No. 06-43

In the Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,
Petitioner,

v.

SCIENTIFIC-ATLANTA, INC AND MOTOROLA, INC.
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF AMICUS CURIAE FOR DEFENSE RESEARCH INSTITUTE IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICUS CURIAE[1]

With the consent of the parties, the Defense Research Institute ("DRI") submits this amicus curiae brief in support of respondents.[2] DRI is an international organization that includes more than 22,000 attorneys involved in the defense of civil litigation. DRI is committed to enhancing the skills, effectiveness, and professionalism of defense attorneys. Because of this commitment, DRI seeks to address issues germane to defense attorneys and the civil justice system, to

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1 Pursuant to Supreme Court Rule 37.6, *amicus curiae* states that no counsel for a party has written this brief in whole or in part and that no person or entity, other than the *amicus curiae*, its members, or its counsel, has made a monetary contribution to the preparation or submission of this brief.

2 Letters reflecting written consent of the parties to the submission of this brief have been filed with the Clerk of Court.

promote the role of the defense attorney, and to improve the civil justice system. DRI has long been a voice in the ongoing effort to make the civil justice system more fair, efficient, and — where national issues are involved — consistent.

To promote these objectives, DRI participates as amicus curiae in cases that raise issues of import to its membership and to the judicial system. The expansion of liability to private plaintiffs under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 that petitioner urges in this case poses a distinct threat to the efficient and fair administration of justice. By seeking to impose costly private litigation on secondary parties, petitioner advocates a result that would have multiple deleterious consequences. It would dramatically expand the scope and uncertainty of securities litigation, thus straining the courts. It would create costly new duties for secondary parties to monitor public statements made by others, thus straining the economy. Congress has not created such duties or grounds for liability against secondary parties, and this Court therefore should reject petitioner's contentions.

The important legal issues in this case are, accordingly, of substantial concern to DRI. Since its members have first-hand experience with litigation under Section 10(b), DRI is well-suited to address the pernicious consequences of the liability standard on which petitioner's arguments are based.

SUMMARY OF ARGUMENT

For reasons stated in the respondents' brief, there is no merit to petitioner's effort to expand Section 10(b) and Rule 10b-5 private liability in ways Congress never enacted and surely never intended. This brief will not replow grounds well presented by respondents. Instead, DRI will provide illustrations of real-world situations — drawn from actual cases — that should inform this Court's assessment of the issues. In addition, DRI will address other statutory provisions that undermine petitioner's contention that there is a need or justification for dramatically enlarging the reach of Section 10(b) to ensnare secondary parties who made no statements and undertook no actions on which investors relied.

1. By definition, the secondary parties that petitioner's theory of liability is intended to reach are outsiders to the company in which plaintiffs are shareholders. These outsiders made no public statements that were false or misleading, nor any statements or actions on which the issuer's shareholders reasonably could have relied. In short, the targets of petitioner's "scheme liability" theory are parties who did not themselves violate Section 10(b) or Rule 10b-5. The question, then, is whether the statute can be read to cover parties who are not within the statutory terms. The analysis and holding in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver*, 511 U.S. 164 (1994), compel the conclusion that Section 10(b) does not reach such secondary actors. Accordingly, the Court should reject petitioner's effort to circumvent the holding of *Central Bank* by relabeling alleged aiders/abettors as "secondary actors" or even "primary actors." Respondents are outsiders to the issuer and their actions did not violate any duty to petitioner imposed by the statute.

