No. 11-510

IN THE
Supreme Court of the United States

DELOITTE & TOUCHE LLP AND JAN A. LOMMELE,
Petitioners,
v.

THE RGH LIQUIDATING TRUST, ON BEHALF OF RELIANCE GROUP HOLDINGS, INC., THE GENERAL UNSECURED CREDITORS OF RELIANCE GROUP HOLDINGS, INC., RELIANCE FINANCIAL SERVICES CORP. (N/K/A REORGANIZED RFS CORPORATION), AND THE GENERAL UNSECURED CREDITORS OF RELIANCE FINANCIAL SERVICES CORP.,
Respondent.

On Petition For A Writ Of Certiorari To The New York Court of Appeals

BRIEF OF *AMICUS CURIAE* THE CENTER FOR AUDIT QUALITY IN SUPPORT OF PETITIONER DELOITTE & TOUCHE LLP

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QUESTION PRESENTED

Whether the New York Court of Appeals, in agreement with the Ninth Circuit but in conflict with the Third Circuit, correctly derived from SLUSA's "Counting of Certain Class Members" provision a "single-entity exemption" under which a state-law securities fraud action that indisputably was brought on behalf of more than 50 bondholders and would otherwise be precluded by SLUSA is permissible so long as the named plaintiff entity itself was not established for the "primary" purpose of bringing the lawsuit?

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BRIEF OF THE CENTER FOR AUDIT QUALITY AS *AMICUS CURIAE* SUPPORTING PETITIONER DELOITTE & TOUCHE LLP

INTEREST OF *AMICUS CURIAE*[1]

The Center for Audit Quality ("CAQ") is a public policy organization of approximately 650 U.S. public company accounting firms (including Deloitte & Touche LLP), representing tens of thousands of professionals dedicated to audit quality. Any U.S. accounting firm registered with the Public Company Accounting Oversight Board ("PCAOB") may join the CAQ. The CAQ seeks to aid investors and the capital markets by advancing constructive suggestions for change rooted in the audit and accounting profession's core values of integrity, objectivity, honesty, and trust. In particular, the CAQ seeks to improve the reliability of public company audits and to enhance their relevance for investors, particularly in this time of growing financial complexity and globalization. The CAQ is dedicated to helping increase public confidence in the auditing process and to maintaining high standards

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[1] Pursuant to this Court's Rule 37.2(a), *amicus* gave at least 10-days' notice to all parties of its intent to file this brief, and has submitted to the Clerk letters of consent from all parties to the filing of this brief. Pursuant to this Court's Rule 37.6, *amicus* states that this brief was not authored in whole or in part by counsel for any party, and that no counsel or party other than *amicus*, its members, or its counsel made a monetary contribution intended to fund the preparation or submission of this brief.

in the accounting profession. To fulfill its mission, the CAQ offers recommendations to policymakers, issues technical support for public company auditing professionals, and participates in the public discussion about financial reporting. Among many other activities, the CAQ regularly submits *amicus* briefs in cases concerning legal rules that affect auditors and the audit process, and their broader impact on investors and the capital markets.

The decision below deepens the pre-existing and irreconcilable split of authority on whether companies with nationally traded securities and secondary participants in the securities markets, including auditors, may be subjected to state-law securities actions brought by legal entities on behalf of more than 50 persons. The Securities Litigation Uniform Standards Act ("SLUSA"), Pub. L. No. 105-353, 112 Stat. 3227 (1998), precludes state-law securities suits "in which damages are sought on behalf of more than 50 persons or prospective class members." 15 U.S.C. § 78bb(f)(5)(B)(i). In agreement with the Ninth Circuit but in conflict with the Third Circuit, the court below held that SLUSA does not preclude state-law securities actions brought by a legal entity on behalf of more than 50 persons.

The absence of uniformity on such an important issue of federal law is particularly problematic for many of the CAQ's members, which are located throughout the United States and have operations in multiple jurisdictions. It is also contrary to Congress's "preference for 'national standards for securities class action lawsuits involving nationally traded securities.'" *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 87-88 (2006) (quoting SLUSA § 2(5), 112 Stat. at 3227). This Court's review is warranted to reconcile the courts' sharply divergent interpretations of SLUSA and to help ensure that—consistent with SLUSA's text, congressional intent, and this Court's prior SLUSA jurisprudence—lower courts do not give judicial imprimatur to "abusive" state-law securities litigation by narrowly construing SLUSA. *Dabit*, 547 U.S. at 81-82, 85-86.

