No. 14-1132

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; KNIGHT CAPITAL AMERICAS L.P., FORMERLY KNOWN AS KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES LLC; E*TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; AND CITADEL DERIVATIVES GROUP LLC,
Petitioners,

v.

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; AND LONDRINA HOLDING LTD.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

According to the Petition, this case presents the following question: "[w]hether § 27 of the Securities Exchange Act of 1934 provides federal jurisdiction over state-law claims seeking to establish liability based on violations of the Act or its regulations or seeking to enforce duties created by the Act or its regulations." Pet. i. That formulation, however, is grossly misleading.

An essential premise of the Petition is that the Third Circuit "held that respondents' claims, while framed as state-law causes of action, are based on alleged violations of, and seek to enforce duties created by, the SEC's Regulation SHO . . . ." Pet. 3. But that premise is demonstrably false. Indeed, the Third Circuit expressly noted: "As we read the Amended Complaint, no causes of action are predicated *at all* on a violation of Regulation SHO." Pet. App. 14a (emphasis in original).

As such, this case presents the following questions:

1. Did the Third Circuit err in finding that "As we read the Amended Complaint, no causes of action are predicated *at all* on a violation of Regulation SHO." Pet. App. 14a (the "Antecedent Fact Question")?

2. If so, did the Third Circuit also err in holding "that § 27 [of the Exchange Act] is coextensive with [28 U.S.C.] § 1331 for purposes of establishing subject-matter jurisdiction" Pet. App. 22a (the "Petition Question")?

RULE 29.6 STATEMENT

Posiljonen AB has no parent corporation, and no publicly held corporation owns 10% or more of Posiljonen AB's stock.

Posiljonen AS has no parent corporation, and no publicly held corporation owns 10% or more of Posiljonen AS's stock.

Sveaborg Handel AS has no parent corporation, and no publicly held corporation owns 10% or more of Sveaborg Handel AS's stock.

Flygexpo AB has no parent corporation, and no publicly held corporation owns 10% or more of Flygexpo AB's stock.

Londrina Holding Ltd. has no parent corporation, and no publicly held corporation owns 10% or more of Londrina Holding Ltd.'s stock.

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COUNTERSTATEMENT OF THE CASE

I. Statutory Background

States have regulated the public securities markets since their inception. *See generally* James Burk, *Values in the Marketplace: The American Stock Market Under Federal Securities Law* 169 (1998) (Table: C.2: Major Actions by Various States to Regulate Securities Business, 1852-1921) (describing state efforts); Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 Tex. L. Rev. 347, 352-64 (1991) (discussing impetus behind state "blue sky laws" regulating securities transactions during early twentieth century).

Early state statutes included specific disclosure requirements and prohibitions on fraud and misrepresentation.[1] These statutes survived numerous federal constitutional challenges on the grounds that they were legitimate exercises of the states' police power. As the Supreme Court explained in upholding a Michigan statute:

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[1] *See, e.g.*, Act of Mar. 10, 1911, ch. 133, 1911 Kan. Sess. Laws 210; Act of May 18, 1912, ch. 69, 1912 Ariz. Sess. Laws 338; Act of Feb. 13, 1913, No. 170, 1912 Vt. Laws 196; Act of July 1, 1912, No. 40, 1912 La. Acts 47; Arkansas Securities Act, No. 214, 1913 Ark. Acts 904; Idaho Securities Act, 1913 Idaho Sess. Laws 454; Act of May 2, 1913, No. 143, 1913 Mich. Pub. Acts 243; Act of Mar. 13, 1913, ch. 85, 1913 Mont. Laws 367; Supervision of Investment Companies, ch. 109, 1913 N.D. Laws 137; Act of Apr. 28, 1913, § 16, 1913 Ohio Laws 743, 751-52; Act of Apr. 7, 1913, C.S.S.B. 78 and 79, 1913 Mo. Laws 112; Act of Apr. 9, 1913, ch. 209, 1913 Me. Laws 291; Act of Aug. 19, 1913, No. 263, 1913 Ga. Laws 117; Act of Apr. 19, 1913, ch. 137, 1913 Iowa Laws 137; Act of Apr. 21, 1913, ch. 199, 1913 Neb. Laws 603; Act of Mar. 12, 1913, ch. 156, 1913 N.C. Sess. Laws 249; Act of Feb. 28, 1913, ch. 341, 1913 Or. Gen. Laws 668; Act of Aug. 21, 1913, ch. 32, 1913 Tex. Gen. Laws 66; Act of Aug. 21, 1913, ch. 756, 1913 Wis. Laws 1108.

> [W]e think the statute under review is within the power of the state. It burdens honest business, it is true, but burdens it only that, under its forms, dishonest business may not be done.

Merrick v. Halsey & Co., 242 U.S. 568, 587 (1917). *See also Hall v. Geiger-Jones Co.*, 242 U.S. 539, 551 (1917) ("[W]e shall not pause to do more than state that the prevention of deception is within the competency of government . . . .").

When Congress enacted federal securities laws, it expressly contemplated an ongoing role for the states. Both the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* (the "Securities Act"), and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (the "Exchange Act"), left the existing state regulatory schemes intact. *See, e.g.*, 15 U.S.C. § 77r; 15 U.S.C. § 78bb. And with the exception of the Exchange Act, every major piece of federal securities legislation has provided for concurrent jurisdiction over federal securities laws. Securities Act of 1933 § 22(a), 15 U.S.C. § 77v(a); Investment Company Act of 1940 § 44, 15 U.S.C. § 80a-43; Investment Advisers Act of 1940 § 214, 15 U.S.C. § 80b-14.

