No. 04-1371

In the Supreme Court of the United States

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

v.

SHADI DABIT

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

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether the Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227, preempts state-law class action claims brought on behalf of persons who held or retained, but did not purchase or sell, securities based upon allegedly fraudulent statements or omissions.

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INTEREST OF THE UNITED STATES

The United States, through the Securities and Exchange Commission (Commission) and the Department of Justice (Department), administers and enforces the federal securities laws. This case involves the extent to which the Securities Litigation Uniform Standards Act of 1998 (SLUSA), Pub. L. No. 105-353, 112 Stat. 3227, preempts private securities fraud class actions brought under state law. Legitimate private actions are an essential supplement to civil enforcement actions and criminal prosecutions brought by the Commission and the Department, but the availability of the class action mechanism and liberal discovery rules create a substantial risk of abusive and counterproductive "strike" suits.

The United States has a strong interest in ensuring that the principles applied in private securities fraud actions promote the purposes of the securities laws without unduly burdening the efficient operation of the securities markets.

In addition, Congress tied the scope of preemption under SLUSA to the scope of conduct prohibited by the statutes and Commission regulations prohibiting securities fraud. Pet. App. 17a-21a. The United States thus has an especially strong interest in the correct interpretation of those provisions, including the "in connection with" requirement at issue in this case.

STATEMENT

1. Section 10(b) of the Securities Exchange Act of 1934 (the 1934 Act) makes it unlawful to "use or employ, in connection with the purchase or sale of any security * * *, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. 78j(b). The Commission's Rule 10b-5 implements Section 10(b) by declaring it unlawful, "in connection with the purchase or sale of any security," to "employ any device, scheme, or artifice to defraud"; "make any untrue statement of a material fact or * * * omit to state a material fact necessary in order to make the statements made * * * not misleading"; or "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. 240.10b-5.

The Commission may bring a civil enforcement action against "any person" who "violated any provision of [the 1934 Act]" or "the rules or regulations thereunder," 15 U.S.C. 78u(d)(3)(A), and the Department may bring criminal prosecutions for willful violations, 15 U.S.C.

78ff(a) (Supp. II 2002). See also 15 U.S.C. 78u(d)(1) (Supp. II 2002) (authorizing Commission actions for prospective injunctive relief whenever a person is "about to engage" in a violation). Section 10(b) has also been construed to afford an implied right of action to private parties, but this Court has held that the private right of action does not extend to individuals who "neither purchased nor sold any of the offered shares." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 725 (1975).

Out of concern that the salutary purposes of private securities litigation were being "undermined by * * * abusive and meritless suits," H.R. Conf. Rep. No. 369, 104th Cong., 1st Sess. 31 (1995), Congress enacted the Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737. That statute adopted numerous reforms applicable to actions brought under the 1934 Act, such as a safe harbor for forward-looking statements, heightened pleading standards, an automatic stay of discovery, and provisions governing the appointment of class action plaintiffs and counsel. See 15 U.S.C. 78u-4(b), 78u-5.

By 1998, however, Congress observed a rise, in response to the PSLRA, of class actions brought in state courts based on state-law claims, which "prevented [the PSLRA] from fully achieving its objectives" of "prevent[ing] abuses in private securities fraud lawsuits." SLUSA § 2(1)-(3), 112 Stat. 3227. Congress therefore found it "appropriate to enact national standards for securities class action lawsuits involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits." SLUSA § 2(5), 112 Stat. 3227. To that end, Congress directed that "[n]o 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," among other things, "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." SLUSA § 101(b), 112 Stat. 3230, 15 U.S.C. 78bb(f)(1)(A).

2. Respondent, a former broker of petitioner's, filed suit in the United States District Court for the Western District of Oklahoma alleging state-law claims for breaches of fiduciary duty and the covenant of good faith and fair dealing. Pet. App. 4a-5a. Respondent alleged that petitioner "issued falsely favorable reports" about certain stocks "in an effort to encourage widespread purchasing of these stocks and to artificially support the stocks['] prices." J.A. 31a. After the alleged manipulation ceased, the stock prices dropped, leaving those "who purchased these stocks at manipulation-inflated prices with substantial losses." J.A. 29a. Respondent sought to represent a class of petitioner's brokers who "purchased" the relevant stocks and were damaged thereby. J.A. 41a.

The district court dismissed the complaint as preempted by SLUSA because it alleged misrepresentations in connection with the purchase of securities. J.A. 49a. The court granted leave to re-plead, however, because it was "conceivable that claims based on wrongfully-induced holding could be pleaded." *Ibid.*

Respondent filed an amended complaint that generally refrains from using the words "purchase" and "sale," but alleges the same scheme to "manipulate the price of [certain] stocks, causing these stocks to trade at artificially inflated prices." J.A. 53a. The class defini-

tion is limited to brokers who "held" the stocks and were damaged thereby. J.A. 64a.

After the Judicial Panel for Multi-District Litigation transferred this case to the Southern District of New York, that court dismissed the amended complaint. Pet. App. 53a-55a. The court explained that respondent's claims are "based on the very same series of transactions and occurrences asserted in the federal securities actions currently being coordinated before this Court" and "fall squarely within SLUSA's ambit." *Id.* at 55a.

