IN CONNECTION WITH WHAT?: *CHADBOURNE & PARKE LLP V. TROICE* AND THE APPLICABILITY OF THE SECURITIES LITIGATION UNIFORM STANDARDS ACT

JOHN W. MESSICK*

I. INTRODUCTION

In 2009, the "financial empire" of Allen Stanford became insolvent and the SEC revealed that Stanford International Bank (SIB) and other investment entities Stanford operated were part of a multi-billion dollar Ponzi scheme.[1] Stanford fraudulently induced investors into purchasing certificates of deposit (CDs) by promising high rates of return and misrepresenting that the CDs were backed by safe, liquid securities.[2] When the fraud finally collapsed, it cost investors billions of dollars. Investors subsequently filed a class action under state law against the law firm of Chadbourne & Parke LLP, which allegedly assisted Stanford in perpetuating the fraud.[3]

However, the state law class action is threatened by the Securities Litigation Uniform Standards Act (SLUSA), which precludes state law class actions brought "in connection with" the purchase or sale of covered securities.[4] In *Chadbourne & Parke LLP v. Troice*,[5] the Supreme Court will decide whether SLUSA applies here because SIB

---

* J.D. Candidate, 2015, Duke University School of Law.

1. *See* Joint Appendix, Vol. II at 427, 434, Chadbourne & Parke LLP v. Troice, Nos. 12-79, 12-86 and 12-88 (U.S. May 3, 2013).

2. *See* Janvey v. Alguire, 647 F.3d 585, 590 (5th Cir. 2011).

3. Brief for Troice Respondents in Opposition at 3, 6–7, Chadbourne & Parke LLP v. Troice, Nos. 12-79, 12-86 and 12-88 (U.S. July 18, 2013) [hereinafter Brief of Respondents]. The Supreme Court is hearing this case alongside an appeal involving another state law class action against the law firm Proskauer Rose LLP, also alleged to have assisted Stanford in his Ponzi scheme, as well as a related appeal involving SIB's insurance brokers. *See infra* note 16.

4. 15 U.S.C.A. § 78bb(f)(1)–(2) (West 2013).

5. Chadbourne & Parke LLP v. Troice, No. 12-79 (U.S. argued Oct. 7, 2013).

marketed the CDs by misrepresenting that they were backed by securities. If the Court finds that the misrepresentations were not "in connection with" the purchase or sale of securities, the state law class action will stand. However, if the "in connection with" requirement is met, then SLUSA preempts the state law class action, and the complaint must be dismissed.

Chadbourne presents the Court with the opportunity to clarify the meaning of "in connection with"—a phrase lower courts have struggled to interpret consistently.[6] Because SIB only misrepresented its holdings in securities—not its transactions in them—the Court will likely rule that SLUSA is inapplicable, and thus that investors may proceed with their class action in state court against Chadbourne & Parke.

II. FACTUAL & PROCEDURAL BACKGROUND

The Petitioner is the law firm of Chadbourne & Parke LLP, which is alleged to have aided and abetted SIB in its fraudulent investment scheme by helping SIB avoid regulatory oversight.[7] Since the late 1980s, R. Allen Stanford operated a vast financial services "empire," consisting of numerous financial entities in the United States and overseas.[8] One such entity was the Antigua-based SIB, whose primary business was marketing and selling CDs, of which it had sold $7.2 billion by 2009.[9] The reality, however, was that several Stanford entities were nothing more than a front for a global Ponzi scheme, whereby SIB used the proceeds from sales of CDs to pay interest on existing CDs.[10] In order to avoid regulatory oversight from the United States and other countries, in 2005 Stanford hired Tom Sjoblom, who was then a partner at Chadbourne & Parke.[11] Among other things, Sjoblom sent a letter to the SEC arguing that the SEC lacked regulatory oversight of SIB's operations, a statement he allegedly knew to be false.[12]

---

6. *See* John M. Wunderlich, *"Uniform" Standards for Securities Class Actions*, 80 TENN. L. REV. 167, 209 (2012) (discussing the widely divergent outcomes in circuit courts' rulings regarding SLUSA).

7. *See* Joint Appendix Vol. II, *supra* note 1, at 455.

8. *See id.* at 427–28.

9. *See id.* at 430.

10. *See* Janvey v. Alguire, 647 F.3d 585, 590 (5th Cir. 2011).

11. *See* Joint Appendix Vol. II, *supra* note 1, at 455.

12. *See id*. at 457. In a letter to the SEC, Sjoblom cited case law holding that the SEC did not have regulatory authority over CDs issued by foreign banks when the government of that foreign country provided sufficient regulatory oversight, which Sjoblom claimed was the case in

Eventually the fraud collapsed, causing thousands of investors to lose their savings.[13] In addition to a suit by the SEC, two groups of Louisiana residents (the Roland plaintiffs) brought suit in state courts against various individuals and entities operated by Stanford for making fraudulent representations about the quality of the CDs.[14] Similarly, two separate complaints were brought under Texas law in the District Court for the Northern District of Texas by the Respondents here (the Troice plaintiffs).[15] The first complaint named SIB's insurance brokers as defendants; the second named the law firms that assisted SIB in evading regulatory oversight as defendants.[16]

The Judicial Panel on Multidistrict Litigation transferred the cases to the Northern District of Texas, which chose one case, *Roland v. Green*, to test the applicability of SLUSA.[17] The district court dismissed the case because it found SIB's investment scheme depended upon the assurance that the investments were backed by securities, and thus the class action was precluded under SLUSA.[18] The Roland and Troice plaintiffs appealed to the Fifth Circuit, challenging the district court's dismissal.[19]

Antigua. *Id.*

13. *See* Brief of Respondents, *supra* note 3, at 4.

