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July 8, 2011

VIA ELECTRONIC FILING

Catherine O'Hagan Wolfe, Esq.
Clerk of the Court
U.S. Court of Appeals, Second Circuit
40 Foley Square
New York, New York 10007

Re: *Wilson v. Merrill Lynch & Co., Inc.*, Docket No. 10-CV-1528 (argued February 25, 2011)

Dear Ms. O'Hagan Wolfe:

On behalf of the Securities Industry and Financial Markets Association ("SIFMA"), we respectfully submit this amicus letter brief in connection with the above-titled action. In particular, SIFMA responds to the five questions posed to the U.S. Securities and Exchange Commission ("SEC") regarding whether Defendants-Appellees Merrill Lynch, Pierce, Fenner & Smith Inc. ("Merrill") and Merrill Lynch & Co., Inc. engaged in market manipulation under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"). (Dkt. No. 90.)

I. STATEMENT OF INTEREST

SIFMA brings together the shared interests of hundreds of securities firms, banks, and asset managers.[1] 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). For more information, visit www.sifma.org.

SIFMA often appears as *amicus curiae* in cases raising issues of importance to the securities markets and the commercial banking industry. The SEC has itself recognized SIFMA's leading role in providing guidance to the financial industry for disclosures pertaining to auction rate securities ("ARS"). *Auction Rate Securities Market: A Review of Problems and Potential Solutions: Hearing Before the Comm. on Fin. Servs.*, 110th Cong. 142 (2008) (testimony of Linda Thomsen, Director, SEC Division of Enforcement) ("L. Thomsen Testimony").

In this matter, the Court poses five questions regarding the ability of Plaintiff/Appellant Colin Wilson ("Plaintiff") to plead an actionable market manipulation claim in light of ubiquitous

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[1] Pursuant to Local Rule 29.1(b), SIFMA discloses that no party's counsel authored this brief in whole or in part; no party or party's counsel contributed money intended to fund preparing or submitting the brief; and no person contributed money intended to fund preparing or submitting the brief.

industry-wide disclosures about auction practices.[2] SIFMA submits that the SEC's position advocates a flawed and unwarranted expansion of private civil liability under Section 10(b) of the Exchange Act. *See Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2303 (2011) (reaffirming that the Section 10(b) implied private right is limited to its current scope).[3] Furthermore, the SEC's order in 2006 tacitly affirmed the legality of the challenged auction practices when properly disclosed by broker-dealers. Recognizing a market manipulation claim in this case would only serve to undermine SIFMA members' reasonable reliance on the SEC's 2006 order, as well as future SEC regulatory guidance.

II. MARKET MANIPULATION & MATERIAL ARS DISCLOSURES

QUESTION NO. 1

Do the Disclosures, as a matter of law, preclude Plaintiff from pleading the "manipulative acts" element of a market manipulation claim?

Yes. As a matter of law, the manipulative acts element of a market manipulation claim cannot be satisfied because the disclosures informed investors that broker-dealers' participation in ARS auctions affected the natural interplay between supply and demand.

A. Broker-Dealers' Participation in the Market Was Both Legal and Fully Disclosed.

A market manipulation claim cannot survive if the allegedly manipulative conduct was commonly known to market participants. *See, e.g.*, *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 43 (2d Cir. 2006). "[N]ondisclosure is usually essential to the success of a manipulative scheme." *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977).

Here, broker-dealers' participation in ARS auctions reflected a common industry practice that was widely known to investors. As the SEC acknowledges in its submission, there is nothing inherently illegal or improper about such conduct if other market participants are on notice of it. (*See* Letter Brief for SEC as Amici Curiae at 13, *Wilson v. Merrill Lynch & Co., Inc., et al.*, Docket No. 10-CV-1528 (filed Jun. 24, 2011) (Dkt. No. 147) ("SEC Letter").) In 2006, the SEC

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[2] After the SEC's 2006 order concerning ARS disclosures, SIFMA developed Best Practices for Broker-Dealers of Auction Rate Securities and created sample disclosure language describing the broker-dealers' role and certain other auction procedures. Merrill Lynch's disclosures are consistent, and in many cases almost identical, with SIFMA's sample disclosure language. SIFMA's model auction procedures, the final version of the Best Practices, and the standard disclosure language are available on SIFMA's website. More recently, certain broker-dealers entered into separate settlements with the SEC and state regulators after the 2008 auction failures. The SEC has recognized that the recent regulatory settlements, "unlike the prior [2006 SEC] investigation, focus not on the auction process but rather *on the marketing of the securities*." L. Thomsen Testimony at 143 (emphasis added).