That dual state-federal regulatory regime continues to this day. *See Flaxel v. Johnson*, 541 F. Supp. 2d 1127, 1144 (S.D. Cal. 2008) ("Although Congress has prohibited the states from regulating the registration of certain classes of securities, states may continue to regulate the sale of securities through statutory and common-law causes of action for securities fraud.") (citing *Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367, 383-84 (1996) ("Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to

securities transactions.")); *Diamond Multimedia Sys., Inc. v. Super. Ct.*, 968 P.2d 539, 552 (Cal. 1999) ("The Securities Exchange Act of 1934 makes it clear that . . . federal law in this arena supplements, but does not displace state regulation and remedies"); *Zuri-Invest AG v. Natwest Fin. Inc.*, 177 F. Supp. 2d 189, 191 (S.D.N.Y. 2001) (denying motion for partial summary judgment of common-law fraud claim on preemption grounds).

A. Relevant New Jersey law

The operative complaint in this case (the "Amended Complaint" or "AC"), seeks relief *exclusively* under the statutory and common law of New Jersey. Pet. App. 41a-102a (AC ¶¶ 1-161). *See also infra* 9 (discussing claims asserted in Amended Complaint).

1. For over 150 years, New Jersey investors have relied on state common law for protection against manipulation of the securities markets. *See, e.g.*, *Morris Canal & Banking Co. v. Fisher*, 9 N.J. Eq. 667 (N.J. 1855) (addressing negotiability of bonds allegedly issued without stockholder authorization). Such is still the case today. *See, e.g.*, *Prudential Ins. Co. of Am. v. Bank of Am., Nat'l Ass'n*, 14 F. Supp. 3d 591 (D.N.J. 2014) (addressing allegations of fraud and negligent misrepresentation regarding underwriting guidelines for residential mortgage backed securities).

2. Like many other states, New Jersey sought to heighten the common law protections for investors in the twentieth century. New Jersey adopted a version of the Uniform Securities Act in 1967 and amended it in 1997. *See* Uniform Securities Law (1997), N.J. Rev. Stat.

§ 49:3-47 *et seq.* ("NJUSL").[2] As amended, NJUSL provides:

> It shall be unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly
>
> (a) To employ any device, scheme, or artifice to defraud;
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading;
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . . .

N.J. Rev. Stat. § 49:3-52.

NJUSL also specifically prohibits any person from quoting a fictitious price for a security, effectuating certain transactions "for the purpose of creating a false or misleading appearance of active trading in a security or with respect to the market for the security," or "employ[ing] any other deceptive or fraudulent device,

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[2] In 1956, various states undertook to bring uniformity to their regulatory schemes. The National Conference of Commissioners on Uniform State Laws approved the Uniform Securities Act that year. Uniform Securities Act (1956) (amended 1958). Thirty-six states and the District of Columbia eventually adopted a version of the Uniform Securities Act. 1 Blue Sky L. Rep. (CCH) § 5501 (1985); *see generally* Aaron D. Rachelson, *Corporate Acquisitions, Mergers, and Divestitures* § 4:79 (2013).

scheme, or artifice to manipulate the market in a security." N.J. Rev. Stat. § 49:3-52.1.

NJUSL defines the terms "fraud," "deceit,'" and "defraud" to include "[g]enerally any course of conduct or business which is calculated or put forward with intent to deceive the public or the purchaser of any security or investment advisory services as to the nature of any transaction or the value of any such security." N.J. Rev. Stat. § 49:3-49(2)(e); *see also id.* ("'Fraud,' 'deceit,' and 'defraud' are not limited to common-law fraud or deceit.").

3. In 1981, the New Jersey legislature enacted the New Jersey Racketeering Influenced and Corrupt Organization Act, N.J. Rev. Stat. § 2C:41 *et seq.* ("NJRICO"). The goal of NJRICO was "to provide that activity which is inimical to the general health, welfare and prosperity of the State and its inhabitants be made subject to strict civil and criminal sanctions." N.J. Rev. Stat. § 2C:41-1.1. The statute contains a liberal construction provision. N.J. Rev. Stat. § 2C:41-6. And predicate acts of racketeering under NJRICO include violations of NJUSL. *See* N.J. Rev. Stat. § 2C:41-1(a) ("'Racketeering activity' means (1) any of the following crimes which are crimes under the laws of New Jersey . . . (p) fraud in the offering, sale or purchase of securities . . . .").

New Jersey courts have interpreted NJRICO consistent with the sweeping intent of the legislature. *See, e.g.*, *State v. Ball*, 661 A.2d 251, 258-59 (N.J. 1995) ("[T]he Legislature decided not to limit the statute's application only to such traditional organized crime interests as the Mafia."); *see generally* John E. Floyd,

RICO State by State: A Guide to Litigation Under the State Racketeering Statutes 520 (1998).

B. Relevant federal law

Although the Amended Complaint seeks relief *only* under New Jersey law, its factual allegations—if proven—would also constitute violations of federal law.

1. Section 10(b) of the Exchange Act and Rule 10b-5 are the principal antifraud provisions in the federal securities regime. Section 10(b) of the Exchange Act generally prohibits, among other things, the use of "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe" in connection with the purchase or sale of securities. 15 U.S.C. § 78j(b). Rule 10b-5 specifically prohibits fraud and misrepresentation in connection with the purchase or sale of any security. *See* 17 C.F.R. § 240.10b-5.

2. In 2004, the Securities and Exchange Commission ("SEC") adopted Regulation SHO pursuant to the Exchange Act to curb a practice called "naked short-selling." *See* 17 C.F.R. § 242.200 *et seq.*; Short Sales, SEC Release No. 34-50103, 69 Fed. Reg. 48,008 (Aug. 6, 2004) (codified at 17 C.F.R. pts. 240, 241 and 242) ("Regulation SHO Release").

