No. 25-351

IN THE

Supreme Court of the United States

SHANDA GAMES LIMITED, YINGFENG ZHANG, LI YAO, LIJUN LIN, HENG WIN CHAN, YONG GUI, SHAOLIN LIANG, DANIAN CHEN,

Petitioners,

v.

DAVID MONK,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION (SIFMA) AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTERESTS OF *AMICUS CURIAE*[1]

The Securities Industry and Financial Markets Association (SIFMA) is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers. Its mission is to support a strong financial industry, while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA is the United States regional member of the Global Financial Markets Association.

Amicus has a substantial interest in the issues presented in the Petition, which arises from a putative class-action. The Second Circuit's decision broadens the scope of allowable securities claims, making it easier for plaintiffs who did not purchase or sell securities on the market at a market price to adequately plead the reliance element of a securities fraud action, and, moreover, to seek class certification on the basis that the reliance issue is common to the class. Moreover, the Second Circuit's decision will allow minority shareholders to collaterally attack the price of a merger transaction in a federal class action suit, supplanting carefully wrought state-law processes that have been developed over time to appropriately protect the interests of dissenting minority shareholders without unduly burdening transactional activity. That decision not only represents an inappropriate federal incursion into state law but also increases the legal risks for buyers

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[1] No counsel for a party authored this brief in whole or in part. No person other than *amicus* or their counsel made a monetary contribution to the brief's preparation or submission. The parties were given timely notice of *amicus*'s intent to file this brief.

in merger and acquisitions transactions. Unless overturned by this Court, these unwarranted changes to federal law and the federal-state balance will adversely affect *amicus*'s members, who participate in and benefit from the Nation's financial markets, which are the strongest, most liquid, and most deeply capitalized in the world.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Second Circuit's decision breaks from this Court's precedents and disrupts the settled balance between federal securities law and state corporate law. Review by this Court is therefore warranted.

In *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), this Court created a rebuttable presumption that investors who trade in an efficient market rely on the integrity of that market—and thus indirectly rely on public misstatements that might affect the market price of a security. The Court made clear in *Basic*, and in subsequent cases, that this presumption is available only to "[a]n investor who buys or sells stock at the price set by the market" and thereby "reli[es] on the integrity of that price." *Id.* at 247. That logic cannot extend to shareholders, like the plaintiff here, who did not make *any* affirmative decision to buy or sell in the period after the claimed misrepresentations were made, and thus could not have relied on the market price, and further did not engage in any other transaction at a market-determined price.

In direct conflict with this Court's precedents, the decision below eliminated *Basic*'s prerequisite of an actual decision to transact at the market price. By doing so, the Second Circuit expanded the reach of federal securities law, extending the *Basic*

presumption to a new category of plaintiffs: shareholders who passively acquiesce in a freeze-out merger and are cashed out of their holdings at a non-market price.

A freeze-out merger occurs when a controlling shareholder of a publicly traded company buys out the shares of the minority shareholders, delists the corporation, and takes it private. The merger price paid to minority shareholders is generally negotiated at arm's length between the buyer and a special committee of independent directors. Because minority shareholders cannot block such a transaction, state law provides them a specific remedy: the right to dissent and seek an "appraisal," a judicial determination of the fair value of their shares. That process is intentionally demanding. To obtain appraisal, a shareholder typically must register dissent, vote against the merger, and file an individual court action. Appraisal proceedings can take years, and often yield no more (and sometimes less) than the negotiated merger price. State appraisal laws thus strike a careful balance: they safeguard minority shareholders without creating too much legal and financial uncertainty for buyers in legitimate merger transactions.

The Second Circuit's decision threatens to upset that balance. It invites shareholders who did not exercise the option to invoke the state-law dissent-and-appraisal remedy to collaterally attack the merger price through a federal securities class action.

The consequences for businesses and investors are serious. The threat of overlapping state and federal litigation will multiply the costs and uncertainties of merger transactions. Buyers will face not only the longstanding risk of appraisal actions by a few

minority shareholders but also the specter of class-wide federal securities claims by every single minority shareholder. The resulting exposure could distort merger pricing and chill beneficial transactions.

