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,
Respondent.

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

BRIEF FOR RESPONDENT

WILLIAM B. FEDERMAN
STUART W. EMMONS
FEDERMAN & SHERWOOD
120 N. Robinson
Suite 2720
Oklahoma City, OK 73102
(405) 235-1560

CLELL I. CUNNINGHAM III
DUNN, SWAN &
CUNNINGHAM, P.C.
210 Park Avenue
Suite 2800
Oklahoma City, OK 73102
(405) 235-8318

DAVID C. FREDERICK
Counsel of Record
PRIYA R. AIYAR
BRENDAN J. CRIMMINS
PATRICK D. CURRAN
KELLOGG, HUBER, HANSEN,
TODD, EVANS & FIGEL,
P.L.L.C.
1615 M Street, N.W.
Suite 400
Washington, D.C. 20036
(202) 326-7900

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QUESTION PRESENTED

Whether the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") preempts claims brought by holders of securities based upon misrepresentations, omissions, or manipulation, notwithstanding SLUSA's language limiting preemption to claims "in connection with the purchase or sale of a covered security," and this Court's interpretation of identical language to cover only claims brought by purchasers or sellers in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF AUTHORITIES iv

STATEMENT 2

SUMMARY OF ARGUMENT.. 19

ARGUMENT.. 21

I. SLUSA DOES NOT PREEMPT SECURITIES FRAUD CLAIMS BROUGHT BY PRIVATE PLAINTIFFS WHO NEITHER BOUGHT NOR SOLD ANY SECURITY IN CONNECTION WITH THE DEFENDANT'S ACTS OR OMISSIONS 21

A. SLUSA's Text Preserves Holder Claims..... 21

B. The Presumption Against Preemption Must Be Applied To SLUSA 26

C. SLUSA Was Not Intended To Preempt The State-Law Holder Claims Of Investors Who Cannot Bring Claims Under Federal Law.. 30

1. Congress intended to halt the flight to state court of federal § 10(b) suits.... 31

2. Congress intended to preserve a private right of action for all victims of fraud 34

3. Congress did not intend to eliminate all state securities class actions 35

D. The Second Circuit's Reading Of SLUSA's Preemption Provision Advances The Policies Underlying The Federal Securities Laws 38

1. Meaningful private enforcement is necessary to preserve the integrity of this country's financial markets....... 39

2. Class actions are necessary for effective enforcement of securities regulations... 41

3. Holder claims are not unmanageable or inherently abusive 42

II. THE SECOND CIRCUIT'S DISPOSITION OF THIS CASE SHOULD BE AFFIRMED....... 47

CONCLUSION 50

TABLE OF AUTHORITIES

Page

CASES

A.S. Goldmen & Co. v. New Jersey Bureau of Sec., 163 F.3d 780 (3d Cir. 1999).. 36

Abelson v. Strong, 644 F. Supp. 524 (D. Mass. 1986)........ 5

Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972) 38

Amchem Prods., Inc. v. Windsor, 521 U.S. 591 (1997) 42

Arent v. Distribution Sciences, Inc., 975 F.2d 1370 (8th Cir. 1992)... 43

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Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299 (1985) 40

Bates v. Dow AgroSciences LLC, 125 S. Ct. 1788 (2005) 26, 27, 28, 50

Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952) 19, 22, 23, 24

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Continental Ins. Co. v. Mercadante, 225 N.Y.S. 488 (N.Y. App. Div. 1927) 4, 5

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CSX Transp., Inc. v. Easterwood, 507 U.S. 658 (1993) 21

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Estate of Rains v. Krause, 803 P.2d 1060 (Kan. Ct. App. 1991) 6

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Greenfield v. Fritz Cos., 98 Cal. Rptr. 2d 530 (Cal. Ct. App. 2000), *rev'd sub nom. Small v. Fritz Cos.*, 65 P.3d 1255 (Cal. 2003) 44

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Medtronic, Inc. v. Lohr, 518 U.S. 470 (1996) 21, 27, 28, 29, 30, 48

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Retail Clerks Int'l Ass'n v. Schermerhorn, 375 U.S. 96 (1963) 30

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382 F. Supp. 2d 549 (S.D.N.Y. 2005).......................... 43

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Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 .... 1, 6

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§ 2(2), 112 Stat. 3227... 7

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§ 409.5-502(a) (2005) 6

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§ 47-31B-502(a) (2005) 6

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17 C.F.R.

Pt. 239 15

Pt. 240:

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Pt. 274 15

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Rule 12(b)(6) 16

Rule 19 48

Rule 20 48

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p. S4802 (May 13, 1998)... 37

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For more than a century, investors have brought claims under state law when a defendant's unlawful acts or omissions induced them to hold securities. In *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), this Court recognized that such holder claims cannot be brought by investors under § 10(b) and Rule 10b-5, because those investors' injuries were not suffered "in connection with the purchase or sale" of securities. In the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), Congress adopted § 10(b)'s "in connection with" phraseology to preempt the class of private actions that could have been brought as federal securities suits but were being asserted under state law ostensibly to evade the heightened pleading requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA"). By the language it chose, the debates it conducted, the doctrine it incorporated, and the history against which it legislated, Congress expressed no intent to extinguish an entire class of investors' claims.

Yet that is precisely what petitioner and its *amici* ask this Court to hold. SLUSA, however, was not designed to extinguish any claims at all. Rather, its purpose was to re-channel from state court to federal court those purchaser-seller claims traditionally brought under federal law and to ensure that such claims could only be brought under the heightened pleading requirements of federal law. Congress expressed no intent – in the language of SLUSA or otherwise – to expand the Act's preemptive scope to an entirely new class of cases that were not cognizable under the federal securities laws. This Court has consistently refused to confer complete immunity on businesses for wrongs recognized under state law absent a clear expression of intent by Congress. Given the well-chronicled abuses in the securities industry, this Court should not infer that Congress intended to leave those injured the most in the aggregate – the smallest investors who practically can seek redress only by banding together in a class action – without any remedy for harms in connection with their holding of securities.

STATEMENT

1. More than 150 years ago, the States initiated the first efforts to ensure the integrity of this country's financial markets. *See* 1 Louis Loss & Joel Seligman, *Securities Regulation* 31-43 (3d ed. 1998) ("Loss & Seligman"); Gerald D. Nash, *Government and Business: A Case Study of State Regulation of Corporate Securities, 1850-1933*, 38 Bus. Hist. Rev. 144, 144-52 (1964) ("Nash"); Louis Loss & Edward M. Cowett, *Blue Sky Law* 3-17 (1958) ("Loss & Cowett"). State supervision of the securities industry began as an aspect of the States' traditional regulation of corporations and other business associations. As the number of corporations increased in the middle of the nineteenth century, States responded by passing targeted legislation directly regulating certain types of issuers of securities. *See* Nash at 148-49; 1 Loss & Seligman at 31-32. In 1911, Kansas passed the first "comprehensive licensing system" for the securities industry, one of many state statutes now referred to as "Blue Sky Laws." *See* Loss & Cowett at 7-9. By 1933, every State but one had enacted such a statute. *See* Loss & Cowett at 10; 1 Loss & Seligman at 40; *see also* Nash at 150-52.

"In the wake of the 1929 stock market crash and in response to reports of widespread abuses in the securities industry," Congress passed "two landmark pieces of securities legislation": the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act"). *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 170 (1994). Recognizing that the States, because of jurisdictional impediments and resource deficiencies, lacked the ability to ensure the optimal level of disclosure, *see* 1 Loss & Seligman at 146-51, 219, Congress in the 1933 and 1934 Acts instituted a national regime of mandatory corporate disclosure. Section 10(b), the general antifraud provision of the 1934 Act, makes it unlawful "[t]o 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 [Securities and Exchange Commission ("SEC")] may prescribe." 15 U.S.C. § 78j(b). In 1942, the SEC adopted Rule 10b-5:

> 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.

17 C.F.R. § 240.10b-5. This Court has implied a private right of action from those provisions. *See Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 & n.9 (1971). Under that right of action, a plaintiff must allege that the defendant's fraudulent conduct was in connection with her own purchase or sale of a security. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

When Congress entered the field of securities regulation in 1933 and 1934, it chose not to displace the existing state systems of securities regulation. The 1933 and 1934 Acts each explicitly preserved applicable state law. *See* 1933 Act § 16, 48 Stat. 74, 84; 1934 Act § 28, 48 Stat. 881, 903. Additionally, "far from preempting the field when interstate commerce is involved, Congress affirmatively yielded to local regulation by inserting a number of intrastate exemptions even when the mails or facilities of interstate commerce are used." 1 Loss & Seligman at 41.

The States have continued their traditional role of protecting investors. "Today all 50 states, the District of Columbia, Guam, and Puerto Rico have blue sky laws in force," with most having adopted the Uniform Securities Act of 1956 and several more the Revised Uniform Securities Act of 1985. *Id.* at 41-42. State statutes and common law provide significant private remedies for investors harmed by fraud and other misconduct. *See* 9 *id.* at 4114-66. "Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to securities transactions." *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 383 (1996).

For at least a century, state law has permitted recovery by investors who have suffered losses in the value of their stock holdings from misconduct. Shareholders have sought recovery for injuries sustained when they were induced by misrepresentations to refrain from selling their securities.[1] Judge Friendly, for example, applied long-

[1] *See*, *e.g.*, *Small v. Fritz Cos.*, 65 P.3d 1255, 1259 (Cal. 2003) (refusing to make exception to "the principle that induced forbearance can be the basis for tort liability" for "lawsuits involving misrepresentations affecting corporate stock"); *Ward v. Atlantic Sec. Bank*, 777 So. 2d 1144, 1146 (Fla. Dist. Ct. App. 2001) (reversing entry of summary judgment against investor who alleged that his stockbroker fraudulently persuaded him to change his mind about selling shares in a fund); *David v. Belmont*, 197 N.E. 83, 83-85 (Mass. 1935) (affirming judgment for plaintiff on a count alleging that defendants had fraudulently induced him to hold stock); *Continental Ins. Co. v. Mercadante*, 225 N.Y.S. 488, 490-91 (N.Y. App. Div. 1927) (holding that plaintiffs had stated cognizable claim for relief by alleging that defendant fraudulently induced them to hold securities); *Fottler v. Moseley*, 60 N.E. 788, 788-89 (Mass. 1901) (rejecting argument that plaintiff could not recover for fraud that had caused him to decide not to sell his stock because he did not take action in reliance on fraudulent statements); *see also Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC*, 376 F. Supp. 2d 385, 407 (S.D.N.Y. 2005) ("The elements of common law fraud [under New York law] thus are largely the same as those of a Rule 10b-5 claim except that there is no requirement that the fraud be 'in connection with the purchase or sale of securities.' In other words, a claim for common law fraud is available to investors who retain their securities in reliance on a defendant's misrepresentations.") (footnote omitted); *Rogers v. Cisco Sys., Inc.*, 268 F. Supp. 2d 1305, 1311 n.13 (N.D. Fla. 2003) (stating

standing New York law to approve a class-action settlement that included state-law holder claims and referred to "the rule of New York law whereby persons who merely held [the company's] securities would have been permitted to show reliance by proving that defendants' alleged misrepresentations and nondisclosures caused them to hold securities they would otherwise have sold." *Weinberger v. Kendrick*, 698 F.2d 61, 78 (1982) (citing *Continental Ins.*, 225 N.Y.S. 488), *modified on reh'g*, 698 F.2d 81 (2d Cir. 1983). In addition to claims of fraud and misrepresentation, investors have brought claims under state law seeking recovery for breaches of fiduciary duty causing decreases in the value of their investments.[2] Finally, some

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that Florida common law permits holders of securities to recover for fraud and negligent misrepresentation); *Gutman v. Howard Sav. Bank*, 748 F. Supp. 254, 261-67 (D.N.J. 1990) (recognizing that, "under New York law, a plaintiff may state a common law fraud claim against a defendant whose misrepresentations caused plaintiff to hold securities that plaintiff otherwise would have sold" and predicting that New Jersey Supreme Court would similarly permit investors to recover under common law for harm caused by fraud and negligent misrepresentation); *Abelson v. Strong*, 644 F. Supp. 524, 532 (D. Mass. 1986) (citing *Holloway v. Forsyth*, 115 N.E. 483 (Mass. 1917), for proposition that "[a] direct purchaser-seller relationship . . . is not necessary [to state a claim for securities fraud] at common law"); *Boykin v. Arthur Andersen & Co.*, 639 So. 2d 504, 506-07 (Ala. 1994) (reversing dismissal of fraud claims by shareholders who alleged that corporate officers and directors of company and the company's auditors misled them regarding company's financial condition); *Manzo v. Rite Aid Corp.*, No. 18451-NC, 2002 Del. Ch. LEXIS 147, at *2, *9-*10, *14 (Del. Ch. Dec. 19, 2002) (indicating holder of securities could state actionable fraud claim), *aff'd*, No. 23, 2003, 2003 Del. LEXIS 303 (Del. May 29, 2003); *cf. Twin Fires Inv., LLC v. Morgan Stanley Dean Witter & Co.*, No. 00-00751-F, 2002 WL 31875204, at *29 (Mass. Super. Ct. Dec. 16, 2002) ("[t]he common law of fraudulent misrepresentation does protect potential buyers of securities"); *Little Beaver Creek Valley R.R. & Hist. Soc., Inc. v. P.L. & W.R.R.*, No. 95-C0-76, 1998 Ohio App. LEXIS 2657, at *14-*15 (Ohio Ct. App. June 10, 1998) (upholding jury verdict for plaintiffs fraudulently induced by attorney not to purchase stock in corporation).

