No. 12-79

IN THE
Supreme Court of the United States

CHADBOURNE & PARKE LLP,
Petitioner,

v.

SAMUEL TROICE, ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

The petition presents two distinct but related questions that have divided the courts of appeals concerning the scope of the Securities Litigation Uniform Standards Act ("SLUSA"), which precludes state-law class actions alleging "a misrepresentation … in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A). The first addresses the standard for determining whether an alleged misrepresentation is made "in connection with" a covered-security transaction. The decision below acknowledges that the circuits are deeply divided over the proper standard. Respondents try to dismiss the conflict as mere semantic disagreement, but the conflict is not only clear and concrete, it is outcome-determinative *in this very case*:

- The district court applied a legal standard adopted by the Eleventh Circuit and dismissed the complaint because it alleged misrepresentations made "in connection with" SLUSA-covered security transactions.

- The Fifth Circuit then *rejected* the Eleventh Circuit standard, adopted a different one, and held—erroneously, petitioner submits—that the alleged misrepresentations were not made "in connection with" SLUSA-covered security transactions.

The divergent legal standards and outcomes below mirror the conflict in the circuits. Review should be granted to resolve the conflict and correct the Fifth Circuit's error in construing SLUSA's "in connection with" requirement.

The Court should not stop there, however, because the decision below also creates a distinct con-

flict concerning SLUSA's effect on state-law claims alleging aiding and abetting of SLUSA-covered fraud. The Fifth Circuit held that such claims are precluded only if the defendant itself made SLUSA-covered misrepresentations. That holding is contrary to decisions of the Ninth and Eleventh Circuits, the statute's plain terms, and SLUSA's central purpose of establishing national standards in securities-fraud class actions.

Certiorari should be granted.

I. REVIEW SHOULD BE GRANTED TO RESOLVE THE SCOPE OF SLUSA'S "IN CONNECTION WITH" REQUIREMENT

A. The Circuits Are Divided

Respondents readily acknowledge (Opp. 12) that the circuits differ in their formulation of the proper standard to govern whether a state-law class action alleges "a misrepresentation … in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A). Indeed, the Fifth Circuit expressly recognizes that since this Court's decision in *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006), "six of [its] sister circuit courts have tried to give dimension to" the "in connection with" requirement, but were unable to agree. App. 16a.

The differing standards adopted in these decisions are not "merely different ways of saying the same thing." Opp. 11. A significant portion of the Fifth Circuit's lengthy opinion was dedicated to an analysis (and express rejection) of standards adopted by the Second, Sixth, and Eleventh Circuits—including detailed substantive critiques of those

standards—as well as its reasons for adopting the Ninth Circuit's standard. Pet. 12-14, 22; App. 16a-20a, 29a-33a. That effort makes sense only if the standard actually matters. And indeed it does, as this case shows.

The district court expressly applied the Eleventh Circuit standard, which asks whether the complaint alleges "either 'fraud that induced [the plaintiffs] to invest with [the defendants] … or a fraudulent scheme that coincided and depended upon the purchase or sale of securities.'" App. 64a (quoting *Instituto de Prevision Militar v. Merrill Lynch*, 546 F.3d 1340, 1349 (11th Cir. 2008) ("*IPM*")). And the court held respondents' claim to be SLUSA-precluded under both prongs of that test. Pet. 18-19; App. 64a-70a. The Fifth Circuit did not disagree that dismissal was required under the Eleventh Circuit standard. To the contrary, it reversed only because it rejected the Eleventh Circuit standard as a matter of law. App. 30a-31a.

There is no doubt that this case could not proceed in the Eleventh Circuit. In *IPM*, a foreign pension fund manager (PFA) had promised that it would invest the plaintiffs' money in SLUSA-covered securities, and instead appropriated the money to itself, just as the Stanford entities did. 546 F.3d at 1348-49. The plaintiff had argued that SLUSA did not apply because the "gravamen" of the fraud did not involve covered-security transactions. But while the Fifth Circuit below accepted that precise argument, App. 36a-37a, the Eleventh Circuit explicitly rejected it, because (as here) the plaintiffs alleged that they were induced to invest with PFA in part by the false promise that its fund was invested in covered securi-

ties. 546 F.3d at 1349-50. And while the Fifth Circuit below believed it dispositive that respondents' investment was also induced by *other* misrepresentations unconnected to SLUSA-covered securities (Pet. 26-27; App. 35a-37a), the Eleventh Circuit expressly rejected that argument as well. 546 F.3d at 1350; Pet. 18.

