No. 12-79

IN THE

Supreme Court of the United States

CHADBOURNE & PARKE LLP,
Petitioner,

v.

SAMUEL TROICE, ET AL.,
Respondents.

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

BRIEF FOR PETITIONER

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QUESTION PRESENTED

The Securities Litigation Uniform Standards Act ("SLUSA") precludes most state-law class actions involving "a misrepresentation" made "in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A). The question presented is whether SLUSA precludes a state-law class action alleging a scheme of fraud that involves misrepresentations about transactions in SLUSA-covered securities.

PARTIES TO THE PROCEEDING

Petitioner is Chadbourne & Parke LLP, a defendant below.

The other defendants below are Proskauer Rose LLP, Thomas V. Sjoblom, and P. Mauricio Alvarado. Proskauer Rose LLP is the petitioner in case number 12-88 (cert. granted Jan. 18, 2013). Messrs. Sjoblom and Alvarado are respondents under this Court's Rule 12.6.

Respondents, plaintiffs below, are Samuel Troice, Horacio Mendez, Annalisa Mendez, and Punga Punga Financial, Ltd., individually and on behalf of a class of all others similarly situated.

RULE 29.6 DISCLOSURE

Petitioner Chadbourne & Parke LLP, a law firm, is a limited liability partnership with no parent company. No entity of any kind has 10 percent or greater ownership in Chadbourne & Parke LLP.

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OPINIONS BELOW

The decision of the court of appeals is reported at 675 F.3d 503, and is reprinted in the Appendix to the Petition for Certiorari ("Pet. App.") at 1a-41a. The opinion of the district court is unreported, and is reprinted at Pet. App. 42a-43a.

JURISDICTION

The court of appeals issued its decision on March 19, 2012 (revised on March 20). Pet. App. 1a. The court denied a petition for rehearing on April 19, 2012. Pet. App. 46a. The petition for a writ of certiorari was filed on July 18, 2012, and granted on January 18, 2013 (limited to the first question presented). This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 101(b)(1)(B) of the Securities Litigation Uniform Standards Act ("SLUSA") provides in part: "No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party 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). Section 101(b)(1)(B) is reproduced in its entirety in the appendix to this brief.

STATEMENT OF THE CASE

A. Statutory Background

1. *The 1934 Act*

a. "In the wake of the 1929 stock market crash and in response to reports of widespread abuses in

the securities industry," *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 170 (1994), Congress enacted the Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74, and the Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881. The 1933 Act is primarily concerned with "initial distributions of securities …[, while] the 1934 Act for the most part regulates post-distribution trading." *Cent. Bank*, 511 U.S. at 171. "The 1933 and 1934 Acts create an extensive scheme of civil liability," including enforcement authority delegated to the Securities and Exchange Commission ("SEC"), and various private causes of action. *Id.*

The "most familiar" of these provisions is § 10(b), "the general antifraud provision of the 1934 Act." *Id.* That provision, which is civilly enforced both by the SEC (pursuant to SEC Rule 10b-5, 17 C.F.R. § 240.10b-5) and privately through an implied cause of action, makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security …, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." 15 U.S.C. § 78j(b). This Court has repeatedly adopted a "broad construction" of the requirement that the fraud be "in connection with the purchase or sale" of a security. *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 84-85 (2006).

In particular, the "in connection with" requirement is to be "construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes.'" *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (quoting *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972)). Thus, this Court

has held the "in connection with" requirement satisfied (for example) by alleged frauds that merely "coincide" with any securities transaction, *United States v. O'Hagan*, 521 U.S. 642, 656 (1997), or by "deceptive practices touching" a securities transaction, *Superintendent of Ins. of the State of New York v. Bankers Life and Cas. Co.*, 404 U.S. 6, 12-13 (1971). The requisite showing is simply "deception 'in connection with the purchase or sale of any security.'" *O'Hagan*, 521 U.S. at 658.

b. At the same time, the Court has repeatedly emphasized that the scope of the implied *private* action available under § 10(b) (as opposed to the scope of the statute itself, subject to SEC enforcement and criminal prosecution) must be construed narrowly. Various "policy considerations" justify limits on private securities-fraud enforcement, including most significantly the fact "that litigation under [§ 10(b)] presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737, 739 (1975). For example, the *Blue Chip Stamps* Court, quoting Judge Friendly, noted "the possibility that unduly expansive imposition of civil liability 'will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers.'" *Id.* at 739 (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968) (concurring opinion)). Further, "in the field of federal securities laws governing disclosure of information even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of

success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment." *Id.* at 740. In that way the "very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit." *Id.* For those policy reasons, the Court held that a private action may be brought only by purchasers or sellers of a security, not by its holders. *Id.* at 754-55.

The Court similarly emphasized the special "dangers of vexatiousness" in holding in *Central Bank* that § 10(b) does not support an action for aiding and abetting securities fraud. 511 U.S. at 189, 191. Such dangers, the Court observed, are especially pronounced with liability for secondary actors, who must "expend large sums even for pretrial defense and the negotiation of settlements." *Id.* at 189. As a result of secondary liability, "newer and smaller companies may find it difficult to obtain advice from professionals," who "may fear that a newer or smaller company may not survive and that business failure would generate securities litigation against the professional, among others." *Id.* And "the increased costs incurred by professionals because of the litigation and settlement costs under 10b-5 may be passed on to their client companies, and in turn incurred by the company's investors, the intended beneficiaries." *Id.*

The Court relied on the same "policy considerations" in concluding that customers and suppliers who facilitate an issuer's fraud through deception but make no public misrepresentations are not subject to private suit under § 10(b). *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S.

148, 152-53 (2008). Citing *Blue Chip Stamps*, the Court explained "that extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies," and that "[a]doption of petitioner's approach would expose a new class of defendants to these risks." *Id.* at 162-64.

2. *Private Securities Litigation Reform Act*

Even as this Court was prescribing the foregoing limits on the § 10(b) private action, securities-fraud class actions continued to proliferate. "Policy considerations similar to those that supported the Court's decision in *Blue Chip Stamps*" led Congress to enact the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. No. 104-67, 109 Stat. 737, which was "targeted at perceived abuses of the class-action vehicle in litigation involving nationally traded securities," *Dabit*, 547 U.S. at 81. "While acknowledging that private securities litigation was 'an indispensable tool with which defrauded investors can recover their losses,'" the House Conference Report accompanying the PSLRA "identified ways in which the class-action device was being used to injure 'the entire U.S. economy.'" *Id.* (quoting H.R. Rep. No. 104-369 (1995) (Conf. Rep.)). "According to the Report, nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and 'manipulation by class action lawyers of the clients whom they purportedly represent' had become rampant in recent years." *Id.* (quoting H.R. Rep. No. 104-369 (1995) (Conf. Rep.)).

Title I of the PSLRA sought to stem those abuses. It amended both the 1933 and 1934 Acts and, among other things, "[i]ts provisions limit recoverable damages and attorney's fees, provide a 'safe harbor' for forward-looking statements, impose new restrictions on the selection of (and compensation awarded to) lead plaintiffs, mandate imposition of sanctions for frivolous litigation, and authorize a stay of discovery pending resolution of any motion to dismiss." *Dabit*, 547 U.S. at 81 (citing 15 U.S.C. § 78u-4, amending the 1934 Act). The PSLRA also heightened the pleading standards for claims brought under § 10(b). *See* 15 U.S.C. § 78u-4(b)(1), (2); *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345 (2005).

Finally, the PSLRA responded to this Court's holding in *Central Bank* by assuring that "[a]iding and abetting liability is authorized in actions brought by the SEC but not by private parties." *Stoneridge*, 552 U.S. at 162 (citing 15 U.S.C. § 78t(e)). The Senate Report noted that "[p]rior to the Supreme Court's decision in *Central Bank of Denver v. First Interstate Bank of Denver*, courts of appeals had recognized that private parties could bring actions against persons who 'aided and abetted' primary violators of the securities laws," but that the Court in *Central Bank* "held that there was no aiding and abetting liability for private lawsuits involving violations of the securities antifraud provisions." S. Rep. No. 104-98, at 19 (1995). Congress concluded "that amending the 1934 Act to provide explicitly for private aiding and abetting liability actions under Section 10(b) would be contrary to [the

Act's] goal of reducing meritless securities ligation." *Id.*

3. <u>*Securities Litigation Uniform Standards Act*</u>

a. The PSLRA made it significantly more difficult to bring vexatious securities class actions in federal court (including by affirming this Court's limitation on private aiding-and-abetting actions), but its success "had unintended consequences." *Dabit*, 547 U.S. at 82. Whereas "[p]rior to the passage of the [PSLRA], there was essentially no significant securities class action litigation brought in State court," H.R. Rep. No. 105-803, at 14 (1998) (Conf. Rep.), the new law created a shift into the state courts by "prompt[ing] at least some members of the plaintiffs' bar to avoid the federal forum altogether." *Dabit*, 547 U.S. at 82. Congress found "considerable evidence" that "a number of securities class action lawsuits ha[d] shifted from Federal to State courts." Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), Pub. L. No. 105-353, § 2(1), (2), 112 Stat. 3227. "[T]his shift," Congress determined, had "prevented th[e] [PSLRA] from fully achieving its objectives." *Id.* § 2(3).

