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

BRIEF OF THE CENTER FOR AUDIT QUALITY AS *AMICUS CURIAE* IN SUPPORT OF NEITHER PARTY

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INTEREST OF THE *AMICUS CURIAE*[1]

The Center for Audit Quality ("CAQ") is a public policy organization that seeks to aid investors and the capital markets by advancing constructive suggestions rooted in the audit and accounting profession's core values of integrity, objectivity, honesty, and trust. Any U.S. accounting firm registered with the Public Company Accounting Oversight Board ("PCAOB") may join the CAQ. The CAQ is affiliated with the American Institute of Certified Public Accountants ("AICPA"), and has approximately 750 U.S. public company accounting firms as members, representing tens of thousands of professionals dedicated to audit quality.

The CAQ seeks to improve the reliability of public company audits and to enhance their relevance for investors, particularly in this time of growing financial complexity and globalization. The CAQ is dedicated to helping increase public confidence in the auditing process and to maintaining high standards in the accounting profession. To fulfill its mission, the CAQ offers recommendations to policymakers, issues technical support for public company auditing professionals, and participates in the public discussion

[1] No counsel for a party wrote this brief in whole or in part, and no counsel for a party or party made a monetary contribution intended to fund the preparation or submission of this brief. No person or entity other than *amicus curiae*, its members, or its counsel made a monetary contribution to this brief's preparation or submission. Petitioners have filed a blanket consent to *amicus* briefs, as reflected on the Court's docket; respondent's written consent to the filing of this brief has been submitted to the Clerk.

about financial reporting. For example, among many other recent activities, the CAQ has filed *amicus* briefs in cases concerning the unconstitutionality of statutory provisions for removal of members of the PCAOB; the confidentiality of documents, communications, and information regarding or relating to a PCAOB inspection; and the distinction between primary and secondary liability under Section 10(b) of the Securities Exchange Act of 1934.

The CAQ has a keen interest in legal rules that affect auditors and the audit process, and the broader impact of such rules on investors and capital markets. This case concerns whether a defendant may be liable under Section 10(b) for statements that are made by and attributed to a company, if the defendant participated in the drafting and dissemination of the statement and if a court infers that "interested investors" would attribute the statement to the defendant. This case is especially important to auditors, because auditors are frequently named as defendants in private securities cases based on allegations that the auditor is liable for the client's statements, even though the statements were not made by or publicly attributed to the auditor.

Every public company must file with the SEC an annual financial statement that has been audited by a certified public accountant. See 15 U.S.C. § 78j-1 (mandating and setting standards for annual audit). These audits are governed by an extensive body of detailed requirements, and typically result in an audit report that contains very specific, public statements by the audit firm. In the case of domestic public companies, the auditor represents that the audit was conducted in accordance with PCAOB standards. If an "unqualified" opinion is warranted, the auditor

represents that the audit provides a reasonable basis on which to opine that the financial statements present fairly, in all material respects, the financial position of the company, the results of its operations, and its cash flows, in conformity with Generally Accepted Accounting Principles ("GAAP").

Investors and courts, however, sometimes mistakenly believe that audit reports are tantamount to assurances that the *company*'s financial statements (1) reflect the only permissible description of the company's financial performance, and (2) are completely accurate. That belief is wrong for two reasons. First, the application of GAAP requires the exercise of professional judgment, and often permits a range of reasonable judgments about how to account for particular transactions. Second, even the most rigorous audit will not examine *every* accounting transaction in the company's records, and may not detect every instance of mistake or fraud. As the Third Circuit has explained, an "audit does not guarantee that a client's accounts and financial statements are correct any more than a sanguine medical diagnosis guarantees well-being; indeed, even an audit conducted in strict accordance with professional standards countenances some degree of calibration for tolerable error which, on occasion, may result in a failure to detect a material omission or misstatement." *In re IKON Office Solutions, Inc.*, 277 F.3d 658, 673 (3d Cir. 2002); see also *Bily* v. *Arthur Young & Co.*, 3 Cal. 4th 370, 379-384 (Cal. 1992) (describing audit standards and process).

For that reason, it is important to protect auditors from liability arising merely from a misleading representation or omission in a company's financial statements, and it is wrong to attribute such a representa-

tion or omission to the auditor. Rather, auditors should be responsible only for *their own* statements. Courts have long held that an auditor's representations in an audit report are "statements" that, if knowingly false, may give rise to liability (if all the other requirements of Section 10(b) are satisfied) in a private securities action. It is through the act of issuing an opinion on the company's financial statements that "the independent auditor assumes a *public* responsibility transcending any employment relationship with the client." *United States* v. *Arthur Young & Co.*, 465 U.S. 805, 817 (1984). Because of the practical and legal significance of the audit report, the statements contained in such reports are carefully written to state clearly the precise representations that the auditor is making. Auditors should not incur liability for statements other than the statements they have actually made.

In addition to performing audits, auditors perform other important tasks for their public company clients that do *not* involve the issuance of a public statement by the auditor, but may result in a public statement by the company. For example, public companies frequently consult with their auditors to discuss the accounting ramifications of various business decisions. Auditors often attend meetings to discuss business transactions, and respond to telephone inquiries from clients requesting advice on the accounting treatment of business decisions. Such interaction assists the client in understanding how business decisions will affect its financial statements and how to structure transactions. Auditors also provide advice to non-audit clients. A company may seek a second opinion from an accounting firm that is not its audi-

tor if a transaction raises novel or undecided accounting issues.

