PROSKAUER ROSE LLP V. TROICE: DECIPHERING THE PROPER SCOPE OF SLUSA

SRIRAM GIRIDHARAN*

I. INTRODUCTION

Over the last twenty years, the field of securities litigation has undergone a massive overhaul. Unhappy shareholders have been suing deep-pocketed defendants on an unprecedented level, often with substantial damages on the line. Both courts and legislatures have attempted to distinguish legitimate claims from mere vexatious litigation, but the line remains blurred. Since 2006, the Roberts Court has issued eight opinions on this topic, ranging from the reach of federal securities law, to class certification for securities fraud claims, to loss causation. In deciding *Proskauer Rose LLP v. Troice*,[1] the Supreme Court aims to bring clarity to this jurisprudence.

In *Proskauer*, the Supreme Court will determine the proper scope of the Securities Litigation Uniform Standards Act (SLUSA).[2] SLUSA, which was passed in 1998, precludes state law private class actions that allege "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security."[3] The Supreme Court previously held that "[i]t is enough that the scheme to defraud and the sale of securities coincide."[4] However, because the Court did not clearly define the term "coincide," there is looming uncertainty in the lower courts regarding what state law class action claims are now precluded by SLUSA.[5] *Proskauer* will likely have major implications for the future of securities law, as it will more

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

1. Proskauer Rose LLP v. Troice, No. 12-88 (U.S. argued Oct. 7, 2013).
2. 15 U.S.C.A. § 78bb (West 2013).
3. *Id*. § 78bb(f)(1)(A).
4. SEC v. Zandford, 535 U.S. 813, 822 (2002).
5. *See* Roland v. Green, 675 F.3d 503, 512 (5th Cir. 2012) ("Since *Dabit*, six of our sister circuit courts have tried to give dimension to the 'coincide' requirement announced in *SEC v. Zandford* and brought into the SLUSA scheme in *Dabit.*"), *cert. granted sub nom.* Proskauer Rose LLP v. Troice, 133 S. Ct. 978 (2013).

clearly define how close to the alleged fraud a transaction must be before it is precluded by SLUSA.

II. FACTUAL AND PROCEDURAL BACKGROUND

In 2009, the Securities and Exchange Commission (SEC) brought suit against Allen Stanford for orchestrating one of the largest and most complex Ponzi schemes in United States history.[6] Financial institutions managed by Mr. Stanford had encouraged investors to buy certificates of deposits (CDs) by promising that the CDs would yield above-market returns once they hit maturity, at which point investors could withdraw funds from them.[7] Mr. Stanford had also misled investors by falsely assuring them that the CDs were backed by liquid assets.[8] In reality, Stanford Investment Bank (SIB) did not have the necessary assets, reserves, and investments to meet its liabilities, and thus was only able to cover interest and redemption payments on its pre-existing CDs by selling new CDs to different investors.[9]

In *Roland v. Green*[10] and *Farr v. Green*,[11] two groups of Louisiana investors (collectively, the Roland plaintiffs) filed separate class actions in state court against several defendants associated with Mr. Stanford (collectively, the SEI defendants). Among the SEI defendants were two entities owned by Mr. Stanford—the Stanford Trust Company and the SEI Investments Company. The Roland plaintiffs alleged that SIB sold CDs to the Stanford Trust Company, which in turn served as custodian for CD purchases made through individual retirement accounts (IRA). Although the CDs themselves were not covered securities—those listed on a regulated, national exchange—SIB deceived investors by claiming that the CDs were backed by covered securities.[12] Moreover, the Roland plaintiffs alleged that the SEI Investments Company purposely misrepresented the value of the CDs.[13] The SEI defendants responded by removing

6. *Id*. at 508.
7. *Id.*
8. *Id*. at 522.
9. *Id.* (citing Janvey v. Alguire, 647 F.3d 585, 590 (5th Cir. 2011)).
10. Roland v. Green, No. 3:2009cv00676 (M.D. La. Aug. 21, 2009).
11. Farr v. Green, No. 3:2009cv00678 (M.D. La. Aug. 21, 2009).
12. *Roland*, 675 F.3d at 508–09.
13. *See id*. at 508 ("According to the plaintiffs, the Trust contracted with SEI to have SEI be the administrator of the Trust, thereby making SEI responsible for reporting the value of the CDs. Plaintiffs . . . allege misrepresentations by SEI induced them into using their IRA funds to invest in the CDs.").

the case to federal court on the basis that SLUSA precluded the action from being tried in state court.[14] The Northern District of Texas consolidated the two cases and, citing the lack of controlling Fifth Circuit authority, employed a test set forward by the Eleventh Circuit to determine the necessary connection between the alleged fraud and the transaction in covered securities for SLUSA preclusion.[15] Under this test, if the grounds for the fraud claim are "in connection with the purchase or sale" of a security as defined in the statute, the case must be dismissed under SLUSA.[16] Because the court found that the investors' claims satisfied the "in connection with" test, the investors' claims were precluded and the action was dismissed.[17]

Next, the district court considered two additional claims relating to Mr. Stanford's Ponzi scheme. A group of Latin American investors (the Troice plaintiffs) filed separate class actions against SIB's insurance brokers (the Willis defendants) and SIB's lawyers from Proskauer Rose LLP (the Proskauer defendants).[18] The Troice plaintiffs brought their claims under Texas law, specifically accusing the Proskauer and Willis defendants of "violations of the Texas Securities Act, aiding and abetting these violations, and civil conspiracy."[19] However, the Troice plaintiffs did not allege that the Proskauer defendants made any misrepresentations to them directly.[20] After the ruling in *Roland*, both defendants moved to have their cases dismissed and the district court, citing its holding in *Roland*, acquiesced.[21] Plaintiffs from all three cases appealed, and the Fifth Circuit consolidated the lawsuits for the purposes of oral argument and disposition.[22] This commentary will place particular focus on the claims against the Proskauer defendants.

