11-0122-cv

United States Court of Appeals

for the

Second Circuit

WC CAPITAL MANAGEMENT, LLC,

Plaintiff-Appellant,

WILLOW CREEK CAPITAL PARTNERS, L.P., a Delaware Limited partnership, WILLOW CREEK SHORT BIASED 30/130 FUND, L.P., a Delaware Limited partnership,

Plaintiffs-Counter-Defendants-Appellants,

– v. –

UBS SECURITIES, LLC, a Delaware limited liability company, UBS AG, a Swiss company,

Defendants-Counter-Claimants-Appellees.

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

BRIEF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS *AMICUS CURIAE* SUPPORTING DEFENDANTS-COUNTER-CLAIMANTS-APPELLEES

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RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Amicus curiae Securities Industry and Financial Markets Association is a non-profit corporation. It has no parent corporation and no publicly held corporation owns 10% or more of its stock.

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STATEMENT OF INTEREST OF THE AMICUS CURIAE[1]

The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). An important function of SIFMA is to represent the interests of its members in the federal courts in cases addressing issues of widespread concern in the securities and financial markets.

SIFMA files *amicus curiae* legal briefs in court cases that raise important policy issues that impact the markets represented by SIFMA or otherwise affect common practices within the financial services industry. SIFMA's *amicus* program relies on judicious case selection to ensure that its advocacy focuses on the most significant and pressing industry interests. Over the past thirty-five years, SIFMA has participated as *amicus curiae* in hundreds of cases. SIFMA has filed nearly a dozen *amicus* briefs in this Court alone, including most recently

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[1] Under Fed. R. App. P. 29(c)(5), SIFMA certifies that no party's counsel authored this brief in whole or in part, and no party or party's counsel contributed money intended to fund the preparation or submission of this brief.

Viking Global Equities LP v. Porsche AG Wendelin Wiedeking, 11-cv-0397 (2d Cir. Aug. 3, 2011) (arguing against the extraterritorial application of Rule 10(b), and a private right thereunder, based on Swap transactions references); *Wilson v. Merrill Lynch & Co., Inc.*, 10-cv-01528 (2d Cir. July 8, 2011) (arguing that the manipulative acts element of a market manipulation claim cannot be satisfied where the challenged conduct reflected a common industry practice that was widely known to investors and disclosed in accordance with the guidance of the Securities and Exchange Commission ("SEC")).

SIFMA files this brief in support of appellees UBS Securities LLC and UBS AG (collectively, "UBS")[2] because inherent in appellants' claims against UBS under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (the "Act"), and Rule 10b-16 thereunder, 17 C.F.R. § 240.10b-16, is a threshold jurisdictional question: Whether Rule 10b-16 provides a private right of action? The district court did not address this question expressly, ruling instead that appellants could not state a claim for a violation of the Rule because the initial margin credit disclosure statement that was provided to them complied with the notice and disclosure obligations set forth in the Rule. While SIFMA believes that the record amply supports the district court's decision, this Court may, of course, affirm on any grounds supported in

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[2] UBS is a member of SIFMA.

the record, even if it is not one on which the district court relied. *Abrahams v. MTA Long Island Bus*, 644 F.3d 110, 115 (2d Cir. 2011). As discussed below, SIFMA respectfully submits that affirmance would also be proper on the separate and independent ground that Rule 10b-16 does not provide a private right of action.

This Circuit has not yet ruled on that question. *In re Refco Sec. Litig.*, 586 F. Supp. 2d 172, 195 (S.D.N.Y. 2008) (raising but not deciding the issue). SIFMA seeks to be heard on its members' behalf because the implication of a private enforcement right to enforce the Rule would impermissibly expand the scope of its enabling statute, Section 10(b), and uproot the balance of enforcement mechanisms that exists under the federal securities laws, whether they be express, implied or brought by the SEC.