The realities of the business and financial world place many companies in this sort of secondary contact with issuers of securities. Vendors, customers, contracting parties, partners, co-venturers, and others are frequently involved in commercial transactions that are reflected in an issuer's financial statements and public disclosures. But there is no justifiable basis for imposing liability under Section 10(b) on these outsiders based on the public statements and allegedly deceptive acts of the issuer. The outsiders have no control over the issuer's statements, may not even be aware of them, and often do not have access to the underlying information required to ascertain the accuracy of the issuer's statements or their materiality to the issuer's shareholders. Indeed, the outsiders may even be victims targeted by the issuer's scheme. Numerous examples drawn from class-action complaints filed in federal court bear out these descriptions. Under settled law, there is no private claim against these outsiders and, typically, they are not sued. But the expansive notions of liability petitioner espouses would impose on such outsiders an entirely new duty to monitor and report to the public on statements made by issuers with whom they have a business relationship. The costly consequences of such a duty underscore the pernicious nature of the rule petitioner urges.

2. In contrast to the burdens petitioner would impose on outsiders, there is scant potential benefit from the rule of expansive private liability that petitioner advances. In its careful creation of the regulatory regime for securities, Congress provided no private liability for such secondary actors. Instead, Congress conferred circumscribed authority on the Securities and Exchange Commission ("SEC") — but not private plaintiffs — to pursue enforcement remedies against persons who substantially contribute to a violation of Section 10(b). *See* Securities Exchange Act of 1934 § 20(e), 15 U.S.C.A. § 78t(e); Sarbanes-Oxley Act of 2002 § 308(a), 15 U.S.C.A. § 7246(a). There is no warrant for this Court to undo the statutory balance of authority and the circumscribed remedies Congress created, especially where the SEC has

successfully implemented its authority to obtain recovery for investors in situations where the SEC has concluded such a remedy is warranted.

ARGUMENT

I. THERE IS NO STATUTORY BASIS FOR THE IMPRACTICAL BURDENS AND EXPANDED LIABILITY PETITIONER SEEKS TO CREATE

At their core, the arguments petitioner advances for imposing liability on respondents can be seen as a semantic circumvention of this Court's holding in *Central Bank.* 511 U.S. 164 (1994). In that case, the Court observed that § 10(b) "prohibits … the making of a material misstatement (or omission) or the commission of a manipulation act," but that the statutory prohibition "does not include giving aid to a person who commits a manipulation or deceptive act." *Id.* at 177 (internal citation omitted); *see also United States v. O'Hagan*, 521 U.S. 642, 651 (1997) ("Liability under Rule 10b-5, our precedent indicates, does not extend beyond conduct encompassed by § 10(b)'s prohibition") (citation omitted) .

In this fundamental respect, *Central Bank* embodies the Court's longstanding refusal "to allow 10b-5 challenges to conduct not prohibited by the text of the statute." 511 U.S. at 173. Consistent with that rule of fidelity to the statutory language, the Court has rejected prior efforts to extend private Section 10(b) liability beyond the statute's express requirements: (1) negligent acts cannot constitute violations[3]; (2) breaches of fiduciary duty are not actionable absent misrepresentation or a lack of disclosure[4]; and (3) there can be no violation without a duty to disclose.[5]

Even for primary wrongdoers whose actions violate statutory standards, there is no private liability absent a plaintiff's reliance on the wrongful acts in connection with the purchase or sale of securities. *Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988). And, as the Court explained in *Central Bank*, lack of reliance on the statements or actions of each defendant is a principal reason why liability does not extend beyond primary wrongdoers to aiders and abettors. 511 U.S. at 180. The Court has instructed that private secondary liability must fail since it necessarily lacks the proofs expressly required by the text of Section 10(b):

> A plaintiff must show reliance on the defendant's misstatement or omission …. Were we to allow the aiding and abetting action … the defendant could be liable without any showing that the plaintiff relied upon the aiders and abettor's statements or actions. …. Allowing plaintiffs to circumvent the reliance requirement would disregard … limits on 10b-5 recovery mandated by our earlier cases. *Id.* at 180

Petitioner in the present case would similarly circumvent the reliance requirement (and the other

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[3] *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 197-98 (1976).

[4] *Santa Fe Indus., Inc. v. Green,* 430 U.S. 462, 463 (1977).

