No. 14-1132

IN THE

# Supreme Court of the United States

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

v.

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

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

## REPLY BRIEF FOR PETITIONERS


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**REGULATIONS**

## REPLY BRIEF FOR PETITIONERS

Section 27 of the Exchange Act establishes a specific rule of jurisdiction applicable in only a narrow category of cases: jurisdiction is proper if, but only if, the complaint seeks "to enforce any … duty created by" the Exchange Act or its regulations. 15 U.S.C. § 78aa(a).[1] That language pointedly does not say that jurisdiction exists only when the suit asserts a *cause of action* created by the Act or its regulations. The question is whether the suit, whatever the source of its cause(s) of action, seeks to enforce a *duty* created by the Act or its regulations. If it does, a judicial judgment about the asserted Exchange Act duty obviously is more than just a "mere possibility," as respondents wrongly assert—it is exactly what the plaintiff seeks.

And it is exactly what respondents seek here. Their complaint asserts state-law causes of action based on alleged "illegal short selling" of Escala stock, which the complaint explicitly *defines* as short selling *in violation of duties prescribed by Exchange*

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[1] Section 27 also reaches suits alleging "violations of" the Exchange Act. 15 U.S.C. § 78aa(a). Respondents contend that "violations" refers only to criminal prosecutions or SEC enforcement actions. Resp. Br. 28. But § 27's venue provision refers to "[a]ny *suit or action* … to enjoin any *violation* of" the Act, which necessarily encompasses private civil actions. 15 U.S.C. § 78aa(a) (emphasis added). The "violations" language simply makes clear that § 27 *also* applies to criminal prosecutions and administrative enforcement actions. Because there is no substantive difference in this context between private suits seeking to remedy Exchange Act violations and suits seeking to enforce Exchange Act duties, this brief focuses on the "duty" language.

*Act Regulation SHO*. The complaint thus seeks a judicial determination that petitioners breached Regulation SHO duties as grounds for recovering under state law. It accordingly falls well within § 27's narrow compass.

Largely ignoring § 27's text in favor of abstract generalities about federal jurisdiction, respondents assert that § 27 is not satisfied here because proving the breaches of Regulation SHO duties they pervasively allege would not be strictly *necessary* to establish state-law liability. While that point might suffice to defeat federal-question jurisdiction under 28 U.S.C. § 1331, there is no comparable necessity requirement in § 27's text or implicit in its purpose. The statute instead means just what it says: federal courts, and only federal courts, may adjudicate suits brought to enforce duties created by the Exchange Act or its regulations, even if the plaintiff might theoretically prevail on independent state-law grounds. The decision below should be reversed.

## ARGUMENT

Respondents make no effort to defend the Third Circuit's holding that § 27 is not itself a grant of jurisdiction. Pet. App. 22a. They instead assert two conflicting theories of § 27's meaning. One is that § 27 jurisdiction is limited to suits asserting causes of action created by the Exchange Act itself and thus is *narrower* than § 1331 jurisdiction. The other is that § 27 is *identical* to § 1331 jurisdiction, because jurisdiction attaches only when adjudicating the alleged Exchange Act duty would be *necessary* to disposition of a state-law cause of action. These differing interpretations share a common feature—they

are both unconnected to the specific language of § 27, which establishes a particular jurisdictional rule covering "all suits … brought to enforce any … duty created by" the Exchange Act or its regulations. 15 U.S.C. § 78aa(a). That rule is easily satisfied by the allegations in respondents' complaint.

### A. Section 27 Jurisdiction Is Not Limited To Causes Of Action Created By The Exchange Act

1. Respondents first argue that § 27 applies only to suits asserting causes of action under the Exchange Act itself and therefore can never apply to suits asserting only state-law causes of action. Resp. Br. 31-33. Respondents' amicus Public Citizen similarly describes § 27 as adopting "the Holmesian view" of federal-question jurisdiction, which reflected Justice Holmes' argument that such jurisdiction should be restricted to "suits arising 'under the law that creates the cause of action.'" Public Citizen Br. 11 (quoting *Am. Well Works Co. v. Layne & Bowler Co.*, 241 U.S. 257, 260 (1916)).

