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No. 09-525

IN THE

Supreme Court of the United States

JANUS CAPITAL GROUP, INC. AND
JANUS CAPITAL MANAGEMENT LLC,
Petitioners,

v.

FIRST DERIVATIVE TRADERS,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
for the Fourth Circuit**

**AMICUS CURIAE BRIEF OF THE
COUNCIL OF INSTITUTIONAL INVESTORS
IN SUPPORT OF RESPONDENT**

JEFFREY P. MAHONEY
General Counsel
COUNCIL OF INSTITUTIONAL
INVESTORS
888 17th Street, NW
Suite 500
Washington, D.C. 20006
(202) 261-7081

GREGORY S. COLEMAN
Counsel of Record
CHRISTIAN J. WARD
RYAN P. BATES
YETTER COLEMAN LLP
221 West Sixth Street
Suite 750
Austin, Texas 78701
(512) 533-0150
gcoleman@yettercoleman.com

Attorneys for Amicus Curiae Council of Institutional Investors in Support of Respondent

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INTEREST OF AMICUS CURIAE[1]

The Council of Institutional Investors is a not-for-profit association of more than 120 public, labor, and corporate pension funds with assets exceeding $3 trillion. Its members are major long-term shareholders with duties to protect the retirement assets of millions of American workers. The Council is an advocate for strong corporate governance standards. Its members seek to protect fund assets through proxy votes, shareholder resolutions, negotiations with regulators, discussions with management, and, when necessary, litigation. The Council has previously appeared as an amicus in cases affecting shareholder rights. See, *e.g.*, *Free Enterprise Fund* v. *Pub. Co. Accounting Oversight Board*, 130 S.Ct. 3138 (2010); *Merck & Co., Inc.* v. *Reynolds*, 130 S.Ct. 1784 (2010); *Stoneridge Investment Partners, LLC* v. *Scientific-Atlanta, Inc*., 552 U.S. 148 (2008); *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd*., 551 U.S. 308 (2007).

The interests of the Council and its members are directly implicated by this case. In the Private Securities Litigation Reform Act of 1995 (PSLRA), Congress recognized that institutional investors are America's largest shareholders and "have the most to gain from meritorious securities litigation." H.R. Conf. Rep. No. 104-369, at 34 (1995) (quoting testimony of Maryellen Andersen, then treasurer of

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[1] Pursuant to Supreme Court Rule 37.6, counsel for amicus certifies that this brief was not authored in whole or in part by counsel for any party, and no person or entity other than amicus or its counsel has made a monetary contribution to the preparation or submission of this brief. Pursuant to rule 37.3(a), letters of consent from all parties to the filing of this brief have been filed with the Clerk.

the Council). Institutional investors also have the most to lose from meritless litigation that depletes shareholder wealth. See S. Rep. No. 104-98, at 9 (1995) ("We are . . . hurt if a system allows someone to force us to spend huge sums of money in legal costs by merely paying ten dollars and filing a meritless cookie cutter complaint against a company or its accountants." (quoting testimony of Maryellen Andersen)). Accordingly, the Council has a strong interest in ensuring that the Court's interpretation of §10(b) of the Securities Exchange Act and rule 10b-5 continues to honor the longstanding aims of those provisions—deterring fraud in the securities markets and compensating those actually injured by such fraud. The Council believes that the interpretation of these provisions should further Congress's manifest goal of allowing legitimate suits to proceed while discouraging meritless "strike suits."

SUMMARY OF ARGUMENT

The prevalence of securities fraud schemes detailed daily in the American press over the last decade provides a strong indication that the need for effective private enforcement of the antifraud provisions of federal securities law remains high. Narrowing the scope of primary liability to exclude secondary actors entirely, or instituting a new requirement that fraud-on-the-market reliance can only be established when bad actors make themselves known through express attribution, would ignore that need in contravention of Congress's plain intent, unjustifiably immunize conduct that is currently prohibited, and provide a roadmap for future fraudsters to avoid liability for their fraudulent acts.