"'Short-selling' is the practice of borrowing shares of stock, selling them and seeking to repurchase those shares at a lower price, returning the lower-priced shares to the lender and keeping the difference as profit." *Fairfax Fin. Holdings. Ltd. v. S.A.C. Capital Mgmt., LLC*, Civ. No. 06-4197, 2007 WL 1456204, at *l (D.N.J. May 15, 2007). Short-selling is generally legal despite its risks. *See, e.g.*, Regulation SHO Release at

48,009 n.6 (recognizing that short-selling can be a "tool for driving the market down" and for "accelerating a declining market") (citing Short Sales of Securities, SEC Release No. 34-13091 (Dec. 21, 1976), 41 Fed. Reg. 56,530 (Dec. 28, 1976)).

"'Naked short-selling' occurs when traders sell shares they do not own or borrow, or ever intend to own, and never deliver the 'borrowed' securities that they sell." Report and Recommendation, ECF No. 36, at 2-3 (citing *Avenius v. Banc of Am. Sec. LLC*, Civ. No. 06-4458, 2006 WL 4008711, at *1 (N.D. Cal. Dec. 30, 2006); *Capece v. DTCC*, Civ. No. 05-80498, 2005 WL 4050118, at *3 (S.D. Fla. Oct. 11, 2005)).

Naked short-selling is often abusive. *See, e.g.*, "Naked" Short Selling Antifraud Rule, SEC Release No. 34-57511, 73 Fed. Reg. 61,666, 61,674 (Oct. 17, 2008) (codified at 17 C.F.R. pt. 240) ("Anti-Fraud Release") ("[F]ails to deliver might be indicative of manipulative 'naked' short selling, which could be used as a tool to drive down a company's stock price . . . ."); CAPT Luncheon, Chairman Harvey Pitt, at 6 (Nov. 16, 2007), *available at* http://www.financialsensearchive.com/fsn/2007/HarveyPitt.pdf ("Phantom shares created by naked short selling are analogous to counterfeit money."). Issuers targeted by naked short-sellers risk losing investor confidence and the ability to raise capital altogether. *See generally* Anti-Fraud Release.

Regulation SHO requires a broker-dealer to have "reasonable grounds" to believe that a security can be borrowed and delivered to the buyer within three days following the trade date before executing a short sale order. 17 C.F.R. § 242.203(b)(1) ("Locate Requirement"). If the short seller fails to deliver the securities for an

extended period, then the broker-dealer may be required to purchase and deliver securities "of like kind and quantity." 17 C.F.R. § 242.203(b)(3) ("Close Out Requirement").

Although there is no specific private right of action to remedy a violation of Regulation SHO, the SEC has advised that such a violation may constitute civilly actionable securities fraud prohibited by Section 10(b) of the Exchange Act. *See* Office of Investor Educ. and Advocacy, SEC, Key Points About Regulation SHO, http://www.sec.gov/investor/pubs/regsho.htm (last modified Apr. 8, 2015) ("Those who deceive about their intention or ability to deliver securities in time for settlement are committing fraud . . . when they fail to deliver securities by the settlement date."); *id.* ("Selling stock short and failing to deliver shares at the time of settlement with the purpose of driving down the security's price . . . would violate various securities laws, including Rule 10b-5 under the Exchange Act.").

II. Procedural History

This lawsuit involves Escala, Inc. ("Escala"), a company whose market capitalization plummeted nearly $800 million in just eleven months. Plaintiff's Reply, ECF No. 30, at 7 n.8. Plaintiffs are former shareholders of Escala including Gregory Manning, Escala's founder and former CEO. Pet. App. 45a-46a (AC ¶¶ 7-13). Defendants are several large financial institutions whose participation in the naked-short selling of Escala common stock, according to Plaintiffs, diluted their voting rights and caused their shares to decline precipitously in value. Pet. App. 46a-47a (AC ¶¶ 14-20). What follows is a brief summary of the relevant procedural history of this litigation.

1. Plaintiffs sued Defendants in the Superior Court of New Jersey, Law Division, Morris County on May 8, 2012. Pet. App. 26a. Plaintiff Gregory Manning, the owner of approximately 2.1 million shares of Escala stock during the relevant period, lives in Morris County, Pet. App. 45a (AC ¶ 7), which neighbors Escala's principal place of business Essex County, Pet. App. 48a (AC ¶ 22). Plaintiffs filed the Amended Complaint on June 7, 2012. Pet. App. 26a.

The Amended Complaint asserts ten causes of action under New Jersey law: (1) violation of NJRICO § 2C:41-2(c), Pet. App. 82a-90a (AC ¶¶ 88-113); (2) violation of NJRICO § 2C:41-2(a), Pet. App. 91a-93a (AC ¶¶ 114-22); (3) unjust enrichment, Pet. App. 93a-94a (AC ¶¶ 123-27); (4) unlawful interference with prospective economic advantage, Pet. App. 94a-95a (AC ¶¶ 128-33); (5) tortious interference with contractual relations, Pet. App. 95a-97a (AC ¶¶ 134-40); (6) unlawful interference with contractual relations, Pet. App. 97a-98a (AC ¶¶ 141-45); (7) third party beneficiary claims, Pet. App. 98a-99a (AC ¶¶ 146-49); (8) breach of the covenant of good faith and fair dealing, Pet. App. 99a-100a (AC ¶¶ 150-54); (9) negligence, Pet. App. 100a-01a (AC ¶¶ 155-58); and (10) punitive and exemplary damages, Pet App. 101a (AC ¶¶ 159-61). It alleges that Defendants committed three predicate acts of racketeering activity under NJRICO: (1) willful violations of NJUSL, Pet. App. 84a-87a (AC ¶¶ 96-101); (2) theft by taking, Pet App. 87a-89a (AC ¶¶ 102-07); and (3) theft by deception, Pet. App. 89a-90a (AC ¶¶ 108-13).