[5] *Chiarella v. United States,* 445 U.S. 222, 232-34 (1980).

requirements of Section 10(b)) by crafting the term "scheme liability" in an effort to reach the "aiding and abetting" liability rejected in *Central Bank*. It is wholly inconsistent with the holding and rationale of *Central Bank* to re-label alleged conduct that previously would have been viewed as aiding and abetting with a new appellation designed only to create an escape hatch from the rule of *Central Bank*. Equally as important, petitioner offers no principled basis for distinguishing aiding and abetting from the conduct it seeks to make subject to private lawsuits. The absence of such a distinction is critical because, by definition, the category of potential new defendants consists of entities that made no statements upon which the public relied in connection with the purchase or sale of securities of the issuer. Accordingly, petitioner's test would necessarily expand private liability for Section 10(b) to "reach[ ] persons who do not engage in the proscribed activities at all" — the very outcome that this Court rejected in *Central Bank*, 511 U.S. at 176.

These concerns are not merely hypothetical. Fact patterns and business relationships drawn from allegations in recently filed securities cases provide real-world scenarios in which petitioner's "but-for" view of causation would create new risks of costly litigation and potential liability that Congress never intended. Moreover, an examination of post-*Central Bank* securities complaints that allege third-party involvement demonstrates why the absence of a workable distinction between non-actionable aiding and abetting and a new form of secondary liability — much less a distinction authorized by Congress — is fatal to petitioner's argument. Should potential private liability be expanded to third parties who may have (or may be considering) a business relationship with the issuer, then a new form of risk would be created for third parties who made no public statements, who did not owe any fiduciary duty to the primary actor's shareholders, and upon whose actions those shareholders did not rely. This new category of prospective defendants could include vendors, customers, potential business partners, outside advisers, and consultants; indeed, even parties who were themselves victimized and financially damaged by the issuer's alleged scheme could be swept within petitioner's view of liability. These illustrations — drawn from the annals of pending and recent litigation – show that corporate relationships do not fit neatly into the matrix of liability petitioner advances.

A rule that subjects third parties or other outsiders to private civil liability for the misstatements, omissions, and schemes of an issuer will assuredly generate uncertainty. Consider, for example, the burden of monitoring the public statements of all vendors with whom one does business. Then consider the reality that any such burden would be compounded by the additional burden of assessing whether each statement is accurate and not misleading. Consider the further burden of assessing whether any statement deemed inaccurate is material to the financial condition of the issuer. And then consider that all of these assessments would have to be undertaken by a third party who lacks access to internal corporate information of the issuer. Indeed, if the inaccuracy of the issuer's statements could be readily ascertained by publicly available information there would be no reasonable reliance by an investor and, hence, no Section 10(b) violation. In short, the new duties and standards that petitioner advocates offer little in the way of practical benefit to investors but impose substantial burdens and costs on others.

A. Vendors

In a class-action complaint involving a vendor and its customer,[6] plaintiffs alleged that one of defendant's subsidiaries engaged in a scheme to overstate its revenues by nearly $900 million. *In re Royal Ahold*, Compl. ¶ 13. Plaintiffs alleged that defendant's subsidiary colluded with its vendors to inflate revenues derived from supplier rebates by preparing false rebate confirmations. *Id.* ¶ 102.

The vendors were not named as defendants in the class-action suit. Yet, the allegations in that case shed light on the expanded litigation exposure vendors would face under petitioner's conception of "scheme liability" and "but-for" causation. Vendors might conclude that they are required to monitor their customers' public disclosures and financial statements regarding the validity of the accounting treatment for such rebates (and other inter-firm transactions). Such a requirement would be extremely costly and could not even be accomplished in any practical way since vendors do not have access to sufficient information to analyze the materiality of such public statements.

B. Customers

In another class-action complaint involving a vendor and its customer,[7] plaintiffs alleged that defendant ("the Vendor") inflated earnings to meet growth and earning

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[6] *In re Royal Ahold N.V. Secs. & ERISA Litig.*, 03-CIV-01539 (D.Md. Filed January 23, 2004); https://ecf.mdd.uscourts.gov/cgi-bin/login.pl?106325525506022-L_835_0-1 ("*In re Royal Ahold*").

