No. 04-1371

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,

Petitioner,

v.

SHADI DABIT, on behalf of himself and all others similarly situated,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

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QUESTION PRESENTED

Whether the Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227, preempts state law "holder" class actions brought on behalf of persons who assert that they were induced by allegedly fraudulent statements or omissions to hold (*i.e.*, refrain from selling), as opposed to purchase or sell, securities?

STATEMENT PURSUANT TO RULE 29.6

Petitioner's corporate disclosure statement was set forth at page ii of its Petition for a Writ of Certiorari. There are no amendments to that statement.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit (Pet. App. 1a-52a) is reported at 395 F.3d 25 (2d Cir. 2005). The order of the district court (Pet. App. 53a-55a) is unreported.

JURISDICTION

The opinion and order of the court of appeals was entered on January 11, 2005. A petition for a writ of certiorari was filed on April 11, 2005 and granted on September 27, 2005. The jurisdiction of this Court rests upon 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The pertinent provisions of the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), 15 U.S.C. §§ 77p & 78bb(f),[1] Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder by the Securities Exchange Commission ("SEC"), 17 C.F.R. § 240.10b-5 (2005), are set forth in an appendix to this brief ("Br. App.").

In pertinent part and subject to inapplicable exceptions reproduced and appended to this brief, section 28(f) of the 1934 Act, as amended by SLUSA, provides:

> (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

1. SLUSA's amendments to section 16 of the Securities Act of 1933, 15 U.S.C. § 77p, and section 28(f) of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(f), are nearly identical. For ease of reference, Merrill Lynch hereafter cites only the 1934 Act amendment, 15 U.S.C. § 78bb(f).

> 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.

15 U.S.C. § 78bb(f)(1) (Br. App. 8a).

STATEMENT OF THE CASE

The question presented in this case requires this Court to construe the scope and meaning of the broad preemptive language Congress used when it enacted SLUSA. Congress expressly preempted (with certain specified statutory exceptions that are not at issue in this case) private covered class actions brought in either state or federal court that seek damages under state law theories for allegedly fraudulent devices, misrepresentations or omissions "in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1). Congress set forth SLUSA's preemptive scope and effect in extremely broad language: "*No* covered class action" which is "based upon the statutory or common law of any State" may be maintained in "any State or Federal court" "by *any* private party" who "allege[s]" either a misrepresentation of a material fact or a deceptive device or contrivance "in connection with the purchase or sale of a covered security." *Id.* (emphasis added).

Congress did not limit SLUSA preemption to suits brought by purchasers or sellers of securities, but rather provided for preemption of all class actions "by any private party" alleging misrepresentations or deceptive practices "in connection with" the purchase or sale of securities. The operative language of SLUSA's preemption provision that is relevant to this case, "in connection with the purchase or sale" of a covered security, tracks the language contained in section 10(b) of the 1934 Act, which this Court has broadly interpreted as not limiting coverage to deception of an identifiable purchaser or seller.

In the decision below, the court of appeals held that putative plaintiffs may avoid the preemptive scope of SLUSA and proceed

with their state law class actions if they allege that they held, rather than purchased or sold, securities as a result of the alleged misrepresentations. In so deciding, the court imported into SLUSA's preemption provision an extratextual purchaser-seller limitation. Yet, the purchaser-seller rule upon which the court relied was created by this Court on policy grounds as a standing limitation on the judicially created private damages remedy under section 10(b). This Court clearly has stated that the purchaser-seller standing rule is not a construction of the "in connection with the purchase or sale" language in section 10(b).

The court of appeals' interpretation of the scope of SLUSA's preemption provision as limited by the "purchaser-seller" standing rule is therefore inconsistent with the plain language and natural meaning of the broad statutory text. In addition, the court of appeals' decision frustrates the legislative scheme enacted in SLUSA, by which Congress sought to further a uniform national legal regime with respect to nationally traded securities by disallowing private class actions from proceeding under disparate state substantive and procedural standards.

As the Seventh Circuit concluded in a subsequent decision by Judge Easterbrook directly conflicting with the opinion below, "[i]t would be more than a little strange" if this Court's decision to limit the standing of non-traders to bring potentially vexatious and hypothetical claims under federal law "became the opening by which that very litigation could be pursued under state law, despite the judgment of Congress (reflected in SLUSA) that securities class actions must proceed under federal securities laws or not at all." *Kircher v. Putnam Funds Trust*, 403 F.3d 478, 484 (7th Cir. 2005), *reh'g denied*, No. 04-1495, 2005 U.S. App. LEXIS 7914 (7th Cir. May 2, 2005), *petition for cert. filed*, 74 U.S.L.W. 3232 (U.S. Sept. 29, 2005) (No. 05-409).

1. Statutory Background

a. Private Securities Litigation Reform Act of 1995

After years of fact-finding, reports and debate, Congress passed the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (the "PSLRA") (codified in part at 15 U.S.C. §§ 77z-1, 78u-4). The purpose of the PSLRA was to improve the efficiency of the capital markets and to foster economic growth by deterring frivolous and burdensome securities litigation and by improving the flow of information to the markets. *See* S. Rep. No. 104-98, at 4-7 (1995).

Among other things, the PSLRA implemented a number of "needed procedural protections to discourage frivolous litigation." H.R. Conf. Rep. No. 104-369, at 31-32 (1995). These included:

(1) Heightened pleading standards for federal securities fraud claims, *see* 15 U.S.C. § 78u-4(b)(1), (2); [2]

(2) A stay of discovery during the pendency of any motion to dismiss, *see* 15 U.S.C. §§ 77z-1(b), 78u-4(b)(3);

(3) Lead plaintiff provisions designed to ensure that a plaintiff with a significant stake in the litigation, rather than a class action lawyer, would control the case, *see* 15 U.S.C. §§ 77z-1(a)(3), 78u-4(a)(3); and

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2. The PSLRA "insists that securities fraud complaints 'specify' each misleading statement; that they set forth the facts 'on which [a] belief' that a statement is misleading is 'formed'; and that they 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'" *Dura Pharms., Inc. v. Broudo*, 125 S. Ct. 1627, 1633 (2005) (quoting 15 U.S.C. § 78u-4(b)(1), (2)). Further, the PSLRA requires plaintiffs to plead and prove that the misconduct alleged "'caused the loss for which the plaintiff seeks to recover.'" *Id*. (quoting 15 U.S.C. § 78u-4(b)(4)).

(4) Sanctions for frivolous litigation, *see* 15 U.S.C. §§ 77z-1(c), 78u-4(c).

Certain of these measures were designed to facilitate early dismissal of nonmeritorious actions or "strike suits," before the expenses of discovery and litigation might push defendants toward settlement rather than resolution on the merits. *See, e.g.*, *Dura Pharms., Inc. v. Broudo*, 125 S. Ct. 1627, 1633 (2005) (PSLRA's strictures are intended to make securities fraud actions "available, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause").

Substantively, the PSLRA established "a safe harbor for forward looking statements, to encourage issuers to disseminate relevant information to the market without fear of open-ended liability." H.R. Conf. Rep. No. 104-369, at 32; *see* 15 U.S.C. §§ 77z-2(c), 78u-5(c). "'Understanding a company's own assessment of its future potential would be among the most valuable information shareholders and potential investors could have about a firm.'" H.R. Conf. Rep. No. 104-369, at 43 (quoting testimony of former SEC Chairman Richard Breeden). The statutory safe harbor was therefore enacted to provide some measure of insulation from liability for a company's disclosure of projections and other forward-looking statements where such statements were accompanied by "meaningful cautionary statements," 15 U.S.C. §§ 77z-2(c)(1)(A), 78u-5(c)(1)(A), or where plaintiffs failed adequately to allege that such statements were made with "actual knowledge" of their falsity, 15 U.S.C. §§ 77z-2(c)(1)(B)(i), 78u-5(c)(1)(B)(i).

b. Securities Litigation Uniform Standards Act of 1998

Less than three years after the passage of the PSLRA, Congress enacted SLUSA "in order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the [PSLRA]." Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353,

§ 2, 112 Stat. 3227, 3227. In SLUSA, Congress enacted a provision of express preemption.

Specifically, SLUSA preempts any "covered class action based upon the statutory or common law of any State" brought "in any State or Federal court" in which "any private party" alleges a "misrepresentation or omission of a material fact" or "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). SLUSA provides that if such a state law class action is filed in state court, it may be removed to federal court, *see* 15 U.S.C. § 78bb(f)(2), and dismissed as preempted by federal securities law, *see* 15 U.S.C. § 78bb(f)(1).

A "covered class action" is defined as any single lawsuit (or group of lawsuits filed in the same court that involve common questions of law or fact) "in which damages are sought on behalf of more than 50 persons or prospective class members." 15 U.S.C. § 78bb(f)(5)(B).[3] A "covered security" is generally a nationally traded security that is listed or authorized for listing on certain national securities exchanges. *See* 15 U.S.C. § 78bb(f)(5)(E) (referring to 15 U.S.C. § 77r(b)(1)) (Br. App. 12a-13a, 7a). This definition of "covered security" leaves intact the states' police powers "to craft laws governing fraud occurring wholly within their borders . . . in face-to-face transactions." *Securities Litigation Uniform Standards Act of 1997: Hearings on S. 1260 Before the Subcomm. on Securities of the S. Comm. on Banking, Hous. & Urban Affairs*, 105th Cong. 46 (1997) (hereinafter, "*1997 Hearing on S. 1260*") (statement of then-SEC Chairman Arthur Levitt, Jr.).

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3. Derivative actions are specifically excluded from the definition of a "covered class action." *See* 15 U.S.C. § 78bb(f)(5)(B), (C). "The derivative form of action permits an individual shareholder to bring 'suit to enforce a *corporate* cause of action against officers, directors, and third parties.'" *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 95 (1991) (emphasis in original) (citation omitted).

SLUSA contains three carefully crafted categories of actions that are expressly preserved from preemption, *see* 15 U.S.C. § 78bb(f)(3) (Br. App. 8a-10a), none of which was present in the earlier versions of the bill and none of which mentions actions by holders of securities.

The first provision, the so-called "Delaware carve-out," 15 U.S.C. § 78bb(f)(3)(A), was the direct result of concerns expressed by the SEC Chairman that an early version of the bill might unintentionally preempt a significant and venerable body of corporate law, particularly in Delaware, relating to issuers' disclosure obligations in the context of mergers and other extraordinary transactions. *See 1997 Hearing on S. 1260*, *supra*, at 47-48. Thus, SLUSA expressly preserves state court jurisdiction over state law claims arising in the proxy solicitation or tender offer context relating to equity holders' decisions about how to vote in a tender offer or exchange offer, or in exercising dissenters' rights or appraisal rights. *See* 15 U.S.C. § 78bb(f)(3)(A)(ii).