Accordingly, "in order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the" PSLRA, Congress enacted SLUSA, which was intended to establish "national standards" for class actions "involving nationally traded securities," SLUSA § 2(5), and to make "Federal court the exclusive venue for most securities class action lawsuits," H.R. Rep. No. 105-803, at 13.

b. A principal way in which SLUSA achieved its stated purposes was by precluding certain securities class actions based on state law. SLUSA amended both the 1933 and 1934 Acts by creating the category of "covered class actions"—defined to mean simply a class action brought on behalf of more than 50 people, 112 Stat. 3232 (codified at 15 U.S.C. § 78bb(f)(5)(B))[1]—and precluding any covered class action, either in state or federal court, "based upon the statutory or common law of any State or subdivision thereof" alleging, among other things, "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security," i.e., a security listed on a national exchange. 112 Stat. 3230 (codified at 15 U.S.C. § 78bb(f)(1); definition of "covered security" codified at *id.* § 78bb(f)(5)(E))). This provision is referred to herein as the Preclusion Provision. SLUSA also included a Removal Provision, which provided that state-law actions falling within the Preclusion Provision that were filed in state court could be removed to federal court, where they would be subject to immediate dismissal. 112 Stat. 3230 (codified at 15 U.S.C. § 78bb(f)(2)) ("Any covered class action brought in any State court involving a covered security, as set forth in paragraph (1), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to paragraph (1).").

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[1] "SLUSA amends the 1933 Act and the 1934 Act in substantially identical ways." *Dabit*, 547 U.S. at 82 n.6. For ease of reference and because they are more relevant to this case, citations are to the 1934 Act amendments.

c. *Dabit* was this Court's first opportunity to interpret the scope of the "in connection with" language in the Preclusion Provision. The Court held that the Preclusion Provision bars state-law fraud class actions brought by *holders* of a security, even though the holders themselves neither purchased nor sold a security, and even though holders have no private cause of action under § 10(b), *see Blue Chip Stamps*, 421 U.S. at 754-55. The Court explained that the SLUSA phrase "in connection with the purchase or sale of a covered security" must be given the same "broad construction" as the nearly identical "in connection with" language in § 10(b) itself, which requires only that the "fraud alleged 'coincide' with a securities transaction—whether by the plaintiff or by someone else." *Dabit*, 547 U.S. at 74, 85 (quoting *O'Hagan*, 521 U.S. at 651). Further, a "narrow reading of the statute," the Court explained, "would undercut the effectiveness of the [PSLRA] and thus run contrary to SLUSA's stated purpose, viz., 'to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives' of the [PSLRA]." *Dabit*, 547 U.S. at 85-86 (quoting SLUSA § 2(5)).

B. Factual Background And Procedural History

1. The appeal below originated as three separate sets of actions, consolidated in the court of appeals, based on the same underlying alleged fraud—the multi-billion dollar Ponzi scheme perpetrated by entities controlled by Allen Stanford, including the Stanford Group Company and (among others) its affiliate, Antigua-based Stanford International Bank ("SIB"). Pet. App. 6a. As a general matter, the Stan-

ford entities' objective was to sell certificates of deposit ("CDs") issued by SIB, which they did by fraudulently "promising above-market returns and falsely assuring investors that the CDs were backed by safe, liquid investments"—i.e., marketable securities sold on national exchanges. *Id.* (quoting *Janvey v. Alguire*, 647 F.3d 585, 590 (5th Cir. 2011)). In fact, "SIB had to use new CD sales proceeds to make interest and redemption payments on pre-existing CDs, because it did not have sufficient assets, reserves and investments to cover its liabilities." *Id.* (quoting *Janvey*, 647 F.3d at 590).

2. The suit against petitioner was brought in federal court by a group of Latin American investors—the *Troice* Plaintiffs (referred to herein as "plaintiffs")—against certain attorneys for the Stanford entities (referred to below as the "Proskauer Defendants," which include Chadbourne & Parke LLP, the petitioner here) for aiding and abetting Stanford's Ponzi scheme. Pet. App. 9a.[2] The complaint alleges that plaintiffs and those similarly situated purchased CDs because they "were repeatedly and uniformly told … that, inter alia: (1) an investment in SIB was safer than investing in U.S. banks because SIB did not make loans but instead invested in

[2] At the same time that it granted certiorari in this action, the Court also agreed to review two other petitions presenting the same question as the one presented here. *Proskauer Rose LLP v. Troice*, No. 12-88, arises from the same aiding-and-abetting complaint as does this case. Pet. App. 9a. The other case, *Willis of Colorado Inc. v. Troice*, No. 12-86, arises from the other two of the three sets of actions that were consolidated below, which the Fifth Circuit construed to allege primary liability based on defendants' own alleged fraudulent misrepresentations. Pet. App. 8a-9a.

safe and highly liquid instruments; (2) SIB and Stanford Financial were U.S.-based businesses regulated by the U.S. Government; and (3) that an investment in SIB was completely safe and secure because it was guaranteed and insured by Lloyd's [of London], was regulated by the Antiguan banking regulatory commission and by an 'outside' audit firm and subjected to regular, 'stringent' risk management examinations." J.A. 470 (Second Amended Complaint ("SAC") ¶ 86)). "All of this was false," the complaint asserts. *Id.*

Especially relevant to this case are the misrepresentations falling into the first category just discussed: plaintiffs were told "that the CDs issued by SIB were safer even than U.S. bank-issued CDs because," among other reasons, "investments in the CDs were liquid and the CDs could be redeemed at any time because SIB … only invested the money in safe, secure and liquid assets." J.A. 433 (SAC ¶ 24). Both courts below accepted that those "safe, secure, and liquid assets"—described elsewhere in the complaint as "highly marketable securities issued by stable governments, strong multinational companies and major international banks," J.A. 444 (SAC ¶ 41), and a "diversified portfolio that included," among other things, "stocks [and] bonds," J.A. 458 (SAC ¶ 65)—are "covered securities" under SLUSA. *E.g.*, Pet. App. 35a-38a, 64a-65a.

In particular, the Stanford entities "touted the high quality of SIB's investment portfolio," "and emphasized the importance of the liquidity of the SIB CD." J.A. 444 (SAC ¶ 41). Investors 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.'" *Id.* Moreover, Stanford Financial trained its brokers "to stress liquidity in their marketing pitches to prospective investors, telling the brokers and advisors that 'liquidity/marketability of SIB's invested assets' was the 'most important factor to provide security to SIB clients.'" *Id.* Thus, "[t]o ensure that depositors could redeem their CDs, Stanford, through its brokers and advisers, assured the investor clients that SIB's investments were liquid and diversified, and therefore that the CDs themselves were highly liquid and could be redeemed with just a few days['] notice." J.A. 444-45 (SAC ¶ 41). In sum, plaintiffs were told that "instead of making loans, SIB took the money it received from the sale of CDs and itself invested in an allegedly diversified portfolio that included stocks, bonds, notes, private equity, precious metals and other commodities, much like a mutual fund." J.A. 458 (SAC ¶ 65).

Contrary to these representations, however, "SIB did not invest in a 'well-diversified portfolio of highly marketable securities.'" J.A. 445 (SAC ¶ 42). Instead, "significant portions of the bank's portfolio were misappropriated by SIB's sole shareholder, Allen Stanford, and used by him to acquire private equity and real estate." *Id.* Thus, "investors like Plaintiffs and the Class purchased participation interests in Stanford Financial and SIB's investment portfolio, just like any mutual or hedge fund." J.A. 442-43 (SAC ¶ 39). But instead of putting plaintiffs' money into the promised diversified portfolio of high-

ly marketable securities, Stanford Financial "pooled all of the investors' money together and scattered it throughout the Stanford Financial enterprise to make investments in various illiquid and high risk assets worldwide." J.A. 443 (SAC ¶ 39). Thus, the Stanford entities' assurance that plaintiffs' "money was being invested in safe, liquid investments that were completely insured" was "a material misstatement because the money was not invested in safe, liquid and fully insured investments." J.A. 480 (SAC ¶ 103).