[3] In deciding *Janus*, the Supreme Court expressly disagreed with the SEC's *amicus* submission in that case concerning the scope of private civil liability under Section 10(b), noting its continued "skepticism over the degree to which the SEC should receive deference regarding the private right of action." *Janus*, 131 S. Ct. at 2303 n.8; *see also Piper v. Chris-Craft Industries, Inc.*, 430 U. S. 1, 41, n.27 (1977) (the SEC's presumed expertise "is of limited value" when analyzing "whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants").

gave the industry specific guidance regarding such notice, ordering settling broker-dealers to provide written descriptions on their publicly accessible websites concerning the nature of their participation in ARS auctions. (Appendix to Brief for Plaintiff at AA121-22 *Wilson v. Merrill Lynch & Co.*, *Inc., et al.*, No. 10-CV-1528 (filed Sept. 14, 2010) (Dkt. No. 39) ("AA").) SIFMA then helped establish model disclosures based on the SEC's guidance.

The SEC's examination of these practices, and its resolution, were widely publicized and publicly known to the investment community. And beyond the SEC's public pronouncements and the disclosures that followed from them, participation by broker-dealers in ARS auctions was a topic explicitly discussed in publicly-disseminated ARS offering documents, newsletters and national news articles. It is an irrefutable fact that "the market" was well-informed that broker-dealers participated in ARS auctions for their own accounts, including trades made for the explicit purpose of avoiding failed auctions when demand would otherwise fail to meet the supply offered for sale in the auctions. Such open and "routine" practices hardly reflect an intent to defraud ARS investors. (*See, e.g.*, AA102-05.)[4]

B. Broker-Dealers Disclosed *Material* Facts that Put Investors on Notice of the Impact on the Natural Interplay Between Supply and Demand.

"The gravamen of manipulation is deception of investors into believing that prices at which they purchase and sell securities are determined by the natural interplay of supply and demand, not rigged by manipulators. . . . In consequence, a private plaintiff in such a case must establish that he or she engaged in a securities trade in ignorance of the fact that the price was affected by the alleged manipulation." *Gurary v. Winehouse*, 190 F.3d 37, 45 (2d Cir. 1999).[5]

Despite the ubiquitous public disclosures about broker-dealers' participation in ARS auctions, including those ordered by the SEC in 2006, the SEC finds fault in them because they "imply that some auctions have sufficient independent demand to prevent failure." (SEC Letter at 12.) The SEC asserts that "Merrill knew there was no such demand, and concealed the fact through its practice of placing support bids in *every* auction with knowledge that its failure to do so would lead to *certain* auction failure and the collapse of the ARS market." (*Id.*)

In making this argument, the SEC improperly attempts to recast Plaintiff's manipulation claim as a misrepresentation claim by identifying supposed "inaccuracies" in the disclosures. Not only is

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[4] Virtually every district court applying this Court's precedent has held that these disclosures preclude investors from alleging viable securities fraud claims against SIFMA members. (*See, e.g.*, Brief for Merrill and Merrill Lynch & Co. at 4 n.1 *Wilson v. Merrill Lynch & Co., Inc., et al.*, No. 10-CV-1528 (filed Oct. 25, 2010) (Dkt No. 65).)

[5] *See also ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 100 (2d Cir. 2007) ("The deception [in a market manipulation claim] arises from the fact that investors are misled to believe that prices at which they purchase and sell securities are determined by the natural interplay of supply and demand, not rigged by manipulators." (internal quotation marks and citations omitted)); *Pross v. Baird, Patrick & Co, Inc.*, 585 F. Supp. 1456, 1459 (S.D.N.Y. 1984) ("So long as a broker adequately discloses its status to its customer it is not fraudulent practice for a brokerage firm to act as a market-maker and to sell securities to its customers as a principal" (internal quotations omitted)).

the SEC's position factually mistaken,[6] but it begs the fundamental question of how broker-dealers could illegally manipulate the ARS markets by engaging in lawful, disclosed market activity for the permissible purpose of preventing auctions from failing. *See United States v. Mulheren*, 938 F.2d 364, 370-71 (2d Cir. 1991) ("traditional badges of manipulation are [not] present" where a defendant purchased shares for its own account in the open market).

