09-1619-cv

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

PACIFIC INVESTMENT MANAGEMENT COMPANY LLC,
RH CAPITAL ASSOCIATES LLC,

Plaintiffs-Appellants,

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

Plaintiffs,

—against—

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. BREITMAN, CMG INSTITUTIONAL TRADING, LLC, CREDIT SUISSE SECURITIES LLC,

(*caption continued on inside front cover*)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF AMICI CURIAE LAW FIRMS IN SUPPORT OF DEFENDANTS-APPELLEES AND AFFIRMANCE OF THE DECISION BELOW

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Defendants.

CORPORATE DISCLOSURE STATEMENT

The amici law firms do not have any parent corporations, and no publicly held company owns more than 10% of any stock in any of the firms.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

IDENTITY AND INTEREST OF AMICI CURIAE 1

SUMMARY OF THE ARGUMENT 2

ARGUMENT 4

I. THE CREATOR TEST URGED BY PLAINTIFFS AND THE SEC WOULD IMPERMISSIBLY IMPOSE PRIMARY LIABILITY ON SECONDARY ACTORS FOR CONDUCT NOT COVERED BY THE LANGUAGE OF SECTION 10(B) OF THE SECURITIES EXCHANGE ACT 4

II. THE THREAT OF SECONDARY LIABILITY UNDER THE SEC'S VAGUE CREATOR STANDARD WOULD HAVE SEVERE, HARMFUL CONSEQUENCES, ESPECIALLY FOR THE PROVISION OF LEGAL SERVICES...11

A. The SEC's proposed creator test would conflict with the complex array of ethical duties governing lawyers working in this area...11

B. The SEC's creator test falls far short of affording the certainty and predictability necessary in the area of securities regulation........15

C. The harms resulting from this uncertainty would be especially severe with regard to the legal profession and its provision of legal advice to promote compliance with the securities laws 17

CONCLUSION...23

TABLE OF AUTHORITIES

Page

CASES

Anixter v. Home-Stake Prod. Co.,
77 F.3d 1215 (10th Cir. 1996) 17

Barker v. Henderson, Franklin, Starnes & Holt,
797 F.2d 490 (7th Cir. 1986) 11

Bloor v. Carro, Spanbock, Londin, Rodman & Fass,
754 F.2d 57 (2d Cir. 1985) 21

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723 (1975)....................18

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

Ernst & Ernst v. Hochfelder,
425 U.S. 185 (1976)....................4

Int'l Inv. Trust v. Cornfeld,
619 F.2d 909 (2d Cir. 1980) 20

Morrison v. Nat'l Australia Bank Ltd.,
547 F.3d 167 (2d Cir. 2008) 8

Pinter v. Dahl,
486 U.S. 622 (1988)....................15

Shapiro v. Cantor,
123 F.3d 717 (2d Cir. 1997) 8, 16

South Cherry Street, LLC v. Hennessee Group LLC,
573 F.3d 98 (2d Cir. 2009) 14

Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.,
128 S. Ct. 761 (2008)....................5, 11, 22

Tellabs, Inc. v. Makor Issues & Rights, Ltd.,
551 U.S. 308 (2007)....................18

Ziemba v. Cascade Int'l, Inc.,
256 F.3d 1194 (11th Cir. 2001) 11

STATUTES

15 U.S.C. § 78j 6

15 U.S.C. § 78t(a) 7

15 U.S.C. § 78t(e) 20, 21

15 U.S.C. § 7245 12

18 U.S.C. § 1001 14

18 U.S.C. § 1621 14

18 U.S.C. § 1622 14

Section 10(b) of the Securities Exchange Act of 1934 .... passim

OTHER AUTHORITIES

17 C.F.R. §§ 205.1-205.6 12

17 C.F.R. § 205.3 13

17 C.F.R. § 205.3(d)(2) 14

17 C.F.R. § 205.5 15

Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 CAL. L. REV. 80 (1981) 6

Rule 10b-5 .... 6, 7, 15, 17

SEC Rules and Regulations, *Implementation of Standards of Professional Conduct for Attorneys*, 68 Fed. Reg. 6296-01 13

