Anwar et al v. Fairfield Greenwich Limited et al Doc. 1384

SULLIVAN & CROMWELL LLP

TELEPHONE: 1-212-558-4000
FACSIMILE: 1-212-558-3588
WWW.SULLCROM.COM

125 Broad Street
New York, NY 10004-2498

LOS ANGELES • PALO ALTO • WASHINGTON, D.C.
FRANKFURT • LONDON • PARIS
BEIJING • HONG KONG • TOKYO
MELBOURNE • SYDNEY

USDC SDNY
DOCUMENT
ELECTRONICALLY FILED
DOC #:
DATE FILED: 6/4/15

May 29, 2015

By Facsimile

Honorable Victor Marrero,
United States District Judge,
Southern District of New York,
Daniel Patrick Moynihan U.S. Courthouse,
500 Pearl Street,
New York, New York 10007.

Re: *Anwar* v. *Fairfield Greenwich Ltd.*—Standard Chartered Cases, No. 09-CV-118 (S.D.N.Y.) (VM) (FM)

Dear Judge Marrero:

As requested, we write on behalf of the Standard Chartered Defendants ("SCB" or the "Bank") regarding the application of the Second Circuit's recent decision in *In re Kingate Management Limited Litigation*, 784 F.3d 128 (2d Cir. 2015) to the claims asserted in the Standard Chartered Cases.

The *Kingate* decision further underscores, indeed compels, the conclusion, set forth in the Bank's letter of October 31, 2014 (Dkt #1333), that all of the Standard Chartered Plaintiffs' claims against SCB are precluded by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), because they are based on allegations that the Bank provided unsupported or misleading investment advice that induced investments in covered securities. As explained in the October 31 submission, in *Romano* v. *Kazacos*, the Second Circuit established that SLUSA precludes all claims (i) predicated on misleading investment advice that "induced" plaintiffs to invest in covered securities, or (ii) that "turn on injuries caused by acting on misleading investment advice—that is, where plaintiffs' claims necessarily allege, necessarily involve, or rest on the purchase or sale of [covered] securities." 609 F.3d 512, 521-23 (2d Cir. 2010) (internal quotations omitted). In *Kingate*, the Second Circuit was explicit that SLUSA precludes any state law claim that requires a plaintiff to show the type of conduct proscribed by Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934, the "anti-falsity provisions" of the federal securities laws. 784 F.3d at 146. Here, plaintiffs' fundamental allegation is that the Bank induced them to invest in covered securities through Fairfield Sentry Ltd. and Fairfield Sigma Ltd. (the "Fairfield Funds") by making recommendations that the Bank knew or should have known were false—conduct plainly

Dockets.Justia.com

implicating the anti-falsity provisions of the federal securities laws—and plaintiffs' claims turn on purported injuries caused by those investments. Plaintiffs' claims thus fall squarely within the SLUSA tests of *Romano* and *Kingate*, and should be dismissed.

A. *Kingate* Confirms That Plaintiffs' Purchases of Madoff Feeder Funds Constitute Purchases of Covered Securities.

As described in the *Anwar* defendants' submissions, *Kingate*, like the Second Circuit's earlier decision in *In re Herald*, 753 F.3d 110, 113 (2d Cir. 2014), holds that investors in Madoff feeder funds purchased those shares "expecting that the Funds were investing the proceeds in S&P 100 stocks, which are covered securities," and thus any claim by investors that they were wrongfully induced to invest in feeder funds like the Fairfield Funds is "in connection with the purchase or sale of a covered security" under SLUSA. *Kingate*, 784 F.3d at 142. There should thus be no dispute, and we believe there is none, that plaintiffs' investments in the Fairfield Funds are properly viewed as investments in "covered securities" under SLUSA.