Whether broker-dealers did or did not participate in every auction is beside the point. The market was well informed about the *material* fact that broker-dealers' routine participation in auctions affected the natural interplay between supply and demand. *See Gurary*, 190 F.3d at 45. To require more of broker-dealers would impose an impossible standard of disclosure not reasonably contemplated by the 2006 SEC order. *See Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000) ("allegations that defendants should have anticipated future events and made certain disclosures earlier than they actually did do not suffice to make out a claim of securities fraud").[7]

Ultimately, the SEC's position allows an impermissible use of the federal securities laws as "an insurance policy against all losses" and undermines SIFMA members' reliance on the SEC's guidance in 2006. *AUSA Life Ins. Co. v. Ernst and Young*, 206 F.3d 202, 234 (2d Cir. 2000).

QUESTION NO. 2

Insofar as the Complaint alleges that Merrill manipulated ARS auctions, do those allegations preclude Plaintiff from pleading market efficiency for purposes of establishing the "fraud on the market" presumption of reliance?

Yes. The allegations of market manipulation preclude Plaintiff from establishing market efficiency for purposes of the fraud-on-the-market presumption of reliance because their allegations preclude the necessary conclusion that the allegedly fraudulent conduct was processed through the natural interplay of supply and demand and thus incorporated into the market price. *See Feinman v. Dean Witter Reynolds, Inc.*, 84 F.3d 539, 541-42 (2d Cir. 1996) (affirming dismissal for failure to allege effective presumption of reliance); *see also In re Initial Pub. Offering Sec. Litig.*, 471 F.3d at 42-43 (fraud-on-the-market presumption inapplicable

[6] The SEC misreads the allegations in the Complaint by claiming that Plaintiff alleges Merrill Lynch placed support bids in every auction. Plaintiff alleges only that Merrill Lynch placed support bids "*if needed* to prevent auction failures" in "every" auction for which it was sole or lead auction dealer and readily did so. (AA39, ¶46 (emphasis added).) Indeed, the SEC undermines its own position by acknowledging that, even at the height of the global credit crisis in February 2008, at least 13% of auctions cleared without any broker-dealer support. (SEC Letter at 3.)

[7] As noted above, the SEC argues that broker-dealers should have informed investors of the supposed *certainty* that broker-dealer support would be necessary to avoid auction failures. (SEC Letter at 13.) However, given the nature of the auctions, a broker-dealer could not know whether a supporting bid would be necessary to make up for a shortfall in demand until after all other market participants placed their own bid and sell orders, *i.e.*, the need for the broker-dealer to make a bid could not be certain until *after* other investors had already decided to participate in the market. And even then, as the SEC acknowledges was appropriate and as discussed in the disclosures, the broker-dealer still had no obligation to make a supporting bid and could decide not to do so. (*See* AA103.) Under the circumstances, a prior disclosure about the "certainty" of auction failure and/or about making support bids in "every" auction, would simply be inaccurate.

where the plaintiffs' own allegations and evidence demonstrate that an efficient market could not be established); *see also id.* at 543 ("It is also doubtful whether the *Basic* presumption can be extended, beyond its original context, to tie-in trading, underwriter compensation, and analysts' reports.").

"Reliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of action." *Stoneridge Inv. Ptnrs., LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008). Plaintiff did not directly rely on any misleading conduct. Indeed, Plaintiff alleges no connection with Merrill at all. Therefore, without alleging sufficient facts to invoke an exception to the direct reliance requirement, such as the fraud-on-the-market theory, a market manipulation claim cannot stand. *See Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, 546 F.3d 196, 200, 210-11 (2d Cir. 2008).