IDENTITY AND INTEREST OF AMICI CURIAE

Amici curiae are the following prominent law firms that practice in the securities field: Alston & Bird LLP; Ashurst LLP; Baker & McKenzie LLP; Bryan Cave LLP; Cadwalader, Wickersham & Taft LLP; Covington & Burling LLP; Fulbright & Jaworski LLP; Jones Day; Kaye Scholer LLP; Paul, Hastings, Janofsky & Walker LLP; Shearman & Sterling LLP; Sidley Austin LLP; and Sonnenschein Nath & Rosenthal LLP. These firms regularly represent parties in a wide range of financial transactions, and have counseled parties in countless matters involving securities litigation and SEC enforcement actions. All parties have consented to the filing of this brief.

Amici have a strong interest in this case because they believe that the test for § 10(b) liability advocated by the plaintiffs and the SEC – imposing liability for any so-called "creator" of a false or misleading statement – would impair the provision of legal services. Amici are concerned that the ambiguity and potentially expansive scope of the "creator" test would create substantial uncertainty about attorneys' ethical and legal obligations regarding attorney-client confidentiality. The "creator" test would also give rise to an enormous amount of unwarranted litigation against attorneys that would negatively affect when and how attorneys advise their clients regarding disclosure documents. Amici accordingly submit this

brief discussing the lack of a legal basis for the "creator" test, and the substantial harms that the test would cause if adopted by this Court.

SUMMARY OF THE ARGUMENT

The plaintiffs' and SEC's "creator" test for liability under § 10(b) of the Securities Exchange Act is unmoored from both the text of the Act and the practical realities of how disclosure documents are prepared. Moreover, its ambiguity and arbitrariness would cause significant harm to secondary parties, particularly attorneys. And the harm to attorneys would ultimately create serious problems for the provision of legal services in the area of securities law.

Despite the Supreme Court's repeated insistence on interpreting § 10(b) strictly in accordance with the statutory language, the SEC argues for a "creator" test without any reference to the statute. According to the SEC, there should be § 10(b) liability for any "creator" of a misstatement in a disclosure document, which includes anyone who drafted the misstatement, provided the faulty information, and possibly even advised the company in a way that created the misstatement. However, § 10(b) does not mention "creators," "drafters," "providers of information," or "advisers."

Moreover, the SEC's approach is based on the unrealistic idea that a particular secondary actor "creates" particular language in a disclosure document. In actuality, the language is the product of a collaboration with many corporate

officers and employees, lawyers, accountants, and other professionals. And the ultimate decision of what goes into a disclosure document belongs not to the secondary actors like attorneys, but to the primary actors who sign the document.

The "creator" test is especially problematic for lawyers because it presents serious conflicts with an already complex set of ethical rules and statutes in this area. Specifically, in a situation where an attorney's work might be used to create a misstatement in a disclosure document, state ethical rules may still require confidentiality. In addition, the Sarbanes-Oxley Act permits, but does not require, disclosure – and even this permission is limited to particular circumstances. The new "creator" test, however, disregards the attorney's ethical duties, and threatens to impose liability on an attorney who behaves in accordance with state rules and the Sarbanes-Oxley Act.

This risk of liability for attorneys, and others, is compounded by the ambiguity of the SEC's test. The Supreme Court has made clear that § 10(b) must be interpreted in a manner that provides clear rules for people to follow, but the SEC provides no real explanation of who counts as a "creator," even admitting its own uncertainty about whether advice could qualify. As a result, everyone who participates in the formation of a disclosure document – regardless of how minor their participation – could face civil liability, and has no way of knowing what their liability might be.

