

1                           **IN THE SUPREME COURT OF THE UNITED STATES**

2   - - - - - x  
3   **SECURITIES AND EXCHANGE COMMISSION, :**  
4                           **Petitioner                           :**  
5                       **vs.                                 :**   **No. 01-147**  
6   **CHARLES ZANDFORD,                                 :**  
7                           **Defendant                                 :**  
8   - - - - - x

9   **Washington, D. C.**

10    **Monday, March 18, 2002**

11                       **The above-entitled matter came on for oral**  
12   **argument before the Supreme Court of the United States at**  
13   **10:02 a.m.**

14   **APPEARANCES:**

15   **MATTHEW D. ROBERTS, ESQ., Assistant to the Solicitor**  
16           **General, Department of Justice, Washington, D. C. ;**  
17           **on behalf of the Petitioner.**

18   **STEVEN H. GOLDBLATT, ESQ., Washington, D. C. ; on behalf**  
19           **of the Respondent.**

20  
21  
22  
23  
24  
25

**C O N T E N T S**

<b>1</b>		
<b>2</b>	<b>ORAL ARGUMENT OF</b>	<b>PAGE</b>
<b>3</b>	<b>MATTHEW D. ROBERTS, ESQ.</b>	
<b>4</b>	<b>On behalf of Petitioner</b>	<b>3</b>
<b>5</b>	<b>STEVEN H. GOLDBLATT, ESQ.</b>	
<b>6</b>	<b>On behalf of Respondent</b>	<b>18</b>
<b>7</b>	<b>MATTHEW D. ROBERTS, ESQ.</b>	<b>45</b>
<b>8</b>	<b>On behalf of Petitioner</b>	
<b>9</b>		
<b>10</b>		
<b>11</b>		
<b>12</b>		
<b>13</b>		
<b>14</b>		
<b>15</b>		
<b>16</b>		
<b>17</b>		
<b>18</b>		
<b>19</b>		
<b>20</b>		
<b>21</b>		
<b>22</b>		
<b>23</b>		
<b>24</b>		
<b>25</b>		

1 P R O C E E D I N G S

2 (10:02 a.m.)

3 CHIEF JUSTICE REHNQUIST: We'll hear argument  
4 now on No. 01-147, Securities and Exchange Commission  
5 versus Charles Zandford. Mr. Roberts.

6 ORAL ARGUMENT OF MATTHEW D. ROBERTS

7 ON BEHALF OF THE PETITIONER

8 MR. ROBERTS: Mr. Chief Justice, and may it  
9 please the Court. Stockbrokers like the respondent are  
10 the critical link between the National Securities Markets  
11 and individual investors who trust brokers to buy and sell  
12 securities for their benefit.

13 Respondent betrayed that trust by selling his  
14 customers' securities not for their benefit, but for a  
15 secret purpose of misappropriating the proceeds and by  
16 embezzling the proceeds as he had planned.

17 In so doing, Respondent violated Section 10(b)  
18 of the Securities Exchange Act and Rule 10b-5. Those  
19 provisions prohibit the use of fraud in connection with  
20 the purchase or sale of any security. Respondent --

21 QUESTION: Mr. Roberts, could you clarify for me  
22 what the government's position is in this case?

23 Suppose -- suppose that the broker had not, when  
24 he sold the stock, intended to embezzle but then he made  
25 the sale and the sale enabled his embezzling. After

1 selling it, he conceived the scheme to embezzle.

2 Is it the government's position that in that  
3 situation a 10(b) would still cover it?

4 MR. ROBERTS: That embezzlement would not be in  
5 connection with the prior sale under the theory that we  
6 are asking the Court to adopt here. But the SEC believes  
7 that it would be a violation of 10(b) under a different  
8 theory which isn't a necessary consequence of the one --

9 QUESTION: We don't have to agree with that to  
10 rule for you --

11 MR. ROBERTS: You don't have to agree with that  
12 to find a violation here.

13 QUESTION: Now, the SEC adjudications that you  
14 rely upon, what kind of a situation do they involve? Do  
15 they all involve --

16 MR. ROBERTS: They involve both situations, Your  
17 Honor.

18 QUESTION: Both situations.

19 MR. ROBERTS: Both situations.

20 QUESTION: Does the SEC routinely audit brokers'  
21 accounts or do spot audits to ensure compliance with the  
22 theory you are suggesting here or are they just reactive  
23 when they find out about a firm?

24 MR. ROBERTS: I am not aware that they routinely  
25 audit the brokers. The NASD does do that and then refers

1 matters to the SEC and consults with the SEC. The SEC  
2 also would respond to complaints that they got or take  
3 investigations if they had reason to believe it was called  
4 to their attention.

5 QUESTION: And I take it that if the NASD tells  
6 the SEC of the existence of a fraud, the SEC can then  
7 request the United States Government to prosecute if there  
8 is a wire fraud or --

9 MR. ROBERTS: They could request a prosecution,  
10 Your Honor, but it's important that the SEC is the federal  
11 agency that's charged with maintaining the integrity of  
12 the markets and investor confidence in the markets, have  
13 direct authority to prevent and to pursue the kind of  
14 fraud that's involved here which is very -- potentially  
15 very unsettling to the markets.

16 Because since most transactions are made through  
17 brokers, if customers and investors can't trust their  
18 brokers to be executing their transactions for the  
19 customer's benefit rather than for the broker's benefits,  
20 the markets can't function effectively.

21 QUESTION: Well, do you say then that any fraud  
22 by a broker in connection with a customer is actionable by  
23 the SEC.

24 MR. ROBERTS: That goes back to the question  
25 that Justice Scalia asked me, Your Honor. And under the

1 theory that we are advocating here, and for the Court to  
2 rule for us here, you don't need to conclude that. The  
3 SEC does take that position.

4 QUESTION: Does take what position?

5 MR. ROBERTS: That any fraudulent conversion by  
6 a broker from a brokerage account is a violation of 10(b)  
7 because it's fraud and it's in connection with the  
8 purchase or sale of securities; because the very purpose  
9 of the brokerage account is to buy and sell securities.  
10 And the broker has access to the customer's assets --

11 QUESTION: That's quite a leap --

12 MR. ROBERTS: -- for the purpose of --

13 QUESTION: That's a leap from any case we've  
14 ever decided.

15 MR. ROBERTS: That is beyond any case that I'm  
16 aware that you have decided. But here the broker actually  
17 converted the securities by means of fraudulent sales.  
18 And his deception not only caused the sales, it was  
19 material to the sales. And the sales themselves, because  
20 they were fraudulent, coincided with and completed the  
21 fraud.

22 And that's very much in tune -- that's really  
23 controlled by past cases of the Court. For instance in  
24 the Bankers Life case, the Court held that corporate  
25 fiduciaries violated Section 10(b) when they deceived the

1 corporation into believing that it would receive the  
2 proceeds of the securities that the corporation sold.

3 QUESTION: But there were misrepresentations  
4 about a particular security. That didn't happen here.

5 MR. ROBERTS: There wasn't a misrepresentation  
6 in Bankers Life about a particular security, there was a  
7 misrepresentation that the corporation would receive the  
8 proceeds. And there was that same misrepresentation here,  
9 Your Honor, only it was by way of an omission or a course  
10 of conduct rather than an affirmative statement.

11 Because the customers had entrusted Respondent  
12 with the authority to trade on their behalf, with the  
13 understanding and the implicit representation that he  
14 would trade on their behalf and that they would receive  
15 the proceeds of the sales, that they would be used for  
16 their benefit in other trades when --

17 QUESTION: So in this case the fraud could have  
18 been avoided under your theory if the broker had gotten in  
19 touch with the clients and said I'm going to sell this but  
20 I'm going to use the money for myself. That would have  
21 turned it from fraud under 10(b) into theft.