The fraud-on-the-market presumption is "based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business" and thus, as noted by the SEC, the market is "interposed between seller and buyer" and transmits information to the investor in the processed form of a market price. *Basic, Inc. v. Levinson*, 485 U.S. 224, 241-42, 244 (1988) (internal quotation marks omitted); *see also* SEC Letter at 14. For the market to serve as the "processor" for purposes of the fraud-on-the-market doctrine, the plaintiff must be able to demonstrate that "the alleged misrepresentations were publicly known (or else how would the market take them into account?), that the stock traded in an efficient market, and that the relevant transaction took place 'between the time the misrepresentations were made and the time the truth was revealed.'" *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2185 (2011). None of these three requirements can be met in light of Plaintiff's allegations in this case.

First, as discussed previously, the nature of a market manipulation claim is that it is based on "nondisclosure." *See Santa Fe Indus., Inc*, 430 U.S. at 477. Here, as summarized by the SEC, "Plaintiff's allegation . . . is that *unbeknownst to the market*, Merrill used support bids to purchase any excess supply." (SEC Letter at 16 (emphasis added).) Under the circumstances, the SEC suggests that "the question of market efficiency for the purposes of the [fraud-on-the-market] presumption is whether, *absent the fraud*, the market efficiently incorporates information and conveys that information to investors." (SEC Letter at 16 (emphasis added).) This analysis misses the mark. The fraud-on-the-market doctrine assumes that an efficient market performs "a valuation process which incorporates all publicly available information, *including misinformation*." *See Joseph v. Wiles*, 223 F.3d 1155, 1164 n.2 (10th Cir. 2000) (emphasis added). If the misconduct in question is not "publicly known," the market cannot perform the valuation process by which the misconduct is incorporated into the market price, negating the theoretical underpinning of the fraud-on-the-market doctrine. *See Halliburton Co.*, 131 S. Ct. at 2185; *see also West v. Prudential Securities, Inc.*, 282 F.3d 935, 938 (7th Cir. 2002) (Easterbrook, J.) (discussing the "mechanism" described in *Basic* "by which public information affects stock prices" and observing that "[n]o similar mechanism explains how prices would respond to non-public information").

Second, the alleged manipulative conduct in this case is that "Merrill used support bids to purchase any excess supply" in a given auction. (SEC Letter at 16.) The SEC explains that, "in the case of insufficient demand to meet the available supply, the auction fails and the interest rate is set at a penalty rate." (*Id.*) In other words, "absent the fraud" alleged here, the market would not function at all, and the resulting rate would be set by contract rather than through the natural

interplay of supply and demand. Thus, the core issue identified by Plaintiff and the SEC, that the supply of ARS outstripped demand in many auctions, produced either a non-functioning market or, in the case of a supporting bid by the broker-dealer, an allegedly "manipulated" market. Either way, the market was not efficient. Nevertheless, the SEC contends that, in the latter situation, manipulation caused a false "appearance of demand where there was none" and that false appearance was incorporated in the market price. (*Id.*) However, "[o]ne fundamental attribute of efficient markets is that *information*, not demand in the abstract, determines stock prices." *West,* 282 F.3d at 939. This case illustrates that point in the extreme; properly understood, the SEC is asserting that the supplemental demand supplied by support bids worked to convert otherwise non-functioning markets into efficient markets. But that is not possible unless the support bids were part of the "natural interplay of supply and demand" – a conclusion diametrically opposed to the premise that those support bids served to manipulate prices in otherwise efficient markets. Under the circumstances, then, the allegations of the case necessarily preclude a conclusion that there was an efficient market.[8]

Third, given the nature of ARS Dutch auctions, investors did not decide to trade at a price set after the occurrence of the alleged manipulative conduct – quite the opposite. As described by the SEC, "[i]n these auctions, buy bids with the lowest interest rate, and then successively higher rates, were accepted until all of the sell orders in that auction were filled." (SEC Letter at 3 (citing AA115).) "If there were not enough bids to cover the securities in the auction, then the auction failed . . ." (*Id.*) In the latter case, however, the managing broker-dealer could make a support bid in the auction in order to make up for "a lack of demand and [thereby] prevent auction failure." (*Id.* at 4 (citing AA38).) The critical point here is that the need for a support bid could not be known to the broker-dealer until *after* other investors made their investment decisions and submitted their bids. Thus, when deciding to bid in the auction, investors could not have relied, either directly or indirectly through the mechanism of the market, on a price set or affected by the broker-dealer's conduct, because the investors' bids occurred *before* the allegedly manipulative conduct of the broker-dealer.