In addition, many of the CAQ's members perform work for companies with nationally traded securities, companies subject to the securities class action mechanism regulated by Congress. H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 730. In that capacity, accounting firms perform audits and provide other services that plaintiffs may choose to challenge through class actions. Accordingly, *amicus* CAQ and its member firms have a keen interest in the question presented for review, because the decision below drastically expands the circumstances in which accounting firms may be exposed to onerous and unpredictable liability in state-law securities actions that Congress intended to preclude with SLUSA.

STATEMENT

"The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated," and thus the federal government regulates these "vital elements of our economy." *Dabit*, 547 U.S. at 78. In particular, Congress has acted forcefully to combat misuse of securities litigation, especially with respect to class-action-style suits.

Recognizing that meritless class actions injure "the entire U.S. economy," Congress enacted the Private Securities Litigation Reform Act ("PSLRA") to curb "abusive" class action practices in suits brought under federal securities laws or regulations such as Securities and Exchange Commission ("SEC") Rule 10b-5. H.R. Rep. No. 104-369, at 31; *see* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737. The PSLRA imposes substantive and procedural requirements and restrictions on such class actions to help ensure appropriately summary dismissal of those suits whose "nuisance value outweighs their merits." *Dabit*, 547 U.S. at 82; *see* H.R. Rep. No. 104-369, at 31.

In an effort to evade the PSLRA's reforms, however, plaintiffs began bringing securities class actions under state law. H.R. Rep. No. 105-803, at 13 (1998). Concerned that this phenomenon would "frustrate the objectives of the [PSLRA]," Congress enacted SLUSA to preclude those suits.

SLUSA bars those suits based on state law that "(1) make use of a procedural vehicle akin to a class action, and (2) allege a misrepresentation or deceptive device in connection with a securities trade." *LaSala v. Bordier et Cie*, 519 F.3d 121, 128 (3d Cir. 2008); *see also* 15 U.S.C. § 78bb(f). The first requirement, and the only one at issue in this case, ensures that SLUSA precludes suits resembling class actions, but not individual actions, and is effectuated by SLUSA's broad definition of the term "covered class action." 15 U.S.C. § 78bb(f)(5)(B).

SLUSA precludes "covered class actions," which the Act defines as "any single lawsuit in which 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 . . . predominate." 15 U.S.C. § 78bb(f)(5)(B)(i) (emphasis added). For purposes of counting class members, SLUSA adopts a rule regarding the counting of entities with constituents, that "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." *Id.* § 78bb(f)(5)(D).

Plaintiffs have sought to circumvent SLUSA by bringing state-law securities claims in which a legal entity would sue on behalf of more than 50 allegedly injured persons whose claims have been assigned to the entity in bankruptcy proceedings, thereby creating a post-bankruptcy liquidating trust. *See* Pet. App. 15-16 (observing the "grow[th] in popularity" of liquidating trusts in bankruptcy proceedings because "claims might exist against the debtor's former insiders, accountants, financiers, and others").

Courts have analyzed whether this evasive maneuver places claims brought by such legal entities within SLUSA's preclusive reach in two different ways. The first approach centers on the inquiry ordained by the text of the SLUSA preclusion provision: whether the lawsuit is "on behalf of" more than 50 injured persons. 15 U.S.C. § 78bb(f)(5)(B)(i); *see LaSala*, 519 F.3d at 134. Other courts, by contrast, instead have instituted a new test that does not appear in the text of SLUSA: whether the entity's "primary purpose" is participating in the state-law securities action. *See, e.g.*, *Smith v. Arthur*

Andersen LLP, 421 F.3d 989, 1008 (9th Cir. 2005); Pet. App. 1, 23-24.

The decision below adopts the latter approach.