That construction contradicts the provision's plain text. If Congress had intended to limit § 27 jurisdiction to suits asserting Exchange Act causes of action, it would have simply granted jurisdiction over "suits asserting causes of action created by the Exchange Act." The language Congress actually used is decidedly different: federal courts have jurisdiction over "all suits … brought to enforce any ... *duty* created by [the Exchange Act] or the *rules and regulations* thereunder." 15 U.S.C. § 78aa(a) (emphasis added). The underscored language precludes respondents' effort to equate "duty" with "cause of

action." First, the concepts are not synonymous—legal duties are enforced *through* causes of action. *See Moore v. Chesapeake & O. Ry. Co.*, 291 U.S. 205, 215 (1934) (describing action in which federal statute "prescribe[d] the duty" but "breach of duty" was "enforced" through state-law action).[2] Second, § 27 applies equally to duties created by "rules and regulations" promulgated under the Exchange Act, even though a regulation "may not create a right [of action] that Congress has not." *Alexander v. Sandoval*, 532 U.S. 275, 291 (2001). Section 27 thus clearly *rejects* the Holmesian view of jurisdiction.

Respondents nevertheless insist that the Holmesian view is "the most natural reading" of § 27's text, because a "suit asserting claims under state law, invoking state-created rights and remedies, is not a suit brought to enforce federal law." Resp. Br. 31 (alterations omitted). But § 27 jurisdiction does not depend on the "rights and remedies" at issue in the suit—it is based solely on whether the suit seeks to "enforce a *duty*" created by the Act or its regulations.

Respondents' emphasis on "rights and remedies" (Resp. Br. 31, 42) conflates § 27, which includes no such phrase, with Exchange Act § 28, 15 U.S.C. § 78bb(a)(2), which provides that Exchange Act "rights and remedies … shall be in addition to any and all other rights and remedies that may exist at law or in equity." The latter provision does not ad-

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[2] For example, ERISA § 404(a) prescribes a fiduciary's duties, 29 U.S.C. § 1104(a), while § 409 establishes liability for breach of those duties, *id.* § 1109, and § 502(a)(2) establishes the cause of action to enforce them, *id.* § 1132(a)(2).

dress *jurisdiction*, but *preemption*, providing that states may establish certain substantive rights and remedies beyond those established under the Exchange Act. And § 27 simply requires that suits invoking such remedies be heard in federal court if they seek to enforce Exchange Act duties.[3]

2. Respondents also misread a footnote in *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996), as holding that § 27 categorically excludes state causes of action, even if they are based on an alleged breach of an Exchange Act duty. Resp. Br. 33-35. The footnote says no such thing.

In *Matsushita*, shareholders of MCA, Inc., sued Matsushita in federal court, alleging that Matsushita's tender offer for MCA shares violated SEC Exchange Act rules addressed only to the conduct of bidders (Matsushita), not targets (MCA). *See* 516 U.S. at 370 (citing 17 C.F.R. §§ 240.14d–10, 240.10b–13 (1994)). In a separate Delaware state-court action, MCA shareholders also sued MCA's directors under state law alleging, inter alia, that their acceptance of the tender offer to become part of Matsushita "wasted corporate assets" by exposing those assets to Matsushita's Exchange Act liabilities. *Id.*; *see Epstein v. MCA, Inc.*, 50 F.3d 644, 660 (9th Cir. 1995). This Court observed in a footnote that § 27 did not apply because the "cause pled was … a state

[3] If anything, § 28 *undermines* respondents' argument, because it demonstrates that Congress appreciated the difference between "rights and remedies," on the one hand, and "duties" on the other. If Congress had limited § 27 jurisdiction to suits asserting "rights and remedies created by the Exchange Act," this would be a very different case.

common-law action for breach of fiduciary duty," 516 U.S. at 382 n.7—an action that could not be based on the MCA directors' breach of Exchange Act duties, because the Exchange Act imposed no duties on those directors. Unlike here, in other words, the Delaware complaint in *Matsushita* did not seek to enforce *Exchange Act duties* against the defendants.

The *Matsushita* footnote thus does not establish that state-law causes of action are categorically excluded from § 27. And *Matsushita* otherwise confirms that § 27 *is* implicated when a state court is asked to resolve Exchange Act questions, creating a "danger that state court judges who are not fully expert in federal securities law will say definitively what the Exchange Act means and enforce legal liabilities and duties thereunder." *Id.* at 383. The complaint here asks New Jersey courts to do exactly that, which is why it triggers § 27 jurisdiction.

### B. Section 27 Is Not Coextensive With § 1331 "Arising Under" Jurisdiction

Respondents' next argument is that § 27 jurisdiction is coextensive with § 1331 because, in their view, § 27 is triggered only when a state-law claim "*necessarily* turns on federal law." Resp. Br. 46; *see Grable & Sons Metal Prods., Inc. v. Darue Eng'g & Mfr'g*, 545 U.S. 308, 314 (2005) (§ 1331 jurisdiction over state-law claim triggered only if claim necessarily requires resolution of federal issue). But by establishing jurisdiction over suits "*brought* to enforce" Exchange Act duties, § 27's language focuses on what the plaintiff *asks* the court to do, not on what the cause of action would *require* the court to

do. The latter inquiry has been read into § 1331 for policy reasons that do not apply to § 27.