3. The three sets of Stanford-related actions discussed above came before the same district court, which held that they were all precluded by SLUSA. The complaints alleged misrepresentations in connection with the purchase or sale of a covered security, the court concluded, because even though the SIB CDs were not themselves "covered securities," the "marketable securities" purportedly backing those CDs were. According to the complaints, "SIB led the Plaintiffs to believe that the SIB CDs were backed, at least in part, by SIB's investments in SLUSA-covered securities," and this "belief induced the Plaintiffs to purchase SIB CDs." Pet. App. 64a-65a. That sufficed to bring the complaint within SLUSA's Preclusion and Removal Provisions. *Id.*; *see* Pet. App. 42a-43a. In addition, the district court concluded that plaintiffs alleged a "fraudulent scheme that coincided and depended upon the purchase or sale of securities" because at least one of the plaintiffs exchanged SLUSA-covered IRA investments to purchase the SIB CDs. Pet. App. 67a-70a; *see also* J.A. 211-21 (Yoder Declaration).

4. The Fifth Circuit consolidated the three sets of actions, and reversed the judgment of dismissal in each of them.

The court first concluded, in conflict with several other circuits (Pet. 16-23), that SLUSA's "in connection with" requirement is properly captured by a standard previously adopted by the Ninth Circuit: "[A] misrepresentation is 'in connection with' the purchase or sale of securities if there is a relationship in which the fraud and the stock sale coincide or are *more than tangentially related*." Pet. App. 32a (quoting *Madden v. Cowen & Co.*, 576 F.3d 957, 965-66 (9th Cir. 2009)) (Fifth Circuit's emphasis). The court believed this standard was faithful to this Court's purported "express[] reli[ance] on 'policy considerations' in its determination of the scope of the 'in connection with' language." Pet. App. 26a (citing *Blue Chip Stamps*, 421 U.S. at 737, and *Dabit*, 547 U.S. at 81). Those "policy considerations," the court explained, require that any interpretation of the "in connection with" requirement not "[p]reclud[e] any group claim against any … debt issue[r] merely because the issuer advertises that it owns [SLUSA-covered securities] in its portfolio." Pet. App. 29a.

Applying its adopted standard to the complaints, the court held that none involved misrepresentations "in connection with" transactions in covered securities, because the alleged misrepresentations about SLUSA-covered securities transactions did not go to the "'heart,' 'crux,' or 'gravamen'" of the fraud. Pet. App. 36a. The court recognized that "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.'" Pet. App. 11a. But the touting of "marketable securities" backing, the court explained, was "but one of a host of (mis)representations made to the Appellants in an attempt to lure them into buying the worthless CDs." Pet. App. 35a-36a. The allegations concerning SLUSA-covered securities thus were "merely tangentially related to the [heart] of the defendants' fraud," which was (according to the court) to represent to plaintiffs "that the CDs were a 'safe and secure' investment that was preferable to other investments for many reasons." Pet. App. 36a-37a. Further, the court of appeals believed it significant that "plaintiffs could not claim that they deposited their money in the bank for the purpose of purchasing covered securities." Pet. App. 37a (quotation omitted).

The Fifth Circuit also rejected the district court's alternative ground for finding SLUSA preclusion. While the court of appeals did "not quarrel with the district court's finding that some plaintiffs sold covered securities to buy the CDs," that was not sufficient to meet the "in connection with" requirement, because the "the entirety of the fraud" did not "depend[] upon the tortfeasor convincing the victims of [the] fraudulent schemes to sell their covered securities in order for the fraud to be accomplished." Pet. App. 39a.

SUMMARY OF ARGUMENT

SLUSA's Preclusion Provision disallows state-law class actions "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). Plaintiffs' state-law class action is precluded because it alleges material misrepresentations about SIB's purchases of covered securities.

I. A. This Court has repeatedly held that the "in connection with" requirement, which was first enacted as part of § 10(b) and later incorporated into SLUSA, must be broadly construed. The "in connection with" requirement is not limited to frauds in which the plaintiff was induced to purchase or sell securities. Rather, this Court has held that the "in connection with" requirement is satisfied so long as the fraud "coincides" with such purchase or sale. Under SLUSA, "it is enough that the fraud alleged 'coincide' with a [covered] securities transaction—whether by the plaintiff or by someone else." *Dabit*, 547 U.S. at 85. "The requisite showing, in other words, is 'deception "in connection with the purchase or sale of any security," not deception of an identifiable purchaser or seller.'" *Id*. (quoting *O'Hagan*, 521 U.S. at 651).

B. Whether construed broadly or not, the "in connection with" requirement is easily satisfied here because under any plausible reading of the Preclusion Provision, plaintiffs' complaint "alleg[es] a misrepresentation … of a material fact" made directly "in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A).

1. The complaint repeatedly alleges that plaintiffs were induced to purchase SIB CDs based in part on the Stanford entities' false representation that the CDs were safe and liquid because they were backed by past and future purchases of covered securities. Whatever other types of misrepresenta-

tions may be "in connection with" the purchase of covered securities, that standard must at least include misrepresentations directly *about* one's own purchases of covered securities.

2. While no further elaboration of the meaning of the "in connection with" language is required to resolve this case, plaintiffs' allegations also fall comfortably within the standards previously articulated by this Court. The complaint alleges "deception 'in connection with the purchase or sale of [a covered] security,'" *O'Hagan*, 521 U.S. at 651, for the reasons already explained. And the alleged misrepresentations not only "coincide" with a purported securities transaction; those covered-securities-related misrepresentations were the drivers of the Stanford Ponzi scheme. That scheme induced plaintiffs to purchase CDs by falsely promising that the CDs were liquid and valuable because SIB only invested in covered securities. Indeed, the complaint alleges that the CDs' purported liquidity was their principal selling point, and that such liquidity was possible, plaintiffs were told, only because CD proceeds were invested in covered securities. In short, misrepresentations concerning SIB's purchase of covered securities were crucial to the alleged fraud, which is why plaintiffs specifically allege that the promise that their money would be invested in covered securities "was a *material misstatement*." J.A. 480 (SAC ¶ 103) (emphasis added).

II. The Fifth Circuit's contrary reading of the "in connection with" requirement lacks merit.

A. The Fifth Circuit concluded that plaintiffs' complaint escapes the Preclusion Provision because

while some of the alleged misrepresentations concerned the purchase or sale of covered securities, the complaint also alleged other misrepresentations, and the SLUSA-covered misrepresentations were in the court's view only "tangentially related" to the "heart," "crux," or "gravamen" of the fraud. That conclusion is wrong for several reasons.

1. The Fifth Circuit's contention is incorrect as a factual matter—the Stanford entities' false promises that the CDs would be backed by past and future purchases of covered securities were in fact crucial to the success of the fraud, for the reasons explained earlier.

2. In any event, the Preclusion Provision is not limited to misrepresentations that are the "heart," "crux," or "gravamen" of the alleged fraud. No such terms appear in the text of the provision. Rather, that provision applies so long as the complaint "alleg[es] … *a* misrepresentation … 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), which is exactly what plaintiffs' complaint alleges. It is irrelevant whether the complaint *also* alleges misrepresentations unconnected with the purchase or sale of a covered security. That does not mean that a complaint is precluded so long as there is *any* mention of misrepresentations in connection with covered-securities transactions—the statute applies only where such misrepresentations are of "a material fact." But nobody argues that the Stanford entities' SLUSA-covered misrepresentations were immaterial to the fraud; on the contrary, plaintiffs expressly allege that they *were* material.

3. The Fifth Circuit's rule would undermine the purposes of SLUSA and the 1934 Act.

The PSLRA imposed significant substantive and procedural limitations on federal securities-fraud class actions, and SLUSA was intended to prevent plaintiffs from evading the strictures of the PSLRA by filing in state court or under state law. Yet the Fifth Circuit's rule would allow precisely such an end-run: all a plaintiff alleging securities fraud would need to do to evade SLUSA (and thus the PSLRA) is add *more* allegations to the complaint unrelated to securities fraud, and try to convince the reviewing court that the additional allegations are the "crux" of the fraud while the others are not. This case provides a good example. Under this Court's decision in *Central Bank*, plaintiffs could not bring a federal securities-fraud claim against petitioner because they allege only that petitioner aided and abetted the underlying Stanford fraud. In the PSLRA, Congress expressly preserved *Central Bank*'s bar on private securities-fraud aiding-and-abetting actions. Yet plaintiffs here admittedly framed their complaints so as to avoid the strictures of *Central Bank* and similar decisions, instead seeking to maintain an aiding-and-abetting action under state-law. That is precisely what SLUSA was enacted to avoid.