The Amended Complaint acknowledges that Defendants' market manipulation *also* violated federal law. *See, e.g.*, Pet. App. 75a-82a (AC ¶¶ 81-87) (discussing pattern of unlawful behavior and history of federal

enforcement). It explicitly does not, however, assert any federal causes of action. *See* Pet. App. 82a-101a (AC ¶¶ 88-161). And it does not allege that Defendants' violations of Regulation SHO were predicate acts for any state law cause of action.

2. Defendant Merrill Lynch, Pierce, Fenner & Smith ("Merrill") filed a Notice of Removal on July 17, 2012. Pet. App. 26a. Defendants contended that removal was proper because (1) the claims in the Amended Complaint "arise under" federal law and therefore confer federal question jurisdiction pursuant to 28 U.S.C. § 1331, and (2) the federal district court was vested with exclusive jurisdiction under § 27 of the Exchange Act.

Plaintiffs moved to remand on August 16, 2012. Pet. App. 26a. According to Plaintiffs, there was no "arising under" jurisdiction under 28 U.S.C. § 1331 because Plaintiffs could establish each of their state law claims without reference to federal law. *See, e.g.*, Motion to Remand, ECF No. 11-2, at 16 ("Here, Plaintiffs can prevail . . . without relying on or proving a violation of federal law by demonstrating that Defendants engaged in deceptive conduct in never intending to make delivery of the shorted Escala stock."); Plaintiffs' Reply, ECF No. 30, at 2 ("It is the intent and effect of Defendant[s'] wrongful conduct that serves as the measure of liability for Defendants' violation of state RICO and other common law claims, not the violation of any federal regulation or rule.").

Plaintiffs also explained that the exclusive jurisdiction provision in § 27 of the Exchange Act does not apply because Plaintiffs sought to vindicate only their rights under New Jersey law:

> Because Plaintiffs' claims arise out of *state* law rights and duties, Plaintiffs have *state* law rights to be free from fraud, misrepresentation, and material omissions in the sale of securities, *state* law rights to be free from market manipulation and *state* law rights to be free from deceit and theft. . . . [New Jersey] provide[s] claims for relief from abuses in the securities field independent of and in addition to federal claims for relief . . . .

Motion to Remand, ECF No. 11-2, at 16-17 (emphasis in original).

3. Recognizing that none of Plaintiffs' claims is predicated on an alleged violation of federal law, the federal magistrate judge recommended remand on December 31, 2012. Pet. App. 9a (Third Circuit discussing Magistrate Judge's Report and Recommendation).

First, the magistrate rejected Defendants' argument that there is "arising under" jurisdiction. *See* Report and Recommendation, ECF No. 36, at 4-10 (28 U.SC. § 1331 holding). As the magistrate wrote:

> Plaintiffs correctly note that, because they may succeed on their New Jersey RICO claims (Counts 1-2) and state common law claims (Counts 3-10) without establishing liability under federal law, the Amended Complaint . . . does not raise necessarily a substantial issue of federal law.

Report and Recommendation, ECF No. 36, at 8.

Next, the magistrate judge rejected Defendants' alternative argument that there is exclusive jurisdiction

in the federal courts pursuant to § 27 of the Exchange Act. *See* Report and Recommendation, ECF No. 36, at 10-12. The magistrate found that the references to violations of the Exchange Act in the Amended Complaint "merely [] support independent state causes of action." Report and Recommendation, ECF No. 36, at 10-11. *See also* Plaintiffs' Reply, ECF No. 30, at 2 ("The gravamen underlying Plaintiffs' Amended Complaint is not that Defendants violated Reg. SHO or other federal regulations, but that by manipulating the value of Escala stock through unlawful naked short sales, Defendants engaged in a pattern of racketeering activity in violation of New Jersey law, resulting in Plaintiffs suffering significant damages.'") (cited in Report and Recommendation, ECF No. 36, at 10).

4. The district court rejected the magistrate's recommendation and denied the motion to remand on March 20, 2013. Pet. App. 25a. The court began by stating the fundamental—but mistaken—premise of its decision:

> Notably, Plaintiffs do not dispute that the alleged unlawful conduct is predicated on a violation of Regulation SHO, 17 C.F.R. § 242.204, promulgated by the Securities and Exchange Commission ("SEC").

Pet. App. 29a.

The district court was confused. As Plaintiffs explained and the magistrate understood, Defendants' unlawful conduct consisted of violating duties owed to Plaintiffs under New Jersey law. *See, e.g.*, Pet. App. 43a (AC ¶ 2) (making clear that entire complaint is based on violations of state law without predication on any violation of Regulation SHO); Motion to Remand, ECF

No. 11-2, at 16-17 (same); Report and Recommendation, ECF No. 36, at 10-11 (recognizing same).

The district court's conclusions that there is exclusive jurisdiction under § 27 of the Exchange Act, *see* Pet. App. 30a-32a, and that there is "arising under" jurisdiction, *see* Pet. App. 32a-38a, both resulted entirely from its mistaken premise. *See* Pet. App. 32a ("As the case at bar is premised upon and its resolution depends upon the alleged violation of a regulation promulgated under the Act, this Court has jurisdiction."); Pet. App. 33a ("To prevail on their various state law claims, [] Plaintiffs must show that the alleged naked short sales were illegal.").

