id.* at 247, 246–47 (majority opinion) ("An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action."); 4 ALAN R. BROMBERG & LEWIS D. LOWENFELS, SECURITIES FRAUD AND COMMODITIES FRAUD

more often courts went further to consider multiple conditions believed to exist in efficient markets, some even considering quantitative measurements as to how the stock in question traded on that market. *Cammer v. Bloom*[88] adopted a widely accepted five-part test for market efficiency that measures weekly trading volume, the number of securities analysts following the stock, the number of market makers in the stock, the company's eligibility to file an S-3 registration statement, and the stock's record of quick price responses to events.[89] The complexity of the evidence has increased the need for hearings to develop the evidence necessary to make these determinations, which has prompted litigants to use experts to resolve complicated financial issues and to challenge submitted statistical evidence.[90] The *Cammer* factors are factual assertions that plaintiffs must prove in each case and thus pose a challenge if plaintiffs are to adhere to *Eisen*'s prohibition of inquiries into the merits of the case.

Two separate factors have restrained *Falcon*'s applicability to maintain a balance between *Eisen* and *Falcon*. First, Congress enacted the Private Securities Litigation Reform Act of 1995 (PSLRA).[91] Remedies under Rule 10b-5 that are too readily available pose a danger to securities markets.[92] When plaintiffs can easily obtain a remedy, the probability that defendants must pay damages increases. Unwilling to accept even a small risk of paying the enormous damages plaintiffs often claim, companies are forced to settle securities claims before trial for amounts disproportionate to

§ 7:484 (2d ed. 2006) ("We think that, at a minimum, there should be a presumption—probably conditional for class determination—that certain markets are developed and efficient for virtually all the securities traded there: the New York and American Stock Exchanges, the Chicago Board Options Exchange and the NASDAQ National Market System."). *But see In re* Data Access Sys. Sec. Litig., 103 F.R.D. 130, 138 (D.N.J. 1984) ("The trading on the over-the-counter market may not constitute an 'active and substantial' market necessary to apply the fraud-on-the-market theory."), *rev'd on other grounds*, 843 F.2d 1537 (3d Cir. 1988).

88. Cammer v. Bloom, 711 F. Supp. 1264 (D.N.J. 1989).

89. *Id.* at 1285–87.

90. *See infra* notes 112–24; *see also* 4 BROMBERG & LOWENFELS, *supra* note 87, § 7:484 ("It is important to have a fairly simple way of resolving—at least tentatively—at an early stage in a case whether the market for a particular security is open, developed and efficient, since this affects whether a claim has been stated and whether a class may be certified. . . . [S]ome sort of evidentiary base is appropriate for class determination.").

91. Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.).

92. *See* SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, J., concurring) (stating that expanding such remedies "will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers").

their merit.[93] In the years following *Basic*, skepticism toward the legitimacy of securities law claims was directed particularly at class actions.[94] These perceptions led to the enactment of the PSLRA, which placed additional burdens on plaintiffs seeking recovery under Rule 10b-5, some of which were specifically directed at class actions.[95] Although the PSLRA did not specifically address procedures relating to class certification,[96] court procedures eventually reflected skepticism regarding class actions that motivated the statute's passage. Courts both invoked a narrow reading of *Eisen* and cited the PSLRA as authority for denying certification even when no express provision of the act compelled the denial.[97]

Second, courts have imposed more stringent restrictions on the use of expert witnesses. The factual inquiries in certification hearings for Rule 10b-5 cases often require the testimony of expert witnesses.[98] Courts exercise a role as "gatekeeper" with respect to expert evidence.[99] In *Daubert v. Merrell Dow Pharmaceuticals, Inc.*,[100] the

93. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 740 (1975); *see also In re* Rhone-Poulenc Rorer Inc., 51 F.3d 1293, 1299 (7th Cir. 1995) (asserting that defendants cannot "stake their companies on the outcome of a single jury trial").

94. *See* H.R. REP. NO. 104-369, at 31, 37 (1995) (Conf. Rep.), *as reprinted in* 1995 U.S.C.C.A.N. 730, 730, 736 (criticizing "manipulation by class action lawyers" and "frivolous securities class actions").

95. *E.g.*, Private Securities Litigation Reform Act § 101, 109 Stat. at 737–49 (codified as amended at 15 U.S.C. §§ 78u–4, 77z–1 (2006)); *see also, e.g.*, 15 U.S.C. § 78u–4(a)(6) (limiting class plaintiffs' attorneys' fees to a "reasonable percentage" of recoveries).