14. *See id.* at 4–5. The defendants named in the Roland plaintiffs' complaint did not appeal the court decision against them, and thus any issues specific to their case are not before the Supreme Court.

15. *See id.* at 6.

16. *See id.* at 6–7. In addition to Chadbourne & Parke, the Petitioners, the complaint also named the law firm of Proskauer Rose LLP as a defendant. These complaints both arise out of the actions of the same partner, Sjoblom, who left Chadbourne to become a partner at Proskauer, where he allegedly continued to assist SIB in evading regulation. *See* Joint Appendix Vol. II, *supra* note 1, at 487–88. Proskauer appealed an adverse Fifth Circuit decision and the Supreme Court granted certiorari to hear the case as a consolidated matter with the case discussed here. *See* Proskauer Rose LLP v. Troice, No. 12-88 (U.S. argued Oct. 7, 2013).

17. *See* Roland v. Green, 675 F.3d 503, 509–10 (5th Cir. 2012), *cert. granted, sub nom* Chadbourne & Parke LLP v. Troice, 133 S. Ct. 977 (2013).

18. *Id.*

19. *Id.* at 511.

III. LEGAL BACKGROUND

A. PSLRA, SLUSA, and Supreme Court Precedent

Chardbourne concerns the meaning of the phrase "in connection with the purchase or sale of a covered security"[20] in determining SLUSA's preclusive scope.[21] This language is derived from Rule 10b-5, which was promulgated in 1942 under § 10(b) of the 1934 Securities Exchange Act.[22] Rule 10b-5 "broadly prohibits deception, misrepresentation, and fraud 'in connection with the purchase or sale of any security.'"[23] Although enforcement of the statute is explicitly granted to the SEC, the Supreme Court has nonetheless recognized an implied private right of action.[24] In order to limit vexatious securities litigation while maintaining a cause of action for deserving plaintiffs, the Court in *Blue Chip Stamps v. Manor Drug Stores*[25] limited recovery under Rule 10b-5 litigation to parties who actually purchased or sold securities.[26] Thus, "holders" of securities—those who are fraudulently induced into waiting to purchase or sell a security—cannot bring claims under Rule 10b-5.[27]

Similarly, in enacting the Private Securities Litigation Reform Act (PSLRA) in 1995, Congress was also motivated by the need to balance providing remedies for deserving plaintiffs with preventing onerous lawsuits.[28] This legislation, which implemented various limitations[29] on covered class actions involving covered securities,[30] unintentionally caused an influx of class action securities fraud claims in state court by virtue of making state law more attractive to

20. A "covered security" is one that is traditionally listed on a national exchange. *See* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 82 (2006).

21. 15 U.S.C.A. § 78bb(f)(1)(A) (West 2013).

22. *Dabit*, 547 U.S. at 78.

23. 17 C.F.R. § 240.10b–5 (2014).

24. Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 (1971).

25. 421 U.S. 723 (1975).

26. *Dabit*, 547 U.S. at 80–81.

27. *See Blue Chip Stamps*, 421 U.S. at 754–55 (holding that plaintiffs could not bring suit because they were neither purchasers nor sellers of securities). The *Blue Chip Stamps* Court emphasized that suits brought by holders of securities were especially prone to abuse. *See Dabit*, 547 U.S. at 71 (discussing *Blue Chip Stamps*).

28. *Dabit*, 547 U.S. at 81.

29. Specifically, PSLRA provided for limits on damages and attorney's fees, sanctions for frivolous litigation, a stay of discovery following a motion to dismiss, restrictions on lead plaintiffs, and a safe harbor provision for forward-looking statements. *See* 15 U.S.C.A. § 78u–4 (West 2013).

30. A "covered class action" is one in which damages are being sought by fifty or more individuals. *Dabit*, 547 U.S. at 83.

plaintiffs than federal law.[31] Thus, to maintain "the congressional preference for [having] national standards for securities class action lawsuits involving nationally traded securities,"[32] and to prevent any one state from unduly burdening the market for nationally traded securities,[33] Congress passed SLUSA in 1998.[34]

The "core provision"[35] of the SLUSA provides:

> No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging . . . a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or . . . that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.[36]

Covered class actions brought under state law that meet the requirements of SLUSA are removed to federal court, where they are subject to dismissal.[37] However, SLUSA does not actually prevent a plaintiff from asserting any cause of action under state law; "[i]t simply denies plaintiffs the right to use the class-action device to vindicate certain claims."[38]

---

31. *See* S. REP. NO. 105-182, at 3 (1998) (commenting that after the passage of PSLRA, "there appear[ed] to be a 'substitution effect' whereby plaintiff's counsel file[d] state court complaints when the underlying facts appear[d] not to satisfy new, more stringent federal pleading requirements, or otherwise [sought] to avoid the substantive or procedural provisions of [PSLRA]"); *see also* Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 303 (1998) (discussing empirical studies of class action fraud claims after PSLRA and noting "[t]he relative stability in overall filing activity masked a significant shift in litigation from federal to state court").

