No. 00-347

In the Supreme Court of the United States

THE WHARF (HOLDINGS) LIMITED, ET AL.,
PETITIONERS

v.

UNITED INTERNATIONAL HOLDINGS, INC., ET AL.

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

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE SUPPORTING RESPONDENTS

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QUESTIONS PRESENTED

1. Whether an action under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5, may be based on misrepresentations about a person's intention to sell securities.

2. Whether an action under Section 10(b) and Rule 10b-5 may be based on misrepresentations made in connection with an oral contract to purchase or sell a security.

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INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission (SEC or Commission) administers and enforces the federal securities laws. This case involves the scope of Section 10(b) of the Securities Exchange Act of 1934 (1934 Act or Exchange Act), 15 U.S.C. 78j(b), and the Commission's Rule 10b-5, 17 C.F.R. 240.10b-5, which implements it. The case also involves the scope of a private action under those provisions. The Commission has an interest in this case because of its potential impact on government enforcement actions, as well as private actions, which serve an important role in complementing government enforcement and compensating injured investors.

STATEMENT

1. Section 10(b), in relevant part, makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security * * *, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. 78j(b). Rule 10b-5 implements Section 10(b) by declaring it unlawful, "in connection with the purchase or sale of any security," "(a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made * * * not misleading, or (c) [t]o 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. Section 10(b) affords an implied right of action to purchasers or sellers of securities who have been injured by its violation. *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971); see also *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975).

2. As described by the court of appeals, the Section 10(b) action in this case has its origins in the 1991 decision by the Government of Hong Kong to grant an exclusive license for the operation of a cable television system there. Pet. App. B2. Petitioner Wharf (Holdings) Limited (hereinafter Wharf), a Hong Kong company, desired to secure the license but had little experience in the cable television business. Wharf therefore decided to seek the assistance of a more experienced company. To that end, Steven Ng, a managing director of Wharf, met with Mark Schneider, a vice president of respondent United International Holdings, Inc. (UIH), a company based in Denver, Colorado, that owns, operates, and invests in cable television systems. Schneider made clear that UIH was not interested in serving as a consultant

for a fee but would assist Wharf in exchange for the right to invest in the Hong Kong cable system. *Ibid.*

UIH provided Wharf with substantial assistance before Wharf submitted its bid for the Hong Kong license. Pet. App. B3. According to UIH, Wharf had promised that the bid to be submitted to the Hong Kong Government would refer to UIH's prospective investment in Cable Network Communications Limited (Wharf Cable), the company Wharf created to operate the cable system. *Id.* at B5. The bid actually submitted, however, made only a noncommittal reference to the possibility of a UIH investment. *Id.* at B6. UIH officials therefore met with Ng in Denver on October 8, 1992. At the meeting, Ng requested that UIH continue its assistance until Wharf could hire suitable permanent employees. UIH officials agreed to do so only if UIH's right to invest was "absolutely firm." *Ibid.* According to UIH witnesses, Ng agreed that Wharf would grant UIH an option to purchase ten percent of the stock in Wharf Cable in exchange for UIH's continued services. *Ibid.* The agreement was not put in writing, and, at trial, Ng denied selling UIH the option. *Id.* at B7.

In April 1993, UIH filed a Form S-1 registration statement with the Commission in which UIH disclosed that it owned an option to purchase ten percent of the equity in Wharf Cable. Pet. App. B8. In June 1993, the Hong Kong government awarded Wharf the license. UIH then conducted a public offering and raised $66 million for its initial investment in the system. In late July or early August, UIH informed Ng that it was ready to exercise the option. *Ibid.*

According to internal documents, Wharf's executives discussed the possibility of a UIH investment during this period, but Wharf's chairman expressed misgivings. Pet. App. B9. Ng asked another Wharf executive: "How do we get out?" *Ibid.* At a meeting in Hong Kong, UIH executives brought up UIH's right to invest, and Wharf's chairman looked surprised. *Id.* at B9-B10.

In November 1993, UIH filed another Form S-1, which stated that UIH "continues to pursue its opportunity to acquire * * * a 10% interest in Wharf Cable" and "is currently negotiating the acquisition of the 10% interest." Pet. App. B10. An internal Wharf document from December 1993 states that "[o]ur next move should be to claim that our directors got quite *upset* over these representations" and that, "[p]ublicly, we *do not* acknowledge [UIH's] opportunity" to acquire the ten percent interest. *Ibid.* Another Wharf document talks about the need to "start to back pedal." *Id.* at B11. In the margin of a letter from Schneider discussing UIH's "expectation of an investment into Wharf Cable," Ng wrote "be careful, must deflect this! how?" *Ibid.* Finally, on March 18, 1994, Ng told Schneider that Wharf was "not ready to entertain [a UIH] investment at this time." *Ibid.*

3. a. UIH filed suit against Wharf in federal district court alleging that Wharf had violated Section 10(b) and Rule 10b-5. Pet. App. B11-B12. UIH also raised various state law claims, including violation of the Colorado Securities Act, breach of contract, common law fraud, breach of fiduciary duty, and negligent misrepresentation. *Id.* at B12. At trial, UIH contended that, at the meeting on October 8, 1992, Wharf sold UIH an option to invest in Wharf Cable in exchange for UIH's services, but that Wharf never intended to honor the option. *Ibid.*; see also *id.* at B15; 5 J.A. EM1-EM3. The jury found for UIH on all claims. Pet. App. B1.

b. The court of appeals affirmed the judgment. Pet. App. B1-B46. As relevant to the questions before this Court, the court of appeals rejected Wharf's argument that the district court lacked jurisdiction over the state law claims because UIH had not stated an actionable federal claim. *Id.* at B12-B18. The court of appeals held that pendent jurisdiction is proper if a party alleges "a substantial and nonfrivolous federal claim," *id.* at B18, and the court concluded that UIH's

allegations "clearly [were] not frivolous" but were "sufficient to state a claim under Rule 10b-5." *Ibid.*

The court of appeals explained that, to state a claim under Section 10(b) and Rule 10b-5, a private plaintiff must allege that the defendant, with scienter, made a material misrepresentation "in connection with the purchase or sale of a security," and that the plaintiff relied on the misrepresentation and sustained damages as the proximate result. Pet. App. B14-B15. The court stated that "UIH has asserted throughout this case, without challenge from Wharf, that the security for 10b-5 purposes is * * * the option" to purchase stock in Wharf Cable. *Id.* at B15. Because "Wharf does not contest on appeal the classification of the option as a security," the court "assume[d] the option is a security" under federal securities law. *Ibid.* The court further explained that UIH alleged that it purchased the option on October 8, 1992, "in exchange for its continued and expanded assistance to Wharf in the pursuit of the cable television bid." *Ibid.* The court noted that UIH also alleged "that Wharf made material misrepresentations and omissions regarding the option" and that those representations "were made either with knowledge of their falsity or with reckless disregard for their truth or falsity." *Ibid.* Because "the misrepresentations were made to influence UIH's investment decision," the court concluded that they "were made in connection with the purchase or sale of a security." *Id.* at B16.