Congress has consistently afforded margin credit regulations special status, and reserved the power to set, administer and enforce those regulations to the federal agencies uniquely positioned to understand them and the systemic risks they are designed to guard against. The implication of a private right of action under Rule 10b-16 would upset that regulatory balance without advancing the cause of full disclosure, which is ably achieved by other means. Further, by arming aggrieved margin customers with the ability to shift their market losses through the threat or instigation of private lawsuits against their margin lenders,

broker-dealers may find it necessary to protect themselves by increasing the costs of margin lending or decreasing the extension of margin credit. Congress and federal agencies have been careful to regulate margin lending without impairing the capital raising function that margin credit promotes. Private litigants should not be permitted to undermine that goal under a tortured interpretation of Section 10(b) and Rule 10b-16.

ARGUMENT

I. IMPLICATION OF A PRIVATE ENFORCEMENT RIGHT UNDER RULE 10b-16 CONFLICTS WITH CLEAR CONGRESSIONAL RECOGNITION THAT MARGIN CREDIT REGULATION IS PROTECTIVE OF THE ECONOMY AND RESERVED FOR FEDERAL ENFORCEMENT

An implied private right of action under Rule 10b-16 runs counter to clear congressional indications that the regulation of margin credit and margin credit disclosure involves important economic concerns and occupies a special status in the regulatory scheme that is uniquely for federal administration and enforcement.[3]

From its inception at the turn of 19th to the 20th century, margin regulation has been designed to promote prudent lending and risk management practices that

[3] The policy reasons against expansion of Section 10(b) set forth herein are, of course, in addition to the Supreme Court's recent mandate that congressional intent is determinative of whether a private right of action exists, and the absence of evidence that Congress intended to create one here. *See Alexander v. Sandoval*, 532 U.S. 275 (2001); *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 164 (2008); *Janus Capital Grp., Inc. v. First Derivative Traders*, ___ U.S. ___, 131 S. Ct. 2296 (2011), discussed *infra*.

protect the solvency of financial institutions extending margin credit. In 1913, the New York Stock Exchange passed a resolution stating that "the acceptance and carrying of an account for a customer, either a member or a nonmember, without proper and adequate margin may constitute an act detrimental to the welfare and interest of the Exchange." Resolution of the Governing Committee, New York Stock Exchange, January 13, 1913. The primary purpose of the resolution was to protect the Exchange from the insolvency of members. Bogen and Krooss, *Security Credit, Its Economic Role and Regulation* 76 (1960). The proliferation of margin credit and the money panics that occurred at the start of the century prompted Congress to create the Federal Reserve System in 1913 to "provide the nation with a safer, more flexible and more stable monetary and financial system." http://www.federalreserve.gov/aboutthefed/mission.htm. As its mission statement makes clear, the Federal Reserve is the prudential regulator of the economy, not the protector of individuals.

In 1933, with the passage of the Banking Act, the Board of Governors of the Federal Reserve (the "FRB") was given the power to limit the supply of funds for securities lending by imposing limits on the amount of capital and surplus a member bank may loan. Pub. L. No. 73-66, 48 Stat. 162. In 1934, the Securities Exchange Act was passed and directed the FRB to prescribe rules "with respect to the amount of credit that may be initially extended and subsequently maintained on

any non-exempted security." 15 U.S.C. § 78g(a). This responsibility was vested in the FRB notwithstanding significant debate over whether it was better assigned to the SEC. Bogen & Krooss, *supra*, at 98. The FRB thereafter issued Regulation T, applicable to extensions of credit by broker-dealers. In doing so, the FRB recognized that it was important that margin regulation not hamper the raising of new capital by industry. *Id*. at 113.

Since receiving its mandate in 1934, the FRB has continued to set and interpret margin credit policy and to preside over an integrated system in which the SEC enforces that policy, with assistance from self-regulatory agencies. For example, the Financial Industry Regulatory Authority ("FINRA"), in a rule approved by the SEC, requires that broker-dealers establish procedures to review limits and types of credit extended, formulate their own margin requirements and review the need to institute higher margin requirements than are required by FINRA. FINRA Rule 4210. FINRA members are required to establish specific limits to "prevent any one customer or group of customers from endangering the member's capital." *Id*.

