No. _____

In The
Supreme Court of the United States

KEVIN LAMPKIN; STEPHEN MILLER, individually and on behalf of all others similarly situated; JOE BROWN; FRANK GITTESS; TERRY NELSON; DIANNE SWIBER; ROBERT FERRELL,

Petitioners,

v.

UBS FINANCIAL SERVICES, INCORPORATED; formerly known as UBS Painewebber, Incorporated; UBS SECURITIES, L.L.C., formerly known as UBS Warburg, L.L.C.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

ANDY TINDEL
Counsel of Record
MT² LAW GROUP
112 East Line Street, Ste. 304
Tyler, Texas 75702
(903) 596-0900
atindel@andytindel.com

BONNIE E. SPENCER
DAWN MEADE
DAVID AUGUSTUS
THE SPENCER LAW FIRM
4635 Southwest Freeway, Ste. 900
Houston, Texas 77027
(713) 961-7770

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

QUESTION PRESENTED

Is the grant of an employee stock option a "sale" of a security under the Securities Act of 1933?

PARTIES TO THE PROCEEDING

The parties to the proceeding are:

1. Plaintiffs-appellants below and Petitioners herein: Kevin Lampkin, Stephen Miller, Joe Brown, Frank Gittess, Terry Nelson, Dianne Swiber, and Robert Ferrell, individually and on behalf of all others similarly situated.

2. Defendants-appellees below and Respondents herein: UBS Financial Services, Inc. and UBS Securities, L.L.C.

RELATED CASES

- *Lampkin, et al. v. UBS Financial Services, Inc., et al.*; No. H-02-0851; U.S. District Court for the Southern District of Texas, Houston Division. Judgment entered Feb. 28, 2017.
- *Lampkin, et al. v. UBS Financial Services, Inc., et al.*; No. 17-20608; U.S. Court of Appeals for the Fifth Circuit. Judgment entered May 24, 2019.

TABLE OF CONTENTS

TABLE OF CONTENTS – Continued

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

PETITION FOR WRIT OF CERTIORARI

Petitioners respectfully petition for writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The opinion of the court of appeals appears at 925 F.3d 727 (5th Cir. 2019) (App. 1-28). The order of the United States District Court for the Southern District of Texas, Houston Division appears at 238 F. Supp. 3d 799 (S.D. Tex. 2017) (App. 31-240).

JURISDICTION

The judgment of the court of appeals was entered on May 24, 2019. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Pertinent provisions of the Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.* are reproduced in the appendix to the petition (App. 243-60).

STATEMENT OF THE CASE

A. Introduction

This petition presents the important and unresolved question of whether the grant of employee stock options to a company's employees constitutes a "sale" of those securities under the Securities Act of 1933 (the "Securities Act"). If the grant of employee stock options does not constitute a "sale" of securities under the Securities Act, the mass distribution of these securities in the United States is a lawless affair, governed neither by the Securities Act, the Securities Exchange Act of 1934, nor the Employee Retirement Income Security Act.

The importance of the question presented cannot be overstated. In 2014, for example, stock options were distributed in the United States to an estimated nine (9) million employees, representing approximately twenty-four percent (24%) of all employees in companies issuing stock.[1] Congress enacted the Securities Act to govern such mass distributions of securities within the United States. The rulings of the courts below in this matter undermine this important purpose, as well as the ability of the Securities Exchange Commission ("SEC") to regulate the proper distribution of securities.

Petitioners, plaintiffs and putative class representatives in the underlying action, brought two

---

[1] Qing Gong et al., *Causal Effects of Stock Options on Employee Retention: A Regression Discontinuity Approach* (Stanford Ctr. for Int'l Dev., Working Paper No. 547, 2015).

distinct categories of claims against the Defendants on behalf of two distinct putative classes of individuals. The district court had jurisdiction to hear these claims under 28 U.S.C. § 1331. One putative class of plaintiffs consisted of former Enron Corp. ("Enron") employees who brought claims against UBS Financial Services, Inc. ("UBS") under Sections 11 and 12 of the Securities Act relating to the grant of Enron incentive employee stock options through Enron's employee stock option plans. This Petition for Writ of Certiorari concerns only these claims.