22 MR. ROBERTS: That would have turned it from  
23 fraud into theft. It would have also been a breach of his  
24 fiduciary duty if he went ahead and they didn't authorize  
25 him. But just like in O'Hagan --

1 QUESTION: But it wouldn't have been fraud.

2 MR. ROBERTS: It wouldn't have been fraud if  
3 there was no deception. It's critical to a 10(b)e  
4 violation that there be deception of some kind.

5 QUESTION: Mr. Roberts, there's one point in  
6 your reply brief that I didn't quite grasp. This action  
7 is brought by the SEC.

8 MR. ROBERTS: Yes.

9 QUESTION: And it hinges on the wrong that was  
10 done to the customer. Could the customer bring this very  
11 lawsuit, could the customer have sued the broker for a  
12 10(b) violation?

13 MR. ROBERTS: In this circumstance, yes, the  
14 customer could have brought a private action against the  
15 broker, Your Honor. That wouldn't be true in every  
16 circumstance because the customer, a private plaintiff  
17 seeking damages has to prove elements of a violation in  
18 addition to what the SEC must prove.

19 A customer has to show causation of the  
20 transaction and loss or damages to the customer. The  
21 customer also has to be an actual purchaser seller. In  
22 the situation where there's a sale by the broker of the  
23 customer's securities, the purchaser-seller requirement  
24 will be met.

25 But there might not be the damages that are



1 necessary unless the broker follows through with his  
2 scheme to misappropriate the proceeds of the sale.

3 QUESTION: But this time he did.

4 MR. ROBERTS: But he did.

5 QUESTION: There's another curiosity in this  
6 case. There was a prosecution for wire fraud, the  
7 restitution sought was \$10,800. And now the SEC is going  
8 after the broker for a much larger sum. Why wasn't a  
9 greater sum asked in the wire fraud case?

10 MR. ROBERTS: I don't know, Your Honor, why the  
11 restitution award in the criminal action was limited to  
12 \$10,000. But it's clear that Respondent, it's clear from  
13 the allegations in the complaint and also from the  
14 criminal trial that Respondent did embezzle far more than  
15 that amount of the Woods' assets.

16 And that's one of the reasons that it's  
17 important for the SEC to be able to pursue this action.  
18 Because if it had to rely on the criminal action, then  
19 there wouldn't be a full disgorgement of the improper  
20 gains by the broker. And there would be far less  
21 deterrent to this kind of activity. Of course a criminal  
22 prosecution is significant deterrent, but --

23 QUESTION: Mr. Roberts, did the allegations of  
24 your complaint in this case accord with the narrower  
25 theory that you now say is enough to decide this case?

1 That is to say, as I read your description of the  
2 complaint, it did not say that the sales of the security  
3 were made with the intention at the time the sales were  
4 made of absconding with the proceeds. All it said is that  
5 he sold the securities and stole the funds.

6 MR. ROBERTS: It does -- it does comport with  
7 our theory, Your Honor. It doesn't in so many words  
8 allege the intent at the time. But the factual  
9 allegations in the complaint necessarily give rise to that  
10 inference. Because, first, one of the allegations is that  
11 Respondent issued checks to himself on the mutual fund  
12 account and that the cashing of those checks caused the  
13 sales.

14 And so when he took the money, he necessarily by  
15 writing the checks to himself, he necessarily had the  
16 intent at the time. And then there are additional  
17 allegations --

18 QUESTION: Wait. Excuse me. He wrote the  
19 checks before the sales were made?

20 MR. ROBERTS: In the -- in the mutual fund  
21 checks, if you look at Page 28A, of the petition, in  
22 paragraph 16 of the complaint, it describes the beginning  
23 of the fraudulent scheme in May of 1988, shortly after Mr.  
24 Wood was hospitalized as a result of his stroke, and notes  
25 that between May and June 1988, Zandford, without the

1 prior knowledge or consent of Wood and Okstulski, issued  
2 three checks to himself totaling \$41,000.

3 The checks were drawn on a joint mutual fund  
4 account held by Wood and Okstulski outside of their  
5 Dominick account, and the funds represented therein were  
6 obtained through the sale of mutual fund shares --

7 QUESTION: It doesn't say they were later  
8 obtained. It just says they were obtained. I don't see  
9 that that says that the funds weren't there until the --  
10 until the checks were written.

11 MR. ROBERTS: I think the way that that kind of  
12 account works is that it's like a checking account with  
13 your mutual funds. You write the check, you write the  
14 checks on the account and the redeeming of the check  
15 causes the sales of the mutual funds. But regardless of  
16 whether it precisely states that, that's certainly a  
17 reasonable inference or facts that can be proved based on  
18 these allegations which is all that's necessary to get  
19 past the dismissal of the complaint, Your Honor.

20 And in addition on the other allegations on the  
21 next page and the paragraphs on the next page, there are  
22 description of repeated sales and repeated conversions  
23 over a long period of time. And, you know, one time maybe  
24 he formed the intent after the sales, although that's  
25 unlikely given that this happened after the allegations in

1 the previous paragraph. But 13 more times, Your Honor, I  
2 think that it's hard to believe.

3 QUESTION: Who gets the recovery, Mr. Roberts?

4 MR. ROBERTS: The recovery goes to the -- to the  
5 government, but the SEC has a policy of if there are  
6 identifiable victims to endeavor to give the victims those  
7 -- those funds and to make them whole if they are  
8 available. So here where there are identifiable victims,  
9 they would do that.

10 QUESTION: Well, isn't it a little odd, you have  
11 two different branches of the government, perhaps not  
12 branches, but two different proceedings, one a criminal  
13 proceeding which authorizes restitution. And in that  
14 proceeding the decision was made that \$10,000 would be  
15 allowed, awarded in restitution.

16 Then the SEC comes along and says, no, that  
17 wasn't enough. We want to get, you know, several hundred  
18 thousand more.

19 MR. ROBERTS: Well, the restitution, first of  
20 all, the purposes of restitution and disgorgement are  
21 different in that one is aimed on the -- is focused on the  
22 making whole the loss to the -- to the people that are  
23 injured, whereas the other is aimed at requiring the  
24 wrongdoer to disgorge any benefit that he got from the  
25 scheme.

1           But in addition, Your Honor, the statute  
2 provides for a civil action and gives the SEC the power to  
3 do that in order to further its role in ensuring the  
4 integrity of the markets and ensuring investor confidence  
5 in the markets. And it empowers the SEC rather than the  
6 individual U.S. attorneys to determine when it's necessary  
7 to ask for that kind of a remedy in order to further those  
8 purposes. And the SEC properly made that determination,  
9 made that determination here.

10           QUESTION: Well, just to explore the point, is  
11 there anything in the record to show that these victims  
12 lost only \$10,000 and that the broker just made all the  
13 rest by churning --

14           MR. ROBERTS: No. Their record I think  
15 establishes that they lost everything that they had  
16 entrusted to him which was 420 roughly, thousands of  
17 dollars' worth.

18           QUESTION: Mr. Roberts, isn't it the case  
19 sometimes in criminal proceedings where restitution is  
20 ordered that full restitution is not ordered for a variety  
21 of reasons, the victim's family -- the defendant's family  
22 may have certain needs and the Court may decide, well, I'm  
23 just going to order a limited amount of restitution. Does  
24 that happen sometimes?

25           MR. ROBERTS: Yes, that certainly happens, Your

1 Honor. Thank you.

2 QUESTION: And if the family has needs, the SEC  
3 doesn't have to worry about it, I take it?

4 MR. ROBERTS: Well, the SEC does its own  
5 balancing of what's appropriate to further the interests  
6 and it asks for a disgorgement which is an equitable  
7 remedy. And the Court takes into account those concerns  
8 in deciding whether to award it. And here the District  
9 Court did determine that it was appropriate to award  
10 disgorgement in the amount of \$343,000.

