No. 07-1384

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellant,

v.

JAMES TAMBONE; ROBERT HUSSEY,
Defendants-Appellees.

On Appeal from the United States District Court
for the District of Massachusetts

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS AMICUS CURIAE IN SUPPORT OF THE PETITIONS FOR REHEARING *EN BANC*

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INTEREST OF AMICUS CURIAE

The Chamber of Commerce of the United States of America ("Chamber") submits this amicus brief in response to the suggestion in the Court's February 23, 2009 order. The Chamber is the world's largest business federation. The Chamber's underlying membership includes more than three million companies and professional organizations of every size, in every industry, and from every region in the country. An important function of the Chamber is to represent the interests of its members in matters before the courts. To that end, the Chamber regularly files amicus briefs in cases that raise issues of concern to the nation's business community, such as cases involving the federal securities laws, including *Stoneridge Investment Partners LLC v. Scientific-Atlanta, Inc.*, 128 S.Ct. 761 (2008).[1]

SUMMARY OF ARGUMENT

The Court should grant rehearing *en banc* and vacate the portion of the Panel Decision addressing § 10(b). Like the recently rejected theory of "scheme" liability, the Panel's "implied statement" theory is an impermissible improvisation to expand liability under § 10(b) and Rule 10b-5 beyond the narrow boundaries drawn by Congress and Supreme Court decisions.

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1 All parties have consented to the filing of this brief.

First, the "implied statement" theory improperly creates a new duty to disclose. Neither underwriters nor their officers have a duty to disclose for purposes of § 10(b) and Rule 10b-5. The "implied statement" theory would create a new § 10(b) duty to disclose based on underwriters' "statutory duties and their central role in the securities market." *SEC v. Tambone*, 550 F.3d 106, 132 (1st Cir. 2008). The theory thus contradicts settled authority that a defendant has a duty to disclose under § 10(b) only if it has "a relationship of trust and confidence," i.e., a fiduciary relationship, with shareholders. *Chiarella v. United States*, 445 U.S. 222, 230 (1980).

Second, the "implied statement" theory disregards the statutory text and Supreme Court precedent by imposing primary liability on participation in someone else's misstatement. The basis of the new § 10(b) liability created by the Panel Decision is that an underwriter helps an issuer make a false statement. That is aiding and abetting and falls outside § 10(b) and Rule 10b-5. Moreover, the defendants here are officers of an underwriter. Those officers did not personally make any statements to shareholders – implied or express – but the Panel Decision would hold them liable because they supervise employees working on an underwriting. Participation through supervision might be properly reachable by the SEC under the aiding and abetting provision of the PSLRA, but not under § 10(b). The Panel Decision, however, makes participation through supervision

actionable under § 10(b) by private plaintiffs, and by the SEC, without satisfying the key requirements of the aiding and abetting statute.

Third, the "implied statement" theory would breed a new wave of private § 10(b) class actions. It would encourage class actions against a host of other secondary actors that pass along statements, such as auditors or proxy solicitors, or have "central roles" in securities transactions. It would also threaten many of the limitations on private liability, like reliance, scienter, and loss causation. Courts in this Circuit would become the favorites for plaintiffs' class action lawyers seeking to expand and profit from the Panel's new theory.

ARGUMENT

I. Section 10(b) Does Not Extend to "Implied Statements" of Non-Speaking Defendants Absent a Fiduciary Duty to Disclose.

There are three traditional bases for § 10(b) liability: (1) a misstatement; (2) expressive conduct; and (3) an omission where there is a duty to disclose. *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 177 (1994) ("the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act"). What the Panel Decision calls an "implied statement" is really one of two things and both fall outside § 10(b). It is either an omission by a defendant without the

necessary duty to disclose or it is an improper new category.[2] Section 10(b) liability for one who neither speaks nor engages in expressive conduct must be "premised upon a *duty to disclose arising from a relationship of trust and confidence between the parties to a transaction*." *Chiarella*, 445 U.S. at 230 (emphasis added). The "implied statement" theory contradicts this settled authority by inventing a sweeping new duty to disclose owed to the entire market based not on a fiduciary relationship, but rather on defendants' "statutory duties and their central role in the securities market." *Tambone*, 550 F.3d at 132. Each of these two bases contradicts precedent.

