

IN THE
Supreme Court of the United States

CENDANT CORPORATION, TIME WARNER INC., RICHARD A. SMITH,
DAVID COLBURN AND ERIC KELLER,
Petitioners,

v.

CALIFORNIA STATE TEACHERS RETIREMENT SYSTEM,
Respondent.

**ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT**

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a secondary actor may be primarily liable under Section 10(b) of the Securities Exchange Act of 1934 for engaging in a “scheme to defraud” with the issuer, notwithstanding this Court’s decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), even where that secondary actor did not itself make or otherwise participate in making the challenged misstatements or omissions or engage in any act of “manipulation,” and where the alleged misconduct of the secondary actor cannot satisfy all elements required for primary liability under Section 10(b).

**LIST OF PARTIES AND
STATEMENT PURSUANT TO RULE 29.6**

L90, Inc., an appellee below, has not joined in this petition and is being served as a respondent.

Pursuant to Supreme Court Rule 29.6, petitioner Cendant Corporation¹ states that it does not have a corporate parent and there is no publicly held corporation that owns 10 percent or more of its outstanding shares of common stock.

Pursuant to Supreme Court Rule 29.6, petitioner Time Warner Inc. states that it does not have a corporate parent and there is no publicly held corporation that owns 10 percent or more of its outstanding shares of common stock.

1. Effective September 5, 2006, Cendant Corporation changed its name and is now known as Avis Budget Group, Inc.

TABLE OF CONTENTS

	<i>Page</i>
QUESTION PRESENTED	i
LIST OF PARTIES AND STATEMENT PURSUANT TO RULE 29.6	ii
TABLE OF CITED AUTHORITIES	v
TABLE OF APPENDICES	ix
OPINIONS BELOW	1
STATEMENT OF JURISDICTION	1
STATUTORY AND REGULATORY PROVISIONS INVOLVED	1
STATEMENT OF THE CASE	2
1. Factual Background and Filing of Complaint	2
2. Proceedings in the District Court	4
3. The Decision Below	6
SUMMARY OF ARGUMENT	9
REASONS FOR GRANTING the PETITION	11
I. The Decision Below Directly Conflicts with Four Other Circuit Courts On an Important and Recurring Issue of Federal Securities Law ...	11

Contents

	<i>Page</i>
II. The Decision Below Is Incorrect Under the Standard for Section 10(b) Liability Articulated in Settled Decisions of this Court	14
A. The Decision Below Cannot Be Reconciled With This Court’s Precedents Governing Primary Liability Under Section 10(b).	14
B. The Decision Below Erroneously Permits a Species of “Aiding and Abetting” Liability Under A Different Name, In Direct Contravention of Central Bank.	18
C. The Ninth Circuit’s Approach Erroneously Dispenses With the Critical Element of Reliance.	21
D. The Decision Below Permits Liability for Conduct That Cannot be Viewed as Having Occurred “In Connection With” the Purchase or Sale of Securities.	23
III. There Are Other Compelling Reasons To Resolve the Circuit Split Now	26
CONCLUSION	30

TABLE OF AUTHORITIES

CASES	<i>Page</i>
<i>In re AOL Time Warner, Inc. Sec. & “ERISA” Litig.</i> , No. 1500, 02 Civ. 5575 2004 WL. 992991 (S.D.N.Y. 2004)	27
<i>Anixter v. Home-Stake Prod. Co.</i> , 77 F.3d 1215 (10th Cir. 1996)	10, 11, 13
<i>Basic Inc. v. Levinson</i> , 485 U.S. 224 (1988)	23
<i>Blue Chip Stamps v. Manor Drug Stores</i> , 421 U.S. 723 (1975)	28, 30
<i>Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.</i> , 511 U.S. 164 (1994)	<i>passim</i>
<i>In re Charter Communications, Inc. Securities Litigation</i> , 443 F.3d 987 (2006)	7, 9, 11, 12, 13
<i>Chiarella v. United States</i> , 445 U.S. 222 (1980) ...	15, 17
<i>Dirks v. SEC</i> , 463 U.S. 646 (1983)	17
<i>Dura Pharmaceuticals, Inc. v. Broudo</i> , 544 U.S. 336 (2005)	21, 30
<i>In re Dynegy, Inc. Sec. Litigation</i> , 339 F. Supp. 2d 804 (S.D. Tex. 2004)	25, 26
<i>In re Enron Corp. Securities, Derivative & “ERISA” Litigation</i> , 310 F. Supp. 2d 819 (S.D. Tex. 2004)	26-27

Cited Authorities

	<i>Page</i>
<i>Ernst & Ernst v. Hochfelder</i> , 425 U.S. 185 (1976)	14, 15, 28
<i>Feldman v. Pioneer Petroleum, Inc.</i> , 813 F.2d 296 (10th Cir. 1987)	19
<i>Fiedler v. Clark</i> , 714 F.2d 77 (9th Cir. 1983)	20
<i>Filler v. Hanvit Bank</i> , 156 F. App'x 413, Nos. 04- 6295-CV, 04-6719-CV, 2005 U.S. App. LEXIS 26443 (2d Cir. Dec. 2, 2005)	13
<i>In re Global Crossing, Ltd. Sec. Litigation</i> , 322 F. Supp. 2d 319 (S.D.N.Y. 2004)	27
<i>K&S Partnership v. Cont'l Bank, N.A.</i> , 952 F.2d 971 (8th Cir. 1991)	19
<i>Landy v. FDIC</i> , 486 F.2d 139 (3d Cir. 1973)	19
<i>In re Lernout & Hauspie Sec. Litigation</i> , 236 F. Supp. 2d 161 (D. Mass. 2003)	26
<i>Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit</i> , 126 S. Ct. 1503 (2006)	27, 30
<i>In re Parmalat Sec. Litigation</i> , 376 F. Supp. 2d 472 (S.D.N.Y. 2005)	22, 23, 26
<i>SEC v. Zandford</i> , 535 U.S. 813 (2002)	17, 18, 24, 25
<i>Santa Fe Industries, Inc. v. Green</i> , 430 U.S. 462 (1977)	6, 15, 28, 30

Cited Authorities

	<i>Page</i>
<i>In re Sargent Walnut Ranches, Inc.</i> , 219 B.R. 880 (E.D. Cal. 1998)	20
<i>Shapiro v. Cantor</i> , 123 F.3d 717 (2d Cir. 1997) . . .	10, 11, 13
<i>In re Software Toolworks Inc. Securities Litigation</i> , 50 F.3d 615 (9th Cir. 1995)	14
<i>Till v. SCS Credit Corp.</i> , 541 U.S. 465 (2004)	20
<i>United States v. O’Hagan</i> , 521 U.S. 642 (1997) . . .	15, 16, 24
<i>In re ZZZZ Best Sec. Litigation</i> , 864 F. Supp. 960 (C.D. Cal. 1994)	22
<i>Ziemba v. Cascade International, Inc.</i> , 256 F.3d 1194 (11th Cir. 2001)	10, 11, 13