The court of appeals rejected Wharf's argument that *Blue Chip Stamps* precluded UIH's Section 10(b) claim. Pet. App. B16. The court explained that UIH purchased the option to acquire stock in Wharf Cable, and purchasers of options are purchasers of securities under *Blue Chip Stamps*. *Ibid.* The court also rejected Wharf's argument that misrepresentations about one's intention to perform a contract to sell a security are not actionable under Section 10(b). *Id.* at B16-B17. Finally, in ruling on Wharf's challenges to the state law claims, the court rejected the contention that the option was

unenforceable under Colorado's statute of frauds. *Id.* at B21-B25.

SUMMARY OF ARGUMENT

I. Actions under Section 10(b) may be based on misrepresentations about a person's intention to sell securities. The language of Section 10(b) does not limit the subject matter of the misrepresentations that may form the basis for liability. The statute covers "*any* manipulative or deceptive device or contrivance," 15 U.S.C. 78j(b) (emphasis added), and prohibits "*all* fraudulent schemes in connection with the purchase or sale of securities." *Bankers Life*, 404 U.S. at 11 n.7 (quoting *A.T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)). Misrepresentation of one's intention to perform a promise, such as the promise to sell securities as provided in an option or other contract, is a well recognized form of fraud. See *Durland* v. *United States*, 161 U.S. 306 (1896); Restatement (Second) of Torts § 530 cmt. c (1977). A misrepresentation is made "in connection with the purchase or sale of any security" when the misrepresentation and the securities transaction are part of the same fraudulent scheme. See, *e.g.*, *United States* v. *O'Hagan*, 521 U.S. 642, 655-656 (1997). Under the 1934 Act, an option on a security is itself a security. 15 U.S.C. 78c(a)(10) (1994 & Supp. IV 1998). Moreover, a contract to purchase or sell a security is a purchase or sale of a security. 15 U.S.C. 78c(a)(13) and (14). Therefore, a misrepresentation of one's intention to sell securities, as promised in an option or other contract, is made "in connection with the purchase or sale of any security."

Decisions of this Court and the courts of appeals confirm that violations of Section 10(b) may be premised on misrepresentations about the intention to buy or sell securities and are not limited to misrepresentations about the value of securities bought or sold. See, *e.g.*, *United States* v. *Naftalin*, 441 U.S. 768 (1979); *Threadgill* v. *Black*, 730 F.2d 810, 811-812 (D.C. Cir. 1984) (per curiam) (Wright, Wilkey,

and Scalia, JJ.); *Madison Consultants* v. *FDIC*, 710 F.2d 57, 61 (2d Cir. 1983); *A.T. Brod*, 375 F.2d at 397. Restricting claims to misrepresentations about value would undermine the Act's purpose "to insure honest securities markets" (*O'Hagan*, 521 U.S. at 658) because it would remove from the Act's purview many pernicious kinds of fraud, including insider trading based on misappropriated information. Limiting the subject matter of the misrepresentations prohibited by Section 10(b) is also inconsistent with the "philosophy of full disclosure" embodied in the Act. *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462, 477 (1977). Because claims based on misrepresentations about the intention to sell securities involve deception, which lies at the heart of what Section 10(b) prohibits, they neither federalize state law contract disputes nor conflict with *Santa Fe*.

II. This case does not present the question whether an action under Section 10(b) may be based on an oral contract to sell a security that is unenforceable under the applicable statute of frauds, because respondents' theory of liability and the court of appeals' decision are premised on a *completed* sale of a security—UIH's purchase of an option, which is itself a security. Moreover, the court of appeals held that the option is enforceable under Colorado law.

To the extent the question is properly presented, Section 10(b) applies to an oral contract to sell a security. Nothing in the language of Section 10(b) suggests that contracts for the sale of securities (or securities themselves) must be written in order to form the basis for liability. Oral contracts to sell securities are generally enforceable under the laws of all 50 States. Moreover, under the prevailing common law rule, a fraud claim based on misrepresentation of a party's intention to fulfill a promise is actionable even if the contract itself is oral and unenforceable under the statute of frauds. Restatement (Second) of Torts § 530 cmt. c.

Blue Chip Stamps does not preclude claims based on oral contracts. In *Blue Chip Stamps*, this Court held that private

plaintiffs suing under Section 10(b) must be purchasers or sellers of securities. 421 U.S. at 731. The Court recognized, however, that holders of options and other contractual rights to purchase or sell securities qualify as purchasers or sellers. *Id.* at 751. The Court in *Blue Chip Stamps* was concerned not about oral testimony per se, but about "the abuse potential and proof problems inherent in suits by investors who neither bought nor sold." *O'Hagan*, 521 U.S. at 664. Suits based on oral contracts do not present comparable problems of proof or potential for abuse.

ARGUMENT

I. ACTIONS UNDER SECTION 10(b) MAY BE BASED ON MISREPRESENTATIONS ABOUT THE INTENTION TO SELL SECURITIES

Petitioners characterize (Br. 22) this case as involving only a "dispute[] over the ownership of securities," and they contend (Br. 22-32) that actions under Section 10(b) may not be based on misrepresentations about a person's intention to sell securities. Petitioners' characterization of the case is based on the mistaken assumption that the only security involved is the Wharf Cable stock: They assert that "UIH did not purchase any security" because it "did not purchase the common stock of Wharf Cable." Pet. Br. 23. Contrary to that assertion, the jury found that Wharf sold UIH an option—the right to acquire a ten percent ownership interest in Wharf Cable—in exchange for UIH's assistance to Wharf in pursuit of the Hong Kong license. 5 J.A. EP7, EP21, EP25. The court of appeals correctly held that UIH's purchase of that option was the purchase of a security under Section 10(b). See Pet. App. B15.[1]

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[1] When an offeree gives valuable consideration to an offeror to hold an offer open, the transaction results in an "option contract" (1 Richard A. Lord, *Williston on Contracts* § 5:16, at 726-727 (4th ed. 1990)), "a unilateral contract which binds the optionee to do nothing, but grants him the

Because "Wharf [did] not contest on appeal the classification of the option as a security," the court of appeals assumed that the option was a security under the federal securities laws. Pet. App. B15. That assumption was correct. An option is itself a security under Section 3(a)(10) of the 1934 Act, which defines "security" to include both "any * * * option * * * on any security" and "any * * * right to * * * purchase, any of the foregoing," including "stock." 15 U.S.C. 78c(a)(10) (1994 & Supp. IV 1998). See *One-O-One Enters., Inc.* v. *Caruso*, 848 F.2d 1283, 1288 (D.C. Cir. 1988) (R.B. Ginsburg, J.). Thus, as the purchaser of an option, UIH was the purchaser of a security under Section 10(b). *Blue Chip Stamps*, 421 U.S. at 751 (holders of "options" are "'purchasers' or 'sellers' of securities"). This case therefore does not involve a "dispute[] over the ownership of securities" (Pet. Br. 22).[2]

Petitioners' further contention that Section 10(b) does not cover misrepresentations about a person's intention to sell securities is incorrect. That contention is inconsistent with the text of Section 10(b), judicial precedent interpreting that provision, and the purposes of the Act.