96. Given the boost that the fraud-on-the-market theory in *Basic* gave to class certification, it would not have been surprising if Congress had responded by legislatively reversing the theory. *Basic* marked the beginning of a period in which the filing rate of class actions tripled. Dunbar & Heller, *supra* note 28, at 529. An earlier version of the PSLRA would have reversed the fraud-on-the-market theory, but the SEC Chairman testified against this version. *See Common Sense Legal Reform Act: Hearings Before the Subcomm. on Telecommunications and Finance of the H. Comm. on Commerce*, 104th Cong. 203 (1995) (statement of Arthur Levitt, Chairman, Securities and Exchange Commission), *available at* http://www.sec.gov/news/testimony/testarchive/1995/spch025.txt ("An actual reliance requirement of the type proposed would also make it virtually impossible for investors to assert their claims as part of a class action.").

97. *See, e.g.*, Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 267–68 (5th Cir. 2007) (citing both *Eisen* and the PSLRA when denying a class certification).

98. Absent Federal Rules of Evidence 702 and 703, expert testimony, usually an opinion based on facts the expert has no first-hand knowledge of, would run afoul of the common law rule excluding hearsay evidence. *See* Margaret G. Farrell, *Coping with Scientific Evidence: The Use of Special Masters*, 43 EMORY L.J. 927, 938 (1994) (stating that hearsay evidence is "evidence not directly perceived by the senses of the person giving the testimony").

99. *See* Note, *Improving Judicial Gatekeeping: Technical Advisors and Scientific Evidence*, 110 HARV. L. REV. 941, 944 (1997) (noting that without a judicial check requiring consideration of contrary opinion, expert testimony could amount to "junk science"). *Daubert* requires judges

Supreme Court set ground rules for courts' gatekeeper role, permitting a federal court to admit expert witness testimony only if it determines that the testimony consists of "(1) scientific knowledge that (2) will assist the trier of fact to understand or determine a fact in issue."[101] The *Daubert* standard makes it easier for courts to reject expert testimony they deem unreliable.[102] These standards force parties to litigate the quality of their experts before the experts can testify. Certification decisions should have the benefit of *Daubert* analysis to "eliminate both unreliable evidence and unsubstantiated class actions."[103]

The *Eisen* rule generally limits review of the merits of the case before certification of the class. Courts swung the pendulum from *Eisen* to *Falcon* by allowing complex evidence and expert witnesses during class certification hearings. Courts then restrained their application of *Falcon*, however, to find a balance between *Eisen* and *Falcon*. The *Eisen-Falcon* framework has proven sufficiently flexible

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to ensure that "an expert's testimony both rests on a reliable foundation and is relevant to the task at hand." Daubert v. Merrell Dow Pharms., Inc., 509 U.S. 579, 597 (1993). *Daubert* interpreted Federal Rule of Evidence 702, which states that

> [i]f scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

FED. R. EVID. 702.

100. Daubert v. Merrell Dow Pharms., Inc., 509 U.S. 579 (1993).

101. *Id.* at 592. The Court then set forth a nonexclusive list of factors that a court might consider when deciding whether to admit expert testimony, such as whether the expert theory or technique is subject to peer review and what its potential rate of error might be. *Id.* at 593–94. In *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137 (1999), the Court articulated the court's role in terms of a "gatekeeping" function applicable to all expert testimony, not just that relating to scientific knowledge. *Id.* at 141.

102. *See* KENNETH S. BROUN, ROBERT P. MOSTELLER & PAUL C. GIANNELLI, EVIDENCE: CASES AND MATERIALS 591 (7th ed. 2007) ("A Rand Institute study of civil cases concluded that since *Daubert*, judges have examined the reliability of expert evidence more closely and have found more evidence unreliable as a result."). *But see id.* ("In contrast, admissibility standards in criminal litigation appear unchanged.").

103. L. Elizabeth Chamblee, Note, *Between "Merit Inquiry" and "Rigorous Analysis": Using* Daubert *to Navigate the Gray Areas of Federal Class Action Certification*, 31 FLA. ST. U. L. REV. 1041, 1088 (2004); *see also* Mandi L. Williams, Note, *The History of* Daubert *and Its Effect on Toxic Tort Class Action Certification*, 22 REV. LITIG. 181, 208 (2003) ("A *Daubert* inquiry should be allowed in class action certification proceedings."). The Supreme Court has rejected the argument that pretrial gatekeeping judicial determinations such as *Daubert* inquiries violate the Seventh Amendment. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2512 n.8 (2007).

to both accommodate increased evidentiary burdens during certification hearings and allow courts to carefully screen cases before certifying a 10b-5 class action, as the next Part shows.

III. APPLYING THE *EISEN-FALCON* FRAMEWORK AFTER THE PSLRA

Courts have increasingly insisted on a greater amount of proof regarding efficiency for the relevant security's market before certifying a securities class action claim based on the fraud-on-the-market theory. The quality of certification decisions that involve increasingly sophisticated economic theory can only improve if parties can explain and challenge the evidence of fraud on the market. Responding to this reality, lower courts have developed, through a case-by-case process, a pretrial certification procedure that conflicts with *Eisen*. As Part IV argues, *Eisen* and *Falcon* allow for this case-by-case balancing. This Part discusses the decisions in *In re PolyMedica* and *In re Initial Public Offerings*, which illustrate how the balancing process works.