1. To construe § 27, respondents rely heavily on rules established in construing § 1331 jurisdiction. But if Congress had intended § 27 to establish only traditional "arising under" jurisdiction, it would have used the same "arising under" language Congress used in many other jurisdictional provisions. Petr. Br. 37-38. Congress conspicuously rejected that formulation in § 27 in favor of a more precise jurisdictional test. Respondents are correct to say that "Congress legislates against the backdrop of traditional jurisdictional principles, and it presumably intends to invoke those traditional principles *unless it affirmatively says otherwise*." Resp. Br. 40 (emphasis added). But respondents ignore their own caveat: Congress here *did* "affirmatively say[] otherwise" by using language different from the "traditional" "arising under" formulation.

Respondents make no effort to explain why Congress would use completely different language to mean exactly the same thing.[4] They instead rely on

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[4] Public Citizen speculates that § 27 was intended in part to grant federal jurisdiction without the amount-in-controversy requirement that § 1331 included at the time. Public Citizen Br. 10. But Congress did not need any special provision to accomplish that goal. When the Exchange Act was enacted, there was already a separate statute—28 U.S.C. § 41(8) (1934), now codified as 28 U.S.C. § 1337—establishing federal jurisdiction over "'all suits and proceedings arising under *any law regulating commerce*,' irrespective of the amount involved." *Peyton v. Ry. Express Agency*, 316 U.S. 350, 351 (1942) (quoting 28 U.S.C. § 41(8)) (emphasis added). The Exchange Act is a "law regulating commerce," as its preamble expressly states, 15

statements in opinions from the Court and individual Justices that have described § 27 "*in passing*" as "a traditional 'arising under' jurisdictional grant." Resp. Br. 37 (emphasis added). These concededly offhand references do not establish controlling constructions of § 27. And the fact that opinions addressing other issues occasionally have employed familiar shorthand when precision was unnecessary hardly establishes that § 27 can be "naturally read" to say something it does not.[5]

The language of § 27 is explained by a problem this Court addressed in *Moore* several months before passage of the Act. The plaintiff in *Moore* asserted a state-law statutory negligence cause of action, but alleged a "breach of the duty imposed by" the federal Safety Appliance Acts ("SAA") to establish the alleged negligence. 291 U.S. at 214. This Court held that "although violation of the [SAA] is involved," the action did not "arise under" the SAA within the

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U.S.C. § 78b, and thus no additional jurisdictional provision would have been needed to encompass Exchange Act cases below § 1331's monetary threshold. The different language of § 27 establishes that Congress intended something *different from* the already-existing "arising under" formulation used in § 1331 and § 1337.

[5] Respondents also cite footnoted dicta in *Pan American Petroleum Corp. v. Superior Court*, 366 U.S. 656 (1961), construing the similarly worded § 22 of the Natural Gas Act ("NGA"). But respondents admit that the question presented here was not presented in *Pan Am*, which held only that the well-pleaded complaint rule applies under the NGA. Resp. Br. 39; *see* Petr. Br. 32-33. The footnote on which respondents rely simply states that the language of § 22 does not preclude application of the well-pleaded complaint rule. 366 U.S. 665 n.2.

meaning of § 1331's predecessor, because the cause of action itself remained fundamentally state-law in character. *Id.* at 216. Section 27 avoids that problem by replacing the traditional "arising under" formulation with the "brought to enforce … any duty" language, thereby ensuring federal jurisdiction over state-law suits that allege violation of Exchange Act duties as a basis for recovery.

In any event, even if respondents were right that § 27 is "naturally read" to confer jurisdiction over any claim "arising under" the Exchange Act, it would not help them, because that expansive term is *naturally* read to include "all cases in which a federal question is 'an ingredient' of the action." *Merrell Dow Pharm. Inc. v. Thompson*, 478 U.S. 804, 807 (1986) (quoting *Osborn v. Bank of the United States*, 22 U.S. (9 Wheat.) 738, 823 (1824)). And there is no dispute that federal jurisdiction would exist here under that construction of "arising under" jurisdiction.