In sum, the market manipulation claims in this case are fundamentally inconsistent with the need for a functioning, economically efficient market to serve as the cornerstone of the fraud-on-the-market presumption of reliance.

QUESTION NO. 3

Assuming that the Complaint sufficiently pleads market efficiency for purposes of establishing the "fraud on the market" presumption, do the Disclosures rebut that presumption by entitling Defendants to the "truth on the market" defense as a matter of law?

Yes. Assuming that Plaintiff would otherwise be entitled to the fraud-on-the-market presumption, Plaintiff's market manipulation claim would be rebutted under the "truth-on-the-

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[8] Moreover, the characteristics of the ARS marketplace do not support market efficiency. ARS did not trade on the NYSE, the NASDAQ or a similar exchange. ARS were sold primarily in periodic, highly structured, individual Dutch auctions; not daily in large volumes on an open and impersonal market. (*See* AA36-37, ¶¶ 34-39.) Further, the marketplace was aware of liquidity risks following the "initial wave" of auction failures in August and September 2007, but investors, including Plaintiff, continued to hold their ARS investments. (AA50, ¶ 102.)

market" defense by broker-dealers' disclosures, other publicly and readily available information regarding liquidity risks, and about the participation of broker-dealers in ARS auctions.

"The 'truth-on-the-market' doctrine is a corollary to the 'fraud on the market' and stands for the proposition that a misrepresentation is immaterial if the information is already known to the market because the misrepresentation cannot then defraud the market." *In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 905 n.46 (S.D. Tex. 2001) (citing *Ganino v. Citizen Utils. Co.*, 228 F.3d 154, 161, 167 (2d Cir. 2000)). As articulated by this Court:

> A defendant may rebut the presumption that its misrepresentations have affected the market price of its stock by showing that the truth of the matter was already known. . . . [T]he corrective information must be conveyed to the public by 'with a degree of intensity and credibility sufficient to counter-balance effectively any misleading information created by' the alleged misstatements.

Ganino, 228 F.3d at 167 (internal citations omitted).

Here, as set forth above, broker-dealers' participation or determination not to participate in the ARS markets and the risk of auction failure and illiquidity were widely publicized by broker-dealers, the SEC, articles in wide circulation, and by ARS auction failures in August and September 2007. Plaintiff therefore cannot meet his initial burden of showing non-disclosure of the purportedly manipulative acts. But regardless, the intensity and credibility of such truthful information in the marketplace would defeat any fraud-on-the-market claim.

QUESTION NO. 4

Is the presumption of reliance set forth in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), generally available for market manipulation claims, and available in particular for the claim pleaded in the instant Complaint?

No. The *Affiliated Ute* presumption of reliance is not generally available for market manipulation claims, and even if available, the allegations in the Complaint do not afford Plaintiff the benefit of the presumption.

Along with the fraud-on-the-market presumption of reliance, courts may presume reliance when a claim rests on an omission of material fact and the plaintiff establishes that the defendant maintained a duty to disclose the omitted fact. *Affiliated Ute*, 406 U.S. at 153-54; *In re WorldCom, Inc. Sec. Litig.*, 219 F.R.D. 267, 291 (S.D.N.Y. 2003). In this case, the *Affiliated Ute* presumption of reliance is unavailable for two reasons. First, an investor having no affiliation with a broker-dealer and alleging no facts to demonstrate that the broker-dealer had a duty to disclose is not afforded the presumption. *See Affiliated Ute*, 406 U.S. at 153-54. Second, the *Affiliated Ute* presumption only applies to omission claims, not in market manipulation cases.[9] Here, Plaintiff does not allege an omissions claim under Rule 10b-5(b), but rather purports to bring a manipulation claim under 10b-5(a) and (c). (*See* AA69, ¶ 206.)