[2] *See Ward*, 777 So. 2d at 1147 (reversing entry of summary judgment against investor who alleged that his stockbroker breached its duty of loyalty and care in fraudulently persuading him to change his mind about selling shares in fund); *Rogers*, 268 F. Supp. 2d at 1314-15

state statutes provide remedies for defrauded investors without requiring those investors to have purchased or sold securities in connection with the fraud.[3]

2. In 1995, Congress passed the PSLRA (codified in part at 15 U.S.C. §§ 77z-1, 78u) to prevent "strike suits," or meritless class actions alleging fraud in the securities market brought to extract settlements from companies seeking to avoid a costly legal proceeding. *See* H.R. Conf. Rep. No. 105-803, at 13 (1998). To deter those suits, the

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(allegation that company's officers "engaged in various conduct in an effort to disguise or misrepresent [the company's] earnings to induce its shareholders to retain their stock" stated claim for breach of fiduciary duty under California law); *see also Fraternity Fund*, 376 F. Supp. 2d at 409-10 (concluding that investors in hedge funds had stated claims under New York law for breach of fiduciary duty against managers who allegedly misrepresented funds' values); *Malone v. Brincat*, 722 A.2d 5, 9, 13 (Del. 1998) ("directors who knowingly disseminate false information that results in . . . damage to an individual stockholder violate their fiduciary duty"; "[h]ere, it is to be noted, the claim appears to be made by those who did not sell and, therefore, would not implicate federal securities laws which relate to the purchase or sale of securities"); *cf. Estate of Rains v. Krause*, 803 P.2d 1060 (Kan. Ct. App. 1991) (table) (holding that plaintiff stated claim upon which relief could be granted by alleging that majority shareholder misled other shareholders to decline offer to buy their stock).

[3] *See Ward*, 777 So. 2d at 1146-47 (since 1992, the Florida Securities and Investors Protection Act has provided a cause of action for fraud "in connection with the rendering of any investment advice"); *see also* D.C. Code §§ 31-5605.02(a)(1), 31-5606.05(a)(3)(A) (2005) (providing for cause of action against one who commits fraud "[i]n connection with the rendering of investment advice"); Idaho Code Ann. §§ 30-14-502(a), 30-14-509(f) (2004) (enacting provisions of Uniform Securities Act of 2002 that impose civil liability for provision of fraudulent investment advice); Iowa Code §§ 502.502, 502.509(6) (2004) (same); 2004 Kan. Sess. Laws ch. 154, §§ 31(a), 38(f) (enacted May 17, 2004) (same); 2005 Me. Legis. Serv. ch. 65 (H.P. 384, L.D. 509) (West) (to be codified at Me. Rev. Stat. Ann. tit. 32, §§ 16502(1), 16509(6)) (same); Mo. Rev. Stat. §§ 409.5-502(a), 409.5-509(f) (2005) (same); Okla. Stat. tit. 71, §§ 1-502(A), 1-509(F) (2005) (same); 2005 S.C. Acts No. 110 (to be codified at S.C. Code Ann. §§ 35-1-502(a), 35-1-509(f)) (same); S.D. Codified Laws §§ 47-31B-502(a), 47-31B-509(f) (2005) (same); 2005 Vt. Acts & Resolves No. 11 (to be codified at Vt. Stat. Ann. tit. 9, §§ 5502(a), 5509(f)) (same); V.I. Code Ann. tit. 9, §§ 652(a), 659(f) (2005) (same).

PSLRA imposed stringent pleading and other procedural requirements on securities class-action plaintiffs.

Three years after the PSLRA was enacted, Congress found that an increased number of plaintiffs were bringing suit against issuers in state court alleging securities fraud under state statutory or common law. *See* SLUSA, Pub. L. No. 105-353, §§ 2(2), 2(5), 112 Stat. 3227, 3227. To prevent plaintiffs from evading the PSLRA by bringing state-law claims in state court that they could have brought in federal court under federal law, Congress passed SLUSA, which amended the 1933 and 1934 Acts to preclude certain class actions under state law as follows:

> 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.

15 U.S.C. § 78bb(f)(1).[4] SLUSA defines a "covered class action" as a suit for damages brought by more than 50 people, but excludes derivative actions from that definition. *See id.* § 78bb(f)(5)(B)-(C). Additionally, SLUSA exempts from preemption certain suits that might otherwise have been held to fall within the statute's preemptive scope – for example, class actions by States and their political subdivisions. *See id.* § 78bb(f)(3)-(4).

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[4] That preemption provision comes from SLUSA's amendment to the 1934 Act. It is "functionally identical" to the preemption provision added by SLUSA to the 1933 Act, 15 U.S.C. § 77p(b). *Kircher v. Putnam Funds Trust*, 403 F.3d 478, 481 (7th Cir.), *petition for cert. pending*, No. 05-409 (U.S. filed Sept. 29, 2005). For convenience, this brief henceforth refers only to the 1934 Act preemption provision.

3. For years, investors have been harmed by a number of trading practices involving manipulation of the securities markets. Two particular abuses – the provision of misleading long-term "buy" or "hold" ratings by investment advisors and the failure of mutual funds to check a practice known as "market timing" – have been uniquely harmful to holders of securities, including the millions of Americans who invest a portion or all of their long-term savings in the stock market.[5]

a. ***Biased investment advice.*** Investment advisors provide clients with detailed assessments of specific securities. Those analyses typically include recommendations, such as "buy" or "sell," based on the current and anticipated performance of the security. *See*, *e.g.*, Pet. Br. 12.

A number of investment advisors, including those employed by Merrill Lynch, have been accused of issuing misleading research reports throughout the 1990s and into the early part of this decade in an effort to secure investment banking business.[6] Investment companies, like Merrill Lynch, tied analyst salaries to the company's gen-

[5] Approximately 91.1 million American investors own individual securities or mutual funds, with the average American household holding approximately $65,000 in these securities. More than $4 trillion of these holdings are invested in mutual funds. *See* Investment Company Institute & Securities Industry Ass'n, *Equity Ownership in America, 2005* (2005); Investment Company Institute, *2005 Investment Company Fact Book* (2005); Financial Policy Forum, *Special Policy Brief 13 – Overview of Mutual Fund Scandal: "A Gauntlet of Fraud"*, at *3 (Dec. 14, 2003; updated May 21, 2004).

[6] *See*, *e.g.*, Conal Walsh, *Joe Public takes on giants of Wall Street*, The Observer (Apr. 14, 2002) (relating allegations that Jack Grubman, the "superstar" analyst for Salomon Smith Barney, and Henry Blodget, the "star analyst" for Merrill Lynch, issued misleading analyses of several companies to secure additional banking business); Rebecca Byrne, *Of Bubble Triumvirate, Only Meeker Remains*, TheStreet.com (Aug. 20, 2002). *See also* SEC Litigation Release No. 18117 (Apr. 28, 2003) (announcing details of SEC settlement with Morgan Stanley for the alleged provision of biased investment advice to clients); SEC Litigation Release No. 18116 (Apr. 28, 2003) (same, for Lehman Brothers); SEC Litigation Release No. 18115 (Apr. 28, 2003) (same, for Merrill Lynch and Henry Blodget).

eration of such business.[7] That compensation scheme provided advisors with an incentive to issue unduly optimistic public evaluations of those companies targeted for lucrative investment banking contracts.

In 2002, New York's Attorney General charged Merrill Lynch with engaging in a pattern of supplying biased advice to investor clients in exchange for investment banking work that yielded considerable fees.[8] Alhough Merrill Lynch's analysts privately believed that stock in certain companies was "crap," a "dog," or "going a lot lower," the analysts continued to recommend those stocks to clients and to the public to attract and retain investment banking business.[9] Indeed, although Merrill Lynch internally classified at least one stock as a "piece of junk," it publicly gave that stock the highest possible quality rating.[10] And at least one Merrill Lynch analyst was fined $225,000 and suspended for one year by the National Association of Securities Dealers ("NASD") after issuing misleadingly favorable reports on the prospects of Merrill Lynch's investment banking clients, while internally predicting that the clients would soon suffer substantial losses when "the debt bomb starts to TICK, TICK, TICK."[11] Merrill Lynch's own analysts recognized the harms that such practices

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[7] *See* Written Testimony Concerning Conflicts of Interest Faced by Brokerage Firms and Their Research Analysts, Before the Subcomm. on Capital Markets, Insurance, & Government Sponsored Enterprises of the House Comm. on Financial Services, 107th Cong. (July 31, 2001) (Statement of Laura S. Unger, Acting Chair, SEC) (explaining that firms pay analysts based on the profitability of investment banking units, which created conflicts of interest).

[8] *See*, *e.g.*, Office of New York State Attorney General Eliot Spitzer, *Merrill Lynch Stock Rating System Found Biased by Undisclosed Conflicts of Interest* (Apr. 8, 2002).

[9] *See* http://www.oag.state.ny.us/press/2002/apr/MerrillL.pdf, at 10-11, 13 (visited Dec. 16, 2005).

[10] *Id.* at 12, 13.

[11] *See* National Association of Securities Dealers, *NASD Fines and Suspends Phua Young, Former Merrill Lynch Research Analyst* (May 25, 2004).

inflicted on the long-term holders of securities. As one analyst pressured to give a "buy" rating to a poor investment stated: "I don't think it is the right thing to do. John and Mary Smith are losing their retirement because we don't want a client's CEO to be mad at us."[12]

Many long-term investors have asserted that they relied to their detriment on biased advice from stock analysts. For example, investors have alleged that they decided, based on specific conversations with investment advisors or on their stock ratings, to hold securities for far longer than they otherwise would have. Merrill Lynch paid at least one former client $400,000 to settle allegations that its misleading research caused more than $800,000 in damages to the client, who held overvalued securities in reliance on Merrill Lynch's biased investment advice.[13] In addition, Merrill Lynch publicly apologized to its clients, shareholders, and employees for its investment advisors' behavior.[14] And, as part of a settlement with the SEC and New York, Merrill Lynch agreed (1) to pay more than $125 million in fines and restitution; (2) to disclose to its clients and the public when it makes an investment recommendation concerning a particular security whether it has received in the past 12 months, or is then entitled to, any compensation from the company being analyzed; (3) to establish an independent monitor for ensuring compliance

[12] Office of New York State Attorney General Eliot Spitzer, *Merrill Lynch Stock Rating System Found Biased by Undisclosed Conflicts of Interest* (Apr. 8, 2002).

[13] *See* Rachel Beck, *Merrill pays $400,000 to tech-battered investor; Settlement follows SEC warnings and trade group guidelines*, Hamilton Spectator, July 21, 2001, at B2. That investor, Debasis Kanjilal, spoke to his Merrill Lynch advisor daily and repeatedly expressed his desire to sell two poorly performing stocks. The advisor, noting that the company still gave these securities a "buy" rating, told Kanjilal to "sit tight" and hold them. Only when the value of the stocks was close to nothing did Merrill Lynch eventually downgrade its analysis and encourage clients, including Kanjilal, to sell. *See id.*

[14] *See*, *e.g.*, Anthony Mason, *Merrill Admits to Wrong Kind of Bull*, CBSNews.com (Apr. 26, 2002) (quoting apology of Merrill Lynch).

with these new policies; and (4) to change significantly its compensation and evaluation methods for analysts.[15]

b. ***Market timing.*** Another type of injury suffered uniquely by investors who hold, but do not trade in, securities stems from the management of mutual funds, such as those of Merrill Lynch.[16] Mutual funds are open-ended funds that invest in a number of assets.[17] Millions of American households have purchased shares of mutual funds and, in so doing, have entrusted $4 trillion in long-term savings to the investment companies that manage the funds.[18] Although mutual funds are "a vital part of this nation's economy" and the investment vehicle on which "[m]illions of investors depend . . . for their financial security,"[19] they have been plagued with problems. Between 1996 and 2001, the average fund-holding American family lost approximately $3,740 in long-term savings to several forms of market manipulation and trading abuse.[20] Among the practices inflicting those losses has been a trading strategy known as "market timing."

