GRANTED

No. 04-1371

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

SHADI DABIT,
Respondent.

**On Writ Of Certiorari
To The United States Court Of Appeals
For The Second Circuit**

BRIEF FOR THE INVESTMENT COMPANY INSTITUTE AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether class actions brought under state law by non-transacting "holders" of securities are precluded by the Securities Litigation Uniform Standards Act of 1998 (SLUSA).

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BRIEF FOR THE INVESTMENT COMPANY INSTITUTE AS AMICUS CURIAE IN SUPPORT OF PETITIONER

The Investment Company Institute (ICI), as *amicus curiae*, respectfully submits that the decision below should be reversed insofar as it holds that state-law "holder" class actions are not precluded by federal law.[1]

INTEREST OF AMICUS

ICI is the national association of the United States investment company industry. ICI's members include mutual funds, closed-end investment companies, exchange-traded funds, and unit investment trusts. ICI's mutual fund members manage more than eight trillion dollars on behalf of 90 million individual investors in nearly half of American households. ICI, *2005 Investment Company Fact Book* 3 & 29, http://www.ici.org/statements/res-/2005_factbook.pdf. Due to their diversification, professional management, and varying investment objectives, mutual funds are the investment vehicle of choice for great numbers of Americans from every walk of life, particularly as they build savings for retirement security. Today, mutual funds make up 43 percent

[1] Pursuant to this Court's Rule 37.6, ICI states that no party's counsel authored this brief in whole or in part, and no person or entity, other than ICI and its members, made a monetary contribution to the preparation or submission of this brief. Counsel of record for both petitioner and respondent have consented to the filing of this brief in letters that have been lodged with the Clerk.

of the \$3.5 trillion in IRAs and about half of the \$2.1 trillion in 401(k) plans. *Id.* at 39 & 41.

ICI members are significant issuers of securities. In recent years, long-term mutual funds have sold more than \$1.4 trillion in new shares annually. *2005 Investment Company Fact Book* 76-77. Unlike other issuers, mutual fund operations are subject to each of the four major federal securities laws. Mutual funds are registered with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940, which subjects them to detailed statutory and regulatory prescriptions regarding their structure, operations, and governance; mutual fund shares must be registered under the Securities Act of 1933; the offer and sale of mutual fund shares are governed by the Securities Exchange Act of 1934; and the investment advisers to mutual funds are regulated under the Investment Advisers Act of 1940. In addition to this comprehensive federal regulation of mutual funds, each State's securities regulator has authority to investigate and bring enforcement actions with respect to fraud and deceit. 15 U.S.C. § 77r(c)(1).

ICI members are also significant purchasers, sellers, and holders of nationally traded securities. On average, ICI members account for 10 percent or more of the annual dollar volume of stock purchases and sales on the U.S. stock exchanges. Moreover, mutual funds hold 22 percent of the outstanding corporate equity in the United States, as well as large amounts of publicly traded debt securities. *2005 Investment Company Fact Book* 6-7.

Since ICI's founding over 60 years ago, one of its main objectives has been to protect and affirmatively advance the interests of mutual fund shareholders through advocacy directed at ensuring a sound legal and regulatory framework for the mutual fund industry. In pursuit of this objective, ICI regularly engages in legislative, regulatory, and other initiatives aimed at increasing government and public awareness of issues affecting investment companies and their shareholders.

STATEMENT

In 1995, Congress enacted the Private Securities Litigation Reform Act (PSLRA) to deter meritless lawsuits alleging securities fraud. *See, e.g.*, H.R. Conf. Rep. No. 104-369, at 31-32 (1995); *In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 978-79 (9th Cir. 1999). Among other significant reforms, the PSLRA imposed new and rigorous pleading requirements for securities fraud actions (15 U.S.C. § 78u-4(b)(1)-(2)) and an automatic stay of discovery until any motions to dismiss have been resolved (15 U.S.C. §§ 77z-1(b) & 78u-4(b)(3)). To avoid the PSLRA requirements, securities plaintiffs increasingly began filing suit in state court, where the PSLRA does not apply. *Riley* v. *Merrill Lynch, Pierce, Fenner & Smith*, 292 F.3d 1334, 1341 n.12 (11th Cir. 2002) ("the decline in federal securities class action suits that occurred after the passage of the PSLRA was accompanied by a nearly identical increase in state court filings"); *see* H.R. Conf. Rep. No. 105-803, at 14 (1998) ("Prior to the passage of the [PSLRA], there was essentially no significant securities class action litigation brought in State court"). These state-court lawsuits presented precisely the opportunities for abuse that Congress had sought to curb by enacting the PSLRA. *Id.* at 13-14.

