09-1619-cv

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

PACIFIC INVESTMENT MANAGEMENT COMPANY LLC, RH CAPITAL ASSOCIATES LLC,

Plaintiffs-Appellants,

PIMCO FUNDS: PACIFIC INVESTMENT MANAGEMENT SERIES, JOSEPH MAZUR, individually and on behalf of all others similarly situated, IRV KREITENBERG, STEVE KREITENBERG, MATTHEW LARSON, AMERICAN FINANCIAL INTERNATIONAL GROUP-ASIA, L.L, MICHAEL ALBRECHT,

Plaintiffs,

v.

MAYER BROWN LLP and JOSEPH P. COLLINS,

Defendants-Appellees,

(*caption continued on inside front cover*)

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF FORMER SEC COMMISSIONERS AND OFFICIALS, LAW AND FINANCE PROFESSORS, AND SECURITIES LAW PRACTIONERS AS *AMICI CURIAE* IN SUPPORT OF APPELLEES AND AFFIRMANCE

Erik S. Jaffe
ERIK S. JAFFE, P.C.
5101 34th Street, N.W.
Washington, D.C. 20008
(202) 237-8165
jaffe@esjpc.com
Counsel for Amici Curiae

(*caption continued*)

REFCO INC., PHILLIP R. BENNETT, GERALD M. SHERER, GRANT THORNTON LLP, BANC OF AMERICA SECURITIES, LLC, BENNETT TRUST, LEO R. BREITMAN, CMG INSTITUTIONAL TRADING, LLC, CREDIT SUISSE SECURITIES LLC, DEUTSCHE BANK, NATHAN GANTCHER, GOLDMAN, SACHS & CO., TONE GRANT, DAVID V. HARKINS, HARRIS NESBITT CORP., HSBC SECURITIES (USA) INC., J.P. MORGAN SECURITIES INC., SCOTT L. JAECKEL, DENNIS A. KLEJNA, THOMAS H. LEE, LIND-WALDOCK SECURITIES LLC, SANTO MAGGIO, MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED, MURIEL SIEBERT & CO., INC., JOSEPH J. MURPHY, RONALD L. O'KELLEY, REFCO GROUP HOLDINGS, INC., REFCO MANAGED FUTURES LLC, SAMUEL A. RAMIREZ & CO. INC., SANDLER O'NEIL & PARTNERS, L.P., SCOTT A. SCHOEN, WILLIAM M. SEXTON, PHILIP SILVERMAN, THE 1997 THOMAS H. LEE NOMINEE TRUST, THE WILLIAMS CAPITAL GROUP, L.P., THL REFCO ACQUISITION PARTNERS, THOMAS H. LEE INVESTORS LIMITED PARTNERSHIP, THOMAS H. LEE PARTNERS, LP, UTENDAHL CAPITAL PARTNERS, L.P., WESTMINSTER-REFCO MANAGEMENT LLC, WILLIAM BLAIR & COMPANY, LLC, THL EQUITY ADVISORS V LLC, THOMAS H. LEE EQUITY FUND V, LP, ROBERT C. TROSTEN, MAYER BROWN LLP, JOSEPH P. COLLINS, BMO CAPITAL MARKETS CORP., NEW REFCO GROUP LTD., LLC, REFCO CAPITAL MARKETS, LTD., REFCO FINANCE HOLDINGS LLC, REFCO FINANCE INC., REFCO GROUP LTD., LLC, THE PHILLIP R. BENNETT THREE YEAR ANNUITY TRUST, THOMAS H. LEE PARALLEL FUND V, LP, THOMAS H. LEE EQUITY FUND V, L.P.

Defendants.

CONTENTS

CONTENTS i

AUTHORITIES ii

INTEREST OF *AMICI* 1

INTRODUCTION 5

SUMMARY OF ARGUMENT 8

ARGUMENT 10

I. THIS CASE IS AN INAPPROPRIATE VEHICLE IN WHICH TO CONSIDER THE SEC'S PROPOSED EXPANSION OF PRIMARY LIABILITY UNDER RULE 10b-5 10

II. EXISTING SECOND CIRCUIT PRECEDENT IS CONTROLLING AND APPROPRIATE 18

A. The Attribution Requirement Provides Clear and Adequate Limits on Private Damages Claims. 18

B. The SEC's Proposed Rule Would Have Adverse Consequences for Advisors, Corporations, and Investors. 19

C. Whether to Expand Liability to Secondary Actors Is a Policy Decision for Congress, Not the Courts. 27

CONCLUSION 30

AUTHORITIES

Cases

Alexander v. *Sandoval*, 532 U.S. 275 (2001) 28

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) 22

Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994) 21, 22, 23, 26, 29

Dura Pharms., Inc. v. *Broudo*, 544 U.S. 336 (2005) 27

In re Refco, Inc. Securities Litig., 609 F. Supp.2d 304 (S.D.N.Y. 2009) 7

Lattanzio v. Deloitte & Touche LLP, 476 F.3d 147 (2d Cir. 2007) 6, 16, 17, 21

Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 128 S. Ct. 761 (2008) 12, 15, 21, 27, 28, 29

Tellabs, Inc. v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007) 28

Wright v. Ernst & Young, LLP, 152 F.3d 169 (2d Cir. 1998) 6, 15, 17

Statutes

15 U.S.C. § 7246 15

15 U.S.C. § 78t(e) 6, 11

18 U.S.C. § 2 11

Other Authorities

148 Cong. Rec. S6584 (daily ed. July 10, 2002) 29

Compl., *SEC v. Collins*, No. 07 Civ. 11343 (S.D.N.Y. Dec. 18, 2007), *available at* http://www.sec.gov/litigation/complaints/2007/comp20402.pdf 6

