16-1914-cv

In the United States Court of Appeals for the Second Circuit

UNIVERSITIES SUPERANNUATION SCHEME LIMITED, EMPLOYEES RETIREMENT SYSTEM OF THE STATE OF HAWAII, NORTH CAROLINA DEPARTMENT OF STATE TREASURER,

Plaintiffs-Appellees,

(*caption continued on inside cover*)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF *AMICI CURIAE* STATE BOARD OF ADMINISTRATION OF FLORIDA ACTING ON BEHALF OF THE FLORIDA RETIREMENT SYSTEM TRUST FUND AND OTHER FUNDS, PROFESSOR EGON GUTTMAN AND PROFESSOR JAMES ANGEL IN SUPPORT OF PLAINTIFFS-APPELLEES URGING AFFIRMANCE

Joe Kendall
KENDALL LAW GROUP, PLLC
3232 McKinney Avenue,
Suite 700
Dallas, Texas 75204
(214) 744-3000

J. Carl Cecere
Counsel of Record
CECERE PC
6035 McCommas Blvd.
Dallas, Texas 75206
(469) 600-9455
ccecere@cecerepc.com

Counsel for Amici Curiae

PETER KALTMAN, individually and on behalf of all others similarly situated, DIMENSIONAL EMERGING MARKETS VALUE FUND, DFA INVESTMENT DIMENSIONS GROUP INC., on behalf of its series Emerging Markets Core Equity Portfolio, Emerging Markets Social Core Equity Portfolio and T.A. World ex U.S. Core Equity Portfolio, DFA INVESTMENT TRUST COMPANY, on behalf of its series The Emerging Markets Series, DFA AUSTRIA LIMITED, solely in its capacity as responsible entity for the Dimensional Emerging Markets Trust, DFA International Core Equity Fund and DFA International Vector Equity Fund by Dimensional Fund Advisors Canada ULC solely in its capacity as Trustee, DIMENSIONAL FUNDS PLC, on behalf of its subfund Emerging Markets Value Fund, DIMENSIONAL FUNDS ICVC, on behalf of its sub-fund Emerging Markets Core Equity Fund, SKAGEN AS, DANSKE INVEST MANAGEMENT A/S, DANSKE INVEST MANAGEMENT COMPANY, NEW YORK CITY EMPLOYEES' RETIREMENT SYSTEM, NEW YORK CITY POLICE PENSION FUND, BOARD OF EDUCATION RETIREMENT SYSTEM OF THE CITY OF NEW YORK, TEACHERS' RETIREMENT SYSTEM OF THE CITY OF NEW YORK, NEW YORK CITY FIRE DEPARTMENT PENSION FUND, NEW YORK CITY DEFERRED COMPENSATION PLAN, FORSTA AP-FONDEN, TRANSAMERICA INCOME SHARES, INC., TRANSAMERICA FUNDS, TRANSAMERICA SERIES TRUST, TRANSAMERICA PARTNERS PORTFOLIOS, JOHN HANCOCK VARIABLE INSURANCE TRUST, JOHN HANCOCK FUNDS II, JOHN HANCOCK SOVEREIGN BOND FUND, JOHN HANCOCK BOND TRUST, JOHN HANCOCK STRATEGIC SERIES, JOHN HANCOCK INVESTMENT TRUST, JHF INCOME SECURITIES TRUST, JHF INVESTORS TRUST, JHF HEDGED EQUITY & INCOME FUND, ABERDEEN EMERGING MARKETS FUND, ABERDEEN GLOBAL EQUITY FUND, ABERDEEN GLOBAL NATURAL RESOURCES FUND, ABERDEEN INTERNATIONAL EQUITY FUND, each a series of Aberdeen Funds, ABERDEEN CANADA EMERGING MARKETS FUND, ABERDEEN CANADA SOCIALLY RESPONSIBLE GLOBAL FUND, ABERDEEN CANADA SOCIALLY RESPONSIBLE INTERNATIONAL FUND, ABERDEEN CANADA FUNDS EAFE PLUS EQUITY FUND AND ABERDEEN CANADA FUNDS GLOBAL EQUITY FUND, each a series of Aberdeen Canada Funds, ABERDEEN EAFE PLUS ETHICAL FUND, ABERDEEN EAFE PLUS FUND, ABERDEEN EAFE PLUS SRI FUND, ABERDEEN EMERGING MARKETS EQUITY FUND, ABERDEEN FULLY HEDGED INTERNATIONAL EQUITIES FUND, ABERDEEN INTERNATIONAL EQUITY FUND, ABERDEEN GLOBAL EMERGING

