NO. 12-86

In the Supreme Court of the United States

WILLIS OF COLORADO INC.; WILLIS GROUP HOLDINGS LIMITED; WILLIS LIMITED; BOWEN, MICLETTE & BRITT, INC.; and SEI INVESTMENTS COMPANY

Petitioners,

v.

SAMUEL TROICE, ET AL.,

Respondents.

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

PETITIONERS' SUPPLEMENTAL BRIEF

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PETITIONERS' SUPPLEMENTAL BRIEF

The United States correctly concludes that the Fifth Circuit erred by finding that SLUSA does not preclude Respondents' claims. Although the Fifth Circuit recognized that Respondents allege misrepresentations about SLUSA-covered securities, the court refused to find SLUSA preclusion because Respondents also allege several misrepresentations regarding other matters not related to covered securities. The United States correctly concludes that the Fifth Circuit was wrong in this regard because the allegations regarding covered securities, by themselves, require SLUSA preclusion.

Elaborate Ponzi schemes, by their nature, require misrepresentations about multiple matters. The fact that misrepresentations about covered securities do not stand alone cannot be a reason to find SLUSA inapplicable. Whatever the precise outer boundaries of SLUSA's "in connection with" requirement, a misrepresentation *about* covered securities is clearly covered, and the Fifth Circuit's decision to find SLUSA inapplicable despite acknowledging such a misrepresentation is indefensible.

Despite the Fifth Circuit's clear error, the United States urges this Court to deny certiorari, arguing that there is no real split of authority over the meaning of SLUSA's "in connection with" requirement. In this regard, the United States argues that the Fifth Circuit's error was not with the test it adopted to analyze the "in connection with" requirement (which it says is not in conflict with the tests adopted by other circuits), but rather with how it applied that test to the facts of this case. But the

United States fails to recognize that it is the Fifth Circuit's test itself that allows for other matters to be considered, even when the fraud at issue involves a misrepresentation about a covered security. In other words, this is not just misapplying law to fact, but adopting a *test* that is squarely in conflict with other circuits because it allows a plaintiff to avoid SLUSA preclusion by merely including alleged misrepresentations about other matters.

The varying formulations of the split are not just semantic differences; they are fundamental methodological differences that will be outcome determinative in many cases, including this one. Consistent with SLUSA's plain text, the Second, Sixth, and Eleventh Circuits have made clear that *one* misrepresentation regarding a covered securities transaction is sufficient to trigger preclusion. In contrast, the Fifth Circuit—applying its own variation of the Ninth Circuit's "more than tangential" standard—has held that one SLUSA-covered misrepresentation is not necessarily sufficient, and that a complaint can be saved from preclusion if the plaintiffs also alleged misrepresentations regarding other matters.

The split is well illustrated by the fact that courts within the Second Circuit have found claims arising out of the Madoff Ponzi scheme to be precluded by SLUSA. Those cases—inexplicably ignored by the United States—are identical to this one in all relevant respects, as they involved a fraudster who recruited new investors by promising, falsely, that invested funds would earn highly attractive returns while being backed by publicly traded securities. And both the Stanford and Madoff schemes have

spawned massive litigation against third parties who are alleged to have participated in the fraud in some tangential way. Yet Madoff-related claims brought in New York and Connecticut courts are precluded by SLUSA, while Stanford-related claims brought in Texas and Louisiana are not. It makes no sense to have the two largest Ponzi schemes in United States history be treated radically differently based on the happenstance of the circuit in which they arose.

As the Madoff cases make clear, there is no question that this case would have been decided differently under the Second Circuit's test (and the Eleventh Circuit's very similar standard). Indeed, the district court applied the Eleventh Circuit's test and found Respondents' claims to be precluded, while the Fifth Circuit rejected that standard and held that SLUSA does not apply here. It is hard to imagine a clearer indication that the split is real—and not semantic—than the fact that the choice of test was outcome determinative in the two courts that have heard the case.