Donald C. Langevoort, *Capping Damages For Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639 (1996) 25

Frank H. Easterbrook & Daniel R. Fischel, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991) 26

H.R. Rep. No. 107-414 (2002) 29

INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION (2006) 25

James D. Cox, Robert W. Hillman, & Donald C. Langevoort, SECURITIES REGULATION: CASES AND MATERIALS (5th ed. 2006) 26

Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487 (1996) 26

John C. Coffee, *Reforming The Securities Class Action: An Essay On Deterrence And Its Implementation*, 106 COLUM. L. REV. 1534 (2006) 26

Joseph A. Grundfest, *Why Disimply*?, 108 HARV. L. REV. 727 (1995) 26

Larry E. Ribstein, *Dabit, Preemption and Choice of Law*, 2006 CATO SUPREME COURT REVIEW 141 (2006) 26

Michael Klausner, *Are Securities Class Actions "Supplemental" to SEC Enforcement? An Empirical Analysis*, Draft Paper, Apr. 1, 2009, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1433577 12

Richard A. Epstein, CASES AND MATERIALS ON TORTS (8th ed. Aspen 2004) 26

S. Rep. No. 104-98 (1995) 28

Stephen J. Choi & Adam C. Pritchard, SECURITIES REGULATION: CASES AND ANALYSIS (2005) 26

Rules

FED. R. APP. P. 29 5

Regulations

17 C.F.R. § 210.10-01(d) 21

17 C.F.R. § 201.1100 15

INTEREST OF *AMICI*

Amici curiae include a bipartisan group of former Commissioners and officials of the United States Securities and Exchange Commission (SEC), prominent law and finance professors whose field of academic inquiry includes securities regulation, class-action practice, and law and economics, and prominent securities law practitioners with extensive experience in representing publicly traded corporations. *Amici* have devoted substantial parts of their professional careers to implementing, drafting, and/or studying the federal securities laws, including how those laws should be interpreted to ensure the protection of investors and the promotion of efficiency, competition, and capital formation. *Amici* write not only because they believe that the decision below should be affirmed, but because they are particularly troubled by the SEC's proposed expansion of the definition of *primary* securities law violators to include persons and entities that merely assisted – via drafting, editing, or reviewing – corporate speakers in crafting statements later alleged to be false or misleading. This expansion raises special concerns when applied to legal counsel providing advice to clients, of which many of the *amici* have unique knowledge and experience. Such an expansion of liability is for Congress, not the courts, to decide, and Congress has consistently declined to expand damages liability to such classically secondary violators.

The former Commissioners, officials, professors, and practitioners joining this brief as *amici*, listed alphabetically by category, are:

The Honorable Harvey L. Pitt, who served as the Chairman of the SEC from 2001 through 2003, and who also served as General Counsel of the SEC from 1975 through 1978.

The Honorable Edward H. Fleischman, who served as a Commissioner of the SEC from 1986 through 1992, and is now Senior Counsel at Linklaters LLP.

The Honorable Joseph A. Grundfest, who served as a Commissioner of the SEC from 1985 through 1990, and who is the William A. Franke Professor of Law and Business and Co-Director of the Rock Center on Corporate Governance at Stanford Law School.

Simon M. Lorne, who served as General Counsel to the SEC from 1993 through 1996, and is now Vice Chairman and Chief Legal Officer of Millennium Management LLC as well as an adjunct member of the faculty of the New York University Law School.

Richard H. Rowe, who served as the Director of the SEC's Division of Corporate Finance from 1976 through 1979, and is now a partner at Proskauer Rose LLP and Chair of the Committee on Law and Accounting of the Business Law Section of the ABA.

Richard A. Epstein, the James Parker Hall Distinguished Service Professor of Law and Director, the Law and Economics Program, at the University of Chicago Law School, and the Peter and Kirsten Bedford Senior Fellow at the Hoover Institution.

Allen Ferrell, the Greenfield Professor of Securities Law at the Harvard Law School, Member of the ABA Task Force on Corporate Governance, and Academic Fellow at the Financial Industry Regulatory Authority. He speaks and writes extensively on securities regulation and litigation.

M. Todd Henderson, Assistant Professor of Law at the University of Chicago Law School. His research and teaching includes corporations, securities regulation, and law and economics.

Steven N. Kaplan, the Neubauer Family Professor of Entrepreneurship and Finance at the University of Chicago Booth School of Business, a Research Associate at the National Bureau of Economic Research, and an associate editor of the Journal of Finance and the Journal of Financial Economics. He is one of the world's foremost researchers on corporate governance, private equity, and venture capital and teaches courses on corporate governance and corporate financial management.

Adam C. Pritchard, the Frances and George Skestos Professor of Law at the University of Michigan Law School, and who served as Senior Counsel in the

Office of the General Counsel of the SEC and a visiting scholar at the SEC. He is the co-author of a leading casebook and treatise on securities regulation and researches and writes extensively regarding securities class action litigation.

Larry E. Ribstein, the Mildred Van Voorhis Jones Chair in Law at the University of Illinois College of Law, Director and Co-Director of the Illinois Business Law and Policy Program from 2006 through the present, and a member of the Executive Committee of the AALS Section on Securities Regulation. He has written numerous books and articles on corporate and securities law.

Amanda M. Rose, Assistant Professor of Law at the Vanderbilt University Law School. Her research and teaching focus on corporate and securities law and she has written on the relationship between public and private enforcement of Rule 10b-5.

James H. Cheek, III, a senior member of the law firm of Bass, Berry & Sims PLC, Co-Chair of the ABA Business Law Section Coordinating Task Force on Financial Institutions and Markets, and who served as Chair of the Business Law Section of the ABA from 1998 through 1999 and Chair of the National Task Force on Corporate Responsibility from 2002 through 2003.