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[15] *See* SEC Litigation Release No. 18117 (Apr. 28, 2003) (outlining details of $125 million in payments); Office of New York State Attorney General Eliot Spitzer, *Spitzer, Merrill Lynch Reach Unprecedented Agreement to Reform Investment Practices* (May 21, 2002) (recounting numerous changes to Merrill Lynch's system of compensating and evaluating its analysts).

[16] *See* Merrill Lynch, *Mutual Funds at Merrill Lynch*, *at* http://askmerrill.ml.com/publish/marketing_centers/products/inv028_MutualFundsatMerrillLynch/ (last visited Dec. 16, 2005).

[17] *See* http://www.sec.gov/investor/tools/mfcc/mutual-fund-help.htm (Oct. 17, 2005).

[18] *See* Financial Policy Forum, *Special Policy Brief 13 – Overview of Mutual Fund Scandal: "A Gauntlet of Fraud"*, at *3.

[19] *Mutual Fund Trading Abuses: Hearing Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary*, 109th Cong. 37 (2005) (Statement of Lori A. Richards, Director, SEC's Office of Compliance Inspections and Examinations) ("2005 House Hearing").

[20] *See* Financial Policy Forum, *Special Policy Brief 13 – Overview of Mutual Fund Scandal: "A Gauntlet of Fraud"*, at *2.

Market timing is the purchase and sale of a mutual fund's shares in a manner that exploits differences between the calculated value and the actual value of those shares. Most mutual funds calculate the value of their entire portfolio (commonly referred to as the Net Asset Value, or "NAV") only once per day, typically at the 4:00pm close of trading on New York exchanges. The NAV is ordinarily calculated by valuing each fund-owned asset using the final price at which it traded on its native exchange that day. For assets listed on the New York exchanges, that method supplies an up-to-date asset price.[21] But for assets listed on foreign exchanges, some of which may have closed as many as 15 hours beforehand, that approach creates a window for arbitrage. Because the NAV is calculated using the closing price of each asset, and not its real-time value based on information revealed after the close of trading on the asset's native exchange, the fund will often give its portfolio an artificially high or low value. Stale information used to calculate the NAV thus creates opportunities to purchase or sell fund shares at an immediate profit.[22]

Long-term holders of mutual fund shares bear the costs of market timing, not the purchasers or sellers of a fund's shares. When an outdated NAV causes a fund to value its shares at an artificially low price, market timers will buy the mutual fund and receive a greater ownership stake in

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[21] An exception to this rule involves relatively illiquid assets, such as small-cap stocks or high-yield bonds, which may not trade often (if at all) in a given trading day. Because an illiquid security may not trade for many hours prior to the close of the New York exchange, the price at which that asset last traded may be significantly outdated and may lead to an artificially low or high NAV, which creates arbitrage opportunities. *See*, *e.g.*, Richard L. Levine, Yvonne Cristovici & Richard A. Jacobsen, *Mutual Fund Market Timing*, Fed. Lawyer, Jan. 2005, at 30.

[22] This time-zone arbitrage problem has been explained as follows: "[s]tock of a Japanese firm that closes in Tokyo at ¥10,000 might trade in Frankfurt at € 75.22 (equivalent to ¥10,500) between the close in Tokyo and the close in New York – but the mutual fund nonetheless would value each share at ¥10,000, because that was its most recent price in the issuer's home market." *Kircher*, 403 F.3d at 480.

the fund than if the NAV had been accurately calculated. Hence, purchasing market timers dilute the existing shares' value in the fund. Similarly, when an outdated NAV causes the fund to value its shares at an artificially high price, market timers will sell the mutual fund and receive a greater price for that sale than an NAV based on up-to-date information. Accordingly, selling market timers deplete the pooled assets of the fund's investors. In either scenario, the parties harmed by market timing are those who held their shares while others purchased or sold. While a mutual fund's use of stale prices may also cause a purchaser to buy a fund share at an artificially high price, or a seller to redeem a share at an artificially low price, those losses do not depend on whether other individuals simultaneously engage in market timing.

Throughout the 1990s, mutual funds began to increase trading fees and implement restrictions on "quick in – quick out" trades of the sort required for market timing.[23] But those efforts did little, if anything, to stem the tide of losses ebbing from legitimate investors' holdings. Timers immediately began to form side agreements with fund managers and investment company employees. Under those agreements, timers provided considerable fixed assets to funds in exchange for the ability to make large-capacity transactions, despite fund policies that discouraged or restricted such trades.[24] Even while funds publicly claimed to be eliminating opportunities for timing,

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[23] *See* Peter Elkind, *The Secrets of Eddie Stern*, Fortune, Apr. 19, 2004, at 106, 114; Levine, Cristovici & Jacobsen, *Mutual Fund Market Timing* at 30.

[24] *See* 2005 House Hearing at 40 (Richards Statement) ("It is important to note that the illegal market timing involved secret arrangements between fund executives and select market timers allowing the timers to engage in more frequent trading than the fund's prospectus or other internal policies allowed. Some of the arrangements involved nominee accounts and false trading records. These were covert, non-disclosed arrangements. In fact, many fund firms stated at the time that they deterred market timers, and had even hired 'market timing police' to prevent this type of trading.").

these quid-pro-quo agreements between market timers and fund managers were rampant within the mutual fund industry and wreaked substantial damage on investors.[25] John Bogle, founder and former CEO of the Vanguard Group, estimated that a combination of market timing and illegal late trading[26] costs long-term holders of mutual fund shares between $5 and $10 billion annually.[27]

4. Until details of the investment companies' provision of biased investment advice and the mutual funds' complicity in the manipulative practice of market timing became public knowledge, the SEC did not undertake significant rulemaking or enforcement action to combat those problems. The SEC and other regulators had long ago obtained evidence of bias in investment advice.[28] They also

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[25] *See* Elkind, *Secrets of Eddie Stern* at 122 ("Clearly, by 2001 everyone connected with the fund industry had to know how crooked the business had become. . . . Everyone seemed to know, that is, except the buy-and-hold investors in mutual funds, and the SEC, which appeared to be clueless. 'I don't think there's anyone at the agency who doesn't wish the agency had been more attuned to this problem before it came to light,' says chagrined SEC enforcement director Steven Cutler.").

[26] *See id.* ("[A]fter the scandal broke, the SEC surveyed the 88 largest fund companies and discovered, stunningly, that half admitted to allowing market timing – and 25% allowed late trading.").

[27] *See*, *e.g.*, Jennifer Barrett, "Inexcusable," MSNBC.com, Nov. 11, 2003 (interview with Bogle, estimating market-timing dilution to cost investors $5 to $10 billion per year). *See also* Eric Zitzewitz, *Who Cares About Shareholders? Arbitrage-Proofing Mutual Funds*, 19 J.L. Econ. & Org. 245, 260 (2003) ("total annualized dilution in the first three quarters of 2001 can be estimated at $4.9 billion per year").

[28] *See*, *e.g.*, Hsiou-wei Lin & Maureen F. McNichols, *Underwriting Relationships, Analysts' Earnings Forecasts and Investment Recommendations*, 25 J. Acct. & Econ. 101 (1998) (concluding that investment analysts provided significantly more favorable analysis when examining securities offered by companies that the analysts' employer was partially or solely underwriting). In 1996, the *Wall Street Journal* reported "significant evidence of bias and possible conflict of interest" in analysts' recommendations. *See* Roger Lowenstein, *Today's Analyst Often Wears Two Hats*, Wall St. J., May 2, 1996, at C1. A few years later, the same paper reported that more than 99 out of every 100 analyst recommendations were a "buy" or "hold" of some shade, while less than 1% recommended a sale of any security. *See* John Hechinger,

knew, since at least 1981, of market timing and the dangers that it posed.[29] But regulators took no meaningful action to correct those problems before 2003.[30]

5. a. In April 2002, before the SEC took action, Dabit, a former Merrill Lynch broker, filed this suit in federal court. He alleged, on behalf of himself and others similarly situated (including current and former Merrill Lynch brokers), that Merrill Lynch willfully distorted its stock

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Heard in New England: Analysts May Hate to Say "Sell," But a Few Companies Do Hear It, Wall St. J., Apr. 8, 1998, at NE2.

[29] *See In re Putnam Int'l Equities Fund, Inc. (No-Action Letter)*, Fed. Sec. L. Rep. ¶ 76,816, 1981 WL 25522, at *4 (SEC Feb. 23, 1981) (opining that investment firm would not face liability for standard NAV policies, so long as more up-to-date information was used to value foreign securities following an "extraordinary event"). *See also Pricing of Redeemable Securities for Distribution, Redemption, and Repurchase*, SEC Release No. IC-14244, 49 Fed. Reg. 46,558, at n.7 (Nov. 21, 1984) (noting the problems of time-zone arbitrage but declining to establish standards governing fund management of market timers).

[30] Despite "abundant evidence that something was seriously amiss in the world of equity analysts," there were "no significant rulemaking" efforts by the SEC or the NASD, and "no major enforcement actions" attempting to address the apparent bias until 2003, long after many state and federal plaintiffs began to assert their rights. *See* Barbara Moses, *The "Discovery" of Analyst Conflicts on Wall Street*, 70 Brook. L. Rev. 89, 97 (2004). No significant attempts to combat market timing occurred until 2004, when the SEC finally engaged in rulemaking to address the harms of market timing by requiring that funds disclose their anti-timing policies to investors. *See Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings*, 69 Fed. Reg. 22,300 (Apr. 23, 2004) (to be codified at 17 C.F.R. Pts. 239, 274). A General Accounting Office ("GAO") probe found "information that was available prior to September 2003 and that was inconsistent with SEC staff's views that market timing was a low-risk area because companies would necessarily act to protect fund returns from the harmful consequences of frequent trading." 2005 House Hearing at 16 (Statement of Richard J. Hillman, GAO, Director of Financial Markets and Community Investment). The GAO noted, for example: "[A] mutual fund company insider provided information to an SEC district office in early 2003 indicating that a company had poor market timing controls, but the office did not act promptly on this information. If the SEC office had acted on this tip in early 2003, it might have identified potentially illegal market timing activity by company insiders." *Id.* at 16-17.

recommendations and breached both the covenant of good faith and fair dealing implied in the brokers' employment contracts and its fiduciary duty to its brokers. Dabit sought to recover for two types of damages incurred between December 1, 1999, and December 31, 2000: (1) holding damages resulting from the brokers' reliance on Merrill Lynch's willfully inaccurate recommendations, which allegedly caused Dabit and the other brokers to hold onto securities that were poor investments; and (2) lost fees, as some clients harmed by Merrill Lynch's biased investment recommendations subsequently closed their accounts with the brokers. *See* JA 28a.