But this Court has never read § 1331 "naturally." It has instead "construed the statutory grant of federal-question jurisdiction as conferring a more limited power," *id.*, for policy reasons specific to § 1331. The main concern is that a natural reading of § 1331 would overrun federal courts with cases that could just as easily be handled by state courts. Petr. Br. 35-36. There is no comparable policy reason to impose such artificial narrowing on § 27. Unlike § 1331, § 27 is *already* limited to a very narrow category of cases: suits brought to enforce the defendant's alleged Exchange Act duties. That language excludes a case in which the Exchange Act duty

arises only by way of defense, because that suit would not be *brought to enforce* the duty. The statutory language likewise precludes jurisdiction over the cases feared by Justice Cardozo, where the Exchange Act issue is merely "lurking in the background." *Gully v. First Nat'l Bank*, 299 U.S. 109, 117 (1936).

Under § 27's plain text, federal jurisdiction is triggered by a state-law claim only where a plaintiff chooses to *allege an Exchange Act duty-breach as a basis for liability* and thus asks the court to adjudicate the Exchange Act duty as part of the claim. In such cases, there is not just a "mere possibility" that the court will address the Exchange Act issue, as respondents repeatedly mischaracterize petitioners' position. There is instead every reason to presume that the state court will resolve the case as pleaded and adjudicate the duty. Section 27 exists to prevent that very outcome.

There is also a strong policy reason to interpret § 27 more broadly than § 1331, for claims that fall within § 27's narrow confines. Because § 27 was enacted specifically to keep certain cases in federal court, its language cannot be construed by reference to the traditional § 1331 jurisdictional principle that state courts are competent to resolve most federal questions, as respondents urge. Resp. Br. 48-49. Section 27's exclusive jurisdiction is founded on the *opposite* premise, *viz.*, that "state court judges" are *not* presumed competent to "say definitively what the Exchange Act means and enforce legal liabilities and duties thereunder." *Matsushita*, 516 U.S. at 383. Respondents observe that state courts do adju-

dicate various general securities-law issues, but the Exchange Act is unique among federal securities laws, addressing the particularly national interests inherent in the national trading markets' proper functioning. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 752 (1975); 15 U.S.C. § 78b (Exchange Act preamble). The fact that some state courts sometimes address fraud by individual issuers in particular securities transactions gives them no expertise in enforcing the reticulated duties the SEC has prescribed to regulate trading on national exchanges.

Finally, importing § 1331's federal-necessity rule into § 27 is not required to make § 27 jurisdiction "workable." Resp. Br. 50. Section 27's jurisdictional rule is already more administrable than the § 1331 multifactor test respondents would impress onto § 27. Under § 27, a court need only ask whether the complaint seeks to establish liability on the ground that the defendant breached an Exchange Act duty. By contrast, § 1331 requires a court to determine whether the federal issue is "(1) necessarily raised, (2) actually disputed, (3) substantial, and (4) capable of resolution in federal court without disrupting the federal-state balance approved by Congress." *Gunn v. Minton*, 133 S. Ct. 1059, 1065 (2013).

The difficulty of the latter inquiry is illustrated by the decisions below, both of which *agreed* that respondents' complaint sought to establish liability in part on the ground that petitioners allegedly violated Regulation SHO, *see infra* at 18, as required for jurisdiction under § 27's plain terms. Yet the courts came to opposite conclusions about § 1331 jurisdic-

tion. *Compare* Pet. App. 33a-34a *with* Pet. App. 13a-18a. Their disagreement was based only on the "necessity" requirement, i.e., whether liability could *possibly* be based on breach of a state-law duty, rather than on the breaches of Regulation SHO duties explicitly pleaded as a basis for liability. The court of appeals did not even reach the additional inquiries required under § 1331, including whether the issue was sufficiently "substantial," and whether jurisdiction would "disrupt[] the federal-state balance."

The fact that § 27 is easier to apply than § 1331 is not to say that jurisdictional inquiries under § 27 will always be devoid of controversy. Important legal rules rarely are. But § 27's straightforward rule is certainly *more* administrable than the § 1331 construct respondents would gloss onto § 27. And because § 27 does not implicate the policy concerns that led to that construct, the fact that § 27's language still might "entail[] some uncertainty" provides "no excuse for judicial amendment of the statute." *Knight v. CIR*, 552 U.S. 181, 194 (2008).

2. Respondents' reading of § 27 also cannot be reconciled with its central objective of keeping Exchange Act issues largely out of state court and thereby assuring "greater uniformity of construction and more effective and expert application of" the Exchange Act and its regulations. *Matsushita*, 516 U.S. at 383 (quotation omitted).