The uniquely federal nature of margin regulation enforcement is evident in the history of Section 7 of the Act, which governs margin requirements. Initially, and in a period when courts exercised significantly more latitude to imply private rights, courts permitted a private right of action by aggrieved investors under that

Section. *See, e.g.*, *Pearlstein v. Scudder & German*, 429 F.2d 1136 (2d Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971) ("*Pearlstein I*") (allowing a private right of action under Section 7 because private actions had been recognized as "effective means of protecting the economy as a whole"). Thereafter, Congress amended Section 7 to add sub-section (f), which makes it illegal for an investor to accept credit in violation of the margin rules. 15 U.S.C. § 78g(f) . This amendment was perceived by the courts to signal Congress's intent to protect the financial markets, rather than individual investors and lenders, through margin regulation. *Pearlstein v. Scudder & German*, 527 F.2d 1141, 1145 n. 3 (2d Cir. 1975) ("*Pearlstein II*") (the addition of subsection (f) "cast[s] doubt on the continued viability of the rationale" of *Pearlstein I*).

In *Bennett v. U.S. Trust Company of N.Y.,* 770 F.2d 308 (2d Cir. 1985), decided even before the shift in implied rights jurisprudence placed singular importance on evidence of congressional intent, the court made clear that there is no private cause of action under Section 7, expressing doubt that "allowing a private cause of action would be consistent with the 'underlying purposes of the legislative scheme,'" which is to regulate the use of credit in securities transactions. The court reasoned that while a private cause of action might deter violations by lenders, "it seems just as conceivable that it could encourage violations by investors seeking to shift the risk of loss." *Bennett*, 770 F.2d at 313

(internal citations omitted).

The unique importance of margin regulation for the protection of the economy and not individual investors is evident in other statutory schemes. The Bankruptcy Code, for example, contains a series of provisions addressing securities contracts. Section 555 of the Bankruptcy Code provides that the exercise of a contractual right to liquidate, terminate or accelerate a securities contract, including a margin contract, "shall not be stayed, avoided or otherwise limited by operation of any provision of this title" unless authorized by the Securities Investor Protection Act or any statute administered by the SEC. 11 U.S.C. §§ 555, 556 & 561. The legislative history of these provisions states that:

> These provisions are intended to reduce "systemic risk" in the banking system and financial marketplace. To minimize the risk of disruption when parties to these transactions become bankrupt or insolvent, the bill amends provisions of the banking and investment laws, as well as the Bankruptcy Code, to allow the expeditious termination or netting of certain types of financial transactions.

H.R. Rep. No. 109-31, pt. 78 at 20 (2005). The house report on a substantially similar bill that was introduced in the 105th Congress explained that:

> Systemic risk is the risk that the failure of a firm or disruption of a market or settlement system will cause widespread difficulties at other firms, in other market segments or in the financial system as a whole. If participants in certain financial activities are unable to enforce their rights to terminate financial contracts with an insolvent entity in a timely manner, or to offset or net

> their various contractual obligations, the resulting uncertainty and potential lack of liquidity could increase the risk of an intermarket disruption.

H.R. Rep. No. 105-688, pt. 1 at 2 (1998). The Securities Investor Protection Act generally incorporates these safe harbor provisions of the Bankruptcy Code. *See* 15 U.S.C. § 78fff(b).

Renewed emphasis on federal prudential management of systemic risk is evident in the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1367 (2010), which reinforces the role and power of federal regulators to prevent systemic risk, including by extending the scope of margin regulation to over-the-counter derivative products. *Id*. at §§ 376, 736.

To be sure, these statutes regulate margin credit, not the scope of disclosures to be made regarding margin credit terms and conditions. Section 10(b), in contrast, is an anti-fraud rule whose particular objective is to provide investors who purchase or sell securities with full disclosure of all material information. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976). Yet the history that led to the SEC's enactment of Rule 10b-16 is consistent with congressional recognition that margin credit disclosure too is a matter for careful, distinctly federal, regulation, and not for enforcement by individual investors.

