

NO. 17-30092

**In the United States Court of Appeals
for the Fifth Circuit**

JOSEPH N. BROYLES; ANNE RICHEY; KAREN L. BARRANCO; SUSAN B. BENINATI; M. BADI ASBAHI; PRESTON CLOYD; CHARLES RICHEY; RUSS P. BARRANCO; REGISTRAR OF VOTERS EMPLOYEE RETIREMENT SYSTEM; JODY A. BARRANCO; JANICE B. VIRGADAMO; FIREFIGHTERS' RETIREMENT SYSTEM,
Plaintiffs - Appellants,

V.

COMMONWEALTH ADVISORS, INCORPORATED; WALTER MORALES; STONE & YOUNGBERG, L.L.C.; STIFEL FINANCIAL CORPORATION; and STIFEL, NICOLAUS & COMPANY, INCORPORATED,
Defendants - Appellees.

Appeal from the United States District Court
For the Middle District of Louisiana, Baton Rouge Division
Case No. 3:10-CV-854, Honorable James J. Brady, United States District Judge

**AMICUS CURIAE BRIEF OF PUBLIC INVESTORS ARBITRATION BAR
ASSOCIATION IN SUPPORT OF APPELLANTS**

Royal B. Lea, III
Texas State Bar No. 12069680
royal@binghamandlea.com
BINGHAM & LEA, P.C.
319 Maverick Street
San Antonio, Texas 78212
(210) 224-1819 Telephone
(210) 224-0141 Facsimile

ATTORNEY FOR PUBLIC INVESTORS
ARBITRATION BAR ASSOCIATION

Amicus Curiae, Public Investors Arbitration Bar Association, files this *Amicus Curiae* Brief in support of Appellants.

CERTIFICATE OF INTERESTED PERSONS

For the purposes of this Court’s Rule 28.1.2, the undersigned counsel certifies that the following listed persons and entities have an interest in the outcome of this case.

Appellants are Joseph N. Broyles, Anne Richey, Karen L. Barranco, Susan B. Beninati, M. Badi Asbahi, Preston Cloyd, Charles Richey, Russ P. Barranco, Registrar of Voters Employee Retirement System, Jody A. Barranco, Janice B. Virgadamo, and the Firefighters’ Retirement System. Appellants are represented by James Richard Swanson, Jason W. Burge, and Alysson Leigh Mills at FISHMAN HAYGOOD, L.L.P., 201 Saint Charles Ave., Ste. 4600, New Orleans, LA 70170.

Commonwealth Advisors, Incorporated and Walter Morales, are Appellees, and are represented by Fredrick R. Tulley and John Anthony Milazzo, Jr. at TAYLOR, PORTER, BROOKS & PHILLIPS, L.L.P., P.O. Box 2471, Baton Rouge, LA 70821-2471.

Stone & Youngberg, L.L.C. is an Appellee, and is represented by George Chester Freeman, III and Jamie Lauren Berger at BARRASSO, USDIN, KUPPERMAN, FREEMAN & SARVER, L.L.C., 909 Poydras Street, Ste. 2400, New Orleans, LA 70112.

Stifel Financial Corporation and Stifel, Nicolaus & Company, Incorporated, are Appellees, and are represented by Robert A. Sacks and Jackson S. Trugman at SULLIVAN & CROMWELL, L.L.P., 1888 Century Park, E., Ste. 2100, Los Angeles, CA 90067-0000; George Denegre, Jr. at LISKOW & LEWIS, P.L.C., 701 Poydras Street, 1 Shell Square, Ste. 5000, New Orleans, LA 70139; and Stephen Henry Kupperman at BARRASSO, USDIN, KUPPERMAN, FREEMAN & SARVER, L.L.C., 909 Poydras Street, Ste. 2400, New Orleans, LA 70112.

Amicus Curiae Public Investors Arbitration Bar Association, or PIABA, is a national, non-profit, voluntary, public bar association. PIABA has no parent corporation, and no publicly held company owns 10% or more of PIABA's stock. Royal B. Lea, III of BINGHAM & LEA, P.C., 319 Maverick Street, San Antonio, Texas 78212, is counsel of record for PIABA.