14. *Id.* at 509.

15. *Id.* at 510.

16. *See, e.g.*, Instituto de Prevision Militar v. Merrill Lynch (*IPM*), 546 F.3d 1340, 1350 (11th Cir. 2008) ("Rather, to avoid preclusion under SLUSA, a claim for relief should clearly state the ground on which it is based, and that ground cannot be one that is 'in connection with the purchase or sale' of [any] security under § 10(b) and SLUSA.").

17. *Roland*, 675 F.3d at 510 (discussing the district court's finding that the Roland plaintiffs' "purchases of SIB CDs were induced by the misrepresentation that SIB invested in a portfolio including SLUSA-covered securities" (internal quotation marks omitted)).

18. *Id.* at 509.

19. *Id.*

20. *Id.* Rather, the Proskauer defendants allegedly made misrepresentations to the SEC, claiming that the SEC had no authority to investigate the operations of Mr. Stanford and SIB. *Id.* at 524.

21. *Id.* at 511 (discussing the district court's holding that SLUSA precluded the Troice plaintiffs' action).

22. *Id.*

III. LEGAL BACKGROUND

A. PSLRA and SLUSA

In 1995 Congress passed the Private Securities Litigation Reform Act (PSLRA) in the hopes that it would combat "perceived abuses of the class-action vehicle in litigation involving nationally traded securities."[23] Arguably the most profound impact of PSLRA was that it "impose[d] heightened pleading requirements in actions brought pursuant to § 10(b)[24] and Rule 10b-5,"[25] two of the most important rules targeting securities fraud. Although the reforms reduced the number of frivolous lawsuits brought in federal court, they also had an unintended effect: Many plaintiffs sought relief in state courts, where PSLRA was not applicable.[26] In 1998, Congress responded by enacting SLUSA, which applied PSLRA at the state level, in order "[t]o stem this shift from Federal to State courts and prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of" PSLRA.[27] Particularly relevant to this case, SLUSA prohibits private class actions in state court alleging "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security."[28]

In passing SLUSA, Congress intended not only to prevent plaintiffs from bypassing PSLRA, but also to recognize the importance of traditional state police powers in regulating certain types of securities fraud. When SLUSA was enacted, Congress expressly noted "the importance of maintaining the vital role of state

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23. *Id.* at 507 (quoting Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*,* 547 U.S. 71, 81 (2006)).

24. Section 10(b) makes it unlawful to "use or employ . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe," in connection with the purchase or sale of certain securities, including those registered on a national securities exchange. 15 U.S.C.A. § 78j(b) (West 2013). Rule 10b-5 is the rule the SEC promulgated under § 10(b). Rule 10b-5 makes it unlawful to use any "device, scheme, or artifice to defraud," or make any misstatement or omission of material fact, in connection with the purchase or sale of a security. 17 C.F.R. § 240.10b-5 (2014). Courts have interpreted § 10(b) and Rule 10b-5 as providing a private right of action. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983) (stating that the existence of a private right of action under Section 10(b) . . . and Rule 10b-5 . . . is simply beyond peradventure").

25. H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.).

26. *See Dabit*, 547 U.S. at 82 ("Rather than face the obstacles set in their path by the Reform Act, plaintiffs and their representatives began bringing class actions under state law, often in state court.").

27. *Id.* (internal quotation marks omitted).

28. 15 U.S.C.A. § 78bb(f)(1)(A).

law in regulating non-national securities."[29] In particular, state law provides an important remedy for breach of fiduciary duty that, as the SEC pointed out in a recent study, is unavailable under federal law.[30] Additionally, circuit courts have emphasized that "[s]ince not every instance of financial unfairness or breach of fiduciary duty will constitute a fraudulent activity under § 10(b) or Rule 10b-5, federal courts should be wary of foreclosing common law breach of fiduciary duty actions which supplement existing federal or state statutes."[31]

B. Dabit *and the "Coincide" Requirement*

In 2006, the Supreme Court attempted to clarify the scope of SLUSA in *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*.[32] In *Dabit*, a former broker and former retail customers brought a class action in state court alleging that Merrill Lynch had breached its contracts with its customers and its fiduciary duties to its brokers by disseminating misleading research information.[33] Specifically, the suit alleged that Merrill Lynch had given inaccurate research and investment recommendations to its brokers, which the brokers passed to the bank's retail customers, resulting in the retail customers holding on to securities that were overvalued.[34] Moreover, the broker-plaintiffs alleged that the misrepresentations damaged their reputations with customers, resulting in a loss of commission fees.[35]

In reaching its decision, the Supreme Court looked to *Blue Chip Stamps v. Manor Drug Stores*,[36] in which it highlighted the "widespread recognition that suits by nonpurchasers and nonsellers present a special risk of vexatious litigation" to companies.[37] The *Dabit* Court noted that the same concern was echoed by Congress

29. S. REP. NO. 105-182, at 8 (1998) (noting "that in order to avoid . . . thwarting . . . the purpose of the [PSLRA], national standards for nationally traded securities must be enacted, while preserving the appropriate enforcement powers of state regulators, and the right of individuals to bring suit").

30. *See* SECURITIES & EXCHANGE COMMISSION, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS 54 (2011), *available at* http://sec.gov/news/studies/2011/913studyfinal.pdf.

31. *See, e.g.*, Gochnauer v. A.G. Edwards & Sons, Inc., 810 F.2d 1043, 1049 (11th Cir. 1987).

32. 547 U.S. 71 (2006).

33. *Id*. at 75.