5. The Third Circuit reversed. Pet. App. 6a. First, the Third Circuit rejected Defendants' argument that there is "arising under" jurisdiction. Pet. App. 11a-18a. In so doing, it determined that Plaintiffs' allegations referring to violations of federal law were merely intended as *evidence* that New Jersey state law was violated. *See* Pet. App. 14a-15a (citing *Lippitt v. Raymond James Fin. Servs., Inc.*, 340 F.3d 1033, 1037 (9th Cir. 2003) (no jurisdiction even where the complaint "unnecessarily describes the alleged conduct of the defendants in terms that track almost verbatim the misdeeds proscribed by [federal law].") (alteration in original)). In this case, the Third Circuit concluded: "no causes of action are predicated *at all* on a violation of Regulation SHO." Pet. App. 14a. *See also* Pet. App. 13a ("Regulation SHO is not an element of Plaintiffs' claims. . . ." "The claims, therefore, could be decided without reference to federal law.").[3]

[3] The Third Circuit also decided—in the alternative—that "even if Plaintiffs' claims were *partially* predicated on federal law," there

Second, the Third Circuit turned to the Petition Question regarding the meaning of § 27 of the Exchange Act. Pet. App. 18a-22a. In order to do so, the court assumed—for the sake of argument—that Plaintiffs' claims "were partially predicated on federal law." Pet. App. 15a (emphasis omitted).[4] In answering the Petition Question, the Third Circuit determined that *if* a state law claim has a sufficient "federal ingredient" to satisfy 28 U.S.C. § 1331, then § 27 of the Exchange Act makes that jurisdiction "exclusive." Pet. App. 20a, 22a. If the state law claim, however, does *not* include a sufficient federal ingredient to satisfy 28 U.S.C. § 1331, then § 27 cannot itself confer jurisdiction. Pet. App. 20a, 22a.

REASONS FOR DENYING THE PETITION

I. Because of the Antecedent Fact Question, This Case Is a Poor Vehicle for Resolution of the Petition Question.

In an effort to obtain further review, Petitioners have mischaracterized the decision below. Specifically, the Petition asserts that:

> Both courts below held that respondents' claims, while framed as state-law causes of

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would still not be jurisdiction under 28 U.S.C. § 1331. Pet. App. 15a. The court explained that alleging federal violations along with state offenses as possible predicate acts of racketeering under NJRICO does not necessarily raise a federal question. Pet. App. 15a. *See also* Pet. App. 18a ("Plaintiffs' claims could rise or fall entirely based on the construction of state law."). And Defendants' arguments that federal law contradicted Plaintiffs' claims did not authorize removal under the well-pleaded complaint rule. Pet. App. 16a-18a.

[4] Without that assumption, § 27 of the Exchange Act would not be triggered at all. *See infra* 16-18.

> action, are based on alleged violation of, and seek to enforce duties created by, the SEC's Regulation SHO, which specifies the circumstances under which securities transactions known as 'short sales' and 'naked short sales' are permissible, and when they are not.

Pet. 3.[5] That is plainly untrue. *See, e.g.*, Pet. App. 13a ("Regulation SHO is not an element of any of Plaintiffs' claims."); Pet. App. 14a ("As we read the Amended Complaint, no causes of action are predicated *at all* on a violation of Regulation SHO.") (emphasis in original).[6]

As such, this Court cannot reach the Petition Question without first reversing the Third Circuit's holding on the Antecedent Fact Question. And as evidenced by Petitioners' attempted sleight-of-hand, the Antecedent Fact Question is not fairly subsumed in the Petition Question. To the contrary, its resolution by the Third Circuit is an independent rationale for the judgment below. And because the petition ignores—or, more accurately, attempts to hide—this adequate alternative basis for affirmance, it should be denied. *See Goldlawr, Inc. v. Heiman*, 369 U.S. 463, 465 n.5 (1962).

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[5] *See also* Pet. 11 ("As a threshold matter, the Third Circuit agreed with the district court that respondents' claims, while nominally asserted under state law, all sought to establish a violation of or enforce a duty created by Regulation SHO.").

[6] *See also* Pet. App. 15a ("Nor, for the reasons above, do we think Plaintiffs' causes of action necessarily need to be predicated on a violation of Regulation SHO for Plaintiffs to have a chance at recovering under state law.").

II. In Any Event, the Petition Question Itself Does Not Warrant Further Review.

Even if this case were an appropriate vehicle to address the Petition Question, the Petition should be denied. According to the Petition, further review is warranted because the Question Presented was incorrectly answered by the Third Circuit, Pet. 21-25; is of national importance, Pet. 25-27; and is the subject of a deep and intractable circuit split, Pet. 13-19. But as explained below, none of those claims is correct.

A. The Third Circuit properly answered the Petition Question.

The Third Circuit properly held "that § 27 [of the Exchange Act] is coextensive with [28 U.S.C.] § 1331 for purposes of establishing subject-matter jurisdiction." Pet. App. 22a. Petitioners argue that the court of appeals' holding is (i) irreconcilable with the text of § 27, Pet. 21-23; (ii) undermines § 27's central purpose, Pet. 23-24; and (iii) is inconsistent with this Court's precedents, Pet. 19-20. Petitioners are mistaken on all counts:

1. First, Petitioners insist that the decision below is irreconcilable with the text of the Exchange Act. Pet. 21-23. Petitioners are wrong.

Section 27 either adds to § 1331 jurisdiction or it does not. It can only do the former if the phrase "brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder" is more far reaching than the "arising under" language in § 1331.[7]

[7] Put another way, the Question Presented turns not, as the Petition suggests, on the meaning of "shall have exclusive jurisdiction," Pet. 21-22, but rather on the meaning of "brought to

The Petition concludes it is, and without any analysis or explanation, boldly asserts that "[t]he language of § 27 could not be clearer." Pet. 34. That is ironic because, according to the Second Circuit, the language of § 27 echoes § 1331 and "plainly refers to claims created by the Act or by rules promulgated thereunder, but not to claims created by state law." *Barbara v. N.Y. Stock Exch., Inc.*, 99 F.3d 49 (2d Cir. 1996) (citations omitted) ("*Barbara*").