The Fifth Circuit's rule would also undermine § 10(b) of the 1934 Act, which contains the same "in connection with" requirement as the SLUSA Preclusion Provision. The 1934 Act was enacted to ensure honesty and full disclosure in the securities markets. A fraud involving misrepresentations of material facts about the purchase or sale of securities obvious-

ly implicates those concerns, and that is so even if the fraud also involves other misrepresentations unrelated to securities. The goals of honesty and full disclosure would be undermined, not furthered, if fraud involving lies about securities transactions were withdrawn from the scope of § 10(b) simply because it also involved lies about other things.

4. Finally, the Fifth Circuit's standard is too subjective. SLUSA preclusion in the court of appeals' view would depend entirely on each individual court's subjective view of the "heart," "crux," or "gravamen" of an alleged fraud, including whether securities-related misrepresentations are included within that "heart," "crux," or "gravamen." The statute, by contrast, asks a simple question: whether the complaint alleges "a misrepresentation … of a material fact in connection with" a covered-securities transaction. This case demonstrates the malleability of the Fifth Circuit's approach—as explained earlier, the Stanford entities' misrepresentations concerning SIB's purchase of covered securities were crucial to the fraud, yet the court of appeals concluded that the "in connection with" standard was nevertheless not satisfied. And such a difficult-to-apply rule is particularly inappropriate when, as here, it governs a threshold determination concerning whether an action can be brought in state court or under state law, rather than the merits of the case.

B. The Fifth Circuit also found it significant that plaintiffs were not promised either a direct ownership stake in covered securities or returns that tracked the performance of SIB's purported securities portfolio. Those considerations are both irrelevant and wrong.

1. The Fifth Circuit's "ownership/returns" test is precluded by SLUSA's text and this Court's precedents. As noted, the Preclusion Provision is satisfied so long as there is "a misrepresentation … of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A). The text does not require that the misrepresentations concern the plaintiff's own purchase of securities, or purchases on the plaintiffs' behalf. In fact, this Court has expressly rejected the position that the "in connection with" requirement is satisfied "only when the plaintiff himself was defrauded into purchasing or selling particular securities." *Dabit*, 547 U.S. at 85. And the Court has further held that the "in connection with" requirement is satisfied, for example, even though the targets of the deception were not party to any security transaction, and even though the parties that did purchase securities from the defendant had no connection to the fraud. *O'Hagan*, 521 U.S. at 658. "[I]t is enough that the fraud alleged 'coincide' with a securities transaction—*whether by the plaintiff or by someone else*." *Dabit*, 547 U.S. at 85 (emphasis added).

2. The Fifth Circuit's ownership/returns rule is also inconsistent with the purpose of the 1934 Act. That Act, as explained, was meant to ensure honesty in the securities market, an objective that is undermined when investors are falsely promised that their investments are safe because they are backed by purchases of covered securities. That the investors would not themselves own the securities is irrelevant—their investment decision relied on the representations made to them about securities transac-

tions being true, which is precisely the assurance that the securities laws are meant to provide.

3. Even if it were relevant whether plaintiffs were promised returns tied to the performance of securities, that standard would be met here, because the success of plaintiffs' investment in SIB CDs was tied directly to the strength of SIB's portfolio, as plaintiffs' own allegations make clear. SIB's supposed portfolio of covered securities was why SIB could say that the CDs were liquid and could safely pay above-market returns. And the plaintiffs' investment in the CDs became worthless precisely because SIB's portfolio was also worthless. The performance of the CDs thus depended directly on the performance of SIB's phantom covered-securities portfolio.

C. Finally, the Fifth Circuit misread this Court's precedents as justifying reliance on "policy considerations" to read the Preclusion Provision narrowly. Those precedents cited such considerations only to construe narrowly the *implied private right of action* under § 10(b). The policies relevant to *SLUSA's Preclusion Provision*, by contrast, support construing the provision broadly.

The Fifth Circuit also misconstrued the relevant policies. The court expressed concern that the "in connection with" language not be construed so broadly as to encompass every fraud that "happens to involve" securities. That concern has no bearing here, because the alleged fraud does not merely "happen to involve" securities. Misrepresentations about the purchase of covered securities were crucial to the fraud, and plaintiffs themselves alleged that those

misrepresentations were "material" to the fraud. Those misrepresentations thus fit comfortably within the test the Preclusion Provision establishes. The Fifth Circuit was also concerned that SLUSA's legislative history expressed an intent to preserve the states' role in the regulation of securities by excluding individual actions and the enforcement authority of state regulators from its scope. But a narrow reading of the "in connection with" requirement is not required to preserve individual and state actions; SLUSA accomplishes that goal by expressly excluding such actions from the Preclusion Provision's reach. And this action involves neither individual actions nor state enforcement authority. It is a *private class action*, which is precisely the type of action to which SLUSA is directed.

ARGUMENT

The SLUSA Preclusion Provision provides: "No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party 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).[3] There is no dispute that this is a "covered class action," that it is "based upon the

[3] This case concerns the scope of the Preclusion Provision. The same analysis, however, applies to the Removal Provision, the scope of which is identical to that of the Preclusion Provision. *See supra* at 8. SLUSA also contains a related provision precluding state-law-based class actions alleging "that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(B).

statutory or common law of [a] State," or that the "highly marketable securities issued by stable governments, strong multinational companies and major international banks" that plaintiffs were told backed the SIB CDs (J.A. 444 (SAC ¶ 41)) are "covered securities" under SLUSA, i.e., securities traded on a national exchange. Thus, the only question is whether this is an action alleging "a misrepresentation … of a material fact in connection with the purchase or sale of" those covered securities. It is. The complaint alleges that SIB induced plaintiffs to invest in its CDs by falsely representing that SIB was buying covered securities to back the CDs. By any understanding, a misrepresentation *about* the purchase or sale of covered securities is a misrepresentation *in connection with* the purchase or sale of covered securities.

I. THIS ACTION IS PRECLUDED BECAUSE THE COMPLAINT ALLEGES "A MISREPRESENTATION" "OF A MATERIAL FACT IN CONNECTION WITH THE PURCHASE OR SALE OF" COVERED SECURITIES

This Court has repeatedly held that the "in connection with" requirement, both in § 10(b) and in SLUSA, must be broadly construed. Particularly in light of that broad construction, plaintiffs' action is precluded under SLUSA because their complaint alleges "a misrepresentation … of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A).

A. This Court's Precedents Require SLUSA's "In Connection With" Requirement To Be Broadly Construed

The analysis "begin[s], as always, with the text of the statute." *Permanent Mission of India to the United Nations v. City of New York*, 551 U.S. 193, 197 (2007). The Court has construed the text at issue here on multiple occasions, each time emphasizing that the "in connection with" language in both § 10(b) and SLUSA should be broadly construed.

1. Section 10(b) of the 1934 Act prohibits the use of "any manipulative or deceptive device or contrivance" "*in connection with* the purchase or sale of any security," 15 U.S.C. § 78j(b) (emphasis added)—the same "in connection with" language later enacted as part of SLUSA. A "narrow construction" of that phrase is, in theory, linguistically available—"one might have concluded that an alleged fraud is 'in connection with' a purchase or sale of securities only when the plaintiff himself was defrauded into purchasing or selling particular securities." *Dabit*, 547 U.S. at 85. But this Court has long rejected that narrow interpretation of § 10(b)'s "in connection with" language. Instead, "when this Court has sought to give meaning to th[at] phrase in the context of § 10(b) and Rule 10b-5, it has espoused a broad interpretation." *Id.*

A broad construction of § 10(b) is warranted, the Court has explained, because one of Congress's "objectives in passing the [1934] Act was 'to insure honest securities markets and thereby promote investor confidence' after the market crash of 1929." *Zandford*, 535 U.S. at 819 (quoting *O'Hagan*, 521

U.S. at 658). "More generally, Congress sought 'to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry.'" *Id.* (quoting *Affiliated Ute Citizens*, 406 U.S. at 151 (quotation omitted)). "Consequently," the Court has explained, "the statute should be 'construed not technically and restrictively, but flexibly to effectuate its remedial purposes.'" *Id.* (quoting *Affiliated Ute Citizens*, 406 U.S. at 151 (quotation omitted)).