The second exception to SLUSA's preemption expressly preserves state court jurisdiction of securities fraud suits "brought by a State or political subdivision thereof or a State pension plan." 15 U.S.C. § 78bb(f)(3)(B). Senator Sarbanes noted that there was no history of state and local governments "abus[ing] the system" as private securities plaintiffs. 144 Cong. Rec. S4811 (daily ed. May 13, 1998).

The third exception expressly preserves state court jurisdiction for actions under contractual agreements between issuers and indenture trustees to enforce the conditions of the indenture. *See* 15 U.S.C. § 78bb(f)(3)(C). This exception addressed concerns that the broad preemptive nature of SLUSA would prevent bondholders, through the indenture trustee, from enforcing certain negotiated contractual rights such as representations, warranties or covenants.

Additionally, SLUSA contains a savings clause clarifying that state securities commissions and agencies or offices performing similar functions retain their jurisdiction under state laws "to investigate and bring enforcement actions." 15 U.S.C. § 78bb(f)(4) (Br. App. 11a); *see also* H.R. Rep. No. 105-640, at 16 (1998). In fact, SLUSA enacted provisions to facilitate reciprocal subpoena enforcement among state securities regulators in order to enhance state enforcement abilities. Pub. L. No. 105-353, § 102, 112 Stat. 3227, 3233 (Br. App. 14a).

Senator Dodd, one of the Senate bill's sponsors, emphasized that SLUSA was a balanced piece of legislation that created a national standard for class action litigation involving nationally traded securities:

> It will not affect the ability of any state agency to bring any kind of enforcement action against any player in the securities markets;
>
> It will not affect the ability of any individual, or even a small group of individuals to bring a suit in state courts against any security, nationally traded or not; [and]
>
> It will not affect any suit, class action or otherwise, against penny stocks or any stock that is not traded on a national exchange.

144 Cong. Rec. S4791 (daily ed. May 13, 1998) (statement of Sen. Dodd); *see also* H.R. Rep. No. 105-640, at 9 (describing the exceptions to preemption); H.R. Conf. Rep. No. 105-803, at 13-14 (1998) (same).

2. Factual Background [4]

Petitioner Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") is a full-service financial services firm engaged in, among other things, underwriting securities offerings to the public, offering brokerage services and investment advice and providing research on approximately 3,000 publicly traded issuers worldwide.

On April 8, 2002, the New York Attorney General filed an *ex parte* motion and affidavit in a New York State court seeking an order to obtain testimony and other discovery from several Merrill Lynch research analysts and managers. The discovery was sought in an effort to support a public enforcement action (never initiated) relating to the content of ratings and research reports on Internet stocks by Merrill Lynch's research analysts. (A 73a-75a.) The State Attorney General, asserting broad enforcement power and potential remedies under New York's Martin Act (which does not require allegations of intent, reliance, damages or the purchase or sale of securities), *see* N.Y. Gen. Bus. Law §§ 352-359-h (McKinney 1996 & Supp. 2005), ultimately negotiated a settlement with Merrill Lynch.[5]

In the weeks following the New York Attorney General's court filings and the attendant media publicity, over 150 putative class actions were commenced against Merrill Lynch in no fewer than twenty jurisdictions nationwide. Of this number, over 140 asserted claims under section 10(b) of the 1934 Act and SEC Rule 10b-5 promulgated thereunder. These federal actions

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4. At this motion to dismiss stage of the proceedings, allegations of fact set forth herein – drawn from the Complaint or Amended Complaint and the exhibits thereto – are accepted as true only for purposes of review. *See Lemon v. Kurtzman*, 403 U.S. 602, 620 (1971).

5. Subsequently, the New York Attorney General, acting together with federal regulators (the SEC, the New York Stock Exchange and the National Association of Securities Dealers), reached a global settlement with many of the industry's full-service financial firms. *See SEC v. Bear, Stearns & Co.*, 2005 WL 217018 (S.D.N.Y. Jan. 31, 2005).

alleged that plaintiffs and the purported class members on whose behalf they claimed to act purchased securities of a variety of internet and high-technology companies based on allegedly false or misleading research reports issued by Merrill Lynch. Six other putative class actions, including Mr. Dabit's, sought relief under state law theories based on the same alleged conduct asserted in the federal securities complaints. *See* Pet. App. 55a.[6]

a. Plaintiff's Initial Complaint

Mr. Dabit, a former Merrill Lynch broker, commenced his diversity action in the United States District Court for the Western District of Oklahoma on April 26, 2002. (A 27a.) He asserted claims for compensatory and punitive damages for breach of fiduciary duty and breach of the covenant of good faith and fair dealing under Oklahoma common law. (A 43a-45a.)

Among other things, Mr. Dabit alleged that Merrill Lynch's research analysts "made materially false and misleading statements [in Merrill Lynch's research reports and recommendations] designed to encourage Plaintiff and Plaintiff's clients to purchase [48 different internet and technology] stocks." (A 38a ¶ 34.) The securities which were the subject of Mr. Dabit's complaint were identified on an exhibit attached to his complaint. (A 28a ¶ 1, 46a, 70a-71a.) He further alleged that when the New York Attorney General's allegations became known, "the price of certain stocks steadily declined, leaving Plaintiff and clients of Plaintiff who purchased these stocks at manipulation-inflated prices with substantial losses." (A 29a ¶ 5.)

Mr. Dabit asserted that he was induced to hold, as well as purchase, securities as a result of the alleged misrepresentations and that "had he been advised of the true facts, [he] would have

6. All six of these state law actions were dismissed by the district court as preempted by SLUSA. *See* Pet. App. 6a-7a. Plaintiffs in only two of the six actions appealed those determinations, both of which were addressed in the decision below. *See id.*

sold them and advised his clients to sell them well before the . . . [s]tocks dramatically declined in value." (A 29a ¶ 7.) His putative class action claims were brought on behalf of himself and all other former or current Merrill Lynch account executives who, while employed by Merrill Lynch, "*purchased* one or more of the [48] ML recommended securities . . . individually or on behalf of Brokers' clients at any time during the period from December 1, 1999 through December 31, 2000 (the 'Class Period')," and who suffered damages "as a result of *owning and holdin*g such ML Stocks during this time period, or who suffered damages as a consequence of the loss of clients due to ML's wrongful actions." (A 28a ¶ 1 (emphasis added).)

Merrill Lynch moved to dismiss Mr. Dabit's complaint as preempted by SLUSA because it was a class action brought under state law alleging that Merrill Lynch made material misrepresentations and omissions in connection with the purchase or sale of nationally traded securities. (A 22a.) The Oklahoma federal district court dismissed the complaint as preempted, with leave to replead. (A 47a-50a.)

b. Plaintiff's Amended Complaint

Mr. Dabit filed an amended complaint on October 21, 2002. This pleading remained essentially unchanged from the original complaint, except for a few word replacements. As the Second Circuit later described, "[i]n his amended complaint . . . Dabit replaced the original complaint's references to purchases of securities with references instead to the owning or holding of securities." (Pet. App. 5a-6a; *compare, e.g.*, A 29a, 37a-38a, 41a ¶¶ 5, 30, 34-35, 48 *with* A 53a, 60a-62a, 64a ¶¶ 5, 27, 31-32, 45.) Thus, for example, in his first complaint, Mr. Dabit had alleged that Merrill Lynch's research analysts "made materially false and misleading statements designed to encourage Plaintiff and Plaintiff's clients to purchase the ML Stocks." (A 38a ¶ 34.) In his amended complaint, he alleged Merrill Lynch's research analysts "made materially false and misleading statements

designed to encourage Plaintiff and Plaintiffs' clients to *continue to hold* the ML Stocks." (A 61a ¶ 31 (emphasis added).)

Mr. Dabit also substituted "owned and continued to own" for the word "purchase" in his putative class definition in paragraph 1 of his complaint. Thus in his amended complaint, he sought to represent himself and all other former or current Merrill Lynch brokers who "*owned and continued to own* one or more of the ML recommended securities" during the putative class period and "who suffered damages as a result of *owning and holding* such ML Stocks during this time period, or who suffered damages as a consequence of the loss of clients due to ML's wrongful actions further described herein." (A 52a ¶ 1 (emphasis added); *compare* A 28a ¶ 1.)

In both Mr. Dabit's initial complaint and the amended complaint, the asserted misstatements made by Merrill Lynch consisted of allegedly misleading research reports concerning publicly traded companies. The research reports published by Merrill Lynch consist of "detailed financial information and investment analysis," *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 176 (2d Cir.), *cert. denied*, 74 U.S.L.W. 3228 (U.S. Oct. 11, 2005) (No. 05-24), as well as recommendations such as "buy" or "accumulate," reflecting the research analyst's expectation of the subject stock's "appreciation potential" over the intermediate (within 12 months) and longer (12-24 months) term. *Id*. at 166. Merrill Lynch's research reports also contained "high" risk ratings which, as the Second Circuit found in the related federal class actions, "incontestib[ly]" disclosed "the risk of price volatility – and hence, the risk of implosion – on the face of every report." *Id.* at 176.

The gravamen of Mr. Dabit's amended complaint is that Merrill Lynch's allegedly false and misleading research reports caused the prices at which 48 specified securities were traded on the public markets to be artificially inflated. Mr. Dabit alleges that he and other brokers were damaged in the market value of

their holdings and in their client relationships when the New York Attorney General's investigation became public and the market prices for the various securities declined significantly. He asserts that "had [Plaintiff] been advised of the true facts, [he] would have sold [the securities] . . . well before the ML Stocks dramatically declined in value." (A 53a-54a ¶ 7.)

In an effort to circumvent SLUSA preemption, Mr. Dabit's amended complaint carefully attempts to avoid allegations that he purchased or sold securities during the putative class period in reliance on the alleged misstatements. *Cf. Kircher*, 403 F.3d at 482 ("Assuming that SLUSA's 'in connection with' [preemptive] language means 'able to pursue a private right of action after *Blue Chip Stamps*,' plaintiffs attempted to frame complaints that avoid any allegations of purchase or sale."). Nevertheless, virtually every aspect of Mr. Dabit's amended complaint alleges conduct by Merrill Lynch that is claimed to have affected the price at which securities were being purchased and sold. (*See, e.g.*, A 53a ¶ 4 ("[T]he price of the ML Stocks promoted by ML were artificially inflated as a result of the manipulative efforts of ML. . . . ML was able to, and did, manipulate the price of the ML Stocks, causing these stocks to trade at artificially inflated prices."); A 53a ¶ 5 (ML's conduct "prevent[ed] Plaintiff from selling his personally held stocks at minimal loss"); A 53a ¶ 6 (ML used "a variety of deceptive devices, artifices and tactics that are the hallmarks of stock manipulation"); *see also* A 59a-60a ¶ 26 (ML reports "were false and contained misleading statements, designed to artificially inflate and artificially support the price of the ML Stock").)

