In the

Supreme Court of the United States

LEHMAN BROTHERS, Petitioner vs JACOB SHEIN, et al., Respondent.	No. 73-439
BENJAMIN SIMON, Petitioner, vs JACOB SCHEIN And MARVIN H. SCHEIN, Respondent.	No. 73-440
INVESTORS DIVERSFIED SERVICES, Inc., et al., Petitioners vs JACOB SCHEIN, et al., Respondents.	No. 73-495

Washington, D. C.
March 19, 1974

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Washington, D. C.
Tuesday, March 19, 1974

The above-entitled consolidated matters came on for argument at 10:29 o'clock a.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM O. DOUGLAS, Associate Justice
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice

APPEARANCES:

JAMES J. HAGAN, Esq., One Battery Park Plaza, New York, New York 10004; for the Petitioners.

DONALD N. RUBY, Esq., 845 Third Avenue, New York, New York 10022; for the Respondents.

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C O N T E N T S

P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments next in 73-439, Lehman Brothers, 440 and 495, the related, consolidated cases.

Mr. Hagan, you may proceed whenever you are ready.

ORAL ARGUMENT OF JAMES J. HAGAN, ESQ.,

ON BEHALF OF THE PETITIONERS

MR. HAGAN: Mr. Chief Justice, and may it please the Court:

These three cases are here on the grant of a writ of certiorari to the court of appeals for the Second Circuit. The issue has been limited to the question of whether the court of appeals erred in failing to certify the question of Florida law to the Supreme Court of Florida, pursuant to its certification statute. I will speak for the petitioners in the three cases which have been consolidated for argument. And I would ask to reserve three minutes for rebuttal, Your Honor.

It is the position of petitioners here, Your Honor, that it was error for the Second Circuit to refuse to certify the issue of Florida law to the Supreme Court of Florida.

The decision below exemplifies a new doctrine under Florida law or in fact the law of any state. Although purporting to find support under the case of Diamond v.

Oreamuno in the Court of Appeals of the State of New York, the decision below here is in fact a radical extension of the Diamond case. The question of Florida law here is significant under the public policy of Florida. It involves a Florida corporation, and it involves the regulation of that corporation's relationship to its fiduciaries and to its shareholders and to those who buy and sell its stock.

The decision below adopted a remedy here which could interfere with recovery by shareholders of that corporation when they sue on an insider trading case.

Therefore, we believe that in light of the significant question of Florida law and public policy that was involved, the Court of Appeals should have certified the question as it was requested to do by Judge Kaufman in his dissenting opinion.

Your Honors, I would briefly discuss the underlying facts in this case and the opinions below.

This case arose out of an alleged misuse of inside information and subsequent insider trading. Lum's Inc. is a Florida corporation which was engaged in the fast food franchising business. During 1969 in an attempt at diversification it acquired a gambling casino in Las Vegas known as Caesar's Palace. And to acquaint the financial community with its new acquisition, it held what it described as a seminar in Caesar's Palace in November of 1969.

Apparently during that seminar it released an

earnings forecast of $1 to $1.10 per share. Subsequently in January of 1970 it was alleged--and when I am making these claims of allegations, I am basically stating the allegations of the Securities and Exchange Commission, which filed a complaint for injunctive relief in December of 1970. All of the subsequent civil cases are basically copies, if you will, of the SEC complaint.

It was alleged that one Melvin Chasen, who was chief operating officer of Lum's, learned of a decline, substantial decline, in the earnings for Lum's second quarter that he advised Mr. Benjamin Simon, who was a registered representative employed by Lehman Brothers in its Chicago office, of this decline, and that Mr. Simon in turn passed on this information to representatives of Investors Diversified Services in Minneapolis. All of these events were alleged to have occurred on january 8th. And on January 9th two of the IDS funds sold 83,000 shares of Lum's stock.

Trading was suspended on the 9th. Lum's issued a press release later in the afternoon, announcing the decline of earnings. When trading resumed the following Monday, the stock was off $3 to $4 per share. The sales on the previous Friday had occurred at $17.

The SEC investigated and in the following December, as I said, they filed an injunction action. And that was followed by a rash of civil suits. And those suits basically

fell into two categories. One category consisted of derivative actions seeking recovery by Lum's of the trading profits. The second category was a class action. Several suits constituted class actions on behalf of sellers or purchasers of the stock on the day of the tradeoff.

So, at the commencement of the litigation there were three prongs to the regulatory structure, the SEC injunction action, the derivative suits, and the class actions.

The defendants below moved to dismiss before Judge Tyler the derivative action. The derivative actions were premised on the rule of Diamond v. Oreamuno, which is a New York case. And that case briefly stated that officers and directors of a corporation who trade on inside information are required to remit their profits to the corporation, even though the corporation has not been damaged in any legal sense. The court espoused this doctrine in the context of a situation which was really a gross instance of misuse of corporate information. The two top officers of the company, MAI, had learned of an earnings decline and sold their own stock, triggering an enormous decline in the price of the shares.

As the case reached the Court of Appeals in New York there were new other actions pending. The SEC had not commenced a proceeding. Section 16b did not apply because the stock had been held more than six months, and there were no class actions or any actions pending by any of the defrauded

purchasers of that stock. And so the argument before the Court of Appeals and strongly urged in the brief by the respondent was that if no remedy is fashioned here, these parties escaped with the illegal profits. That was the context of the Diamond case. It is the law in New York. To the best of our research, it has never been cited or discussed in any decision in any other state court. It is five years old now. It came down in 1969.

So, the derivative suits here were premised on the Diamond case. But it was the defendant's position that it was the law of Florida that applied to the responsibility of insiders to the corporation.

Q The defendants here?