At a minimum, the SEC's ambiguous and seemingly expansive test would give rise to a huge amount of § 10(b) litigation for secondary actors. This litigation would impose great costs on those parties regardless of the secondary actor's actual guilt. These costs would impair the availability and increase the costs of legal services that are crucial in ensuring securities law compliance.

ARGUMENT

I. THE CREATOR TEST URGED BY PLAINTIFFS AND THE SEC WOULD IMPERMISSIBLY IMPOSE PRIMARY LIABILITY ON SECONDARY ACTORS FOR CONDUCT NOT COVERED BY THE LANGUAGE OF SECTION 10(B) OF THE SECURITIES EXCHANGE ACT

As the Supreme Court explained in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994), "our cases considering the scope of conduct prohibited by § 10(b) in private suits have emphasized adherence to the statutory language." Both before and after *Central Bank*, the Supreme Court has refused to expand liability based on plaintiff and SEC arguments relying on "broad congressional purposes behind the Act – to protect investors from false and misleading practices that might injure them." *Id.* at 173-74 (discussing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976)).

Thus, in *Central Bank*, the Court declined the opportunity to extend the implied private right of action under § 10(b) to reach aiding and abetting liability, noting that "[i]f . . . Congress intended to impose aiding and abetting liability, we

presume it would have used the words 'aid' and 'abet' in the statutory text. But it did not." *Id.* at 177. Similarly, last year in *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 773 (2008), the Court refused to extend private liability to alleged deceptive conduct by a corporation's suppliers and customers on a theory of "scheme" liability, noting that "[c]oncerns with the judicial creation of a private cause of action caution against its expansion," especially because in enacting the Private Securities Litigation Reform Act, "Congress accepted the § 10(b) private cause of action as then defined but chose to extend it no further." *Id.* at 773.

The proposal advanced in the SEC's amicus brief that this Court adopt a new test of § 10(b) liability, covering any person who "creates" a false or misleading statement, is one more creative endeavor to extend the implied cause of action under the Act beyond the reach of the statute's language. Under the SEC's proposed test, a person may be liable as a creator "if he provides the false or misleading information that another person then puts into the statement," or if he "actually drafted" the "document containing false or misleading statements," regardless of whether that statement is attributed to him. Brief of the Securities and Exchange Commission, Amicus Curiae ("SEC Br.") at 7.

Despite the Supreme Court's clear guidance, the SEC provides no textual basis for its theory. Indeed, aside from a reference to one clause discussed below,

the SEC does not mention the language of § 10(b) in its brief. While the SEC does discuss Rule 10b-5, *Central Bank* made clear that in deciding the scope of the private cause of action, the Court must interpret § 10(b) because "the private plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b)." 511 U.S. at 173. Just as the "'the language of Section 10(b) does not [by its] terms mention aiding and abetting,'" *id.* at 175 (quoting Brief for the SEC as Amicus Curiae at 8), it does not mention the "creation" of a misstatement. Rather, § 10(b) states: "It shall be unlawful for any person, directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance . . . ." 15 U.S.C. § 78j. Thus, the liability attaches to the person who "use[s] or employ[s]" the device. It does not attach to the person who "creates" a misstatement that another person then uses or employs as a manipulative or deceptive device. The SEC purports to rely on the language in § 10(b) whereby a person may be liable for acting "directly or indirectly," *see* SEC Br. at 18, but the Court rejected this exact argument in *Central Bank*. 511 U.S. at 176; *see also* Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 CAL. L. REV. 80, 94 n.83 (1981) (explaining that the "directly or indirectly" language is part of § 10(b)'s jurisdictional clause, and that "there is no support for the proposition that

Congress intended the 'directly or indirectly' language to encompass secondary liability").[1]