[7] *Laborers Local 1298 Pension Fund, v. Campbell Soup Co.*, 00-CIV-152 (D.N.J. Filed July 27, 2000); http://securities.stanford.edu/1013/CPB00/ ("*Laborers Local 1298*").

estimates. *Laborers Local 1298,* Compl. ¶ 2. Plaintiffs alleged that defendant improperly recognized material amounts of revenue as sales which were in fact a sham and not properly recognizable revenue. *Id.* ¶ 9. The next year, customers purchased much less from the Vendor and the Vendor announced unexpected losses, causing its stock price to drop dramatically. *Id.* ¶ 8.

In this situation, it is fair to inquire whether petitioner's notion of "scheme liability" and "but-for" causation would require customers to monitor their vendors' public disclosures and financial statements regarding the validity of the accounting treatment for sales. Wholly aside from the cost of such an endeavor, there is the virtual certainty that the customers would lack access to sufficient information to make an exhaustive, accurate analysis. Contrary to petitioner's contention, Section 10(b) does not make a customer his vendor's bookkeeper.

C. Parties in Merger Discussions

In one recent class-action complaint,[8] plaintiffs accused defendant (a regional company) of issuing false and misleading statements in connection with an Agreement and Plan of Merger ("the Merger Agreement") it entered into to be acquired by a large national company. *In re Northpoint,* Compl. ¶ 31.

Shortly after announcing the Merger Agreement, the defendant was forced to restate its financials and reveal an inability to collect nearly one third of its receivables. *Id.* ¶ 5.

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[8] *In re Northpoint Comm'ns. Group, Inc. Secs. Litig.*, No. C-01-1473 (N.D. Cal. Filed Aug. 23, 2001); http://securities.stanford.edu/1017/NPNTQ01/ ("*In re Northpoint*").

In connection with the restatement, the defendant issued a press release indicating that the merger was still on track, but did not mention the Merger Agreement's provision allowing the acquirer to withdraw from the merger if defendant's business took an adverse turn. *Id.* ¶ 5. Nine days later, the national company withdrew from the Merger Agreement and terminated its funding, citing the defendant's poor financial condition and false quarterly reports. The defendant's stock plummeted. *Id.* ¶ 6.

The complaint did not name the national company as a defendant. Indeed, the national company had been kept in the dark about defendant's financial condition and played no role in defendant's false public statements. It is fair to ask, however, whether the "but-for" causation that petitioner urges here would have required the national company to monitor and issue corrections for all public statements by its potential merger partner. Such a duty would be particularly onerous and costly if the national company had to assess whether the misstatements were material and then hire counsel, accountants, and others to correct any inaccuracies. In this real-world situation, the defendant's alleged scheme was directed at the national company as well as at its own shareholders. Yet, petitioner's overly expansive theory of "scheme liability" has the troublesome potential of creating a risk of liability for the victimized national company.

D. Partnerships

1. In a class-action complaint filed early this year in the Southern District of New York,[9] plaintiffs alleged

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[9] *Elec. Workers Pension Fund v. Nuvelo, Inc.*, Case No. 07-CIV-0975 (S.D.N.Y. Filed Feb. 9, 2007); http://securities.stanford.edu/1037/NUVO_01/ ("*Elec. Workers*").

that defendant issued false and misleading statements about the development and regulatory review of a new product. *Elec. Workers,* Compl. ¶ 35 Defendant is alleged not to have divulged the fact that its collaborator (the "Collaborator"), a larger company, opted to grant a license rather than invest additional development funds after a review of privately collected data. *Id.* ¶ 11. Defendant instead represented its Collaborator's decision to opt out of funding further development as "purely a strategic decision . . . not necessarily a decision regarding" the product or the defendant." *Id.* The Collaborator made no statements about the issuer that were alleged to be misleading.