The Court should grant review to restore the limits on *Basic* and preserve the proper boundaries between federal securities law and state corporate governance.

ARGUMENT

I. THE COURT SHOULD GRANT REVIEW BECAUSE THE SECOND CIRCUIT'S DECISION CONFLICTS WITH THIS COURT'S PRECEDENTS.

As the Petition explains, the Second Circuit's decision conflicts with *Basic* and later cases limiting the fraud-on-the-market presumption to plaintiffs who bought or sold securities at a price set by an efficient market. See Pet. 16–18. A freeze-out transaction like the one that underlies this case is a completely different animal. The price that a minority shareholder takes through the freeze-out is set by private negotiation, not any public market. Because there was no transaction anchored to the market price here, *Basic* cannot apply. See *id.* at 18–19.

Basic also cannot apply for a distinct if related reason. This Court's precedents foreclose application of the fraud-on-the-market presumption to plaintiffs (like the plaintiff here) who never made an active investment decision. *Basic*'s thesis is that when an investor acts in reliance on the market's integrity, he indirectly relies on alleged misinformation incorporated by the market. Logically, that principle cannot extend to an investor who makes no affirmative choice at all.

This case illustrates the point. Like many shareholders in freeze-out mergers, the plaintiff here "was no more than a bystander." Pet. App. 73a. He did not allege that he made any investment decision during the merger. As a result, consistent with applicable law, the plaintiff automatically received the price negotiated between the special committee of the board and the buyers. The Second Circuit postulated that the plaintiff might have relied on the market price in deciding "whether to … dissent and seek appraisal." Pet. App. 43a. But the plaintiff nowhere pled that he gave any thought at all to either option. So there is no basis to infer—nor to presume—that the plaintiff considered the market price in deciding "whether to … dissent and seek appraisal." *Id*. Because he made no evaluation either way, he necessarily did not consider or rely on the market price, or anything else. And *Basic* could not apply.

In addition to being illogical on its own terms, the Second Circuit's decision to extend *Basic* to the freeze-out context is in serious tension with this Court's decision to preserve *Basic*, on *stare decisis* grounds, within its traditional bounds, notwithstanding serious and abiding criticisms from members of this Court and academic commentators. See*, e.g.*, *Halliburton Co.* v. *Erica P. John Fund, Inc.*, 573 U.S. 258, 285 (2014) (*Halliburton II*) (Thomas, J., concurring (charging that *Basic* "turned to nascent economic theory and naked intuitions about investment behavior in its efforts to fashion a new, easier way to meet the reliance requirement").

Far from endorsing novel extensions of *Basic*, the Court has sought to hem in *Basic* by emphasizing that the *Basic* presumption may be rebutted by defendants. *Id.* at 268–69, 284; *Goldman Sachs Grp., Inc.* v.

Arkansas Tchr. Ret. Sys., 594 U.S. 113, 125 (2021). The Second Circuit majority acknowledged that requirement in passing, but never engaged with Judge Jacobs' trenchant dissenting observation that "here, the presumption is rebutted at the outset," given that Monk's transaction did not occur on the market or at a market-determined price. See*, e.g., Basic*, 485 U.S. at 248–49 (explaining that Defendants "also could rebut the presumption of reliance as to plaintiffs who would have [transacted] without relying on the integrity of the market."). If that is not enough, it is not clear what the Second Circuit has in mind for how defendants may rebut the presumption with respect to a plaintiff who has *not* traded in a market supposedly impacted by freeze-out merger activity, but nonetheless claims to have been affected in some way by market movement. And that uncertainty will only add to the litigation burdens that will flow from the court of appeals' unwarranted extension of the *Basic* presumption beyond its traditional open market context.

The Second Circuit's decision is incorrect and conflicts with this Court's precedents. This Court should grant review.