3. The court of appeals vacated in part and remanded. Pet. App. 1a-52a. Noting that SLUSA preempts claims based on misrepresentations "in connection with the purchase or sale" of securities, the court began its analysis with the recognition that "the meaning of 'in connection with' under SLUSA is coterminous with the meaning of the nearly identical language of § 10(b) of the [1934 Act] and its corresponding Rule 10b-5." Pet. App. 3a. In construing the meaning of that phrase, however, the court relied on this Court's holding in *Blue Chip*, *supra*, that persons who neither purchased nor sold securities lack standing to pursue a private right of action under Section 10(b) or Rule 10b-5. Pet. App. 27a-30a. The court recognized that "[t]he limitation on standing to bring private suit for damages" under *Blue Chip* "is unquestionably a distinct concept from the general statutory or regulatory prohibition on fraud in connection with the purchase or sale of securities." *Id.* at 27a. Nonetheless, "[b]ecause *only* purchasers and sellers have a federal private damages remedy," the court concluded that "Congress meant to import the settled standing rule along with the 'in connection with' phrase as a substantive standard," and thereby ex-

empted claims of non-purchasers and non-sellers from preemption. *Id.* at 28a.

The court of appeals also relied on an "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." Pet. App. 30a-31a (quoting *City of Milwaukee* v. *Illinois*, 451 U.S. 304, 316 (1981)). It determined that Congress had not manifested such a purpose because, although "[t]he legislative history * * * generally indicates a broad preemptive intent," it "contains no specific mention of holding claims or other non-purchaser/non-seller claims." *Id.* at 31a.

Finally, the court of appeals held that respondent's class action claims are preempted in part. "[C]laims of brokers who purchased the stock during the class period in reliance on the misrepresentations" were held to be preempted, while claims based on holding (but not purchasing or selling) stocks were held not to be preempted. Pet. App. 41a. Because the amended complaint does not distinguish between the two sets of claims, the court of appeals remanded with instructions to dismiss all such claims without prejudice to repleading the non-preempted claims. *Id.* at 42a-43a.

SUMMARY OF ARGUMENT

SLUSA preempts state-law class action claims alleging "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. 78bb(f)(1)(A). The court of appeals correctly held that "the meaning of 'in connection with' under SLUSA is coterminous with the meaning of the nearly identical language of § 10(b) of the [1934 Act] and its corresponding Rule 10b-5." Pet. App. 3a. Because

respondent alleges that petitioner made misrepresentations that inflated the prices at which securities were bought and sold, his claims fall well within the scope of Rule 10b-5 and are therefore preempted by SLUSA.

The court of appeals nonetheless held that respondent could avoid preemption by "exclud[ing] from the class claimants who purchased in connection with the fraud." Pet. App. 43a. That holding is incorrect because it conflates the question of standing to sue with the question of the conduct alleged. Preemption under SLUSA turns on whether the defendant allegedly committed fraud in connection with the purchase or sale of securities, not whether the plaintiff or class members themselves purchased or sold securities. Under *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), the latter inquiry determines whether a particular plaintiff has standing to sue, but not whether the defendant committed fraud in connection with the purchase or sale of securities.

The court of appeals further erred by relying on an "assumption" of non-preemption and a perceived absence of relevant legislative history. Because securities markets and transactions have long been regulated by the federal government, no such "assumption" applies to SLUSA's express preemption provision. In any event, SLUSA's text overcomes any applicable assumption by clearly and manifestly tying its preemptive effect to the scope of Rule 10b-5's substantive prohibition against securities fraud. The legislative history confirms that Congress intended to apply uniform federal standards to all securities fraud class actions except those it expressly exempted. The uniformity that Congress intended to achieve would be illusory if the uniform federal standards were not binding on plaintiffs who held,

rather than purchased or sold, an affected security during the period of alleged fraud. Under the court of appeals' theory, state-law class actions could proceed in virtually every case of alleged fraud, because it is generally possible in class actions to allege that the same fraudulent conduct injured purchasers and holders alike.

Indeed, the decision below would have the perverse effect of reading a law designed to eliminate abusive and meritless lawsuits to preserve the suits most likely to be abusive and meritless. If any set of plaintiffs were to be exempted from preemption, it would not be those who neither purchased nor sold securities. *Blue Chip* denies standing to such plaintiffs precisely because their suits present an especially high risk of abuse in light of the relative ease of alleging, and difficulty of disproving, that a plaintiff relied on public representations in *not* purchasing or selling a security. Construing *Blue Chip* to immunize "holder" class actions from SLUSA preemption would contravene the intent of Congress and the policies recognized by this Court in *Blue Chip* by permitting a particularly abusive category of state-law class actions to escape SLUSA's reach.

ARGUMENT

THERE IS NO PURCHASER/SELLER LIMITATION ON THE SCOPE OF SLUSA PREEMPTION

In pertinent part, SLUSA provides that "[n]o covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging * * * a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. 78bb(f)(1)(A). As the court of appeals recognized, there is no dispute that this

case is a "covered class action" (see 15 U.S.C. 78bb(f)(5)(B)(i)) based on state common law claims (for breach of fiduciary duty and the duty of good faith and fair dealing, see Pet. App. 6a), involving securities covered by SLUSA (because they are traded on national exchanges, see 15 U.S.C. 78bb(f)(5)(E), 77r(b)(1)). See Pet. App. 16a-17a.

Nor is there any dispute that the amended complaint alleges misrepresentations. See Pet. App. 17a. Instead, the question is "whether these purported misrepresentations were alleged to be 'in connection with the purchase or sale' of the covered securities." *Ibid*. Because the amended complaint alleges as a key premise of respondent's claims that the misrepresentations caused stocks to trade at inflated prices, the misrepresentations were plainly made "in connection with the purchase or sale" of securities—*regardless* of whether this particular plaintiff class bought or sold securities in connection with the misrepresentations.

