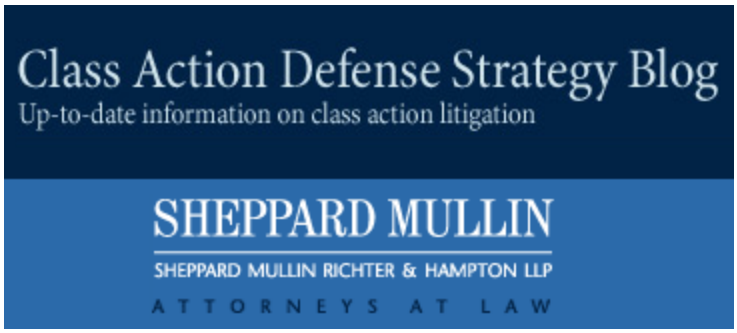

Class Action Defense Strategy Blog

Posted at 5:28 AM on December 1, 2009 by Sheppard Mullin

Third Circuit Affirms District Court Order Granting Class Certification In Section 11 Securities Case

By Christina Costley and Aimee Kahn

In *In re Constar Int'l, Inc. Securities Litigation*, No. 08-2461, 2009 WL 3462032 (3d Cir. Oct. 29, 2009), the United States Court of Appeals for the Third Circuit affirmed an order by the United States District Court for the Eastern District of Pennsylvania certifying a class of plaintiffs who brought suit under Section 11 of the Securities Act of 1933. The Court held that the district court did not abuse its discretion by certifying the class, notwithstanding defendants' argument that the district court erred in concluding that the "predominance" element of Rule 23(b)(3) had been met before deciding whether the stock traded in an efficient market. The district court held that a claim for fraudulent statements in a registration statement under Section 11 (as distinct from a claim for securities fraud brought under Section 10(b) of the Securities Exchange Act of 1934) does not require plaintiffs to establish reliance or loss causation.

Plaintiffs in *Constar* brought suit on behalf of a class of investors who purchased shares in the company through an initial public offering. The complaint alleged that Constar's registration statement misrepresented Constar's goodwill, assets, operational strength and capacity, equipment quality and customer base in order to give the appearance that the company was competitive when, in fact, the business was weak. Plaintiffs sought certification of a class under Rule 23, asserting that they had satisfied all requirements of Rule 23(a) (numerosity, typicality and adequacy) and the "predominance and superiority" element from Rule 23(b)(3). The district court, acting on the recommendation of a special master, agreed with plaintiffs but certified the issue for interlocutory appeal. Defendants sought review by the Third Circuit.

The Third Circuit affirmed certification of the class. In so holding, it rejected defendants' argument that the district court had abused its discretion by applying a "liberal construction" standard that presumed class certification was appropriate. Quoting its 2008 decision in *In re Hydrogen Peroxide Antitrust Litigation*, 552 F.3d 305, 312 (3d Cir. 2008) [see Antitrust Law Blog article here], which was issued *after* the district court's decision, the Third Circuit agreed

that class certification required rigorous scrutiny of all Rule 23(a) requirements and of the elements of Rule 23(b). The Court further noted that no presumption in favor of class certification existed. Still, despite general language to the contrary in the special master's recommendation, the Third Circuit found that the district court *had* complied with *Hydrogen Peroxide*'s requirement of "rigorous" scrutiny when conducting its analysis. Thus, the Court found no error on this basis.

The Third Circuit also rejected defendants' argument that plaintiffs had not established the predominance of common questions of law and fact, as required by Rule 23(b)(3), because the stock did not trade on an efficient market. Defendants argued that, absent an efficient market, the court could not presume that the class members would share the same legal and factual issues when establishing materiality, loss causation and reliance. The Court, however, found that the existence of an efficient market was not relevant to certification of a Section 11 class. The Court pointed out that because the case was brought under Section 11, and not Section 10(b), plaintiffs were required to establish only materiality, not loss causation (unless plaintiffs purchased stock more than twelve months before the effective date of the registration statement) or reliance. Further, the Court noted that "because a misrepresentation is material if a reasonable investor would have considered a fact important, the effect of a material misrepresentation is felt uniformly across the class of investors, regardless of whether the market is efficient." As such, the Court concluded, an efficient market was not a predicate for class certification in a Section 11 case in the same way that it would be in a case brought under Section 10(b).

Constar underscores the "stark contrast" between claims brought under Section 11 and those brought under Section 10(b). As *Constar* illustrates, plaintiffs in the Third Circuit bring class actions under Section 11 face fewer hurdles at the class certification stage than those bringing class actions under Section 10(b).