34. *Id.* A "holder" class action is distinct from a "typical Rule 10b-5 class action in only one respect: It is brought by holders instead of purchasers or sellers." *Id.* at 89.

35. *Id.* at 76.

36. 421 U.S. 723 (1975).

37. *Id.* at 740.

when it passed both PSLRA and SLUSA.[38] Additionally, prior cases had construed the "in connection with" language used in § 10(b) and Rule 10b-5 broadly, and applied this precedent to determine that under SLUSA, preclusion applies when fraud merely "coincides" with the securities transaction.[39] Congress had not only used the same words in enacting SLUSA as it did in § 10(b), but also had "used them in a provision that appears in the same statute as § 10(b)."[40] Based on these principles, the *Dabit* Court held that SLUSA's "in connection with" requirement possesses the same meaning as that of § 10(b), and that state-law holder class actions are also precluded under SLUSA.[41]

C. Circuit Courts Struggle with Dabit

Since the *Dabit* decision, no fewer than six different circuit courts have attempted to define the scope of SLUSA's "coincide" requirement.[42] The Eleventh Circuit, in *Instituto de Prevision Militar v. Merrill Lynch*,[43] held that the "coincide" requirement is met if either "fraud that induced [plaintiffs] to invest with [the defendant(s)] or a fraudulent scheme . . . coincided and depended upon the purchase or sale of [covered] securities."[44] There, a Guatemalan government agency, which had administered a pension for the country's military veterans, brought claims against Merrill Lynch.[45] The agency had invested in the Pension Fund of America (PFA) and, along with other PFA investors, sued Merrill Lynch for "actively promot[ing] PFA and vouching for the character of PFA's principals."[46] The Eleventh Circuit ruled in favor of the defendants, holding that SLUSA precluded the

38. *See* H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.) (noting that prior to the enactment of PSLRA, "nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and 'manipulation by class action lawyers of the clients whom they purportedly represent' had become rampant" (citation omitted)).

39. *See Dabit*, 547 U.S. at 85 ("Under our precedents, it is enough that the fraud alleged 'coincide' with a securities transaction—whether by the plaintiff or by someone else." (citing United States v. O'Hagan, 521 U.S. 642, 651 (1997))).

40. *See id*. at 96 (noting that "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").

41. *See id.* at 89 ("The misconduct of which respondent complains here—fraudulent manipulation of stock prices—unquestionably qualifies as fraud 'in connection with the purchase or sale' of securities . . . .").

42. *See* Roland v. Green, 675 F.3d 503, 512 (5th Cir. 2012) ("Since *Dabit*, six of our sister circuit courts have tried to give dimension to the 'coincide' requirement . . . ."), *cert. granted sub nom.* Proskauer Rose LLP v. Troice, 133 S. Ct. 978 (2013).

43. 546 F.3d 1340 (11th Cir. 2008).

44. *Id.* at 1349.

45. *Id.* at 1342.

46. *Id.* at 1343 (alteration in original).

agency's claims because their complaint was about "fraud that induced it to invest with PFA, which means that its claims [we]re 'in connection with the purchase or sale' of a security under SLUSA."[47]

The Ninth Circuit, in *Madden v. Cowen & Co.*,[48] interpreted the "coincide" requirement slightly differently.[49] In *Madden*, the plaintiffs were shareholders of two medical care providers that were looking to be bought by a larger company.[50] The plaintiffs had retained an investment bank to help them look for prospective buyers.[51] And the investment bank had suggested a stock-swap merger with a publicly traded company. However, the publicly traded company's stock tumbled soon after it acquired the plaintiffs' companies.[52] The plaintiffs then sued the investment bank in state court for negligent misrepresentation and professional negligence.[53] Looking to *Dabit*'s ruling that SLUSA must be interpreted in the same light as § 10(b), the court concluded that the "coincide" requirement is met if the alleged fraud and the sale of stock are "more than tangentially related."[54] Applying this test, the court determined that the "misrepresentations and omissions alleged . . . [were] more than tangentially related to [the shareholders'] purchase of the [publicly-traded company's] securities," and thus the class action was precluded.[55]

Most recently, the Second Circuit in *Romano v. Kazacos*[56] held that the "coincide" requirement is met when the "plaintiff's claims 'turn on injuries caused by acting on misleading investment advice'—that is, where plaintiff's claims 'necessarily allege,' 'necessarily involve,' or 'rest on' the purchase or sale of securities."[57] There, retirees of Xerox and Kodak alleged that defendant Morgan Stanley "misrepresented that if appellants were to retire early, their investment savings would be sufficient to support them through

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47. *Id.* at 1349.
48. 576 F.3d 957 (9th Cir. 2009).
49. *See id.* at 965–66 ("Under our Section 10(b) cases, a misrepresentation is 'in connection with' the purchase or sale of securities if there is 'a relationship in which the fraud and the stock sale coincide or are more than tangentially related.'" (quoting Falkowski v. Imation Corp., 309 F.3d 1123, 1131 (9th Cir. 2002))).
50. *Id.* at 962.
51. *Id.*
52. *Id.* at 962–63.
53. *Id.* at 963.
54. *Id.* at 965–66.
55. *Id.* at 966 (internal quotation marks omitted).
56. 609 F.3d 512 (2d Cir. 2010).
57. *Id.* at 522 (citation omitted).

retirement."[58] As a result, the retirees had "deposited their retirement savings into Morgan Stanley IRA accounts, where covered securities were purchased on their behalf."[59] The court found that SLUSA preclusion applied because the defendants had fraudulently induced the appellants into investing in securities by misleading them about future returns.[60]