A. The Key Statutory Phrase "In Connection With The Purchase Or Sale" Of A Security Has The Same Meaning In SLUSA That It Has In Section 10(b) And Rule 10b-5

As the court of appeals correctly concluded, "the meaning of 'in connection with' under SLUSA is coterminous with the meaning of the nearly identical language in § 10(b) of the [1934 Act] and its corresponding Rule 10b-5." Pet. App. 3a. "In using the phrase 'in connection with the purchase or sale of a covered security,' Congress * * * was using language that, at the time of SLUSA's enactment, had acquired settled, and widely-acknowledged, meaning in the field of securities law, through years of judicial construction in the context of § 10b-5 lawsuits." *Riley* v. *Merrill Lynch, Pierce,*

Fenner & Smith, Inc., 292 F.3d 1334, 1342-1343 (11th Cir.), cert. denied, 537 U.S. 950 (2002); accord Pet. App. 20a-21a; *Disher* v. *Citigroup Global Mkts. Inc.*, 419 F.3d 649, 654 (7th Cir. 2005); *Rowinski* v. *Salmon Smith Barney Inc.*, 398 F.3d 294, 299 (3d Cir. 2005). When, as here, "administrative and 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 administrative and judicial interpretations as well." *Bragdon* v. *Abbott*, 524 U.S. 624, 645 (1998); see *NLRB* v. *Amax Coal Co.*, 453 U.S. 322, 329 (1981); *Lorillard* v. *Pons*, 434 U.S. 575, 580-581 (1978).

Accordingly, "[e]very court of appeals to encounter SLUSA has held that its language has the same scope as its antecedent in Rule 10b-5." *Kircher* v. *Putnam Funds Trust*, 403 F.3d 478, 482 (7th Cir. 2005), petition for cert. pending, No. 05-409 (filed Sept. 29, 2005); see Pet. App. 19a-20a; *Disher*, 419 F.3d at 654; *Rowinski*, 398 F.3d at 299; *Riley*, 292 F.3d at 1342-1343; *Green* v. *Ameritrade, Inc.*, 279 F.3d 590, 597 (8th Cir. 2002). As the court of appeals noted, both parties to this case have agreed with those holdings. Pet. App. 17a, 26a; see Pet. 13; Br. in Opp. 12-13; Resp. C.A. Br. 19. The conclusion is inescapable that the "in connection with" requirement in SLUSA has the same meaning as the corresponding phrase in Section 10(b) and Rule 10b-5.

B. The Amended Complaint Alleges Fraud "In Connection With" The Purchase And Sale Of Securities

Under the standards governing Rule 10b-5 actions, the amended complaint alleges numerous misrepresentations and omissions "in connection with the purchase or sale of a covered security." 15 U.S.C. 78bb(f)(1).

1. Rule 10b-5 is construed "not technically and restrictively, but flexibly to effectuate its remedial purposes." *SEC* v. *Zandford*, 535 U.S. 813, 819 (2002) (quoting *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972)); accord *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 10-12 & n.7 (1971); Pet. App. 22a. It prohibits not only "garden variety" fraud, but "*all* fraudulent schemes in connection with the purchase or sale of securities." *Superintendent of Ins.*, 404 U.S. at 11 n.7 (quoting *A.T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)).

Under Rule 10b-5, all misrepresentations "touching" (*Superintendent of Ins.*, 404 U.S. at 12-13) or "coincid-[ing]" (*Zandford*, 535 U.S. at 825) with securities transactions are "in connection with" them, such as when a misrepresentation and a sale are "part of the same fraudulent scheme," *Alley* v. *Miramon*, 614 F.2d 1372, 1378 n.11 (5th Cir. 1980) (Wisdom, J.), or otherwise "[a]re not independent events," *Zandford*, 535 U.S. at 820. See *United States* v. *O'Hagan*, 521 U.S. 642, 655-656 (1997); Pet. App. 23a. Thus, Rule 10b-5 is violated "whenever [false] assertions are made * * * in a manner reasonably calculated to influence the investing public" in their decisions regarding the purchase or sale of securities. *SEC* v. *Texas Gulf Sulfur Co.*, 401 F.2d 833, 862 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969); accord, *e.g.*, *McGann* v. *Ernst & Young*, 102 F.3d 390, 393-394 (9th Cir. 1996) (citing cases), cert. denied, 520 U.S. 1181 (1997).

2. The amended complaint alleges that petitioner employed "the hallmarks of stock manipulation" in order to "caus[e] [certain] stocks to *trade* at artificially inflated prices." J.A. 53a (emphasis added). According to the amended complaint, petitioner's "ratings, reports,

and recommendations regarding [certain] stocks were false and contained misleading statements." J.A. 59a. Those allegedly false representations included "buy recommendations" and "strong buy recommendations." J.A. 62a, 64a; see J.A. 63a. In order to mislead "not only investors who were brokerage customers * * * but also individual investors," petitioner "continually promoted the * * * [s]tocks in the press, on television and the internet." J.A. 63a. "[T]hese deceptive reports were disseminated * * * in an effort to artificially support the stocks['] prices." J.A. 54a.

The amended complaint further alleges that petitioner and its agents "traded against [petitioner's] published research recommendations"—*i.e.*, sold the stocks while encouraging others to buy them. J.A. 54a; see J.A. 64a. At the same time, petitioner allegedly "refus[ed] to execute * * * [its customers'] orders to sell these stocks." J.A. 54a. "As a result of [petitioner's] efforts, * * * [affected] companies were better able to use their stock as currency in transactions." J.A. 55a.

Those allegations not only assert fraud coinciding with securities transactions, which is sufficient under *Zandford*, they assert that petitioner succeeded in "causing * * * stocks to trade"—*i.e.*, to be purchased and sold—"at artificially inflated prices." J.A. 53a; see *O'Hagan*, 521 U.S. at 664. Petitioner's alleged selling of the securities at fraudulently inflated prices likewise constitutes fraud in connection with the purchase or sale of securities. See *Wharf (Holdings) Ltd.* v. *United Int'l Holdings, Inc.*, 532 U.S. 588, 596 (2001).