As the Third Circuit explained, Pet. App. 19a-20a, this Court has already rejected Petitioners' textual argument. *Pan Am. Petroleum Corp. v. Super. Ct. of Del. for New Castel Cnty.*, 366 U.S. 656 (1961) ("*Pan American*") involved § 22 of the Natural Gas Act ("NGA"), 15 U.S.C. § 717u—a provision whose language is materially identical to § 27 of the Exchange Act.[8] There, this Court explicitly rejected the "plain meaning" argument advanced in the Petition: it concluded that the meaning of the phrase "brought to enforce any liability

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enforce any liability or duty created by this chapter or the rules and regulations thereunder."

[8] *Compare* 15 U.S.C. § 717u ("The District Courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules, regulations, and orders thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this chapter or any rule, regulation, or order thereunder.") *with* 15 U.S.C. § 78aa(a) ("The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.").

or duty created by" was coextensive with, and not broader than, § 1331. *Compare Pan American*, 366 U.S. at 665 n.2 ("The foregoing conclusions are not affected by want of explicit limitation to jurisdiction 'arising under' the Natural Gas Act [because s]uch limitation is clearly implied, as the authoritative Committee Reports indicate.") (quoting H. R. Rep. No. 709, 75th Cong., 1st Sess., p. 9 (1937); S. Rep. No. 1162, 75th Cong., 1st Sess., p. 7 (1937)) *with* Pet. 22-23 ("The specific jurisdictional language reflected in § 27 is different from, and broader than, the general 'arising under' language of § 1331, confirming that § 27 is *not* 'coextensive with § 1331,' as the Third Circuit held.") (emphasis in original).[9]

2. Petitioners next contend that the decision below "undermines § 27's central purpose: 'to achieve greater uniformity of construction and more effective and expert application of that law.'" Pet. 23 (citation omitted). This contention is hard to take seriously.

The Petition warns of the "danger presented where state-court judges who are not fully expert in federal securities law endeavor to interpret and enforce those laws . . . ." Pet. 24 (quotation marks omitted). For over 80 years, however, state courts have regularly and competently adjudicated complex questions of federal securities law.

It is beyond any serious dispute that the provision for exclusive federal jurisdiction in § 27 does not mean that state courts have *no role* in the adjudication and interpretation of issues involving the Exchange Act.

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[9] Although the Petition labors mightily to distinguish *Pan American* from this case, Pet. 24-25, it fails to even mention the relevant language (quoted above) from the *Pan American* opinion.

Indeed, it has been well settled for decades that § 27 "tolerates serious state intrusions into the uniform, federal adjudication of the Exchange Act." Note, *The Securities Exchange Act and the Rule of Exclusive Federal Jurisdiction*, 89 Yale L.J. 95, 110 (1979). For example:

State courts frequently resolve the facts and law pertaining to Exchange Act defenses. *See, e.g.*, *Banque Indosuez v. Pandeff*, 603 N.Y.S.2d 300, 303 (N.Y. App. Div. 1993) (concluding that state courts' consideration of Exchange Act-based defenses "neither violates the Securities Exchange Act nor offends notions of federalism"); *Scope Indus. v. Skadden, Arps, Slate, Meagher & Flom*, 576 F. Supp. 373 (C.D. Cal. 1983) (acknowledging that state courts are competent to adjudicate the merits of Exchange Act-based defenses); *Birenbaum v. Bache & Co., Inc.*, 555 S.W.2d 513, 516 (Tex. Civ. App. 1977) (state court had power to make findings of law and fact because "the issue of [the Exchange Act] violation only appeared by way of defense," and thus it was "merely a question in the case, rather than a claim for relief").

State court findings of fact concerning Exchange Act defenses are frequently given preclusive effect in federal actions concerning related Exchange Act claims. *See, e.g.*, *Maidman v. O'Brien*, 473 F. Supp. 25 (S.D.N.Y. 1979) (denying re-litigation of Exchange Act claim); *Osadchy v. Gans*, 436 F. Supp. 677, 684-85 (D.N.J. 1977) (where issues of scienter and reasonable reliance were resolved in earlier state court proceeding, the federal court "must conclude that [the Exchange Act] action is barred . . . by the doctrine of collateral estoppel"); *Connelly v. Balkwill*, 174 F. Supp. 49 (N.D. Ohio 1959) (applying doctrines of res judicata and collateral estoppel

to bar plaintiffs from re-litigating Exchange Act claims and issues that were previously decided in state court).

And state court approval of settlements releasing Exchange Act claims are frequently recognized in federal courts despite the grant of exclusive jurisdiction in § 27 of the Exchange Act. *See, e.g.*, *Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367, 368 (1996) (state court's approval of a comprehensive settlement to release Exchange Act claims "preclude[s] ongoing or future federal-court litigation of any released claims"); *Facebook, Inc. v. Pacific Northwest Software, Inc.*, 640 F.3d 1034 (9th Cir. 2011) (mediation settlement agreement, providing mutual release of all claims arising out of transaction that gave rise to the mediation, barred Exchange Act claims); *Grimes v. Vitalink Commc'ns Corp.*, 17 F.3d 1553, 1564 (3d Cir. 1994) (state court's approval of settlement releasing parties' federal securities laws claims "was entitled to full faith and credit by the district court even though the state court did not have jurisdictional competency to entertain the present exclusive federal [Exchange Act] claims").

Petitioners invite this Court to revisit its long-standing interpretation of materially identical Congressional language based upon vague and unsupported assertions about the "central purpose" of § 27 of the Exchange Act. *Cf.* American Law Institute, *Study of the Division of Jurisdiction Between State and Federal Courts* 183 (1969) ("ALI Jurisdiction Study") (concluding, based on legislative history, that the congressional grant of Exchange Act exclusive jurisdiction was largely the result of "pure happenstance"); *Lippitt v. Raymond James Fin. Servs., Inc.*, 340 F.3d 1033, 1044 n.6 (observing that "[s]ome courts have recognized that there is little legislative

history to explain the purpose of Section 27's grant of exclusive federal jurisdiction.") (citations omitted). That invitation should be declined.[10]

3. Finally, Petitioners argue that the Third Circuit's resolution of the Petition Question cannot be reconciled with three decisions of this Court. Pet. 19-20 (briefly discussing *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010) ("*Morrison*"), *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979) ("*Touche Ross*"), and *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964)) ("*Borak*"). Again, Petitioners are mistaken.

