NO. 12-88

In the
Supreme Court of the United States

PROSKAUER ROSE LLP,

PETITIONER,

v.

SAMUEL TROICE, HORATIO MENDEZ, ANNALISA MENDEZ, PUNGA PUNGA FINANCIAL, LTD., individually and on behalf of a class of all others similarly situated,

RESPONDENTS.

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

REPLY TO BRIEF IN OPPOSITION

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INTRODUCTION

The brief in opposition entirely fails to address the principal reasons for granting review and resolving the important SLUSA questions presented by the petition.

First, respondents never address the substantial confusion generated by the Fifth Circuit's divergent construction of SLUSA and § 10(b), in violation of this Court's determination that the identical phrase "in connection with" should be given the same "broad interpretation" in both statutes. *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85 (2006).

Second, respondents do not meaningfully address the pervasive circuit split regarding the proper test for SLUSA preclusion. Respondents concede that the tests used by the Second, Sixth, Seventh, Eighth, Ninth and Eleventh Circuits differ from each other and from the Fifth Circuit's test. While respondents assert that the differences are only "semantic," Opp. 13-14, the Fifth Circuit clearly believed they were outcome determinative, and respondents have not shown otherwise.

Third, respondents likewise fail to address any of the grounds for review of the Fifth Circuit's decision on aiding and abetting. They acknowledge the Fifth Circuit's disagreement with the Eleventh Circuit over this issue, but argue—without support—that it makes no difference in this case. At the same time, they disregard the conflicts between the Fifth Circuit's decision and (i) SLUSA's statutory text, (ii) Congress's intent in enacting SLUSA and (iii) other provisions of the Exchange Act, particularly § 10(b) and § 20(e).

Fourth, respondents nowhere challenge the elements that make this case a suitable vehicle to resolve these issues: the decision below is based on a pure legal issue and, if allowed to stand, will elude review because it will invite the filing of securities cases in state court, which, if removed, will be remanded pursuant to non-reviewable district court orders.

ARGUMENT

I. The Fifth Circuit's Interpretation of SLUSA Conflicts With and Confuses This Court's Interpretation of § 10(b)

The Fifth Circuit's test for when a misrepresentation or omission is made "in connection with" a covered security transaction under SLUSA clearly is different from, and more restrictive than, the standard described in this Court's § 10(b) precedents. Pet. 16-24. As a result, the Fifth Circuit's opinion cannot be squared with *Dabit*, which held that Congress must be presumed to have intended the phrase "in connection with" in SLUSA to have the same "broad interpretation" as in § 10(b). *Dabit*, 547 U.S. at 85.

Respondents never address this argument. They do concede, in a footnote, that the "in connection with" requirement in SLUSA is construed in the same manner as in § 10(b) and argue that "[a]n overexpansive reading of the phrase [in SLUSA] would lead inexorably to an overexpansive reading of the phrase [in § 10(b)]. Opp. 24 n.6. Their argument misses the mark. The court below erred by interpreting the "in connection with" requirement in SLUSA more narrowly than this Court's precedents describe the requirement in § 10(b).

Respondents make a similar error. They argue that "a false promise that SIB would invest in covered securities for its own account" would not satisfy SLUSA's "in connection with" requirement because "the purported buyer (SIB) would not be deceived in connection with the purported transactions in covered securities." Opp. 25. This statement misapplies this Court's § 10(b) precedents. Section 10(b) does not require the buyer of the security to be the deceived party. *United States v. O'Hagan*, 521 U.S. 642, 656 (1997) ("in connection with" requirement satisfied "even though the person or entity defrauded is not the other party to the trade"). Nor does it require the deception to occur in a particular securities transaction, so long as the transaction forms part of a scheme that, as a whole, is deceptive. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 9-10 (1971) ("in connection with" requirement satisfied, even where company received full value for sale of its bond portfolio, because transaction formed part of scheme to misappropriate proceeds through investment in worthless CD).[1]

Respondents do not dispute that *someone* (*i.e.*, investors) was deceived by SIB's false promise to invest in SLUSA-covered securities, nor do they contest that this misrepresentation induced investors to purchase SIB CDs and to liquidate SLUSA-covered securities in other accounts to reinvest the proceeds in SIB CDs.[2] Respondents alleged this in their complaint, as the district court and Fifth Circuit recognized. *See* Pet. 10-14, 19.

