Third Circuit Affirms Class Certification in <u>In re DVI, Inc. Sec. Litig.</u>

Krislov & Associates, Ltd. achieved a significant, wide-ranging securities fraud decision from the Third Circuit Court of Appeals that is highly favorable to investors, especially institutional investors, upholding a district court's class certification ruling against auditors, Deloitte & Touche LLP, of a now defunct medical equipment finance company, DVI, Inc., which at one point reported over $ 2 billion in assets.

In <u>In **re DVI, Inc. Sec. Litig**.</u>, -- F.3d --, 2011 WL 1125926 (3d Cir. Mar. 29, 2011), the Third Circuit affirmed both the grant of class certification as against the company's accountants, and the denial of class certification against the lawyers who had crafted the "workaround" scheme to justify the company's failing to report material weaknesses in its internal controls.

<u>First, the case as against the accountants:</u>

<u>Fraud on the Market/Market Efficiency Issues.</u> First, the Third Circuit addressed Deloitte's argument that the District Court abused its discretion in finding that DVI's common stock, which traded on the New York Stock Exchange ("NYSE"), and its two tranches of Senior Notes (one which traded on the NYSE and the other on the Over-the-Counter market), traded in efficient markets.

Recognizing the district court's consideration of conflicting expert reports, the Third Circuit held that the district court did not abuse its discretion in crediting Plaintiffs' expert, Dr. Michael Hartzmark of Navigant Economics, over defendants' experts, and in finding that numerous factors that courts typically apply to determine whether a market is efficient were met in this case.

Rather than create a bright-line standard which would preclude certain markets from qualifying for the presumption, the Third Circuit instead opted for a more flexible approach, instructing that "listing of a security on a major exchange such as the NYSE or the NASDAQ weighs in favor of a finding of market efficiency," and that "[o]ther factors may be relevant to assessing market efficiency, particularly when securities traded in markets less open and well-developed than those of the major exchanges." <u>Id.</u> at *5 (further stating that "[t]he type of security (stocks, bonds, convertibles, derivatives, etc.), the company's industry, the security's price, and other considerations should guide district courts in deciding which factors are most relevant to an efficiency analysis.").

The Third Circuit also approved of the District Court's choice of factors considered for each DVI security (nine for DVI's common stock and six for DVI's senior notes), which were set forth in <u>Cammer v. Bloom</u>, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989), <u>Krogman v. Sterritt</u>, 202 F.R.D. 467, 478 (N.D. Tex. 2001), and <u>In re Polymedica Corp. Sec. Litig.</u>, 453 F. Supp. 2d 260, 273, 276-77 (D. Mass. 2006), and the weight the district court gave to each factor for the market efficiency determination. <u>Id.</u> at *5 fn4. Focusing on what it described as "normally the most important factor in an efficiency analysis," the Third Circuit affirmed the District Court's giving more weight to the "cause-and-effect" relationship between a company's material disclosures and the security price, and in rejecting Deloitte's arguments that this factor was unsatisfied because DVI securities only experienced a 60 to 65% correlation between significant price movements and news events, and because too much time transpired between news events and price changes. Id. at *5-6. The Third Circuit concluded that a higher correlation was not necessary given, as Plaintiffs' expert noted, two peer reviewed studies reported that "only about one-third of statistically significant changes in the stock price of publicly traded companies are actually associated with identifiable news or events." Id. at *6. With respect to the speed of the price change after DVI-related news events, the Third Circuit rejected Deloitte's argument that "public information [must] be absorbed instantaneously" in order for the market to be deemed efficient; instead applying a less rigorous and more reasonable standard on the view that "a perfectly efficient market is not attainable." In re DVI, at *6 (holding that because "some information took two days to affect the price does not undermine a finding of efficiency.").

Certifying also for purchasers of debt securities. In specifically addressing DVI's debt securities (i.e., its two tranches of 9.875% Senior Notes), an area of securities law less developed compared to equity securities, the Third Circuit affirmed the district court's treatment of the two tranches as one security for purposes of analyzing the efficiency of the markets because, as Plaintiffs' expert opined, the two notes were substantially identical and experienced a high price correlation. Id. at *5, fn15 (recognizing the District Court's findings that "the tranches had identical terms, covenants, and provisions" and "a 99.2% price correlation"). The Third Circuit also concluded that the lower court's use of legal standards, its factual findings and its weighing of factors in concluding that DVI's markets for its debt securities were efficient was not an abuse of discretion.

Rejecting Oscar's requirement to prove loss causation at the class certification stage. After its market efficiency determinations, the Third Circuit then turned to Deloitte's request for the Court to adopt the Fifth Circuit's holding in Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261 (5thCir. 2007), which held that plaintiffs must prove loss causation at the class certification stage in order to invoke the fraud-on-the-market presumption of reliance (an issue that is scheduled to be argued to the U.S. Supreme Court on April 25, 2011 in Erica P. John Fund, Inc. v. Halliburton, 131 S.Ct. 856 (2011)). Weighing in on the matter ahead of the Supreme Court, the Third Circuit held that at class certification plaintiffs need only show that loss causation is susceptible to class-wide proof. Rejecting Deloitte's request to adopt Oscar's holding, the Third Circuit stated that "Oscar appears to shift the burdens announced in Basic, undermining the purpose of the presumption of reliance." In re DVI, at *7.

