No. 98-1271

In the Supreme Court of the United States

OCTOBER TERM, 1998

JOHN ROMANO, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether a stock trader employed by a broker-dealer is a primary violator of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), rather than only an aider and abettor, when the trader, acting at the direction of the instigator of a market manipulation, executes trades that he knows are manipulative.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-14a) is reported at 155 F.3d 107. The opinion of the district court granting in part petitioner's motion to dismiss for failure to state a claim (Pet. App. 17a-23a) is reported at 929 F. Supp. 168. The order of the district court certifying its dismissal order for interlocutory appeal (Pet. App. 24a-26a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on August 28, 1998. A petition for rehearing was denied on November 13, 1998 (Pet. App. 15a-16a). The petition for a writ of certiorari was filed on February 5, 1999.

The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1994, the Securities and Exchange Commission (Commission) brought this civil law enforcement action against petitioner and others, alleging violations of various provisions of the federal securities laws. Pet. App. 5a; Gov't C.A. App. 1. In its amended complaint, the Commission alleges, *inter alia*, that petitioner and others entered into an agreement to manipulate upward the price of the stock of U.S. Environmental, Inc. (USE). Gov't C.A. App. 13-14, 30-37, 45-46, 51-53; Pet. App. 3a-5a.

Specifically, the amended complaint alleges that petitioner was employed as a securities trader by Castle Securities Corp. (Castle), a securities broker-dealer. Gov't C.A. App. 16, 18; Pet. App. 3a. Castle agreed to participate in a scheme whereby it and others, including petitioner, would manipulate the price of USE stock. Gov't C.A. App. 25-26, 30-31; Pet. App. 3a. At the direction of stock promoter Mark D'Onofrio (D'Onofrio), certain of the participants in the scheme traded USE shares among themselves for the purpose of creating the appearance of an actual market for the stock, thereby raising the stock's price. Gov't C.A. App. 30-31, 33-36; Pet. App. 3a.

As alleged in the amended complaint, petitioner's role in the stock manipulation scheme was to execute, for the other participants, sham trades that he knew had no economic substance. The trades were executed for the purpose of affecting USE's stock price by creating the false appearance of market activity. Gov't C.A. App. 32-33; Pet. App. 3a-5a. In addition, petitioner entered quotations for USE shares on behalf of Castle

at prices specified by D'Onofrio rather than on the basis of actual market activity. Gov't C.A. App. 32; Pet. App. 4a.

The amended complaint further alleges that petitioner knew that the trades he executed, although ostensibly arms'-length trades between Castle and other broker-dealers, were in fact directed on both sides by D'Onofrio. D'Onofrio told petitioner in advance that Castle would be receiving an order from another broker-dealer, and he specified the price at which petitioner was to fill the order. Gov't C.A. App. 33-34; Pet. App. 5a. D'Onofrio supplied petitioner with the USE stock that Castle needed to fill buy orders, giving Castle a discount (and therefore a guaranteed profit); D'Onofrio also purchased USE stock that petitioner had acquired on behalf of Castle, always at a profit to Castle. Gov't C.A. App. 32-33; see Pet. App. 4a.

The amended complaint alleges that the participants in the fraudulent scheme succeeded in manipulating the price of USE stock from $.05 to in excess of $5 per share. Gov't C.A. App. 13, 37. Castle received $175,000 for executing trades at the direction of D'Onofrio and other participants. *Id.* at 40.

2. In the third claim for relief, which is the sole claim currently at issue, the amended complaint alleges that the market manipulation scheme described above violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5. Gov't C.A. App. 51-53. The third claim for relief also alleges that the scheme violated Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a). Gov't C.A. App. 51-53; Pet. App. 12a-13a.

Petitioner moved to dismiss the third claim for relief for failure to state a claim. Pet. App. 5a-6a. The

district court granted the motion, holding that the allegations in the complaint relating to that claim failed to make out a violation of Section 10(b) and Rule 10b-5. *Id.* at 18a-21a.[1] Relying on this Court's decision in *Central Bank* v. *First Interstate Bank*, 511 U.S. 164 (1994), the district court held that there is no aiding and abetting liability under Section 10(b) and Rule 10b-5. Pet. App. 19a. The district court further held that the allegations in the complaint established only that petitioner was an aider and abettor of the market manipulation scheme, not that he was a primary violator. *Id.* at 19a-21a.