Karl John Ege, senior counsel of the law firm of Perkins Coie LLP, former Vice Chairman and Chief Legal Officer of Russell Investments, Immediate Past Chair of the Business Law Section of the ABA, and the ABA Business Law

Section's Liaison to the ABA Task Force on Financial Markets Regulatory Reform.

Stanley Keller, a partner in the law firm of Edwards Angell Palmer & Dodge LLP, former Chair of the Federal Regulation of Securities Committee of the Business Law Section of the ABA, and a member of the ABA Task Force on Attorney-Client Privilege.[1]

Amici's authority to file this brief comes from FRAP 29(a), and the consent of all parties.

INTRODUCTION

This case involves alleged conduct by outside counsel relating to offerings of bonds and common stock that represents, at best, classic aiding and abetting of securities law violations by a corporation and its officers. Aiding and abetting a securities law violation is, of course, illegal, and *amici* here do not suggest that aiding and abetting should go unpunished. In this case itself, the individual attorney who allegedly aided and abetted the false statements by the corporation was indeed prosecuted and convicted of secondary securities law violations, and is the subject of an SEC enforcement action. Compl., *SEC v. Collins*, No. 07-Civ.-11343 (S.D.N.Y. Dec. 18, 2007), *available at* http://www.sec.gov/litigation/

[1] The views presented in this brief are those of the *amici* joining the brief, and not those of the institutions with which they are or were formerly affiliated.

complaints/2007/comp20402.pdf; *see also* 15 U.S.C. § 78t(e) (Section 20(e)) ("Prosecutions of Persons Who Aid and Abet Violations"). The issue, therefore, is not whether such conduct will be permitted or will go unpenalized, but whether the law also permits, in addition to the criminal and civil proceedings that have already occurred, a further private class action for money damages.

In this Circuit, the law is clear that no such private action exists against the non-speaking aiding and abetting conduct alleged in this case. As the court below recognized, the false statement at issue was made by the corporation itself and was neither attributed to nor adopted by the attorney and law firm defendants in this case. The alleged involvement of outside counsel in the false statement was limited to drafting and reviewing portions of the documents containing the false statements. As required by this Court's precedents, such conduct in allegedly assisting the creation of a false statement by a corporation, that is not attributed to the attorney or his law firm, at most alleges a secondary violation of aiding and abetting the false statement of the corporation, and does not give rise to a private claim for damages. *Lattanzio v. Deloitte & Touche LLP*, 476 F.3d 147, 153-56 (2d Cir. 2007); *Wright v. Ernst & Young, LLP*, 152 F.3d 169, 174-76 (2d Cir. 1998).

In an *amicus* brief to this Court, however, the SEC takes issue with the legal standard applied by the district court. In dismissing the Section 10(b) claims against the outside attorney and his former law firm, the district court applied this

Court's decisions in *Lattanzio* and *Wright* to hold that because the allegedly false and misleading statements by Refco were not "attributed" to Collins or Mayer Brown, there was no primary violation by such secondary actors, and hence no cause of action for damages. *In re Refco, Inc. Securities Litig.*, 609 F. Supp.2d 304, 312 (S.D.N.Y. 2009). The SEC objects to the "attribution" rule as the dividing line for primary and secondary violators in the false statements context, and instead proposes an alternative rule under which "a person makes a false or misleading statement and thus can be liable as a primary violator of Rule 10b-5 when that person <u>creates</u> the statement." SEC Br. at 7 (emphasis in original). According to the SEC, in addition to the usual case of a person actually making a statement by speaking, issuing a written statement, or adopting a statement as his own, a person also "creates" and thus "makes" a false statement when he "provides the false or misleading information" to another speaker. The SEC thus suggests the possibility that "a person who actually drafted an offering document containing false or misleading statements can be a primary violator" as can be the person "who supplied the writer with the false or misleading information in the document." SEC Br. at 7. Emphasizing the breadth of the new rule it here proposes, the SEC notes that a person can be a primary violator regardless whether he was part of a group working on the document and "regardless of whether he

initiated the false or misleading statement, i.e., whether the idea for the misstatement was his own or came from somebody else." SEC Br. at 9.[2]

Curiously, the SEC takes no position on whether its new rule should apply to the claims in this case or whether the decision below should be affirmed or reversed, SEC Br. at 5, making it difficult to predict how its proposed rule would be applied in actual cases.

SUMMARY OF ARGUMENT

This Court should decline the SEC's invitation to use this case as a vehicle for inventing a new rule expanding primary liability for false statements to virtually any person involved in the statement's creation. This case is a particularly inappropriate vehicle for considering such a new rule insofar as the SEC declines to state its views on whether or how its proposed rule might even apply to this case, bases its proposal on a concern over hypothetical situations that have nothing to do with this case, and has ample opportunity to present its proposed rule in its own enforcement actions or in an appropriate private suit where the SEC could apply the rule to a specific set of facts. By simply inviting a new rule without relevant factual context, the SEC effectively is seeking an

[2] The SEC, at 9, generously allows that a person who prepared a "truthful and complete" portion of a document containing false statements elsewhere would not be a "primary" violator absent a duty to speak. One wonders whether the SEC would still consider such persons "secondary" violators.

advisory opinion from this Court announcing a broad and amorphous rule with unknown scope and effect. And despite the SEC's acrobatic efforts to claim otherwise, the rule it proposes would require overruling this Court's decisions in *Wright* and *Lattanzio*, which reject primary liability in precisely the circumstances the SEC argues would be included in its new rule. This Court should decline the SEC's invitation to issue a rash advisory opinion overruling established precedent.

