Nos. 12-79, 12-86 and 12-88

IN THE

Supreme Court of the United States

CHADBOURNE & PARKE LLP,

Petitioner,

and

WILLIS OF COLORADO INCORPORATED,
BOWEN, MICLETTE & BRITT, INC. AND
SEI INVESTMENTS COMPANY,

Petitioners,

and

PROSKAUER ROSE LLP,

Petitioner,

v.

SAMUEL TROICE, *et al.*,

Respondents.

ON WRITS OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF *AMICI CURIAE* PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION, AARP AND NETWORK FOR INVESTOR ACTION AND PROTECTION IN SUPPORT OF RESPONDENTS

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IDENTITY OF *AMICI CURIAE* AND THEIR INTERESTS IN THE CASE[1]

Public Investors Arbitration Bar Association ("PIABA"), AARP and Network for Investor Action and Protection ("NIAP") respectfully submit this Brief as *Amici* in support of Respondents, Samuel Troice, *et al.* *Amici* support affirmance of the opinion of the Court of Appeals.[2] The resolution of this case will have a significant impact on the integrity of the securities markets and the remediation of fraud in those markets. The remediation of fraud is of particular concern to all *Amici*.

PIABA is an international bar association established in 1990 to promote the interests of public investors in securities and commodities arbitration and litigation. PIABA members include current and former state and federal securities regulators, securities professors, and experienced securities practitioners.

PIABA also publishes books and reports on securities arbitration and litigation, conducts regular CLE programs for its members, and communicates directly with governmental and quasi-governmental

1. Counsel signing this Brief for PIABA, AARP, and NIAP authored this Brief together with assistance from other members or representatives of their respective organizations. No counsel for any party in this case participated in any way in authoring this Brief. No person or entity other than the organizations identified here as *Amici* made any monetary contribution to the authorship or cost of filing of this Brief.

2. Petitioners and Respondents have consented to the filing of this Amicus Brief.

securities regulators, such as the Securities and Exchange Commission, the North American Securities Administrators Association, and the Financial Industry Regulatory Authority, on issues of interest to PIABA members and public investors. This Court, federal Circuit Courts of Appeal, and state supreme courts have permitted PIABA to appear as an *amicus curiae* in cases involving issues important to public investors' claims against their stockbrokers, financial advisors, securities and issuers.

AARP is a nonpartisan, nonprofit organization with a membership that helps people turn their dreams into real possibilities, strengthens communities and fights for issues that matter most to families, such as employment, healthcare, income security, retirement planning, affordable utilities and protection from financial abuse. AARP is dedicated to addressing the needs and interests of older workers, and strives through legal and legislative advocacy to preserve the means to enforce their rights.

AARP submits comments on legislative and regulatory proposals that address investment fraud, files amicus briefs in cases involving the securities laws, and opposes legislative efforts to limit the remedies of defrauded investors.

NIAP is a nonprofit organization with over 1,000 associate members. It represents investors and their interests. NIAP participates in proceedings before Congress and courts, and deals with the media. NIAP arose because of the Madoff fraud, but its efforts also extend to other forms of fraud and misconduct that victimize investors, including the Stanford fraud.

SUMMARY OF ARGUMENT

SLUSA, the Securities Litigation Uniform Standards Act, followed PSLRA, the Private Securities Litigation Reform Act, as an effort to curb abuses in class actions by "professional plaintiffs" involving publicly traded securities. Congress intended in enacting the PSLRA to protect statements by national *issuers* to promote raising capital and the efficiency of national capital markets. But Congress in enacting PSLRA and SLUSA did not intend in either statute to preclude the rights of defrauded purchasers of private offerings under state law or to preclude claims against anyone other than issuers in national markets. Nor did Congress intend to allow frauds in private offerings. Private litigants acting as private attorneys general have long been an important part of securities regulation under state law, given the significant volume of private offerings, many of which are used in fraudulent schemes. With the anticipated increase of private offerings after the passage of the Jumpstart Our Business Startups Act (or "JOBS Act"), private litigation is more important than ever in serving that purpose.