The United States also argues that the leading cases from the Second and Eleventh Circuits are distinguishable because the fraud in those cases caused the plaintiffs to purchase SLUSA-covered securities, while the fraud in this case caused the plaintiffs to purchase CDs (which are not covered securities). But that factual difference is not legally relevant. If a misrepresentation about a covered security causes someone to part with their money, then SLUSA applies without regard to whether the victim thought they were buying a covered security, a CD backed by covered securities, or something else. Indeed, the fundamental problem in the most

egregious Ponzi schemes is that the thing the victim thinks he is purchasing does not even exist. As SLUSA itself makes clear, it simply makes no sense to have the initial coverage of the securities laws or SLUSA preclusion turn on what the victim is induced to purchase. SLUSA requires only that the *misrepresentation* be "in connection with" a covered security, and a misrepresentation *about* a covered security clearly satisfies that requirement.

In sum, the split is real and the choice of legal standard is outcome determinative in this case. This Court should grant certiorari to resolve this conflict and correct the Fifth Circuit's demonstrably erroneous interpretation of SLUSA.

I. THE UNITED STATES CORRECTLY ACKNOWLEDGES THAT THE FIFTH CIRCUIT'S DECISION WAS WRONG

A. The United States (at 10-13) correctly identifies the flaws of the Fifth Circuit's decision. The "crux" of the Stanford fraud was the promise that SIB CDs were safe, liquid investments that would deliver high returns. U.S. Br. 10. As the United States explains, the representation that the CDs were backed by a diversified portfolio of covered securities was "important to the success of that tactic." *Id.* Indeed, Stanford's scheme could not have succeeded *without* this misrepresentation because "[t]here was no other apparent source of the funds necessary to make the CDs function . . . and to allow the investors to realize the financial benefits they had been promised." *Id.*

The Fifth Circuit refused to apply SLUSA because it concluded that these misrepresentations

about covered securities were rendered "tangential" by *other* alleged misrepresentations that did not involve covered securities. Pet.App.37-39. As the United States explains, that holding was clearly wrong. It is true that the other alleged misrepresentations "[could] have been relevant to a prospective purchaser," but "only the assertions about covered securities would have answered investors' questions about *how* SIB would be able to deliver the promised high returns on the CDs—questions that any reasonable investor would have asked before buying a financial instrument from a foreign bank." U.S. Br. 11.

In sum, the misrepresentations about covered securities were "crucial to the Stanford fraud," and were "sufficient to trigger SLUSA preclusion." *Id.* at 12-13; *see* Pet. 18-23; Pet. Reply 8-10. The United States correctly acknowledges that the Fifth Circuit's decision was wrong because it failed to recognize the significance of the misrepresentations about covered securities in this case.[1] However, as discussed below, the United States fails to recognize that the Fifth Circuit's test is inconsistent with SLUSA and conflicts with other circuits' tests because it allows for other alleged misrepresentations to prevent SLUSA preclusion even when there is unquestionably a misrepresentation about a covered security.

[1] The United States also agrees with Petitioners that "there is no jurisdictional bar to this Court's consideration of the case." U.S. Br. 20 n.6; *see* Pet. Reply 10-13.

II. THERE IS A BONA FIDE SPLIT OF AUTHORITY OVER THE MEANING OF SLUSA'S "IN CONNECTION WITH" REQUIREMENT THAT WARRANTS THIS COURT'S REVIEW

Although it recognizes the serious flaws in the Fifth Circuit's analysis, the United States nonetheless argues that this Court should deny certiorari. The government's effort to deny a circuit split is unpersuasive, as the split is demonstrably outcome determinative.

A. The United States' primary argument is that there is no real split of authority over the meaning of SLUSA's "in connection with" requirement, and that the test adopted by the Fifth Circuit is not in conflict with other circuits' tests. But the fundamental problem with the Fifth Circuit's approach—and the fundamental conflict with other circuits—is that the Fifth Circuit holds that a misrepresentation about covered securities is not sufficient if other alleged misrepresentations render it too *tangential* to the fraudulent scheme. Pet.App.33-34. This is in direct conflict with other circuits that have held—consistent with SLUSA's plain text—that the existence of *one* covered misrepresentation is sufficient to trigger preclusion, regardless of whether the complaint also alleges misrepresentations about other matters. As the Sixth Circuit has explained, SLUSA "does not ask whether the complaint makes 'material' or 'dependent' allegations of misrepresentations in connection with buying or selling securities." *Segal v. Fifth Third Bank*, 581 F.3d 305, 311 (6th Cir. 2009). Instead, it asks only "whether the complaint includes these types of allegations, pure and simple." *Id.*

Here, the Fifth Circuit acknowledged a misrepresentation about covered securities, but then went on to parse the rest of the complaint to determine whether the covered misrepresentation was too tangential or extraneous to give rise to preclusion. This is not just a different formulation of the same test; it is an entirely different (and entirely misguided) *methodology* for determining when SLUSA applies.