STATUTES

15 U.S.C. § 78j(b)	<i>passim</i>
15 U.S.C. 78t(e)	20
28 U.S.C. § 1254(1)	1
17 C.F.R. § 240.10b-5 (2004)	<i>passim</i>
Senate Report (Banking, Housing, and Urban Affairs Committee), S. Rep. No. 104-98, (1995), <i>reprinted</i> <i>in</i> 1995 U.S.C.C.A.N. 679	20

*Cited Authorities**Page***ARTICLES**

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TABLE OF APPENDICES

	<i>Page</i>
Appendix A — Opinion Of The United States Court Of Appeals For The Ninth Circuit Filed June 30, 2006	1a
Appendix B — Opinion Of The United States District Court For The Central District Of California Dated March 7, 2003	32a

Petitioners Cendant Corporation (“Cendant”), Richard A. Smith (“Smith”), Time Warner Inc. (“Time Warner”), David Colburn (“Colburn”) and Eric Keller (“Keller”) (collectively, “Petitioners”) respectfully request that a writ of *certiorari* issue to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The order of the district court granting Petitioners’ motions to dismiss the first amended consolidated complaint with prejudice is reported at 252 F. Supp. 2d 1018 (C.D. Cal. 2003) and is reprinted in the Appendix (“Pet. App.”) at 32a-90a. The decision of the Court of Appeals for the Ninth Circuit (Gould, J., joined by Beezer and Nelson, JJ.) affirming the district court, but remanding for further proceedings, is published at 452 F.3d 1040 (9th Cir. 2006) and reprinted at Pet. App. 1a-31a.

STATEMENT OF JURISDICTION

The court of appeals filed and entered its opinion and judgment on June 30, 2006. On September 21, 2006, this Court granted an extension of time through November 13, 2006 to file this petition. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

The relevant statutory and regulatory provisions are Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (the “Exchange Act”), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (2004).

Section 10(b) of the Exchange Act provides in relevant part:

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest for the protection of investors.

15 U.S.C. § 78j(b).

Rule 10b-5 promulgated thereunder provides:

§ 2401.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To 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, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

STATEMENT OF THE CASE

1. Factual Background and Filing of Complaint

This securities class action was commenced shortly after a December 21, 2001 public announcement by Homestore.com, Inc. (“Homestore”) stating that recently discovered accounting

errors had caused it to recognize revenue improperly. After an internal investigation, Homestore restated its financial statements for 2000 and the first three quarters of 2001. According to the First Amended Consolidated Complaint (“FACC”) of plaintiff California State Teachers’ Retirement System (“Plaintiff”), the restatement reduced Homestore’s previously-reported aggregate revenue for that period by approximately \$190 million.

This action initially was brought against only Homestore and three of its senior executives. In the FACC, Plaintiff added Exchange Act claims against virtually every company (and a number of individuals), including Petitioners Cendant and Time Warner, as well as L90, Inc. (“L90”), that allegedly were parties to one or more of the business transactions which Homestore accounted for improperly on its financial statements. Petitioner Smith served as Chairman and Chief Executive Officer of Cendant’s Real Estate Division and was alleged to have been involved in the disputed transactions involving Cendant. Petitioners Colburn and Keller served as managers in the business affairs unit of Time Warner and were alleged to have been involved in the disputed transactions involving Time Warner.

None of these additional 19 defendants (collectively, the “Outside Defendants”) was alleged to have made (or participated in the making of) any of Homestore’s purportedly false and misleading statements (or omissions) or Homestore’s accounting decisions. Instead, the theory of the FACC as to the Outside Defendants was that, by entering into business transactions with Homestore with knowledge that *Homestore* would account for such transactions improperly on *Homestore’s* financial statements, the Outside Defendants engaged in a Rule 10b-5 “scheme to defraud” that assisted Homestore’s fraud – *i.e.*, Homestore’s allegedly improper recognition of revenue from those transactions on its published financial statements. Plaintiff alleged that, without this supposed “participation” of the Outside Defendants, “Homestore could not [have] undertake[n] this financial fraud.” *See* FACC at 2.

As summarized by the Ninth Circuit, the nature of the alleged business transactions involving Petitioners and L90² was as follows:

Plaintiff alleges Homestore entered into fraudulent transactions with [Time Warner and L90] in which Homestore purchased revenue for itself and then recorded that revenue in violation of SEC accounting rules. In the alleged “triangular transactions,” Homestore entered into sham transactions with “Third Party Vendors” who then returned the money to Homestore through contracts with [Time Warner] or L90. Plaintiff alleges Homestore overpaid for an asset owned by Cendant in return for Cendant’s agreement that it would funnel some of the money back to Homestore through a related business entity. The complaint further alleged that the recording of gross revenue from these transactions [by Homestore] contravened SEC rules regarding barter transactions or the buying of revenue, and that the triangular transactions were often done without the full knowledge of Homestore’s auditor.

(Pet. App. 2a-3a).

2. Proceedings in the District Court

In January 2003, Petitioners and the other Outside Defendants moved to dismiss the FACC, arguing that the FACC was defective as a matter of law in light of *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

The District Court agreed. In an Opinion and Order dated March 7, 2003, the District Judge held that the Section 10(b) claims in the FACC should be dismissed as against the Outside Defendants (the “Dismissal Order”). In reaching this decision,

2. In the Ninth Circuit, Plaintiff abandoned its appeal of the District Court’s dismissal (also pursuant to *Central Bank*) of the FACC as against the other thirteen Outside Defendants. Accordingly, those transactions are not discussed herein.

the District Judge found that the alleged conduct of the Outside Defendants – *i.e.*, entering into transactions with Homestore that allegedly facilitated Homestore’s ability to improperly recognize revenue – “appears to be exactly the role of aiders and abettors prior to *Central Bank*, and is exactly the role that *Central Bank* exempted from liability.” (Pet. App. 81a).

The District Court observed that the FACC failed to allege that any of the Outside Defendants made any of the purportedly false or misleading statements by Homestore or “played any ‘significant role’ in the drafting or editing of such statements.” (Pet. App. 79a). The District Court declined Plaintiff’s invitation to excuse this legal defect simply because the FACC characterized the Outside Defendants’ role in entering into business transactions with Homestore as “participation” in a “scheme to defraud.” Rather, the District Court held that such a “scheme” theory would improperly impose primary liability on the Outside Defendants even though Plaintiff did not rely on their purported conduct. As the District Court explained:

In the present case, plaintiff suffered damage through its reliance on false or misleading statements, not from the ‘scheme’ itself. Thus, the scheme is one step removed from the injured party. The scheme was not complete until the statement was made. Essentially what plaintiff alleges is a scheme to make a deceptive statement or material omission. Yet the principal “wrong” under the rule is the statement, not the scheme. Therefore, it is appropriate to require defendants in this case to be connected in some material way to the drafting of the statements made to the investing public. Here, this means the SEC filings, the press releases, the oral statements of Homestore, and the supporting statements of its auditor Because plaintiff did not (and cannot) sufficiently allege that any of the [Outside Defendants] substantially contributed to those statements, it cannot state a claim against those

defendants for damages resulting from reliance on statements or material omissions.

(Pet. App. 80a).

