09-1619-cv

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PACIFIC MANAGEMENT COMPANY LLC,
RH CAPITAL ASSOCIATES LLC,

Plaintiffs-Appellants,

PIMCO FUNDS: PACIFIC INVESTMENT MANAGEMENT SERIES,
JOSEPH MASUR, individually and on behalf of all others similarly situated,

(For Continuation of Caption See Inside Cover)

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

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

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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,

REFCO INC., PHILLIP R. BENNETT, GERALD M. SHERER, GRANT THORNTON LLP, BANC OF AMERICA SECURITIES, LLC, BENNETT TRUST, LEO R. BRIETMAN, CMG INSTITUTIONAL TRADING, LLC, CREDIT SUISE SECURITIES LLC, DEUTSCHE BANK, NATHAN GANTCHER, GOLDMAN, SACHS & CO., GRANT THORNTON, LLP, 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 AL. 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., WESTMINISTER-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, and THOMAS H. LEE EQUITY FUND V. L.P.,

Defendants.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES. iii

INTEREST OF THE *AMICUS CURIAE*. 1

ARGUMENT. 4

I. THE "CREATOR" THEORY HAS BEEN REPEATEDLY URGED IN VARIOUS OTHER GUISES AND REPEATEDLY REJECTED. 5

A. Over The Last Fifteen Years, The SEC Has Repeatedly Advocated For Sweeping Definitions of Primary Liability Against Secondary Actors, But Courts Have Consistently Rejected These Efforts. 6

1. The SEC Favored Broad Liability For Secondary Actors, But The Supreme Court And Congress Disagreed. 7

2. Following *Central Bank* And The PSLRA, The SEC Sought To Revive Aiding And Abetting By Broadly Redefining Primary Liability. 9

3. *Wright*'s Bright-Line Test Requires That A Defendant *Actually* – As Opposed To Impliedly Or Indirectly – Make A Statement, And Further Rejects The SEC's Position That Attribution Is Optional. 11

4. *Stoneridge* Rejected The SEC's Attempt To Circumvent *Central Bank* Under The Rubric Of "Scheme Liability". 13

TABLE OF CONTENTS—continued

Page

5. Despite *Wright*, *Lattanzio*, And *Stoneridge*, The SEC Continues To Insist That Primary Liability Can Attach To Secondary Actors Who Themselves *Neither* Make A Public Statement *Nor* Have A Statement Attributed To Them. 16

B. The SEC's Attempts To Distinguish This Court's Precedents Are Unsuccessful. 17

1. *Wright* and *Lattanzio* Are Not Distinguishable 17

2. This Court Has Not Relaxed The Bright-Line Rule Articulated In *Wright* and *Lattanzio*. 18

C. The SEC's Hypotheticals Do Not Support A Different Result. 20

II. "CREATOR" LIABILITY WOULD UNDERMINE PREDICTABILITY AND USHER IN A NEW ERA OF COSTLY STRIKE SUITS. 23

A. A "Creator" Test Would Be Highly Unpredictable. 24

B. The "Creator" Test Would Dissuade Secondary Actors From Performing Services That Are Beneficial To Public Companies And Their Investors. 26

CONCLUSION. 29

CERTIFICATE OF COMPLIANCE

CERTIFICATE OF SERVICE

TABLE OF AUTHORITIES

Page(s)

<u>Cases</u>:

Avis Budget Group v. *California State Teachers' Retirement System*,
128 S. Ct. 1119 (2008). 15

Central Bank of Denver, N.A. v. *First Interstate Bank of Denver, N.A.*,
511 U.S. 164 (1994). . . . . *passim*

Harrison v. *Dean Witter Reynolds, Inc.*, 79 F.3d 609 (7th Cir. 1996). 21

Harsco Corp. v. *Segui*, 91 F.3d 337 (2d Cir. 1996). 21

In re Alstom SA Sec. Litig., 406 F. Supp. 2d 433 (S.D.N.Y. 2005). 19

In re Carter, No. 3-5464, 1981 WL 384414 (SEC Feb. 28, 1981).. . . . . 28, 29

In re Global Crossing, Ltd. Sec. Litig.,
322 F. Supp. 2d 319 (S.D.N.Y. 2004).. 18

In re IKON Office Solutions, Inc. Sec. Litig.,
131 F. Supp. 2d 680 (E.D. Pa. 2001). 27

In re Kendall Square Research Corp. Sec. Litig.,
868 F. Supp. 26 (D. Mass. 1994). 27

In re Scholastic Corp. Sec. Litig., 252 F.3d 63 (2d Cir. 2001). 18

In re Seracare Life Sciences, Inc. Sec. Litig., No. 05-CV-2335-H (CAB),
2007 WL 935583 (S.D. Cal. Mar. 19, 2007). 27

Lattanzio v. *Deloitte & Touche LLP*,
476 F.3d 147 (2d Cir. 2007). . . . . *passim*

TABLE OF AUTHORITIES—continued

Page(s)

Novak v. *Kasaks*, 216 F.3d 300 (2d Cir. 2000). 18

Planned Parenthood of Southeastern Pennsylvania v. *Casey*,
505 U.S. 833 (1992). 23

Shapiro v. *Cantor*, 123 F.3d 717 (1997). 11

Simpson v. *AOL Time Warner, Inc.*, 452 F.3d 1040 (9th Cir. 2006). 13, 14

Stoneridge Investment Partners, LLC v. *Scientific-Atlanta, Inc.*,
128 S. Ct. 761 (2008). . . . . *passim*

