Securities Litigation As A Window Into Supreme Court Litigation

*Remarks of Thomas Goldstein**

Thanks very much. For me, to give a talk to this group of experts about securities law is a little bit like carrying coals to Newcastle. It seems unlikely that I will educate you about what's going on in the Supreme Court's securities law jurisprudence when you know infinitely more about that topic than I do. And so I thought it would be more helpful if I came at this from the perspective of the strategy of the lawyers involved in the cases at the Court.

Why might that matter? As the lawyers who are working on the cases, a huge amount of effort goes into preparing. We spend hundreds if not thousands of hours preparing the briefs. We spend God-awful amounts of time practicing for oral argument. But once the decision is issued, the sense among lawyers, academics, and the public is that the outcome was preordained—that is, that the law required X, or at least that these nine Justices would inevitably have decided X. There is no real sense that the lawyers made any difference. So there is a real question: does the advocacy change the outcome? Does it make any difference at all?

Also, sometimes the Court's opinions don't tell the whole story. The written ruling has to conform to all the basic principles of judicial decisionmaking. But the Justices are human beings. And as lawyers, we try to tap into all their motivations. So the advocacy may drive decisions in ways that you can't see without looking behind the scenes.

To elaborate on those points, I propose to give you my perspective on two securities cases I worked on last term. I argued the *Chadbourne & Parke LLP v. Troice*[1] case, which arose under the Securities Litigation Uniform Standards Act ("SLUSA"). I was also heavily involved in coordinating the plaintiffs' side of *Halliburton v. Erica P. John Fund* ("*Halliburton II*"), which involved the continuing vitality of the "fraud

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1. Chadbourne & Parke LLP v. Troice, 571 U.S. —, 134 S. Ct. 1058 (2014).

on the market presumption."[2]

To remind you of the background, *Troice* is the Ponzi scheme case involving Allen Stanford, who owned the modestly named Stanford International Bank in Antigua. Allen Stanford made the compelling case to investors that if they would give him their money he would issue a certificate of deposit ("CD") and, miracle upon miracles, he would give them a substantially above-market rate of return.[3]

But rather than invest the money, Stanford bought a lot of polo ponies, which did not provide the rate of return that one would have hoped.[4] He bought a lot of land in Antigua, which is a lovely place, but is still not something that's going to generate a huge return.[5] Almost $6 billion turned into around $200 million.[6] It was a Ponzi scheme—money from new investors went to pay off redemptions and to pay interest. A lot of retirees lost all of their savings and those folks sued Allen Stanford and his advisers who allegedly participated in the scheme.[7]

They sued under state law. The district court dismissed the suits under SLUSA,[8] which requires the dismissal of a state law class action that alleges a misrepresentation in connection with the purchase or sale of a covered security.

SLUSA is the successor not just to Section 10(b) and Rule 10b-5, but also the Private Securities Litigation Reform Act ("PSLRA"). Congress had passed the PSLRA to make it much tougher to bring securities class actions in federal court. That led plaintiffs to file suit in state court instead. SLUSA responded to that maneuver.

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2. *See generally* Halliburton v. Erica P. John Fund, Inc. (*Halliburton II*), 573 U.S. —, 134 S. Ct. 2398 (2014).

3. *Troice*, 134 S. Ct. at 1059–60.

4. *See* Steven Berk, *Depression Postpones Allen Stanford Ponzi Scheme Trial*, CORP. OBSERVER (Jan. 7, 2011), http://www.thecorporateobserver.com/2011/01/07/depression-postpones-allen-stanford-ponzi-scheme-trial/ (discussing how Stanford abused investment funds by spending them on private jets and polo ponies).

5. *See* Nick Davis, *Allen Stanford: Antigua Feels the Fallout of Ponzi Case*, BBC NEWS (Mar. 8, 2012), http://www.bbc.com/news/business-17298267 (reporting that Antigua was in "dire need of foreign direct investment" at the time Stanford set up his offshore bank).

6. *See* Cole Epley, *Allen Standford's Accounting Execs Convicted of Wire Fraud*, MEMPHIS BUS. J. (Nov. 20, 2012, 11:31 AM), http://www.bizjournals.com/memphis/news/2012/11/20/allen-stanfords-accounting-execs.html (reporting that Stanford and his accountants told investors that his Antiguan bank had more than $5 billion, when it actually held less that $200 million).