In response to this widespread evasion of the PSLRA by state-court litigation, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (SLUSA) to "establish[] uniform national rules for securities class action litigation involving our capital markets." H.R. Conf. Rep. No. 105-803, at 13. In so doing, Congress explained that "in order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the [PSLRA], it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities." SLUSA § 2(5), 112 Stat. 3227. To accomplish this goal, SLUSA provides that "[n]o covered class action based upon the statutory or common law of any State . . . may be maintained in any State or Federal court by any private party alleging" misrepresentations or manipulation "in connection with the purchase or sale" of covered securities, including mutual fund shares. 15 U.S.C. §§ 77p(b) & 78bb(f)(1).

SLUSA's description of the class actions within its preclusive reach—*i.e.*, those alleging a "misrepresentation or omission of a material fact," or a "manipulative or deceptive device or contrivance," occurring "in connection with the purchase or sale" of securities—was borrowed from Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, the basic anti-fraud provisions of the federal securities laws. In *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), this Court held that a private plaintiff cannot maintain a Rule 10b-5 action unless the plaintiff is a purchaser or seller of securities. This judicially created rule of standing is "inapplicable," however, in actions to enforce Rule 10b-5 by public prosecutors. *United States* v. *Naftalin*, 441 U.S. 768, 774 n.6 (1979). The question in this case is what relevance, if any, the *Blue Chip Stamps* purchaser/seller standing limitation has to the scope of SLUSA preclusion. Pet. i.

The court below held that "the purchaser-seller rule of [*Blue Chip Stamps*] applies as a limit on SLUSA's 'in connection with' requirement such that SLUSA does not preempt claims that do not allege purchases or sales made by the plaintiff or the alleged class members." Pet. App. 4a. The Seventh Circuit, by contrast, has concluded that "SLUSA is as broad as § 10(b) itself and that limitations on private rights of action to enforce § 10(b) and Rule 10b-5"—including particularly the *Blue Chip Stamps* purchaser/seller standing limitation—"do not open the door to litigation about securities transactions under state law." *Kircher* v. *Putnam Funds Trust*, 403 F.3d 478, 484 (7th Cir. 2005), *cert. pending*, No. 05-409.

SUMMARY OF ARGUMENT

SLUSA provides that class actions alleging securities fraud must proceed in federal court pursuant to the PSLRA, if at all; at the same time, it expressly exempts a number of traditional state-law remedies. The additional extra-statutory exemption for state-law "holder" class actions recognized by the court below is (1) inconsistent with SLUSA's statutory text and structure; (2) unsupported by its legislative history; and (3) unwarranted and unnecessary as a matter of public policy. Accordingly, the decision below should be reversed.

1. The plain language and structure of SLUSA do not support an exemption for state-law "holder" class actions. The "in connection with" requirement of § 10(b) and Rule 10b-5 is met if the alleged misconduct "coincides" with the purchase or sale of securities. *SEC* v. *Zandford*, 535 U.S. 813 (2002). Applying the same construction to SLUSA means that a class action alleging misconduct in connection with *someone*'s purchase or sale of securities is precluded, even if the plaintiff does not have standing to bring a private Rule 10b-5 action under the rule of *Blue Chip Stamps*. One year before SLUSA was enacted, this Court held that the *Blue Chip Stamps* rule is *not* a substantive restriction on the "in connection with" requirement. *United States* v. *O'Hagan*, 521 U.S. 642 (1997). Congress is presumed to have maintained that distinction in SLUSA.

2. Nor does the legislative history support an exemption for state-law "holder" class actions. Congress understood that SLUSA would preclude some cases that could be brought under state, but not federal law. At the same time, it expressly exempted some traditional state-law remedies, including derivative actions. Congress thus struck a careful balance between private enforcement in federal and state courts. The court below upset that balance by recognizing an extra-statutory exemption for "holder" class actions.