A. Securities Cases through In re PolyMedica

In the wake of PSLRA's enactment, courts have applied the *Eisen-Falcon* framework in various ways that increase procedural demands when deciding certification issues in Rule 10b-5 actions but that are difficult to explain through any single principle. Cases can be grouped into three categories: (1) those that apply *Eisen* and limit inquiries, (2) those that apply *Falcon* and permit broad inquiries, and (3) those that adopt a mixed approach.[104] Courts still sometimes cite the *Eisen* rule as curtailing factual inquiries in challenges to certification motions in Rule 10b-5 cases.[105] More often, courts take a mixed approach to applying the *Eisen* rule by incorporating the *Falcon* holding in view of the complexities of proving market

104. *See* Miller, *supra* note 41, at 55–61 (analyzing various class action proceedings in terms of "strong-form" and "weak-form" applications of the *Eisen* rule).

105. *See, e.g.*, Lehocky v. Tidel Techs., Inc., 220 F.R.D. 491, 498 (S.D. Tex. 2004) (citing *Eisen* for the proposition that courts assume the allegations in a complaint are true for purposes of a class certification motion). Yet the court had actually conducted a hearing on market efficiency at which both sides submitted expert testimony and performed "sophisticated statistical tests," *id.* at 506, and the court evaluated the evidence under *Cammer* standards, *id.* at 505–09. Thus the curtailment effectively operated only to exclude the defendants' offer of rebuttal evidence, which the court said was a matter for trial. *Id.* at 505 n.16.

efficiency and other elements of fraud on the market. *O'Neil v. Appel*[106] illustrates this mixed approach. The *O'Neil* opinion suggested that *Basic* modified *Eisen*, at least to the extent necessary to permit procedures for adequately considering fraud-on-the-market issues.[107] The court's consideration involved conducting a hearing[108] during which the court tested the evidence against the *Cammer* standards[109] to determine whether market efficiency had been shown.[110] The court recognized *Eisen* as a limit but did not hesitate to consider any substantive merits issues intertwined with the certification decision.[111]

At the other end of the spectrum, some courts allow significantly more factfinding to determine market efficiency. In *Krogman v. Sterritt*,[112] for instance, the court invited dueling experts to prove whether the relevant market was efficient.[113] In *Krogman*, investors sought to certify a class in a securities fraud action.[114] The investors' expert testified that the average weekly turnover of the company's stock was high enough to create a presumption that the market was efficient.[115] The company's expert testified that the investors' expert's calculations were incorrect and that the stock was not actively traded.[116] The court agreed with the company's expert that "the presumption of market efficiency, which would support an application of fraud on the market theory, [did] not apply."[117] The court denied certification because each investor would have had to

106. O'Neil v. Appel, 165 F.R.D. 479 (W.D. Mich. 1996).

107. *Id.* at 497 ("By adopting the fraud-on-the-market theory, the *Basic* court implied, though perhaps unintentionally, that the district courts *must* examine some of the merits." (quoting *In re* Seagate Tech. II Sec. Litig., 843 F. Supp. 1341, 1367 (N.D. Cal. 1994))).

108. *Id.* at 494.

109. *See supra* note 89 and accompanying text.

110. *O'Neil*, 165 F.R.D. at 500–01.

111. *See id.* at 500 (stating that "the court is not required at this point to decide the merits of plaintiffs' fraud-on-the-market theory," but "[o]n the basis of the evidence now of record, . . . plaintiffs have virtually no chance of succeeding on this theory").

112. Krogman v. Sterritt, 202 F.R.D. 467 (N.D. Tex. 2001).

113. *Id.* at 474 ("[T]his Court must decide whether Plaintiffs have proven that the OTCBB market was efficient."); *see also* Serfaty v. Int'l Automated Sys., Inc., 180 F.R.D. 418, 421 (D. Utah 1998) ("[T]he determinative question now becomes whether IAS stock traded in an efficient market . . . .").

114. *Krogman*, 202 F.R.D. at 470–71.

115. *Id.* at 474.

116. *Id.* at 474–75.

117. *Id.* at 475, 478.

prove individual reliance and therefore failed to meet the predominance requirement of Rule 23.[118]

Additionally, in cases such as *Bell v. Ascendant Solutions, Inc.*,[119] the court invited full *Daubert* challenges to expert testimony and excluded experts' opinions based on *Daubert* considerations.[120] In *Ascendant Solutions*, investors sought to certify a class in a securities fraud action.[121] The investors proffered an expert to prove the company's securities traded on an efficient market, and the company sought to exclude the expert's testimony.[122] The court applied *Daubert*, found the expert's testimony unreliable, and granted the company's motion to strike the testimony.[123] Each investor would have to prove individual reliance, so the court denied certification because the investors failed to meet the predominance requirement of Rule 23.[124] In circuits that had not yet specified procedures for certification hearings, the time was ripe for defendants to challenge the omission of these procedures.[125]

In the First Circuit, defendants in *In re PolyMedica* challenged the district court's class certification procedures.[126] The district court had accepted the defendants' argument that a "more searching inquiry" was appropriate in deciding class certification issues,[127] thus rejecting a narrow reading of the *Eisen* rule and aligning this court with a majority of other federal circuits. Nevertheless, the district

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118. *Id.* at 478.