A second putative class of plaintiffs consisted of UBS retail brokerage clients who brought claims against UBS and UBS Securities, L.L.C. under Section 10(b) of the Securities Exchange Act of 1934 (the "Securities Exchange Act") relating to these individuals' purchase of Enron securities in UBS brokerage accounts. This Petition for Writ of Certiorari does not include these claims.

Petitioners filed their complaint on March 7, 2002. On February 28, 2017 – almost exactly *15 years later* and long after the parties had fully completed both extensive fact and expert discovery in this matter – the district court dismissed both categories of Petitioners' claims under Rule 12(b)(6) of the Federal Rules of Civil Procedure for failure to state a claim. After the district court denied a request for reconsideration, Petitioners filed their notice of appeal on September 21, 2017. The parties presented oral arguments to the United States Court of Appeals for the Fifth Circuit on October 1, 2018. The United States Court of Appeals for the Fifth

Circuit issued its opinion on May 24, 2019, affirming the district court's dismissal.

B. Summary of Petitioners' 1933 Act Claims

Section 11 of the Securities Act provides a cause of action to any person who acquires a security for which the associated registration statement contains an untrue or misleading statement of material fact. This cause of action may be brought against an "underwriter" of the security, among others. Petitioners allege UBS was an "underwriter" of Enron employee stock options by virtue of UBS's role as the exclusive administrator of Enron's employee stock option plans. As the administrator of the employee stock option plans, UBS assumed exclusive responsibility for the following underwriting activities:

- Record keeping for Enron with respect to all stock options granted under Enron's employee stock option plans, including notifying Enron employees of the stock option grants;
- Confirming employee eligibility for proposed transactions;
- Recording transactions on an individual and aggregate basis daily;
- Establishing an Omnibus Account to hold Enron common shares pending transfer to employee accounts;

- Coordinating with Enron all "Insider" sales subject to Section 16 of the Securities Exchange Act;
- Calculating and recording tax withholdings for each transaction;
- Opening and maintaining employee accounts and issuing confirmations, Forms 1099, and monthly account statements;
- Clearing exercise transactions and wiring funds to Enron's designated bank account;
- Maintaining a staff of UBS Financial Representatives to answer Enron employee questions regarding Enron stock option plans and stock options;
- Assisting Enron affiliate employees in preparing and filing Rule 144 documentation and Stockholder Representation Letters; and
- Maintaining an Internet site for Enron employees to access and review their stock option grants.

Section 12 of the Securities Act similarly provides a cause of action to any person who purchases a security for which the associated prospectus contains an untrue or misleading statement of material fact. This cause of action may be brought against a "seller" of the security. Petitioners allege UBS was a "seller" of Enron employee stock options by virtue of UBS's promotion and solicitation of the Enron stock options to

Petitioners, motivated in part by UBS's desire to serve its own financial interests.

There is little or no dispute concerning whether the subject registration statements and prospectuses contained untrue or misleading statements of material fact. The specific statements at issue are Enron's financial reports publicly filed with the Securities and Exchange Commission ("SEC") and incorporated by reference into the relevant registration statements and prospectuses. Enron's formal restatement of these public financial reports as a result of the discovery of widespread corporate fraud remains well-known. In fact, the district court itself stated that "the Prospectuses and Registration Statements undisputedly contained inaccurate financial statements and other information and omitted material information[.]" (App. 145).

The parties also agree that, in order for Petitioners to state a claim either under Section 11 or Section 12 of the Securities Act, there must have been the "sale" of a security. The specific question brought before this Court is whether the grant of an employee stock option is a "sale" of a security under the Securities Act.