The district court ruled that Dabit's complaint was preempted by SLUSA and dismissed the case without prejudice, explaining that Dabit could file an amended complaint pleading "claims based on wrongfully-induced holding." JA 49a. Dabit filed an amended complaint, which defined the class as including those brokers who "owned and continued to own one or more of the [Merrill Lynch] recommended securities . . . or recommended such securities to their clients during the period from December 1, 1999 through December 31, 2000 . . . and who suffered damages as a result of owning and holding such [Merrill Lynch] Stocks during this time period." JA 52a (¶ 1). The new class definition also included those brokers "who suffered damages as a consequence of the loss of clients due to [Merrill Lynch's] wrongful actions." *Id.*

b. Dabit's complaint was transferred, along with more than 120 others, to the Southern District of New York by the Judicial Panel on Multidistrict Litigation ("JPML"). Following transfer, Merrill Lynch again moved to dismiss Dabit's complaint under Rule 12(b)(6) as preempted by SLUSA. The court dismissed Dabit's suit with prejudice. The court determined that the holding and lost-fee claims in Dabit's amended complaint were "based on the very same alleged series of transactions and occurrences asserted" in other federal securities actions consolidated before the court by the JPML. Pet. App. 55a. Thus, the court concluded that Dabit's claims fell "squarely within SLUSA's ambit." *Id.*

c. The Second Circuit partially reversed. It consolidated Dabit's appeal with another to address "whether [SLUSA] . . . preempts claims that do not allege that putative class members purchased or sold particular securities in reliance upon the defendant's alleged misconduct." Pet. App. 2a. Recognizing that Congress borrowed SLUSA's "in connection with" language from § 10(b) of the 1934 Act and SEC Rule 10b-5, the court determined that SLUSA's "in connection with" requirement must be read in light of *Blue Chip Stamps*, which held that plaintiffs proceeding under the implied right of action to enforce § 10(b) and Rule 10b-5 must have themselves bought or sold in connection with the alleged misconduct. The court concluded that SLUSA does not preempt the claims of non-transacting plaintiffs, explaining that this interpretation comports with the Act's stated goal of closing the "federal flight" loophole in the PSLRA. Although the Second Circuit recognized 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," *id.* at 27a, it found that observation to have "little persuasive force in this context, because SLUSA deals with precisely the category of actions subject to the purchaser-seller rule," *id.* at 28a.

The court of appeals then elaborated on the category of claims that SLUSA does not cover. It cautioned that "a plaintiff who alleges the purchase and retention of securities in reliance on the misrepresentation but who forswears *damages* from the purchase and seeks only 'holding damages' has still run afoul of SLUSA, which by its plain terms preempts claims 'alleging' fraud in connection with the purchase or sale, and not merely claims seeking damages specifically traceable to the initial purchase." *Id.* at 39a. The court explained that, to state a non-preempted holder claim based on the fraud-induced retention of securities, a plaintiff must plead that she "purchased stock independent of any misrepresentation but was induced to retain it by a material misrepresentation or omission." *Id.* at 37a.

Examining Dabit's amended complaint, the court of appeals noted that the class definition failed to distinguish between brokers who purchased in reliance on Merrill Lynch's investment advice and those who bought Merrill Lynch-recommended securities before any relevant misrepresentation. *See id.* at 40a-43a. Because the complaint did not permit the court to identify the claims of brokers who bought in connection with the alleged fraud (which are preempted) and those of brokers who only held in connection with the claimed misconduct (which are not preempted), the Second Circuit agreed with the district court that Dabit's amended complaint must be dismissed under SLUSA. *See id.* at 40a, 43a. But the court held that the dismissal should have been without prejudice. *See id.* at 43a. Accordingly, the court vacated the dismissal with prejudice and remanded this case to the district court to give Dabit the opportunity to file an amended complaint alleging non-preempted holder claims. *See id.*[31]

As the case comes to this Court, there is no active complaint. The question presented is whether SLUSA preempts every conceivable state-law claim for damages that could be brought by a non-transacting private securities plaintiff such as Dabit.

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[31] The court of appeals also held that Dabit's claim for lost fees was not preempted because that claim, "by its very nature, does not allege fraud that 'coincide[s]' with the sale or purchase of a security." Pet. App. 44a (citing *SEC v. Zandford*, 535 U.S. 813, 825 (2002)). Merrill Lynch has not sought this Court's review of that ruling.

SUMMARY OF ARGUMENT

A private plaintiff alleging that a defendant's bad acts caused a decrease in the value of an investment has not "alleg[ed]" wrongdoing "in connection with the purchase or sale of a covered security" under SLUSA, unless the plaintiff also alleges that the defendant's misstatements or omissions were made in connection with the plaintiff's purchase or sale. That interpretation of SLUSA flows from the text of the statute, accords with this Court's presumption against preemption, fulfills Congress's purpose in enacting SLUSA, and is necessary to ensure the integrity of the Nation's securities markets.

First, in private securities litigation under § 10(b) and Rule 10b-5, the phrase "in connection with the purchase or sale" has a settled judicial interpretation: A private party does not assert a claim "in connection with the purchase or sale of any security" within the meaning of § 10(b) and Rule 10b-5 unless that party avers that the defendant's act or omission was in connection with her own purchase or sale. *See Blue Chip Stamps*, 421 U.S. at 730-31, 749. Congress incorporated that interpretation of § 10(b) and Rule 10b-5 when it used the same language while legislating in the context of private securities litigation. *Blue Chip Stamps* and the Second Circuit opinion on which that decision was based – *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952) – make clear that the purchaser-seller rule derives from the phrase "in connection with the purchase or sale" in § 10(b) and Rule 10b-5. SLUSA applies solely to private suits for damages and should be interpreted in accordance with this Court's cases construing § 10(b) and Rule 10b-5 in such suits.

Second, this Court presumes that Congress does not intend to preempt traditional state-law causes of action. The States have regulated the securities industry for more than 150 years, and investors have brought state-law holder claims for more than a century. Petitioner and its *amici* exaggerate the need for uniformity in the securities industry, which provides no warrant for disregarding the traditional presumption against preemption.

Third, Congress's purpose, as evidenced by the legislative history, was to preempt only those claims that could have been brought under federal law. Congress enacted SLUSA to prevent plaintiffs from evading heightened federal pleading requirements by filing such claims in state court under the guise of state law. Congress intended to secure a cause of action to all legitimately aggrieved investors, preserving state-law class actions where state law presented the only available remedy.

Fourth, state-law class actions are necessary to deter fraud in the securities industry. The limitations of public securities enforcement have repeatedly been recognized by Congress, this Court, and the SEC itself. Petitioner's proposed construction of SLUSA would functionally eliminate any right of action, in any courtroom at any level, for millions of defrauded investors. By denying investors the opportunity to pursue legitimate but low-value claims through class actions, petitioner's preferred interpretation would ensure that the many American households with modest long-term savings will never be compensated adequately for their losses. Such a construction of SLUSA is contrary to the long tradition of private securities enforcement and unnecessary as a practical matter. State legislatures and state courts are more than capable of establishing workable standards to manage non-purchaser and non-seller claims and to prevent frivolous suits.

Accordingly, this Court should affirm the Second Circuit's judgment, which upheld the dismissal of Dabit's amended complaint without prejudice to his ability to plead non-preempted claims on behalf of himself and any others who did not purchase or sell securities in connection with fraud by Merrill Lynch.

ARGUMENT

I. SLUSA DOES NOT PREEMPT SECURITIES FRAUD CLAIMS BROUGHT BY PRIVATE PLAINTIFFS WHO NEITHER BOUGHT NOR SOLD ANY SECURITY IN CONNECTION WITH THE DEFENDANT'S ACTS OR OMISSIONS

A. SLUSA's Text Preserves Holder Claims

1. SLUSA's plain language does not preclude class actions in which the fraud alleged by private plaintiffs is not in connection with their own purchases or sales of securities. When, as here, a statute contains an express preemption provision, "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); *accord Medtronic, Inc. v. Lohr*, 518 U.S. 470, 484 (1996) ("our analysis of the scope of the pre-emption statute must begin with its text"); *see also Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 517 (1992). For SLUSA to preempt a claim, the private plaintiff must "alleg[e]" misconduct "in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1).

The operative language in SLUSA's preemption provision – "in connection with the purchase or sale" – replicates the identical phrase in § 10(b) and Rule 10b-5, both of which proscribe fraudulent conduct "in connection with the purchase or sale of any security." In private securities litigation under § 10(b) and Rule 10b-5, that phrase has a settled judicial interpretation: a private party does not allege misconduct "in connection with the purchase or sale of any security" within the meaning of § 10(b) and Rule 10b-5 unless that misconduct was in connection with the plaintiff's own purchase or sale of a security. *See Blue Chip Stamps*, 421 U.S. at 730-31, 749. "When . . . judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its . . . judicial interpretations as well." *Bragdon v. Abbott*, 524 U.S. 624, 645 (1998); *see Lorillard v. Pons*, 434 U.S. 575, 581 (1978). The phrase "in connection with the purchase or sale" in SLUSA's preemption provision must be given the same construction as the identical language in § 10(b) and Rule 10b-5 in the context in which SLUSA applies – that is, private securities litigation.

2. In *Blue Chip Stamps*, then-Justice Rehnquist's opinion for the Court made clear that the purchaser-seller rule, far from being untethered to the "in connection with the purchase or sale" language of § 10(b), was an interpretation of that language in the context of private suits for damages. For example, the Court stated that "the wording of § 10(b), making fraud *in connection with the purchase or sale of a security* a violation of the Act, is surely badly strained when construed to provide a cause of action, not to purchasers and sellers of securities, but to the world at large." 421 U.S. at 733 n.5. Referring to *Birnbaum* – the Second Circuit opinion that originated the purchaser-seller rule – the Court observed that longstanding acceptance of "*Birnbaum*'s reasonable interpretation of the wording of § 10(b), wording which is directed toward injury suffered 'in connection with the purchase or sale' of securities, argues significantly in favor of acceptance of the *Birnbaum* rule by this Court." *Id.* at 733 (footnote omitted). The Court added that "[t]he wording of § 10(b) directed at fraud 'in connection with the purchase or sale' of securities stands in contrast with the parallel antifraud provision of the 1933 Act . . . . When Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly." *Id.* at 733-34. The Court's reliance on policy concerns in *Blue Chip Stamps* "to flesh out the portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance," *id.* at 737, simply amplifies the rationale for the purchaser-seller rule as an interpretation of the "in connection with" phrase.[32]

That conclusion draws support from the Second Circuit's reasoning in *Birnbaum*, which undergirded this Court's construction in *Blue Chip Stamps*. In *Birnbaum*, the controlling shareholder and president of a corporation sold his shares at a price that included a substantial control premium, shortly after he had rejected a merger opportunity that would have been highly profitable for all of the company's shareholders. *See* 193 F.2d at 462. Minority shareholders brought suit under Rule 10b-5 against the former controlling shareholder and other former directors, alleging that the defendants had breached their fiduciary duties. *See id.* The district court dismissed the action, explaining that Rule 10b-5 was "aimed only at 'a fraud perpetrated upon the purchaser or seller' of securities and [had] no relation to breaches of fiduciary duty by corporate insiders resulting in fraud upon those who were not purchasers or sellers." *Id.* at 463. The Second Circuit agreed, rejecting the plaintiffs' contention that "the applicability of [Rule 10b-5] is not limited to the actual purchasers or sellers of securities," and holding that the "meaning and scope" of Rule 10b-5 must be understood with reference to the SEC's purpose in adopting it. *Id.* Before the adoption of that rule, "[n]o prohibition existed [under federal law] against fraud on a seller of securities by the purchaser if the latter was not a broker or a dealer." *Id.* In adopting Rule 10b-5, the SEC explained that it was closing that "'loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase.'" *Id.* (quoting SEC Release No. 3230 (May 21, 1942)). From that, the Second

[32] *Cf.* Oral Arg. Tr. at 17, *Blue Chip Stamps v. Manor Drug Stores*, No. 74-124 (Mar. 24, 1975) ("*Blue Chip Stamps* Oral Arg. Tr.") ("QUESTION: But it is a construction of the statute that the courts have been engaged in, isn't it? It's not just some judicial policy; it's a construction of the federal statute. MR. RYAN: That's correct.").

Circuit concluded that "the only purpose" of Rule 10b-5 was to make the prohibition against fraud by *sellers* of securities in § 17(a) of the 1933 Act, 15 U.S.C. § 77q(a), applicable to purchasers as well as sellers, and that Rule 10b-5 thus "extended protection *only* to the defrauded purchaser or seller." 193 F.2d at 463-64 (emphasis added).[33]

3. Merrill Lynch and its *amici* contend, however, that the scope of SLUSA's preemption should be governed by this Court's cases involving criminal prosecutions and civil enforcement actions brought by the SEC under § 10(b) and Rule 10b-5. *See*, *e.g.*, *United States v. O'Hagan*, 521 U.S. 642 (1997). SLUSA's *raison d'être*, however, is the preemption of *private* damages actions brought under state law to evade heightened federal-law pleading rules. Like the *Blue Chip Stamps* rule, SLUSA's preemption provision applies only to civil suits by aggrieved investors. *See* 15 U.S.C. § 78bb(f)(5)(B) (defining a "covered class action" as one seeking damages). There is no reason to think that Congress incorporated or ratified in SLUSA judicial decisions defining the scope of criminal enforcement under § 10(b) and Rule 10b-5; SLUSA has no bearing on, and was not designed to preempt, suits by the government.