1. The RGH Liquidating Trust, acting on behalf of, among others, more than 800 bondholders that assigned their claims in bankruptcy proceedings to the RGH estate for ultimate assignment to the Trust, filed a New York state-law action against RGH's outside auditor, Deloitte & Touche LLP ("Deloitte"), and a Deloitte principal in New York state court, seeking more than $500 million in damages. Among other things, the Trust asserted that Deloitte fraudulently caused RGH's financial condition to be misstated, thus inducing the bondholders to buy or refrain from selling RGH bonds. It is undisputed that the bondholders could not have brought these claims under federal securities law because of the federal statute of limitations. Pet. App. 45; *see id.* at 27.

2. Deloitte moved to dismiss, arguing that SLUSA precludes the lawsuit. Pet. App. at 68. The state trial court denied that motion with respect to the more than 50 bondholders, holding that the Trust is a single person for purposes of SLUSA preclusion because its primary purpose is not the pursuit of state-law securities claims. *Id.* at 69-73. The intermediate state appellate court unanimously reversed. It held that SLUSA precludes the Trust's suit because the Trust is acting on behalf of more than 50 allegedly injured persons, namely, the more than 50 bondholders who are "the allegedly injured parties for whom damages are sought." *Id.* at 54.

3. A divided panel of the New York Court of Appeals reversed, allowing the Trust's state-law claims on behalf of RGH's bondholders to proceed.

The majority held that the Trust's suit was not precluded by the text of SLUSA because the Trust's "primary purpose" is not the pursuit of a state-law securities claim. Pet. App. at 23. In so holding, the Court of Appeals recognized that the issue of whether the Trust's state-law claims are precluded by SLUSA "is a difficult one, which will ultimately be resolved by the federal courts." *Id.* at 12-13. Until such time, the Court of Appeals chose a side from the split of authority in federal circuit courts: it explicitly rejected the Third Circuit's approach of looking to whether the plaintiff's claim is "on behalf of" more than 50 injured persons, *LaSala*, 519 F.3d at 134, and instead adopted the Ninth Circuit's reading of the legislative history of SLUSA as suggesting that some suits brought by "a trustee in bankruptcy" should not be precluded. Pet. App. 13-14, 23-24. Specifically, the majority embraced the Ninth Circuit's "single-entity exemption" from SLUSA preclusion, in which an entity acting on behalf of more than 50 persons may bring a state-law securities action despite SLUSA if the "primary purpose" of the entity is something other than bringing suit. *Id.* at 18-21.

The dissent argued that SLUSA bars the Trust's state-law action. The key, in the dissent's view, was that the Trust is acting on behalf of the more than 50 bondholders whose claims had been assigned to the Trust. Pet. App. at 28-29. "[T]o ignore th[at] obvious fact," the dissent reasoned, "simply invites evasion of SLUSA." *Id.* at 30. The dissent criticized the majority for reaching the wrong result based on "a confused reading of SLUSA's legislative history," specifically, a reading that overlooks the "critical" difference between a "trustee in bankruptcy" that acts on behalf of the debtor estate and a post-bankruptcy liquidating trust assigned claims of more than 50 potential plaintiffs. *Id.* at 30-31.

SUMMARY OF ARGUMENT

In conflict with the decision of the Third Circuit but in agreement with the decision of the Ninth Circuit, the New York Court of Appeals' decision will significantly narrow SLUSA's preclusive effect on state-law securities actions—an outcome that would fly in the face of this Court's admonition requiring courts to apply a "broad" interpretation of SLUSA preclusion. *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85-86 (2006). Certiorari is warranted to reconcile the lower courts' disparate interpretations of SLUSA, and to restore the broad preclusion that Congress created with respect to state-law securities class actions.

I. The decision below deepens the existing split in authority whether, and when, SLUSA precludes state-law securities actions brought by a legal entity on behalf of more than 50 persons. The circuits, and now New York's state court of last resort, have taken two different approaches to SLUSA preclusion: one focuses on an inquiry posed by the text of the SLUSA preclusion provision—whether the lawsuit is "on behalf of" more than 50 injured persons—while the other centers on a new test that does not appear in the text of SLUSA—whether the entity's "primary purpose" is participating in the state-law securities action. In light of this fundamental disagreement among the circuits, now furthered by a prominent state court of last resort, companies with nationally traded securities and the secondary participants with whom they work, including auditors, face intolerable uncertainty regarding SLUSA's preclusive scope and their potential liability with respect to state-law securities class actions. The uncertainty is profound because SLUSA preclusion is often outcome-determinative.