Mr. Dabit alleged further that Merrill Lynch interfered with the actual selling of securities:

> [Merrill Lynch] artificially propped up the price of various . . . [s]tocks by *refusing to execute and otherwise actively discouraging the execution of orders to sell these stocks. These efforts improperly*

> *restrained investor selling*, caused the supply of these stocks in the marketplace to be understated, caused the demand for the stocks in the marketplace to be overstated and, as a result, further caused the price of these stocks to be artificially inflated and/or maintained.

(A 54a-55a ¶ 11 (emphasis added).) Mr. Dabit also alleged that Merrill Lynch and various of its agents, affiliates and employees were selling the subject securities during the relevant period. (A 54a ¶ 9, A 63a ¶ 40.)

3. The Proceedings Below

The Judicial Panel on Multidistrict Litigation transferred the various pending actions, including Mr. Dabit's, to the Honorable Milton Pollack, Senior United States District Judge for the Southern District of New York, for coordinated pretrial proceedings. (Pet. App. 6a-7a; A 121a-129a; A 12a.) The Panel explained that it granted Merrill Lynch's motion for a transfer because Mr. Dabit's action "share[d] factual questions" with the federal class actions brought under section 10(b) of the 1934 Act. (A 123a.)

Merrill Lynch moved to dismiss Mr. Dabit's amended complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, on the ground that it was a "covered class action" proceeding under state law theories that alleged misrepresentations, omissions and manipulative and deceptive devices in connection with the purchase or sale of securities and, therefore, was preempted under SLUSA. (A 12a.) Judge Pollack granted the motion and dismissed the amended class action complaint as preempted, finding it self-evident that "[t]he claims alleged . . . f[e]ll squarely within SLUSA's ambit" because they were "based on the very same alleged series of transactions and occurrences asserted in the federal securities actions currently being coordinated before this Court." (Pet. App. 55a.)

Mr. Dabit appealed. Following oral argument, the Second Circuit requested answers from the SEC to specific posed questions. (A 5a-7a.) The SEC responded in an Amicus Brief (A 8a; Pet. App. 72a-100a) as follows: (1) The "in connection with" language in SLUSA has the same meaning as the phrase is used in section 10(b) of the 1934 Act (*see* Pet. App. 80a-83a); (2) adoption of a purchaser-seller limitation on SLUSA preemption is not consonant with either the statutory language or SLUSA's legislative purpose (*see* Pet. App. 88a-94a); and (3) where the statutory requirements are satisfied, SLUSA preempts class actions under state law that could not have been brought pursuant to section 10(b) and Rule 10b-5 (*see* Pet. App. 87a, 95a-99a).

4. The Decision Below

On January 11, 2005, the Second Circuit issued its opinion affirming in part and vacating in part the district court's decision. (Pet. App. 1a-52a.) The Second Circuit held that the judicially crafted purchaser-seller standing rule that was adopted by this Court in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), as a standing limit on implied private rights of action for money damages under section 10(b) of the 1934 Act also "applies as a limit on SLUSA's 'in connection with' requirement such that SLUSA does not preempt claims that do not allege purchases or sales made by the plaintiff or the alleged class members." (Pet. App. 3a-4a.) In so importing this judicially crafted rule of standing into SLUSA's enacted language, the Second Circuit disagreed with the SEC. (*See* Pet. App. 26a-36a.)

The court below began with the premise agreed upon and urged by all parties and the SEC – that interpretation of SLUSA's "in connection with" language should be undertaken by reference to the extensive body of law construing the same language in section 10(b). (Pet. App. 17a.) In next turning to the issue of whether so-called "holder" claims were preempted by SLUSA, the Second Circuit acknowledged that the purchaser-

seller limitation was a "rule of standing" (Pet. App. 24a), adopted by this Court in light of "policy considerations" (Pet. App. 25a). The court went on to note that "[t]he limitation on standing to bring private suit for damages for fraud in connection with the purchase or sale of securities is unquestionably a distinct concept from the general statutory and regulatory prohibition on fraud in connection with the purchase or sale of securities." (Pet. App. 27a.)

Nevertheless, the court concluded that "the fact that the standing rule is analytically distinct from the underlying prohibition on fraud does not compel the conclusion that SLUSA preempts more than the purchaser/seller category of private damage actions over which the 'in connection with' source language operates." (Pet. App. 28a.) To the contrary, "it is far more natural to suppose that Congress *meant to import* the settled standing rule along with the 'in connection with' phrase as a substantive standard." (*Id.* (emphasis added).) Presumably because it concluded Congress "meant to import" the judicially created standing rule into the "in connection with" statutory language, the court held that Congress in fact did so. The court so held despite the fact that the purchaser-seller standing limitation appears nowhere in SLUSA's language and despite the court's earlier recognition that the standing rule was a prudential, policy-based judicial limit which "is unquestionably a distinct concept from the general statutory and regulatory prohibition" encompassed in the statute's language.

Having "*suppose[d]* that Congress *meant to import*" a standing limitation as a substantive scope restriction that does not appear in the statute, the court then looked to legislative history to determine whether anything there *disproved* a theorized intent by Congress to do what the court concluded it must have meant to do without so saying. The Second Circuit relied upon statements by members of Congress that SLUSA would further the purposes of the PSLRA "by stemming the migration of claims from federal to state court." (Pet. App. 21a.)

From this the court below concluded, once again disagreeing with the SEC (*compare* Pet. App. 29a-35a *with* Pet. App. 88a-99a), that a broad statement of congressional intent was a statement of limitation and that SLUSA was intended to preempt *only* those state law class actions that were "capable of being brought under federal law." (Pet. App. 21a.)

The Second Circuit acknowledged that the legislative history "generally indicates a broad preemptive intent." (Pet. App. 31a). It also recognized in a parenthetical that "Congress may have been unaware of the existence of state law holding claims when it enacted SLUSA." (Pet. App. 32a). Yet despite these acknowledgments, the court appears to have placed great weight on its observation that "holder" claims were not listed among the "*examples* of *non*-preempted claims" noted in a statement by a single Senator. (Pet. App. 33a (emphasis added).) The court did not address the statute's limited and carefully crafted exceptions to preemption or the fact that holder claims are not included within those exceptions.

Applying the foregoing reasoning to Mr. Dabit's amended complaint, the Second Circuit held that Mr. Dabit's "holding" claims, as pled, were preempted by SLUSA because his putative class definition failed to exclude persons who also purchased securities during the putative class period. (Pet. App. 38a-39a.) The court concluded:

> Given the close relationship in most instances between a holding claim and the purchase of securities, and given SLUSA's manifest intent to preempt state-law claims alleging fraud in connection with an actual purchase, it is sensible to require a would-be "holding" lead plaintiff expressly to exclude from the class claimants who purchased in connection with the fraud and who therefore could meet the standing requirement for maintenance of a 10b-5 action.

(Pet. App. 43a.)

Having determined that properly pled "holder" claims are not preempted by SLUSA, the court permitted Mr. Dabit the opportunity to replead so as to exclude from his putative holder class any person who purchased securities during the class period after an alleged misrepresentation. (*See* Pet. App. 43a.)

In direct conflict with the decision below, the Seventh Circuit, in an opinion by Judge Easterbrook, held that claims by holders of mutual fund securities are preempted by SLUSA. *See Kircher*, 403 F.3d at 484. The Seventh Circuit concluded that the "in connection with the purchase or sale" language in SLUSA "is as broad as § 10(b) itself" and is not affected by "limitations on private rights of action to enforce § 10(b)," such as the purchaser-seller requirement rule adopted by the Court in *Blue Chip Stamps*. *Id.* "To say that SLUSA uses the same language as § 10(b) and Rule 10b-5 is pretty much to resolve the point." *Id.* at 483; *see also Disher v. Citigroup Global Mkts. Inc.*, 419 F.3d 649, 654-55 (7th Cir. 2005).

This Court granted certiorari in the wake of the split among the circuit courts on this important issue of federal statutory law.

SUMMARY OF ARGUMENT

The court of appeals erred in concluding that Mr. Dabit might plead a state law holder class action that could survive preemption under SLUSA. As a statute of express preemption, SLUSA's preemptive scope necessarily is determined by reference to the plain language and natural meaning of the statute. That language requires class actions asserting holder claims to be preempted.

The broad preemptive language Congress enacted in SLUSA does not limit preemption to suits brought by purchasers or sellers of securities, but rather provides for preemption of all class actions "by any private party" alleging misrepresentations or deceptive practices "in connection with" the purchase or sale of securities. It is not disputed that the

phrase "in connection with the purchase or sale" of securities in SLUSA's preemption provision has the same meaning as it does in section 10(b) of the 1934 Act. This Court has consistently and expressly held that the alleged fraud need not be perpetrated on an identifiable purchaser or seller of a security in order for it to be "in connection with" the purchase or sale of securities and therefore actionable under section 10(b), so long as the fraud "touches upon" or coincides with a securities transaction *by someone*.

The purchaser-seller standing limitation that this Court adopted in *Blue Chip Stamps* does not alter or construe the scope of section 10(b) coverage or the meaning of section 10(b)'s "in connection with the purchase or sale" language imported into SLUSA. As this Court has stated, most recently in its *O'Hagan* decision announced one year before the passage of SLUSA, the purchaser-seller rule is not a construction of the text or scope of section 10(b), but rather is a policy-based, judicially imposed standing limit on the availability of particular remedies (private damages actions) available to enforce section 10(b). There accordingly is no basis to import that standing rule to limit the plain language of SLUSA's preemptive scope.

Any contrary holding would frustrate the purposes of SLUSA and lead to an irrational statutory result. Holder claims are precisely among the type of claims that this Court in *Blue Chip Stamps* concluded were the most vexatious, having an *in terrorem* effect and settlement value wholly out of proportion to their underlying merit – or lack thereof. They rely on a paradoxical, speculative and potentially non-cognizable theory of damages that is based on the alleged ability of plaintiffs to benefit from asserted misrepresentations on an insider basis, at the expense of the marketplace. Yet under the court of appeals' reasoning, holder claims would survive preemption whereas claims by purchasers would be preempted and allowed to be brought only in federal court subject to the PSLRA's stringent pleading and proof standards (or not at all). Holder plaintiffs

would thus have at their disposal an arsenal of potential procedural and substantive state law remedies foreclosed to purchasers or sellers.

Such a result would not only be irrational. It would stand as an obstacle to the accomplishment of Congress' objectives in SLUSA – to promote uniformity in the national securities markets, to prevent flight of vexatious and unmeritorious class actions from federal to state court where they can escape the heightened standards of the PSLRA and to encourage companies' disclosures to the marketplace.