3. There is no sound public policy support for exempting state-law "holder" class actions from SLUSA. Although the legislative history is silent as to "holder" class actions, that silence is explained by the fact that such actions were unknown before SLUSA was enacted. They have proliferated since solely as a means to evade the restrictions of the PSLRA. But the whole point of SLUSA was to stop the "flight" of securities litigation to state court. "Holder" suits

are rife with opportunities for abuse and, if allowed to proceed under state law, would harm issuers and investors alike. And they are unnecessary for investor protection, because purchasers and sellers have sufficient recourse to hold wrongdoers accountable in private Rule 10b-5 litigation (in addition to public enforcement proceedings). Allowing non-transacting "holders" to maintain class actions under state law, in short, would contravene the carefully calibrated scheme of securities enforcement established by Congress in the PSLRA and SLUSA.

ARGUMENT

ICI has a uniquely balanced perspective on the issue in this case, because its members identify with both plaintiffs and defendants in securities fraud lawsuits. Precluding "holder" class actions, as ICI advocates, is entirely consistent with the interests of mutual funds and their investors. Investor protection, which is both the overriding goal of the securities laws and one of ICI's central missions, requires reversal of the decision below.

Mutual funds are significant investors, holding almost one-quarter of all outstanding stock of American public companies, and they and their shareholders have a vested interest in robust enforcement of the securities laws to eradicate securities fraud. ICI's members, therefore, approach this case as potential *plaintiffs* (or class members) in securities fraud actions. "Holder" class actions, however, are not necessary to protect mutual funds or their investors from fraud or deceitful conduct, because federal and state securities laws already provide ample recourse against such unlawful conduct. And such actions are rife with opportunities for abuse, to the detriment of both mutual funds and their investors.

Mutual funds are also significant issuers of securities, with trillions of dollars in shares outstanding, and they are regulated, and subject to liability, under the securities laws. ICI's members are thus also interested in the scope of SLUSA preclusion as potential *defendants* in securities fraud lawsuits. Permitting "holder" class actions could significantly harm the interests of mutual funds and their investors. Such actions drive down investment returns by subjecting issuers, including both mutual funds and the companies in which they are invested, to meritless claims that are costly to defend and settle.

In both the PSLRA and SLUSA, Congress struck a careful balance between the interests of investors and the interests of issuers and other market participants. Well-founded private securities litigation may ultimately benefit investors by combating fraud and contributing to good corporate governance, and class action lawsuits can serve as a valuable supplement to public enforcement of the securities laws. H.R. Conf. Rep. No. 104-369, at 31. At the same time, unmeritorious strike suits can adversely impact shareholder returns by forcing companies to spend time and money defending themselves against frivolous claims. *Id.* at 23. In light of such concerns, Congress determined in SLUSA that class actions involving securities fraud should proceed, if at all, in federal court pursuant to the PSLRA, while expressly preserving a number of traditional state-law remedies. H.R. Conf. Rep. No. 105-803, at 13. An additional extra-statutory exemption for state-law "holder" class actions is (1) inconsistent with SLUSA's statutory text and structure; (2) unsupported by its legislative history; and (3) unwarranted and unnecessary as a matter of public policy. Accordingly, the decision below should be reversed.

1. The plain language and structure of SLUSA do not support, much less require, an exemption for state-law "holder" class actions. If alleged misconduct "coincides" with a purchase or sale of securities by someone (including someone other than the plaintiff), then the "in connection with" requirement of Rule 10b-5 is met. *SEC* v. *Zandford*, 535 U.S. 813, 822 (2002). Applying "the normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning" (*Gustafson* v. *Alloyd Co.*, 513 U.S. 561, 570 (1995) (internal quotations omitted)), a lawsuit alleging misconduct that coincides with *someone*'s purchase or sale of securities is pre-

cluded by SLUSA even if the plaintiff does not meet the *Blue Chip Stamps* standing limitation. *Kircher*, 403 F.3d at 484 ("*Blue Chip Stamps* combined with SLUSA may mean that [such claims] must be litigated as derivative actions or committed to public prosecutors, but this is not a good reason to undercut the statutory language"). The contrary conclusion of the court below is irreconcilable with the statutory framework.