B. The Fifth Circuit's approach to SLUSA squarely conflicts with the approach of the Second and Eleventh Circuits. Pet. 23-26; Pet. Reply 3-6. The Eleventh Circuit asks whether the plaintiffs' claims are premised on either: (1) fraud that "induced" the plaintiffs to invest with the defendants; or (2) a fraudulent scheme that "coincided and depended upon" the purchase or sale of SLUSA-covered securities. *Instituto de Prevision Militar v. Merrill Lynch*, 546 F.3d 1349 (11th Cir. 2008) ("*IPM*")). The Second Circuit's test similarly asks whether the complaint "necessarily" alleges, involves, or rests on misrepresentations regarding SLUSA-covered securities. *Romano v. Kazacos*, 609 F.3d 512, 522 (2d Cir. 2010).

And, not only is the Fifth Circuit's test entirely different from the Eleventh and Second Circuits' tests, the procedural history of this case makes clear that it is outcome determinative. The district court applied the Eleventh Circuit's test and found the claims precluded. Pet.App.65-67. The Fifth Circuit applied its novel variation of the Ninth Circuit's test and found them not precluded. Pet.App.31-38. Accordingly, the United States' suggestion (at 19-20)

that any tension among the circuits is more semantic than real is simply incorrect.

It is clear that this case would have come out differently in the Second and Eleventh Circuits. There is no question that the plaintiffs' purchases of SIB CDs were *induced* by misrepresentations about covered securities, and that the Stanford Ponzi scheme rested on such misrepresentations. Pet.App.66-67. As the United States concedes, the misrepresentation that depositors' funds were being invested in covered securities was "crucial to the Stanford fraud." U.S. Br. 12; *see* Pet.App.36-37 (misrepresentations about covered securities were intended to "lure" Respondents into "buying the worthless CDs").

The United States nonetheless attempts to distinguish *IPM* (11th Circuit) and *Romano* (2nd Circuit) on the ground that those cases involved fraudulent schemes to induce investors to purchase covered securities, while the CDs at the heart of the Stanford fraud were uncovered securities. U.S. Br. 13-17. But that is a factual distinction without a legal difference. The text of SLUSA requires only that the *misrepresentation* be "in connection with" a covered security. 15 U.S.C. § 78bb(f)(1). It makes no difference whether the misrepresentation about a covered security induces someone to buy a covered security, a CD backed by such securities, or something else. The United States itself makes this point elsewhere in its brief, noting that SLUSA should have applied here even though "Stanford and SIB did not seek to induce investors to purchase covered securities." U.S. Br. 12.

SLUSA focuses on what the misrepresentation is about (covered securities), not on what the fraudster uses the misrepresentation to sell. SLUSA's focus on the misrepresentation is particularly important for Ponzi schemes where the thing the fraudster purports to sell—be it covered securities, CDs backed by securities, or something else—may not even exist. Indeed, courts applying the Second Circuit's test in Madoff cases have rejected the government's precise factual distinction as legally irrelevant. As one court explained, "[m]isrepresentations related to non-covered limited partnership interests may be nonetheless 'in connection with' covered securities where the Funds were created for the purpose of investing in such securities, and the misrepresentations 'had the effect of facilitating [the] fraud.'" *Newman v. Family Management Corp.*, 748 F. Supp. 2d 299, 312 (S.D.N.Y. 2010) (citation omitted).

That is precisely the case here. Even though the SIB CDs were not themselves covered securities, they were marketed to investors based on the false promise that deposited funds would be backed by SLUSA-covered securities. That allegation would have been more than sufficient to trigger SLUSA preclusion under the standards applied by the Second and Eleventh Circuits.

C. The split of authority is dramatically illustrated by the differential treatment of the two largest Ponzi schemes in United States history. While courts applying the Second Circuit's test have found efforts to sue remote parties in the Madoff cases SLUSA-precluded, the Fifth Circuit—applying its own misguided test—has allowed such suits to

proceed. But despite Petitioners' reliance on these Madoff-related precedents, *see* Pet. 27-28 & n.11; Pet. Reply 5-6, the United States simply ignores these cases and the split they reflect.