11 QUESTION: It is odd that there was no kind of,  
12 apparently no cooperation here, that the criminal case  
13 goes on for that limited amount and then the SEC comes in  
14 after. Don't the relevant prosecutors talk to each other  
15 in advance about a case like this?

16 MR. ROBERTS: Yes, they do talk to each other.  
17 But the decision, Your Honor, whether to bring the  
18 prosecution and what to charge and what to ask for is the  
19 decision of the prosecutors, whereas the decision of what  
20 is appropriate to pursue as a civil action in order to  
21 further the purposes of the securities laws is the  
22 responsibility of the SEC.

23 And if the two arms don't necessarily agree that  
24 that can all be done in a criminal proceeding, then  
25 sometimes a civil proceeding is necessary to accomplish

1 the goals and --

2 QUESTION: The SEC is an independent regulatory  
3 agency, isn't it?

4 MR. ROBERTS: Yes, it is.

5 QUESTION: So it's not within the control of the  
6 President?

7 MR. ROBERTS: Um --

8 QUESTION: So if the Justice Department  
9 disagrees with the SEC, the SEC can still go off on its  
10 own. Is that the way the scheme works in theory?

11 MR. ROBERTS: Well, in theory, Your Honor, yes.  
12 Although here in the Supreme Court the Solicitor General  
13 represents the SEC. And in order for the SEC to come  
14 here, the Solicitor General has to authorize the action.

15 QUESTION: Is there any limit, if we have a  
16 broker, a licensed broker, is there any limit at all or  
17 just any fraud by a licensed broker falls within 10(b)?

18 MR. ROBERTS: Well, again, I'd like to reiterate  
19 that to decide this case and under the theory that we are  
20 advancing here, you don't need to reach that. But even  
21 under the other theory that I alluded to, there are limits  
22 to what would be covered.

23 For instance a broker could defraud customers by  
24 convincing them to pursue an investment advisory  
25 relationship. And that would not be -- that would not

1 necessarily be covered.

2 In addition, the broker might defraud the  
3 customers of assets that are outside of the brokerage  
4 account and that aren't securities because the broker has  
5 developed a relationship of trust with the customer. That  
6 wouldn't be covered under the other theory.

7 In addition, the broker, I guess it's a similar  
8 thing, the broker could defraud the customer into making  
9 some other kind of investments, real estate investments,  
10 because of the relationship of trust that had developed.

11 But the SEC has consistently taken the position  
12 that with regard to brokerage accounts and the brokerage  
13 relationship that involves the purchase or sale of  
14 securities and that exists for the purpose of the purchase  
15 or sale of securities, that it is a violation when the  
16 broker defrauds its customer.

17 QUESTION: Suppose the -- suppose Zandford were  
18 not a licensed broker, he just was pretending to be a  
19 broker but he wasn't at all. He went to these people and  
20 said, I'm a broker, give me your money; and the same thing  
21 happened?

22 MR. ROBERTS: That would still be -- and then he  
23 -- they gave him the money and he purchased securities and  
24 then sold the securities?

25 QUESTION: Yes, but he's not licensed to sell



1 any.

2 MR. ROBERTS: That would still be a violation,  
3 Your Honor, because he would have the same fiduciary  
4 relationship with them by virtue of them making him their  
5 agent for securities transactions and entrusting their  
6 assets to him to engage in securities transactions. And  
7 when he sold for the secret purpose of misappropriating  
8 the proceeds rather than for their benefit, and he did not  
9 disclose that he was doing that, he would be deceiving  
10 them in connection with the sale of securities, just as  
11 Mr. Zandford did here. And that would be a violation  
12 under these circumstances.

13 If there are no further questions, I would like  
14 to reserve the remainder of my time for rebuttal.

15 QUESTION: Very well, Mr. Roberts. Mr.  
16 Goldblatt, we'll hear from you.

17 ORAL ARGUMENT OF STEVEN H. GOLDBLATT  
18 ON BEHALF OF THE PETITIONER

19 MR. GOLDBLATT: Mr. Chief Justice, and may it  
20 please the Court:

21 We do not dispute, I don't think it can be  
22 disputed, that this conduct obviously is covered by any  
23 number of laws, civil, criminal, state, federal, the rules  
24 of this self-regulatory organization, and the Court below  
25 recognized that as well. But it treated the question of

1 whether or not Mr. Zandford was also liable under Section  
2 10(b) as a different question requiring a specific proof.  
3 And it is that proof that the Court found wanting.

4 In that regard, I think it's also important that  
5 one of the pivotal factors in our theory of the case was  
6 that this was a discretionary account. And the SEC was  
7 relying on the bare facts alleged in the wire fraud  
8 indictment to prove its case. And under those  
9 circumstances, there was no investment decision being made  
10 by the victims in this case.

11 And we argued to the Court below and we submit  
12 to this Court that that's a pivotal distinction in 10(b)  
13 context. Because 10(b) deals with investment decisions.  
14 And if no one is being defrauded in the decision they are  
15 making as to the purchase or sale, all that leaves the SEC  
16 with in this case is the conversion of the proceeds.

17 QUESTION: Well, the District Court granted  
18 summary judgment in favor of the SEC as I understand it.

19 MR. GOLDBLATT: That's correct.

20 QUESTION: And the Court of Appeals reversed and  
21 in effect granted summary judgment for Mr. Zandford.

22 MR. GOLDBLATT: That's also correct.

23 QUESTION: So you have to take the allegations  
24 in the complaint as true at that point I think, don't you?

25 MR. GOLDBLATT: Mr. Chief Justice, we don't

1 think so, because those allegations were not being  
2 considered by the Court of Appeals. I think the SEC at  
3 various points has indicated in its pleadings that the  
4 facts alleged in the indictment were the same as the  
5 complaint, and that may have caused part of the problem.  
6 But the only facts alluded to by the Court of Appeals as  
7 you indicated is in effect granting summary judgment to  
8 the non-moving party.

9 In that regard, there's no reference at all in  
10 the opinion of the Court of Appeals referring to any of  
11 the facts in the complaint. They refer to the indictment.

12 QUESTION: Well, should there have been some  
13 reference to the facts in the complaints since they were  
14 about to render summary judgment against the SEC?

15 MR. GOLDBLATT: That may well be the case. The  
16 problem we have with that is the question of issue  
17 preservation. When the SEC petitioned for rehearing,  
18 ordinarily -- in the ordinary case, if you reverse an  
19 order granting summary judgment, you obviously don't grant  
20 summary judgment to the non-moving party; you remand for  
21 further proceedings.

22 But when the SEC moved for rehearing and  
23 rehearing en banc, it did not raise the issue with the  
24 Court as to why it had remanded with instructions to  
25 dismiss. So on this record you really don't know what the

1 reasoning of the Court of Appeals was.

2 QUESTION: But wouldn't they have to, Mr.  
3 Goldblatt? This -- a complaint to be thrown out when  
4 there's been nothing beyond the complaint doesn't --  
5 mustn't you listen to the facts as pled in the complaint?

6 MR. GOLDBLATT: Justice Ginsburg, my point is,  
7 is that the question that I think that is presented in  
8 this case is whether the SEC by its own actions limited  
9 itself to the facts asserted for purposes of summary  
10 judgment which were the facts in the indictment.

11 Now, if the Court of Appeals is operating under  
12 the assumption that that was their case, it could, if that  
13 was their case and it was clear that was what it had to  
14 consider, if it concluded those facts were insufficient as  
15 a matter of law, that would be the only rationale in light  
16 of its opinion which only considered the facts in the  
17 indictment.