The purchaser/seller limitation announced in *Blue Chip Stamps* is a rule of *standing*, not a substantive element of the Rule 10b-5 cause of action. It "does not stem from a construction of the phrase 'in connection with the purchase or sale of any security'" in Rule 10b-5. *Holmes* v. *SIPC*, 503 U.S. 258, 284 (1992) (O'Connor, J., concurring). Rather, it rests on "what may be described as policy considerations," particularly the "danger of vexatiousness" inherent in securities fraud litigation. *Blue Chip Stamps*, 421 U.S. at 737. The Court pointed to two specific dangers: First, even meritless cases have significant settlement value "so long as [the plaintiff] may prevent the suit from being resolved against him by dismissal or summary judgment"; and second, the "potential for possible abuse of the liberal discovery provisions" available to plaintiffs. *Id.* at 740-41. To combat these problems, the Court adopted a rule limiting the class of private Rule 10b-5 plaintiffs to those who had actually purchased or sold securities. *Id.* at 754-55.

The *Blue Chip Stamps* Court recognized that its judicially created standing limitation would prevent some private plaintiffs from bringing a Rule 10b-5 action for conduct that met the *statutory* elements of a § 10(b) violation, including the "in connection with" requirement. 421 U.S. at 738; *see also Chiarella* v. *United States*, 445 U.S. 222, 238 n.* (1980 (Stevens, J., concurring) ("the limitation on the right to recover pecuniary damages in a private action identified in *Blue Chip* is not necessarily coextensive with the limits of [Rule 10b-5] itself"). This does not prevent vigorous enforcement of the securities laws, because the SEC and federal prosecutors can still bring administrative and criminal proceedings against § 10(b) violators.[2]

In *United States* v. *O'Hagan*, 521 U.S. 642 (1997), the Court held unequivocally that the *Blue Chip Stamps* standing limitation does not apply to actions by public officials to enforce § 10(b) and Rule 10b-5. *Id.* at 665 ("Criminal prosecutions do not present the dangers the Court addressed in *Blue Chip Stamps*, so that decision is 'inapplicable' to indictments for violations of § 10(b) and Rule 10b-5") (quoting *Naftalin*, 441 U.S. at 774 n.6). Rather, the statutory "in connection with" element is met if "*someone* buy[s] or sell[s] the security during the period of allegedly fraudulent conduct." Louis Loss & Joel Seligman, *Securities Regulation* 3721 (3d ed. 2004).

The court below "suppose[d] that Congress meant to import the settled [*Blue Chip Stamps*] standing rule along with the 'in connection with' phrase as a substantive standard." Pet. App. 28a. This supposition, however, overlooks the fact that only a year before SLUSA was enacted, this Court had reiterated that the purchaser/seller standing limitation is *not* a substantive aspect of the "in connection with" requirement. *O'Hagan*, 521 U.S. at 665. By expressly incorporating the "in connection with" requirement, but saying nothing of a purchaser/seller limitation, Congress presumably maintained this distinction in SLUSA. *Davis* v. *Mich. Dep't of Treasury*, 489 U.S. 803, 813 (1989) ("When Congress codifies a judicially defined concept, it is presumed, absent an express statement to the contrary, that Congress intended to adopt the interpretation placed on that concept by the courts").

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[2] In 2004 alone, the SEC and state regulators secured roughly $2.5 billion in disgorgement and penalties on behalf of mutual fund shareholders. PricewaterhouseCoopers LLP, *2004 Securities Litigation Study* 18, http://www.10b5.com/-2004_study.pdf.

When Congress wants to adopt a purchaser/seller limitation, it well knows how to do so. *See* Insider Trading & Secs. Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677, 4680-81 (codified at 15 U.S.C. § 78t-1) (limiting statutory right of action to contemporaneous purchasers and sellers). Congress chose not to in SLUSA, instead adopting language that—as authoritatively construed by this Court—expressly precludes state-law actions alleging misconduct that coincides with *someone's* purchase or sale of securities. *O'Hagan*, 521 U.S. at 658 (parallel language of § 10(b) "requires deception 'in connection with the purchase or sale of any security,' *not* deception of an identifiable purchaser or seller") (emphasis added); *see also Carpenter* v. *United States*, 484 U.S. 19, 24 (1987).