Rule 10b-16 was adopted by the SEC at the direction of Congress as an analog to the Truth in Lending Act ("TILA"), 15 U.S.C. §1601 et seq. TILA was

enacted to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." *Id.* § 1602. Congress expressly created a private right of action under TILA, but specifically exempted securities accounts from the scope of the statute. *Id.* §§ 1604(2); 1640(c). The Senate Report noted that, in recommending the exemption, "the Committee intends for the SEC to require substantially similar disclosure by regulation as soon as it is possible to issue such regulation." Exchange Act Release No. 34-8773, 34 F.R. 19717 (1969). Congress' exemption of margin disclosures from the scope of TILA confirms that margin regulation is an area uniquely suited to regulation by the SEC and suggests that Congress did not wish to extend the private right in TILA to those disclosures. *Furer v. PaineWebber, Inc.*, 1982 WL 1309 (C.D. Cal. 1982) (exemption of margin disclosures from scope of TILA is plausible indication that Congress "did not wish to extend the private right extended therein to apply to brokers"); *see also Slomiak v. Bear Stearns & Co.*, 597 F. Supp. 676, 681 (S.D.N.Y. 1984) ("Congruity of purpose between TILA and Rule 10b-16 does not mandate identical enforcement mechanisms.").

The unique importance of margin credit, and so its regulation, reflected in these numerous statutory schemes, provides a strong reason not to extend the scope of Section 10(b) to support a private right of action under Rule 10b-16. The

practical consequences of expanding Section 10(b) to find a private right under Rule 10b-16 also argues against such a right. In times of severe market stress, market investors may find that risks they knowingly undertook have materialized. That is precisely when their creditors need, and are required to exercise for their own protection, and the protection of the economy more broadly, the ability to request more margin, often in compressed time frames driven by rapid market fluctuations. *See, e.g.*, FINRA Rule 4210; NASD Special Notice to Members 99-33 ("NASD Regulation believes that increasing the maintenance margin requirements to be applied to certain stocks is an appropriate response to extreme volatility in those stocks."). While of course investors should be informed that this may occur, that objective can be, and in fact is, achieved by means other than arming aggrieved investors with a private enforcement right. *See, e.g.*, FINRA Investor Alert, *Investing with Borrowed Funds: No Margin For Error*, http://www.finra.org/investors/protectyourself/investoralerts/marginandborrowing/p005973 ("Some firms raise their maintenance margin requirements for certain volatile stocks or a concentrated or large position in a single stock to help ensure that there are sufficient funds in their customer accounts to cover the large swings in the price of these securities. . . . These changes in firm policy often take effect immediately and may result in the issuance of a maintenance margin call (or 'house call'). Again, if you fail to satisfy the call,

your firm may liquidate a portion of your account.”).

Private enforcement of Rule 10b-16 could not only impede the nimble risk management responses that the margin regulation scheme is designed to promote, it could also impair investors’ access to margin credit and, by extension, hamper the capital raising process. The cost, uncertainty and disruption associated with litigation would “allow plaintiffs with weak claims to extort settlements from innocent companies.” *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740-41 (1975). Broker-dealers might find it necessary to protect themselves by raising the cost of margin credit and/or reducing its availability to the investing public. The Supreme Court has found these consequences to caution against the expansion of Section 10(b). *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 164 (2008).