Integral to the Third Circuit's decision on whether Plaintiffs could show class-wide proof of loss causation in this case was the Court's recognition that cases that fit within those that the Court defined as "typical" – where plaintiffs allege that fraudulent misrepresentations artificially inflated the price of the security – "damages as well as loss causation are susceptible of determination through evidence common to the class." Id., at *9, n. 23. Without any challenges to classifying the case as "typical," the Third Circuit indicated that Plaintiffs' loss causation burdens at the class certification stage are easily met. Id. at *9 fn 18 &23 ("In most cases, unmoored from the presumption of reliance, loss causation is unlikely to defeat class certification because it is generally susceptible of class-wide proof.").

Rejecting defendants' attacks on investors who actually investigate. After finding that the District Court was correct in affording Plaintiffs the benefit of the fraud-on-the-market presumption, the Third Circuit turned to Deloitte's challenges attempting to rebut the presumption. First, the Third Circuit addressed the threshold issue of whether district courts should address rebuttal arguments at the class certification stage; ruling that they should. Id. at *8. Next, in an issue important to institutional investors, the Third Circuit determined whether Deloitte successfully rebutted the presumption, and ultimately rejected all of Deloitte's challenges based on institutional investor trading strategies and subjective price forecasts as grounds for rebuttal. Specifically, the Third Circuit affirmed the lower court's rejection of Deloitte's unsupported accusations of insider trading by Plaintiffs in DVI's securities, finding Plaintiffs' contacts with DVI insiders to investigate the bona fides of the issuer's releases a common and acceptable practice. Id. at *10. The Third Circuit also ruled that an investor's subjective belief that a security is incorrectly priced is also common practice and not a basis for rebutting the fraud-on-the-market presumption. Id. (refusing to expand its decision in Zlotnick v. Tie Communications, 836 F.2d 818 (3d Cir. 1988), holding that certain short-selling investors in defendants' company could not invoke a presumption of reliance, to purchasers who have a personal belief as to the security's value). In support, the Third Circuit reasoned that "[r]eliance on the integrity of the market price means only that an investor relies on the fact that the price reflects publicly available information as the market digests it, and nothing more." Id. at *11 (further recognizing the significant contributions that "sophisticated institutional investors, who are preferred as class representatives" make to market efficiency).

Rejecting exclusion of "In & Out Traders". Finally, the Third Circuit rejected Deloitte's contention that it rebutted the presumption of reliance because some "in-and-out" traders – investors who sold their securities before the first corrective disclosure – suffered no loss and therefore loss causation cannot be shown for those traders. In rejecting Deloitte's argument, the Third Circuit noted that crediting Deloitte's position would unnecessarily "require the District Court to rule on the earliest date a corrective disclosure occurred – a ruling that on its face does not implicate predominance because it would be made using evidence common to the class." Id. at *8. Moreover, the Court affirmed the District Court's finding that "Deloitte provide[d] no evidence" and, therefore, "ha[d] not met its burden" to show why the existence of "in-and-out" trades during the class period rebutted the presumption. Id. at *9.

Second, Post-Stoneridge non-liability for attorneys and other non-signers. In another aspect of the case, the court upheld the lower court's denial of class certification to pursue claims against the Clifford Chance lawfirm; in the court's view investors cannot assert class securities claims against "non-signing" attorneys who allegedly created, crafted and choreographed a "workaround" that caused the company to omit material disclosures in their SEC filings. A similar situation is pending on petition for cert in the Refco case, which, though conferenced in January, has not yet been decided.

Clint Krislov, lead attorney for Lead Plaintiffs and the Class, stated, "the Third Circuit's ruling against the accountants is a substantial victory for institutional investors, protecting them from baseless attacks on honest investigation by diligent investment funds which base their investment decisions on their independent evaluation of markets and pricing. With respect to the ruling on Clifford Chance, we will consider all our options, including whether to petition the U.S. Supreme Court. "

Michael Karnuth, another primary attorney for Lead Plaintiffs and the Class, stated, "the Third Circuit's decision is a victory for investors on several fronts. The decision allows investors to bring class cases to redress fraud rather than be dismissed on buyer beware principles based on nebulous and hyper-technical market efficiency challenges, or premature and unduly burdensome loss causation objections." Mike Karnuth further stated, "we're also very pleased that the district court and the Third Circuit agreed that our client's trading strategies and access to management were proper. This ruling not only vindicates our clients, but also allows institutional investors with similar common trading strategies to pursue appointment as lead plaintiffs without the threat of retribution."

For further information, Contact:

Krislov & Associates, Ltd.,

20 North Wacker Drive, Suite 1350

Civic Opera Building

Chicago, Illinois 60606

Telephone:312-606-0500

Facsimile 312-606-0207

Email: mail@krislovlaw.com