United States v. *Cullen*, 499 F.3d 157 (2d Cir. 2007). 26

United States v. *Lanier*, 520 U.S. 259 (1997). 26

Wright v. *Ernst & Young LLP*, 152 F.3d 169 (2d Cir. 1998). . . . . *passim*

Statutes and Rules:

15 U.S.C. § 78t(e). 8

15 U.S.C. § 78t(a). 21

17 C.F.R. § 240.10b-5(b). 14

Miscellaneous:

141 CONG. REC. S17935 (Dec. 5, 1995) (Statement of Senator D'Amato). 3

TABLE OF AUTHORITIES—continued

Page(s)

141 CONG. REC. S17933 (Dec. 5, 1995) (Ltr. from SEC Chairman Levitt to Senator D'Amato) 8

H.R. REP. NO. 104-369 (1995) (Conf. Rep.). 8

Frederick L. Jones & K. Raghunandan, *Client Risk and Recent Changes in the Market for Audit Services*, 17 J. ACCT. & PUB. POL'Y 169 (1998). . . . 28

Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. No. 104-67. . . . . 1, 8

INTEREST OF THE *AMICUS CURIAE*

The Chamber of Commerce of the United States of America ("Chamber") is the world's largest business federation. The Chamber represents an underlying membership of more than three million companies and professional organizations of every size, in every industry, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the executive branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases that raise issues of vital concern to the nation's business community.

This is such a case. In *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), the Supreme Court held that there is no implied private right of action for aiding and abetting violations of Section 10(b), an outcome that Congress embraced in the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. No. 104-67. Throughout the fifteen years since *Central Bank*, however, the Securities and Exchange Commission ("SEC") has led a sustained (and unsuccessful) effort in this Court and elsewhere to redefine *primary* liability so broadly as to gain through the back door what the Supreme Court and Congress determined was unavailable through the front.

That effort continues here. In this case, a class of plaintiffs alleged that Refco had deceived investors by filing documents with the SEC that misstated its financial

condition. Plaintiffs alleged that Mayer Brown LLP and Joseph P. Collins, a former partner at Mayer Brown, were liable for Refco's allegedly fraudulent financial statements because, among other things, Mayer Brown had drafted portions of the documents, and because some of the documents identified Mayer Brown as co-counsel to Refco. The district court dismissed the claims against the Mayer Brown defendants, holding that "a secondary actor cannot incur primary liability * * * for a statement not attributed to the actor at the time of its dissemination." SPA-17 (quoting *Wright* v. *Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998)).

On appeal, the SEC, as *amicus*, asks this Court to reject the district court's reliance on *Wright* and instead adopt the agency's latest, expansive formulation of primary liability, according to which anyone who somehow "creates" a statement – even if he himself does not actually make the statement, and even if the statement is never even attributed to him – could be held liable as a primary violator. The SEC's misguided approach, however, would not only circumvent *Central Bank* and the PSLRA; it would also eviscerate the bright-line rule established in *Wright*, and reaffirmed only two years ago in *Lattanzio* v. *Deloitte & Touche LLP*, 476 F.3d 147 (2d Cir. 2007), under which a secondary actor may *not* be held liable as a primary violator unless (1) he himself actually makes a material misstatement or omission,

and (2) "the misrepresentation" is "attributed" specifically to him "at the time of public dissemination." *Wright*, 152 F.3d at 175.

Maintenance of the sensible, bright-line rule established by this Court's precedents is critical to the Chamber's members. As Congress and the courts have recognized, vague or amorphous definitions of primary liability against secondary actors would "make it impossible for large firms to come in and use their expertise because they are afraid of being sued." 141 CONG. REC. S17935 (daily ed. Dec. 5, 1995) (statement of Senator D'Amato). Accord *Central Bank*, 511 U.S. at 188 (recognizing that "[s]econdary liability for aiders and abetters exacts costs that may disserve the goals of fair dealing and efficiency in the securities markets"). The SEC's "creator" theory would open the door to the very unpredictability that Congress and courts have sought to eliminate, and would deter critical secondary actors such as attorneys, accountants, investment bankers and others from performing salutary functions that might, under the vagaries of a new "creator" test, enmesh them in catastrophically expensive litigation. The Chamber's members accordingly have a strong interest in ensuring that this Court gives the "creator" theory a proper burial in this case.

All parties have consented to the filing of this Brief.

ARGUMENT

For the most part, the substance of the SEC's so-called "creator" theory of liability under Section 10(b) is nothing new. According to the SEC, a secondary actor would be primarily liable for an otherwise actionable misstatement (1) "if the statement is written or spoken by him"; (2) "if he allows the statement to be attributed to him"; *or* (3) "if he provides the false or misleading information that another person then puts into the statement." Brief for the SEC as *Amicus Curiae* at 7, No. 09-1619-cv ("SEC Br."). For at least a decade, the SEC has urged courts to adopt variations of this expansive third prong. All of those efforts have been emphatically rejected by the federal appellate courts, as have similar efforts by class action plaintiffs to poke holes in the clear holdings of *Central Bank* and *Wright*. See, *e.g.*, *Stoneridge Investment Partners, LLC* v. *Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008); *Wright*, 152 F.3d at 172. Rather than take that message to heart, the SEC has continued to press for broad definitions of "primary" liability (indeed, if anything the SEC's definitions have grown *broader* over time). As with each previous packaging of the same proposal, however, the "creator" theory threatens to impose an elastic and unpredictable standard of liability that would reach classic secondary conduct. The Court should put an end to the SEC's attempts to revisit and overturn this Court's sensible framework for Section 10(b) liability.