Respondents contend that this case is distinguishable from *IPM* because respondents "do not allege that they were induced by fraud to invest with SIB on the promise that their money would be invested in covered securities." Opp. 16. But that is exactly what they allege. According to their complaint, respondents were told that SIB "focuses on 'maintaining the highest degree of liquidity as a protective factor for our depositors' and that the bank's assets are 'invested in a well-diversified portfolio of highly marketable securities issued by stable governments, strong multinational companies and major international banks.'" SAC ¶ 41.[1] To be sure, SIB did not promise respondents that they would *directly own* covered securities (Opp. 17), but covered security transactions were integral to the investment scheme: the SIB CDs were purportedly safe and liquid specifically because SIB's assets would be invested in covered securities. Nothing in *IPM* suggests a "direct ownership" requirement, and respondents do not explain why one should exist.

Respondents correctly recognize that the Second Circuit has adopted a test similar to the "depends upon" prong of the Eleventh Circuit's (Opp. 18), un-

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[1] Respondents do not appear to dispute that the "marketable securities" at issue here were SLUSA-covered securities.

der which a complaint is SLUSA-precluded "where plaintiff's claims 'necessarily allege,' 'necessarily involve,' or 'rest on' the purchase or sale of securities." *Romano v. Kazacos*, 609 F.3d 512, 522 (2d Cir. 2010). That standard is satisfied here—the alleged fraud "necessarily involve[s]" covered-security transactions, *id.* at 522, because the Ponzi scheme could only succeed if investors continued believing that proceeds from CD sales would be used to purchase covered securities, and thus continued to purchase the CDs.

Indeed, as the petition explains (at 20), the great majority of district courts in the Second Circuit have found the SLUSA standard satisfied in nearly identical so-called Madoff "feeder fund" cases, which were brought by investors in hedge funds (the feeder funds) that had in turn invested in Madoff's fund, alleging fraud against the feeder funds. Respondents say those cases are different because "unlike the present cases, investors alleged that they intended to invest, directly or through one or more investment funds, in a purported portfolio of covered securities that Madoff never actually purchased on the investors' behalf." Opp. 19. But again, this case is no different—respondents "part[ed] with the money intending that it be invested in [covered] securities." *Id.* (quoting *In re J.P. Jeanneret Assoc., Inc.*, 769 F. Supp. 2d 340, 364 (S.D.N.Y. 2011)) (internal quotation mark omitted; alterations in original). As here, investors in the "feeder funds" did not attempt to purchase a direct interest in covered securities, but instead purchased limited partnership interests in the funds themselves, whose returns depended on the performance of Madoff's purported portfolio of

covered securities. *E.g.*, *Newman v. Family Mgmt. Corp.*, 748 F. Supp. 2d 299, 304 (S.D.N.Y. 2010). There is no relevant difference between that arrangement and the one respondents allege here, under which they invested in interest-bearing instruments whose returns and liquidity were dependent on the performance of SIB's purported portfolio of covered securities.

Similar to the Second and Eleventh Circuits, the Sixth Circuit has held SLUSA's "in connection with" requirement satisfied when the fraud "coincide[s] with" or "depend[s] on" securities transactions. *Segal v. Fifth Third Bank*, 581 F.3d 305, 310 (6th Cir. 2009) (quotation omitted). That standard is satisfied here as well. Pet. 21.

Respondents seek to distinguish *Segal* on the ground that the defendants there—a bank acting as a trustee and its holding company—"were acting in a fiduciary capacity, buying covered securities for the benefit of plaintiff beneficiaries, not trading for themselves," whereas "SIB was buying securities for its own account, not for the benefit of plaintiffs." Opp. 21. But respondents do not explain why that distinction makes any difference here: in both cases, the fraud included misrepresentations in connection with covered-security transactions. Nor is there merit to respondents' contention that the fraud here "was complete when plaintiffs purchased their [CDs] and did not depend upon SIB's subsequent purchase, or non-purchase, of covered securities." *Id.* Respondents allege a Ponzi scheme, which by definition was *not* complete when any particular investor (except the last one) purchased a CD. The fraud could only be sustained by continuously enticing new in-

vestors. And as explained, the fraud here directly "depend[ed] on" (*Segal*, 581 F.3d at 310) misrepresentations concerning covered-securities transactions, which is in part what induced respondents and others to purchase the CDs.