MR. HAGAN: The defendants, Your Honor, were Lum's Corporation, Mr. Chasen, Lehman Brothers and its employee Benjamin Simon, Investors Diversified Services and two of its funds and two employees of IDS who are alleged to have received the tip and recommended the sale of the stock.

Q In the Diamond case the defendants were corporate officers or directors?

MR. HAGAN: Yes, Your Honor. They were actually corporate officers and directors, including directors who had not actually made the trades but had acquiesced in a situation after they learned of the matter. And the lower court had dismissed the case against those directors. And the appellate

division had affirmed and the Court of Appeals affirmed on that point, holding only the wrongdoing officers and directors--

Q Who had actually done the selling, who had actually sold shares.

MR. HAGAN: That had actually sold the shares.

Q In this case were any defendants corporate officers or directors?

MR. HAGAN: Just Mr. Chasen. Mr. Chasen was an officer and also a director of Lum's. Lehman Brothers had no relationship to Lum's. It was not its investment advisor. It had not done any investment banking for it. It was really without dispute that there was no relationship there.

Some of the IDS funds held the stock in its portfolio. Other than that, there was no relationship there either. So, the only conceivable nexus between our case and Diamond was Mr. Chasen.

As I said, the defendants moved to dismiss on the ground that Florida applied. Under the law of Florida, you first must show damage to your corporation before a derivative suit will lie. That even under Diamond, assuming arguendo Diamond applied, there were no profits here on the part of any defendant other than arguably the idea of funds. And other than Mr. Chasen, who had no profits, there were no fiduciaries involved.

Q Mr. Hagan, I take it that Florida law does

apply here.

MR. HAGAN: Your Honor, in the lower court before Judge Tyler, the defendants argued that Florida law applied, but the respondents disputed this point. They argued strenuously before Judge Tyler that New York law applied, and they urged that the Diamond rule be imposed and that the rule be expanded. And the expansion, of course, had to proceed on two grounds. It had to go beyond the officer-director holding of Diamond, because that was holding of Diamond, officers and directors; and the rationale was encouragement of private attorneys general to regulate the corporation. It was phrased in that manner.

They also had to go beyond Diamond to pick up parties who had not profited, because again in Diamond only the directors who had actually profited had been held liable.

So, there were two extensions of Diamond, and in effect they were urging a rule which really had very little relationship back to the Diamond case, although that was the springboard for the argument.

Q Did your clients make any request to Judge Tyler that he certify that Florida law question to the Florida courts?

MR. HAGAN: No, we did not, Your Honor.

Q The Florida statute does not take references.

MR. HAGAN: That is correct, Mr. Justice Brennan.

The Florida statute, unlike other statutes in many states, only permits an appellate court to certify the question. Subsequent statutes in many of our states that have been adopted in the last number of years have adopted the recommendation of the uniform commissioners, the Uniform Act, and permit district courts to certify.

But, in any event, the question was never raised before Judge Tyler.

Q When did you first request that this question be certifified?

MR. HAGAN: The first request was on the petition for rehearing before the Second Circuit, Your Honor.

Q It was after the decision came down, including Judge Kaufman's dissent?

MR. HAGAN: That is correct. Judge Kaufman's dissent was the first time the certification question was raised, to the gest of my knowledge, by any litigant or judge.

Q Was there a reason for not moving for certification before the decision?

MR. HAGAN: Your Honor, I think as far as the present petitioners were concerned, it was their position that the law of Florida was not unclear or uncertain. Florida law--at least let me clarify that. It was not unclear to the extent that Florida's law required that you show actual damages to

your corporation before a derivative suit would lie. The Diamond case in New York flatly contradicted that. It held no damage requirement was necessary.

Secondly, to the extent that Florida had never discussed the Diamond rule, it could have been argued, I suppose, that it was therefore uncertain. So, to that extent, you could either say the Florida law was settled against the respondents or uncertain because they had never discussed Diamond and one could only speculate what they would do if Diamond was argued to them. But again, even if you argued Diamond on the facts of this case, this is not a Diamond situation.

Q Have you answered Mr. Justice Blackmun: Is there any dispute among the parties now that Florida law is--

MR. HAGAN: Yes, I was getting to that. I am sorry, Mr. Justice Brennan. In the lower court, respondents argued New York law; Judge Tyler found Florida law. On appeal the respondents here, appellants before the Second Circuit, conceded Florida law applied.

So, when Mr. Justice Waterman wrote his majority opinion, he pointed out both parties concede and we so find that Florida law applied. So that although there was a dispute in the district court as to the proper choice of law, there was no dispute before the Second Circuit on this point.

Q And none here, of course?

MR. HAGAN: There appears to be none here, no.

Q I was just going to ask whether Judge Kaufman's dissent on the certification issue was really his own idea.

MR. HAGAN: Yes, Your Honor.

Q It was not discussed at oral argument.

MR. HAGAN: Not discussed at oral argument and not discussed in the briefs.

Q I presume if you had prevailed in the Second Circuit without ever certifying to the Supreme Court of Florida, you would not be interested in certifying.

MR. HAGAN: Your Honor, it was not our position before the Second Circuit--first of all, the predicate for certification is a finding that the law of the state is unsettled or uncertain, and it was never our position and it is not our position today actually that the law of Florida was so uncertain or unsettled. It became that way for the first time on the opinion out of the Second Circuit. Prior to that opinion, the law of Florida as enunciated in four intermediate appellate court opinions was that damages were required in a situation like this.

Q The Second Circuit cannot change the law of Florida, can it?

MR. HAGAN: Your Honor, what the Second Circuit did here, I submit, was impose a new rule on the law of Florida. The Second Circuit here adopted as Florida's rule a doctrine which no one can find in the law of Florida, at least none of the

parties has been able to find it in the law of Florida. Certainly my friend from the respondents has been unable to point out any Florida authorities in support. And the majority in the Second Circuit agreed that there were no Florida precedents on point.