Respondents do not seriously contend that their interpretation of § 27 would advance Congress's objective of mitigating the "danger that state-court judges who are not fully expert in federal securities law will say definitively what the Exchange Act

means and enforce legal liabilities and duties thereunder." *Id.* Respondents instead invoke the truism that no statute seeks to achieve its purpose at all costs, and they observe that the well-pleaded complaint rule precludes absolute interpretive uniformity and expert application of the Exchange Act. Resp. Br. 41-43. But nobody contends that § 27 must create *complete* interpretive uniformity—its principal objective was to assure "*greater* uniformity" than § 1331 would allow. *Matsushita*, 516 U.S. at 383 (emphasis added). Applying § 27 by its plain terms would further that purpose, whereas respondents' atextual interpretation would authorize state courts to make definitive, precedential rulings on Exchange Act duties merely because those courts *might* issue dispositive rulings on state-law issues instead.

Consider the example the Third Circuit cited: a state-law RICO suit alleging both Exchange Act and state-law violations as predicate acts. Pet. App. 15a. Because such a suit expressly asks the court to interpret and enforce Exchange Act duties, it falls unambiguously within § 27's ambit. There is no basis in the text or purpose of § 27 for excluding such a suit merely because it *also* asks the court to find violations of independent state-created duties. Yet respondents' theory would require those suits to proceed in state court. Pet. App. 15a.

The example illustrates why § 27 does not exclude state-law claims that seek enforcement of the defendant's Exchange Act duties merely because it is *possible* that "no actual federal issue" will be "ultimately reached." Resp. Br. 49. For one thing, it is highly unlikely that when a complaint explicitly in-

vokes a federal duty as a basis for liability, a federal court would simply ignore the federal duty and focus solely on alternative state-law duties. But even that rare situation would hardly constitute a unique or troubling exercise of federal judicial power. Federal courts *routinely* resolve purely state-law issues when they exercise diversity jurisdiction. *See* 28 U.S.C. § 1332. And the federal-officer removal statute, 28 U.S.C. § 1442(a), requires only the existence of a federal *defense*. *Mesa v. California*, 489 U.S. 121, 136 (1989). That statute reflects a "congressional policy" that the federal interests involved "require the protection of a federal forum," *Kircher v. Putnam Funds Trust*, 547 U.S. 633, 644 n.12 (2006), even though the court might never reach any federal issue.

The same policy is embodied in the Exchange Act, which was enacted to "remove impediments to and perfect the mechanisms of a *national* market system for securities and a *national* system for the clearance and settlement of securities transactions," and to "protect," among other things, "interstate commerce, the national credit, the Federal taxing power." 15 U.S.C. § 78b (emphasis added). And the whole point of § 27 was to assure that this overriding *federal* interest would be protected by expert *federal* courts.

3. Respondents also cite a separate statute, § 22 of the Securities Act of 1933, to argue that Congress intended § 27 to operate as an ordinary "arising under" jurisdictional grant. But Securities Act § 22 only confirms the error in respondents' analysis of § 27.

Unlike § 27, Securities Act § 22 establishes concurrent jurisdiction in federal and state courts, but otherwise uses nearly identical jurisdictional lan-

guage. 15 U.S.C. § 77v(a). Also unlike § 27, § 22 includes a non-removal clause, which provides: "Except as provided in section 77p(c) of this title, no case arising under [the Securities Act] and brought in any State court of competent jurisdiction shall be removed to any court of the United States." 15 U.S.C. § 77v(a)). Respondents assume that "arising under" as used in that non-removal clause refers to the language of § 1331. They then reason that because § 22's jurisdictional grant cannot logically be broader than its non-removal clause, the jurisdictional grant cannot confer jurisdiction more broadly than § 1331. And because § 22's jurisdictional grant is identical to § 27's, respondents conclude that § 27 also cannot confer jurisdiction more broadly than § 1331. Resp. Br. 35-36.

Respondents' logic fails at its threshold premise: the phrase "arising under" as used in § 22's non-removal clause refers not to § 1331 jurisdiction, but to the full limits of Article III jurisdiction. This distinction is evident both from the legal backdrop against which § 22 was enacted, and from a subsequent amendment confirming the distinction.

a. At the time the Exchange Act was enacted, this Court's precedents established that the phrase "arising under" as used in *removal* provisions referred to Article III limits, not the more restricted limits of *statutory jurisdictional grants*. The first federal-question jurisdiction provision, enacted in 1875, both granted original jurisdiction over "all suits ... arising under" federal law and permitted parties to remove from state court any civil suit "arising under" federal law. 18 Stat. 470, 470-71.

