No. 14-1132

In the Supreme Court of the United States

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

Petitioners,

v.

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

Respondents.

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

BRIEF FOR RESPONDENTS

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QUESTION PRESENTED

Section 27 of the Securities Exchange Act of 1934 (Exchange Act) provides that federal courts "shall have exclusive jurisdiction" over "violations of [the Exchange Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by [the Exchange Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a).

In this case, Respondents filed suit under state law in New Jersey state court seeking to enforce liabilities and duties created by New Jersey law, not the Exchange Act or its regulations. It is undisputed that not a single claim raised in this suit *necessarily* turns on federal law, but Petitioners maintain that at least one claim *might possibly* turn on an Exchange Act regulation, a contention the court of appeals rejected and Respondents dispute.

The question presented is:

Whether Section 27 of the Exchange Act strips away traditional state-court jurisdiction over state-law claims whenever there is a *mere possibility* that an issue related to the Exchange Act might resolve one element of a single claim.

RULE 29.6 STATEMENT

Posiljonen AB has no parent corporation, and no publicly held corporation owns 10% or more of Posiljonen AB's stock.

Posiljonen AS has no parent corporation, and no publicly held corporation owns 10% or more of Posiljonen AS's stock.

Sveaborg Handel AS has no parent corporation, and no publicly held corporation owns 10% or more of Sveaborg Handel AS's stock.

Flygexpo AB has no parent corporation, and no publicly held corporation owns 10% or more of Flygexpo AB's stock.

Londrina Holding Ltd. has no parent corporation, and no publicly held corporation owns 10% or more of Londrina Holding Ltd.'s stock.

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INTRODUCTION

This dispute involves a classic case of market manipulation. Respondents were investors in Escala Group, Inc. ("Escala"). They sued Petitioners, a group of major financial institutions, in New Jersey state court asserting a series of New Jersey state-law claims. In each of those state-law claims, Respondents alleged that Petitioners caused their investment in Escala to decline substantially through a pattern of manipulative "naked short-selling."

"'Short-selling' is the practice of borrowing shares of stock, selling them and seeking to repurchase those shares at a lower price, returning the lower-priced shares to the lender and keeping the difference as profit." *Fairfax Fin. Holdings. Ltd. v. S.A.C. Capital Mgmt., LLC*, Civ. No. 06-4197, 2007 WL 1456204, at *l (D.N.J. May 15, 2007).

"'Naked short-selling' occurs when traders sell shares they do not own or borrow, or ever intend to own, and never deliver the 'borrowed' securities that they sell." Report and Recommendation, ECF No. 36, at 2-3 (citing *Avenius v. Banc of Am. Sec. LLC*, Civ. No. 06-4458, 2006 WL 4008711, at *1 (N.D. Cal. Dec. 30, 2006); *Capece v. DTCC*, Civ. No. 05-80498, 2005 WL 4050118, at *3 (S.D. Fla. Oct. 11, 2005)).

Manipulative naked short-selling can artificially depress a stock's price at the expense of innocent investors and the gain of abusive brokers and traders. That is what Respondents allege occurred here—Petitioners did not merely fail to follow the fine print of some technical regulation; they engaged in pure and simple manipulative and deceptive practices, exactly the kind of behavior that has been long prohibited under New Jersey common law and statutes.

New Jersey is not alone. The common and statutory law of numerous states similarly forbids Petitioners' conduct, and the Securities Exchange Act of 1934 ("Exchange Act") and its implementing regulations likewise target this financial misbehavior.

As is their right, Respondents chose to seek a remedy for Petitioners' misconduct *exclusively* under New Jersey law. Every claim asserted by Respondents is a New Jersey claim seeking to remedy violations of New Jersey law. And as the court of appeals expressly held, none turns in any way on federal law: "As we read the Amended Complaint, no causes of action are predicated *at all* on a violation of [federal law]." Pet. App. 14a (emphasis in original). Were the entirety of the Exchange Act and its regulations repealed tomorrow, not a single claim in Respondents' complaint would be threatened.

Undaunted, Petitioners claim Section 27 of the Exchange Act confers exclusive jurisdiction in these circumstances, stripping New Jersey state courts of the ability to determine whether Petitioners violated New Jersey state law. Not so.

Petitioners misread the text of the Exchange Act to suggest a radical jurisdictional theory that is simultaneously unfaithful to Congressional intent, this Court's jurisdictional teachings, and common sense.

Affirmance is warranted.

STATEMENT

A. Statutory Background

1. States have long made it illegal to manipulate the securities markets. *See generally* James Burk, *Values in the Marketplace: The American Stock Market Under Federal Securities Law* 169 (1988) (Table: C.2: Major Actions by Various States to Regulate Securities Business, 1852-1921) (describing state efforts); Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 Tex. L. Rev. 347, 352-64 (1991) (discussing impetus behind state "blue sky laws"); Louis Loss & Edward M. Cowett, *Blue Sky Law* 7-8 (1958) (asserting that blue sky laws grew out of awareness of "the many instances in which unsophisticated . . . investors had been bilked of their life savings by sellers of worthless or fraudulent securities").

By the time Congress passed the first federal securities laws, every state but Nevada had enacted its own. Joel Seligman, *The Transformation of Wall Street* 45 (rev. ed. 1995). Many of these state statutes had prohibitions on fraud and misrepresentation.[1] And the state regulatory infrastructures were generally well-

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[1] *See, e.g.*, Br. in Opp. 1 n.1 (collecting statutes). These statutes survived numerous constitutional challenges because they were deemed legitimate exercises of the states' police power. As this Court confirmed in upholding one statute:

> [W]e think the statute under review is within the power of the state. It burdens honest business, it is true, but burdens it only that, under its forms, dishonest business may not be done.

Merrick v. N.W. Halsey & Co., 242 U.S. 568, 587 (1917). *See also Hall v. Geiger-Jones Co.*, 242 U.S. 539, 551 (1917) ("[W]e shall not pause to do more than state that the prevention of deception is within the competency of government . . . .").

developed. S*ee* Larry D. Soderquist, *Understanding the Securities Laws* 16 (2d ed. 1990) (noting exclusive securities regulation by states until 1933).

2. It was against this backdrop of established state regulation that Congress passed the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* ("Securities Act"), and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq*. ("Exchange Act"). Drafters of the federal Acts relied heavily on existing state statutes for guidance. *See* 1 Louis Loss & Joel Seligman, *Securities Regulation* 180 (1989) (antifraud provisions drawn from New York's Martin Act).[2] In enacting federal legislation, they hoped to make it more difficult for prospective fraudsters to elude regulation through state loopholes or by crossing state lines. *See generally* Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 Stan. L. Rev. 273, 280-82 (1998) (explaining impetus to improve deterrence and enforcement).

Both Acts largely preserved and supplemented existing state authority over the securities markets. They explicitly provided that "the rights and remedies provided by this subchapter shall be *in addition to* any and all other rights and remedies that may exist at law or in equity." Securities Act of 1933, Pub. L. No. 73-22, ch. 38, § 16, 48 Stat. 74, 84 (1933); Securities Exchange Act of 1934, Pub. L. No. 73-291, ch. 404, § 28, 48 Stat.

[2] *See also* Raymond Moley, *After Seven Years* 180 (1939) (drafter Benjamin Cohen said to have "considerable experience in the drafting of state [securities] laws"); James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 Geo. Wash. L. Rev. 29, 33 (1959) (drafter James Landis had spent several years studying state blue sky laws).

881, 903 (1934) (emphasis added). And the Securities Act included a removal bar that permitted plaintiffs to litigate their claims in state court regardless of the defendants' forum preference. 15 U.S.C. § 77v(a).

Indeed, the available legislative history makes clear that Congress specifically intended an ongoing role for the states in securities regulation. *See Hearings on S. Res. 84, S. Res. 56 & S. Res. 97 Before the S. Comm. on Banking and Currency*, 73d Cong. 6577 (1934) (statement of Thomas Corcoran, principal Exchange Act draftsman, regarding intention to leave states as much leeway as possible to regulate securities transactions); *Leroy v. Great W. United Corp.*, 443 U.S. 173, 182 n.13 (1979) (legislative history of Exchange Act indicated intent to leave states significant authority).[3]

The Exchange Act did not include an express private right of action for defrauded purchasers or sellers of securities.[4] After its passage, defrauded securities investors continued to bring state lawsuits in state courts. *See, e.g.*, *White v. Fin. Guarantee Corp.*, 56 P.2d 550, 551 (Cal. Ct. App. 1936) (securities fraud under California Corporate Securities Act); *Anderson v. Mikel Drilling Co.*, 102 N.W.2d 293, 297 (Minn. 1960) (securities fraud under Minnesota Securities Act);

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[3] *See also* Perino, *Fraud & Federalism*, at 281-82 (explaining that displacing state authority would have heightened already significant constitutional questions); Joel Seligman, *Remarks at University of Washington Securities Law Conference* (Mar. 1997) (asserting that Speaker Rayburn insisted on preservation of state securities regulation as condition of speedy passage).

[4] It *did* create a private right of action for market manipulation. *See* 15 U.S.C. § 78i.

Curtis v. State, 109 S.E.2d 868, 871 (Ga. Ct. App. 1959) (securities fraud under Georgia Securities Act).

3. Meaningful federal-securities litigation had to await a number of watershed developments, including: the Securities and Exchange Commission (SEC) promulgation of Rule 10b-5 (1942);[5] judicial recognition of a private right of action to enforce Rule 10b-5 (1946);[6] SEC support for private federal securities law enforcement (early 1960s);[7] and the liberalization of Rule 23 of the Federal Rules of Civil Procedure (1966).[8]

Following the advent of the modern federal class action device, the growing plaintiffs' securities class action bar largely ignored the state courts.[9] It remained

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[5] Exchange Act Release No. 34-3230 (May 21, 1942). Rule 10b-5 specifically prohibits fraud and misrepresentation in connection with the purchase or sale of any security. *See* 17 C.F.R. § 240.10b-5. It is the principal antifraud provision in the federal securities regime.

[6] *See Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512, 514-15 (E.D. Pa. 1946).