II. THE SCOPE OF THE IMPLIED RIGHT OF ACTION UNDER SECTION 10(b) IS NARROW, AND IMPLYING ONE UNDER RULE 10b-16 EXCEEDS IT

Neither Section 10(b) nor Rule 10b-16 expressly provides a private right of enforcement. *Stoneridge*, 552 U.S. at 163; *In re Refco*, 586 F. Supp. 2d at 195. To establish that a private right exists to enforce a regulation, a plaintiff must show first that the right originates in the statute, and next that the regulation “applies – but does not expand – the statute.” *Abrahams*, 644 F.3d at 118 (*citing Alexander v. Sandoval*, 532 U.S. 275, 285, 291 (2001)). In *Sandoval*, the Supreme Court held

that the implication of a private right of action requires a showing that the statute in question evidences congressional intent to create that right. Further, even where that showing is made, a regulation promulgated pursuant to the statute must not exceed its scope. In other words, the agency may not with its regulation "create a right that Congress has not." *Sandoval*, 532 U.S. at 291. Indeed, "it is most certainly incorrect to say that language in a regulation can conjure up a private cause of action that has not been authorized by Congress. Agencies may play the sorcerer's apprentice, but not the sorcerer himself." *Id.*

A. An Implied Private Right Under 10(b) Exists But Its Scope Is Narrow and Jealously Interpreted

A review of the history of implied private rights of action under Section 10(b) demonstrates that the scope of implied rights is narrow and narrowing.

The Supreme Court first recognized a private right of action under Section 10(b) in *Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971). Like the majority of cases involving private actions under Section 10(b), *Bankers Life* involved a private right of action under Rule 10b-5, 17 C.F.R. 240.10b-5, promulgated thereunder. When the Supreme Court decided *Bankers Life*, it understood that where a statute failed to provide an express private remedy, it was "the duty of the courts" to "provide such remedies as are necessary to make effective the congressional purpose" of the statute. *See J.I. Case Co. v. Borak*, 377 U.S. 426, 432-33 (1964).

The Court later abandoned the "understanding of private causes of action that held sway 40 years ago," and, in *Sandoval*, noted that "[n]ot even when interpreting the same Securities Exchange Act of 1934 that was at issue in *Borak* have we applied *Borak*'s method for discerning and defining causes of action." *Sandoval*, 532 U.S. at 284. Post-*Sandoval*, the judicial task is "to interpret the statute Congress has passed to determine whether it displays intent to create not just a private right, but also a private remedy." *Id*. at 286. Statutory intent is determinative of the question. "Without it, a cause of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute." *Id*. at 286-87 (internal citations omitted). Federal court decisions reflecting a judicial willingness to weigh statutory purpose and other policies in the context of implied rights of action "belong to 'an *ancien regime*.'" *Olmstead v. Pruco Life Ins. Co. of N.J.*, 283 F.3d 429, 434 (2d Cir. 2002) (*quoting Sandoval*, 532 U.S. at 287).

Leading up to and since *Sandoval*, the Supreme Court has hued strictly to the statutory language and legislative intent of Section 10(b), imposing increasingly narrow boundaries on the reach of the private right implied in the statute. *See e.g.*, *Hochfelder*, 425 U.S. at 200-01 (a private litigant must allege scienter in a claim under Section 10(b) and Rule 10b-5 where the language of

the statute "so clearly connotes intentional misconduct"); *Aaron v. S.E.C.*, 446 U.S. 682 (1980) (scienter is an element in a Commission enforcement action under Section 10(b) because the statutory language and its legislative history support a scienter requirement "regardless of the identity of the plaintiff or the nature of the relief sought"); *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 177-78 (1994) (private aiding and abetting actions do not lie under Section 10(b), the scope of which is delimited by its text and makes no mention of aiding and abetting liability). Explaining its increasingly restrictive interpretation of the contours of the private right under Section 10(b), the Court observed in *Stoneridge*: "Concerns with the judicial creation of a private cause of action caution against its expansion. The decision to extend the cause of action is for Congress, not for us." 552 U.S. at 165. Thus, "though it remains the law, the § 10(b) private right should not be extended beyond its present boundaries." *Id.*

And the right has not been extended. Most recently, in *Janus Capital Grp., Inc. v. First Derivative Traders*, ___ U.S. ___, 131 S. Ct. 2296 (2011), the Court again declined to expand the scope of private civil liability under the statute, holding that it does not extend to persons or entities without ultimate control over the content of an allegedly fraudulent statement. The Court observed that its holding "accords with the narrow scope that we must give the

implied right of action." *Id.* at 2298 (*citing Stoneridge*, 552 U.S. at 167).