Accordingly, applying *Central Bank*, the District Court held that the Outside Defendants could not be held liable for any material misstatement or omission by Homestore (or any of its officers) no matter how much “[they] assisted or participated in transactions that led to th[ose] statement[s] or omission[s].” (Pet. App. 77a). The District Court also observed that a contrary holding “would broaden the scope of the securities acts so as to haul into court anyone doing business with a publicly traded company,” a result the District Court concluded would be patently improper in light of *Central Bank* and “absent direction from Congress,” which in 1995 had specifically “declined to create an express private right of action for aiding and abetting securities fraud” in the wake of *Central Bank*. (Pet. App. 74a).

3. The Decision Below

Plaintiff appealed to the United States Court of Appeals for the Ninth Circuit. On June 30, 2006, the Ninth Circuit issued its opinion, affirming the District Court’s dismissal of the FACC, but remanding to the District Court “so that Plaintiff may seek leave . . . to amend the complaint if that can be done consistent with this opinion.” (Pet. App. 31a). In its decision, the Ninth Circuit declined to reject as a matter of law – as foreclosed by *Central Bank* – the “scheme to defraud” theory of liability advanced by Plaintiff. Rather, the Ninth Circuit articulated a novel legal standard under which “scheme” allegations may adequately state a Section 10(b) claim against secondary actors consistent with *Central Bank*.

The Ninth Circuit focused only on the “deceptive” prong of Section 10(b) because it agreed that the alleged conduct of the Outside Defendants could not be considered “manipulative” as that term of art is used in the securities context. (*See* Pet. App. 13a n.2 (citing *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977)). It also focused only on alleged “misstatements,” finding that there could be no “actionable omissions” because

“[t]here are no allegations that any Defendant was subject to a duty to disclose in the context of these transactions.” (Pet. App. 13a n.2).

Nevertheless, the Ninth Circuit concluded that a secondary actor may be liable for “deceptive” conduct under Section 10(b) by engaging in a “scheme to defraud” with the issuer when the secondary actor’s conduct had “the principal purpose and effect of creating a false appearance of fact in the furtherance of a scheme to defraud” (Pet. App. 16a) (the “Purpose and Effects Test”), even where the secondary actor does not make (or otherwise participate in the making of) any alleged misstatements or omissions. According to the Ninth Circuit, if its newly articulated Purpose and Effects Test is satisfied, then the secondary actor has itself engaged in “deceptive” conduct within the meaning of Section 10(b) and, thus, can be held primarily liable consistent with this Court’s decision in *Central Bank*. In so ruling, the Ninth Circuit rejected the argument – accepted only a few months earlier by the Eighth Circuit in *In re: Charter Communications, Inc. Securities Litigation*, 443 F.3d 987 (2006), *petition for cert. filed*, 75 U.S.L.W. 3034 (U.S. July 7, 2006) (No. 06-43) – that the only conduct which can be “deceptive” within the meaning of Section 10(b) (as construed by this Court) is the making of a material misstatement or an omission (where one is under a duty to disclose).

The Ninth Circuit next addressed whether an additional element of a Section 10(b) claim – that the actionable conduct be “in connection with” the purchase or sale of a security – could be satisfied as against a non-speaking secondary actor in a “scheme to defraud” case such as this. Without focusing (as we submit it should have) on the specific alleged conduct by the secondary actor in furtherance of the so-called “scheme,” the Ninth Circuit, citing to no legal precedent, summarily concluded that a “scheme” itself, viewed as a whole, could be viewed as having “coincided” with the sale of securities, such that the “in connection with” element would be satisfied. More specifically, the Ninth Circuit explained:

Similarly, a scheme to misrepresent the publicly reported revenue of a company may coincide with the purchase or sale of securities because the scheme will not be complete until the fraudulent information is introduced into the securities market. That every participant in the scheme did not release the information to the public does not diminish the causal connection between all defendants in the scheme and the securities market. . . . If multiple participants used or employed a deceptive device in furtherance of a scheme to misrepresent the reported revenues of a company, then all participants may be viewed as having acted in connection with the purchase or sale of securities.

(Pet. App. 21a).

Finally, the Ninth Circuit addressed whether the critical element of “reliance” could be satisfied as against secondary actors in a “scheme to defraud” case. The inability of plaintiffs to demonstrate reliance on a secondary actor’s conduct was one of the primary reasons this Court had rejected “aiding and abetting” liability in *Central Bank*. See *Central Bank*, 511 U.S. at 190-91. Accordingly, Petitioners argued to the Ninth Circuit that, just as with “aiding and abetting” liability, holding secondary actors liable under a “scheme to defraud” theory in a statements case, where such actors did not make any of the challenged statements, would improperly dispense with the element of reliance by imposing liability on secondary actors where plaintiffs relied *only* on statements made by others, and not on any words or conduct of the secondary actor in furtherance of the alleged “scheme.”

Rather than address this argument directly in its decision, the Ninth Circuit implicitly rejected it and instead articulated yet another novel legal theory under which a plaintiff’s “reliance” on a silent secondary actor’s conduct in “scheme” cases would simply be presumed:

We may presume, absent persuasive conflicting evidence, that purchasers relied on misstatements produced by defendant as part of a scheme to defraud, even if the defendant did not publish or release the misrepresentations directly to the securities market [A] plaintiff may be presumed to have relied on this scheme to defraud if a misrepresentation, which necessarily resulted from the scheme and the defendant’s conduct therein, was disseminated into an efficient market and was reflected in the market price.

(Pet. App. 23a).

Having thus articulated three entirely new legal standards to support potential liability in “scheme” cases – the “Purpose and Effects” test, that the scheme as a whole need only coincide with the purchase or sale of securities, and that reliance upon a secondary actor’s conduct may simply be presumed – the Ninth Circuit concluded that the conduct of Petitioners, as currently alleged in the FACC, failed to satisfy the Purpose and Effects Test and, thus, that the FACC was properly dismissed. In order to allow Plaintiff the opportunity to “take advantage of the reasoning in [its] opinion,” however, the Ninth Circuit remanded the case to the District Court where Plaintiff “may seek leave . . . to amend the complaint” again in a manner which might satisfy the newly articulated standards for “scheme” liability against secondary actors.

SUMMARY OF ARGUMENT

The decision below conflicts squarely and directly with the Eighth Circuit’s recent decision in *Charter*, which correctly applied *Central Bank* to hold that “any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under Section 10(b) or any subpart of Rule 10b-5.” 435 F.3d at 992. It also conflicts with the holdings of every other circuit that, in the wake of *Central Bank*, has considered the issue of whether secondary-

actor defendants who were not alleged to have made any of the allegedly false statements (or omissions) themselves can be liable under Section 10(b). *See, e.g., Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226 (10th Cir. 1996); *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997); *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001).

The Ninth Circuit's ruling is contrary to *Central Bank* and other precedent of this Court because it permits liability against secondary actors for conduct that, prior to *Central Bank*'s rejection of aiding and abetting liability, was alleged to be classic "aiding and abetting" conduct. It also permits such liability against secondary actors under novel and unprecedented legal theories: The court below allows plaintiffs the benefit of a "presumption of reliance" upon the secondary actor's conduct even where a plaintiff relied only on the conduct (*i.e.*, statements) of someone other than the secondary actor, and it sets forth the legal fiction that the secondary actor's conduct can be viewed as having "coincided with" or occurred "in connection with" the purchase or sale of a security because the "scheme to defraud" as a whole (and the conduct of all participants in the scheme) coincides with the purchase or sale of securities once another participant in the scheme introduces fraudulent information into the marketplace.