The standard crafted by the Court of Appeals properly balances those interests. An investor tricked into purchasing an illiquid private offering not traded in a national market should be permitted to invoke state law rights and remedies even if she sold covered securities to fund the purchase.

ARGUMENT

I. Private Remedies under State Law Provide Vital Protection for Investors Not Available Under Federal Law

Allowing defrauded investors to assert their own private rights of action is "'an indispensable tool'" crucial to "maintaining the integrity of domestic capital markets." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 321, n.4 (2007) (quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81 (2006)). Today, both state and federal laws regulate the purchase and sale of securities. But state law came long before federal law,[3] and the right of investors to sue has long been a critical component of state regulation of securities. Joseph C. Long, 12A Blue Sky Law § 9:151.27 (West 2012). As Professor Long observes:

> The civil recovery provisions of the state securities acts serve an important *public* function in the enforcement of those acts. The state securities agencies and criminal prosecutors simply have neither the staff nor the funds to fully enforce the acts. As a result, the investor bringing a civil recovery serves as a private attorney general.

Id. (original emphasis).

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3. Christopher R. Lane, 39 New Eng. L. Rev. 317, 321 (2005) ("[s]tate regulation began well before … the federal … laws …."); Jonathan R. Macy & Geoffrey P. Miller, Origin of the Blue Sky Laws, 70 Tex. L. Rev. 347, 348 (1991) (nearly exclusive state regulation for "more than a generation" before Securities Act of 1933).

As part of their enforcement scheme, state securities regulators rely heavily upon plaintiffs acting as private attorneys general, often with the benefit of fee shifting statutes, to enhance enforcement and ferret out fraud. Private plaintiffs acting as private attorneys general are often better positioned than public regulators to discover and pursue fraudulent schemes in the sale of investments. Private plaintiffs also provide states with an efficient means of increasing enforcement without increasing the size of government staffs or straining public finances.

Congress recognized before enacting SLUSA that the legislation had been criticized "as being an affront on Federalism and contrary to the recent trend towards reinforcing state rights."[4] Ultimately, Congress voted to pass SLUSA, but Congress said in doing so that it was "sensitive" to the importance of protecting individual states' decisions about how to conduct their own securities regulation schemes.[5]

Congress has recognized that "[p]rivate securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action."[6] This Court has acknowledged that "[n]othing in the PSLRA…casts doubt on [that] conclusion." *Tellabs,* 551 U.S. at 321, n.4. As with the PSLRA, Congress intended for SLUSA to prevent abuses

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4. SENATE REPORT NO. 105–182, S. REP. 105-182, 4, 1998 WL 226714, 3.

5. SENATE REPORT NO. 105–182, S. REP. 105-182, 4, 1998 WL 226714, 3.

6. HOUSE CONFERENCE REPORT NO. 104-369, H.R. CONF. REP. 104-369, 31, 1995 U.S.C.C.A.N. 730, 0, 1995 WL 709276, 26.

in class action litigation involving nationally traded securities,[7] but did not intend to preclude investors' individual rights to sue.[8] According to the testimony of Arthur Levitt, then the Chairman of the SEC to Congress, "private rights of action are not only fundamental to the success of our securities markets, they are an essential complement to the SEC's own enforcement program."[9] Congress has observed that "private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs."[10]

State law-based private securities litigation is also important because it provides remedies for financial wrongs not available under federal securities statutes. Investors can sue not only under state "blue sky" laws, but also under state common law for breach of fiduciary duty[11] and breach of contract.[12] Fiduciary duties under state

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7. *Dabit*, 547 U.S. at 80-82.

8. *See* footnote 17 below and accompanying text.