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[33] An interpretation of SLUSA's preemption provision that incorporates *Blue Chip Stamps* finds additional support in Congress's decision to tie SLUSA's preemptive scope to the *allegations* in the plaintiff's complaint. SLUSA precludes "covered class action[s]" "by any private party *alleging*" "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) (emphasis added). In a securities fraud case, a private party alleging misconduct "in connection with the purchase or sale" of securities must aver that the fraud was "in connection with" her own purchase or sale. That statement of fact is what *Blue Chip Stamps* required to allege fraud "in connection with the purchase or sale of any security." Thus, if the plaintiff is a non-transacting holder of securities, she is not in fact a "private party alleging" a misrepresentation or manipulation "in connection with the purchase or sale of a covered security," *id.* Congress's use of language that makes preemption turn on the allegations of a private party confirms that the phrase "in connection with the purchase or sale" in SLUSA must be given the meaning this Court gave those words in *Blue Chip Stamps*.

Indeed, in *O'Hagan*, this Court expressly rejected the notion that civil cases construing § 10(b) defined the scope of criminal § 10(b) liability. *See* 521 U.S. at 664-65 (discussing *Central Bank* and *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992), and noting that those cases "concerned only private civil litigation under § 10(b) and Rule 10b-5, not criminal liability").

In any event, *O'Hagan* did not hold that the purchaser-seller rule of *Blue Chip Stamps* was unrelated to the texts of § 10(b) and Rule 10b-5. Rather, that case held that the government could prosecute under § 10(b) and Rule 10b-5 a fiduciary who in fact traded on misappropriated financial information. *See* 521 U.S. at 656. In characterizing *Blue Chip Stamps*' holding "that only actual purchasers or sellers of securities may maintain a private civil action under § 10(b) and Rule 10b-5" as motivated by "policy considerations," *O'Hagan* merely emphasized that this limitation was specific to the implied private right of action under § 10(b) and did not determine the scope of § 10(b) liability in regulatory or criminal enforcement suits. *Id.* at 664.

The *O'Hagan* Court's remarks about *Blue Chip Stamps* did not repudiate the latter's conclusion that such a limitation on private suits stems from the phrase "in connection with the purchase or sale" in § 10(b) and Rule 10b-5. *See Blue Chip Stamps*, 421 U.S. at 733 (emphasizing that, in the context of private suits, Congress's wording "is directed toward injury suffered 'in connection with the purchase or sale' of securities"). Indeed, *O'Hagan* had no occasion to question that conclusion, because it did not even involve a private suit for damages. *See SEC v. Edwards*, 540 U.S. 389, 396 (2004) (noting that this Court is not bound by dictum on the meaning of one of its prior decisions); *Maryland v. Wilson*, 519 U.S. 408, 412-13 (1997) (same); *see also Landgraf v. USI Film Products*, 511 U.S. 244, 265 (1994) (reciting "canon of unquestionable vitality . . . 'that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used'") (quoting *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264, 399 (1821)).

Merrill Lynch is mistaken in suggesting (at 33) that affirming the Second Circuit's judgment would cast doubt on the proposition that the government in a criminal prosecution need not show that a defendant's misconduct was in connection with a particular victim's securities transaction. This case involves the interpretation of SLUSA, not § 10(b) or Rule 10b-5. This Court's acknowledgement that Congress incorporated the rule of *Blue Chip Stamps* in SLUSA when it preempted damages actions by private parties "alleging" fraud "in connection with the purchase or sale" of securities would not alter the settled meaning of § 10(b) and Rule 10b-5.

4. Contrary to Merrill Lynch's assertion (at 7-8), SLUSA's explicit preservation of several categories of claims from preemption without mentioning holder claims, *see* 15 U.S.C. § 78bb(f)(3)-(4), does not mean that Congress intended to preempt non-transacting plaintiffs' actions. The specific carveouts simply demonstrate that SLUSA's preemption is not complete. *Cf. Sprietsma v. Mercury Marine*, 537 U.S. 51, 63-64 (2002) (reading express preemption clause more narrowly because of exception contained in savings clause). In any event, because SLUSA's preemption provision simply does not cover claims by plaintiffs who neither bought nor sold in connection with the defendant's misconduct, Congress had no reason to exempt those claims from SLUSA's preemptive scope.

B. The Presumption Against Preemption Must Be Applied To SLUSA

1. Not only is the foregoing construction of SLUSA's preemption provision true to the text of the clause, it accords with this Court's strong presumption against preemption. "[B]ecause the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action." *Bates v. Dow AgroSciences LLC*, 125 S. Ct. 1788, 1801 (2005) (internal quotation marks omitted); *see also Medtronic*, 518 U.S. at 485 ("In all pre-emption cases, . . . we 'start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.'") (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)) (alteration in original). The presumption against preemption applies to discerning whether Congress intended any preemption at all and to gleaning the scope of an express preemption statute. *See id.* Thus, "[e]ven if [Merrill Lynch] had offered [this Court] a plausible alternative reading of [SLUSA's preemption provision] – indeed, even if its alternative were just as plausible as [Dabit's] reading of that text – [this Court] would nevertheless have a duty to accept the reading that disfavors pre-emption." *Bates*, 125 S. Ct. at 1801.

The presumption against preemption is particularly strong where, as here, the conclusion that claims are preempted would eliminate remedies traditionally available under state law. *See id.* State courts have entertained actions for damages by injured investors both before and after the enactment of the 1933 and 1934 Acts, including in circumstances where relief under § 10(b) and Rule 10b-5 would have been precluded under *Blue Chip Stamps*. Specifically, shareholders have brought claims of fraud and misrepresentation to recover for injuries sustained when they were induced to refrain from selling securities, and claims for breaches of fiduciary duty when those breaches have caused decreases in the value of their investments. *See supra* pp. 4-6. This Court expressly acknowledged that tradition in *Blue Chip Stamps*. *See* 421 U.S. at 739 n.9.[34] Nothing in SLUSA's text or background manifests a clear intent to preempt a non-transacting plaintiff's state-law claims, which cannot be brought un-

[34] Indeed, questions arose about the availability of a state-law remedy to plaintiffs who could not allege a claim under *Birnbaum*'s interpretation of § 10(b) and Rule 10b-5. *See Blue Chip Stamps* Oral Arg. Tr. at 22.

der federal law. As was the case in *Medtronic*, "[i]t is, to say the least, 'difficult to believe that Congress would, without comment, remove all means of judicial recourse for those injured by illegal conduct,' and it would take language much plainer than the text of [SLUSA] to convince [this Court] that Congress intended that result." 518 U.S. at 487 (opinion of Stevens, J.) (quoting *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 251 (1984)) (citation omitted).[35]

2. The federal government contends (at 22) that this Court should ignore its presumption against preemption in this case because the federal government has for some time regulated the securities markets and the securities industry requires uniform federal standards. The government is wrong on both counts. To be sure, the federal government has had a prominent role in the regulation of publicly traded securities since the New Deal era. But, in *Bates* and *Medtronic*, federal regulation had existed since 1910 and 1906, respectively, *see Bates*, 125 S. Ct. at 1794; *Medtronic*, 518 U.S. at 475, and this Court nonetheless applied its presumption against preemption. *See also Sprietsma*, 537 U.S. at 56 (first federal statute regulating boat safety enacted in 1910).

Further, the securities industry is no more – in fact, it is less – in need of uniform national standards than the industries involved in prior cases where this Court held that state common-law claims were not preempted. In *Bates*, for example, this Court's conclusion that state-law claims survived preemption created the possibility that Dow would be induced to alter the labels on its pesticides in response to the (possibly divergent) verdicts of 50 States' juries. *See* 125 S. Ct. at 1799. In *Sprietsma* and *Medtronic*, this Court permitted state-law claims to proceed even though those claims challenged the design and manufacture of the defendants' products. *See Sprietsma*, 537 U.S. at 66-67 (claim that defendant manufactured

[35] The statutes amended by SLUSA explicitly preserved "any and all other rights and remedies that may exist at law or in equity." 15 U.S.C. § 78bb(a).

an unreasonably dangerous outboard motor because the product lacked a propeller guard not preempted); *Medtronic*, 518 U.S. at 492-94 (defective design claims not preempted). In those cases, the disuniformity permitted by this Court had the potential to force the defendants to make state-specific changes in how they designed and built their products.

That is not the case here: No investment company or securities issuer will, if the Second Circuit's decision is upheld, be forced to alter its products or services in a state-specific fashion, thereby increasing transaction costs for trading in national securities. Instead, to avoid liability under state law, a potential defendant need only tell the truth to the investing public and, specifically, to the millions of Americans pursuing a long-term holding strategy. That approach – simply avoiding misrepresentations, misleading omissions, and the use of manipulative or deceptive devices – is all that is necessary to deal in nationally traded securities without exposure to liability for fraud on holders. *See Cipollone*, 505 U.S. at 529 (plurality op.) ("State-law prohibitions on false statements of material fact do not create 'diverse, nonuniform, and confusing' standards. Unlike state-law obligations concerning the warning necessary to render a product 'reasonably safe,' state-law proscriptions on intentional fraud rely only on a single, uniform standard: falsity.").

The case cited by the government in urging that the presumption against preemption should not apply, *United States v. Locke*, 529 U.S. 89 (2000), is patently inapposite. *Locke* involved "[t]he authority of Congress to regulate interstate navigation" – "an area where the federal interest has been manifest since the beginning of our Republic and is now well established." *Id.* at 99. In the securities field, by contrast, the States were the exclusive regulators until the 1930s, and there has been concurrent state and federal regulation ever since. Although "[u]niformity is undoubtedly important to the [securities] industry," that "interest is not unyielding," *Sprietsma*, 537 U.S. at 70, particularly when, as here, providing the uniformity sought by Merrill Lynch conflicts with the States' "legitimate and compelling interest in preserving a business climate free of fraud and deceptive practices," *Small*, 65 P.3d at 1264 (internal quotation marks omitted). Given the strong state interest in protecting citizens against fraud – as well as the absence of "diverse, nonuniform, and confusing" state-law standards for fraud, *see Cipollone*, 505 U.S. at 529 (plurality op.) – there is no warrant for abandoning this Court's longstanding presumption against preemption in this case.

C. SLUSA Was Not Intended To Preempt The State-Law Holder Claims Of Investors Who Cannot Bring Claims Under Federal Law

Respondent's interpretation of SLUSA's preemption provision also best suits Congress's purpose, which "'is the ultimate touchstone' in every pre-emption case." *Medtronic*, 518 U.S. at 485 (quoting *Retail Clerks Int'l Ass'n v. Schermerhorn*, 375 U.S. 96, 103 (1963)). As the Second Circuit recognized below, interpreting the phrase "in connection with the purchase or sale" in SLUSA to have the same meaning as it does in the context of private litigation under § 10(b) and Rule 10b-5 fulfills Congress's intention of preempting private damages suits under state law that could have been brought under the implied private right of action to enforce the federal antifraud provisions, with the attendant restrictions of the PSLRA. *See* Pet. App. 21a ("If the 'in connection with' phrase is read to reach the same conduct under SLUSA as it does under § 10(b) and Rule 10b-5, then SLUSA will preempt precisely those state class actions which could be brought as federal actions subject to the heightened requirements of the PSLRA."). Nothing in the legislative history indicates that Congress intended to stop investors from seeking redress through traditional common-law causes of action when the rule of *Blue Chip Stamps* prevents them from alleging claims under federal law.

1. Congress intended to halt the flight to state court of federal § 10(b) suits

Following the PSLRA's enactment, the number of class-action securities lawsuits filed in state court increased somewhat.[36] Congress determined that the increase was due to plaintiffs with federally cognizable claims leaving federal court and filing those same claims under state law in state court to avoid PSLRA requirements. *See, e.g.*, H.R. Conf. Rep. No. 105-803, at 14-15 (1998) (Joint Explanatory Statement of the Committee of Conference).

Congress believed that this flight of plaintiffs from federal to state court, if left unchecked, might undermine Congress's goals in passing the PSLRA. Thus, according to SLUSA's Senate co-sponsor, the Act was intended to halt the migration of suits from federal to state court. *See* 143 Cong. Rec. S10475 (Oct. 7, 1997) (Sen. Gramm) ("[W]hile we had dealt with the problem [of abusive securities lawsuits] in Federal court, we now [after the passage of the PSLRA] were seeing a migration of these lawsuits to State courts with a real effort and apparently a successful effort to circumvent what we had done."). The statements of SLUSA's supporters and critics further confirm that the Act's objective was to ensure that the PSLRA was not gutted by a new wave of state-law claims.[37]

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[36] *See* Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 Stan. L. Rev. 273, 298-315 (1998); Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 Cornell L. Rev. 1, 42-45 (1998) (concluding that, beyond an initial spike in 1996, no lasting migration from federal to state court could be seen).