Mr. Lea is the primary author of this Brief and the Motion for Leave submitted with this Brief. Mr. Lea did not contribute money to fund the preparation or submission of this Brief or the Motion for Leave. Mr. Lea is a member of PIABA. Other members of PIABA collaborated with Mr. Lea on this Brief. He and the other members of PIABA pay annual membership dues to support PIABA's operations and activities, which include the preparation and submission of *amicus curiae* briefs in cases on appeal in federal and state courts throughout the United States. No person other than PIABA, its members (through their payment of membership dues

to PIABA), or its counsel (who are members of PIABA) made a monetary contribution intended to fund the preparation or submission of this Motion and Brief.

Signed on July 11, 2017.

/s/ Royal B. Lea, III

ROYAL B. LEA, III,

Attorney of record for PIABA

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**IDENTITY OF *AMICUS CURIAE*, ITS INTEREST
IN THE CASE, AND AUTHORITY TO FILE THIS BRIEF**

Public Investors Arbitration Bar Association (“PIABA”) respectfully submits this Brief as *amicus curiae* in support of Plaintiffs-Appellants, Joseph N. Broyles, *et al.*

PIABA is an international bar association, which was established in 1990 as an organization to promote the interests of the public investor in securities and commodities arbitration and litigation. PIABA members include current and former state and federal securities regulators, securities professors, and experienced securities practitioners. PIABA furthers its goals by sponsoring educational programs, publishing journals, participating in regulatory activities, and frequently, submitting briefs as *amicus curiae* in cases impacting public investors.

PIABA publishes books and reports on securities arbitration and litigation, conducts regular CLE programs for its members, and communicates directly with governmental and quasi-governmental agencies, such as the Securities and Exchange Commission, the North American Securities Administrators’ Association, and the Financial Industry Regulatory Authority on issues of interest to PIABA members and public investors. The United States Supreme Court, federal Circuit Courts of Appeal, and state supreme courts have permitted PIABA to appear as an *amicus curiae* in cases involving issues of importance to public investors’ claims against their stockbrokers and financial advisors.

PIABA submits this Brief to address the trial court's errors in using Delaware law to decide if investors own their claims that they were fraudulently induced to invest in securities and in deciding the investors lacked standing to assert those claims.

Under Federal Rule of Appellate Procedure 29(a), an *amicus curiae* other than the government may file a brief only with leave of court or when all parties consent. PIABA has requested leave of court to file this Brief because, as explained more fully in PIABA's Motion for Leave, all parties have not consented to PIABA filing this *amicus* Brief.

No party's counsel has participated in writing this Brief. No party (or party's counsel) has contributed money to fund preparing or submitting this Brief. No one, other than PIABA, has contributed money that was intended to fund preparing or submitting this Brief.

FACTUAL BACKGROUND

PIABA expects that the parties will present a full explanation of the facts to the Court, so PIABA does not undertake to do that. PIABA's interest in this case is limited to its concern that the trial court erred by concluding that purchasers of securities do not have standing to assert claims for fraudulent inducement when they were induced to purchase securities with misrepresentations and omissions. Fraudulent inducement claims are based on misrepresentations made directly to

purchasers of securities, and therefore belong to those purchasers, not to the entities in which they invest.

PIABA understands that the plaintiffs in these two consolidated cases divide into two groups: one group (in case no. 3:10-CV-00854-JJB-SCR) alleges that they purchased securities—shares in hedge funds—based on false and misleading representations; the other (in case no. 3:10-CV-00857-JJB-SCR) is comprised of the hedge funds themselves (organized as limited liability companies under Delaware or Cayman Island law) in which the purchasers bought shares.¹ PIABA refers in this Brief to the plaintiffs who allege that they were fraudulently induced to purchase securities by misrepresentations and omissions as the “Purchaser Plaintiffs” and to the investment funds in which the Purchaser Plaintiffs invested as the “Fund Entities.”