Nor is there substantial risk that retaining these features of the private 10b-5 remedy as they

have been interpreted for decades will increase nonmeritorious class action filings. Indeed, all the relevant empirical trends indicate that both filings and settlements of securities class actions continue to decrease from pre-PSLRA levels, even though secondary-actor liability and the lack of an express attribution requirement are present features of securities law. The Court has striven for a sensible balance between deterring fraud and avoiding the social costs of frivolous litigation. The changes petitioners seek would sharply undermine the first of those goals without substantially advancing the second. Those changes are not dictated by this Court's precedents or the language that Congress and the SEC used in drafting §10(b) and rule 10b-5. And they should be rejected.

Even if an express attribution requirement is adopted, however, this case should nonetheless be reanalyzed in light of the fiduciary duty that investment advisers like petitioners owe to investors, including a duty to disclose that extends to disclosing the adviser's role in making public statements by a mutual fund.

ARGUMENT

I. ACHIEVING CONGRESS'S GOAL OF DETERRING SECURITIES FRAUD REQUIRES THE STRONG INCENTIVES PROVIDED BY A ROBUST PRIVATE RIGHT OF ACTION UNDER RULE 10B-5.

A. There Is No Question That Secondary Actors Are, and Must Remain, Primarily Liable for Their Fraudulent Acts.

Section 10(b) of the Securities Exchange Act of 1934, codified as amended at 15 U.S.C. §78j, provides that 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 in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. 15 U.S.C. §78j(b).

Pursuant to this grant of authority, the SEC has promulgated rule 10b-5, which makes it

> unlawful for any person, directly or indirectly, . . . [t]o make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security. 17 C.F.R. §240.10b-5.

As the text of these legislative and administrative pronouncements makes clear, and as this Court's precedents properly recognize, so-called "primary liability" under rule 10b-5 clearly and correctly extends beyond a single actor to encompass those "secondary" actors who engage in, rather than merely aid and abet, proscribed activity. *E.g.*, *Cent. Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994) (recognizing that any "secondary" actor "including a lawyer, accountant, or bank . . . may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under rule 10b-5 are met" and expressly noting that in "any complex securities fraud, moreover, there are likely to be multiple violators"); accord *Stoneridge*, 552 U.S., at 166 ("[T]he implied

right of action in §10(b) continues to cover secondary actors who commit primary violations.").

These clear pronouncements cannot be reconciled with petitioners' repeated assertions that participating in fraudulent conduct is in all cases excepted from private liability.[2] *E.g.*, Pet. Br. 11 ("'Participation' is a signifier of secondary action, and a service provider cannot be held liable for assisting another company with its public statements."); *id.*, at 35-36 ("Nor is there private liability for 'participating' in the writing of another company's statement."). Indeed, petitioners are admirably direct in arguing that, for purposes of rule 10b-5(b), the *only* entity to whom liability could ever possibly attach is the one that voluntarily self-identifies as the "speaker"—that signs its name to a statement, as it were—no matter the degree of involvement another entity may have in writing, editing, or even delivering the statement or the degree of control another entity may exercise over the "speaker." *Id.*, at 37-38.

There is a real and substantial difference between "participat[ing] in a scheme to violate §10(b)," *Stoneridge*, 552 U.S., at 156, and participating in the making of a public misstatement of material fact. The plaintiffs' factual allegations in this case, which must be accepted as true, draw a picture of fraud perpetrated by insiders that is a far cry from the

[2] The Council concurs with respondent that resolving this case does not require addressing the liability of true secondary actors because petitioners are properly classified as primary actors. Resp. Br. 35-41. The Council discusses this point in response to the claims made by petitioners and their amici only to explain why continuing to subject secondary actors to securities fraud liability is both necessary and within Congress's clear intent.

scheme liability based on an "arm's length business transaction in goods or services other than securities" that was rejected in *Stoneridge*. See *In re Charter Commc'ns, Inc., Sec. Litig.*, 443 F.3d 987, 992-993 (CA8 2006), aff'd *sub nom. Stoneridge*, 552 U.S., at 167. Nor is petitioners' position consistent with statements from this Court that bear directly on the question. Petitioners wholly ignore—and fail even to acknowledge—*Central Bank*'s sensible recognition that in "any complex securities fraud, . . . there are likely to be multiple violators." 511 U.S., at 191.

Petitioners' suggestion that it is, in essence, impossible for more than one person or entity to "make" a statement within the meaning of rule 10b-5 and §10(b) is equally absurd.