[37] *See, e.g.*, H.R. Conf. Rep. No. 105-803, at 14-15 (Joint Explanatory Statement of the Committee of Conference) ("[S]ince passage of the [PSLRA], plaintiffs' lawyers have sought to circumvent the Act's provisions by exploiting differences between Federal and State laws by filing frivolous and speculative lawsuits in State court, where essentially none of the [PSLRA]'s procedural or substantive protections against abusive suits are available."); 143 Cong. Rec. S10476 (Oct. 7, 1997) (Sen. Dodd) (urging SLUSA's passage because "*[t]his migration of frivolous class actions to State court threatens the effectiveness of the reform act*") (emphasis added); 144 Cong. Rec. H6055 (July 21, 1998) (Rep.

To achieve this goal, Congress required all federally cognizable class-action securities suits to be brought in federal court under federal law. *See supra* p. 7. The legislative record is unambiguous: Congress intended only to preempt those suits migrating from federal to state court, and to leave unaffected traditional state-law securities class-action suits. In the words of Senator Dodd, SLUSA's Senate co-sponsor, "[SLUSA] will [allow Congress to address this state litigation problem] in a very targeted and narrow way, *essentially preempting only those class actions that have recently migrated to State court, while leaving traditional State court actions and procedures solidly in place. . . . This legislation has been carefully crafted only to affect those types of class actions that are appropriately heard on the Federal level*." 143 Cong. Rec. S10477 (Oct. 7, 1997) (emphasis added). Although petitioner attempts to downplay this explanation of SLUSA's scope as that of a "single Senator," Pet. Br. 17, that very same sentiment was echoed by other sponsors of the legislation. *See*, *e.g.*, 144 Cong. Rec. E1385 (July 22, 1998) (Rep. Fazio) ("*Only those suits traditionally filed in Federal courts would be affected by H.R. 1689, while those claims that historically have been pursued in State courts would be left undisturbed*.") (emphasis added); *id.* at E1390 (Rep. Eshoo) ("I would like to make clear that *the bill is not a*

Bliley) ("The Uniform Standards Act will permit meritorious claims to continue to be filed *while preventing the migration of baseless class actions to state courts*. . . . This legislation will put a stop to the inappropriate use of state courts to circumvent the protections that Congress deemed appropriate in 1995 [in the PSLRA].") (emphasis added); *id.* at H10780 (Oct. 13, 1998) (Rep. Eshoo) ("These frivolous suits, traditionally filed in Federal courts, are now being filed in State courts circumventing the intent of the Congress in [the PSLRA]."); *id.* at H10786 (Rep. Tauzin) ("We are back here today because in spite of the fact that we put an end to these strike lawsuits [by passing the PSLRA] . . . we learned that the unscrupulous members of the trial board who were pressing these cases before simply did an end around. They went to State court and increasingly used the authority of the State court to do exactly what they used to do in Federal court . . . . *In short, this [statute] is carefully tailored now to stop the end runs* . . . .") (emphasis added).

federal power grab. We are returning to federal courts cases which until the 1995 Reform Act had always been heard in federal courts. [SLUSA] is limited in scope . . . .") (emphasis added).

Amici assert that Congress was unaware of *Blue Chip Stamps* and the purchaser-seller rule at the time of SLUSA's passage. *See* Investment Co. Inst. *Amicus* Br. 10-11 (asserting that "one might reasonably expect at least one reference to *Blue Chip Stamps*, or the purchaser/seller standing limitation, in the debates that preceded SLUSA's enactment. But there is none. It does not appear from the record that *Blue Chip Stamps* was even considered, let alone implicitly codified, by any legislator who voted on SLUSA."). This plainly erroneous assertion ignores the legislative record. Congress was well aware of *Blue Chip Stamps* and the purchaser-seller limitation. Indeed, both were discussed as part of the penultimate debate on SLUSA's passage. *See* 144 Cong. Rec. H10775 (Oct. 13, 1998) (Dissenting Views of Joint Explanatory Statement of the Committee of Conference) (lamenting the retainer of recklessness liability and arguing that, "just as *there is no remedy under Section 10(b) for those who neither purchase nor sell securities because Congress knew how to create such a remedy but did not*, there can be no liability for reckless conduct under Section 10(b) because Congress clearly knew how to impose liability for reckless behavior but did not") (emphasis added) (citing *Blue Chip Stamps*, 421 U.S. at 734).

Congress understood that, by selecting the "in connection with" language interpreted in *Blue Chip Stamps*, it had preserved claims by holders. *See Blue Chip Stamps*, 421 U.S. at 733-34 ("When Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly."). Congress could have selected different language that would completely preempt all securities litigation, *including* holder claims, had that been SLUSA's goal. For example, Congress might have preempted all state-law class actions alleging harm in connection with the purchase, sale, or *re-*

tention of a security. Using broader language still, Congress might have preempted all actions involving or relating to a nationally traded security. But Congress did not select such language. Instead, it chose the very text interpreted by this Court in *Blue Chip Stamps*, text that – in this Court's view – evidenced a congressional intent not to encompass non-purchasers and non-sellers.

Thus, in specifying rules for "purchase" and "sale" alone, Congress consciously chose not to address holder claims. This was true when Congress declined to authorize holder claims in enacting § 10(b), and it was true again when Congress declined to preempt holder claims in enacting SLUSA. Congress's awareness of *Blue Chip Stamps*, and its understanding of the textual basis for that decision, further bolsters the traditional presumption that Congress intended to ratify that judicial construction when it enacted SLUSA. *See supra* pp. 21-23.

2. Congress intended to preserve a private right of action for all victims of fraud

Congress recognized the necessity of offering, at either the state or federal level, a private right of action for all legitimately aggrieved parties. In enacting SLUSA, it endeavored to prevent abusive litigation while still securing a private right of action to all genuine victims of fraud. SLUSA's Senate co-sponsor recognized "just how important the private litigation system has been in maintaining the integrity of our capital markets," as "[i]t is highly questionable whether our markets would be as deep, as liquid, as strong, as transparent, were it not for our system of maintaining private rights of action against those who commit fraud." 143 Cong. Rec. S10476 (Oct. 7, 1997) (Sen. Dodd). This same concern with preserving a right of action for all aggrieved investors animated many stages of the Act's progress through Congress.[38] Neither the proce-

[38] *See*, *e.g.*, 144 Cong. Rec. H10777 (Oct. 13, 1998) (Letter from Sen. Reed to Sen. Dingell) ("Only a meaningful right of action against those who defraud can guarantee investor confidence in our national markets."); *id.* at E1424 (July 24, 1998) (Rep. Harman) ("Mr. Speaker, let

dural requirements established in the PSLRA, nor the limitation on federal flight established in SLUSA, conflict with that clear purpose. Holder claims are an important element of traditional state-law securities regulation and have been recognized by several States for more than a century. *See supra* pp. 4-6. The PSLRA and SLUSA preserved that component of the current regulatory scheme, without which many instances of securities fraud would go unremedied.

3. Congress did not intend to eliminate all state securities class actions

Petitioner claims that Congress enacted SLUSA to create a single, uniform system of securities litigation. *See* Pet. Br. 34; *see also* U.S. Br. 24. That contention, however, ignores the limitations of the statutory scheme. In crafting SLUSA's language, Congress permitted state law to apply to nationally traded securities through private actions of 49 or fewer investors, *see supra* p. 7, and through public enforcement of state statutes by appropriate state entities, *see id.* Thus, consistent with congres-

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me assure my colleagues that the reform measure before us continues to protect investors. *It recognizes the important role the private litigation system has played in maintaining the integrity of our capital markets*. Yet, at the same time, the bill recognizes that forum shopping cannot be a new pathway for enterprising parties to gain new profits. *The rights of the aggrieved investor to seek justice and restitution is maintained*, while the opportunity to manipulate procedures to the detriment of the company and legitimate investors is hopefully ended.") (emphases added); *id.* at S12445 (Oct. 13, 1998) (Rep. D'Amato) ("Now, let me make one thing clear – *we are not talking about preventing legitimate litigation. Real plaintiffs with legitimate claims deserve their day in court*. . . . Companies that engage in fraudulent conduct should be held fully liable for their actions . . . .") (emphasis added); *id.* at H10779 (Rep. Oxley) ("The conference report preserves the ability of individual investors to file suits that are appropriately brought in State courts, while preventing lawyers from using securities class actions filed in State court for their personal gains."); *see also id.* at S12906 (Oct. 21, 1998) (Sen. Reed) ("[A]s the Senate considered partially preempting state law [in the PSLRA], many Senators, including the primary sponsors of the bill, made clear that preemption would only occur if the federal standard insured investors protection from fraud.").

sional intent, securities litigation is not uniformly federal after SLUSA. Class-action suits by 50 or more purchasers and sellers with federal claims must uniformly be brought under federal law and in federal court; but a company whose securities are nationally traded must still comply with up to 51 different sets of regulations, as state law applies through public enforcement actions or through suits brought by small groups of investors with potentially significant holdings in the company. Such a company must, after SLUSA's passage, comply with different state standards regarding registration of securities,[39] scienter,[40] aiding and abetting,[41] and causation.[42] It is therefore inaccurate to claim that, were holder claims permitted, "uniformity" would be lost in securities regulation.

Moreover, petitioner's assertion that SLUSA's goal was absolute "uniformity" in the class-action field cannot be reconciled with the text of the Act or the legislative record. In SLUSA, Congress explicitly found that "[s]tate securities regulation is of continuing importance, together with Federal regulation of securities, to protect investors and

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[39] *See*, *e.g.*, *A.S. Goldmen & Co. v. New Jersey Bureau of Sec.*, 163 F.3d 780, 782 (3d Cir. 1999) (noting that New Jersey's securities laws require registration of some securities immune from registration under federal law, and upholding the ability of New Jersey securities regulators to prohibit the national offering of unregistered securities by a New Jersey company, even though the relevant securities were not required to be registered federally).

[40] *See*, *e.g.*, *Secretary of State v. Tretiak*, 22 P.3d 1134, 1140 (Nev. 2001) (holding that "reliance and scienter are not required elements of securities fraud in state enforcement actions"); *Kittilson v. Ford*, 608 P.2d 264, 265 (Wash. 1980) (holding that negligence is sufficient to impose liability under state securities law); *Merrill Lynch, Pierce, Fenner & Smith v. Byrne*, 320 So. 2d 436, 440 (Fla. Dist. Ct. App. 1975) (same).

[41] *See*, *e.g.*, *Riedel v. Acutote of Colorado*, 773 F. Supp. 1055, 1066 (S.D. Ohio 1991) (noting that state securities law imposed liability on one who "participated in or aided the seller in any way" in a sale, making secondary liability under state law "much broader than the parallel federal provision").

[42] *See*, *e.g.*, *E.F. Hutton & Co. v. Rousseff*, 537 So. 2d 978, 981 (Fla. 1989) (holding that proof of loss causation is not required for liability under state securities law).

promote strong financial markets." § 2(4), 112 Stat. 3227. SLUSA's sponsors and supporters were careful to note that the bill did not preempt all state-law securities class-action lawsuits. *See*, *e.g.*, H.R. Conf. Rep. No. 105-803, at 15 (Joint Explanatory Statement of the Committee of Conference) ("The solution to this problem [of 'federal flight'] is to make Federal court the exclusive venue for *most* securities fraud class action litigation involving nationally traded securities.") (emphasis added); 143 Cong. Rec. S10477 (Oct. 7, 1997) (Sen. Dodd) (stating that SLUSA will preempt "only those class actions that have recently migrated to State court," but not displacing others "traditional[ly]" heard in state court); *id.* ("[t]his legislation has been carefully crafted only to affect *those types* of class actions that are appropriately heard on the Federal level," recognizing that other "types" of securities class actions are appropriately heard in state court) (emphasis added); 144 Cong. Rec. S4802 (May 13, 1998) (Sen. Kerry) (noting that SLUSA covers "class action lawsuits alleging the commission of securities fraud in connection with the purchase or sale of a covered security," and concluding that "all class action suits of *this type*" should be "brought in federal courts") (emphasis added). Contrary to petitioner's assertion, those statements illustrate that Congress intended *some* number of state-law securities class actions to survive after SLUSA's enactment.