18 QUESTION: But the government's petition here  
19 sets forth some facts. The stockbroker sells his  
20 customers for his own benefit. And so it -- and in your  
21 brief in opposition you didn't challenge that question,  
22 did you?

23 MR. GOLDBLATT: Yes, I did.

24 QUESTION: You did? What did you say?

25 MR. GOLDBLATT: I challenged the -- in our brief

1 in opposition, we challenged any consideration of any  
2 facts beyond the indictment, that any issue with regard to  
3 facts in the complaint were not before the Court of  
4 Appeals and were not relied on by the SEC.

5 QUESTION: But that just seems weird in a way.  
6 I mean, this is a civil action. And to insist that it be  
7 tried on the facts and an indictment in the criminal case  
8 as opposed to as alleged in a complaint in this very case  
9 seems odd.

10 MR. GOLDBLATT: I absolutely agree. But the  
11 question is not so much whether that was of the making of  
12 the Court of Appeals or whether that was of the making of  
13 the SEC. And I think it was the Court's understanding  
14 that that was the SEC's position, that they were narrowing  
15 themselves to the indictment, and that's what the Court  
16 considered.

17 But regardless, even with the facts, I mean, if  
18 I'm wrong on that, regardless of the facts even with the  
19 facts that the SEC relies on from the complaint, you  
20 essentially have the same problem.

21 And again, it's not a question of whether this  
22 conduct is covered. It's covered under the broker rules.  
23 But for purposes of 10(b) as the SEC now concedes, this  
24 would also affect private actions.

25 And in that regard, these facts simply do not

1 meet the paradigm for a 10(b) violation which is either  
2 that somebody is duped into buying or selling a security,  
3 a particular security, because that's the paradigm for the  
4 statute, or in limited circumstances such as a case like  
5 O'Hagan, where it affects market integrity, the Court has  
6 also found liability. But that's in a situation --

7 QUESTION: Suppose that the customer comes to  
8 the broker and says, here's 100 shares of the ABC Company,  
9 sell these shares for me and put the money in your broker  
10 account. And the broker, before he sells, has the intent  
11 to take the money for the broker's own account. Is there  
12 a fraud under your theory?

13 MR. GOLDBLATT: Under that theory, I would  
14 submit there is a fraud. That is unauthorized to take the  
15 money in that situation and he's duped into turning over  
16 the securities to the broker, and there is an investment  
17 decision being made. But you have a particular --

18 QUESTION: No. No. He's made the investment  
19 decision in my hypothetical. He said, I don't want your  
20 advice about selling. You sell these things. I'm  
21 directing you to do that.

22 MR. GOLDBLATT: In that circumstance, if he then  
23 sells the security and places it in the account, then he  
24 has completed the instructions. But if he sells the  
25 security and converts it to his own use, then I believe

1 you don't have in that situation, in other words, if those  
2 are the instructions from the client to the broker -- I  
3 correct myself. That would not be a 10(b)e violation.

4 It will be a violation of the broker rules. It  
5 will be a conversion. It will be a criminal act. But  
6 there will be no fraud. He will have carried out the  
7 instructions to sell the stock. There's no inducement  
8 there to sell --

9 QUESTION: Well, only in really a Pickwickian  
10 sense of the term. He carried out the instructions to  
11 sell the stock but he keeps the money. Nobody would  
12 construe the instructions that way.

13 MR. GOLDBLATT: Understood. But nor were -- the  
14 instructions were to sell the stock. He is not being  
15 duped into selling the stock. That is exactly what he  
16 wanted done. What he's being duped into is the proceeds  
17 are being converted. But the difference with Bankers Life  
18 is that the 10(b) violator in that case actually goes to  
19 the person and says we should sell this, with the intent  
20 of diverting the proceeds.

21 That person is duped into believing by the actor  
22 that they are making the sale with the understanding that  
23 they will get the proceeds. Again it -- for purposes  
24 of --

25 QUESTION: How does that differ from here? I

1 thought here that what our facts that we are assuming are  
2 that the stockbroker says to the client, I have control of  
3 your account and I'll sell for your benefit. That's the  
4 implicit instruction.

5 The client says sell for my benefit. And here  
6 the stockbroker sells for his own benefit. What's the  
7 difference between that case which is this one, and the  
8 one Justice Kennedy is submitting?

9 MR. GOLDBLATT: I think the difference is for  
10 purposes of the 10(b) paradigm it requires that the sale  
11 be induced by the broker for fraudulent reasons. If all  
12 he's doing is converting the proceeds --

13 QUESTION: But here we also have, as they have  
14 emphasized about 50 times, not simply stealing. What we  
15 have is a sale of stock where the stockbroker has the  
16 intent when he sells the stock to keep the money, contrary  
17 to what the implicit assumption is about what the client  
18 wants.

19 Now, that seems to be a little extra thing here  
20 so we don't have to reach all these broad issues. Now,  
21 what do we -- that's what I find indistinguishable.

22 MR. GOLDBLATT: Justice Breyer, here is the  
23 distinction that I would draw. In the Bankers Life  
24 situation where you have the sale induced, the 10(b)  
25 violation is complete when the sale is made.



1           In the situation you describe, until and unless  
2 the broker, having followed the instructions and sold the  
3 stock, until and unless he actually converts the proceeds  
4 to his own use, you don't have a 10(b) violation.

5           QUESTION: Why don't you? I mean, if we could  
6 ever prove it? Suppose in fact the broker, because we had  
7 a mind-reading machine, sold the stock in order to convert  
8 the proceeds, puts the money in the account and then dies.  
9 I mean, you know, it's a little weird, but nonetheless if  
10 we could ever prove such a thing, why wouldn't that be a  
11 violation of 10b-5?

12           MR. GOLDBLATT: Because until and unless he  
13 actually converts the proceeds, he hasn't violated 10(b).  
14 He has not done anything against his client's  
15 instructions.

16           QUESTION: He hasn't? He has converted -- he  
17 has sold the shares, contrary to the instruction, sell  
18 them for my benefit, for his own benefit.

19           MR. GOLDBLATT: My point is that until he  
20 actually converts, while that money is still in the  
21 account, while the stock has been sold consistent with the  
22 directions, until and unless he actually converts the  
23 proceeds to his own use, he has not violated 10(b).

24           QUESTION: But what about, never mind the taking  
25 of the proceeds. Suppose you have a broker who for some

1 reason because he has an interest in a company or  
2 something else sells stock in a customer's account where  
3 it didn't really make sense to sell it.

4 The only benefit from selling it is a benefit  
5 for the broker himself. His brother-in-law is with a  
6 company that would profit from this sale of the stock.  
7 Would that be covered by 10(b)?

8 MR. GOLDBLATT: I think that would be covered by  
9 10(b).

10 QUESTION: Well, why isn't that the same  
11 situation here? Because this sale was not a sale -- never  
12 mind the later theft -- the sale was not a sale for the  
13 benefit of the customer which is what he's promised to do.

14 He's promised, I'll manage these stocks for your  
15 benefit. And here he sells them when the customer's  
16 interest did not call for a sale. The only reason the  
17 sale happened is that the broker had his own interest in  
18 mind.