32. *Dabit*, 547 U.S. at 87.

33. *See* H.R. REP. NO. 105-803, at 5 (1998) (Conf. Rep.) (noting that "a single state can impose the risks and costs of its pecular [sic] litigation system on all national issuers [of securities]").

34. *Dabit*, 547 U.S. at 82.

35. *Id.* at 83.

36. *See* 15 U.S.C.A. § 78bb(f)(1)(A)–(B) (West 2013).

37. *See id.* § 78bb(f)(2).

38. *Dabit*, 547 U.S. at 87. Although SLUSA does not deny any individual plaintiff the right to assert any cause of action under state law, in many instances a class action is the only economically viable means by which plaintiffs may pursue a fraud claim. *See* Wunderlich, *supra* note 6, at 171 (2012) (discussing how plaintiffs who have suffered relatively small losses individually can bear the cost of expensive securities fraud litigation by aggregating their claims in a class action suit).

B. Dabit *and the Meaning of "In Connection With" Under SLUSA*

In *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*,[39] the Supreme Court addressed the meaning of the phrase "in connection with" in SLUSA for the first time.[40] In *Dabit*, former Merrill Lynch brokers alleged that the investment bank had breached its fiduciary duty and covenant of good faith by providing the brokers with misleading research about the stocks held by their clients.[41] Managers at the bank supposedly instructed analysts to issue overly optimistic reports of the stocks' outlook; the brokers in turn told their own clients to hold the shares longer than the clients would have without these reports.[42] When the prices of these stocks eventually fell, clients left the bank, causing the brokers to lose commission fees.[43] The brokers filed a class action against Merrill Lynch under Oklahoma law; Merrill Lynch responded by filing a motion to dismiss, arguing that SLUSA precluded the class action.[44]

The Supreme Court overruled a Second Circuit holding that fraud is only "in connection with" the purchase or sale of a security if actual purchasers or sellers allege they were injured by the fraud.[45] The Court highlighted that it had previously held, regarding the phrase "in connection with" under § 10(b) and Rule 10b-5, that it was enough that a fraud "coincide" with a securities transaction, regardless of whether the plaintiff was party to that transaction.[46] Finding that Congress must have been aware of how both the Court and the SEC had been interpreting "in connection with" in § 10(b) and Rule 10b-5 when enacting SLUSA, the Court reasoned that Congress must have intended the phrase to have the same meaning there as it did in §

---

39. 547 U.S. 71 (2006).
40. *Id.* at 71.
41. *Id.* at 75.
42. *Id.*
43. *Id.* at 76.
44. *Id.*
45. *See id.* at 76–77. Thus, under the Second Circuit's reasoning, because holders of securities (rather than purchasers or sellers) were alleging injury, SLUSA did not apply. *Id*. The Second Circuit reached its decision by adopting the purchaser-seller requirement from *Blue Chip Stamps*. *See id.* However, in overturning the ruling of the Second Circuit, the Supreme Court found that *Blue Chip Stamps* addressed the private scope of action under § 10(b) and Rule 10b-5, not the meaning of "in connection with," which the Court viewed as a separate concept. *See id*. at 81.
46. *See id.* at 85 ("The requisite showing . . . is deception 'in connection with the purchase or sale of any security,' not deception of an identifiable purchaser or seller." (quoting United States v. O'Hagan, 521 U.S. 642, 658 (1997))).

10(b) and Rule 10b-5.[47] In addition, considering the policy considerations underlying SLUSA,[48] and noting "[t]he magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities,"[49] the Court ruled that "in connection with" should be interpreted broadly.[50] Thus, under SLUSA, "it is enough that the fraud alleged 'coincide' with a securities transaction," to preclude a state law class action.[51] In other words, to invoke SLUSA preclusion, it is not necessary to show that an "identifiable purchaser or seller" of securities was deceived; instead, one must only show "deception in connection with the purchase or sale of any security."[52]

C. Lower Courts Struggle to Interpret Dabit

Courts have had difficulty in assigning a precise meaning to "in connection with," and as a result many circuit courts have crafted their own language to describe the requirement.[53] For example, in *Instituto de Prevision Militar v. Merrill Lynch* (*IPM*),[54] a group of investors alleged that a pension fund had misappropriated their investments for personal use.[55] The investors claimed that Merrill Lynch was liable for their loss under Florida law because the investment bank had permitted the fund to hold itself out as Merrill Lynch's business partner, and because the investment bank had failed to prevent the fund from misappropriating money from the investors' accounts.[56] Merrill Lynch moved to dismiss, arguing that SLUSA precluded the plaintiffs' claims.[57] The Second Circuit held that the "coincide" requirement was met if the plaintiffs were induced into investing with the defendants because the plaintiffs believed they were investing in covered securities, or if the "fraudulent scheme . . .

47. *See id.* ("Congress can hardly have been unaware of the broad construction adopted by both this Court and the SEC when it imported the key phrase—'in connection with the purchase or sale'—into SLUSA's core provision.").

48. *See id.* at 86 (discussing how a narrow interpretation of the phrase would be contrary to SLUSA's purpose).

49. *Id.* at 78.

50. *Id.* at 85–86.

51. *Id*. at 85 (quoting *O'Hagan*, 521 U.S. at 651).