> "The word 'make' has many meanings, among them 'To cause to exist, appear or occur,' Webster's International Dictionary, (2d Ed.). To hold the statute broad enough to include deliberate action from which a false entry by an innocent intermediary necessarily follows gives to the words employed their fair meaning and is in accord with the evident intent of Congress. To hold that it applies only when the accused personally writes the false entry or affirmatively directs another so to do would emasculate the statute—defeat the very end in view." *United States* v. *Giles*, 300 U.S. 41, 48-49 (1937) (construing predecessor to 18 U.S.C. §1005, concerning the making of a "false entry in any book, report, or statement" of certain banks).

At the least, the Court should adopt the position on the meaning of rule 10b-5's use of "make" ably articulated by the Federal Government and the SEC.

B. Requiring Direct and Express Attribution Would Foster Fraud and Badly Disserve Congress's Goals.

For similar reasons, the Court should not adopt petitioners' contention that only express attribution of statements to particular actors is sufficient to establish reliance on those statements under a fraud-on-the-market theory. Adopting a strict attribution requirement is inconsistent with the realities of modern securities markets and would actively encourage fraud, most troublingly by actors who, like petitioners, can exert control over issuers to ensure that statements are not attributed to them.

Attribution as a component of market reliance is an artificial concept, and one that finds no real basis in this Court's decisions. See, *e.g.*, *Stoneridge*, 552 U.S., at 159-160 (omitting any mention of attribution as a necessary component of reliance on public statements); *Basic Inc.* v. *Levinson*, 485 U.S. 224, 242-244 (1988) (same); Prentice, *Stoneridge*, Securities Fraud Litigation, and the Supreme Court, 45 Am. Bus. L.J. 611, 654 (2008) ("Until the lower courts started fumbling around with *Central Bank*, no court in the history of fraud jurisprudence had held that a fraudster may avoid liability by the simple expedient of refusing to allow his name to be attached to a fraudulent statement that he might have initiated, drafted, reviewed, and/or corrected.").

That fact reflects market reality: Whether public information is attributed, and to whom, may alter the weight given that information by the market, but it is not true to say either that unattributed information is rejected or that attribution to a reasonable source does not occur. Thus, attribution may go to the question of *materiality* of a particular statement, but

it has little to do with whether the market as a whole can be said to have *relied* on it.[3] That, in fact, is the entire premise of the fraud-on-the-market presumption: "In an open and developed market, the dissemination of material misrepresentations or withholding of material information typically affects the price of the stock, and purchasers generally rely on the price of the stock as a reflection of its value." *Basic Inc.*, 485 U.S., at 244 (quoting *Peil* v. *Speiser*, 806 F.2d 1154, 1161 (CA3 1986)). The market relies on *all* public information, regardless of its authorship, but it does so to varying degrees. Indeed, a fraudster's intentional misattribution of a statement may actually increase the materiality of a

[3] A recent decision from the Fifth Circuit requiring express attribution to demonstrate reliance outside a fraud-on-the-market context provides a clear example of this illogic. See *Affco Investments 2001 LLC* v. *Proskauer Rose L.L.P.*, __ F.3d __ (CA5 Oct. 27, 2010) (slip op., at 13) ("Knowing the identity of the speaker is essential to show reliance because a word of assurance is only as good as its giver."). While this idealized view may provide good advice, markets in truth rely on anonymous information regularly, even when doing so may be unreasonable or risky; attribution is not a necessary condition for such reliance. And erroneous for a similar reason is the belief that "[a]bsent attribution, plaintiffs cannot show that they relied on defendants' *own* false statements." *Ibid.* (quoting *Pac. Investments Mgmt. Co.* v. *Mayer Brown LLP*, 603 F.3d 144, 148 (CA2 2010)). Fraud-on-the-market theory presumes reliance on the information publicly conveyed in a statement, not on the imprimatur of the one who makes it. See *Basic Inc.*, 485 U.S., at 244. Attribution is logically necessary only to show reliance on imprimatur—that is, on the fact that a particular defendant made the statement. But when plaintiffs demonstrate that the defendant did make the statement and that the market relied on that public information, they have indeed shown "that they relied on defendants' *own* false statements." *Affco Investments 2001*, __ F.3d, at __, (slip op., at 13).

particular statement, and it is nonsensical to suggest that the success of such a scheme is sufficient to immunize it from fraud liability under §10(b) and rule 10b-5.