C. The District Court's Basis for Dismissing the 1933 Act Claims

The district court dismissed the Petitioners' claims in a voluminous opinion concluding in part that, as a matter of law, the grant of an Enron employee stock option was not a "sale" of securities under the

Securities Act. (App. 233). The district court arrived at this conclusion by first examining the Enron employee stock option plans at issue through the "investment contract" analysis articulated in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) and applied in the context of a pension plan in *Int'l Bhd. of Teamsters v. Daniel*, 439 U.S. 551 (1979). (App. 76-82).

In *Howey*, this Court established the required analysis for determining whether a given financial relationship constitutes an "investment contract" for purposes of the Securities Act's use of that term within the definition of "security" in 15 U.S.C. § 77b(1).[2] This Court later applied this analysis to the specific context of a noncontributory, compulsory pension plan. *Daniel*, 439 U.S. at 558-62. The Court held in *Daniel* that, because there is no investment of money or expectation of profits from a common enterprise, an interest in a noncontributory compulsory pension plan is not an "investment contract" and thus not a "security" under the Securities Act. *See id.* at 559. Importantly, the Court emphasized that there was no need to extend the Securities Act to such plans given that they are specifically governed by the protections of the Employee

[2] "[A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise." *Howey*, 328 U.S. at 298-99.

Retirement Income Security Act, 29 U.S.C. §§ 1001 *et seq.* ("ERISA"). *See id.* at 569-70.

The district court in this matter then considered SEC Release No. 33-6188, 45 F.R. 8960, 1980 WL 29482 (Feb. 1, 1980), in which the SEC sought to apply *Daniel* to other types of employee benefit plans not specifically covered by the decision. (App. 82-85). Relying on SEC Release No. 33-6188, the district court concluded that "compulsory noncontributory stock option plans where the employees do not individually bargain to contribute cash or other consideration are not 'sales' under the definition of the Securities Act of 1933." (App. 83). The district court cited to the following language from the SEC Release to support this conclusion:

> Stock bonus plans are plans under which an employer awards shares of its stock to covered employees at no direct cost to the employees. . . . While the stock awarded to the employees under the above types of plans is a security, the staff generally has not required it to be registered. The basis for this position generally has been that there is no "sale" in the 1933 Act sense to employees, since such persons do not individually bargain to contribute cash or other tangible or definable consideration to such plans.

(App. 83; citing SEC Release No. 33-6188, 1980 WL 29482 at *15).

The district court stated that in reaching its conclusion, it expressly relied upon two related cases from the District of New Jersey that applied the SEC's

"no-sale" reasoning specifically to the context of an employee stock option plan (in contrast to the stock bonus plans cited in SEC Release No. 33-6188) – *McLaughlin v. Cendant Corp. (In re Cendant Corp. Sec. Litig.)*, 76 F. Supp. 2d 539 (D.N.J. 1999) and *Wyatt v. Cendant Corp. (In re Cendant Corp. Sec. Litig.)*, 81 F. Supp. 2d 550 (D.N.J. 2000) (collectively referred to herein as the "*Cendant* cases"). (App. 85-91). The district court at the same time stated that, in reaching its conclusion and following the *Cendant* cases, it expressly rejected the conflicting decision of the Ninth Circuit in *Falkowski v. Imation Corp.*, 309 F.3d 1123 (9th Cir. 2002), *amended*, 320 F.3d 905 (9th Cir. 2003), *abrogated on other grounds by Proctor v. Vishay Intertechnology, Inc.*, 584 F.3d 1208 (9th Cir. 2009). (App. 89). In *Falkowski*, the Ninth Circuit determined that the grant of an employee stock option does constitute the "sale" of a security under the relevant definitions of the Securities Act and the Securities Exchange Act of 1934. *See Falkowski*, 320 F.3d at 1129-30.

