

**IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

DAVID KURZ and RAYMOND HEINZL,
Plaintiffs-Appellants,

v.

FIDELITY MANAGEMENT & RESEARCH COMPANY and
FMR CO., INC.,
Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of Illinois
Case No. 3:07-CV-00709-JPG-DGW
The Honorable J. Phil Gilbert

**BRIEF FOR DEFENDANTS-APPELLEES
FIDELITY MANAGEMENT & RESEARCH COMPANY
AND FMR CO., INC.**

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 08-2733

Short Caption: Kurz v. Fidelity Management and Research Co.

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party or amicus curiae, or a private attorney representing a government party, must furnish a disclosure statement providing the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P. 26.1.

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No publicly held company owns 10% or more of the shares of either FMR or FMR Co., Inc.

Attorney's Signature: /s/ Stephen M. Shapiro Date: July 24, 2008

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Attorney's Signature: /s/ Timothy S. Bishop Date: July 24, 2008

Attorney's Printed Name: Timothy S. Bishop

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Attorney's Printed Name: Joshua D. Yount

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Attorney's Signature: /s/ Katherine E. Agonis Date: November 3, 2008

Attorney's Printed Name: Katherine E. Agonis

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Attorney's Signature: /s/ Rebecca R. Jackson Date: July 24, 2008

Attorney's Printed Name: Rebecca R. Jackson

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Attorney's Signature: /s/ James N. Benedict Date: July 24, 2008

Attorney's Printed Name: James N. Benedict

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Attorney's Signature: /s/ Sean M. Murphy Date: July 24, 2008

Attorney's Printed Name: Sean M. Murphy

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STATEMENT CONCERNING ORAL ARGUMENT

Defendants-Appellees Fidelity Management & Research Company and FMR Co., Inc., respectfully request oral argument. This appeal is controlled by existing precedent that required the district court to dismiss plaintiffs' suit pursuant to the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). Nevertheless, plaintiffs assert that they may avoid the preemptive effect of SLUSA by labeling a claim that defendants violated a duty of best execution as a state law contract claim, thereby evading Congress's intent that claims that sound in securities fraud must be litigated in federal court subject to the uniform requirements of federal securities law, including the Private Securities Litigation Reform Act of 1995 ("PSLRA"). Plaintiffs' theory would undermine Congress's purposes in enacting the PSLRA and SLUSA and would have profound adverse consequences for public securities markets. Defendants believe oral argument would assist the Court in reviewing plaintiffs' proposed end-run around the PSLRA and SLUSA.

JURISDICTIONAL STATEMENT

Plaintiffs' jurisdictional statement is not complete and correct because it fails to set forth the basis for the district court's exercise of federal jurisdiction.

Plaintiffs filed this suit in the Circuit Court for St. Clair County, Illinois on September 27, 2007. A29.¹ On October 10, 2007, defendants timely removed the suit to the United States District Court for the Southern District of Illinois under 15 U.S.C. §§ 77p(c) and 78bb(f)(2) on the ground that plaintiffs brought a class action based on state law alleging a misrepresentation or omission of material fact in connection with the purchase or sale of a covered security. Notice of Removal (R. 2). The district court agreed that removal was proper and federal jurisdiction existed under SLUSA (15 U.S.C. §§ 77p(b), (c), 78bb(f)(1), (2)). A65.

Following removal, the district court on June 10, 2008, dismissed the complaint without prejudice under SLUSA. A64. Plaintiffs filed a notice of appeal on July 10, 2008. Notice of Appeal (R. 13). The June 10 judgment is a "final decision," which this Court has jurisdiction to review under 28 U.S.C. § 1291. See *Garratt v. Knowles*, 245 F.3d 941, 945 n.3 (7th Cir. 2001).

STATEMENT OF THE ISSUE PRESENTED

Whether the district court correctly dismissed plaintiffs' complaint as preempted by SLUSA because, in claiming that defendants failed to obtain best execution for securities transactions—a type of claim long understood to sound in securities fraud—plaintiffs alleged that defendants made material misrepresent-

¹ "A__" refers to the Appendix filed with plaintiffs' brief.

ations and omissions and engaged in a fraudulent scheme in connection with the purchase or sale of covered securities.

STATEMENT OF THE CASE

After plaintiff Kurz voluntarily dismissed his original federal court complaint (see A1-A27), plaintiffs Kurz and Heinzl filed the class action complaint here at issue in the Circuit Court of St. Clair County, Illinois. A29. Plaintiffs alleged that defendants Fidelity Management and Research Company and FMR Co., Inc. breached “best execution” obligations “incorporated” in “confirmation agreements” issued by brokers when executing purchases and sales of securities. Compl. ¶¶ 12-13 (A31-A32). Plaintiffs alleged that investors in Fidelity mutual funds (“Fidelity Funds”) were third-party beneficiaries of these best execution duties. *Id.* ¶ 16 (A32). And they further alleged that those duties were violated by an undisclosed “bribery scheme” in which defendants’ individual securities traders were given improper gifts and entertainment by securities broker Jefferies & Co. in exchange for placing securities orders with Jefferies. *Id.* ¶ 18 (A33).

Defendants timely removed the St. Clair County action to the district court. Defendants explained that because plaintiffs’ purported contract claim sounds in fraud it falls within the preemptive scope of SLUSA, triggering SLUSA’s removal provisions codified in 15 U.S.C. §§ 77p(c) and 78bb(f)(2). Notice of Removal (R. 2) at 5-7.

Following removal, the district court concluded that the complaint appeared to fall within SLUSA’s preemptive scope and ordered plaintiffs to show cause why it

should not be dismissed. A48-A63. After full briefing, the court held that SLUSA preempted plaintiffs' case and dismissed it. A64-A73.

STATEMENT OF FACTS

Beginning with the PSLRA in 1995, Congress repeatedly has enacted legislation to rein in abusive securities class action litigation, assuring that class actions involving nationally traded securities are heard in federal court and governed by uniform federal standards. Plaintiffs attempted to circumvent these standards by labeling as a state-law "breach of contract" claim what in reality is a claim of fraudulent misstatements and omissions in connection with securities transactions—a "best execution" claim of the very kind that for decades has been brought under Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b). The fit between plaintiffs' allegations and the elements of a contract claim is so poor as to confirm that their contract claim is a contrivance designed to evade the PSLRA and SLUSA.

In straining to characterize their claim as one for breach of contract, plaintiffs seek to evade safeguards imposed on securities class actions by the federal securities laws, including the PSLRA and SLUSA. Those safeguards include procedural requirements and substantive rules—like the uniform national Section 10(b) statute of limitations and exacting standards for pleading the elements of a Section 10(b) cause of action—that present formidable obstacles to plaintiffs' claim. If merely relabeling a Section 10(b) claim as a "breach of contract" were enough to circumvent federal reforms, Congress's efforts to curb securities class action abuses

would count for nothing. Judge Gilbert correctly determined that SLUSA governs and requires dismissal.

A. The Statutory Framework.

The Supreme Court explained in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739-740 (1975), that the private right of action for securities fraud under Section 10(b) “presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general.” In particular, the Court recognized that, because of the risk of a jury verdict holding a defendant liable for huge losses, “even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success” if the plaintiff is able to “prevent the suit from being resolved against him by dismissal or summary judgment.” *Id.* at 740-741. The threat of costly and disruptive discovery adds a further “*in terrorem* increment” to the settlement value of a suit. *Ibid.*

Accordingly, the Supreme Court limited the scope of private securities actions to curtail their coercive potential and make meritless claims easier “to dispose of before trial.” *Blue Chip Stamps*, 421 U.S. at 742.² Despite these limitations, empirical studies continued to show that “[f]or practical purposes, the merits do not matter” in Section 10(b) class actions. Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 *Stan. L. Rev.* 497,

² See also *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (requiring proof of scienter); *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977) (limiting Section 10(b) to manipulative or deceptive conduct); *Central Bank v. First Interstate Bank*, 511 U.S. 164, 189 (1994) (rejecting aiding and abetting claims under Section 10(b)).

499, 501 (1991) (the risks of large damages awards and the huge cost of litigation meant that trial was not “a practically available alternative” to settlement; and “the strength of the case on the merits has little or nothing to do with determining the amount of the settlement”).

1. The Private Securities Litigation Reform Act of 1995.

Responding to this “significant evidence of abuse” that undermined “American capital markets” and caused “serious injuries to innocent parties” who were “forced to pay exorbitant ‘settlements,’” Congress passed the PSLRA in 1995 to protect “all who are associated with our capital markets from abusive securities litigation.” H.R. Conf. Rep. No. 104-369, at 31-32 (1995). The PSLRA included significant procedural and substantive safeguards against abusive suits, among them:

- A heightened pleading standard that requires plaintiffs to identify each allegedly fraudulent statement, explain why it is fraudulent, and state with particularity facts giving rise to a “strong inference” that the defendant acted with scienter. 15 U.S.C. § 78u-4(b)(2); see *Tellabs, Inc. v. Makor Issues & Rights*, 127 S. Ct. 2499, 2509-2510 (2007).
- A requirement that plaintiffs plead and prove that the fraud actually “caused the loss for which the plaintiff seeks to recover damages.” 15 U.S.C. § 78u-4(b)(4); see *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336 (2005).
- A stay of discovery during the pendency of a motion to dismiss. 15 U.S.C. § 78u-4(b)(3).

- A requirement that each plaintiff file a certification with the complaint, identifying all of the plaintiff's transactions in the securities at issue. 15 U.S.C. § 78u-4(a)(2).

2. The Securities Litigation Uniform Standards Act of 1998.

Before the PSLRA, state law played virtually no role in class action suits involving nationally-traded securities. H.R. Rep. No. 105-640, at 10 (1998). But after the PSLRA went into effect, “[r]ather than face the obstacles set in their path by the Reform Act, plaintiffs and their representatives [brought] class actions under state law, often in state court.” *Merrill Lynch v. Dabit*, 547 U.S. 71, 82 (2006).

To prevent “State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the [PSLRA],” Congress enacted SLUSA. Pub. L. No. 105-353, § 2(5), 112 Stat. 3227, 3227 (codified at 15 U.S.C. § 78a note). SLUSA mandates 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 party alleging,” “in connection with the purchase or sale of a covered security,” either “a misrepresentation or omission of a material fact” or “that the defendant used or employed any manipulative or deceptive device or contrivance.” 15 U.S.C. § 78bb(f)(1); see also *id.* § 77p(b). A “covered class action” is a damages action brought on behalf of 50 or more persons. *Id.* § 78bb(f)(5). A “covered security” is a security that is “traded nationally and listed on a regulated national exchange,” *Dabit*, 547 U.S. at 83, or that, like mutual fund shares, is “issued by an investment company that is registered * * * under the Investment Company Act of 1940.” See

15 U.S.C. § 78bb(f)(5)(E); *id.* § 77r(b)(2); *Kircher v. Putnam Funds*, 403 F.3d 478, 481 (7th Cir. 2005) (“[i]nvestments in mutual funds are ‘covered securities’”), vacated on other grounds, 547 U.S. 633 (2006). Under SLUSA, if such a class action is brought in state court, it may be removed to federal district court and thereafter dismissed. 15 U.S.C. § 78bb(f)(2); see also *id.* § 77p(c).

These provisions sought not only to prevent evasion of the PSLRA, but also to ensure that uniform standards of “federal law, not state law,” would govern class actions alleging securities fraud. *Dabit*, 547 U.S. at 88; see H.R. Conf. Rep. No. 105-803, at 13 (1998) (Congress sought to “establis[h] uniform national rules for securities class action litigation involving our national capital markets”). Especially pertinent here, those standards include the one and two year statutes of limitations (running from inquiry notice) for private securities suits set forth in the securities laws (15 U.S.C. § 77m; 28 U.S.C. § 1658(b)), and exacting requirements for pleading and proving loss causation.