At same time, the Court, as the markets necessarily do, should take cognizance of the clear distinction between conduct that is attribut*ed* and conduct that is attribut*able*. Not all statements that are unattributed are unattributable, and the markets receive and process information, assigning it value by making judgments about its source on a constant basis. If attribution were a necessary component of reliance—a dubious proposition—it must necessarily reflect these realities of the market. Thus, if a reasonable investor aware of the circumstances would understand a particular actor to be making a statement even without express attribution, it violates the realism that underlay adoption of the fraud-on-the-market theory of reliance in the first place to preclude reliance on that statement simply because those involved in making it did not identify themselves. See *Basic Inc.*, 485 U.S., at 243-244 ("The modern securities markets, literally involving millions of shares changing hands daily, differ from the face-to-face transactions contemplated by early fraud cases, and our understanding of rule 10b-5's reliance requirement must encompass these differences." (footnotes omitted)).

The attribution requirement "creates a safe harbor whereby a cunning wrongdoer will not be exposed to liability if he simply avoids the association of his name with the misleading statement at the time of its dissemination, regardless of his actual responsibility. This creates an end run around the goals of fairness, honesty, and full disclosure."

Grubb, Attorneys, Accountants, and Bankers, Oh My! Primary Liability for Secondary Actors in the Wake of *Stoneridge*, 62 Vand. L. Rev. 275, 298 (2009). Worse still, allowing an issuer to make material public misstatements through the agency of a nominally separate entity that it actually controls would open a gaping loophole in the securities laws. The corporate structure that permits petitioners to straightfacedly assert that, as a matter of law, they have no liability for misstatements they allegedly participated in making, about a policy they certainly directed, need not be confined to the mutual fund industry. It would be ironic—and tragic for American investors—if the management structure imposed in that industry by the Investment Company Act of 1940 to eradicate conflicts of interest should, decades later, provide a roadmap for restructuring other securities issuers, even publicly traded corporations, so as to preclude any possibility of fraud liability under the securities laws.[4] Requiring express attribution in order to recognize the market's reliance on a statement is a legal fiction that deviates sharply from reality; it is made a travesty when the actor whose nonattribution shields it from liability

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[4] Indeed, hedge funds and private equity funds already commonly employ similar corporate structures. See, *e.g.*, Bullard, Regulating Hedge Fund Managers: The Investment Company Act as a Regulatory Screen, 13 Stan. J.L. Bus. & Fin. 286, 305 (2008) (noting that the publicly traded Blackstone Group, for example, is structured as a general partnership with a "separate entity controlled exclusively by Blackstone management . . . as the sole general partner" which "public investors have no ability to remove" and that Blackstone and others have claimed that such structure permits them to evade regulatory classification under the Investment Company Act of 1940).

actually controls both the statement and the attribution process itself. Foxes should not be left to guard henhouses.

Allowing an issuer to make material public misstatements through the agency of a nominally separate entity that it actually controls would ignore the reality of securities fraud and unjustifiably exalt form over substance. There is no plausible reading of §10(b) or rule 10b-5 that suggests liability under those provisions is limited to only those instances of fraud where the fraudster is open and aboveboard about his actions.

C. Developments Since *Central Bank* Underscore the Continuing Need to Police the Markets and Provide Strong Disincentives to Fraud.

Primary liability under rule 10b-5 must continue to extend to secondary actors, and fraud-on-the-market reliance must not be hamstrung by an artificial express attribution requirement, in order to provide adequate deterrence against fraud. "The securities statutes seek to maintain public confidence in the marketplace. They do so by deterring fraud, in part, through the availability of private securities fraud actions." *Dura Pharm., Inc.* v. *Broudo*, 544 U.S. 336, 345 (2005); accord *Randall* v. *Loftsgaarden*, 478 U.S. 647, 664 (1986) ("Congress' aim in enacting the 1934 Act was not confined solely to compensating defrauded investors. Congress intended to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions."); see also S. Rep. No. 73-792, at 1-5 (1934) (highlighting the purposes of establishing the SEC and granting it authority to enforce the Securities Exchange Act of 1934—to

ensure honest markets for securities and to promote investor confidence).