May I say, Mr. Justice Rehnquist, it disregarded the four decisions of the Florida intermediate appellate courts on the damage point, exemplified by Palma v. Zerbey, which was 1966. It disregarded those in a footnote as not persuasive because there had not been any extensive discussion of the question, and there had been some rather conclusory statements citing earlier opinions. And the only analysis of it is in that footnote where the court said it found these cases not persuasive, and that was the end of the Florida law as far as the majority opinion below was concerned.

Of course, our position had been that to that extent the law is settled, and here you cannot state a claim unless you can prove damages.

In any event, Judge Tyler--I am sorry, Mr. Chief Justice.

Q And some of these cases that are cited here on certification were suo sponte by the appellate court, were they not?

MR. HAGAN: Which case? I am sorry.

Q I do not recall which one, but it was very, very

often.

MR. HAGAN: Yes, Your Honor. This has happened here. This Court has suo sponte certified questions on many occasions.

Q I do not know about many, but we did in Aldrich, did we not?

MR. HAGAN: You did in Aldrich and you did in Clay and you did in, I believe, Dresner v. City of Tallahasee.

Q I remember Aldrich was suo sponte. Was Clay?

MR. HAGAN: I believe Clay also, Your Honor, was suo sponte. I do not believe that anyone had requested certification there. In fact, I believe that is the first reported decision that I am aware of where the question arose.

And this Court has many times of course expressed its views on certification, the appropriateness of it, even those on the Court that have expressed reservations about the whole abstention doctrine and the problems it raises have often times endorsed certification.

In any event--I am sorry, are there any other questions on that point?

Judge Tyler found that Florida law applied. He found that damages were required. He decided the question under Diamond out of an abundance of caution and said that even if Diamond were the law of Florida, it did not apply because none of the parties fit within the Diamond rule. The

one that was an officer had not profited. The ones that profited were not officers or directors.

When the case went up to the Second Circuit, the majority in effect--they did reverse Judge Tyler. They found that there was no Florida law on point. They believed they had the right to look to the law of other states, specifically New York and the Diamond rule, and they then extended the Diamond rule in several respects. They extended the concept of the fiduciary beyond the officer and director category to pick up, as they put it, anyone who receives inside information becomes ipso facto a fiduciary. Although they did not use the term, I suppose the concept would be something akin to a constructive fiduciary once he received the information.

They then postulated a common enterprise theory, cited certain anti-trust cases to support the proposition, and then said as in a conspiracy situation or a joint tort that all of the defendants were liable for the profits of any one. They spent some time discussing the problems with law of insider trading and the necessity to tighten the doctrine.

Judge Kaufman's dissent agreed, of course--and there is no issue here--on the condemnation of insider trading. He held, however, that the majority had invented a totally new concept of law, even under the law of New York. Certainly it had no basis in Florida law. He urged that the majority certify the question to the Supreme Court of Florida. There

was no discussion in the majority opinion. It had no response, did not respond to Judge Kaufman's comment. Petitions for rehearing were filed. It was urged on the court that the matter be certified, but it was not, denied, and we are now here on certiorari.

And we urge, Your Honor, that it was error for the court to refuse to certify in this area. This decision has imposed, in effect, a new regulatory framework upon trading in the stock of Florida corporations.

Q May I ask, Mr. Hagan, if there were not this Florida procedure, would this be a case for a federal abstention?

MR. HAGAN: We believe it would be, Your Honor.

Q There is no constitutional question to be avoided.

MR. HAGAN: Your Honor, we feel that under this Court's decision in Thibodaux and in Kaiser Steel, this would be the type of question--there is no neat characterization of when a question like this can really be said to support abstention, but we believe that even if you did not have a certification statute, strong argument could be made here for abstention because of the policy questions involved.

After all, this is a Florida corporation. The State of Florida has expressed its own public policy by adopting a certification statute, the first state to do so in

1945, that it would like to have a say in what the law of Florida is. And for a federal court to discuss the duties and liabilities flowing from certain factual situations involving a Florida corporation seems to me--

Q That is an argument whether this would habe been a case for absrention.

MR. HAGAN: That is; you are right.

Q As long as Florida has this statute, the federal courts ought to avail themselves.

MR. HAGAN: That is our position, Your Honor.

Q Mr. Hagan, do you think it makes any difference that Thibodaux arose in a district court in Louisiana and depended an Louisiana law and Kaiser arise in a district court in New Mexico and depended on New Mexico law, whereas this arose in the Southern District of New York and depended on Florida law?

MR. HAGAN: I think it makes our case much stronger, Your Honor, because--

Q Why?

MR. HAGAN: Because in those situations presumably the federal court sitting in those districts would be knowledgeable in the law of the jurisdiction. The district court sitting in Louisiana could be presumed to be more knowledgeable of Louisiana law than say a New York federal court. And it is rather ironic here, Your Honor, to think that

if this case had arisen in the Fifth Circuit within which Florida lies, this question would undoubtedly, if one can read the Fifth Circuit precedents correctly, would have been certified to the Supreme Court of Florida. The Fifth Circuit has used this procedure on many occasions.

Q What does the district, according to the Southern District of New York, tell these litigants to do when it abstains? Does it just dismiss their action and tell the plaintiff to go get service in Florida?

MR. HAGAN: Your Honor, if a state has a certification statute--and today 12 states do, and there has been quite a trend here in the last number of years--depending upon whether the statute of the state permits district court certification or appellate court certification, the parties frame a certified question to the court of that state. There is a briefing period of 60 days under the Florida statute. The question is presented; the parties brief it; oral argument is optional; and then the certifying court responds back and answers that the law of Florida in this situation is thus and so. That is reported back to the federal court. This raises none of the problems that have plagued the courts over the number of years since the abstention doctrine was first enunciated.