B. The District Court Complaint.

Plaintiff Kurz initially filed a federal class action complaint against Fidelity Management & Research Company and FMR Co., Inc. (collectively, “Fidelity”), which are registered investment advisers that provide advisory services to mutual funds and other clients (but not to individual investors). Compl. ¶¶ 5-6 (A30).³ Kurz

³ Fidelity Management and Research and FMR have investment advisory agreements to manage the investment portfolios of over 300 Fidelity-branded mutual funds (“Fidelity Funds”). The Fidelity Funds are investment companies registered with the SEC under the Investment Company Act of 1940 and the Securities Act of 1933, and offer their shares to the public under these registrations.

asserted that he and the putative class members were investors in mutual funds or other investment portfolios managed by Fidelity. 1st Am. Compl. ¶¶ 4-5 (A5); see 15 U.S.C. §§ 80b-2(a)(11), 80b-3. According to Kurz’s complaint, brokers issued “transaction confirmations” to Fidelity to document execution of securities trades on behalf of Fidelity Funds and other investment portfolios. 1st Am. Compl. ¶¶ 9, 11 (A6-A7). These broker confirmations, mandated by SEC regulation (17 C.F.R. § 240.10b-10), allegedly “incorporated” requirements of the National Association of Securities Dealers (NASD) and New York Stock Exchange (NYSE) that defendants and their brokers obtain “best execution” on behalf of investors. *Id.* ¶¶ 9, 11-12 (A6-A7).⁴ Kurz claimed that these transaction confirmations “form[ed] a binding contract” enforceable by the plaintiff class of investors as “third-party beneficiaries.” *Id.* ¶¶ 9, 12-13, 15 (A6-A8). The breach of contract occurred, Kurz alleged, when Fidelity “directed securities transaction business to [broker Jefferies & Co.] based on payments and gifts” to Fidelity traders, “result[ing] in higher execution costs than would have been realized but for the breaches of their ‘best execution’ obligations.” *Id.* ¶¶ 21-22 (A9).

Kurz asserted federal jurisdiction over his claim under Class Action Fairness Act of 2005 (“CAFA”), 28 U.S.C. § 1332(d)(2). 1st Am. Compl. ¶ 1 (A4). Judge Gilbert

See 15 U.S.C. §§ 77b(a)(1), 77r(b)(2); Compl. ¶ 6 (A30). Each Fidelity Fund is owned by its shareholders and governed by a Board of Trustees, a majority of whom must be unaffiliated with the Fund’s advisers.

⁴ NASD and NYSE rules are part of a comprehensive federal scheme for regulation of the securities industry. They are reviewed and approved by the SEC pursuant to the Securities Exchange Act and are enforced by the NYSE and NASD as well as the SEC. See 15 U.S.C. §§ 78o-3, 78s, 78u(d)-(f).

ordered plaintiffs to show cause why the complaint should not be dismissed pursuant to the exception to CAFA for suits related to a covered security. A19-A26.⁵ The district court also ordered Kurz to address whether, if the court lacked jurisdiction under CAFA, it nevertheless had subject matter jurisdiction pursuant to SLUSA. A25.

C. The State Court Complaint.

Rather than respond to the order to show cause, Kurz voluntarily dismissed his federal suit. A27. The same day, he filed a class action complaint in the Circuit Court of St. Clair County now joined by an additional plaintiff, Raymond Heinzl. A29. That state court complaint, at issue here, was based on the same allegations of breach of contract asserted in the federal complaint Kurz had just dismissed. Plaintiffs alleged an undisclosed “bribery scheme” in which defendants’ individual securities traders were given gifts and entertainment by securities broker Jefferies & Co. in exchange for placing securities orders with Jefferies, in violation of best execution duties. Plaintiffs sought to plead around the CAFA and SLUSA jurisdictional provisions Judge Gilbert had identified. They alleged that because their claim “relates to” securities, it was “carve[d] out” from federal removal jurisdiction under CAFA by 28 U.S.C. § 1332(d)(9)(C). Compl. ¶ 6 (A30). And they sought to escape removal under SLUSA by asserting that the complaint “does not

⁵ CAFA provides that federal diversity jurisdiction exists over class actions in which the amount in controversy exceeds \$5 million and at least one member of the proposed class is a citizen of a different state than any defendant. 28 U.S.C. § 1332(d)(2). Federal jurisdiction does not extend, however, to class actions that “solely” involve a claim concerning a covered security. *Id.* § 1332(d)(9).

allege fraud, misrepresentation, or omission” of any material facts “in connection with the purchase or sale of a ‘covered security.’” *Id.* ¶ 3 (A29).

Plaintiffs stated that they are “former shareholders” in Fidelity Funds and “former clients” of Fidelity. Compl. ¶¶ 4, 24 (A30, A35). They sought to represent a class of persons who were clients of Fidelity or investors in portfolios managed by Fidelity at any time between May 1, 2002 and October 31, 2004, and who liquidated their investments before December 21, 2006. *Id.* ¶ 28 (A35).⁶

Plaintiffs alleged once again that the “standard forms of confirmation agreements” incorporated rules of the NASD and NYSE (now merged and known as FINRA) which required “that Fidelity, FMR, and their executing brokers achieve ‘best execution’ in entering into transactions on behalf of investors like Plaintiffs.” Compl. ¶¶ 12-13 (A31-A32). Plaintiffs did not attach any “confirmation agreement” to their complaint. They did, however, acknowledge that best execution obligations derive not from such “agreements” but from federal securities law and rules promulgated thereunder by self-regulatory organizations that are themselves creatures of federal securities law. See 15 U.S.C. § 78o-3.

Specifically, plaintiffs attached NASD Rule 2320 (as of Nov. 8, 2006), which provided in pertinent part that “[i]n any transaction for or with a customer,” a

⁶ This class definition is apparently meant to include persons who owned Fidelity-managed investment products other than mutual funds. See Pls. Br. 23. Plaintiffs Kurz and Heinzl invested only in Fidelity Funds (see R.11, Brown Aff. ¶ 3) and so lack standing to assert claims of investors in other products (something that would have been revealed had plaintiffs filed the certification that is required by the PSLRA, see p. 7, *supra*). As explained in this brief, SLUSA precludes plaintiffs’ contract claims regardless of whether those claims are asserted on behalf of mutual fund investors or investors in other Fidelity-managed investment products.

“member” of the NASD (*i.e.*, a broker-dealer), “shall use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.” Compl. Ex. A (A38-A39). Plaintiffs also attached to their complaint an NYSE Information Memo, “*Best Execution*” Obligations (Feb. 5, 1997). Compl. Ex. B (A40). That NYSE Memo—citing SEC guidance—stated that the SEC “has emphasized that it is the fiduciary responsibility of broker-dealers to seek the most favorable terms reasonably available under the circumstances in order to achieve the best execution for a customer’s transaction.” *Ibid.* Neither document governs the defendants, which are registered investment advisers, not broker-dealers or members of the NYSE or NASD. See p. 8 & n. 3, *supra*.

Plaintiffs further alleged that they and other investors in Fidelity Funds “rely upon” best execution duties “[i]n deciding to invest in portfolios managed by Fidelity and FMR.” Compl. ¶ 15 (A32). And they claimed that investors in Fidelity Funds and Fidelity-managed accounts were the “intended third-party beneficiaries” of confirmation “agreements” incorporating these best execution obligations. *Id.* ¶ 16 (A32). They asserted that, in a “tawdry bribery scheme,” Fidelity breached those confirmation agreements whenever it sent execution business to broker Jefferies & Co. based on payments and gifts its traders received from Jefferies. *Id.* ¶¶ 17-23 (A33-A34). Plaintiffs claimed that they and the class “were unaware of Defendants’ wrongful conduct.” *Id.* ¶ 22 (A34). They sought unspecified “excess execution costs” as damages. Compl. ¶ 38 (A37).

D. The District Court’s Decision Dismissing Plaintiffs’ Complaint Under SLUSA.

After defendants removed the St. Clair County action to federal court under SLUSA (Notice of Removal (R. 2) at 5-7), Judge Gilbert dismissed plaintiffs’ breach of contract suit “because SLUSA precludes a plaintiff from maintaining a securities fraud class action based on state law.” A66-A67. Plaintiffs conceded that some of the conditions for the applicability of SLUSA were satisfied—that their suit is a “covered class action” that rests on state law, and that Fidelity Funds shares and the securities the Funds traded were “covered securities.” A70, A72 & n.2. The district court held that plaintiffs’ suit also satisfied the other two SLUSA conditions—that the suit alleges “a misrepresentation or omission of material fact” that occurred “in connection with the purchase or sale of a covered security.” A73.

1. The district court held that plaintiffs allege material misrepresentations and omissions.

Judge Gilbert held that plaintiffs in substance allege both an omission and a misrepresentation of material facts. “Plaintiffs allege that they were ‘unaware’ of the bribery scheme. In other words, Fidelity and FMR had a conflict of interest which they failed to disclose to their clients, including Plaintiffs.” A71; see Compl. ¶ 22 (A34). And “the [best execution] contracts contained a misrepresentation” that defendants and Jefferies promised to supply best execution when “neither party to the contract ever had any intention of fulfilling [the] term[s] of the contracts.” A71. “This is so,” the court explained, because “according to Plaintiffs’ Complaint, at the time they entered into the Agreement, Defendants and Jefferies both knew that the

contract had been awarded to Jefferies based, not on who would deliver the ‘best execution,’ but on the bribes given by Jefferies” to Fidelity traders. *Ibid.*

2. The district court also held that plaintiffs’ allegations satisfy the “in connection with” requirement.

A misrepresentation or omission occurs “in connection with” the purchase or sale of securities, Judge Gilbert observed, “whenever it ‘coincides with a securities transaction—whether by the plaintiff or someone else.’” A71 (quoting *Dabit*, 547 U.S. at 85). The court held that plaintiffs’ allegations satisfied this requirement in two separate ways.

First, the misrepresentations and failure to disclose “coincide” with plaintiffs’ purchase of shares in Fidelity mutual funds because plaintiffs alleged that they relied on defendants’ “contractual and industry duties” to seek best execution “[i]n deciding to invest in portfolios managed by Fidelity.” A72; see *ibid.* (“Plaintiffs invested in Defendants’ mutual funds because they believed Defendants’ material misstatements as to how Defendants went about choosing transaction brokers”); Compl. ¶ 15 (A32).

Second, “Defendants’ material misstatements coincide with Jefferies’ purchases and sales of securities in the mutual funds’ underlying portfolios.” A72. In fact, “[t]he purchase and sale of securities was at the heart of the [alleged] scheme” because “the transactions were the machinery through which Jefferies collected its commissions,” which was “[t]he goal of the alleged bribery scheme.” *Ibid.* Because plaintiffs brought in the guise of a contract suit what is in fact a

“securities class action lawsui[t] alleging fraud,” Judge Gilbert dismissed plaintiffs’ complaint. A68.

E. The Settlement of the SEC’s Fraud Case Against Fidelity.

While this case was pending in the district court the SEC and Fidelity entered into a settlement agreement, accompanied by a cease-and-desist order, which shows that the “best execution” violations alleged by plaintiffs give rise to an omission and misrepresentation claim under the federal securities laws. *In re Fidelity Management & Research Co. & FMR Co., Inc.*, SEC Release No. IA-2713 (Mar. 5, 2008) (“SEC Order”), available at <http://www.sec.gov/litigation/admin/2008/ia-2713.pdf>.⁷

The SEC framed these same factual allegations as an omission and misrepresentation claim. The agency alleged—in findings that Fidelity neither admitted nor denied—that Fidelity engaged in fraudulent omissions and misrepresentations pertaining to its duty as “an investment adviser * * * to seek best execution for its clients’ securities transactions” when “Fidelity allowed certain employees’ receipt of travel, entertainment and gifts * * * to enter into the selection of brokers” but “failed to disclose” that those factors affected Fidelity’s selection of brokers for its clients’ transactions. SEC Order ¶¶ 20-22; see also *id.* ¶¶ 63, 73-78, 95-96 (statements by Fidelity that it selected brokers based on best execution were “materially false and misleading,” and it “failed to disclose” a “material conflict of

⁷ This Court may take judicial notice of the SEC’s order. See *Menominee Indian Tribe v. Thompson*, 161 F.3d 449, 456 (7th Cir. 1998); *Ezra Charitable Trust v. Tyco Int’l*, 466 F.3d 1, 9 n.7 (1st Cir. 2006) (taking judicial notice of SEC complaint).

interest that influenced the traders’ selection of brokers”). Based on these allegations, the SEC charged that Fidelity violated Section 206 of the Investment Advisers Act, 15 U.S.C. § 80b-6, which—like Section 10(b), upon which it was modeled—prohibits an investment adviser from engaging in “fraudulent” and “deceptive” conduct.