II. THE COURT SHOULD GRANT REVIEW BECAUSE THE SECOND CIRCUIT'S DECISION WILL HAVE SIGNIFICANT NEGATIVE CONSEQUENCES.

Review is also warranted because the decision below dramatically expands the reach of federal securities law, disrupting the balance between federal and state regulation of corporate transactions. First, the decision's extension of *Basic*'s fraud-on-the-market presumption to plaintiffs who never bought or sold securities at the market price vastly enlarges the

reach of federal securities class actions. Second, in doing so, the decision intrudes into an area traditionally governed by state corporate law, allowing shareholders who declined to pursue state appraisal remedies to mount collateral federal class actions—thereby compounding uncertainty, raising litigation costs, and deterring legitimate mergers and acquisitions.

A. The Second Circuit's Decision Expands Federal Securities Class Actions To Plaintiffs Who Never Purchased Or Sold Securities On The Market At The Market Price.

The Second Circuit's decision significantly broadens the reach of federal securities law. No other court of appeals has extended *Basic*'s presumption of reliance to a plaintiff who made no active decision to transact at the market price in an efficient market, and who in fact did not engage in any transaction at a market-determined price. As the Petition explains (at 25–26), other Circuits have faithfully adhered to *Basic*'s requirement that a plaintiff buy or sell securities tied to the market price set by an efficient market, *Basic*, 485 U.S. at 247.

The Second Circuit alone has failed to respect that limitation. The panel majority described its decision as a straightforward extension of *Black* v. *Finatra Cap., Inc.*, 418 F.3d 203 (2d Cir. 2005). But that case, too, wrongly afforded the *Basic* presumption to a plaintiff who had not purchased securities at the market price. Instead, he was "solicited ... to privately purchase … stock at a discount to the market price," *id.* at 205; see Pet. App. 43a.

The Second Circuit's earlier precedents involving merger-and-appraisal transactions confirm that the decision below is a departure from *Basic*'s rule. In those cases, the Second Circuit required proof of actual reliance and did not invoke *Basic*. In *Wilson* v. *Great American Industries*, *Inc.*, 979 F.2d 924 (2d Cir. 1992), minority shareholders, claimed that fraudulent proxy statements induced their votes in favor of a freeze-out merger, thereby "depriv[ing] them of their state appraisal rights." *Id.* at 930. *Wilson* emphasized that a plaintiff in such a case must present "proof that the misrepresentations induced plaintiffs to engage in the subject transaction" and that "transaction causation may be shown when a proxy statement, because of material misrepresentations, causes a shareholder to forfeit his appraisal rights by voting in favor of the proposed corporate merger." *Id.* at 931. *Grace* v. *Rosenstock*, 228 F.3d 40 (2d Cir. 2000), rejected a similar claim because "plaintiffs did not vote in favor of the merger and did not show that they relied on the proxy materials in any way that caused them to forfeit their rights to appraisal," *id.* at 49–50. Neither *Wilson* nor *Grace* mentioned *Basic*. Rightly so, given that this Court's precedents do not extend the fraud-on-the-market presumption to plaintiffs, such as dissenting shareholders in a freeze-out merger, who do not transact that the market price.

The decision here thus extends *Basic*—and with it, the specter of federal securities class actions. Before the decision here, a plaintiff involved in a transaction untethered to the price set by an efficient market was required to plausibly plead actual reliance (as in *Wilson* and *Grace*). The decision below newly makes it unnecessary for a plaintiff in such a transaction to plead (let alone prove) actual reliance on the alleged misrepresentations. Instead, a plaintiff who did not

buy or sell shares at the market price can state a claim by invoking the *Basic* fraud-on-the-market presumption. That change enlarges the universe of potential plaintiffs who can state a claim for securities fraud.

Disturbingly, this outlier decision is now the *de facto* nationwide rule. Venue in a § 10b suit—which must involve "the purchase or sale of [a] security," 15 U.S.C. § 78j(b)—is almost always proper in the Southern District of New York, where virtually every publicly traded security is listed, see *id.* § 78aa (establishing venue under the Exchange Act in "the district wherein any act or transaction constituting the violation occurred"). Going forward, plaintiffs (and their counsel) will take advantage of the Second Circuit's new rule by filing securities class action where the plaintiff did not purchase or sell shares on the market will in federal court in New York.