[7] *See J.I. Case Co. v. Borak*, 377 U.S. 426, 427 (1964); *In re Cady, Roberts & Co.*, Exchange Act Release No. 6668, [1961-1964 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,803, at 81,013 (Nov. 8, 1961).

[8] *See* Arthur R. Miller, *Of Frankenstein Monsters and Shining Knights: Myth, Reality, and the "Class Action Problem"*, 92 Harv. L. Rev. 664, 665-68 (1979) (analyzing effect of the 1966 amendments).

[9] As one prominent practitioner told Congress, "State court class actions involving nationally traded securities were virtually unknown . . . ." *The Securities Litigation Uniform Standards Act of 1997 – S. 1260: Hearing before the Subcomm. on Sec. of the S. Comm. On Banking, Hous. & Urban Affairs*, 105th Cong. 70 (1998) (statement of John F. Olson, Gibson, Dunn & Crutcher LLP). *See generally* Perino, *Fraud and Federalism*, at 284-86 (explaining that federal class action litigation under Rule 10b-5 offers advantages

uncontroversial, however, that a victim of securities fraud or market manipulation could *choose* between bringing suit in state court for state law violations,[10] in federal court for Exchange Act violations, or in federal court for both state law and Exchange Act violations.[11]

4. By the mid-1990s, there was broad legislative consensus that federal securities class actions had evolved into a practice rife with abuse. *See Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006) ("*Dabit*"). Congress enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA") to curb these perceived abuses, in large part by imposing significant new procedural hurdles. H.R. Conf. Rep. No. 104-369, 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 730. But because these rules did not apply to state court litigation, the PSLRA had the "unintended consequence" of driving securities class actions to state courts. *Dabit*, 547 U.S. at 81-82; *see also* H.R. Rep. No. 105-640, at 10 (1998).

In response, Congress passed the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), which effectively abolished state law *class actions* concerning fraud or manipulation of the federally regulated securities market. *See* SLUSA, Pub. L. No. 105-353, §§ 2(2), (5), 112 Stat. 3227, 3227 (1998) (goal to

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over state actions, including easier class certification and greater potential damages from nationwide classes, and that many state laws limit securities actions in important ways).

[10] *See, e.g.*, *Tucker v. Mariani*, 655 So. 2d 221, 224 (Fla. Dist. Ct. App. 1995) (securities fraud under Florida Statutes).

[11] *See, e.g.*, *Gieringer v. Silverman*, 539 F. Supp. 498, 501 (E.D. Wis. 1982), *aff'd*, 731 F.2d 1272 (7th Cir. 1984) (Exchange Act and Wisconsin Securities Act claims).

"prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the [PSLRA]").

As this Court has explained, SLUSA did not "preempt" state law, but rather made "some state-law claims nonactionable through the class action device in federal as well as state court." *Kircher v. Putnam Funds Trust*, 547 U.S. 633, 636 n.1 (2006). In other words, Congress did not choose to preempt all state laws prohibiting fraud or market manipulation in connection with federally regulated securities, but only to preclude class action lawsuits asserting those claims. *Dabit*, 547 U.S. at 87 ("The [Exchange] Act does not deny any individual plaintiff, or indeed any group of fewer than 50 plaintiffs, the right to enforce any state-law cause of action that may exist.").

Consequently, the dual state-federal regulatory regime contemplated by the Depression-era Congress continues to this day.

B. Procedural History

Respondents are former shareholders of Escala, a New Jersey-based company whose market capitalization plummeted nearly $800 million in the short span of eleven months. Pls.' Reply, ECF No. 30, at 7 n.8; Pet. App. 45a-46a (AC ¶¶ 7-13). Petitioners are several large financial institutions who facilitated the manipulative naked short-selling of Escala common stock. Pet. App. 46a-47a (AC ¶¶ 14-20).

"'Short-selling' is the practice of borrowing shares of stock, selling them and seeking to repurchase those shares at a lower price, returning the lower-priced shares to the lender and keeping the difference as profit." *Fairfax Fin. Holdings. Ltd. v. S.A.C. Capital Mgmt., LLC*, Civ. No. 06-4197, 2007 WL 1456204, at *l (D.N.J. May 15, 2007).

"'Naked short-selling' occurs when traders sell shares they do not own or borrow, or ever intend to own, and never deliver the 'borrowed' securities that they sell." Report and Recommendation, ECF No. 36, at 2-3 (citing *Avenius v. Banc of Am. Sec. LLC*, Civ. No. 06-4458, 2006 WL 4008711, at *1 (N.D. Cal. Dec. 30, 2006); *Capece v. DTCC*, Civ. No. 05-80498, 2005 WL 4050118, at *3 (S.D. Fla. Oct. 11, 2005)). Naked short-selling can be a tool for market manipulation. This case is about whether Petitioners engaged in a pattern of manipulative naked short-selling in violation of New Jersey laws.

1. On May 8, 2012, Respondents sued Petitioners in the Superior Court of New Jersey, Law Division, Morris County. Pet. App. 26a. Plaintiff Gregory Manning, the owner of approximately 2.1 million shares of Escala stock during the relevant period, lives in Morris County, Pet. App. 45a (AC ¶ 7), which neighbors Escala's principal place of business, Essex County, Pet. App. 48a (AC ¶ 22). In an Amended Complaint, Respondents alleged two kinds of wrongdoing under New Jersey law:[12]

[12] Specifically, the Amended Complaint asserts ten specific causes of action under New Jersey law: (1) violation of NJRICO § 2C:41-2(c), Pet. App. 82a-90a (AC ¶¶ 88-113); (2) violation of NJRICO § 2C:41-2(a), Pet. App. 91a-93a (AC ¶¶ 114-22); (3) unjust enrichment, Pet. App. 93a-94a (AC ¶¶ 123-27); (4) unlawful interference with prospective economic advantage, Pet. App. 94a-95a (AC ¶¶ 128-33); (5) tortious interference with contractual relations, Pet. App. 95a-97a (AC ¶¶ 134-40); (6) unlawful interference with contractual relations, Pet. App. 97a-98a (AC ¶¶ 141-45); (7) third party beneficiary claims, Pet. App. 98a-99a (AC ¶¶

First, they alleged that Petitioners—in their capacity as securities brokers—intentionally gave false "locates" to customers who wanted to short Escala stock. *See, e.g.*, Pet. App. 58a (AC ¶ 41) ("Defendants were saying they had Escala securities available to lend to facilitate additional short selling *at the same time* they did not have sufficient Escala securities to cover past sales.") (emphasis added); Pet. App. 58a (AC ¶ 42) ("Defendants claimed to receive Locates from other Defendants (or non-party banks) on dates when those other Defendants (or non-party banks) did not have sufficient Escala securities to cover the alleged Locates and accepted Locates they knew were unreliable."); Pet. App. 74a (AC ¶ 79a) ("[Defendants] created false documentation of their . . . loaning and ownership in Escala shares.").

According to the Amended Complaint, Defendants' motive was simple: to reap massive commissions for doing nothing. Pet. App. 88a (AC ¶ 106) ("Defendants charged short sellers fees for these sham 'loans' of stock."). By permitting their customers to short more stock than actually existed in a small, thinly-traded company, Defendants depressed Plaintiffs' share value to collect bogus commissions for themselves. Pet. App. 56a (AC ¶ 37a) (alleging harm through "creating and/or using unauthorized counterfeit shares to increase the pool of tradable common stock which operated to dilute the shares owned by Plaintiffs").[13]

146-49); (8) breach of the covenant of good faith and fair dealing, Pet. App. 99a-100a (AC ¶¶ 150-54); (9) negligence, Pet. App. 100a-01a (AC ¶¶ 155-58); and (10) punitive and exemplary damages, Pet App. 101a (AC ¶¶ 159-61).

[13] Because Escala is a thinly-traded company, naked short-selling is much more likely to materially depress the price of its stock. For large companies with many traded shares, the likelihood

These factual allegations support claims under two different New Jersey statutes, each of which constitutes a predicate act for purposes of the New Jersey Racketeering Influenced and Corrupt Organization Act, N.J. Rev. Stat. § 2C:41 *et seq.* ("NJRICO"); *see* Pet. App. 82a-93a (AC ¶¶ 88-122) (Counts One and Two).[14]

a. They constitute securities fraud under New Jersey's Uniform Securities Law, (1997) N.J. Rev. Stat. § 49:3-47 *et seq.* ("NJUSL").[15] Pet. App. 85a (AC ¶ 99)

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that a short position will be quickly matched with a long position is high, even if a specific long cannot be immediately located. For companies with only a small amount of actively traded shares, the odds are higher that shorts will not find corresponding longs, in which case "counterfeit" shares that dilute the value of actual shares are effectively created. *See generally Key Points about Regulation SHO*, SEC Office of Investor Education and Advocacy (April 8, 2015), http://www.sec.gov/investor/pubs/regsho.htm.

[14] The New Jersey legislature enacted NJRICO in 1981 "to provide that activity which is inimical to the general health, welfare and prosperity of the State and its inhabitants be made subject to strict civil and criminal sanctions." N.J. Rev. Stat. § 2C:41-1.1. The statute contains a liberal construction provision. N.J. Rev. Stat. § 2C:41-6. New Jersey courts have interpreted NJRICO consistent with that intent. *See, e.g.*, *State v. Ball*, 661 A.2d 251, 258-59 (N.J. 1995). *See generally* John E. Floyd, *RICO State by State: A Guide to Litigation Under the State Racketeering Statutes* 520 (1998).

[15] For over 150 years, New Jersey investors have relied on state common law for protection against manipulation of the securities markets. *See, e.g.*, *Morris Canal & Banking Co. v. Fisher*, 9 N.J. Eq. 667 (N.J. 1855) (addressing negotiability of bonds allegedly issued without stockholder authorization). Such is still the case today. *See, e.g.*, *Prudential Ins. Co. of Am. v. Bank of Am., Nat'l Ass'n*, 14 F. Supp. 3d 591 (D.N.J. 2014) (addressing allegations of fraud and negligent misrepresentation regarding underwriting guidelines for residential mortgage backed securities). To enhance its common law protections for investors, New Jersey adopted and later amended the NJUSL, a version of the Uniform Securities Act.