The district court's final step was to apply its conclusion to the allegations of Petitioners' complaint. The district court found the Enron employee stock option plans at issue to be noncontributory and compulsory employee benefit plans for Enron's employees. (App. 190). Based on this finding, the district court thus held the grant of an Enron employee stock option pursuant to such a plan was not the "sale" of a security for purpose of the Securities Act. (App. 233-34).

D. The Appellate Court's Basis for Affirming the District Court

The Fifth Circuit affirmed the district court's dismissal of the Securities Act claims based on its own conclusion that the grant of employee stock options under Enron's employee stock option plans was not the "sale" of a security under the Securities Act. (App. 18-19). Like the district court, the Fifth Circuit also based its conclusion on the determination that the Enron stock option plans at issue were noncontributory and compulsory employee benefit plans, thus invoking the SEC's "no-sale" doctrine. (App. 18). Also like the district court, the Fifth Circuit cited the *Cendant* cases as support for its decision. (App. 15).

Unlike the district court, though, the Fifth Circuit expressly considered the SEC's definition of what constitutes a voluntary and contributory employee benefit plan as stated in SEC Release No. 33-6281, 1981 WL 36298 (Jan. 15, 1981). (App. 13-14). Petitioners argued the SEC's stated definition clearly applies to make employee stock option plans voluntary and contributory employee benefit plans – by definition. The Fifth Circuit sidestepped this definition, however, by taking a statement from Petitioners' brief out of context in order to avoid its only logical application. (App. 16).

In response to UBS's argument that it could not be an underwriter because Petitioners did not actually exercise the stock options and purchase Enron common stock, Petitioners emphasized that their claims related specifically to the granting of the stock options at issue

(i.e., that the granting of the stock option is the "sale" at issue and the stock option is the "security" at issue). To this end, Petitioners stated in their brief to the Fifth Circuit that their "claims in no way depend upon the exercise of a stock option to purchase the underlying stock." The Fifth Circuit misappropriated this statement to say that, by it, Petitioners had intentionally "disclaimed" any affirmative investment decision connected with their claims. (App. 16). As a result, the Fifth Circuit determined that assessing Petitioners' claims under the SEC's definition was not required in this case. Nevertheless, the Fifth Circuit did go on to find that the Enron plans were compulsory and non-contributory, a finding necessary to its ultimate conclusion. (App. 18). In connection with this finding, the Fifth Circuit made the following critically important misstatement of the law:

> *The fact that [Petitioners] would eventually make an affirmative investment decision* – whether to exercise the option or let it expire – at some point in the future *is of no consequence*.

(App. 18) (emphasis added).

In reaching its conclusion, the Fifth Circuit also expressly rejected Petitioners' argument that an SEC administrative action against Google, Inc. ("Google") and Google's general counsel conclusively demonstrates that the SEC's "no-sale" doctrine does not apply in the context of employee stock options granted pursuant to an employee stock option plan. (App. 16-17). Petitioners argued that the SEC's administrative

action against Google unambiguously affirms that the granting of employee stock options is indeed a "sale" of those securities under the Securities Act. While the Fifth Circuit acknowledged that Petitioners' "interpretation" of the SEC's action against Google is "plausible," it nevertheless concluded that the SEC did not truly intend by its action against Google "a wholesale rejection of the no-sale doctrine in the context of employee option grants."[3] (App. 17). Disregarding the import of SEC Release No. 33-6281 from 1981, the Fifth Circuit went on to state that even if Petitioners' argument is correct, the action against Google would "represent a change in the SEC's stance" and could not be retroactively applied to UBS's actions between 1998 and 2001. (App. 17-18). Having set aside Petitioners' arguments, the Fifth Circuit affirmed the district court's decision to dismiss Petitioners' Securities Act claims because Petitioners "failed to demonstrate that the grant of Enron options amount to the sale of a security." (App. 18-19).