This absence of uniformity is particularly problematic for companies and secondary participants that operate in multiple jurisdictions, which face the very real possibility that liability will depend in large part on the forum in which plaintiffs choose to file suit. The lack of uniformity also contravenes Congress's clearly stated preference for national standards for securities class action lawsuits involving nationally traded securities.

II. The decision below dramatically narrows the intended reach of SLUSA, thereby increasing the exposure of companies with nationally traded securities, and of secondary participants in the securities markets, to state-law securities actions that would otherwise be precluded. Under this narrow understanding of SLUSA, companies and secondary participants face the daunting specter of returning to an environment of excessive and expensive securities litigation over meritless claims of the very sort that Congress sought to bar with the PSLRA and SLUSA. The predictable consequence is that defendants will be unfairly forced to settle meritless "strike suits."

The PSLRA and SLUSA embody a regulatory approach to class action securities litigation that provides the balance, as set by Congress, between the limited role of secondary participants in the securities markets and the amount of potential liability they face to permit efficient operation of the securities markets. The decision below threatens that carefully-balanced regulatory scheme by significantly narrowing SLUSA's preclusive scope, thereby broadening liability risk for auditors, law firms, underwriters, and other secondary participants. This ultimately disserves the public interest because such increased risks will limit the availability of services and raise their price, burdening companies and their investors and customers and further damaging the American economy.

ARGUMENT

I. THE DECISION BELOW DEEPENS THE EXISTING CONFLICT OF AUTHORITY REGARDING THE SCOPE OF PRECLUSION UNDER SLUSA.

The circuits and a prominent state court of last resort have adopted two irreconcilable approaches for determining whether SLUSA precludes state-law securities actions brought by a legal entity on behalf of a large group of claimants. That disagreement leaves companies with nationally traded securities and the thousands of firms that perform work for those companies—including accounting, consulting, banking, and law firms—with profound uncertainty regarding the circumstances in which they will fall prey to what Congress has repeatedly characterized as "abusive litigation" that injures "the entire U.S. economy." *E.g.*, H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 730.

The court below, in assessing whether a legal entity plaintiff may bring a state-law securities claim on behalf of a large group of claimants and avoid SLUSA preclusion, bypassed the definition of "covered class action"—*i.e.*, "any single lawsuit in which 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 . . . predominate," 15 U.S.C. § 78bb(f)(5)(B)(i)—and focused instead on a different provision that specifies the mechanism for counting the number of beneficiaries of the single lawsuit, providing that "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." *Id.* § 78bb(f)(5)(D). In doing so, the court followed the Ninth Circuit's interpretation of the provision to require inquiry into the "primary purpose" of the legal entity serving as the nominal plaintiff, such that "an entity is not one person if its 'primary purpose' is to pursue causes of action," and embraced the Ninth Circuit's conclusion that although SLUSA precludes suits brought by entities "established for *the* purpose of participating in the [securities] action," it does not bar claims brought by entities established only "in part for the purpose" of such litigation. *Smith v. Arthur Andersen LLP*, 421 F.3d 989, 1008 (9th Cir. 2005) (emphasis in original); *see* Pet. App. 23-24 (agreeing with the Ninth Circuit's approach of "zero[ing] in on whether the [entity's] 'primary purpose' is litigation of such [securities] claims"). The court below thus held that SLUSA contains a "single-entity exemption" and does not preclude a state-law securities suit brought by an entity assigned the litigation claims of more than 50 parties. *See* Pet. App. 25.