In particular, § 10(b) was not aimed at secondary actors, like lawyers, who do not actually use or employ the deceptive device at issue. Rather, the statute focuses liability on those that are actually responsible for the misstatement, and does not reach those with secondary roles. In addition to the language of § 10(b), which is limited to the person who actually commits the deception, other statutory provisions reinforce this point. Specifically, there is liability for anyone who "controls any person liable" under the Act, *see* 15 U.S.C. § 78t(a), and anyone who commits a violation "by means of any other person," *id.* § 78t(b). Moreover, other sections identify the individuals that could commit a violation, including only those primary actors that personally engage in the prohibited action. *See, e.g.*, *id.* § 77k (concerning liability for false registration statements). As the Court explained in *Central Bank*, it would be anomalous for liability for false registration statements to be limited to primary actors, while liability for other false statements extended to secondary actors. *See* 511 U.S. at 180. And, just as none of the other sections of the statute adopts aiding and abetting liability, *see id.*, none adopts a creator test.

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[1] Even if this Court looked only to the language of Rule 10b-5, the SEC's theory is likewise inconsistent with the language of the Rule. *See* Brief for Defendants-Appellees at 34-36.

This Court has likewise recognized the importance, in any assessment of possible § 10(b) liability, of the defendant's specific role in the challenged conduct. In *Shapiro v. Cantor*, 123 F.3d 717 (2d Cir. 1997), this Court held that an "accountant shares in an insider's duty to disclose if the accountant exchanges his or her role for a role as an insider who vends the company's securities," but not where his involvement is limited to "preparing the financial projections that were later included in the principal defendants' offering memoranda." *Id.* at 721. Also, in the extraterritoriality context, this Court recognized that there was no jurisdiction for an alleged § 10(b) violation for a subsidiary that supposedly "*created* and sent artificially inflated numbers up to its parent company." *Morrison v. Nat'l Australia Bank Ltd.*, 547 F.3d 167, 175 (2d Cir. 2008) (emphasis added). While the subsidiary "may have been the original source of the problematic numbers, those numbers had to pass through a number of checkpoints manned by [the parent company's] personnel before reaching investors." *Id.* at 176-77. Thus, the party that actually made the statement was the party "more directly responsible for the harm to investors" under § 10(b). *Id.* at 176.

The SEC claims that the "creator" of a statement "is, with regard to that statement, not just an aider and abettor: he is responsible for the statement's coming into being." SEC Br. at 8. However, the Commission's view overstates the secondary actor's actual role. A lawyer helping to prepare a disclosure

document has no authority to force the company to report particular information or place particular language in that statement. The lawyer serves the company, and the corporate officials have the ultimate choice of what goes into the securities disclosures. That is why certain officers sign those disclosures: by attributing the statement to particular individuals, investors know who is responsible for it.

One consequence of this muddling of responsibility is the SEC's own ambiguity on whether an attorney's "advice" could give rise to liability. According to the SEC, "[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. The SEC fails to recognize that it is *always* the company's independent choice on whether to follow the lawyer's advice. The idea that lawyers control corporate disclosures in the manner assumed by the Commission simply misconceives the relationship between lawyers and their clients.

Furthermore, the SEC's theory ignores other practical realities concerning how securities-related disclosures are prepared. The SEC's theory is premised on the idea that some particular person who is not an officer of the company "creates" false or misleading language in those statements. At the same time, the Commission must acknowledge that "a person who prepared a truthful and complete portion of a document would not be liable as a primary violator if there

were false or misleading statements, prepared by other people, in other portions of the document, unless, of course, the person was subject to a duty to speak." *Id.* at 9.

Seldom, however, are disclosure documents so easily chopped into pieces that can be sorted among their innocent and guilty "creators." Disclosure documents are prepared through a collaborative process with many corporate officers and employees, in-house and outside lawyers, accountants, and other professionals. Rarely is a single person responsible for any particular section. The specific financial numbers and language in the disclosures are usually analyzed, discussed, and changed by many people throughout the process. Under the Commission's test, in a situation where a law firm advises a company regarding how to report a given transaction, courts would be required to draw countless fine distinctions in order to identify "creators." *See infra* Part II.B. This ambiguity demonstrates that the SEC's theory has no more basis in practical reality than it does in the language of Section 10(b).