(alleging that Defendants violated NJUSL "by making phantom loans of counterfeit Escala stock to facilitate naked short sale transactions . . ."). *See generally* Pet. App. 84a-87a (AC ¶¶ 96-101h).

b. They constitute theft by taking under the New Jersey Code of Criminal Justice ("New Jersey Criminal Code"), N.J. Rev. Stat. § 2C:20-4 (2013). Pet. App. 88a (AC ¶ 106) ("Defendants engaged in theft by taking by purporting to loan short sellers Escala stock that Defendants did not own nor had any intention of obtaining and never did obtain . . . ."). *See generally* Pet. App. 87a-89a (AC ¶ 106).

Second, the Amended Complaint alleges that Petitioners—in their capacity as proprietary traders—engaged in a scheme to short Escala stock which they knew or should have known they could not possibly cover, and that they used their status as brokers to conceal that scheme. *See, e.g.*, Pet. App. 44a (AC ¶ 4) ("Defendants implemented a sophisticated scheme to conceal and cover-up their illegal conduct to avoid detection."); Pet. App. 74a (AC ¶ 79a) ("[T]o conceal their unlawful naked short selling of Escala stock, Defendants . . . created false documentation of their trading . . . in Escala shares."); Pet. App. 74a (AC ¶ 79c) ("[T]o conceal their unlawful naked short selling of Escala stock, Defendants . . . knowingly and intentionally mis-marked order tickets . . . and falsely report[ed] counterfeit or phantom shares on brokerage statements to investors, including the Plaintiffs in order to mislead them.").

According to the Amended Complaint, Petitioners' motive was simple: to make money by driving down the price of Escala stock. Pet. App. 73a (AC ¶ 78) ("The data reflects that there was an illegal bear raid on Escala securities, with massive volumes of non-existent counterfeit stock used to manipulate pricing."). By shorting more stock in a small, thinly-traded company than actually existed, Petitioners both financially gained and diluted Respondents' interest. Pet. App. 56a (AC ¶ 37a) (alleging harm through "creating and/or using unauthorized counterfeit shares to increase the pool of tradable common stock which operated to dilute the shares owned by Plaintiffs").

These factual allegations support claims under three different New Jersey statutes, each of which constitutes a predicate act for the purposes of NJRICO.

a. They constitute securities fraud under NJUSL. Pet. App. 85a (AC ¶ 98a) (alleging that Petitioners violated NJUSL by "selling Escala stock short at times when Defendants neither possessed nor intended to obtain Escala stock to deliver by the Settlement Date"). *See generally* Pet. App. 84a-87a (AC ¶¶ 96-101a).

b. They constitute theft by taking under the New Jersey Criminal Code, N.J. Rev. Stat. § 2C:20-4. Pet. App. 87a (AC ¶ 105) ("Defendants unlawfully took property of Plaintiffs, with the intention of depriving them of that property by . . . selling Escala stock short at times when they neither possessed nor intended on obtaining Escala stock to deliver by the Settlement Date . . . .").

c. They constitute theft by deception under the New Jersey Criminal Code, N.J. Rev. Stat. § 2C:20-3. Pet. App. 89a (AC ¶ 110) ("Defendants, by . . . promis[ing] to borrow Escala stock that it did not borrow and had no intention of borrowing, committed the crime of theft by deception prohibited by N.J.S.A. 2C:20-4."). *See generally* Pet. App. 89a-113a (AC ¶¶ 108-113).

2. To be clear: the Amended Complaint explicitly does *not* assert any federal causes of action. *See* Pet. App. 82a-101a (AC ¶¶ 88-161). Nor does it allege violations of federal law or regulation as predicate acts for violations of NJRICO alleged in Counts One and Two. *See* Pet. App. 82a-93a (AC ¶¶ 88-122).

The Amended Complaint does, however, seek to educate the reader about the history of clear SEC guidance that manipulative naked short-selling is illegal under federal law and many state laws, making Petitioners' conduct especially egregious. *See, e.g.*, Pet. App. 53a (AC ¶ 30) ("[T]he SEC, which regulates federal securities laws that are substantially similar to New Jersey's Securities Act, has explicitly stated that selling stock short and failing to deliver shares at the time of settlement with the purpose of driving down the security's price' constitutes a 'manipulative activity' that 'in general, would violate various securities laws.'").[16]

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[16] In 2004, the SEC adopted Regulation SHO to clarify that manipulative naked short-selling is illegal and to curb its spread. *See* 17 C.F.R. § 242.200 *et seq.*; Short Sales, SEC Release No. 34-50103, 69 Fed. Reg. 48,008 (Aug. 6, 2004) (codified at 17 C.F.R. pts. 240, 241 and 242) ("Regulation SHO Release"). As the SEC explained, manipulative naked short-selling is fraudulent. *See, e.g.*, "Naked" Short Selling Antifraud Rule, SEC Release No. 34-57511, 73 Fed. Reg. 61,666, 61,674 (Oct. 17, 2008) (codified at 17 C.F.R. pt. 240) ("[F]ails to deliver might be indicative of manipulative 'naked' short selling . . . ."); Office of Investor Educ. and Advocacy, SEC, Key Points About Regulation SHO, http://www.sec.gov/investor/pubs/regsho.htm ("Those who deceive about their intention or ability to deliver securities in time for settlement are committing fraud . . . when they fail to deliver securities by the settlement date."); *id.* ("Selling stock short and failing to deliver shares at the time of

The Amended Complaint also explains that the "SEC formally articulated the pernicious effects of naked short selling on the securities markets" over a decade ago in enacting Regulation SHO, Pet. App. 51a-53a (AC ¶¶ 28-29); and that the SEC had since "reaffirmed its '. . . zero tolerance for abusive naked short selling' by strengthening investor protection," Pet. App. 53a-54a (AC ¶ 30). And it describes Petitioners' history of repeated violations of Regulation SHO to explain that Petitioners had a history of sanctions by the Financial Industry Regulatory Authority and other regulatory agencies and thus punitive damages would be warranted. *See* Pet. App. 75a-82a (AC ¶¶ 81-87) (discussing history of sanctions by the FINRA and other regulatory agencies).

3. Petitioner Merrill Lynch, Pierce, Fenner & Smith ("Merrill") filed a Notice of Removal. Pet. App. 26a. Petitioners contended that removal was proper because (1) the claims in the Amended Complaint "arise under" federal law and therefore confer federal question jurisdiction pursuant to 28 U.S.C. § 1331, and (2) the federal district court was vested with exclusive jurisdiction under Section 27 of the Exchange Act.

Respondents then moved to remand. Pet. App. 26a. As Respondents explained, there was no "arising under" jurisdiction under 28 U.S.C. § 1331 because they could establish each of their state law claims without reference to federal law. *See, e.g.*, Motion to Remand, ECF No. 11-2, at 16 ("Here, Plaintiffs can prevail . . . without relying

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settlement with the purpose of driving down the security's price . . . would violate various securities laws, including Rule 10b-5 under the Exchange Act.").

on or proving a violation of federal law by demonstrating that Defendants engaged in deceptive conduct in never intending to make delivery of the shorted Escala stock."); Pls.' Reply, ECF No. 30, at 2 ("It is the intent and effect of Defendant[s'] wrongful conduct that serves as the measure of liability for Defendants' violation of state RICO and other common law claims, not the violation of any federal regulation or rule.").

Respondents also explained that the exclusive jurisdiction provision in Section 27 of the Exchange Act does not apply because Respondents sought to vindicate only their rights under New Jersey law:

> Because Plaintiffs' claims arise out of *state* law rights and duties, Plaintiffs have *state* law rights to be free from fraud, misrepresentation, and material omissions in the sale of securities, *state* law rights to be free from market manipulation and *state* law rights to be free from deceit and theft. . . . [New Jersey] provide[s] claims for relief from abuses in the securities field independent of and in addition to federal claims for relief . . . .

Motion to Remand, ECF No. 11-2, at 16-17 (emphasis in original).

4. Recognizing that none of Respondents' claims is predicated on an alleged violation of federal law, the federal magistrate judge recommended remanding the action. Pet. App. 9a (Third Circuit discussing Magistrate Judge's Report and Recommendation).

First, the magistrate rejected Petitioners' argument that there is "arising under" jurisdiction:

> Plaintiffs correctly note that, because they may succeed on their New Jersey RICO claims (Counts 1-2) and state common law claims (Counts 3-10) without establishing liability under federal law, the Amended Complaint . . . does not raise necessarily a substantial issue of federal law.

Report and Recommendation, ECF No. 36, at 8.

Next, the magistrate rejected Petitioners' alternative argument that there is exclusive jurisdiction in federal court pursuant to Section 27 of the Exchange Act. *See* Report and Recommendation, ECF No. 36, at 10-12.

The magistrate found that the references to violations of the Exchange Act in the Amended Complaint "merely . . . support independent state causes of action." Report and Recommendation, ECF No. 36, at 10-11. *See also* Pls.' Reply, ECF No. 30, at 2 ("The gravamen underlying Plaintiffs' Amended Complaint is not that Defendants violated Reg. SHO or other federal regulations, but that by manipulating the value of Escala stock through unlawful naked short sales, Defendants engaged in a pattern of racketeering activity in violation of New Jersey law, resulting in Plaintiffs suffering significant damages.'") (cited in Report and Recommendation, ECF No. 36, at 10).

5. The district court rejected the magistrate's recommendation and denied the motion to remand. Pet. App. 25a. The court began by stating the fundamental—but mistaken—premise of its decision:

> Notably, Plaintiffs do not dispute that the alleged unlawful conduct is predicated on a violation of Regulation SHO, 17 C.F.R. § 242.204, promul-

> gated by the Securities and Exchange Commission ("SEC").

Pet. App. 29a.