19 MR. GOLDBLATT: Justice Scalia, the reason why  
20 that doesn't work here is because as the Court of Appeals  
21 found, there's no evidence in this record to establish  
22 that the sales themselves were inconsistent with the  
23 client's interests. Regardless of what Zandford may have  
24 been thinking, the evidence simply showed that they were  
25 sold. He has discretionary power to do it --

1           QUESTION: Well, does it have to be  
2 inconsistent? Do you have to prove that they were  
3 inconsistent with the interest or is it enough to prove  
4 that the broker did not act in the customer's interest?  
5 Isn't that enough for the breach of the fiduciary duty?  
6 Even if it turns out that, what do you know, it was a good  
7 idea to sell, the market crashes, nonetheless he was  
8 guilty of a fiduciary breach if he didn't sell it because  
9 he thought it would help the customer but he thought it  
10 would help him. Wouldn't that be a breach right then and  
11 there?

12           MR. GOLDBLATT: It might be a breach of  
13 fiduciary duty in the trust sense. It does not affect the  
14 sale unless you can establish that the sale is  
15 unauthorized, it is inconsistent with the client's  
16 interest.

17           QUESTION: It is unauthorized. I didn't  
18 authorize him to sell stock for his benefit. The whole  
19 idea was he was supposed to sell it for mine.

20           MR. GOLDBLATT: But the sale itself was  
21 authorized. The only point I'm bringing out is in a  
22 situation like Bankers Life where the broker induces the  
23 sale with fraudulent intent, you have a complete violation  
24 when the stock is sold. It makes no difference after that  
25 whether the broker is successful or unsuccessful in

1 diverting the proceeds. You have established a fraudulent  
2 sale in which an investor's decision has been induced by  
3 fraudulent intent.

4 In the situation where the sale is authorized,  
5 either because the client calls the broker and says I want  
6 you to sell XYZ Corporation today, and the broker does  
7 that --

8 QUESTION: That one I agree with.

9 MR. GOLDBLATT: In that situation, regardless of  
10 what the broker is thinking, he may be thinking I'm going  
11 to take the money and run.

12 QUESTION: But that isn't what happened here.  
13 The customer didn't call up and say sell.

14 MR. GOLDBLATT: No, but --

15 QUESTION: The broker has authority to sell but  
16 he has authority to sell in the interest of the client.  
17 And no interest of the client called for the sale of these  
18 securities. The only thing that called for the sale of  
19 the securities was without selling them, I can't get the  
20 money to steal.

21 MR. GOLDBLATT: Justice Scalia, in that regard  
22 we point to two decisions from the 7th Circuit in O'Brien  
23 and Congregation that deal with discretionary accounts.  
24 And when a client turns money over to an investment  
25 counselor or broker and says, you make the decisions, I'm

1 giving you blanket authority, and that's what we have in  
2 this record; in that situation, that takes you out of the  
3 10(b) paradigm

4 QUESTION: Well, it's true in effect that not  
5 every breach of fiduciary duty is a fraud.

6 MR. GOLDBLATT: That's correct. Not every  
7 breach of fiduciary duty is a fraud, and not every breach  
8 of fiduciary duty will violate 10(b).

9 QUESTION: But in your paradigm, you are saying  
10 the authorization is induced by fraud and that's crucial.  
11 But in -- why don't you have the equivalent of it here?

12 Because what you have here is a continuing  
13 authorization. There is an authorization generally given  
14 at the beginning and the theory is that that authorization  
15 continues so that at every moment subsequent to that the  
16 client is saying yes, you may sell these things or buy as  
17 you see fit for my benefit, so that at any moment at which  
18 the client remains silent and allows that authorization to  
19 continue, if at that moment the broker has formed the  
20 intent, which you would take to be sufficient, why doesn't  
21 that function in the same way as the authorization  
22 specifically induced?

23 The client is being quiet and he's continuing  
24 the authorization because the broker is implicitly lying.

25 MR. GOLDBLATT: Justice Souter, my answer to

1 that is this: If it is shown, in other words, assuming  
2 you have a discretionary account to invest conservatively,  
3 if a broker then goes and buys a penny stock, that is  
4 outside the scope of the discretionary authorization and  
5 it would be a violation of 10(b). What the --

6 QUESTION: Well, it's outside of the  
7 authorization at the beginning because the authorization  
8 under no circumstances covered that kind of a sale.

9 MR. GOLDBLATT: Yes, it was outside the scope of  
10 the authority.

11 QUESTION: But the term of the authorization  
12 that I'm saying is crucial, and what I thought you were  
13 saying is crucial in the case that you succeed is the term  
14 of the authorization that in effect says, you may sell  
15 this stock for my benefit. And you are saying if a  
16 specific decision to that effect is induced by fraud,  
17 that's enough. It gets you within the rule.

18 And I'm saying if a continuing decision, a  
19 decision evidenced by the client's silence is induced,  
20 that should be sufficient too.

21 MR. GOLDBLATT: And one of the things that the  
22 Court of Appeals found here was that that was not  
23 established. With regard to the various sales, when these  
24 checks were written, the Court concluded there was nothing  
25 in the record to conclude that those sales --

1           QUESTION: Okay. Then maybe this case should  
2 come out your way. But as a matter of theory, isn't it  
3 the same case whether it's a continuing authorization or  
4 an authorization which is specifically induced?

5           MR. GOLDBLATT: In either situation if you can  
6 show that the sale itself is a violation of that  
7 authorization or a breach of it, yes. But in this case  
8 the Court was very careful on that in saying not only that  
9 this was a discretionary account, but in light of the  
10 allegations in the indictment there was just no proof in  
11 the record that any of these sales were in violation --

12           QUESTION: Yes, but you are going back to the  
13 indictment and ignoring the complaint.

14           MR. GOLDBLATT: Even with the complaint there's  
15 really nothing in the complaint that they are relying on  
16 other than the mutual fund account, and again --

17           QUESTION: Well, the course of conduct, one  
18 transaction after another is relevant; isn't it?

19           MR. GOLDBLATT: Not given the time factor. And  
20 we are not talking -- the time factor is actually from  
21 March of '88 to September of '90. And in that regard  
22 there's just nothing in the record -- we don't even know  
23 what the securities were that were bought or sold. And  
24 that's the problem with their theory of this case. It's  
25 overarching in where it goes.

1           There's no proof that any of these sales were  
2 not consistent with the authorization, were not in the  
3 client's interests. And they didn't attempt to prove it.

4           QUESTION: In the case of churning --

5           QUESTION: Well, is there any proof that any of  
6 the proceeds were ever given to the owner of the  
7 principal?

8           MR. GOLDBLATT: The proof is that the proceeds  
9 go to three contracts that were determined by the jury in  
10 the wire fraud case to be fraudulent that are agreements  
11 that were between Zandford and the clients. One was a  
12 personal loan, one was an investment that the Court  
13 determined to be fraudulent. That's where the fraud takes  
14 place. That's where the conversion takes place, not  
15 sooner, under our theory and under what the Court found.

16           QUESTION: You say that there's no evidence that  
17 the sale was made for the fraud. But if as the government  
18 says, some of these sales were made to cover a check  
19 written on the account, the sale would not have occurred  
20 had the check not been written. And that check he wrote  
21 to himself or to one of these contract accounts. Doesn't  
22 that make it automatic that the sale occurred in order to  
23 get the money to pay him?

24           MR. GOLDBLATT: I don't believe so, Justice  
25 Scalia. And I don't believe that was their theory in the



1 indictment. The checks were written on the account but he  
2 had authority to do that. There's no --

3 QUESTION: Fine.

4 MR. GOLDBLATT: -- indication that was wrong --

5 QUESTION: And is the writing of the check what  
6 caused the sale?

7 MR. GOLDBLATT: Positions were liquidated in  
8 order to pay the checks.

9 QUESTION: Right.

10 MR. GOLDBLATT: But there's no indication that  
11 those sales were not a deliberate decision to sell those  
12 securities at that point to take the money and put it into  
13 something else. There's nothing to indicate that that was  
14 unauthorized to do that. Because we don't know what the  
15 thoughts were.