II. THE THREAT OF SECONDARY LIABILITY UNDER THE SEC'S VAGUE CREATOR STANDARD WOULD HAVE SEVERE, HARMFUL CONSEQUENCES, ESPECIALLY FOR THE PROVISION OF LEGAL SERVICES

A. The SEC's proposed creator test would conflict with the complex array of ethical duties governing lawyers working in this area

The Supreme Court has recently warned against interpretations of § 10(b) that create "a risk that the federal power would be used to invite litigation beyond the immediate sphere of securities litigation and in areas already governed by functioning and effective state-law guarantees." *Stoneridge*, 128 S. Ct. at 771. Here, the SEC's proposal would interfere with existing state and federal requirements regarding attorney conduct.

The duties that lawyers must honor in cases of potential securities fraud are discernible only by reading and reconciling the provisions of the federal securities laws with the ethical obligations owed under state rules governing the legal profession. Courts have long recognized that a lawyer's ethical duties must be considered when analyzing the application of § 10(b). For example, a lawyer will not be liable for a failure to speak where, "because of its fiduciary obligations to its client, [the law firm] had certain privileges not to disclose information about" its client. *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1206 (11th Cir. 2001); *see also Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 497 (7th Cir. 1986) ("Neither lawyers nor accountants are required to tattle on their clients in the

absence of some duty to disclose. To the contrary, attorneys have privileges not to disclose.") (internal citations omitted).

Congress addressed this issue directly in the Sarbanes-Oxley Act, which ordered the SEC to provide rules "setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers." 15 U.S.C. § 7245. This includes a rule "requiring an attorney to report evidence of a material violation of securities law . . . by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company," and if they do "not appropriately respond to the evidence, . . . requiring the attorney to report the evidence to" the board of directors or a committee thereof. *Id.* The SEC has provided specific requirements in accordance with this statute, including a description of the circumstances whereby an attorney can reveal client confidences. *See* 17 C.F.R. §§ 205.1-205.6. While these provisions are complex and not without ambiguity, they reflect an effort to reconcile the requirements of attorney disclosure with the state ethical requirements.

The SEC's creator theory would complicate this already difficult area further by placing new, and potentially conflicting, duties on attorneys. To begin with, an attorney who learns that his work is being used to make a misstatement could be put in an impossible position. If, after following his up-the-ladder reporting

obligations within the corporation under Sarbanes-Oxley, the corporation still decides to make the misstatement, the attorney may then have an ethical duty not to reveal client confidences. Notwithstanding that duty, an attorney who behaves ethically by making no further disclosures runs a real risk of "creator" liability under the SEC's loosely conceived standard.

Indeed, the "creator" standard of liability would present head-spinning questions of reconciliation with existing pronouncements of the SEC itself, in cases where a lawyer's work product is arguably being put to deceptive uses. The SEC rules permit attorneys to disclose confidential information and engage in a so-called "noisy withdrawal" under certain circumstances. *See* 17 C.F.R. § 205.3. However, the SEC rejected the idea of requiring attorneys to make a noisy withdrawal, in part because it would be inconsistent with state rules and interfere with the attorney-client relationship. *See* SEC Rules and Regulations, *Implementation of Standards of Professional Conduct for Attorneys*, 68 Fed. Reg. 6296-01, at 6318 (Feb. 6, 2003) ("The Commission received comments indicating that the rule, and particularly the proposal regarding 'noisy withdrawal,' would cause issuers to be less willing to seek legal advice and would result in issuers being less forthcoming with their counsel. . . . Since the rule, as adopted, will not require mandatory withdrawal or disclosure to the Commission, we believe that Part 205 will not have any adverse impact on attorney-client communications.").