In *O'Hagan*, this Court held that the *Blue Chip Stamps* standing limitation is inapplicable to cases that "do not present the dangers" of vexatious litigation that led the Court to adopt the rule. *O'Hagan*, 521 U.S. at 665. SLUSA preclusion obviously does not present these dangers; to the contrary, SLUSA (like the PSLRA before it) was enacted to address precisely the same evils that animated the *Blue Chip Stamps* policy determination. *See Dura Pharms., Inc.* v. *Broudo*, 125 S. Ct. 1627, 1634 (2005). Accordingly, SLUSA should not be circumvented on the basis of a judicially created rule that was designed to ameliorate, not exacerbate, precisely the same concerns that underlie SLUSA preclusion. *Cf. A.C. Frost & Co.* v. *Coeur d'Alene Mines Corp.*, 312 U.S. 38, 41-43 (1941) (refusing to apply a judicially created rule that would hinder the purpose of the securities laws).

2. The decision below is no more faithful to the legislative history of SLUSA than it is to the statutory text and structure. The court below thought that "Congress sought only to ensure that class actions brought by plaintiffs who satisfy the *Blue Chip* purchaser-seller rule are subject to the federal securities laws." Pet. App. 35a. But if that were the case, one might reasonably expect at least one reference to *Blue Chip Stamps*, or the purchaser/seller standing limitation, in the debates that preceded SLUSA's enactment. But there

is none. It does not appear from the record that *Blue Chip Stamps* was even considered, let alone implicitly codified, by any legislator who voted on SLUSA.

The court below nonetheless read SLUSA's legislative history as "suggesting that Congress understood that it was only preempting claims that could have been brought in federal court to begin with." Pet. App. 32a. But SLUSA's legislative history plainly demonstrates precisely the opposite. Members of both the House and Senate recognized that SLUSA would preclude some class actions that might be permissible under state law but could not be brought by a private plaintiff under federal law for a variety of reasons. *See e.g.*, S. Rep. No. 105-182, at 21-22 (1998) (additional views of Sens. Sarbanes, Bryan & Johnson); 144 Cong. Rec. S. 4778, S. 4786 (1998) (ltr. by B. Roper of the Consumer Fed'n of Am., introduced by Sen. Sarbanes); *id.* at S. 4797-98 (statement of Sen. Johnson); 144 Cong. Rec. H. 6052, H. 6056 (1998) (statement of Rep. Stupak); *see also Testimony of U.S. Secs. & Exch. Comm'n Concerning S. 1260, The "Secs. Litig. Uniform Standards Act of 1997" Before the S. Banking Subcomm.*, 105th Cong. 21 (1997) ("Levitt Testimony"), http://www.sec.gov/news/testimony/testarchive/-1997/tsty1997.txt ("Because a number of states allow claims that cannot be brought under federal law, . . . the bill will preclude relief as a practical matter" for some investors).

For example, "there is no aiding-and-abetting liability in private actions for most federal securities fraud claims." Levitt Testimony at 21; *see Cent. Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994). By contrast, "[f]orty-nine states as well as the District of Columbia allow for some form of aiding-and-abetting liability." Levitt Testimony at 21. But a proposed amendment that would have allowed state-law aiding and abetting claims to proceed in federal court was defeated. 144 Cong. Rec. S. 4778, S. 4784 (1998).

Similarly, "private actions under the federal securities laws are subject to a short statute of limitations." Levitt Testimony at 20; *see Lampf, Pleva, Lipkind, Prupis & Petigrow*

v. *Gilbertson*, 501 U.S. 350 (1991) (superseded in part by Pub. L. No. 107-204, Title VIII, § 804(a), 116 Stat. 801 (2002) (codified as amended at 28 U.S.C. § 1658)). "By contrast, 33 states allow for longer limitations periods." Levitt Testimony at 21. Congress rejected a proposed amendment, however, that would have allowed a plaintiff asserting a precluded state law class action to bring a federal claim under the applicable state law statute of limitations. 144 Cong. Rec. at S. 4803.

These two examples show that the court below was simply wrong in concluding that Congress intended SLUSA to preclude only those actions that could be brought under federal law. *Cf.* 144 Cong. Rec. at S. 4805 (statement of Sen. Dodd) (the "purpose of this bill is a uniform standard for . . . nationally traded securities"; "[i]f you are going to apply 50 different statute of limitations you have just destroyed the very purpose of the legislation"). The mere fact that "holder" class actions cannot be brought by private plaintiffs under Rule 10b-5, therefore, does not mean that Congress intended to exempt such actions from SLUSA's preclusive reach. This is confirmed by the fact that Congress considered, and expressly exempted, a number of *other* state-law remedies.