ARGUMENT

I. The Language and Natural Meaning of SLUSA Require Express Preemption of State Law Class Actions Asserting Holder Claims.

"If [a] statute contains an express pre-emption clause, the task of statutory construction must in the first instance focus on the plain wording of the clause, which necessarily contains the best evidence of Congress' pre-emptive intent." *CSX Transp., Inc. v. Easterwood*, 507 U.S. 658, 664 (1993); *see also Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 138 (1990) ("To discern Congress' intent we examine the explicit statutory language and the structure and purpose of the statute.").

In extremely broad express language, SLUSA preempts covered private class actions for damages brought by "any private party" based upon state law. It provides that "no covered class action" which is "based upon the statutory or common law of any State" may be maintained in "any State or Federal court" "by any private party" who "allege[s]" either a misrepresentation of a material fact or a deceptive device or contrivance "in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1). Covered class actions asserting "holder" claims fall within the scope of this broad express

preemption provision. Pursuant to SLUSA, holder class actions seeking damages under state law must be dismissed or, if initially filed in state court, may properly be removed to federal court and then dismissed. *See* 15 U.S.C. § 78bb(f)(1), (2).

A. Under the natural meaning of the phrase, state law holder claims allege misrepresentations "in connection with the purchase or sale" of a security.

The natural meaning of SLUSA's preemption clause "is conspicuous for its breadth." *FMC Corp. v. Holliday*, 498 U.S. 52, 58 (1990) (addressing ERISA's broad "relate to" preemptive language). This is especially true with respect to the broad "connection with" language which this Court has held to be, in the context of interpreting another statute and as a purely textual matter of natural meaning, unquestionably expansive in scope. *See New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 656 (1995) (interpreting ERISA).

In class actions asserting "holder" claims under state law, plaintiffs allege they were induced to hold, rather than to buy or sell, securities during the relevant class period. Such claims necessarily allege fraud or misrepresentations "in connection with the purchase or sale" of securities in at least three respects.

First, holder claims, including Mr. Dabit's, are premised on allegations that a misrepresentation or deceptive scheme inflated the company's publicly-traded share price. *See supra*, pp. 11-14 (allegations of amended complaint). Yet manipulation or misrepresentations that artificially inflate (or depress) trading prices of publicly-traded securities cannot occur without trading, *i.e.*, purchases and sales of securities. Here, the alleged fraud – that Merrill Lynch promoted (and, through its brokers, sold) securities by issuing allegedly misleading research reports and recommendations "designed to artificially inflate and artificially support the price of the ML Stock" (A 59a-60a ¶ 26) and allegedly "improperly restrained investor selling" further causing "the

price of these stocks to be artificially inflated" (A 54a-55a ¶ 11) – is in connection with actual purchases and sales of securities by market participants at prices affected by publicly disseminated research reports.

Second, holder class actions allege misstatements "in connection with the purchase or sale" of securities because they assert that as a result of the asserted misrepresentations, the plaintiffs *refrained from selling* securities at a point in time at which plaintiffs claim they otherwise would have. In other words, holders essentially assert that the alleged misrepresentations altered the timing of their sale of securities and they claim damages based on their missed opportunity to sell the securities at prices higher than what a later sale did or might garner once the alleged misrepresentations were revealed. Such a claim is naturally "in connection with the purchase or sale" of securities, whether that claim is characterized as one in which a plaintiff holds securities or as one in which a plaintiff refrains from selling securities. Mr. Dabit additionally alleges that Merrill Lynch and various of its agents, affiliates and employees were selling the subject securities during the relevant period. (A 54a ¶ 9, A 63a ¶ 40.)

Third, the damages sought to be recovered in holder claims are based on the allegedly diminished value at which the plaintiffs' securities eventually were sold or might yet be sold. Just as "[s]hares are normally purchased with an eye toward a later sale," *Dura Pharms.*, 125 S. Ct. at 1631, so also are shares held with an eye toward a later sale. To allege damages or loss as a holder, therefore, a plaintiff must allege actual or anticipated future sales of securities at collapsed market value. Whether the sale has actually been effectuated or is yet anticipated, the damages sought by holder claims are "in connection with the purchase or sale" of securities.

Notably, for a claim to fall within SLUSA's preemptive scope, the alleged misrepresentation need not necessarily be "in connection with the purchase or sale of securities" *by the*

plaintiff asserting such claims. It is sufficient that the alleged misrepresentation be in connection with the purchase or sale of securities *by someone*. Where Congress has intended to limit statutory coverage or liability only to acts directed to the actual purchasers or sellers of the securities in question, rather than broadly "in connection with" the purchase or sale of a security by someone through the impersonal securities exchanges, it has done so expressly. *See*, *e.g.*, 15 U.S.C. § 78r(a) (providing right of action for misleading statements in SEC filings to "any person . . . who, in reliance upon such statement shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance . . ."); 15 U.S.C. § 77k(a) (providing right of action by reason of a false registration statement to "any person acquiring" the security); 15 U.S.C. § 77*l*(a) (providing right to sue a seller of a security who had engaged in proscribed practices "to the person purchasing such security from him"); 15 U.S.C. § 78t-1(a) (providing right of action against someone who illegally trades on inside information "to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased . . . or sold . . . securities of the same class").

In SLUSA, by contrast, Congress employed the broader, impersonal language preempting claims by "*any* private party" asserting misrepresentations "*in connection with* the purchase or sale" of securities. (emphasis added.) Because every unique word in a statute must be interpreted as having distinct meaning, *see Dole Food Co. v. Patrickson*, 538 U.S. 468, 476-77 (2003) (statutes should be construed, if possible, so that "'every word has some operative effect'") (citation omitted), SLUSA should not be read as preempting only those claims that involve misrepresentations to a purchaser or seller of securities, rather than in connection with the purchase or sale of securities. *See also Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 383, 385 (1992) (petitioner's contention that a provision preempting state law "relating to rates, routes, or services" "only pre-empts the States from actually prescribing rates, routes, or services . . . simply reads the words 'relating to' out of the statute").

B. This Court has broadly construed the "in connection with" language of section 10(b) that is imported into SLUSA's preemption provision.

It is not disputed that the phrase "in connection with" in SLUSA has the same meaning as it does in section 10(b) of the 1934 Act, particularly because SLUSA amended the 1934 Act. *See Gustafson v. Alloyd Co.*, 513 U.S. 561, 570 (1995) ("[T]he 'normal rule of statutory construction' [is] 'that identical words used in different parts of the same act are intended to have the same meaning.'") (citation omitted); *accord IBP, Inc. v. Alvarez*, No. 03-1238, slip op. at 6-7, 10-13 (U.S. Nov. 8, 2005) (Court's construction of "principal activity" in one part of a statute held to have the same meaning in another part of the same statute).

Section 10(b) makes it unlawful for any person "[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 Commission may prescribe." 15 U.S.C. § 78j(b) (emphasis added). Every court of appeals to address SLUSA's preemptive scope, including the court below, has held that its "in connection with" language "has the same scope as its antecedent in section 10(b) and Rule 10b-5." *Kircher*, 403 F.3d at 482; *see also Dabit*, 395 F.3d at 34-36; *Rowinski v. Salomon Smith Barney Inc.*, 398 F.3d 294, 299 (3d Cir. 2005); *Falkowski v. Imation Corp.*, 309 F.3d 1123, 1129-31 (9th Cir. 2002), *amended on other grounds*, 320 F.3d 905 (9th Cir. 2003); *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1342-43 (11th Cir. 2002); *Green v. Ameritrade, Inc.*, 279 F.3d 590, 596-97 (8th Cir. 2002). If conduct falls within the broad prohibitory language of section 10(b), private state law covered class actions seeking damages for such conduct are preempted under SLUSA as well.

This Court has consistently adopted a broad reading of the phrase "in connection with the purchase or sale" of securities in the context of section 10(b) that does not limit coverage of the section to deception directed at or affecting identifiable purchasers or sellers. *See United States v. O'Hagan*, 521 U.S.

642, 658 (1997). Most recently, in *SEC v. Zandford*, 535 U.S. 813 (2002), the Court held that conduct may be "in connection with" the purchase or sale of securities even if the conduct did not affect the trading decisions of the defrauded parties or concern the value of securities, so long as the alleged fraud "coincided" with securities transactions by someone. *Id.* at 819-20. The Court held that a broker's "'scheme to defraud' . . . throughout [a] 2-year period during which [the broker] made a series of transactions [unknown to his clients] that enabled him to convert the proceeds of the sales of [his clients'] securities to his own use," was "in connection with" the securities transactions because the transactions were necessary to accomplish the allegedly fraudulent scheme. *Id.* at 820-21 ("The securities [transactions] and respondent's fraudulent practices [are] not independent events."). This Court rejected the broker's contention that his sales of the securities, because perfectly lawful in themselves, were separate events from the misappropriation of the proceeds – which occurred subsequently – and thus insufficient to violate section 10(b), *see id.* at 820, holding that "[i]t is enough that the scheme to defraud and the sale of securities coincide." *Id.* at 822.

Notably, in *Zandford* the defrauded party was not the person making investment decisions and the alleged fraud did not even concern the value of securities or the investment decisions – as it indisputably does in this case. Yet this Court went so far as to expressly reject the proposition that the "in connection with" language could be limited to violations related to "'market integrity or investor understanding.'" *Id.* at 818 (citation omitted). The Court noted that "neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act." *Id.* at 820; *see also id.* at 819 (noting that "the SEC has consistently adopted a broad reading of the phrase 'in connection with the purchase or sale of any security'"); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12-13 (1971) (holding actionable under section 10(b) "deceptive practices touching"

the sale of securities).[7] Thus, while *Zandford* refused to limit the scope of section 10(b) to fraud concerning the value of securities or investment decisions, it undeniably found such fraud to fall squarely within the scope of section 10(b).

Similarly, in *O'Hagan*, 521 U.S. 642, the alleged fraudulent conduct did not affect the investment decisions of the defrauded party and did not wrongfully induce anyone to purchase or sell securities. The Court held that Mr. O'Hagan violated section 10(b) and Rule 10b-5 when he defrauded his law firm's client by using the client's inside information concerning a planned tender offer to purchase the securities of the target company for his own account. The fraud against the third party (in that case, the client) who owned confidential information merely coincided with or touched upon securities transactions *by someone* (in that case, by the defendant himself, who used the misappropriated information to purchase or sell securities). *See id*. at 647-48, 659-59.