119. Bell v. Ascendant Solutions, Inc., No. Civ.A. 301CV0166N, 2004 WL 1490009 (N.D. Tex. July 1, 2004) (mem.).

120. *See, e.g.*, Bell v. Fore Sys., Inc., No. Civ.A. 97-1265, 2002 WL 32097540, at *1, *4 (W.D. Pa. Aug. 2, 2002) (mem.) (granting the defendants' motion to strike the testimony of the plaintiffs' expert on *Daubert* grounds); *Ascendant Solutions*, 2004 WL 1490009, at *3–4 (same); *see also* Miller, *supra* note 41, at 63 ("The fraud-on-the-market presumption in *Basic* cannot be intelligently administered without at least a preliminary look at the merits-related issue of whether the relevant market is efficient.").

121. *Ascendant Solutions*, 2004 WL 1490009, at *1.

122. *Id.*

123. *Id.* at *4.

124. *Id.* at *5.

125. Prior to the circuit court decision in *In re PolyMedica*, the First and Second Circuits were among those that did not provide for a full pretrial hearing of individual reliance evidence. *See In re* Visa Check/MasterMoney Antitrust Litig., 280 F.3d 124, 135 (2d Cir. 2001) (stating that a certification proponent need only show that Rule 23 requirements were met "based on methodology that was not fatally flawed"); *In re* PolyMedica Corp. Sec. Litig., 224 F.R.D. 27, 34 (D. Mass. 2004) ("The First Circuit has not addressed the issue [of the level of inquiry for class certification] squarely . . . ."), *vacated and remanded*, 432 F.3d 1 (1st Cir. 2005).

126. *In re PolyMedica*, 432 F.3d at 4.

127. *In re PolyMedica*, 224 F.R.D. at 34.

court rejected the defendants' further argument that courts should determine whether a market is efficient using a widely accepted, economics-based standard that prices must reflect "all," rather than "most," publicly available material information.[128] The plaintiffs' expert relied on the five *Cammer* factors and testified that the relevant market was efficient.[129] The defendants' expert relied on three factors not enumerated in *Cammer* and testified that the relevant market was not efficient.[130] The district court found the plaintiffs' expert witness testimony that the stock price in question reflected "most" publicly available information was sufficient and ordered certification even though the defendants provided evidence that the price did not reflect "all" publicly available information.[131] On appeal, the First Circuit held that the district court improperly determined that market efficiency must reflect "all" such information.[132] It therefore vacated the lower court's order and remanded the case for further proceedings consistent with its opinion.[133] At the same time that the First Circuit required this higher standard of proof, it also accepted the mixed reading of the *Eisen-Falcon* framework that the lower court had adopted to permit considering evidence relevant to whether the higher standard of proof was met.[134] The First Circuit held that "the district court must evaluate the plaintiff's evidence . . . critically without allowing the defendant to turn the class-certification proceeding into an *unwieldy* trial on the merits."[135] The First Circuit's friendliness to merits-related investigations permitted the district court to weigh competing evidence, including expert testimony regarding the *Cammer* factors.[136] The First Circuit then found that the district court was not permissive enough because the district court had rejected the defendant's

128. *Id.* at 41.

129. *In re PolyMedica*, 432 F.3d at 4.

130. *Id.*

131. *In re PolyMedica*, 224 F.R.D. at 43.

132. *In re PolyMedica*, 432 F.3d at 13–14.

133. *Id.* at 19. The court rejected an even higher standard of "fundamental value efficiency" that would have required showing not only that the price reflects such information but also that it is accurate. *Id.* at 16.

134. *Id.* at 6.

135. *Id.* at 17. The court's emphasis suggests that the First Circuit thought the scope of the trial court's consideration of the merits was unacceptable rather than the fact that the trial court had reached the merits at all.