16 QUESTION: It was authorized?

17 QUESTION: I'm missing something. Why do you  
18 write the check first if all you intend to do is to take  
19 the proceeds and buy another stock for the client's  
20 benefit? It's the sequence of the check, I think, that's  
21 bothering me.

22 MR. GOLDBLATT: Well, the sequence of the check  
23 is to take the money out of the account and invest it  
24 otherwise, which is why you would do it that way or could  
25 do it that way. But we know very little about it. But

1 there's nothing --

2 QUESTION: Doesn't it matter who the check is  
3 written to? I mean, I presume these checks that the  
4 government was referring to were not checks sort of  
5 payable to the mutual fund to buy more stock or payable  
6 for the purchase of other stock. It was simply payable to  
7 the broker; wasn't it?

8 MR. GOLDBLATT: Well, it was payable to the  
9 broker or accounts controlled by the broker. But as the  
10 evidence establishes in the record on affirming the appeal  
11 on the sufficiency of the evidence claim, the money went  
12 into other investments. And that's what Zandford's  
13 defense was. These were other legitimate investments and  
14 that's what I was doing with the money, and they knew  
15 about it and that's what that was.

16 QUESTION: So they can't -- you are saying they  
17 can't trace any proceeds necessarily from the checks drawn  
18 into Zandford's personal accounts or --

19 MR. GOLDBLATT: Well, they -- the way they  
20 describe it, it goes to accounts controlled by Zandford.  
21 So they do indicate that the conversion of the proceeds  
22 into other investments was fraudulent.

23 QUESTION: Well, let me just see what your  
24 theory is here. Suppose the way it works is that there's  
25 a mutual fund account and the broker decides, I want to

1 take this money for my own purposes to spend on a pleasure  
2 cruise. I write the check that causes the sale of the  
3 security. Under your theory, is there a 10b-5 violation?

4 MR. GOLDBLATT: If the writing of the check is  
5 unauthorized, it's going to be a 10b-5 violation.

6 QUESTION: Everybody knows he didn't -- the  
7 client didn't authorize the broker to take a pleasure  
8 cruise. That's my hypothetical.

9 MR. GOLDBLATT: Then it would be a 10b-5e  
10 violation. What the Court found lacking here was any  
11 evidence that the sale itself of the securities by the  
12 writing of the check established a 10b-5 --

13 QUESTION: But it's alleged properly. I mean, I  
14 read on Page 29A, in July -- there's a misprint in the  
15 paragraph, but in July 1998 Zandford without the prior  
16 knowledge or consent of -- must be of Wood -- sold three  
17 securities in the Wood account for a total of \$145,000.  
18 What their claim is, is that without the client's consent,  
19 the broker sold the securities and then after that he used  
20 the proceeds for himself. All right. Now, on your  
21 theory, that alleges a violation of the securities law.  
22 Is that right?

23 MR. GOLDBLATT: Under my theory, that would  
24 allege it.

25 QUESTION: All right.

1           MR. GOLDBLATT: But the Court of Appeals  
2 found --

3           QUESTION: Fine. Then the correct thing of  
4 disposition in your view of this case, since the  
5 allegation is there, and since the Court of Appeals said  
6 that the criminal case didn't investigate this matter  
7 about whether it was or without the client's consent, your  
8 view is we should have a remand so that they can have a  
9 trial on the question of whether Mr. Wood did consent to  
10 the sale. Is that right?

11          MR. GOLDBLATT: No, Justice Breyer, that's not  
12 right.

13          QUESTION: Because?

14          MR. GOLDBLATT: Because two things. One, the  
15 Court of Appeals found that there was no evidence because  
16 it was a discretionary account, that there was anything  
17 unauthorized about it. There wasn't any consent needed.

18          QUESTION: Of course there was no evidence.  
19 That's because the government relied upon the criminal  
20 case. So the Court of Appeals says they are wrong to rely  
21 on that. Then as you pointed out at the beginning, the  
22 correct result is to send it back so now the government  
23 has a chance to put in other evidence, if you are right  
24 about what the evidence shows.

25          MR. GOLDBLATT: In the ordinary course I would

1 agree with that. All other things being equal, that would  
2 be the result. But if in fact the SEC by its litigation  
3 posture chose to rest exclusively on the criminal  
4 indictment, this other case --

5 QUESTION: You mean there is something in this  
6 record where the SEC says, by the way, if this criminal  
7 case does not provide sufficient evidence, we do not  
8 intend to put in any other evidence. Where does it say  
9 that?

10 MR. GOLDBLATT: It doesn't say that. There are  
11 representations that the criminal case is the same as the  
12 civil case. At the time of our argument in this case, we  
13 argued to the Court that if this is all they have, if the  
14 criminal indictment is -- yes, in the Court of Appeals.  
15 If this is all they have, then there's nothing to send it  
16 back for. Because this evidence in the criminal case --

17 QUESTION: You mean it's going to be agreed that  
18 there is no doubt that this retarded individual of a very  
19 advanced age agreed that his securities would be sold for  
20 the purpose of the broker running off with the money?

21 MR. GOLDBLATT: Justice Breyer, I think that --

22 QUESTION: I say that with some sarcasm in my  
23 voice, because it sounds to me incredible.

24 MR. GOLDBLATT: Obviously these are very hard  
25 facts to argue. But my point is, he went to jail for

1 almost five years. It violates all sorts of rules,  
2 provisions, statutes, there's no question about this.  
3 This conduct is controlled. The Court of Appeals had no  
4 doubt about that. But a 10(b) violation is different.  
5 And also the SEC's litigation posture is different. If  
6 they are going to give up the facts in the complaint and  
7 argue the case on the indictment, in a strategical attempt  
8 to get the Court to rule the way they want, which is the  
9 broadest possible 10(b), then they have got to live with  
10 it. And when the fact --

11 QUESTION: That's for purposes of their  
12 affirmative motion for summary judgment. They could then  
13 say these facts are established. That's not a sufficient  
14 reason for granting summary judgment the other way around.

15 MR. GOLDBLATT: I absolutely agree, Justice  
16 Stevens, and our only point there is --

17 QUESTION: Therefore, we should not ignore the  
18 allegations of the complaint that go beyond the  
19 indictment.

20 MR. GOLDBLATT: The only objection I have to  
21 that is the fact that they sought rehearing and they  
22 sought rehearing and bond, and not one word was mentioned  
23 about a remand for dismissal. They were still arguing  
24 collateral estoppel and on the facts of the indictment we  
25 win outright. They did not even bring it to the attention

1 of the Court.

2 QUESTION: That's because they were trying to  
3 win outright.

4 MR. GOLDBLATT: That's right.

5 QUESTION: But that doesn't justify your winning  
6 outright.

7 MR. GOLDBLATT: When they file -- of course.  
8 There's no question that both sides agree that Bankers  
9 Life and O'Hagan control and we say it's clear we win.  
10 That's the normal case. But when they don't seek  
11 rehearing on that basis so this Court doesn't even know  
12 why the Court of Appeals did what it did, and when they  
13 file for certiori and don't raise that as a claim for  
14 reversing or --

15 QUESTION: Well, when you say we don't know the  
16 reason why the Court of Appeals did what it did, I mean,  
17 it wrote an opinion, which usually gives the reason why  
18 the Court of Appeals did what it did. Are you complaining  
19 that they didn't say anything on rehearing?

20 MR. GOLDBLATT: What I'm saying is when this  
21 comes up for the first time in the opinion of the Court of  
22 Appeals and they file for rehearing, and they don't even  
23 bring it to the attention of the Court so that the Court  
24 can determine whether there is something to be corrected  
25 or whether this is the Court's understanding from oral

1 argument that is what their case is.