This Court stated explicitly and unequivocally that section 10(b), "as written, does not confine its coverage to deception of a purchaser or seller of securities; rather, the statute reaches any deceptive device used 'in connection with the purchase or sale of any security.'" *Id.* at 651 (citation omitted); *see also id.* at 658 (section 10(b)'s "language . . . requires deception 'in connection with the purchase or sale of any security,' not deception of an identifiable purchaser or seller").

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7. The SEC has frequently taken the position in formal adjudications that an alleged fraud need not concern the value of a particular security or aim at the purchase of a security to be "in connection with the purchase or sale," so long as it "coincided with" or subsequently resulted in nonfraudulent purchases or sales by someone. *See, e.g.*, *In re Orlando Joseph Jett*, File No. 3-8919, 2004 SEC LEXIS 504, at *69-73 (Mar. 5, 2004) (employer required to purchase securities to effectuate what were previously illusory exchanges); *In re Scott Simon Fraser*, File No. 3-11271, 2003 SEC LEXIS 2269, at *6 (Sept. 25, 2003); *In re Genesis Trading*, File No. 3-10194, 2000 SEC LEXIS 858, at *6-10 (May 1, 2000).

> [A] fiduciary's fraud is consummated . . . when, without disclosure to his principal, he uses [confidential] information to purchase or sell securities. The securities transaction and the breach of duty thus coincide. *This is so even though the person or entity defrauded is not the other party to the trade*. . . . "[A] fraud or deceit can be practiced on one person, with resultant harm to another person or group of persons."

Id. at 656 (emphasis added) (quoting Barbara Bader Aldave, *Misappropriation: A General Theory of Liability for Trading in Nonpublic Information*, 13 Hofstra L. Rev. 101, 120 (1984)); *id.* at 660 ("We . . . note again that § 10(b) refers to 'the purchase or sale of any security,' not to identifiable purchasers or sellers of securities.").

Significantly, *O'Hagan* involved a criminal prosecution, in which principles of lenity applicable to criminal statutes would mitigate against a broad reading of a statutory provision, if ambiguous. *See O'Hagan*, 521 U.S. at 679 (Scalia, J., concurring in part, dissenting in part). Nevertheless, the majority adopted the broad reading of the "in connection with" language. The purchase or sale of a security can be executed by *anyone* coincidentally with or as a result of the alleged fraud and need not be by the defrauded party in order for the alleged fraud to be "in connection with the purchase or sale" of securities.

There can be no doubt, and there is no dispute, that holder claims involving publicly traded securities allege that the purchase and sale of securities *by someone* coincide with the alleged wrongdoing. In fact, the fraud asserted in holder claims is completed only when some investors are induced by the misrepresentation to trade in securities, because only when there are securities transactions can prices be artificially inflated. Indeed, the "in connection with the purchase or sale"

requirement is met where, as here, the complaint alleges that misrepresentations or omissions are disseminated in a public medium to the marketplace. *See Basic Inc. v. Levinson*, 485 U.S. 224, 235 n.13 (1988) ("Rule 10b-5 is violated whenever assertions are made, as here, in a manner reasonably calculated to influence the investing public . . . if such assertions are false or misleading or so incomplete as to mislead. . . .") (ellipsis in original) (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 862 (2d Cir. 1968) (en banc)).[8]

Indeed, unlike *Zandford* or *O'Hagan* (where the Court nevertheless found misstatements "in connection with the purchase or sale" of securities), the alleged misstatements at issue here – Merrill Lynch's research reports – addressed the value of the underlying securities with the alleged aim of influencing investment decisions to purchase or sell. Here, Mr. Dabit alleges that Merrill Lynch "published two types of reports which were received by investors" (A 60a ¶ 28); that he was misled into "believing in the honesty and integrity of . . . the ML Stocks' market prices as presented by ML" in the reports

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8. The Second Circuit's interpretation in *Texas Gulf Sulphur* of "in connection with the purchase or sale" as encompassing statements reasonably calculated to influence the investing public has been widely accepted and adopted by several circuit courts of appeal. *See Semerenko v. Cendant Corp.*, 223 F.3d 165, 175-76 & n.5 (3d Cir. 2000); *Herpich v. Wallace*, 430 F.2d 792, 805-06 (5th Cir. 1970); *Britt v. Cyril Bath Co.*, 417 F.2d 433, 435-36 (6th Cir. 1969); *SEC v. Dolnick*, 501 F.2d 1279, 1283-84 (7th Cir. 1974); *McGann v. Ernst & Young*, 102 F.3d 390, 392-94 (9th Cir. 1996); *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90, 101-02 (10th Cir. 1971).

The SEC likewise has consistently adopted the reasoning of *Texas Gulf Sulphur* in formal adjudications. *See, e.g., In re Benjamin C. Snyder*, File No. 3-10871, 2002 SEC LEXIS 1619, at *4-5 (June 25, 2002) (dissemination of false or misleading information over the internet held "in connection with the purchase or sale" even in the absence of any allegations of price inflation or purchases and sales); *In re Charles Plohn & Co.*, File No. 3-4243, 1975 SEC LEXIS 2559, at *49-50 (Oct. 6, 1975); *In re Martin Herer Engelman*, 52 S.E.C. 271, 283 (1995).

(A 60a ¶ 27); that he "relied upon the reports and ratings which ML knew were not accurate and not correct" (A 60a ¶ 28); and that the reports "effect[ed] an artificial inflation and artificial price of the ML Stocks" (A 62a ¶ 34). Such claims fall within the core of statements "in connection with the purchase or sale" of securities, whether or not the defrauded party or plaintiff (rather than someone else) is the actual purchaser or seller of securities. They thus come within the express language of SLUSA's broad preemptive scope.

C. The *Blue Chip Stamps* purchaser-seller standing limitation is not a construction of section 10(b) and thus is not imported into SLUSA.

Although correctly recognizing that SLUSA's "in connection with" language tracks that of section 10(b) and should be construed as having a coextensive scope, the court below went astray when it concluded that the purchaser-seller standing requirement limits the broad prohibitory language enacted by Congress in section 10(b) itself – and therefore limits SLUSA's preemptive scope as well. The standing rule of *Blue Chip Stamps* was adopted by this Court as a *judicially crafted limit* on a *judicially inferred* private remedy to enforce section 10(b), and not as an interpretation of the broad language of section 10(b).

The private damages remedy is one of several available to enforce section 10(b) violations, the others of which are not limited by this standing requirement.[9] In numerous decisions, this Court has stated that the purchaser-seller rule is not based upon a construction of, is not coextensive with and is not even required by the statutory language of section 10(b). It instead

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9. For example, the "purchaser-seller" rule does not limit the SEC's broad enforcement authority under section 10(b), *see Zandford*, 535 U.S. at 819-25, or the federal government's authority to prosecute criminal violations of the securities laws, *see O'Hagan*, 521 U.S. at 651; *United States v. Naftalin*, 441 U.S. 768, 771-73 & n.4 (1979).

constitutes a policy-based standing limit on one of several available remedies to enforce section 10(b). There accordingly is no basis for importing the purchaser-seller restriction applicable to a subset of section 10(b) private enforcement actions into SLUSA's preemption provision.

This Court itself, when it announced the purchaser-seller standing rule in *Blue Chip Stamps*, expressly rejected the suggestion that this limitation could be "divine[d] from the language of § 10(b)." 421 U.S. at 737; *see also id*. at 748-49 ("No language in either of these provisions [section 10(b) and Rule 10b-5] speaks at all to the contours of a private cause of action for their violation."). Rather, the Court considered "what may be described as policy considerations" in arriving at the standing limitation, *id.* at 737, and concluded that there were sufficient advantages to the purchaser-seller rule "purely as a matter of policy." *Id*. at 739. As Judge Easterbrook noted:

> *Blue Chip Stamps* came out as it did not because § 10(b) and Rule 10b-5 are limited to situations in which the plaintiff itself traded securities, but because a private right of action to enforce these provisions is a judicial creation and the Court wanted to confine these actions to situations where litigation is apt to do more good than harm.

Kircher, 403 F.3d at 483.

This Court noted that its standing rule would not limit the prohibitory scope of the enacted language of section 10(b) because "[o]ur decision in *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969), established that the purchaser-seller rule imposes no limitation on the standing of the SEC to bring actions for injunctive relief under § 10(b) and Rule 10b-5." *Blue Chip Stamps*, 421 U.S. at 751 n.14. Rather than limiting the scope of the language of section 10(b), the Court determined that the "private cause of action which has been judicially found to exist" under Rule 10b-5 should be "judicially delimited." *Id.* at 749.

The Court expressly recognized that its extratextual, prudential rule of standing would limit some federal claims that otherwise fall within the scope of the statutory language, because it noted the rule would preclude some shareholders from recovering, in a private action, damages caused by fraud "in connection with the purchase or sale" of securities. *See id.* at 738-39.

Even before adoption of the purchaser-seller standing requirement in *Blue Chip Stamps*, this Court was careful to distinguish between the broad coverage of the text of the statutory provisions of the securities laws and judicial limits that may be imposed on private actions brought to enforce them. *See, e.g., SEC v. National Sec., Inc.*, 393 U.S. at 467 n.9 ("in connection with the purchase or sale of any security" is "relevant only to the question of statutory coverage," and in a case brought by the Commission "there are no [*Birnbaum*] 'standing' problems lurking in the case"); *see also Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 382 (1970) (in construing a statutory provision of the securities laws, noting the distinction between the effect of an interpretation on actions for "private redress" and "enforcement actions by the Securities and Exchange Commission itself"); *see also Eason v. General Motors Acceptance Corp.*, 490 F.2d 654, 657-58 (7th Cir. 1973) (Stevens, J.).

In virtually every pertinent decision after *Blue Chip Stamps*, this Court could not have been "plainer in holding that the questions of liability and relief are separate in private actions under the securities laws." *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 64 (1975); *see also Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 172-73 (1994) (distinguishing between "the scope of conduct prohibited by § 10(b)," and "the elements of the 10b-5 private liability scheme," citing *Blue Chip Stamps* as an "elements" case).

Thus, this Court has consistently described the purchaser-seller requirement of *Blue Chip Stamps* as a rule of standing for one subset (private damages actions) of the types of remedies

available to enforce section 10(b), and not as a construction of the statutory scope or language of section 10(b). *See, e.g.*, *Chiarella v. United States*, 445 U.S. 222, 238 n.* (1980) (Stevens, J., concurring) ("[T]he limitation on the right to recover pecuniary damages in a private action identified in *Blue Chip* is not necessarily coextensive with the limits of [Rule 10b-5] itself."); *United States v. Naftalin*, 441 U.S. 768, 774 n.6 (1979) ("This case involves a criminal prosecution. The decision in [*Blue Chip Stamps*], which limited to purchasers or sellers the class of plaintiffs who may have private implied causes of action under [SEC] Rule 10b-5, is therefore inapplicable.") (citing *National Sec.*, 393 U.S. at 467 n.9).