MARKETS EQUITY FUND, ABERDEEN GLOBAL ETHICAL WORLD EQUITY FUND, ABERDEEN GLOBAL RESPONSIBLE WORLD EQUITY FUND, ABERDEEN GLOBAL WORLD EQUITY DIVIDEND FUND, ABERDEEN GLOBAL WORLD EQUITY FUND, ABERDEEN GLOBAL WORLD RESOURCES EQUITY FUND, ABERDEEN EMERGING MARKETS EQUITY FUND, ABERDEEN ETHICAL WORLD EQUITY FUND, ABERDEEN MULTI-ASSET FUND, ABERDEEN WORLD EQUITY FUND, ABERDEEN LATIN AMERICA EQUITY FUND, INC., AAAID EQUITY PORTFOLIO, ALBERTA TEACHERS RETIREMENT FUND, AON HEWITT INVESTMENT CONSULTING, INC., AURION INTERNATIONAL DAILY EQUITY FUND, BELL ALIANT REGIONAL COMMUNICATIONS INC., BMO GLOBAL EQUITY CLASS, CITY OF ALBANY PENSION PLAN, DESJARDINS DIVIDEND INCOME FUND, DESJARDINS EMERGING MARKETS FUND, DESJARDINS GLOBAL ALL CAPITAL EQUITY FUND, DESJARDINS OVERSEAS EQUITY VALUE FUND, DEVON COUNTY COUNCIL GLOBAL EMERGING MARKET FUND, DEVON COUNTY COUNCIL GLOBAL EQUITY FUND, DGIA EMERGING MARKETS EQUITY FUND L.P., ERIE INSURANCE EXCHANGE, FIRST TRUST/ABERDEEN EMERGING OPPORTUNITY FUND, GE UK PENSION COMMON INVESTMENT FUND, HAPSHIRE COUNTY COUNCIL GLOBAL EQUITY PORTFOLIO, LONDON BOROUGH OF HOUNSLOW SUPPERANNUATION FUND, MACKENZIE UNIVERSAL SUSTAINABLE OPPORTUNITIES CLASS, MARSHFIELD CLINIC, MOTHER THERESA CARE AND MISSION TRUST, MOTHER THERESA CARE AND MISSION TRUST, MTR CORPORATION LIMITED RETIREMENT SCHEME, MYRIA ASSET MANAGEMENT EMERGENCE, NATIONAL PENSION SERVICE, NPS TRUST ACTIVE 14, OHIO PUBLIC EMPLOYEES RETIREMENT SYSTEM, WASHINGTON STATE INVESTMENT BOARD, ABERDEEN LATIN AMERICAN INCOME FUND LIMITED, ABERDEEN GLOBAL EX JAPAN PENSION FUND PPIT, FS INTERNATIONAL EQUITY MOTHER FUND, NN INVESTMENT PARTNERS B.V., acting in the capacity of management company of the mutual fund NN Global Equity Fund and in the capacity of management company of the mutual fund NN Institutioneel Dividend Aandelen Fonds, NN INVESTMENT PARTNERS LUXEMBOURG S.A., acting in the capacity of management company SICAV and its Sub-Funds and NN (L) SICAV, for and on behalf of NN (L) Emerging Markets High Dividend, NN (L) FIRST, AURA CAPITAL LTD., WGI EMERGING MARKETS FUND, LLC, BILL AND MELINDA GATES FOUNDATION TRUST, BOARD OF REGENTS OF THE UNIVERSITY OF TEXAS SYSTEM, TRUSTEES OF THE

ESTATE OF BERNICE PAUAHI BISHOP, LOUIS KENNEDY, individually and on behalf of all others similarly situated, KEN NGO, individually and on behalf of all others similarly situated, JONATHAN MESSING, individually and on behalf of all others similarly situated, CITY OF PROVIDENCE, individually and on behalf of all others similarly situated, UNION ASSET MANAGEMENT HOLDING AG,

Plaintiffs,

v.

PETROLEO BRASILEIRO S.A. PETROBRAS, BB SECURITIES LTD., MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED, BANK OF CHINA (HONG KONG) LIMITED, BANCA IMI, S.P.A., SCOTIA CAPITAL (USA) INC., THEODORE MARSHALL HELMS, PETROBRAS GLOBAL FINANCE B.V., PETROBRAS AMERICA INC., CITIGROUP GLOBAL MARKETS INC., ITAU BBA USA SECURITIES, INC., J.P. MORGAN SECURITIES LLC, MORGAN STANLEY & CO. LLC, MITSUBISHI UFJ SECURITIES (USA), INC., HSBC SECURITIES (USA) INC., STANDARD CHARTERED BANK, BANCO BRADESCO BBI S.A.,

Defendants-Appellants,

JOSE SERGIO GABRIELLI, SILVIO SINEDINO PINHEIRO, PAULO ROBERTO COSTA, JOSE CARLOS COSENZA, RENATO DE SOUZA DUQUE, GUILLHERME DE OLIVEIRA ESTRELLA, JOSE MIRANDA FORMIGL FILHO, MARIA DAS GRACAS SILVA FOSTER, ALMIR GUILHERME BARBASSA, MARIANGELA MOINTEIRO TIZATTO, JOSUE CHRISTIANO GOME DA SILVA, DANIEL LIMA DE OLIVEIRA, JOSE RAIMUNDO BRANDA PEREIRA, SERVIO TULIO DA ROSA TINOCO, PAULO JOSE ALVES, GUSTAVO TARDIN BARBOSA, ALEXANDRE QUINTAO FERNANDES, MARCOS ANTONIO ZACARIAS, CORNELIS FRANCISCUS JOZE LOOMAN, JP MORGAN SECURITIES LLC, PRICEWATERHOUSECOOPERS AUDITORES INDEPENDENTES,

Defendants.

CORPORATE DISCLOSURE STATEMENT

The State Board of Administration of Florida has no parent company and no publicly held corporation owns 10% or more of its stock.

The other *amici* are individuals.

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STATEMENT OF INTEREST[1]

The State Board of Administration of Florida was created by the Florida Constitution and is governed by a three-member Board of Trustees that includes the Governor, Chief Financial Officer, and the Attorney General of the State of Florida. The SBA has over $170 billion in assets under management for many different public investment funds and trust clients, including the assets of the Florida Retirement System Trust Fund, which alone is of the largest public retirement plans in the US.

Egon Guttman is the Levitt Memorial Trust Scholar and professor emeritus at the American University Washington College of Law. He served as a member of the US delegation to UNCITRAL on Model Laws on Letters of Credits and on Intermediated Securities, and authored the treatise *Modern Securities Transfers*, now in its Fourth Edition, as well as numerous articles on Article 8 of the UCC and other commercial law issues.

James Angel, Ph.D, is a professor of finance at Georgetown University Business School. He has written widely on the structure and regulation of financial markets, including on securities settlement, and has testified before Congress on

[1] Pursuant to Fed. R. App. P. 29(c)(5) and Circuit Rule 29.1, *amici curiae* state that no counsel for a party authored this brief in whole or in part, and no counsel or party contributed money that was intended to fund preparing or submitting the brief. All parties have consented to the filing of this brief.

issues relating to the proper design of financial markets.

Amici thus have extensive experience applying, litigating, and commenting upon the federal securities laws and the mechanics of modern securities transactions, making them well situated to discuss the immobilized and electronically traded securities at issue in this case. This case also directly affects *amici* because our ranks include institutional investors that regularly transact in these electronically traded securities on behalf of thousands of public employees, thereby staking hundreds of billions of pension dollars on the expectation that they will be accorded the same respect and legal status as securities conveyed in paper form.

BACKGROUND AND SUMMARY OF THE ARGUMENT

The Petrobras Notes at issue in this case do not trade on any centralized exchange, but instead change hands through "over-the-counter" transactions occurring in multiple locations. Appellants would use this feature as a roadblock against certification, suggesting that certain class members cannot meet the requirements imposed by *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), which limited the protections of the American securities laws to those who purchased securities in "domestic" transactions.

