No. 06-43

In The Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,

Petitioner,

v.

SCIENTIFIC-ATLANTA, INC., *et al.*,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

MOTION FOR LEAVE TO FILE BRIEF OUT OF TIME AND BRIEF *AMICI CURIAE* OF FORMER SEC COMMISSIONERS IN SUPPORT OF PETITIONER

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MOTION FOR LEAVE TO FILE BRIEF OUT OF TIME OF *AMICI CURIAE* FORMER SEC COMMISSIONERS IN SUPPORT OF PETITIONER

Pursuant to Supreme Court Rule 37.3, William H. Donaldson and Arthur Levitt, Jr., former Chairmen of the Securities and Exchange Commission, and Harvey J. Goldschmid, former Commissioner of the SEC, respectfully move for leave to file a brief *amici curiae* out of time, and to file the accompanying brief in support of the petitioner.

Amici regret missing the deadline for filing. This is one of the most important securities cases to be heard by this Court in many years. As former Chairmen and Commissioners of the Securities and Exchange Commission, *amici* have been involved extensively in securities law policy and enforcement and respectfully believe they have a perspective that might assist in the Supreme Court's consideration of the issue now pending before the Court.

Amici expected that the Solicitor General would support the past and current position of the Securities and Exchange Commission on the issue presented and file an *amicus curiae* brief on behalf of the United States in support of petitioner. *Amici* apologize for the late motion, but saw no need to file this brief until after June 11, 2007, when petitioner's brief was filed and an *amicus* brief of the United States supporting petitioner was not. Plaintiffs consent to the filing of this *amici* brief; Defendants do not. Since Defendants have been granted an extension of time

to file their brief until August 15, 2007, the granting of this motion would not prejudice them.

Respectfully submitted,

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BRIEF *AMICI CURIAE* OF FORMER SEC COMMISSIONERS IN SUPPORT OF PETITIONER

INTEREST OF *AMICI*[1]

This *amici curiae* brief is submitted by William H. Donaldson, former Chairman of the Securities and Exchange Commission (2/18/03 – 6/30/05, appointed by President George W. Bush), Arthur Levitt, Jr., former Chairman of the

[1] This brief was not authored in whole or in part by counsel for a party. No person or entity other than *amici curiae* or their counsel made a monetary contribution to the preparation or submission of this brief. Plaintiffs' blanket letter of consent to the filing of this brief is on file with the Court. Defendants do not consent to the filing of this brief.

SEC (7/27/93 – 2/9/01, appointed by President William J. Clinton), and Harvey J. Goldschmid, former Commissioner of the SEC (7/31/02 – 7/31/05, appointed by President George W. Bush) in support of Petitioner. Throughout our tenure of service at the SEC, during Administrations of both political parties, we have been involved in Commission policy and enforcement regarding so-called "fraudulent scheme liability." We believe the continued viability of private actions based on such liability is essential for the protection of the nation's investors and the integrity of our financial markets.

This is one of the most important securities cases to be heard by this Court in many years. It is critical to the antifraud purposes of the federal securities laws that actors, other than issuers and their officers and directors, who actively engage in deceptive conduct – for the purpose and with the effect of creating a false statement of material fact in the disclosure of a public corporation – continue to be held liable in private actions.

Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, as the SEC explained recently, include "conduct beyond the making of false statements or misleading omissions, for facts effectively can be misrepresented by action as well as words." *Amicus Curiae* Brief of the SEC filed October 22, 2004 in *Simpson v. AOL Time Warner, Inc.* (*Cal. St. Teachers Ret. Sys. v. Homestore.com, Inc.*, No. 04-55665 (9th Cir.), at 8 (quoted in *In re Enron Corp. Sec. Litig.*, 2006 U.S. Dist. LEXIS 43146, at *165 (S.D. Tex. June 5, 2006), *rev'd, Regents of the Univ. of Cal. v. Credit Suisse First Boston*, 482 F.3d 372 (2007)). We believe that this Court's resolution of the issue of fraudulent scheme liability in the instant case will have a profound effect on the continued deterrence of fraud, the

ability of defrauded investors to recover their losses, and the overall fairness and effectiveness of our securities markets. We urge this Court to reaffirm liability for actors who actively engage in deceptive conduct as part of a fraudulent scheme.

INTRODUCTION

The federal securities laws reflect Congress' broad purpose to protect investors and preserve the integrity of the markets by deterring, punishing, and allowing civil remedies for manipulative and deceptive conduct. In particular, Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), prohibits "any manipulative or deceptive device or contrivance" and provides a broad grant of authority to the Commission to enact rules "in the public interest or for the protection of investors." The Commission promulgated Rule 10b-5, 17 C.F.R. §240.10b-5, to deter and prevent fraud.