The Commission further stated that the report of a former federal judge to the independent trustees of the Fidelity Funds concluded that “it is impossible to ‘prove’ statistically that the traders’ receipt” of gifts resulted “in excessive execution costs for the Funds,” but that there was a possibility that it did so. SEC Order ¶ 87. It noted that Fidelity had agreed to pay the Funds \$42 million plus interest upon the independent trustees’ recommendation. *Id.* ¶¶ 90-91. The Commission found that Fidelity also had taken remedial actions, disciplining employees, changing its policies and procedures as to conflicts of interest, enhancing management oversight of trading operations, and substantially increasing funding for ethics compliance. *Id.* ¶ 92.

SUMMARY OF ARGUMENT

I. Plaintiffs allege violations of the duty of best execution that for decades have been recognized by the courts and the SEC to sound in securities fraud. *E.g.*, *Newton v. Merrill Lynch*, 135 F.3d 266, 269-270 (3d Cir. 1998) (en banc); *In re Sage Advisory Servs.*, SEC Release No. IA-1954, 75 SEC Docket 1073 (July 27, 2001). Consistent with that history, the SEC in its own action against Fidelity asserted that the very conduct alleged by plaintiffs—that the Fidelity traders’ receipt of gifts

improperly influenced their choice of brokers to execute securities transactions—constituted fraud and deceit involving material misrepresentations and omissions. Plaintiffs therefore “could have brought [their best execution claims] directly under Rule 10(b) in federal court.” *Kircher v. Putnam Funds*, 403 F.3d 478, 484 (7th Cir. 2005), vacated on other grounds, 547 U.S. 633 (2006). Transforming causes of action that typically “have been filed in federal court under Rule 10b-5” into state law claims is “the very sort of maneuver that SLUSA is designed to prevent.” *Ibid.*

Plaintiffs protest that they allege only breach of contract and that their complaint disavows any intent to allege the elements of securities fraud. But it is settled law that plaintiffs cannot escape SLUSA simply by affixing the label “breach of contract” to their allegations or making self-serving assertions that they do not allege securities fraud. Instead, it is the substance of the complaint that controls whether SLUSA applies—“the conduct alleged, not the words used to describe the conduct.” *Kutten v. Bank of Am.*, 530 F.3d 669, 671 (8th Cir. 2008), petition for cert. filed (No. 08-333) (Sept. 10, 2008). The conduct plaintiffs challenge here—failure to provide best execution—is a quintessential example of securities fraud.

Plaintiffs’ complaint—with its allegations of a “tawdry bribery scheme” that violated “industry duties” and caused “unaware” investors to “rely” to their detriment—confirms that this is not a real contract case. In fact, it is utterly incoherent as a suit in contract. The alleged best execution contracts are agreements between the Fidelity defendants and broker Jefferies—yet according to plaintiffs the contracts required Fidelity to send execution business to a broker

other than Jefferies. The alleged contracts were in the form of transaction confirmations sent by Jefferies to Fidelity—yet by the time a confirmation was issued the transaction to which it related had by definition already been completed. And the “contracts” allegedly incorporated best execution obligations that the NYSE and NASD impose on broker-dealers—yet the defendants are registered investment advisers, not broker-dealers or members of the NYSE or NASD, and as such are not subject to these NYSE and NASD rules. Moreover, the excess costs that plaintiffs claim as damages would have been paid by the Fidelity Funds, making the only appropriate action a derivative one, not an investor class action. See *Kircher*, 403 F.3d at 484 (“claims of the sort plaintiffs want to pursue must be litigated as derivative actions or committed to public prosecutors”). Finally, plaintiffs concede that the duty of best execution exists independent of contract. It arises from the federal securities laws they seek to evade.

Plaintiffs struggle to transform this securities fraud suit into a contract case because they cannot satisfy critical requirements of the Section 10(b) cause of action. For example, plaintiffs could not satisfy Section 10(b)’s two year statute of limitations—triggered by inquiry notice—because reports of Fidelity’s involvement in the conduct plaintiffs challenge appeared in the national media two-and-a-half years before plaintiffs filed their complaint. Nor could they plead or prove loss causation under the PSLRA’s demanding standard. Plaintiffs’ complaint incorporates by reference the conclusion of an independent investigation that there is “an absence of proof of diminished execution quality” resulting from the

misconduct plaintiffs' allege (Pl. Br. 16; A41), and plaintiffs fail to identify any excess costs they supposedly paid. Plaintiffs' attempt to evade these standards by calling their claim one for breach of contract is precisely what SLUSA is designed to prevent.

II. Turning to the statutory elements of SLUSA preemption, the district court correctly held that plaintiffs' complaint in substance alleges material omissions and misrepresentations in connection with the purchase and sale of covered securities. The complaint expressly alleges that Fidelity made a material omission when it failed to disclose that its equity traders accepted gifts in exchange for placing orders with a broker, contrary to Fidelity's best execution obligations. Compl. ¶ 22 (A34). Under federal securities law an investment adviser ordinarily has a duty to disclose conflicts of interest to investors, and failure to do so may be a material omission under Section 10(b). *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 194, 200 (1963); *Monetta Fin. Servs. v. SEC*, 390 F.3d 952, 955-956 (7th Cir. 2004).

Plaintiffs also explicitly claim that they were deceived by a representation that Fidelity would provide best execution for investors in Fidelity Funds, when Fidelity in fact intended to choose brokers not on the basis of best execution but instead on the basis of bribes received. Compl. ¶¶ 12-15, 22 (A31-A32, A34). As Judge Gilbert held, a promise made with an intent not to perform is a misrepresentation covered by Section 10(b). *Wharf (Holdings) Ltd. v. United Int'l Holdings*, 532 U.S. 588, 596-597 (2001); *Newton*, 135 F.3d at 274.

Plaintiffs further allege facts showing that the omissions and misrepresentations occurred in connection with purchases and sales of securities. SLUSA’s “in connection with” requirement is broadly construed and requires only that a fraud coincide with or touch upon a securities transaction. *Merrill Lynch v. Dabit*, 547 U.S. 71, 85 (2006); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971). Plaintiffs claim that they relied upon the supposed best execution “contracts” when they purchased shares in Fidelity Funds, and that those “contracts” took the form of a broker’s confirmation that *securities trades* for Fidelity Funds had been completed. *Id.* ¶¶ 8, 10, 12-13, 15 (A30-A32). These allegations easily satisfy the “in connection with” standard.

III. Plaintiffs urge a narrow interpretation of SLUSA. But the Supreme Court held in *Dabit* that the Act must be given broad preemptive scope to achieve Congress’s goal of ensuring that securities fraud actions are brought in federal court subject to uniform federal law. By seeking relief under a fabricated state law theory, plaintiffs’ suit poses the very dangers that led to SLUSA’s enactment: evasion of federal limits on securities fraud class actions that Congress adopted to deter strike suits, development of lax and variable state law standards that would interfere with national markets for securities, and wasteful, duplicative litigation. Plaintiffs’ artful pleading does not save their suit from SLUSA; it confirms that SLUSA applies.

STANDARD OF REVIEW

Whether plaintiffs’ complaint was properly removed and dismissed under SLUSA is a question of law that turns on the allegations in the complaint. The

district court's ruling is reviewed de novo, as is its interpretation of SLUSA. *Riley v. Merrill Lynch*, 292 F.3d 1334, 1336 (11th Cir. 2002); *Disher v. Citigroup Global Mkts.*, 419 F.3d 649, 651 (7th Cir. 2005), vacated on other grounds, 548 U.S. 901 (2006).

ARGUMENT

I. PLAINTIFFS' BEST EXECUTION ALLEGATIONS ARE QUINTESSENTIAL EXAMPLES OF SECURITIES FRAUD CLAIMS UNDER SECTION 10(B) AND RULE 10B-5, SQUARELY COVERED BY SLUSA.

"SLUSA," this Court observed in *Kircher*, "uses the same language as § 10(b) and Rule 10b-5," with the result that SLUSA preemption of state law claims applies whenever plaintiffs "could have brought [their claims] directly under Rule 10b-5 in federal court" or "the SEC [could] maintain an action under § 10(b) and Rule 10b-5." 403 F.3d at 483-484. Other courts agree that "SLUSA's coverage follows the contours of Section 10(b) and Rule 10b-5," because both Section 10(b) and SLUSA apply to material omissions or misrepresentations made in connection with the purchase or sale of securities. *Siepel v. Bank of America*, 526 F.3d 1122, 1127 (8th Cir. 2008); *Boyce v. AIM Mgmt. Group*, 2006 WL 4671324, at * 6 (S.D. Tex. Sept. 29, 2006) (SLUSA preempts "all permutations of fraud that 'coincided' with securities transactions"); *Prager v. Knight/Trimark Group*, 124 F. Supp. 2d 229, 235 (D.N.J. 2000) (SLUSA applies whenever "plaintiff has pleaded what are, in essence, securities fraud claims"). SLUSA's legislative history confirms that the Act's goal is to ensure that claims that could be brought as securities fraud are "maintained

pursuant to the provisions of Federal securities law, in Federal court.” H.R. Rep. No. 105-803, at 13.

The question here, then, is whether plaintiffs’ best execution claim “is a securities fraud wolf dressed up in a breach of contract sheep’s clothing.” *Felton v. Morgan Stanley Dean Witter*, 429 F. Supp. 2d 684, 687, 693 (S.D.N.Y. 2006); see A59. The answer plainly is “yes.” “Best execution” claims like plaintiffs’ can be and typically are brought under Exchange Act Section 10(b) and Rule 10b-5 and are precisely the sort of claims SLUSA was designed to cover. See *Kircher*, 403 F.3d at 482 (“SLUSA can do its job only if [it] covers those claims that engage Rule 10b-5 (and thus come within the [PSLRA]) if presented directly under federal law”).

In determining whether a complaint sounds in securities fraud the labels plaintiffs deploy are not controlling. Courts uniformly hold that “SLUSA preemption is based on the conduct alleged, not the words used to describe the conduct.” *Kutten*, 530 F.3d at 671; see also *Miller v. Nationwide Life Ins. Co.*, 391 F.3d 698, 702 (5th Cir. 2004) (SLUSA preclusion “hinges on the content of the allegations—not on the label affixed to the cause of action”); *Anderson v. Merrill Lynch*, 521 F.3d 1278, 1286 (10th Cir. 2008) (SLUSA precludes state law claims that in substance allege federal securities fraud “regardless of how artfully or cleverly plaintiffs attempt to plead them”). Accordingly, plaintiffs’ characterization of their best execution claim as one for “breach of contract” is not determinative. It

is, the district court recognized, “the substance rather than the form of a claim” that counts. A70.⁸

Similarly, plaintiffs’ boiler-plate statement that they “d[o] not allege fraud, misrepresentation, or omission of any material facts * * * in connection with the purchase or sale of a ‘covered security,’” besides being incorrect, is insufficient to evade SLUSA. Compl. ¶ 3 (A29). See *Segal v. Fifth Third Bank*, 2008 WL 819290, at *4 (S.D. Ohio Mar. 25, 2008) (SLUSA applies even though plaintiffs “specifically allege that their claims are not based upon any misrepresentation, or failure to disclose, or fraudulent scheme”); *Boyce*, 2006 WL 4671324, at * 6 (such disclaimers are “illusory”). Plaintiffs’ disclaimer states a legal conclusion that carries no weight. *County of McHenry v. Ins. Co.*, 438 F.3d 813, 818-819 (7th Cir. 2006); *Hickey v. O’Bannon*, 287 F.3d 656, 658 (7th Cir. 2002).