This Court's decisions in *Wright* and *Lattanzio* establish an appropriate and workable standard in the mine-run of cases where outside accountants, advisors, consultants, and attorneys have some involvement in the preparation of corporate documents but are not the actual speakers to whom any false statement is attributed. This Court's recognition of the limits of the implied cause of action under Section 10(b) and Rule 10b-5, and its reluctance to broaden damages liability to include ordinary advisors acting in a non-speaking capacity, is consistent with the Supreme Court's reluctance to expand liability for damages to secondary actors in general and is more than justified by the difficult policy questions and practical consequences that surround any such expansion of damages liability.

If the SEC's proposed standard were adopted, it would greatly expand the range of potential defendants for virtually any false statement given that corporations routinely seek advice and assistance from many outside advisors

when preparing statements or financial documents. Under the SEC's proposed rule, outside lawyers, accountants, actuaries, financial consultants, and the like would be exposed to substantial litigation risk from zealous plaintiffs' attorneys. The costs of such litigation risk, and the consequences for market efficiency, have been recognized by numerous scholars and the Supreme Court. Whether to impose such costs on a vast new category of "creator" defendants involves numerous policy decisions and the balancing of the potential good, if any, from such a rule, against its substantial costs. Such policy balancing is best left to Congress which, when last asked by the SEC and others to expand damages liability to secondary actors, declined to do so. This Court has correctly refused to expand damages liability to non-speaking secondary actors, and it should decline the SEC's invitation to abandon existing precedent and do so now.

ARGUMENT

I. THIS CASE IS AN INAPPROPRIATE VEHICLE IN WHICH TO CONSIDER THE SEC'S PROPOSED EXPANSION OF PRIMARY LIABILITY UNDER RULE 10b-5.

The SEC's *amicus* brief in this case is a peculiar document. It proposes a new standard for private damages liability for false statements that does not require a defendant to have actually spoken or adopted the false statement. It does not require a person claiming injury from a false statement even to have known of or relied upon the involvement of such a non-speaking defendant. It opposes this Court's established "attribution" requirement as supposedly too narrow to address

hypothetical anonymous or behind-the-scenes wrongdoers, yet offers a "creator" test that is so broad that it would sweep in virtually all outside advisors and consultants operating in the normal course. It offers a few meager justifications for its proposed expansion of private damages liability, yet fails to explain how even one of those justifications has any relevance or application to this case. And, perhaps because the SEC's arguments indeed have nothing to do with this case, it declines to take any position on how or even whether its proposed "creator" rule would apply to this case, and expresses no views whether the case should be affirmed or reversed. In short, the SEC asks for an advisory opinion adopting a new legal rule effectively overruling this Court's precedents without doing any of the heavy lifting necessary to justify such a drastic change or to demonstrate the scope and consequences of its new rule in actual or typical cases involving outside advisors.

First, this case does not involve any dispute over whether aiding and abetting of securities law violations should be permitted or should go unpunished. *Amici* here fully acknowledge the SEC's authority to bring a civil enforcement action and the Justice Department's authority to prosecute the aiding and abetting conduct alleged in this case. 15 U.S.C. § 78t(e); 18 U.S.C. § 2. Indeed, the SEC *has* brought an enforcement action against defendant Collins alleging that he aided and abetted Refco's false statements and Collins has been prosecuted and convicted for

his alleged assistance in Refco's securities fraud. But it is precisely because existing public enforcement options were amply available in this case that the SEC's request for an expansion of private damages liability is so unnecessary and peculiar in this case. Far from establishing that there is any need for supplemental enforcement and deterrence against typical secondary actors, or any need to redefine the line between primary and secondary liability in the usual case, the SEC's exercise of its enforcement discretion in this case, and the conviction of attorney Collins for secondary securities law violations, strongly suggest that supplemental private damages suits are generally unnecessary. *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, --, 128 S. Ct. 761, 773 (2008) ("Secondary actors are subject to criminal penalties, see, *e.g.,* 15 U.S.C. § 78ff, and civil enforcement by the SEC, see, *e.g.,* § 78t(e). The enforcement power is not toothless. …. And in this case both parties agree that criminal penalties are a strong deterrent."). And, indeed, there appears to be little empirical support for the notion that class action suits are a valuable supplement to public enforcement in any event. *See* Michael Klausner, *Are Securities Class Actions "Supplemental" to SEC Enforcement? An Empirical Analysis*, Draft Paper, Apr. 1, 2009, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1433577, at 1 (raising "doubt regarding the claim that securities class actions provide a useful supplement to SEC enforcement").

Second, whatever the SEC's hypothetical concerns in other cases, none of those concerns apply here, and the SEC does not claim otherwise. For example, while the SEC notes a generic concern with supplementing civil enforcement actions, that concern is simply not relevant here given that the outside attorney, Collins, has already been prosecuted and convicted for his conduct, and the SEC has already brought an enforcement action against Collins for aiding and abetting. It is hard to imagine why such ample and effective actions must be supplemented by private litigants acting out of their own, rather than the public, interest. Indeed, the SEC's own reluctance to take a position in this case, and its tentative suggestion that a person would "arguably not cause a misstatement where he merely gave advice to another person regarding what was required to be disclosed," SEC Br. at 11, demonstrates both that there is no justification for extending primary liability to cover this case, and the inevitable uncertainty that would result if the SEC's broad and amorphous rule were adopted.

The hypothetical circumstances discussed by the SEC, at 4, 14-15 – involving anonymous speakers or behind-the-scenes actors pulling the strings of the putative speakers – are interesting, but of little relevance here. This was not a case of anonymous tips on the internet, but involved express and highly formalized statements by Refco regarding Refco's own bonds and stocks. The investing public understood precisely who was responsible for such corporate statements.