52. *Id.*

53. *See* Wunderlich, *supra* note 6, at 209 (discussing the widely divergent outcomes in circuit court rulings regarding SLUSA).

54. 546 F.3d 1340 (11th Cir. 2008).

55. *Id.* at 1342.

56. *Id.* at 1342–43.

57. *Id.* at 1344.

coincided with and depended upon the purchase or sale of [covered] securities."[58] The court found that the plaintiffs' complaint alleged that the defendant's fraud had induced them to invest with the pension fund. Because of this, the court ruled that their claims were "in connection with the purchase or sale" of securities, and so SLUSA applied.[59]

The Ninth Circuit took a slightly different approach in *Madden v. Cowen & Co.*[60] In *Madden*, the plaintiffs, former shareholders of a closely-held corporation, filed a class action against an investment bank that advised them to sell their company to a publicly traded corporation in exchange for shares of the publicly traded corporation.[61] When the publicly traded corporation's stock price plummeted a few months later, it greatly diminished the value of the shares the plaintiffs had received. The plaintiffs filed suit against the investment bank for professional negligence under California law.[62] Finding that a fraud is "in connection with" covered securities if the "fraud and stock sale coincide or are more than tangentially related," the Ninth Circuit ruled that SLUSA precluded the plaintiffs' action because Cowen's investment advice met this standard.[63]

Adding an additional layer of complexity, lower courts have taken different approaches to determine whether a class action is precluded under SLUSA when there is a disconnect between the fraudulent representations made to the plaintiffs and the actual purchase or sale of covered securities.[64] In these "feeder fund" cases, the defendant fraudulently induces the investors to purchase some type of uncovered financial product, which is related in some way to

58. *Id.* at 1349.
59. *Id.*
60. 576 F.3d 957 (9th Cir. 2009).
61. *Id.* at 962.
62. *Id.* at 962–63.
63. *Id.* at 966 (quoting Falkowski v. Imation Corp., 309 F.3d 1123, 1131 (9th Cir. 2002)). In addition to the Second and Ninth Circuits, several other circuit courts have addressed the meaning of "coincides with," each creating a slightly different test. *See e.g.* Romano v. Kazacos, 609 F.3d 512, 522 (2d Cir. 2010) (holding "coincide" to mean "necessarily allege," "necessarily involve," or "rest on" the purchase or sale of covered securities); Siepel v. Bank of Am., N.A., 526 F.3d 1122, 1127 (8th Cir. 2008) (interpreting "coincide" as meaning "related to" the purchase or sale of covered securities); Gavin v. AT&T Corp., 464 F.3d 634, 639 (7th Cir. 2006) (defining "coincide" to mean "'involving nationally traded securities'" (quoting Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 81 (2006))).
64. Roland v. Green, 675 F.3d 503, 514 (5th Cir. 2012), *cert. granted sub nom.* Chadbourne & Parke LLP v. Troice, 133 S. Ct. 977 (2013).

transactions involving covered securities.[65] The most common method of analyzing fraudulent schemes structured as feeder funds is the "purpose approach," which considers the purpose of the fraudulent investment scheme.[66] Under this analysis, a court must decide if "the uncovered securities (feeder funds) 'were created for the purpose of investing in [covered] securities.'"[67] If the fraud "inevitably included the purchase and sale of covered securities," then SLUSA applies.[68] However, there is no categorical rule for analyzing cases under the purpose approach.[69] Some courts have looked to whether the purpose of the fund itself was to invest in covered securities,[70] while others have examined the purpose of the relationship between the investor and the defendant.[71]

Despite the different meanings courts have assigned to "in connection with" and the different approaches they have taken to analyzing feeder fund cases, there is one point on which they have been largely in agreement: that the economic realities of the investment scheme determine whether SLUSA is triggered, regardless of how the fraud is described in the pleadings.[72]

---

65. *See id.* at 516–17.

66. *See id.* Other approaches include the "product approach," which simply looks at whether the product that was purchased was a covered security, and the "separation approach," which considers the degree of separation between the business entities that separate the fraud and the securities transaction. *See id.* at 514–15.

67. *See id.* at 517 (quoting Newman v. Family Mgmt. Corp., 748 F. Supp. 299, 312 (S.D.N.Y. 2010)).

68. *See id.* (quoting *In re* Beacon Assocs. Litig., 745 F. Supp. 2d 386, 430 (S.D.N.Y. 2010)).

69. The purpose approach cases described in *Roland* do not adopt the term "purpose approach." Rather, the phrase was coined by the Fifth Circuit to describe a general trend in the analysis of multilayered investment schemes. *See id.*

70. *See, e.g.*, *Newman*, 748 F. Supp. at 312 (noting that misrepresentations about non-covered interests in a partnership may still be "in connection with" covered securities under SLUSA if the partnership was created for the purpose of investing in covered securities); *Beacon Assocs.*, 745 F. Supp. 2d at 430.