2. In a class-action complaint filed in 2002,[10] plaintiffs alleged that defendant, a biotechnology company, disseminated materially false and misleading statements regarding the clinical success of its drug trials, its compliance with FDA filing requirements, and its estimated revenue. *Krosser,* Compl. ¶ 1. Plaintiffs alleged that the clinical trials were not successful, that the defendant filed an inadequate application with the FDA, and that the estimated revenues were baseless and misleading. *Id.* ¶ 71. When the FDA rejected the application, the issuer's stock price dropped. *Id.* ¶ 79.

Consistent with settled law, plaintiffs did not sue the large pharmaceutical company that partnered with defendant and provided substantial funding. The large pharmaceutical company had no duty to defendant's shareholders, took no part in defendant's publications, and defendant's shareholders could not have relied on the larger company to

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[10] *Krosser v. Imclone Sys., Inc.,* Case No. 02-CIV-00136 (S.D.N.Y. Filed Jan. 8, 2002); http://securities.stanford.edu/1023/IMCL02-01/ ("*Krosser*").

monitor defendant's public statements. Would petitioner's arguments in the present case expand private liability to reach such situations? If so, then the notion of "scheme liability" would impose increased transactions costs that clearly could dissuade large companies from partnering with smaller ones.

3. In a class-action complaint filed in 2000,[11] plaintiffs alleged that defendant manufacturer made misleading statements indicating that its technology had been approved by a private industry regulator (the "Regulator"). *Birnbaum*, Compl. ¶ 4. Plaintiffs further alleged that without the Regulator's imprimatur there would be no demand for defendant's products. *Id.* ¶ 30. But, the Regulator had not approved the technology and allegedly sent defendant a private cease-and-desist letter demanding that it discontinue its public claims to the contrary. *Id.* ¶ 5. The false-approval claims allegedly allowed defendant to mislead plaintiffs regarding its financial health and prospects. *Id.* ¶ 31. Again, it is pertinent to inquire whether petitioner's notion of "scheme liability" would expand Section 10(b)'s reach to permit a lawsuit against such parties as the Regulator, which was essentially a victim of the issuer's false statements.

These real-life examples clearly demonstrate that one need not resort to hypotheticals to conclude that petitioner's theory of "scheme liability" would nullify the distinction between primary and secondary liability that informed this Court's decision in *Central Bank*. The result would be an upsurge in third parties becoming defendants in private litigation for actions that do not violate Section 10(b) as that

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[11] *Birnbaum v. Terayon Comm'ns Sys. Inc.*, Case No. 00-CIV-03912 (C.D. Cal. Filed Apr. 13, 2000); http://securities.stanford.edu/1014/TERN00/ ("*Birnbaum*").

statute has long been interpreted. At the end of the day, petitioner's contention that Section 10(b) should be construed flexibly to cover a variety of "schemes" misses a fundamental point: to say that a "scheme" violates the statute does not mean that a particular third party has violated the statute. As Congress and this Court have determined, liability to private plaintiffs should be based on measuring a defendant's conduct against statutory standards and elements, not on measuring the depth of a defendant's pockets. *Tellabs, Inc., v. Makkor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2508 (2007).

II. CONGRESS HAS NOT EXPANDED 10(b) LIABILITY FOR PRIVATE LAWSUITS AGAINST SECONDARY PARTIES

Petitioner's formulation of "scheme liability" would radically expand Section 10(b) beyond the scope authorized by Congress. Petitioner's arguments are contrary to the statutory language and to all appropriate indicia of legislative intent. Indeed, Congress has given no indication that it has created private liability in these circumstances, and multiple clear indications that it has not. In at least four enactments since the *Central Bank* decision, Congress has legislated major changes to class action and securities law procedures. If Congress intended to impose a duty on secondary parties to monitor representations made by their business associates and others, it had ample opportunity to do so.