I. THE "CREATOR" THEORY HAS BEEN REPEATEDLY URGED IN VARIOUS OTHER GUISES AND REPEATEDLY REJECTED

The SEC proposes that secondary actors should incur primary liability under Section 10(b) when they are responsible for "creating" a false or misleading statement. In the agency's view, such a secondary actor might be primarily liable *not only* "if the statement is written or spoken by him," but also (a) "if he provides the false or misleading information *that another person then puts into the statement,*" *or* (b) "if he allows the statement to be attributed to him." SEC Br. 7 (emphasis added). In the SEC's view, performing *any* of these various acts renders one a "creator" and is sufficient to give rise to primary liability.

As we explain below, this formulation is logically precluded by precedents of this Court and the Supreme Court, which require *both* making an actual statement (the first of the SEC's three alternative definitions) *and* attribution; either element alone is insufficient. The SEC's further suggestion that liability should attach to anyone who merely "provides" false information that *another person* utters means that *neither* the making of an actual statement *nor* attribution is required – exactly the opposite of what *Wright* held. In addition to being irreconcilable with a decade of this Court's precedents, the SEC's proposal amounts to an end run around *Central Bank*'s holding that no private cause of action exists for aiding and abetting under

Section 10(b). The Court should emphatically reaffirm that it meant what it said in *Wright* and later cases, and reject the SEC's latest attempt to circumvent those holdings.

A. Over The Last Fifteen Years, The SEC Has Repeatedly Advocated For Sweeping Definitions of Primary Liability Against Secondary Actors, But Courts Have Consistently Rejected These Efforts

Since the Supreme Court decided *Central Bank* in 1994, the SEC has aggressively advanced broad theories of primary liability for secondary actors. Those efforts have been rejected not only by the Supreme Court and the courts of appeals, but also by Congress itself, which in crafting the PSLRA refused the SEC's appeals to overrule *Central Bank*. Undaunted by each of these judicial and legislative setbacks, the SEC has proceeded to come up with new ways of repackaging its defeated arguments for expansive liability and simply contended in the next case that *virtually identical conduct* does, in fact, give rise to primary liability.

The "creator" theory, which is in material part indistinguishable from theories rejected in *Stoneridge*, *Wright*, and similar cases, exemplifies the SEC's attempts to sidestep precedents with which it disagrees.

1. The SEC Favored Broad Liability For Secondary Actors, But The Supreme Court And Congress Disagreed

In 1994, the Supreme Court considered whether the Securities Exchange Act of 1934 provided an implied private right of action for aiding-and-abetting liability. The SEC, as *amicus curiae*, contended that aiding and abetting was "well established in both civil and criminal actions by 1934" (Brief for the SEC as *Amicus Curiae* at 10, *Central Bank* v. *First Interstate Bank of Denver*, No. 92-854 (Sept. 10, 1993)), and that Congress thus intended to include it within the scope of the Act (*id.* at 11). The agency also emphasized "policy" considerations it claimed supported a Rule 10b-5 cause of action for aiding and abetting, arguing that liability was necessary to deter secondary actors from contributing to fraudulent activities. *Id.* at 16-17.

The Court explicitly rejected the SEC's position, reasoning that "the text of the 1934 Act does not itself reach those who aid and abet a § 10(b) violation." *Central Bank*, 511 U.S. at 177. The Court explained:

> [T]he statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act. * * * The proscription does not include giving aid to a person who commits a manipulative or deceptive act. We cannot amend the statute to create liability for acts that are not themselves manipulative or deceptive within the meaning of the statute.

Id. at 177-78 (internal citations omitted). In so holding, the Court recognized that foreclosing private actions against aiders and abettors might enable some secondary

actors to escape Section 10(b) liability. But that concern could not, in its view, "override our interpretation of the text and structure of the Act." *Central Bank*, 511 U.S. at 188. Indeed, it noted that the policy concerns flowed both ways, and that "[s]econdary liability for aiders and abettors exacts costs that may disserve the goals of fair dealing and efficiency in the securities markets." *Ibid.*

In the wake of *Central Bank*, the SEC strongly urged Congress to reinstate a private right of action for secondary violations. See, *e.g.*, Ltr. from SEC Chairman Levitt to Senator D'Amato, 141 CONG. REC. S17933, S17935 (Dec. 5, 1995) ("[W]e have consistently advocated reversal of Supreme Court decisions of *Lampf* and *Central Bank*. It is unfortunate that Congress has not restored these investor protections that were removed by the Supreme Court."). Congress, however, was not persuaded. In enacting the PSLRA in 1995, Congress codified aiding and abetting liability but did so *only* for enforcement actions brought by the SEC itself. See Pub. L. No. 104-67, § 104; 15 U.S.C. § 78t(e); see also *Stoneridge*, 128 S. Ct. at 771.

Congress's refusal to reinstate the private right of action for secondary violations flowed from its conviction that "[t]he private securities litigation system is too important to the integrity of American capital markets to allow this system to be undermined by those who seek to line their own pockets by bringing abusive and meritless suits." H.R. REP. No. 104-369, at 31 (1995) (Conf. Rep.). Congress's

concerns about the position advocated by the SEC were entirely consistent with those expressed in *Central Bank* by the Supreme Court, which observed that "the rules for determining aiding and abetting liability are unclear" (511 U.S. at 188), and "[b]ecause of the uncertainty of the governing rules, entities subject to secondary liability as aiders and abettors may find it prudent and necessary, as a business judgment, to abandon substantial defenses and to pay settlements in order to avoid the expense and risk of going to trial." *Id.* at 189.