Together Section 10(b) and Rule 10b-5 are the chief weapons in the SEC's arsenal against securities fraud and the principal means by which defrauded investors recover their losses from those who perpetrate frauds. If allowed to stand, the decision below would make virtually invulnerable those who actively, purposely, and with market effect, engage in deceptive conduct and would cause grave harm. The decision conflicts with the language and purposes of Section 10(b), the historical position of the Commission, and well-grounded judicial precedent.

The decision below immunizes non-issuers who commit securities fraud from private liability merely because they were cunning enough to avoid making a

public statement. Those who – with purpose and effect – actively engage in fraudulent acts as part of a scheme with the issuer to defraud investors should be held primarily liable, regardless of whether they speak to the market, assuming all the other requirements to plead and prove a claim under Section 10(b) and Rule 10b-5 are met.

Fraudulent scheme liability neither results in undue liability exposure for non-issuers, nor an undue burden upon capital formation. Holding liable wrongdoers who actively engage in fraudulent conduct that lacks a legitimate business purpose does not hinder, but rather enhances, the integrity of our markets and our economy. We believe that the integrity of our securities markets is their strength. Investors, both domestic and foreign, trust that fraud is not tolerated in our nation's securities markets and that strong remedies exist to deter and protect against fraud and to recompense investors when it occurs. The decision below, if left standing, would dramatically undermine private enforcement of our securities laws and investor confidence in our securities markets.

SUMMARY OF ARGUMENT

Meritorious private actions to enforce the federal antifraud securities laws are an essential supplement to government actions. Private actions are the principal means by which defrauded investors recover their losses due to the Commission's limited resources and powers. The Commission's traditional position has been that a party commits a primary securities fraud violation for which it may be held liable in a private action by actively engaging in fraudulent conduct as part of a scheme to

defraud investors, even if it does not make a public statement. Such "fraudulent scheme liability" is consistent with the purposes of the federal securities laws and essential to the protection of investors, the integrity of the securities markets, and the ability of America to remain the world's leader in capital formation. The Court should reverse the decision below and reaffirm the availability of fraudulent scheme liability.

ARGUMENT

The broad antifraud purposes of Section 10(b) of the Securities Exchange Act of 1934, have long been fully recognized by this Court. *See, e.g., SEC v. Zandford*, 535 U.S. 813, 821 (2002) (noting statute's broad language and interpretation); *United States v. O'Hagan*, 521 U.S. 642, 658 (1997) (noting Congress' intention "to insure honest securities markets and thereby promote investor confidence"); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977) ("No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices"); *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 152-53 (1972) (noting statute's broad language accords with Congress' "fundamental purpose . . . to achieve a high standard of business ethics in the securities industry") (internal quotation marks omitted).

This Court and the SEC have also "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 (SEC)." *Tellabs,*

Inc. v. Makor Issues & Rights, Ltd., 2007 U.S. LEXIS 8270, *9 (June 21, 2007). "[P]rivate securities litigation [i]s an indispensable tool with which defrauded investors can recover their losses – a matter crucial to the integrity of domestic capital markets." *Id.* at *24 n.4 (internal quotation marks omitted).

The Commission's traditional position has been that a person may commit a "manipulative or deceptive" act constituting a primary violation of Section 10(b) without making a public statement. The SEC consistently has expressed this position through rulemaking,[2] *amicus* briefs in private litigation,[3] civil actions brought by the

[2] *See, e.g.*, Rule 10b-5(a) and (c), and many other rules promulgated by the Commission under Section 10(b) prohibiting manipulative or deceptive acts without requiring misstatements or omissions. Rule 10b-1, 17 C.F.R. §240.10b-1; Rule 10b-3, 17 C.F.R. §240.10b-3; Rule 10b-5-1, 17 C.F.R. §240.10b-5-1; Rule 10b-5-2, 17 C.F.R. §240.10b-5-2; Rule 10b-10, 17 C.F.R. §240.10b-10; Rule 10b-16, 17 C.F.R. §240.10b-16; Rule 10b-17, 17 C.F.R. §240.10b-17.

[3] *See, e.g.*, *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006) ("We agree with the SEC that engaging in a transaction, the principal purpose and effect of which is to create the false appearance of fact, constitutes a 'deceptive act' "), *petition for cert. filed sub nom. Cal. St. Teachers Ret. Sys. v. Homestore.com, Inc.*, 75 U.S.L.W. 3236 (U.S. Oct. 19, 2006) (No. 06-560); *In re Enron Corp. Sec. Litig.*, 2006 U.S. Dist. LEXIS 43146, at *165 (S.D. Tex. June 5, 2006) (noting Commission's argument "deceptive acts under Section 10(b) include conduct beyond the making of false statements or misleading omissions, for facts effectively can be misrepresented by action as well as words. For example, if an investment bank falsely states that a client company has sound credit, there is no dispute that it can be primarily liable. If the bank creates an off-balance-sheet sham entity that has the purpose and effect of hiding the company debt, it has achieved the same deception, and liability should be equally available"), *rev'd, Regents of the Univ. of Cal. v. Credit Suisse First Boston*, 482 F.3d 372 (2007); *Amicus Curiae* Brief of the SEC filed April, 1998 in *Klein v. Boyd*, No. 97-1142 (3d Cir.).