PIABA focuses its Argument below on the factual allegations by the Purchaser Plaintiffs that they were fraudulently induced to purchase securities based on material misrepresentations and omissions and on the trial court’s erroneous dismissal of their claims based on those allegations. *See, e.g.*, ROA.5088, ¶7 (Rec. Doc. 184).

¹ *See* ROA.5086-5168 (Rec. Doc. 184) & ROA.5169-5352 (Rec. Doc. 185).

SUMMARY OF THE ARGUMENT

The trial court erred in dismissing the claims of the Purchaser Plaintiffs asserting their rights against promoters and sellers of investments for fraudulent inducement to purchase securities through false and misleading misrepresentations regarding the value of the investments. ROA.6472 (Rec. Doc. 274) & ROA.43748 (Rec. Doc. 931). The trial court's conclusion that those claims are derivative and belong to the Fund Entities and not the Purchaser Plaintiffs is legally erroneous. The Fund Entities were not injured by false representations to the Purchaser Plaintiffs that induced the Purchaser Plaintiffs to part with money and pay artificially inflated prices for investments in the Funds. The Purchaser Plaintiffs were harmed personally and directly—they parted with money previously belonging to them before their purchases based on false and misleading misrepresentations and omissions.

ARGUMENT

The Purchaser Plaintiffs allege direct claims—*i.e.*, claims only they could own for their personal injuries in being induced by fraud to purchase securities. This Court and many others recognize that claims for fraudulent inducement to invest in securities belong to the investors who part with their funds to become owners of the securities through the chicanery of a seller or promoter. *See, e.g., Highland Capital Mgmt. LP v. Chesapeake Energy Corp. (In re Seven Seas Pet. Inc.)* 522 F.3d 575,

585-87 (5th Cir. 2008) (bondholders fraudulently induced to invest in bonds owned fraudulent inducement claims); *Medkser v. Feingold*, 307 Fed. Appx. 262, 265 (11th Cir. 2008) (investors “fraudulently induced ... to invest their money into fund had right to sue”); *Hirsch v. Arthur Anderson & Co.*, 72 F.3d 1085, 1093-96 (2d Cir. 1995) (investors fraudulently induced to invest in Ponzi scheme owned claims to recover investments).²

The trial court based its decision on Delaware law,³ but even the Supreme Court of Delaware holds that fraudulent inducement claims belong to the cheated investors tricked into purchasing securities and that fraudulent inducement claims are controlled by the law of the state on which the investors base their claims. *Citigroup Inc. v. AHW Inv. P’ship*, 140 A.3d 1125, 1140 n.76 (Del. 2016) (recognizing “[q]uintessential example[] of personal claim[] would [be] a tort claim for fraud in connection with the purchase of shares”; quoting *In re El Paso Pipeline Partners, LP*, 132 A.3d 67, 76 (Del. Ch. 2015)).

The trial court erred by looking to Delaware law to decide if the Purchaser Plaintiffs’ fraudulent inducement claims are direct or derivative. Delaware law, of course, does matter for determining whether a claim for breach of fiduciary duty by

² The United States Supreme Court recognized in *dicta* in *Blue Chip Stamps v. Manor Drug Stores* that the express rights of purchasers to sue under the 1933 and 1934 Acts are *not* derivative. 421 U.S. 723, 735-36 (1975) (those rights are “*non derivative* private civil remedies”; emphasis added).

³ ROA.6475 (Rec. Doc. 274).

a shareholder who already owns shares against management or a third party is direct or derivative. *Id.* at 1127. But before a court takes up the direct-or-derivative analysis, it must first decide if the plaintiff is alleging a claim that belongs to her or one that belongs to the entity in which she has invested. *Id.* Claims of mismanagement and breach of fiduciary duty by shareholders who purchased before the events of mismanagement on which the claims are based—and who do not assert fraudulent inducement—generally do belong to the entity rather than shareholders.