First, underwriters' statutory duties to *investigate* under §§ 11 and 12 of the Securities Act of 1933 do not equate to the considerably different duty to *disclose* under § 10(b). As the Supreme Court has explained, "[b]ecause the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general antifraud proscriptions of the federal securities laws." *Dirks v. SEC*, 463 U.S. 646, 657 (1983) (emphasis added). *Accord SEC v. Cochran*, 214 F.3d 1261, 1264-65 (10th

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[2] An "implied statement" is not the same thing as a half-truth, which is covered by § 10(b). A half-truth is an express statement that is literally true but omits a material fact. *See, e.g., Forgarazzo v. Lehman Bros., Inc.*, 341 F. Supp. 2d 274, 294 (S.D.N.Y. 2004) ("A statement can also be misleading, though not technically false, if it amounts to a half-truth by omitting some material fact.").

Cir. 2000) ("[T]he duty to disclose material facts arises only where there is some basis outside the securities laws, such as state law, for finding a fiduciary or other confidential relationship."); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 496 (7th Cir. 1986) ("The duty must come from a fiduciary relation outside securities law."). Thus, an underwriter does not have a § 10(b) duty to disclose except in the rare case that particular facts show it has "a fiduciary or quasi-fiduciary confidential relationship" with the shareholders of the particular issuer. *In re Enron Corp. Secs., Deriv. & ERISA Litig.*, No. 01-3624, 2009 WL 565512, at **26, 29 (S.D. Tex. Mar. 5, 2009). The SEC did not allege a fiduciary relationship between the defendants in this case and the mutual fund's shareholders.

Indeed, it is because underwriters do not have a fiduciary duty to disclose that Congress in 1933 had to create express statutory liabilities whereby certain plaintiffs could sue underwriters in specified circumstances. The statutory duties under §§ 11 and 12 thus cannot be equated with a § 10(b) duty to disclose owed by a fiduciary. To start, the two sets of duties are owed to very different sets of persons. Section 11 duties are owed only to those who purchase the securities pursuant to the initial offering or those secondary purchasers who can "'trace' their shares to the faulty registration." *Krim v. PCOrder.com, Inc.*, 402 F.3d 489, 495-96 (5th Cir. 2005); 15 U.S.C. § 77k(a). The tracing requirement significantly narrows the class of potential plaintiffs to whom § 11 duties are owed, since "it is

often impossible to determine whether previously traded shares are old or new." *Barnes v. Osofsky*, 373 F.2d 269, 272 (2d Cir. 1967). Similarly, a defendant owes § 12 duties only "to the person purchasing [the] security from him." 15 U.S.C. § 77*l*(a)(2). The statutory language thus "contemplates a buyer-seller relationship not unlike traditional contractual privity," *Pinter v. Dahl*, 486 U.S. 622, 642 (1988). And the Supreme Court specifically rejected extending § 12 liability to those "whose participation in the buy-sell transactions is a substantial factor in causing the transactions to take place." *Id.* at 649. In contrast, when a § 10(b) duty to disclose exists, it extends far much more broadly, such that "privity of dealing or even personal contact . . . is the exception and not the rule." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 739, 745 (1975).

The "implied statement" theory fundamentally misreads the express bases for liability under the 1933 Act. Sections 11 and 12 impose liability on underwriters for the acts of underwriting, offering, or selling without a reasonable investigation, *regardless of whether they make any statements themselves.* *Stoneridge* made clear that § 11 reaches underwriters specifically in their role as non-speaking "secondary actors":

> All secondary actors, furthermore, are not necessarily immune from private suit. The securities statutes provide an express private right of action against accountants and *underwriters in certain circumstances*, see 15 U.S.C. § 77k . . . .