Under this "broader interpretation" of the statute, *Dabit*, 547 U.S. at 85, a fraud is considered "in connection with" the purchase or sale of a security so long as it "coincide[s]" with such purchase or sale, *O'Hagan*, 521 U.S. at 656, or if it "touch[es] a securities transaction," *Bankers Life*, 404 U.S. at 13. "Notably," the Court has emphasized, this understanding of the statute's language "comports with the longstanding views of the SEC." *Dabit*, 547 U.S. at 85.

Applying this broad understanding of the "in connection with" standard, the Court has held the standard satisfied even when the fraudulent activity has no effect on the value of the securities transaction at issue. *Bankers Life and Casualty Co.*, 404 U.S. at 9. Similarly, the Court has held that fraud is "in connection with" the purchase or sale of a security when there is no misrepresentation about the value of any security. *Zandford*, 535 U.S. at 820. Fraudulent conduct that takes place *after* a securities transaction is executed nevertheless can be "in connection with" the transaction. *The Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*, 532 U.S. 588, 590 (2001). And a fraud is "in connection with"

a securities transaction even if the defrauded victim is not a party to the fraudulent transaction. *O'Hagan*, 521 U.S. at 658.

2. In enacting the SLUSA Preclusion Provision, Congress borrowed the "in connection with" language from § 10(b). And as this Court explained in *Dabit*, "Congress can hardly have been unaware of the broad construction adopted by both this Court and the SEC when it imported the key phrase—'in connection with the purchase or sale'—into SLUSA's core provision." 547 U.S. at 85. Given the established canon that when "judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its ... judicial interpretations as well," *id.* at 85-86 (quotation omitted; omission in original), the same "broad construction" applicable to § 10(b)'s "in connection with" requirement applies to SLUSA.

Moreover, "[t]he presumption that Congress envisioned a broad construction follows not only from ordinary principles of statutory construction but also from the particular concerns that culminated in SLUSA's enactment." *Id.* at 86. "A narrow reading of the statute," the Court explained, "would undercut the effectiveness of the [PSLRA] and thus run contrary to SLUSA's stated purpose, viz., 'to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives' of the [PSLRA]." *Id.* (quoting SLUSA § 2(5)). The question in *Dabit* was whether SLUSA precludes claims by "holders" of securities—i.e., neither purchasers nor sellers. Applying SLUSA's purposes to the resolution of that question, the Court ex-

plained that because "class actions brought by holders pose a special risk of vexatious litigation," *id.* (citing *Blue Chip Stamps*, 421 U.S. at 739), "[i]t would be odd, to say the least, if SLUSA exempted that particularly troublesome subset of class actions from its pre-emptive sweep," *id.*

Thus, under SLUSA, as under § 10(b), "it is enough that the fraud alleged 'coincide' with a securities transaction—whether by the plaintiff or by someone else." *Id.* at 85 (citing *O'Hagan*, 521 U.S. at 651). "The requisite showing, in other words, is 'deception "in connection with the purchase or sale of [a covered] security," not deception of an identifiable purchaser or seller.'" *Id.* (quoting *O'Hagan*, 521 U.S. at 651).

B. The Complaint's Allegations Fall Squarely Within The Terms Of SLUSA's Preclusion Provision

Whether broadly construed or not, the "in connection with" requirement is easily satisfied here, because under any plausible reading of the Preclusion Provision, plaintiffs' complaint "alleg[es] a misrepresentation … of a material fact" made directly "in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A). The rule of broad construction just discussed only makes matters simpler.

1. The complaint alleges that SIB repeatedly represented that CDs were a safe and liquid investment *because they were backed by SIB's purchases of covered securities*:

- "the CDs issued by SIB were safer even than U.S. bank-issued CDs because," among other reasons, "investments in the CDs were liquid and the CDs could be redeemed at any time because SIB … only invested the money in safe, secure and liquid assets," i.e., covered securities. J.A. 433 (SAC ¶ 24).
- SIB "focuses on 'maintaining the highest degree of liquidity as a protective factor for our depositors' and … 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.'" J.A. 444 (SAC ¶ 41).
- "SIB's investments were liquid and diversified, and therefore … the CDs themselves were highly liquid and could be redeemed with just a few days['] notice." J.A. 444-45 (SAC ¶ 41).
- "instead of making loans, SIB took the money it received from the sale of CDs and itself invested in an allegedly diversified portfolio that included [covered securities,] much like a mutual fund." J.A. 458 (SAC ¶ 65).
- plaintiffs' "money was being invested in safe, liquid investments that were completely insured, which was a material misstatement because the money was not invested in safe, liquid and fully insured investments." J.A. 480 (SAC ¶ 103).

Those allegations unambiguously assert misrepresentations by SIB about its own transactions in covered securities. As the United States has explained, "[f]alse statements about one's own transactions in covered securities are naturally characterized as misrepresentations 'in connection with the purchase or sale of' such securities." U.S. Cert. Amicus Br. 12.[4] Whatever the scope of the phrase "in connection with," it must at least include misrepresentations *about* transactions in SLUSA-covered securities.

To be sure, SIB never actually purchased (or sold) any covered securities. But a false promise to purchase or sell a security certainly is "in connection with" a securities transaction, even though no transaction ever occurred. *Cf. Zandford*, 535 U.S. at 819. What matters is that plaintiffs allege misrepresentations about SIB's (non-existent) purchase of covered securities, which is all that the statute requires.

A simple counterfactual demonstrates the point. Suppose that all the aforementioned representations that the Stanford entities made to plaintiffs had been true—that SIB in fact "took the money it received from the sale of CDs and itself invested in" covered securities, J.A. 458 (SAC ¶ 65), such that plaintiffs' "money was being invested in safe, liquid investments." J.A. 480 (SAC ¶ 103). In that circumstance, the Stanford entities' representations to that

[4] The United States certiorari-stage amicus brief represents the position of the SEC. U.S. Cert. Amicus Br. 22. The SEC's construction of the "in connection with" language in an amicus brief is entitled to deference under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). *See United States v. Mead Corp.*, 533 U.S. 218, 229-33 (2001).

effect would undoubtedly be representations "in connection with" the purchase of covered securities. The only difference here is that those representations were lies—i.e., *mis*representations—but their falsity did not make them any less "in connection with" the purchase of covered securities.

Or take another example. Assume a complaint identical to plaintiffs' complaint, except that instead of falsely representing that plaintiffs' money (i.e., the proceeds from CD sales) was being invested in covered securities, the Stanford entities represented that SIB would invest plaintiffs' money in AAA-rated covered securities, but actually invested them in much riskier covered securities (e.g., small-cap technology stocks). No one would contend that those false representations are not "in connection with" the purchase of a covered security. The only difference here is that rather than purchasing riskier covered securities than promised, SIB purchased no covered securities at all. Again, the difference is the nature of the misrepresentation about covered-securities transactions, not the "connection with" such transactions.

2. No further elaboration of the "in connection with" standard is required to resolve this case—as explained, misrepresentations *about* one's own purchases of covered securities are clearly *in connection with* the purchase of covered securities. Not surprisingly, that result is fully consistent with this Court's prior articulations of the scope of the "in connection with" requirement.

Certainly, the complaint alleges "deception 'in connection with the purchase or sale of [a covered]

security,'" *Dabit*, 547 U.S. at 85, for the reasons already explained. And the alleged misrepresentations no doubt "coincide" with a purported securities transaction. *Id.* Indeed, they do much more than that. The alleged fraud was a Ponzi scheme, and the alleged misrepresentations—including those about transactions in covered securities—were the drivers of that scheme.

A Ponzi scheme works by inducing investors to give the schemer money through false representations. Here, the Stanford entities induced plaintiffs to purchase the SIB CDs by falsely promising that the CDs were liquid and valuable because SIB "only invested [its] money in safe, secure and liquid" SLUSA-covered securities. J.A. 433 (SAC ¶ 24). Stanford specifically directed his brokers and agents "to stress liquidity in their marketing pitches to prospective investors" because "'liquidity/marketability of SIB's invested assets' was the 'most important factor to provide security to SIB clients.'" J.A. 444 (SAC ¶ 41). And the *only* basis for Stanford's promise that the CDs were liquid was that the money was being invested in a diversified portfolio of covered securities. J.A. 432-33 (SAC ¶ 24). That is why plaintiffs specifically allege that this misrepresentation is "material." J.A. 480 (SAC ¶ 103). In particular, the complaint alleges that the Stanford entities' representation that "money was being invested in safe, liquid investments that were completely insured" "was a *material misstatement* because the money was not invested in safe, liquid and fully insured investments." *Id.* (emphasis added).