A. Private Securities Litigation Reform Act

Shortly after the decision in *Central Bank*, Congress passed the Private Securities Litigation Reform Act ("PSLRA") in 1995 (and amended it in 1997). 15 U.S.C. §§

78u-4 *et seq.* The PSLRA was an extensive overhaul of class-action litigation that sought to curb class-action abuses, including professional claimants, the race to the courthouse, and awards of excessive attorneys' fees. The PSLRA did not create a Section 10(b) secondary liability scheme in favor of private plaintiffs. To the contrary, the PSLRA added a separate section that authorized the SEC — and not private parties — to pursue administrative remedies against secondary actors who aid and abet violations of Section 10(b). *See* page 17, *infra*.

B. Securities Litigation Uniform Standards Act

The Securities Litigation Uniform Standards Act of 1998, 15 U.S.C.A. § 78bb(f) ("SLUSA"), was designed to protect the integrity of the federal securities laws. SLUSA preempted certain state-law actions for fraud, negligence, or breach of fiduciary duty and allowed federal courts to stay discovery in state-court actions that might interfere with the federal securities action. It did not create the private Section 10(b) liability for secondary parties that petitioner urges in this case.

C. Class Action Fairness Act

The Class Action Fairness Act of 2005, 28 U.S.C. §§ 1332(d), 1453, and 1711-1715, strengthened certain provisions of the PSLRA by imposing new requirements for approval of class-action settlements and the award of attorneys' fees, as well as making it easier to remove state-law class-actions to federal court by permitting minimal diversity, an aggregation of claims and eliminating the requirement that defendants unanimously consent to removal. Once again, Congress did not address Section 10(b) secondary liability in this Act, and petitioner's argument in favor of unbridled private liability for secondary actors is fundamentally inconsistent with the curbs Congress enacted to eliminate the excesses of lawyer-driven litigation.

D. Sarbanes- Oxley Act

The Sarbanes-Oxley Act of 2002 (15 U.S.C.A. §§ 78d-3 *et al*.) the most recent overhaul of the federal securities laws, instituted additional monitoring and disclosure mechanisms for public companies, but nothing remotely like the regime of new duties and private liability petitioner urges on this Court. Indeed, in significant ways petitioner's view of Section 10(b) would render important provisions of Sarbanes-Oxley redundant. The Act redefined the responsibilities of attorneys, accountants and management to review and monitor company policies and disclosure. But the Sarbanes-Oxley Act does not require company outsiders to report Section 10(b) breaches to company management or the public. Imposing these duties on outsiders is duplicative and expansive of preexisting statutory duties on others: Section 10A of the Exchange Act, 15 U.S.C.A. § 78j-1 (2002), requires accountants to report findings of illegal acts to the independent audit committee or SEC; and Section 307 of the Sarbanes-Oxley Act provides a reporting-up mechanism for attorneys who suspect "evidence of a material violation of securities law or a breach of fiduciary duty" by their clients.[12]

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[12] Under Sarbanes-Oxley, attorneys must report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company up through the company's hierarchy and to the public if the company fails adequately to correct its actions. The duty to monitor and report wrongdoing does not extend beyond these named groups.

In addition, Sarbanes-Oxley augmented the carefully circumscribed regulatory regime to allow the SEC — but not private plaintiffs — discretion to commence actions to obtain compensation for investors from secondary parties whose participation in statutory misconduct is sufficiently egregious to warrant sanction. Sarbanes-Oxley Act of 2002 § 308(a), 15 U.S.C.A. § 7246(a). Accordingly, there is no merit to petitioner's alarmist contention that "[w]ithout fear of [Section 10(b)] private liability, business partners would have an incentive to provide false documents" and that secondary actors would "be free from liability."[13]