2. Following *Central Bank* And The PSLRA, The SEC Sought To Revive Aiding And Abetting By Broadly Redefining Primary Liability

Although *Central Bank* forced private plaintiffs to abandon aiding and abetting as a means of holding secondary actors liable for securities fraud, it held open the possibility that a secondary actor "may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met." 511 U.S. at 191 (emphasis in original). The SEC, along with private plaintiffs, soon began to urge courts to liberalize the requirements for primary liability in an effort to gain back what the Supreme Court held – and Congress agreed – never should have been available in the first place. These initial efforts focused primarily on what a defendant had to do to "make" a misrepresentation under Rule 10b-5(b). Over the

ensuing years, the SEC deployed several closely related theories under which it defined "making" extremely broadly.

In an *amicus* brief filed in 1998, the SEC asked the Third Circuit – just as it now asks this Court – to extend primary liability to anyone who "creates a misrepresentation," even if he never actually utters it. Brief for the SEC as *Amicus Curiae* at 17-19, *Klein* v. *Boyd*, Nos. 97-1143; 97-1261 (3d Cir. 1998) ("SEC Br. in *Klein*"), available at http://www.sec.gov/litigation/briefs/klein.txt. The agency argued that "the word 'makes' as used in *Central Bank* does not have a precise meaning independent of the circumstances of the particular case" (*id*. at 19), and "it would not be necessary for a person to be the initiator of a misrepresentation in order to be a primary violator" (*id.* at 17). Instead, the SEC contended, "a person can be a primary violator if he or she writes misrepresentations for inclusion in a document to be given to investors, even if the idea for those misrepresentations came from someone else." *Id.* at 17-18. Nor did the SEC accept that attribution was necessary for liability: "Nothing in *Central Bank*," it said, "indicates that * * * only persons who sign documents or are otherwise identified to investors can be primarily liable." *Id.* at 12.

The SEC acknowledged (*id.* at 11 n.4) that, just a year before, the Second Circuit had held that,

> if *Central Bank* is to have any real meaning, a defendant must actually *make* a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b).

Shapiro v. *Cantor*, 123 F.3d 717, 720 (1997) (emphasis added) (citation omitted). But the SEC argued that *Shapiro* was distinguishable on its facts, since the defendant accounting firm in that case was not alleged to have actually created any misrepresentation.

The version of the "creator" theory articulated by the SEC in *Klein* was similar to (though less expansive than) what it advocates here. As explained below, this Court squarely rejected that theory in *Wright* – and then again in *Lattanzio.*

3. ***Wright*'s Bright-Line Test Requires That A Defendant *Actually* – As Opposed To Impliedly Or Indirectly – Make A Statement, And Further Rejects The SEC's Position That Attribution Is Optional**

Although it was possible in early 1998 for the SEC to disclaim any attribution requirement in its *Klein* briefing (*Shapiro* had not addressed that question), the agency's position became less tenable just six months later. In *Wright*, 152 F.3d at 175, this Court established a two-part, bright-line test that rejected the theory behind the SEC's "creator" test.

In *Wright*, the Court affirmed the dismissal of a Section 10(b) claim against an auditor based on an allegedly false press release issued by the auditor's client. The Court held that it was not sufficient to allege that the auditor had "provided false and misleading advice" to the issuer, or that it had "'signed-off' or approved the financial information within th[e] press release." 152 F.3d at 172. Nor did it matter that "the market understood the press release as an implied statement by [the auditor] that the financial information contained therein was accurate." *Ibid*. Instead, the Court reiterated the *Shapiro* requirement that "a defendant must actually *make* a false or misleading statement in order to be held liable under Section 10(b)." *Id.* at 175 (emphasis added) (quotation marks and citation omitted). Critically, the Court also held that, because Section 10(b) requires a showing that the plaintiff relied on the defendant's misstatement, "the misrepresentation must be attributed to that specific actor at the time of public dissemination." *Ibid.*

Two year ago, this Court affirmed its bright-line rule. In *Lattanzio* v. *Deloitte & Touche LLP*, 476 F.3d 147, 154 (2d Cir. 2007), it considered whether an auditor could be held liable for false statements that plaintiffs alleged the auditor had helped draft and file, although the auditor had not issued an audit report. Applying *Wright*'s bright-line test, the Court held that no liability could lie. As for the requirement that the defendant must be the speaker, it explained that a plaintiff's mere "understanding"

as to who is behind the statement is not enough: "[u]nless the public's understanding is based on the accountant's articulated statement, the source for that understanding – whether it be a regulation, an accounting practice, or something else – does not matter." *Id*. at 155. Nor was the independent requirement of attribution satisfied, even for documents that the auditor allegedly helped to draft: "[The financial reports] * * * were not attributed to [the auditor] when they were disseminated. Under *Central Bank*, [the defendant] is not liable for merely assisting in the drafting and filing of the quarterly statements." *Id* at 154. (citing *Wright*, 152 F.3d at 174).

In short, even if the SEC enjoyed some doctrinal room to argue in its 1998 *Klein* briefing that "actually making" and "attribution" are not necessary for primary liability under a "creator" theory, in the intervening decade that possibility has been extinguished as this Court has twice rejected the idea.