As explained above, the Third Circuit correctly held that § 27 of the Exchange Act does not confer jurisdiction over a cause of action created by state law unless that cause of action has a federal ingredient sufficient to satisfy the test for "arising under" jurisdiction pursuant to 28 U.S.C. § 1331. *See supra* 16-18. Neither *Morrison* nor *Touche Ross* nor *Borak* hold or suggest otherwise.

In *Morrison*, the only question presented was "whether § 10(b) of the . . . Exchange Act . . . provides a cause of action to foreign plaintiffs suing foreign and American defendants for misconduct in connection with securities traded on foreign exchanges." *Morrison*, 561 U.S. at 250-51. The plaintiffs in that case "alleged

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[10] The extensive role of state courts in addressing Exchange Act issues has even prompted some notable commentators to argue that "the dubious advantages of exclusive federal jurisdiction do not sufficiently outweigh the complexities it has created . . . and the statute should be amended to conform to the concurrent-jurisdiction pattern of all of the other SEC acts." Louis Loss, *The SEC Proxy Rules and State Law*, 73 Harv. L. Rev. 1249, 1254-57 (1960). *See also* ALI Jurisdiction Study at 78-79, 183, 413.

violations of §§ 10(b) and 20(a) of the . . . Exchange Act . . . .” *Id.* at 252.[11] In *Touche Ross*, the only question presented was whether § 17(a) of the Exchange Act created an implied cause of action for damages under certain circumstances. *Touche Ross*, 442 U.S. at 562 (identifying the question presented).[12] The plaintiffs in that case asserted “federal claims . . . based on § 17(a) of the [Exchange] Act.” *Id.* at 566.[13] And in *Borak,* this Court addressed whether § 27 of the Exchange Act permitted a private plaintiff to sue for violation of § 14(a) of the statute. *Borak*, 377 U.S. at 428. The plaintiffs in that case also asserted claims created by the Exchange Act itself. *See id.* at 427 (“The second count alleged a violation of § 14(a) of the . . . Exchange Act . . . .”).

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[11] The defendants argued that § 10(b) of the Exchange Act did not allow plaintiffs to sue under the circumstances at issue. No one, of course, disputed that the federal court had jurisdiction to determine the scope of the § 10(b) private right of action. Indeed, in answering the question presented, this Court felt compelled to clarify that the case did not raise a question of subject matter jurisdiction *at all*. *Morrison*, 561 U.S. at 254 (“[T]o ask what conduct § 10(b) reaches is to ask what conduct § 10(b) prohibits, which is a merits question.”).

[12] As in *Morrison*, *Touche Ross* did not present any question of subject matter jurisdiction. This Court’s only discussion of § 27 of the Exchange Act was to contrast it with substantive provisions of the statute like §§ 10(b) or 17(a). *See Touche Ross*, 442 U.S. at 577 (explaining that § 27 “creates no cause of action of its own force and effect” and noting that “[t]he source of plaintiffs’ rights must be found, if at all, in the substantive provision of the 1934 Act which they seek to enforce, not in the jurisdictional provision”).

[13] Although the holding of *Touche Ross* has no relevance to the Petition Question, this Court’s treatment of state law supports the decision below. *See Touche Ross*, 442 U.S. at 566 n.7 (explaining, without criticism, that an identical lawsuit, except for the omission of the Exchange Act claim at issue, was being litigated in state court).

This case, however, does *not* involve the assertion of a private right action created by the Exchange Act itself. *See supra* 9-10 (explaining that Plaintiffs expressly chose not to assert any Exchange Act claim). As such, *Morrison*, *Touche Ross*, and *Borak* do not bear whatsoever on the Petition Question.

B. Any circuit conflict over the Petition Question is limited and hardly intractable.

The decision below acknowledged some conflict between the circuits over the Petition Question. *See, e.g.*, Pet. App. 20a ("[W]e disagree with the line of Ninth Circuit cases which have held that there can be jurisdiction under § 27 . . . even when there is not under § 1331."). But, contrary to Petitioners' suggestion, Pet. 13-17, such conflict is limited and hardly intractable.

1. Including the decision below, two circuits have now squarely and correctly held that § 27 of the Exchange Act does not authorize federal jurisdiction over state law claims that fail to satisfy the "arising under" test of 28 U.S.C. § 1331. *See Barbara*, 99 F.3d at 55 ("Our determination that Barbara's state court complaint did not 'arise under' federal law within the meaning of section 1331 effectively resolves our inquiry under section 27 of the Exchange Act as well."); Pet. App. 22a ("We agree with the Second Circuit's holding in *Barbara* that § 27 is coextensive with § 1331 for purposes of establishing subject–matter jurisdiction . . . .").

Petitioners suggest that the Second Circuit has somehow retreated from its *Barbara* holding. *See* Pet. 17 n.3 (citing *NASDAQ OMX Grp., Inc. v. UBS Sec., LLC*, 770 F.3d 1010, 1030 (2d Cir. 2014) ("*NASDAQ*") and *D'Alessio v. N.Y. Stock Exch., Inc.*, 258 F.3d 93, 100-04 (2d Cir. 2001) ("*D'Alessio*"). That is untrue.