Id. at 773-74 (emphasis added). And *Central Bank* similarly recognized that § 12 liability for underwriters is not based on their making a statement themselves, but rather for offering or selling securities "by means of" someone else's misstatement or omission. *Central Bank*, 511 U.S. at 179. Indeed, if statements by underwriters were an element under either § 11 or § 12, Congress would have provided an express defense for an underwriter that made a disclaimer stating that it was not making a statement about its own investigation. But Congress did not provide such an express defense. Instead, the express due diligence defense in §§ 11 and 12 requires that the underwriter in fact undertake a reasonable investigation, regardless of what the underwriter says or disclaims. There is thus no principled basis to extrapolate from (a) 1933 Act liabilities for the non-communicative *conduct* of underwriting, selling, or offering, that (b) an underwriter is a speaker or has a duty to disclose under the 1934 Act. To the contrary, such an extrapolation would obliterate the careful limits on liability under the 1933 Act. *See, e.g.*, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 (1974) (rejecting interpretations of § 10(b) that would "nullify the effectiveness of the carefully drawn procedural restrictions on th[e] express actions" in §§ 11 and 12).

Second, the Supreme Court has twice rejected creating a duty to disclose based on defendants' "central role in the securities market." *Tambone*, 550 F.3d at 132. In *Dirks*, 463 U.S. at 667, the Court reversed the Eighth Circuit's

imposition of a duty to disclose based on the role of "securities industry professionals," *Dirks v. SEC*, 681 F.2d 824, 839, 841-42 (D.C. Cir. 1982). Similarly, in *Chiarella*, 445 U.S. at 233, the Court reversed the Second Circuit's determination that a duty arose from the defendant's status as a "market insider," *United States v. Chiarella*, 588 F.2d 1358, 1364-66 (2d Cir. 1978). In doing so, the Court held:

> Formulation of such a broad duty, which departs radically from the established doctrine that duty arises from a specific relationship between two parties, should not be undertaken absent some explicit evidence of congressional intent.

Chiarella, 445 U.S. at 233 (citation omitted).

II. Officers' Participation Through Supervision Does Not Give Rise to Primary Liability Under § 10(b).

The SEC concedes that its § 10(b) claims are premised on the defendants' *participation* in the business of their company. In the SEC's words, "it was the conduct of Tambone and Hussey – their *participating* as securities professionals in the underwriting of fund shares – that gave rise to their implied representations to investors that they have a reasonable basis for a belief in the accuracy and completeness of the prospectuses." (*See* SEC's Br. in Opp'n to Pets. for Reh'g *En Banc* at 22 (emphasis added).) Specifically, "[t]he SEC alleges that Tambone and Hussey, as executives of the primary underwriters of the Columbia Funds, were responsible for *overseeing* the distribution of fund prospectuses to

potential investors." *Tambone*, 550 F.3d at 143 (emphasis added). An officer's supervision of others in a company could at most be aiding and abetting, not the basis for a primary violation, even assuming, for argument's sake, that the company is a primary violator.

A. Silent Officers of a Company Do Not Have a Duty to Disclose.

When an underwriter, or any company, makes a statement, the company itself is the speaker, not its supervisory officials unless they themselves sign the statement, speak the words, or personally have a fiduciary duty to disclose. To hold otherwise would vastly expand the class of individuals who will be sued in § 10(b) cases.

The officers of an underwriter do not have a fiduciary duty to disclose to the issuer's shareholders. As in this case, the officers of an underwriter are usually strangers to those purchasing the securities of the issuer. The Supreme Court has rejected the imposition of a duty to disclose between strangers. *See Chiarella*, 445 U.S. at 232-33 ("No duty could arise from petitioner's relationship with the sellers of the target company's securities, for petitioner had no prior dealings with them. He was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was, in fact, a complete stranger . . . [to] the sellers.").