Commission,[4] and the Commission's own administrative adjudications.[5]

The SEC's position is both reasonable and necessary for the protection of investors. An intentional scheme to engage in sham transactions for the purpose of artificially inflating a public corporation's financial statements, as alleged in the instant case, is anathema to what Congress sought to accomplish by enacting Section 10(b).

Although the Commission has the authority to proceed against aiders and abettors, 15 U.S.C. §78t(e), private litigants do not. *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver*, 511 U.S. 164 (1994). Investors must rely primarily on private actions to recover when

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[4] *See, e.g., SEC v. Dibella*, 2005 U.S. Dist. LEXIS 31762, *11 (D. Conn. Nov. 29, 2005) (noting Commission's position subsections (a) and (c) prohibit schemes to defraud regardless whether any material statements or omissions were made).

[5] *See, e.g., In re Robert W. Armstrong, III*, 2005 SEC LEXIS 1497, *23 (June 24, 2005) (misstatement or omission not required for liability under subsection (a) or (c) of Rule 10b-5: "A person's conduct as part of a scheme constitutes a primary violation when the person directly or indirectly engages in a manipulative or deceptive act as part of the scheme. . . . Schemes used to artificially inflate the price of stocks by creating phantom revenue fall squarely within both the language of section 10(b) and its broad purpose, to prevent practices that impair the function of stock markets in enabling people to buy and sell securities at prices that reflect undistorted (though not necessarily accurate) estimates of the underlying economic value of the securities traded, and nothing in the language of Section 10(b) or Rule 10b-5 or in the case law interpreting them shields a defendant from liability for direct participation in such a scheme") (internal quotation marks omitted); *In re Cady, Roberts & Co.*, 1961 SEC LEXIS 386, *9, 40 S.E.C. 907, 911 (Nov. 8, 1961) ("These anti-fraud provisions are not intended as a specification of specific acts or practices which constitute fraud, but rather are designed to encompass the infinite variety of devices by which undue advantage may be taken of investors and others").

defrauded. The SEC's disgorgement and civil money penalty powers, although enhanced by the Sarbanes-Oxley Act, are limited, and will generally cover only a fraction of the damage done to investors by serious securities fraud. Moreover, the SEC with limited resources cannot possibly undertake to bring actions in every one or even most of the financial fraud cases that have proliferated over the past few years.

Thus, the elimination of fraudulent scheme liability would mean, in practical terms, that defrauded investors would not be able to recover their losses from any party other than the public company that issued the financial or other public statements. But in many fraud cases, the issuer becomes bankrupt or unable to satisfy a judgment once the fraud is exposed. If the only party investors could proceed against were the issuer (and its directors and officers), defrauded investors would be unable to recover much of their losses and public confidence in the markets would surely suffer. Private cases, so long as they are well-grounded, are an important enforcement mechanism supplementing the SEC in the policing of our markets.[6] Most often, the larger the frauds, the greater investors must rely on private cases to recover their losses. In the *Enron* case, for example, the Commission and the Department of Justice were able to obtain only $440 million for investors (*see* http://www.sec.gov/divisions/enforce/claims/enron.htm) out of total claimed losses of approximately $40 billion (*see* Petition for Writ of Certiorari at 5 n.8, *The*

[6] In enacting the Private Securities Litigation Reform Act of 1995, 109 Stat. 737, Congress "installed both substantive and procedural controls" designed to ensure private cases are well-grounded. *Tellabs*, 2007 U.S. LEXIS, at *23.

Regents of the Univ. of Cal. v. Merrill Lynch Pierce Fenner & Smith, Inc., (No. 06-1341)).

The most serious effect of the elimination of fraudulent scheme liability would be on deterrence and the integrity of the markets – the foundations of public confidence and trust in the markets. *See Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 345 (2005) ("The securities statutes seek to maintain public confidence in the marketplace. . . . by deterring fraud, in part, through the availability of private securities fraud actions"); *J. I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964) (private securities fraud actions provide "a most effective weapon in the enforcement" of securities law and are "a necessary supplement to Commission action"). What signal would it send to banks, broker-dealers, accountants, and lawyers to relieve them of all possibility of private liability so long as they do not speak publicly about the transactions with respect to which they perform their essential services? What signal would it send to investors to deprive them of the ability to recover significant parts of their losses in cases where actors actively and purposefully engaged in a fraudulent scheme?

The continuation of fraudulent scheme liability will not harm American competitiveness; in fact, investor faith in the safety and integrity of our markets *is* their strength. The fact that our markets are the safest in the world has helped make them the strongest in the world. Capital formation through the United States securities markets since the enactment of the federal securities laws has been a resounding success.

CONCLUSION

We respectfully urge this Court to reverse the decision of the court below and to reaffirm the availability of fraudulent scheme liability under Section 10(b) and Rule 10b-5.

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