The district court did not square its finding with multiple provisions of the Amended Complaint. As Respondents explained and the magistrate understood, Petitioners' unlawful conduct was violating duties owed to Respondents under New Jersey law, not federal law. *See, e.g.*, Pet. App. 43a (AC ¶ 2) (making clear that entire complaint is based on violations of state law without predication on any violation of Regulation SHO); Motion to Remand, ECF No. 11-2, at 16-17 (same); Report and Recommendation, ECF No. 36, at 10-11 (recognizing same).

Resting entirely on its original premise, the district court nevertheless found exclusive jurisdiction under Section 27 of the Exchange Act, *see* Pet. App. 30a-32a, as well as "arising under" jurisdiction, *see* Pet. App. 32a-38a. *See* Pet. App. 32a ("As the case at bar is premised upon and its resolution depends upon the alleged violation of a regulation promulgated under the Act, this Court has jurisdiction."); Pet. App. 33a ("To prevail on their various state law claims, . . . Plaintiffs must show that the alleged naked short sales were illegal.").

6. The Third Circuit reversed. Pet. App. 6a. First, the Third Circuit rejected Petitioners' argument that there is "arising under" jurisdiction. Pet. App. 11a-18a. It determined that Petitioners referred to violations of federal law merely as atmospheric evidence that similar New Jersey state law was violated. *See* Pet. App. 14a-15a (citing *Lippitt v. Raymond James Fin. Servs., Inc.*, 340 F.3d 1033, 1037 (9th Cir. 2003) (no jurisdiction even where the complaint "unnecessarily describes the

alleged conduct of the defendants in terms that track almost verbatim the misdeeds proscribed by [federal law].") (alteration in original)).

In this case, the Third Circuit concluded, "no causes of action are predicated *at all* on a violation of Regulation SHO." Pet. App. 14a (emphasis in original). *See also* Pet. App. 13a ("Regulation SHO is not an element of Plaintiffs' claims. . . . The claims, therefore, could be decided without reference to federal law.").[17]

Second, the Third Circuit considered—for the sake of argument—what result would obtain if Respondents' claims "were partially predicated on federal law." Pet. App. 15a (emphasis omitted). The Third Circuit determined that *if* a state law claim has a sufficient "federal ingredient" to satisfy 28 U.S.C. § 1331, then Section 27 of the Exchange Act makes that jurisdiction "exclusive." Pet. App. 20a, 22a. If the state law claim, however, does *not* include a sufficient federal ingredient to satisfy 28 U.S.C. § 1331, then Section 27 provides no alternative means to confer jurisdiction. Pet. App. 20a, 22a.

SUMMARY OF ARGUMENT

Contrary to Petitioners' contention, Section 27 of the Exchange Act does not aggressively strip away traditional state-court jurisdiction over ordinary state-law claims simply because there is a *mere possibility* that some issue related to the Exchange Act *might*

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[17] *See also* Pet. App. 18a ("Plaintiffs' claims could rise or fall entirely based on the construction of state law."). And Petitioners' arguments that federal law contradicted Respondents' claims did not authorize removal under the well-pleaded complaint rule. Pet. App. 16a-18a.

prove relevant. Petitioners' view of the law is indefensible in multiple respects, and it should be rejected.

I. Petitioners' jurisdictional theory flunks every modern mode of statutory analysis.

A. Petitioners misread Section 27's plain text. There is no basis for saying that Congress intended federal courts to displace state courts whenever a plaintiff happens to mention an Exchange Act "violation" in his complaint. Even on Petitioners' own admission, Congress wanted certain suits in federal court so federal courts could *decide* securities issues—not so federal courts could resolve purely state-law claims whenever a plaintiff mentions a federal "violation" in passing. Congress created jurisdiction in federal courts because the Act gave rise to direct criminal liability (and related civil enforcement provisions); it needed to authorize federal courts to hear *those* claims, not state-law suits, under state law, that have no business directly punishing or enforcing "violations" of the Act.

Nor are Petitioners correct that Respondents' action falls within Section 27 by somehow seeking to enforce Regulation SHO. That theory is not even factually presented, since Respondents' complaint unequivocally does *not* seek to enforce any component of federal law. In form and substance, the complaint asserts state-law claims seeking to invoke independent standards under New Jersey's civil jurisprudence. Regulation SHO has nothing to do with Respondents' ability to prevail on these claims.

In any event, Section 27 is textually limited to suits brought to enforce liabilities and duties *created by the Act*, not liabilities and duties *created by state law*. A state-law cause of action is brought to enforce a liability "created" under state law. It makes no difference that a state standard may *mirror* the federal standard. The content of state law is still determined by the State's political branches. It is the State's decision to shape its own duties and liabilities however it wishes, even if that means *replicating* federal law. Congress expressly preserved the States' role in regulating securities by authorizing state-created "rights and remedies" "in addition" to those under the Act. Litigants are entitled to pursue those rights, rather than federal rights, in seeking relief for unlawful conduct. And suits seeking those state-created rights are indisputably *not* brought to enforce anything *created by the Act* itself. If Congress were unhappy with that result, it would not have limited Section 27's jurisdictional sweep to matters *created by the Act* while simultaneously authorizing matters *not* *created by the Act*.

This Court has further confirmed that Section 27's language means what it plainly says. In *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996), this Court examined a state-law claim, acknowledged that it turned on an embedded Exchange Act issue, and *still* refused to dislodge state-court jurisdiction—all because the state-court action "was not 'brought to enforce' any rights or obligations under the Act." *Id.* at 381-82, 382 n.7. Actions under state law seek to enforce *duties and liabilities under state law*. Petitioners offer no reason this Court should flatly depart from its holding in *Matsushita*.

B. Nor can Petitioners square their expansive reading of Section 27 with its critical surrounding provisions. The Securities Act's anti-removal provision used the same jurisdictional language as the

Exchange Act—"all suits in equity and actions at law brought to enforce any liability or duty created by th[e Act]." But it also prohibited parties from "remov[ing]" cases "brought in any State court of competent jurisdiction" that "aris[e] under th[e Act]." 15 U.S.C. § 77v. The language defining each category is technically different, but it is inconceivable that Congress intended any daylight between actions to "enforce" the Act and actions "arising under" the Act. Yet according to Petitioners, cases that merely "enforce" a federal right (without arising under federal law) form the *exclusive* subset that can be removed to federal court. This leaves federal claims in state court and state claims in federal court—exactly the opposite of any sensible interpretation.

C. Petitioners' understanding of Section 27 directly conflicts with this Court's consistent characterization of Section 27 itself and analogous statutes. In a long line of cases, this Court has invoked Section 27 and described it (in passing) as covering cases "arising under" the Act. This Court chooses its words carefully, and it is well accustomed to reading jurisdictional provisions. If Section 27 textually embraced the extraordinary sweep that Petitioners urge, surely the Court would have noticed before now. Casual readings are often natural readings, and this Court's language in those cases confirms Section 27's plain and ordinary meaning.

Moreover, this Court has twice construed this key language in cases where it actually mattered. It construed the language in *Matsushita* in a manner impossible to square with Petitioners' reading. And it construed materially indistinguishable language in *Pan American Petroleum Corporation v. Superior Court of Delaware for New Castle County*, 366 U.S. 656 (1961), and again reached the same conclusion: Section 27 was not intended as a sharp departure from the jurisdictional norm, but rather codified the usual jurisdictional principles that respect the proper relationship between federal and state courts.

D. Contrary to Petitioners' contention, an unprecedented exclusion of state judicial authority is unnecessary to advance Congress's statutory objectives. Uniformity was assuredly important to Congress, but it did not pursue that goal at all costs. Quite the contrary, the Exchange Act reflects Congress's careful balancing of federal and state interests. Congress directly authorized states to regulate in the area, and it indisputably tolerated state courts reviewing federal claims (as defenses and counterclaims), just as Congress tolerates similar incursions to "uniformity" in virtually every other "exclusive jurisdiction" setting. Petitioners' flawed views would upset the concurrent roles Congress preserved for state law and state courts. And this is no minor deal: it is simply breathtaking to presume that Congress would rather uproot a broad swath of state-law claims from state courts just to avoid the possibility that state courts might occasionally resolve a matter of federal law. Congress does not endorse such remarkable intrusions on the federal-state relationship in such subtle (and counter-textual) ways.

II. Petitioners' "federal possibility" theory invites a radical and unsound departure from one of the most enduring and fundamental principles of federal jurisdiction.

A. There is no principle of law or logic that permits exclusive federal jurisdiction to turn on the mere *possibility* that a claim might rely on a federal violation.

Congress is well aware how to eliminate all state-court control over certain federal issues—it is called complete preemption. Yet Congress refused to include anything approaching that high standard in Section 27. As with all other statutes, Congress drafts jurisdictional statutes against the backdrop of settled and accepted principles. In this area, there are few principles more settled or accepted than the notion that mere "possibilities" are not enough: federal jurisdiction requires that the federal ingredient be a *necessary* component of a state-law claim. Petitioners admit they cannot meet that bedrock standard here, and they are wrong to suggest Congress threw it out the door without so much as a hint it was embracing such a drastic shift.

B. Unlike Petitioners' theory, a more traditional view of Section 27 is sound in principle and workable in practice. Adhering to traditional concepts (those that have served the courts well for centuries) ensures that courts and litigants can operate under a known, predictable, administrable standard. In many cases, it will be highly difficult to determine whether a state-law claim is actually "enforcing" some unspecified federal law. It avoids messy disputes over efforts to read federal issues between the lines of purely state-law claims (as here), and it prevents eliminating state-court jurisdiction only so federal courts can entertain countless state-court actions that are ultimately resolved without any remote airing of any federal issue. Congress does not divest an entire category of state judicial authority in such a haphazard fashion. Petitioners' theory is fundamentally unsound, and it should be rejected.

ARGUMENT

Petitioners are correct that the "jurisdictional test" established by Section 27 is "clear and simple." Pet. Br. 2. But they have gotten that simple test wrong.

These facts are undisputed: Respondents alleged ten claims below, and not a single one necessarily turns on federal law. Each and every claim was a product of New Jersey law, and premised on duties and liabilities created by New Jersey, not Congress. Each and every claim has at least some means of prevailing without uttering a single syllable on the Exchange Act or its regulations.