A writ of certiorari to review the decision below is warranted now. The question presented is a discrete and important issue of federal statutory law that has been the subject of extremely thorough, albeit conflicting, analyses and holdings by the circuit courts and district courts throughout the country. In an area of law that this Court has stated "demands certainty and predictability," *Central Bank*, 511 U.S. at 188 (citation omitted), the legal standard of liability adopted by the court below threatens a large number of companies with the costs of defending potentially expensive and vexatious securities litigation in the Ninth Circuit simply because they engaged in business transactions with issuers who allegedly subsequently accounted for the transactions fraudulently. This case is a

paradigmatic example of that threat. Despite prevailing at both the District Court and the Ninth Circuit, if the District Court were to erroneously rule against Petitioners on remand, Petitioners would have no appeal as of right as to that decision until after costly discovery and a trial. Because many non-speaking defendants in the position of Petitioners will settle rather than face such costs and risks, this Court's immediate review is necessary to prevent the continuation of frivolous litigation and unmerited settlements.

REASONS FOR GRANTING THE PETITION

I. The Decision Below Directly Conflicts with Four Other Circuit Courts On an Important and Recurring Issue of Federal Securities Law

Pursuant to the novel legal tests articulated in the decision below, the Ninth Circuit concluded that a secondary actor may be primarily liable for securities fraud when that secondary actor engaged in “conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme [to defraud with the issuer.]” (Pet. App. 16a). In so holding, the Ninth Circuit expanded on the definition of “deception” under Section 10(b) beyond false statements or omissions. The decision below squarely conflicts with the Eighth Circuit's recent decision in *Charter*, 443 F.3d at 992 (“[a] device or contrivance is not “deceptive,” within the meaning of § 10(b), absent some misstatement or a failure to disclose by one who has a duty to disclose”), as well as every other circuit that has considered this issue in the wake of *Central Bank*. See, e.g., *Anixter*, 77 F.3d at 1226 (10th Cir. 1996) (“Reading the language of 10(b) and 10b-5 through the lens of *Central Bank of Denver*, we conclude that in order for [secondary actors] to “use or employ” a “deception” actionable under the antifraud law, they must themselves make a false or misleading statement (or omission) that they know or should know will reach potential investors.”); *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997) (same); *Ziembra v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001) (same).

In *Charter*, the plaintiffs brought a securities fraud class action against a publicly-traded cable television provider (the “Issuer”), in which they challenged certain of the Issuer’s financial statements and press releases as materially misleading. *Id.* at 990. The plaintiffs also named as defendants, among others, two of the Issuer’s equipment vendors (the “Vendors”), alleging that the vendors could also be liable as primary violators for engaging in a “scheme to defraud” with the Issuer, because the Vendors allegedly entered into “sham transactions” with the Issuer “knowing” that the Issuer intended to later account for them improperly on the Issuer’s financial statements. *Id.* at 989-90. The alleged sham transactions involved the Issuer paying additional money to the Vendors to be returned to the Issuer in the form of advertising fees. *Id.* at 990.

Thus, in *Charter*, as here, plaintiffs sought to hold secondary actors liable for a “scheme to defraud” under Section 10(b) based on their having entered into transactions with the issuer defendant, which the issuer then purportedly accounted for fraudulently on its financial statements. *Id.* at 991. As is the case here, the secondary actor defendants in *Charter* were not alleged to have made any publicly disseminated misstatements or to have played any role in preparing or disseminating the Issuer’s allegedly fraudulent financial statements and press releases on which plaintiffs relied.

Yet contrary to the decision below, the Eighth Circuit in *Charter*, relying on *Central Bank*, affirmed dismissal of plaintiffs’ complaint against the Vendors and flatly rejected plaintiffs’ attempt to utilize a Rule 10b5 “scheme to defraud” theory of liability to circumvent *Central Bank*. *See id.* at 992. More specifically, the Eighth Circuit reasoned that “any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable [for a “scheme to defraud”] under Sec. 10(b) or any subpart of Rule 10b-5.” *Id.* Thus, according to the Eighth Circuit, the district

court properly dismissed the claims against the secondary actors “as nothing more than claims[] barred by *Central Bank*.”³ *Id.*

The Eighth Circuit’s decision in *Charter* followed that of numerous other courts of appeals that, in the wake of *Central Bank* and standing in direct conflict with the decision below, routinely dismissed securities fraud claims against secondary-actor defendants who were not alleged to have committed a primary violation of Section 10(b) by themselves making any of the allegedly false statements (or omissions). *See, e.g., Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997) (“If *Central Bank* is to have any real meaning, a defendant must actually make a false or misleading statement . . . [a]nything short of such conduct is merely aiding and abetting. . . .”); *Anixter*, 77 F.3d 1215, 1226 (10th Cir. 1996) (same); *Ziemba v. Cascade Int’l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001) (same).⁴

3. The Second Circuit recently reached a similar result as the Eighth Circuit in a summary order. *See Filler v. Hanvit Bank*, Nos. 04-6295-CV, 04-6719-CV, 156 F. App’x 413, 2005 U.S. App. LEXIS 26443 (2d Cir. Dec. 2, 2005). In *Filler*, the plaintiffs brought a Section 10(b) claim against three banks alleging that the banks engaged in “sham transactions” with an issuer that enabled the issuer to inflate its earnings and revenues. 156 F. App’x at 414, 2005 U.S. App. LEXIS 26433, at *3. The banks were even alleged to have issued false loan confirmations to the issuer’s auditor. *Id.* The Second Circuit, relying on *Central Bank* and several Second Circuit decisions in the wake of *Central Bank*, affirmed the dismissal of plaintiffs’ claims, holding that “a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b)” and that the misrepresentation must be attributed to the defendant at the time of public dissemination. *Id.* at 415, 2005 U.S. App. LEXIS, at *6 (quoting *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997)). According to the Second Circuit, “[a]nything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b).” *Id.* (quoting *Shapiro*, 123 F.3d at 720).

4. These decisions are from Circuits which follow what is commonly-referred to as the “bright-line” rule, under which liability under Section 10(b) can be imposed on those who actually make a false

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See generally Brian E. Pastuszenski, Christopher F. Robertson & Jason D. Frank, *Central Bank is Alive and Well: Defense Strategies for Defeating “Scheme to Defraud” Allegations in Private Securities Litigation*, American Law Institute, at 441 (May 2003) (“ALI Commentary”).

This Court should grant review to resolve the direct conflict between the decision below and that of the Eighth Circuit and other circuits in post-*Central Bank* decisions.