[3] After briefing to the Fifth Circuit had concluded, the SEC initiated an essentially identical administrative action, with an essentially identical finding and an essentially identical cease-and-desist order, against Credit Karma, Inc. SEC Release No. 33-10469, 2018 SEC LEXIS 709 (Mar. 12, 2018). Petitioners made the Fifth Circuit aware of this SEC Release at oral arguments in this matter.

REASONS FOR GRANTING THE PETITION

THE PETITION SHOULD BE GRANTED TO RESOLVE A CONFLICT BETWEEN THE CIRCUITS AND TO SETTLE AN IMPORTANT QUESTION OF FEDERAL LAW

This Court may grant a petition for writ of certiorari when a United States court of appeals "has entered a decision in conflict with the decision of another United States court of appeal on the same important matter[.]" SUPREME COURT RULE 10(a). This Court may also grant a petition for writ of certiorari to settle an important question of federal law. SUPREME COURT RULE 10(c). Both reasons weigh in favor of granting the petition in this matter.

A. The Fifth Circuit's Decision Conflicts with *Falkowski v. Imation Corp.*, 309 F.3d 1123 (9th Cir. 2002) on the Same Important Matter.

The Fifth Circuit's decision directly conflicts with the decision of the Ninth Circuit in *Falkowski v. Imation Corp.*, 309 F.3d 1123 (9th Cir. 2002), *amended*, 320 F.3d 905 (9th Cir. 2003), *abrogated on other grounds by Proctor v. Vishay Intertechnology, Inc.*, 584 F.3d 1208 (9th Cir. 2009)[4] on the specific issue of

[4] The determination in *Proctor* relevant to *Falkowski* was clarifying that SLUSA does not displace state law with federal law "but instead provides a federal defense precluding certain state law actions from going forward." *Proctor*, 584 F.3d at 1219-20.

whether the grant of an employee stock option constitutes a "sale" of that security under the relevant definitions of the Securities Act and the Securities Exchange Act of 1934.

In *Falkowski*, the Ninth Circuit considered the question of whether the Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. §§ 77p; 78bb(f)(1)-(2) ("SLUSA") preempts state law fraud claims relating to the grant of employee stock options. *See Falkowski*, 320 F.3d at 1126. Relying on the definitional language of the Securities Act and the Securities Exchange Act, the Ninth Circuit held that SLUSA does preempt the claims because the alleged fraud took place "in connection with the purchase or sale of a covered security." *Id.* Specifically, the Ninth Circuit examined the definition of "sale" under the Securities Act and the Securities Exchange Act and noted that both of these statutes specifically define the term "to include any contract to buy or sell a security." *Id.* at 1129.

The Ninth Circuit reinforced its decision by relying on this Court's decision in *Blue Chip Stamps v. Manor Drug Stores*, wherein this Court stated for purposes of the Securities Exchange Act of 1934 that holders of options to purchase or sell securities are recognized as "purchasers" or "sellers" specifically because the definition of "sale" gives them such status. *See id.* (citing *Blue Chip Stamps*, 421 U.S. 723, 751 (1975)). Applying this same rationale and the definitions in the Securities Act and the Securities Exchange

Act to the context of employee stock options, the Ninth Circuit concluded that:

> [t]he grant of an employee stock option on a covered security is therefore a 'sale' of that covered security. The option is a contractual duty to sell a security at a later date for a sum of money, should the employee choose to buy it. Whether or not the employee ever exercises the option, it is a 'sale' under Congress's definition.

Falkowski, 309 F.3d at 1129-30.

The district court in *Lampkin*, however, expressly rejected the Ninth Circuit's decision in *Falkowski*. (App. 89). In doing so, the district court emphasized that *Blue Chip Stamps*, which the Ninth Circuit quoted in *Falkowski*, "was issued before *Daniel* (1979) and before [SEC Release No. 33-6188]." (App. 89). The district court's reasoning was inconsistent, though, by failing to regard the fact that both *Daniel* and SEC Release No. 33-6188 were issued before the SEC revised its definition for a voluntary contributory plan in SEC Release No. 33-6281, as addressed further below.