In fact, putting aside Section 27, none of these claims would even conceivably belong in federal court by themselves. Under any existing, ordinary jurisdictional analysis, the states would retain their authority to adjudicate matters of state law in their own state courts. In other words, there is not a jurisdictional test that exists today, in any other area or form, that would even permit these claims to enter federal court, much less to eliminate state judicial authority in the process.

Petitioners, however, do not advance any ordinary or existing jurisdictional theory. On the contrary, Petitioners have introduced a new concept of federal jurisdiction, one based on the mere possibility that a federal issue might arise in the case. According to Petitioners, the fact that a single claim might possibly turn on a federal regulation is sufficient to eviscerate state-court jurisdiction and remove the entire dispute to federal court—even if the case never ultimately raises a single federal ingredient.

As explained below, Petitioners are wrong. There is no such thing as "federal possibility" jurisdiction. Section 27 nowhere hints of such a radical intrusion on traditional state authority, or such a stark departure from the most fundamental and enduring principles of federal jurisdiction. Congress crafted Section 27 to usher true federal claims to federal court; it did not intend or allow the complete displacement of the state judiciary whenever a state-law complaint mentions federal law.

The decision below should be affirmed.[18]

I. Section 27 of the Exchange Act Was Not Intended to Strip State Courts of Jurisdiction Over State-Law Claims That Might Turn on Federal Law.

Petitioners cannot prevail without establishing that Section 27 embraces exclusive jurisdiction whenever there is a mere possibility that a federal issue under the Exchange Act will arise. Petitioners' theory is at odds with Section 27's plain text, incompatible with its surrounding provisions, out of step with this Court's

[18] Petitioners devote several pages of their brief ascribing error to the court of appeal for "[holding] that § 27 does not grant jurisdiction at all, but instead merely deprives state courts of jurisdiction when federal jurisdiction would exist under another provision, such as § 1331." Pet Br. at 28-32. With all due respect to Petitioners, they have misconstrued the decision below. In rejecting the position urged by Petitioners, the Third Circuit concluded the jurisdictional scope of Section 27 is no broader than Section 1331, and therefore simply meant to say that Section 27 could not supply an independent *conceptual* basis for awarding jurisdiction. Accordingly, while the Third Circuit's decision admittedly relies on jurisdictional concepts embodied in 1331 (something the Petitioners believe, incorrectly, is error), it did not formally hold, as Petitioners claim, that Section 27 could "not grant jurisdiction at all" were 28 U.S.C. § 1331 repealed. In any event, that debate is academic because, whether Section 27 of the Exchange Act is a "standalone" grant of jurisdiction or not—it simply does not reach claims like those of Respondents.

cases, and inconsistent with legislative intent. Congress does not typically abandon centuries of jurisdictional practice by saying so little and meaning the opposite of what it said. Petitioners' theory must be rejected.

A. Petitioners Misread the Text of Section 27.

In Section 27 of the Exchange Act, Congress specifically granted district courts "exclusive jurisdiction" over "violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder." 15 U.S.C. § 78aa(a). In arguing that "section 27 confers exclusive federal jurisdiction over respondents' complaint," Pet. Br. 19 (capitalization removed), Petitioners advance two textual arguments. Neither is correct.

1. In passing, but repeatedly, Petitioners maintain that there is exclusive federal jurisdiction over this case simply because the Amended Complaint *asserts* that Petitioners violated Regulation SHO, irrespective of *any* connection to an actual claim. *See, e.g.*, Pet. Br. 2 ("The jurisdictional test established by th[e] language [of Section 27] is clear and simple: if the complaint on its face alleges a violation of the Act or its regulations . . . then federal courts have exclusive jurisdiction.").[19]

[19] Petitioners repeat this assertion throughout their opening brief. *See* Pet. Br. 17 ("federal courts have exclusive jurisdiction when a complaint alleges 'violations of' the Exchange Act or its regulations"); *id.* at 23 ("if the complaint on its face asserts a violation of the Act or its regulations . . . the complaint is subject to the exclusive jurisdiction of the federal courts"); *id.* at 34 ("The rule established by § 27's plain text could hardly be clearer: whether the complaint on its face asserts a violation of the Act or its regulations or seeks to enforce a duty thereunder.").

This reading of Section 27 is untenable. Consider a garden-variety state law breach-of-contract action in which plaintiff alleges, for atmospherics, that defendant is a bad actor who recently violated the Exchange Act. Under Petitioners' theory, Section 27 would divest the state court of jurisdiction—despite the contract claim having nothing whatsoever to do with the background allegation. There is no reason to believe that Congress intended such an absurd result.

Of course, there is a far simpler and more sensible reading of the phrase vesting "exclusive jurisdiction of violations of th[e Act]." 15 U.S.C. § 78aa(a). And that reading is made clear from the very next two sentences of Section 27—which describe venue for criminal proceedings and civil-enforcement actions asserting "violations" of the Act. *See id.* ("Any criminal proceeding may be brought in the district wherein any act or transaction constituting *the violation* occurred. Any suit or action . . . *to enjoin any violation* of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found . . . .") (emphases added).

Put simply, Congress referred to exclusive jurisdiction of "violations of this chapter" as distinct from "all suits in equity and actions at law brought to enforce any liability or duty created by this chapter" because the former phrase was needed to confer jurisdiction over lawsuits to criminally punish or civilly enjoin violations of the Exchange Act.[20]

[20] Of course, "violations of this chapter" will often subject the violator to "liability." *See, e.g.*, 15 U.S.C. § 78ff(c)(1)(A) ("Any issuer that violates subsection (a) or (g) of section 78dd–1 of this title shall be fined not more than $2,000,000.") If a lawsuit is *actually*

2. Alternatively, Petitioners argue that Section 27 eliminates state court jurisdiction over Respondents' suit because Respondents' state law claims indirectly seek to enforce "duties" imposed by a federal regulation:

> The complaint . . . seeks "to enforce dut[ies] created by [the Act] or the rules and regulations thereunder," *id.*, because respondents' complaint seeks to hold petitioners liable for violating the "locate" and "close-out" duties of Regulation SHO. The fact that respondents seek to enforce those duties though state-law causes of action does not matter, because the statute applies broadly to "*all* suits in equity and actions at law brought to enforce" duties created by the Exchange Act or its regulations."

Pet. Br. 21. Again, Petitioners are mistaken.

a. As an initial matter, Petitioners' theory is based on a factual premise that was *expressly rejected* by the Third Circuit—*i.e.*, that at least one of Respondents' causes of action might somehow require a judicial determination that Regulation SHO had been violated.

"brought to enforce [that] liability," it would surely be subject to exclusive federal jurisdiction. But *whether Respondents' lawsuit* was "brought to enforce any liability" resulting from an Exchange Act violation is the very disputed issue in this case. Petitioners cannot obtain reversal by merely accusing Respondents of "alleg[ing] a violation of the act or its regulation." Such an accusation begs the relevant question—*i.e.*, whether Petitioners' lawsuit is actually "brought to enforce any liability" resulting from the alleged Exchange Act violation. Indeed, Petitioners' own amici concede as much. *See, e.g.,* Sec. Indus. and Fin. Mkt. Assoc. Br. at 7 ("By its terms, the first clause of Section 27—the violations clause—extends to suits that, whether or not pleaded under the Exchange Act, *are predicated on alleged violations of the Act.*") (emphasis added).

See Pet. App. 14a ("As we read the Amended Complaint, no causes of action are predicated *at all* on a violation of Regulation SHO.") (emphasis in original). The court of appeals was correct.

There is no mention of Regulation SHO (or any federal law) in *any* of the 73 paragraphs of the Amended Complaint setting forth Respondents' claims against Petitioners. *See* Pet. App. 82a-93a (AC ¶¶88-122). Put simply, Respondents do not need to prove anything about Regulation SHO to establish their state law claims. And their state law RICO claim turns entirely on state law predicates, none of which invokes Regulation SHO or even mirrors its terms. Indeed, the only conceivable role Regulation SHO will have in this case is *as a defense*—should Petitioners argue that New Jersey law is conflict preempted because of Regulation SHO. A federal issue arising as a defense is categorically irrelevant for purposes of "exclusive jurisdiction" under Section 27.

Nor does it make one whit of difference that the fact section of Respondents' Amended Complaint references Regulation SHO and explains that Petitioners have violated it in the past. These references did not seek "a judicial determination that . . . Regulation SHO . . . was violated." Pet. Br. 3. To the contrary, those references simply illustrated that Petitioners had a history of sanctions by the Financial Industry Regulatory Authority and other regulatory agencies and thus punitive damages would be warranted against them. *See* Pet. App. 75a-82a (discussing history of sanctions by the Financial Industry Regulatory Authority and other regulatory agencies). Indeed, the bulk of these particular references involved *other parties and other events*, "violations" that obviously have nothing to do with proving the underlying merits of any claim in *this* case.[21]

b. In any event, Petitioners misread Section 27's plain terms. On its face, Section 27 is textually limited to suits brought to enforce liabilities and duties "*created by [the Exchange Act]*," not liabilities and duties *created by state law*. A suit asserting claims under state law, invoking state-created rights and remedies, is not a suit brought to *enforce* federal law.

This is the most natural reading of the text. A state lawsuit is by definition brought to enforce a liability "created" under state law; the liability would not exist but for the state's decision to create the cause of action, and any "liability" is authorized by the state itself, not federal law. When a court enters judgment on a state law claim, it is awarding relief based on the "liability and duty" *created by state law*. If the state repealed those rights and remedies, the action would fail—even if the same rights and remedies were found independently in the Exchange Act.