II. The Decision Below Is Incorrect Under the Standard for Section 10(b) Liability Articulated in Settled Decisions of this Court

A. The Decision Below Cannot Be Reconciled With This Court’s Precedents Governing Primary Liability Under Section 10(b).

The decision below undermines core securities law precedents of this Court because it does not limit section 10(b) liability to the making of a misstatement (or omission) or engaging in an act of “manipulation.” It is well settled under longstanding decisions of this Court that Section 10(b) only prohibits conduct that is “manipulative” or “deceptive” within the meaning of the statute. *See Hochfelder*, 425 U.S. at 213-14. “Manipulative” conduct has been defined by this Court as “virtually a term of art when used in connection with securities markets . . . [which] refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.” *Santa Fe*, 430 U.S. at 476. This Court has defined “deceptive” conduct

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statement or, at the very least, to whom the false statement is attributed at the time that it is made. The Ninth Circuit, in the wake of *Central Bank*, adopted a more lenient standard than the bright-line rule, under which Section 10(b) liability for a “misstatement” may extend to those who either (i) make such a statement, *or* (ii) directly and substantially participate in the making (i.e., drafting or editing) of a false statement by another. *See, e.g., In re Software Toolworks Inc. Sec. Litig.*, 50 F.3d 615, 628-29 & n.3 (9th Cir. 1995).

to include only the common law categories of a misrepresentation or an omission if there is a duty to disclose. *See Chiarella v. United States*, 445 U.S. 222, 236 (1980).

Moreover, the Court has repeatedly recognized that subsections (a) and (c) of Rule 10b-5 – where the “scheme” to defraud language relied upon by the Ninth Circuit is found – cannot create liability for conduct that is not prohibited under Section 10(b), the Rule’s enabling statute. *See 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 [Section] 10(b)’s prohibition.”); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 472-74 (1977) (rejecting an attempt to state a claim under clauses (a) and (c) of Rule 10(b) because “the language of the statute must control the interpretation of the Rule”); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14 (1976) (Rule 10b-5’s “scope cannot exceed the power granted the [SEC] by Congress under § 10(b)”).

Accordingly, the “only” conduct which violates Section 10(b) – and thus can be a basis for primary liability under section 10(b) or Rule 10b-5 – is the making of a material misstatement (or omission) or the commission of a manipulative act. This Court unambiguously reaffirmed this principle in *Central Bank*:

As in earlier cases considering conduct prohibited by § 10(b), we again conclude that the statute prohibits *only* the making of a material misstatement (or omission) or the commission of a manipulative act.

511 U.S. at 177 (emphasis added) (citing *Santa Fe*, 430 U.S. at 473 (1977); *Hochfelder*, 425 U.S. at 214.⁵ The holding and

5. Further underscoring this Court’s long-held view is the fact that no decision exists in which this Court has found Section 10(b) liability to exist absent an act of “manipulation,” or a false statement or omission. *See Santa Fe Indus.*, 430 U.S. at 474 (merger transaction was not “deceptive” for purposes of Section 10(b) liability where complaint failed to allege a material misrepresentation or failure to disclose). Insider trading cases are no exception, since Section 10(b) liability in
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import of this well-established precedent is clear: Secondary actors can *only* be liable for securities fraud if they *themselves* “employ[] a manipulative device or make[] a material misstatement (or omission)” and “*all*” other elements for primary liability under Section 10(b) are satisfied. *Id.* at 191 (emphasis in the original).

According to the decision below, however, a secondary actor may be primarily liable for securities fraud despite not having made any of the challenged misstatements or omissions if that secondary actor engaged in “conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme [to defraud.]” (Pet. App. At 16a). But this same “scheme to defraud” theory of liability for secondary actors was advanced and rejected by this Court in *Central Bank*. Seizing on the “scheme” language of Rule 10b-5, as plaintiffs do here, the National Association of Securities and Commercial Law Attorneys, as *amicus curiae* in support of respondents in *Central Bank*, argued that “a scheme to defraud typically involves multiple parties who conspire with, or aid and abet, one another in order to perpetrate the fraudulent scheme” and thus “[a]ll members of such a scheme are responsible [under Rule 10b-5].” See Brief for Amicus Curiae National Association of Securities and Commercial Law Attorneys in Support of Respondents at 3-4, *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994). This Court did not accept this argument, holding instead that section 10(b) prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act. See *Central Bank*, 511 U.S. at 177. This holding was consistent with long-settled securities precedent of this Court:

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those situations are based on one or more “omissions” by a trader who fails to disclose information in circumstances where there is a duty to speak. See *United States v. O’Hagan*, 521 U.S. 642, 651 (1997) (insider trading violates Section 10(b) and Rules 10b-5(a) and (c) because it involves a trader’s failure to disclose — an “omission” — in circumstances where the trader has a duty to speak).

Even in cases relying on Rule 10b-5(a) (where the “scheme . . . to defraud” language is found), this Court has declined to allow Section 10(b) liability for an omission by someone who neither speaks nor has a duty to disclose as a fiduciary. *See Chiarella v. United States*, 445 U.S. 222, 230, 235 (1980); *Dirks v. SEC*, 463 U.S. 646, 665-667 (1983).

The Ninth Circuit attempts to reconcile its “scheme to defraud” holding with this Court’s precedent by relying on *SEC v. Zandford*, 535 U.S. 813 (2002). According to the Ninth Circuit, *Zandford* “held that a non-speaking actor who engages in a ‘scheme to defraud’ has used or employed a deceptive device within the meaning of Section 10(b).” (Pet. App. 14a). But this reliance on *Zandford* is unavailing and incorrect. *Zandford* did not alter this Court’s long-held view, as reaffirmed in *Central Bank*, that the only conduct prohibited by Section 10(b) is the making of a misstatement (or omission) or the commission of a manipulative act. Rather, *Zandford* was a classic Section 10(b) “omission” case involving a fiduciary (who had a duty to disclose) who defrauded his client by engaging in the purchase and sale of securities without disclosing to the client certain material information.⁶ *See Zandford*, 535 U.S. at 820-25 & n.4 (“any distinction between omissions and misrepresentations is illusory in the context of a broker who has a fiduciary duty to her clients”) (emphasis added). The issue in *Zandford* was not whether the fiduciary’s omission was fraudulent within the meaning of Section 10(b); rather, the fraudulent nature of the conduct was undisputed because the broker owed a fiduciary duty, and the only issue decided by this Court was whether that fiduciary’s omission was “in connection with” the sale of a security.

6. More specifically, in *Zandford*, the defendant broker sold his client’s securities and stole the proceeds. *See Zandford*, 535 U.S. at 820-25. The reason that this conduct violated section 10(b) was that the broker breached his duty to disclose to his client that the reason he liquidated her stocks was to misappropriate the proceeds for his own use. *See id.* Without the duty to disclose and resultant omission, the broker would not have engaged in conduct violating the statute.

Nothing in *Zandford* thus supports the Ninth Circuit's conclusion that engaging in a Rule 10b-5 "scheme to defraud" can be an independent ground for liability against a secondary actor where that actor did not itself violate Section 10(b) by making a misleading statement or omission in the face of a duty to disclose.

B. The Decision Below Erroneously Permits a Species of "Aiding and Abetting" Liability Under A Different Name, In Direct Contravention of *Central Bank*.

If allowed to stand, the decision below will reopen liability that *Central Bank* foreclosed. *See, e.g., ALI Commentary*, at 443 (post-*Central Bank*, the plaintiffs' securities bar began arguing that "scheme to defraud" could properly be read broadly enough to reach secondary actors not alleged to have made any statement relied upon by plaintiffs, "notwithstanding that such a broad reading . . . would appear to overrule the Supreme Court's prohibition on aiding and abetting liability").