III. CONGRESS GAVE THE SEC DISCRETION TO DETERMINE THE PURSUIT OF SECTION 10(b) CIVIL CLAIMS AGAINST SECONDARY ACTORS

Congress authorized the SEC to pursue secondary actors under Section 20(e) of the Exchange Act. In doing so, Congress intended to have the SEC's discretion guide whether civil claims should be brought against secondary actors. 15 U.S.C. § 78u(d)(1) empowers the SEC to exercise "its discretion [to] bring an action in the proper district court … [and] enjoin such acts or practices" that violate the securities laws. ("Section 21(d)(1)"). Section 21(d)(1) specifies that secondary actors will be pursued by the SEC "in its discretion." Moreover, Section 308 of the Sarbanes-Oxley Act — the "Fair Funds" provision — permits investors to be compensated for injuries caused by the activity of secondary actors. This combination of statutory provisions ensures that secondary actors whom Congress has deemed to

[13] Pet. Br. 35.

be culpable are not "free from liability" as petitioner suggests. In contrast, petitioner's "scheme liability" approach to Section 10(b), would place that "discretion" in the hands of private litigators without any Congressional authorization. But, as Congress and the Courts have seen, private plaintiffs have no incentives to limit the bounds of "lawyer-driven" litigation. The Court should, accordingly, reject petitioner's effort to create a new form of private liability not contemplated or authorized by Congress.

A. Congress Authorized Only the SEC to Pursue Secondary Actors

Under Section 20(e) of the Exchange Act, the SEC is authorized to pursue persons who provide substantial assistance to violators of Section 10(b):

> For purposes of any action brought by the [SEC] under paragraph (1) or (3) of section 78u(d) of this title, any person that knowingly provides substantial assistance to another person in violation of a provision of this chapter, or of any rule or regulation issued under this chapter, **shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided**.

(Emphasis added).[14]

If petitioner's view of Section 10(b) were correct, therefore, Section 20(e) would be redundant. *See Mackey v.*

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[14] Section 10(b) – 15 U.S.C. § 78j – is part of the "chapter" referred to in Section 20(e).

Lanier Collection Agency & Service, Inc., 486 U.S. 825, 837 (1988) (Court is "hesitant to adopt an interpretation of a congressional enactment which renders superfluous another portion of that same law"). Although the SEC is empowered to hold secondary actors liable for aiding and abetting or causing violations of Section 10(b), private plaintiffs are not.

In contrast to the specific provisions for SEC enforcement proceedings against secondary actors, Congress created no such authorization for private suits under Section 10(b). As this Court noted "[i]f … Congress intended to impose aiding and abetting liability, we presume it would have used the words 'aid' and 'abet' …. it did not." *Central Bank*, 511 U.S. at 177 (citation omitted). Because Congress never "enacted a general civil aiding and abetting statute … there is no general presumption that the plaintiff may also sue aiders and abettors" for damages it sustains as the result of a statutory violation. *Id.* at 182 (citation omitted). More telling is that while Congress did not prohibit aiding and abetting in Section 10(b), it specifically prohibited aiding and abetting in several other provisions of the securities laws. *Id.* at 182-83.[15]

Similarly, the fact that Congress separately and exclusively authorized the SEC to pursue persons who substantially assist violations of Section 10(b) establishes that Section 10(b) does not create the expansive private

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[15] Petitioner attempts to avoid the consequences of this statutory language by arguing that respondents themselves engaged in barred deceptive practices and are therefore primary actors. Pet. Br. 20 n. 5, citing *Central Bank*, 511 U.S. at 176. To the contrary, petitioner's "but - for" analysis establishes that the conduct it challenges is the respondents' alleged aid to Charter: "Charter could not have succeeded in publishing the false financial statements that injured investors 'but for' the deceptive acts of [Defendants]." Pet. Br. 40.

liability urged in this case. If Section 10(b) already authorized the pursuit of secondary actors, then there would have been no need for a specific, separate provision in the same statute that authorizes the SEC to pursue civil claims against aiders and abettors.