71. *See, e.g.*, Rowinski v. Saloman Smith Barney Inc., 398 F.3d 294, 303 (3d Cir. 2005) ("[T]he action arises from the broker/investor relationship, the 'very purpose' of which is 'trading in securities.'" (quoting Angelastro v. Prudential-Bache Sec., Inc., 764 F.2d 939, 944 (3d Cir. 1985))); Levinson v. PSCC Servs., Inc., No. 3:09-CV-00269 (PCD), 2009 WL 5184363, at *11 (D. Conn. Dec. 23, 2009) (noting that the agreement between the plaintiffs and defendants "was formed for the purpose of investing Plaintiffs' funds in securities"); Backus v. Conn. Cmty. Bank, N.A., No. 3:09-CV-1256, 2009 WL 5184360, at *8 (S.D.N.Y. Dec. 23, 2009) ("The . . . agreement governing the parties' dealings states that the relationship was created for the purpose of investment in securities[.]").

72. *See* Wunderlich, *supra* note 6, at 184 (noting that "federal courts have unanimously said that the substance, not the form, of the complaint controls for purposes of SLUSA preclusion").

IV. HOLDING

Reversing the decision of the district court, the Fifth Circuit found that the misrepresentations made by SIB and Chadbourne & Parke were not "in connection with the purchase or sale of a security" because they were "not more than tangentially related" to those transactions. Therefore, SLUSA did not apply and the state law class action against Chadbourne & Parke could proceed.[73] In determining that "'not more than tangentially related' to covered securities" was the standard by which the investors' complaints should be evaluated, the court first considered whether a plaintiff or defendant-oriented analysis was more appropriate for determining whether SLUSA applied.[74] Under a plaintiff-oriented test, SLUSA applies if the plaintiffs were "induced" into investing in non-covered securities because they "thought they were investing in covered securities or invested because of (representations about) covered securities."[75] A defendant-oriented test, on the other hand, looks to whether the defendants' scheme "coincided and depended upon" transactions involving covered securities by examining "whether the defendants' fraudulent scheme would have been successful without the (representations about) securities."[76]

The court decided that the plaintiff-oriented inquiry's "inducement" requirement was misguided because it "import[ed] causation into a test [from *Dabit*] whose language ("coincide") specifically disclaim[ed]" causation.[77] Because of this, the defendant-oriented analysis was more faithful to the Supreme Court's "coincides with" requirement.[78] However, the court reasoned that the defendant-oriented "depended upon" language created too stringent a standard, and that "more than tangentially related" was the best formulation of the requirement.[79] The Fifth Circuit found that this test best accounted

73. *Roland*, 675 F.3d at 523–24.

74. *Id.* at 518–19. Although Chadbourne & Parke are the named defendants, SLUSA preclusion turns on whether SIB's misrepresentations to the investors were "in connection with" the purchase or sale of a covered security. Thus, the defendant-oriented test must view the situation from SIB's perspective.

75. *Id.* at 519 (quoting Instituto de Prevision Militar v. Merrill Lynch, 546 F.3d 1340, 1349 (11th Cir. 2008)).

76. *Id.*

77. *Id.*

78. *See id.* ("The defendant-oriented perspective . . . is more faithful to the Court's statement that '[t]he requisite showing . . . is deception in connection with the purchase or sale of any security, not deception of an identifiable purchaser or seller.'" (quoting Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 82 (2006))).

79. *Id.* at 520 (quoting Madden v. Cowen & Co., 576 F.3d 957, 996 (9th Cir. 2009)). The

for the Supreme Court's instruction that "in connection with" not be construed so broadly that SLUSA precludes every common law action for fraud brought under state law.[80]

Because SIB's fraud had been a multi-layered feeder fund, it was necessary for the court to examine the "actualities of the alleged schemes."[81] Although SIB had claimed that the CDs were attractive investments because they were backed by covered securities, this was one of many misrepresentations made to the investors designed to inveigle them into purchasing the CDs.[82] Assuming the perspective of SIB, misrepresentations about covered securities were "merely tangentially related" to the fraudulent scheme, and the "heart, crux, and gravamen" of the scheme was that the CDs were a superior investment for a multitude of reasons, not just because they were backed by covered securities.[83] As a result, the Fifth Circuit held that the fraudulent schemes of SIB were "not more than tangentially related to the purchase or sale of covered securities" and therefore did not trigger SLUSA preclusion.[84]

Finally, the court noted that the allegations against the law firm defendants, including Chadbourne & Parke, were different because the investors did not claim that the law firms made any misrepresentations to them.[85] Rather, the law firms allegedly aided and abetted SIB's fraud by misrepresenting the SEC's ability to regulate SIB, and had these misrepresentations not been made, the harm to plaintiffs would not have occurred.[86] Nonetheless, the court found that the misrepresentations were "not more than tangentially related to the purchase or sale of covered securities," and so SLUSA was not triggered.[87] Chadbourne & Parke appealed and the Supreme

court found that "depended upon" was too high of a requirement for SLUSA to apply because other circuits had generally relied on less restrictive standards in formulating their own tests. *See id.* ("The Sixth Circuit . . . seemed to suggest that while a claim that 'depended on' a securities transaction was sufficient, there were other connections that would also meet the 'coincide' requirement.").

80. *Id.* (citing SEC v. Zandford, 535 U.S. 813, 820 (2002)).

81. *Id.* at 521.

82. *Id.* at 522.

83. *See id.* These other reasons included that the investments would yield a higher rate of return, were more liquid than other investments, and were subject to regulatory oversight.

84. *See id.*

85. *See id.* at 523.

86. *See id.* at 523–24.

87. *Id.* at 524.