The approach adopted by the Third Circuit focuses on the definition of "covered class action" and that definition's attention to the identity and number of "*injured* persons" on whose behalf the legal entity brings claims. *LaSala v. Bordier et Cie*, 519 F.3d

121, 133-34 (3d Cir. 2008) (emphasis in original). Rejecting the "primary purpose" test, the Third Circuit held that "the phrase 'on behalf of 50 or more persons' seems to refer to someone bringing a claim on behalf of 50 or more *injured* persons." *Id.* at 133-34 (emphasis in original). "In other words," the court explained, "the phrase refers to the assignors of a claim, not to the assignee (or, if the assignee is a trust, to its beneficiaries)." *Id.* The court observed that SLUSA's requirement that questions of law or fact common to "those persons" on whose "behalf" the action is brought would "lack any pertinence" if "those persons" need not share a common injury. *Id.* The Third Circuit thus correctly began and ended its analysis by ascertaining the number of beneficiaries of the single lawsuit. Although the Third Circuit concluded that SLUSA did not preclude the action before it because there was only one assignor (the bankrupt corporation), the dissent below found it "apparent that the *LaSala* court would have held the present case to be barred by SLUSA" because "it is undisputed that 'the assignors' were not a bankrupt corporation, but more than 50 bondholders." Pet. App. 32; *see also LaSala*, 519 F.3d at 137-38 (claims brought by the same trust that belonged originally to more than 50 purchasers of a covered security "would seem to take the form of a covered class action").

In light of this irreconcilable disagreement among the circuits and the New York state court of last resort, companies with nationally traded securities and secondary participants in the securities markets face substantial uncertainty regarding SLUSA's reach and their exposure to state-law securities litigation. In addition, entities amenable to suit in more than one jurisdiction face the very real possibility that their state-law securities liability will depend largely on the forum in which the plaintiff chooses to sue. For example, an accounting firm with offices on both sides of the Hudson River, which divides the State of New York from the Third Circuit, would be confronted with very different potential liability risk depending on where a securities action brought by a legal entity acting on behalf of a large group of claimants is filed: If the suit were filed in a federal district court in the Third Circuit, then the accounting firm would face potential liability only if the legal entity plaintiff were acting on behalf of fewer than 50 "injured parties"; if the suit were filed in a nearby New York state court, then the accounting firm would face potential liability so long as the single entity plaintiff was not formed for the "primary purpose" of litigation, regardless of the number of "injured parties" that have their claims assigned to that entity.

This uncertainty and inconsistency about the scope of SLUSA's protections is inefficient and inequitable. *See, e.g.*, Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 Duke L.J. 945, 962 (1993) ("Overbreadth and uncertainty deter beneficial conduct and breed costly litigation."); Robert John Grubb II, Note, *Attorneys, Accountants, and Bankers, Oh My! Primary Liability for Secondary Actors in the Wake of* Stoneridge, 62 Vand. L. Rev. 275, 304-05 (2009). As this Court warned, "uncertainty and excessive litigation can have ripple effects." *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 189 (1994); *id.* (uncertainty will lead defendants "to abandon substantial defenses and to pay settlements in order to avoid the expense and risk of going to trial").

Moreover, the uncertainty is directly contrary to Congress's intent in adopting SLUSA, which was to foreclose recourse to the state courts and state law with respect to abusive litigation tactics that harm the U.S. economy by instituting consistently-applied, uniform national standards. In enacting SLUSA, Congress evinced a clear "preference for 'national standards for securities class action lawsuits involving nationally traded securities.'" *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 87-88 (2006) (quoting SLUSA, § 2(5), Pub. L. No. 105-353, 112 Stat. 3227, 3227 (1998)).[2]

The Court should grant review to determine whether the Ninth Circuit and New York Court of

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[2] The decision below also threatens the uniform operation of the bankruptcy laws and encourages forum-shopping among bankruptcy jurisdictions. The creation in bankruptcy proceedings of post-bankruptcy liquidating trusts and other legal entities has "grown in popularity" in the "post-*Enron/Worldcom* world" "where claims might exist against the debtor's former insiders, accountants, financiers, and others," especially because the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, allows debtors to defer litigation issues to such entities and debtors are more than happy to do so. Pet. App. 15-16; Andrew M. Thau *et al.*, *Postconfirmation Liquidation Vehicles (Including Liquidating Trusts and Postconfirmation Estates)*, 16 J. Bankr. L. & Prac. 201 (2007). Because creditors in the Ninth Circuit and New York state courts are able to evade SLUSA by having their claims assigned to such a separate legal entity in bankruptcy proceedings, they will seek to force the bankruptcy proceedings of companies with nationally traded securities into those favorable jurisdictions.