In response to concerns that SLUSA "would eliminate important areas of state corporate law that have long coexisted with—indeed, predate by almost a century—the federal securities laws" (Levitt Testimony at 22), Congress adopted amendments to ensure that certain remedies available under state corporate law would remain available. S. Rep. No. 105-182, at 6. SLUSA exempts actions brought under the law of the State where the issuer is incorporated or organized involving tender offers and communications concerning certain requests for shareholder action (15 U.S.C. §§ 77p(d)(1)(B) & 78bb(f)(3)(A)(ii)), as well as actions under contractual agreements between issuers and indenture trustees (*id.* §§ 77p(d)(3) & 78bb(f)(3)(C)). "These exceptions have become known as the 'Delaware carve-outs.'" *Malone* v. *Brincat*, 722 A.2d 5, 13 (Del. 1998).

In addition to the Delaware carve-outs, SLUSA exempts from its coverage class actions brought by States, political subdivisions, and state pension plans (15 U.S.C. §§ 77p(d)(2) & 78bb(f)(3)(B)), and "exclusively derivative action[s] brought by one or more shareholders on behalf of a corporation" (*id.* §§ 77p(f)(2)(B) & 78bb(f)(5)(C)).[3] SLUSA also limits its class action definition to suits brought on behalf of 50 or more persons, and specifically provides that "a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member." *Id.* §§ 77p(f)(2) & 78bb(f)(5)(B).

The express exemptions that Congress included in SLUSA all contain built-in safeguards against frivolous litigation. For example, derivative litigation requires a threshold showing of merit in order to overcome the demand requirement and judicial scrutiny before settlement. And traditional state corporate law actions must be brought under, and conform to, the law of the state of incorporation. "Holder" class actions, by contrast, have no comparable limitations to protect against abuse; to the contrary, such actions present precisely the dangers that Congress sought to ameliorate by enacting SLUSA and the PSLRA. *See* Joshua D. Ratner, Comment, *Stockholders' Holding Claim Class Actions Under State Law After The Uniform Standards Act of 1998*, 68 U. Chi. L. Rev. 1035, 1058 (2001).

Moreover, the statutory exemptions further demonstrate the careful balance struck by Congress in SLUSA: To ensure

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[3] The statutory exemption for derivative cases is important because most claims brought by non-transacting "holders" are actually derivative in nature. *Schuster* v. *Gardner*, 127 Cal. App. 4th 305 (2005); *Manzo* v. *Rite Aid Corp.*, No. 18451-NC, 2002 Del. Ch. LEXIS 147, *20 (Dec. 19, 2002), *aff'd*, 825 A.2d. 239 (Del. 2003); *Arent* v. *Distrib. Sci., Inc.*, 975 F.2d 1370, 1373 (8th Cir. 1992); *Crocker* v. *FDIC*, 826 F.2d 347 (5th Cir. 1987).

effective enforcement of the securities laws while protecting both companies and investors from abusive litigation, Congress made a series of judgments regarding whether particular claims could be brought in state court or under state law. The court below upset that balance by recognizing an extra-statutory exemption for state-law "holder" class actions. *Cf. Lander* v. *Hartford Life & Annuity Ins. Co.*, 251 F.3d 101, 114 (2d Cir. 2001) ("because Congress delineated certain exceptions to the general preemptive force of SLUSA, [federal courts should be] reluctant to impose additional exceptions, particularly when such exceptions are unsupported by the text, history, or purpose of the statute"). Such judicial second-guessing contravenes the congressional intent underlying SLUSA.

3. Just as nothing in the statute or legislative history requires, or even supports, exempting state-law "holder" class actions from SLUSA preclusion, no sound policy basis exists for recognizing such an exemption. In this regard, it is important to note that in *Blue Chip Stamps* this Court was "free to weigh" policy considerations because "[n]o language" in the statute or regulation "speaks at all to the contours of a private cause of action for their violation." 421 U.S. at 749; *see Holmes*, 503 U.S. at 289-90 (Scalia, J., concurring in the judgment) ("the limitation we approved in *Blue Chip Stamps* was essentially a legislative judgment rather than an interpretive one"). By contrast, the Judiciary has no warrant to rely on policy considerations to change or disregard plain statutory language. *See, e.g., CSX Transp., Inc.* v. *Easterwood*, 507 U.S. 658, 664 (1993) ("If the statute contains an express pre-emption clause, the task of statutory construction must in the first instance focus on the plain wording of the clause").