B. The "Fair Funds" Provisions of the Sarbanes-Oxley Act Provide Compensation to Victims

Among the additional weapons in the SEC's enforcement arsenal is Section 308(a) of the Sarbanes-Oxley Act, entitled "Civil penalties added to disgorgement funds for the relief of victims." 15 U.S.C. § 7246(a). Section 308(a) authorizes the SEC to seek orders from federal courts placing civil penalties obtained against violators in a "disgorgement fund" created for the benefit of the victims. *Id.*[16] When moving for such relief, the SEC submits to the court a plan describing how and to whom the disgorged funds and penalties will be distributed. The court then determines whether the plan's details are "fair and reasonable." *E.g., Official Comm. of Unsecured Creditors of WorldCom, Inc. v. SEC,* 467 F.3d 73, 82-83 (2d Cir. 2006) (citing *SEC v. Wang,* 944 F.2d 80, 85 (2d Cir. 1991)).

Section 308 is part of a legislative structure that provides disincentives for parties while simultaneously compensating injured investors. In passing prior securities legislation, Congress had observed that punishing violators

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[16] Section 308(a) authorizes the SEC to direct — in administrative proceedings — that the penalties be placed in disgorgement funds. Moreover, Section 308(b) authorizes the SEC to accept donations and gifts for inclusion in disgorgement funds.

and deterring future violations required a combination of disgorgement and civil penalties:

> Disgorgement merely requires the return of wrongfully obtained profits; it does not result in any actual economic penalty or act as a financial disincentive to engage in securities fraud …. The Committee therefore concluded that authority to seek or impose substantial money penalties, in addition to disgorgement of profits, is necessary for the deterrence of securities law violations ….

1990 U.S.C.C.A.N. 1379, 1384-86 (quoting the U.S. House of Representatives Report on the Securities Enforcement Remedies Act and Penny Stock Reform Act of 1990). Because Section 308(a) allows the SEC to add penalties to disgorgement funds, the Fair Funds provision increases compensation to victims while simultaneously providing significant disincentives for potential violators of the securities laws.

C. The "Fair Funds" Provision Has Compensated Victims

The SEC has applied the "Fair Funds" provision to secondary actors — aiders and abettors — and thereby garnered compensation for injured investors while providing disincentives for future violations of the securities laws. For example, in a complaint the SEC filed in the United States District Court in Houston, Merrill Lynch & Co., Inc. was alleged to have aided and abetted Enron Corporation in committing securities fraud. *See* SEC Litigation Release No. 18038, 2003 SEC LEXIS 620 at *1 (Mar. 17, 2003). Along with the filing of the complaint, the SEC also announced that Merrill Lynch had agreed to a settlement:

> [T]he Commission has agreed to accept Merrill Lynch's offer to settle this matter. Merrill Lynch, without admitting or denying the allegations in the complaint, has agreed to pay $80 million dollars in disgorgement, penalties and interest and has agreed to the entry of a permanent anti-fraud injunction prohibiting future violations of the federal securities laws. The Commission intends to have these funds paid into a court account pursuant to the Fair Funds provisions of Section 308(a) … for ultimate distribution to the victims of the fraud.

Id. at *1-*2. The SEC also alleged that J.P. Morgan Chase & Co. aided and abetted Enron Corporation in securities fraud – and Morgan, too, "agreed to pay disgorgement, penalties and interest in the amount of $135 million." SEC Litigation Release No. 18252, 2003 SEC LEXIS 1775 (July 28, 2003).

These examples show that the victim compensation plan Congress created is working and has provided substantial recoveries to investors even in the absence of the open-ended Section 10(b) private liability petitioner advocates. Companies that have been the subjects of Section 308(a) proceedings cannot reasonably be considered to have been "free from liability" or to be lacking incentive to avoid future violations of the securities laws. But that is the only remedy Congress created.

In the final analysis, only Congress is empowered to determine the efficacy of the remedies it enacted. Consistent with the carefully balanced statutory scheme, and with this Court's well-settled rules of statutory construction, petitioner's plea for judicial creation of new forms of liability should be rejected.

CONCLUSION

The judgment should be affirmed.

Respectfully submitted.

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