A. The Language Of Section 10(b) Does Not Limit The Subject Matter Of The Misrepresentations That It Prohibits

Section 10(b) makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security * * *, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. 78j(b). Rule 10b-5 implements that

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right to accept or reject [an] offer in accordance with its terms" (*id.* at 717).

[2] Even if the only relevant "security" were the Wharf Cable stock, the case would still involve fraud in connection with the purchase of the stock. As we explain at pp. 13, 23-24, *infra*, a "purchase" of a security under Section 10(b) includes "any contract" to purchase a security.

proscription by declaring it unlawful, "in connection with the purchase or sale of any security," "(a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made * * * not misleading, or (c) [t]o 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 statute and rule are coextensive in scope. *O'Hagan*, 521 U.S. at 651.

1. The text of Section 10(b) covers "*any* manipulative or deceptive device or contrivance" (emphasis added). It does not require that the deception involve any particular subject matter. Rather, Section "10(b) is a 'catchall' antifraud provision." *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 382 (1983). The text of Rule 10b-5 also makes that comprehensive coverage clear. Section 10(b) and Rule 10b-5 thus "prohibit *all* fraudulent schemes in connection with the purchase or sale of securities." *Bankers Life*, 404 U.S. at 11 n.7 (quoting *A.T. Brod*, 375 F.2d at 397).

As the text of Rule 10b-5 demonstrates, 17 C.F.R. 240.10b-5(b), misrepresentations are a well recognized category of fraud. And misrepresentation of one's intention to perform a promise, such as a promise to sell securities as provided in an option contract, is itself a well recognized kind of fraud. More than a century ago, in *Durland*, 161 U.S. at 312-314, this Court held that the mail fraud statute, which applied to "any scheme or artifice to defraud," criminalized the defendant's sale of bonds that he did not intend to honor. As this Court noted in *O'Hagan*, the coverage of the mail fraud statute provides "a particularly apt source of guidance" in determining the coverage of Section 10(b). 521 U.S. at 654.

Misrepresentation of the intention to perform an agreement is also a recognized form of fraud under the common law. See Restatement (Second) of Torts § 530 cmt. c (1977)

("Since a promise necessarily carries with it the implied assertion of an intention to perform, it follows that a promise made without such intention is fraudulent."); *e.g.*, *Formosa Plastics Corp. USA* v. *Presidio Engr's & Contractors, Inc.*, 960 S.W.2d 41, 46-47 (Tex. 1998); *Brody* v. *Bock*, 897 P.2d 769, 775-776 (Colo. 1995) (en banc); *Sea-Land Serv., Inc.* v. *O'Neal*, 297 S.E.2d 647, 651 (Va. 1982). Wharf's misrepresentation of its intention to sell UIH the stock of Wharf Cable as promised in the option falls squarely within this category of fraud.[3]

2. Petitioners attempt (Br. 23, 26) to ground their proposed bar to liability for misrepresentations about the intention to sell securities in Section 10(b)'s requirement that misrepresentations be made "in connection with the purchase or sale of any security." That requirement, however, does not limit the subject matter of prohibited misrepresentations. Rather, it demands a "connection" or relationship between the misrepresentation and the purchase or sale of a security. See *Bankers Life*, 404 U.S. at 12 (paraphrasing "in connection with" as "touching").[4]

The necessary connection exists "when the proscribed conduct and the sale [or purchase] are part of the same fraudulent scheme." *Alley* v. *Miramon*, 614 F.2d 1372, 1378

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[3] Misrepresentations must be material to trigger liability under Section 10(b). See 17 C.F.R. 240.10b-5(b). A misrepresentation is material if a reasonable person would attach importance to the fact misrepresented in determining his course of action with respect to the transaction. *Basic Inc.* v. *Levinson*, 485 U.S. 224, 238 (1988). Misrepresentation of one's intention to honor one's promise under an option or other contract unquestionably is material, because the expectation that one will do so provides the inducement for the other party to purchase the option or enter into the contract.

[4] See also *SEC* v. *Clark*, 915 F.2d 439, 449 (9th Cir. 1990) ("in connection with" requires "some nexus" between the deceit and a securities transaction); *Abrams* v. *Oppenheimer Gov't Sec., Inc.*, 737 F.2d 582, 593 (7th Cir. 1984) ("some nexus but not necessarily a direct and close relationship"); *Brown* v. *Ivie*, 661 F.2d 62, 65 (5th Cir. 1981) ("a nexus"), cert. denied, 455 U.S. 990 (1982).

n.11 (5th Cir. 1980) (Wisdom, J.). That principle is illustrated by *O'Hagan*, in which this Court found the "in connection with" requirement satisfied when a fiduciary, without disclosure to his principal, uses confidential information to purchase securities from, or sell them to, another party. The Court explained that the "in connection with" requirement is met because "the fiduciary's fraud is consummated, not when the fiduciary gains the confidential information, but when, without disclosure to his principal, he uses the information to purchase or sell securities." 521 U.S. at 655-656.

Misrepresentations about the value of securities bought or sold fall within the "in connection with" language because those misrepresentations bear on the appropriate consideration for the purchase or sale. However, contrary to petitioners' contention (Br. 25-27, 31), neither that phrase nor any other language in Section 10(b) or Rule 10b-5 "would indicate that those provisions were intended to deal only with fraud as to the 'investment value' of securities, and, indeed, it is established that a 10b-5 action will survive even though the fraudulent scheme or device is unrelated to 'investment value.'" *A.T. Brod*, 375 F.2d at 396-397; see *SEC* v. *Jakubowski*, 150 F.3d 675, 679-680 (1998) (Easterbrook, J.), cert. denied, 525 U.S. 1103 (1999). Thus, in *O'Hagan*, the misrepresentation was the fiduciary's false profession of his intention to honor his duty of loyalty to his principal, 521 U.S. at 653-654, a misrepresentation that did not concern the value of the securities in which the fiduciary traded. And, in *Bankers Life*, the misrepresentation was that a corporation that sold bonds would receive their proceeds, when insiders actually intended to misappropriate those proceeds for their own use. 404 U.S. at 9-10.