First of all, the delay problem is minimized. You do not hear of a situation where you have to proceed in a

lower court and up through the appellate procedures in a state. You go directly to the supreme court of that state for a final and definitive ruling on the law.

But I would say, Mr. Justice Rehnquist, that here if the Fifth Circuit had had this, I am sure it would have been certified. The fact that the Second Circuit had it and did not certify it when presumably it is not that knowledgeable on Florida law is an even stronger case for certification.

If I might, I would like to briefly discuss the trend here, which I think is important, Your Honors, because there has been since 1960--since this Court first used the certification doctrine--there has been a development here which I know this Court is aware of. And if in fairness the Court disagrees with this trend, presumably this would be the case to discuss it, because since 1960 in the Clay case, when there was only one state with a certification statute, this Court followed up with certification suggestions in Aldrich, in Dresner, in 1963; in 1964 in his concurrence in the England case Mr. Justice Douglas, although expressing strong reservations about the abstention doctrine, strongly endorsed certification as a possible solution to these problems.

Q You say there are now what, 11 states?

MR. HAGAN: Now we have 12, Your Honor. We had 10 in our main brief, and we actually picked up two more in our reply brief; Minnesota and Oklahoma adopted it at the '73

sessions. And we cited those in our reply brief.

Q Are they all rather similar statutes?

MR. HAGAN: Basically, yes, because in 1965 you had four states adopt, Hawaii, Maine, New Hampshire, and Washington. There was some difference among them. But in '67 a uniform act was adopted by the commissioners of state law. This was basically the Florida statute, with some minor variations.

Q Except that it expands to the district court.

MR. HAGAN: It goes to the district court also, permits district court certification. It was approved by the ABA in '67, by the ALI, American Law Institute, in '69; and since that time you have had a number of other states, so that you now have 12 states that have adopted this doctrine.

So, we submit, this was a proper case for certification. It should have been certified. And failure to do so when requested by Judge Kaufman was error sufficient to justify reversal and remand.

Q Is there anything in any of these statutes which permit, where there are federal questions in the case, a reservation of the federal questions as we held in England, a litigant in an abstention case might be--

MR. HAGAN: Yes. They do not really extend to that problem that we had in England, the danger of deciding the federal question in the res judicata problem that arises. They are limited to the question of state law and where the question

of state law may be determinative of the issue, not just--

Q And the Uniform Act is so limiting.

MR. HAGAN: Yes, that is right, Your Honor.

MR. CHIEF JUSTICE BURGER: Mr. Ruby.

ORAL ARGUMENT OF DONALD N. RUBY, ESQ.,

ON BEHALF OF THE RESPONDENTS

MR. RUBY: Mr. Chief Justice, and may it please the Court:

As the petitioner has acknowledged this morning, the only question before this Court is whether the Court of Appeals for the Second Circuit committed reversible error in this action, which is based upon diversity of jurisdiction. In deciding the question of Florida common law, rather than certifying it to the Florida Supreme Court, pursuant to Florida's optional certification procedure.

This Court denied petitioner's request that it review the merits of this decision or whether the court below violated the principles of Erie v. Tompkins in reaching its decision.

Petitioners, I suggest, no doubt recognizing the weakness of their position on the question which is before this Court, had nevertheless argued the merits of this decision at great length in their brief and also this morning. Since the merits itself of the decision are not before the Court, I shall not address myself to them this morning. But I would say only

in passing that an examination of the decision below I think clearly reveals that the Court of Appeals for the Second Circuit was quite mindful of its obligations under Erie to decide this case under Florida law and that the Court's decision is well supported by authorities, including Florida case law; and I might add they cited a decision of the Florida Supreme Court in support of their decision.

Petitioner referred to four cases in his oral argument which he alleges the Court of Appeals disregarded or over looked. I might say only in commenting upon that that only one of these cases was even cited by the petitioners to the Court of Appeals. Three of them have been referred to in their brief to this Court but were not even included in their brief to the Court of Appeals.

Q May I ask, Mr. Ruby, the way the Florida rule reads, there has to be an initial determination (a) whether Florida law would be determinative and (b) that there are no clear controlling precedents in the decisions of the Supreme Court of Florida. I take it that initial determination has to be made by the dertifying court, does it?

MR. RUBY: Yes, Mr. Justice Brennan.

Q You are not suggesting that an fact the majority below did even make that inquiry,did they?

MR. RUBY: I would not say that the Court of Appeals believed that the question was settled. I am not suggesting

that.

Q My question was rather whether the majority in the Court of Appeals even addressed themselves to the two questions whether Florida law would be determinative--I guess they did say that--but about the other, that there are no clear controlling precedents under the decisions of the Supreme Court of Florida. Did they address themselves to that?

MR. RUBY: I think there is a threshold question, if I may answer your question in this fashion. I think the basic question is, Is this an appropriate case for certification? In that Judge Kaufman, in his dissent, did make a passing reference to the possibility of certification, I would assume that the court in their deliberations probably considered the whole question, and they may have come to the conclusion--and I believe it is well supported--this was not an appropriate case for certification.

And I might also say, since I think you have really brought this point up, petitioner refers to the fact that the Florida legislature has enacted this certification statute, and suggest to this Court that that is a reason for having a federal court in effect abstain through certification in a diversity case.

First of all, the Florida statute, of course, is optional in the sense that it leaves it up to the federal court to decide what to do. But I think the more important

answer is that the Florida legislature cannot, by enacting the statute, take away the rights which are given to litigants under the diversity of jurisdiction statute to go into a federal court and to have their claims adjudicated there. And whether they have that right and whether the Court erred in this case I think must be determined under federal law, which I will come to.

Q Mr. Ruby, before you get to that, once Judge Kaufman raised this certified question point, is it not significant that the other two members of the panel did not say anything?