3. Even if the amended complaint had not included express references to trading and selling, it would still have alleged fraud in connection with the purchase or sale of securities. As the court of appeals held, preemp-

tion turns on the "substance" of the allegations, not whether the complaint uses any particular terminology. Pet. App. 16a; see, *e.g.*, *Miller* v. *Nationwide Life Ins. Co.*, 391 F.3d 698, 702 (5th Cir. 2004); *Dudek* v. *Prudential Sec., Inc.*, 295 F.3d 875, 879-880 (8th Cir. 2002). A contrary approach "would allow artful pleading to undermine SLUSA's goal of uniformity—a result manifestly contrary to congressional intent." *Rowinski*, 398 F.3d at 300.

As the Third Circuit explained in a materially identical case, the scheme alleged by respondent "necessarily 'coincides' with the purchase or sale of securities" because "[f]or [it] to work, investors must purchase the misrepresented securities." *Rowinski*, 398 F.3d at 302 (quoting *Zandford*, 535 U.S. at 825); see *Disher*, 419 F.3d at 655 (holding materially identical claims preempted by SLUSA). If the alleged fraudulent misrepresentations or omissions did not lead investors to purchase the affected securities at inflated prices, the price inflation that is an *essential component* of the alleged fraudulent scheme and respondent's alleged injury simply could not occur.[1] Thus, claims like those at issue here are preempted even when they are artfully drafted to disguise their necessary relationship to the purchase or sale of securities.[2]

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[1] Although the alleged fraud in this case involved a manipulation, publicly disseminated fraudulent representations concerning a publicly traded security would affect market purchases and sales irrespective of whether there were a manipulation.

[2] This case therefore does not require the Court to explore the outer limits of the "in connection with" requirement. The Court need not determine, for example, whether that requirement could be satisfied by fraud that did not induce any investors to purchase or sell securities, but instead induced them only to hold securities they already owned.

C. The "In Connection With" Requirement Is Satisfied Regardless Of Whether Respondent Or The Class Members Purchased Or Sold Securities

Although respondent's amended complaint plainly alleges fraud "in connection with the purchase or sale" of covered securities, the court of appeals held that respondent could avoid preemption by "exclud[ing] from the class claimants who purchased in connection with the fraud and who therefore could meet the standing requirement for maintenance of a 10b-5 action." Pet. App. 43a. In other words, the court concluded that SLUSA does not preempt claims that allege fraudulent misrepresentations in connection with the purchase or sale of securities if the claims are brought by people who lack standing to bring Rule 10b-5 actions because they did not purchase or sell securities.

That conclusion is incorrect. By its plain text, SLUSA preempts class actions alleging misrepresentations or omissions "in connection with the purchase or sale" of securities, regardless of whether the plaintiff class would have standing to pursue that violation under federal law. The court of appeals' contrary holding would open a gaping and illogical loophole by permitting potentially the *most* abusive securities class actions to escape SLUSA and the PSLRA, contrary to Congress's expressed intent to require such class actions to proceed only under uniform federal standards.

See SEC Br. at 6, 16-17, *Blue Chip*, *supra*. Nor need the Court determine whether or under what circumstances the requirement could be satisfied by brokers' misrepresentations to their customers relating to the customers' brokerage accounts. See *Zandford*, 535 U.S. at 819, 825 n.4; *Rowinski*, 398 F.3d at 301-302.

1. *The* Blue Chip *purchaser/seller rule does not apply to the determination whether a fraud is "in connection with" the purchase or sale of a security*

Neither Section 10(b) nor Rule 10b-5 affords an express private right of action. See *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 748-749 (1975). Although this Court has long recognized an implied right of action for private parties, see, *e.g.*, *Superintendent of Ins.*, 404 U.S. at 13 n.9, it has held that the implied right of action does not extend to individuals who "neither purchased nor sold any of the offered shares," including those who "allege that they decided not to sell their shares because of an unduly rosy representation or a failure to disclose unfavorable material." *Blue Chip*, 421 U.S. at 725, 737-738.

But whether a particular plaintiff has standing to pursue a private right of action is an altogether different question from whether a defendant violated the law. See, *e.g.*, *Cannon* v. *University of Chicago*, 441 U.S. 677, 688 (1979). The *Blue Chip* Court repeatedly emphasized that its holding applies only to standing and is not a limitation on the scope of Rule 10b-5's prohibition against fraud in connection with the purchase or sale of a security. Accordingly, the *Blue Chip* purchaser/seller rule is irrelevant in determining the coverage of the "in connection with" requirement.

Indeed, the *Blue Chip* Court analyzed the language of Section 10(b) and Rule 10b-5, including the "in connection with" requirement, and chose *not* to rest its decision on a textual foundation because "[n]o language in either of those provisions speaks at all to the contours of a private right of action." 421 U.S. at 749; see *id.* at 733-737. Instead, the Court decided—"as a matter of policy"—that extending the implied right of action to plain-

tiffs who neither purchased nor sold securities in reliance on an alleged violation would present an unwarranted "danger of vexatious litigation" in light of the ease of alleging, but difficulty of disproving, that a plaintiff had relied on public statements in *not* taking action. *Id.* at 739, 740; see *id.* at 739-749. Thus, "*Blue Chip Stamps* came out as it did not because § 10(b) and Rule 10b-5 are limited to situations in which the plaintiff itself traded securities, but because a private right of action to enforce these provisions is a judicial creation and the Court wanted to confine these actions to situations where litigation is apt to do more good than harm." *Kircher*, 403 F.3d at 483; see *SEC* v. *Rana Research, Inc.*, 8 F.3d 1358, 1364 (9th Cir. 1993); *United States* v. *Newman*, 664 F.2d 12, 17 (2d Cir. 1981); Pet. App. 24a-25a.

