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

SUPPLEMENTAL BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS-APPELLEES

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The Chamber of Commerce of the United States of America ("Chamber") submits this supplemental *amicus* brief in response to the invitation of the Court's July 22, 2009 order granting rehearing *en banc*. The Chamber previously submitted an *amicus* brief in support of the petitions for rehearing *en banc*, in which the Chamber set forth its interest in this matter and its arguments against extending § 10(b) liability to secondary actors who allegedly participate in a fraud by supervising underwriting. Rather than repeat those arguments here, this supplemental brief specifically addresses the counter-arguments made by the Securities and Exchange Commission ("SEC") in its June 1, 2009 reply brief.

SUMMARY OF ARGUMENT

None of the SEC's arguments support imposing § 10(b) liability on supervising officers of an underwriter that passes on the statements of a different entity, the issuer of the securities. As we explained in our opening brief, underwriters and their supervising officers do not make any statements themselves. The SEC does not dispute this. Rather, the SEC clings to the notion that § 10(b) liability can be premised on fictitious "implied statements" that supposedly should be deemed to arise from the "important" role of underwriters. The SEC also raises for the first time on appeal the theory that § 10(b) liability can be premised on defendants' allegedly deceptive conduct. Neither theory is permissible.

First, the SEC's "implied statement" theory is directly contrary to Supreme Court precedent. Section 10(b) liability for one who neither speaks nor engages in expressive conduct, as was the case here, requires a "duty to disclose arising from a relationship of trust and confidence between parties to a transaction." *Chiarella v. United States*, 445 U.S. 222, 230 (1980). The SEC's attempt to nullify that controlling authority on the ground that it applies to omissions but not "implied statements" is unavailing. Silence is only an "implied statement" that nothing is amiss when a defendant has a duty to disclose material facts. Otherwise, silence is silence. The SEC's argument that § 10(b) liability can be "founded on [a] special duty" for defendants that play an important role has been rejected by the Supreme Court.

Second, the SEC waived its ability to attack defendants' "conduct" as a basis for liability under § 10(b) and Rule 10b-5 because the SEC did not appeal the district court's dismissal of claims under the subsections of Rule 10b-5 that cover illicit "conduct." In any event, the non-expressive "conduct" alleged here – participating in another entity's fraud – is simply a re-labeling of aiding and abetting. Only Congress is empowered to amend the securities laws to expand primary liability under § 10(b).

Third, the SEC has no answer as to how its expansive "implied statement" theory could be cabined to prevent a wave of private § 10(b) class actions in this Circuit. The SEC simply cannot escape the fact that judicially superseding the congressional prohibition on private suits against aiders and abettors would cause class action plaintiffs and their lawyers to flock to this Circuit's courts.

For these reasons, the Court should reject the SEC's effort to judicially expand § 10(b) and affirm the district court's dismissal of the § 10(b) claims.

ARGUMENT

I. Non-Speaking Underwriter Defendants Do Not Make "Implied Statements" Absent a Fiduciary Duty to Disclose.

As we demonstrated in our opening brief, neither underwriters nor supervisory officers of underwriters make statements when the underwriters pass along the statements of others. (Chamber Br. at 9.) They are silent. Silence is not actionable under § 10(b), however, "absent a duty to speak." *Chiarella*, 445 U.S. at 235. And not just any duty suffices – the defendant must have a "duty to disclose *arising from a relationship of trust and confidence between parties to a transaction*." *Id.* at 230 (emphasis added).

The SEC does not contend that underwriters have a fiduciary duty to disclose. Indeed, it is because of the absence of such a duty that Congress had to create statutory duties to investigate under §§ 11 and 12 of the 1933 Act that underwriters owe *only to certain plaintiffs in certain circumstances*. (*See* Chamber

Br. at 5-7.) The SEC concedes that its "implied statement" theory under § 10(b) is *not* founded on the statutory duties created by the 1933 Act. (SEC Reply Br. at 11 n.10 ("the implied representation stems not from §§ 11 and 12").) Thus, the SEC's "implied statement" theory would invent a new duty to disclose for all underwriters and their officers that, unlike the duties under §§ 11 and 12 of the 1933 Act, would be owed to all market participants. The SEC's theory would thus improperly evade the procedural and substantive limits on liability that Congress set forth in §§ 11 and 12. (*See* Chamber Br. at 5-6.) The Supreme Court has held that § 10(b) of the 1934 Act should not be interpreted to obliterate the limits set forth in the 1933 Act. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 (1976) (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).