Appeals' narrow interpretation of the circumstances in which SLUSA precludes state-law securities actions brought by a single legal entity on behalf of a large group of claimants is consistent with the congressionally-mandated regulatory scheme for securities actions.

II. ALLOWING PLAINTIFFS TO CIRCUMVENT THE CONGRESSIONAL PLAN EMBODIED IN THE PSLRA AND SLUSA HAS FAR-REACHING IMPLICATIONS FOR THE AMERICAN ECONOMY.

The Ninth Circuit and New York Court of Appeals' narrow understanding of SLUSA's preclusive scope has significant ramifications for all companies with nationally traded securities, the secondary participants with whom they work, and investors in American financial markets. In the Ninth Circuit and in New York, companies and secondary participants face the daunting specter of expensive securities litigation over meritless claims, of the very sort that Congress sought to bar with the PSLRA and SLUSA. This unduly narrow interpretation of SLUSA has serious financial implications for not only these parties, but also investors and the American economy.

A. The Ninth Circuit and New York Court of Appeals' decisions give judicial imprimatur to lawyers' most recent maneuver to circumvent congressional regulation of the securities markets. Indeed, Congress in the past two decades has twice significantly reformed the nation's securities laws to bar the types of suits that the Ninth Circuit and the New York Court of Appeals allow to proceed.

In 1995, Congress enacted the PSLRA "to protect investors and maintain confidence in our capital markets" in response to "significant evidence" of "abusive" class-action litigation practices. H.R. Rep. No. 104-369, at 31. The PSLRA imposes numerous restrictions on securities class actions brought under *federal* law, including heightened pleading requirements, a stay of discovery pending resolution of any motion to dismiss, limits on recoverable damages and attorneys' fees, proportionate liability, restrictions on the selection of (and compensation awarded to) a lead plaintiff, and mandatory sanctions for frivolous litigation. *See* 15 U.S.C. § 78u-4.

Plaintiffs made an end-run around the PSLRA, however, by "filing frivolous and speculative lawsuits" under *state* law, often in the form of class actions. H.R. Rep. No. 105-803, at 15 (1998). By doing so, plaintiffs could increase their chances of obtaining extortionate settlements, not only by avoiding the PSLRA's procedural safeguards, but also by choosing to sue in states with longer statutes of limitations than those provided by federal law, or which recognize substantive theories of liability not available under the federal securities laws, such as for aiding and abetting or claims based on "holding," rather than buying or selling, a security.

Quickly responding to that evasion, H.R. Rep. No. 105-803, at 15, Congress enacted SLUSA to prevent plaintiffs from filing under state law any suits that make use of a procedural device akin to a class action and allege fraud in connection with a securities trade. SLUSA, 112 Stat. at 3227.

Both the PSLRA and SLUSA make it harder for plaintiffs to profit by filing meritless securities suits. As Congress explained with respect to both laws, plaintiffs often file these "strike suits" "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." H.R. Rep. No. 105-803, at 13. That expense, Congress found, arises from "the abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle." H.R. Rep. No. 104-369, at 31. Plaintiffs tend to "target[] deep pocket defendants, including accountants, underwriters, and individuals who may be covered by insurance, without regard to their actual culpability," in order to maximize their gains. *Id.* This harms companies with nationally traded securities and, ultimately, the American economy. *Id.*