4. ***Stoneridge* Rejected The SEC's Attempt To Circumvent *Central Bank* Under The Rubric Of "Scheme Liability"**

The SEC's subsequent attempts to avoid *Central Bank*'s holding fared no better. In *Simpson* v. *AOL Time Warner Inc.*, 452 F.3d 1040 (9th Cir. 2006), a class of plaintiffs alleged that defendants had entered into sham business transactions with Homestore, an issuer of securities, to create the illusion of revenue. Plaintiffs alleged that Homestore's business partners were primary violators of Section 10(b), under the

theory that they had entered into a "scheme to defraud" investors. Homestore's business partners made no statement to Homestore's investors, nor were any statements alleged to be attributed to them.

As *amicus curiae*, the SEC urged the Ninth Circuit to embrace scheme liability as a theory under which secondary actors might incur primary liability. See Brief for the SEC as *Amicus Curiae, Simpson v. Homestore.com, Inc.*, No. 04-5564, 2004 WL 5469571 (9th Cir. Oct. 2004). It argued that "[a]ny person who directly or indirectly engages in a manipulative or deceptive act as part of a scheme to defraud can be a primary violator of Section 10(b) and Rule 10b-5(a)." *Id.* at *16. See also *id.* at *20 ("If * * * the third party engages with the corporation in a transaction whose principal purpose and effect is to create a false appearance of revenues, * * * it may be a primary violator."). The SEC acknowledged that *Central Bank* had considered reliance to be a critical element of primary liability under Section 10(b), but argued that, as that case had been brought under Rule 10b-5(b), which concerns statements or omissions, the "[t]he Court * * * had no occasion * * * to address the reliance requirement in the context of a scheme to defraud under Rule 10b-5(a)." *Id.* at *21. The Ninth Circuit adopted the SEC's position. *Simpson*, 452 F.3d at 1048.

The Supreme Court then granted *certiorari* in *Stoneridge*, a case presenting the same issue as *Simpson* and, just as it had in *Central Bank*, rejected the concept of

broad liability for secondary actors.[1] As framed by the Court, the issue was whether an issuer's business partners, which had entered into transactions that allegedly enabled the issuer's misleading statements – but who *themselves* did not actually make any public statement – are primarily liable under Section 10(b) on the theory that they "engaged in conduct with the purpose and effect of * * * further[ing] a scheme to misrepresent * * * revenue." *Stoneridge*, 128 S. Ct. at 769-770. The Court rejected plaintiffs' theory – which had been endorsed by the SEC before the Ninth Circuit – as an attempt to circumvent *Central Bank* through artful pleading. "Were we to adopt [the suggested] construction of § 10(b)," the Court explained, "it would revive in substance the implied cause of action against all aiders and abettors except those who committed no deceptive act in the process of facilitating the fraud." 128 S. Ct. at 771. The Court emphasized that, in light of Congress's demonstrated willingness to craft the law with precision, Section 10(b) liability "should not be [judicially] extended beyond its present boundaries." *Id.* at 773.

[1] A week after the *Stoneridge* decision, the Supreme Court granted the petition for certiorari in *Simpson*, vacated the Ninth Circuit's judgment, and remanded the case for further consideration in light of *Stoneridge*. See *Avis Budget Group* v. *California State Teachers' Retirement System*, 128 S. Ct. 1119 (2008).

5. Despite *Wright*, *Lattanzio*, And *Stoneridge*, The SEC Continues To Insist That Primary Liability Can Attach To Secondary Actors Who Themselves *Neither* Make A Public Statement *Nor* Have A Statement Attributed To Them

Notwithstanding its multiple setbacks, the SEC has not abandoned or even limited its position; quite the opposite, its formulation of "creator" liability appears to have *expanded* in the face of this tsunami of adverse decisions. Whereas prior to *Wright* the SEC argued that a person can be a primary violator if "he or she writes misrepresentations," regardless whether there is attribution (SEC Br. in *Klein* at 17-18), in its present submission, it proposes "creator" liability for a person *not only* "if the statement is written or spoken by him," *or* "if he allows the statement to be attributed to him," *but also* "if he provides the false or misleading information *that another person then puts into the statement*." SEC Br. at 7 (emphasis added). In other words, whereas *Wright* and *Lattanzio* explicitly require both a misstatement *and* attribution, the SEC would phrase those requirements in the disjunctive, and would also support liability even for individuals who make no statement at all.

The SEC justifies its position by attempting to distinguish the adverse decisions and, as in *Central Bank*, advocating policy rationales for broad liability under Section 10(b). But, as we explain below, its attempts at explaining away case law are unconvincing. The current iteration of the "creator" test is substantively

indistinguishable from theories of secondary liability that courts have roundly rejected.

B. The SEC's Attempts To Distinguish This Court's Precedents Are Unsuccessful

The SEC submits that, although attribution is "one means by which a person can create a false or misleading statement and thus be a primary violator," it is "not necessarily the exclusive means." SEC Br. at 11. But simply asserting it does not make it so, and the SEC's efforts to find ambiguity in *Wright* and *Lattanzio* – or to suggest that this Court has relaxed the attribution requirement it established in those cases – is not persuasive.