7. Scott Cohn, *Five Years After Stanford Scandal, Many Victims Penniless*, CNBC (Feb. 15, 2014), http://www.cnbc.com/id/101418516# (describing many of Stanford's investors as now-penniless retired oil workers).

8. *Troice*, 134 S. Ct. at 1060.

Critically, SLUSA is narrower than 10(b) and the PSLRA. The latter apply to a misrepresentation "in connection with the purchase or sale of [a] security,"[9] whereas SLUSA applies more narrowly to a misrepresentation or omission "in connection with a purchase or sale of a covered security."[10] A covered security generally is a security that's traded on a national exchange.[11] So, SLUSA says you can't file a state-law securities suit involving a nationally traded security. Congress decided those cases needed to be litigated under federal law because the issuer has no idea where his or her purchasers are located. If you're IBM and you're selling your stock, it's not fair to IBM to have to defend these cases in every single state around the country; instead, federal court is the appropriate forum.

The question in *Troice* was: What do you do when the misrepresentation involves the sale of something that is *not* a covered security? A CD is not traded on a national exchange, so it is not a covered security. On the other hand, in selling the CDs, Stanford said something along the lines of, "if you give me your money, I'll invest it in the stock market." According to the *Troice* defendants, SLUSA applied because he was saying lies about covered securities that were causing people to buy the non-covered CDs.

So the fraud was one step removed from covered securities. The issue presented by the case was: when is there is a sufficient connection with the purchase or sale of covered security even though what the fraud involves the sale of something else?

After the district court dismissed the complaints, the Fifth Circuit ordered the suits over the Stanford CDs reinstated.[12] The defendants filed three certiorari petitions. The Supreme Court called for the views of the Solicitor General, who advised the Justices to take the case and rule for the defendants. The Court granted the petitions.

As the plaintiffs' lawyer, I faced an obvious dilemma: a conservative majority on the U.S. Supreme Court views plaintiffs—and class action plaintiffs in particular—with deep suspicion. The defense community has convinced the majority that there is too much abusive litigation of all kinds, including securities class sanctions. In general, the Court is convinced that litigation is a drain on the economy and on innovation. So, the defense perspective in arguing that the Supreme Court should

9. 15 U.S.C. § 78j(b) (2012).
10. 15 U.S.C. § 78bb(f)(1)(A).
11. 15 U.S.C. § 77r(b)(1)(A).
12. Roland v. Green, 675 F.3d 503 (5th Cir. 2012).

take the *Troice* case and reverse was: we are companies; they are class action plaintiffs' lawyers; are we done yet?

It then got worst because the one thing you kind of hope for if you're going to be on the plaintiffs' side is some measure of support from a Democratic administration. So when the Court calls for the use of the Obama administration's Solicitor General, one ordinarily expects the government would say that these plaintiffs have a perfectly fine state law cause of action. Instead, the Obama administration said, "oh no, you cannot have this kind of lawsuit."[13]

That was initially a puzzle and a significant problem. But it ended up being our savior. That was so because the Obama administration had an angle in supporting the defendants. Anybody who files an amicus brief has an angle; they want something done. So why was the United States in this case saying we think the defendant should win?

The answer requires going back to the source of SLUSA's text: "in connection with the purchase or sale of a covered security."[14] The "in connection with" language was the key to the question in *Troice*. The issue at bottom was how close a fraud must be to a regulated sale to be subject to the securities laws.

The Securities and Exchange Commission ("SEC") was in the case because the "in connection with" phrase comes from 10(b), which is enforced by the SEC. The government was on the side of the *Troice* defendants because the defendants were arguing for a broad reading of "in connection with."[15] The defendants wanted to tie the non-covered CDs to the covered securities that Stanford claimed that he was buying.

What the SEC wanted to do was apply a defense victory in *Troice* to expand its own authority under 10(b). The SEC wanted to be able to bring cases in which defendants engaged in fraud with respect to the sale of a non-security through statements about securities.

So what I said to the Supreme Court was that this Stanford thing was really a one-off silly case under SLUSA. There aren't any other of these. Don't be bothered about it; there's never been another case like this and there never will be anymore. Instead, the real implication of the case is for the scope of 10(b). If you rule for the defendants, then the SEC will bring many more 10(b) cases. Then the plaintiffs' bar—

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13. The Obama administration represented the Securities and Exchange Commission, supporting the defendants. Lawrence Hurley, *U.S. Justices Say Allen Stanford Victims Can Sue Lawyers, Brokers*, REUTERS (Feb. 26, 2014, 4:09 PM), http://www.reuters.com/article/2014/02/26/us-usa-court-stanford-idUSBREA1P17220140226.