Applying these well-settled legal standards, courts readily have concluded that SLUSA preempts suits for “breach of contract” that are in essence securities fraud claims. *E.g.*, *Miller*, 391 F.3d at 702 (SLUSA precluded a breach of contract claim by an annuity buyer against a seller who allegedly issued a prospectus containing misleading information about trading fees); *Kutten*, 530 F.3d at 671

⁸ Plaintiffs are wrong in suggesting (at 12-13) that this Court adopted a different rule in *Kircher*. In deciding that SLUSA preempted market-timing claims, this Court observed that the plaintiff did not “assert that a mutual fund broke a promise.” 403 F.3d at 483. But it did not purport to give blanket immunity from SLUSA to all claims styled “breach of contract.” *Kircher* merely acknowledged that a simple broken promise does not involve the fraud and deceit necessary to trigger SLUSA. As we explain below, plaintiffs here assert best execution violations that are quintessentially the subject of securities fraud claims and that were therefore properly dismissed under SLUSA.

(SLUSA preempted claim that defendant bank breached a contract when it transferred trust assets to a mutual fund owned by the bank; “without allegations of deceptive and misleading conduct,” the claim was “empty”); *Rowinski v. Salomon Smith Barney*, 398 F.3d 294, 299 (3d Cir. 2005); *Felton*, 429 F. Supp. 2d at 687, 693. Similarly, when state law breach of fiduciary duty allegations could support a Section 10(b) claim, courts hold that SLUSA is satisfied and the claim is dismissed. *Siepel*, 526 F.3d at 1124-1127; *Anderson*, 521 F.3d at 1285; *Prof'l Mgmt. Assocs. Employees' Profit Sharing Plan v. KPMG*, 335 F.3d 800, 802-803 (8th Cir. 2003); *In re NYSE Specialists Sec. Litig.*, 405 F. Supp. 2d 281, 307 (S.D.N.Y. 2005), *aff'd in part and vacated in part as to other issues*, 503 F.3d 89 (2d Cir. 2007).

Looking to the substance of plaintiffs’ “breach of contract” complaint here, Judge Gilbert correctly concluded that it sounds in securities fraud, resting on allegations of material omissions and misrepresentations made in connection with transactions in mutual fund shares and in securities purchased or sold by mutual funds. Decades of judicial and SEC precedent confirm that the gravamen of best execution claims is securities fraud. Indeed, the SEC found that the very conduct that forms the basis of plaintiffs’ suit involved fraudulent omissions and misrepresentations. The contrived nature of plaintiffs’ contract allegations confirms the obvious: that plaintiffs tried to twist their best execution claims into a breach of contract cause of action because they cannot satisfy essential requirements for a federal securities fraud class action.

A. Best Execution Claims Are Securities Fraud Claims That Should Be Brought Under Section 10(b) And Rule 10b-5.

Longstanding judicial and administrative precedent recognizes that a plaintiff may bring best execution claims under Section 10(b) and Rule 10b-5. The Third Circuit explained in *Newton* that the duty of best execution requires broker-dealers to “seek to obtain for [their] customer orders the most favorable terms reasonably available under the circumstances.” 135 F.3d at 270; see Disclosure of Order Execution and Routing Practices, SEC Release No. 34-43590, 65 Fed. Reg. 75,414, 75,431-32 (Dec. 1, 2000); SEC Div. of Mkt. Reg., *Market 2000* V-2 to V-3 (1994). The court observed that “a broker-dealer, by accepting an order without price instructions, impliedly represents that the order will be executed in a manner consistent with the duty of best execution.” 135 F.3d at 269. Accordingly, “a broker-dealer who accepts such an order while intending to breach that duty makes a misrepresentation that is material to the purchase or sale.” *Ibid.* The en banc court concluded that the plaintiff customers could maintain a Section 10(b) claim against broker-dealers on their theory that “defendants’ acceptance of the [plaintiffs’] orders was reasonably understood as a representation that they would not be executed at the [National Best Bid and Offer] price when better prices were reasonably available elsewhere.” *Id.* at 271; see also *Sinclair v. SEC*, 444 F.2d 399, 400-401 (2d Cir. 1971) (failure to provide best execution violated Section 10(b)). For purposes of SLUSA, no meaningful distinction can be drawn between the Section 10(b) cause of action for securities fraud in *Newton* and plaintiffs’ best execution allegations in this case.

Many other decisions have ruled that best execution claims may be brought under Section 10(b) and so are preempted by SLUSA. In the *NYSE Specialists Securities Litigation*, for example, plaintiffs brought state law breach of fiduciary duty claims against specialists in stocks traded on the NYSE, alleging that the specialists violated their obligation to “obtain best execution by matching transactions and crossing customer orders,” where possible, without “interposition[ing] themselves between matching offsetting orders.” 405 F. Supp. 2d at 291. Because the gravamen of plaintiffs’ allegations was defendants’ “fail[ure] to disclose material facts concerning the conduct of the specialists” that violated their duty of best execution—claims that could have been brought under Section 10(b)—the court dismissed those claims under SLUSA. *Id.* at 307-308; see also *Pearce v. UBS Paine Webber*, 2003 WL 25518056, at *14 (D.S.C. Nov. 4, 2003) (a state law best execution claim alleging broker-dealer failed to disclose markups and commissions on trades could have been litigated under Section 10(b) and so was covered by SLUSA).

The SEC also treats failure to provide best execution as a violation of Section 10(b). The agency has approved *Newton’s* premise that the duty of best execution entails a representation that the broker-dealer will execute trades in a way that maximizes the customer’s economic gain. See Regulation NMS, SEC Release No. 34-51808, 70 Fed. Reg. 37,496, 37,538 & n.340 (June 29, 2005) (“If the broker-dealer intends not to act in a manner that maximizes the customer’s benefit when he accepts the order and does not disclose this to the customer, the broker-dealer’s

implied representation is false”). It also has characterized a violation of the duty of best execution as an omission of material fact under Section 10(b). See *Market 2000*, at V-2 & n.10 (“failure to * * * provide sufficient disclosure in the absence of best execution has resulted in violations of the antifraud provisions of the federal securities laws”; “[t]ypically, best execution cases * * * have been brought as omissions of material fact under Section 17(a)(2) of the Securities Act of 1933 and Sections 10(b) and 15(c)(1) and Rules 10b-5(b) and 15c1-2(b) of the Exchange Act”).

Accordingly, the Commission for decades has brought best execution claims under Section 10(b). *E.g.*, *Sage Advisory*, 75 SEC Docket 1073 (investment advisor violated Section 10(b) by having client pay excess commissions to generate soft dollar payments, in breach of best execution duties); *In re Edgemont Asset Mgmt.*, SEC Release No. 34-29326, 50 S.E.C. 592 (June 18, 1991) (broker aided and abetted violations of Section 10(b) by interposing a broker-dealer, resulting in failure to obtain “best price and execution” for client); *In re Del. Mgmt.*, SEC Release No. 34-8128, 43 S.E.C. 392 (July 19, 1967) (managers of mutual fund violated Section 10(b) by interposing brokers, resulting in higher brokerage costs, where prospectus represented that funds sought most favorable executions).

“Given the expertise of the SEC” and “the confidence the Congress has placed in the agency,” its determination that best execution claims fall within Section 10(b), and therefore within SLUSA, is entitled to great deference. *Gordon v. NYSE*, 422 U.S. 659, 689-690 (1975); see also *SEC v. Zandford*, 535 U.S. 813, 819-820 (2002). Congress is presumed to have known about and approved this consistent

line of judicial and administrative precedent when it passed SLUSA. *Dabit*, 547 U.S. at 85-86; *Cannon v. Univ. of Chi.*, 441 U.S. 677, 696-699 (1979).

B. The SEC Charged That The Best Execution Violations That Are Also The Subject Of Plaintiffs' Complaint Constituted Securities Fraud.

The SEC's analysis of the very conduct underlying plaintiffs' complaint confirms that the complaint is in reality one for securities fraud. Based on findings that Fidelity neither admitted nor denied, the SEC charged that Fidelity violated Section 206 of the Investment Advisers Act, 15 U.S.C. § 80b-6, when it "failed to disclose" the "conflicts of interest arising from the receipt by certain Fidelity executives and traders" of gifts from Jefferies, and also when it made "materially false and misleading statements" that it "selected brokers for its clients' transactions based on [best execution] factors but failed to include the additional significant factors considered by certain traders," namely, the receipt of improper gifts from brokers. SEC Order ¶¶ 20-22.

Because the Fidelity defendants are investment advisers governed by the Investment Advisers Act, rather than broker-dealers, the SEC chose to bring its "best execution" charges against defendants under Section 206 rather than under Section 10(b) of the Exchange Act. Section 206, however, was modeled on Section 10(b), and like Section 10(b) prohibits "fraud and deceit." See 8 Louis Loss & Joel Seligman, *SECURITIES REGULATION* 3953-3954 (rev. 3d ed. 2004) (Section 206, modeled on the antifraud prohibitions of Securities Act § 17(a), Securities Exchange Act § 10(b), and Rule 10b-5, prohibits investment advisers from engaging "in any

transaction, practice, or course of business which operates as a fraud or deceit upon any client”). Accordingly, whether brought under Exchange Act Section 10(b) or Investment Adviser Act Section 206, the SEC’s charges show that the essence of best execution claims like plaintiffs’ is securities fraud. See *Sage Advisory*, 75 SEC Docket 1073; *In re Founders Asset Mgmt.*, SEC Release No. IA-1879, 72 SEC Docket 1627 (June 15, 2000); *In re Smirlock*, SEC Release No. IA-1393, 51 S.E.C. 849 (Nov. 29, 1993) (all finding that best execution violations involved misrepresentations or omissions prohibited by Section 206).⁹

C. Plaintiffs’ Contrived Contract Claim Confirms That Securities Fraud Is The Essence Of Their Complaint.

Plaintiffs now pretend (at 14) that their complaint simply alleges that they “contracted for a service (best execution), they did not receive that service, and they have been damaged.” But their complaint tries to construct a breach of contract claim by pointing to transaction confirmations that a broker-dealer sent to Fidelity, which plaintiffs allege impliedly incorporated NYSE and NASD rules requiring broker-dealers to provide best execution to their customers. The complaint alleges that plaintiffs were the third party beneficiaries of these implied “confirmation agreements,” which were supposedly breached when factors other than best

⁹ There is no “in connection with” requirement under Section 206, but “when there is a securities transaction” involved, Section 10(b) of the Exchange Act provides an additional cause of action for fraud prohibited by Section 206. Loss & Seligman, *supra*, at 3954. Thus, by charging a violation of Section 206 here, the SEC equated the failure to seek best execution with a “fraud or deceit” within the meaning of Section 206 and, by extension, Section 10(b) as well.

execution played a part in Fidelity's selection of brokers. Compl. ¶¶ 18, 20, 22-23 (A33-A34).

As a contract claim, these allegations are incoherent. First, the alleged "confirmation agreements" are between executing broker Jefferies and Fidelity. But plaintiffs allege that the implied best execution terms of these agreements required Fidelity to send its execution business not to Jefferies but to a different broker. Second, these "confirmation agreements" are confirmations sent by Jefferies to Fidelity to document an executed securities transaction. But by the time Jefferies issued such a confirmation, the transaction had by definition already been completed. Third, these "confirmation contracts" allegedly incorporated best execution obligations that the NASD and NYSE impose on broker-dealers. But defendants are registered investment advisers, not broker-dealers, and as such are not subject to these rules. Fidelity was in fact the customer of the broker-dealer, Jefferies.

It makes no sense to claim that Fidelity is bound by an implied contract to adhere to rules of self-regulatory organizations that on their face do not apply to investment advisers, or that an agreement implied after a securities transaction was completed would require Fidelity to have placed the transaction with a broker other than the one who already executed it. This Alice-in-Wonderland construct makes even less sense when it is realized that plaintiffs elsewhere in their complaint allege that Fidelity had an "industry" duty of best execution independent of any contract with Jefferies. Compl. ¶ 15, A32. See *Bell Atl. Corp. v. Twombly*, 127

S. Ct. 1955, 1974 (2007) (claim must be “plausible on its face” to survive dismissal motion).

There is additional incoherence in plaintiffs’ insistence (at 6-7, 15-17) that while it was Fidelity that contracted with Jefferies to provide plaintiffs with best execution, it was individual “rogue” brokers who caused breaches of those contracts. In fact, the complaint expressly alleges that “Defendants” Fidelity and FMR Co., not “individual brokers,” engaged in the misconduct that forms the basis of the suit. *Id.* ¶¶ 22-23 (A34). Plaintiffs’ “rogue broker” theory, moreover, is senseless because a corporation can act only through its agents. *E.g., Peterson v. Sealed Air Corp.*, 902 F.2d 1232, 1237 (7th Cir. 1990).