MR. RUBY: You Honor, I cannot of course search into the minds of the other two judges, but I would assume from the fact that--

Q You can find from their minds that they did not comment. You can find that out.

MR. RUBY: Yes, that is true, Your Honor.

Q So, they did not make a ruling on this at all, did they?

MR. RUBY: I would say that in effect they made a ruling by deciding the case.

Q But they did not say that we find that this is not the proper case to be certified. They never said that.

MR. RUBY: They did not say it in those words, Mr. Justice Marshall, but I would say the clear inference from

the fact that they did go ahead and decide the case on the merits is that they determined that this was not an appropriate case for certification.

Q But they did not give any reasons for it.

MR. RUBY: They did not express any reasons; that is correct.

The basic rule, turning to the federal law, governing the obligation of federal courts to decide questions of state law in actions based upon diversity jurisdiction was of course set forth by this Court in the Meredith case, which is generally regarded as a landmark decision covering the obligation of federal courts to decide questions of state law in diversity cases.

This Court said, and I will quote briefly, "It has from the first been deemed to be the duty of the federal courts, if their jurisdiction is properly invoked, to decide questions of state law whenever necessary to the rendition of a judgment."

This Court then went on to say that 'in the absence of exceptional circumstances a failure to decide such questions of state law--and again I quote--"merely because the answers to the questions of state law are difficult or have not yet been given by the highest court of the state would thwart the purposes of the jurisdictional act."

The principles that have been set forth by Meredith have been reaffirmed by this Court on several occasions. In

Propper v. Clark this Court indicated that to allow the difficulty of an issue of state law to deter a federal court in deciding the issue of state law in a diversity case would be--and again I quote--"to enervate diversity jurisdiction."

Again in McNeese v. Board of Education this Court noted that in the diversity of citizenship case--and I quote--"We hold that difficulties and perplexities of state law are no reason for referral of the problem to the state court."

Q What reason, do you think, could be imagined to do it?

MR. RUBY: I am sorry, Your Honor?

Q What reason can you imagine would be necessary to have the question certified? Are you not arguing that you do not certify any?

MR. RUBY: No, Your Honor.

Q You are not arguing that, are you?

MR. RUBY: No, Your Honor. But it is our position that certification is a form of abstention. In effect, by certifying the question, the federal court abdicates its responsibility to decide the question of state law in a diversity case, and it submits the issue to the state court.

Q So, you do not do it on a diversity case?

MR. RUBY: You do it, Your Honor, in a case, we submit, would be a proper case for abstention, since it is in effect a form of abstention. Now, it may be preferable to

outright dismissal as a form of abstention. But I think the question remains whether it is proper for the federal court at all to abstain from deciding the case in a diversity case and to submit the issue to a state court.

Q It is a form only of qualified abstention, is it not? When you certify, it retains jurisdiction.

MR. RUBY: It retains jurisdiction, Your Honor, but I think that nevertheless it is abstention in the sense that if the duty of the federal courts under the jurisdictional act is to decide all questions necessary to the adjudication of the judgment in a diversity case--

Q I have difficulty seeing why there is any incompatibility with the idea of asking the highest court of the state to declare what the law is so that the federal court can be aided in the exercise of its diversity jurisdiction.

MR. RUBY: I think there is no incompatibility, Your Honor, if it is a proper case for a federal court to say to the litigants we will not decide your issue. I think if we have to choose between, for example, outright dismissal and certification, there is no question that the certification statute may serve a useful purpose. And, of course, many commentators have indicated that in such circumstances it does serve a useful purpose. But I would respectfully submit to this Court that the issue in this case is not in effect the general proposition where the certification may serve a useful

function--

Q Mr. Ruby, I gather had there been a decision of the Supreme Court of Florida, a white horse case with your own, since this whole case depends on Florida law, were that true, the Second Circuit and the district court would not necessarily have had to apply that Florida case, would it not?

MR. RUBY: There is no question about that, Your Honor.

Q So, really what is involved here then is there is no such case, I gather.

MR. RUBY: There is no case directly.

Q Right. Or at least it is debatable whether there is anything that even points to the Florida answer. And here is a way that you can get, because there is not presently one, a decision of the Florida Supreme Court on what the Florida law is, and that certainly is more definitive than anything either this Court or the Second Circuit or the district court can provide.

MR. RUBY: I think that is true, Your Honor, but I think you do so and what you give up, I think, is really what has to be considered.

Q I do not see what you are giving up here.

MR. RUBY: What you give up, I think, first of all--and perhaps it is more than just giving up something--I think it does represent a disregard of what the duty is on the

federal courts under the diversity of citizenship act. I believe that imposed upon the federal courts--

Q I suggest, Mr. Ruby, rather than not doing their job, they are doing it more effectively if they take advantage of this opportunity.

MR. RUBY: First of all, of course, they are not deciding the case themselves. I will not belabor this point--

Q But they have to decide it as it would be decided under Florida law.

MR. RUBY: That is correct.

Q And that being so, and there not presently being any decisions of the Florida Supreme Court that provide the answer--and here you have an opportunity to get the decision that is applicable to your very case.

MR. RUBY: That is true, Your Honor, but I think this Court has considered this kind of situation in other cases. If I might for example, perhaps in responding to you, refer to what this Court said in the Propper v. Clark case, in that case I think this Court clearly indicated that a federal court should not submit questions of state law to a state court where the federal courts have been granted jurisdiction of the controversy in the absence of special circumstances. I will quote briefly from it. "The submission of special issues"--in effect here we are talking about a special issue--"is a useful device in judicial administration in such

circumstances as existed"--and then it refers to Magnolia, Specter, Fieldcrest, and Pullman. Those were all classic abstention cases.

Q Mr. Ruby, what happens if the Supreme Court of Florida this morning renders an opinion in another case on all fours with this one?