136. *Id.* at 4–5.

additional evidence regarding factors beyond those enumerated in *Cammer*.[137]

The First Circuit acknowledged that abandoning a narrow reading of *Eisen* presents practical difficulties. It recognized that without a bright-line rule, defendants would always press the court to require more, and plaintiffs to require less, evidence of efficiency.[138] The First Circuit directed trial courts to keep these demands in balance through "broad discretion."[139]

Although the First Circuit's guidance may seem overly general, on remand it inspired a better-focused rehearing by the trial court. The district court applied *Daubert* standards to its evaluation of the plaintiff's expert testimony, found the testimony was only marginally persuasive,[140] and admitted the evidence that it had previously rejected.[141] This evidence proved relevant to the standard of "information efficiency" and to conclusively showing that it was not met.[142]

B. The Second Circuit Joins the Party in In re IPO

Shortly after *In re PolyMedica* was decided, the Second Circuit had a similar opportunity to rethink the *Eisen* issues in *In re Initial Public Offerings (IPO) Securities Litigation*.[143] The *In re IPO* plaintiffs alleged "a vast scheme to defraud the investing public," bringing claims under Rule 10b-5 and other securities laws against fifty-five underwriters, 310 issuers, and hundreds of associated individuals.[144] The defendants' alleged scheme involved wrongfully requiring purchasers of securities in initial public offerings to commit to paying

137. *Id.* at 19. The rejected evidence included an expert report based in part on results of a "serial correlation test" and a "put-call parity test" that tended to show constraints on the ability of short sellers to trade on information relating to the stock in question. *Id.* at 18 n.21. This evidence, in turn, would have tended to show a limitation on the ability of market participants to exploit profit opportunities and would thus arguably have been inconsistent with the "all" information standard of market efficiency. *Id.*

138. *Id.* at 17.

139. *Id.*

140. *In re* PolyMedica Corp. Sec. Litig., 453 F. Supp. 2d 260, 270 (D. Mass. 2006).

141. *Id.* at 272–79.

142. *Id.*

143. *In re* Initial Pub. Offerings Sec. Litig., 471 F.3d 24 (2d Cir. 2006).

144. *In re* Initial Pub. Offering Sec. Litig., 241 F. Supp. 2d 281, 293, 399 (S.D.N.Y. 2003) ("[T]he motions to dismiss are, for the most part, denied.").

additional forms of compensation, such as purchasing additional shares in the aftermarket.[145]

After having previously denied a substantial portion of the defendants' motion to dismiss the various claims,[146] District Judge Scheindlin considered the plaintiffs' motion for class certification.[147] The defendants vigorously opposed this motion,[148] submitting "thousands of pages of briefs, affidavits, exhibits and reports in opposition to the motion."[149] Judge Scheindlin was able to find in the record three items that were probative on the question of market efficiency: (1) the stock in question was to be traded on the NASDAQ National Market, (2) it was traded at high volumes, and (3) coverage by analysts and in the media was substantial.[150] Notwithstanding the subsequent amendments to Rule 23,[151] Judge Scheindlin invoked the mixed approach toward the *Eisen-Falcon* framework and deferred definitive proof of certification issues until trial.[152] Although she acknowledged the arguable relevance of broader tests of efficiency,[153] Judge Scheindlin nevertheless concluded that the three items were sufficient under the "some showing" standard[154] established in *Caridad v. Metro-North Commuter Railroad*,[155] which she believed to be the evidentiary standard at the certification stage.[156] Judge Scheindlin therefore granted the motion for class certification.[157]

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145. *In re Initial Pub. Offerings*, 471 F.3d at 27. The court saw the fact pattern as a continuation of long-standing securities industry practice of generating profits by artificially creating "hot issues markets." *In re Initial Pub. Offering,* 241 F. Supp. 2d at 298–308.

146. *In re Initial Pub. Offering*, 241 F. Supp. 2d at 298 ("Plaintiffs have pled a coherent scheme . . . to defraud the investing public. As such, these lawsuits may proceed.").

147. *In re* Initial Pub. Offering Sec. Litig., 227 F.R.D. 65 (S.D.N.Y. 2004). Six "test cases" were selected to determine whether the suits could proceed as class actions. *Id.* at 70.

148. *Id.* at 71 ("In their zeal to defeat the motion for class certification, defendants have launched such a broad attack that accepting their arguments would sound the death knell of securities class actions.").

149. *Id.*

150. *Id.* at 107.

151. *See supra* notes 96–99 and accompanying text.

152. *In re Initial Pub. Offering*, 227 F.R.D. at 107 n.325.

153. *Id.* at 107 & n.323 (mentioning the five *Cammer* factors).

154. *Id.* at 107. "Under any conceivable test for market efficiency, these three facts are sufficient to meet plaintiff's Rule 23 burden to make 'some showing' that the stocks in question traded on an efficient market." *Id.*

155. Caridad v. Metro-North Commuter R.R., 191 F.3d 283 (2d Cir. 1999).

156. *Id.* at 292.

157. *In re Initial Pub. Offering*, 227 F.R.D. at 122.