Conjuring specters of "dark pools" of securities, and complaining about the variety of ways Petrobras Notes trade around the globe (BB Securities Ltd., *et al*. Br. 7, 30; Helms, *et al*. Br. 3, 5, 39), Appellants suggest that claimants who

purchased Petrobras Notes in foreign transactions may end up in the classes, and insist that purging the classes of these foreign claimants will be so burdensome as to make the classes unascertainable and the class action unmanageable.

The district court correctly rejected this effort at the certification stage, determining that the classes could feasibly be limited to domestic purchasers by utilizing one method *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 68 (2d Cir. 2012), endorsed for meeting *Morrison*'s "transactional test," 561 U.S. at 269, for off-exchange transactions: asking claimants to individually prove where they became "irrevocably bound" to purchase their securities. (A-6128-29.)

But in a precursor decision dismissing certain named plaintiffs' claims, it effectively denied Petrobras Note purchasers any means of satisfying a *second* method *Absolute Activist* endorsed for proving their purchases were domestic: demonstrating that "transfer of title" to the securities occurred in the United States. 677 F.3d at 68. And this method would make the particularized, "fact-intensive" inquiry Appellants demand entirely unnecessary.

All trades in Petrobras Notes, regardless of their origins, should properly be regarded as occurring in the United States because the Petrobras Notes are housed at the Depository Trust Company, and all transactions in those notes occur through DTC's process of "settlement," when the notes are debited from the seller's brokerage account and deposited into the buyer's brokerage account. These

transactions bear all the hallmarks of title transfers and take place entirely within DTC's self-contained electronic system in the New York area, making all trades within that system—including those in Petrobras Notes—domestic.[2]

The district court nevertheless declined to recognize this legal and practical reality, concluding that the property interest obtained through DTC settlement did not fit within *Absolute Activist*'s idea of a "title" transfer. It determined that *Absolute Activist* demanded receipt of "[legal] title" (A-5182) to make a transaction domestic—a threshold that no investor in Petrobras Notes can cross. This is because, as the court recognized, "[t]he DTC," or its corporate affiliate "Cede & Co," which often serves as DTC's nominee, retains legal title to the securities themselves, with only a beneficial ownership interest in the securities going to the investor. (A-5181.) This arrangement, typical for depositories like DTC, is deemed necessary to facilitate the efficient electronic transfer of securities. But to the district court, this arrangement made it impossible for holders of Petrobras Notes—or *any* holders of such electronic securities—to prove they *ever* acquired "title" that would satisfy *Absolute Activist*.

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[2] As the Petrobras prospectuses for the debt securities at issue in this case indicate, Petrobras reserved the right to have some of the securities stored electronically at Euroclear and other foreign depository institutions for trading abroad. (*E.g.*, A-2832, A-2870.) But there is no question that DTC was to be the sole registered holder of the securities, meaning that transactions conducted through these foreign depositories would still settle within DTC's system. (A-2870-72.)

This restrictive reading of *Absolute Activist* was based in part on a misunderstanding about "[t]he mechanics of DTC settlement," assuming them to be mere "actions needed to carry out" transactions, rather than "'the transactions themselves.'" (A-5182, quoting *Loginovskaya v. Batratchenko*, 764 F.3d 266, 275 (2d Cir. 2014).) To this the court added a prudential concern: worrying that if "most securities transactions settle through the DTC or similar depository institutions," recognizing DTC settlement to effectuate a title transfer would mean that "[t]he laws would reach most transactions, not because they occurred on a domestic exchange but because they settled through the DTC" (A-5181), rendering "nugatory" "the entire thrust of *Morrison* and its progeny." (A-5182.)

Amici see things differently. Despite its diminutive-sounding name, the beneficial ownership interest received electronically during settlement at DTC is no mere precursor to a transaction. It conveys the same ownership rights as the paper security certificates it was designed to replace, provided in the same manner as securities acquired through an exchange. The entire system of modern securities transactions rests on the assumption that these electronically conveyed interests will be accorded the same legal status as all other securities, and the securities laws should follow suit.

A refusal to recognize DTC settlement transfers as domestic transactions, on the other hand, would not serve *Morrison*'s underlying goals. It would instead

undermine them. Instead of preventing the *foreign expansion* of the securities laws, such a rule would impose artificial *domestic restrictions* on their protections, subverting long-established rules about the types of "purchases" and "sales" that should fall within their scope.

Accordingly, *amici* urge the Court to expressly recognize that the DTC settlement process effects a domestic title transfer, making all transactions in securities immobilized at DTC domestic and within the scope of the securities laws. Such recognition will allow these class actions to go forward with a sharper focus, grounded in the legal and practical realities of modern securities ownership.

ARGUMENT

There is no need to individually purge the classes of foreign claimants because *all* transfers of Petrobras Notes are domestic transactions subject to the federal securities laws.

Appellants' effort to defeat class certification founders on an unjustified premise: that transactions in Petrobras Notes took place at many different locations, thereby necessitating a "fact-intensive" inquiry into the situs of each transaction to determine the classes' proper composition. The inquiry is actually far simpler. Although buyers and sellers agreed to transact in Petrobras Notes—becoming "irrevocably bound" under *Absolute Activist*'s first prong, 677 F.3d at 67—in different locations, "title is transferred" to all Petrobras Notes, under *Absolute Activist*'s second prong, *id.* at 68, in only a single location: the New York area, at

the point DTC "settles" the transaction by transferring the notes between the sellers' brokerage account and the buyer's account.

During this settlement process, investors acquire the same property interest as recipients of paper security certificates, executed in the same manner as virtually all trades on domestic exchanges. And settlement is not merely an action needed to carry out a title transfer, or some intermediary step along the way; settlement *is* the title transfer—conveying the only property interest the investor will ever receive.