Under this Court's precedents, these allegations satisfy § 10(b)'s "in connection with" requirement.

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[1] Respondents claim *SEC v. Zandford*, 535 U.S. 813 (2002) and *Bankers Life* are distinguishable because "the focus of the fraud" in those cases was on the sale of securities. Opp. 26 n.7. Not so; those cases—like this one—involved alleged schemes to misappropriate assets that depended on securities transactions. *See Zandford*, 535 U.S. at 815-16 (defendant broker misappropriated proceeds from sale of clients' securities); *Bankers Life*, 404 U.S. at 8-9 (defendants acquired company's stock indirectly using proceeds from sale of company's securities). The scheme respondents allege in this case is materially indistinguishable. *See infra* 4-5.

[2] Respondents suggest they never alleged a false promise by Stanford to invest CD sales *proceeds* in highly liquid marketable securities, only that SIB's "existing portfolio already consisted" of such investments. Opp. 25. But respondents cannot escape their complaint, which alleged Stanford sales agents told them 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 in safe, secure and liquid assets." R. 171.

See, e.g., *Bankers Life & Cas. Co.*, 404 U.S. at 9-10, 12-13. Under the Fifth Circuit's decision, however, these allegations are insufficient to satisfy SLUSA's "in connection with" requirement because they do not describe a scheme in which the covered securities transactions (actual or promised) were more than "tangentially related to the heart, crux, or gravamen" of the alleged fraud. App. 38a (quotation marks omitted).

Because the Fifth Circuit's approach to SLUSA is not faithful to this Court's § 10(b) precedents, the decision below creates significant uncertainty regarding the correct interpretation of both statutes, necessitating this Court's review.

II. The Acknowledged Circuit Split Is Outcome Determinative, Not Semantic

While respondents quote the various standards for SLUSA preclusion adopted by the courts of appeals, respondents cite no authority for their position that these obviously divergent tests are "conceptually very similar." Opp. 13.

Nor can they. The outcome-determinative nature of the circuit split is evident from the decision below. The Fifth Circuit acknowledged that the district court faithfully applied the Eleventh Circuit's standard, but after considering that standard—which is satisfied if either (1) an alleged fraud "induced" a covered securities transaction or (2) a fraudulent scheme "depends upon" such a transaction—the Fifth Circuit rejected both prongs before announcing that it would follow the Ninth

Circuit's "more than tangentially related" test. App. 31a-35a. That the Fifth Circuit reversed the district court after applying a different standard demonstrates that the standard determined the outcome.

Respondents' position is also rebutted by a comparison of the Fifth Circuit's test to case law from other circuits. In the Fifth Circuit, a court must evaluate the importance of the covered securities transaction to the alleged fraudulent scheme and determine whether the transaction is "more than tangentially related" "to the 'heart,' 'crux,' or 'gravamen' of the defendant's fraud." App. 38a. The Sixth Circuit has explicitly disclaimed such an analysis. *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305, 311 (6th Cir. 2009). While the Second and Eleventh Circuits have precluded class actions under SLUSA where they alleged that fraud "induced" a covered securities transaction, *Romano v. Kazacos*, 609 F.3d 512, 523 (2d Cir. 2010); *Instituto de Prevision Militar v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 546 F.3d 1340, 1349 (11th Cir. 2008) ("*IPM*"), the Fifth Circuit, in direct conflict with these decisions, held that this case was *not* precluded, even though it found that some investors were induced to sell covered securities to buy SIB CDs, because "the fact that covered securities were in fact traded as a part of the fraud is . . . not dispositive," App. 41a.[3]

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[3] Contrary to respondents' assertion, Opp. 25, the petition correctly stated that the Fifth Circuit's finding (…continued)

Respondents assert that the standards applied by these other circuits would not result in preclusion here, Opp. 16-21, but their arguments fall flat. They say, for example, that unlike in *Romano*, "there is no allegation that plaintiffs expected investment returns from a portfolio investment that was never acquired." Opp. 18. But that is *exactly* what respondents alleged in their complaint, where they claimed that Stanford sold "approximately $7.2 billion worth of SIB CDs by [falsely] touting: (i) the bank's safety and security; (ii) *consistent, double-digit returns on the bank's investment portfolio*; and (iii) high return rates on the CD that greatly exceeded those offered by commercial banks in the United States," R. 183 (emphasis added), which, respondents alleged, Stanford falsely attributed to the fact that "SIB did not make loans but instead invested in safe and highly liquid instruments," R. 200.