The Ninth Circuit's approach contradicts *Central Bank* because it would permit liability for securities fraud against secondary actors who have not themselves engaged in conduct that violates Section 10(b). As recent accounts in the securities industry press recognize, "[i]f the courts, such as the Ninth Circuit in the Homestore appeal, accept 'scheme to defraud' liability . . . the impact of *Central Bank* will be largely vitiated . . . and the old aiding and abetting moniker will no longer be needed to bring lawyers, accountants, and banks (and possibly even business partners) back into the securities class action arena." Tracy A. Nichols & Stephen P. Warren, *Aiding and Abetting Liability Under Section 10(B)*, S&P's Rev. of Sec. & Commodities Reg., May 4, 2005; *see also* Peter M. Saporoff & Breton Leone-Quick, *Secondary Actor Liability: The Next Major Securities Litigation Issue to be (Re) Considered by the Supreme Court?*, American Law Institute, at 883 (April 2005) ("[A]s a result of . . . rulings

[implementing and adhering to *Central Bank*], plaintiffs are now alleging claims based on non-representational conduct pursuant to either Rules 10b-5(a) and (c), or a fraudulent ‘scheme’ theory under Section 10(b) itself.”); Matthew L. Mustokoff, “*Scheme*” *Liability Under Rule 10B-5: the New Battleground in Securities Fraud Litigation*, Federal Lawyer, at 20 (June 2006) (“[N]owadays, increasingly more plaintiffs, in an attempt to sidestep the ruling handed down in *Central Bank*, are relying on Rule 10b-5(a) and (c).”).

Indeed, the conduct of Petitioners that Plaintiff challenges here under a “scheme to defraud” theory of liability is the same sort of conduct that was challenged as “aiding and abetting” prior to *Central Bank*. See, e.g., *K&S P’ship v. Cont’l Bank, N.A.*, 952 F.2d 971, 976-77, 979-80 (8th Cir. 1991) (participation in business transactions challenged as “substantial assistance” in furtherance of primary violation); *Feldman v. Pioneer Petroleum, Inc.*, 813 F.2d 296, 301 (10th Cir. 1987) (“Plaintiffs also alleged that Fidelity Bank, N.A. and its president . . . aided and abetted in a conspiracy to promote the scheme by engaging in a fraudulent and deceptive transaction”); see also *Landy v. FDIC*, 486 F.2d 139, 163 (3d Cir. 1973) (addressing whether the “substantial assistance” component of aiding and abetting was satisfied where the secondary actor engaged in “a business transaction . . . which foreseeably permits one of the parties to it . . . to independently engage in illegal action”). In the words of the District Court below, Petitioners were alleged to have played “exactly the role [in Homestore’s fraud] that *Central Bank* exempted from liability.” (Pet. App. 81a).

The Ninth Circuit’s legally defective “scheme to defraud” theory should not be permitted to stand simply because it may be used to reach (and/or deter) allegedly “bad” conduct by secondary actors that would otherwise not be subject to a private right of action. Under the federal securities laws, Section 10(b) is but one provision of a broad remedial

scheme. For example, in 1995, Congress amended the Exchange Act – in direct response to *Central Bank* – to authorize the SEC to bring enforcement actions for aiding and abetting violations of Section 10(b). *See* 15 U.S.C. § 78t(e) (2006). But at the same time, Congress specifically elected to leave intact *Central Bank*'s bar on such claims by private litigants. *See, e.g.*, Senate Report (Banking, Housing, and Urban Affairs Committee), S. Rep. No. 104-98, at 19 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 698 (“The Committee considered testimony endorsing the result in *Central Bank* and testimony seeking to overturn this decision. The Committee believes that amending the [Exchange] Act to provide explicitly for private aiding and abetting liability actions under Section 10(b) would be contrary to S. 240’s goal of reducing meritless securities litigation. The Committee does, however, grant the SEC express authority to bring actions seeking injunctive relief or money damages against persons who, knowingly aid and abet primary violators of the securities law.”); *see also id.* at 49, 1995 U.S.C.C.A.N. at 727 (considering SEC Chairman’s testimony that private “aiding and abetting” liability should be restored so that individuals who “act behind the scenes and do not themselves make statements” may be liable under Section 10(b)).

Thus, in addition to creating an impermissible end-run around this Court’s decision in *Central Bank*, the decision below improperly disregards the express intent of Congress by effectively reviving a species of “aiding and abetting” liability even though Congress specifically decided it should *not* exist. *See generally Till v. SCS Credit Corp.*, 541 U.S. 465, 480 n.19 (2004) (declining to adopt an interpretation of the Bankruptcy Code that “Congress considered but rejected”); *Fiedler v. Clark*, 714 F.2d 77, 79 (9th Cir. 1983) (declining to recognize right of action that “Congress considered and explicitly rejected”); *see also In re Sargent Walnut Ranches, Inc.*, 219 B.R. 880, 884 (E.D. Cal. 1998)

(“It is one thing to construe a statute liberally. It is another to legislate from the bench.”).

C. The Ninth Circuit’s Approach Erroneously Dispenses With the Critical Element of Reliance.

Central Bank’s discussion of reliance in rejecting aiding and abetting liability applies with equal force to – and demonstrates a fundamental defect of – the “scheme to defraud” theory of liability accepted by the Ninth Circuit in the decision below. In a “statements” case such as this, to sanction liability against a secondary actor that did not make *any* of the challenged misstatements or omissions, or participate in the making of such statements, would create liability for the secondary actor without any showing that the plaintiff relied upon such actor’s conduct – precisely the result this Court rejected in *Central Bank*. See *Central Bank*, 511 U.S. at 181.

In *Central Bank*, this Court made clear that a secondary actor can be liable for securities fraud only if “*all*” of the elements under Section 10(b) are satisfied in respect of the secondary actor. 511 U.S. at 191. One such fundamental element is reliance, a point emphasized in *Central Bank*. *Id.* at 180 (“A plaintiff must show reliance on *the defendant’s* misstatement or omission to recover under 10b-5.”) (emphasis added); see also *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005) (reliance is one of the “basic elements” of a Section 10(b) claim).

The Ninth Circuit below, applying circular reasoning, held that reliance could be satisfied in respect of a non-speaking secondary actor in a “scheme to defraud” case because a plaintiff “may be *presumed* to have relied on th[e] scheme to defraud if a misrepresentation, which necessarily resulted from the scheme and the defendant’s conduct therein, was disseminated into an efficient market and was reflected in the market price.” (Pet. App. 23a) (emphasis added).

But this newly adopted presumption of “reliance” cannot be squared with *Central Bank*. In fact, the inability of plaintiffs to establish reliance in respect of secondary actors was one of the primary reasons this Court rejected aiding and abetting liability in *Central Bank*. *See id.* at 180. Under an aiding and abetting theory of liability, this Court reasoned, a defendant could be found liable without any showing by plaintiff that he relied upon any statement or act *by the defendant* in making his investment decision. *See id.* As this Court explained, such a result would be patently improper:

Our reasoning is confirmed by the fact that respondents’ arguments would impose 10b-5 aiding and abetting liability when at least one element *critical* for recovery under 10b-5 is absent: reliance. A plaintiff must show reliance on *the defendant’s* misstatement or omission to recover under 10b-5. *Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor’s statements or actions* Allowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases.