14. 15 U.S.C. § 78bb(f)(1)(A).

15. Hurley, *supra* note 13.

those evil tricky people—will bring more private suits under Section 10(b)-5. In other words, the upshot of the defendants' legal rule is going to be a huge amount of federal securities litigation that you don't want.

I do think that argument was the key to the plaintiffs' victory. But I don't think that you can understand that fact just from reading the Justices' opinions, which provide a very incomplete story.

So if you are looking for what will drive the next SLUSA decision, you should think about it from that perspective. If the case is going to be about "in connection with," you have to think about the other more-important provisions in which those words appear.

Now take the *Halliburton II* case, which is a much bigger deal. In *Halliburton II*, we are dealing with the mother of all shifts on the Court: the ongoing debate over the correctness of *Basic, Inc. v. Levinson*[16] twenty-five years later.

The key question for the *Halliburton II* plaintiffs was to identify a strategy to save *Basic*. We could not flip the script, as in *Troice*. A defense victory in *Halliburton II* unquestionably would limit securities litigation.

On the other hand, we likely had four votes to begin with: the Court's four more liberal Justices were unlikely to gut 10(b) class actions so aggressively. But we needed a fifth vote.

That vote would have to come from a conservative. It seemed very unlikely that we could persuade those Justices of the underlying soundness of *Basic*. Four had affirmatively invited consideration of whether to overrule that decision. Given the hostility to plaintiffs' class actions, we would need a different theme.

We settled on institutional responsibility. And we looked to the conservative Justice who had not invited reconsidering *Basic*: the Chief Justice.

So, our principal push was: this is not the case about securities law at all. This is a case about consistency and stability—i.e., stare decisis.

We had a two-pronged approach. First, we organized a number of briefs directed to the point that securities class actions are not a major problem and are closely overseen by Congress. Second, we pressed very hard the principle that errors in statutory construction get fixed by Congress, not by overruling precedents.

That second argument had a critical subtext. The conservative

16. Basic, Inc. v. Levinson, 485 U.S. 224 (1988).

majority on the Supreme Court is anxious to have the opportunity to overturn a number of *constitutional* decisions. When the Supreme Court does that, it loves to draw the distinction that in constitutional law—unlike statutory law—only we can fix our problems. That was recently true in campaign finance with cases like *Citizens United v. F.E.C.*[17] and in issues of race with the Voting Rights Act.

So the subtext of our argument was that, if the Court's majority was going to rely on the distinction between statutory and constitutional cases in those very significant contexts, it could not fairly overrule *Basic*. It needed to say that if the fraud-on-the-market presumption is an incorrect interpretation of section 10(b), then it is Congress' job to fix it.

That theme seemed to have taken hold. The Chief Justice's opinion stressed that the defendants were effectively arguing that *Basic* was wrong when it was decided. So it was up to the legislature to address that concern.

There was another part of our advocacy that should be mentioned. If someone hostile is deciding something involving you, it is frequently best to identify some way that they can rule against you that you can live with. It would have been be deeply unsatisfying for the Supreme Court majority to pass entirely on the prospect of imposing some further limits on plaintiffs' securities class actions. The least awful thing that they could do was to permit the defendants to litigate price impact at the class certification stage. We understood from lawyers in the bar that district courts were already doing that, because defendants were introducing event studies to disprove the efficiency of the relevant market. So a Supreme Court ruling to that effect wouldn't really change anything. So another point of advocacy that you don't quite see in the opinion is that sometimes the Justices believe they are changing the law, and they aren't.

As a final point, I will contrast the defense strategy in *Troice* and *Halliburton II*, which seemed to lack much subtlety. Their theme was, at bottom, the brute-force point that they were the defendants and the other side was the plaintiffs, who must lose. But in securities class action litigation, the winning streak of the plaintiffs' side is actually exceptional. This doesn't seem to be an area of the law in which the Supreme Court is willing to reach a results-oriented decision, no matter what the cost.

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17. Citizens United v. Fed. Elections Comm'n, 588 U.S. 310 (2010).