9. SENATE REPORT NO. 104-98, S. REP. 104-98, 8, 1995 U.S.C.C.A.N. 679, 687, 1995 WL 372783, 7.

10. HOUSE CONFERENCE REPORT NO. 104-369, H.R. CONF. REP. 104-369, 31, 1995 U.S.C.C.A.N. 730, 0, 1995 WL 709276, 26.

11. It "is clear that a broker owes a fiduciary duty of care and loyalty to a securities investor." *See, e.g., Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1049 (11th Cir. 1987) (citing *Dupuy v. Dupuy,* 551 F.2d 1005, 1015 (5th Cir. 1977) .

12. *See, e.g., Komanoff v. Mabon, Nugant & Co.*, 884 F. Supp. 848, 859-60 (S.D.N.Y. 1995); *Iowa Grain v. Farmers Grain and Feed Co.*, 296 N.W.2d 22, 24 (Iowa 1980).

common law have played an important role in securities enforcement since at least a half a century before the federal government passed its first securities laws. *See, e.g., Marvin v. Brooks*, 94 N.Y. 71 (1883).[13]

This Court held early on in its analysis of private rights under Securities and Exchange Act Rule 10b-5 that state law, not federal law, is the source of fiduciary duties and the private actions and remedies for the breaches of those duties. *Santa Fe Indus. v. Green*, 430 U.S. 462, 479-80 (1977). In *Stoneridge Inv. Partners v. Scientific-Atlanta, Inc.*, this Court repeated its caution against letting the federal securities laws interfere with the well "functioning and effective state-law guarantees" provided by actions for breaches of fiduciary duties. 552 U.S. 148, 161 (2008).

SLUSA can sometimes foreclose state law rights and remedies for investors.[14] Accordingly, the Court should construe SLUSA so that the statute does not preclude important state law rights and remedies when doing so

13. Even though the facts that support the elements of these fundamental state law causes of action form the core of almost all business relationships and have been traditionally regulated by state common law, they can still be precluded by SLUSA. *See, e.g., Gray v. Seaboard Sec., Inc.*, 126 F. App'x 14, 17 (2d Cir. 2005) (claims for breach of contract and negligence preempted by SLUSA); *Sofonia v. Principal Life Ins. Co.*, 465 F.3d 873, 875 (8th Cir. 2006) (claims for fraud, breach of fiduciary duty and unjust enrichment preempted by SLUSA); *In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d 845, 871 (D. Md. 2005) (claims for breach of fiduciary duty/constructive fraud, aiding and abetting breach of fiduciary duty, and unjust enrichment preempted by SLUSA).

14. *See* footnote 13 above.

would not serve the purpose of the statute. State common law breach of fiduciary duty actions provide an important remedy not available under federal law. "The federal securities statutes were modeled after the common law actions of fraud and deceit," not state fiduciary duty law. *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1049 (11th Cir. 1987). "Fraud is not the same as breach of fiduciary duty." *Id.* SEC staff has observed that "broker-dealers are generally not subject to a fiduciary duty under the *federal* securities laws."[15] Because "not every instance of financial unfairness or breach of fiduciary duty will constitute a fraudulent activity under § 10(b) or Rule 10b-5," the Court should be "wary of foreclosing common law breach of fiduciary duty actions which supplement existing federal or state statutes." *Gochnauer*, 810 F.2d at 1049.

II. Applying SLUSA to Disputes Regarding Non-Covered Securities Would Not Advance the Purpose of Either SLUSA or the PSLRA

Because SLUSA precludes application of state law, it should be narrowly construed so as to preserve legitimate state interests.