Indeed, the *Blue Chip* Court implicitly recognized that the substantive coverage of Rule 10b-5 extends farther than the universe of suits brought by private plaintiffs with standing. The Court acknowledged that "a disadvantage" of its policy-based standing rule is that it "prevents some deserving plaintiffs from recovering damages which have in fact been caused *by violations of Rule 10b-5*." 421 U.S. at 738 (emphasis added). The Court later reiterated that its rule "undoubtedly excludes plaintiffs who have in fact been damaged by violations of Rule 10b-5." *Id.* at 743. The Court thus made clear that "[t]he purchaser/seller standing limitation * * * does not stem from a construction of the phrase 'in connection with the purchase or sale of any security,'" but instead relates solely to the standing of private plaintiffs, and that the scope of private lawsuits is narrower then the substantive scope of the "in connection with" prohibition. *Holmes* v. *Securities Investor*

Prot. Corp., 503 U.S. 258, 284 (1992) (O'Connor, J., concurring in part and in the judgment); see *id.* at 289-290 (Scalia, J., concurring in the judgment); *O'Hagan*, 521 U.S. at 664-665; *SEC* v. *National Sec., Inc.*, 393 U.S. 453, 467 n.9 (1969) (distinguishing between the "coverage" of Rule 10b-5 and the "standing" of private plaintiffs).

The *Blue Chip* Court underscored those points by explaining that its "purchaser-seller rule imposes no limitation on the standing of the SEC." 421 U.S. at 751 n.14; accord *O'Hagan*, 521 U.S. 642, 664-665 (1997); *United States* v. *Naftalin*, 441 U.S. 768, 774 n.6 (1979); *National Sec.*, 393 U.S. at 467 n.9; *In re Engelman*, 52 S.E.C. 271, 283 n.43 (1995) ("The purchaser-seller standing requirement does not apply to Commission-instituted cases."). In a suit for civil penalties or a criminal prosecution, the government must establish that the defendant "violated" Rule 10b-5, including its "in connection with" requirement. 15 U.S.C. 78u(d)(3)(A); see 15 U.S.C. 78ff(a) (Supp. II 2002). The government's ability to pursue such actions even when a private plaintiff would be barred by the *Blue Chip* standing rule necessarily means that the "in connection with" and standing inquiries are distinct. As Judge Easterbrook explained for the Seventh Circuit, the government's "[i]nvocation of [Rule 10b-5] does not depend on proof that the agency or the United States purchased or sold securities; instead the 'in connection with' language ensures that the fraud occurs in securities transactions rather than some other activity." *Kircher*, 403 F.3d at 483; cf. *O'Hagan*, 521 U.S. at 660 ("§ 10(b) refers to 'the purchase or sale of any security,' not to identifiable purchasers or sellers of securities").

2. *SLUSA's text expressly ties preemption to the scope of Rule 10b-5's "in connection with" requirement, not to whether a particular plaintiff would have standing to sue for a violation of Rule 10b-5*

Because the *Blue Chip* purchaser/seller rule is a judicially crafted, prudential standing requirement that is premised on policy grounds rather than an interpretation of the statutory "in connection with" requirement, it does not limit the scope of that statutory phrase. The court of appeals appeared to recognize as much when it stated that *Blue Chip*'s "limitation on standing to bring private suit[s] for damages * * * is unquestionably a distinct concept from the general statutory and regulatory prohibition on fraud in connection with the purchase or sale of securities," and "should not be conflated with the question of whether the 'in connection with' requirement ha[s] been met." Pet. App. 27a (quoting *Ontario Pub. Serv. Employees Union Pension Trust Fund* v. *Nortel Networks Corp.*, 369 F.3d 27, 34 (2d Cir. 2004) (internal quotation marks omitted), cert. denied, 125 S. Ct. 919 (2005)). But the court of appeals then veered off course by concluding that "[b]ecause *only* purchasers and sellers have a federal private damages remedy, it is * * * natural to suppose that Congress meant to import the settled standing rule *along with* the 'in connection with' phrase as a substantive standard" in delimiting SLUSA's preemptive scope. *Id.* at 28a (emphasis added). Nothing in the text or history of SLUSA justifies creation of such a limitation on the scope of SLUSA preemption.[3]

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[3] The two other courts of appeals that held claims by non-purchasers and non-sellers not to be preempted under SLUSA erroneously reasoned that *Blue Chip* interpreted Rule 10b-5's "in connection with"

a. The court of appeals did not (and could not) identify anything in SLUSA's text that "import[s]" the standing rule "along with" the separate "in connection with" requirement. Pet. App. 28a. Congress easily could have limited preemption to cases involving allegations of fraud "in connection with the purchase or sale of covered securities *by the plaintiff*." It did not do so. Likewise, Congress could have limited its focus to the claims of purchasers or sellers, rather than "any private party," 15 U.S.C. 78bb(f)(1)(A). Again, it did not do so. Instead, Congress intentionally employed broad statutory language that ties the preemptive force of SLUSA directly to the full scope of the prohibitions contained in Section 10(b) and Rule 10b-5 themselves. As already explained, no standing requirement limits the scope of those prohibitions. See *supra* pp. 15-17.

Congress also tailored the scope of SLUSA preemption by crafting several express exceptions to preemption, none of which applies here. See 15 U.S.C. 78bb(f)(3) and (5)(C). Those exceptions relate to derivative actions; actions based on some contractual rights; actions brought by States, political subdivisions of States, and state pension plans; and certain actions arising under the law of the issuer's state of incorporation. *Ibid*. Congress's express inclusion of those exceptions further confirms that it did not intend any others. See, *e.g.*, *TRW Inc.* v. *Andrews*, 534 U.S. 19, 28 (2001) ("Where Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are

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requirement. See *Riley*, 292 F.3d at 1343-1345; *Green*, 279 F.3d at 597-598. The Second Circuit is the only court of appeals to reach the incongruous conclusion that *Blue Chip* does *not* interpret that language but nonetheless *does* limit the scope of SLUSA preemption.

not to be implied, in the absence of evidence of a contrary legislative intent.").