1. *Wright* and *Lattanzio* Are Not Distinguishable

The SEC argues that *Wright* and *Lattanzio* are distinguishable on their facts because, in those cases, the financial results in question were not audited, and – in the SEC's view – there accordingly was no allegation that "false or misleading statements had been attributed to [defendant accounting firms]." *Id.* at 12. But that is simply incorrect. In both cases, the *central allegation* was that investors understood that accountants had approved the misleading statements, and therefore attributed the statements to those accountants. In *Wright*, this Court rejected the plaintiff's claim that the market viewed the company's press release "as an implied assertion by [the

auditor] that [the company's] financial statements were accurate." 152 F.3d at 176. Likewise, in *Lattanzio*, plaintiffs argued that "an investor (understanding [the auditor]'s regulatory obligation [to review a company's financial statements]) would construe [the auditor]'s silence as its imprimatur." 476 F.3d at 155. The Court flatly dismissed the relevance of what investors might infer from the auditor's involvement: "Unless the public's understanding is based on the accountant's articulated statement, the source for that understanding – whether it be a regulation, an accounting practice, or something else – does not matter." *Id.* at 155. Accordingly, *Wright* and *Lattanzio* plainly are *not* distinguishable on the ground the SEC suggests.

2. This Court Has Not Relaxed The Bright-Line Rule Articulated In *Wright* and *Lattanzio*

Next, the SEC suggests (SEC Br. at 13-14) that decisions after *Wright* have relaxed its strict attribution requirement, but that too is incorrect. The two cases cited for that proposition – *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63 (2d Cir. 2001), and *Novak* v. *Kasaks*, 216 F.3d 300 (2d Cir. 2000) – nowhere mention *Wright*, much less modify the rule in that case (which they could not have done, as the Court was not sitting *en banc*). See *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 331 (S.D.N.Y. 2004) (*Scholastic* "did not explicitly overrule *Wright* – in fact, it failed to cite either *Wright* or *Central Bank* – and it gave scant explanation of its holding.").

Indeed, *Lattanzio* was decided six years after *Scholastic* and seven years after *Novak*, and explicitly reiterated the holding in *Wright*. 476 F.3d at 155.[2]

The SEC's argument that the strict attribution rule can be (and has been) relaxed also overlooks the critical importance of the element of *reliance*. See *Stoneridge*, 128 S. Ct. at 769 ("Reliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of action."); *Central Bank*, 511 U.S. at 180 (describing reliance as an element "critical for recovery"). If

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[2] To the extent *Novak* and *Scholastic* retain any precedential value following *Lattanzio*, they are limited to the narrow context of misleading statements made by (a) corporate insiders and (b) subsidiary corporations, both of which are uniquely identified with the corporation itself. Judge Marrero has cogently set forth the rationales behind these two exceptions, explained why each is entirely consistent with *Wright*, and made clear that *neither* rationale supports liability for unattributed statements by secondary actors:

> *Scholastic* can be read as comporting with *Wright*'s reliance requirement because it is reasonable to infer that an investor, when evaluating the financial statements of a company, at least implicitly relies on the officers of that company, who are generally understood to be responsible for day-to-day corporate affairs including preparation of statements for public disclosure. * * * *This situation is distinct from that of an outside auditor, as to whom it cannot be said that investors generally rely for unattributed representations, unless there is the specific attribution of statements to that auditor, as was required by* Wright. A subsidiary * * * is more akin to a corporate officer than to an outside auditor, in that one can infer that investors are more likely to identify with and rely on the statements of the subsidiary, whether made expressly or indirectly, when evaluating the consolidated financial results of the corporate parent.

In re Alstom SA Sec. Litig., 406 F. Supp. 2d 433, 466 n.29 (S.D.N.Y. 2005) (emphasis added).

a misstatement is not attributed to the defendant, an investor cannot have acted with the requisite reliance *on that defendant*. That is why *Wright* and *Lattanzio* require *both* (1) that a defendant make an actual (rather than implied) statement, *and* (2) that the statement be attributed to the defendant. *Wright*, 152 F.3d at 174; *Lattanzio*, 476 F.3d at 153. Compare SEC Br. at 7 (requiring that a statement be "written or spoken by [the defendant], * * * *or* [that the defendant] allow[] the statement to be attributed to him.") (emphasis added). And the reliance requirement is no easier to reconcile with the SEC's contention that a defendant is liable if he merely "*provides* the false or misleading information *that another person then puts into the statement*" (*ibid.* (emphasis added)): if the defendant himself does not speak, an investor necessarily cannot rely to his detriment on the defendant's statement. No amount of relabeling and recharacterizing by the SEC can avoid these fundamental shortcomings in its theory of liability.

C. The SEC's Hypotheticals Do Not Support A Different Result

The SEC next suggests (SEC Br. at 14-15) that, if taken seriously, the attribution requirement set forth in this Court's cases would allow individuals to "arrange for [a misleading statement] to be issued in someone else's name" in order to avoid liability, and would permit anonymous internet tipsters to mislead with impunity. Neither imagined scenario justifies judicial expansion of Section 10(b)'s

implied private right of action. Cf. *Stoneridge*, 128 S. Ct. at 773 (Section 10(b) liability "should not be [judicially] extended beyond its present boundaries.").

The hypothetical individual who "arranges" for another to issue a misleading statement is not off the hook for lack of attribution; he likely is liable as a controlling person under Section 20(a) of the Exchange Act.[3] If one person truly compels another to act as a mouthpiece in this way, then liability under Section 10(b) is unnecessary to prevent fraud. Conversely, if the hypothetical behind-the-scenes individual lacks the power to compel another person to speak, then the alleged wrongdoer would be guilty, if at all, merely of aiding and abetting the person who actually speaks – the precise theory of liability foreclosed by *Central Bank*.