The Second Circuit's decision also appears to make class certification far easier. As this Court has explained, "[a]bsent the fraud-on-the-market theory, the requirement that Rule 10b–5 plaintiffs establish reliance would ordinarily preclude certification of a class action seeking money damages because individual reliance issues would overwhelm questions common to the class." *Amgen Inc.* v. *Conn. Ret. Plans & Tr. Funds*, 568 U.S. 455, 462–63 (2013). The *Basic* presumption thus "facilitates class certification by recognizing a rebuttable presumption of classwide reliance on public, material misrepresentations when shares are traded in an efficient market." *Id.*

The Second Circuit's decision, however, may permit class certification based on *Basic* even where plaintiffs did not purchase or sell shares in an efficient market. This case illustrates the point. The panel's decision

opens the door to a class of every Shanda shareholder—enabling every one of them to claim the appraisal price—when only three shareholders exercised their appraisal rights, and the rest (like Monk) "passive[ly] acquiesce[d] to the forced tendering." Pet. App. 57a (Jacobs, J., dissenting).

Such an expansion of the federal securities class action threatens serious harm to defendants and shareholders. As Congress and this Court have long recognized, private securities-fraud litigation is "subject to abuse, including the 'extract[ion]' of 'extortionate settlements' of frivolous claims." *Amgen*, 568 U.S. at 475 (quoting 476 H.R. Conf. Rep. No. 104–369, pp. 31–32 (1995)). Overly permissive class certification lies at the heart of that problem. The potential damages exposure in securities class action suits is so immense that defendants often face "the choice … [to] settle or risk the very real possibility of a jury verdict that threatens bankruptcy." Adam C. Pritchard, Stoneridge Investment Partners v. Scientific-Atlanta: *The Political Economy of Securities Class Action Reform*, 2008 Cato S. Ct. Rev. 217, 225 (2008).

Shareholders suffer too. Empirical studies show that securities class actions and settlements depress stock prices, destroying shareholder value. U.S. Chamber Inst. for Legal Reform, *Economic Consequences: The Real Costs of U.S. Securities Class Action Litigation* 1–2 (2014), https://tinyurl.com/dnhyjhfx. One study estimated that shareholders lose $39 billion annually, compared to the $5 billion that investors recover through settlements. *Id.* at 3. Securities class actions therefore "transfer wealth systematically [away] from 'buy and hold' investors" such as "the small investor who buys and holds for retirement." John C. Coffee Jr.,

Reforming the Securities Class Action: On Deterrence and Its Implementation, 106 Colum. L. Rev. 1534, 1560 (2006). Expansions of securities class actions like the decision below only accelerate these troubling trends.

B. The Second Circuit's Decision Expands Federal Law Into A Domain Traditionally Regulated By State Corporate Law, Increasing Legal Risk In Merger Transactions.

The decision below also threatens to "swallow whole" existing "state law protections for minority shareholders." Pet. App. 75a (Jacobs, J., dissenting). This incursion of federal law into a domain traditionally reserved to States is problematic in itself. It also creates substantial new risks for the business community.

1. "Corporations are creatures of state law," *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462, 479 (1977), so state corporate law—not federal securities law—has traditionally governed how minority shareholders dissent against a merger and the remedies available when they do, see generally George S. Geis, *An Appraisal Puzzle*, 105 Nw. U. L. Rev. 1635, 1641–43 (2011) (discussing the origins of these state corporate laws). States have carefully and comprehensively regulated the remedies for shareholders who choose to dissent from a merger, as well as how those shareholders may access those remedies. See *id.* The typical remedy is a judicial "appraisal" of the fair value of the dissenting shareholder's shares.