B. *Kingate* Dictates Dismissal of All Remaining Claims in the Standard Chartered Cases Pursuant to SLUSA.

Kingate also resolves any lingering ambiguity that the state law claims that remain pending in the Standard Chartered Cases fall within the ambit of SLUSA. Under *Kingate*, SLUSA precludes any state law claim that requires a plaintiff to show the type of false "conduct *by the defendant* that is specified in SLUSA's operative provisions," namely, the anti-falsity provisions of the federal securities laws. 784 F.3d at 146. As set forth in the *Anwar* defendants' submissions, *Kingate* provides extensive guidance regarding the type of alleged wrongdoing that meets this standard. Of particular importance to the Standard Chartered Cases, *Kingate* identifies the following two categories of wrongdoing that trigger SLUSA preclusion: (1) allegations of a defendant's negligent or fraudulent "misrepresentations and misleading omissions . . . made in connection with the Funds' investments with Madoff in covered securities and with their oversight of these investments," 784 F.3d at 134-35,151; and (2) any other allegations of "conduct by the defendant that would be actionable under the anti-falsity provisions" of Sections 17(a) or 10(b) either as a private claim or through an enforcement action by the U.S. Securities and Exchange Commission, *id.* at 147, 149. In determining whether a state law claim depends on the type of conduct that triggers SLUSA, *Kingate* requires the Court to consider each "claim's theory of the defendant's liability," rather than merely whether "false conduct" is "an essential element" of the claim. *Id.* at 149, 153 n.25.

1. Plaintiffs Concede That Their Omissions-Based Claims Are Barred Under *Kingate*'s SLUSA Test.

As explained more fully in SCB's prior submissions, plaintiffs' remaining claims all are based on two theories of why SCB should be held liable for losses associated with their investments in the Fairfield Funds:

- The Bank allegedly omitted material facts regarding Bernard Madoff when it recommended the Fairfield Funds to plaintiffs—namely, "that Madoff was actually executing the split-strike conversion strategy" for the Funds (the

"Omission Theory"), *Anwar* v. *Fairfield Greenwich Ltd.*, 745 F. Supp. 2d 360, 371-73 & n.7 (S.D.N.Y. 2010) ("*SCB I*"); and

- The Bank allegedly misled plaintiffs by recommending the Fairfield Funds as a sound investment without conducting adequate due diligence to support that recommendation (the "Due Diligence Theory"), *id.* at 376; *Anwar*, 826 F. Supp. 2d 578, 555, 557-58 (S.D.N.Y. 2011); *Anwar*, 891 F. Supp. 2d 548, 557 (S.D.N.Y. 2012).

Plaintiffs concede that if the Standard Chartered Cases are a "covered class action," then all claims based on their Omission Theory are precluded under *Kingate*. (*See* May 27, 2015 Joint Letter from Sharon L. Nelles and Richard E. Brodsky at 2 (Dkt. #1381).) For the reasons set forth below, the remaining claims, all based on the Due Diligence Theory, likewise fail as they are in fact claims that clearly require proof of conduct by the Bank that, under *Kingate*, is the type of wrongdoing that triggers SLUSA preclusion

2. The Due Diligence Theory Claims Fall Within *Kingate*'s SLUSA Test Because They Require Proof of the Bank's Alleged False or Misleading Conduct, Including Misrepresentations or Omissions.

Plaintiffs' Due Diligence Theory claims rest on allegations that SCB recommended the Fairfield Funds as a sound and appropriate investment for plaintiffs even though SCB either (i) "believed" the Funds were "going to explode one of these days" (Pls' Nov. 17, 2014 Letter at 4 (Dkt. #1349)), or, (ii) through proper due diligence, should have "recogniz[ed] from the numerous red flags that flew all around Madoff that an investment with Madoff was overly risky" (*id.* at 12). *See also SCB I*, 745 F. Supp. 2d at 378 (characterizing one plaintiff's gross negligence and fiduciary duty claims as "recommending that an investor place hundreds of thousands of dollars in an investment without the financial institution doing anything to ensure the investment was sound"). The claims meet *Kingate*'s test for SLUSA preclusion for at least three reasons:

First, the Due Diligence Theory claims require proof that the Bank engaged in the type of conduct that is proscribed by the anti-falsity provisions of Sections 10(b) and 17(a). *Kingate*, 748 F.3d at 147. Since as far back as 1969, courts have recognized that recommending an investment without conducting adequate due diligence necessarily involves false or misleading conduct proscribed by the anti-falsity provisions, when, in *Hanley* v. *SEC*, the Second Circuit held that investment professionals make an implicit representation that they have an adequate basis for their investment recommendations. 415 F.2d 589, 595-97 (2d Cir. 1969). Thus, where an investment professional has not conducted adequate due diligence, the very act of making an investment recommendation constitutes a misrepresentation that implicates the anti-falsity provisions of the federal securities laws. *Id.* (affirming penalties under Sections 17(a) and 10(b) against "securities salesmen" for failure to conduct adequate due diligence prior to making an investment recommendation).