MR. RUBY: Your Honor, I suppose an application could be made to the Court of Appeals in that unlikely event. And I recognize that there are instances which occur where a federal court may decide a case and then subsequently a state court may decide it differently. That is a problem that is involved not only in the diversity area; it is involved in every case where you have a conflicts of law rule, where one state has to decide what another state would do.

Mr. Justice Marshall, I might add that if this case had been brought, for example, in the state courts of New York, which it might have, the New York State courts would have had the obligation under their conflicts of law rule to decide what Florida law was and then to apply it.

Of course, there is always the danger that their decision could be wrong.

Q I am just talking about this case. You are deciding it on Florida law. And this opinion comes down and a week later the Florida court has an identical case on all fours and in its opinion says, "The Second Circuit is completely

wrong in its interpretation of Florida law." Does that do anything for good judicial precedent?

MR. RUBY: Certainly not, Your Honor. Certainly not.

Q And is not that what this is for, is to make sure that does not happen? It could not happen,could it? If the question had been certified, it could not happen.

MR. RUBY: It could not happen if the question was certified, but, Your Honor, if the question was certified, not only would you have what I have referred to as in effect a denial of the rights under diversity jurisdiction, but you would have what this Court I think has talked about time and time again, the desire not to compel litigants to go down, if I may borrow the phrase from Mr. Justice Douglas, a long and expensive road to obtain an adjudication in a case that they have brought.

Q Where we have invoked this Florida procedure in Clay and in Aldrich and in Dresner, we did not have any federal questions--or did we in those cases?

MR. RUBY: Yes, Mr. Justice Brennan. Clay was a classic abstention case.

Q So, we had a federal constitutional question we would have had to decide?

MR. RUBY: Precisely, precisely.

Q Was that true in the other two, Aldrich and

Dresner?

MR. RUBY: Neither Aldrich nor Dresner were even diversity cases. And in both of those cases you had a problem in one case about due process under the federal Constitution which could be avoided. And in the other case you had an interpretation of the full faith and credit clause.

Q That was a divorce case, was it not?

MR. RUBY: Yes, that is correct. So that both of those cases really do not support the proposition in this case because they involve the classic type of abstention.

If I might just continue my answer to Mr. Justice Marshall, I believe that one of the real problems in any kind of abstention, including certification, is the delay and the extra burdens, the added expense. Certification may lessen those burdens. But it certainly does not eliminate them. It has been reported that certification to the State of Florida increases the length of a case maybe by at least a year. It in effect produces two full dress appeals where one had taken place before.

And I might say that this particular case is really an inappropriate case to permit this kind of certification, since the delay involved here is even more pronounced because of the fact that the petitioners here did not even request certification--

Q Does the Supreme Court of Florida hear oral

argument?

MR. RUBY: Yes, they do, Mr. Justice Rehnquist. They have a full dress appeal.

Q So, the parties would then go down to Tallahasee and argue their case?

MR. RUBY: That is correct.

In this case, the petitioners in effect allowed the parties and the court to go through the whole appeal before the Court of Appeals for the Second Circuit. They allowed the court to deliberate, to reach its decision, and then finally, seizing really upon what Mr. Justice Kaufman had added in his opinion--because his main part of his opinion is he dissented on the merits. However, he added at the end that perhaps certification should have been used. Seizing upon that, the petitioners then made a motion for rehearing. And I think it is interesting to note that even in their petition for rehearing they did not come out in a forthright way and say this case should be certified. They asked for a rehearing en banc on the merits, in effect asking the Court of Appeals for the Second Circuit again to decide the case on the merits. and then in the final paragraph of their 12-page petition for rehearing, in effect what they said is, "If you are not going to decide in our favor, then please send the case down to the State of Florida."

I might say perhaps in support of some of the points

I have said before, that commentators have said in many instances--I will refer to Professor Wright as an example of this--that certification, and I quote, "is an undesirable innovation if it will lead to an abrogation of the Meredith doctrine." And similar expressions are found in other commentaries.

The threshold question that I would submit to this Court is whether this was basically a case for abstention of any kind. And I think if you look at the nature of the case and the instances in which this Court has granted abstention, I think it is clear it is not.

There is no constitutional question that can be avoided in this case. There is no constitutional question involved. There is no state regulatory scheme involved; and try as they may, the petitioners attempt to create some kind of regulatory scheme. And yet the issue in this case essentially involves the breach of a fiduciary duty, alleged breach of a fiduciary duty. I suppose if certification were appropriate or abstention were appropriate in this case, one might say then in virtually in any case where one alleges a breach of a fiduciary duty, if there is an unsettled issue of law, that that is a proper case for certification.

Q But you still agree that Florida law controls?

MR. RUBY: There is no question about that, Mr. Justice Marshall. Under the Erie case I think the Court

of Appeals clearly recognized that, and it did its duty, I would submit, under Erie as required by Congress under the Diversity of Jurisdiction Act to decide the case unless there was special circumstances which this Court has said warranted abstention.

No one in this case was asking a federal court to in effect enjoin state officials from carrying out their act. There is no peculiar local issue involved here such as eminent domain that was involved in Thibodaux. There was no issue here, as there was in the Kaiser case involving the control of vital natural resources.

Q The inquiry under Erie is actually--for the court sitting in the Southern District of New York--is, What conflicts of law would the New York Court of Appeals apply in this case? Is it not?

MR. RUBY: That is correct.

Q And then you would look to that new York law, and if that New York law in turn refers you to Florida law, then the district court goes to Florida law.

MR. RUBY: That is correct, Mr. Justice Rehnquist.

The main issue in this case is not even the propriety of the petitioners' conduct. Even the petitioners have conceded here that the act that was committed--that is, trading with inside information--has been subject to universal condemnation. So that we are not even talking, as we are in

most abstention cases, with whether certain conduct within a state is proper or not. What we are talking about in this case is whether or not Lum's should have a remedy to recover recover the profits which were made by these defendants as a result of their alleged trading with the use of confidential corporate information.