See id. (citations omitted; emphasis added).

In adopting a “presumption” of reliance, the court below failed even to address this Court’s discussion of reliance in *Central Bank*, much less attempt to reconcile its “presumption” with *Central Bank*. Instead, the Ninth Circuit relied on two district court decisions – *In re ZZZZ Best Securities Litigation*, 864 F. Supp. 960, 973 (C.D. Cal. 1994), and *In re Parmalat Securities Litigation*, 376 F. Supp. 2d 472, 508 (S.D.N.Y. 2005) – to support its presumption of reliance in “scheme” cases. In both of these cases, however, the defendants who were held primarily liable were alleged to have actually *made* material misstatements. *See ZZZZ Best*, 864 F. Supp. at 964; *Parmalat*, 376 F. Supp. 2d at 509. In fact, the district court in *Parmalat* explicitly held that

plaintiffs could *not* establish reliance in respect of the defendants who did not make any representations. *See Parmalat*, 376 F. Supp. 2d at 509 (“The bank defendants, however, made no representations in connection with those schemes, at least none relevant here. The plaintiffs therefore cannot be said to have relied on the banks.”). Thus, neither the reasoning nor the holdings of either decision offer any support for the notion that reliance can, consistent with *Central Bank*, somehow be presumed in a statements case as to a non-speaking secondary actor merely because a “scheme to defraud” has been alleged.

Central Bank is clear: In order to hold a secondary actor liable for securities fraud, a plaintiff must have relied on *that actor’s* conduct. *Central Bank*, 511 U.S. at 180 (“A plaintiff must show reliance on *the defendant’s* misstatement or omission to recover under 10b-5.”) (emphasis added). In a fraud-on-the-market “statements” case such as this, a plaintiff can only establish reliance because the market relied on the statements of the specific defendant. *See Basic Inc. v. Levinson*, 485 U.S. 224, 241-45 (1988). Unless a secondary actor makes or participates in making a false statement, a plaintiff simply cannot demonstrate reliance on such actor’s conduct in furtherance of any “scheme to defraud.”

D. The Decision Below Permits Liability for Conduct That Cannot be Viewed as Having Occurred “In Connection With” the Purchase or Sale of Securities.

The Ninth Circuit’s decision also is legally defective because it permits liability against secondary actors for conduct that cannot be viewed as having occurred “in connection with” the purchase or sale of any security. *See* 15 U.S.C. § 78j(b) (2006) (section 10(b) liability attaches only to those who “use or employ, *in connection with the purchase or sale of any security* . . . any manipulative or deceptive device or contrivance”) (emphasis added).

According to *SEC v. Zandford*, 535 U.S. 813 (2002), in order for the “in connection with” requirement to be satisfied, the challenged conduct at issue must “coincide” with the purchase or sale of a security. *Id.* at 825. Concluding that this requirement was met in *Zandford*, this Court explained:

The securities sales and respondent’s fraudulent practices were not independent events. This is not a case in which, after a lawful transaction had been consummated, a broker decided to steal the proceeds and did so. . . . Rather, *respondent’s fraud coincided with the sales themselves.*

Id. at 820 (emphasis added); *see also United States v. O’Hagan*, 521 U.S. 642, 656 (1997) (trading on misappropriated information met the “in connection with” requirement because “[t]he securities transaction and the breach of duty . . . coincide[d]”).

Here, it is difficult (if not impossible) to understand how secondary actor conduct, such as entering into business transactions with an issuer, which are later purportedly misrepresented by the issuer on its financial statements, can be viewed as “coinciding with” or occurring “in connection with” the purchase or sale of any security. The business transaction itself – in contrast to an issuer’s subsequent misreporting of the transaction on its own publicly issued financial statements – does not deceive investors or otherwise coincide with any subsequent purchase of securities.

The Ninth Circuit attempts to address this glaring problem, but its reasoning is flawed. According to the Ninth Circuit, a “scheme” to misrepresent the publicly reported revenue of a company may “coincide” with the purchase or sale of securities because “the scheme will not be complete until the fraudulent information is introduced into the securities market.” (Pet. App. 21a). Thus, because the “scheme to defraud” – viewed as a whole – can be said to have coincided with the purchase or sale of securities, the

Ninth Circuit summarily concluded that “all participants [in the scheme] may be viewed as having acted in connection with the purchase or sale of securities.” (Pet. App. 21a).

Such “group” reasoning, however, cannot be reconciled with this Court’s precedents. As noted, *Central Bank* was clear that, in order for secondary actors to be primarily liable under Section 10(b), a plaintiff must plead and prove that the conduct of such secondary actors *independently* satisfies *each* element of a violation of Section 10(b). *See Central Bank*, 511 U.S. at 191. The court below ignored this mandate by erroneously concluding that the “in connection with” requirement can be satisfied as against secondary actors in “scheme” cases – regardless of when their *own* conduct in furtherance of the alleged scheme took place – based solely on the later conduct of the issuer defendant (*i.e.*, here, in the words of the Ninth Circuit, introducing “fraudulent information . . . into the securities market”). (Pet. App. 21a).

A correct application of *Zandford* and *Central Bank* is demonstrated by a recent federal district court decision, *In re Dynegy, Inc. Sec. Litig.*, 339 F. Supp. 2d 804 (S.D. Tex. 2004). In that case, plaintiff challenged not only statements made by the issuer defendant Dynegy, but also the conduct of Citigroup, seeking to hold Citigroup liable for allegedly structuring and funding the transactions that Dynegy was alleged to have subsequently misreported on its financial statements. *See id.* at 915-16. Applying *Zandford*, the court concluded that “[b]ecause plaintiffs in this case do not allege any facts showing that Citigroup’s allegedly manipulative and deceptive acts coincided with sales of Dynegy securities,” *see id.* at 916, the “in connection with” requirement was not independently satisfied in respect of Citigroup, as it must be in order for Citigroup to be primarily liable under *Central Bank*. *See Dynegy*, 339 F. Supp. 2d at 915 (under *Central Bank*, a “secondary actor may not be liable for primary violations under an alleged scheme to defraud unless all of

the requirements for liability under Rule 10b-5 have been satisfied *as to the secondary actor*”) (emphasis added).

Thus, as the district court in *Dynegy* properly concluded, secondary actors cannot be held liable under Section 10(b) for a “scheme to defraud” or otherwise where, as here, such actors are alleged to have engaged in conduct one or more steps removed from the relevant securities transactions, because such claims do not satisfy Section 10(b)’s “in connection with” requirement in respect of the secondary actor’s conduct.