Since *Hanley*, the SEC and private plaintiffs have routinely asserted claims under the anti-falsity provisions based on conduct that is identical to the Bank's conduct challenged here—namely, recommending an investment without conducting adequate due diligence. *See,*

e.g., *South Cherry St., LLC* v. *Hennessee Grp. LLC*, 573 F.3d 98 (2d Cir. 2009) (dismissing Section 10(b) claim based on defendant's failure to conduct due diligence before recommending a hedge fund that turned out to be a Ponzi scheme for failure to adequately plead scienter); *In re Capital Fin. Servs., Inc.*, 102 S.E.C. Docket 2435 (Dec. 16, 2011) (finding investment advisor violated Sections 17(a) and 10(b) by "fail[ing] to perform reasonable due diligence on numerous private placement offerings prior to recommending them to customers where the offerings turned out to be a classic Ponzi scheme and offering fraud"); *In re Wells Fargo Brokerage Servs. LLC, et al.*, Release No. 33-9349 at 9 (Aug. 14, 2012) ("A broker or salesperson who fails to investigate facts surrounding a security and who subsequently recommends that security to customers without having an adequate and reasonable basis for that recommendation may be in violation of the antifraud provisions of the federal securities laws, including Sections 17(a)(2) and 17(a)(3) of the Securities Act." (quoting *SEC* v. *Great Lakes Equities*, 1990 WL 260587 at *6 (E.D. Mich. Sept. 4, 1990))); *In re Donald J. Anthony, Jr., et al.*, Release No. 33-9454 at 5 (Sept. 23, 2013) (alleging violations of Sections 17(a) and 10(b) for "failure to perform reasonable due diligence to form a reasonable basis for their recommendations to customers" and making misrepresentations and omissions in recommending investments). Indeed, 23 of the initial 28 plaintiffs who filed claims against SCB in this multidistrict litigation attempted to assert claims under Section 10(b) based on the Due Diligence Theory, confirming that plaintiffs themselves understood their Due Diligence Theory necessarily involved allegations of conduct proscribed by the anti-falsity provisions. (SCB Oct. 31, 2014 Letter at 3-4; *SCB I*, 745 F. Supp. 2d at 369-71.)

Second, plaintiffs' Due Diligence Theory claims depend on allegations that SCB falsely recommended the Fairfield Funds as a sound investment. The investment recommendation is an essential component of plaintiffs' claims because the duty to conduct due diligence, whatever its scope, arises only as a result of the recommendation or advice.[1] And, under plaintiffs' theory of liability, the Bank's recommendation itself allegedly constituted a misrepresentation because the Bank either did not honestly believe that the Fairfield Funds were a sound investment or did not conduct adequate due diligence to make an informed recommendation in the first place. Statements of opinion that are not honestly held, or lack a good faith basis of fact, constitute an actionable misrepresentation or omission under the federal securities laws. *See, e.g.*, *Omnicare, Inc.* v. *Laborers Dist. Council Const. Indus. Pension Fund*, 135 S. Ct. 1318, 1329-32 (2015) (recognizing in Section 11 context that opinion is actionable if

---

[1] This Court previously dismissed breach of fiduciary duty and gross negligence claims based on a failure to conduct adequate due diligence where the plaintiffs did not allege that SCB recommended plaintiff's investment in Fairfield Sentry or otherwise provided investment advice. *Anwar*, 826 F. Supp. 2d at 591-92 ("It . . . defies logic to assume that SCBI breached its fiduciary duty or was grossly negligent in recommending Fairfield Sentry without conducting due diligence when the [plaintiffs] have not even alleged that SCBI recommended the securities or advised them in the first place."); *see also* Maridom Am. Compl. ¶ 4 (alleging that "when advising a client to make a particular investment, the advisor must have a reasonable basis, as a result of such investigation as is necessary under the circumstances, for that recommendation").