Plaintiffs’ assertion that they are entitled to enforce “confirmation agreements” between Fidelity and Jefferies as third-party beneficiaries is also legally deficient. Under Illinois law only a party expressly identified in a contract is entitled to bring a breach of contract claim as a third-party beneficiary. *Altevoigt v. Brinkoetter*, 421 N.E.2d 182, 187 (Ill. 1981); *Paukovitz v. Imperial Homes*, 649 N.E.2d 473, 475 (Ill. App. 1995); *McCoy v. Ill. Int’l Port Dist.*, 778 N.E.2d 705, 712 (Ill. App. 2002). Plaintiffs nowhere allege that the contracts identify third-party beneficiaries. Nor do plaintiffs allege that the agreements were undertaken for their *direct* benefit, a fatal omission because an “incidental benefit is not a sufficient basis” for a third-party beneficiary claim. *Paukovitz*, 649 N.E.2d at 475.

Moreover, because any “breach of contract” injury from the alleged failures of best execution would have been to the Fidelity Funds, plaintiffs’ remedy would be

limited to a derivative action on behalf of the Funds (which, given the Board's prior comprehensive review and response to the conduct alleged, see p. 16, *supra*, would have been unnecessary and redundant). See *Tooley v. Donaldson, Lufkin & Jenrette*, 845 A.2d 1031, 1039 (Del. 2004) (to bring a direct action, a shareholder must show "direct injury * * * independent of any alleged injury to the corporation"); *Kircher*, 403 F.3d at 484 ("claims of the sort plaintiffs want to pursue must be litigated as derivative actions or committed to public prosecutors").

In short, plaintiffs' contract claim is an effort to pound a square peg into a round hole. Best execution claims against investment advisers are really claims of securities fraud under Section 10(b) and Rule 10b-5. It is only because plaintiffs do not want to face the procedural and substantive burdens imposed by the federal securities laws that they tried to transform their claim into a breach of contract claim. The asserted breach of contract theory simply does not fit best execution claims that courts and the SEC have long recognized are grist for litigation under Section 10(b) and Rule 10b-5.

D. Plaintiffs Seek To Evade The Requirements Of Federal Securities Law Because They Mandate Dismissal Of Plaintiffs' Best Execution Claims.

Plaintiffs' defective contract suit is a transparent effort to circumvent standards governing securities fraud claims that would have defeated this suit had it been brought under Section 10(b)—"the very sort of maneuver that SLUSA is designed to prevent." *Kircher*, 403 F.3d at 484. For example, the statutes of limitations for any securities fraud claims had run by the time plaintiffs first filed

suit in August 2007. After a plaintiff discovers or should have discovered facts constituting a violation, he has one year to bring suit under the Securities Act and two years to bring suit under the Securities Exchange Act. 15 U.S.C. § 77m; 28 U.S.C. § 1658(b); *DeBenedictis v. Merrill Lynch*, 492 F.3d 209, 215-216 (3d Cir. 2007). Press reports of defendants' involvement in the conduct plaintiffs allege appeared across the nation by December 2004, two-and-a-half years before plaintiffs acted, making a securities fraud suit time-barred. *E.g.*, Beth Healy & Andrew Caffrey, *Fidelity Fines 14 Traders Amid Probe*, Boston Globe, Dec. 17, 2004, at A1; Susanne Craig et al., *Fidelity Traders May Catch Heat from Gift Probe*, Wall St. J., Dec. 10, 2004, at C1; Jenny Anderson, *On Wall Street, A Closer Look At Giving Gifts*, N.Y. Times, Nov. 24, 2004, at C1.

In federal court under federal securities law, plaintiffs' best execution claims also would be dismissed for failure to plead loss causation. See 15 U.S.C. § 78u-4(b)(4). Plaintiffs never even identify the particular Fidelity Funds in which they invested or when they bought and sold—as the PSLRA requires lead plaintiffs to do (15 U.S.C. § 78u-4(a)(2))—much less allege the excess costs they supposedly paid. Nor do they offer any reason to think that they actually suffered a loss caused by defendants' alleged misconduct. In fact, their complaint “incorporates by reference a December 21, 2006 letter from E.C. Johnson 3d, the Chairman of the Fidelity Board of Trustees” (Pls. Br. 16) explaining that independent investigators found “an absence of proof of diminished execution quality” resulting from the misconduct plaintiffs allege. A41; see SEC Order ¶ 87. The complaint never links defendants'

alleged misconduct to any undisclosed fees or any reduction in the value of Fidelity Funds, a common stumbling block in suits against mutual fund managers. See, e.g., *In re Salomon Smith Barney Mut. Fund Fees Litig.*, 441 F. Supp. 2d 579, 589-591 (S.D.N.Y. 2006); *In re Morgan Stanley & Van Kampen Mut. Fund Sec. Litig.*, 2006 WL 1008138, at *8-*10 (S.D.N.Y. Apr. 18, 2006); *Castillo v. Dean Witter Discover & Co.*, 1998 WL 342050, at *5 (S.D.N.Y. June 25, 1998).

If successful, plaintiffs' effort to evade the PSLRA and SLUSA by thinly disguising their securities fraud claims would frustrate Congress's efforts to curb abusive securities fraud class actions and establish uniform national standards for securities fraud suits. See Part III, *infra*.

II. PLAINTIFFS ALLEGE MATERIAL MISREPRESENTATIONS AND OMISSIONS IN CONNECTION WITH SECURITIES TRANSACTIONS, WHICH FALL SQUARELY WITHIN SLUSA.

After carefully analyzing the allegations of the complaint and the requirements of SLUSA, Judge Gilbert concluded that plaintiffs' complaint in substance alleges material omissions and material misrepresentations made in connection with the purchase or sale of securities and so must be dismissed under SLUSA. A69-A73; see *LaSala v. Bordier et Cie*, 519 F.3d 121, 141 (3d Cir. 2008) (SLUSA applies when "an allegation of misrepresentation in connection with a securities trade, implicit or explicit, operates as a factual predicate to a legal claim"), petition for cert. filed (No. 08-168) (Aug. 7, 2008); *Behlen v. Merrill Lynch*, 311 F.3d 1087, 1096 (11th Cir. 2002) (SLUSA applies when plaintiff "implicitly alleged that the defendants failed to disclose material facts" in connection with

securities transactions); accord *Prof'l Mgmt. Assocs.*, 335 F.3d at 803. That ruling was correct in every respect.

A. Plaintiffs Allege Material Omissions And Misrepresentations.

1. The complaint alleges that Fidelity failed to disclose that it selected Jefferies to execute securities trades on the basis of bribes, not best execution.

Plaintiffs explicitly allege that “[a]t all times relevant” they and the “Plaintiff class were unaware of Defendants’ wrongful conduct” in “direct[ing] securities transaction business to Jefferies based on payments and gifts” to Fidelity traders, “in b[r]each and total disregard of their ‘best execution’ obligations.” Compl. ¶ 22 (A34). “In other words,” the district court explained, defendants “had a conflict of interest which they failed to disclose.” A71.

This allegation that Fidelity failed to disclose a material conflict of interest that thwarted best execution is a fraudulent omission allegation. Under the Investment Advisers Act an adviser has “an affirmative duty of ‘utmost good faith and full and fair disclosure of all material facts’” and “[f]ailure to disclose material facts must be deemed fraud or deceit within [the Act’s] intended meaning.” *Capital Gains Research*, 375 U.S. at 194, 200; see *Monetta*, 390 F.3d at 955-956 (adviser had a duty to disclose that it allocated shares of initial public offerings to directors of its mutual fund clients; failure to disclose amounted to “fraud or deceit”).

In addition, an investment adviser’s failure to disclose a conflict of interest may be an actionable omission under Section 10(b). See *Vernazza v. SEC*, 327 F.3d 851, 860 (9th Cir. 2003) (investment advisers “had a duty to disclose any potential

conflicts of interest accurately and completely”; failure to do so violated Section 10(b)); *Market 2000 V-2 & n.10* (best execution cases are “[t]ypically * * * brought as omissions of material fact under” Section 10(b)). In *Felton*, for example, the court dismissed under SLUSA a complaint alleging that defendant breached a contractual obligation to follow NYSE and NASD rules when its securities analysts issued opinions tainted by conflicts of interest, because the allegedly undisclosed conflicts were “a quintessential example of a fraudulent omission of a material fact under the federal securities laws.” 429 F. Supp. 2d at 687, 693.

A duty to disclose may also arise when there is “an inaccurate, incomplete, or misleading prior disclosure.” *Winer Family Trust v. Queen*, 503 F.3d 319, 329 (3d Cir. 2007). Rule 10b-5 requires disclosure of material facts “necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.” 17 C.F.R. § 240.10b-5. Because plaintiffs here allege that Fidelity promised to provide investors with best execution, Fidelity’s alleged failure to reveal that best execution was compromised by a conflict of interest would potentially have been a breach of these duties too.

Because plaintiffs maintain that Fidelity did not disclose its supposedly self-interested procedure for selecting brokers, contrary to its federal law obligation to provide best execution, they have alleged a material “omission” for purposes of the securities laws.

2. The complaint also alleges that Fidelity misrepresented that it would choose brokers based on their ability to provide best execution.

Judge Gilbert properly held that in addition to alleging a material omission, plaintiffs in substance allege a material misrepresentation. Plaintiffs say that *before* the issuance of the transaction confirmations that supposedly embodied Fidelity's best execution obligations, and even though defendants "knew that the practice * * * was improper and unlawful and contrary to their 'best execution' obligations," defendants directed securities transaction business to Jefferies based on payments and gifts to Fidelity traders, "in b[r]each and total disregard of their 'best execution' obligations." *Id.* ¶ 22 (A34).

Entering an agreement with the intent not to fulfill it, the Supreme Court has held, is not a simple breach of contract but a fraud. *Wharf (Holdings) Ltd. v. United Int'l Holdings*, 532 U.S. 588, 596-597 (2001). The Supreme Court therefore upheld a finding of liability under Section 10(b) against a defendant who sold an option to purchase stock "while secretly intending from the very beginning not to honor the option." *Ibid.* Similarly, in *Newton*, 135 F.3d at 274, the en banc Third Circuit determined that allegations of best execution violations stated a claim under Section 10(b) because defendants' implicit representation that they would execute orders to maximize plaintiffs' economic benefit was false "*at the time it was made*" when defendants "intended to execute the plaintiffs' orders at the [National Best Bid and Offer] price even if better prices were reasonably available."

In short, as Judge Gilbert recognized (A71), the federal securities laws distinguish between breaking a promise, which is a simple breach of contract, and making a promise without any intention to keep it, as plaintiffs allege here, which inherently involves a misrepresentation. And plaintiffs admit that this misrepresentation was directed to investors and was material to them. See Compl. ¶ 15 (A32) (“investors like Plaintiffs * * * rely upon * * * the obligation of ‘best execution’” when “deciding to invest in portfolios managed by Fidelity”).

3. Plaintiffs’ argument that they do not allege material omissions and misrepresentations is meritless as a matter of law.