B. Rule 10b-16 Imposes Obligations Not Found in Section 10(b); It Does Not Apply the Statute, It Expands It

Section 10(b) is an anti-fraud statute. It prohibits

> any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any national securities exchange . . . [t]o 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.

15 U.S.C. § 78j(b). Section 10(b) specifically distinguishes between those rules promulgated under the statute that "prohibit fraud, manipulation, or insider trading," and those that "impos[e] or specify[] reporting or recordkeeping requirements, procedures or standards as prophylactic measures against fraud." *Id.* § 78j. The text of each rule makes clear the category into which it falls. Rules 10b-1, 10b-3, 10b-5, 10b-9, 10b-17 and 10b-21 identify prohibited conduct that "shall constitute a 'manipulative or deceptive device or contrivance' as used in Section 10(b) of this Act."[4]

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[4] *See* 17 C.F.R. §§ 240.10b-1, 10b-3, 10b-5, 10b-9, 10b-17 and 10b-21. Rule 10b-18 is a safe harbor provision that defines what is *not* a manipulative or deceptive act when undertaken in connection with transactions by issuers and their

In contrast, Rules 10b-10 and 10b-16 impose certain affirmative duties on broker-dealers. These rules, unlike the rules set forth in the preceding paragraph, focus on the reporting and recordkeeping of regulated parties, and consequently convey no intent to confer privately enforceable rights. *See Lindsay v. Ass'n of Prof'l Flight Attendants*, 581 F.3d 47, 53 (2d Cir. 2009) (the court could "discern no intent to confer privately enforceable rights" in statute that imposed duties on carriers, their officers or agents). Rule 10b-16 imposes on brokers and dealers the obligation to establish procedures for providing credit information at the time a margin account is opened and periodically thereafter.[5] Rule 10b-16 also creates a duty to provide customers with notice and information when changes are made in the original credit terms. Importantly, the Rule does *not* state that a failure to establish adequate

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affiliates. *Id*. § 240.10b-18. Rules 10b-2, 10b-4, 10b-6, 10b-7, 10b-8, 10b-11, 10b-12, 10b-13, 10b-14, 10b-15, 10b-19 and 10b-20 either have been not proposed, or have been proposed but not adopted, adopted and replaced, or adopted and rescinded.

[5] Rule 10b-10 requires a broker-dealer that effects customer transactions in securities other than U.S. savings bonds or municipal securities to provide a written confirmation to the customer at or before completing a transaction. 17 C.F.R. § 240.10b-10. No court has recognized a private right of action under Rule 10b-10, and whether such a right exists is an open question in this circuit. *See Press v. Quick & Reilly, Inc.*, 218 F.3d 121, 126 n.7 (2d Cir. 2000). Rules 10b-10 and 10b-16 are similar in that they provide a mechanism for customer protection under the securities laws by promoting full disclosure. They are also similar in that both focus on the regulated parties, and thus convey no intent to confer privately enforceable rights. *See Bellikoff v. Eaton Vance Corp.*, 481 F.3d 110, 116 (2d Cir. 2007).

procedures, or to provide change notices, "shall constitute a manipulative or deceptive device or contrivance" under the statute. Were a private enforcement right to be implied in the Rule, that right necessarily would consist of an action premised upon a broker-dealer's failure to develop the procedures the rule prescribes. This plainly exceeds the scope of Section 10(b), the text of which does not even arguably address a broker-dealer's obligation to adopt procedures, much less suggest that a failure to do so constitutes a manipulative or deceptive device or contrivance for which a civil litigant may recover.