The court below placed great weight on the fact that the legislative history of SLUSA "contains no specific mention of holding claims," perhaps because "Congress may have been unaware of the existence of state law holding claims." Pet. App. 31a-32a (internal quotation omitted). But silence alone is obviously an insufficient basis for inferring a judicial exemption to a statute that, on its face, precludes "holder" class actions. *See, e.g.*, *Pittston Coal Group* v. *Sebben*, 488 U.S. 105, 115 (1988) ("It is not the law that a statute can have no effects which are not explicitly mentioned in its legislative history"). Even if congressional silence could invite judicial policymaking, however, the policies expressed in the PSLRA and SLUSA provide a clear answer to the question in this case. *See* Pet. App. 29a (recognizing that the persistence of "holder" class actions may undermine the goals of the PSLRA).

Congress's silence on the issue of "holder" class actions is easily explained by the fact that such claims simply were not recognized in any jurisdiction when SLUSA was enacted.[4] A district court subsequently held that securities

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[4] State blue sky laws have always limited relief to transacting shareholders (*see, e.g.*, CCH, Inc., Blue Sky L. Rep. ¶5550 (1997)), and common law "holder" class actions are almost exclusively a post-SLUSA invention. *See WM High Yield Fund* v. *O'Hanlon*, No. 04-3423, 2005 U.S. Dist. LEXIS 12064, *41 (E.D. Pa. May 13, 2005) (noting that no Pennsylvania case had previously addressed the viability of holder claims); *Amzak Corp.* v. *Reliant Energy, Inc.*, No. 03-C0877, 2004 U.S. Dist. LEXIS 16514, *19 n.3 (N.D. Ill. Aug. 18, 2004) (same: Illinois); *Weinstein* v. *Ebbers (In re WorldCom, Inc. Sec. Litig.)*, 336 F. Supp. 2d 310, 319 (S.D.N.Y. 2004) (same: Georgia); *Shirvanian* v. *DeFrates*, No. 14-02-0447-CV, 2004 Tex. App. LEXIS 182, at *47 (Jan. 8, 2004) (same: Texas), *vacated on other grounds*, 161 S.W.3d 102 (Tex. App. 2004); *Rogers* v. *Cisco Sys., Inc.*, 268 F. Supp. 2d 1305, 1312-13 (N.D. Fla. 2003) (same: Florida); *Small* v. *Fritz Cos.*, 30 Cal. 4th 167, 171 (2003) (same: California). The few "holder" class actions that were filed prior to SLUSA were dismissed as meritless. *See Arent*, 975 F.2d 1370; *Crocker*, 826 F.2d 347; *Chanoff* v. *United States Surgical Corp.*, 857 F. Supp. 1011 (D. Conn.), *aff'd*, 33 F.3d 50 (2d Cir. 1994); *Arnlund* v. *Deloitte & Touche LLP*, 199 F. Supp. 2d 461, 486-90 (E.D. Va. 2002). Respondent's reliance on Senator Dodd's statement that SLUSA would pre-

[Footnote continued on next page]

plaintiffs could avoid SLUSA preclusion by suing on behalf of a class of "holders" who could not meet the *Blue Chip Stamps* standing limitation. *Gordon* v. *Buntrock*, No. 00CV303, 2000 U.S. Dist. LEXIS 5977 (N.D. Ill. Apr. 28, 2000). Since then, state-law actions on behalf of "holder" classes have become commonplace. *See* Pet. 17 n.5 (listing cases). Because practically *any* Rule 10b-5 claim can be recast as a "holder" action simply by defining the class to exclude purchasers and sellers, *Gordon* provided a roadmap for securities litigants to evade both SLUSA and the PSLRA.