2 QUESTION: You are saying that the government  
3 didn't raise this issue in their petition for rehearing to  
4 the Court of Appeals.

5 MR. GOLDBLATT: They did not even mention it.

6 QUESTION: Well, but I don't know that they have  
7 to. I mean, so long as they properly petition here, I  
8 don't know that you need have a petition for rehearing in  
9 the Court of Appeals.

10 MR. GOLDBLATT: Ordinarily I would absolutely  
11 agree, Mr. Chief Justice. But I think when it's something  
12 that comes up in the opinion from the Court of Appeals  
13 that on its face doesn't have any explanation that  
14 basically says instead of going back so you can prove your  
15 case, we're throwing it out completely, and they don't say  
16 a word to the Court of Appeals, that's the wrong remedy.  
17 I mean, that's the first thing --

18 QUESTION: But Mr. Goldblatt, the Court of  
19 Appeals decision didn't turn on issue preclusion, it  
20 turned on a notion that in order to have a violation of  
21 10(b) you had to have some kind of misleading about the  
22 merits of a certain security, something tied to the  
23 security, and not that they regarded this as a common law  
24 crime as theft.

25 MR. GOLDBLATT: The Court concluded --



1           QUESTION: I mean, the point they made was it's  
2 the same as if what was entrusted to the broker were a car  
3 and he sold the car for himself instead of the customer.

4           MR. GOLDBLATT: The point was that the  
5 securities were incidental to this fraud. They were not  
6 an integral part of it, and --

7           QUESTION: May I just interrupt with one. The  
8 question presented is whether when the stockbroker sells  
9 his customer's certain securities for his own benefit.  
10 Now, do we have to assume he sold them for his own benefit  
11 at the time the sale was made or are you saying in fact he  
12 sold them for his principal's benefit and later decided to  
13 appropriate the proceeds?

14          MR. GOLDBLATT: Justice Stevens, what I am  
15 saying is there is no proof in this record that at the  
16 time of the sales --

17          QUESTION: Well, maybe there's no proof but the  
18 question we are asked to decide is when he does it for his  
19 own benefit is it a violation of 10(b)4? That's what the  
20 question is.

21          MR. GOLDBLATT: I understand that, Justice  
22 Stevens, and --

23          QUESTION: And what's your answer to the  
24 question? Your answer to the question is he didn't do it.

25          MR. GOLDBLATT: My answer to the question is it

1 is authorized sale, either on the instructions of the --

2 QUESTION: Well, if it's a sale for his own  
3 benefit.

4 MR. GOLDBLATT: And at the same time it is also  
5 consistent with the client's instructions, until he  
6 converts, he has not violated 10(b).

7 QUESTION: Even though the sale was for his own  
8 benefit at the time he made the sale.

9 MR. GOLDBLATT: Even though he -- if it is for  
10 his own benefit -- in other words, it could be both at the  
11 same time. At the time of the sale, if the client calls  
12 you and says sell my XYZ stock, I want it sold today, and  
13 you sell it with the intent to convert the proceeds, that  
14 sale is not simply for the broker's benefit. It is  
15 consistent with the instructions. It is an authorized  
16 sale. Until and unless he actually converts the proceeds,  
17 he has violated nothing.

18 QUESTION: But when you say it is consistent  
19 with the instruction, you are assuming the instruction  
20 simply means you can buy or you cancel, whereas the  
21 argument is that the instruction is you can buy for my  
22 benefit or you cancel for my benefit. And if we accept  
23 the latter characterization as true, then even under your  
24 own theory, he was not making a sale that he was  
25 authorized to make.

1           MR. GOLDBLATT: I would disagree, Justice  
2 Souter. On this record it may well be that it was for his  
3 benefit, but I don't think you can conclude it was not for  
4 his client's benefit as well.

5           QUESTION: Mr. Goldblatt, before you sit down,  
6 would you say something about the fact that you have  
7 adjudications by the SEC that adopt the theory that they  
8 are arguing before us, why shouldn't we defer if the  
9 question is a close one?

10          MR. GOLDBLATT: As I understand it --

11          QUESTION: These are formal adjudications under  
12 the Administrative Procedures Act and they have ruled in  
13 accordance with the theory that the government is now  
14 arguing. Why isn't that entitled to deference?

15          MR. GOLDBLATT: Justice Scalia, assuming -- and  
16 because my time has run out -- assuming that Congress in  
17 fact delegated the discretion to the Agency, I don't think  
18 you can find in any of the various things that they rely  
19 on, any rule dealing with 10(b) or Section 10b-5 that  
20 speaks to the precise issues that are raised in this case  
21 or even close to them. What they do is they have rules  
22 that in 16 or so cases, or whatever the number, they have  
23 prosecuted for 10(b) violations brokers who convert. But  
24 they are not necessarily, as a matter of fact I don't  
25 recall any of them being discretionary accounts or

1 presenting the type of 10(b) analysis, fraud in connection  
2 with a purchase or sale of securities.

3 QUESTION: So you are saying we can defer it,  
4 but there's nothing to defer it to.

5 MR. GOLDBLATT: That is correct. Assuming there  
6 is deference, there's nothing to defer it to, and if there  
7 was, it would be a rule that they are ultimately asking  
8 for that a broker any time they convert from the account  
9 violates 10(b) and that would be arbitrary. That is not  
10 the way this rule is applied. It is applied on a careful  
11 case-by-case basis. So whichever way you go on that, I  
12 don't think it gets them the deference they seek. I would  
13 add, however, with the little time that I have left, that  
14 I do not believe they would get that deference.

15 On churning, Justice Ginsburg, just to get to  
16 that point, in a churning case, I think that is more the  
17 O'Hagan paradigm. You consummate the fraud through the  
18 sale itself. It is the sale that completes the violation.  
19 It is the sale that consummates the violation of fiduciary  
20 duty. That's the difference between here and a churning  
21 case.

22 Until and unless Zandford converts those  
23 proceeds, which is done through agreements that are  
24 outside the scope of the securities laws, he has not  
25 violated 10(b).

1           In a churning case, the sale itself consummates  
2 it and it meets the other conditions that are required in  
3 O'Hagan. That is a different situation and it is also  
4 established, of course, in that situation through the  
5 pattern of sales you have the proof that you don't have  
6 here, which is that those sales were not in the client's  
7 interests. If you cannot establish that they --

8           QUESTION: Thank you, Mr. Goldblatt.

9           MR. GOLDBLATT: Thank you.

10          QUESTION: Mr. Roberts. Mr. Roberts, the  
11 government wants the Court of Appeals reversed here, I'm  
12 sure. But does it want the summary judgment granted by  
13 the District Court for the SEC affirmed?

14          REBUTTAL ARGUMENT OF MATTHEW D. ROBERTS

15                   ON BEHALF OF THE PETITIONER

16          MR. ROBERTS: No, Your Honor, we didn't seek  
17 review of the reversal of the summary judgment. We sought  
18 review of a different part of the Court of Appeals  
19 opinion. After it reversed the summary judgment, it  
20 explained why it didn't think summary judgment could be  
21 granted, it went on to say that the allegations in the  
22 complaint didn't state a claim under 10(b). And that's  
23 what we want reversed.

24                   And the Court of Appeals relied on the facts in  
25 Page 8A of the petition. The Court of Appeals states in

1 the part of the opinion that's relevant here that the SEC,  
2 I'm in the middle paragraph of that page under the B, and  
3 I think it's the third sentence, says it, meaning the SEC,  
4 alleges that Zandford defrauded the Woods by failing to  
5 inform them that he intended to sell their securities in  
6 order to obtain the proceeds for himself.