According to the district court, the Commission had alleged only that petitioner had "executed elements of the manipulative trades of D'Onofrio" and that he had "follow[ed] directions from D'Onofrio." Pet. App. 19a-20a. In the district court's view, petitioner "did not himself make wash sales, match orders, or use undisclosed nominees to artificially affect the price of securities."[2] *Id.* at 20a. The district court concluded that, even if petitioner "knew that D'Onofrio was manipulating USE stock, he did not himself manipulate USE stock because he did not himself have a manipulative purpose." *Ibid.*; see also *id.* at 25a ("where, as here,

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[1] In granting the motion to dismiss the third claim, the district court addressed only Section 10(b) and Rule 10b-5, and did not address Section 17(a), which the Commission relied upon as an alternative basis for the claim. Pet. App. 12a-13a.

[2] "'Wash' sales are transactions involving no change in beneficial ownership. 'Matched' orders are orders for the purchase/sale of a security that are entered with the knowledge that orders of substantially the same size, at substantially the same time and price, have been or will be entered by the same or different persons for the sale/purchase of such security." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 205 (1976).

manipulation is the basis of the claim, manipulative intent, and not mere knowledge or recklessness, is required before Rule 10b-5 is violated").

3. The district court certified the dismissal order for interlocutory appeal pursuant to 28 U.S.C. 1292(b). Pet. App. 24a-26a. The court of appeals granted the motion for interlocutory appeal, and reversed. *Id.* at 1a-14a. The court pointed out that the complaint alleged that:

(a) participants other than petitioner, directed by D'Onofrio, "traded USE shares among themselves for the purpose of creating the appearance of an actual market for trading USE shares";

(b) petitioner participated in the market manipulation scheme by, *inter alia*, "effecting directed and controlled trades" and "effecting wash sales and matched orders";

(c) petitioner "agreed to execute trades as directed by D'Onofrio, and also agreed to move, or adjust, the price Castle quoted for USE shares at D'Onofrio's direction"; and

(d) during the manipulation, D'Onofrio alerted petitioner in advance that Castle would be receiving orders for USE stock from specific parties and told petitioner how to fill the orders, in terms of number of shares and price.

Id. at 3a-5a (internal quotation marks omitted).

In view of the facts alleged in the complaint, the court held that petitioner could be liable as a primary violator of Section 10(b). Pet. App. 3a. While recogniz-

ing that this Court held in *Central Bank* that "civil liability under § 10(b) applies only to those who 'engage in the manipulative or deceptive practice,' but not to those 'who aid and abet the violation,'" the court of appeals concluded that petitioner's conduct fell "well within the boundaries of primary liability." *Id.* at 8a (quoting *Central Bank*, 511 U.S. at 167). In *Central Bank*, the court explained, the defendant—an indenture trustee alleged to have conducted inadequate oversight—had concededly neither made a material misstatement nor committed a manipulative act. *Id.* at 11a (citing *Central Bank*, 511 U.S. at 177). In the present case, by contrast, "[petitioner] himself 'commi[tted] a manipulative act,' by effecting the very buy and sell orders that manipulated USE's stock upward." *Id.* at 12a (citing *Central Bank*, 511 U.S. at 177). The court of appeals observed that "if the trader who executes manipulative buy and sell orders is not a primary violator, it is difficult to imagine who would remain liable after *Central Bank*." *Id.* at 11a.

The court viewed it as "of no relevance that D'Onofrio, not [petitioner], masterminded the USE stock manipulation." Pet. App. 12a. *Central Bank*, the court explained, made clear that secondary actors in a securities fraud scheme can be liable as primary violators. *Ibid.* (citing *Central Bank*, 511 U.S. at 191). Similarly, the court of appeals disagreed with the district court's conclusion that petitioner "did not himself manipulate USE stock because he did not himself have a manipulative purpose." *Id.* at 8a; see also *id.* at 20a. Rather, petitioner's conduct, as alleged in the complaint, amounted to manipulation of USE stock "even if [petitioner] did not share [D'Onofrio's] specific overall purpose to manipulate the market." *Id.* at 3a; see also *id.* at 8a.