Although the Fifth Circuit's decision directly conflicts with *Falkowski*, the Fifth Circuit did not address *Falkowski* in its decision.

B. The Fifth Circuit's Decision Also Conflicts with SEC Interpretations and Administrative Actions Concerning this Important Question of Federal Law.

i. Conflict with SEC Interpretations

The Fifth Circuit's decision directly conflicts with SEC Release No. 33-6281 concerning whether an employee benefit plan is voluntary and contributory. Again, the Fifth Circuit recognized that Enron's employee stock option plans required Petitioners to "eventually make an affirmative investment decision – whether to exercise the option or let it expire[.]" (App. 18). Nevertheless, the Fifth Circuit stated that this "affirmative investment decision . . . is of no consequence." (App. 18). On this basis, the Fifth Circuit found Enron's employee stock option plans to be noncontributory and compulsory employee benefit plans. (App. 18).

The Fifth Circuit's statement is more than an erroneous factual finding or the misapplication of a properly stated rule of law. The Fifth Circuit's statement that Petitioners' "affirmative investment decision – whether to exercise the option or let it expire – at some point in the future is of no consequence" directly conflicts with the SEC's express and authoritative interpretations of the Securities Act. *See Chevron U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 844 (1984) (recognizing this Court's long recognition that "considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer" and that, accordingly, "a court

may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.").

SEC Release No. 33-6281 represents the SEC's interpretation of the Securities Act. It unambiguously states that "*the determination* of whether a plan is a voluntary contributory plan *rests solely* on whether or not the participating employee can *decide at some point* whether or not to contribute their own funds to the plan." SEC Release No. 33-6281, 1981 WL 36298 at *2 (Jan. 15, 1981) (emphasis added). The SEC provided the following example that specifically encompasses the situation of Enron's employee stock option plans recognized by the Fifth Circuit:

> Thus, for example, each of the following types of plans would be considered voluntary and contributory because each permits employees to make a determination, either at the time they join the plan or later, whether they will invest their own money: . . . (3) a plan which is mandatory as to participation but provides employees with a choice whether or not to invest their own funds.

Id.

Having set forth this example, SEC Release No. 33-6281 then states that "the staff continues to hold the view that all voluntary contributory plans are subject to the 1933 Act[.]" *Id.*

The Fifth Circuit's statement that Petitioners' affirmative investment decision is of no consequence

creates a conflict in the law concerning the standard for determining whether an employee benefit plan is a voluntary contributory plan.

ii. Conflict with SEC Actions

The Fifth Circuit's decision also directly conflicts with continuing SEC administrative actions based on the express and necessary premise that the grant of an employee stock option constitutes a "sale" of that security under the Securities Act. If the Fifth Circuit's decision is allowed to stand, it arguably extinguishes the SEC's ability to regulate the mass distribution of securities by employers to their employees through employee stock option plans. The issue remains the definition of "sale" under the Securities Act.

SEC Release No. 33-8523 involves a cease-and-desist order entered by the SEC against Google and its general counsel concerning the company's issuance of over $80 million worth of stock options to its employees and consultants from 2002 to 2004. SEC Release No. 33-8523, 2005 WL 82435 (Jan. 13, 2005). The SEC found that Google and its general counsel violated the registration requirements of Section 5 of the Securities Act in connection with the granting of these employee stock options. *See id.* at *4. Under Section 5 of the Securities Act, a company cannot offer or sell its securities to the public without first registering the offering with the SEC or having a valid exemption from registration. *See id.* at *2; *see also* 15 U.S.C. § 77e(a). Google attempted to rely upon the exemption to Section 5's

registration requirement provided by Rule 701 promulgated under the Securities Act. *See* 2005 WL 82435 at *2; *see also* 17 CFR § 230.701. The SEC found, however, that Google failed to comply with the requirements of Rule 701 and thus "offered to sell and *sold its securities* without a registration statement filed or in effect and without a valid exemption from registration" in violation of Sections 5(a) and (c) of the Securities Act. 2005 WL 82435 at *4 (emphasis added). Based on these findings, the SEC entered a cease-and-desist order against Google and its general counsel. *See id.*