Nor does it matter if state law is modeled after federal standards. State regulation is still *state* regulation. When a party invokes state law, it is invoking "any and all other rights and remedies that may exist," *i.e.*, those of the state, 15 U.S.C. § 78bb(a)(2), and those rights and remedies are created by the state. The fact that the state elected to mirror federal law (if that is

[21] A fair reading of the complaint, as confirmed by the court of appeals, confirms that the factual predicate for Petitioners' theory simply does not exist. This is a complaint with claims based exclusively on state law—in every respect. Because the question presented is not actually presented on these facts, the Court should consider dismissing the petition as improvidently granted.

what it did) is irrelevant to the *source* of the rights invoked in state court. The operative question under Section 27's text is which body of law "created" the liabilities and duties at issue. There is no basis in law or logic for saying that a right created by state law (in every sense of the word) is actually a right created by federal law just because one resembles the other.[22]

Petitioners' contrary position misunderstands the nature of state regulation. States, as independent sovereigns, may prohibit in their own law (and make actionable in their own courts) whatever conduct they choose. Congress did not "create" any state laws, and the SEC did not promulgate any New Jersey regulations pursuant to the Exchange Act. These are New Jersey rights created by its legislature, and their content is dictated by New Jersey law. They survive independently of any federal law or regulations.

Indeed, Congress expressly preserved the States' independent regulation in this area, 15 U.S.C. § 78bb(a)(2), including the power to authorize additional rights and remedies. If Congress wanted those rights and remedies adjudicated exclusively in federal court, it would have said so. It instead limited Section 27's jurisdictional provision to liabilities and duties *created by the Act*—at the same time it explicitly contemplated

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[22] If Federal Law *A* bars Misconduct *X*, and New Jersey Law *A* bars Misconduct *X*, then only claims relying on the former can be said to have brought to enforce duties "created by" Federal Law *A*. For example, if New York also enacted laws that barred Misconduct *X*, a New Jersey suit entirely invoking New Jersey law seeking to remedy Misconduct *X* could not be said to be enforcing duties created by New York law, even though New York law would be consonant with the result.

additional rights <u>*not*</u> *created by the Act*. Petitioners' theory is simply incompatible with the statutory text.

c. For the same reasons, certain amici are also wrong that Petitioners can dodge Section 27's textual requirements by focusing on the source of the claim: "[n]either prong of Section 27 turns on whether the Exchange Act itself creates the *claim* that is being asserted, and thus it is irrelevant whether the asserted claims purport to arise under state law." NASDAQ et al. Br. 7 (emphasis in original).

Section 27 expressly requires the suit to enforce a duty or liability "*created by [the Exchange Act]*." A suit to enforce liabilities or duties under state law is not a suit to enforce liabilities or duties created by the Act—and that holds true even if the state's substantive law tracks some federal standards.

Again, the content of a state's substantive law is reserved to the state's political branches. States may decide to mirror federal law or deviate from federal law, just as New Jersey is alleged to depart from federal law here. A suit enforcing those policy determinations is one enforcing a *state* rule or regulation, not a *federal* rule or regulation. So even if the Exchange Act need not "create the claim that is being asserted," the claim still must be brought to enforce the Exchange Act's provisions—not state law standards that voluntarily (and unremarkably) overlap (or are entirely coterminous) with federal law.

3. This Court has already construed this language to mean exactly what it says. In *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996), the Court confronted a state law claim alleging corporate waste by "exposing the corporation to liability under the [Exchange Act]," and the Court still held that the state

court retained jurisdiction: it made no difference that "the plaintiff class premised one of its claims of fiduciary breach" on a federal allegation because "the cause pleaded was nonetheless a state common-law action for breach of fiduciary duty." *Id.* at 382 n.7. The Court thus specifically held that "[t]he Delaware court asserted judicial power over a complaint asserting purely state-law causes of action," and thus "the Delaware action was not 'brought to enforce' any rights or obligations under the Act." *Id.* at 381-82.

Petitioners' reading of Section 27 is impossible to square with *Matsushita*. A suit seeking relief on state-created "rights or obligations" is *not* seeking to enforce any "rights or obligations" under the Act, even if aspects of the claim are premised on federal law. It is still the *state*, not the federal government, that elected to make federal law relevant, and it is still a state-created "liability or duty" that will be the ultimate source of any judgment.

Petitioners attempt to brush aside *Matsushita* as holding only that state courts can review and approve proposed *settlements* of federal claims. Pet. Br. 24. *Matsushita* indeed did hold exactly that, but it was not *all* that *Matsushita* held. *See* 516 U.S. at 380-86, 389 n.7. The predicate question was whether the state court was properly exercising jurisdiction in the first place. *Id.* at 375. Were it the rule that any incorporation of federal law into a state-created right defeated state jurisdiction, *Matsushita* would have come out exactly the other way. Petitioners' view is directly at odds with *Matsushita*'s holding and its plain-text reading of Section 27's unambiguous language. Petitioners are thus right that "[j]urisdiction is not always so simple, but that is no reason to complicate things when it is." Pet. Br. 2. Both

Section 27 and *Matsushita* mean what they say, and Petitioners lose for exactly those reasons.

B. Petitioners' Reading of Section 27 Is Irreconcilable With Identical Language in the Securities Act.

At best, the meaning of Section 27 in this context is ambiguous, requiring an examination of the Act's "broader structure":

> [W]e must turn to the broader structure of the Act to determine the meaning of [the provision]. "A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme . . . because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law." *United Sav. Assn. of Tex. v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988).

King v. Burwell, 135 S. Ct. 2480, 2492 (2015) (quoting *United Sav. Assn. of Tex. v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371 (1988)). But Petitioners urge this Court to do precisely the opposite: to read an ambiguous provision in a way that would render a related provision absurd.

The Securities Act uses the terms "created by" and "arising under" to refer to the same universe of claims. Although certain amendments have altered the statute's functional reach, the law authorizes federal jurisdiction over certain claims while simultaneously prohibiting removal of those same claims:

> The district courts of the United States . . . shall have jurisdiction . . . with respect to . . . all suits in equity and actions at law brought to enforce

> any liability or duty created by this subchapter. . . . [Yet] no case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States.

15 U.S.C.A. § 77v. This provision, admittedly, is one designed to preserve concurrent jurisdiction. But the *way* the provision uses "created by" and "arising under" to preserve concurrent jurisdiction is telling. For this provision to make sense, Congress must have considered the set of suits enforcing duties "created by" the Securities Act *to be no more expansive* than the set of suits "arising under" the Securities Act.

This provision alone shows the impossibility of Petitioners' reading of Section 27. Petitioners have argued that "created by" has a broader jurisdictional reach than "arising under," with "created by" reaching state law claims that might possibly turn on federal law, and "arising under" only reaching claims that, among other things, *necessarily* turn on federal law. If Petitioners are right about the meaning of "created by," then here is how the above provision reads:

> The district courts of the United States . . . shall have jurisdiction . . . with respect to . . . all suits **that *might* turn on federal law**. . . . [Yet] no case **that *necessarily* turns on federal law** brought in any State court of competent jurisdiction shall be removed to any court of the United States.

That Congress would want to bar removal with respect to claims that actually turned on federal law but permit removal for claims that might turn on federal law is, respectfully, absurd.

C. Petitioners' Reading of Section 27 Is Irreconcilable With This Court's Long-standing Interpretation of the Precise Statutory Phrase at Issue.

Petitioners cannot square their novel and sweeping view of Section 27's language with this Court's consistent interpretation of exactly the same language in Section 27 itself and analogous statutes.

1. For decades, this Court has described Section 27 as a traditional "arising under" jurisdictional grant. *See, e.g.*, *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 159 (1976) (Stevens, J., dissenting) (Section 27 addresses cases "arising under" the Exchange Act); *Will v. Calvert Fire Ins. Co.*, 437 U.S. 655, 670 (1978) (Brennan, J., dissenting) ("Section 27 of the 1934 Act . . . gives the federal courts exclusive jurisdiction over claims arising under the Act.") (emphasis omitted).

While the Court has often invoked those characterizations in passing, they still underscore a fundamental point: Section 27's plain text is most naturally read—as one does in passing—to mean exactly what this Court has repeatedly said: it applies to cases arising under the Act. Petitioners' contrary view requires a startling departure from longstanding practice. If Section 27 were most naturally read to mean what Petitioners contend, the Court would likely have noticed something amiss in its past cases; there is no reason to believe that Congress would have legislated such a novel change in such a subtle fashion.[23]

[23] Petitioners, both at the petition stage and in their merits brief, repeatedly cite dicta from prior decisions of this Court for the proposition that Section 27 of the Exchange Act confers jurisdiction. Oddly, however, they fail to acknowledge that the very same dicta

In any event, not *all* of the Court's past language on this point has been in passing. Indeed, as noted above, *Matsushita* confronted this question and read Section 27 exactly the way Respondents do. Jurisdiction is simply not triggered when a party brings suit to enforce state law liabilities and duties created by state law claims—even if aspects of those claims turn on federal law:

> While § 27 prohibits state courts from adjudicating claims *arising under* the Exchange Act, it does not prohibit state courts from approving the release of Exchange Act claims in the settlement of suits over which they have properly exercised jurisdiction, *i.e.*, suits arising under state law or under federal law for which there is concurrent jurisdiction. *In this case, for example, the Delaware action was not "brought to enforce" any rights or obligations under the Act.*

516 U.S. at 381-82 (emphasis added). And the Court reached this conclusion despite acknowledging, explicitly, that the class plaintiffs "alleg[ed]" that the defendant violated state law by "exposing the corporation to liability under [the Exchange Act]." *Id.* at 382 n.7. If Petitioners were correct, it is hard to understand how that "state common-law action for breach of fiduciary duty" was "not 'brought to enforce' rights or obligations under the Act." *Id.* at 381, 82 n.7.

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makes clear that the jurisdiction conferred by Section 27 is no broader than the familiar "arising under" language of Section 1331. And they further fail to acknowledge the critical passages, noted above, where the Court again squarely confronted the issue in a context where its language mattered. Petitioners have no obvious answer for the Court's deliberate choice of words in this setting.

2. This Court has also had an opportunity to consider the meaning of "created by" language nearly identical to that in Section 27 in a different substantive setting. In *Pan American Petroleum Corporation v. Superior Court of Delaware for New Castle County*, 366 U.S. 656 (1961), this Court considered the meaning of the Natural Gas Act (NGA)'s jurisdictional provision. The relevant NGA provision provided that federal courts "shall have exclusive jurisdiction of violations of [the NGA] or the rules, regulations, and orders thereunder, and of all . . . actions at law brought to enforce any liability or duty created" by the NGA. *Id.* at 662. This Court concluded that, based on both general jurisdictional principles and the legislative history of the act, the meaning of "brought to enforce any liability or duty created" was no broader than the meaning of "arising under" in 28 U.S.C. § 1331. *Id.* at 665 n.2.