Respondents' assertion that this case would not be precluded under the Eleventh Circuit's test is

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(continued…)

concerning the actual trading of covered securities concerned sales by some investors who liquidated their accounts to reinvest the proceeds in SIB CDs. Pet. 19. Nor has petitioner abandoned the argument that SLUSA precludes this case based upon such sales. Opp. 26 n.7. The petition clearly asserts the conflict between this Court's precedents and the Fifth Circuit's rejection of this theory as a basis for review. Pet. 2, 19-21. Indeed, the SEC relied on an identical theory, concerning identical securities sales, to satisfy § 10(b)'s "in connection with" requirement in related litigation against Stanford. Pet. 20-21.

equally faulty. *IPM* does not support their contention that SLUSA applies only where a complaint alleges a plaintiff "directly or indirectly [bought] an interest in . . . covered securities." Opp. 17. To the contrary, in *IPM*, plaintiffs did not "directly or indirectly" buy any covered security; they bought an uncovered product (a retirement trust account consisting of an insurance policy) marketed as having a covered security component (a mutual fund). *IPM*, 546 F.3d at 1351-52. Similarly, respondents allegedly purchased uncovered products (SIB CDs) marketed using a false risk-return profile directly attributable to SIB's purported investments in covered securities, Pet. 10-11.

More fundamentally, respondents' attempts to conjure away this concrete circuit split by relying on their own investments and subjective expectations confirm the need for review. While the Fifth Circuit's SLUSA analysis expressly considers such factors as a plaintiff's investment purpose and the layers of separation between the plaintiff's investment and a covered security, App. 23a, this Court has rejected them, holding that SLUSA does not depend on any transaction by a plaintiff at all. *See Dabit*, 547 U.S. at 85. Even the Ninth Circuit—which the Fifth Circuit purported to follow—has made clear that a plaintiff's actual investments and investment purpose are "irrelevant" to the SLUSA inquiry. *U.S. Mortgage, Inc. v. Saxton*, 494 F.3d 833, 844-45 (9th Cir. 2007).[4]

Nor should this Court defer resolution of the circuit split, as respondents contend. Opp. 14. With at least six circuits having weighed in, the split is mature. Leaving it unaddressed will promote confusion in federal law—as respondents themselves apparently concede. *See* Opp. 14 & n.3 (noting the "imprecision" of the various courts of appeals' formulations, and acknowledging that a lawyer "would be hard-pressed to predict with any confidence" how SLUSA will be applied in any circuit).

III. The Fifth Circuit's Analysis of Aiding and Abetting Claims Foments a Circuit Split and Conflicts With SLUSA and § 10(b)

The court below held, without support in the statutory text or this Court's precedents, that for SLUSA preclusion to apply in aiding and abetting cases, the alleged misstatements by a *defendant* must be what are "more than tangentially" related to a covered securities transaction. App. 43a-44a. The petition provided four independent reasons why review of this holding is essential, Pet. 21-23, but the

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[4] In *Saxton*, plaintiffs were induced to make loans and allegedly were defrauded into forbearing from exercising rights under the loan agreements based on false financial statements. 494 F.3d at 844-45. As in this case, the plaintiffs in *Saxton* neither invested in covered securities nor expected to own any interest in covered securities. *Cf.* Opp. 17.

opposition either fails to address them or responds unpersuasively.

First, there is an actual conflict between the Fifth and Eleventh Circuits concerning the application of SLUSA to aiding and abetting claims. Pet. 29. Respondents do not deny that the Fifth Circuit's method of analysis differs from the Eleventh Circuit's; but they claim it makes no difference in this case, because the Fifth Circuit concluded that no primary actor's conduct was "in connection with" a covered securities transaction; therefore, the aiding and abetting claims were not, either. Opp. 29. But that is not what the Fifth Circuit held. The Fifth Circuit instead asked whether the alleged misrepresentations by petitioner's former partner were "in connection with" a covered securities transaction and concluded that they were too many levels removed to satisfy SLUSA. App. 43a-44a. The Fifth Circuit failed to conduct the correct analysis—which the Eleventh Circuit employed—of asking whether the complaint alleged a fraudulent scheme involving transactions in covered securities.