The courts of appeals have also repeatedly applied Section 10(b) to fraud that did not involve misrepresentations about the securities themselves or the consideration paid. See, *e.g.*, *Jakubowski*, 150 F.3d at 679 (defendant misrepresented his identity "in order to induce the issuer to accept his offer to

buy"); *Marbury Mgmt., Inc.*, v. *Kohn*, 629 F.2d 705, 707 (2d Cir.) (trainee's misrepresentation that he was an experienced stockbroker "not only induced the purchase of the securities involved but their retention as investments as well"), cert. denied, 449 U.S. 1011 (1980). It is thus well established that the "in connection with" requirement is met when there is a "straightforward cause and effect" relationship between the misrepresentation and a securities transaction. *In re Ames Dep't Stores, Inc. Stock Litig.*, 991 F.2d 953, 967-968 (2d Cir. 1993); see also *SEC* v. *Drysdale Sec. Corp.*, 785 F.2d 38, 42-43 (2d Cir.), cert. denied, 476 U.S. 1171 (1986); *McGrath* v. *Zenith Radio Corp.*, 651 F.2d 458, 467 (7th Cir.), cert. denied, 454 U.S. 835 (1981).

That the "in connection with" language poses no obstacle to liability for misrepresentation of the intention to sell securities is particularly clear because a "contract to purchase or sell securities is expressly defined by § 3(a) of the 1934 Act * * * as a purchase or sale of securities for the purposes of that Act." *Blue Chip Stamps*, 421 U.S. at 750-751; see 15 U.S.C. 78c(a)(13) and (14). Section 10(b) thus prohibits not only deception "in connection with the purchase or sale of any security," but also deception "in connection with a contract to purchase or sell any security."

When a party enters into a contract to purchase securities—either an option or a conventional contract—few deceptions could be more closely connected to the transaction than the other party's misrepresentation about its intention to sell the securities. That deceit affects the value of the option or other contractual right and consequently the price the purchaser is willing to pay. A contract that the seller secretly does not intend to honor has little value. Even if the purchaser successfully sues to enforce the contract, its value is significantly reduced by the costs of litigation and delay. Moreover, the false representation of intention to sell induces the buyer to enter into the contract, because no one would contract to buy from someone who

does not intend to sell. In this case, Wharf's misrepresentation that it would sell UIH Wharf Cable stock pursuant to the option when Wharf did not intend to sell satisfied the "in connection with" requirement because it affected the value of the option and induced UIH to expend valuable resources to purchase the option.[5]

B. Precedent Supports Section 10(b) Actions Based On Misrepresentations About The Intention To Sell Securities

Contrary to petitioners' contention (Br. 24-32), the decisions of this Court and the courts of appeals establish that actions under Section 10(b) may be premised on misrepresentations about the intention to sell securities. For example, in *United States* v. *Naftalin*, 441 U.S. 768 (1979), this Court upheld a criminal conviction under Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), that was based on the defendant's misrepresentation about his intention to sell securities. The defendant falsely represented that he owned stock that he entered into a contract with a broker-

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[5] This case therefore does not require the Court to explore the outer limits of the "in connection with" requirement. We note, however, that a misrepresentation may satisfy the "in connection with" requirement even if it does not induce the securities transaction. 8 Louis Loss & Joel Seligman, *Securities Regulation* 3686-3687 (3d ed. 1991); see, *e.g.*, *O'Hagan*, 521 U.S. at 655-656 (discussed at p. 12, *supra*). The "in connection with" requirement does, however, preclude actions based on circumstances not involving the purchase or sale of a security. Moreover, the other requirements of Section 10(b) must be satisfied—that there was a deceptive or manipulative device or misrepresentation, that it was material, and that it was made with scienter. See *SEC* v. *First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996), cert. denied, 522 U.S. 812 (1997). A private plaintiff (but not the government) must also establish reliance (or causation) and damages. *SEC* v. *Rana Research, Inc.*, 8 F.3d 1358, 1364 (9th Cir. 1993); *SEC* v. *Blavin*, 760 F.2d 706, 711 (6th Cir. 1985). And, a private plaintiff seeking damages must establish standing under *Blue Chip Stamps* as a purchaser or seller and satisfy the pleading requirements of the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737.

dealer to sell; in fact, he did not own the stock, and he was unable to deliver it because it rose in price before the settlement date. 441 U.S. at 770-771. The Court's conclusion that a misrepresentation concerning the ability and intention to deliver stock can form the basis for liability under Section 17(a) is instructive with respect to the scope of Section 10(b), because Section 17(a)'s prohibition on fraud "in the offer or sale of any securities" is analogous to Section 10(b)'s prohibition on fraud "in connection with the purchase or sale of securities." See *Herman & MacLean*, 459 U.S. at 383 (characterizing *Naftalin* as "applying § 17(a) of the 1933 Act to conduct also prohibited by § 10(b)"); *Naftalin*, 441 U.S. at 773 n.4 (suggesting that "in" and "in connection with" are coterminous); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 213 n.32 (1976) (noting substantial overlap between the texts of Rule 10b-5 and Section 17).

Although this Court has not ruled on the same issue in a Section 10(b) case, in *Bankers Life*, 404 U.S. at 10 n.7, the Court cited with approval two court of appeals decisions that held deception about a party's intention to buy or sell securities actionable under Section 10(b). In one of those cases, *A.T. Brod*, 375 F.2d at 397, the Second Circuit held that a customer's misrepresentation that he would pay for stock he ordered, when he intended to pay only if the value of the stock had increased by the settlement date, violated Section 10(b). In the other, *Allico National Corp.* v. *Amalgamated Meat Cutters & Butcher Workmen of North America*, 397 F.2d 727, 729-730 (1968), the Seventh Circuit held that the plaintiff stated a claim under Section 10(b) when it alleged that the seller of securities breached an installment sales contract by entering into a more favorable contract with another buyer and converting shares for which the plaintiff had already paid in order to sell them to the second buyer.