Court granted certiorari.[88]

V. ARGUMENTS

A. Petitioner's Argument

Chadbourne & Parke first contends that, pursuant to Supreme Court precedent, the "in connection with" requirement must be construed broadly, both in SLUSA and in § 10(b).[89] Although a narrow reading of that requirement is textually possible, the Court rejected such a reading in *Dabit*.[90] Furthermore, a broad reading of "in connection with" in SLUSA is supported by Congress's policy objective: to prevent plaintiffs from circumventing PSLRA by filing securities class actions in state court.[91] However, even if the "in connection with" requirement is read narrowly, Respondents' complaint meets this requirement because SIB misrepresented that the CDs were a safe and liquid investment, backed by a portfolio of covered securities, when in fact they were not.[92] That the misrepresentations concerning covered securities were made at a different time from any of SIB's transactions in securities is irrelevant, because the misstatements and transactions were part of a common fraudulent scheme.[93]

Chadbourne & Parke next argues that the Fifth Circuit's decision is flawed for three reasons. First, Chadbourne & Parke claims that, contrary to the lower court's ruling, SIB's misrepresentations were crucial to the fraudulent scheme.[94] Only misrepresentations about covered securities could answer investors' questions about how SIB was able to promise high rates of return on safe, liquid investments, and these characteristics were the most important factor in marketing the CDs to SIB's investors.[95] Second, the Fifth Circuit's reasoning that

88. Chadbourne & Parke LLP v. Troice, 133 S. Ct. 977 (2013); Petition for Writ of Certiorari at i, No. 12-79 (U.S. July 18, 2012).

89. Brief for Petitioner at 27, Chadbourne & Parke LLP v. Troice, No. 12-79 (U.S. May 3, 2013).

90. *Id.* at 24–45 ("[T]his Court has long rejected that narrow interpretation of § 10(b)'s 'in connection with' language. Instead, 'when this Court has sought to give meaning to th[at] phrase in the context of § 10(b) and Rule 10b-5, it has espoused a broad interpretation.'" (quoting Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 85 (2006))).

91. *Id.* at 25–26.

92. *Id.* at 28–30.

93. Reply Brief for Petitioner at 8, Chadbourne & Parke LLP v. Troice, No. 12-79 (U.S. Aug. 18, 2013).

94. Brief for Petitioner, *supra* note 89, at 34–35.

95. *Id.* at 35–36.

SLUSA preclusion does not apply because SIB's misrepresentations concerning covered securities were "but one of a host of (mis)representations" is not textually supported by SLUSA.[96] By the terms of the statute, if a complaint alleges "*a* misrepresentation" in connection with covered securities, SLUSA applies, and it is irrelevant whether the defendants made misrepresentations about things other than covered securities.[97] Under the Fifth Circuit's reasoning, Chadbourne & Parke claims, plaintiffs could avoid SLUSA preemption by adding allegations of fraud unrelated to covered securities to their complaints, so that the fraud actually involving covered securities was only one of several misrepresentations.[98] This would undermine the purpose of SLUSA, which was to ensure that plaintiffs do not side-step PSLRA by bringing class actions in connection with covered securities in state court.[99] Finally, Chadbourne & Parke argues that the Fifth Circuit's test of determining the "heart," "crux," or "gravamen" of a fraud to decide if SLUSA applies is overly subjective, and courts will struggle to apply it.[100]

B. Respondents' Argument

Respondents first argue that the complaints do not allege any material misrepresentation concerning covered securities. The CDs were not covered securities, nor were their returns tied in any way to the performance of covered securities. Therefore, their sale did not convey any ownership interest in covered securities.[101] Furthermore, Respondents do not allege that Chadbourne & Parke made any representations to them directly, but rather that Chadbourne & Parke misrepresented to the SEC that SIB was not subject to regulation.[102]

Next, Respondents reject Chadbourne & Parke's argument that because SIB claimed it owned a portfolio of liquid assets, SLUSA was triggered.[103] First, because SIB was a foreign bank and claimed its portfolio contained "highly marketable securities issued by stable national governments, strong multinational companies, and major

96. *Id.*
97. *Id.* (quoting 15 U.S.C. § 78bb(f)(1)(A) (2006)) (emphasis added).
98. *Id.* at 38.
99. *Id.* at 36.
100. *Id.* at 40.
101. Brief of Respondents, *supra* note 3, at 18.
102. *Id.*
103. *Id.* at 21.

international banks," there was no reason for individual investors to believe that their individual investments would lead SIB to purchase securities traded on American exchanges.[104] Second, Respondents argue that even if SIB had explicitly stated it owned covered securities, the "in connection with" requirement of SLUSA would not be satisfied.[105] Such a claim would merely relate to the ownership of securities and would not coincide with any actual transaction; thus it would not be "in connection with" the "purchase or sale" of any securities.[106] This construction makes sense in light of Congress's goal in enacting § 10(b), which was not to punish all deceptive conduct, but rather to regulate only certain transactions in national securities markets. SIB's misrepresentations did not introduce dishonesty into national securities markets, and thus did not interfere with the congressional purpose behind the legislation.[107]