In this, the American model of market transparency enforced through regulation has been wildly successful. Indeed, it has long been understood that United States capital markets are the deepest and most liquid anywhere in major part precisely because they have been widely and correctly perceived as the fairest and best policed in the entire world. See Bhide, Efficient Markets, Deficient Governments, Harv. Bus. Rev., Nov. 1994, at 128, 130-131 ("U.S. rules protecting investors are the most comprehensive and well enforced in the world."); see also Coffee, Law and the Market: The Impact of Enforcement, 156 U. Pa. L. Rev. 229, 245-246 (2007) (arguing that "the greater institutional commitment of the United States to enforcement—administered by multiple and often competing enforcers, private and public"—"disproportionately repel[s] particular classes of issuers" but simultaneously lowers the cost of capital for issuers willing to sacrifice "controlling shareholders' enjoyment of private benefits" in exchange for significant valuation premiums); cf. Jackson & Roe, Public and Private Enforcement of Securities Laws: Resource-Based Evidence 2 (Harv. Pub. Law, Working Paper No. 08-28, 2009) ("Allocating more resources to public enforcement is positively associated with robust capital markets, as measured by market capitalization, trading volume, the number of domestic firms, and the number of initial public offerings."), available at http://ssrn.com/abstract=1000086. Empirical evidence demonstrates that mandatory disclosure rules, antifraud rules, and insider trading prohibitions enforced by the SEC and private actors "serve to strengthen capital markets and encourage economic

development." Prentice, The Inevitability of a Strong SEC, 91 Cornell L. Rev. 775, 831-832 & 831 n.348 (2006). "Mandatory disclosure and antifraud provisions both contribute to share price accuracy and because both decrease costs and increase fairness for parties participating in capital markets, they also improve liquidity." *Id.*, at 832. In contrast, "[i]n an unregulated environment, gatekeepers are unreliable, and exchanges both suffer serious conflicts of interest and lack viable enforcement mechanisms to prevent most types of securities fraud." *Id.*, at 828; see also *United States* v. *O'Hagan*, 521 U.S. 642, 658 (1997) ("[I]nvestors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law.").

But that well-deserved and hard-earned reputation can only be maintained through consistent effort and sustained attention to rooting out fraud. And the Court has repeatedly noted the importance of private enforcement of §10(b) and rule 10b-5 as a mechanism for sustaining and channeling that effort. *E.g.*, *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007) ("This Court has long recognized that meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively, by the Department of Justice and the Securities and Exchange Commission."); *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 310 (1985) ("[Private rights of action] provide 'a most effective weapon in the enforcement' of the securities laws and are a 'necessary supplement to Commission action.'" (quoting *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964))). But as long and

painful experience has shown, where that necessary diligence and attention wane, fraud follows.

The successive and massive regulatory failures in America's securities markets in the past decade underscore the continued need for strong deterrence. The Court has been made well aware of the numerous frauds perpetrated by the likes of Enron, WorldCom, Tyco, Adelphia, and RefCo, and the direct involvement of secondary actors in those frauds. See, *e.g.*, Coffee, Understanding Enron, 57 Bus. Law. 1403, 1404-1405 (2002). But it is clear that the wave of massive securities fraud exposures heralded by the collapse of Enron did not wash away all of the market's bad actors—far from it.

More recently, fraud has emerged as a major concern in markets for mortgage-backed securities. Seemingly rampant misconduct and fraud in the mortgage servicing and securitization industries have led major banks to suspend foreclosure actions nationwide and attorneys general of all 50 states to open investigations into the integrity of foreclosures and the underlying mortgage lending practices. See Martin, All 50 States Start Inquiry into Foreclosures, N.Y. Times, Oct. 13, 2010, http://nyti.ms/cNQRww ("The inquiry will focus on signed affidavits that mortgage loan servicers have filed with the court without confirming their accuracy, a practice known as robo-signing."); see also Morgenson & Martin, Big Legal Clash on Foreclosure Is Taking Shape, N.Y. Times, Oct. 20, 2010, at A1 ("Banks routinely failed to record each link in the chain of documents that demonstrate ownership of a note. . . . Other record-keeping problems . . . involve endorsements, a process that occurs when notes are transferred and validated with a stamp to identify the institution that

bought it.") And federal regulators, including the SEC and the federal Financial Fraud Enforcement Task Force, have also taken notice. Westbrook, SEC Discussing Foreclosures with Other Regulators, Chairman Schapiro Says, Bloomberg News, Oct. 19, 2010, http://bit.ly/aJGxnO.