7 So the facts that the Court of Appeals were  
8 considering are precisely the same facts that we are  
9 relying on here, Your Honor. And the --

10 QUESTION: Go ahead. I have a different  
11 subject. Finish this one.

12 MR. ROBERTS: Okay. I was just going say that  
13 the indictment is no different in any event, and on Page  
14 41A in paragraph 5 of the indictment it alleged that  
15 Charles Zandford caused checks to be issued against the  
16 security positions of William R. Wood and Diane Okstulski  
17 and made payable to Charles Zandford, thereby causing  
18 their securities to be liquidated.

19 QUESTION: But it doesn't say it was without  
20 their consent. Nowhere in the --

21 MR. ROBERTS: It says it was part of a scheme  
22 and artifice to defraud.

23 QUESTION: That's true. That's true.

24 MR. ROBERTS: So I think that pretty well  
25 encompasses that.

1           QUESTION: Mr. Roberts, we have apparently some,  
2 I would call it a factual disagreement, as to whether any  
3 adjudications by the SEC adopt the theory that you are  
4 arguing before us today. What are your best cases?

5           MR. ROBERTS: Okay. I would point to, on page  
6 36 of our brief we discuss the Southeastern Securities  
7 Corporation adjudication, Your Honor, from 1949, seven  
8 years after the SEC promulgated Rule 10(b).

9           In that case the facts were that the president  
10 and director of the brokerage firm sold the customer's  
11 securities without her knowledge or consent and converted  
12 the proceeds of the sale to his own use. And after  
13 explaining that there was a relationship of trust and  
14 confidence and that he had a fiduciary duty, the SEC  
15 addressed the argument that this conduct was authorized  
16 because he had discretion over the customer's affairs by  
17 virtue of a general power of attorney, and rejected that  
18 argument, noting that even assuming the power of  
19 attorney's validity, it didn't authorize this conduct  
20 absent a showing of full and specific disclosure to and  
21 understanding consent by the customer.

22           And then the Commission concluded that the  
23 stockbroker's taking and sale of the customer's securities  
24 and his use of the proceeds constituted a willful abuse of  
25 his trust and a violation of --

1           QUESTION:  When do you say Rule -- or Section  
2  10(b) is violated?  Let's assume that this scheme is  
3  discovered before he actually runs off with the money.  He  
4  sold the stocks in order to run off with the proceeds, but  
5  you get him before he runs off with the proceeds.  Has  
6  there been a violation --

7           MR. ROBERTS:  Yes.

8           QUESTION:  -- at the time of the sale?

9           MR. ROBERTS:  Yes.  There's a violation at the  
10 time of the sale.

11          QUESTION:  Okay.

12          MR. ROBERTS:  The discretionary authority  
13 doesn't make the sale authorized because he's authorized  
14 only to sell for the benefit of the customers.

15          QUESTION:  Well, I mean, it seems to me that's  
16 logical and that sort of makes me worry about -- about the  
17 great scope of litigation that we are inviting if you say  
18 civil actions not by the Commission but by individuals are  
19 also available under this theory.

20          Whenever a broker sells stock, he's always open  
21 to the charge that he wasn't doing it in my interest, he  
22 was doing it in his own, and you have a lawsuit.

23          MR. ROBERTS:  Two -- two points to address that  
24 concern, Your Honor.  First of all, as I was discussing  
25 with Justice Ginsburg earlier, when there is -- a private



1 action requires proof of damages. And if the broker  
2 doesn't follow through with his plan to convert the  
3 proceeds, there will be -- it will be frequently the case  
4 that the customer can't show damages and needs to be able  
5 to allege those as a required part of the action, couldn't  
6 bring it at all, end, case over.

7 QUESTION: Well, the stock's gone up. I mean,  
8 the stock that has been sold has gone up enormously.

9 MR. ROBERTS: Right.

10 QUESTION: And all the plaintiff has to allege  
11 is you really didn't sell it in my interest, you sold it  
12 because you were going to run off with the proceeds, and  
13 look what happened, the stock went way up.

14 MR. ROBERTS: No, Your Honor. Under the Private  
15 Securities Litigation Reform Act, the plaintiff has to  
16 state with particularity facts giving rise to a strong  
17 inference that the defendant acted with the requisite  
18 fraudulent state of mind.

19 QUESTION: Well, are you saying that every  
20 breach of fiduciary duty is a fraud under 10(b)?

21 MR. ROBERTS: No, Your Honor. Only secret or  
22 deceptive breaches of fiduciary duty are frauds.

23 QUESTION: What about a standard churning case?  
24 Aren't most breaches of fiduciary duty secret? I mean,  
25 you don't announce that you are breaching a fiduciary

1 duty.

2 MR. ROBERTS: Many of them, particularly  
3 breaches of the duty of loyalty will be secret, Your  
4 Honor. But not every breach of fiduciary duty is going to  
5 be -- is going to be secret or knowing. A breach of the  
6 duty of care wouldn't even be knowing necessarily. A  
7 breach of the duty of fairness as in the Santa Fe case  
8 where all the factors disclosed would not be deceptive,  
9 there would be no violation. But in O'Hagan, the Court  
10 explained that when the -- when a fiduciary pretends  
11 loyalty to the principal and instead embezzles the  
12 principal's property, that's a fraud. And that's a  
13 fraud --

14 QUESTION: What happens with standard churning  
15 cases?

16 MR. ROBERTS: This is -- this is just like a  
17 standard churning case, Your Honor. A churning case is  
18 one --

19 QUESTION: Well, is there authority that this is  
20 a 10b-5 violation --

21 MR. ROBERTS: Yes.

22 QUESTION: -- and it's a given or are we holding  
23 that in this case.

24 MR. ROBERTS: Well, you are not addressing  
25 churning because obviously that's not here. But I think

1 that the courts of appeal have unanimously concluded that  
2 churning is a violation. And that's because the broker  
3 who has control over the account and who's been entrusted  
4 with trading authority by the customer is making the  
5 trades, not in furtherance of the customer's investment  
6 objectives but in furtherance of the broker's aim of  
7 gaining commission.

8 QUESTION: So if you prevail in this case, this  
9 case will be authority which validates all of the circuit  
10 opinions holding that churning is a violation.

11 MR. ROBERTS: Well, again, Your Honor, churning  
12 is -- it's a different -- it's a different factual  
13 scenario because there are repeated sales and because the  
14 proceeds aren't taken. And I suppose that a distinction  
15 could be drawn between when the proceeds are taken and if  
16 the proceeds -- if it isn't a question of taking the  
17 proceeds but just making a commission, which the customer  
18 knows that the broker is doing. But I do think this would  
19 be strong precedent in support of those cases.

20 QUESTION: Would you want to argue that  
21 distinction, Mr. Roberts?

22 MR. ROBERTS: Not particularly. I was  
23 acknowledging that I think this would be strong precedent.  
24 But I -- Respondent concedes that churning is covered, the  
25 courts of appeals unanimously have held that churning is

1 covered. I have no doubt that churning is covered. The  
2 SEC has no doubt that churning is covered. So you  
3 wouldn't be breaking -- wouldn't be breaking new ground in  
4 holding that. I mean, it would be in the sense that it  
5 would be your decision, but you can make the distinctions  
6 in future cases that you feel are appropriate and  
7 necessary, Your Honor.

8 (Laughter.)

9 QUESTION: Too true. Too true.

10 (Laughter.)

11 MR. ROBERTS: If there are no further questions,  
12 the Government would ask that the decision of the Court of  
13 Appeals be reversed.

14 CHIEF JUSTICE REHNQUIST: Thank you, Mr.  
15 Roberts. The case is submitted.

16 (Whereupon, at 10:59 a.m., the case in the  
17 above-entitled matter was submitted.)

18  
19  
20  
21  
22  
23  
24  
25