Respondents finally argue that SLUSA does not encompass a situation in which defendants fraudulently induce plaintiffs to purchase CDs by falsely promising to purchase covered securities with the proceeds of the CDs.[108] Respondents claim that Chadbourne & Parke advances an unprecedented construction of the "in connection with" requirement, one that would greatly broaden the preclusive effects of SLUSA.[109] Noting that the Court warned against reading "in connection with" too broadly,[110] Respondents assert that the construction Chadbourne & Parke advocates limits state law class actions at the same time as expanding the ability of the federal government and private citizens to bring suits under Rule 10b-5.[111] This would undermine Congress's goal of limiting class actions involving nationally traded securities while simultaneously respecting state authority to regulate non-national securities.[112]

104. *Id.* at 21–22.
105. *Id.* at 22.
106. *Id.*
107. *Id.* at 26 (citing United States v. O'Hagan, 521 U.S. 642, 658 (1997)).
108. *Id.* at 30–31.
109. *Id.*
110. *Id.* at 41 (citing SEC v. Zandford, 535 U.S. 813, 820 (2002)).
111. *Id.* at 43.
112. *Id.* at 43–45.

VI. ANALYSIS

Chadbourne and the related cases before the Court present an opportunity for the Court to not only further elucidate the "coincides with" requirement set forth in *Dabit*, but also to address the applicability of SLUSA in cases involving complex feeder fund investment schemes, such as the one at hand (or those operated by Bernie Madoff).[113] Although *Dabit* clarified that SLUSA preclusion extends to holders of securities, lower courts nonetheless have struggled to define and consistently apply the "coincides with" requirement.[114] As judicial uncertainty increases the cost of capital,[115] the Court should try to create a bright line rule.

A. Refining Dabit

At the outset, the Court should find that SIB's misrepresentations were crucial to the success of the fraud: Stanford told his brokers to market the CDs by emphasizing that they were highly liquid because they were backed by securities.[116] Yet, no securities transaction took place (or purportedly took place) as a direct result of plaintiffs' investments with SIB. The Court affirmed in *Dabit* that SLUSA requires that the misrepresentation be "in connection with" the *purchase or sale* of a security and that the fraud "coincide" with a securities transaction by some party. Here, the relevant misrepresentations made by SIB were about securities it purportedly *already* held. Thus, the issue is not whether SLUSA would preclude a class action by plaintiffs holding securities—*Dabit* makes it clear that it would. Rather, this case is about whether defendant's holding of (or misrepresenting they held) covered securities can invoke SLUSA preclusion. A good rule for such cases would be that when a defendant makes a misrepresentation about securities it holds—not

113. *See, e.g.*, Newman v. Family Mgmt. Corp., 748 F. Supp. 299, 302 (S.D.N.Y. 2010) (adjudicating a class action brought against a "sub-feeder" fund that invested with Madoff's "feeder funds"); Levinson v. PSCC Services, Inc., No. 3:09-CV-00269 (PCD), 2009 WL 5184363, at *1 (D. Conn. Dec. 23, 2009) (considering a class action brought against a retirement fund that invested with Madoff).

114. *See* Roland v. Green, 675 F.3d 503, 512 (5th Cir. 2012) (remarking that *Dabit*'s "coincides with" requirement is "not particularly descriptive"), *cert. granted sub nom.* Chadbourne & Parke LLP v. Troice, 133 S. Ct. 977 (2013); Wunderlich, *supra* note 6, at 210 (noting the need for either the Court or Congress to take action to clarify SLUSA).

115. *See* Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 DUKE L.J. 945, 962 (1993) (discussing how uncertainty and a lack of bright line rules increases the cost of capital).

116. Brief for Petitioner, *supra* note 89, at 32.

securities transactions it plans or promises to make as a result of the plaintiff's investment—SLUSA should not apply.

At times, it may be difficult to determine when a defendant's misrepresentations meet this standard. For example, the investors here believed that SIB had previously made transactions in covered securities (because SIB claimed to hold a portfolio of such securities) and probably believed SIB would eventually purchase covered securities in the future with proceeds from the sale of CDs. And at first glance this seems like a misrepresentation "in connection with" the purchase or sale of covered securities. The distinguishing factor here, however, is that an investor is unlikely to have believed that SIB would engage in a securities transaction as a result of that investor's individual purchase of a CD. Because of this, SIB's misrepresentations are more accurately characterized as concerning its holdings in securities, rather than its transactions in them.[117] That the purported securities transactions occurred in the same time frame, and may have occurred as part of a "common scheme" as Respondents argue,[118] does not change the fact that, from the perspective of an investor, the two were not connected. Thus, SLUSA is inapplicable here.

B. Implications and Policy Considerations

Regardless of the legal standard the Court applies, *Chadbourne* will likely have serious consequences for both issuers of securities as well as secondary defendants, like Chadbourne & Parke. There are numerous policy arguments for and against holding SLUSA inapplicable to SIB's fraud, but ultimately the benefits of permitting state law class actions in cases such as the one at hand outweigh the costs.

On the one hand, affirming the decision of the Fifth Circuit would likely increase the number of state law class actions filed against law firms and other actors who advise issuers.[119] This is particularly

117. *See* Brief of Respondents, *supra* note 3, at 22 ("[N]o plaintiff could have understood that his or her individual purchase would necessarily lead SIB to buy securities traded on a U.S. exchange."). Defendants misrepresented their "general practice" to investors, but did not "promise to use money from any particular plaintiff to buy anything." *See id.* at 30. On the other hand, had SIB promised to use investors' money to purchase securities, then SIB would have been making misrepresentations about its transactions in securities, and SLUSA would apply. *See, e.g.*, Barron v. Igolnikov, No. 09 Civ. 4471(TPG), 2010 WL 882890, at *5 (S.D.N.Y. Mar. 10, 2010) (discussing Madoff's Ponzi scheme, in which he told investors he would purchase covered securities with their investments, then sent them falsified documentation of the transactions).