Plaintiffs simply ignore their own allegations that Fidelity failed to disclose material information. And they advance legally defective arguments about the misrepresentation issue. To begin with, plaintiffs (at 11) cite this Court’s decision in *United States v. Montana*, 199 F.3d 947, 950 (7th Cir. 1999), for the proposition that a promise is a “performative utterance” that does not assert anything to be true or false. But, as the Supreme Court explained in *Wharf*, every promise is accompanied by an implied assertion of “good faith,” including the intention to perform. 532 U.S. at 596. That assertion, unlike a performative utterance, makes a “truth claim.” See *Montana*, 199 F.3d at 950. That is why a promise made while harboring a “secret reservation” is a material misrepresentation. *Wharf*, 532 U.S. at 596.¹⁰

¹⁰ The complaint alleges just such a secret reservation. The alleged statement plaintiffs label a “performative utterance” here—that Fidelity “would select execution brokers on the basis of the most favorable practicable execution costs” (Pls. Br. 12)—would have been misleading in light of the complaint’s allegations

Plaintiffs also criticize the district court for “speculating” that Fidelity did not intend to provide best execution when it contracted with Jefferies. That ruling, however, reflects plaintiffs’ own allegations. Br. 6, 15-18. The “contracts” plaintiffs invoke are transaction confirmations sent by the executing broker *after* a transaction was complete to confirm that it took place. The only logical reading of plaintiffs’ allegations is thus that when those agreements were made, Fidelity was already well aware that it had placed the trade with Jefferies based on bribes and not best execution. No “speculation” was necessary to reach that conclusion.

Plaintiffs further contend (at 10, 18) that their “impliedly asserted * * * ‘false promises’” would be “actionable only if [they were] alleged to be the scheme employed to accomplish the fraud,” which plaintiffs deny is the case. In support, plaintiffs cite cases addressing the common-law cause of action for promissory fraud under Illinois law. *Ibid.*; see *Ass’n Benefit Servs. v. Caremark Rx*, 493 F.3d 841, 853 (7th Cir. 2007). But whether plaintiffs adequately pleaded a claim for promissory fraud under Illinois law is irrelevant to the district court’s determination—confirmed by the SEC’s position with regard to the same underlying facts—that plaintiffs could have brought this case as one for federal securities fraud, which is the controlling issue under SLUSA. *Wharf* and *Newton* show there is no “scheme” requirement in federal securities law. Beyond this, plaintiffs allege that false promises of best execution were a central part of an undisclosed and continuing scheme to defraud and mislead them. See Compl. ¶ 15 (A32).

that Fidelity actually intended to place execution business on the basis of gifts and favors. *E.g.*, Compl. ¶ 18 (A33).

B. Plaintiffs Allege Material Omissions And Misrepresentations In Connection With The Purchase And Sale Of Securities.

Judge Gilbert also correctly ruled that SLUSA’s “in connection with” standard is easily satisfied in this case. The Supreme Court has “espoused a broad interpretation” of SLUSA’s requirement that omissions or misrepresentations occur “in connection with the purchase or sale of a covered security” (*Dabit*, 547 U.S. at 85), mirroring its holding that Section 10(b)’s identical “in connection with” provision “must be read flexibly, not technically and restrictively.” *Bankers Life*, 404 U.S. at 12. An expansive interpretation, the Court observed, serves SLUSA’s vital purpose of preventing state-law actions from frustrating the objectives of the PSLRA. *Dabit*, 547 U.S. at 86; see Part III, *infra*. Accordingly, “[i]t is enough that the fraud alleged ‘coincide’ with” or “touch” a securities transaction, “whether by the plaintiff or by someone else.” *Id.* at 85; *Bankers Life*, 404 U.S. at 12-13.

Applying these principles, Judge Gilbert correctly held that the misconduct plaintiffs allege coincided with and touched upon *both* mutual fund purchases by Fidelity customers and trades of portfolio securities by Fidelity mutual funds executed through Jefferies. A71-73.

1. Plaintiffs allege material omissions and misrepresentations in connection with securities trades on behalf of Fidelity Funds.

Plaintiffs do not even acknowledge, much less challenge, the district court’s ruling that defendants’ alleged omissions and misstatements coincided with purchases and sales of portfolio securities by Fidelity Funds. Plaintiffs have therefore waived any challenge to that ruling. *United States v. Dabney*, 498 F.3d

455, 460 (7th Cir. 2007) (an argument “not raised or developed in the opening brief * * * is waived”). For that reason alone, this Court should affirm the district court’s conclusion that the alleged fraud occurred “in connection with” a securities transaction.

Waiver aside, the district court correctly discerned that the purchase and sale of portfolio securities by the Funds is “at the heart of the scheme complained of by Plaintiffs.” A72. According to plaintiffs, defendants failed to obtain best execution by selecting Jefferies to execute securities transactions for Fidelity Funds based on gifts to Fidelity personnel. Compl. ¶ 22 (A34). Those securities transactions consummated the alleged scheme to withhold best execution. They were also the source of Jefferies’ commissions (in exchange for which gifts were allegedly given to Fidelity traders) and of plaintiffs’ alleged injuries (in the form of allegedly higher execution costs for securities trades). *Id.* ¶¶ 21, 23, 38 (A34, A37). Securities transactions thus are a necessary and integral part of the alleged scheme. They are its “machinery,” as the district court aptly noted. A72.

When a securities transaction “consummates” a fraud, the fraud certainly “coincides” with and “touches” the transaction. See *United States v. O’Hagan*, 521 U.S. 642, 656 (1997) (trading on misappropriated information consummates fraud and satisfies the “in connection with” requirement). The same is true when securities transactions are necessary to make an alleged scheme work, the allegations concern relationships the “very purpose of which is trading in securities,” or securities trading is what gives rise to the plaintiffs’ claimed

damages. *Rowinski*, 398 F.3d at 302-303. Because the portfolio trades by Fidelity Funds exhibit all these characteristics, there can be no doubt that plaintiffs allege fraud “in connection with” those trades.

Contrary to plaintiffs’ assertion (at 25), an alleged deception does not have to concern the value of a security to meet the “in connection with” requirement. “[N]either the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of [Section 10(b)].” *Zandford*, 535 U.S. at 820; see also *SEC v. Jakubowski*, 150 F.3d 675, 679-680 (7th Cir. 1998). It thus does not matter that defendants’ alleged omissions and misrepresentations do not directly concern prices or other characteristics of the securities traded by the Fidelity Funds.

That conclusion is confirmed by decisions addressing other types of “trading process” claims, of which best execution claims are only one variety. Such claims allege fraud concerning trading terms and duties rather than the characteristics of particular securities, and numerous courts have found them to satisfy the “in connection with” requirement. *E.g.*, *Siepel*, 526 F.3d at 1124, 1126-1127 (SLUSA applies to claims of investment steering); *Miller*, 391 F.3d at 702 (SLUSA applies to allegations of undisclosed transaction fees); *Behlen*, 311 F.3d at 1094 (SLUSA applies to claims of excessive fees); *Angelastro v. Prudential-Bache Sec.*, 764 F.2d 939, 942-944 (3d Cir. 1985) (Section 10(b) applies to claims concerning margin terms); *Costello v. Oppenheimer & Co.*, 711 F.2d 1361, 1368 (7th Cir. 1983) (Section 10(b) applies to churning claims); *Rabin v. JPMorgan Chase*, 2007 WL 2295795, at

*7 (N.D. Ill. Aug. 3, 2007) (SLUSA applies to claims of unauthorized trading and excessive fees).

It also makes no difference that Fidelity Funds, rather than plaintiffs, bought and sold these securities. Plaintiffs have no claim except as shareholders in Fidelity Funds, so can hardly be heard to complain that the Funds' actions are irrelevant. And the "identity of the plaintiffs" does not control whether a fraud was "in connection with" a securities transaction: "it is enough that the fraud alleged 'coincide' with a securities transaction—*whether by the plaintiff or by somebody else.*" *Dabit*, 547 U.S. at 85, 89 (emphasis added). After all, the federal government's ability to bring charges under Section 10(b) "does not depend on proof that [it] purchased or sold securities; instead the 'in connection with' language ensures that the fraud occurs in securities transactions rather than some other activity." *Kircher*, 403 F.3d at 483.

2. Plaintiffs allege material omissions and misrepresentations in connection with transactions in Fidelity mutual funds shares.

The district court also was correct in ruling that the alleged fraud occurred "in connection with" purchases of mutual fund shares by Fidelity customers. Plaintiffs claim that "[i]n deciding to invest in portfolios managed by Fidelity and FMR" investors "rely upon contractual and industry duties designed to protect their interests including the obligation of 'best execution.'" Compl. ¶ 15 (A32). In other words, plaintiffs and other investors bought Fidelity Funds shares because they believed an alleged misstatement that defendants would secure best execution.

When a misstatement induces a securities transaction, the transaction coincides with the misstatement. *Angelastro*, 764 F.2d at 944-945; *Jakubowski*, 150 F.3d at 679; *Sofonia v. Principal Life Ins.*, 465 F.3d 873, 879-880 (8th Cir. 2006); *United Int'l Holdings v. Wharf (Holdings) Ltd.*, 210 F.3d 1207, 1221 (10th Cir. 2000), *aff'd*, 532 U.S. 588 (2001); *Instituto De Prevision Militar v. Merrill Lynch*, 2008 WL 4723777, at *8-*9 (11th Cir. Oct. 29, 2008). Plaintiffs' reliance allegation thus compels the conclusion that defendants' supposed misconduct occurred "in connection with" the purchase of Fidelity Funds shares. Plaintiffs' prayer to recover the share value lost to excess execution costs confirms the closeness of that connection. *Rowinski*, 398 F.3d at 301-303.

Relying on *Gavin v. AT&T Corp.*, 464 F.3d 634 (7th Cir. 2006), plaintiffs argue that the "in connection with" requirement is not met because their purchases of Funds shares preceded Fidelity's failure to supply best execution. *Gavin* is readily distinguishable. It involved efforts by AT&T to complete the administrative task of exchanging shares of a company that had merged with AT&T six months earlier. *Id.* at 637. The plaintiff alleged that, long after the merger, AT&T misleadingly represented that shareholders would have to pay for the exchange, when it was possible to obtain a free exchange. *Id.* at 637-638. This Court held that SLUSA did not preempt state law fraud claims because the fraudulent representations were not made "in connection with" the sale of shares in the merger. *Id.* at 638. All sales had occurred at the time of and on the terms set by the merger, even if shares were not physically exchanged until later. *Ibid.* Shareholders had not been "induced by

fraudulent representations” to vote for the merger; the alleged fraud was not “traceable to something that occurred before the sale was complete”; and the issues in the case had “nothing to do with” any “concern of federal securities law.” *Id.* at 638-640.

Here, by contrast, plaintiffs cannot escape their own allegation that they and other putative class members were “induced by fraudulent representations” to buy Fidelity Funds shares. *Gavin*, 464 F.3d at 638; Compl. ¶ 15 (A32). And even if plaintiffs’ purchases of shares preceded the period of Fidelity’s alleged misconduct, putative class members and other investors made purchases during that period which, based on plaintiffs’ reliance allegation, would have been “induced by fraudulent representations” about best execution. That those purchases coincided with Fidelity’s alleged misconduct is enough to satisfy the “in connection with” requirement. See *Dabit*, 547 U.S. at 89 (SLUSA preempted claims by “holders” who made purchases prior to an alleged fraud, because other investors traded while the fraud was going on); *Instituto De Prevision Militar*, 2008 WL 4723777, at *7-*9 (SLUSA preempted claims for post-investment theft where fraud induced investment).

Furthermore, the “breach of contract” plaintiffs allege is directly “traceable to” Fidelity’s supposed fraudulent representations. *Gavin*, 464 F.3d at 639. According to the complaint, the third-party beneficiary rights that plaintiffs allegedly possess under the Fidelity-Jefferies “contracts” arise because plaintiffs bought Fidelity Funds shares in reliance on Fidelity’s best execution obligations.

Compl. ¶¶ 15-16 (A32). Those fraudulently induced securities transactions thus are integral to the “contract” plaintiffs want to enforce and the alleged “breach” they attack. It is all part of the same alleged fraud, which is enough to satisfy the “in connection with” requirement. *Zandford*, 535 U.S. at 822 (“It is enough that the scheme to defraud and the sale of securities coincide”).