Other courts of appeals have likewise held that actions under Section 10(b) may be based on misrepresentations of

an intention to buy or sell securities. See *Threadgill*, 730 F.2d at 811-812 ("fraud in the purchase or sale includes '[e]ntering into a contract of sale [of a security] with the secret reservation not to fully perform'"); *Madison Consultants*, 710 F.2d at 61 (allegations that defendants lied about their intention not to purchase plaintiffs' stock stated a claim); *Fogarty* v. *Security Trust Co.*, 532 F.2d 1029, 1032-1033 (5th Cir. 1976) (action under Rule 10b-5 could be valid if defendant promised to buy stock but did not intend to keep the promise); *Walling* v. *Beverly Enters.*, 476 F.2d 393, 396 (9th Cir. 1973) (plaintiff stated valid claim by alleging that defendant entered into an agreement to sell stock to plaintiff "with the intent not to perform its obligations unless it later determined that it was in its best interests to do so"); *Richardson* v. *MacArthur*, 451 F.2d 35, 40 (10th Cir. 1971) (Rule "10b-5 has been found to be a proper civil remedy for a scheme whereby individuals were induced into contracting for the purchase of stock which the seller had no intention of giving up."). See also *Luce* v. *Edelstein*, 802 F.2d 49, 55 (2d Cir. 1986) ("making a specific promise to perform a particular act in the future while secretly intending not to perform that act may violate Section 10(b) where the promise is part of the consideration for the transfer of securities"); accord *In re Phillips Petroleum Sec. Litig.*, 881 F.2d 1236, 1245 & n.13 (3d Cir. 1989); *McGrath*, 651 F.2d at 466.[6]

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[6] The four cases on which petitioners rely do not hold to the contrary. In *Gurwara* v. *Lymphomed, Inc.*, 937 F.2d 380, 381 (7th Cir. 1991), the plaintiff alleged that his employer misrepresented his rights under a stock option to induce him to take action that made him ineligible to exercise those rights. The court of appeals rejected the plaintiff's claim, which identified the underlying stock as the security, but expressly declined to decide whether he "might have sued successfully under section 10(b) for misrepresentations in connection with his *option contract*." *Id.* at 382 n.2. Moreover, in *Jakubowski*, 150 F.3d at 679, the Seventh Circuit rejected as incorrect the dicta in *Gurwara* that suggested that a misrepresentation must relate to the value of the security. In two of the other cases cited by petitioners, the plaintiffs apparently did not allege that, at the time that

C. Limiting The Scope Of Section 10(b) As Petitioners Urge Would Undermine The Act's Purposes

Congress's purposes in enacting Section 10(b) would be seriously undermined by a rule that misrepresentations about the intention to sell securities are outside its scope or that Section 10(b) encompasses only misrepresentations about the value of a security. Such a rule would frustrate Section 10(b)'s purpose "to insure honest securities markets" (*O'Hagan*, 521 U.S. at 658) by removing from its purview many pernicious varieties of fraud. For example, the misappropriation theory of insider trading upheld in *O'Hagan* involves a deception that does not relate to the value of the securities traded. And the frauds perpetrated by customers against broker-dealers in *Naftalin* and *A.T. Brod* involved misrepresentations about intentions to buy or sell securities. In addition, fraud by broker-dealers against customers often involves misrepresentations about salesperson qualifications, risks of margin trading, a brokerage firm's solvency, or the level of trading in a customer's account.[7]

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the defendants entered into the contracts to sell the securities, the defendants did not intend to honor the contracts; moreover, the courts of appeals did not consider whether there was fraud in connection with the *contracts*. See *Stanford* v. *Humphrey*, 894 F.2d 410 (9th Cir. 1990) (Table) (1990 WL 4659); *Hunt* v. *Robinson*, 852 F.2d 786 (4th Cir. 1988). In the last case cited by petitioners, *Tully* v. *Mott Supermarkets, Inc.*, 540 F.2d 187, 191 (3d Cir. 1976), the plaintiffs alleged that the defendants sold stock to others without affording the plaintiffs a right of first refusal. The defendants, however, were not parties to the agreement creating the right of first refusal, see *id.* at 190, so the plaintiffs had no claim that the defendants entered into that agreement with the intent not to perform. Moreover, elsewhere in its opinion, the court held that the "plaintiffs possessed no entitlement or contractual right to purchase [the] stock on a preferential basis." *Id.* at 193.

[7] See *Angelastro* v. *Prudential-Bache Sec., Inc.*, 764 F.2d 939, 946 (3d Cir.), cert. denied, 474 U.S. 935 (1985); *Abrams* v. *Oppenheimer Gov't Sec., Inc.*, 737 F.2d 582, 588 (7th Cir. 1984); *Kehr* v. *Smith Barney, Harris Upham & Co.*, 736 F.2d 1283, 1286 (9th Cir. 1984); *Costello* v. *Oppenheimer & Co.*, 711 F.2d 1361, 1368 (7th Cir. 1983); *Arrington* v. *Merrill*

Moreover, "the fundamental purpose of the 1934 Act 'to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*'" would also be eroded by petitioners' proposed rule. *Santa Fe*, 430 U.S. at 477 (citation omitted). A philosophy of full disclosure is inconsistent with subject matter limitations on which misrepresentations are prohibited. Permitting misrepresentations as fundamental as misstatements of one's intention to buy or sell securities in accordance with one's promises under a contract for sale would create a significant gap in the full disclosure regime.

Indeed, permitting misrepresentations about the intention to buy or sell securities as promised would strike at a core purpose of Section 10(b)—to prevent "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Ernst & Ernst*, 425 U.S. at 199. As the Commission explained in its amicus brief in *A.T. Brod*, "the artificial demand created by purchasing securities which are not to be paid for unless the market value of the stock rises[] can have an unsettling and potentially manipulative effect on the securities market." 375 F.2d at 397. The same is true of selling securities that the seller does not intend to deliver unless the market value of the securities falls, as in *Naftalin*.

Finally, a rule exempting certain categories of misrepresentations from Section 10(b) would also create uncertainty about its scope and could increase, rather than decrease, litigation. For example, in this case, there is a dispute whether Wharf's misrepresentation affected the value of the security that UIH purchased. Compare Pet. Br. 25-26 with pp. 13-14, *supra*.

Lynch, Pierce, Fenner & Smith, Inc., 651 F.2d 615, 619 (9th Cir. 1981); *Marbury Mgmt.*, 629 F.2d at 707.

D. Section 10(b) Actions Based On Misrepresentations About The Intention To Sell Securities Neither Federalize State Law Contract Disputes Nor Conflict With *Santa Fe*

Contrary to petitioners' contention (Br. 25-26, 31, 32), permitting Section 10(b) actions based on misrepresentations about the intention to buy or sell securities does not federalize state law actions for breach of contract. Furthermore, petitioners err in arguing (Br. 24-25) that actions based on those misrepresentations conflict with this Court's decision in *Santa Fe*.

Claims based on misrepresentations about the intention to buy or sell securities differ from ordinary breach-of-contract claims because they involve alleged fraud in the inducement of a securities transaction. If a person enters into a contract to purchase or sell a security with the intent to perform and subsequently fails to honor the contract, the failure to perform gives rise to an action for breach of contract, but there is no action under Section 10(b). If, however, a person enters into a contract to purchase or sell a security but secretly does not intend to honor the contract, an action can be brought under Section 10(b) based on the misrepresentation. See *In re Phillips Petroleum Sec. Litig.*, 881 F.2d at 1245 & n.13; *Luce*, 802 F.2d at 56; *Fogarty*, 532 F.2d at 1033. Cf. *Durland*, 161 U.S. at 312-314 (rejecting contention that sale of bonds with intent not to honor them entails only a breach of contract). Because Section 10(b) "trains on conduct involving manipulation or deception," a Section 10(b) action that is premised on deception presents no improper federalization of state law. *O'Hagan*, 521 U.S. at 655.