The whole point of SLUSA was to stop the "flight" of securities litigation to state court as plaintiffs' lawyers sought to avoid the PSLRA. *See* Pet. App. 21a (citing SLUSA § 2, 112 Stat. at 3227). The upsurge in the number of "holder" class actions since SLUSA's enactment plainly reflects continuing "flight." This is particularly troublesome, because "holder" claims present tremendous opportunities for abuse, as recognized by this Court (*Blue Chip Stamps*, 421 U.S. at 734-35, 742) and by those few jurisdictions that have decided to allow them. *See Small* v. *Fritz Cos.*, 30 Cal. 4th 167, 184-85 (2003).[5] Affirmance of the decision below would thus have the perverse effect of allowing the most pernicious category of securities fraud claims to go forward in state

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[Footnote continued from previous page]

serve "traditional state court actions" (Opp. to Pet. for Cert. 13) is thus misplaced: The "holder" class actions at issue here are *not* "traditional" state court actions by any stretch.

5 SLUSA should not be construed to allow States to recognize *new* class action remedies on behalf of "holders" that would allow securities litigants to avoid the strictures of the PSLRA. Indeed, one of the primary motivations for SLUSA was a post-PSLRA California ballot initiative that would have dramatically expanded the state-law remedies for securities fraud. *See* Timothy J. Burger, *New Securities Reform Fight Looms*, The Recorder, Apr. 16, 1997, at 1.

court, free of the PSLRA's protections against abusive litigation—including provisions designed to prevent the exploitation of absent class members. *See* 15 U.S.C. §§ 77z-1(a) & 78u-4(a). Such suits would continue to be filed in "lottery" jurisdictions across the country, leading to *in terrorem* settlements as issuers and other market participants seek to avoid the costs of defense and the risk that "a local judge or jury may produce an idiosyncratic award." *Kircher*, 403 F.3d at 484.

Almost by definition, mutual fund investors are "holders" of securities. Approximately 92 percent of fund shareholders are saving for retirement. *2005 Investment Company Fact Book* 30. "Most shareholders have invested in mutual funds for many years; 70 percent have owned funds for at least 10 years." *Id.* at 31. More than 80 percent of mutual fund investors make *no* sales from their portfolios in a given year. *See* ICI, *Facts About Funds: A Guide To Investment Company Research About Mutual Funds & Mutual Fund Shareholders*, at 4 (2004), http://www.ici.org-/pdf/bro_facts-aboutfunds.pdf. And although periodic purchases by mutual fund investors are common (through retirement contributions or dividend reinvestment, for example), a class can be defined to exclude such purchases. Thus, if "holder" class actions are allowed to proceed under state law, state-law claims could be asserted against mutual funds and their affiliates in virtually any circumstance.

While state-law "holder" class actions pose a very real threat to mutual funds and other issuers (and, ultimately, their shareholders), such lawsuits are not necessary to protect mutual fund shareholders or other investors. ICI's members, with over $8 trillion under management, have seen firsthand the problems for investors caused by abusive class action litigation. ICI supported both the PSLRA and SLUSA because those statutes promote vigorous enforcement of the securities laws while deterring strike suits that serve merely to enrich a few while diluting the returns of ordinary investors. *See, e.g.*, H.R. Conf. Rep. No. 104-369, at 32 ("When an issuer must pay lawyers' fees, make settlement payments, and expend management and employee resources in defending a meritless suit, the issuers' own investors suffer").

"Holder" class actions are not necessary to combat securities fraud because purchasers and sellers have sufficient recourse to hold wrongdoers accountable in private Rule 10b-5 litigation (in addition to public enforcement proceedings). Yet "holder" class actions, while unnecessary, carry enormous potential for abuse—to the detriment of issuers and investors alike. Long-term, buy-and-hold investors favor good corporate governance, predictable regulation, and effective enforcement; but they have no interest in "get rich quick" litigation, which benefits only "those who seek to line their own pockets by bringing abusive and meritless suits." H.R. Rep. No. 104-369, at 31-32. The decision below, if allowed to stand, would only encourage the proliferation of such suits, to the detriment of the investing public.

Congress has already made the *policy* determination in SLUSA that the interests of investors in the national securities markets are generally served by uniform, national standards for class action litigation; at the same time, Congress recognized the importance of certain state law remedies (in addition to public enforcement actions) and drew careful, express exemptions to safeguard them. Allowing non-transacting "holders" of securities to maintain class actions under state law cannot be squared with that carefully calibrated regime. The court below exceeded the proper judicial role in crafting an additional exemption to SLUSA preclusion for state-law "holder" class actions—an exemption that is not supported by the statutory text, its legislative history, or sound public policy. Unless corrected by this Court, America's investors will pay the price for that mistake.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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