According to Petitioners, however, *Pan American* was all about the well-pleaded complaint rule; it did not purport to equate 28 U.S.C. § 1331 and the NGA. It simply held that a federal issue arising as a defense could not satisfy the terms of the NGA's "exclusive" jurisdiction provision.

Petitioners, again, are *half*-right. But their view simply refuses to acknowledge the Court's critical footnote, which presumably meant (again) exactly what the Court said: the "exclusive" jurisdiction language was coterminous with the traditional "arising under" standard, and there was no reason to think Congress intended to depart from that settled standard. *Id.*

Petitioners' only effort to acknowledge this declaration is brushing aside the Court's direct statement as rooted exclusively in legislative history. Pet. Br. 38-39. To be sure, that legislative history—a single snippet reproduced in the opinion—presumably did bolster the Court's conclusion, but the Court's predominant consideration was the same one that applies here: Congress legislates against the backdrop of traditional jurisdictional principles, and it presumably intends to invoke those traditional principles unless it affirmatively says otherwise. As in *Pan American*, Congress did not say otherwise here.

Petitioners accordingly err in attempting to shoehorn this discussion into the well-pleaded complaint rule. Their position is out of step with *Pan American*, and they offer no compelling basis for construing the identical language in each Act to mean two very different things. Their argument should be rejected.

D. Petitioners' Reading of Section 27 Does Not Advance the "Purposes" of the Exchange Act.

According to Petitioners, "uniformity" was the driving concern underlying Section 78aa. Pet. Br. 24. It was essential, Petitioners tell us, to preserve federal control over all features of the Exchange Act: only expert federal judges could construe and apply its provisions in a uniform, fair, and predictable manner. *Id.* at 25-27. This policy concern, Petitioners argue, warrants construing Section 27 to its outer limit: "[s]tate courts, of course, are considered competent to decide most questions of federal law," but here "Congress has concluded that state courts are not well-equipped to conduct the careful application of the sensitive federal interests." *Id.* at 27. Thus, according to Petitioners, any reading that permits state courts to resolve federal questions undermines the statutory purpose. *See, e.g.*, *id.* at 25 n.8.

Petitioners are mistaken. It is assuredly true that Congress was concerned about preserving some degree of federal uniformity. But "no legislation pursues its purposes at all costs." *Rodriguez v. United States*, 480 U.S. 522, 525-26 (1987) (per curiam). Petitioners cannot simply invoke "uniformity" and assume that *anything* promoting that value to its outer bounds is automatically correct. "[I]t frustrates rather than effectuates legislative intent simplistically to assume that *whatever* furthers the statute's primary objective must be the law." *Id.* at 526; *see also Norfolk S. Ry. Co. v. Sorrell*, 549 U.S. 158, 171 (2007).

The right question is not whether Congress felt that federal courts should retain more control than usual, but whether Congress indicated an obvious intent to advance that interest to the exclusion of everything else. Congress expressed no such intention here. Petitioners' novel theory would frustrate the careful balance Congress struck between federal and state authority, and Petitioners' reading of Section 27 is unnecessary to promote uniformity in this area. Their argument should be rejected.[24]

1. Petitioners' sweeping theory is at odds with Congress's scheme. Congress intended to preserve concurrent roles for state law and state courts in regulating securities, and Petitioners cannot seriously suggest otherwise. By its plain language, Section 27 directly contemplates that States will retain their traditional role in securities regulation, authorizing

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[24] The United States' failure to support Petitioners in this case speaks volumes about whether or not it believes claims like those made by Respondents threaten the uniformity or efficacy of federal securities regulation.

independent "rights and remedies" in addition to those found in the Act. 15 U.S.C. § 78bb(a)(2). If Congress felt that the states' participation threatened the "uniform" enforcement of the federal securities laws, it would not have expressly permitted those laws to coexist with the federal scheme.

It makes little sense to suggest that Congress permitted states to pass laws in this area, but refused to permit states to enforce those laws in their own courts whenever the subject matter overlaps too closely with federal regulation. *Matsushita*, 516 U.S. at 383 ("Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to securities transactions.") (citing 15 U.S.C. § 78bb(a)).

Nor are Petitioners correct that Congress refused state courts any role in resolving federal issues under the Exchange Act. Congress indisputably accepted that *some* federal issues—even *pure* federal issues—would remain in state court. Under the well-pleaded complaint rule, for example, all federal *defenses* will be resolved in state actions, even those requiring courts to construe and apply federal law. One cannot determine the scope of federal conflict preemption, for example, without construing and applying federal law—even though that leaves state court judges to "'say definitively what the Exchange Act means and enforce legal liabilities and duties thereunder.'" Pet. Br. 24 (quoting *Matsushita*, 516 U.S. at 383). And Congress was surely aware that *federal counter-claims* would remain in state court for adjudication—a counter-claim is not a "suit" even if it "enforces" federal issues.

If Congress wanted to avoid this result, it assuredly knew how to: it could have adopted language more like SLUSA, which provides an easy model for removing all matters involving federal securities to federal court. *See, e.g.*, *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 74, 82-83 (2006) (permitting removal and dismissal of all class claims alleging wrongdoing "in connection with" a covered security).

Instead, however, Congress carefully limited Section 27's "exclusive" jurisdiction to those suits particularly enforcing rights "created by" the Act itself. This may leave open the possibility of state courts adjudicating federal questions, but it also respects the natural balance that Congress struck between the state and federal systems. Just as in other common settings, Congress has refused to strip away *all* state jurisdiction in order to achieve perfect uniformity.

2. In any event, Petitioners' theory is unnecessary to accomplish Congress's objectives. Petitioners first overstate the problem: by ushering all true federal claims to federal court, Congress ensures that the federal judiciary will develop a sufficient body of law on these questions that can inform state judges when they happen to encounter federal issues. That promotes "uniformity" without disturbing the proper role Congress preserved for state courts.

And *Pan American* itself squarely refutes Petitioners' view that *any* state court adjudication is too much state court adjudication. *See* 366 U.S. at 665 (rejecting contention that "permit[ting] the state courts to entertain the [state-law] suits . . . will jeopardize the uniform system of regulation that Congress established through the Natural Gas Act"). As this Court explained, it can always ensure uniformity by reviewing cases from state courts that decide any important federal question. *Id.* at 665-66. If the Court felt that its supervisory role accommodated "uniformity" concerns under the Natural

Gas Act, it is unclear why Petitioners believe this Court's supervisory role is inadequate to accommodate the same concerns under the Exchange Act.

* * *

It is worth pausing to consider what Petitioners ask this Court to do. Petitioners ask this Court to presume that Congress was so concerned about "uniformity" that it was willing to forbid state court jurisdiction not only over federal claims, but also over any state law claim that just *might possibly* turn on federal law. Any directive forbidding state courts from determining federal claims is already unusual. But it is simply extraordinary to presume that Congress, without saying so directly, intended to intrude on the states' power in their own courts to review claims created by their own legislature, despite possibly never implicating a single federal issue. If that were truly Congress's intent, one would expect to find language far clearer than this.

In the end, Petitioners cannot use a general sense of legislative purpose to rewrite the actual text. *See, e.g.*, *Norfolk S. Ry. Co. v. Sorrell*, 549 U.S. 158, 171 (2007) ("the statute's remedial purpose cannot compensate for the lack of a statutory basis"). And in any event, Petitioners' general sense of legislative purpose is wrong. Congress wrote a measured jurisdictional statute that respects traditional jurisdictional principles and preserves the states' traditional role in this area—all while increasing uniformity by ushering the vast majority of federal issues to federal courts (in exactly the same fashion, with exactly the same exceptions, that Congress embraced in parallel contexts). The fact that Congress authorized "exclusive" jurisdiction—even to promote uniformity—does not mean that Congress stripped away state jurisdiction over common state-law claims simply to avoid the possibility of any federal issue being resolved in a state tribunal. *Cf. Gunn v. Minton*, 133 S. Ct. 1059 (2013).

II. Petitioners' "Federal Possibility" Rule Is a Radical and Unwise Departure from One of the Most Enduring Principles of Federal Jurisdiction.

According to Petitioners, Congress intended Section 27 to confer jurisdiction over any cause of action that *might* rely on a violation of the Exchange Act. As Petitioner puts it:

> To be clear, nothing in § 27's language states or suggests that jurisdiction attaches only if the Regulation SHO violations and duties alleged in the complaint are *necessary* elements of respondents' claims. The language instead provides that when a violation or duty of the Act or its regulations is asserted, a federal court is the only court that can decide whether the alleged violation occurred or the duty was breached. It is accordingly irrelevant that other grounds also may provide a basis for liability—§ 27's text bars a state court from even considering whether the asserted violation occurred or the asserted duty was breached, because those matters are subject to the exclusive jurisdiction of the federal court. The presence of those allegations in a state-court complaint justifies removal, even if the complaint also asserts other possible bases for liability.

Pet. Br. at 22 (emphasis in original).

As Petitioners would have it, the mere possibility of a federal issue is enough for jurisdiction. As explained below, Petitioners' view is radical, unwise, and contrary to this Court's sensible jurisdictional modesty. Indeed, just two years after the passage of the Exchange Act, no less a jurist than Justice Cardozo rejected the kind of "federal possibility jurisdiction" put forth by Petitioners. *See Gully v. First National Bank*, 299 U.S. 109, 117, 118 (1936) ("[A] dispute so doubtful and conjectural" is not sufficient to divest a state court of jurisdiction; "[t]he most one can say is that a question of federal law is *lurking in the background*.") (emphasis added).

Also telling is that, although Section 27 has been law for over eight decades, absent from Petitioners' brief is even a single citation to a judicial decision that has adopted Petitioners' position. If Congress had intended for federal possibility jurisdiction, it seems unlikely that this particular innovation would have escaped notice for 81 years. More likely is that Petitioners are alone in their error. It should remain that way.