A. All transactions in Petrobras Notes settle through DTC, effectuating a domestic title transfer.

Central securities depositories like DTC came into being amid the "paperwork crunch" of the 1960s, when the dominant securities trading mechanism of the day, which required physically transferring paper certificates and accounting for the transfer in the issuer's records, began to suffer serious strain under an ever-burgeoning volume of trades. *See* U.C.C. Art. 8, Prefatory Note, I.C.[3] Securities depositories offered a solution to this problem by eliminating the need for physical exchanges of paper in securities transactions. Rather than issue physical certificates to individual investors, these depositories take possession of a single "global note" representing all of the securities, thereby "immobilizing" them in a single location.

[3] *See also* Virginia B. Morris & Stuart Z. Goldstein, DTCC, *Life Cycle of a Security* 2 (2010).

See Life Cycle of a Security 2, 11. The depository holds legal title to the note, and transfers ownership interests in the underlying securities through electronic "book entries" moving them from one member's account into another as the interests change hands, thereby providing a transfer process that is cheaper, more efficient, and less risky than a transfer of paper certificates. *Id*. 2-3, 5.

DTC itself was created in 1973, *id*. at 5, and has become the most popular central securities depository in the United States, boasting over 600 member banks and broker-dealers, *see* U.C.C. Art. 8, Prefatory Note, I.C, and controlling 85% to 90% of all US trades in equities and corporate and municipal bonds, *see Life Cycle of a Security* 5, 10. The overall system DTC maintains to facilitate trades is complex, with multiple electronic verification and notification steps, including a "chain reaction" of adjustments to book entries outside DTC by which brokers account for the trades to their customers. (A-5181.) But the transfer of ownership for every trade unambiguously occurs only at a single designated time and location: at the point of "settlement," when the securities are electronically transferred out of the seller's brokerage account and into the buyer's brokerage account, *Life Cycle of a Security* 8-9, which occurs at DTC's corporate headquarters in the New York area.[4]

[4] DTC's computerized system was once housed in a vault in New York City. But this location suffered damage from flooding during Hurricane Sandy, and since then DTC has moved its vault and primary operations facility to Jersey City, with certain operations also located in Brooklyn. *See* DTCC, *Important Notice for the*

1. Settlement of transactions through DTC satisfies *Absolute Activist*'s requirements for a domestic title transfer.

Just as DTC's electronic settlement system mimics the delivery of paper securities, without the bother of an actual physical exchange, transfers of securities through this system are recognized—under a legal regime specifically designed to establish the property rights acquired in these transfers—to have the same legal effect, and convey the same property rights, as receipt of paper securities certificates.

a. DTC settlement transfers title as readily as receipt of a paper securities certificate.

Ownership of immobilized securities is governed by Article 8 of the Uniform Commercial Code, adopted in New York under N.Y. U.C.C. §§ 8-501–8-511. Under Article 8, an investor in a security immobilized at DTC obtains a beneficial ownership interest—termed by the Code a "security entitlement"—when DTC credits the financial asset to the investor's brokerage account by "book entry" in its electronic system, U.C.C. § 8-501(b)(1) & cmt. 2; *id*. Art. 8, Prefatory Note, I.C. Although this security entitlement comes through DTC, rather than directly from the issuer as would be the case with a paper certificate, it is "itself a form of property interest not merely an *in personam* claim against" DTC. U.C.C. Art. 8, Prefatory Note, II.C. And it is this security entitlement, not the legal title held by DTC, that

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Depository Trust Company, Nos. 0626-13 (Apr. 18, 2013), 1178-13 (Jul. 25, 2013), 1375-1, (Aug. 28, 2013), 0996-13 (Jun. 13, 2013), 0734-13 (May 2, 2013), *available at* www.dtcc.com.

represents true ownership of the security.

Receipt of a security entitlement provides all the "economic and corporate benefits of ownership," U.C.C. Art. 8, Prefatory Note, II.C, including the rights to interest, dividends, stock splits, and voting, *Life Cycle of a Security* 2,10; U.C.C. § 8-505. The investor, not DTC, controls the right to dispose of the security. Sandra M. Rocks & Carl S. Bjerne, *The ABCs of the UCC Article 8: Investment Securities* 30 (Amelia H. Boss ed. 1997); U.C.C. §§ 8-504, 8-506, 8-508. And should DTC or the issuer for any reason dissolve, the investor, not DTC's creditors, would receive the proceeds of dissolution. Steven L. Schwarcz, *Intermediary Risk in A Global Economy*, 50 Duke L.J. 1541, 1571 (2001) . Accordingly, both as a matter of DTC's rules and common understanding, the "actual owner" of a security, "entitled to all the benefits—and risks—associated with" ownership, is "always" the beneficial owner, *Life Cycle of a Security* 10, who enjoys "both use and title" to the security, despite legal title residing with the depository, *Black's Law Dictionary* 1280 (10th ed. 2014).

The entitlement in a security held by DTC is accounted for in the same manner as a paper certificate, U.C.C. Art. 8, Prefatory Note, II.C., and in all other respects, it is irrelevant that one owner might possess a paper certificate while another might hold her position through an intermediary. These are merely "different ways of acquiring an interest in the underlying security." *Id*. *Absolute Activist*, endorsed the

principle that receipt of paper documents effectuating a transfer of securities was considered a title transfer, referencing the result in *Quail Cruises Ship Management Ltd. v. Agencia de Viagens CVC Tur Limitada*, 645 F.3d 1307, 1310 (11th Cir. 2011), 677 F.3d at 68.

A failure to accord the beneficial ownership interest conveyed through DTC settlement the same status would run counter to long-settled securities-law doctrine, and Congress's explicit directive. Beneficial property interests in securities are hardly foreign to the federal securities laws, but have long been recognized to exist in securities independently from legal title. Beneficiaries of a "trust or a joint venture," and shareholders in a "corporation which owns" securities all possess beneficial ownership interests in the underlying securities. *Whiting v. Dow Chem. Co.*, 523 F.2d 680, 686 (2d Cir. 1975). And importantly, such beneficial ownership interests have been held to exist for investors whose brokers hold securities in "street name" for their benefit. *Drachman v. Harvey*, 453 F.2d 722, 726-27 & n.8 (2d Cir. 1971); *see also DeJulius v. New England Health Care Emps. Pension Fund*, 429 F.3d 935, 936-37 (10th Cir. 2005).