The SEC nonetheless advances three arguments in support of its theory, all of which are unavailing. First, the SEC argues that "implied statements" are not omissions, and therefore no fiduciary duty to disclose is necessary to impose § 10(b) liability for "implied statements." (SEC Reply Br. at 12-13.) This argument is a red herring. The SEC is correct that "[t]here is a distinction between a representation that is implied from an actor's conduct, and an omission to speak." (*Id.* at 12.) But that category of so-called "implied representations" – and the lower court cases and Restatement provisions relied on by the SEC to exemplify them – concerns fraud resulting from expressive *conduct* by certain defendants that implies very *specific* facts. For instance, the main case cited by the SEC, *Midwest Commerce Banking*, stated in dicta that a law firm could be sued for common law fraud where its conduct "treat[ed] the transaction as valid" when, in fact, necessary approvals were lacking. *Midwest Commerce Banking v. Elkhart City Centre*, 4 F.3d 521, 523-24 (7th Cir. 1993) (affirming dismissal on other grounds). Without authority, the SEC improperly seeks to apply this case law to different defendants – underwriters – and to create the very general implied representation that all material facts have been disclosed.

Moreover, particularly because § 10(b) can be the basis of a criminal prosecution, its contours cannot shift and expand as the common law changes over time. The SEC does not cite any authority that the common law considered underwriters to make "implied statements" when § 10(b) was enacted in 1934. In all events, "Section 10(b) does not incorporate common-law fraud into federal law." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 771 (2008).

Second, the SEC asserts, "The implied representations at issue here are founded on the special duty owed by an underwriter to potential purchasers of the shares it distributes." (SEC Reply Br. at 14.) This argument ignores that the

Supreme Court has already twice rejected a "special duty" based on the importance of certain industry players. In *Dirks v. SEC*, 463 U.S. 646, 667 (1983), 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).

Third, the SEC attempts to shoehorn this case into the theory of "insider trading" set forth in *Chiarella* and *Dirks*. Not only is this theory of liability improperly raised for the first time at this late stage on appeal, it is nonsensical: the defendants themselves did not own or sell any shares; the underwriter they work for owned and sold the shares. The SEC's new theory also proposes a radical rewriting of insider trading law under which anyone with non-public material information commits insider trading, regardless of whether they had a fiduciary duty to disclose. That result is directly contrary to the holdings of *Chiarella* and *Dirks*. *See Chiarella*, 445 U.S. at 235; *Dirks*, 463 U.S. at 665.

II. The Conduct Alleged by the SEC – Participation Through Supervision – Does Not Give Rise to Primary Liability Under § 10(b).

In its reply brief, the SEC also attempts to pin § 10(b) liability on defendants' *conduct*. Specifically, the SEC argues that "Tambone and Hussey engaged in their own deceptive conduct *in furtherance of the fraud*" by participating in "underwriting the offerings and disseminating the prospectuses" in violation of Rule 10b-5(a) and (c). (SEC Reply Br. at 2 (emphasis added), 13.) At the outset, the SEC's deceptive conduct theory has been waived. As the Panel Decision correctly noted, "the SEC has not pursued on appeal the district court's dismissal of" claims under subsections (a) and (c) of Rule 10b-5, which collectively govern liability for deceptive conduct. *SEC v. Tambone*, 550 F.3d 106, 130 (1st Cir. 2008); *see also* 17 C.F.R. § 240.10b-5(a) (making it unlawful "to employ any device, scheme, or artifice to defraud") and (c) (making it unlawful "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person").

Moreover, as we explained previously, silent underwriters who pass along prospectuses containing statements made by another company do not engage in any expressive conduct. (Chamber Br. at 9.) Instead, Congress has provided that such participation "in furtherance of the fraud" of another entity can only be the basis for aiding and abetting liability, not primary § 10(b) liability. 15 U.S.C. § 78t(e) (providing that the SEC, but 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 Rule 10b-5). Despite what the SEC claims, "[a]llegations of 'assisting,' 'participating in,' 'complicity in' and similar synonyms . . . all fall within the prohibitive bar of *Central Bank*." *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997).

In an effort to elevate the conduct here from aiding and abetting to primary liability, the SEC cites three inapposite categories of cases. (SEC Reply Br. at 7-8.) Each category is inapposite because it concerns the liability of a company, or an officer of that company, for implied representations about that same company. The first category involves implied representations by broker-dealers to their customers that the broker-dealers themselves are charging a reasonable price. *See, e.g.*, *Grandon v. Merrill Lynch & Co.*, 147 F.3d 184, 194 (2d Cir. 1998) (broker-dealers primarily liable for sending customers confirmation statements that suggest no excessive markups). The second category involves implied representations by corporate executives who, through certain conduct, adopt the statements of third parties (*e.g.*, analysts) about their own company. *See, e.g.*, *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 373 (5th Cir. 2004) (refusing to attribute analyst statements about a company to certain of the company's executives). And the third category involves implied representations *by a speaker* who expresses an opinion that the speaker did not believe. *See, e.g., Weiss v. SEC*, 468 F.3d 849, 855 (D.C. Cir. 2006) ("Under the securities laws, a statement of opinion includes an implied representation that the speaker rendered the opinion in good faith and with a reasonable basis.").