Even if one were to interpret Rule 10b-16 to compel the disclosure of margin credit terms – an impermissible exercise under current law, but one often undertaken in the *"ancien regime"* – there is no "specific legislative history showing that the Congress which enacted the Exchange Act believed that failure to disclose credit terms on margin loans could amount to a violation of section 10(b)." *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 538 n.7 (9th Cir. 1984) (*citing* 4 J. Ellenberger & E. Mahar, *Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934* xvii (1973)).

As *Sandoval* makes clear, congressional intent is the "keystone" as to whether a federal private right exists for a statute; without it, "'a cause of

action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute.'" *Bellikoff v. Eaton Vance Corp.*, 481 F.3d 110, 116 (2d Cir. 2007) (*quoting Sandoval*, 532 U.S. at 286-287); *In re Refco,* 586 F. Supp. 2d at 194 (*Robertson* and similar decisions may be incompatible with more "recent Supreme Court and Second Circuit decisions that have taken a more restrictive view towards implying private rights of action").

Liang v. Dean Witter and Co., Inc., 540 F.2d 1107 (D.C. Cir. 1976), which is cited and heavily-relied upon by appellants, considered the question of implied right of action prior to the *Sandoval* decision, and employed reasoning that is specifically proscribed by *Sandoval*. In *Liang*, the D.C. Circuit Court of Appeals stated that "[i]t may be safely assumed that non-compliance with Rule 10b-16 provides a basis for a private cause of action" because "[i]t is already established that a violation of Rule 10b-5, a rule of disclosure analogous to Rule 10b-16, implies a civil remedy." *Liang*, 540 F.2d at 1113 n.25. The *Liang* court's logic ignores that, "unlike 10b-5, which functions as a general catch-all anti-fraud provision, Rule 10b-16 is much narrower in scope and focuses specifically on the broker's disclosure of the terms of credit." *In re Refco*, 586 F. Supp. 2d at 195. The *Liang* decision has been criticized for its "radically [] abbreviated" reasoning, *Robertson*, 749

F.2d at 534, and there is no basis for it to be relied upon post-*Sandoval*.

Similarly pre-*Sandoval*, in *Angelastro v. Prudential-Bache Sec., Inc.*, 764 F.2d 939 (3d Cir. 1985), the Third Circuit permitted a private suit under Rule 10b-16, holding that the rule – like Rule 10b-5 – "advances the statutory goals of promoting full disclosure of material information and of protecting investors from fraudulent practices." 764 F.2d at 949. Curiously, the court took pains to distinguish *Seidman v. Merrill Lynch, Pierce, Fenner & Smith, Inc*., 465 F. Supp. 1233 (S.D.N.Y. 1979), which refused to imply a private right of action under SEC Rule 15c3-3(b) "because that rule merely provides a standard of conduct to be followed by a broker-dealer for the purpose of ensuring the orderly operation of the exchange" and, unlike Rule 10b-5, was "not aimed at preventing fraud on investors." *Angelastro*, 764 F.2d at 949 n.15. The *Angelastro* court did not explain why a right should be implied under Rule 10b-16, notwithstanding that, like Rule 15c3-3(b), it does not address or define fraud, but rather provides a standard of conduct to be followed by a broker-dealer. 17 C.F.R. § 240.15c3-3(b). Like the court in *Liang* (upon which the *Angelastro* court relied), the Third Circuit appears to have aligned Rule 10b-16 with Rule 10b-5 in its analysis for the simple, but insufficient, reason that both were enacted under Section 10(b).

Because Rule 10b-16 imposes on broker-dealers affirmative duties to

conform to specific standards and to adopt procedures, Rule 10b-16 does not simply apply Section 10(b), it expands it. In these circumstances, an implied right of action cannot be found.