A state law claim for breach of contract is thus fundamentally different from a federal securities fraud action. The former seeks to enforce a contract; the latter is based on deception. That difference is reflected in the applicable measure of damages. In a typical breach-of-contract action,

the plaintiff is entitled to damages measured by the benefit of the bargain. 3 E. Allan Farnsworth, *Farnsworth on Contracts* § 12.8, at 186 (1990). In contrast, in actions under Section 10(b), the basic measure of damages, with certain exceptions, is the out-of-pocket loss caused by the deception. See 9 Louis Loss & Joel Seligman, *Securities Regulation* 4413-4415 (3d ed. 1992).[8]

When there is fraud in the inducement of a contract to purchase or sell securities, and the party committing the fraud fails to perform under the contract, the injured party has a state law claim for breach of contract as well as a claim under Section 10(b). The fact that the plaintiff also has a state law claim for breach of contract does not preclude liability under Section 10(b). See *Madison Consultants*, 710 F.2d at 65.

This Court's decision in *Santa Fe* in no way points to a contrary conclusion. That case involved a claim that the defendant majority shareholder, although it made full disclosure, breached its fiduciary duty to minority shareholders in a freeze-out merger. The Court ruled that that claim, standing alone, did not state a cause of action under Section 10(b). The primary basis for the Court's holding was not that the case involved issues traditionally governed by state law, but rather that "the transaction, if carried out as alleged in the complaint, was neither deceptive nor manipulative." 430 U.S. at 474. The Court distinguished the situation in *Santa Fe*, which involved only a breach of fiduciary duty, from cases "in which the breaches of fiduciary duty held violative of Rule 10b-5 included some element of deception." *Id*. at 475 & n.15.

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[8] Thus, the benefit-of-the-bargain damages awarded in this case might not have been appropriate if the only claim had been under Section 10(b). Also, the district court correctly limited the punitive damages to the state law claims because only "actual damages" are available under the Exchange Act. 15 U.S.C. 78bb(a). See 9 Loss & Seligman, *supra*, at 4423-4424.

This Court has since confirmed that misrepresentations about matters of corporate governance may be actionable under the federal securities laws. In *Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1090-1098 (1991), the Court held that misrepresentations in proxy materials about the fairness of a proposed transaction could give rise to a claim under the federal securities laws. Distinguishing *Santa Fe*, the Court explained that, while state law governs internal corporate affairs, Section 14(a) of the 1934 Act, which governs proxy solicitations, "does impose responsibility for false and misleading proxy statements." *Id.* at 1093 n.6. The Court elaborated that, "[a]lthough a corporate transaction's 'fairness' is not, as such, a federal concern, a proxy statement's claim of fairness presupposes a factual integrity that federal law is expressly concerned to preserve." *Ibid.* The same analysis applies to Section 10(b) actions involving misrepresentations with respect to securities contracts: Contract disputes, as such, are not a federal concern, but Section 10(b) is expressly designed to prohibit fraud in connection with contracts to purchase or sell securities.

Although the Court in *Santa Fe* expressed concern over the unwarranted encroachment of federal law into areas traditionally regulated by state law, that concern arose from the prospect of federal regulation absent deceptive conduct. See 430 U.S. at 478-479 (absent deception, federal action could "interfere" with or "overrid[e]" state law and policies). The Court recognized that "the existence of a particular state-law remedy is not dispositive of the question whether Congress meant to provide a similar federal remedy." *Id.* at 478. In cases like the one now before this Court, "[s]ince there was a 'sale' of a security and since fraud was used 'in connection with' it, there is redress under [Section] 10(b), whatever might be available as a remedy under state law." *Bankers Life*, 404 U.S. at 12; see also 15 U.S.C. 78bb(a) (Subject to limited exceptions not relevant here, "[t]he rights and remedies provided by this chapter shall be in

addition to any and all other rights and remedies that may exist at law or in equity."). Creating an exception from liability under Section 10(b) for misrepresentations that are actionable under state law would eliminate Section 10(b) as a meaningful check on securities fraud, because defendants could reformulate almost all allegations of false statements as allegations of breaches of a state law duty. See *Madison Consultants*, 710 F.2d at 65; 5A Arnold Jacobs, *Litigation and Practice Under Rule 10b-5*, § 11.01, at 1-323 to 1-325 (1996).

II. AN ACTION UNDER SECTION 10(b) MAY BE BASED ON AN ORAL CONTRACT FOR THE PURCHASE OR SALE OF A SECURITY

Petitioners also argue (Br. 32-39) that an action under Section 10(b) may not be based on an oral contract that is unenforceable under the applicable state statute of frauds. That question is not actually presented by this case, for two reasons: First, as we have explained, the decision of the court of appeals does not premise Wharf's liability on a "contract" to purchase or sell a security or on the Act's provisions (15 U.S.C. 78c(a)(13) and (14)) defining "purchase" and "sale" to include such a contract. Rather, the court held Wharf liable based on a *completed* sale of a security—UIH's purchase at the October 8, 1992, meeting of an option, which is itself a "security." See pp. 5, 8-9, *supra*. The court of appeals assumed that the option qualified as a security under Section 10(b) because it concluded that petitioners had not contested that classification. Pet. App. B15. It is not clear that petitioners contend even now that the oral option is not a "security" under Section 10(b).[9] In any event, this Court

[9] Petitioners argue (Br. 36-37, 41) that recognition of an "oral security" in this case is inconsistent with *Blue Chip Stamps*. *Blue Chip Stamps*, however, concerns a private plaintiff's standing to bring a damages action under Section 10(b) and in no way suggests that the definition of "security" in 15 U.S.C. 78c(a)(10) (1994 & Supp. IV 1998) excludes oral

ordinarily does not address questions that were not raised in or decided by the court of appeals. *National Collegiate Athletic Ass'n* v. *Smith*, 525 U.S. 459, 470 (1999).

Second, the court of appeals expressly rejected petitioners' contention that the option was unenforceable under Colorado's statute of frauds. Pet. App. B21-B25. This Court normally defers to the construction given a state statute by the court of appeals unless that court's decision is plainly erroneous. *Brockett* v. *Spokane Arcades, Inc.*, 472 U.S. 491, 499-500 & n.9 (1985). Reconsideration of the state law issues in this case is particularly unwarranted because Colorado law no longer subjects contracts for the sale of securities to the statute of frauds. Pet. App. B22 n.2. Indeed, as we explain below, oral contracts for the sale of securities are now generally enforceable under the law of all 50 States. See pp. 25-26, *infra*.