We would submit only to the Court on this point that it cannot be seriously urged that it is the public policy of Florida that persons should be permitted to engage in trading with confidential corporate information in the stock of Florida corporations and that the decision in this case would interfere with that public policy.

Therefore, we would submit that this case does not present the classic conflicts where special circumstances which would have warranted abstention.

I would say recognizing really that this is not a proper abstention case, the main thrust of the petitioners' argument is that any case which involves an unsettled issue of law, of state law, is a case which is a proper case for certification. And they go even further. They say if the court does not certify, even if it was never even requested to do so, that it has committed error.

I think this Court has made it clear that--and if I may borrow a phrase from Mr. Justice Brennan--there is a very narrow corridor through which a federal court may escape from

its obligation to decide state law questions when federal jurisdiction is properly invoked. We would respectfully submit that to accept the petitioners' contention that where there is an unsettled issue of state law--and I might say parenthetically in a majority of cases it might be reasonably contended that the state law issue is not settled--that this would be to open the door wide and really to turn this narrow corridor, which the Court has very carefully limited into what I think might be described as really a wide canyon. And I think these are the clear implications of the petitioners' argument.

There is no support that the petitioners can gain, as I have indicated, from either the Clay case or Dresner. Aldrich, since in those cases you are dealing with classic abstention cases. In fact, Aldrich and Dresner were not even diversity cases.

In Clay I think it is also appropriate to note--and I have referred to this, the remarks by Mr. Justice Douglas, where he gave protest to the practice of making litigants travel a long and expensive road in order to obtain justice. And I might add that the case has already been pending three years. Certification will now require the parties to perhaps spend another year on an appellate level by going down to Florida. If certification is appropriate here, it may well be appropriate after trial, assuming that the plaintiffs prevail on the allegations of the complaint. The proof in this case may be

different than the allegations of the complaint, and the issue may arise how the plaintiffs prove the case under Florida law. And again the argument could be made that that is an issue which should be certified. and the case may go on for many more years, with the consequent burdens to the parties as a result of that.

Q Have you run across an SEC case that took less than three years?

MR. RUBY: I suppose, Your Honor, only where there in consent judgments. Generally not.

But I think nevertheless the object here is certainly not to increase the time or expense to the litigants.

Q Mr. Hagan, are these respondents also parties to the class actions--

MR. RUBY: I am sorry, I am Mr. Ruby.

Q I beg your pardon, Mr. Ruby. Are the respondents in this case parties to the class action suit?

MR. RUBY: They are, Your Honor, and they were also of course parties to the action brought by the SEC. I might say in that there was a consent judgment by the mutual fund defendents. They consented to judgment against them. Lehman Brothers went to trial, and the district court found they were not liable on the limited ground that they were not responsible for their agent, who is the one who in effect passed on the information.

Q Is that in the SEC injunction suit?

MR. RUBY: It was, Your Honor.

Q What is the current status of the class action suit?

MR. RUBY: I believe that it is still pending, Your Honor. I do not know its precise status. I know they are still pending and being litigated.

As i have indicated before, I would like to just turn for a moment to the equities of this case. I think this is a particularly inappropriate case, I would submit to the Court, to find that the court below erred in not certifying where the petitioners never even requested certification before an adverse decision on the merits.

This Court has said I think time and time again that such a procedure is to be criticized and certainly should not be sanctioned where one goes into court, submits his rights to court, gets an adverse decision, and then wants to go to another court to litigate the same issues.

In the Hostetter case, in holding that it was not error in not abstaining, this Court referred to the fact that neither party had requested it.

In the England case, in somewhat different circumstances, this Court indicated that where a party like the petitioners freely litigates his claims in one court, even though he may not be required to do so, he should not be allowed

to ignore the adverse decision and then start all over in another court. And that is precisely what the petitioners are seeking to do here. As Mr. Justice Rehnquist aptly noted, we would not be here today seeking certification, if the petitioners had prevailed in the Court of Appeals.

This Court in England said that such a procedure, the kind that the petitioners are seeking to follow now, would countenance an unnecessary increase in the length and cost of litigation.

! nd there are many other cases along those lines. Those cases involving disqualification of a judge at court indicate that the litigant cannot experiment with the Court to see what happens, and this is precisely what the petitioners have done here. They were quite willing to let the Court of Appeals decide the case. But then when it was decided against them after they, so to speak, tested the water, found it not to their liking; then they urged that the court should not have decided the case to begin with.

Mr. Hagan this morning in his reply brief I think made remarkable statement in response to Mr. Rehnquist's question. He said that there was no occasion for certification until after the decision below, since the law of Florida was not debatable or uncertain.

I might say in passing if the law was not uncertain, then you would not even have a proper case for certification.

But the implication of what the petitioners are saying is that you do not even determine whether certification is appropriate by considering the nature of the case or the issues before decision. What you do is that after the decision you look at the decision and if you think it is wrong, then you argue that certification should have taken place.

I would suggest respectfully to the court that this procedure has nothing to commend it and certainly should not be sanctioned by this Court in this case.

One further point on the procedure. The petitioners attempt in their reply brief to overcome the obvious inequity of the procedure they followed by making reference to the decision in the Kaiser case where, after an adverse decision, the petitioner made a motion asking the court of appeals to abstain, pending a determination in a pending declaratory judgment action in the state. The Tenth Circuit denied that motion, with Judge Brown, who was sitting by designation from the Fifth Circuit, dissenting.

This Court of course then went on to reverse and order abstention.