In short, without the Stanford entities' misrepresentations about purchases of covered securities, this

would have been an entirely different fraud—and likely less successful. The Stanford Ponzi scheme did not merely "coincide" with misrepresentations about purchases of covered securities—although that would be enough to bring it within the Preclusion Provision's scope—it depended on them for its ongoing success. This case thus rests easily within this Court's prior construction of the "in connection with" requirement.

II. THE FIFTH CIRCUIT'S CONTRARY READING OF THE "IN CONNECTION WITH" REQUIREMENT LACKS MERIT

The Fifth Circuit managed to turn this very easy case into an unduly difficult one by imposing on SLUSA's Preclusion Provision several arbitrary constraints found nowhere in the statute or this Court's precedents. First, the Fifth Circuit held that the alleged misrepresentations concerning SLUSA-covered security transactions did not satisfy the statute because they were only "tangentially related to the 'heart,' 'crux,' or 'gravamen'" of the Stanford fraud. Pet. App. 36a. Second, the Fifth Circuit found it significant that "plaintiffs could not claim that they deposited their money in the bank for the purpose of purchasing covered securities," or that their returns would directly track those of SIB's purported portfolio of covered securities. Pet. App. 37a (quotation omitted). Finally, the court of appeals believed "policy considerations" require a narrow reading of the Preclusion Provision. Pet. App. 26a. Each contention is meritless.

A. Misrepresentations Of Material Fact In Connection With Covered Securities Transactions Need Not Be The "Crux" Of The Alleged Fraud, Though They Were Here

The court of appeals acknowledged that the complaint alleged misrepresentations concerning SLUSA-covered securities transactions: "To be sure, the CDs' promotional material touted that SIB's portfolio of assets was invested in" covered securities. Pet. App. 35a. The court discounted that alleged falsehood, however, because it was only "one of a host of (mis)representations made to the Appellants in an attempt to lure them into buying the worthless CDs." Pet. App. 35a-36a. In the court's view, the fraud "was representing to the Appellants that the CDs were a 'safe and secure' investment that was preferable to other investments for many reasons," and the misrepresentations concerning covered securities transactions were "merely tangentially related to the 'heart,' 'crux,' or 'gravamen'" of that fraud. Pet. App. 36a-37a.

That analysis misreads the complaint, misconstrues the text of SLUSA, and contravenes the objective of the federal securities laws.

1. *The Alleged Misrepresentations Concerning Covered-Securities Transactions Were Crucial To SIB's Fraud*

Contrary to the Fifth Circuit's reading of the complaint, the Stanford entities' false representation that proceeds from the CD sales were to be invested in covered securities was crucial to the alleged fraud. First, the statement was not simply one among a

"host" of misrepresentations—the complaint alleged just *three* misrepresentations, and the false claim about covered securities investments was first on the list:

> Plaintiffs were repeatedly and uniformly told … that, inter alia: (1) an investment in SIB was safer than investing in U.S. banks because SIB did not make loans but instead invested in safe and highly liquid instruments; (2) SIB and Stanford Financial were U.S.-based businesses regulated by the U.S. Government; and (3) that an investment in SIB was completely safe and secure because it was guaranteed and insured by Lloyd's [of London], was regulated by the Antiguan banking regulatory commission and by an "outside" audit firm and subjected to regular, "stringent" risk management examinations.

J.A. 470 (SAC ¶ 86).

Second, the misrepresentations about covered securities investments bore particular significance to the success of the scheme. As the government explained in its certiorari-stage amicus brief, while non-securities-related representations could have been relevant to SIB investors, "only the assertions about covered securities would have answered investors' questions about *how* SIB would be able to deliver the promised high returns on CDs—questions that any reasonable investor would have asked before buying a financial instrument from a foreign bank." U.S. Cert. Amicus Br. 11. Indeed, Stanford brokers "stress[ed] liquidity in their marketing pitches to prospective investors" because "'liquidi-

ty/marketability of SIB's invested assets' was the '*most important factor* to provide security to SIB clients.'" J.A. 444 (SAC ¶ 41) (emphasis added). And as explained, the *only* reason investors believed that the CDs were liquid was that SIB assets were being invested in a liquid portfolio of covered securities. J.A. 432-33 (SAC ¶ 24). In short, the Stanford entities' "misrepresentations about their own holdings were crucial to the Stanford fraud." U.S. Cert. Amicus Br. 12.

2. *Under SLUSA's Plain Text, It Is Irrelevant That The Complaint Included Misrepresentations About Other Matters*

Even if the Stanford entities misrepresentations about their covered-securities transactions were less crucial to their scheme, they would still satisfy the "in connection with" requirement. Under the statute's plain terms, all that is required is "*a* misrepresentation … of a material fact in connection with" a covered securities transaction. 15 U.S.C. § 78bb(f)(1)(A) (emphasis added). In other words, there must be *a* pertinent misrepresentation, and it must be material. It is irrelevant whether the complaint *also* alleges *other* misrepresentations that would themselves not be covered under SLUSA.

That is not to say that any complaint alleging a stray misrepresentation concerning covered-securities transactions will be precluded under SLUSA. The Preclusion Provision requires that the misrepresentation be "of a *material fact*." *Id.* (emphasis added). Thus, misrepresentations concerning covered-securities transactions that are not material to the fraud will not trigger the Preclusion Provision.

Here, however, the Stanford entities' representations that the CD proceeds were invested in a liquid and safe portfolio of covered securities is at the very least *material* to the fraud, even if not "crucial" to it. U.S. Cert. Amicus Br. 12. The complaint alleges that the assurance that "money was being invested in safe, liquid investments that were completely insured" "was a *material misstatement* because the money was not invested in safe, liquid and fully insured investments." J.A. 480 (SAC ¶ 103) (emphasis added). And even absent that explicit concession, materiality is apparent from the remainder of the allegations. A misrepresentation is material if there is a "substantial likelihood that the disclosure of the [truth] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quotation omitted). Any reasonable investor would find it significant that purportedly safe and liquid CDs that she has purchased are backed not by a diversified portfolio of safe covered securities but instead by risky and highly illiquid "private equity and real estate" investments. J.A. 445 (SAC ¶ 42).

3. *Denying SLUSA Preclusion Based On The Existence Of Non-SLUSA-Covered Misrepresentations Would Undercut The Objectives Of Both SLUSA And The 1934 Act*

The Fifth Circuit's position would also undercut the objectives of the federal securities laws, namely SLUSA and the Securities Exchange Act of 1934.

a. The principal purpose of SLUSA was to prevent plaintiffs from circumventing the restrictions of

the PSLRA by simply filing their securities-fraud class actions in state courts or under state law. *See supra* at 7-9. The PSLRA in turn was intended to eradicate "perceived abuses of the class-action vehicle in litigation involving nationally traded securities." *Dabit*, 547 U.S. at 81; *see supra* at 5-7. For example, the PSLRA imposes on federal securities-fraud plaintiffs heightened pleading standards and procedural requirements, sanctions for frivolous litigation, and authorizes discovery stays pending the resolution of motions to dismiss. *See supra* at 6.

The Fifth Circuit's rule would run directly contrary to Congress's effort in SLUSA to shore up the PSLRA's requirements by assuring that they cannot be evaded by filing securities-fraud class actions in state court or under state law. Under the Fifth Circuit's construction of "in connection with," plaintiffs can avoid SLUSA preclusion, even of complaints alleging SLUSA-covered misrepresentation, by simply larding them up with *additional* allegations of fraud unrelated to nationally traded securities.

This case demonstrates the point especially well. Because petitioner is alleged only to have aided and abetted the Ponzi scheme, there is no question that *Central Bank* and *Stoneridge* would bar a federal securities-fraud suit against petitioner. One of the PSLRA's purposes was to preserve that bar. In particular, Congress in enacting the PSLRA considered and rejected a proposal to reverse this Court's holding in *Central Bank* and allow private aiding-and-abetting actions, 15 U.S.C. § 78t(e), on the ground that private aiding-and-abetting liability "would be contrary to [the Act's] goal of reducing meritless securities ligation." S. Rep. No. 104-98, at 19.