Long before *Morrison*, acquisition of such beneficial interests was understood to constitute a "purchase" and "sale" of a security under the Securities Exchange Act of 1934. There Congress explicitly provided that "purchase" of such a "beneficial" interest, described as an interest "provid[ing] incidents of ownership comparable to

direct ownership" of the security, 15 U.S.C. § 78m(o), triggers insider disclosure obligations, and the potential for insider trading liability, under Sections 13 and 16 of the Exchange Act, 15 U.S.C. §§ 78m(d)(1), (f)(1), (g)(1), & (o), 78p. *See generally* Note, *Beneficial Ownership Under Section 16(b) of the Securities Exchange Act of 1934*, 77 Colum. L. Rev. 446 (1977) (collecting cases on the types of interests that qualify as beneficial ownership interests under Section 16(b)). Acquisition of such a beneficial ownership interest also carries with it a host of other regulatory protections and responsibilities under the Exchange Act. *See* 15 U.S.C. §§ 78f(10)(A) & (C), 78i(a)(1), 78n(b)(2) & (d)(1), 78u-4(a)(9), 78bb(d).

In keeping with Congress's understanding, courts have long considered transfers of such beneficial interests to be sufficient to constitute the required "purchase" or "sale" to bring a claim within the scope of Section 10(b), 15 U.S.C. § 78j(b); *see Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730-31 (1975). Accordingly, the possessor of a beneficial ownership interest may bring a claim for securities fraud without joining the legal title holder, as this Court confirmed just last year in *Brecher v. Republic of Argentina*, 806 F.3d 22, 25 (2d Cir. 2015), a case which involved Argentine Notes that Appellants concede are "in all relevant respects identical to the Petrobras Notes" at issue here. (Helms, *et al*. Br. 40 n.14.) *See also, e.g.*, *Drachman*, 453 F.2d at 727.

The case for treating the beneficial interest acquired through DTC as a sale is

even stronger under the Securities Act of 1933, because since the Act's enactment, 48 Stat. 74, Congress has defined "sale" to expressly encompass transactions involving "disposition" of an "interest in a security" in addition to those disposing of the security itself, 15 U.S.C. § 77b(3), a definition that clearly encompasses the property interest acquired during the process of DTC settlement.

Morrison did not purport to change this longstanding—and ultimately Congressionally mandated—understanding that transfers of beneficial interests fall within the scope of the securities laws, a fact *Absolute Activist* recognized through its focus on "title." Conveyance of title does not connote any particular property interest. Instead, it refers to the point—geographical or temporal—where the owner of a property interest obtains its "legal link" to that property interest, *Black's Law Dictionary* 1712 (10th ed. 2014), which, once obtained, allows him to withstand the claims of other would-be owners, D. Barlow Burke, *The Law of Title Insurance* § 3.07 (3d ed. 2016). It is thus common to speak of obtaining "title" by possession, or "title" by adverse possession—descriptors referring to means of acquiring property rather than specific property interests. *See Black's Law Dictionary* 1213 (10th ed. 2014). And one need not obtain *all* interests in property to enjoy title. On the contrary, property is routinely divided into separately titled interests, such as the legal "title" and equitable "title" that exist simultaneously in property held in trust. George G. Bogert & George T. Bogert, *The Law of Trusts and Trustees* § 17 (2d ed.

1984). *Absolute Activist*'s use of the term "title" was therefore apt, because the conveyance of title denotes a time, or more importantly, *a location*, where a transaction in property is consummated, thus making it possible to determine whether a securities transaction occurs domestically.

The conveyance that occurs during DTC settlement—which provides the recipient with a universally recognized property right—thus fits as comfortably within *Absolute Activist*'s conception of a "title" transfer as conveyance of a paper securities certificate, a fact that *Absolute Activist* itself recognized. *Absolute Activist* observed that the "ordinar[y]" definition of a "sale," and a transfer of title, can involve either a "'transfer of property'" or a "'transfer'" of some formal document of "'title'" representing the property, *Absolute Activist*, 677 F.3d at 68 (quoting *Black's Law Dictionary* 1454 (9th ed. 2009)). This conception of title matches Article 8's rules for conveyance of securities, which provide in U.C.C. § 8-104(a) that title for paper securities is conveyed when the document itself is transferred under U.C.C. § 8-301, while title to immobilized securities is conveyed when a person "acquires a security entitlement" upon settlement under U.C.C. § 8-501.[5] Accordingly, by adopting this "ordinar[y]" of a sale, *Absolute Activist* explicitly

[5] *Absolute Activist* also showed that its conception of title matched that of the U.C.C. by referencing the definition of a "sale" adopted in Article 2, *see* 677 F.3d at 68.

recognized, and meant to accommodate, the modern transfer of securities immobilized within depository institutions like DTC.

The fact that settlement through DTC is the legal and logical equivalent of delivery of paper securities also undermines the district court's conclusion that the mechanics of settlement are mere "actions needed to carry out transactions," and not the "'transactions themselves.'" (A-5182, quoting *Loginovskaya*, 764 F.3d at 275.) Unlike the wire transfer of funds at issue in *Loginovskaya*, which was deemed insufficient to constitute a domestic transaction because it was not provided in exchange for an immediate purchase of securities, but went instead into a fund to be used for future securities purchases, 764 F.3d at 269, 275, DTC settlements are complete securities transactions in-and-of themselves, effectuating a title transfer without any further action by DTC or by anyone else.

In sum, recognizing the transmission of a beneficial ownership interest through the DTC settlement process as a title transfer is necessary to give effect to *Absolute Activist*, to respect Congress's judgments about purchases and sales at the foundation of the federal securities laws, and to accommodate the realities of virtually all modern securities transactions.

b. Over-the-counter transactions settling through DTC utilize the same method of transfer as all trades on domestic exchanges.