Likewise, there is no suggestion that Collins and/or Mayer Brown were somehow puppet-masters manipulating Refco into making the false statements. Rather, this is at best a classic case of aiding and abetting a primary violation by the corporation itself, falls easily within the SEC's jurisdiction, and falls just as easily outside the scope of the implied private cause of action under Section 10(b) and Rule 10b-5.

If the SEC is concerned about the hypothetical situations it cites, then it should wait for such a situation to arise and make its arguments in such a case with the actual facts presented and other available legal theories and applicable statutory sections presented for comparison. But for the mine-run of cases involving ordinary interactions between corporations and their advisors, such as here, there is no need for the rule the SEC proposes and ample danger in expanding damages liability for all advisors. This Court thus should decline the SEC's invitation to foray into unknown and undeveloped legal territory based on mere speculation regarding unusual hypothetical cases unlike the case at bar.

Third, as for the SEC's reference to a generic interest in providing compensation to investors, SEC Br. at 3, that interest is far from universally accepted as a justification for expanding private damages actions in the securities context, *see infra* at 24-27, and there is little or no claim that it is meaningful in this case. Additionally, the SEC's citation to a general statement from Congress in

the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, is hardly support for ever-expanding securities liability, particularly as that Act was expressly designed to limit the breadth and ease of filing private securities suits, and overtly declined to extend private damages suits to secondary actors such as are involved in this case. *Stoneridge*, 552 U.S. at --, 128 S. Ct. at 771.

Investors injured by corporate misstatements already have a cause of action against the primary violators – the corporation and its responsible officers – and often receive substantial recoveries or settlements from such suits. *Wright*, 152 F.3d at 171 ("the class reached a settlement with [the corporation] under which the company agreed to pay $1,480,000 to the class"). And such compensation is already supplemented by the SEC's existing mechanisms for imposing civil penalties, and for compensating victims of fraud through its authority under the "Fair Funds" provision in the Sarbanes-Oxley Act of 2002. 15 U.S.C. § 7246; *see also* 17 C.F.R. §§ 201.1100 to 201.1106; *Stoneridge*, 552 U.S. at --, 128 S. Ct. at 773 ("Since September 30, 2002, SEC enforcement actions have collected over $10 billion in disgorgement and penalties, much of it for distribution to injured investors.") (citing SEC, 2007 Performance and Accountability Report, p. 26, www.sec.gov/about/secpar2007.shtml (as visited Jan. 2, 2008)). Those remedies would seem to be more than adequate in this case. The SEC has made no attempt

to demonstrate a need for still further supplementation from suits against a broad array of tangentially involved secondary actors.

Fourth, the SEC's request for a new rule of primary liability is particularly suspect here in that it would require this Court to overrule existing circuit precedent. Although the SEC purports to reconcile its proposed rule with *Lattanzio* and *Wright*, those cases are squarely inconsistent with the rule the SEC proposes. For example, whereas the SEC would impose "creator" liability upon a person who merely "drafted" an offering statement "containing" false or misleading statements, or "supplied" false or misleading information used in the document, "regardless of whether he initiated the false or misleading statement," SEC Br. at 7, 9, this Court in *Lattanzio* squarely held that a plaintiff "cannot rely on the accountant's alleged assistance in the drafting or compilation of a filing," 476 F.3d at 153. *See also id.* at 154 ("Under *Central Bank*, Deloitte is not liable for merely assisting in the drafting and filing of the quarterly statements"); *id.* at 155 (confirming approval of a Massachusetts district court case for the proposition that "an accountant's review and approval of a company's financial statement are insufficient to support the imposition of liability on the accountant"). Similarly in *Wright*, this Court compared the competing tests for primary liability, endorsed the "bright-line" attribution test and *rejected* the "substantial[] participat[ion]" test that, as with the SEC's test, would impose primary liability based on an

accountant's "'significant role in drafting and editing'" an allegedly misleading letter or involvement "in the creation of false documents." 152 F.3d at 174-75 (citations omitted); *see also id.* at 176 (declining to adopt the substantial participation test).

Despite the SEC's inventive assertion that this Court viewed attribution as merely "one means" by which an outside advisor can become primarily liable for corporate misstatements, this Court was more than clear in its holdings that "a plaintiff *must* allege a misstatement that is attributed to the accountant 'at the time of its dissemination'" and that "a party can incur liability *only* if a misstatement is attributed to it at the time of dissemination." *Lattanzio*, 476 F.3d at 153, 155 (quoting and citing *Wright*, 152 F.3d at 174, 175) (emphasis added); *Wright*, 152 F.3d at 175 ("a secondary actor *cannot* incur primary liability under the Act for a statement not attributed to that actor at the time of its dissemination") (emphasis added). And the SEC's suggestion that the drafting of a statement constitutes the creation, and hence "making," of that statement is utterly incompatible with this Court's express rejection of the "drafting" of documents as a basis for primary liability.

Given the stark contrast between this Court's holdings in *Lattanzio* and *Wright* and the SEC's proposed rule, the SEC effectively is seeking to overrule those cases. Such an effort to overrule existing circuit precedent places a heavy

burden on the SEC that it has not even attempted to shoulder in this case. Given the extremity of the SEC's request, the dubious connection it has to this case, and the slim effort the SEC has made to justify the change, this Court should not entertain such request and should continue to apply the attribution rule under its controlling precedent.

II. EXISTING SECOND CIRCUIT PRECEDENT IS CONTROLLING AND APPROPRIATE.

As noted above, and in ample detail by the Defendants-Appellees, this Court's precedents in *Wright* and *Lattanzio* establish a bright line "attribution" rule applicable in the ordinary case of secondary advisors involved in the preparation of corporate documents. Defendants-Appellees' Br. at 19-24, 26-30. Absent attribution of a false statement to such secondary actors, they will not be liable as primary violators subject to private damages suits. That bright-line rule is clear, easily applied in the vast majority of ordinary cases, and controlling here.