The court of appeals was not "moved by the observation that the standing rule is merely a judge-made gloss on the statute and the Rule, because private Rule 10b-5 damages actions are themselves a creature of judicial implication." Pet. App. 28a. But the relevant factor of the *Blue Chip* rule is not that it was judge-made, but that it is a rule about the scope of standing as opposed to an interpretation of the substantive scope of the prohibitions in Rule 10b-5. Moreover, there is no need to infer anything about SLUSA's explicit text. Congress focused on the preemption issue and could have linked the scope of preemption to the scope of standing, but instead chose to key the scope of preemption to the conduct alleged.

The court of appeals sought support from a footnote in *Blue Chip* stating that the "disadvantage" of the purchaser/seller rule—*i.e.*, its tendency to prevent some victims of Rule 10b-5 violations from recovering damages—is "attenuated to the extent that remedies are available to nonpurchasers and nonsellers under state law." 421 U.S. at 738 n.9; see Pet. App. 29a. According to the court of appeals, "SLUSA's wholesale importation of the language that gave rise to this balancing judgment must * * * be presumed to represent a ratification of that judgment." *Id.* at 30a.

This Court's passing observation in the cited footnote, which merely reflects the pre-SLUSA reality that state-law claims were not preempted, cannot sustain the weight placed on it by the court of appeals. The *Blue Chip* Court made no "balancing judgment" that standing should be denied under federal law only because and only to the extent that it was available under state law—much less that standing should be denied because

it was available in state-law *class actions*, which are the only actions preempted by SLUSA. To the contrary, this Court emphasized at length the danger of permitting suits by non-purchasers and non-sellers to proceed *at all*. See 421 U.S. at 742-748. Far from conditioning application of the purchaser/seller rule on the availability of state remedies, the *Blue Chip* Court adopted that standing limitation as a uniform requirement applicable to all private plaintiffs under Section 10(b) and Rule 10b-5, without regard to their state-law remedies. 421 U.S. at 749, 755.

Even if this Court had based the *Blue Chip* standing rule on the assumption that non-purchasers and non-sellers could assert securities fraud claims in some States, moreover, Congress could not have "ratified" that judgment by preempting all class actions based on Section 10(b)'s "in connection with" requirement. The ratification doctrine applies only to congressional reenactment of statutory texts with settled interpretations. See generally *Department of Transp.* v. *Public Citizen*, 541 U.S. 752, 770 n.4 (2004). *Blue Chip* does not interpret the "in connection with" requirement, however, and SLUSA does not address standing. Thus, the purported "balancing judgment" would not have been an interpretation of the statutory text at issue here, and the ratification doctrine provides no support for the court of appeals' reasoning. *Ibid.*[4]

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[4] The extent to which suits by "holder" classes would be actionable under state law but for the preemptive effect of SLUSA is unclear. States vary in their receptiveness to holder claims. See *In re Worldcom, Inc. Sec. Litig.*, 336 F. Supp. 2d 310, 319-323 (S.D.N.Y. 2004) (surveying state laws); Pet. App. 38a n.14. In those States that permit holder actions, moreover, SLUSA permits individual and derivative actions to proceed, and persons injured by holding stock may also bene-

b. Lacking a textual basis for its conclusion, the court of appeals turned to an "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." Pet. App. 30a-31a (quoting *City of Milwaukee* v. *Illinois*, 451 U.S. 304, 316 (1981)). But that "'assumption' of nonpre-emption is not triggered when the State regulates in an area where there has been a history of significant federal presence." *United States* v. *Locke*, 529 U.S. 89, 108 (2000). The federal government has extensively regulated the national securities markets and securities transactions for many decades, and Congress determined that the interstate (and increasingly international) character of those markets confirms the propriety of and need for uniform national regulation of securities fraud class actions. See S. Rep. No. 182, 105th Cong., 2d Sess. 3-5 (1998). The "assumption" of non-preemption is therefore inapplicable here. Indeed, Congress enacted SLUSA for the very purpose of preempting state-law class action claims.

Even if such an "assumption" were applicable in this case, "[t]he purpose of Congress [remains] the ultimate touchstone" and "primarily is discerned from the language of the pre-emption statute and the statutory framework surrounding it." *Medtronic, Inc.* v. *Lohr*, 518 U.S. 470, 485-486 (1996) (internal quotation marks omitted). Thus, the "assumption" is overcome when, as here, the statutory text is clear. See *ibid.*; *Cipollone* v. *Liggett Group, Inc.*, 505 U.S. 504, 522-523 (1992) (plurality opinion); *id.* at 548-549 (Scalia, J., concurring in part and dissenting in part); *Shaw* v. *Delta Air Lines, Inc.*, 463 U.S. 85, 97 (1983).

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fit from state and federal enforcement actions. See pp. 3-4, 19, *supra*.

The court of appeals thought that "[t]here is no clear support in the legislative history for the conclusion that Congress intended SLUSA to preempt claims that do not satisfy the *Blue Chip* rule" because the legislative history "contains no specific mention of holding claims or other non-purchaser/non-seller claims." Pet. App. 31a. Even if the court of appeals' analysis of the legislative history were correct (but see pp. 23-26, *infra*), the *absence* of relevant legislative history would reveal nothing about Congress's intent and could not overcome the plain statutory text, which is keyed to the conduct alleged, not the plaintiff's status. *Morales* v. *Trans World Airlines, Inc.*, 504 U.S. 374, 385 n.2 (1992); *Shaw*, 463 U.S. at 97. "[I]t would be a strange canon of statutory construction that would require Congress to state in committee reports or elsewhere in its deliberations that which is obvious on the face of a statute." *Harrison* v. *PPG Indus., Inc.*, 446 U.S. 578, 592 (1980); see *Patenaude* v. *Equitable Life Assurance Soc'y*, 290 F.3d 1020, 1025 (9th Cir. 2002) (holding that SLUSA's definition of "covered security" encompasses variable annuities even though they are not mentioned in the legislative history).