Congress explained that SLUSA "is designed to protect the interests of shareholders and employees of

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15. *Study on Investment Advisors and Broker-Dealers, Securities and Exchange Commission*, report by staff of the U.S. Securities and Exchange Commission, January 2011 available at <http://sec.gov/news/studies/2011/913studyfinal.pdf> at p. 54 (emphasis added).

public companies that are the target of meritless 'strike' suits."[16] In explaining its rationale for this preference, Congress said:

> It is important to note that companies cannot control where their securities are traded after an initial public offering. As a result, companies with *publicly-traded* securities cannot choose to avoid jurisdictions which present unreasonable litigation costs. Thus, a single state can impose the risks and costs of its peculiar litigation system on all *national issuers*.
>
> The solution to this problem is to make Federal court the exclusive venue for most securities fraud class action litigation involving *nationally traded* securities.[17]

Congress intended for the PSLRA to assist national issuers in raising capital, especially issuers in high tech businesses, and, accordingly, to increase the efficiency of capital markets. This was made plain in a Senate Report:

> Disparate, and shifting, state litigation procedures may expose *issuers* to the potential for *significant liability that cannot be evaluated in advance or assessed when a statement is made*.

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16. HOUSE CONFERENCE REPORT NO. 105-803, H.R. CONF. REP. 105-803, 13, 1998 WL 703964, 10 (emphasis added).

17. HOUSE CONFERENCE REPORT NO. 105-803, H.R. CONF. REP. 105-803, 15, 1998 WL 703964, 12 (emphasis added).

* * * * *

> Further, the Committee has found that this state class-action trend has had an impact beyond the number of, and dollar amounts involved in, the class actions filed. *This trend has created a ripple-effect that has inhibited small, high-growth companies in their efforts to raise capital, and has damaged the overall efficiency of our capital markets*. Specifically, the increased risk of state court class actions has had a chilling effect on the use of the "safe-harbor" and other important provisions of the 1995 Act. T*he safe harbor was intended to help get valuable financial forecasts and forward-looking information to investors, so that these investors could make decisions with as much information as possible*; as Thomas O'Hara of the National Association of Investors Corporation ("NAIC"), testified:
>
>> *The key to becoming successful with high-tech investments* is a willingness to recognize—and tolerate—the inherent volatility of the business *and access to crucial forward-looking information so an investor can make a wise decision.*[18]

In short, the PSLRA was intended to put an end to "strike suits" against *issuers*. Congress thought these suits were based on *alleged* misstatements—on *alleged*,

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18. S. Rep. No. 105-182, 2nd Sess. 1998, Report of the Committee on Banking, Housing and Urban Affairs, May 4, 1998, 1998 WL 226714, at *3. (emphases added).

and often *thinly* alleged, fraud—and would be brought by "plaintiffs' lawyers" if the market price of a newly issued security were to drop in a national market after issuance. Congress did not intend to protect third-party middlemen hatching fraudulent Ponzi schemes or to preclude the rights of the victims of those schemes.

This case has nothing to do with the protection of *issuers*—particularly high tech companies—against liability for statements whose legal consequences cannot be assessed in advance. This case has nothing to do with strike suits or with merely *alleged* fraud, let alone *thinly* alleged fraud. Nor does this case involve protecting the ability of high tech issuers to raise capital.

Congress was concerned about national issuers and publically traded securities. Issuers of limited private placements choose where they sell their securities, and can avoid jurisdictions they perceive as presenting unreasonable litigation costs. Private offerings also are a major source of fraud, and are a primary concern of state securities regulators and state law private securities litigation. Congress clearly intended to leave private, limited offerings outside of the scope of SLUSA. Allowing issuers in private placements the benefits of SLUSA preclusion would not advance the purposes of SLUSA. It would only serve to create additional obstacles for defrauded investors seeking to recover their losses.

Congress recognized when it enacted SLUSA the importance of maintaining the vital role of state law in regulating non-publicly traded securities. Congress found "that in order to avoid…thwarting…the purpose of the Private Securities Litigation Reform Act of 1995,

national standards for nationally traded securities must be enacted, *while preserving the appropriate enforcement powers of state regulators, and the right of individuals to bring suit*."[19] Congress explained:

> In recognition of this dual [state-federal] system, this legislation uses the approach that the National Securities Markets Improvement Act of 1996 ("NSMIA") employed…The Committee strongly notes that this legislation *only covers precisely those securities defined in the NSMIA*, principally those securities that are traded on national exchanges."[20]

Congress thus intended for SLUSA preclusion to be limited to publically traded securities, and clearly recognized the vital importance of state law regulation and remedies when dealing with non-publically traded securities, such as private placements.