Thirteen years later, the SEC released substantially identical findings against Credit Karma, Inc. ("Credit Karma") in SEC Release No. 33-18398. The SEC found that Credit Karma also violated the registration requirements of Section 5 of the Securities Act by granting approximately $13.8 million in stock options to its employees within the period of one year. *See* SEC Release No. 33-18398, 2018 SEC LEXIS 709 at 2, 7. As with Google, the SEC found that Credit Karma failed to meet the requirements of Rule 701 and thus "offered to sell and *sold its securities* without a registration statement filed or in effect and without a valid exemption from registration" in violation of Sections 5(a) and (c) of the Securities Act. *Id.* at *4 (emphasis added). Based on these findings, the SEC entered a cease-and-desist order against Credit Karma and also imposed a substantial civil money penalty against the company. *See id.* at *8.

The SEC's ability to regulate the United States securities markets is vital to the proper function of the

markets. The Fifth Circuit's decision undermines the SEC's ability to fulfill its critical regulatory function in the context of securities granted through employee stock option plans. As this Court has previously noted:

> In *Teamsters v. Daniel*, 439 U.S. 551, 99 S.Ct. 790, 58 L.Ed.2d 808 (1979), we held that a noncontributory, compulsory pension plan was not a security. One of our reasons for our holding in *Daniel* was that the pension plan was regulated by the Employee Retirement Income Security Act of 1974 (ERISA). . . . Since ERISA regulates the substantive terms of pension plans, and also requires certain disclosures, it was unnecessary to subject pension plans to the requirements of the federal securities laws as well.

Marine Bank v. Weaver, 455 U.S. 551, 558 at n.7 (1982). The Fifth Circuit's decision now creates a situation where the issuance of statutorily defined securities is governed by neither the federal securities laws nor ERISA. Petitioners respectfully submit the Court must resolve the conflict the Fifth Circuit's decision has created regarding the proper interpretation of the Securities Act.

C. The Fifth Circuit's Adoption of the *Cendant* Cases' Misstatement of Law Requires the Court's Exercise of its Supervisory Powers.

Finally, the Fifth Circuit's decision is the first decision of a United States court of appeals to adopt the

reasoning of the *Cendant* cases and extend the "no-sale" doctrine to the context of employee stock option plans. In reaching its decision, the Fifth Circuit found the *Cendant* cases to be "[c]onsistent with the interpretations of the SEC[.]" (App. 15). This finding creates a unique issue calling for an exercise of this Court's supervisory power to remedy the *Cendant* cases' gross misstatements of law, which has already found its way into several United States district court decisions.[5]

The first of the two *Cendant* cases was *McLaughlin*, wherein the New Jersey district court sought to determine whether the plaintiff's acquisition of stock options involved a purchase or sale of securities under the Securities Exchange Act. *See McLaughlin*, 76 F. Supp. 2d at 542. In its analysis, the New Jersey District Court relied upon two cases, *Bauman v. Bish*, 571 F. Supp. 1054 (N.D. W.Va. 1983) and *Childers v. Northwest Airlines, Inc.*, 688 F. Supp. 1357 (D. Minn. 1988), both of which involve employee stock *ownership* plans ("ESOPs") governed by ERISA (in contrast to employee stock *option* plans not governed by ERISA). In applying *Bauman* and *Childers*, the New Jersey District Court incorrectly states that both of these referenced cases involve employee stock *option* plans. *See McLaughlin*, 76 F. Supp. 2d at 544-45. Having affirmatively misstated that *Bauman* and *Childers* involve stock *option* plans, the New Jersey District Court then relies on these cases, as it has described them, to