3. The legislative history and the policies underlying SLUSA confirm that Congress did not exempt from preemption the claims of plaintiffs who would lack standing to pursue a Rule 10b-5 claim

The court of appeals also erred in concluding that "to the extent the legislative history casts any light on the question, it suggests that Congress intended to preempt only those state claims that had migrated from federal court in response to the PSLRA." Pet. App. 32a. Because people who neither purchased nor sold securities

lacked standing to pursue Rule 10b-5 actions before Congress enacted the PSLRA, the court concluded that Congress did not intend to affect their state-law class action claims. See *ibid*. That result, however, would turn congressional intent on its head by exempting an especially abusive category of securities fraud class actions from the uniform national standards that Congress adopted to *prevent* abuse.

a. The court of appeals was correct insofar as it recognized that Congress was concerned that plaintiffs were evading the PSLRA by bringing securities fraud class actions in state instead of federal courts. See SLUSA § 2(2) and (3), 112 Stat. 3227; H.R. Conf. Rep. No. 803, 105th Cong., 2d Sess. 1 (1998); S. Rep. No. 182, *supra*, at 3-4. But Congress responded to that development not only by permitting the removal of affected cases from state to federal courts, see 15 U.S.C. 78bb(f)(2), but "[a]dditionally" by "establish[ing] uniform national rules for securities class action litigation involving our national capital markets." H.R. Conf. Rep. No. 803, *supra*, at 13. Concerned about the "dangers of maintaining differing federal and state standards of liability for nationally-traded securities," Congress chose to give "due consideration to the benefits flowing to investors from a uniform national approach." S. Rep. No. 182, *supra*, at 3. Congress recognized that "[s]ome critics of establishing a uniform standard of liability have attacked such legislation as being an affront on Federalism," but it "found the interest in promoting efficient national markets to be the more convincing and compelling consideration in this context." *Id*. at 4.

Thus, there is no support for the improbable conclusion that Congress intended to preempt only those state-law claims that can be pursued successfully under fed-

eral law, while leaving intact all state-law claims that are legally meritless under federal law. Rather, Congress intended to apply uniform federal standards to securities class actions, which it perceived to be the source of most abusive securities litigation, "while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits." SLUSA § 2(5), 112 Stat. 3227. Congress thus drew the line between class actions and other types of securities litigation, a line that has nothing to do with whether a class action plaintiff would have standing to pursue a claim under federal law.

The court of appeals relied on a floor statement by Senator Dodd to the effect that SLUSA would work "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." Pet. App. 32a-33a (quoting 143 Cong. Rec. 21,357 (1997)) (emphasis added). That floor statement of a single legislator provides no support for the court's conclusion because Senator Dodd expressly identified the "traditional State court actions and procedures" he had in mind, and actions by "holders" were not among them. *Ibid*. See also *Consumer Prod. Safety Comm'n* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 118 (1980) ("[O]rdinarily even the contemporaneous remarks of a single legislator who sponsors a bill are not controlling in analyzing legislative history."). Moreover, it is not clear that Senator Dodd used the term "migrate" narrowly to exclude claims like respondent's that presumably would have been brought in federal court on behalf of purchasers before the PSLRA, migrated to state court to avoid the PSLRA, and were

later partially transmogrified into a "holder" suit to circumvent both the PSLRA and SLUSA.

More illuminating is the Senate Committee report, which explains that SLUSA is to be "interpreted broadly" to effectuate Congress's intent to "effectively reach[] those actions that could be used to circumvent" the PSLRA. S. Rep. No. 182, *supra*, at 8. Because state-law "holder" actions would circumvent the uniform federal standards of Rule 10b-5 and the PSLRA, exempting such suits from preemption would be contrary to that intent. See generally *Rowinski*, 398 F.3d at 299 ("Congress envisioned a broad interpretation of SLUSA to ensure the uniform application of federal fraud standards."); *Newby* v. *Enron Corp.*, 338 F.3d 467, 472 (5th Cir. 2003) ("[I]n enacting SLUSA Congress sought to curb all efforts to circumvent the reforms put into place by PLSRA."); *Miller*, 391 F.3d at 702 (same).[5]

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[5] The court of appeals also pointed to Senator Dodd's statement that SLUSA affects only "those types of class actions that are appropriately heard on the Federal level." 143 Cong. Rec. at 21,357; see Pet. App. 33a. As the committee reports explain, Congress concluded that class action claims regarding nationally traded securities are appropriately heard on the federal level because of the need for uniform national standards. See p. 24, *supra*. That such claims may be dismissed for lack of standing when they pose a particularly high risk of abuse does not mean that they should be heard on the state level; it means that they uniformly should be dismissed by federal courts.