C. Rule 10b-16 Governs the Relationship Between the Broker Dealer and the Customer; the Conduct It Prescribes Is Not in Connection with the Purchase or Sale of Securities as That Requirement Has Been Construed by the Courts

Rule 10b-16 exceeds the scope of Section 10(b) for the additional reason that a violation of the Rule does not satisfy the "in connection with the purchase or sale of any security" element of a claim under Section 10(b). The law in this Circuit "is clear that unless the alleged fraud concerns the value of the securities bought or sold, or the consideration received in return, such fraud is not 'in connection with' the purchase or sale of a security within the meaning of Rule 10b-5." *Bissell v. Merrill Lynch & Co., Inc.*, 937 F. Supp. 237, 242 (S.D.N.Y. 1996) (*citing Chem. Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 943 (2d Cir. 1984), *cert. denied*, 469 U.S. 884 (1984), *Saxe v. E.F. Hutton & Co., Inc.*, 789 F.2d 105, 108 (2d Cir. 1986)). Although the Second Circuit has "broadly construed the phrase 'in connection with,'" the act complained of "must somehow *induce[]* the purchaser to purchase the security at issue." *Romano v. Kazacos*, 609 F.3d 512, 522 (2d Cir. 2010) (*quoting Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 537

(2d Cir. 1999) (emphasis in original).[6]

Rule 10b-16 fundamentally concerns the margin credit agreement between a broker-creditor and its customer-debtor.[7] Non disclosure of information identified in the Rule is a non-disclosure of terms and conditions of the loan arrangement, not information relating to the value or price of the securities purchased with loan proceeds. *See Levitin v. PaineWebber*, 933 F. Supp. 325, 329 (S.D.N.Y. 1996) (broker-dealer's failure to disclose that it earned interest on its customers' collateral and the proceeds of their short sales was not "in connection with" the purchase or sale of securities and plaintiff could not recover under Section 10(b) for an alleged violation of Rule 10b-16). Disclosures or non-disclosures relating to the mechanics of a sale have nothing to with ensuring that "buyers of securities get what they think they are getting and that sellers of securities are not tricked" into accepting inadequate consideration. *Chem. Bank*, 726 F.2d at 943; *Vigilant Ins. Co. v. C.&F. Brokerage Serv.*, 751 F. Supp. 436, 438 (S.D.N.Y. 1990) (alleged diversion of proceeds and retention of interest on cash given as collateral for stock

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[6] The cited cases discuss the "in connection with" requirement in the context of Rule 10b-5 claims. But the requirement is found directly in Section 10(b) and, as discussed *infra*, the limitations in Section 10(b) liability apply equally to Rule 10b-16.

[7] The parties to the instant appeal apparently incorporated Rule 10b-16 into their contract, further demonstrating that the Rule governs the relationship between a broker-dealer and a customer. *See* Pl.'s Mem. in Opp., 13, Dkt. 19, 10-cv-03020 (*citing* Compl. ¶¶ 23, 33, 71 and Bohan Decl., Ex. A (the UBS/Willow Creek contract) at ¶¶ 1, 31(f)).

loans was "not in connection with" the purchase or sale of securities); *Bosio v. Norbay Sec., Inc.*, 599 F. Supp. 1563, 1566 (E.D.N.Y. 1985) (broker's misuse of sale proceeds not "in connection with" the sale because the misrepresentation related "to the arrangements concerning the mechanics of the sale").

Thus, because Rule 10b-16 concerns the disclosure of credit terms between a debtor and creditor, and not the effectuation of a purchase or sale of securities, any purported violation of Rule 10b-16 does not satisfy the "in connection with" prong of Section 10(b) liability.

CONCLUSION

For all of the foregoing reasons, SIFMA urges the Court to find that there is no implied right of private action under Rule 10b-16.

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CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, the foregoing brief is in 14-Point Times Roman proportional font and contains 5,560 words and thus is in compliance with the type-volume limitation set forth in Rule 32(a)(7)(B) of the Federal Rules of Appellate Procedure.

Dated: New York, New York
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I, Maryna Sapyelkina, being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age.

On August 26, 2011

deponent served the within: **Motion for Leave to File an Amicus Brief, and Brief of the Securities Industry and Financial Markets Association as Amicus Curiae supporting Defendants-Counter-Claimants-Appellees**

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