To the extent the question posed by petitioners is properly presented, petitioners' contentions are incorrect: A violation of Section 10(b) can be predicated on an oral contract, and *Blue Chip Stamps* does not preclude private actions based on such a violation.

A. Section 10(b) Applies To An Oral Contract To Sell A Security

1. Section 10(b) applies to the "purchase or sale of any security." 15 U.S.C. 78j(b). The 1934 Act defines "purchase" and "sale" to include "any contract" to purchase or sell a security. 15 U.S.C. 78c(a)(13) ("The terms 'buy' and 'purchase' each include any contract to buy, purchase or otherwise

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agreements. Neither the text of Section 78c(a)(10) nor any case law of which we are aware requires that securities in general or options in particular be written. Courts have recognized that investment contracts, which are defined as securities under Section 78c(a)(10), can be oral. See p. 25, *infra*. Furthermore, when Congress intended to require a writing, it did so explicitly. See p. 24, *infra*. Finally, as we explain at pp. 28-30, *infra*, *Blue Chip Stamps* does not preclude private damages actions based on oral agreements.

acquire."); 15 U.S.C. 78c(a)(14) ("The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."). Excluding oral contracts from the coverage of Section 10(b) would improperly read the word "any" out of, or the word "written" into, the statutory phrase "any contract."

When Congress intended to require a writing under the securities laws, it did so explicitly. See 15 U.S.C. 77b(10) (1994 & Supp. IV 1998) (defining prospectus as "any * * * communication, written or by radio or television, which offers any security for sale or confirms the sale of any security"). Indeed, even if an oral contract were unenforceable as a matter of state law, which the contract in this case was not, it would be included within the protection of the federal securities laws. The word "contract" was commonly understood during the early 1930s, when the securities laws were enacted, to include both enforceable and unenforceable contracts. See Restatement (First) of the Law of Contracts § 1 cmt. e (1932) ("The term contract is generic. As commonly used, and as here defined, it includes varieties described as voidable, *unenforceable*, formal, informal, express, implied, * * * unilateral, bilateral.") (emphasis added). The Restatement defined an "unenforceable contract" as "one which the law does not enforce by direct legal proceedings, but recognizes in some indirect or collateral way as creating a duty of performance," and gave as an example a contract that does not satisfy the statute of frauds. *Id.* § 14. The term "contract" in the Exchange Act should be construed in accordance with that contemporaneous understanding.

That is the approach this Court took in *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946), when construing the term "investment contract" in the definition of "security" in Section 2(1) of the Securities Act of 1933, 15 U.S.C. 77b(1).[10]

[10] Both Section 2(1) of the Securities Act of 1933 and Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10) (1994 & Supp. IV 1998), define the term "security" to include "investment contract." The definitions of "security" in the two Acts "are virtually identical and [are] treated as such in

Noting that the term is "undefined by the Securities Act or by relevant legislative reports," the Court considered how the term was used under state blue sky laws prior to adoption of the federal statute, and determined that it had been "broadly construed * * * so as to afford the investing public a full measure of protection." 328 U.S. at 298. Based on that analysis, the Court held that "an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." *Id.* at 298-299. The Court nowhere suggested that an investment contract must be written. And the courts have since recognized that investment contracts can be oral in whole or in part. See, *e.g.*, *Canadian Imperial Bank of Commerce Trust Co.* v. *E.R. Fingland*, 615 F.2d 465, 466-467 & n.5 (7th Cir. 1980); *SEC* v. *Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974); *Anderson* v. *Francis I. DuPont & Co.*, 291 F. Supp. 705, 708 (D. Minn. 1968).

2. Not only is there no basis in the text of Section 10(b) to exclude oral contracts from its scope, but there is also no policy reason to do so. Oral contracts for the sale of securities are generally enforceable under state law. The Uniform Commercial Code was amended in 1994 to make the statute of frauds inapplicable to securities contracts. See U.C.C. § 8-113 (1995) ("a contract for the sale or purchase of a security is enforceable whether or not there is a writing"). That provision has been adopted by all 50 States with only minor variations. See [State UCC Variations] U.C.C. Rep. Serv. (CBC) at xxi-xxii (West Sept. 2000) (Table of Enactments of 1994 Amend. (rev. art. 8)) (noting adoption of Section 8-113

[this Court's] decisions." *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681, 686 n.1 (1985).

by all States except South Carolina); S.C. Code Ann. § 36-8-113 (Law. Co-op. 2000) (adopting Section 8-113).[11]

Moreover, under the traditional common law rule, a fraud claim based on misrepresentation of a party's intention to perform a contract is actionable even if the contract itself is oral and unenforceable under the statute of frauds. See Restatement (Second) of Torts § 530 cmt. c. Although, as petitioners note (Br. 35), that rule is not followed in all jurisdictions, it is the traditional majority rule. See Dan D. Dobbs, *The Law of Torts* 1377 (2000); W. Page Keeton, *Prosser and Keeton on Torts* 763-764 (5th ed. 1984); *e.g.*, *Walker* v. *U-Haul Co. of Miss.*, 734 F.2d 1068, 1076-1078 (5th Cir. 1984); *Brody*, 897 P.2d at 776; *Tenzer* v. *Superscope, Inc.*, 702 P.2d 212, 218-219 (Cal. 1985); *Burgdorfer* v. *Thielemann*, 55 P.2d 1122, 1125-1128 (Or. 1936). Section 10(b), which prohibits "*all* fraudulent schemes in connection with the purchase or sale of securities," *Bankers Life*, 404 U.S. at 11 n.7, and is "in part designed to *add* to the protections provided investors by the common law," *Basic, Inc.* v. *Levinson*, 485 U.S. 224, 244 n.22 (1988) (emphasis added), certainly should not be construed more narrowly than common law fraud.