Second, and more fundamentally, respondents ignore that by limiting SLUSA preclusion to cases where a defendant's alleged misstatements are "in connection with" a covered security transaction, the Fifth Circuit engrafted an additional requirement onto the statutory text. That text provides that SLUSA applies to any private state-law class action alleging "*a* misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security," 15 U.S.C. § 78bb(f)(1)(A) (emphasis added), but imposes no limits on who must make the misrepresentation. Pet. 22. The conflict between the Fifth Circuit's analysis and SLUSA's text is independently sufficient to warrant review, and respondents do not argue otherwise.

Third, respondents ignore that the Fifth Circuit's decision contravenes an important congressional purpose in enacting SLUSA: protecting secondary actors perceived as having deep pockets from meritless lawsuits. Pet. 29-30. The Fifth Circuit's SLUSA analysis dictates an illogical result—abusive actions subject to amorphous liability standards will proceed against secondary actors, while claims against primary violators will be precluded. Pet. 29. Respondents assert this result is appropriate because courts should be wary of foreclosing state law aiding and abetting claims that supplement federal law, but their sole support for this proposition is a decision that predates SLUSA by more than a decade, does not deal with a federal preclusion statute and does not even mention aiding and abetting. Opp. 27 (citing *Gochnauer v. A.G. Edwards & Sons*, *Inc.*, 810 F.2d 1042, 1049 (11th Cir. 1987)).

Regardless, this Court rejected virtually the same argument in *Dabit,* observing that the purpose of SLUSA preclusion is not to preserve state law claims, but rather "to limit the availability of remedies under state law." 547 U.S. at 88 n.13. In any event, any confusion regarding how far Congress intended to go in prohibiting aiding and abetting claims "in connection with" securities transactions *favors* review.

Fourth, respondents do not address the conflict between the decision below and § 20(e) of the Exchange Act, which authorizes the SEC to bring claims against aiders and abettors. Pet. 22-23. The Fifth Circuit's decision essentially negates § 20(e), because it holds that SLUSA does not preclude aiding and abetting claims unless the alleged aiders are themselves primary violators who made misstatements "in connection with" covered securities transactions. *See* Pet. 22-23. Under *Dabit*, the same interpretation must be given to § 10(b), with the nonsensical result that to be held liable under § 20(e), an aider would likewise have to commit a primary violation of § 10(b). Because aiders and abettors are distinct from primary violators, *see Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* 511 U.S. 164, 176 (1994), Congress cannot have intended this result. Respondents fail to contest—and therefore concede—that this conflict, standing alone, warrants review.

IV. This Case is a Suitable Vehicle to Resolve These Important Issues of Federal Law

Respondents argue that this case is not a suitable vehicle to resolve the scope of SLUSA's "in connection with" requirement because there are no allegations of covered security transactions. Opp. 15. The court below, however, found that covered securities were sold as part of the fraud, and that Stanford's marketing materials included false representations that the proceeds would be invested in SLUSA-covered securities in order to induce respondents' purchases. Such allegations suffice under *Dabit* and the standards adopted by other courts of appeal.

Respondents also fail to contest that this case presents a rare opportunity for this Court to resolve these important issues of federal law. Pet. 30-32. SLUSA issues typically arise in actions filed in state court and removed to federal court. A restrictive reading of SLUSA will result in many more actions filed in the first instance in state court, and those that are removed to federal court on SLUSA grounds will be remanded. Such district court remand orders are ordinarily unreviewable. 28 U.S.C. § 1447(d); *Kircher v. Putnam Funds Trust*, 547 U.S. 633, 639-40 (2006). Without this Court's review, securities plaintiffs are likely to file in state courts within the Fifth Circuit, where well-crafted complaints can evade federal jurisdiction. This result is contrary to Congress's intention. SLUSA § 2(2), (5); 112 Stat. 3227 (SLUSA was enacted to "prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives" of the PSLRA).

CONCLUSION

For the foregoing reasons, and those set forth in the petition, the Court should grant review.

Respectfully submitted,

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