The Court should explicitly hold that DTC settlement effectuates a domestic

title transfer not only to grant it the same status as its *legal* equivalent—conveyance of paper securities, but also to treat it like its *functional* equivalent—trade on a domestic exchange. *Morrison* held that all trades occurring on domestic exchanges should automatically be considered domestic, 561 U.S. at 267, not simply because the exchanges were located domestically, but because the "transactions" on those exchanges occurred domestically, with the exchange serving "as a proxy for a domestic transaction." *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 180 (2d Cir. 2014). But in the modern trading environment, exchanges simply provide marketplaces for matching buyers and sellers. The stocks traded on domestic exchanges are actually immobilized at DTC, [6] and thus the actual "transactions" in those securities happen through settlement at DTC.[7]

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[6] *See* DTCC, *Equity, Corporate and Muni Debt Transaction Processing*, <goo.gl/d1Txg1> (noting that DTC "provides settlement services for virtually all equity, corporate debt and municipal debt trades transacted on the New York Stock Exchange, NASDAQ, regional exchanges and electronic communication networks (ECNs) in the U.S."). In fact, both the NYSE and NASDAQ now mandate that securities listed on their exchanges be immobilized at DTC. *See Handbook of Key Global Financial Markets, Institutions, and Infrastructure* 563 (Gerard Caprio, ed. 2013).

[7] Some companies *list* their securities on domestic exchanges, although those securities do not actually *trade* there, instead changing hands through a variety of over-the-counter mechanisms that do not necessarily utilize DTC's services. But all of the securities that actually *trade* on domestic exchanges settle through DTC, and it is only these on-exchange trades that are automatically deemed to be domestic under *Morrison*. *See City of Pontiac*, 752 F.3d at 179-81.

A failure to accord over-the-counter transactions settling through DTC the same status as transactions on domestic exchanges, when both sets of trades occur in the exact same manner—and indeed, within the exact same *facilities*—cannot be squared with *Morrison* itself, which mandates that off-exchange and on-exchange transactions be treated equally, as they are suffused with the same "'national public interest.'" 561 U.S. at 263 (quoting 15 U.S.C. § 78b). And even before *Morrison*, the Supreme Court held that "[t]he fact that the transaction is not conducted through a securities exchange or an organized over-the-counter market" should be regarded as "irrelevant to the coverage of § 10(b)," *Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 10 (1971), thus dictating that *all* transactions settled through DTC be considered domestic transactions, even when they occur off-exchange.

2. It would be wrong to insist that only transfer of legal title satisfies *Absolute Activist*.

It is important for the Court to explicitly hold that the beneficial interest conveyed during DTC settlement satisfies *Absolute Activist*'s conception of a "title" transfer and thus *Morrison*'s conception of a "domestic" "purchase and sale." But it is also important that the Court explicitly *reject* the idea that conveyance of legal title is necessary to satisfy those tests. The term "legal title" does not appear anywhere in *Absolute Activist* or *Morrison*. And demanding transfer of legal title would attach undue significance to what is merely a ministerial formality,

unreflective of true ownership. "Legal title" is merely "apparent" ownership, and does not necessarily carry with it the "beneficial interest" that constitutes *true* ownership. *Black's Law Dictionary* 1713 (10th ed. 2014). For immobilized securities—and indeed, for all securities in which a beneficial ownership interest exists—the legal title holder merely holds the property for the benefit of the beneficial interest holder, in a relationship akin to a trust. Schwarcz, 50 Duke L.J. at 1566.

Because legal title usually reflects a mere formality of ownership, courts routinely disregard it in determining whether goods are "sold" or "title" is transferred, as this Court did in *United States v. Balanovksi*, 236 F.2d 298 (2d Cir. 1956). *Bananovski* concerned whether an Argentine partnership derived domestic taxable income from commissions and profits earned on a series of equipment sales that the partners arranged between US suppliers and the Argentine government. *See id*. at 300-01. The Court determined that for each of a series of transactions, the equipment was "sold" within the United States, making the income from those goods taxable under subsections 119(a)(6) and (e) of the 1939 Internal Revenue Code, because the customer acquired at least "'beneficial' title" in the equipment when it was delivered domestically to a carrier for shipment to Argentina. *Id*. at 304. The Court found it unnecessary to consider whether, at the time the goods left the country, "'legal' title" may have rested with an American intermediary bank,

resulting from its possession of shipping documents relating to each equipment sale, *id*. at 305-06, because the customer's beneficial title in the equipment was *alone* enough to make the sales domestic.

Other federal courts have followed this logic, allowing economic realities of ownership, rather than mere "refinements of [legal] title," *Corliss v. Bowers*, 281 U.S. 376, 378 (1930), to drive determinations about the point at which "sales" occur.[8] Indeed, when the district court on remand from *Absolute Activist* was faced with exactly the inquiry in this case—applying *Absolute Activist*'s newly minted definition of "sale" to determine the situs of transactions in securities immobilized at DTC—it too disregarded the fact that DTC held legal title, and likewise disregarded entirely the fact that the transactions might have taken place in multiple locations, where the trades were arranged. Instead, it determined that all sales in the immobilized security occurred "in New York," at DTC's home office, because it concluded that transfer of title occurs "where a trade settles." *Absolute Activist Master Value Fund, Ltd. v. Ficeto*, No. 09-cv-8862, 2013 WL 1286170, at *18

[8] *See S.R.A., Inc. v. Minn.*, 327 U.S. 558, 570 (1946) (finding that a private entity which obtained ownership of the beneficial interest in property pursuant to an executory contract was not exempt from state property taxes simply because the United States retained legal title to the property in question); *Estate of Kenneth L. Lay v. Comm'r of Internal Revenue*, 102 T.C.M. (CCH) 202 (Aug. 29, 2011) ("The status of the legal title to the annuity contracts does not control in determining whether a sale occurred. Beneficial ownership, and not legal title, determines ownership for Federal income tax purposes.").

(S.D.N.Y. Mar. 28, 2013). The logic of these cases is compelling and should be explicitly adopted by this Court.

Indeed, it is important that the Court take this occasion to unequivocally reject the idea that conveyance of legal title is necessary to satisfy *Absolute Activist*, because there is no guaranty that the district court's dismissal ruling will ever be appealed. Left alone, litigants will use that decision to unfairly disadvantage investors in a variety of contexts. Because investors in securities immobilized at DTC receive only a beneficial interest, and never full title, insistence upon transfer of legal title would impose a requirement that is impossible to satisfy, effectively depriving this entire class of investors of the ability to prove the viability of their securities-fraud claims under *Absolute Activist*'s second prong. That leaves these investors only one option for proving they acquired their securities domestically: demonstrating where "irrevocable liability" was incurred under *Absolute Activist*'s first prong. But this would force them to prove their claims through evidence that, while feasible to analyze, will be expensive and time-consuming to obtain, thus increasing the administrative burden and expense of maintaining an action for securities fraud. This additional burden will be multiplied many times over for institutional investors, which are likely to engage in large volumes of trades, thus making it harder for them to discharge their duty to protect their clients' funds. Insistence on conveyance of legal title also unfairly disadvantages foreign investors,

who may be deemed to have obtained their securities abroad, and thus denied the protections of the securities laws, even though the securities they purchased never left the United States. Such a rule would thus ultimately diminishes the protections of the securities laws for those whose trades settle through DTC, when it ought to be clear that all such transactions are domestic.