IV. HOLDING

After reviewing both *Dabit* and the legislative history of PSLRA and SLUSA, the Fifth Circuit analyzed whether the "in connection with" requirement of SLUSA precluded the plaintiffs' claims.[61] The circuit court adopted the view of the Ninth Circuit and ruled that the SEI and Willis defendants' actions were too far removed from the securities transaction to satisfy SLUSA's "coincide" requirement.[62] The Fifth Circuit thus reversed the district court's ruling.[63] Additionally, with regard to the aiding and abetting claims against the Proskauer defendants, the court concluded that because the alleged misrepresentations were even further removed from the misrepresentations made by the other defendants, SLUSA preclusion did not apply.[64]

A. The "In Connection With" Requirement

The Fifth Circuit noted that courts "do not write on a blank slate" in determining the scope of the "in connection with" requirement of SLUSA.[65] Using the same line of reasoning as the Supreme Court in *Dabit*,[66] the circuit court concluded that Congress had intended the "in connection with" requirement to be interpreted in the same manner as in § 10(b).[67]

58. *Id.* at 515.
59. *Id.* at 520.
60. *See id.* at 523.
61. *See* Roland v. Green, 675 F.3d 503, 518 (5th Cir. 2012) ("It is against this backdrop that we must go about formulating our standard for judging the connection of claims like the Appellants' to the purchase or sale of covered securities."), *cert. granted sub nom.* Proskauer Rose LLP v. Troice, 133 S. Ct. 978 (2013).
62. *Id.* at 519–20, 522.
63. *Id.* at 523.
64. *Id.*
65. *Id.* at 511.
66. *See* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 85-86 (2006).
67. *Roland*, 675 F.3d at 512.

The Fifth Circuit also found "Congress's explicit concern about the distinction between national, covered securities, and other, uncovered securities" to be very persuasive in balancing the rights of federal and state courts to hear claims relating to securities fraud. After analyzing the congressional record and highlighting the need to respect traditional state police powers,[68] the court concluded that Congress intended SLUSA to apply only to "transactions involving national securities."[69] The court reasoned that because companies do not have any control over their stock after their initial public offering, litigation concerning these securities should be heard at the federal level, so that "national issuers are not subject to any of fifty different state systems."[70]

In reaching this conclusion, however, the court noted that non-national securities were still under state law jurisdiction and thus were not unregulated.[71] In enacting PSLRA and SLUSA, Congress had to balance the need for "national standards for securities class action lawsuits involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits."[72] An overbroad reading of SLUSA, Congress feared, would potentially destabilize creditor-debtor regimes.[73] Given that nearly every company owns some covered securities, and that most are backed by a portfolio in the same way as SIB's CD's, the court concluded that following the district court's view that preclusion should apply merely because of some vague connection to a covered security "would be a major change in the scope of SLUSA";[74] it would become far too easy for a company to avoid litigation at the state level.

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68. *See id.* at 517 ("'[T]he securities governed by this bill—and it is important to emphasize this point—are by definition trading on national exchanges. As we all know, securities traded on national exchanges are bought and sold by investors in every State, and those investors rely on information distributed on a national basis.'" (quoting 144 CONG. REC. 4799 (1998) (statement of Sen. Joseph Lieberman))); *see also* 144 CONG. REC. 10780 (1998) (statement of Rep. Anna Eshoo) ("This legislation is limited in scope and only affects class action lawsuits involving nationally traded securities.").

69. *Roland*, 675 F.3d at 517.

70. *See* H.R. REP. NO. 105-803, at 15 (1998) (Conf. Rep.).

71. *Roland*, 675 F.3d at 518.

72. *See* H.R. REP. NO. 105-803, at 2.

73. *Id.*; *see also* Janvey v. Adams, 588 F.3d 831, 835 (5th Cir. 2009).

74. *Roland*, 675 F.3d at 518.

In determining when a claim is precluded by SLUSA, the court reasoned that the Second, Ninth, and Eleventh Circuit cases were most relevant to defining the "coincide" requirement because these courts had previously considered the issue.[75] The court began with the Eleventh Circuit test, which "identifies the two different perspectives from which courts approach the question of connectivity."[76] The first perspective analyzes the claims from the plaintiff's perspective, by asking whether the plaintiffs were induced into believing that they were either investing in covered securities or investing in transactions because of representations regarding transactions in covered securities.[77] Conversely, the second perspective looks at the allegations from the view of the defendant, and asks whether or not the defendant would have still committed the fraud without the alleged covered securities transaction.[78] The court reasoned that a plaintiff-oriented perspective unnecessarily imported a causation requirement into SLUSA analysis[79] and that the defendant-oriented perspective was more in line with the Court's statements in *Dabit*.[80]

After concluding that "the defendant-oriented perspective is the proper point of view from which to consider the allegations,"[81] the Fifth Circuit eliminated the Second and Eleventh Circuit tests because each was "too stringent a standard."[82] Instead, the court adopted the Ninth Circuit's test from *Madden* as the "best articulation of the 'coincide' requirement" because it followed Supreme Court

75. *See id.* at 513 ("The Second, Ninth, and Eleventh Circuits have, however, attempted to give dimension to what is sufficiently connected/coincidental to a transaction in covered securities to trigger SLUSA preclusion.").

76. *See id.* at 518–19 ("*IPM* held that the 'coincide' requirement is met if either 'fraud . . . induced [plaintiffs] to invest with [the defendant(s)]' or 'a fraudulent scheme . . . coincided and depended upon the purchase or sale of [covered] securities.'" (quoting *IPM*, 546 F.3d 1340 (11th Cir 2008))).

77. *See IPM*, 546 F.3d at 1349 (focusing on whether the complaint alleged a "fraud . . . [that] induced [plaintiffs] to invest with [the defendant(s)]" or "a fraudulent scheme . . . [that] coincided and depended upon the purchase or sale of [covered] securities").