These actions have raised fears that potentially unenforceable—and hence worthless—instruments have infected the $2.8 trillion market for U.S. residential mortgage-backed securities, the largest investment asset class in the world. See Whelan & Simon, Mortgage Investors Are Set for More Pain, Wall St. Journal, Oct. 6, 2010, http://bit.ly/b1PdFc; Dennis & Cha, Reston-Based Company MERS in the Middle of Foreclosure Chaos, Wash. Post, Oct. 8, 2010, http://wapo.st/9f2knt ("To convince courts that they have the right to foreclose on homes, banks and lenders have often found it difficult—when challenged—to provide the paperwork showing they indeed own the loans."); Smith, Congressmen Attack LPS, Servicer Misconduct, Naked Capitalism, Oct. 1, 2010, http://bit.ly/a3jxSu ("[T]he problem of widespread failures to convey notes to the securitization trust isn't a 'technicality'; it means what were sold as [mortgage-backed securities] are potentially just unsecured consumer paper.").

Nor are poor mortgage servicing practices the sole concern: outright fraud on investors appears to have played a significant role in lenders' securitization of mortgage-backed investments in the last decade. See, *e.g.*, Gittelsohn & Shenn, Banks Face Two-Front War on Bad Mortgages, Foreclosures, Bloomberg News, Oct. 20, 2010, http://bit.ly/99KJUO ("Investors . . . contend that sellers are obligated to repurchase some mortgages because

of misrepresentations such as overstatements of borrowers' income or inflated appraisals."); Stempel, BofA Sues FDIC over Taylor Bean Mortgage Losses, Reuters, Oct. 20, 2010, http://reut.rs/bWsWw4 ("Bank of America . . . has sued [FDIC] over $1.75 billion of investor losses mainly from the 2009 collapses of a large regional bank and large mortgage lender. . . . Bank of America accused executives at Taylor Bean, Colonial and Platinum of having fraudulently schemed to 'double- and triple-pledge mortgages and steal assets' . . . ."); Bank of America's Reply to Objection, Dkt. No. 1559, *In re Taylor, Bean & Whitaker Mortg. Corp.*, No. 09-bk-07047-JAF, at 2 (Bankr. MD Fla. June 16, 2010) ("Indeed, it appears as though many loans and other mortgage-related assets have been double and even triple-pledged to various constituencies."). It appears that, quite predictably, securities fraud simply followed capital flows out of stocks and into the bubble in mortgage-backed securities that has been bursting in slow motion over the past two years.

Professor Bhide's assessment of the wellsprings of American securities markets' strength and liquidity and *Central Bank of Denver* both appeared in the same year, 1994. While that was mere happenstance, it is not clear that the same can be said for the fact that the parade of fraud-related investment scandals kicked off by Enron has coincided with a succession of steps, both legislative and judicial, that, by ever further restricting the viability of the private 10b-5 right of action, have eroded its value as a significant deterrent against securities fraud. See Coffee, Gatekeeper Failure and Reform, 84 B.U. L. Rev. 301, 318-321 (2004) (observing that the marked decrease in the risk of liability for secondary actors preceded and may have been a

causative factor in the investment frauds uncovered in the late 1990s and early 2000s). And though correlation need not imply causation, the consequence of further tightening the scope of primary liability to exclude secondary actors, or of effectively doing so by imposing an artificial attribution requirement to prove fraud-on-the-market reliance, is virtually certain. See Coffee, Law and the Market, *supra*, at 245-246. It would serve as an open invitation to fraud by secondary actors, and it would offer incentives to now-primary actors to shield themselves from potential future liability by manipulating the corporate form to artificially relabel themselves as exempt secondary actors.

II. FURTHER NARROWING OF POTENTIAL 10B-5 FRAUD LIABILITY IS NOT NECESSARY TO PREVENT STRIKE SUITS OR OTHER MERITLESS LITIGATION.