speaker lacked a good faith basis for the opinion); *City of Omaha, Neb. Civilian Employees' Ret. Sys.* v. *CBS Corp.*, 679 F.3d 64, 67-68 (2d Cir. 2012) (holding that misstatements regarding opinions are actionable under Sections 10(b) and 20(a) if plaintiffs "plausibly allege that defendants did not believe the statements . . . at the time they made them" (citations omitted)). Because plaintiffs' Due Diligence Theory claims are premised on the Bank's allegedly false or misleading recommendation that the Fairfield Funds were sound investments, *Kingate*'s test for SLUSA preclusion is met. 784 F.3d at 134-35, 151.

Third, lest there be any doubt that plaintiffs' Due Diligence Theory claims are based on alleged misrepresentations and omissions, plaintiffs' complaints are replete with allegations that the Bank made false representations about the nature, price and financial prognosis of the Fairfield Funds, which plaintiffs contend SCB knew, or should have known through adequate due diligence, were false or misleading. *See SCB I*, 745 F. Supp. 2d at 376-77. For example, plaintiffs allege:

- "In recommending the purchases of FSF Shares, SCBI told Plaintiffs that these would be safe investments with a steady return . . . . Each of Plaintiffs justifiably accepted these statements and relied on them. . . ." (Maridom Am. Compl. ¶ 27.)

- "American Express Bank represented to Headway that the Sentry Fund was a self-standing fund of funds with assets in bona fide investment vehicles . . . . Headway relied upon [the Bank's relationship managers] to ensure the Funds were, at a minimum, bona fide investment vehicles." (Headway Compl. ¶¶ 38, 77.)

- "SCBI promoted investments in the Fairfield Sentry Fund to Plaintiff as generating stable and steady returns with low volatility." (Skyworth Products Compl. ¶ 4.)

- "[The Bank's relationship manager] recommended the Fairfield Funds to Plaintiffs, advising Plaintiffs that American Express Bank Ltd. and/or Standard [Chartered] had conducted extensive due diligence on the fund before recommending it . . . . [and] represented the Fairfield Funds as being safe, secure and as close to an equivalent of cash as an investment could be." (Gerico, Inc. Compl. ¶¶ 17, 18.)

(*See* Ex. A to Oct. 31, 2014 Letter for listing of similar allegations made by plaintiffs in other Standard Chartered Cases.) These allegations, which are a predicate to plaintiffs' Due Diligence Theory claims, clearly meet *Kingate*'s test for SLUSA preclusion because they require proof that the Bank's alleged misrepresentations and misleading omissions led plaintiffs to purchase the Fairfield Funds, which constituted an attempted investment in covered securities. 784 F.3d at 134-35, 151.

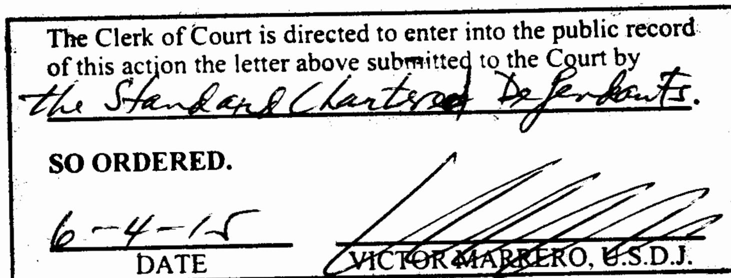
* * *

For all the foregoing reasons, the Court should dismiss the Standard Chartered Cases pursuant to SLUSA.

Respectfully submitted,

Sharon L. Nelles

cc: Standard Chartered Plaintiffs' Steering Committee (by E-mail)



The Clerk of Court is directed to enter into the public record of this action the letter above submitted to the Court by the Standard Chartered Defendants.

SO ORDERED.

6-4-15
DATE

VICTOR MARRERO, U.S.D.J.