78. *See Roland*, 675 F.3d at 519 ("The 'depended upon' prong . . . essentially ask[s] whether the defendants' fraudulent scheme would have been successful without the (representations about) transactions in covered securities.").

79. *See id.* ("By tying the 'coincide' requirement to 'inducement,' [the plaintiffs' perspective] unnecessarily imports causation into a test whose language ('coincide') specifically disclaims it.").

80. *Id.* ("The defendant-oriented perspective, like *IPM*'s 'depends upon' prong, 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, 85 (2006))).

81. *Id.*

82. *Id.*

precedent while simultaneously giving due weight to the major policy and legislative concerns underlying SLUSA.[83] In particular, the court noted that the *Madden* test prevented SLUSA from being "construed so broadly as to [encompass] every common-law fraud that happens to involve [covered] securities."[84] The Fifth Circuit concluded that in order for SLUSA preclusion to apply, the fraud would have to be "more than tangentially related to (real or purported) transactions in covered securities."[85]

Although the Fifth Circuit agreed with the district court's determination that "the CDs were uncovered securities," they felt that it was necessary to further scrutinize the "schemes and purposes of the frauds alleged by the *Roland* Plaintiffs."[86] In applying the *Madden* test, the Fifth Circuit noted that the actual "heart" of the fraud was SIB's misrepresentation to investors that the CDs were a "safe and secure" investment.[87] Although the district court reasoned that the plaintiffs' claims were precluded because the CDs were backed in part by "covered securities," the Fifth Circuit instead concluded that it was "but one of a host of (mis)representations made to the plaintiffs in an attempt to lure them into buying the worthless CDs."[88] Similarly, the fact that the CDs were marketed with references to SIB's portfolio was considered too vague and "tangential to the schemes advanced by the SEI and Willis Defendants."[89] Finally, although a few plaintiffs sold covered securities in order to finance the purchase of the CDs, this only constituted a tangential relationship because SIB did not directly convince the investors to sell the securities.[90]

83. *Id.* at 519–20 (citing Madden v. Cowen & Co., 576 F.3d 957, 965–66 (9th Cir. 2009)).

84. *Id.* at 512 (quoting SEC v. Zandford, 535 U.S. 813, 820 (2002)).

85. *Id.* at 520.

86. *Id.* at 521.

87. *Id.* at 522 ("For example, as alleged by the *Roland* Plaintiffs, the CDs were principally promoted as being preferable to other investments because of their liquidity, consistently high rates of return, and the fact that SEI and other regulators were keeping a watchful eye on SIB.").

88. *Id.* at 521.

89. *Id.* at 522.

90. *See id.* at 523 ("[Unlike cases in which] the entirety of the fraud depended upon the tortfeasor convincing the victims of those fraudulent schemes to sell their covered securities in order for the fraud to be accomplished, the allegations here are not so tied with the sale of covered securities.").

B. Aiding and Abetting

Next, the Fifth Circuit ruled that SLUSA did not preclude the aiding and abetting claims against the Proskauer defendants.[91] The court viewed the claims against the Proskauer defendants as "different from those alleged against the other defendants" in that the plaintiffs did not allege that the Proskauer defendants made *any* misrepresentations to them personally.[92] Instead, the court focused on Proskauer's misrepresentations to the SEC, in informing the SEC that it could not investigate the operations of Mr. Stanford and SIB.[93] The court reasoned that because of Proskauer's misrepresentations, the fraud was allowed to continue and the Troice plaintiffs were harmed.[94] Based on the Ninth Circuit test, however, these actions were even further removed from the fraud than the misrepresentation made by SIB.[95] Because the misrepresentations made by the Proskauer defendants "were not more than tangentially related to the purchase or sale of covered securities," SLUSA preclusion did not apply.[96]

The Supreme Court granted the Proskauer defendants' writ of certiorari to determine the scope of SLUSA's "in connection with" requirement, and specifically to determine whether it precludes a class action brought under state law "where the alleged purchase or sale of a covered security is more than tangentially related to the heart, crux, or gravamen of the alleged fraud."[97]

V. ARGUMENTS

A. Arguments for Petitioner, Proskauer Rose LLP

1. "In Connection With" does Not Equate to "Coincide"

Petitioner argues that the "coincide" test employed by the Fifth Circuit is far more restrictive than Congress had intended.[98] SLUSA was enacted as "remedial legislation, with an expansive preclusive

91. *Id.* at 524.
92. *Id.* at 523.
93. *Id.* at 524.
94. *Id.*
95. *Id.*
96. *Id.*
97. Proskauer Rose LLP v. Troice, 133 S. Ct. 978 (2013); Petition for Writ of Certiorari at i, Proskauer Rose LLP v. Troice, No. 12-88 (U.S. July 18, 2012). The Court also granted petitions for writ of certiorari submitted by several of the other defendants in the proceedings below.
98. Reply Brief for Petitioner at 3–4, Proskauer Rose LLP v. Troice, No. 12-88 (U.S. Aug. 19, 2013).

effect."[99] Moreover, SLUSA was intended to mirror the Supreme Court's interpretation of § 10(b)'s "in connection with" requirement.[100] Petitioner argues that while the "coincide" requirement might be sufficient to meet the requirements of § 10(b), it is not a *necessary* factor for preclusion to apply.[101] In addition to *Dabit*, Petitioner relies on *United States v. O'Hagan*,[102] where the Supreme Court held that the misappropriation prong of § 10(b) was satisfied because "the securities transaction and the breach of duty . . . coincide[d]."[103] Moreover, Petitioner notes that in *SEC v. Zandford*,[104] the Court stated that it is "enough that the scheme to defraud and the sale of securities coincide."[105] In each of these cases, the Supreme Court held that "the scope of SLUSA or § 10(b), as applicable, was *more expansive* than the lower courts believed."[106] Although a showing that the two events coincided could certainly meet SLUSA's requirement, the lack of such a showing does not necessarily mean that the action should be precluded.[107]