The Kaiser case, however, certainly is a different kind of case and does not sanction the kind of procedure that the petitioners have followed here. Kaiser was a classic abstention case. You were dealing there with the law of eminent domain. You were dealing there with the control of a

vital natural resource, water within the State of New Mexico. Even the attorney general of New Mexico had come in and ask that abstention take place. Where you have this classic abstention case, then the fact that a litigant did not ask for certification perhaps is not determinative, because there you are dealing with great public stakes.

I will close just by referring to what Judge Brown said in his dissent in the Tenth Circuit. He said, "If we were not dealing with serious matters of great public moment and importance to New Mexico, I would be quite willing to say to Kaiser that it must live with the consequences of a federal court diversity jurisdiction."

Finally he went on to say, "Similarly the fact that the motion is now made after the adverse decision of this Court, while a powerful circumstance in many situations, does not prevent the exercise of abstention now in view of these great public stakes."

And I would only urge this court that here where we are not dealing with those great public stakes or considerations that are present in abstention, that the failure to request certification before an adverse decision should either constitue a waiver or bar to argue that the court erred in not doing so or, at the very least, should represent, in Judge Brown's words, powerful circumstance in determining whether the court of appeals, assuming that it had any discretion to

certify, abuse that discretion. We submit that it did not, and we respectfully urge that the decision of the Court of Appeals should be affirmed. Thank you.

Q Mr. Ruby, had the petioners here suggested to the Second Circuit at the oral argument of the case that it be certified, what is your guess as to the reaction of the panel?

MR. RUBY: Mr. Justice Blackmun, I cannot say what they would do. I would say what I think they should do. I would think because this case does not involve those considerations which justify a federal court abstaining from deciding the question itself, I would say it should not have certified in this case. Because in my judgment this court has indicated that a federal court is under a duty which is placed upon it by Congress in the Jurisdictional Act to decide questions of state law except in those very narrow circumstances. And I would respectfully submit that an examination of the nature of this case would reveal that those circumstances are not present. And, therefore, I would believe that the Court of Appeals would come to that conclusion. And I would assume, Your Honor, that since Judge Kaufman at least alluded to it, that there was some discussion among the judges, and this may well have been a consideration which influenced the court to decide the case, as well as I have indicated the failure of the petitioners to request it.

Q Do you feel that the failure of the majority even to mention it in their written opinion is not necessarily indicative of the fact that they felt the case had gone too far for certification?

MR. RUBY: I certainly do not, Your Honor. I think the fact that Judge Kaufman at least did mention it would suggest that the court did give consideration to it and decided on various grounds that it should decide the case and not certify.

If there are no other questions, thank you very much.

CHIEF JUSTICE BURGER: Mr. Hagan, you have about five minutes left.

REBUTTAL ARGUMENT BY JAMES J. HAGAN, ESQ.,

ON BEHALF OF THE PETITIONERS

MR. HAGAN: Your Honors, I believe that Mr. Ruby has overstated the position of the petitioners here and overstated the argument. We do not argue here for abstention. His entire argument and rebuttal and response is based on an abstention argument on behalf of the petitioners. Of course this does not take away the right of any party to go into federal court.

The argument in favor of certifacation is that it preserves that right, that federal fact finding is available, federal rules of discovery are available. The only issue that

is certified is the issue of state law, and it is found by the federal court in the same manner many other things are found in a litigation. In this case the question of Florida law almost becomes in effect a fact to be found by utilizing the certification statute.

They argue merit. They are setting up a straw man here. We do not claim abstention. There is no need for it. That is in effect the beauty of the new certification statutes. These arguments that have plagued the courts and the commentators for 20 or 30 years may in the future start to alleviate because abstention in this area may not be necessary any more.

Mr. Justice Marshall has well pointed out that their basic position is that certification is not justified in any case, because obviously you always have delay. The delay involved may be several months, it may be six months or more. But I would say that the answer to this delay argument, which is always brought up by the party opposing either abstention or certification was well answered by this Court back in 1942 in Fieldcrest Dairies, where Mr. Justice Douglas said, "Considerations of delay, inconvenience, and cost to the parties,which have been urged upon us, do not call for a different result." They were there granting abstention.

So, we are here concerned with a much larger issue as to the appropriate relationship between federal and state

authorities functioning as a harmonious whole. That issue is exactly before the Court today. The problems that have been raised by abstention over the years have now started to result in the statutory certification process. And I submit the Court should now encourage it.

And finally this point that who gets certification, whether you grant certification, should almost be a form of gamesmanship as to who asks first or who does not ask for it. It is simply inappropriate. When we were before the Second Circuit, we parties to a litigation where our view was that Florida law did not support the claim and the district court had so found and respondents here were unable to cite a single Florida case supporting their position. It was not our position before the Second Circuit that Florida law was so uncertain as to require certification. It became that way when the majority here developed the doctrine it did. Only then did the question of certification come to the forefront. Prior to that time, our position was not that the law of Florida was unsettled or uncertain.

With all of the problems Mr. Ruby points out about classical abstention, certainly the court that has had the most experience with certification in a federal context has not found it to be a burden and has found it in fact to be a great benefit.

As recently as 1969 the Fifth Circuit in Martinez

v. Rodriguez said the following: "We would be remiss if we did not once again seize the opportunity to extol the virtues of the Florida certification procedure. For example, while this court, following the footsteps of the stalwarts below might have reached the same conclusion as that of the Florida court with respect to the issue in this case, our decision would have had no assurance of predictable correctness. No matter how many federal judges, trial, appellate, three-judge panel, or the full panoply of the court en banc, any decision would have been an eerie guess. Now the guesswork has been eliminated and we are quickly presented with a definitive explication of Florida law."

That is the view of the Fifth Circuit, not just these petitioners, and we submit that this Court should reverse the decision below and direct the Second Circuit also to certify this question of Florida law to the Supreme Court of Florida.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

[Whereupon, at 11:36 o'clock a.m., the case was submitted.]

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