The Ninth Circuit and the New York Court of Appeals' decisions contravene congressional intent by opening the courts to meritless actions that could not have proceeded under either federal law, due to the PSLRA's protections, or state law, due to SLUSA preclusion. Specifically, the decisions permit plaintiffs to circumvent SLUSA's procedural protections simply by having their claims assigned to a post-bankruptcy legal entity, such as a liquidating trust, during bankruptcy proceedings. In this case, for example, the suit at issue could not have proceeded under federal law due to a federal procedural rule protecting potential defendants and the judicial process (the statute of limitations), Pet. App. 45; *see id.* 27, and because the federal securities laws do not recognize "holder" claims, *see Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 754-55 (1975). And it could not have proceeded as a typical class action under state law because of SLUSA. The plaintiffs avoided this result merely by having their claims assigned to a single entity in the course of bankruptcy proceedings. The New York Court of Appeals' decision to allow that suit to go forward constitutes an end-run around SLUSA's preclusion of state-law securities class actions. That is not to say that plaintiffs such as those in this case are normally without remedy. They can pursue their claims directly in federal court pursuant to federal procedures; they simply cannot use a litigation trust to avoid SLUSA.

B. Allowing this end-run around SLUSA affects not only companies with nationally traded securities, but also the secondary participants in the securities markets and investors. H.R. Rep. No. 104-369, at 31.

1. Congress has observed that strike suits tend to be "target[ed] [at] deep pocket defendants, including accountants." H.R. Rep. No. 104-369, at 31. Indeed, an increasing number of plaintiffs have begun filing state-law securities actions against accounting firms seeking to recover hundreds of millions of dollars. *See, e.g.*, *Smith*, 421 F.3d at 989; *Gutierrez v. Deloitte & Touche, LLP*, 147 F. Supp. 2d 584 (W.D. Tex. 2001).[3]

The accounting profession is significantly burdened by litigation where there is a broad scope of liability. *See, e.g.*, Final Report of the Advisory Committee on the Auditing Profession to the U.S.

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[3] These suits have been filed against other types of secondary participants that perform work for companies with nationally traded securities, such as banks, *LaSala*, 519 F.3d at 121 (involving a bank), and law firms, *In re Global Crossing Sec. & ERISA Litig.*, 225 F.R.D. 436, 447 (S.D.N.Y. 2004) (approving law firm's payment of $19.5 million in partial settlement of state-law claims).

Department of the Treasury ("Final Report") VII:25 (Oct. 6, 2008). That is because the accounting "profession faces catastrophic litigation risk different from that of other businesses." *Id.* at VII:27. The fees received from an audit are disproportionately small relative to the auditor's potential liability for that audit, which in some cases could be alleged to be the full decline in a public company's market value resulting from revelation of an undetected fraud—an amount that is often now counted in the billions of dollars. When this liability exposure is compared to the combined partner capital retained by the firms, the threat that catastrophic litigation risk poses to the viability of accounting firms is simply undeniable. *See* Luigi Zingales *et al.*, Committee on Capital Markets Regulation, Interim Report of the Committee on Capital Markets Regulation, at 87 (Nov. 30, 2006) ("Interim Report") (the liability exposure of accounting firms "exceeds the combined partner capital" of the largest firms); Eric L. Talley, *Cataclysmic Liability Risk Among Big Four Auditors*, 106 Colum. L. Rev. 1641, 1642 (2006) ("Auditors now face enhanced vulnerability to liability risks that—at least according to some—threaten the very viability of the industry as we know it.").

These risks have rendered third-party insurance for large company audits generally unavailable, further compounding the profession's risks. The combination of catastrophic litigation risk and the difficulty of obtaining third-party insurance further threatens the profession's sustainability by increasing concentration in the profession. It not only threatens the viability of larger firms, but also limits the willingness of smaller firms to perform audits for public company clients. Specifically, smaller accounting firms are reluctant to pursue public company clients whose market capitalization could spell enterprise-threatening liability in the event of a stock drop. Final Report at VII:28.

In addition, the threat of disproportionate liability "discourag[es] the best and brightest from entering and remaining" in the profession, "inhibiting the use of professional judgment, impeding the evolution of more useful audit reports, and causing overly cautious audits or 'defensive' auditing." Final Report at VII:28.

2. The resulting harms from this end-run around SLUSA preclusion are not limited to the accounting profession, because secondary participants in securities markets play a critical role in helping to ensure the reliability of the securities markets, at a cost to investors that does not (yet) account for the potential expansive liability triggered by the decision below. Ultimately, therefore, investors will suffer significant harm from the erroneous interpretation of SLUSA in this case.