2. Legislative Intent and Policy Considerations

Petitioner argues that adopting the Fifth Circuit's "coincide" test would negatively impact the future of securities law.[108] For example, the Fifth Circuit ruled that the alleged fraud did not meet the appropriate SLUSA standard due to the "multiple layers of separation" between the misrepresentation and the investment.[109] However, complex frauds, particularly those of the magnitude carried out by Mr. Stanford, will inevitably be comprised of such layers; to prevent SLUSA from applying to these types of cases "simply cannot be squared with the scope of § 10(b)'s 'in connection with' requirement as [the] Supreme Court has interpreted it."[110]

99. Brief for Petitioner, Proskauer Rose LLP v. Troice, No. 12-88 (U.S. May 3, 2013).
100. *Id.* at 5.
101. *Id.* at 18.
102. 521 U.S. 642 (1997).
103. *Id.* at 656.
104. 535 U.S. 813 (2002).
105. Brief for Petitioner, *supra* note 99, at 18 (citing *Zandford*, 535 U.S. at 822).
106. *Id.* at 19 (citing *Zandford*, 535 U.S. at 820–21).
107. *Id.* at 21.
108. *Id.* at 23–24.
109. *Id.*
110. *Id.* at 24.

Petitioner bases much of its policy argument around the Supreme Court's admonition that the "in connection with" requirement be given broad construction.[111] Petitioner contends that Respondents' own allegations "make plain that SIB's false promise to invest proceeds of CD sales in covered securities was part of Stanford's fraudulent scheme."[112] Petitioner claims that SIB's ownership of a portfolio of covered securities is irrelevant, as the actual misrepresentation was made concerning the purchase of covered securities.[113] As this is what Respondents allege, the Court "need not go beyond their averments to conclude that SIB's misrepresentations were 'in connection with' the purchase of covered securities."[114]

3. SLUSA's "In Connection With" Requirement was Satisfied

Next, Petitioner contends that because investors were induced into selling covered securities to finance the purchase of the CDs, SLUSA's "in connection with" requirement was met.[115] Petitioner claims the actual objective of the fraud scheme is not "essential to the 'in connection with' analysis"; once the securities transaction is a part of the fraud, it is irrelevant what actually happens to the revenue.[116] The Supreme Court has ruled that it is irrelevant where the money originated from, as long as "there was a 'sale' of a security and . . . fraud was used 'in connection with' it."[117] Here, the fraud specifically targeted individuals who were "most likely to sell 'covered securities' to buy SIB CDs."[118] Consequently, Petitioner argues that Mr. Stanford's targeting of these individuals was integral to the continuation of the fraud and that a covered securities transaction was therefore foreseeable.[119]

Similarly, Petitioner alleges that Mr. Stanford's misrepresentations concerning investing revenue from CD sales in "covered securities" are sufficient to meet the "in connection" requirement of SLUSA.[120] Mr. Stanford's brokers and advisors had been told that the

111. *Id.* at 13.
112. Reply Brief for Petitioner, *supra* note 98, at 11.
113. *Id.* at 13–14.
114. *Id.* at 14.
115. Brief for Petitioner, *supra* note 99, at 33–34.
116. Reply Brief for Petitioner, *supra* note 98, at 7.
117. *Id.* at 8 (quoting Superintendent of Ins. of N.Y. v. Bankers Life & Case. Co., 404 U.S. 6, 12 (1971)).
118. *Id.*
119. *Id.*
120. *Id* at 14–15.

"liquidity/marketability of SIB's invested assets" was the "most important factor to provide security to SIB clients."[121] Coupled with the fact that the Supreme Court has repeatedly interpreted the "in connection with" requirement broadly, Petitioner claims that these misrepresentations are sufficiently close to the alleged fraud to warrant SLUSA preclusion.[122]

4. Aiding and Abetting

Finally, with regard to the "aiding and abetting" claims, Petitioner argues that part of Congress's intent in enacting SLUSA was to prevent deep-pocketed defendants from being targeted for private litigation.[123] However, if such litigation were to encompass third-party companies as well, defendants would find it difficult to obtain help from professionals due to the increased cost of doing business.[124] Lawyers, Petitioner argues, would "find their loyalties divided between the interests of their clients and their own financial interests in avoiding exposure to vexatious lawsuits."[125] In keeping with the legislative intent of SLUSA, Petitioner contends that the aiding and abetting claims against Proskauer must be preempted as well.[126]

B. Arguments for Respondents, Aggrieved Investors

1. "In Connection With" Must be Construed Narrowly

Respondents argue that neither their supposed sale of covered securities to purchase the CDs nor SIB's claim that it owned a portfolio of liquid assets triggered preclusion under SLUSA.[127] Furthermore, the SEI defendants' actions fail to meet the "coincide" requirement as set by *Dabit*.[128] The allegations merely stated that SIB

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121. *Id.* at 13 (citation omitted).

122. *Id.* at 11. *See* SEC v. Zandford, 535 U.S. 813, 825 (2002) (noting that a misrepresentation and securities transaction need only "coincide" to be sufficiently connected); *Superintendent of Ins. of N.Y.*, 404 U.S. at 12 (holding that the two need only "touch").

123. Brief for Petitioner, *supra* note 99, at 21–22.

124. *Id.* at 23 ("Not only does the availability of liability insurance enhance the risk that law firms will be targeted as deep pockets, the cost of securing insurance will certainly increase, resulting in increased costs to clients and clients' investors." (citation omitted) (internal quotation marks omitted)).

125. *Id.* at 24.