B. Participation Through Supervision Is Better Policed by the SEC Under the Aiding and Abetting Statute.

Participation in another defendant's fraud is exclusively reachable under the 1934 Act by the SEC as aiding and abetting. *See, e.g.*, *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997) ("Allegations of 'assisting,' 'participating in,' 'complicity in' and similar synonyms . . . all fall within the prohibitive bar of *Central Bank.*"). Under § 104 of the PSLRA, only the SEC – not private plaintiffs – may bring a civil enforcement action against "any person that knowingly provides substantial assistance to another person in violation of" § 10(b) and Rules 10b-5. 15 U.S.C. § 78t(e). *See also* S. Rep. No. 104-98, at 19 (1995) ("amending the 1934 Act to provide explicitly for private aiding and abetting liability actions under Section 10(b) would be contrary to [the] goal of reducing meritless securities litigation"). Congress did not allow even the SEC to sue when the defendant was merely reckless or assisted in an insubstantial way.

The Panel Decision found that the SEC had adequately alleged aiding and abetting here. In going further and allowing § 10(b) liability for that same conduct under its new "implied statement" theory, however, the Panel Decision has improperly rewritten the securities laws to allow both SEC *and private actions* based on aiding and abetting – or its synonym, "participating" – without having to allege and prove "knowledge" and "substantial assistance." *Central Bank*, 511 U.S. at 184. ("The fact that Congress chose to impose some forms of secondary liability,

but not others, indicates a deliberate congressional choice with which the courts should not interfere."). The effect would be to open the floodgates to the litigation Congress sought to avoid in enacting § 104 of the PSLRA. *See, e.g.*, *Stoneridge*, 128 S. Ct. at 771 (refusing to "revive in substance the implied cause of action against all aiders and abettors"). Even if the "implied statement" theory of § 10(b) liability could be limited to SEC enforcement actions, the lack of "legal limitations" on aiding and abetting liability would mean "market participants are forced to rely on the reasonableness of the SEC's litigation strategy," which "can be hazardous." *Dirks*, 463 U.S. at 664 n.24.

III. The "Implied Statement" Theory Would Breed Private § 10(b) Litigation.

A. Private Class Action Plaintiffs Will Attempt to Apply the "Implied Statement" Theory to Other Defendants.

The "implied statement" theory should be rejected for the additional reason that its impact on private § 10(b) class actions could not be easily contained. *See Santa Fe Indus. v. Green*, 430 U.S. 462, 478 (1977) (rejecting § 10(b) claims that "could not be easily contained"). Plaintiffs would argue that, by its very logic, the Panel Decision would apply to other "intermediar[ies] between the issuer of the securities and the investors," i.e., other middlemen who pass on the statements of the issuer. *Tambone*, 550 F.3d at 131. For instance, the "implied statement" theory might reach lawyers or investor relations personnel who pass on materials,

auditors (with respect to the unaudited sections of an issuers' financial statements), proxy solicitors, and others who (like underwriters) lack a fiduciary duty to make disclosures to an issuer's shareholders, but who have various statutory duties or assertedly "central roles" in the securities markets. Such widespread potential application would erase the clear lines carefully drawn by Congress and the Supreme Court as to who can and cannot sue and be sued under the federal securities laws. The courts would have to draw new lines on a case-by-case basis – a process that would take years. This would contradict *Central Bank*'s admonition that § 10(b) is "an area that demands certainty and predictability." *Central Bank*, 511 U.S. at 188 (internal quotation marks omitted).