---

[5] *See, e.g.*, *Fraser v. Fiduciary Trust Co. Intern.*, 417 F. Supp. 2d 310, 318 (S.D.N.Y. 2006) and *Fishoff v. Coty, Inc.*, 2009 WL 1585769 at *5 & n.74 (S.D.N.Y. June 8, 2009).

conclude that the plaintiff's acquisition of stock options did not involve a purchase or sale under the Securities Exchange Act. *See id.* at 545. Then, in *Wyatt*, the New Jersey District Court cites and depends upon its own decision in *McLaughlin* to reiterate the same conclusion in *Wyatt*. *See, e.g., Wyatt*, 81 F. Supp. 2d at 557 ("To resay, an employee-participant in a compulsory, noncontributory *option plan* is not a purchaser of securities under §10(b)." (emphasis added)).

The specific legal error embedded within the analysis of the New Jersey District Court that has carried forward into this and every other case that relies on the *Cendant* cases or any of their progeny is that neither *Bauman* nor *Childers* in any way involved employee stock *option* plans. Instead, both *Bauman* and *Childers* involved ESOPs, which are governed under ERISA. *See Bauman*, 571 F. Supp. 1063-65; *Childers*, 688 F. Supp. 1359, 1362-63. Critical distinctions exist in the law between an Employee Stock *Ownership* Plan (ESOP) governed by ERISA and an employee stock *option* plan *not* governed by ERISA. *See* 29 U.S.C. § 1002(1)-(3) (defining employee benefit plans governed by ERISA); 29 U.S.C. § 1107(d)(6) (defining an employee stock ownership plan under ERISA); and 26 U.S.C. § 422(b) (defining an incentive stock option); *see also Raskin v. CyNet, Inc.*, 131 F. Supp. 2d 906, 909-10 (S.D. Tex. 2001) (distinguishing between an ESOP and an employee stock option plan and affirming that an employee stock option plan is not an ERISA plan).

In an ESOP, an employee does not directly own an interest in the underlying stock. *See* 29 U.S.C. § 1102(a) (requiring employee benefit plan assets to be held by a trust). The employee instead holds a beneficiary interest in stocks owned directly by the ERISA trust and managed by the plan's trustee. *See id.*; *see also* 29 U.S.C. § 1003(8). *Daniel* and SEC Release No. 33-6188 concern the question of whether this beneficial interest should be considered an "investment contract" and thus a "security" under the Securities Act. In contrast, when an employee acquires a stock option pursuant to an employee stock option plan, that employee directly owns a security and individually possesses the associated investment decisions required by the very nature of that security. *See* 15 U.S.C. § 77b(a)(1).

These critical legal distinctions must not be washed away through *McLaughlin* misquoting the *Childers* opinion and removing the term "ESOPs" in order to replace it with the phrase "[option plan]." *Compare, McLaughlin* 76 F. Supp. 2d at 545 ("'[P]laintiffs' participation in the [option plan] was . . .'") *with Childers*, 688 F. Supp. at 1363 ("plaintiffs' participation in the ESOPs was . . . "). Petitioners respectfully submit that the legal errors of the *Cendant* cases adopted by the Fifth Circuit in this matter require this Court to exercise its supervisory power in order to remedy this gross misstatement of the law.

CONCLUSION

For the foregoing reasons, Petitioners respectfully request their petition for writ of certiorari be granted to review the judgment of the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

ANDY TINDEL
Counsel of Record
MT² LAW GROUP
112 East Line Street,
Ste. 304
Tyler, Texas 75702
(903) 596-0900
atindel@andytindel.com

BONNIE E. SPENCER
DAWN MEADE
DAVID AUGUSTUS
THE SPENCER LAW FIRM
4635 Southwest Freeway,
Ste. 900
Houston, Texas 77027
(713) 961-7770