The Second Circuit reversed the certification order and aligned itself with the majority of other circuits,[158] including the First Circuit post-*In re PolyMedica*, on issues including (1) using *Eisen* to limit the scope of class certification hearings,[159] (2) the standard of proof in class certification motions,[160] and (3) the standard for admitting expert testimony in these hearings.[161]

The Second Circuit embraced a practical reinterpretation of *Eisen* for efficient market determinations that should help make these determinations more accurate. As to the first issue, whether *Eisen* limits class certification hearings, the Second Circuit undertook a "careful examination" of the *Eisen* rule before reaching its decision.[162] The court focused on the possible justification for the rule that a pretrial hearing of evidence could prejudice a defendant, but ultimately dismissed the justification as "fatuous."[163] The court also looked at the specific facts of *Eisen*, pointing out that the district court "had not looked at the merits in order to determine whether any one of the Rule 23 requirements was met."[164] In this light, the court concluded that *Eisen* did not mean that a party could avoid establishing a Rule 23 requirement whenever the Rule 23 issue related to the merits.[165] The court thus joined the majority of other courts, requiring an appropriate Rule 23 determination even when the Rule 23 issue overlaps with a merits issue.[166]

The Second Circuit then addressed the standard of proof plaintiffs must meet to prove fraud on the market during certification hearings. The court rejected *Caridad*'s "some showing" standard for proof in Rule 23 matters, stating that the standard was too low.[167]

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158. *See In re* Initial Pub. Offerings Sec. Litig., 471 F.3d 24, 38–39, 41, 45 (2d Cir. 2006) (outlining the majority view, agreeing with this view, and reversing the certification order).

159. *Id.* at 33–34, 41.

160. *Id.* at 39–42.

161. *Id.* at 41–42.

162. *Id.* at 33.

163. *Id.* at 38 n.9.

164. *Id.* at 34.

165. *Id.* at 33.

166. *Id.* at 41.

167. *Id.* at 40. The court struggled to find a different standard. It cited without approval decisions in other circuits that held that parties seeking certification must establish Rule 23's requirements by a preponderance of the evidence. *Id.* at 29–30. The court then reexamined its own then-recent decision in *Heerwagen v. Clear Channel Communications*, 435 F.3d 219 (2d Cir. 2006), which had held that, at least for 23(b)(3) predominance, preponderance was the lowest possible standard. *In re Initial Pub. Offerings*, 471 F.3d at 37 & n.8.

Instead, it concluded the proper standard was whether "discretion has been exceeded (or abused)," leaving the trial judge "some leeway."[168] This decision added support to the First Circuit's holding in *In re PolyMedica*, endorsing an appropriately flexible, discretionary standard that can respond to the expanding variety of issues presented by class actions.[169] *In re IPO* urged, following from *Eisen*, that courts should exercise this discretion to avoid "a protracted mini-trial of substantial portions of the underlying litigation" but should still use *Falcon* to demand enough evidence "by affidavits, documents, or testimony" to satisfy each Rule 23 requirement.[170] The opinion balanced familiar concerns of each of these Supreme Court precedents, indirectly endorsing extensive evidentiary proceedings when considering class certification.[171]

Continuing to apply a mixed approach to the *Eisen-Falcon* framework, the Second Circuit clarified the third issue regarding the standard for admitting expert testimony. The court held that expert testimony was not subject only to a limited *Daubert* standard requiring the testimony to not be "fatally flawed."[172] Instead, district courts should allow "statistical dueling" of experts and "assess all of the relevant evidence admitted at the class certification stage and determine whether each Rule 23 requirement has been met, just as the judge would resolve a dispute about any other threshold prerequisite for continuing a lawsuit."[173]

Notwithstanding its tolerance for inquiries into the merits of a case and statistical dueling of experts, the Second Circuit found that this particular case required no further inquiries or experts.[174] This decision to close the record on efficiency could seem inconsistent with the court's instruction to allow expert witnesses and evidence going to the merits of the case. Yet ordering more evidence would have been pointless because the Second Circuit concluded that initial public offerings are never an efficient market.[175] The Court reasoned that

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168. *In re Initial Pub. Offerings*, 471 F.3d at 40 (noting that this leeway "is not boundless").

169. *See supra* note 139 and accompanying text.

170. *In re Initial Pub. Offerings*, 471 F.3d at 41.

171. Although the court reversed her certification decision, the Second Circuit opinion reflects no disapproval of the extensive record that was developed in Judge Scheindlin's court as to whether Rule 23 requirements were met.

172. *In re Initial Pub. Offerings*, 471 F.3d at 36 & n.7.

173. *Id.* at 42.

174. *Id.*

175. *Id.*

"[t]he fraud-on-the-market 'presumption can not logically apply when plaintiffs allege fraud in connection with an IPO, because in an IPO there is no well-developed market in offered securities.'"[176] The court supported its decision by stating that (1) other courts had issued similar holdings with respect to initial public offerings, (2) SEC rules limited analyst coverage during such offerings, and (3) the plaintiffs' own allegations showed that the market was slow to react once the truth of the fraudulent scheme became known.[177] Therefore, the court's decision indicates that more evidence is not always better than less and that courts must exercise discretion to distinguish whether the submitted evidence meets the relevant standard.