Merrill Lynch and its *amici* place great emphasis on a statement by the Seventh Circuit that "[i]t would be more than a little strange if the Supreme Court's decision [in *Blue Chip Stamps*] to block private litigation by non-traders 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 law or not at all." *Kircher*, 403 F.3d at 484. But there is nothing strange about a conclusion that holder claims fall outside SLUSA's scope, because the Seventh Circuit is simply wrong that Congress mandated in SLUSA that "securities class actions must proceed under federal securities law or not at all." *Id.* Congress did not intend to preempt *all* state-law class actions involving securities. Indeed, if it had, it could have achieved that result in much plainer language. More fundamentally, there is nothing anomalous or illogical in recognizing that Congress, in precluding damages suits under state law that could have been brought under federal law, intended to restrict the operation of SLUSA's preemption provision to actions by those who traded in connection with the alleged fraud – that is, actions that could have been brought under federal law. An anomaly would be created, however, if this Court were to agree with the Seventh Circuit that *Blue Chip Stamps* justifies an interpretation of SLUSA that would deny to investors the very types of claims that *Blue Chip Stamps* said are available only under state law to plaintiffs because such claims do not exist under § 10(b) and Rule 10b-5.

D. The Second Circuit's Reading Of SLUSA's Preemption Provision Advances The Policies Underlying The Federal Securities Laws

Federal securities laws, which SLUSA merely amended, "'embrace a fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*.'" *Central Bank*, 511 U.S. at 171 (quoting *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972)) (alteration in original). Continuing to permit private plaintiffs to bring holder claims under state law, as they have done for more than a century, furthers that "fundamental purpose." On the other hand, abolishing holder claims shields wrongdoers from liability and threatens the integrity of America's financial markets. Indeed, the Seventh Circuit candidly admitted that its reading of SLUSA's preemption provision would leave some injuries in the hands of public prosecutors, which have been slow to respond to innovative forms of securities fraud, such as market timing. *See Kircher*, 403 F.3d at 484.

1. Meaningful private enforcement is necessary to preserve the integrity of this country's financial markets

At the time of SLUSA's consideration, the then-Chairman of the SEC reminded Congress that a private right of action was an invaluable element in securities regulation efforts:

> *The Commission has always relied, and continues to rely, on private actions in both federal and state courts to support the agency's efforts to combat fraud.* Private actions are an especially important supplement to the Commission's enforcement program today because of the phenomenal growth of the securities industry during a time when the Commission's staff and budget levels have remained relatively constant. *The importance of private actions has been reinforced by the recently reported rise in fraud similar to that witnessed during the bull market of the 1980s.*

Prepared Testimony of The Honorable Arthur Levitt, Jr., SEC Chairman, and The Honorable Isaac C. Hunt, SEC Commissioner, Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs (Oct. 29, 1997) (emphases added). These sentiments echoed the longstanding position of the Commission.[43]

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[43] *See Securities Investor Protection Act of 1991: Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 102d Cong. 15-16 (1991) (testimony of Richard C. Breeden, SEC Chairman) (explaining that a meaningful private right of action is necessary to supplement the SEC's enforcement activity, because the SEC is able to prosecute only a fraction of the cases in which investors have suffered losses); *Private Litigation Under the Federal Securities Laws: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 103d Cong. 113-14 (1993) (testimony of William R. McLucas, Director, SEC Division of Enforcement) (explaining that the SEC is unable to address all securities violations and that SEC enforcement actions cannot substitute for private actions in allowing investors to recover losses, because, "[a]lthough the Commission usually makes disgorged funds available for the compensation of injured investors, the amount of investor losses often exceeds the wrongdoer's ill-gotten gains") (footnote omitted). The

Congress took the SEC's warnings to heart, and itself noted that a private right of action is invaluable to the maintenance of healthy markets. *See supra* pp. 36-37. Indeed, Congress has recently reaffirmed its commitment to providing a meaningful private right of action for aggrieved investors. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 306(a)(2)(B), 116 Stat. 745, 779, codified at 15 U.S.C. § 7244(a)(2)(B) (creating a new private right of action against directors or officers buying or selling certain securities during specified periods); *id.* § 804(a)(2), 116 Stat. 801, codified at 28 U.S.C. § 1658(b) (extending the statute of limitations on securities fraud claims). This Court has often noted that a private right of action is indispensable in encouraging efficient national markets and maintaining investment levels.[44]

Petitioner's proposed construction of the Act ignores that reality and functionally eliminates any right of action for millions of victims of market manipulation. The abolition of holder claims would seriously distort financial markets by precluding compensation for massive and longstanding fraud. As a result of market timing alone, millions of investors have suffered what a leading mutual fund manager describes as $5 to $10 billion per year in dilution and depletion of their securities holdings.[45] *See*

SEC has presented similar views to this Court in prior litigation. *See*, *e.g.*, Brief for the SEC as *Amicus Curiae* in Support of Partial Affirmance at 6, *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983) (Nos. 81-680 & 81-1076), 1982 WL 608452 ("Given the limited enforcement resources of the Commission, the private right of action is vital to effective enforcement of Section 10(b).").

[44] *See*, *e.g.*, *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) ("[W]e repeatedly have emphasized that implied private actions provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to [SEC] action.'") (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964)).

[45] Market timers have operated unchecked for a great many years. *See*, *e.g.*, Don M. Chance & Michael L. Hemler, *The Performance of Professional Market Timers: Daily Evidence from Executed Strategies*, 62 J. Fin. Econ. 377, 378 (2001) (tracking "the performance of 30 professional market timers during 1986-1994").

supra pp. 11-14. Yet, as of May 2005, the SEC had brought only 29 enforcement actions against mutual funds and their employees, and had recovered less than $2 billion in settlements.[46] That recovery, while not insubstantial, represents only a fraction of the tens of billions in losses caused by market timers prior to 2003. Moreover, no more than $1 billion of the recovery has been earmarked for restitution to aggrieved investors.[47] Because only holders (and not purchasers or sellers) are the victims of market timing, *see supra* pp. 12-13, a private right of action for holders is the only remedy for the millions of investors whose long-term savings have been diluted. As the SEC itself recognizes, *see supra* note 43, public enforcement is simply insufficient to that task.

2. Class actions are necessary for effective enforcement of securities regulations

Just as it ignores the realities of securities enforcement, petitioner's proposed construction of SLUSA ignores the realities of modern litigation and the fact that meritorious and socially desirable claims will not be brought if the costs of litigation are prohibitively high. It is not true that injured investors whose claims would be preempted under petitioner's theory will simply file suit individually rather than as part of a class action. Between 1996 and 2001, the average fund-holding American family lost approximately $3,740 of its long-term savings to several forms of market manipulation. *See supra* p. 11 & note 20. Although that average dollar amount is a significant sum, it is likely not enough to make an individual suit for damages economically viable. Millions of families, moreover, suffered losses of less than that average figure, but that involve billions of dollars in the aggregate. For many ordinary stockholders, the denial of class relief would mean no relief at all. As this Court has recognized, "'[t]he policy

[46] *See* 2005 House Hearing at 22 (Fig. 1) (Hillman Statement), 38 (Richards Statement).

[47] *See id.* at 21 (Hillman Statement) (estimating restitution at $800 million to $1 billion).

at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights.'" *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 617 (1997) (quoting *Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 344 (7th Cir. 1997)); *accord Deposit Guar. Nat'l Bank v. Roper*, 445 U.S. 326, 338 n.9 (1980). The unavailability of class-action lawsuits in this context would be a tremendous windfall for the many perpetrators of fraud whose conduct escapes the enforcement of federal or state authorities. It would also ensure that millions of Americans go uncompensated for their losses – losses that may exceed the windfall received by defrauding parties.

3. Holder claims are not unmanageable or inherently abusive

By affirming the decision below, this Court would not invite abusive complaints. The Second Circuit was careful to establish safeguards against frivolous lawsuits by sham holders. To plead a valid holder claim for fraud in the Second Circuit, a plaintiff must demonstrate that her purchase of the security occurred *before* the onset of the misrepresentation or omission of the defendant. *See* Pet. App. 38a-39a. If the complaint is silent as to the manner in which class members came to own the relevant securities, or if it includes a mix of purchasers (some in reliance on the fraud, others not in reliance), the complaint cannot proceed; the decision below requires that the plaintiff's class definition explicitly disclaim those who purchased in reliance on the fraud. *See id.* at 41a-43a. Under the Second Circuit's standard, only individuals who purchased pre-fraud and therefore could not bring purchaser claims, and who did not sell in reliance on the fraud and therefore could not bring seller claims, will qualify as class members. *See*, *e.g.*, *Gordon v. Buntrock*, No. 00 CV 303, 2000 U.S. Dist. LEXIS 5977, at *10-*11 (N.D. Ill. Apr. 28, 2000) (noting that plaintiff had gone to great lengths to stress that his complaint alleged misrepresentations only in connection with the holding of securities, and that class members had not been deceived into initially purchasing the stock). It is simply not true that "virtually any purchaser or seller claim could, if gerrymandered as to the timing of the class period and tweaked a bit in its allegations, be stated as a holder suit." Chamber of Commerce *Amicus* Br. 25; *accord* U.S. Br. 28-29. In fact, the opposite is true: an individual with a viable purchaser claim will not have a viable holder claim, and vice versa.

Although the Second Circuit has already taken steps to safeguard against holder claims that are speculative or that merely attempt to circumvent the pleading requirements for purchaser-seller claims, state courts are of course fully equipped to ensure that only plaintiffs with meritorious claims proceed to trial and recover. State courts have established their own, often stringent, pleading requirements for state-law holder claims. Some courts have held that holders of securities could not plead actionable claims for relief under state common law because their claims either were "too speculative"[48] or should have been brought as derivative actions[49]; because the investors could not establish either loss causation[50] or reliance[51]; or because the State declined to recognize a securities fraud claim for those who are neither purchasers nor sellers.[52]

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[48] *See Crocker v. FDIC*, 826 F.2d 347, 350-51 (5th Cir. 1987) (applying Mississippi law); *Chanoff v. United States Surgical Corp.*, 857 F. Supp. 1011, 1018 (D. Conn.) (applying Connecticut law), *aff'd*, 31 F.3d 66 (2d Cir. 1994).

[49] *See, e.g.*, *Smith v. Waste Mgmt., Inc.*, 407 F.3d 381 (5th Cir. 2005) (Delaware law); *Arent v. Distribution Sciences, Inc.*, 975 F.2d 1370, 1372-73 (8th Cir. 1992) (Minnesota law); *Kagan v. Edison Bros. Stores, Inc.*, 907 F.2d 690, 692 (7th Cir. 1990) (Illinois law).

[50] *See, e.g.*, *Arent*, 975 F.2d at 1374; *Kagan*, 907 F.2d at 692; *Crocker*, 826 F.2d at 351-52.

[51] *See In re WorldCom, Inc. Sec. Litig.*, 382 F. Supp. 2d 549, 559-60 (S.D.N.Y. 2005) (applying New York Law); *Rogers*, 268 F. Supp. 2d at 1313-14.

[52] *See Loop Corp. v. McIlroy*, No. A04-362, 2004 WL 2221619, at *5 (Minn. Ct. App. Oct. 5, 2004) ("Minnesota law has not recognized a common-law holding claim related to securities."); *see also In re WorldCom, Inc. Sec. Litig.*, 336 F. Supp. 2d 310, 322-23 (S.D.N.Y. 2004) (pre-

As is typically the case in our federal system, each State remains free to craft its own procedural rules and evidentiary standards for managing holder claims. States can, for example, build in a corroboration requirement, such that mere subjective belief will not state a claim. *See Small*, 65 P.3d at 1265 (requiring holders to allege "actions, as distinguished from unspoken and unrecorded thoughts and decisions, that would indicate that the plaintiff actually relied on the misrepresentations" in deciding not to sell a security). As for the concern that issuers could be "hauled into court 'any time a stock price fluctuated,'" that "could only happen after the plaintiff(s) had decided to shoulder 'the formidable task of proving common law fraud.'" *Greenfield v. Fritz Cos.*, 98 Cal. Rptr. 2d 530, 543 (Cal. Ct. App. 2000), *rev'd on other grounds sub nom. Small v. Fritz Cos.*, 65 P.3d 1255 (Cal. 2003). Indeed, the California Supreme Court requires holders to "allege specific reliance on the defendants' representations: for example, that if the plaintiff had read a truthful account of the corporation's financial status the plaintiff would have sold the stock, how many shares the plaintiff would have sold, and when the sale would have taken place." *Small*, 65 P.3d at 1265. And most States reject the fraud-on-the-market theory of proving reliance that prevails in federal court under *Basic Inc. v. Levinson*, 485 U.S. 224, 241-49 (1988). *See*, *e.g.*, *Mirkin v. Wasserman*, 858 P.2d 568, 584 (Cal. 1993) (refusing to incorporate the fraud-on-the-market doctrine into the law of deceit). In addition to requiring plaintiffs to plead and prove the elements of whatever claim they seek to bring, States are free to reject holder claims altogether. *See supra* note 52 (collecting cases rejecting holder claims under state law). States should be afforded the opportunity to create a

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dicting that Georgia Supreme Court would not permit plaintiffs' putative class action to proceed because it would not "recognize a cause of action for a class of plaintiffs who are alleged to have held their stock in reliance on misrepresentations or omissions," or, if it did, it would require allegations of individualized, justifiable reliance).

workable balance between the rights of aggrieved investors and the needs of defendants and the judicial system.