More recently, in the years preceding passage of SLUSA, the Court was unequivocal in stating that the *Blue Chip Stamps* standing requirement does not limit the language or scope of section 10(b) or Rule 10b-5. In *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992), four concurring members of this Court – who would have decided the case on other grounds than those addressed by the majority – stated clearly that "[t]he purchaser/seller standing limitation in Rule 10b-5 damages actions . . . does not stem from a construction of the phrase 'in connection with the purchase or sale of any security.'" *Id.* at 284 (O'Connor, J., joined by White and Stevens, JJ., concurring in part and concurring in the judgment); *see also id.* at 289-90 (Scalia, J., concurring in the judgment) ("[T]he limitation we approved in *Blue Chip Stamps* was essentially a legislative judgment rather than an interpretive one.").

Those clear statements by the concurring Justices in *Holmes* were adopted by a majority of the Court in *O'Hagan*, 521 U.S. at 664-65 (citing concurring opinions of Justice O'Connor and Justice Scalia in *Holmes*), one year before SLUSA was adopted. The Court in *O'Hagan* articulated clearly its settled understanding of the scope of section 10(b) as not limited by the purchaser-seller standing requirement: "The provision, as written, does not confine its coverage to deception of a

purchaser or seller of securities; rather the statute reaches any deceptive device used 'in connection with the purchase or sale of any security.'" *Id.* at 651 (citation omitted). The Court acknowledged that "[w]e so confined the § 10(b) private right of action because of 'policy considerations.'" *Id.* at 664 (quoting *Blue Chip Stamps*, 421 U.S. at 737). To hold otherwise would mean that *O'Hagan* must be overruled because the defrauded party there was not a purchaser or seller of securities.

It has therefore been the longstanding and consistent view stated by the Court that the purchaser-seller requirement of *Blue Chip Stamps* is a prudential rule of standing and not a construction of section 10(b). Accordingly, there is no basis to conclude that the purchaser-seller standing requirement limits the broad language of SLUSA's preemption provision to less than its natural and understood meaning. Under that meaning, a class action asserting "holder" claims under state law seeks recovery from the effects of misrepresentations on the trading price of securities and, therefore, from misrepresentations "in connection with the purchase or sale" of securities.

II. Importing into SLUSA the Purchaser-Seller Standing Limitation Would Frustrate Congress' Purpose and Lead to an Absurd Interpretation of the Statute.

In the decision below, the Second Circuit did not purport to rely on the natural meaning of the "in connection with" language or upon the interpretation that the same language has been accorded in section 10(b). Yet its resort to legislative history to depart from the established natural, broad meaning of the language used in SLUSA's preemption provision and importation of a judicial rule of standing, which finds no support in the text of the statute, must be rejected. "We must give effect to this plain language [of the preemption provision] unless there is good reason to believe Congress intended the language to have some more restrictive meaning." *Shaw v. Delta Air Lines, Inc.*, 463

U.S. 85, 97 (1983). Here there is no reason to suppose that Congress intended to depart from the statute's natural meaning.

Rather, adoption by this Court of the Second Circuit's unnatural, constricted reading of SLUSA's preemptive language would lead to an irrational statutory result and is contrary to the legislative history. It also would frustrate the comprehensive legislative scheme adopted by Congress. Such a reading accordingly must be rejected under ordinary statutory interpretation rules, as well as principles of implied preemption. *See, e.g.*, *Buckman Co. v. Plaintiffs' Legal Comm.*, 531 U.S. 341, 352 (2001) (finding implied preemption notwithstanding express preemption provision) (citing *Geier v. American Honda Motor Co.*, 529 U.S. 861 (2000)).

A. Congress enacted SLUSA to curb the filing of securities class actions in state courts.

SLUSA marked the third of a series of major Congressional enactments between 1995 and 1998 designed to further dramatically the development of a uniform nationwide regime of securities law. These enactments modified the Securities Act of 1933 ("1933 Act") and the 1934 Act, both of which were "landmark pieces" of legislation that established the modern securities markets. *Central Bank*, 511 U.S. at 170-71. "The 1933 Act regulates initial distributions of securities, and the 1934 Act for the most part regulates post-distribution trading." *Id.* at 171.

By 1995, Congress found that the number of private securities fraud class actions filed in the United States had grown dramatically, with adverse effects upon the productivity and competitiveness of U.S. businesses. *See* S. Rep. No. 104-98, at 8-10 (1995). Virtually since the initial recognition by this Court of the private damages remedy under section 10(b) and Rule 10b-5, "[t]here has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in

general." *Blue Chip Stamps*, 421 U.S. at 739. This is because large extracted settlements and discovery abuses can result from even unmeritorious complaints. *See id.* at 741 ("a plaintiff with a largely groundless claim [can] simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value" out of proportion to the underlying merits); *accord Dura Pharms.*, 125 S. Ct. at 1634.

The growth in national securities class actions was fueled by the convergence of at least two factors: (1) the liberalization of Rule 23 of the Federal Rules of Civil Procedure in 1966, which substantially expanded the availability of the class action device;[10] and (2) this Court's decision in 1988 permitting plaintiffs to invoke the so-called "fraud on the market" presumption of reliance as a surrogate for actual reliance at the class-certification stage. *See Basic Inc.*, 485 U.S. at 242 (acknowledging that "[r]equiring proof of individualized reliance from each member of the proposed class effectively would have prevented respondents from proceeding with a class action, since the individual issues then would have overwhelmed the common ones").

Among other things, Congress heard reports that it had become commonplace for plaintiffs and their attorneys to file securities class actions with form complaints immediately upon (even just hours after) a significant drop in an issuer's share price, with little or no apparent investigation of any alleged wrongdoing by the defendants or of the underlying merits of

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10. *See, e.g.*, Michael P. Dooley, *The Effects of Civil Liability on Investment Banking and the New Issues Market*, 58 Va. L. Rev. 776, 828-29 (1972) (cited in *Blue Chip Stamps*, 421 U.S. at 740) (explaining that "[p]rior to 1966, a class action based on the existence of common questions was simply a permissive joinder device [binding only parties] . . . who appeared as intervenors in the action"). Under the changes in 1966, a putative class includes anyone who has not "opted out," thus vastly increasing the potential liability to issuers as well as the size of attorneys' fees for plaintiffs' counsel. *See id.* at 828-29.

the action. *See*, *e.g.*, S. Rep. No. 104-98, at 4, 8-9 (1995); H.R. Conf. Rep. No. 104-369, at 31 (1995).

The abusive practices sought to be curbed by the PSLRA included:

> (1) the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action;
>
> (2) the targeting of deep pocket defendants, including accountants, underwriters, and individuals who may be covered by insurance, without regard to their actual culpability;
>
> (3) the abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle; and
>
> (4) the manipulation by class action lawyers of the clients whom they purportedly represent.

H.R. Conf. Rep. No. 104-369, at 31.

To address these concerns, the PSLRA implemented a number of "needed procedural protections to discourage frivolous litigation." *Id*. at 31-32. *See supra* pp. 4-5.

Shortly after the passage of the PSLRA in 1995, a new phenomenon occurred: the plaintiffs' securities bar began to file class actions in state courts in order to avoid the myriad reforms and barriers Congress had enacted to stem abusive federal securities litigation. "Prior to the passage of the [PSLRA], there was essentially no significant securities class action litigation brought in State court." H.R. Rep. No. 105-640, at 10 (1998);

see also H.R. Conf. Rep. No. 105-803, at 14 (1998) (setting forth identical language).[11] Yet in its Report to the President and the Congress on the First Year of Practice Under the [PSLRA], "the SEC called the shift of securities fraud cases from Federal to State court 'potentially the most significant development in securities litigation' since passage of the [PSLRA]." H.R. Rep. No. 105-640, at 10 (citation omitted).

This rise in state court class actions undermined the PSLRA because "essentially none of the [PSLRA's] procedural or substantive protections against abusive suits are available" in state court. H.R. Rep. No. 105-640, at 10; *accord* H.R. Conf. Rep. No. 105-803, at 14-15. In actions that are permitted to proceed under state law, plaintiffs can, for example, proceed under more lenient pleading standards; seek punitive damages; seek to bring claims based on forward-looking statements that would otherwise be covered by the federal safe harbor; and utilize the "*in terrorem*" effects of discovery (which, in many state court actions, is not stayed pending disposition of a motion to dismiss) to extract settlements disproportionate to the actual merits of the action.

As highlighted by Representative Eshoo – co-sponsor of the House SLUSA bill – in her testimony before the Senate:

> Migration to State courts is not a minor problem. It represents an undermining of the core

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11. Both reports cited Joseph A. Grundfest & Michael A. Perino, *Securities Litigation Reform: The First Year's Experience: A Statistical and Legal Analysis of Class Action Securities Fraud Litigation under the Private Securities Litigation Reform Act of 1995*, Stanford Law School (Feb. 27, 1997). *See also 1997 Hearing on S. 1260*, *supra*, at 68 (prepared statement of Michael A. Perino) (in 1992, 1993 and 1994, respectively, there were 4, 1 and 1 state class actions alleging fraud in the sale of a publicly traded security); 144 Cong. Rec. H6063 (daily ed. July 21, 1998) (statement of Rep. Deutsch) (noting that by comparison to prior years, there had been a 6000% increase in state securities class action filings after the passage of the PSLRA).

> reforms implemented in the [PSLRA]. This is because the [PSLRA] relies on uniform application and enforcement of the law to be effective. Without this uniform standard, the law is undermined, the strike suits continue and companies and investors are held hostage. This is particularly true for the two key elements of the [PSLRA]: Safe Harbor [for Forward Looking Statements] and Stay of Discovery.

1997 Hearing on S. 1260, supra, at 7. Congress recognized that the shift of class actions to state court could become more acute in the future because "without a national standard for liability, the potential threat is always there that one State will change its laws in such a way as to become the haven for litigation." *Id*. at 15 (opening statement of co-sponsor Sen. Dodd).

In response to these concerns, several bills were introduced in both the House of Representatives and the Senate. The first bill introduced in the House would have preempted, without exception, all private civil actions under state law which alleged "a misrepresentation or omission in connection with the purchase or sale of any covered security" or "that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of any covered security." H.R. 1653, 105th Cong. § 2 (1997). Another House bill would have limited preemption to state law class actions, rather than to all private securities actions brought under state law. The latter bill also contained a removal provision. *See* H.R. 1689, 105th Cong. § 2 (1997).

In the Senate, Senators Gramm, Dodd, Domenici and ten co-sponsors introduced their own version of the legislation. *See* S. 1260, 105th Cong. (1997). This bill mirrored the latter House bill except that it applied only to nationally traded securities and securities of investment companies. *See id.* § 2.