In contrast to the standards adopted by the Second, Sixth, and Eleventh Circuits, the "more than tangentially related" standard originally articulated by the Ninth Circuit, and adopted by the Fifth Circuit below, would allow respondents' state-law claims to proceed. Opp. 21-23. Accordingly, whether a state-law class action is precluded by SLUSA (or removable under SLUSA) depends entirely on the circuit in which the class-action complaint is filed—a clear invitation to forum-shopping. Pet. 25. Certiorari thus is compelled by SLUSA itself, which was enacted specifically to end such practices by creating uniform national standards for securities-fraud class actions.

B. The Decision Below Is Incorrect

The pertinent question under SLUSA is whether the complaint alleges "a misrepresentation … in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A). The court of appeals answered that question in the affirmative, which should have ended the case. "To be sure," the court explained, "the CDs' promotional material touted that SIB's portfolio of assets was invested in 'highly marketable securities issued by stable governments, strong multinational companies and major international banks,'" App. 35a—i.e., SLUSA-covered securities. In other words, Stanford Financial allegedly lied about purchasing a portfolio of

covered securities, for the specific purpose of inducing plaintiffs' continued investments and thereby facilitating the entire fraudulent scheme. By any sensible construction, that misrepresentation was made "in connection with" the purchase of covered securities.

Respondents' answers are unpersuasive. The rule they offer appears to be that SLUSA "require[s], at a minimum, a direct or indirect purchase or sale of covered securities, or a contract to do so." Opp. 15. Respondents suggest that if (as here) a fraud does not in fact result in a covered-security transaction, it is SLUSA-precluded only if a contract to engage in such a transaction is alleged. Respondents do not explain the basis for that limitation. Nor could they, because there is none. The statute only requires allegations of "*a misrepresentation*"—not a contract containing a misrepresentation—"in connection with" a covered-security transaction.[2]

Respondents also say the alleged misrepresentation concerning the investment of SIB's assets in covered securities "was itself only tangentially related to the fraudulent scheme." Opp. 23. Not so—the misrepresentation was a necessary and integral component of the entire scheme. *Supra* at 5. The Fifth Circuit found the covered-transaction misrepresentations were not "more than tangentially related" to the fraud only because respondents *also* alleged *other* statements and conduct that the court considered more important. App. 35a-38a. But that

[2] Indeed, *Dabit* held a claim SLUSA-precluded even though the complaint "omitted all direct references to purchases" and alleged only that plaintiffs were induced by misrepresentations "to hold onto overvalued securities." 547 U.S. at 76.

approach is contrary to SLUSA, which requires only "*a* misrepresentation" in connection with covered-security transactions—a standard readily satisfied here.

Respondents also contend that "Stanford's misrepresentations that SIB's portfolio was invested in highly liquid, marketable, and secure assets do not transform fraud in the purchase and sale of the CDs into fraud in connection with the purchase or sale of a covered security." Opp. 24. Respondents again misunderstand the governing standard. Petitioner does not contend that the *CDs themselves* were covered securities. The covered securities were those purportedly held in SIB's portfolio—SIB's promise to invest in those securities was the inducement to invest. Stanford's misrepresentations were thus connected directly to SIB's covered-security transactions.[3]

Respondents next try to defend the decision below on policy grounds, but again to no avail. They

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[3] Respondents argue that they do not allege that SIB falsely promised to use proceeds of CD sales to make future investments in covered securities, but rather that they only allege "misrepresentations by SIB that its existing portfolio already consisted of highly liquid marketable securities." Opp. 25. That argument is contrary to respondents' complaint, which alleges that they were falsely told "that investments in the CDs were liquid and the CDs could be redeemed at any time because SIB, through Stanford Financial, only invested the money"—i.e., the proceeds from CD sales—"in safe, secure and liquid assets." SAC ¶ 24. Indeed, the Fifth Circuit concluded that these misrepresentations were made "in an attempt to lure them into buying worthless CDs" (App. 36a), and the district court similarly explained that respondents' "CD purchases were induced by a belief that the SIB CDs were backed in part by investments in SLUSA-covered securities" (App. 66a.).

cite legislative history emphasizing "the importance of 'preserving the appropriate enforcement powers of state regulators, and the rights of individuals to bring suit.'" Opp. 26 (quoting S. Rep. No. 105-182, at 8 (1992)). The citation is a non sequitur: this action involves *neither* the "enforcement powers of *state regulators*," nor "the rights of *individuals* to bring suit." This is a state-law *class action*, which is precisely the type of action to which SLUSA is directed. Pet. 28 n.3.