Yet the Fifth Circuit would have allowed plaintiffs to evade the PSLRA and *Central Bank* by letting the case proceed under state law merely because it includes alleged misrepresentations beyond the key SLUSA-covered misrepresentation concerning SIB's own securities transactions. Indeed, that was plaintiffs' admitted motivation for filing this suit under state law—it was part of a "strategy" to "get around the U.S. Supreme Court's rulings in [*Central Bank*] and [*Stoneridge*], which have been the death knell to federal securities law claims against third party advisors to accused fraudsters." Julie Triedman, *Fifth Circuit Green-Lights $7 Billion Claims Against Proskauer, Other Stanford Advisors*, AmLaw Daily (Mar. 20, 2012). That is precisely the result SLUSA was enacted to prevent. SLUSA § 2; *see also Dabit*, 547 U.S. at 86.

b. The Fifth Circuit's rule also would undermine § 10(b) of the 1934 Act. Just as this Court's § 10(b) precedents controlled the scope of the Preclusion Provision in *Dabit*, this Court's reading of the Preclusion Provision's "in connection with" requirement here will control the scope of the same language in § 10(b).

As explained, Congress enacted the 1934 Act to promote investor confidence by ensuring honesty in the securities markets and furthering a policy of full disclosure. *See supra* at 25-26. A fraud involving misrepresentations of material fact about the purchase or sale of securities obviously implicates those concerns. And those concerns are in no way diminished simply because the fraud *also* involves *other* misrepresentations unrelated to securities. It hardly promotes investor confidence or furthers a philoso-

phy of full disclosure in the securities markets to withdraw a fraud involving lies about securities transactions from the scope of § 10(b) simply because it also involves lies about other things.

The result of the Fifth Circuit's theory would be to displace the SEC's authority over frauds involving both material securities-related and non-securities-related misrepresentations, so long as a court holds that the latter are more important than the former. There is no conceivable reason to deprive the SEC of jurisdiction over securities fraud just because it also has non-securities aspects.

4. *The Fifth Circuit's Test Is Too Subjective And Ad Hoc*

Under the Fifth Circuit's rule, SLUSA preclusion would become essentially a guessing game. To decide whether misrepresentations concerning transactions in covered securities constitute the "heart," "crux," or "gravamen" of the fraud, a court must first decide what the heart, crux, or gravamen of the alleged fraud is, then whether the SLUSA-covered misrepresentations are sufficiently crucial to that fraud. SLUSA preclusion under the Fifth Circuit's rule thus would depend entirely on each individual court's ad hoc view of a given complaint's allegations. The statute itself, by contrast, mandates a simple, largely black-and-white question, *viz.*, whether the complaint alleges "a misrepresentation … of a material fact in connection with" a covered-securities transaction.

This case provides a perfect example of the Fifth Circuit rule's malleability. For the reasons discussed earlier, the Stanford entities' misrepresenta-

tions concerning SIB's purported purchases of covered securities were central to the Stanford Ponzi scheme—they were crucial to inducing plaintiffs and those similarly situated to purchase the SIB CDs. Yet the Fifth Circuit was nevertheless able to exclude the case from SLUSA's scope by reading the fraud allegations flexibly. Preclusion under SLUSA should not turn on such subjectivity, particularly when the standard is found nowhere in the text of the statute.

Difficult-to-apply rules are particularly ill-suited to threshold determinations such as whether a suit is properly brought under state law or in state court. The SLUSA Removal Provision is a jurisdictional provision—it provides for federal subject-matter jurisdiction when there otherwise would be none. *See Kircher v. Putnam Funds Trust*, 547 U.S. 633, 642-44 (2006). Conditioning federal jurisdiction on the vagaries of a judicial determination about what the "heart," "crux," or "gravamen" of a fraud really is would be a harm in itself, for "[c]omplex jurisdictional tests complicate a case, eating up time and money as the parties litigate" the proper forum for adjudication, and "not the merits of their claims." *Hertz Corp. v. Friend*, 130 S. Ct. 1181, 1193 (2010). And because the Fifth Circuit's rule necessarily applies not only in the SLUSA context but also to § 10(b), the SEC's jurisdiction under § 10(b) would similarly turn on an ad hoc judicial determination of the "gravamen" of an alleged fraud.

In short, there is nothing to recommend the Fifth Circuit's view that the existence of non-SLUSA-covered misrepresentations takes this case outside of SLUSA's scope, and there are many reasons to reject

it. The Court should apply the Preclusion Provision's plain text, which requires only "*a* misrepresentation … of a material fact in connection with" a covered-securities transaction, 15 U.S.C. § 78bb(f)(1)(A), a standard readily satisfied here.

B. It Does Not Matter That Plaintiffs Were Not Promised Direct Ownership In Covered Securities, Or That Their Promised Returns Would Not Directly Track Those Of SIB's Supposed Portfolio Of Covered Securities

The Fifth Circuit found significance in the fact that plaintiffs were not promised direct ownership in covered securities, but rather in CDs backed by covered securities. Pet. App. 37a. Because those CDs promised fixed rates of return, rather than returns tracking SIB's purported investments in covered securities, plaintiffs were not claiming that they made deposits "for the purpose of purchasing covered securities." *Id.* (quotation omitted; alteration in original).

Like the argument addressed in the prior section, these considerations both contravene SLUSA and the 1934 Act and misread the complaint.

1. *The Fifth Circuit's Ownership/Returns Test Is Precluded By SLUSA's Text And By This Court's Precedent*

To start, it makes no difference under SLUSA whether plaintiffs were promised either direct ownership of covered securities or returns based on SIB's ownership of covered securities. All that matters is

that material misstatements were made about investments in covered securities.

The Fifth Circuit did not even attempt to square its ownership/returns rule with the statute's text. Nor could it. Again, the Preclusion Provision applies so long as there is "a misrepresentation … of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1)(A). Nothing in the text requires that those misrepresentations concern the *plaintiff's* purchase or sale of securities, or a purchase or sale on the plaintiff's behalf, or for the plaintiff's benefit.

This Court, in fact, has already rejected a substantively identical position, *viz.*, that "an alleged fraud is 'in connection with' a purchase or sale of securities only when the plaintiff himself was defrauded into purchasing or selling particular securities." *Dabit*, 547 U.S. at 85. More than that, this Court held in *Zandford* that the "in connection with" requirement was satisfied absent any misrepresentation concerning the value of securities. 535 U.S. at 820. And in *O'Hagan*, the Court held fraud to be "in connection with the purchase or sale of any security" even though the targets of the deception were not party to any securities transaction at all, and even though the parties that purchased securities from the defendant had no connection whatever to the fraud. 521 U.S. at 658.

This Court rejected those limitations on the "in connection with" requirement because they were found nowhere in the text. The Court should for the same reason reject the Fifth Circuit's attempt to require a direct link between plaintiffs' promised re-

turn and the covered securities SIB promised to purchase. Under SLUSA (as under § 10(b)), "it is enough that the fraud alleged 'coincide' with a securities transaction—*whether by the plaintiff or by someone else*." *Dabit*, 547 U.S. at 85 (citing *O'Hagan*, 521 U.S. at 651) (emphasis added). "The requisite showing, in other words, is 'deception "in connection with the purchase or sale of any security," not deception of an identifiable purchaser or seller.'" *Id.* (quoting *O'Hagan*, 521 U.S. at 658). And deception in connection with the purchase of covered securities is precisely what plaintiffs' complaint alleges, for the reasons already explained.

2. *The Fifth Circuit's Ownership/Returns Rule Is Inconsistent With The Purpose Of The 1934 Act*

As explained earlier, the 1934 Act was intended primarily "to insure honest securities markets and thereby promote investor confidence." *O'Hagan*, 521 U.S. at 658. That objective is obviously implicated when investors are falsely promised that their investments are safe because they are backed up by a diversified portfolio of securities when they are in fact backed up by something else entirely. It does not matter that the investors would not themselves own the underlying portfolio of securities. Their investment decision relied on precisely the assurance that the securities laws were meant to provide—that material representations made to them about securities transactions will be true. When those representations turn out to be false, securities fraud has occurred.

3. *An Ownership/Returns Test Would Be Satisfied Here*

Although it is irrelevant whether plaintiffs were promised either direct ownership of covered securities or returns based on the performance of covered securities, that type of standard would be satisfied here in any event. The success of plaintiffs' investment in SIB CDs was tied directly to the strength of SIB's portfolio. Plaintiffs allege they were told that "instead of making loans, SIB took the money it received from the sale of CDs and itself invested in an allegedly diversified portfolio that included stocks, bonds, notes, private equity, precious metals and other commodities, much like a mutual fund." J.A. 458 (SAC ¶ 65). Thus, "investors like Plaintiffs and the Class *purchased participation in Stanford Financial and SIB's investment portfolio*, just like any mutual fund or hedge fund." J.A. 442-43 (SAC ¶ 39) (emphasis added). After all, SIB's supposed portfolio of covered securities was the reason that it could promise high liquidity and higher-than-normal returns. And in fact, the CDs turned out to be worthless because the risky and illiquid assets SIB *actually* invested in were themselves worthless. The overall performance of the CDs thus depended directly upon the performance of SIB's underlying portfolio, which plaintiffs were (falsely) promised was constituted through the purchase of covered securities.