A. The Attribution Requirement Provides Clear and Adequate Limits on Private Damages Claims.

Particularly in cases involving express corporate speech in the form of official filings or registrations, there is no doubt who the responsible speaker is and corporations may easily attribute statements to third parties when the corporation and the public relies on such parties. Under such circumstances, this Court's precedents permit both adequate public and private remedies against the primary

and secondary participants in any false statement, and provide a clear limitation on the potential monetary liability of secondary actors.

Given the SEC's undisputed authority to bring enforcement actions against secondary violators, and the threat of criminal prosecution against such persons, there is ample incentive for secondary actors to comply with the law. There is likewise ample incentive – both civil and criminal – for corporations and their officers to speak accurately, to check the accuracy of any materials prepared for them, and to attribute their statements to third parties insofar as they are relying on such parties. In terms of both law enforcement and public reliance, this Court's existing precedent is more than adequate and provides clear guidance for both corporations and their outside advisors.

B. The SEC's Proposed Rule Would Have Adverse Consequences for Advisors, Corporations, and Investors.

The SEC's proposed rule, however, would undermine that bright-line precedent, to the great detriment of those who must navigate the complexities of securities law, the efficiency of the market, and even investors themselves.

First, the SEC's broad "creator" rule would vastly expand the range of potential defendants subject to damages suits, with substantial adverse consequences for the market and no obvious benefits to the public. In the ordinary course of preparing all manner of corporate statements, corporations seek the

advice and assistance of a multitude of outside advisors. Attorneys and accountants are the two most obvious, assisting with the drafting of financial statements, offering documents, registration statements, and a myriad other corporate communications. Indeed, one reason such advisors are so heavily involved in corporate communications is precisely the risk of liability for the corporation if such statements are later deemed to run afoul of the securities laws. In addition to lawyers and accountants, numerous others regularly provide information for, draft portions of, and review corporate communications. Actuaries provide information regarding pension plan assets and liabilities, investment banks provide information regarding corporate transactions, and financial advisors and consultants provide information regarding corporate investments and assets. Each of those advisors similarly may assist in drafting or reviewing documents touching upon their areas of advice. Under the SEC's proposed "creator" rule, all of those outside advisors would be potentially liable for any false statements any time they provide even informal information to the corporation, draft, edit, or review corporate communications, or even act as mere scriveners incorporating information provided to them by the corporation itself.

One example that is particularly noteworthy is the effect the SEC's rule would have on accounting firms and their potential liability for unaudited quarterly financials. Under SEC rules, quarterly financial statements, though unaudited,

must still be "reviewed by an independent public accountant" regardless whether the company makes any public representations to that effect. 17 C.F.R. § 210.10-01(d); *Lattanzio*, 476 F.3d at 154-55. Indeed, in *Lattanzio*, this Court rejected a claim of primary liability based on just such required involvement by an accounting firm in a company's unaudited quarterly financials. *Id.* at 155-56. Whereas *Lattanzio* held that such required involvement did not transform the accounting firm into the "maker" of unaudited false statements, and that "attribution" was the "determinant of whether a defendant has made a statement for purposes of § 10(b)," *id.* at 156, the SEC's proposed rule would impose just such primary "creator" liability on non-speaking persons or firms that "drafted" such statements, even where they are not the source of any misstatement or misinformation.

Second, the breadth and vagueness of the SEC's proposed rule would invite abusive litigation against numerous corporate advisors, forcing them, at a minimum, to insure against the risk of even meritless suits. As the Supreme Court noted in *Stoneridge*, expanding potential liability to secondary actors carries with it the consequence that "extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies." 552 U.S. at --, 128 S. Ct. at 772; *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 189 (1994)

("'[L]itigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general.'") (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975)). "[E]xpos[ing] a new class of defendants to these risks" would cause outside advisors "to protect against these threats, raising the costs of doing business" *Id.* Such costs will not merely impact the advisors at risk, but inevitably will be factored back into the fees outside advisors charge for their services, ultimately being paid for by investors and translated into a dead-weight loss to the company. *Central Bank*, 511 U.S. at 189 (increased prices of professional services due to an uncertain risk of liability would "in turn [be paid] by the company's investors, the intended beneficiaries of the statute"). Indeed, because damages exposure from securities suits will almost always be far greater than the ordinary cost of the services provided by lawyers and other advisors, the cost of insuring against such potential liability could lead to a very substantial increase in fees.

Third, in addition to the costs of the liability risk itself being passed on to the corporation and its investors, exposing advisors to liability for virtually any communication they may touch will also affect whether and how they will provide their advisory services. If an outside advisor assumes liability for the work product of corporate employees or other corporate advisors, many firms may refuse to assist those corporations most in need of their services, to the detriment of both

such corporations and the investing public. *Central Bank*, 511 U.S. at 189 ("ripple effects" from litigation risk to outside advisers includes possibility that "newer and smaller companies may find it difficult to obtain advice from professionals").

And even where advisors continue to provide services, the expanded primary liability risk that would be created by the SEC's proposed rule would force them to seek extraordinary and perhaps total control over what information makes its way into corporate documents, control over how that information is expressed, and even an ability to "veto" the selection of certain other advisors deemed unsatisfactory. In essence, each outside advisor would be placed in the *de facto* position of having to warrant the accuracy of all corporate communications and hence would become his brother's (or sister's) keeper. Imposing such a gate-keeping role on each potentially liable advisor would force all advisors to devote far more resources and time to monitoring such statements in order to protect themselves from liability. The additional time spent on such monitoring will not only be redundant with the corporation's own monitoring to avoid liability, but will be redundant across numerous advisors working on a common document. The added transactional costs of such defensive monitoring by outside advisors, as well as the likely antagonism it would create among advisors and between advisors and corporations, represent additional dead-weight losses to the corporation and its shareholders without any necessarily significant gain in accuracy for corporate communications.