In addition, the potential for abuse through true "holder" claims – that is, claims by persons induced to hold their securities or harmed while holding securities – is not nearly as great as that for mere non-purchaser claims of the sort at issue in *Blue Chip Stamps*. With respect to the latter claims, a near-infinite universe of potential plaintiffs could assert that they subjectively intended to purchase a stock, but were induced not to do so by the defendant's fraud. With respect to the former, only those persons having already purchased the security prior to the advent of the fraud would be permitted to bring suit. Any difficulties of proof in such suits are not insurmountable and do not justify denying holder plaintiffs access to both state and federal court.[53] Indeed, non-seller suits, by definition, provide evidence to cabin the speculative nature of the suit. Whereas a non-purchaser could assert an intent to purchase any number of shares, exposing the defendant to nearly unlimited damages, a non-seller claim is necessarily limited to the number of shares that the seller held at the time of the induced non-sale. Accordingly, the non-seller claims that would be permitted to proceed under a proper construction of the Act are not subject to the same type of abuse as the non-purchaser claims considered by this Court in *Blue Chip Stamps*, which were "unconstrained by any such anchor in demonstrable fact." *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1092 (1991).

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[53] In at least some cases, plaintiffs will be able to provide convincing evidence corroborating their desire to sell and the inducement leading them to forbear that sale. *See*, *e.g.*, *supra* note 13 (discussing Merrill Lynch settlement with Debasis Kanjilal, who called his Merrill Lynch investment advisors daily and communicated his desire to sell certain stocks, but was repeatedly encouraged to "sit tight"). Moreover, given that the plaintiff in a non-seller case has already purchased at least one security (the security at issue in the complaint), it is conceivable that the plaintiff could prove an intent to sell by providing evidence of prior patterns of purchase and sale activity.

Merrill Lynch and its *amici* further contend that classes of holders who have been fraudulently induced by public statements to retain stock in publicly traded companies cannot establish that they have been harmed. They claim that the damages of those holders would be either (1) nothing, as the earlier revelation of the truth would have caused the same loss in value to the stock, or (2) too speculative to maintain. Their contention is incorrect in both respects, and more fundamentally, is irrelevant to the question before this Court.

First, it is far from clear that a security loses the same value when, on the one hand, negative information is released in a timely and permissible manner, and, on the other, the same information is fraudulently withheld for some period of time and is then either discovered or revealed. It defies common sense to suppose that the entire decrease in value following a belated disclosure – such as a significant accounting restatement – is attributable to the mere learning of bad news. Much of that drop in stock price is likely a result of the impact of the discovery of fraud on investor confidence in the issuer's management. The fraud might also expose the company to monetary liability in civil and criminal proceedings, and the market is likely to look skeptically upon other non-fraudulent disclosures by the corporation, causing a further decrease in the stock's value. *See Small*, 65 P.3d at 1271 (Baxter, J., concurring) (observing that "delayed disclosure of bad news, under circumstances suggesting that earlier reports were dishonestly or incompetently false, might have an effect on the market price of the shares beyond the effect of the bad news itself").

Second, the damages in a holder suit are no more speculative than for many traditional causes of action. As with other torts alleging the temporary or permanent destruction in value of private property (such as misappropriation or conversion), damages may be ascertained by submitting expert testimony on the quantum of temporarily reduced value in the property – for example, the opportunity cost to the plaintiff of the defendant's wrongdoing. Any difficulties in obtaining this proof do not justify denying a plaintiff the opportunity to submit such evidence to a jury. *See id.* at 1270 (Kennard, J., concurring) ("Experts may disagree – they often do – but that is no reason to reject a holder's cause of action."). Moreover, there is no need to peg a holder's damages to an actual sale or to discount a holder's damages based on a post-fraud increase in the value of the security. Even a subsequent increase in the price of the stock does not fully compensate an aggrieved holder. The asset, for the period that its value was diminished, caused its owner a tangible loss, as it was not available for any number of uses (such as collateral for a loan). *See id.* at 1267 (Kennard, J., concurring) (collecting examples of tangible harms inflicted absent a sale of the security). That is enough – as it is in an action for misappropriation or conversion – to state a claim for the loss caused by the temporary deprivation of the property's full value. Even if the loss suffered by an investor in a publicly traded company who is fraudulently induced to hold shares is not cognizable under federal law, our federal system permits States to define the contours of their common-law claims. *See*, *e.g.*, *id.* at 1263-64.

In any event, the contentions of Merrill Lynch and its *amici* are irrelevant to the present inquiry. The operative question at this stage is not "whether [state] law would permit recovery on such a theory, but only whether the putative state-law claim falls within SLUSA's preemptive scope." Pet. App. 38a n.14. *See also id.* at 44a n.16 ("[I]n considering whether a claim is preempted by SLUSA we do not consider the merit of the claim under state law.").

II. THE SECOND CIRCUIT'S DISPOSITION OF THIS CASE SHOULD BE AFFIRMED

The Court should affirm the Second Circuit's judgment upholding the dismissal of Dabit's amended complaint without prejudice to his ability to file a new complaint containing claims that would not be preempted under the Second Circuit's interpretation of SLUSA. Dabit may plead several successful holder claims consistent with the

Second Circuit's requirements. Although we detail multiple theories of relief that SLUSA would not preempt, we also note that, "[b]ecause the pre-emption defense raises a threshold issue, [this Court has] no occasion to consider the merits of [Dabit's] claims, or even whether the claims are viable as a matter of [state] law." *Sprietsma*, 537 U.S. at 56; *see also Medtronic*, 518 U.S. at 495 (noting that "the precise contours of [the plaintiffs'] theory of recovery have not yet been defined").

Fraudulent inducement to hold. Dabit purchased securities prior to the provision of any biased investment reports by Merrill Lynch analysts, and subsequently held those securities on the basis of Merrill Lynch's recommendations. He therefore may seek to recover for the damages he suffered as a consequence of his induced failure to sell. That is the allegation Dabit attempted to make in his first amended class-action complaint. *See* JA 52a (¶ 1) (describing the class as one consisting of brokers who "owned and continued to own" securities recommended by Merrill Lynch during the class period); *id.* (¶ 2) (alleging that, "*after* Plaintiff[']s purchase of the [securities]," Merrill Lynch "failed to advise Plaintiff of the fact of the decreasing values of the [securities], and misrepresented to Plaintiff that the [securities] were worthy of holding in Plaintiff's or Plaintiff's clients' portfolio") (emphasis added).

Market-timing injuries. Dabit also owned mutual funds offered by Merrill Lynch for his and his clients' accounts, *see supra* note 16, and therefore may attempt to recover for the actions of the fund managers in permitting market timers to dilute fund assets.[54] As noted above, *see supra* pp. 13-14, many mutual funds published, but did not adhere to, policies designed to discourage or eliminate market timing. Dabit may be able to plead a holder claim for the fund's intentional non-compliance with those pro-

[54] If such funds were managed by a different Merrill Lynch entity, Dabit presumably would be free on remand to add that entity as a defendant. *See* Fed. R. Civ. P. 19, 20.

cedures. For funds with a large proportion of international assets traded on foreign exchanges, such a claim might be significant, as those funds were particularly susceptible to time-zone arbitrage. *See id.* at 12.

Of course, Dabit may have other claims, unrelated to any fraud in connection with the purchase or sale of securities, that can proceed without regard to whether SLUSA preempts holder claims and that Dabit should have the opportunity to plead. This Court granted certiorari to resolve a conflict in the courts of appeals on the meaning of the phrase "in connection with the purchase or sale of a covered security" in SLUSA. *See* Pet. i. Even if this Court reverses the Second Circuit, not every class action of 50 persons or more proceeding under state law that alleges misconduct "coincid[ing]," *Zandford*, 535 U.S. at 820, with a transaction in a nationally traded security will be preempted by SLUSA. For SLUSA to apply, the plaintiff must allege "a misrepresentation or omission of a material fact" or "that the defendant used or employed any manipulative or deceptive device or contrivance," 15 U.S.C. § 78bb(f)(1). Plaintiffs such as Dabit may still bring class actions under state law to recover for harm caused by, for example, negligence; breach of contract, *see Falkowski v. Imation Corp.*, 309 F.3d 1123, 1131 (2002), *amended on other grounds*, 320 F.3d 905 (9th Cir. 2003); *Norman v. Salomon Smith Barney Inc.*, 350 F. Supp. 2d 382, 385-88 (S.D.N.Y. 2004); *Xpedior Creditor Trust v. Credit Suisse First Boston (USA) Inc.*, 341 F. Supp. 2d 258, 269-70 (S.D.N.Y. 2004); or breach of fiduciary duties or the implied covenants of good faith and fair dealing, *see Norman*, 350 F. Supp. 2d at 385-88; *Xpedior Creditor Trust*, 341 F. Supp. 2d at 269-70; *cf. Kircher*, 403 F.3d at 482-83 (citing *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977)). That does not mean, of course, that a plaintiff can avoid SLUSA preemption merely by omitting to plead that a misrepresentation was made with scienter, as required by *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197, 199 (1976). But when a claim does not require the plaintiff to prove that the defendant made a misrepresentation or omission, or engaged in manipulation, the existence of such facts does not bring the claims within SLUSA's preemptive scope.[55]

Lost fees. Dabit also has asserted a separate claim for fees lost when customers transferred their brokerage accounts from Merrill Lynch following disclosures of its biased and misleading investment advice. *See* JA 52a. The Second Circuit recognized that that claim did "not allege fraud that 'coincide[s]' with the sale or purchase of a security," Pet. App. 44a (quoting *Zandford*, 535 U.S. at 825), and held it not preempted, *id.* Merrill Lynch did not seek this Court's review of that aspect of the court of appeals' judgment. On remand, an additional theory of non-preempted lost fees could be based on an allegation that Merrill Lynch's fraud reduced the asset values in the portfolios of Dabit's clients, causing a corresponding reduction in fees collected based on a percentage of assets under management.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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[55] *Cf. Bates*, 125 S. Ct. at 1798 (noting that preemption was inappropriate unless a state rule both (1) established a requirement "for labeling or packaging," and (2) imposed a requirement "in addition to or different from" federal law; holding that, where common-law rules established rules for product *design* or *testing*, rather than rules for *labeling* or *packaging*, suits on those common-law theories were not preempted). Without regard to this Court's construction of the "in connection with the purchase or sale" standard, common-law claims not requiring a plaintiff to allege a "misrepresentation or omission" are not preempted by SLUSA. *See id.* at 1797-99 (concluding that, because "[t]he proper inquiry calls for an examination of the elements of the common-law duty at issue," defective product design claims did not establish a requirement for "labeling" and "packaging," and therefore were not preempted).

Respectfully submitted,

WILLIAM B. FEDERMAN
STUART W. EMMONS
FEDERMAN & SHERWOOD
120 N. Robinson
Suite 2720
Oklahoma City, OK 73102
(405) 235-1560

CLELL I. CUNNINGHAM III
DUNN, SWAN &
CUNNINGHAM, P.C.
210 Park Avenue
Suite 2800
Oklahoma City, OK 73102
(405) 235-8318

DAVID C. FREDERICK
Counsel of Record
PRIYA R. AIYAR
BRENDAN J. CRIMMINS
PATRICK D. CURRAN
KELLOGG, HUBER, HANSEN,
TODD, EVANS & FIGEL,
P.L.L.C.
1615 M Street, N.W.
Suite 400
Washington, D.C. 20036
(202) 326-7900

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