III. Non-Covered Securities, including Regulation D Private Placement Offerings, are a Significant Source of Securities Fraud

Limited, private placement offerings are not "covered securities" under SLUSA. Congress crafted SLUSA to preserve the enforcement powers of state regulators, and the right of individuals to bring suit under state law for these non-covered securities.

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19. SENATE REPORT NO. 105–182, S. REP. 105-182, 8, 1998 WL 226714, 7 (emphasis added).

20. SENATE REPORT NO. 105–182, S. REP. 105-182, 5, 1998 WL 226714, 4 (emphasis added).

"Rule 506 permits a private issuer to sell unregistered securities to any 'accredited investor' and up to thirty-five other unaccredited purchasers, so long as certain requirements are met." *Brown v. Earthboard Sports USA, Inc.*, 481 F.3d 901, 905-06 (6th Cir. 2007). Regulation D imposes other limitations on private offerings. For example, "there must be no 'general solicitation' of purchasers of the securities; and…the securities must contain restrictions on their resale." *Thompson v. RelationServe Media, Inc.*, 610 F.3d 628, 642 n. 5 (11th Cir. 2010). With limited offerings and restrictions on resale, issuers of Regulation D offerings can choose to avoid jurisdictions they perceive as presenting unreasonable litigation costs.

The "professional plaintiffs"[21] at whom SLUSA was aimed are not likely to purchase private placements anticipating litigation. Private placements are sold primarily to accredited investors and generally have very limited liquidity. So the "professional plaintiffs" could not easily sell them after their lawyers had commenced abusive litigation for which they were purchased.

Rather, investors in Regulation D offerings generally were expected to be the very institutional investors whom Congress preferred to be in control of class action

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21. "Professional plaintiffs who own a nominal number of shares in a wide array of public companies permit lawyers readily to file abusive securities class action lawsuits." HOUSE CONFERENEC REPORT NO. 104-369, H.R. CONF. Rep. 104-369, 32, 1995 U.S.C.C.A.N. 730, 731, 1995 WL 709276, 27.

litigation under the PSLRA and SLUSA.[22] In enacting the PSLRA, Congress found that "increasing the role of institutional investors in class actions will ultimately benefit shareholders and assist courts by improving the quality of representation in securities class actions."[23] Because Regulation D offerings are not aimed at the "professional plaintiffs" purchasing a few shares in public companies targeted in the PSLRA and SLUSA, private offerings are not subject to the same concerns about "strike suits" that SLUSA was intended to curb.

Regulation D offerings, however, are fertile ground for defrauding investors. The North American Securities Administrators Association[24] lists private placements under Regulation D, Rule 506 among the top ten investor traps.[25] NASAA explains:

> Investors should be aware that, even in the case of legitimate issuers, private placement

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22. "The Conference Committee seeks to increase the likelihood that institutional investors will serve as lead plaintiffs…." HOUSE CONFERENCE REPORT NO. 104-369, H.R. CONF. REP. 104-369, 34, 1995 U.S.C.C.A.N. 730, 733, 1995 WL 709276, 28.

23. HOUSE CONFERENCE REPORT NO. 104-369, H.R. CONF. REP. 104-369, 34, 1995 U.S.C.C.A.N. 730, 733, 1995 WL 709276, 28.

24. NASAA is a voluntary association whose membership consists of 67 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico.

25. *See* 2011 NASAA's Top Investor Traps, available at <http://www.nasaa.org/3752/top-investor-traps/>.