Finally, misstatements regarding efforts to obtain best execution certainly are a “concern of federal securities law.” *Gavin*, 464 F.3d at 640. That is why the SEC, NASD, and NYSE have all issued rules and other pronouncements on the subject. That is why the SEC instituted administrative proceedings against Fidelity based on the conduct underlying plaintiffs’ complaint. And that is why the SEC and the courts have long recognized that best execution failures sound in securities fraud. Neither *Gavin* nor the fact that plaintiffs’ purchases preceded the alleged failure to supply best execution saves plaintiffs’ claims from SLUSA preemption.¹¹

¹¹ Citing *French v. First Union Securities*, 209 F. Supp. 2d 818 (M.D. Tenn. 2002), plaintiffs attempt to analogize their case to “broker selection” cases that, they say, do not involve frauds “in connection with” a securities transaction. But many cases hold that misstatements affecting broker selection occur “in connection with” securities transactions when they induce an investment. *E.g.*, *Mfrs. Hanover Trust v. Drysdale Sec. Corp.*, 801 F.2d 13, 20, 21-22 (2d Cir. 1986); *Marbury Mgmt. v. Kohn*, 629 F.2d 705, 710 (2d Cir. 1980); *Cinicolo v. Morgan Stanley*, 2004 WL 2848542, at *3-*6 (S.D.N.Y. Dec. 9, 2004). And this Court has held that broker selection frauds meet the virtually identical “in connection with” requirement under the Commodity Exchange Act. *Hirk v. Agri-Research Council*, 561 F.2d 96, 103-104 (7th Cir. 1977). *French*—which predates *Dabit*—ignored all this law and also incorrectly concluded that misstatements must pertain to the particular securities involved, a proposition conclusively refuted by *Zandford*, 535 U.S. at 819-820. Beyond that, plaintiffs’ core allegation is that Fidelity did not obtain best execution, which is a trading process, not a broker selection claim, and one long held to satisfy the “in connection with” requirement. See pp. 25-28, 42-43, *supra*.

In short, plaintiffs' arguments that Fidelity's alleged misconduct did not occur "in connection with" purchases of Fidelity mutual fund shares are frivolous. The district court correctly held that those purchases, as well as the Funds' purchases of portfolio securities, satisfy the "in connection with" requirement and thus bring the omissions and misrepresentations plaintiffs allege within the scope of SLUSA.

III. PLAINTIFFS' ARGUMENT RESTS ON A NARROW READING OF SLUSA THAT WOULD THWART CONGRESS'S PURPOSE.

Citing cases involving different removal statutes with different goals, plaintiffs urge that SLUSA should be interpreted narrowly and any doubts resolved in favor of state court jurisdiction over plaintiffs' state law claim. Br. 8. But the Supreme Court has held that "the particular concerns that culminated in SLUSA's enactment" show that "Congress envisioned a broad construction" of the Act. *Dabit*, 547 U.S. at 86. "A narrow reading" runs "contrary to SLUSA's stated purpose." *Ibid*. Likewise, the few "tailored exceptions to SLUSA's pre-emptive command"—for example for actions brought by state agencies or state pension plans and suits to enforce agreements between an issuer and indenture trustee (15 U.S.C. § 77p(d), § 78bb(f)(3))—show that it is "inappropriate for courts to create additional, implied exceptions." *Dabit*, 547 U.S. at 87-88.

SLUSA is therefore to be construed broadly to effectuate important federal policies in an area in which "[t]he magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated." *Dabit*, 547 U.S. at 78. Those federal policies prevent state

class action suits grounded in securities fraud “from being used to frustrate the objectives of the [PSLRA]” and establish “national standards for securities class action lawsuits involving nationally traded securities.” 15 U.S.C. § 78a note. Allowing plaintiffs’ suit to proceed would defeat both of those goals.

A. Allowing Plaintiffs’ State Contract Suit To Proceed Would Frustrate The Objectives Of The PSLRA.

Congress determined in 1995 that the securities “class-action device was being used to injure ‘the entire U.S. economy’” through “nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and ‘manipulation by class action lawyers of the clients whom they purportedly represent,’” which among other ills “resulted in extortionate settlements, chilled any discussion of issuers’ future prospects, and deterred qualified individuals from serving on boards of directors.” *Dabit*, 547 U.S. at 81. The PSLRA introduced numerous substantive and procedural safeguards designed to curb these abuses, described at pp. 6-7, *supra*.

The PSLRA’s imposition of these “special burdens” had an “unintended consequence.” *Dabit*, 547 U.S. at 82. Plaintiffs’ counsel “began bringing class actions under state law, often in state court” to avoid the PSLRA’s requirements. *Id.* at 82, 88; see H.R. Conf. Rep. No. 105-803, at 14-15. Congress quickly enacted SLUSA “[t]o stem this ‘shif[t] from Federal to State courts’” and thereby prevent state law actions “‘from being used to frustrate the objectives of the Reform Act.’” *Dabit*, 547 U.S. at 82; see *Kircher*, 403 F.3d at 482, 484 (“SLUSA is designed to prevent plaintiffs from migrating to state court in order to evade rules for federal securities

litigation in the [PSLRA],” “in the hope that a local judge or jury may produce an idiosyncratic award”); H.R. Conf. Rep. No. 105-803, at 13.

Permitting plaintiffs to frame best execution claims as state law breach of contract class actions would thoroughly undermine Congress’s efforts to deter securities strike suits and blackmail settlements. Indeed, it would magnify those problems as plaintiffs forum-shopped for friendly state court venues where the settlement pressures on a defendant are greatest. See <http://www.atra.org/reports/hellholes>. “SLUSA can do its job only if [it] covers those claims that engage Rule 10b-5 (and thus come within the 1995 statute) if presented directly under federal law.” *Kircher*, 403 F.3d at 482. There are a host of judicial and administrative remedies available to investors that more efficiently vindicate the policies underlying the securities laws than state contract suits, and there is no reason for this Court to allow evasion of the PSLRA’s safeguards by artful pleading.

B. Allowing Plaintiffs’ State Contract Suit To Proceed Would Expose National Securities Markets To Duplicative Litigation With Inconsistent Results.

When the same facts alleged in a breach of contract complaint could also be alleged as the basis for a securities fraud claim, as here, “[t]he prospect is raised * * * of parallel class actions proceeding in state and federal court, with different standards governing claims asserted on identical facts”—a prospect that the Supreme Court has held “squarely conflicts with the congressional preference for ‘national standards for securities class action lawsuits involving nationally traded securities.’” *Dabit*, 547 U.S. at 86-87.

“[D]iffering federal and state standards” applied to the securities and mutual funds industries would threaten liability that “cannot easily be evaluated in advance” or “assessed when a statement is made.” S. Rep. No. 105-182, at 3 (1998). And, Congress concluded, no “single state” should be able to “impose the risks and costs of its peculiar litigation system on all national issuers.” H.R. Conf. Rep. No. 105-803, at 15. All these liability risks and litigation costs of state court class actions could “distor[t] the efficient operation” of the national securities markets. S. Rep. No. 105-182, at 5.

Nothing could be more destructive of Congress’s policy that securities class actions “must be maintained pursuant to the provisions of Federal securities law, in Federal court” than to encourage the end-run that plaintiffs seek here. H.R. Rep. No. 105-803, at 13. As Representative Bliley, the House Manager for SLUSA, explained, “lawsuits alleging violations that involve securities that are offered nationally belong in Federal court.” 144 Cong. Rec. 26,007 (1998); see *Kircher*, 403 F.3d at 484 (“securities class actions must proceed under federal securities law or not at all”).

There is every reason to expect that if this suit were allowed to go forward, contract and other state law suits would become the plaintiff bar’s vehicles of choice. See H.R. Conf. Rep. No. 105-803, at 14-15 (the plaintiff bar rushed to “circumvent the [PSLRA’s] provisions by exploiting differences between Federal and State laws by filing frivolous and speculative lawsuits in State court, where essentially none of the Reform Act’s procedural or substantive protections against

abusive suits are available”). After all, if alleged violations of the securities-law duty of best execution may be turned into state contract claims based on terms “implied” in securities confirmation slips, plaintiffs could allege implied contract terms governing virtually any aspect of an investor’s relations with any mutual fund company, portfolio manager, or broker. See *Felton*, 429 F. Supp. 2d at 687, 693 (securities fraud suit dressed up as contract action based on incorporated SRO rules and customs). And those state law suits would carry the same dangers that the PSLRA and SLUSA addressed: wasteful and duplicative litigations, fishing expedition discovery, disruption of business operations, and blackmail settlements to avoid the risk of open-ended liability at the hands of state juries in venues such as St. Clair County under lax and malleable state standards.

Just as the allegation in *Dabit* that Merrill Lynch had “breached the * * * covenant of good faith and fair dealing it owed its brokers” did not take the case outside the scope of SLUSA (547 U.S. at 75), so the state breach of contract allegations here cannot alter the fact that in substance plaintiffs complain about federal securities fraud. SLUSA was designed to combat artful pleading, not encourage it. SLUSA thus required removal and dismissal of plaintiffs’ suit.

CONCLUSION

The judgment of the district court should be affirmed.

Respectfully submitted.

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November 3, 2008

STATUTORY ADDENDUM

I. SLUSA AND ITS LEGISLATIVE HISTORY

Securities Exchange Act § 28, as amended by the Securities Litigation Uniform Standards Act

15 U.S.C. § 78bb. *Effect on existing law.*

* * *

(f) *Limitations on remedies.*

(1) *Class action limitations.* No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging--

(A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or

(B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

(2) *Removal of covered class actions.* Any covered class action brought in any State court involving a covered security, as set forth in paragraph (1), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to paragraph (1).

* * *

(5) *Definitions.* For purposes of this subsection, the following definitions shall apply:

* * *

(B) *Covered class action.* The term “covered class action” means--

(i) any single lawsuit in which--

(I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or

(II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties

similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or

(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which--

(I) damages are sought on behalf of more than 50 persons; and

(II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

(C) *Exception for derivative actions.* Notwithstanding subparagraph (B), the term “covered class action” does not include an exclusively derivative action brought by one or more shareholders on behalf of a corporation.

(D) *Counting of certain class members.* For purposes of this paragraph, a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action.

(E) *Covered security.* The term “covered security” means a security that satisfies the standards for a covered security specified in paragraph (1) or (2) of section 18(b) of the Securities Act of 1933 [15 U.S.C.A. § 77r(b)], at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred, except that such term shall not include any debt security that is exempt from registration under the Securities Act of 1933 [15 U.S.C.A. § 77a et seq.] pursuant to rules issued by the Commission under section 4(2) of that Act [15 U.S.C.A. § 77d(2)].

(F) *Rule of construction.* Nothing in this paragraph shall be construed to affect the discretion of a State court in determining whether actions filed in such court should be joined, consolidated, or otherwise allowed to proceed as a single action.

Securities Exchange Act § 1, Note

15 U.S.C. § 78a. *Short title.*

* * *

HISTORICAL AND STATUTORY NOTES

* * *

Findings in Support of the Securities Litigation Uniform Standards Act of 1998

Pub.L. 105-353, § 2, Nov. 3, 1998, 112 Stat. 3227, provided that: “The Congress finds that--

“(1) the Private Securities Litigation Reform Act of 1995 sought to prevent abuses in private securities fraud lawsuits;

“(2) since enactment of that legislation, considerable evidence has been presented to Congress that a number of securities class action lawsuits have shifted from Federal to State courts;

“(3) this shift has prevented that Act from fully achieving its objectives;

“(4) State securities regulation is of continuing importance, together with Federal regulation of securities, to protect investors and promote strong financial markets; and

“(5) in order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995, it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits.”

* * *

SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998

HOUSE CONFERENCE REPORT NO. 105-803

October 9, 1998

[footnotes omitted]

Mr. Bliley, from the committee of conference, submitted the following

CONFERENCE REPORT

* * *

THE SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998

Uniform Standards

Title 1 of S. 1260, the Securities Litigation Uniform Standards Act of 1998, makes Federal court the exclusive venue for most securities class action lawsuits. The purpose of this title is to prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than in Federal, court. The legislation is designed to protect the interests of shareholders and employees of public companies that are the target of meritless “strike” suits. The purpose of these strike suits is to extract a sizeable settlement from companies that are forced to settle, regardless of the lack of merits of the suit, simply to avoid the potentially bankrupting expense of litigating.