Moreover, even the permissive "noisy withdrawal" authorized by the SEC is limited to specific situations that would not cover many circumstances in which the attorney could be liable as a creator of a misstatement.[2]

The predicament becomes more difficult in the situation – which is probably far more common – where the attorney believes that his work *might* be used to make a misstatement. The consciousness of a risk of a misstatement could satisfy the scienter requirement of recklessness under § 10(b). *See, e.g.*, *South Cherry Street, LLC v. Hennessee Group LLC*, 573 F.3d 98, 109 (2d Cir. 2009). However, such uncertainty would make it doubtful that disclosure of client confidences would be permitted under state ethical rules or under Sarbanes-Oxley. *See* 17 C.F.R. § 205.3(d)(2) (noting that disclosure is permitted only when "the attorney

[2] *See* 17 C.F.R. § 205.3(d)(2) ("An attorney . . . may reveal to the Commission, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary: (i) To prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors; (ii) To prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, proscribed in 18 U.S.C. 1621; suborning perjury, proscribed in 18 U.S.C. 1622; or committing any act proscribed in 18 U.S.C. 1001 that is likely to perpetrate a fraud upon the Commission; or (iii) To rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used."). Based on this section, a disclosure would not be permitted if it were not "reasonably . . . necessary," to prevent substantial injury or perjury under certain specific statutes. Of course, such requirements are not elements of a violation of § 10(b).

reasonably believes [it] necessary" to prevent certain violations). The problem is even worse for an associate at a law firm whose concerns are dismissed by the partner in charge. Sarbanes-Oxley recognizes this concern, and makes certain allowances for subordinate attorneys. *See* 17 C.F.R. § 205.5. However, the SEC's theory would presumably apply equally to any so-called creator of a misstatement.

B. The SEC's creator test falls far short of affording the certainty and predictability necessary in the area of securities regulation

The Supreme Court has repeatedly emphasized that securities regulation is "'an area that demands certainty and predictability.'" *Cent. Bank*, 511 U.S. at 188 (quoting *Pinter v. Dahl*, 486 U.S. 622, 652 (1988)). In particular, for § 10(b), a "'shifting and highly fact-oriented disposition of the issue of who may [be liable for] a damages claim for violation of Rule 10b-5' is not a 'satisfactory basis for a rule of liability imposed on the conduct of business transactions.'" *Id.* (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 755 (1975)).

The extreme ambiguity of the creator test is apparent. To begin with, *Central Bank* recognized that "the rules for determining aiding and abetting liability are unclear." 511 U.S. at 188. The rules for determining creator liability are much more unclear, since they do not exist. The SEC itself admits that it does not know whether an attorney providing advice could qualify as a creator. *See* SEC Br. at 10-11. More generally, because the "creator" idea has no roots in the statute, the common law, or anywhere else, it has no real definition. The SEC

claims that it applies to people who "drafted" the statements, or "supplied the writer with false or misleading information." *Id.* at 7. However, these categories create more questions than they answer. Who counts as a drafter: a person who suggests language, a person who writes a first draft that he expects will be vetted by others, a person who polishes another person's draft, a person who inserts a few words, a person who physically types up the language, or all of the above? Similarly, who counts as a supplier of information: a person who gathers the data, a person who compiles it, a person who verifies it, a person who performs computations on the data, a person who gives estimates, a person who provides information about legal or accounting rules, or all of the above? A huge number of people may participate in some form in the preparation of financial statements and other securities-related disclosures, and the SEC's test provides no certainty to any of them.

Of course, courts could limit the application of the creator test to higher-level people, thereby protecting subordinates at some level from liability. However, the SEC has given no indication that the test should be so limited, or how to draw the line. The Commission's proposal lacks even the specificity of "a rule allowing liability to attach to an accountant or other outside professional who provided 'significant' or 'substantial' assistance to the representations of others," which provides only limited guidance to litigants. *Shapiro*, 123 F.3d at 717

(quoting *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226-27 (10th Cir. 1996)).