> offerings are highly illiquid, generally lack transparency and have little regulatory oversight. In the United States, the federal exemption for private placement offerings provided under Rule 506 of Regulation D continues to be abused by criminals. Although properly used by many legitimate issuers, unscrupulous promoters use Rule 506 to cloak an otherwise fraudulent offering in legitimacy.[26]

Regulation D offerings constitute a significant and growing portion of the U.S. securities market. "In 2009, 26,485 Regulation D … offerings were filed with the SEC with an estimated offering total of $609 billion. That compares to 11,000 such offerings in 1996."[27] States cannot review these offerings before they are marketed to investors; the SEC generally does not review them either.[28] Rule 506 offerings are also exempt from registration under federal securities laws. *Topalian v. Ehrman*, 954 F.2d 1125, 1129 (5th Cir. 1992). With this minimal regulatory scrutiny, "Rule 506 offerings have become the favorite vehicle under Regulation D and many of them are fraudulent."[29]

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26. *See* 2011 NASAA's Top Investor Traps, available at <http://www.nasaa.org/3752/top-investor-traps/>.

27. *See* NASAA's Legislative Agenda Item No. 3 – Strengthen State/Federal Collaboration, available at <http://www.nasaa.org/issues-and-advocacy/legislative-agenda-3/>.

28. *See* NASAA's Legislative Agenda Item No. 3 – Strengthen State/Federal Collaboration, available at <http://www.nasaa.org/issues-and-advocacy/legislative-agenda-3/>.

29. *See* NASAA's Legislative Agenda Item No. 3 – Strengthen State/Federal Collaboration, available at <http://www.nasaa.org/issues-and-advocacy/legislative-agenda-3/>.

The passage of the JOBS Act[30] will inevitably and substantially increase the volume of largely unregulated private offerings, with their attendant opportunity for fraud and abuse. Indeed, earlier this year the SEC commenced an action against a promoter who represented that the JOBS Act allowed him to raise *billions* of dollars from investors in what appears to have been a completely fraudulent scheme to dupe investors.[31]

IV. SLUSA Can Preclude More Than Class Actions

This Court thought in *Dabit* that SLUSA would deny plaintiffs only the right to use "class-action" procedure, but would not deny any individual plaintiff or group of fewer than 50 plaintiffs the right to pursue a state law cause of action. 547 U.S. at 87. In fact, however, SLUSA can be stretched to do just that.

"Covered class actions" under SLUSA include both traditional, actual class actions, and other actions joined, consolidated or otherwise proceeding as a single action. 15 U.S.C. § 78 bb (f) (5) (b) (ii) (II). Lower courts have said that SLUSA applies to preclude state law claims even of plaintiffs who opposed joinder or consolidation of their claims with claims of others to aggregate to more than 50. *See, e.g., Backus v. Conn. Comm. Bank, N.A.*, 789 F. Supp. 2d 295, 301 (D. Conn. 2011) (SLUSA "does not limit … applicability" to consolidation "without a plaintiff's objection").

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30. Jumpstart Our Business Startups Act of 2012, 112 Pub. L. No. 106, 126 Stat. 314 (codified in scattered sections of 15 U.S.C.).

31. SEC Release 2013-73, April 25, 2013.

Stretching SLUSA at the top to expand the meaning of "in connection with the purchase or sale of a *covered* security" will necessarily stretch the result at the bottom. When the financial advisor for the 51st investor in a fraudulent limited offering advises the investor to sell her mutual funds to buy an unregistered, private offering and the investor files her own individual complaint based on state law principles of fiduciary duty, defendants will seek to consolidate her claim with those of the other investors and use SLUSA to preclude her state law rights. There will be no public market for her to liquidate the investment, which will not be listed on any national exchange. Nevertheless, the issuer and sellers will say the fraud was in connection with the sale of covered mutual fund shares, and therefore, the investor's state law claim is precluded by SLUSA. Congress never intended that result.

V. Conclusion

The Fifth Circuit standard for SLUSA preclusion in cases in which investors claim fraud in the purchase of uncovered securities strikes a proper balance among the competing interests of state and federal law, investor rights and protection, and preventing abuse in class action litigation involving nationally traded securities. The Court should affirm the opinion of the Court of Appeals.

Respectfully submitted,

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