Nor does the SEC's anonymous internet tipster example withstand scrutiny. To prevail under Section 10(b), it is not enough for a plaintiff to show that he relied on a misstatement; he must instead show that he *reasonably* relied on that misstatement. See *Harsco Corp.* v. *Segui*, 91 F.3d 337, 342 (2d Cir. 1996) ("The general rule is that reasonable reliance must be proved as an element of a securities fraud claim.") (citing *Harrison* v. *Dean Witter Reynolds, Inc.,* 79 F.3d 609, 618 (7th Cir. 1996) ("The fact of reliance . . . is not enough by itself; that reliance must be

[3] See 15 U.S.C. § 78t(a) ("Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable.").

justifiable, or reasonable.")). The "reasonable reliance" requirement is unlikely to be met by an individual claiming to have lost money by acting on an anonymous internet tip; Section 10(b) was never intended to be an insurance policy for reckless investors.

More broadly, the SEC's complaint (SEC Br. at 14) that a strict reading of the Exchange Act and judicial precedents "would shield significant misconduct from liability" is a note it has sounded, without success, as far back as *Central Bank*. See 511 U.S. at 188 ("The SEC points to various policy arguments in support of the 10b-5 aiding and abetting cause of action. It argues, for example, that the aiding and abetting cause of action deters secondary actors from contributing to fraudulent activities and ensures that defrauded plaintiffs are made whole."). The Supreme Court has repeatedly rejected such policy-based pleas, explaining not only that "[p]olicy considerations cannot override our interpretation of the text and structure of the Act" (*ibid.*) but also that policy considerations point in both directions.

Finally, the SEC's suggestions notwithstanding, there is no reason to believe that the securities fraud bar is needed in cases like this one to "supplement the civil enforcement actions that the Commission brings." SEC Br. 3. More often than not, private enforcement actions merely follow enforcement actions brought by the SEC, and target not the fraudfeasor itself, but secondary actors that might be more solvent. That explains why, despite *Central Bank*, *Wright*, *Lattanzio*, *Stoneridge*, and a host

of similar decisions that explicitly circumscribe liability for secondary actors, plaintiffs continue to manufacture distinctions without substance in the hope of surviving dispositive motions and exacting a settlement. The Court should not reward that effort.

* * *

This truly is a case of "déjà vu all over again." The SEC's "creator" theory is an amalgamation of theories that have been squarely rejected in other guises; to the extent the new formulation differs from those the SEC previously has advocated, it is, if anything, *more* aggressive and less defensible. As we next explain, embracing the SEC's expansive theory not only would wreak doctrinal havoc, but also would threaten precisely the broad and unpredictable liability that both Congress and the Supreme Court have rejected.

II. "CREATOR" LIABILITY WOULD UNDERMINE PREDICTABILITY AND USHER IN A NEW ERA OF COSTLY STRIKE SUITS

As demonstrated above, in urging the adoption of its "creator" theory of primary liability, the SEC is effectively asking this Court to overrule *Wright* and *Lattanzio*. But principles of *stare decisis* prohibit such a course unless the Court concludes that the controlling precedents have "proven to be intolerable or simply [defies] practical workability." *Planned Parenthood of Southeastern Pennsylvania*

v. *Casey*, 505 U.S. 833, 854 (1992). Here, there are no compelling reasons to depart from the Court's controlling precendents; to the contrary, there are compelling reasons why the Court should *not* overrule *Wright* and *Lattanzio.* The SEC's "creator" test would destroy the clarity and predictability that the Court in *Central Bank* considered so important, and would pose a clear threat of unbridled liability to secondary actors. As a consequence, attorneys, auditors, underwriters, and other secondary actors – all of whom would prove attractive targets for plaintiffs alleging that they had a role in somehow "creating" the alleged fraudulent statements – would be dissuaded from providing assistance and counsel in difficult cases.

A. A "Creator" Test Would Be Highly Unpredictable

As explained above, the Supreme Court in *Central Bank*, and Congress in the PSLRA, stressed the importance of ensuring "certainty and predictability" (*Central Bank*, 511 U.S. at 188) (quotation marks and citation omitted) in the securities laws, and of avoiding costly strike suits that are difficult to defeat before discovery. Liability for "creating" misstatements would dramatically undermine both of these goals.

To understand the staggering breadth of the SEC's proposed theory, one need look no further than its brief. As explained above, the SEC takes the view that primary violators include secondary actors who do not themselves make any written

or spoken statements that are fradulent but who either "provide[] the false or misleading information that another person then puts into the statement" or "allow[] the [fraudulent] statement to be attributed to him." SEC Br. at 7. According to the SEC, a person who in this was "created" a false or misleading statement "would be primarily liable * * * * regardless of whether he initiated the false or misleading statement, *i.e.*, whether the idea for the misstatement was his own or came from someone else." *Id*. at 9. Moreover, a person would also be considered a primary violator where he "'caused' a false or misleading statement to be made" (*id.* at 10), or "*in effect* caused the misrepresentation to be made" (*ibid.* (emphasis added)) (quotation marks and citation omitted). According to the SEC, however, a person "would *arguably* not cause a misstatement where he merely gave advice to another person regarding what was required to be disclosed and then that person made an independent choice to follow the advice." *Id.* at 10-11 (emphasis added).

This dizzying array of verbal formulations – all offered within the space of only four pages of the SEC's brief – demonstrates just how difficult it would be to define, and thus to predict, liability under a "creator" standard. Indeed, it is difficult to think of *any* area of law that imposes a less predictable standard than the SEC's proposal that liability attach to anyone who "*in effect* cause[s a] misrepresentation to be made" (*id*. at 10 (emphasis added)). What does that mean? What is more, "[p]rovid[ing]

the false or misleading information" (SEC Br. at 7) to someone else who speaks bears a striking resemblance to aiding and abetting the speaker's creation of a statement, and well-intentioned secondary actors might rightfully wonder what they must do to ensure that they do not "allow[] the statement to be attributed to [them]" (*ibid.*).