Investors look to auditors, law firms, underwriters, and other secondary participants in the securities markets to provide services necessary for companies with nationally traded securities. A decrease in the availability of those services, therefore, would harm investors and undermine confidence in and the reliability of the markets, contrary to "[t]he overriding purpose of our Nation's securities laws." H.R. Rep. No. 104-369, at 31.

Repeatedly exposing auditors to practically boundless liability, for example, could foreseeably lead to the demise of another major accounting firm "with disastrous consequences for corporate governance worldwide." Interim Report at 86. Indeed, accounting profession experts have concluded that "the threat of the loss of a major auditing firm due to litigation is real." Final Report at VII:26 (relying on data provided by the accounting profession and testimony from academic, legal, and insurance experts). The erosion of congressional reforms through a contraction of SLUSA would potentially increase instability in U.S. capital markets due to increased uncertainty over accounting firms' viability.

The risk of increased liability alone would drive business decisions that could ultimately harm investors. Industries that are frequently targeted for securities litigation or that are subject to complex accounting rules might find that high-quality services are unavailable or prohibitively costly. In addition, "newer and smaller companies may find it difficult to obtain advice from professionals" at all. *Cf. Cent. Bank*, 511 U.S. at 189 (addressing liability under Rule 10b-5). Accountants and other secondary participants "may fear that a newer or smaller company may not survive and that business failure would generate securities litigation against the professional, among others." *Id*. Reaction to that fear would decrease customer choice and undercut the benefits that flow from competition.

The history of the accounting profession demonstrates that this danger is real. Before this Court rejected secondary liability for private suits under Section 10(b), "independent accountants undertook various protective measures" to minimize their expanding liability under aiding-and-abetting theories, "such as restricting their representation to clients in lower-risk industries." Francine A. Ritter, Note, *Accountability of the Independent Accountant* *as Auditor in the Wake of* Central Bank, 31 Suffolk U. L. Rev. 873, 875 (1998).

More generally, even if the availability of accounting services does not change, broadening potential liability for auditors disserves the public interest because "increased civil exposure [for accountants] must ultimately raise the price of accounting services," burdening companies listed on the U.S. markets—and, ultimately, their investors and customers. *Baena v. KPMG LLP*, 453 F.3d 1, 9 (1st Cir. 2006). Indeed, "[n]o one sophisticated about markets believes that multiplying liability is free of cost. And the cost, initially borne by those who raise capital or provide audit or other services to companies, gets passed along to the public." *SEC v. Tambone*, 597 F.3d 436, 452-53 (1st Cir. 2010) (Boudin, J., concurring); *see also Cent. Bank*, 511 U.S. at 189 ("[T]he increased costs incurred by professionals because of the litigation and settlement costs under 10b-5 may be passed on to their client companies, and in turn incurred by the company's investors . . . ."). In other words, "[i]f there is excessive . . . litigation, too many resources will be spent on litigation and on litigation avoidance. The cost of capital will then increase just as if a wasteful tax had been imposed on capital formation." Joseph A. Grundfest, *Why Disimply?*, 108 Harv. L. Rev. 727, 732 (1995) (emphasis omitted).

Thus, narrowing the preclusion of SLUSA so as to allow state-law securities actions purportedly brought on behalf of investors or creditors will harm investors throughout the nation. *See* Irwin J. Sugarman, *Lawyers & Accountants Liability After* Central Bank, 1998 A.B.A. Sec. Litig. & Arbitration G-79, at *G-79 (explaining that "extending the reach of civil liability under Section 10(b) might, in fact, *harm investors*, the intended beneficiaries of the statute") (emphasis added)).

Increased costs also take their toll on the competitiveness of U.S. capital markets as a whole. An "important factor" contributing to the "loss of U.S. public market competitiveness compared to global public markets" is the "growth of U.S. regulatory compliance costs and liability risks compared to other developed and respected market centers," including with respect to U.S. auditors. Interim Report at x, 4-5, 88-89.

Congress intended to preclude that result by enacting the PSLRA and SLUSA. The Court should grant review in this case to ensure that the limitations that Congress imposed in those acts are consistently applied and respected by lower courts.

CONCLUSION

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

Respectfully submitted.

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