Senator Dodd explained the rationale for preemption of state securities fraud causes of action:

> In general, I believe that the 1995 Reform Act . . . is working pretty well. In fact, . . . it's working so well on the Federal level that weaker claims have migrated from Federal courts to State courts. . . . a development that threatens, I think, the success that we have achieved to date in this general area.

See 1997 Hearing on S. 1260, *supra*, at 15 (opening statement of Sen. Dodd).

The final version of SLUSA was passed by unanimous consent in the Senate and by a vote of 319-82 in the House. *See* 144 Cong. Rec. S12,450 (daily ed. Oct. 1998); 144 Cong. Rec. H10,800-01 (daily ed. Oct. 13, 1998). President Clinton, who had vetoed the PSLRA, signed SLUSA into law on November 3, 1998.[12]

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12. SLUSA was enacted on the heels of another significant piece of legislation that constituted a further and significant tilt toward uniform national securities law standards. In 1996, Congress enacted the National Securities Markets Improvement Act ("NSMIA"), Pub. L. No. 104-290, 110 Stat. 3416 (codified in scattered sections of 15 U.S.C. §§ 77a, 78a, 80a-1, 80b-1), amending the 1933 Act, the 1934 Act and the Investment Company Act of 1940. Congress did so "to further advance the development of national securities markets and eliminate the costs and burdens of duplicative and unnecessary regulation." H.R. Rep. No. 104-622, at 16 (1996). The House Report noted that "the system of dual Federal and state securities regulation has resulted in a degree of duplicative and unnecessary regulation . . . that, in many instances, is redundant, costly, and ineffective." *Id*. The NSMIA preempts vast areas of state regulation governing the registration and offerings of nationally traded securities by, for example, prohibiting states from imposing any conditions on the content of proxy statements, reports to shareholders or other disclosure documents required to be filed with the SEC. *See* 15 U.S.C. § 77r(a)-(b).

B. The Second Circuit's construction of SLUSA would frustrate Congress' purpose and produce an absurd result that must be rejected.

In the face of SLUSA's carefully crafted provisions designed to prevent vexatious, potentially unmeritorious and burdensome class actions from migrating to state court, Congress most certainly did not intend to allow private securities class actions asserting "holder" claims to survive preemption, whereas state law class actions brought by purchasers and sellers of securities are undisputedly preempted by SLUSA. Any conclusion to the contrary would lead to an irrational result that must be rejected as a matter of statutory interpretation. *See Johnson v. United States*, 529 U.S. 694, 707 n.9 (2000) ("'[N]othing is better settled, than that statutes should receive a sensible construction, such as will effectuate the legislative intention, and if possible, so as to avoid an unjust or an absurd conclusion.'") (alteration in original) (quoting *In re Chapman*, 166 U.S. 661, 667 (1897)).

Holder claims present the greatest risk for the type of vexatious securities litigation that Congress sought to eliminate when it enacted SLUSA. As this Court stated in *Blue Chip Stamps*, the purchaser-seller rule limiting the availability of private redress under section 10(b) was desirable as a policy matter precisely to limit plaintiffs' ability to seek recovery for holder claims through private damage actions:

> [P]urchasers and sellers at least seek to base recovery on a demonstrable number of shares traded. In contrast, a putative plaintiff, who neither purchases nor sells securities but sues instead for intangible economic injury such as loss of a noncontractual opportunity to buy or sell, is more likely to be seeking a largely conjectural and speculative recovery in which the number of shares involved will depend on the plaintiff's subjective hypothesis.

Blue Chip Stamps, 421 U.S. at 734-35. *See also Kircher*, 403 F.3d at 483 ("The Justices [in *Blue Chip Stamps*] observed that

anyone can *say* that a failure to trade bore some relation to what the issuer did (or didn't) disclose, but that judges and juries would have an exceedingly hard time knowing whether a given counterfactual claim ('I *would have* traded, if only . . .') was honest.") (ellipsis in original).

The speculative nature of evidence and proof in holders cases thus presents a very real risk that the mere pendency of the action "has a settlement value to the plaintiff out of any proportion to its prospect of success at trial." *Blue Chip Stamps*, 421 U.S. at 740. Because such an action "will turn largely on which oral version of a series of occurrences the jury may decide to credit, . . . the case will be virtually impossible to dispose of prior to trial other than by settlement." *Id*. at 742. In holder actions, "bystanders to the securities marketing process" can "await developments on the sidelines without risk, claiming that inaccuracies in disclosure caused nonselling in a falling market and that unduly pessimistic predictions by the issuer followed by a rising market caused them to allow retrospectively golden opportunities to pass." *Id*. at 747.

By contrast to holder claims involving "would have"/"should have"/"could have" plaintiffs, purchasers' and sellers' claims are more readily demonstrable in objective terms. "The fact of purchase of stock and the fact of sale of stock are generally matters which are verifiable by documentation, and do not depend upon oral recollection, . . . [and] can normally be established by the defendant either on a motion to dismiss or on a motion for summary judgment." *Id*. at 742. And yet, under the Second Circuit's reasoning, state law class actions brought by purchasers or sellers of securities are preempted by SLUSA whereas the less verifiable class actions brought by holders of securities are not.

In addition to being among the most vexatious types of claims, holder claims are the least likely to present meritorious grounds for recovery of damages, especially on a class basis.

Holder claims are a relatively recent innovation that have been asserted largely subsequent to the passage of the PSLRA and SLUSA.[13] As the court below recognized, "Congress may have been unaware of the existence of state law holding claims when it enacted SLUSA." (Pet. App. 32a). Such claims arose and have vastly proliferated as artful pleading devices to attempt to avoid the preemptive scope of SLUSA.[14] *See Kircher*, 403 F.3d at 482 ("Assuming that SLUSA's 'in connection with' [preemptive] language means 'able to pursue a private right of action after *Blue Chip Stamps*,' plaintiffs attempted to frame complaints that avoided any allegations of purchase or sale.").

Yet holder claims rest, in essence, upon a paradoxical theory of recovery. Insofar as holders had been induced to purchase, as well as to hold, securities based on alleged misrepresentations (as Mr. Dabit initially pled in his original complaint), then these plaintiffs may seek recovery under section 10(b) as purchasers of securities. In such circumstances, state law holder claims are

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13. Holder claims, as applied to impersonal transactions on the national securities markets, are of recent vintage and the jurisdictions to address them have expressed disparate views as to the treatment of such cases. *See Manzo v. Rite Aid Corp.*, 2002 Del. Ch. LEXIS 147, at *2, *11-13 (Del. Ch. Dec. 19, 2002), *aff'd mem.*, 825 A.2d 239 (Del. 2003); *Small v. Fritz Cos.*, 65 P.3d 1255, 1265-66 (Cal. 2003); *Amzak Corp. v. Reliant Energy, Inc.*, 2004 U.S. Dist. LEXIS 16514, at *16-19 (N.D. Ill. Aug 18, 2004); *Rogers v. Cisco Sys., Inc.*, 268 F. Supp. 2d 1305, 1311-14 & n.18 (N.D. Fla. 2003); *Gordon v. Buntrock*, No. 99 CH 18378, at *6-15 (Ill. Cir. Ct. Ch. Div. July 19, 2004); *In re WorldCom, Inc. Sec. Litig.*, 336 F. Supp. 2d 310, 319-23 (S.D.N.Y. 2004).

14. In light of SLUSA's removal provisions, federal courts since 1998 have frequently confronted holder claims. *See* Pet. at 17 n.5. Published and electronically available decisions since the filing of the Petition for Certiorari include: *Disher*, 419 F.3d 649; *Felton v. Morgan Stanley Dean Witter & Co.*, 2005 U.S. Dist. LEXIS 19484 (S.D.N.Y. Sept. 6, 2005); *In re Lord Abbett Mut. Funds Fee Litig.*, 385 F. Supp. 2d 471 (D.N.J. 2005); *In re Eaton Vance Mut. Funds Fee Litig.*, 380 F. Supp. 2d 222 (S.D.N.Y. 2005); and *Sered v. Bristol-Myers Squibb Co.*, 2005 U.S. Dist. LEXIS 16433 (N.D. Ill. July 1, 2005).

a duplicative and, being inherently unreliable in terms of proof, a vexatious means of allowing additional class action attorneys to evade the heightened requirements of the PSLRA and to seek recovery from the coffers of corporations and their shareholders. *See, e.g.*, *1997 Hearing on S. 1260*, *supra*, at 3 (statement of Sen. Faircloth) ("[T]he core issue here is about stopping class action lawsuits that are designed to make certain lawyers rich at the expense of the private sector . . . [while the] shareholders collect pennies on the dollar. . . .").

Insofar as holders purchased prior to the asserted misrepresentations and were later induced by the misrepresentations to refrain from selling at artificially high prices, then they can have suffered no actual damages when the truth comes out in the market, much less suffered legally cognizable or nonspeculative damages. As Judge Friendly noted in *Levine v. Seilon, Inc.*, 439 F.2d 328 (2d Cir. 1971):

> [Plaintiff could not allege any injury] caused by [defendant's] representation since, according to the complaint, if the representation had not been made, the price of his stock would not have been inflated, and there would have been no gain to be realized by a sale.

Id. at 333-34. *See also Crocker v. FDIC*, 826 F.2d 347, 351 n.6 (5th Cir. 1987) (holders cannot allege any cognizable, lawful injury from an alleged misrepresentation because any profit plaintiffs could have made by selling their stock before the market learned the truth "would have resulted from insider trading in violation of the securities laws"); *see also id.* at 351-52.

The allegations in Mr. Dabit's amended complaint in fact underscore this paradox. Mr. Dabit does not allege when he or the putative class members purchased the securities or how the timing of those purchases related to the timing of the asserted

misrepresentations.[15] It is entirely possible that Mr. Dabit's seemingly arbitrary putative class period was constructed artfully simply to avoid alleging securities purchases in an attempt to avoid bringing federal claims subject to the burdens of the PSLRA. Such an attempt should be rejected as directly contrary to SLUSA. As Judge Easterbrook noted, "plaintiffs' effort to define non-purchaser-non-seller classes is designed to evade [the] PSLRA in order to litigate a securities class action in state court in the hope that a local judge or jury may produce an idiosyncratic award. It is the very sort of maneuver that SLUSA is designed to prevent." *Kircher*, 403 F.3d at 484.

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15. Mr. Dabit included no allegations as to why he began his putative class period as late as December 1, 1999 or why he ended it on December 31, 2000. He did not allege the dates on which the misrepresentations or falsified research reports were issued or how the timing of those misrepresentations related to when he purchased the securities in question. Nor did he allege when he might otherwise have sold the securities but for the misrepresentations. Mr. Dabit incorporated by reference the New York Attorney General's affidavit (A 55a ¶ 12) and exhibited it to his complaint (A 72a-117a), but the affidavit in turn stated that the alleged misstatements on the part of Merrill Lynch took place during a broader period, "[f]rom the spring of 1999 to the fall of 2001." (A 82a.)