However, a claim of fraudulent inducement is based on the law of the state in which the investor purchased the security, not Delaware law. *Id.* (“holder” claims belonged to investors “under the state law that governs the claims,” and were not Delaware fiduciary duty claims). The Delaware Supreme Court so held in *Citigroup* in analyzing a “holder” claim. *Id.* at 1127 & 1140 (holder claims “could not possibly belong” to the entity and “Delaware law has nothing to do with” the claims). The Delaware Court relied in part on decisions involving fraudulently induced purchases, and held further that the rule must apply with at least equal force for an investor’s fraudulent inducement claim. *Id.* at 1140, n.76 (citing example of fraudulent inducement to purchase).

This Court’s decision in *Highland Capital Management* addressed standing in the context of whether fraudulent inducement claims belonged to the defrauded bond purchasers or to the bankruptcy trustee of the insolvent entity that issued the

bonds. The debate was not between the defrauded purchasers and the entity in which they had invested. 522 F.3d at 578 (purchasers of unsecured bonds). But that difference is not material here. The trustee in *Highland Capital Management* was the trustee of the bankruptcy estate of the bankrupt entity. Nevertheless, the investors' claims were not based on mismanagement. Instead, the claims were asserted by investors claiming they were fraudulently induced to invest. *Id.* at 586 (allegations that reserve estimates were false and estimates used to induce potential investors to acquire interests or refrain from selling). The analysis and result should be the same here. The Purchaser Plaintiffs are the ones who relied on false representations to part with their purchase money. They were the victims of the fraudulent inducement, not the Fund Entities.

A cheated purchaser of shares in a Delaware entity who pleads the necessary elements of a claim of fraudulent inducement under the law of the state in which she purchased the shares must be permitted to proceed with her claim under her state law without roadblock from arguments about Delaware direct-or-derivative law. Sellers of fictitious securities issued by entities organized under Delaware law should not be permitted to avoid claims by defrauded investors under the Blue Sky laws of the states where the purchasers live by throwing Delaware direct-or-derivative law in the way. The Delaware Supreme Court has specifically so held.

Citigroup, 140 A.3d at 1127, 1132-33 & nn.38-43, 1140 & nn.75-76 (nature and ownership of claim controlled by investors' state law).

Accordingly, this Court should not let the trial court's flawed decision stand. To do so would result in injustice for numerous defrauded investors. The rights and remedies for investors suing under the laws of many states to recover for purchases of investments induced by fraud would be rendered meaningless. Fraudulent investment promoters, scam issuers, and unscrupulous stock brokers would rely upon such a decision as a shield to block otherwise meritorious claims by defrauded investors who, through no fault of their own, fall for scams and part with hard earned money or retirement savings. Fraudsters would use the decision to argue that cheated investors lose because only illusory entities fabricated by con artists would be entitled to assert claims.

CONCLUSION

The Court should reverse the trial court's holding that the Purchaser Plaintiffs fraudulent inducement claims are derivative. And the Court should reverse the trial court's holding that Delaware law controls analysis of whether the fraudulent inducement claims are direct or derivative. The fraudulent inducement claims belong to the Purchaser Plaintiffs, who should be permitted to assert their fraudulent inducement claims under Louisiana law.

Respectfully submitted,

BINGHAM & LEA, P.C.
319 Maverick Street
San Antonio, Texas 78212
(210) 224-1819 Telephone
(210) 224-0141 Facsimile

By: /s/ Royal B. Lea, III

Royal B. Lea, III
Texas State Bar No. 12069680
royal@binghamandlea.com

ATTORNEY FOR PUBLIC INVESTORS
ARBITRATION BAR ASSOCIATION

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of FED. R. APP. P. 32(a)(7)(B) because:

- this brief contains 1,765 words, excluding the parts of the brief exempted by FED. R. APP. P. 32(a)(7)(B)(iii), *or*
- this brief uses a monospaced typeface and contains _____ lines of text, excluding the parts of the brief exempted by FED. R. APP. P. 32(a)(7)(B)(iii).

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Signed on July 11, 2017.