All three categories of cases are distinguishable from this case. The first two involve defendants whose conduct implies something *about their own company*, and the third involves a defendant who speaks but implies something false. This case, however, involves allegations that non-speaking officers of one company (an underwriter) helped pass along the fraudulent statements of and about another company (the mutual fund that issued the shares). That can only be aiding and abetting.

The SEC's efforts to judicially expand § 10(b) to include aiding and abetting should be rejected. Only Congress has the authority to even consider creating a new cause of action for private plaintiffs to bring primary § 10(b) suits against secondary actors who allegedly participate in the frauds of and about other companies. *See, e.g., Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 184 (1994) ("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."). Indeed, that is why Senator Specter recently introduced a bill to do what the Supreme Court in *Stoneridge* could not, "revive in substance the implied cause of action against all aiders and abettors." *Stoneridge*, 128 S. Ct. at 771; *see also* Liability for Aiding and Abetting Securities Violations Act of 2009, S. 1551, 111th Cong. (2009). Senator Specter's proposal allows private suits for aiding and abetting. It also lowers the level of scienter that the SEC must prove for an aiding and abetting claim from knowledge to recklessness. S. 1551, 111th Cong. Although the Chamber opposes Senator Specter's proposal to overrule *Central Bank* and *Stoneridge*, at least that proposal is made in the only forum with authority to consider it: Congress. This Court should reject the SEC's improper request that the judiciary expand § 10(b) liability to what is at most aiding and abetting by non-speaking supervisory officers of underwriters.

III. The SEC's Novel Theories of Liability Would Breed Private § 10(b) Class Action Litigation.

Both the "implied statement" theory and the SEC's participation-as-deceptive-conduct theory would breed private litigation. The SEC's only response is that (1) that result has not happened yet, and (2) the "implied statement" theory would not expand the class of § 10(b) defendants. (SEC Reply Br. at 14-15.) The SEC's theory is entirely new, however, and that is why this wave of litigation has not occurred yet. In particular, no court has recognized a § 10(b) duty to disclose to the entire marketplace owed by underwriters, their supervising officers, and other important players.

Thus, as we explained in our opening brief, the "implied statement" theory would threaten key limitations on private liability. (Chamber Br. at 12-15.) Class action plaintiffs would advocate ways to circumvent the need to plead and prove individual reliance by arguing that the presumption of reliance under the *Affiliated Ute* doctrine applicable to certain omissions, or the fraud-on-the-market doctrine applicable to express statements, also applies to "implied statements." *See Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153-54 (1972); *Basic, Inc. v. Levinson*, 485 U.S. 224, 247 (1988). Class action plaintiffs would also seek to muddy the waters as to what level of scienter is required and whose state of mind matters for an "implied statement" – the underwriter's or the issuer's. (*See* Chamber Br. at 13-14.) And perhaps most problematic of all, it would be difficult to measure loss causation in "implied statement" cases. Would plaintiffs' purported losses run from the revelation that the *underwriter* did not conduct a reasonable investigation, or from the corrective disclosure that the *issuer* made a false statement in the prospectus, without regard to disclosure of any inaction by the underwriter defendant? (*See id.* at 14-15.) The SEC does not and cannot deny that sorting through how various key limitations on private § 10(b) litigation apply under the SEC's new theory would consume this Circuit's resources for years, if not decades.

Thus, to allow private § 10(b) liability for conduct traditionally reachable only by the SEC as aiding and abetting would necessarily open the floodgates to private class action litigation. Indeed, as Congress recognized in enacting the aiding and abetting statute, "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." S. Rep. No. 104-98, at 19 (1995). The Court should reject the SEC's backdoor attempt to judicially expand the private right of action under § 10(b). *See Stoneridge*, 128 S. Ct. at 773 ("The decision to extend the cause of action is for Congress, not for us."); *see also Alexander v. Sandoval*, 532 U.S. 275, 286-87 (2001) ("Without [a congressional directive], a cause of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute.").

CONCLUSION

For the reasons set forth above and in our opening brief, the Court should affirm the decision of the district court with respect to § 10(b).

Dated: September 1, 2009

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Frank M. Scaduto, hereby certify that on this 1st day of September 2009, I caused copies of the foregoing brief to be served on counsel for the parties at the addresses listed below by first-class mail and delivered the requisite copies of the brief to the Clerk of Court by FedEx Overnight.

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