B. *The "Implied Statement" Theory Would Threaten Limitations on Private Liability.*

The "implied statement" theory would also threaten key limitations on the implied § 10(b) cause of action. For example, potential class action plaintiffs would argue that an "implied statement" is akin to an omission by a defendant with a duty to disclose, and thus reliance could be presumed under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 125, 153-54 (1972). Likewise, class action plaintiffs would argue that the fraud-on-the-market presumption of reliance applies to an "implied statement" every bit as much as to an express statement. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 247 (1988). Defendants would counter that there is no reliance without attribution, see *Wright v. Ernst & Young LLP*, 152

F.3d 169, 175 (2d Cir. 1998), and attribution is impossible in the case of an entity or person that did not actually speak or have a duty to disclose. Indeed, it would be improper to create presumptions of reliance for the new "implied statement" theory under the § 10(b) implied action because in 1995, when Congress enacted an aiding and abetting action for the SEC only, "Congress accepted the § 10(b) private cause of action *as then defined but chose to extend it no further*." *Stoneridge*, 128 S.Ct. at 773 (emphasis added). Accordingly, courts must limit the implied § 10(b) action "consistent with the narrow dimensions [courts] must give to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law." *Id.* at 774. Nonetheless, if the Panel Decision were left standing, courts in this Circuit would have to sort through a mess of new plaintiffs, new defendants, and new reliance theories.

The "implied statement" theory also threatens § 10(b)'s scienter requirement. The scienter traditionally required is knowledge or reckless disregard of the falsity of the misstatement or omission. But here, the Panel Decision appears to lower the threshold by saying that an underwriter violates § 10(b) if it lacks a "*reasonable basis to believe* that the key statements in the prospectuses regarding market timing were accurate and complete." *Tambone*, 550 F.3d at 130-31 (emphasis added). Moreover, courts would have to decide whose state of mind matters when a corporate underwriter is sued under § 10(b): only those officials

who disseminated the underwriting materials, or others who worked in the background on the underwriting? *Cf. Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 366 (5th Cir. 2004) (scienter of corporate issuer is limited to the state of mind of the corporate officials who made or issued the misstatement, not the knowledge of other officers and employees in the corporation).

Furthermore, the "implied statement" theory would have to be reconciled with the PSLRA's requirement that "the act or omission of *the defendant* alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages." 15 U.S.C. § 78u-4(b)(4) (emphasis added). Accordingly, a class action plaintiff could not allege or prove loss causation against an underwriter unless there was a price drop after disclosure that *the underwriter did not conduct a reasonable investigation. See Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 175 (2d Cir. 2005) (no loss causation against an investment bank for an analyst's report when there was no "corrective disclosure regarding the falsity of Merrill's 'buy' and 'accumulate' recommendations"). Class action plaintiffs would nonetheless argue, as they did in "scheme" liability and aiding and abetting cases before the Supreme Court rejected those theories, that loss causation against an underwriter is satisfied by a stock drop following the

corrective disclosure of the issuer's false statement without any reference to the underwriter.

For all these reasons, the Panel Decision's decision would encourage costly litigation in this Circuit's courts and impede the capital markets. It would foster exactly the kind of "extensive discovery and the potential for uncertainty and disruption in a lawsuit [that] allow plaintiffs with weak claims to extort settlements from innocent companies." *Stoneridge*, 128 S.Ct. at 772. "This uncertainty and excessive litigation can have ripple effects," restricting access to capital markets and ultimately injuring investors, the intended beneficiaries of the statute. *Central Bank*, 511 U.S. at 189. As Congress concluded when it enacted the PSLRA: "Fear of litigation keeps companies out of the capital markets." H.R. Rep. No. 104-50, at 20 (1995).

CONCLUSION

The Court should grant the petitions for rehearing *en banc* and vacate the Panel Decision.

Dated: April 22, 2009

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I, Richard D. Bernstein, hereby certify that on this 22nd day of April 2009, I caused copies of the foregoing brief to be served on counsel for the parties at the addresses listed below by FedEx Overnight and delivered the requisite copies of the brief to the Clerk of Court by FedEx Overnight.

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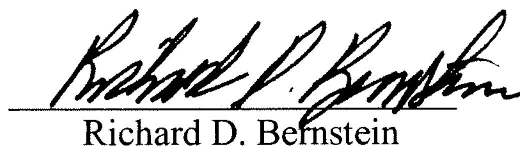

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