Moreover, the troublesome domestic effects of this rule will not be confined to investors whose securities are housed within DTC. On the contrary, this rule would harm *all* purchasers of immobilized securities, including participants in the multi-trillion dollar bond market, regardless of the institution in which the securities are housed. It will also lead to absurd results in which purchases of bonds issued by *US municipalities* might be regarded as foreign, consequences that collectively *would* render *Absolute Activist*'s second prong "nugatory" for virtually all off-exchange transactions.

More importantly, introducing the idea that acquisition of a beneficial interest in a security might not be a "purchase" and "sale" subject to the federal securities laws will deeply unsettle securities law in a variety of areas outside cross-border transactions. Defendants will rely upon that idea to support attempts to deny *all* investors who do not hold legal title to their securities of the chance to plead a cause of action for securities fraud, conceivably affecting every investor who holds securities at a brokerage. And insiders will likewise use it to support creative

attempts at evading the reporting obligations and insider-trading prohibitions of Sections 13 and 16 of the Exchange Act simply by arranging for legal title to their securities to be held by someone else.

Perhaps most fundamentally, leaving standing the idea that conveyance of legal title is essential for *all* title transfers in securities would undermine the very idea of immobilized securities, and strikes a blow to the foundation of the entire worldwide financial system—a system that can dispense with paper securities certificates, thereby achieving efficiencies that are vital to accommodate today's huge trading volumes, only because "the record of debts and credits in a security account" can be regarded as final and "conclusive evidence of title."[9] For all these reasons, it is imperative that this Court take this opportunity to explicitly adopt the proper rule, to prevent these disruptions from occurring.

B. Recognizing the domesticity of all transactions settling through DTC serves *Morrison*'s underlying concerns.

Explicitly recognizing that settlement through DTC effects a domestic title transfer will also further the goals that *Morrison* sought to achieve in fashioning its "transactional test," 561 U.S. at 269.

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[9] Robert Pardy, *Regulatory and Institutional Impacts of Securities Market Computerization* Annex I-4 (The World Bank Country Econ. Dep't, Working Papers Series, No. WPS 868 (Feb. 1992).

1. This rule's focus on DTC settlement respects *Morrison*'s boundaries on the permissible international scope of US securities laws.

Morrison recognized that extraterritorial application of the federal securities laws had the potential to interfere with foreign regulatory interests, because "foreign countries regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction," 561 U.S. at 256, and the limits *Morrison* imposed with its "transactional test" were meant to prevent the securities laws from being applied in ways that might interfere with other countries' priorities concerning their own markets. But such concerns are not present in this case—for reasons quite apart from the fact that the transactions at issue fit neatly within *Morrison*'s test designed to respect those boundaries.

For one thing, foreign interests are particularly attenuated here because the Petrobras Notes at issue in this case do not trade on any exchange, either foreign or domestic, and thus do not implicate foreign jurisdictions' interest in regulating conduct occurring on their own exchanges. More importantly however, recognition that DTC settlements are domestic purchases and sales will not offend foreign jurisdictions' regulatory interests, but will instead comport with their own expectations regarding the situs of transactions in immobilized securities. This is because most foreign jurisdictions are ahead of the United States in explicitly recognizing that for immobilized securities, title transfer occurs where settlement

occurs; thus foreign regulators would consider trades settling within DTC to be US transactions occurring *outside* their borders.[10] Recognition by US courts of the same rule would thus raise no concern of trampling foreign interests or upsetting international relations.

Moreover, in purely practical terms, treating DTC settlement as a title transfer will not dramatically expand the scope of the securities laws, as the district court feared. Although DTC and its affiliates currently handle the majority of settlements for over-the-counter transactions, this is mainly because volumes of stocks and equities traded in US markets dwarf those in other parts of the world. In a single day, more than 19.3 billion shares of stock can trade across equity markets in the United States, in contrast to 1.6 billion shares traded across all European markets. *See* Virginia B. Morris & Stuart Z. Goldstein, DTCC, *Guide to Clearance and Settlement: an Introduction to the DTCC* 5 (2009). DTC's dominance in settlement is thus merely a reflection of the dominance of US markets in securities transactions,

[10] For instance, the European Parliament, the directly elected body of the nations of the European Union, in a series of legislative directives enacted to ensure compatibility between member nations' respective settlement systems, called for measures to ensure the "enforceability" of electronic settlement as a "mechanism for title transfer," Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on Financial Collateral Arrangements, 3003 J.O. (L 168/44) 14 (EN), <goo.gl/b1HpRJ>, and recognized that "title" in immobilized securities is "evidenced by entries in a register or account" maintained by an intermediary, *id*. art. 2(g).

and is a simple consequence of the fact that DTC directs its operations to the American market. This American focus counsels *in favor* of treating transactions settling through DTC as domestic, not against such a rule.

Moreover, regarding DTC settlements as domestic does not necessarily guaranty that settlements through "similar depository institutions" will be domestic. (A-5182.) On the contrary, the majority of other settlement institutions do not serve the US market, but instead conduct operations throughout Europe and around the world. Some of these institutions simply settle transactions occurring on their home countries' exchanges, but there are numerous others that handle select over-the-counter transactions as well.[11] These international settlement institutions provide a great and growing alternative to DTC. Indeed, depositories in India now handle more eligible issues than DTC, although they still settle fewer trades overall.[12] And just as trades settled domestically by DTC are considered domestic, trades settled by these foreign institutions are unquestionably foreign, because their title transfers occur abroad. *In re Vivendi Universal, S.A. Sec. Litig.*, 284 F.R.D. 144, 151

[11] European Central Bank, *the Blue Book: Payment and Securities Settlement Systems in the European Union* vols. I & II (Aug. 2007) (outlining payment and settlement systems both in European and non-European countries), <goo.gl/xs1tVk>.