118. *See supra* Part V.A.

119. *See* Brief Amicus Curiae of DRI—the Voice of the Defense Bar in Support of

problematic because class actions often seek to shift the entire cost of a client's fraudulent scheme to third-party actors,[120] especially when those directly involved in the fraud are insolvent, as is the case with SIB. Furthermore, liability for aiding and abetting would raise the cost of doing business for these third-party actors;[121] this cost would be passed on to clients, and ultimately investors.[122]

Nonetheless, these considerations are offset by the policy benefits of holding SLUSA inapplicable in cases such as this. First, because claims for aiding and abetting fraud are not permitted under § 10(b),[123] and because investors often can economically justify claims only through class actions, a ruling that SLUSA applies might leave investors without a method of aggregating claims against third-party defendants. This would effectively relegate investors' claims to a legal "no man's land" between federal and state law.[124] Thus, to hold SLUSA applicable here would deny investors a state law cause of action in the name of furthering nationally uniform regulation, when no comparable federal cause of action is available. Second, the fraudulent representations made by SIB, which primarily involved CDs, are not the type targeted by national securities legislation, because they probably did not introduce dishonesty into national markets. Generally, national securities laws serve to promote investor confidence in two ways: by requiring certain disclosures so that investors have sufficient information to determine the value of a security,[125] and by prohibiting false or misleading statements that would cause an investor to misjudge the value of a security.[126]

Petitioners at 2, Chadbourne & Parke LLP v. Troice, Nos. 12-79, 12-86 and 12-88 (U.S. May 10, 2013).

120. *See id.*

121. *See* Stoneridge Inv. Partners, LLC v. Sci.-Atlanta, 552 U.S. 148, 163–64 (2008).

122. *See* Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 189 (1994) (discussing the implications of allowing private actions for aiding and abetting securities fraud under Rule 10b-5).

123. *See id.* at 190.

124. *See* Brief of Sixteen Law Professors as Amici Curiae in Support of Respondents at 17, Chadbourne & Parke LLP v. Troice, Nos. 12-79, 12-86 and 12-88 (U.S. July 24, 2013).

125. *See* Urska Velikonja, *The Cost of Securities Fraud*, 54 WM. & MARY L. REV. 1887, 1897–98 (2013) ("[T]he securities acts and implementing regulations require firms to disclose relevant information about their financial condition, products and markets, management, and competitive and regulatory climate.").

126. *See* Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 386–87 (1990) ("According to the Court, section 10(b) proscribes knowing and intentional misconduct designed to deceive or defraud investors.").

Here, by comparison, SIB never specifically indicated the securities it planned to purchase or already held, nor did it make any false statements about the transactions themselves, other than the fact that they took place at all. Although such a claim is clearly fraudulent, it likely would not harm market integrity because it is not a misrepresentation that would cause investors to misevaluate the price of a security.[127]

Thus, although holding SLUSA inapplicable and permitting state law class actions would potentially raise the cost of capital by third-party actors to increased liability, this cost is offset by the need to provide some remedy—either at the federal or state level—to plaintiffs who are legitimately harmed by a third-party's assistance in a fraud, especially when the defendant's misrepresentations do not introduce dishonesty into national markets, as is the case here. In light of this, under whichever standard it adopts, the Court should hold SLUSA inapplicable here and permit the state law class action to proceed against Chadbourne & Parke.

VII. CONCLUSION

Chadbourne gives the Court the chance to clarify *Dabit* and to address the application of SLUSA to fraudulent feeder fund investment schemes. Because SIB's misrepresentations were primarily about its current securities holdings, and thus necessarily about transactions that occurred in the past, it is difficult to say that the misrepresentations were "in connection with" the purchase or sale of any securities. Thus, the Court will likely rule that SLUSA is inapplicable. The Court *could* reach this conclusion by further elucidating the "coincides with" standard of *Dabit* or by adopting the "not more than tangentially related to" standard used by the Fifth Circuit. But either approach would be ill-advised as lower courts would continue to struggle to interpret and consistently apply the indeterminate language of either standard.[128] Instead, the Court

127. As a counterexample, consider if an SIB employee stated that SIB had purchased $10 million in shares of X Corporation for its portfolio, because X Corporation was performing well and SIB expected the value of the shares to appreciate. If this statement was false because the purchase never took place and X Corporation was not expected to perform well, then this misrepresentation would likely have introduced dishonesty into the national securities markets.

128. For the same reasons that lower courts struggled to interpret *Dabit*'s "coincides with" requirement, it is unlikely that any of the standards crafted by the circuit courts, such as the "more than tangentially related to" standard of *Roland*, would prove any easier for lower courts to apply consistently. *See supra* Part III.C.

should create a new standard for determining if the fraud in a feeder fund investment scheme was "in connection with" covered securities. Specifically, the Court should rule that when a defendant makes a misrepresentation about its *holdings* in securities, SLUSA does not apply. Under that standard, in *Chadbourne* the Court should find that SLUSA is inapplicable and thus Respondents' state law class action is not precluded.