The fact that the SEC cannot consistently state its own test speaks volumes about the near impossibility of clearly defining what it means to "create" a statement, and it reveals the chaos that will follow if this Court allows plaintiffs to be inventive in pleading such an open-ended standard. As the the Supreme Court has made clear, this is "an area that demands certainty and predictability." *Central Bank*, 511 U.S. at 188 (citation omitted). Compare *United States* v. *Cullen*, 499 F.3d 157, 163 (2d Cir. 2007) (under rule of lenity, a standard "applies only to conduct clearly covered") (citing *United States* v. *Lanier*, 520 U.S. 259, 266 (1997)). The SEC's "creator" standard flunks that test.

B. The "Creator" Test Would Dissuade Secondary Actors From Performing Services That Are Beneficial To Public Companies And Their Investors

The unpredictability and elasticity of the proposed "creator" test for liability would make critical secondary actors reluctant to offer valuable services.

1. A "creator" standard might be invoked by plaintiffs against auditors, attorneys, and underwriters, charging that they created, or facilitated the creation of,

periodic financial statements or disclosures that are not formally audited. Since *Central Bank*, however, courts have consistently rejected attempts by class action counsel to sue secondary actors on the basis of alleged misstatements made by their clients, precisely because the scope of such liability would be nearly boundless. See, *e.g.*, *Wright*, 152 F.3d at 175; *Lattanzio*, 476 F.3d at 153; *In re IKON Office Solutions, Inc. Sec. Litig.*, 131 F. Supp. 2d 680, 685 n.5 (E.D. Pa. 2001); *In re Kendall Square Research Corp. Sec. Litig.*, 868 F. Supp 26, 28 (D. Mass. 1994); *In re Seracare Life Sciences, Inc. Sec. Litig.*, No. 05-CV-2335-H (CAB), 2007 WL 935583, at *10 (S.D. Cal. Mar. 19, 2007). Under the expansive liability regime advocated by the SEC, however, it would be a simple enough matter for inventive plaintiffs' counsel to attempt to extend Section 10(b) liability to secondary actors on the basis of their clients' public statements. First, counsel would assert that the client company fraudulently accounted for some transaction in its financial statements. Next, counsel would allege that the company's attorney, underwriter, or auditor "provide[d] the false or misleading information" (SEC Br. at 7), or drafting suggestions, that found their way into the statement. Experience teaches that the heightened pleading requirements of the PSLRA would be cold comfort in the face of such claims.

2. Once liability for deception under Section 10(b) is untethered from any requirement that the defendant make an actual, contemporaneously attributed

misstatement, there will be a chilling effect on the performance by secondary actors of services that are beneficial to companies and their shareholders. In the years immediately preceding passage of the PSLRA, it was well documented that rampant class action litigation made accounting firms increasingly unwilling to perform audits for clients perceived as risky, such as those in financial distress, smaller or less-well established companies (including start-ups), and companies operating in volatile industries such as technology. Frederick L. Jones & K. Raghunandan, *Client Risk and Recent Changes in the Market for Audit Services*, 17 J. ACCT. & PUB. POL'Y 169, 179 (1998).

Likewise, under a theory in which an attorney's drafting suggestions might implicate him in a lawsuit under a "creator" theory, securities lawyers across the country may conclude that it is safest in many cases to abstain from counseling public companies on difficult disclosures. The Supreme Court has expressed concern that "newer and smaller companies" often have difficulty obtaining high-caliber professional counsel because their "business failure would generate securities litigation against the professional." *Central Bank*, 511 U.S. at 189. The SEC itself has recognized this problem. It observed long ago that "[c]oncern about his own liability may alter the balance of [a lawyer's] judgment in one direction as surely as an unseemly obeisance to the wishes of his client can do so in the other. While one

imbalance results in disclosure rather than concealment, neither is, in the end, truly in the public interest." *In re Carter*, No. 3-5464, 1981 WL 384414, at *25 (SEC Feb. 28, 1981). A standard that "would permit a lawyer to avoid or reduce his liability simply by avoiding participation in the drafting process," the SEC has noted, "may well have the undesirable effect of reducing the quality of the disclosure by the many to protect against the defalcations of the few." *Id.* at *24.

Against this backdrop, confining primary liability for misstatements to those defendants who *actually make* a misstatement *contemporaneously attributed to them* guards against the prospect that secondary actors will be made to cover investment losses for which their actions were not in fact responsible. Conversely, expanding Section 10(b) liability in the manner urged (yet again) by the SEC here would drive up the costs to businesses of the professional help they need – at obvious cost to the economy as a whole.

CONCLUSION

For the foregoing reasons, and those set forth in the brief of the Defendants-Appellees, this Court, in affirming the decision below, should reject the SEC's proposed theory of "creator" liability by stating explicitly that the theory is precluded under the reasoning of *Central Bank* and its progeny.

Respectfully submitted.

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6,914 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using WordPerfect X3 in Times New Roman 14-point font.

Dated: September 16, 2009

/s/ Damon W. Taaffe
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CERTIFICATE OF SERVICE

I, Damon Taaffe, hereby certify that on September 16, 2009, the attached Brief Of The Chamber Of Commerce Of The United States Of America As *Amicus Curiae* In Support Of Appellees was served upon the following by electronic mail and FedEx on the following:

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