IV. A PROPOSAL TO EMBRACE DISCRETION

Rule 23 establishes the procedures for certifying a class. *Eisen* and *Falcon* interpreted the rule, but in contrasting ways. *Eisen* interpreted the rule narrowly, precluding review of the case's merits before class certification; *Falcon* allowed wide review of the merits to determine class certification. Analyzing the facts of the cases presented in this Note in the context of the *Eisen-Falcon* continuum, this Part asserts several ideas. First, it maintains that judicial discretion stemming from the contrasting holdings in *Eisen* and *Falcon* suits securities class actions. This Part demonstrates how the holdings in *Eisen* and *Falcon* complement each other to allow just the right amount of evidence into class certification proceedings to certify the appropriate class efficiently. This Part concludes by contending that the flexibility these two holdings allow is superior to the alternatives and will likely continue to assist courts in class certification proceedings.

Scholars have praised judicial discretion during litigation, arguing that "judicial discretion does, in fact, lead to greater fairness and equality."[178] These commentators have argued for using judicial discretion in areas of law other than securities, including bankruptcy[179]

176. *Id.* (quoting Berwecky v. Bear, Stearns & Co., 197 F.R.D. 65, 68 n.5 (S.D.N.Y. 2000)).

177. *Id.* at 42–43.

178. Rosemary Barkett, *Judicial Discretion and Judicious Deliberation*, 59 FLA. L. REV. 905, 907 (2007).

179. *See, e.g.*, Lauren E. Tribble, Note, *Judicial Discretion and the Bankruptcy Abuse Prevention Act*, 57 DUKE L.J. 789, 815 (2007) ("Congress should revise the means test to allow judges more discretion in identifying abusive debtors.").

and criminal sentencing.[180] Judicial discretion to use both the holdings in *Eisen* and *Falcon* seems particularly suited to Rule 10b-5 securities class actions. Rule 10b-5 securities class actions frequently involve the application of the fraud-on-the-market theory, creating the need to deal procedurally with large amounts of technical economic data in certification hearings regarding market efficiency.[181] The theory has increased rapidly in complexity and importance since the Supreme Court approved the theory in *Basic*.[182] This evolution toward complexity may continue, if not accelerate, as courts become more sophisticated in their understanding of the finance and thus require additional proofs before accepting economics-based presumptions,[183] and as securities lawyers develop useful economic tools to provide those proofs.[184] Rules that govern securities class action procedures will benefit from flexibility that allows judges to deal with these changes without the need for detailed regulations that take every consideration into account. Though the complexity of class action securities cases has grown, the decisions established in *Eisen* and *Falcon* when applied together provide a framework to adapt to the increased complexity.

The *Eisen-Falcon* framework influences procedure on two levels. The first is a prohibition against using certification as a pretext for ruling on the general merits of the case rather than only on specific certification issues.[185] For example, a violation of this level may have existed if the *In re IPO* district court had invited submission of broad categories of evidence leading to a certification decision based on its belief that a violation of securities laws had been shown, or equally if the Second Circuit had based its reversal on the opposite view. The distinction between issues going to the merits and issues regarding certification is often hard to define, however. This framework then operates on a second level at which courts must make difficult

180. *See, e.g.*, Barkett, *supra* note 178, at 907.

181. *See supra* Part II.

182. Basic Inc. v. Levinson, 485 U.S. 224, 247 (1988).

183. *See* Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 269 (5th Cir. 2007) (holding that, in a fraud-on-the-market case, "loss causation must be established at the class certification stage by a preponderance of all admissible evidence").

184. *See generally* Linda Allen, *Meeting* Daubert *Standards in Calculating Damages for Shareholder Class Action Litigation*, 62 BUS. LAW. 955 (2007) (proposing an economics-based method to calculate damages for shareholder class action suits).

185. Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 177–78 (1974).

procedural choices about how to resolve those intertwined issues efficiently and fairly without violating the first-level prohibition.[186]

Courts encounter many problems within the *Eisen-Falcon* framework when they deal with the substantive issues that determine the scope of a class. There is not a single procedure to determine how much expert testimony is necessary to competently judge class certification. Both sides in the suit would wish to bring as many witnesses and as much testimony to support their arguments as possible, swinging the pendulum toward *Falcon* from the judicial economy of *Eisen*. But without standards of a gatekeeper function to limit *Falcon*, the side with the greater resources would have an advantage.

The courts have constructed rules that allow parties to introduce some evidence but still limit the *Falcon* tendency toward considering large amounts of evidence and remain somewhat close to *Eisen*. For example, courts have used the five *Cammer* factors to determine market efficiency.[187] Through the *Cammer* factors, courts can allow plaintiffs and defendants to introduce some evidence but can limit the evidence only to that which is relevant to the five factors. Additionally, courts have applied *Daubert*'s gatekeeper analysis when deciding whether to allow expert witness testimony.[188] By allowing expert witness testimony only when courts deem it reliable, courts have balanced *Eisen* and *Falcon*.