It is entirely possible that, depending on when he purchased the securities included in his amended complaint, Mr. Dabit might be, with respect to some of the same securities, a member of the putative classes in purchaser class actions under section 10(b) that allege deceptively-induced purchases of securities during a period predating the start of Mr. Dabit's putative class period. *E.g.*, Civ. No. 02-CV-3452 (S.D.N.Y) (motion to dismiss pending) (Aether stock; class period Nov. 15, 1999 to Feb. 7 2001); Civ. No. 02-CV-7218 (S.D.N.Y.) (motion to dismiss pending) (CMGI stock; class period Mar. 23, 1999 to Oct. 27, 2000); Civ. No. 02-CV-3050 (S.D.N.Y.) (motion to dismiss pending) (Internet Capital stock; class period Aug 5, 1999 to Oct. 8, 2000); *see also In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 289 F. Supp. 2d 416 (S.D.N.Y. 2003) (dismissing complaint concerning eToys stock; putative class period July 17, 1999 to Nov. 8, 2000), *appeal pending*; *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 218 F.R.D. 408 (S.D.N.Y. 2003) (dismissing complaint concerning Doubleclick stock; putative class period Nov. 29. 1999 to Apr. 15, 2001), *appeal pending.*

The policy motivating the purchaser-seller rule in *Blue Chip Stamps* is wholly inapplicable to SLUSA. Indeed, in light of Congress' carefully crafted attempt in SLUSA to preempt those suits most subject to abuse, the Court should reject any reading of Congress' intent that would allow the most vexatious and unmeritorious holding claims (and artful pleaders) to survive or evade preemption, but that would preempt the generally more objectively verifiable claims. *See generally Clinton v. City of New York*, 524 U.S. 417, 429 (1998) (finding " no plausible reason why Congress would have intended to provide for" "special treatment of actions filed by natural persons" while precluding "entirely jurisdiction over comparable cases brought by corporate persons. Acceptance of the Government's new-found reading . . . 'would produce an absurd and unjust result which Congress could not have intended'") (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 574 (1982)).

Any such reading allowing state law holder class actions to proceed while barring purchaser class actions under state law must, moreover, be rejected under implied preemption principles because it would entirely frustrate the purposes of SLUSA. *See Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372-73 (2000) ("state law is naturally preempted to the extent of any conflict with a federal statute," including where the state law "'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress'") (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)); *see also Geier*, 529 U.S. at 881 (state common-law tort action that stood as an obstacle to important means-related federal objectives held preempted); *Perez v. Campbell*, 402 U.S. 637, 651-52 (1971) (state statutes that unintentionally frustrate the full effectiveness of federal law preempted).

C. Congress recognized SLUSA might foreclose some claims altogether.

Contrary to the court of appeals' supposition, there is no basis to believe that Congress intended only private securities class actions which might be brought under federal law to be preempted by SLUSA. Instead, Congress recognized when it sought to close the "federal flight loophole" through SLUSA that it might also be extinguishing altogether certain state law claims or remedies which could potentially leave investors with no effective federal or state legal recourse.

Congress adopted SLUSA's broad preemption provision over the opposition of many members of Congress, as well as witnesses and interested parties, who argued that "[p]reempting state remedies now – and requiring fraud victims to seek relief solely under the federal standards . . . could leave investors with severely limited ability to protect themselves against fraud." 144 Cong. Rec. S4797 (daily ed. May 13, 1998) (statement of Sen. Johnson).[16] In recommending in July 1998 the passage of

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16. *See also Hrg. Before the Subcomm. on Securities on S. 1260*, 105th Cong. 50 (1998) (prepared statement of Mary Rouleau, Consumer Federation of America) (SLUSA's "sweeping preemption" would "deny[] defrauded investors access to State court where most states recognize recklessness as a basis for liability, have a longer statute of limitations, and offer some form of aiding and abetting liability"); *Hrg. Before the Subcomm. on Fin. & Hazardous Mat'ls on H.R. 1689*, 105th Cong 9 (1998) (statement of Rep. Markey) ("It may well turn out that the ability to bring a class action lawsuit in State court may be the only meaningful way for some defrauded investors to recover financial losses in light of the severe, procedural, and substantive limitations established under the 1995 act. . . ."); 144 Cong. Rec. S4783-84 (letter from the Gov't Fin. Officers' Ass'n, et al. to Sen. Sarbanes) (objecting to absence of aiding and abetting liability and longer statutes of limitation and objecting to the "covered class action" definition); 144 Cong. Rec. S4787, S4794-96 (statement of Sen. Bryan) (no aiding and abetting or joint and several liability and 33 states have longer statute of limitations); *id*. at S4803-04 (statement of Sen. Cleland) (elimination of "more expansive investor protections" such as aider and abetter liability and longer statute of limitations "could be catastrophic for millions of Americans").

SLUSA over such opposition, the House Committee on Commerce stated in its concluding paragraph on "Background and Need for Legislation":

> The Committee heard testimony from opponents of the legislation, such as Ms. Mary Rouleau of the Consumer Federation of America (CFA), who testified that the bill was premature, unwarranted based on available evidence, harmful to investors, *and overly broad in its proposed preemption of State law*. The Committee believes that the overwhelming weight of the evidence available to it supports going forward with this bill at this time for the reasons previously noted.

H.R. Rep. No. 105-640, at 11 (1998) (emphasis added).

An additional dissent of Congressman Klink included with the Commerce Committee report stated of the legislation,

> I fear that the Committee is moving to cut off the state avenue for class action securities suits. That could mean that investors would have no ability to seek relief from securities wrongdoers, and that is unacceptable to me.
>
> . . . .
>
> Another question I have is, are we now saying to the states that we in Washington, DC, know better than the states what cases should go through state courts and which should not? . . . Are we next going to tell them they can't hear tobacco cases?

Id. at 52-53.[17]

17. In fact, that is what happened next. In the Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4, Congress amended the diversity jurisdiction statute, 28 U.S.C. § 1332, to give federal courts original jurisdiction of most class action litigation, making them removable to federal court. "Covered class actions" addressed by SLUSA are specifically excluded (Cont'd)

Despite these stated concerns, Congress nevertheless chose to enact SLUSA's broad preemptive language, aware that some investors might be left without a private class action remedy and that state law protections otherwise applicable to such class actions could be entirely displaced. In so doing, Congress manifested its intent to have federal law provide a uniform substantive as well as procedural standard for covered class action claims based on misrepresentations in connection with the purchase or sale of nationally-traded securities. That policy choice should be respected.

(Cont'd)

from the diversity jurisdiction and removal provisions enacted by the Class Action Fairness Act, "to avoid disturbing in any way the federal vs. state court jurisdictional lines already drawn in the securities litigation class action context [by SLUSA]." S. Rep. No. 109-14, at 45, 49-50 (2005).

CONCLUSION

The decision of the court of appeals should be reversed in relevant part with instructions that the holder claims should be dismissed with prejudice.

Respectfully submitted,

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APPENDIX

15 U.S.C. § 77p

§ 77p. Additional remedies; limitation on remedies

(a) Remedies additional

Except as provided in subsection (b), the rights and remedies provided by this subchapter [15 U.S.C.A. § 77a et seq.] shall be in addition to any and all other rights and remedies that may exist at law or in equity.

(b) 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—

(1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or

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

(c) Removal of covered class actions

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

(d) Preservation of certain actions

(1) Actions under State law of State of incorporation

(A) *Actions preserved*

Notwithstanding subsection (b) or (c), a covered class action described in subparagraph (B) of this paragraph 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.

(B) *Permissible actions*

A covered class action is described in this subparagraph 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 the issuer that—

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

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

(2) *State Actions:*

(A) *In General*

Notwithstanding any other provision of this section, nothing in this section 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.

(B) *State Pension Plan Defined*

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

(3) *Actions Under Contractual Agreements Between Issuers and Indenture Trustees*

Notwithstanding subsection (b) or (c), 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.

(4) *Remand of removed actions*

In an action that has been removed from a State court pursuant to subsection (c), if the Federal court determines that the action maybe maintained in State

court pursuant to this subsection, the Federal court shall remand such action to such State court.

(e) 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.

(f) Definitions

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

(1) *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.

(2) *Covered class action—*

(A) In general

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.

(B) Exception for derivative actions

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

(C) 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.

(D) Rule of construction

Nothing in this paragraph shall be construed to affect the discretion of a State court in determining whether actions filed in such court should be joined, consolidated, or otherwise allowed to proceed as a single action.

(3) *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 77r(b) of this title 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 this subchapter pursuant to rules issued by the Commission under section 77d(2) of this title.

15 U.S.C. § 77r(b)(1)(A)

(b) Covered securities

For purposes of this section, the following are covered securities:

(1) *Exclusive Federal Registration of Nationally Traded Securities*. A security is a covered security if such security is —

(A) listed, or authorized for listing, on the New York Stock Exchange or the American Stock Exchange, or listed, or authorized for listing, on the National Market System of the Nasdaq Stock Market (or any successor to such entities);

* * * *

15 U.S.C. § 78bb(f)

(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.* Notwith-standing 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 [15 U.S.C.A. § 77r(b)], 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 [15 U.S.C.A. § 77a et seq.] pursuant to rules issued by the Commission under section 4(2) of that Act [15 U.S.C.A. § 77d(2)].

(F) *Rule of Construction*. Nothing in this paragraph shall be construed to affect the discretion of a State court in determining whether actions filed in such court should be joined, consolidated, or otherwise allowed to proceed as a single action.

* * * *

Sec. 102 Promotion of Reciprocal Subpoena Enforcement

(a) Commission Action. — The Securities and Exchange Commission, in consultation with State securities commissions (or any agencies or offices performing like functions), shall seek to encourage the adoption of State laws providing for reciprocal enforcement by State securities commissions of subpoenas issued by another State securities commission seeking to compel persons to attend, testify in, or produce documents or records in connection with an action or investigation by a State securities commission of an alleged violation of State securities laws.

(b) Report. — Not later than 24 months after the date of enactment of this Act, the Securities and Exchange Commission (hereafter in this section referred to as the "Commission") shall submit a report to the Congress—

(1) identifying the States that have adopted laws described in subsection (a);

(2) describing the actions undertaken by the Commission and State securities commissions to promote the adoption of such laws; and

(3) identifying any further actions that the Commission recommends for such purposes.

15 U.S.C. § 78j

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange,

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

* * * *

17 C.F.R. § 240.10b-5

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.