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[9] *See Desai v. Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 940 (9th Cir. 2009) (*per curiam*) (*Affiliated Ute* presumption applies, not in market manipulation cases, but where the defendant failed "to disclose accurate information relating to the value of a security where one has a duty to disclose it").

A. The *Affiliated Ute* Presumption Requires A Plaintiff To Demonstrate that Broker-Dealers Owed A Duty to Disclose.

In order to be held liable for omitting a fact, a defendant must owe a duty to disclose.[10] The SEC's response fails to acknowledge this requirement. (*See* SEC Letter at 18-19.) Those who were customers of downstream distributors, like Plaintiff, and not the direct customers of broker-dealers, are without any basis to allege privity or a fiduciary or other duty. *See Resnik v. Swartz*, 303 F.3d 147, 154 (2d Cir. 2002) ("For an omission to be actionable, the securities laws must impose a duty to disclose the omitted information."). In fact, when testifying before Congress, the SEC defended the adequacy of the broker-dealers' disclosures, and took the position that any further "disclosure obligation is on those who are selling the product and it is a secondary sale, by and large." *See* L. Thomsen SEC Testimony at 26.

Moreover, if the *Affiliated Ute* presumption is applied in this case, it would further abandon the "duty" requirement that establishes some connection between the plaintiff and the defendant. Even though broker-dealers made material information publicly available on their websites and in SEC filings, they would have the additional, albeit impossible, obligation to *directly* disclose information to downstream investors even though those broker-dealers have no connection with the downstream investors prior to their purchases of ARS.

B. Because the Affiliated *Ute* Presumption Requires a Duty to Disclose, the *Affiliated Ute* Presumption is Generally Inappropriate for Market Manipulation Claims.

Reliance may be presumed when a claim rests on an omission of material fact.[11] But with manipulation claims, other circuits have held that the *Affiliated Ute* presumption does not generally apply to manipulation cases.[12] For example, the Tenth Circuit reasoned:

> Any fraudulent scheme requires some degree of concealment, both of the truth and of the scheme itself. We cannot allow the mere fact of this concealment to transform the alleged malfeasance into an omission rather than an affirmative act. To do otherwise would permit the *Affiliated Ute* presumption to swallow the reliance requirement almost completely.

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[10] *See Basic*, 485 U.S. at 239 n.17 ("Silence, absent a duty to disclose, is not misleading under Rule 10b-5."); *ZVI Trading Corp. Employees' Money Purchase Pension Plan & Trust v. Ross* (*In re Time Warner Inc. Sec. Litig.*), 9 F.3d 259, 267 (2d Cir. 1993) ("[A]n omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted facts."); *Press v. Chemical Inv. Servs. Corp.*, 988 F. Supp. 375, 385-86 (S.D.N.Y. 1997) (rejecting omission claims against broker and noting that "*[e]ven if [omitted] information is material, there is no liability under Rule 10b-5 unless there is a duty to disclose it*" (emphasis in original) (internal citations omitted)).

[11] *See Affiliated Ute*, 406 U.S. at 153-54; *In re WorldCom, Inc. Sec. Litig.*, 219 F.R.D. at 291; *see also Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc.*, No. 05 Civ. 1898(SAS), 2006 WL 2161887, at *9 (S.D.N.Y. Aug. 1, 2006).

[12] *See Desai*, 573 F.3d at 940; *accord Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1119 (5th Cir. 1988) (applying the *Affiliated Ute* presumption in non-disclosure cases, but not in falsehood or distortion cases), *judgment vacated on other grounds*, 492 U.S. 914 (1989).

Joseph, 223 F.3d at 1163. Although the SEC attempts to recast Plaintiff's allegations as an omissions claim, the *Affiliated Ute* presumption is inapplicable in this case because Plaintiff, after amending his complaint, declined to bring a claim under Rule 10b-5(b).