Addressing the adequacy of the complaint's allegations of scienter, the court of appeals found it sufficient that the complaint alleged that petitioner "intentionally engaged in manipulative conduct" and "executed trades that he knew were for a manipulative purpose." Pet. App. 9a-10a (internal quotation marks omitted). The court also noted that, "although [it] need not rely on this point," the complaint would have been sufficient to make out a Section 10(b) violation even if it had only alleged reckless conduct. *Id.* at 10a.

ARGUMENT

The decision of the court of appeals is interlocutory, is correct, and does not conflict with any decision of this Court or of any other court of appeals. Review by this Court is unwarranted.

1. In this interlocutory appeal, the court of appeals reversed the district court's holding that the third claim in the Commission's complaint failed to state a claim under Section 10(b). The court of appeals remanded the case for further proceedings, and noted that among the issues left open was petitioner's alternative argument that the third claim should be dismissed for failure to plead fraud with particularity. Pet. App. 13a. The ruling of the court of appeals therefore does not even definitively resolve whether the third claim for relief should be dismissed prior to trial. Moreover, if proceedings on remand were ultimately to result in a final judgment against petitioner on that claim, petitioner would be free to seek review of that final judgment, and could seek to bring his present contention before this Court by way of a petition for a writ of certiorari. See, *e.g.*, *Washington* v. *Washington State Commercial Passenger Fishing Vessel Ass'n*, 443 U.S. 658, 672 n.19 (1979); *Reece* v. *Georgia*, 350 U.S. 85, 87 (1955). Except

in extraordinary circumstances not present here, this Court's practice is to decline to exercise certiorari jurisdiction over cases that are in an interlocutory posture. See, *e.g.*, *Brotherhood of Locomotive Firemen* v. *Bangor & Aroostook R.R.*, 389 U.S. 327, 328 (1967) (per curiam); *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916) ("[E]xcept in extraordinary cases, the writ [of certiorari] is not issued until final decree. * * * [The absence of a final judgment] of itself alone furnishe[s] sufficient ground for the denial of [an] application."); see also *Virginia Military Inst.* v. *United States*, 508 U.S. 946, 946 (1993) (opinion of Scalia, J., respecting denial of petition for writ of certiorari).

2. In any event, the ruling below is correct. The complaint alleges that petitioner knowingly participated in a scheme to manipulate the price of USE stock, and that his role in that scheme was to personally execute manipulative sham trades that were essential to the functioning of the scheme. The court of appeals rightly concluded that this conduct falls "well within the boundaries of primary liability" under Section 10(b). Pet. App. 8a. Although petitioner contends that a trade is not manipulative unless it is "intended to mislead investors by artificially affecting market activity," Pet. 13 (emphasis omitted) (quoting *Sante Fe Indus.* v. *Green*, 430 U.S. 462, 476 (1977)), the complaint in this case alleges that the trades at issue were so intended and that petitioner knew that when he executed them. Petitioner cites no case holding that more is required to establish liability as a primary violator of Section 10(b). See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976) ("[t]he words 'manipulative or deceptive' * * * strongly suggest that § 10(b) was intended to proscribe *knowing or intentional* misconduct") (emphasis added);

cf. Restatement (Second) of Torts § 8A (1965) ("If the actor knows that the consequences are certain, or substantially certain, to result from his act, and still goes ahead, he is treated by the law as if he had in fact desired to produce the result.") (cited at Pet. App. 10a).[3]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[3] Petitioner also seeks review of the court of appeals' remark that an allegation of recklessness can support a Section 10(b) claim. See Pet. 14-16; Pet. App. 10a (noting that eleven circuits have so held). The court of appeals expressly noted, however, that it was not relying on such a theory in this case. Pet. App. 10a. The correctness of the court of appeals' observation is therefore not properly presented for this Court's review. See, *e.g.*, *Black* v. *Cutter Labs.*, 351 U.S. 292, 297 (1956) ("This Court, however, reviews judgments, not statements in opinions.").