This Court held that the 1875 law's "arising under" removal provision reached any case within Article III's broad scope, including any case in which a federal question "forms an ingredient of the original cause" even though it also "involves questions which do not at all depend on the Constitution or laws of the United States," and any case where the federal issue would be raised only by way of defense. *New Orleans, M. & T.R. Co. v. Mississippi*, 102 U.S. 135, 141 (1880); *see Union Pac. Ry. Co. v. Myers*, 115 U.S. 1, 13-14 (1885). In *Metcalf v. City of Watertown*, 128 U.S. 586 (1888), however, the Court held that the 1875 act's "arising under" jurisdictional grant did *not* invoke the limits of Article III, but included what is now labeled the "well-pleaded complaint rule" and thus was not triggered by the existence of a federal defense. *Id.* at 588-89. *Metcalf* distinguished *Mississippi* as a "removal case[]." *Id.* at 589.

In 1887, Congress amended the federal-question removal provision, superseding *Mississippi* and *Myers* by limiting removal to suits "arising under" federal law "of which the courts are given original jurisdiction by the preceding section." 24 Stat. 552, 553-54. This Court subsequently held that this new and narrower removal provision was coextensive with the narrower statutory "arising under" jurisdictional grant, but only because of the specific language Congress added in the 1887 Act. *See Tennessee v. Union & Planters' Bank*, 152 U.S. 454, 461-62 (1894).

The 1933 Congress thus would have recognized that the term "arising under" in the removal context invoked full Article III jurisdiction *unless* the term was limited by additional statutory language. By

omitting any such limitation from § 22's "arising under" non-removal provision, Congress invoked the limits of Article III jurisdiction and imposed the broadest possible bar to removal, thereby avoiding any disputes over removal of cases in which a Securities Act issue arose only as a defense or was only an "ingredient" of the pleaded claims.

b. A 1998 amendment to § 22's non-removal clause confirms that its reference to "arising under" invokes Article III jurisdiction rather than § 1331's statutory limits. That amendment added a proviso—which respondents' brief replaces with an ellipsis, Resp. Br. 36—excluding certain cases from the non-removal provision. The provision now reads: "*Except as provided in section 77p(c) of this title*, no case arising under" the Securities Act and filed in state court "shall be removed to any court of the United States." 15 U.S.C. § 77v(a) (emphasis added). The "except" proviso refers to cases that fall *outside* § 1331, but *within* Article III—they are "covered class action[s] based upon the *statutory or common law of any State* or subdivision thereof" that allege securities fraud, regardless whether the complaint alleges a Securities Act violation. 15 U.S.C. § 77p(b) (emphasis added); *see Kircher*, 547 U.S. at 642 (only cases falling within § 77p(b) are removable under § 77p(c)). Federal jurisdiction in such removed cases is predicated only on the federal preclusion *defense* created by § 77p(b). *See Kircher*, 547 U.S. at 642-44 & n.12. The "except" proviso thus confirms that—consistent with this Court's pre-1933 precedents construing "arising under" in the removal context—§ 22's non-removal clause invokes full Article III ju-

risdiction, rather than the narrower limits prescribed by § 1331.

c. In sum, read as a whole and in the context in which it was originally enacted, § 22's non-removal clause does not support, but undermines, respondent's contention that § 22's jurisdictional grant (and hence § 27's as well) must be read as coextensive with § 1331 "arising under" jurisdiction. The clause reflects Congress's recognition that a removal prohibition *broader* than § 1331 is necessary to bar removal of any case falling within § 22's jurisdictional grant. It follows that § 27's jurisdictional grant is likewise broader than § 1331, at least for the narrow category of cases the provision addresses.

### C. Section 27's Plain Language Encompasses Respondents' Complaint

As both courts below recognized, respondents' complaint asserts violations of Regulation SHO duties and therefore triggers § 27 jurisdiction unless § 27 is limited to suits in which adjudication of an Exchange Act duty is *necessary* to resolution of the claim. Pet. App. 29a (district court) ("the alleged unlawful conduct is predicated on a violation of Regulation SHO"); *id.* at 9a (Third Circuit) (respondents "assert in their Amended Complaint, both expressly and by implication, that [petitioners] repeatedly violated federal law," i.e., Regulation SHO).[6] Respond-

[6] Respondents cite the Third Circuit's statement that none of the claims in the complaint "are predicated *at all* on a violation of Regulation SHO," Pet. App. 14a, but that portion of the opinion was analyzing jurisdiction under § 1331 and its required "necessity" showing. Pet. App. 13a-15a. As the court explained in the next two sentences—omitted by respondents—

ents essentially agree—as they put it, their complaint does not trigger federal jurisdiction because they "do not *need* to prove anything about Regulation SHO to establish their state law claims." Resp. Br. 30 (emphasis added). And petitioners, they say, can establish jurisdiction only by showing "that at least one of Respondents' causes of action might somehow *require* a judicial determination that Regulation SHO had been violated." Resp. Br. 29 (emphasis added).