126. *Id.*

127. Brief of Respondents at 19–22, Proskauer Rose LLP v. Troice, Nos. 12-79, 12-86 and 12-88 (U.S. July 18, 2013) (rejecting Petitioner's claim that because at least one of the Respondents allegedly sold covered securities to purchase the CDs, SLUSA preclusion applies).

128. *See id.* at 8 ("SIB did not make its misrepresentations contemporaneously with . . . the same transaction as its separate supposed purchase of 'liquid assets'; the two thus did not

told its employees to push the CDs, not that the objective of the fraud was to steal the covered securities.[129] Given that "securities laws do apply to a scheme in which the victim is induced to sell securities and then deprived of the proceeds,"[130] the employees were not concerned about the origins of the money used to purchase the CDs.[131] Therefore, Respondents contend, SIB's actions are at most tangentially related to the fraud.

Similarly, Respondents claim that because the portfolio consisted only marginally of covered securities, applying SLUSA preclusion would lead to absurd results.[132] Under this interpretation, companies would be able to avoid liability simply by mentioning some vague relationship to "covered securities" when marketing products to investors.[133] Yet, simply making misrepresentations concerning covered securities that SIB "held" would be insufficient to trigger preclusion under federal securities law as well.[134] Because the supposed covered securities had already been "purchased" by the time SIB made its misrepresentations to investors, the "in connection with" requirement was not met.[135]

2. Cases Presented by Petitioner are Irrelevant

Additionally, Respondents contend that the "in connection with" interpretation under § 10(b) and Rule 10b-5 has never been interpreted in the manner Petitioner advances. No decision has extended the statute and rule to cases where a non-security was fraudulently sold after "the seller misrepresent[ed] its intent to buy covered securities in which no other party w[ould] hold any interest."[136] Instead, Petitioner focuses on cases where the "victim arguably purchases a share of the covered securities themselves,"[137] "the defendant's misrepresentations manipulated the market for

'coincide.'").

129. *Id.* at 20 (citation omitted).

130. *Id.* (citing Superintendent of Ins. v. Bankers Life & Case. Co., 404 U.S. 6, 10 (1971)).

131. *Id.* (citation omitted).

132. *Id.* at 20–21.

133. *See id.* at 11 ("On petitioner's reading, every false statement about securities ownership—whether in a credit application, a job interview, or anywhere else—potentially constitutes securities fraud.").

134. *Id.* at 22 ("The federal securities laws . . . apply only to misrepresentations in connection with the 'purchase or sale' of regulated securities.").

135. *Id.* at 24–25.

136. *Id.* at 12.

137. *Id.* at 16.

covered securities,"[138] or "plaintiffs lost money when funds ostensibly invested for their benefit were misappropriated."[139] Respondents conclude that Petitioner is unable to find a relevant case because the misrepresentation here was merely tangentially related to a covered securities transaction and, therefore, SLUSA does not apply.[140]

3. SLUSA's Scope of Protections Differs from that of § 10(b)

Finally, Respondents argue that holding in favor of Petitioner would undermine the legislative intent behind SLUSA.[141] The "courts should assume that 'the historic police powers of the States' are not superseded 'unless that was the clear and manifest purpose of Congress.'"[142] However, Respondents argue that it was "Congress's decision in SLUSA to preserve—not to override or displace—the states' historical role in providing civil remedies for fraud."[143] In fact, though Congress premised SLUSA's scope on § 10(b), it specifically noted that SLUSA only applied to "covered securities" whereas § 10(b) encompassed all securities.[144] Moreover, when Congress adopted the phrase and definition of "covered security," Congress specifically mentioned that it did not intend "to alter, limit, expand, or otherwise affect in any way any State statutory or common law with respect to fraud or deceit . . . in connection with securities or securities transactions."[145] Thus, although Congress may have modeled SLUSA's "in connection with" requirement after § 10(b), Respondents argue that adopting Petitioner's interpretations would go against legislative intent and impede the traditional rights of states to regulate non-national securities.

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138. *Id.* at 39 (citing U.S. Mortgage, Inc. v. Saxton, 494 F.3d 833, 845 (9th Cir. 2007)).

139. *Id.* at 33 (citing Grippo v. Perazzo, 357 F.3d 1218, 1220–21 (11th Cir. 2004)).

140. *See id.* at 34 ("Petitioner's inability to cite a single case on point is no surprise. The securities laws do not apply to a party's sale of a non-covered asset through a false statement of an intention later to buy a covered security for itself.").

141. *See id.* at 11 (noting that "Congress did not intend to undo the established allocation of federal and state regulatory authority" by allowing any false statement about securities ownership to constitute securities fraud).

142. *Id.* at 28–29 (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

143. *Id.* at 43–44.

144. *Id.* at 21.

145. *Id.* at 45 (citing H.R. REP. NO. 104-622, at 34 (1996)).

VI. ANALYSIS

In deciding *Proskauer*, the Supreme Court must balance the broad interpretation of § 10(b) as stated in *Dabit* with the traditional power of states to regulate the use of class actions as a consumer remedy.[146] The Supreme Court should hold for Respondents and affirm the Fifth Circuit's ruling because the misrepresentations made by SIB were not directly "in connection with" a purchase or sale of securities. *Proskauer* is distinguishable from precedent cited by Petitioner as the misstatements did not "coincide" with a securities transaction.[147] Moreover, from a policy perspective, holding in favor of Respondents will preserve the important balance of power between the federal and state in adjudicating securities fraud. Even though a broad interpretation of the "coincide" requirement would only preclude state law *class actions*, in practice, the cost of individual litigation would be prohibitively expensive to be a feasible alternative to class actions.[148] In addition, the Court should hold that the aiding and abetting claims against the Proskauer defendants are not precluded, as the Proskauer defendants' actions are even further removed from the sale or purchase of covered securities.