Concerns about the prevalence of meritless securities litigation have for decades been invoked by this and lower courts as the primary rationale for ever-narrowing boundaries of securities fraud liability. See, *e.g.*, *Merrill Lynch, Pierce, Fenner & Smith Inc.* v. *Dabit*, 547 U.S. 71, 81 (2006); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 214 n.33 (1976) (refusing to "significantly broaden the class of plaintiffs who may seek to impose liability . . . under the Acts" because "the inexorable broadening of the class of plaintiff . . . will ultimately result in more harm than good" (quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 747-748 (1975))); *Regents of Univ. of Cal.* v. *Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 392 (CA5 2007) (insisting that, as the ultimate priority, "the rule of liability" must be construed "so as to avoid . . . '*in terrorem*

settlements' resulting from the expense and difficulty of, even meritoriously, defending this kind of litigation" (quoting *Hundahl* v. *United Benefit Life Ins. Co.*, 465 F.Supp. 1349, 1360 (ND Tex. 1979))). Such concerns are significantly diminished in light of post-*Central Bank* developments and so have lost their power to justify further narrowing the scope of primary liability under rule 10b-5, particularly at the risk of creating an easily manipulable safe harbor for fraud through an express attribution requirement. See *Randall*, 478 U.S., at 664 (declining to restrict §10(b) where the effect of doing so "would often be substantially to insulate those who commit securities frauds from any appreciable liability to defrauded investors" and so to diminish "the incentives for [securities market actors] to comply with the federal securities laws" by "seriously impair[ing] the deterrent value of private rights of action").

Congress and the courts have responded to these concerns effectively, by enacting legislation designed to curb litigation abuses and by wielding those new laws proactively to screen out potentially nonmeritorious cases, both frivolous and otherwise. The Private Securities Litigation Reform Act of 1995, for example, imposes heightened pleading requirements, mandates imposition of sanctions for frivolous litigation, provides a safe harbor for forward-looking statements, imposes restrictions on the selection and compensation of lead plaintiffs in securities class actions, limits recoverable damages and attorneys' fees, imposes a proportionate damages model, and permits staying of discovery pending resolution of motions to dismiss. See 15 U.S.C. §78u-4. The Securities Litigation Uniform Standards Act of 1998 (SLUSA) forecloses any opportunity to evade these restrictions by filing securities class actions in

state court. See 15 U.S.C. §78bb. And subsequent decisions have further heightened both the pleading and proof burdens that securities class action plaintiffs must bear. *E.g.*, *Stoneridge*, 552 U.S., at 160-161; *Tellabs*, 551 U.S. at 322-324; *Merrill Lynch, Pierce, Fenner & Smith Inc.*, 547 U.S., at 84-85; *Dura Pharm.*, 544 U.S., at 345.

By most accounts, these efforts have been very successful. See Johnson *et al.*, Do the Merits Matter More? The Impact of the Private Securities Litigation Reform Act, 23 J.L. Econ. & Org. 627, 627 (2007) (noting that the PSLRA significantly improved the correlation of litigation to instances with hard evidence indicating fraud—accounting restatements and documented insider trading). Thus, the percentage of securities class actions alleging a claim under rule 10b-5 has fallen sharply and consistently since *Dura Pharmaceuticals*, from 91% in 2005 to only 66% in 2009. Cornerstone Research, Securities Class Action Filings 2009: Year in Review 26-27 (2010), http://bit.ly/8XaeUi. Only 1.8% of unique issuers listed on the NYSE, NASDAQ, or Amex exchanges were named as a defendant in a 2009 class action, well below even the 2.4% post-PSLRA average. *Id.*, at 10. Similarly, settlements in 2009 averaged only $37.2 million, below the post-PSLRA average of $55.4 million. Cornerstone Research, Securities Class Action Settlements: 2009 Review & Analysis 2 (2010), http://bit.ly/aIebaV. And the median 2009 settlement of a securities class action recovered only 2.3% of the plaintiffs' estimated damages, down from the historical 2.9% average from 2002 to 2008. *Id.*, at 5. Indeed, data suggests that these measures have perhaps been *too* successful. See Choi, Do the Merits Matter Less After the Private Securities Litigation Reform Act?, 23 J.L.

Econ. & Org. 598, 598 (2007) (noting that "evidence that the PSLRA increased the significance of merit-related factors in determining the incidence and outcomes of securities fraud class actions" is consistent with two hypotheses—that PSLRA "may have reduced solely the incidence of nuisance litigation," or that it "may have also reduced meritorious claims"—and concluding the latter is true).