C. The harms resulting from this uncertainty would be especially severe with regard to the legal profession and its provision of legal advice to promote compliance with the securities laws

Because of the ambiguity and potentially enormous breadth of the creator test, secondary actors would face a great deal of § 10(b) litigation, regardless of their actual culpability. Plaintiffs will routinely name as a defendant almost every person who came into contact with the allegedly false financial statement. Presumably, under the SEC's test, the claim that a defendant "wrote," "drafted," or "provided information" for a false statement would be a sufficient allegation of the defendant's participation in the purported fraud. As discussed *supra* Part II.B, it will often be extremely difficult, if not impossible, to determine who actually "created" a particular misstatement. That is why it makes sense to leave the untangling of responsibility to the SEC and prosecutors, who can investigate and exercise discretion in pursuing aiders and abettors – rather than private plaintiffs who will simply name everyone as defendants. Indeed, many of the secondary actors, like law firms or accounting firms, would represent an easy deep pocket to target for litigation.

"'[L]itigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general'" because

it "requires secondary actors to expend large sums even for pretrial defense and the negotiation of settlements." *Cent. Bank,* 511 U.S. at 189 (quoting *Blue Chip Stamps*, 421 U.S. at 739). Moreover, "even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment." *Blue Chip Stamps*, 421 U.S. at 740. This value comes from the prospect of extensive discovery, the disruption of the defendant's business, and the unwillingness to take a risk, however small, of potentially crushing liability. *See id.* at 740-42; *see also Cent. Bank*, 511 U.S. at 189 ("Because 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.").

The SEC argues that the strong-inference scienter standard will ensure that baseless § 10(b) litigation does not proceed past the pleading stage. *See* SEC Br. at 15-16. However, the strong-inference requirement will be inadequate to protect many innocent parties. The assessment of the adequacy of a scienter pleading is a highly individualized exercise, depending on all of the allegations in the complaint. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322-23 (2007). As a

result, the outcome is often unpredictable. And, for law-firm defendants, plaintiffs may find other defendants who have an incentive to claim that they relied upon counsel approval, even if such approval never occurred. Simply put, once liability is expanded beyond those who used or employed the manipulative or deceptive device, law firms will face very serious dangers in § 10(b) cases, regardless of what they could ultimately prove at trial.

This risk and uncertainty could have a serious effect on how law firms provide services to their clients. As the Supreme Court explained, "newer and smaller companies may find it difficult to obtain advice from professionals" for fear that such a company "may not survive and that business failure would generate securities litigation against the professional, among others." *Cent. Bank*, 511 U.S. at 189. For established companies as well, "the increased costs incurred by professionals because of the litigation and settlement costs under 10b-5 may be passed on to their client companies, and in turn incurred by the company's investors, the intended beneficiaries of the statute." *Id.* Ultimately, the risks of financial liability would compound with the ethical dilemmas discussed above to further impair the availability and increase the costs of legal services that are, on the whole, highly beneficial in advancing the cause of securities law compliance. The SEC provides no policy justification to outweigh these harms.

In considering the SEC's proposed extension of liability to "creators," one must keep in mind that under existing law, an attorney's position does not exempt him from liability for participating in securities fraud. "Any person or entity, including a lawyer . . . who employs a manipulative device or *makes a material misstatement (or omission) on which a purchaser or seller of securities relies* may be liable as a primary violator . . . ." *Cent. Bank*, 511 U.S. at 191 (emphasis added). Moreover, lawyers may be subject to criminal prosecution or an SEC enforcement action for aiding and abetting a § 10(b) violation. *See id.* at 190; 15 U.S.C. § 78t(e). Importantly, Congress placed these latter avenues of enforcement against lawyers and others in the discretion of public authorities with responsibility to advance the public interest, without concern for leverage in private litigation or personal financial gain.