Standing is far from the only reason that a claim might fail under federal but not state law. Federal securities fraud plaintiffs must satisfy heightened pleading requirements, 15 U.S.C. 78u-4(b), establish scienter in some cases, *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 199 (1976), and prove in some cases that the alleged misrepresentations fall outside of the PSLRA's safe harbor for forward-looking statements, 15 U.S.C. 78u-5(c)(1). A plaintiff class's failure to satisfy such requirements does not mean that the class should be able to take advantage of less stringent state-law standards. Instead, it means that the suit is

b. Recognition of an implicit exception to SLUSA's preemptive scope would be particularly inappropriate in the context of this case, because an exception for claims brought by those who neither purchased nor sold securities would directly frustrate Congress's goals in enacting the statute.

i. The need for uniform national standards, like the text of SLUSA's preemption provision, does not turn on the identity of the plaintiff in a particular case. In order to "encourage the voluntary disclosure of information by corporate issuers," the PSLRA created a "safe harbor" for forward-looking statements. S. Rep. No. 98, 104th Cong., 2d Sess. 4-5 (1995); see 15 U.S.C. 78u-5. That safe harbor could not accomplish its purpose of encouraging disclosure if some plaintiffs could evade it by filing under state law. Similarly, "to encourage plaintiffs' lawyers to pursue valid claims for securities fraud and to encourage defendants to fight abusive claims," the PSLRA adopted a modified proportionate liability standard, heightened pleading requirements, and a stay of discovery pending the resolution of motions to dismiss. S. Rep. No. 98, *supra*, at 6-7 (emphasis omitted); see 15 U.S.C. 78u-4(b), (c) and (f). Those and other requirements would likewise fail to discourage the filing of meritless suits if such suits could be brought under state law on behalf of people who did not purchase or sell securities.

The artificiality of any distinction based on an individual plaintiff's trading activity (or lack thereof) is fur-

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precisely the type of class action that Congress targeted. As Judge Easterbrook explained, SLUSA's "pre-emptive effect is not confined to knocking out state-law claims by investors who have *winning* federal claims * * * It covers both good and bad securities claims—*especially* bad ones." *Kircher*, 403 F.3d at 484.

ther underscored by the fact that a single securities fraud scheme will frequently victimize purchasers, sellers, *and* holders—and there will often be substantial overlap among those classes, because purchasers generally become holders, and sellers tend to be former holders. Thus, in related proceedings before the district court that dismissed this case, purchasers and sellers are pursuing actions against petitioner based on the same underlying transactions. Pet. App. 55a. The original and amended complaints in this case likewise allege a class of purchasers and sellers, as well as holders. *Id.* at 4a-5a, 40a-41a; cf. *id.* at 42a-43a (recognizing the "close relationship" between claims based on purchases and those based on holdings as well as the difficulty in disentangling the two).

To apply uniform national standards in cases brought by purchasers and sellers, but differing state-law standards in cases brought by holders *based on the same underlying conduct*, would deprive the uniform national standards of any semblance of uniformity. In cases in which some of the misrepresentations occurred before a plaintiff's purchase of a security, it would also elevate artful pleading over substance, because such plaintiffs might attempt to avoid preemption by focusing on misrepresentations made between their purchases and sales and limiting the scope of requested damages. Respondent has done just that: after the district court dismissed respondent's original complaint because it alleged that he purchased securities in reliance on a fraudulent scheme, respondent recast himself as a "holder" in his amended complaint in hopes of avoiding preemption. See pp. 4-5, *supra*. As explained above, SLUSA was intended in part to *combat* artful pleading, not to encourage it. See pp. 12-13, *supra*. That is another reason

why a plaintiff should not be able to "avoid preemption by asserting it is only claiming damages suffered as a result of holding its stock." *Professional Mgmt. Assocs., Inc. Employees' Profit Sharing Plan* v. *KPMG*, 335 F.3d 800, 803 (8th Cir. 2003), cert. denied, 540 U.S. 1162 (2004).

ii. If any set of plaintiffs were to be exempted from preemption, it would not be those who neither purchased nor sold securities. As the court of appeals appeared to recognize, such an exemption would "*allow* the very category of claims that the Supreme Court identified in *Blue Chip* as posing a particularly high risk of vexatious litigation." Pet. App. 29a. Although private securities class actions are an important supplement to government enforcement actions, this Court recognized in *Blue Chip* that "[t]he risk of strike suits is particularly high" in cases not brought by purchasers or sellers because such plaintiffs could reach trial merely by asserting that they relied on a public misrepresentation or material omission in *not* buying or selling stock. 421 U.S. at 742.

The potential for abuse is further underscored by respondent's theory of injury and damages. Although some persons who are fraudulently induced not to purchase or sell securities may be injured thereby, see *Blue Chip*, 421 U.S. at 738, 743, the amended complaint alleges that respondent was injured by petitioner's failure to disclose that it had fraudulently inflated the stock prices because respondent would have sold his shares before the prices declined had he known the truth, see J.A. 53a-54a. That is not even a cognizable injury. Absent the alleged fraud, the prices never would have become fraudulently inflated. And if petitioner had disclosed the alleged fraud, the stock prices likely would have fallen immediately to reflect that information, pre-

venting respondent from selling at the inflated levels. See *Crocker* v. *FDIC*, 826 F.2d 347, 351 (5th Cir. 1987), cert. denied, 485 U.S. 905 (1988); *Arent* v. *Distribution Scis., Inc.*, 975 F.2d 1370, 1374 (8th Cir. 1992); *Levine* v. *Seilon, Inc.*, 439 F.2d 328, 333-334 (2d Cir. 1971) (Friendly, J.); cf. *Basic, Inc.* v. *Levinson*, 485 U.S. 224, 246-247 (1988). In any event, respondent "could hardly be heard to claim compensation for the premium he might have extracted from some innocent victim if he had known of the fraud and the buyer did not." *Levine*, 439 F.2d at 333. Respondent had no legally-protected right to *benefit* from the alleged fraud.

Because *Blue Chip* and SLUSA constrain potentially abusive suits in compatible ways, and suits by plaintiffs who neither purchased nor sold securities in connection with alleged fraud epitomize the potential for abusive suits that this Court and Congress sought to combat, "[i]t would be more than a little strange if [this] Court's decision to block private litigation by non-traders became the opening by which that very litigation could be pursued under state law." *Kircher*, 403 F.3d at 484. Permitting SLUSA and *Blue Chip* to complement one another would be far more consistent with congressional intent than treating the judicial restriction as annulling the congressional one.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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