To the contrary, the Second Circuit has made clear that a state law claim with embedded federal securities questions may only be heard in federal court if the state law claim satisfies the "arising under" test of 28 U.S.C. § 1331. *See, e.g.*, *D'Alessio*, 258 F.3d at 101 ("We find the facts present in this case distinguishable from those in *Barbara*, and conclude that the instant suit implicates a federal interest sufficiently substantial to confer subject matter jurisdiction *under section 1331*.") (emphasis added);[14] *NASDAQ*, 770 F.3d at 1030 ("In sum, upon conducting the analysis prescribed by *Gunn-Grable* . . . we conclude that the district court correctly exercised federal jurisdiction here.") (citations omitted).

2. Petitioners assert that, in conflict, "[t]he Fifth and Ninth Circuits have held that § 27 itself creates federal jurisdiction, regardless whether § 1331 separately applies." Pet. 14. That is far from clear. And to the extent it is true, it hardly represents the type of intractable lower court division that warrants immediate review by this Court.

The only Fifth Circuit case to address the issue is *Hawkins v. National Association of Securities Dealers Inc.*, 149 F.3d 330 (5th Cir. 1998). To be sure: the *Hawkins* court did hold "that § 27 provided federal jurisdiction without conducting any analysis under § 1331." Pet. 13 (citing *Hawkins*, 149 F.3d at 331-32). But

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[14] *See also D'Alessio*, 258 F.3d at 104 ("In sum, because D'Alessio's claims necessarily require a court to construe both the federal law governing securities trading on a national exchange *and* the NYSE's role, as defined under federal law, in enforcing and monitoring a member's compliance with those laws, we conclude that the federal interest underlying D'Alessio's claims is sufficiently substantial *to 'arise under' federal law within the meaning of section 1331.*") (emphasis added).

it seems beyond any serious dispute that the facts of *Hawkins* would satisfy the test announced by this Court several years after *Hawkins* in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 545 U.S. 308 (2005) ("*Grable*"). As such, it is not clear that the Fifth Circuit's failure to discuss 28 U.S.C. § 1331 indicates its belief that § 27 of the Exchange Act would confer jurisdiction over a state law claim (unlike the one in *Hawkins*) that failed to satisfy the "arising under" test of 28 U.S.C. § 1331. Likely for that reason, the Third Circuit expressed its *potential* disagreement with the Fifth Circuit. *See* Pet. App. 20a n.9.

The Ninth Circuit's decision in *Sparta Surgical Corp. v. National Association of Securities Dealers, Inc.*, 159 F.3d 1209 (9th Cir. 1998), is also in tension with the decision below. But the Ninth Circuit's position on the Petition Question is murky and rapidly evolving. *See, e.g.*, *Lippitt v. Raymond James Fin. Servs., Inc.*, 340 F.3d 1033, 1042 (9th Cir. 2003) (holding that "because Lippitt challenges conduct solely under state law—irrespective of whether it is legal under [federal] rules—his claims do not fit under Section 27" because "exclusive jurisdiction, under Section 27 of the Exchange Act, is for actions 'brought to enforce any liability or duty *created* by this chapter or the rules and regulations thereunder . . . .'") (emphasis in original); *California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 841 (9th Cir. 2004) (explaining that this case is like *Sparta* because "[t]he state lawsuit turns, entirely, upon the defendant's compliance with a federal regulation" and not like *Lippitt* where reference to federal law was hardly "unavoidable").[15] That is likely

[15] *See also Sacks v. Dietrich*, 663 F.3d 1065, 1069 (9th Cir. 2011) (concluding that "because application of federal law is necessary to

why the Third Circuit expressed disagreement only with "*the line* of Ninth Circuit cases which have held that there can be jurisdiction under § 27 . . . even when there is not under § 1331." Pet. App. 20a (emphasis added).

C. Petitioners and their amici overstate the importance of the Petition Question.

In closing, Petitioners argue that the Petition Question is one of national importance. *See* Pet. 25-27; *see also* Brief for the Securities Industry and Financial Markets Association as Amicus Curiae Supporting Petitioners, *Merrill Lynch v. Manning*, No. 14-1132, 2015 WL 1776462 (U.S. Apr. 16, 2015). According to Petitioners, that is true for two reasons. First, the decision below "will encourage forum shopping by plaintiffs who would dress up alleged violations of federal securities law in state-law garb." Pet. 26. And second, "[t]he decision below will . . . permit state courts within the Third Circuit to insert themselves into the regulation of trade settlement and clearing for securities transactions executed on national exchanges" which "will generate substantial uncertainty and confusion for market participants." Pet. 26. Each of these claims, however, is specious.

The decision below will not encourage forum shopping by plaintiffs seeking to "dress up alleged violations of federal securities law in state-law garb." The reason is simple. Any state-law-created claims that meaningfully turn on a federal ingredient (from the Exchange Act or elsewhere) are already subject to federal jurisdiction under the test set forth by this Court

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resolve each of the state law theories, this action involves a substantial federal question").

in *Grable*. If such claims (as in this case) do not satisfy the *Grable* test, then the plaintiffs who bring them in state court can hardly be described as forum shoppers attempting to adjudicate federal claims in a more favorable venue.

It is similarly clear that the decision below will not permit state courts to interpret federal securities law in a manner that "will generate substantial uncertainty and confusion for market participants." As explained in detail above (*supra* 1-3), a dual state-federal securities regulatory regime has existed for decades. The role of states in that regime includes not only independent regulation of market conduct (*supra* 1-3), but also significant interpretation of Exchange Act provisions and rules (*supra* 18-21).

State courts have regulated securities and adjudicated defenses, counterclaims, and other Exchange Act issues for years without any evidence of crisis. Indeed, the exact position taken by the Third Circuit here has been the law in the Second Circuit for nearly two decades without any chorus of objectors. Petitioners' contrary assertions blink at reality.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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