A. It Is a Bedrock Presumption That, Absent Complete Preemption, There Is No Federal Jurisdiction Over State Law Claims Unless They *Necessarily* Raise a Federal Issue.

Petitioners' view is a monumental departure from the traditional rules of federal jurisdiction. It is a bedrock presumption that state-law claims must (at a minimum) *necessarily* raise a federal issue to create jurisdiction: "'[A] right or immunity created by the Constitution or laws of the United States must be an element, and an essential one, of the plaintiff's cause of action.'" *Franchise Tax Bd. of Cal. v. Construction Laborers Vacation Trust for S. Cal.*, 463 U.S. 1, 10-11 (1983) (quoting *Gully v. First Nat'l Bank in Meridian*, 299 U.S. 109, 112 (1936)) (emphasis added).

Petitioners concede, as they must, that none of Respondents' claims *necessarily* turns on federal law.

But, according to Petitioners, that is irrelevant because "nothing in § 27's language states or suggests that jurisdiction attaches only if the Regulation SHO violations and duties alleged in the complaint are *necessary* elements of respondents' claims." Pet. Br. 22.

This is twice wrong. First, it flips the relevant standard on its head. The presumption is that traditional jurisdictional principles apply, not the other way around. The question is thus not whether "§ 27's language states or suggests" that the traditional rules apply, but whether Petitioners have identified any reason to think otherwise. *See, e.g.*, *Pan American*, 366 U.S. at 665 n.2 (refusing to set aside traditional limits on jurisdiction simply because the Natural Gas Act did not explicitly invoke those traditional "limitations"). Petitioners have wholly failed in that regard.

Second, in any event, Petitioners again misread Section 27's text. The traditional rule recognizes that suits do not truly arise under federal law—or enforce any rights under federal law—when they assert independent state-law theories sufficient to resolve the dispute. Any claim that does not have an essential federal ingredient is not *necessarily* brought to enforce federal law. It is *possibly* brought to enforce federal law, and there is no such thing as "federal possibility" jurisdiction. The fairest reading of Section 27 is that claims are "brought" to enforce a duty when they necessarily present the question.

This Court has taken pains to be clear about what it means by "necessary." The jurisdiction triggering issue must be unavoidable; alternate theories that *could* invoke the issue are an insufficient basis for jurisdiction. *Cf. Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 809-10 (1988) ("[A] claim supported by alternative theories in the complaint may not form the basis for § 1338(a) jurisdiction unless patent law is essential to each of those theories."). In *Christianson*, after examining both patent law and generally applicable principles of jurisdiction, the Court declared that jurisdiction turns on "claims, not theories." *Id.* at 811.

A Congressional provision of exclusive jurisdiction is not a sufficient reason to relax the necessity requirement. Even in that context, this Court has insisted that only state-law claims that, *inter alia*, "necessarily raise a stated federal issue" can be heard in federal court. *Gunn v. Minton*, 133 S. Ct. 1059, 1065 (2013) (quoting *Grable & Sons Metal Products, Inc. v. Darue Engineering & Mfg.*, 545 U.S. 308, 314 (2005)).

B. The Federal Necessity Presumption Is Easily Administrable and Strikes the Appropriate Balance Between Federal and State Interests.

1. Making jurisdiction dependent on the federal issue being a necessary one is a condition consonant with this Court's institutional reluctance to expand federal jurisdiction absent pellucid Congressional command. The requirement that the federal issue be essential to the state claim avoids unnecessarily divesting state courts of authority (whether systematically if federal jurisdiction is exclusive, or in only certain cases via removal if federal jurisdiction is concurrent) over state law disputes, and federalism presumptively respects a state's prerogative to enact laws that promote the welfare of its citizens and to resolve disputes over those laws, without federal interference.

Indeed, absent that solicitude, the well-pleaded complaint rule would make little sense. That long-settled rule denies general federal question jurisdiction, as well as other more specific types of federal question jurisdiction, to any case that does not present a federal issue on the face of the well-pleaded complaint, even if a federal issue is certain to appear as a defense or in a counterclaim. *Holmes Group, Inc. v. Vornado Air Circulation Systems, Inc.*, 535 U.S. 826, 831-32 (2002); *Franchise Tax Bd. v. Constr. Laborers Vacation Trust,* 463 U.S. 1, 9-10 (1983), *superseded by* 28 U.S.C. § 1441(e); *Louisville & Nashville R.R. Co. v. Mottley*, 211 U.S. 149 (1908).

The well-pleaded complaint rule thus guarantees that issues of federal law raised in defenses and counterclaims are routinely decided by state courts in the context of state law claims. That has not troubled this Court, even in areas of exclusive federal jurisdiction where the Congressional interest in uniformity is heightened. *See, e.g.*, *Holmes Group*, 535 U.S. at 831-32 (rejecting federal jurisdiction in cases involving a patent-law counterclaim); *Cf.* 13D Charles A. Wright & Arthur R. Miller, *Federal Practice and Procedure: Jurisdiction* § 3584 (3d ed. 2002) (explaining that "an affirmative defense based upon federal law, including the Exchange Act, may be adjudicated by a state court"). State law decisions on federal law are not binding outside the State, and even within the State, the appellate process (aided by SEC intervention where appropriate) is likely to correct an erroneous reading of federal law. Should that fail, review by this Court can address the problem.

2. Petitioners fail to acknowledge a very real harm of their "federal possibility" rule: it *guarantees* state courts will be divested of jurisdiction in cases in which no actual federal issue is ultimately reached. Litigants (or aggressive judges) would only need identify a potential

federal issue relevant to the claims asserted to unlock the doors of federal court; whether that issue was ever reached (or even likely to be reached) would not matter. If possibility rather than necessity is sufficient to trigger jurisdiction, federal courts would routinely decide purely state-law claims. Necessity imposes a meaningful limit on the divestment of state court jurisdiction; possibility does not.[25]

3. Nor is Petitioners' rule practical. Necessity as a jurisdictional minimum makes sense because it is workable. When federal necessity is the test, a judge reading a state law complaint need only confirm a proffered state law theory could legitimately vindicate the state law claims; if so, states retain jurisdiction. In contrast, under Petitioners' approach, judges would be obligated to examine the factual allegations of all complaints to determine whether those allegations corresponded to an Exchange Act violation that would aid the prosecution of a state law claim; only after such a searching review, and a rejection of that possibility, could the case proceed in state court. Petitioners will presumably protest that, here, Respondents mentioned Regulation SHO in the complaint, and therefore their test is easy to apply. But rules transcend cases. As a hypothetical plaintiff would not need to name the Act to plead facts that would (1) constitute a violation or breach of duty under the Act and (2) therefore might serve as a potential ingredient in a plaintiff's state law claim,

[25] And given that state courts, under the well-pleaded complaint rule, *already* decide Exchange Act claims or issues that arise in the context of counterclaims or defenses, the incremental benefit of a "federal possibility" rule—limiting state courts from weighing in on federal questions embedded in state law claims—seems modest.

Petitioners' rationale would reach, and require examination of, unlabeled factual allegations.

4. Ultimately, Petitioners know that under traditional jurisdictional principles and assumptions—that state-law claims should not be heard in federal court absent a necessary federal ingredient; that states are presumed competent arbiters of federal law; and that conflict preemption can protect federal substantive interests—Petitioners lose (as they did below). They therefore must insist here that such principles, and jurisdictional restraint generally, are specific to Section 1331 and play no meaningful role in Section 27. Pet. Br. 34-35 (arguing that this Court's narrow interpretation of "arising under" is attributable to policy reasons specific to Section 1331).

Petitioners credit the rooster for the sunrise. Professions of jurisdictional caution draw vitality from this Court's commitment to federalism, not something peculiar about Section 1331. Section 1331 is admittedly the context in which this Court most frequently has the opportunity to express restraint, but a reluctance to interfere with state laws and tribunals does not vanish merely because Section 1331 is not at issue. *Cf. Gunn v. Minton*, 133 S. Ct. 1059, 1064 (2013) (holding that 28 U.S.C. § 1338 cannot reach state law claims that fail to "necessarily raise a stated federal issue"); *Holmes Group, Inc. v. Vornado Air Circulation Sys., Inc.*, 535 U.S. 826 (2002), *superseded by* 28 U.S.C. § 1295(a)(1) (applying well-pleaded complaint rule to patent claims); *Matsushita Electric Industrial Co., Ltd. v. Epstein*, 516 U.S. 367 (1996) (explaining that a state law derivative claim that might turn on an Exchange Act violation is still properly before a state court); *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 809-10 (1988) (denying Section 1338 jurisdiction unless patent law is essential to each theory of a claim); *Shamrock Oil & Gas Corp. v. Sheets*, 313 U.S. 100, 109 (1941) (articulating, in a diversity setting, this Court's "[d]ue regard for the rightful independence of state governments"); *Strawbridge v. Curtiss*, 7 U.S. 267 (1806) (adopting complete diversity rule). Honest federalism requires jurisdictional restraint, across contexts, and that is a truth this Court has never failed to recognize.

Given the above, one would therefore expect unmistakable language from Congress were it to invent a heretofore unprecedented "federal possibility" jurisdictional paradigm that would throw open federal court to anyone capable of identifying, from the vast universe of federal regulations promulgated under the Act, a single regulation potentially at issue.[26] To the contrary, all the relevant contextual evidence is that Congress meant nothing of the sort. If Congress intended so stinging a rebuke to state courts as Petitioners' federal possibility jurisdiction, it would have done so plainly.

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[26] Congressional desire for uniformity cannot be enough, as the Court has not jettisoned traditional jurisdictional principles in those settings. *See, e.g.*, *Gunn v. Minton*, 133 S. Ct. 1059 (2013); *Holmes Group, Inc. v. Vornado Air Circulation Systems, Inc.*, 535 U.S. 826 (2002); *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800 (1988).

CONCLUSION

For the reasons set forth above, the judgment of the Third Circuit should be affirmed.

Respectfully submitted,

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