Indeed, in most cases, such costs will be imposed even though there would have been no false statement at all, as is the case for the vast majority of corporate communications. The expensive and likely paranoid defensive strategies the SEC's proposed rule would engender thus could thwart various transactions from occurring (for reasons having nothing to do with their merits) or slow them down immeasurably.

Fourth, particularly in the context of legal services, the defensive posture forced by the SEC's proposed rule would have negative consequences for the attorney-client relationship. As noted in the Brief of *Amici Curiae* Law Firms, at 12-14, attorneys facing liability for their involvement with virtually any corporate statement will be placed in an untenable position vis-à-vis their ethical obligations concerning client confidentiality. Such attorneys may have to defensively limit their involvement in corporate communications in order to avoid such conflicts and ethical quandaries, ultimately hindering their ability to candidly advise their corporate clients. But the availability of such advice is one of the best means of ensuring legal compliance with the securities laws, and hence the perverse effect of the SEC's proposed rule may be to make it more difficult for corporations to live up to their legal obligations, to the detriment of the investing public.

Fifth, even in generally meritorious cases where shareholders eventually recover added compensation from third parties involved in corporate false

statements, it is far from clear that investors benefit over the long term from such compensation when considered across the range of their holdings. A broad consensus in the academic community recognizes that the out-of-pocket measure of damages utilized in Rule 10b-5 class actions challenging aftermarket fraud is economically irrational. Innocent investors, rather than the actual wrongdoers, most often fund the recovery in Rule 10b-5 class actions. Payments by ancillary defendants, like accountants and investment banks, may be charged back to issuers (and, indirectly, their innocent shareholders) through increased fees due to litigation risk. *See* Donald C. Langevoort, *Capping Damages For Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 649 (1996). Moreover, ancillary defendants may themselves be publicly owned companies, thus implicating yet another group of innocent investors. As a result, the amount that some investors gain from private Rule 10b-5 class actions "will show up on the other side of the capital marketplace ledger as roughly an equal charge to other[]" innocent investors. Langevoort, 38 ARIZ. L. REV. at 649; *see* INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION at 79 (2006) (the transfer from diversified investors to other diversified investors "represents a pocketshifting wealth transfer that compensates no one in any meaningful sense and that incurs substantial wasteful transaction costs in the process"). Given that diversified investors are unlikely, over time, to suffer net harm from aftermarket securities

fraud,[3] this very expensive system of investor self-insurance is difficult to defend from a compensatory standpoint. John C. Coffee, *Reforming The Securities Class Action: An Essay On Deterrence And Its Implementation*, 106 COLUM. L. REV. 1534, 1545 (2006) ("From a compensatory perspective, the conclusion seems inescapable that the securities class action performs poorly.").

And, even aside from the wasteful pocketshifting of the actual recoveries from securities litigation, the transaction costs of the additional litigation itself is simply an outright loss to investors. Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1502 (1996) ("the risk of litigation, unlike the risk of securities fraud, cannot be diversified against because the legal fees of both sides constitute a deadweight loss"). More enforcement thus is not an unmitigated good. To the contrary, "[i]f there is excessive securities litigation, too many resources will be spent on litigation and on litigation avoidance. The cost of capital will then increase just as if a wasteful tax had been imposed on capital formation." Joseph A. Grundfest, *Why Disimply*?, 108 HARV. L. REV. 727, 732 (1995) (emphasis omitted); *see also Central Bank*, 511 U.S. at 188

---

[3] *See* Frank H. Easterbrook & Daniel R. Fischel, THE ECONOMIC STRUCTURE OF CORPORATE LAW 339-341 (1991); Richard A. Epstein, CASES AND MATERIALS ON TORTS 1124 n. 4 (8th ed. Aspen 2004); Stephen J. Choi & Adam C. Pritchard, SECURITIES REGULATION: CASES AND ANALYSIS 348 (2005); James D. Cox, Robert W. Hillman, & Donald C. Langevoort, SECURITIES REGULATION: CASES AND MATERIALS 727-728 (5th ed. 2006); Larry E. Ribstein, *Dabit, Preemption and Choice of Law*, 2006 CATO SUPREME COURT REVIEW 141, 147-152 (2006).

(expanding damages liability to secondary actors would "exact[] costs that may disserve the goals of fair dealing and efficiency in the securities markets").

C. Whether to Expand Liability to Secondary Actors Is a Policy Decision for Congress, Not the Courts.

Given such competing concerns raised by expanding liability to outside advisors, the decision whether to do so should be made by Congress, not the courts. As the Supreme Court has regularly and forcefully noted, the competing policy concerns raised by expanding damages liability counsel the courts to be wary of expanding such liability beyond the parameters of the existing implied cause of action under Section 10(b) and Rule 10b-5. *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 347 (2005) (rejecting plaintiffs' claim that loss causation need not be alleged with specificity based on concerns about "'abusive' practices"). Similarly, "[c]oncerns with the judicial creation of a private cause of action caution against its expansion. The decision to extend the cause of action is for Congress, not for us." *Stoneridge*, 552 U.S. at --, 128 S. Ct. at 773.

Congress has now stepped in and provided some guidance on private actions, and courts must now step back and leave any further policy choices to Congress. As the Supreme Court has recognized, the "PSLRA was intended to have 'Congress … reassert its authority in this area,'" and Congress "accepted the § 10(b) private cause of action as then defined but chose to extend it no further."