As already shown, however, necessity is relevant to § 1331, not to § 27. And leaving necessity aside, there is no doubt that § 27 is satisfied: respondents elected to allege that petitioners violated duties created by Regulation SHO as a basis for tort recovery under New Jersey law, even if they could *also* establish liability on independent state-law grounds.[7]

The complaint seeks to establish liability for conduct respondents describe interchangeably as "un-

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the New Jersey RICO claim did not explicitly identify a violation of Regulation SHO as a "predicate act," and the other state-law claims did not "*necessarily* need to be predicated on a violation of Regulation SHO for Plaintiffs to have a chance at recovering under state law." Pet. App. 15a (emphasis added). At the certiorari stage, respondents argued that that the same statement from the Third Circuit's opinion created an "antecedent fact question" about the complaint's allegations that made the case a "poor vehicle" for resolving § 27's meaning. Opp. 14. This Court implicitly rejected that contention in granting certiorari.

[7] Petitioners have always contended that the complaint satisfies § 1331. If § 1331's necessity requirement also applies to § 27, petitioners submit that the complaint still triggers jurisdiction.

lawful naked short selling" or "illegal short selling." Respondents allege that short selling is a "legal and accepted trading strategy," but only "[w]hen conducted in accordance with securities and other laws and regulations." Pet. App. 49a (Compl. ¶ 24). And "a critical requirement of a *lawful* short sale," the complaint alleges, is compliance with "securities laws and regulations [that] require a Short Seller to borrow the stock it sold and deliver that borrowed stock within three days of the short sale (the 'Settlement Date')," a "settlement cycle … known as 'T+3.'" Pet. App. 49a-50a (Compl. ¶ 24).

The only securities law or regulation identified in the complaint as allegedly "requir[ing] a Short Seller to borrow the stock it sold and deliver that borrowed stock" is Regulation SHO. Pet. App. 51a-52a (Compl. ¶¶ 24, 28). According to the complaint, Regulation SHO was promulgated to establish "uniform 'Locate' and 'Close-Out' requirements and prevent unlawful naked short selling, in which market participants like the Defendants … never intended to borrow or locate for delivery to buyers and close-out by settling their trades." Pet. App. 52a (Compl. ¶ 28). The complaint alleges that Regulation SHO requires a seller to "Locate" stock—i.e., identify shares to borrow—and deliver shares on the T+3 Settlement Date or immediately "Close-Out" the "fail to deliver." The complaint alleges that petitioners' decisions not to do so means they engaged in "unlawful naked short selling" that created an "unauthorized, fictitious and/or phantom share of stock." Pet. App. 44a, 51a-52a, 54a-56a (Compl. ¶¶ 4, 27-28, 31, 34-35); *see* Petr. Br. 9-10, 20-21. The only alleged

source of the duties to "Locate" and "Close-Out" is Regulation SHO itself—as the Third Circuit recognized, "there is no New Jersey analogue to Regulation SHO." Pet. App. 9a.

The complaint, in short, *defines* the "illegal short selling" that is the basis for liability as short selling in violation of Regulation SHO duties. The complaint then alleges that petitioners committed a pattern of this "illegal short selling," as illustrated by repeated alleged violations of Regulation SHO. Pet. App. 75a-81a (Compl. ¶ 81-85). Turning to respondents' claimed injuries, the complaint alleges that petitioners committed this same "illegal short selling" to create "counterfeit shares" of Escala stock and thereby dilute respondents' share values, Pet. App. 57a-75a, 81a-82a (Compl. ¶¶ 39-80, 86-87), including by giving and receiving "false 'Locates'" of Escala stock, Pet. App. 58a (Compl. ¶ 41). The complaint also cites the Regulation SHO "Threshold list" of "fail[s] to deliver" for Escala stock to establish that petitioners were committing "naked short selling" to "manipulate the pricing of Escala downward." Pet. App. 63a (Compl. ¶ 53). Finally, respondents' state-law causes of action assert as a basis for liability respondents' "illegal" or "unlawful" "naked short selling"—again, defined in the complaint as short selling that violates Regulation SHO duties—which allegedly injured respondents by creating "counterfeit shares" of Escala stock through failures to obtain a Regulation SHO Locate and to deliver by the Settlement Date. Pet. App. 85a-86a, 88a, 95a, 96a, 97a, 99a, 100a) (Compl. ¶¶ 98, 100, 105, 131, 137, 143, 152, 157).