C. The Fifth Circuit's Evaluation Of Policy Concerns Was Unwarranted And Erroneous

1. The Fifth Circuit rested its narrow view of the Preclusion Provision on this Court's purported "ex-

press reliance on 'policy considerations' in its determination of the scope of the 'in connection with' language in Section 10(b), *Blue Chip Stamps*, 421 U.S. at 737, and SLUSA, *Dabit*, 547 U.S. at 81." Pet. App. 26a. That analysis misreads this Court's precedent.

To be sure, it is appropriate (and, indeed, necessary) to consider the purposes of SLUSA and, by extension, the PSLRA, when interpreting the Preclusion Provision. And as explained earlier, those purposes confirm that plaintiffs' complaint is precluded by SLUSA. But the "policy considerations" the Court considered in *Blue Chip Stamps* were not the purposes underlying the relevant statute—in that case, § 10(b)—but rather considerations relevant to the scope of the *implied right of action* available to enforce that statute. *See supra* at 3-4.

That is why *Dabit* specifically explains that *Blue Chip Stamps* relied on "policy considerations" to "define the scope of a private right of action under [§ 10(b)]—*not* to define the words 'in connection with the purchase or sale.'" *Dabit*, 547 U.S. at 84 (emphasis added). Rather than construe the "in connection with" requirement narrowly in light of policy considerations, *Dabit* does the opposite. It reads the statutory language as it was written, and emphasizes that "when this Court *has* sought to give meaning to the ['in connection with' language], it has espoused a broad interpretation." *Id.* at 85. And as explained, the Preclusion Provision—particularly given the Court's "broad interpretation"—comfortably encompasses plaintiffs' complaint.

2. The Fifth Circuit's misreading of this Court's precedents is confirmed by the appellate court's misapplication of the relevant "policy considerations."

a. One such consideration identified by the Fifth Circuit was this Court's observation in *Zandford* that the "in connection with" requirement "'must not be construed so broadly as to [encompass] every common-law fraud that happens to involve [covered] securities.'" Pet. App. 32a (quoting *Zandford*, 535 U.S. at 820) (alterations in original). That observation has no bearing here—this case is not one about fraud that just "happens to involve" covered securities. As explained, the alleged fraud depended directly on misrepresentations about covered-securities transactions. And plaintiffs expressly allege that those misrepresentations were "material" to the fraud.

Nevertheless, the court of appeals expressed concern that if SLUSA preclusion applied here, then the Preclusion Provision "could potentially subsume any consumer claims involving the exchange of money or alleging fraud against a bank, without regard to the product that was being peddled." Pet. App. 29a (quotation omitted). That was so, the court believed, because "every bank and almost every company owns some covered securities in its portfolio, and every debt instrument issued by these banks and companies is backed by this portfolio in the same way the CDs here were ultimately backed by the assets in SIB's portfolio." *Id.*

That concern is baseless. The Preclusion Provision would not apply merely because a debt issuer advertises that it owns covered securities. The debt

issuer would have to make a *misrepresentation* (or omission). That misrepresentation (or omission) would have to be of a *material fact*. And it would have to be *in connection with the purchase or sale of a security*. 15 U.S.C. § 78bb(f)(1)(A). Those conditions are not satisfied when a bank that commits fraud happens to advertise that it owns securities unconnected to the fraud. But when those conditions *are* satisfied—for example, when a debt issuer lures investors by falsely promising that the debt can be redeemed at any time and is safely able to pay above-market interest because it is backed by past and future purchases of nationally traded securities—the debt issuer commits securities fraud, and there is no plausible reason why the Preclusion Provision (or § 10(b), for that matter) would be inapplicable.

b. Another "policy consideration" cited by the Fifth Circuit was the supposed recognition in a Senate Report of "the importance of maintaining the vital role of state law in regulating non-national securities." App. 28a. But the "state law" mentioned in the Report was "the appropriate enforcement powers for *state regulators*, and the right of *individuals* to bring suit," neither of which SLUSA addresses at all. S. Rep. No. 105-182, at 8 (1998) (emphasis added). There is no need to interpret the "in connection with" requirement narrowly to preserve "individual" actions or those brought by "state regulators," because the statute preserves them expressly. *See* 15 U.S.C. § 78bb(f)(5)(B) (defining "covered class action" to mean an action brought on behalf of more than 50 people); *id.* § 78bb(f)(3)(B)(i) (excluding actions brought on a state's behalf from the scope of the Pre-

clusion and Removal Provisions); *id.* § 78bb(f)(4) (same for state enforcement actions). And in any event, this case obviously does not involve action by "state regulators" or by "individuals." It is instead a state-law *class action*—precisely the type of action to which SLUSA is directed. *See id.* § 78bb(f)(1), (2); SLUSA § 2; S. Rep. No. 105-182, at 8.

The Fifth Circuit's evaluation of policy considerations thus misses the mark completely. The policy considerations that *are* relevant—those underlying SLUSA, the PSLRA, and the 1934 Act—point in the opposite direction, toward a broad construction of the "in connection with" requirement that easily encompasses the allegations here.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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STATUTORY APPENDIX

APPENDIX

Section 101(b)(1)(B) of the Securities Litigation Uniform Standards Act, as currently codified at 15 U.S.C. § 78bb(f), provides:

(f) Limitations on remedies

(1) Class action limitations

No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging—

(A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or

(B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

(2) Removal of covered class actions

Any covered class action brought in any State court involving a covered security, as set forth in paragraph (1), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to paragraph (1).

(3) Preservation of certain actions—

(A) Actions under State law of State of incorporation

(i) Actions preserved

Notwithstanding paragraph (1) or (2), a covered class action described in clause (ii) of this

subparagraph that is based upon the statutory or common law of the State in which the issuer is incorporated (in the case of a corporation) or organized (in the case of any other entity) may be maintained in a State or Federal court by a private party.

(ii) Permissible actions

A covered class action is described in this clause if it involves—

(I) the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or

(II) any recommendation, position, or other communication with respect to the sale of securities of an issuer that—

(aa) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and

(bb) concerns decisions of such equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights.

(B) State actions

(i) In general

Notwithstanding any other provision of this subsection, nothing in this subsection may be construed to preclude a State or political subdivision thereof or a State pension plan from bringing an action involving a covered security on

its own behalf, or as a member of a class comprised solely of other States, political subdivisions, or State pension plans that are named plaintiffs, and that have authorized participation, in such action.

(ii) State pension plan defined

For purposes of this subparagraph, the term "State pension plan" means a pension plan established and maintained for its employees by the government of a State or political subdivision thereof, or by any agency or instrumentality thereof.

(C) Actions under contractual agreements between issuers and indenture trustees

Notwithstanding paragraph (1) or (2), a covered class action that seeks to enforce a contractual agreement between an issuer and an indenture trustee may be maintained in a State or Federal court by a party to the agreement or a successor to such party.

(D) Remand of removed actions

In an action that has been removed from a State court pursuant to paragraph (2), if the Federal court determines that the action may be maintained in State court pursuant to this subsection, the Federal court shall remand such action to such State court.

(4) Preservation of State jurisdiction

The securities commission (or any agency or office performing like functions) of any State shall retain

jurisdiction under the laws of such State to investigate and bring enforcement actions.

(5) Definitions

For purposes of this subsection, the following definitions shall apply:

(A) Affiliate of the issuer

The term “affiliate of the issuer” means a person that directly or indirectly, through one or more intermediaries, controls or is controlled by or is under common control with, the issuer.

(B) Covered class action

The term “covered class action” means—

(i) any single lawsuit in which—

(I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or

(II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or

(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which—

(I) damages are sought on behalf of more than 50 persons; and

(II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

(C) Exception for derivative actions

Notwithstanding subparagraph (B), the term "covered class action" does not include an exclusively derivative action brought by one or more shareholders on behalf of a corporation.

(D) Counting of certain class members

For purposes of this paragraph, a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action.

(E) Covered security

The term "covered security" means a security that satisfies the standards for a covered security specified in paragraph (1) or (2) of section 18(b) of the Securities Act of 1933, at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred, except that such term shall not include any debt security that is exempt from registration under the Securities Act of 1933

pursuant to rules issued by the Commission under section 4(2) of that Act.