Additionally, consistent with the determination that Congress made in the National Securities Markets Improvement Act (NSMIA), this legislation establishes uniform national rules for securities class action litigation involving our national capital markets. Under the legislation, class actions relating to a “covered security” (as defined by section 18(b) of the Securities Act of 1933, which was added to that Act by NSMIA) alleging fraud or manipulation must be maintained pursuant to the provisions of Federal securities law, in Federal court (subject to certain exceptions).

“Class actions” that the legislation bars from State court include actions brought on behalf of more than 50 persons, actions brought on behalf of one or more unnamed parties, and so-called “mass actions,” in which a group of lawsuits filed in the same court are joined or otherwise proceed as a single action.

* * *

The managers note that a report and statistical analysis of securities class actions lawsuits authored by Joseph A. Grundfest and Michael A. Perino reached the following conclusion:

The evidence presented in this report suggests that the level of class action securities fraud litigation has declined by about a third in federal courts, but that there has been an almost equal increase in the level of state court activity, largely as a result of a “substitution effect” whereby plaintiffs resort to state court to avoid the new, more stringent requirements of federal cases. There has also been an increase in parallel litigation between state and federal courts in an apparent effort to avoid the federal discovery stay or other provisions of the Act. This increase in state activity has the potential not only to undermine the intent of the Act, but to increase the overall cost of litigation to the extent that the Act encourages the filing of parallel claims.

Prior to the passage of the Reform Act, there was essentially no significant securities class action litigation brought in State court. In its Report to the President and the Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995, the SEC called the shift of securities fraud cases from Federal to State court “potentially the most significant development in securities litigation” since passage of the Reform Act.

The managers also determined that, since passage of the Reform Act, plaintiffs’ lawyers have sought to circumvent the Act’s provisions by exploiting differences between Federal and State laws by filing frivolous and speculative lawsuits in State court, where essentially none of the Reform Act’s procedural or substantive protections against abusive suits are available. In California, State securities class action filings in the first six months of 1996 went up roughly five-fold compared to the first six months of 1995, prior to passage of the Reform Act. Furthermore, as a state securities commissioner has observed:

It is important to note that companies can not control where their securities are traded after an initial public offering. * * * As a result, companies with publicly-traded securities can not choose to avoid jurisdictions which present unreasonable litigation costs. Thus, a single state can impose the risks and costs of its peculiar litigation system on all national issuers.

The solution to this problem is to make Federal court the exclusive venue for most securities fraud class action litigation involving nationally traded securities.

* * *

THE SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998

SENATE REPORT NO. 105-182

May 4, 1998

[footnotes omitted]

Mr. D'Amato, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

[To accompany S. 1260]

* * *

PURPOSE AND SCOPE OF LEGISLATION

The need for this legislation became apparent during a Securities Subcommittee hearing on July 24, 1997. This hearing was held to review the status of the implementation and impact of the "Private Securities Litigation Reform Act of 1995." During the course of that hearing one disturbing trend became apparent; namely, that there was a noticeable shift in class action litigation from federal to state courts. At this hearing, one witness pointed out the dangers of maintaining differing federal and state standards of liability for nationally-traded securities:

Disparate, and shifting, state litigation procedures may expose issuers to the potential for significant liability that cannot easily be evaluated in advance, or assessed when a statement is made. At a time when we are increasingly experiencing and encouraging national and international securities offerings and listings, and expending great effort to rationalize and streamline our securities markets, this fragmentation of investor remedies potentially imposes costs that outweigh the benefits. Rather than permit or foster fragmentation of our national system of securities litigation, we should give due consideration to the benefits flowing to investors from a uniform national approach.

Former SEC Commissioner Joseph Grundfest summarized this post 1995 Act increase in state securities class actions in testimony co-authored with his fellow Stanford Law School faculty member Michael Perino:

The relative stability of the aggregate litigation rate masks a significant shift of activity from federal to state court * * *. There is

widespread agreement that these figures represent a substantial increase in state court litigation. Two phenomena seem to explain the bulk of this shift. First, there appears to be a “substitution effect” whereby plaintiff’s counsel file state court complaints when the underlying facts appear not to satisfy new, more stringent federal pleading requirements, or otherwise seek to avoid the substantive or procedural provisions of the Act. Second, plaintiffs appear to be resorting to increased parallel state and federal litigation in an effort to avoid federal discovery stays or to establish alternative state court venues for settlement of federal claims.

While there was some disagreement as to the exact size of the increase in state class-action filings, the overall evidence received by the Committee is compelling. As one witness testified “(t)he single fact is that state-court class actions involving nationally traded securities were virtually unknown prior to the [1995 Act]; they are brought with some frequency now.”

Further, the Committee has found that this state class-action trend has had an impact beyond the number of, and dollar amounts involved in, the class actions filed. This trend has created a ripple-effect that has inhibited small, high-growth companies in their efforts to raise capital, and has damaged the overall efficiency of our capital markets. Specifically, the increased risk of state court class actions has had a chilling effect on the use of the “safe-harbor” and other important provisions of the 1995 Act. The safe harbor was intended to help get valuable financial forecasts and forward-looking information to investors, so that these investors could make decisions with as much information as possible; as Thomas O’Hara of the National Association of Investors Corporation (“NAIC”), testified:

The key to becoming successful with high-tech investments is a willingness to recognize—and tolerate—the inherent volatility of the business and access to crucial forward-looking information so an investor can make a wise decision.

A number of witnesses at the July 1997 hearing advocated legislation to establish uniform standards for private securities class action litigation. This legislation is an outgrowth of the July 1997 hearings and subsequent investigation and oversight by the Committee.

Some critics of establishing a uniform standard of liability have attacked such legislation as being an affront on Federalism and contrary to the recent trend towards reinforcing state rights. Proponents of the legislation have argued that we live in an information age in which we have truly national, if not international, securities markets and that uniform standards are entirely consistent with Congress’s preeminent power over the regulation of interstate and foreign

commerce. The Committee, while sensitive to both these considerations, found the interest in promoting efficient national markets to be the more convincing and compelling consideration in this context.

We do have national markets for certain securities, and fraudulent and abusive securities class action litigation distorts the efficient operation of those markets and the optimal allocation of available capital. Commissioner Keith P. Bishop, then-California's primary state securities regulator, testified before the Subcommittee on Securities in July, 1997, that the preponderance of class action litigation in several states is irrelevant to the true national nature of the problem:

It is important to note that companies can not control where their securities are traded after an initial public offering * * *. As a result, companies with publicly-traded securities can not choose to avoid jurisdictions which present unreasonable litigation costs. Thus, a single state can impose the risks and costs of its peculiar litigation system on all national issuers.

The Committee emphasizes the important role that the local "cop on the beat," i.e., the state securities regulators, plays in a complementary state-federal securities regulatory system. In recognition of this dual system, this legislation uses the approach that the National Securities Markets Improvement Act of 1996 ("NSMIA") employed. The purpose of NSMIA was described by SEC Chairman Levitt in testimony regarding that legislation:

The current system of dual federal-state regulation is not the system that Congress or the Commission would create today if we were designing a new system * * *. An appropriate balance can be attained in the federal-state arena that better allocates responsibilities, reduces compliance costs and facilitates capital formation, while continuing to provide for the protection of investors. The bill's approach to the division of responsibilities in the investment adviser and investment company areas exemplifies such a balance.

As introduced, the legislation incorporated the conceptual framework of NSMIA (with respect to interplay of federal and state regulation), while complementing, and hopefully giving full force to the 1995 Act. The Committee strongly notes that this legislation only covers precisely those securities defined in the NSMIA, principally those securities that are traded on national exchanges. During the course of the two hearings held by the Subcommittee on Securities on this legislation, the Subcommittee received a great deal of constructive advice about how best to give effect to the 1995 Act.

* * *

Definition of “Class Action”

The Subcommittee on Securities heard testimony from the Securities and Exchange Commission and others that the definition of class action originally drafted as part of S. 1260 would inadvertently include cases that were beyond the intent of the legislation—such as certain types of individual state private securities actions.

In response to these concerns, the Committee made several significant changes to the definition of class action. Because of the unique nature of the suits that the Committee has made subject to the legislation’s provisions, this definition cannot simply track the exact language of Rule 23 of the Federal Rules of Civil Procedure.

In order to ensure that individual state actions would not be included as part of the bill’s definitions, it was necessary for the Committee to create a standard of demarcation between individual actions appropriately brought in state court and those actions that should be subject to the bill’s provisions. To address this goal, and to establish objective criteria in the application of the definition, the Committee specifically included a threshold number of fifty or more persons or prospective class members as part of the definition of a class action under this legislation.

* * *

Finally, while the Committee believes that it has effectively reached those actions that could be used to circumvent the reforms enacted by Congress in 1995 as part of the Private Securities Litigation Reform Act, it remains the Committee’s intent that the bill be interpreted broadly to reach mass actions and all other procedural devices that might be used to circumvent the class action definition.

* * *

II. SECURITIES EXCHANGE ACT PROVISIONS

Securities Exchange Act § 10(b)

15 U.S.C. § 78j. *Manipulative and deceptive devices.* It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SEC Rule 10b-5

17 C.F.R. § 240.10b-5. *Employment of manipulative and deceptive devices.* It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Securities Exchange Act § 21D(b)(4)

15 U.S.C. § 78u-4. *Private securities litigation.*

* * *

(b) *Requirements for securities fraud actions.*

* * *

(4) *Loss causation.* In any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages.

III. PROVISIONS OF INVESTMENT COMPANY ACT AND INVESTMENT ADVISERS ACT

Investment Company Act § 34(b)

15 U.S.C. § 80a-33. *Destruction and falsification of reports and records.*

* * *

(b) *Untrue statements or omissions.* It shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this subchapter or the keeping of which is required pursuant to section 80a-30(a) of this title. It shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading. For the purposes of this subsection, any part of any such document which is signed or certified by an accountant or auditor in his capacity as such shall be deemed to be made, filed, transmitted, or kept by such accountant or auditor, as well as by the person filing, transmitting, or keeping the complete document.

Investment Advisers Act § 206

15 U.S.C. § 80b-6. *Prohibited transactions by investment advisers.* It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly--

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

* * *

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Investment Advisers Act § 207

15 U.S.C. § 80b-7. *Material misstatements.* It shall be unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission under section 80b-3 or 80b-4 of this title, or willfully to omit to state in any such application or report any material fact which is required to be stated therein.

IV. STATUTE OF LIMITATIONS PROVISIONS

Sarbanes-Oxley Act § 804(a)

28 U.S.C. § 1658. *Time limitations on the commencement of civil actions arising under Acts of Congress.*

* * *

(b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(47)), may be brought not later than the earlier of—

(1) 2 years after the discovery of the facts constituting the violation; or

(2) 5 years after such violation.

Securities Act § 13

15 U.S.C. § 77m. *Limitation of actions.* No action shall be maintained to enforce any liability created under section 77k or 77l(a)(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 77l(a)(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 77l(a)(1) of this title more than three years after the security was bona fide offered to the public, or under section 77l(a)(2) of this title more than three years after the sale.

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a)(7)(B) because it contains 13,236 words excluding the parts of the brief exempted by Rule 32(a)(7)(B)(iii).

2. This brief complies with typeface and type style requirements of Federal Rule of Appellate Procedure 32(a)(5) & (6) and Circuit Rule 32(B) because it was prepared in a proportionally spaced typeface using Microsoft Word 2000 in 12-point Century Schoolbook for both the text and footnotes.

Dated: November 3, 2008

Stephen M. Shapiro

CIRCUIT RULE 31(e) CERTIFICATION

The undersigned attorney certifies that he has filed electronically, pursuant to Circuit Rule 31(e), a copy of this brief that is in searchable PDF format and free from viruses. No appendix has been filed.

Dated: November 3, 2008

Stephen M. Shapiro

CERTIFICATE OF SERVICE

The undersigned attorney hereby certifies that on November 3, 2008, he caused two copies of this brief to be placed with a third-party commercial carrier for overnight delivery, and caused a digital version of the brief to be sent by email, to the following:

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