A. Monitoring the Scope of SLUSA

Due to the strong policy justifications of SLUSA, the Supreme Court will likely place great weight on legislative intent. The legislative history demonstrates that Congress had a strong interest in "preserving the appropriate enforcement power of state regulators and the right of individuals to bring suit."[149] And a *reasonably narrow* interpretation of the "coincide" requirement protects both interests. Moreover, adopting Petitioner's argument and precluding all state action that "bears only an attenuated connection to the challenged transaction" would inevitably curtail the ability of states to regulate

146. *See, e.g.*, *Rice*, 331 U.S. at 230 ("So we start with the assumption that the historic police powers of the States were not superseded . . . unless that was clear and manifest purpose of Congress.").

147. Brief of Respondents, *supra* note 127, at 37 ("Petitioner never offers a theory of how a statement like SIB's could be material to its own purchase or sale of a covered security.").

148. Brief of Sixteen Law Professors as Amici Curiae in Support of Respondents at 17, Proskauer Rose LLP v. Troice, Nos. 12-79, 12-86 and 12-88 (U.S. July 24, 2013) [hereinafter Brief of Sixteen Law Professors] ("Denial of class relief under both federal and state law as a matter of statutory interpretation would mean no relief at all.").

149. S. REP. NO. 105-182, at 8 (1998); *see also* 144 CONG. REC. S4791 (1998) (statement of Sen. Chris Dodd) ("It will not affect any suit, class action or otherwise, against penny stocks or any stock that is not traded on a national exchange.").

corporate laws that have traditionally been within their jurisdiction.[150] Furthermore, prior Supreme Court cases point to a strong presumption *against* federal preemption of state law causes of action,[151] further supporting a narrower reading of "coincide." Given that "every bank and almost every company owns some covered securities,"[152] the Supreme Court should not allow preemption to extend as far as Petitioner claims it does.

The Court has also held that SLUSA applies only to misrepresentations that are "in connection with the purchase or sale of a covered security,"[153] as opposed to simply being in connection with a security itself.[154] Respondents invested money in CDs, but there was no actual transaction with regard to such securities. Furthermore, as the Fifth Circuit noted, allowing SLUSA to apply here merely because Petitioner deceived investors into believing that the CDs were backed by covered securities would allow any defendant to avoid liability for securities fraud simply by mentioning any type of relationship to covered securities during a marketing pitch.[155] Moreover, the Supreme Court emphasized that the "scope of SLUSA is about the *security*, rather than either the *issuer* or the alleged fraud."[156] Therefore, in applying the rule, the nature of the investment itself is most crucial. Here, Respondents merely bought CDs from SIB, and in so doing, "no one intended that any party to the transaction would obtain any interest in any covered security."[157]

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150. Brief of Sixteen Law Professors, *supra* note 148, at 3.

151. *Id.* at 19 ("The presumption against preemption is particularly strong where a conclusion that claims are preempted would eliminate remedies traditionally available under state law."); *see also* Bates v. Dow AgroSciences LLC, 544 U.S. 431, 449 (2005) ("If Congress had intended to deprive injured parties of a long available form of compensation, it surely would have expressed that intent more clearly.").

152. Roland v. Green, 675 F.3d 503, 518 (5th Cir. 2012), *cert. granted sub nom.* Proskauer Rose LLP v. Troice, 133 S. Ct. 978 (2013).

153. *See* SEC v. Zandford, 535 U.S. 813, 819 (2002).

154. *See, e.g.*, *id.* at 822 (ruling that the securities fraud must "coincide" with a securities transaction). Previous cases required, "at a minimum, a direct or indirect purchase or sale of covered securities, or a contract to do so." Brief of Sixteen Law Professors, *supra* note 148, at 12–13.

155. *Roland*, 675 F.3d at 522 ("Precluding any group claim against any such debt issue merely because the issuer advertises that it owns these assets in its portfolio would be a major change in the scope of SLUSA.").

156. Brief of Sixteen Law Professors, *supra* note 148, at 28 (alteration in original) (citing Morrison v. Aust. Nat'l Bank, 130 S. Ct. 2869 (2010)).

157. *Id.* at 29.

B. Aiding and Abetting

If the Supreme Court rules that the misrepresentations made by SIB were too far removed from the covered securities transaction to be precluded by SLUSA, then the argument for precluding the claims against the Proskauer defendants are even more tenuous. Though Petitioner claims that SIB misrepresented the "liquidity, soundness, and safety of investing in the CDs,"[158] The Proskauer defendants made no direct misrepresentation to Respondents. Furthermore, because aiding and abetting claims traditionally have been adjudicated under state law, public policy would further direct the Court to rule in favor of Respondents.

VII. CONCLUSION

The Supreme Court should affirm the Fifth Circuit's decision and hold that SLUSA precludes an action where the alleged purchase or sale of a covered security is not "more than tangentially related" to the "heart, crux, or gravamen" of the alleged fraud.[159] The Court should limit the scope of SLUSA in order to ensure that traditional state police powers—including the ability to regulate consumer remedies such as class action lawsuits and the internal workings of corporations with sufficient ties to the state—are kept intact. If the Court were to hold otherwise, the implications for many investment vehicles that merely "touch" covered securities could be quite substantial. Companies would find themselves able to avoid class actions through SLUSA preclusion simply by claiming some type of relationship to covered securities. There is little to suggest Congress intended such a result.

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158. *Roland*, 675 F.3d at 523.

159. *See id.* at 521 ("[W]e find the references to SIB's portfolio being backed by 'covered securities' to be merely tangentially related to the 'heart,' 'crux,' or 'gravamen' of the defendants' fraud.").