III. There Are Other Compelling Reasons To Resolve the Circuit Split Now

This case presents an appropriate vehicle for this Court to resolve the Circuit conflict and dispute over whether, consistent with precedents of this Court, secondary actors can be liable for “deceptive” conduct for engaging in a “scheme to defraud” without making misstatements or omissions. Arguments concerning this question will not be refined or resolved by allowing it to percolate further among the Circuit courts. Instead, the question presented is a discrete, well-defined and extremely important issue of law, which has now been decided definitively – in opposite ways – by Ninth Circuit and four other circuit courts post-*Central Bank*.⁷

7. Additionally, several District Courts also have issued detailed opinions analyzing this issue, reaching differing conclusions. *Compare, e.g., In re Dynegy, Inc. Sec. Litig.*, 339 F. Supp. 2d 804, 916 (S.D. Tex. 2004) (“[P]laintiffs cannot invoke subsections (a) and (c) of Rule 10b5 to circumvent Central Bank’s limitations on liability for secondary actor’s involvement in the preparation of false and misleading statements.”), with *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 172 (D. Mass. 2003) (declining to dismiss claims against secondary actor business partners alleged to have engaged in “sham transactions” about which the issuer later made misstatements); *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 505 (S.D.N.Y. 2005) (same). *See also In re*

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Petitioners respectfully submit that as long as there is at least one forum such as the Ninth Circuit, which has reached a result at odds with *Central Bank*, it will serve as a portal for plaintiffs to bring a species of “aiding and abetting” claims against secondary actors. In open-market securities cases to which the Ninth Circuit’s decision will apply, the securities typically at issue are traded nationally, which means plaintiffs can select virtually any forum in which to bring their claims. Entities doing business with a publicly-traded issuer will face the risk of excessive, vexatious litigation because any business transaction can be improperly accounted for by one party to it. *See Central Bank*, 511 U.S. at 189 (“uncertainty” can result in “excessive litigation” and “litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from . . . litigation in general”) (citation omitted).

There can be little doubt that, if the decision is permitted to stand, lawyers across the nation will begin naming as defendants all manner of companies (particularly companies with “deep pockets,”) merely because they engaged in significant business transactions with issuers who allegedly accounted for the transactions fraudulently on their books. Such scenarios should not be allowed to develop, particularly in light of the expensive and often vexatious nature of securities litigation. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 126 S. Ct. 1503, 1510-11 (2006) (discussing “the widespread recognition that ‘litigation under Rule 10b-5 presents a danger of vexatiousness different in

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Enron Corp. Securities, Derivative & “ERISA” Litig., 310 F. Supp. 2d 819 (S.D. Tex. 2004); *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319 (S.D.N.Y. 2004); *In re AOL Time Warner, Inc. Sec. & “ERISA” Litig.*, 381 F. Supp. 2d 192 (S.D.N.Y. 2004); *see generally* Peter M. Saporoff & Breton Leone-Quick, *The Debate Over Secondary Actor Liability is Now Before the Circuit Courts*, American Law Institute, at 1000 (May 2006) (“District Courts have been split as to how to address these new types of [“scheme”] pleadings.”).

degree and in kind from that which accompanies litigation in general” such as the “targeting of deep-pocket defendants”) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975)); see also *Santa Fe Indus.*, 430 U.S. at 478-79 (declining to interpret Section 10(b) in a manner that would “pos[e] a danger of vexatious litigation”) (citation omitted). Cf. *Ernst & Ernst*, 425 U.S. at 214 n.33 (“[W]e are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good.”) (quoting *Blue Chip Stamps*, 421 U.S. at 747-48).

Other important policy considerations also counsel strongly in favor of granting this Petition at this time. In *Central Bank*, this Court observed that the area of securities law “‘demands certainty and predictability.’” *Central Bank*, 511 U.S. at 188 (citation omitted). Thus, “‘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.* (citation omitted; alteration in original). But the Ninth Circuit’s decision revives the very “uncertainty” that this Court sought to eliminate in *Central Bank*. *Id.* at 189. For example, attempting to distinguish its holding from *Central Bank* and mere “aiding and abetting” liability, the Ninth Circuit states:

It is not enough that a transaction in which a defendant was involved had a deceptive purpose and effect; the defendant’s own conduct contributing to the transaction or overall scheme must have had a deceptive purpose and effect. . . . Thus, when determining whether a defendant is a ‘primary violator,’ the conduct of each defendant, *while evaluated in its context, must be viewed alone* for whether it had the purpose and effect

of creating a false appearance of fact in the furtherance of an overall scheme to defraud.

Op. at 7249-50 (emphasis added).

This standard is the antithesis of certainty and predictability. It has bred litigation against business partners, investment banking firms, lawyers, and others in the Ninth Circuit and in the district courts. These are precisely the entities that *Central Bank* held should not be part of Section 10(b) litigation because they neither make statements to investors nor have a duty to speak to investors. *Central Bank* taught that it is “undesirable” to have “decisions ‘made on an ad hoc basis, offering little predictive value’ to those who provide services to participants in the securities business.” 511 U.S. at 188 (citation omitted).

In an area of law that “demands certainty and predictability,” *id.*, a party should *not* be forced to worry about entering into a transaction with a publicly-traded issuer because the issuer may decide to record the transaction inaccurately on its financial statements. Further, employees of a publicly-traded issuer who are not involved in the issuance or preparation of financial statements should not face the specter of litigation merely because a transaction in which they were involved in a non-accounting role is subsequently accounted for improperly by others on the issuer’s financial statements. Yet so long as the decision below remains unreviewed, such a possibility will become a factor to assess each and every time a third party is considering a business transaction with a publicly traded issuer, because plaintiffs could always later challenge the “principal purpose” of the transaction. If business enterprises are forced to deal with such issues, transaction costs will undoubtedly increase and get passed on to a company’s investors. *See Central Bank*, 511 U.S. at 189 (declining to expand the scope of securities fraud liability in part because the resulting “uncertainty and excessive litigation” could lead

to increased costs for companies that ultimately may be “incurred by the company’s investors, the intended beneficiaries of the statute”).

This case is illustrative of that danger. In order to prevail on the legal merits in the courts below, Petitioners will have had to win at least four rounds of briefing: the original dismissal ruling, the Ninth Circuit’s decision, the remand, and an inevitable appeal after remand. And, if the district court erroneously rules against Petitioners on remand, Petitioners would have no appeal as of right as to that decision until after costly discovery and a trial. Rather than face similar costs and risks, many non-speaking defendants who are unable to prevail at the threshold, motion to dismiss stage will settle, passing on costs to issuers and ultimately investors in future transactions. This Court has warned against the deleterious effect of such settlements. *See Dura*, 544 U.S. at 347; *Central Bank*, 511 U.S. at 189. This Court’s immediate review is necessary to prevent the continuation of vexatious litigation and unmerited settlements. Indeed, this Court has previously granted certiorari to resolve important Section 10(b) civil liability issues in cases involving circuit court decisions that, as here, improperly remanded District Court decisions granting Rule 12(b)(6) dismissals of complaints with prejudice. *See Dabit*, 126 S. Ct. at 1507 (SLUSA preemption); *Dura*, 544 U.S. at 340 (loss causation); *Santa Fe Indus. v. Green*, 430 U.S. 462, 469 (1977) (§ 10(b) does not apply to mismanagement); *Blue Chip Stamps*, 421 U.S. at 727 (Section 10(b) plaintiffs are limited to actual purchasers and sellers).

CONCLUSION

For the foregoing reasons, the petition for writ of *certiorari* should be granted.

Respectfully submitted,

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