Those allegations unambiguously seek to enforce Regulation SHO's Locate and Close-Out duties through state-law remedies. Pet. App. 101a. The alleged Regulation SHO violations are hardly mere "background" (Resp. Br. 30)—they are central to the liability respondents seek to establish. It is fantasy to suggest that the complaint's claims are "based exclusively on state law—in every respect." Resp. Br. 31 n.21. Respondents say that Regulation SHO is not mentioned "in *any* of the 73 paragraphs of the Amended Complaint setting forth Respondents' claims against Petitioners." Resp. Br. 30 (citing Pet. App. 82a-93a (Compl. ¶¶ 88-122)). But *the first paragraph* they cite incorporates every prior allegation by reference. Pet. App. 82a (Compl. ¶ 88). And the substantive claims that follow explicitly allege liability based on the "unlawful" or "illegal" "naked short selling" that is earlier *defined* as a violation of Regulation SHO duties. *See supra* at 21-22.

Even if a court adjudicating the complaint could theoretically ignore the alleged Regulation SHO duties that saturate the complaint and still find liability, breaches of those duties nevertheless are *alleged* as a basis for state-law liability, which suffices to trigger jurisdiction under § 27. And make no mistake, those allegations matter, even if there is a possibility that respondents might prevail in the absence of Regulation SHO, as respondents suggest. Resp. Br. 2. If respondents had not chosen to allege Regulation SHO duties, their case would look very different: the complaint could not assert violations of the Locate and Close-Out requirements, because no such requirements exist under any New Jersey

law or regulation, and respondents therefore could not base any claims on "illegal short selling" as they currently define it. Petitioners, in turn, would have a compelling motion to dismiss on the ground that the conduct alleged violates no duty prescribed by New Jersey law. As it is, however, the complaint respondents chose to plead is one that relies on Regulation SHO duties as a basis for state-law liability, which is why the complaint triggers § 27 jurisdiction.

## CONCLUSION

The decision below should be reversed.

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# STATUTORY APPENDIX

# APPENDIX

**Section 2 of the Securities Exchange Act of 1934 provides:**

**15 U.S.C. § 78b. Necessity for regulation**

For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports to remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions and the safeguarding of securities and funds related thereto, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions:

(1) Such transactions (a) are carried on in large volume by the public generally and in large part originate outside the States in which the exchanges and over-the-counter markets are located and/or are effected by means of the mails and instrumentalities of interstate commerce; (b) constitute an important part of the current of interstate commerce; (c) involve in large part the securities of issuers

engaged in interstate commerce; (d) involve the use of credit, directly affect the financing of trade, industry, and transportation in interstate commerce, and directly affect and influence the volume of interstate commerce; and affect the national credit.

(2) The prices established and offered in such transactions are generally disseminated and quoted throughout the United States and foreign countries and constitute a basis for determining and establishing the prices at which securities are bought and sold, the amount of certain taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and the value of collateral for bank loans.

(3) Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities which (a) cause alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce, (b) hinder the proper appraisal of the value of securities and thus prevent a fair calculation of taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and (c) prevent the fair valuation of collateral for bank loans and/or obstruct the effective operation of the national banking system and Federal Reserve System.

(4) National emergencies, which produce widespread unemployment and the dislocation of

trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets, and to meet such emergencies the Federal Government is put to such great expense as to burden the national credit.

**Section 27 of the Securities Exchange Act of 1934 provides in relevant part:**

**15 U.S.C. § 78aa. Jurisdiction of offenses and suits**

**(a) In general**

The district courts of the United States * * * shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. * * *

* * *

**Section 28 of the Securities Exchange Act of 1934, provides in relevant part:**

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

* * *

**(b) Rule of construction**

Except as provided in subsection (f), the rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity.

* * *

**Section 16 of the Securities Act of 1933, as amended by § 101(a) of the Securities Litigation Uniform Standards Act Of 1998, provides in relevant part:**

**15 U.S.C. § 77p. Additional remedies; limitation on remedies**

* * *

**(b) 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—

(1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or

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

**(c) Removal of covered class actions**

Any covered class action brought in any State court involving a covered security, as set forth in subsection (b), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b).

* * *

**Section 22 of the Securities Act of 1933 provides in relevant part:**

**15 U.S.C. § 77v. Jurisdiction of offenses and suits**

**(a) Federal and State courts; venue; service of process; review; removal; costs**

The district courts of the United States * * * shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, except as provided in section 77p of this title with respect to covered class actions, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. * * * Except as provided in section 77p(c) of this title, no case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. * * *

* * *