/s/ Royal B. Lea, III
ROYAL B. LEA, III
BINGHAM & LEA, P.C.
319 Maverick Street
San Antonio, Texas 78212
(210) 224-1819 Telephone
(210) 224-0141 Facsimile
royal@binghamandlea.com

ATTORNEY FOR PUBLIC INVESTORS
ARBITRATION BAR ASSOCIATION

CERTIFICATE OF SERVICE

I hereby certify that on this 11th day of July, 2017, a true and correct copy of the above and foregoing has been served by e-mail on the all parties listed below through the Court’s Electronic Case Noticing System.

James Richard Swanson
jswanson@fishmanhaygood.com
Jason W. Burge
jburge@fishmanhaygood.com
Alysson Leigh Mills
amills@fishmanhaygood.com
FISHMAN HAYGOOD, LLP
201 Saint Charles Ave., 46th Floor
New Orleans, LA 70170

COUNSEL FOR APPELLANTS

Robert A. Sacks
sacksr@sullcrom.com
Jackson S. Trugman
trugmanj@sullcrom.com
SULLIVAN & CROMWELL, LLP
1888 Century Park, E.
Los Angeles, CA 90067

and

George Denegre, Jr.
gdenegre@liskow.com
LISKOW & LEWIS, P.L.C.
701 Poydras Street, Ste. 5000
New Orleans, LA 70139

and

Fredrick R. Tulley
Fred.tulley@taylorporter.com
John Anthony Milazzo, Jr.
John.milazzo@taylorporter.com
TAYLOR, PORTER, BROOKS &
PHILIPS, LLP
P.O. Box 2471
Baton Rouge, LA 70821-2471

*COUNSEL FOR APPELLEES,
COMMONWEALTH ADVISORS, INC.
and WALTER MORALES*

George Chester Freeman, III
gfreeman@barrassousdin.com
Jaimie Lauren Berger
jberger@barrassousdin.com
BARRASSO, USDIN, KUPPERMAN,
FREEMAN & SARVER, LLC
909 Poydras Street, Ste. 2400
New Orleans, LA 70112

*COUNSEL FOR APPELLEES,
STONE & YOUNGBERG, LLC*

Stephen Henry Kupperman
skupperman@barrassousdin.com
BARRASSO, USDIN, KUPPERMAN,
FREEMAN & SARVER, LLC
909 Poydras Street, Ste. 2400
New Orleans, LA 70112

*COUNSEL FOR APPELLEES,
STIFEL FINANCIAL CORP. and
STIFEL, NICOLAUS & CO., INC.*

/s/ Royal B. Lea, III

ROYAL B. LEA, III

United States Court of Appeals

FIFTH CIRCUIT
OFFICE OF THE CLERK

LYLE W. CAYCE
CLERK

TEL. 504-310-7700
600 S. MAESTRI PLACE
NEW ORLEANS, LA 70130

July 14, 2017

Mr. Royal B. Lea III
Bingham & Lea, P.C.
319 Maverick Street
San Antonio, TX 78212

No. 17-30092
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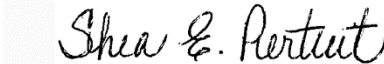
Dear Mr. Lea,

The following pertains to your brief electronically filed on July 14, 2017.

You must submit the 7 paper copies of your brief required by 5TH CIR. R. 31.1 within 5 days of the date of this notice pursuant to 5th Cir. ECF Filing Standard E.1.

Sincerely,

LYLE W. CAYCE, Clerk



By: _____
Shea E. Pertuit, Deputy Clerk
504-310-7666

cc:

Ms. Jamie Lauren Berger
Mr. Jason W. Burge
Mr. George Denegre Jr.
Mr. George Chester Freeman III
Mr. Stephen Henry Kupperman
Mr. John Anthony Milazzo Jr.
Ms. Alysson Leigh Mills
Mr. Robert A. Sacks
Mr. James Richard Swanson
Mr. Jackson S. Trugman
Mr. Fredrick R. Tulley