Stoneridge, 552 U.S. at --, 128 S. Ct. at 773 (quoting S. Rep. No. 104-98, p. 4-5 (1995)). Particularly in light of Congress' affirmative involvement in addressing the parameters of Section 10(b) claims, the days of judicially-implied private rights of action are now long past. *Alexander* v. *Sandoval*, 532 U.S. 275, 287 (2001); *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 327 (2007) ("It is the federal lawmaker's prerogative . . . to allow, disallow, or shape the contours of … § 10(b) private actions").

If the SEC believes that an expansion of private securities litigation is advisable – in light of the changes wrought by the PSLRA, to better incentivize gatekeepers to police for fraud, or for any of the other various policy reasons set forth in its brief – it should direct its proposals to Congress, not this Court. It is Congress that must balance the putative benefits of extended damages liability against the costs of expanding the class of defendants subject to abusive and costly litigation. *See, e.g.,* S. Rep. No. 104-98, at 48 (1995) (noting risks of meritless litigation raised by private aiding-and-abetting liability).

The SEC's proposed new definition of a primary violator asks this Court to do precisely what the Supreme Court refused to do in *Central Bank* and *Stoneridge* – expand damages liability to behavior best described as aiding and abetting. The SEC has twice sought and failed to obtain such expanded private damages liability

from the Supreme Court, and has likewise failed to convince Congress of the wisdom of such an expansion.[4]

Although the Commission's tactic is new – redefining what it means to "make" a statement to include conduct aiding another in the making of a statement – what they seek is little different from their past failed attempts to allow private suits against aiders and abettors. *Central Bank*, 511 U.S. at 188-90 (rejecting SEC's policy arguments for imposing private damages liability on aiders and abettors); Defendants-Appellees' Br. at 39 n. 22 (describing position recommended by the SEC but rejected by the Solicitor General and the Supreme Court). Just as the plaintiffs' (and the SEC's) theory in *Stoneridge* would have "revive[d] in substance the implied cause of action against all aiders and abettors" with only limited exceptions, and would have "undermine[d] Congress' determination that this class of defendants should be pursued by the SEC and not by private litigants," 552 U.S. at --, 128 S. Ct. at 771, so too would the SEC's theory in this case provide a back-door to imposing liability on aiders and abettors and undermining Congress' policy choices. The SEC having failed to persuade either the Supreme

---

[4] Congress consciously decided, both when it enacted Section 20(e) in 1995 and again when it enacted Sarbanes-Oxley in 2002 – *not* to extend the right to enforce this liability to private plaintiffs. *See* S. Rep. No. 104-98, at 48 ("The Committee believes that amending the 1934 Act to provide explicitly for private aiding and abetting liability actions under Section 10(b) would be contrary to S. 240's goal of reducing meritless securities litigation"); H.R. Rep. No. 107-414, at 54 (2002); 148 Cong. Rec. S6584 (daily ed. July 10, 2002).

Court or Congress to expand private damages liability to secondary actors, this Court should not entertain the SEC's efforts to reargue such matters in yet another, and less appropriate, venue.

CONCLUSION

To the extent the SEC is genuinely concerned with the speculative situations of anonymous speech or behind-the-scenes manipulation of speakers, it should address those concerns in a case involving those facts. This Court in this case, however, should avoid altering its established and sensible rule in an ordinary case such as this merely out of some speculative concern for unusual hypothetical cases not relevant here.

This Court should affirm the decision below and confirm the applicability of its attribution rule in cases involving outside advisors.

Respectfully Submitted,

s/ Erik S. Jaffe
Erik S. Jaffe
ERIK S. JAFFE, P.C.
5101 34th Street, N.W.
Washington, D.C. 20008
(202) 237-8165
jaffe@esjpc.com

Counsel for Amici Curiae

September 16, 2009

CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing Brief of Former SEC Commissioners and Officials, Law and Finance Professors, and Securities Law Practioners as *Amici Curiae* In Support of Appellees and Affirmance, complies with the type-face requirements of Fed. R. App. P. 32(a)(5) & (6) and the 7,000 word type-volume limitation of Fed. R. App. P. 29(d) and 32(a)(7)(B) in that it uses Times New Roman 14-point type and contains 6995 words, excluding the table of contents, table of authorities, and certificates of counsel. The number of words was determined through the word-count function of Microsoft Word.

s/ Erik S. Jaffe
Erik S. Jaffe

ANTI-VIRUS CERTIFICATION

I hereby certify that the foregoing Brief of Amici Curiae submitted in PDF format as an attachment to an e-mail sent to **civilcases@ca2.uscourts.gov**, was scanned using Norton Internet Security version 16.7.2.11 (with updated virus definition file as of 9/16/2009) and no viruses or other security risks were found.

s/ Erik S. Jaffe
Erik S. Jaffe

CERTIFICATE OF SERVICE

I hereby certify that, on this 16th day of September, 2009, I caused the foregoing Brief of *Amici Curiae* Former SEC Commissioners, *et al.*, to be served by First Class mail, postage pre-paid, on the following:

John P. Coffey
Bernstein Litowitz Berger
& Grossman LLP
1285 Avenue of the Americas
New York, N.Y. 10019
sean@blbglaw.com

Stuart M. Grant
Grant & Eisenhofer, P.A.
485 Lexington Avenue, 29th Floor
New York, N.Y. 10017
sgrant@gelaw.com

Megan McIntyre
Grant & Eisenhofer, P.A.
1201 North Market Street
Wilmington, DE 19801
mmcintyre@gelaw.com

John K. Villa
Williams & Connolly LLP
725 Twelfth Street, N.W.
Washington, D.C. 20005
jvilla@wc.com

William J. Schwartz
Cooley Godward Kronish LLP
1114 Avenue of the Americas
New York, N.Y. 10036
wschwartz@cooley.com

I further certify that a PDF copy of this brief was e-mailed on this date to each of the above counsel.

s/ Erik S. Jaffe
Erik S. Jaffe