In *Desai*, the Ninth Circuit explained why it is necessary to maintain "the well-established distinction, for purposes of the *Affiliated Ute* presumption, between omission claims, on the one hand, and misrepresentation and manipulation claims, on the other." 573 F.3d at 941. It reasoned as follows:

> Manipulative conduct, by contrast, is actionable under Rule 10b-5(a) or (c) and includes activities designed to affect the price of a security artificially by simulating market activity that does not reflect genuine investor demand. In order to succeed, manipulative schemes must usually remain undisclosed to the general public. *If such nondisclosure of a defendant's fraud was an actionable omission, then every manipulative conduct case would become an omissions case. If that were so, then all of the Supreme Court's discussion of what constitutes manipulative activity would be redundant.* We decline to read the Supreme Court's case law on manipulative conduct as little more than an entertaining, but completely superfluous, intellectual exercise.

Id. at 940-41 (emphasis added).

When read in context with the Supreme Court's recent pronouncement that "the § 10(b) private right should not extend beyond its present boundaries," the reasoning of the Tenth Circuit and Ninth Circuit is compelling. *Stoneridge*, 552 U.S. at 165; *Janus*, 131 S. Ct. at 2303. By permitting extension of the *Affiliated Ute* presumption to manipulation cases, the Court would be expanding the scope of liability by essentially removing reliance as a separate element for a manipulation claim. *Joseph*, 223 F.3d at 1162-63; *Desai*, 573 F.3d at 940-41.[13]

QUESTION NO. 5

Do the Disclosures, as a matter of law, preclude Plaintiff from pleading that he justifiably relied on an assumption of the ARS market's integrity?

Yes. The disclosures and other publicly available information preclude Plaintiff from alleging that he relied on the assumption of the ARS market's integrity because Merrill disclosed that its participation in the ARS auctions affected the natural interplay between supply and demand.

Regardless of the theory of class-wide or individual reliance, reliance must be "reasonable." *See Emergent Capital Inv. Mgmt. LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 195-96 (2d Cir. 2003) (affirming dismissal of 10b-5 claim where reliance not reasonable). In assessing the reasonableness of a plaintiff's alleged reliance, this Court considers the entire context of the transaction, including factors such as its complexity and magnitude, the sophistication of the parties, and the content of any agreements between them. *See Lazard Freres & Co. v. Protective*

[13] *See Malack v. BDO Seidman, LLP*, 617 F.3d 743, 754 (3d Cir. 2010) (*Stoneridge* provides "general support for rejecting such new presumptions of reliance"); *Desai*, 573 F.3d at 942.

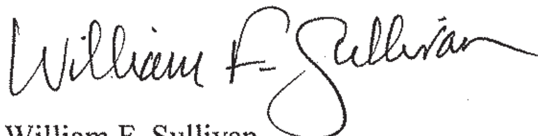
Life Ins. Co., 108 F.3d 1531, 1541-43 (2d Cir. 1997) (finding "substantial and sophisticated player" in debt market assumed known risks, and its failure to protect itself from those known risks rendered reliance unreasonable).

Where the party claiming justifiable reliance "'has the means of knowing, by the means of ordinary intelligence, the truth, or the real quality of the subject of the representation, he must make use of those means, or he will not be heard to complain that he was induced to enter into the transaction by misrepresentations.'" *Hyosung Am., Inc. v. Sumagh Textile Co., Ltd.*, 137 F.3d 75, 78 (2d Cir. 1998) (quoting *Mallis v. Bankers Trust Co.*, 615 F.2d 68, 80-81 (2d Cir. 1980) *abrogated on other grounds by Crigger v. Fahnestock and Co., Inc.*, 443 F.3d 230 (2d Cir. 2006)). Any form of reliance alleged in this case would be manifestly unreasonable in light of extensive website disclosures, the offering documentation, SEC releases and regulations, and numerous other publications that all discussed allegedly withheld facts, as well as prior, well-publicized ARS auction failures.[14] At a minimum, investors were readily aware that broker-dealers' participation in the ARS auctions affected the natural interplay between supply and demand. *See Zlotnick v. TIE Commc'n*, 836 F.2d 818, 823-24 (3d Cir. 1988) (not reasonable for investors to rely on the market price when they know market price does not incorporate all material information).

III. CONCLUSION

For the foregoing reasons, SIFMA requests that this Court affirm the decision of the District Court in favor of Defendants-Appellees.

Sincerely,



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cc: All counsel

[14] *See, e.g., Gurary*, 190 F.3d at 45 (holding that plaintiffs' ignorance of manipulative conduct is required to state a claim).