The multi-billion dollar Madoff and Stanford frauds are analytically identical: in both cases, the fraudsters recruited new investors through false representations that their funds would earn above-market returns with limited risk because investments were in or backed by SLUSA-covered securities. Stanford sold his CDs by asserting that they were backed by covered securities, while Madoff lured investors by promising that he would purchase covered securities for the benefit of funds in which plaintiffs invested. *See In re Herald, Primeo & Thelma*, 2011 WL 5928952, at *8 (S.D.N.Y. Nov. 29, 2011); Pet.App.67-68 n.12.

Despite these similarities, courts have taken starkly different approaches in applying SLUSA to these two Ponzi schemes. Claims against third parties arising out of the Madoff fraud that were brought in New York or Connecticut are precluded, *see* Pet. 27-28 & n.11, while Stanford-related claims against third parties that were brought in Texas or Louisiana are not. That stark difference makes no sense (especially since litigation arising out of the two schemes is likely to persist for years to come—and to target deep-pocketed defendants far removed from the actual fraud) and underscores the split of authority between the Second and Fifth Circuits.

The plethora of Madoff-related litigation also squarely refutes the government's suggestion (at 20 n.7) that the facts of this case are "unusual" and

unlikely to recur. This supposedly rare fact pattern has now recurred twice within the last few years, in the two largest Ponzi schemes in U.S. history, each of which involved billions of dollars, thousands of victims, and massive litigation after the frauds were detected. As long as fraudsters promise above-market returns for investments backed with covered securities these issues will continue to recur.

The United States is also wrong to suggest (at 13, 16) that this case is unique because it involves a "multi-layered transaction." First, there is nothing unique about the multiple layers at issue in the Stanford Ponzi scheme. Multiple "layers" are also present in the Madoff Ponzi scheme. Indeed, successful Ponzi schemes tend to be complicated, multi-layered, and supported by multiple misrepresentations. Second, and most important, the number of "layers" is irrelevant. What is relevant is whether a misrepresentation about covered securities is at play, as that is what triggers the application of the securities laws generally and SLUSA preclusion in particular.

D. Finally, the United States suggests (at 18-19) that the Fifth Circuit did not adopt a special rule treating aiders and abettors differently for SLUSA purposes, but rather simply applied its mistaken inquiry into whether any alleged misrepresentations about covered securities were "too tangential" to all defendants, including those who made no direct misrepresentations to investors about covered securities. Petitioners do not disagree—which is why we present only a single question. While the difference between primary and secondary liability matters for liability under Section 10(b)(5), it should

not make any direct difference for purposes of SLUSA preclusion. All that is required for SLUSA preclusion is a misrepresentation by someone about a covered security as part of the scheme alleged to be the basis for the defendant's liability.[2]

That said, one of the many defects of the Fifth Circuit's approach is that by asking whether the misrepresentation about a covered security was only tangential when weighed against the other allegations in the complaint, the decision makes it easier to ensnare aiders and abettors (secondary actors). Pet. 28-32. To even explain why those secondary actors are liable, plaintiffs will necessarily have to make additional allegations about why the secondary actors have any business being defendants when they did not themselves make the misrepresentations about covered securities. Thus, the critical misrepresentation about covered securities may seem more tangential in cases against actors far-removed from that misrepresentation, even though none of that matters for SLUSA purposes.

Respondents' lawyers boasted they had found a path around both SLUSA and *Stoneridge v. Scientific-Atlanta*, 552 U.S. 148 (2008). Pet. 32. Now that the United States has recognized that the

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[2] Although it is not critical for SLUSA preclusion purposes, it should be noted that, contrary to the United States' suggestion (at 5), Willis is not alleged to have made a misrepresentation about covered securities directly to investors. Instead, it is only alleged to have made a representation about insurance coverage. Pet. 11.

decision below is wrong, this Court should grant plenary review and make clear there is no means to circumvent SLUSA or this Court's precedents. An alleged misrepresentation about a covered security is sufficient to bring a complaint squarely within SLUSA.

CONCLUSION

The Court should grant the petition.

Respectfully submitted,

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