[12] Bank for Int'l Settlements, *International Banking Statistics* Table CSD5 (Mar. 2014), <www.bis.org/cpmi/publ/d142a.pdf>.

(S.D.N.Y. 2012) (holding that transfers of securities immobilized in a foreign depository were foreign transactions); *In re Sanofi-Aventis Sec. Litig.*, 293 F.R.D. 449, 458 (S.D.N.Y. 2013) (same).

The availability of these foreign settlement institutions will prevent any dramatic expansion in the scope of the federal securities laws, and their projected growth suggests that the proportion of securities transactions subject to the US securities laws is likely to shrink, not grow, over time.

2. This rule clarifies the scope of the securities laws in ways that match the legitimate expectations of both issuers and investors.

Another of *Morrison*'s goals in addressing the extraterritorial scope of the securities laws was to bring clarity and predictability to an area of securities law that had been subject to "unpredictable and inconsistent" rules. 561 U.S. at 260. But further clarification of the law is still necessary, especially for off-exchange transactions, because the process of proving the situs of a transaction through *Absolute Activist*'s "irrevocable liability" prong may be feasible, but it is still cumbersome and time-consuming, and does not necessarily give the guidance *Morrison* meant to provide.

Recognition that trades settling through DTC are domestic transactions will clarify this area of the law by making plain to issuers that the choice to use American settlement institutions brings with it the obligations of the American securities laws,

regardless of whether the transactions occur over-the-counter or on an exchange. Conversely, an issuer seeking to avoid application of the US securities laws could choose to settle transactions through a foreign securities settlement institution.

This rule would also match expectations that issuers and investors already have about the scope of the securities laws. One of the major reasons that companies, including many international companies, are drawn to American markets is to access the deep pool of capital available from both American investors and foreign investors who direct their investments here. *See* Howell E. Jackson & Eric J. Pan, *Regulatory Competition in International Securities Markets: Evidence from Europe - Part II*, 3 Va. L. & Bus. Rev. 207, 226-27 (2008). But studies show that investors choose the American markets because they know their investments will enjoy the full panoply of protections available under the federal securities laws.[13]

By choosing DTC to settle their transactions, as opposed to one of the many international securities settlement systems available abroad, issuers are directing their securities to the American market and to investors who reasonably expect to enjoy the protections of the federal securities laws. This is especially true for the Petrobras Notes at issue in this case. Petrobras registered the offerings at issue with

[13] *See*, *e.g.*, Council of Institutional Investors, Morrison v. National Australia Bank: *The Impact on Institutional Investors* 14 & n.84-85 (Feb. 2012), <goo.gl/d3PBu7> (outlining a number of studies showing a "positive connection between investor protection and capital allocation").

exchanges in the United States (A-4779-80), and filed prospectuses for the notes with the SEC. (A-2813; A-2909.) It gave numerous indications in those prospectuses that transactions in Petrobras Notes would be governed by the federal securities laws, informing investors that their interests in the notes would be held within DTC, which is regulated by the Federal Reserve and is located in New York (A-4770); that DTC is regulated as a "clearing agency" under Section 17A of the Exchange Act (A-A-3007); that the notes would be delivered via DTC "against payment in New York;" and that New York law would govern the offerings, (A-2909, A-2834).

An investor with even a cursory understanding of *Morrison*, upon reading these prospectuses, would justifiably expect transactions in Petrobras Notes to be domestic and subject to US securities laws. And any investor looking at a similar prospectus for another company should be entitled to make the same assumption.

A contrary rule, on the other hand, would upset investors' justified expectations, permitting issuers to refuse to honor their tacit agreement to abide by American securities laws through an opportunistic bait-and-switch based on obscurities within the system for settling the trades that no reasonable investor can be expected to understand. This would permit large multinational companies with billions of dollars and assets and revenues in this country to raise substantial funds from investors in America while avoiding the imposition of the US securities laws.

And subjecting investors to such unsettling of expectations would undermine the investor confidence so vital for making the American securities marketplace attractive.

* * *

For all the reasons outlined above, *amici* urge the Court to explicitly hold that all transactions in securities settling at DTC are domestic. This fatally undermines Appellants' objections about the administrability of the two classes of plaintiffs in this case. Even if Appellants' speculations were correct, and certain buyers and sellers of Petrobras Notes negotiated their purchases from outside the United States, there is still no question that for all Petrobras Notes, title transferred, and thus a domestic transaction occurred, when the transactions actually settled in DTC in New York. This provides reason to affirm the decision below even if it was not a ground relied upon in reaching that decision.

CONCLUSION

The Court should explicitly recognize that securities transactions settling through DTC are domestic transactions within the reach of the federal securities laws, and on that basis affirm the certification of two classes of purchasers of Petrobras Notes.

Respectfully submitted,

/s/ J. Carl Cecere

J. Carl Cecere
Counsel of Record
CECERE PC
6035 McCommas Blvd.
Dallas, Texas 75206
(469) 600-9455
ccecere@cecerepc.com

Counsel for Amici Curiae

Joe Kendall
KENDALL LAW GROUP, PLLC
3232 McKinney Avenue,
Suite 700
Dallas, Texas 75204
(214) 744-3000

CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Rule 29(d) of the Federal Rules of Appellate Procedure because this brief contains 6,900 words, excluding the parts of the brief exempted by Rule 32(a)(7)(B)(iii) of the Federal Rules of Appellate Procedure.

This brief complies with the typeface and type-style requirements of Federal Rules of Appellate Procedure 32(a)(5) and 32(a)(6) because the brief has been prepared using Microsoft Word 2013 in 14-point Times New Roman font, which is a proportionately spaced typeface.

/s/ J. Carl Cecere

J. Carl Cecere

CERTIFICATE OF SERVICE

I hereby certify that on September 1, 2016, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Second Circuit using the CM/ECF system, which will send notice of such filing to all counsel who are registered CM/ECT users.

/s/ J. Carl Cecere

J. Carl Cecere