Indeed, excluding oral contracts from the coverage of Section 10(b) would seriously undermine its antifraud protections. A large part of the business of the securities markets is transacted orally or through electronic means of communication. See U.C.C. § 8-113 (official cmt.); Egon Guttman, *Investment Securities Law: New Federal and State Developments and Their Effect on Article 8*, 24 U.C.C. L.J. 307, 334 (1992). Moreover, fraud often occurs through oral misrepresentations. If a plaintiff could not bring a securities fraud

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[11] The only variation that appears relevant here is that Alabama law requires a writing when the security is not traded on "a national stock exchange or * * * the over-the-counter securities market." Ala. Code § 8-9-2(8) (1999).

action without a written contract, unscrupulous brokers could keep all dealings with purchasers oral, or fail to follow through on commitments to memorialize oral agreements in writing, in order to preclude liability under Section 10(b). Limiting the scope of Section 10(b) to written contracts is thus "unsuited to the realities of the securities business." U.C.C. § 8-113 (official cmt.).[12]

3. It is therefore not surprising that most courts of appeals that have considered the question have held that Section 10(b) covers oral contracts. See *Threadgill*, 730 F.2d at 811-812 ("There is no exception for oral contracts."); *Fogarty*, 532 F.2d at 1034 ("Of course, state statutes of frauds do not bar recovery under 10b-5."); *Desser* v. *Ashton*, 573 F.2d 1289 (2d Cir. 1977) (Table), affirming without written opinion 408 F. Supp. 1174, 1175 (S.D.N.Y. 1975) ("contract could satisfy the 'purchaser-seller' requirement if it was not an enforceable contract under the applicable law"); see also *Madison Consultants*, 710 F.2d at 66 (finding valid claim under Section 10(b) after noting that state law contract claim "might be barred by the statute of frauds").[13]

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[12] As this case illustrates, private securities transactions, which, like transactions in the public markets, are subject to Section 10(b), *Landreth*, 471 U.S. at 692; *Bankers Life*, 404 U.S. at 10, also frequently involve oral representations and agreements.

[13] Petitioners cite two decisions to the contrary. In one of those decisions, however, the court also endorsed the proposition that "an allegation that a securities transaction was fraudulently induced by a promise, even an unenforceable one, to perform a future act can be actionable under Section 10(b) if the promise is part of the consideration of the sale." *Pelletier* v. *Stuart-James Co.*, 863 F.2d 1550, 1556 (11th Cir. 1989). In the other, *Kagan* v. *Edison Brothers Stores, Inc.*, 907 F.2d 690, 691 (7th Cir. 1990), the court concluded that exclusion of oral contracts from the scope of Section 10(b) was mandated by the U.C.C. provision that subjected securities contracts to the statute of frauds and by this Court's decision in *Blue Chip Stamps*. As we have explained (see p. 25, *supra*), however, that U.C.C. provision has been repealed; and, as we explain below, *Blue Chip Stamps* does not preclude actions under Section 10(b) based on oral contracts for the purchase or sale of securities. See also Guttman, *supra*, at 335 (criticizing *Kagan* as inconsistent with the principle that failure to

B. *Blue Chip Stamps* Does Not Preclude Claims Based On Oral Contracts For The Purchase Or Sale Of Securities

Petitioners' contention (Br. 32-45) that this Court's decision in *Blue Chip Stamps* precludes private actions based on oral contracts for the purchase or sale of securities is also mistaken. *Blue Chip Stamps* held that the class of private plaintiffs in damages actions under Section 10(b) is limited to "actual purchasers and sellers" of securities. 421 U.S. at 731. The Court recognized that "the holders of puts, calls, options, and other contractual rights or duties to purchase or sell securities have been recognized as 'purchasers' or 'sellers' of securities for purposes of Rule 10b-5 * * * because the definitional provisions of the 1934 Act themselves grant them such a status." *Id.* at 751. As we have explained, those provisions encompass oral as well as written, and enforceable as well as unenforceable, contracts. See pp. 23-27, *supra*. Thus, rather than supporting petitioners' argument, *Blue Chip Stamps* requires that it be rejected.[14]

Petitioners misread *Blue Chip Stamps* as establishing a general rule against Section 10(b) actions based on oral testimony. The Court's concern in *Blue Chips Stamps* was not about oral testimony per se, but about "the abuse potential and proof problems inherent in suits by investors

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comply with the statute of frauds only makes a contract unenforceable, not illegal or void).

[14] It might be argued that a plaintiff is not an "actual" purchaser (*Blue Chip Stamps*, 421 U.S. at 731) if the contract for sale is unenforceable under state law, even though there is a "purchase" and "sale" as defined in the securities laws. That conclusion, however, would have to be based on extra-textual "policy considerations," and such considerations are not appropriate here because, unlike in *Blue Chip Stamps*, the "express 'intent of Congress'" can be "divine[d] from the language of § 10(b)." 421 U.S. at 737. In any event, as we have explained above, the contract for sale in this case was enforceable under state law, as the Tenth Circuit found, see Pet. App. B21-B25, and, as we explain in the text following this note, policy considerations do not justify precluding private actions under the circumstances here.

who neither bought nor sold, but asserted they would have traded absent fraudulent conduct by others." *O'Hagan*, 521 U.S. at 664. Allowing plaintiffs to base claims on their own testimony about an otherwise unverifiable decision not to purchase or sell a security would allow them "to manufacture claims of hypothetical action, unconstrained by independent evidence." *Virginia Bankshares*, 501 U.S. at 1093. As the Court explained in *Blue Chip Stamps*, "[p]laintiff's entire testimony could be dependent upon *uncorroborated* oral evidence," and "[t]he jury would not even have the benefit of weighing the plaintiff's version against the defendant's version, since the elements to which the plaintiff would testify would be in many cases totally unknown and unknowable to the defendant." 421 U.S. at 746 (emphasis added). "Recognizing liability to merely would-be investors * * * would have exposed the courts to litigation unconstrained by any * * * anchor in demonstrable fact, resting instead on a plaintiff's 'subjective hypothesis' about the number of shares he would have sold or purchased." *Virginia Bankshares*, 501 U.S. at 1092 (quoting *Blue Chip Stamps*, 421 U.S. at 734-735). "[B]ystanders to the securities marketing process could await developments on the sidelines without risk, claiming that inaccuracies in disclosure caused nonselling in a falling market and that unduly pessimistic predictions by the issuer followed by a rising market caused them to allow retrospectively golden opportunities to pass." *Blue Chip Stamps*, 421 U.S. at 747.[15]

Those concerns are not present in actions based on oral contracts to purchase or sell securities. A suit based on the plaintiff's decision not to buy or sell securities would require the plaintiff to establish only his own mental processes. By

[15] Thus, the Court in *Blue Chip Stamps* recognized the "worth and frequent high value of oral testimony" (421 U.S. at 743) and simply sought to ensure that there "will generally be an objectively demonstrable fact in an area of the law otherwise very much dependent upon oral testimony" (*id.* at 747).

contrast, a suit based on an oral contract requires the plaintiff to establish that he *and the defendant* exchanged words of offer and acceptance that resulted in a contract for the sale of a security. Moreover, in a suit such as this one, the plaintiff must also prove *the defendant's* intention not to honor the contract's terms. The crucial facts are thus far from "unknown and unknowable to the defendant" (*Blue Chip Stamps*, 421 U.S. at 746), and he can present his own testimony and evidence in rebuttal. The jury can then "weigh[] the plaintiff's version against the defendant's" (*ibid.*) as in any other lawsuit.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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