It is of course true that, as respondents next assert, Congress did not intend "to preclude *all* state-law securities fraud actions." Opp. 27 (emphasis added). Nobody suggests otherwise. Congress did, however, plainly intend to preclude *certain* state-law securities-fraud class actions, i.e., those alleging "a misrepresentation … in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A).

Finally, respondents contend that SLUSA should not be "expand[ed] … to reach secondary transactions by issuers, downstream of purported purchasers of uncovered securities." Opp. 27. But again, the statute requires only an alleged "a misrepresentation … in connection with" a covered-security transaction—SLUSA is agnostic as to whether the purported transaction directly involves the plaintiff, or is one step removed. *See Dabit*, 547 U.S. at 89 ("identity of the plaintiffs does not determine whether the complaint alleges fraud 'in conection with the purchase or sale'" of securities). Indeed, both *IPM* and the Madoff "feeder fund" cases involve transactions "downstream of purported purchasers of uncovered securities." In *IPM*, PFA induced plaintiffs

to invest in its pension fund by promising to purchase covered securities. And the "feeder fund" cases involve the purchase of limited partnership interest in those funds, which promised to invest the proceeds with Madoff, who in turn promised to invest in covered securities. *See supra* at 3-6. Respondents' argument only demonstrates the significance of this issue and the conflict it has engendered.

II. REVIEW SHOULD BE GRANTED TO DETERMINE WHETHER SLUSA PRECLUDES CLAIMS AGAINST ALLEGED AIDERS AND ABETTORS OF SLUSA-COVERED SECURITIES FRAUD

The complaints against the SEI and Willis Defendants and the petitioner here all raise the same question warranting review, i.e., whether the complaints allege a misrepresentation made "in connection with" a SLUSA-covered security transaction. But the complaint against petitioner also raises a second, related question, one that has generated an equally important conflict in the circuits: whether a state-law class action alleging only that defendant *aided and abetted* an underlying securities fraud is SLUSA-precluded, where the underlying fraud claim would be precluded but the aider and abettor did not itself make any SLUSA-covered misrepresentations. Pet. 29-34. The Fifth Circuit held that aiding-and-abetting claims are precluded only if the defendant itself makes SLUSA-covered misrepresentations, which is not alleged here. That decision conflicts squarely with decisions of the Ninth and Eleventh Circuits, both of which hold that claims for aiding and abetting SLUSA-covered fraud are precluded, without regard to whether the defendant's own

statements would satisfy the SLUSA standard. Pet. 30-31. It is also squarely in conflict with the plain language of the statute, which requires preclusion of any claim alleging "a misrepresentation … in connection with" a covered-security transactions, regardless whether the misrepresentation is made by the defendant. Pet. 32-34; *see also* Br. of Breazeale, Sachse & Wilson, LLP as *Amicus Curiae* 8-12.

Respondents contend that this question is not presented here, because once the Fifth Circuit determined that primary claims based on SIB's own fraud were not precluded by SLUSA, it followed that the aiding-and-abetting claim against petitioner was not precluded. Opp. 28-31. But that analysis holds only insofar as the Fifth Circuit *correctly* held that the underlying fraud is not SLUSA-covered. If the fraud *is* SLUSA covered, there remains a distinct question whether the aiding-and-abetting claim in this case may proceed because petitioner did not make its own SLUSA-covered misrepresentations.

This case thus cleanly presents both questions, each of which implicates a clear and important circuit conflict and thus warrants resolution. If the Court limits review to only the question whether the underlying fraud is SLUSA-precluded, it will remain Fifth Circuit law that state-law aiding-and-abetting class actions may proceed *even if* the primary fraud involves SLUSA-covered fraud, so long as the defendant (i.e., the aider and abettor) itself did not make SLUSA-covered misrepresentations. The Fifth Circuit will thus become a haven for state-law aiding-and-abetting securities-fraud class actions. That result is in sharp tension with Congress's intent to bar such actions under federal law, *e.g.*, *Cent. Bank*

of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 191 (1994), and contrary to SLUSA's principal purpose of assuring uniform national standards for securities-fraud class actions. Pet. 33-34.

CONCLUSION

The petition should be granted.

Respectfully submitted,

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