Moreover, the heightened requirements for a criminal prosecution or an SEC enforcement action based on an aiding and abetting theory ameliorates some of the concerns about interference with the provision of legal advice. A person may be liable as an aider and abettor if three elements are met: "(1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party; (2) 'knowledge' of this violation on the part of the aider and abettor; and (3) 'substantial assistance' by the aider and abettor in the achievement of the primary violation." *IIT, an Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980);

see also 15 U.S.C. § 78t(e) (allowing SEC enforcement action against person who "knowingly provides substantial assistance to another person in violation of" the securities laws). "In alleging the requisite 'substantial assistance' by the aider and abettor, the complaint must allege that the acts of the aider and abettor proximately caused the harm to the corporation on which the primary liability is predicated." *Bloor v. Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 57, 62 (2d Cir. 1985).

These requirements for aiding and abetting liability in a prosecution or SEC enforcement action are more demanding than the SEC's proposal of creator liability in two important respects. First, the secondary party must have knowledge of the violation; recklessness is not enough. The SEC acknowledges that one motivation behind its proposed creator test is to circumvent this limitation on aider-and-abettor liability. *See* SEC Br. at 4 ("[T]here are instances where the Commission . . . might find it necessary to assert a claim for primary liability . . . because the aiding-and-abetting statutory provision arguably requires the Commission to satisfy a higher scienter standard . . . ."). But the knowledge requirement in an aiding and abetting action is crucial because it ensures that an attorney who is uncertain about a possible misstatement will not be found liable because he kept client communications confidential in the face of such doubt.

Second, the alleged aider and abettor must provide "substantial assistance." This requirement ensures that attorneys will not be held liable – or forced to

disclose confidential information – simply because they provided information, advice, or language that did not substantially aid the fraud.[3] Accordingly, the SEC's new creator standard of liability would present a threat of unpredictable liability well beyond that posed by public enforcement actions, against lawyers as against anyone else, based on an aiding and abetting theory.

In summary, after *Central Bank*, the SEC sought aiding and abetting liability for private plaintiffs as well as for SEC enforcement actions, but Congress carefully limited secondary liability to the latter. *Stoneridge*, 128 S. Ct. at 768-69. In its post-Sarbanes-Oxley rulemaking, the Commission exercised restraint in tabling provisions, relating to a mandatory "noisy" withdrawal under certain circumstances, that would have imposed complexity and greater risk on lawyers rendering securities law advice. The vague creator standard of liability proposed by plaintiffs and the SEC is sharply at odds with the careful deliberation and restraint shown by these two decisions. If the SEC perceives a class of wrongdoers whose conduct is not, but should be, reached by § 10(b), the Commission's argument is properly addressed to Congress, not to this Court.

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[3] The SEC claims that its theory is "consistent" with the approach of a few courts that hold "a defendant is a primary violator where he 'caused' a false or misleading statement to be made." SEC Br. at 10. However, causation and creation are not remotely equivalent, and this supposed consistency is simply one more example of the ambiguity in the SEC's approach. In any event, a causation test suffers from many of the same defects – including the lack of a textual basis in § 10(b) – that plague the "creator" test.

CONCLUSION

For the foregoing reasons, the district court's judgment should be affirmed.

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This brief complies with the type-volume limitation in Federal Rules of Appellate Procedure 29(d) and 32(a)(7)(B)(i). It contains 5,387 words as counted by the word-processing system used to prepare the brief, exclusive of the parts of the brief exempted from the type-volume limitation by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

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Docket Number: 09-1619-cv

I, Natasha R. Monell, hereby certify that the Amicus Brief submitted in PDF form as an e-mail attachment to **civilcases@ca2.uscourts.gov** in the above referenced case, was scanned using CA Software Anti-Virus Release 8.3.02 (with updated virus definition file as of 9/11/2009) and found to be VIRUS FREE.

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