The appraisal process is deliberately demanding. "The appraisal remedy is complicated, and shareholders have to navigate a variety of hurdles to protect their claims." *Id.* at 1645. In Delaware, for

instance, a dissenting shareholder must deliver a written appraisal demand to the corporation before the merger vote and must also vote against the merger.[2] *Id.* at 1646–47 (citing Del. Code Ann. tit. 8, § 262(a), (d)(1)). Each dissenting shareholder seeking an appraisal must file his or her own lawsuit. *Id.* at 1647 (citing Del. Code Ann. tit. 8, § 262(e)). These appraisal proceedings "can take years." *Id.* And "it is possible for courts to award a *lower* price for the stock than the merger consideration provided." *Id.*

These procedural hurdles are by design. The appraisal remedy is meant to be a limited safety valve to protect dissenting shareholders from abuse, while preserving efficiency in merger transactions. See *id.* at 1657–59.

Consistent with this purpose, appraisal actions are relatively rare. One study of Delaware appraisal actions calculated that in 2019, roughly 5% of appraisal-eligible transactions faced an appraisal claim, down from a peak of around 25% in the 2010s. See Wei Jiang, Tao Li & Randall Thomas, *The Long Rise and Quick Fall of Appraisal Arbitrage*, 100 B.U. L. Rev. 2133, 2137 (2020).

The Second Circuit's decision upends this careful regime, by allowing dissenting shareholders to belatedly challenge the merger price in a federal case on behalf of a putative class. As just described, challenging the merger price in a transaction like this one typically requires registering dissent, engaging counsel, and filing an appraisal action in the company's state of incorporation. But under the decision here, a shareholder can do nothing, see how

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[2] The merger at issue in this case was governed by Cayman Islands law, which is modeled on Delaware law. *See* Pet. 9.

other shareholders come out in the appraisal action, and then launch a collateral attack on the merger price in federal court in a securities class action. That is exactly what happened here: the plaintiff took no action, did not pursue the appraisal process, and now asks a federal court to award him—and every other shareholder in the class—the appraisal value awarded to those who did dissent and seek appraisal.

That is not a proper role for federal securities law. Recognizing that federal securities litigation under § 10(b) is "a judicial construct that Congress did not enact in the text of the relevant statutes," *Stoneridge Inv. Partners LLC* v. *Sci.-Atlanta, Inc.*, 552 U.S. 148, 164 (2008), this Court has been "reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden," *Santa Fe Indus.*, 430 U.S. at 479. Here, there is no "clear indication" that Congress intended to blow up state-law remedies for dissenting shareholders by inviting federal courts to revisit merger valuations.

2. That invitation substantially increases the legal risks to buyers in merger transactions subject to appraisal.

Even before the Second Circuit's decision, the carefully cabined state-law appraisal remedy introduces legal and financial uncertainty into mergers. In every appraisal-eligible merger, the buyer faces uncertainty about whether an appraisal will be sought, and then about whether dissenting shareholders will ultimately be entitled to a payout and (if so) how large. See Geis, *supra*, at 1663–64. The law of appraisal drives some of this uncertainty. Empirical studies confirm that changes in appraisal

law directly affect the frequency of appraisal challenges and, in turn, influence overall deal activity. See generally Jiang, *supra*. Scholars have likewise documented how evolving appraisal caselaw can destabilize expectations for buyers in merger transactions, chilling beneficial transactions and increasing deal costs. Geis, *supra*, at 1639–40 (warning that expanded appraisal rights risk deterring "sensible deals" and increasing uncertainty and costs in merger transactions).

The decision here threatens the same consequences for businesses—on a greater scale. Now, a buyer in a merger transaction must contend not only with potential state-law appraisal actions but also with collateral federal securities suits by shareholders who neither registered their dissent nor voted against the merger. And because the Second Circuit's rule makes it easier to certify such shareholders as a class, the resulting litigation risk is multiplied. Defendants can now face federal verdicts awarding every minority shareholder the appraisal value, rather than the negotiated price.

The looming threat of such a verdict provides plaintiffs' counsel with powerful leverage to extract settlements. The Second Circuit's decision thus threatens to impose a heavy new tax on merger transactions—one that could deter legitimate and economically valuable activity.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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