The PSLRA, SLUSA, and subsequent case law developments, including *Stoneridge*, provide strong and adequate safeguards against strike suits. But responding to continued attacks on private enforcement of rule 10b-5 by further narrowing the scope of primary liability and raising additional hurdles to the imposition of liability for fraud risks transforming §10(b) into a mere paper tiger—jeopardizing the very features of American securities markets that have made them the most successful in the world. See Prentice, The Inevitability of a Strong SEC, *supra*, at 829-832; Coffee, Law and the Market, *supra*, at 245-246.

III. IF DIRECT ATTRIBUTION IS REQUIRED, INVESTMENT ADVISERS' FIDUCIARY DUTY DEMANDS THEY ENSURE ACCURATE AND COMPLETE ATTRIBUTION.

Even if express attribution were strictly demanded, investment advisers should be held, as a function of their fiduciary duty to mutual fund shareholders, to be required to ensure that their participation is fully, adequately, and expressly disclosed. "The Investment Advisers Act of 1940," as this Court has long held, "reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship,' as well as a

congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested." *Sec. & Exch. Comm'n* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-192 (1963) (quoting 2 Loss, Securities Regulation 1412 (2d ed. 1961)). Unlike a claim based on an arm's-length transaction like those alleged in *Stoneridge*, the existence of a fiduciary duty alters the analysis. See *id.*, at 194.

At least one district court, faced with a post-*Stoneridge* instance of claimed primary liability by a secondary actor, has recognized that fact. See *Lopes* v. *Vieira*, 543 F.Supp.2d 1149, 1177-1178 (ED Cal. 2008) (noting that "liability of an attorney or law firm under Section 10(b) will depend on whether a duty to the investors exists"). The court sensibly reserved judgment on whether a secondary actor's liability can be premised on such a duty until the full contours of the duty could be explored in light of the facts of the case. See *ibid.* ("[T]he existence of a duty . . . will depend upon the facts . . . [and so] cannot be resolved at the pleading stage."). Unlike the attorney considered in *Lopes*, however, whose fiduciary duty may run only to his client and not to the investors, see Haft & Hudson, Liability of Attorneys & Accountants for Securities Transactions §3.2 (2007) (arguing on this basis that attorneys, unlike accountants, have no duty to disclose material facts to nonclient investors), an investment adviser's duty indisputably extends to the investors in the fund he advises. See *Capital Gains Research Bureau*, 375 U.S., at 194 (noting that an investment adviser's fiduciary duty may encompass "an affirmative duty of utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to

employ reasonable care to avoid misleading his clients" (internal quotation marks omitted)).

Moreover, if express attribution is a requirement in order for investors to invoke the fraud-on-the-market theory of *Basic*, *Inc.* v. *Levinson*, 485 U.S. 224, 242-244 (1988), recognition that investment advisers' fiduciary duty extends to disclosing or ensuring disclosure of their role in making statements would align that duty with the obligations of rule 10b-5 itself. If an actor's unattributed material participation in making statements is insufficient to establish reliance under the fraud-on-the-market theory, even where a reasonable investor would attribute the statements to the actor, attribution itself is then a material fact, the omission of which makes the statements misleading in light of the circumstances under which they were made, because its omission misleads the investors about the degree of the actor's purported nonparticipation in making the statements. See 17 C.F.R. §240.10b-5(b); *Capital Gains Research Bureau*, 375 U.S., at 186-187 (noting that "a fundamental purpose" of the securities laws is "to substitute a philosophy of *full disclosure* for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry" (emphasis added)).

CONCLUSION

The Court should reject petitioners' call to completely immunize secondary actors from primary liability by imposing a new requirement that, for reliance to be established under the fraud-on-the-market doctrine, bad actors must expressly attribute statements to themselves. The investing public would be ill-served by such rules, which would give perpetrators of fraud an easy way to insulate themselves from direct liability.

Respectfully submitted,

JEFFREY P. MAHONEY
General Counsel
COUNCIL OF INSTITUTIONAL INVESTORS
888 17th Street, NW
Suite 500
Washington, D.C. 20006
(202) 261-7081

GREGORY S. COLEMAN
Counsel of Record
CHRISTIAN J. WARD
RYAN P. BATES
YETTER COLEMAN LLP
221 West Sixth Street
Suite 750
Austin, Texas 78701
(512) 533-0150
gcoleman@yettercoleman.com

Attorneys for Amicus Curiae Council of Institutional Investors in Support of Respondent