By following *Eisen*, courts can certify classes quickly and begin considering the case's merits. To ensure the certified class is correct, however, courts must use *Falcon* to consider some evidence during class certification. The continuum of *Eisen* to *Falcon* permits this flexibility—judges can use their discretion to emphasize *Falcon* if they need more information to refine the class or to emphasize *Eisen* to limit that inquiry when efficiency requires.

Judges' increasing tolerance for extensive certification hearings has shown the *Eisen* rule's adaptability to these intertwined issues; indeed, during these proceedings, courts have found the presumed tension between *Eisen* and *Falcon* to be more apparent than real. *In*

186. *See* Gen. Tel. Co. of the Sw. v. Falcon, 457 U.S. 147, 160 (1982) ("Sometimes the [merits and certification] issues are plain enough from the pleadings to determine whether the interests of the absent parties are fairly encompassed within the named plaintiff's claim, and sometimes it may be necessary for the court to probe behind the pleadings before coming to rest on the certification question.").

187. *See supra* note 89 and accompanying text.

188. *See supra* notes 101–03 and accompanying text.

re PolyMedica[189] and *In re IPO*[190] show that, to the extent tension exists, courts can resolve it. Both cases criticized precedents within their respective circuits that gave too little weight to *Falcon* and misread *Eisen* as directing courts to certify classes as long as the pleadings were formally adequate.[191] Instead, the cases integrated the two Supreme Court opinions by accepting *Falcon*'s instruction that courts may examine the facts underlying a certification decision while also acknowledging *Eisen* by not allowing the inquiry to become a pretext for courts to reject plaintiffs' claims on the merits.[192]

Reading *Eisen* and *Falcon* separately, the cases appear to contradict each other. *Eisen* precludes review of the merits of the case before class certification; *Falcon* allows wide review of the merits to determine class certification. In practice, as subsequent court rulings demonstrate, the holdings of these two cases create a continuum giving courts flexibility depending on the facts of the situation. Courts' continued, frequent citation of the two holdings over such a lengthy period, during which courts have often applied both cases in evolving areas of specialized securities law, suggests *Eisen* and *Falcon* were reasonably well designed to help courts during periods of transition and stress. The flexibility the two decisions permit has benefited the adjudication of class certification in securities class actions. These class certification hearings will continue to test the ability of judges to exercise sound discretion, but selecting one rule or the other, or some newly substituted rule, for courts to apply on a one-size-fits-all basis likely would not assist judges.

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189. *See supra* notes 126–42 and accompanying text.

190. *See supra* Part III.B.

191. *See In re* Initial Pub. Offerings Sec. Litig., 471 F.3d 24, 34 (2d Cir. 2006) ("Unfortunately, the statement in *Eisen* that a court considering certification must not consider the merits has sometimes been taken out of context and applied in cases where a merits inquiry either concerns a Rule 23 requirement or overlaps with such a requirement."); *In re* PolyMedica Corp. Sec. Litig., 432 F.3d 1, 16 (1st Cir. 2005) ("Courts which choose to consider such fundamental value evidence at the class-certification stage run the risk of turning the class-certification proceeding into a mini-trial on the merits, which must not happen.").

192. *See In re Initial Pub. Offerings*, 471 F.3d at 41 ("[A] district court judge may certify a class only after making determinations that each of the Rule 23 requirements has been met [but] in making such determinations, a district judge should not assess any aspect of the merits unrelated to a Rule 23 requirement . . . ."); *In re PolyMedica*, 432 F.3d at 17 ("Exercising its broad discretion, . . . the district court must evaluate the plaintiff's evidence of efficiency critically without allowing the defendant to turn the class-certification proceeding into an *unwieldy* trial on the merits.").

CONCLUSION

Federal courts have undertaken a localized, circuit-by-circuit and case-by-case effort to establish standards for determining the sufficiency of claims invoking the fraud-on-the-market theory for class certification. This effort has proceeded on two fronts. One concerns the substantive question of what elements are required for a showing of market efficiency. The other concerns procedural questions of what standards of proof apply and when in the trial parties bring their evidence. The substantive question has attracted more academic attention than the procedural question. It continues to evolve in ways that cannot be predicted with certainty, though the fraud-on-the-market theory likely will continue to require more complex factual investigations. Although the related procedural question may seem of less intellectual interest, how it is resolved in a particular case can affect the outcome as much as, if not more than, the substantive question. Rule 23's inherent flexibility and the Supreme Court's contrasting decisions in *Eisen* and *Falcon* together give courts substantial discretion when deciding class certification—and courts have seized that opportunity. Given the evolving nature of the fraud-on-the-market theory, the *Eisen* and *Falcon* rules are both necessary and appropriate to adjudicating securities class action cases. Courts should preserve the *Eisen-Falcon* continuum.