These consultations are valuable to both the client and shareholders. The client may refrain from entering into a transaction or making a strategic business move if it does not have guidance as to the accounting implications of its decision. Such consultations also reduce the risk that the company's initial accounting treatment of the transaction will be incorrect, and that the company will have to correct its interim unaudited financial statements when it issues its annual, audited financial statements.

Of course, companies are not required to consult with their auditors on every accounting issue. Even when they do consult auditors, the information that they provide to the auditor may be incomplete or inaccurate, whether for innocent reasons (in the usual case) or otherwise (in the rare case of intentional fraud). Auditors also have no control over the myriad public statements that may be made by a company or its executives. For those reasons, investors cannot reasonably assume that statements made by a company or its executives have been vetted and approved by the company's auditor. Vague standards that permit auditor liability based on that assumption, or on an auditor's consultation on accounting matters that are implicated in a misleading statement or omission by the company, would subject auditors to large litigation costs and risks when they have done nothing wrong. Without clear and appropriate liability standards, auditors' legitimate concerns about the enormous costs and risks of class action securities litigation may cause them to curtail their provision of services or to raise the prices they charge, even

though such services benefit investors and conscientious public companies.

The interests of auditors and investors alike will be best served by clear standards delineating the circumstances in which auditors may incur liability in private securities actions under Section 10(b). Investors will benefit from knowing when they may (and may not) rely on an auditor's actual (or assumed) opinion concerning statements made by companies. Auditors will benefit from clear rules that will protect them from liability – and from the costs and risks of meritless class action litigation – for conduct that does *not* violate Section 10(b). The CAQ respectfully submits this *amicus curiae* brief to explain why the Fourth Circuit's decision in this case, and the liability standards advocated by the government, would disserve investors' and auditors' interests.

SUMMARY OF ARGUMENT

Central Bank of Denver, N.A. v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), held that there is no private right of action for aiding and abetting violations of Section 10(b). Liability for aiding and abetting, the Court explained, is inconsistent with the text and structure of the Securities Exchange Act of 1934, as well as with the requirement that private plaintiffs prove reliance on a misleading statement *made by the defendant*. In 1995, Congress authorized the SEC to bring actions against defendants who knowingly aided and abetted violations. In 2010, it authorized SEC actions against reckless aiders and abettors. On both occasions, however, Congress ratified the holding of *Central Bank* by refusing to authorize private suits against secondary actors that merely aided and abetted violations of

Section 10(b) by others. The liability standards adopted by the Fourth Circuit and supported by the government are inconsistent with *Central Bank* and with Congress's responses to that decision.

Central Bank's core holding requires liability standards that draw a clear distinction between a defendant's own statements or omissions and the statements or omissions of others. The Fourth Circuit ignored that distinction by holding that a defendant may be deemed to have made a statement merely by "participating" in the writing or dissemination of a statement made by someone else. The Fourth Circuit's standard is indistinguishable from the definition of aiding and abetting used by lower courts before *Central Bank*. The government, in attempting to defend that standard, emphasizes that petitioners, as investment advisers to the fund that issued the statement, controlled the drafting and dissemination of the fund's statements, much like corporate insiders. But the Fourth Circuit's liability standard draws no distinction between insiders who control the issuance of a statement, and outside professionals such as auditors who do not exercise such control but might be said to have "participated" in the creation of the statement. The government's suggestion that primary liability can arise if a defendant participates "to a sufficient degree" would make it exceedingly difficult for outside professionals to obtain dismissal of a securities complaint if the professional had even the most fleeting involvement in the allegedly misleading statement – the kind of involvement that constitutes, at most, aiding and abetting.

Central Bank, and the requirement that private plaintiffs must prove reasonable reliance on the defendant's statement, also require that plaintiffs suing

outside professionals must prove that a statement was expressly attributed to the defendant. Without such attribution, investors can at most *assume* that the auditor has endorsed a statement made by its client, and reliance based on such an assumption is inherently unreasonable. Unlike corporate executives who control the statements issued by the corporation and whose own words and conduct may be attributed to the corporation as a matter of law, auditors typically do not control a corporation's statements or speak on its behalf. The Fourth Circuit and the government suggest that express attribution should not be required because, in this case, investors would naturally infer that a fund's prospectus bears the imprimatur of the fund's investment adviser. That reasoning has no application to outside professionals such as auditors. Unlike the reliance posited in this case, which is inferred on the theory that investors would perceive no meaningful difference between the speaker and the defendant, investors rely on an audit opinion for the very reason that auditors are impartial and independent from the company. When reliance is predicated on the speaker's independence from the company, reasonable investors cannot and should not merely assume that the company's statement bears the implied and unqualified imprimatur of its independent auditor.

This Court has emphasized the necessity of clear liability standards for securities violations. Standards that permit private suits against auditors only for statements made by and attributed to them will provide certainty and predictability. By contrast, the Fourth Circuit's standards will generate uncertainty and unpredictability. Such vague standards are especially problematic for auditors, who are often the

targets of meritless lawsuits under Section 10(b) merely because they are deep-pocketed defendants.

The aftermath of *Central Bank* vividly confirms the need for clear distinctions between primary violations and aiding and abetting. Securities plaintiffs and the SEC have persistently attempted to evade the holding of *Central Bank* by seeking to expand the definition of primary violations to encompass conduct that is, at most, aiding and abetting. This Court has already rejected the SEC's attempt to expand primary liability under the rubric of "scheme liability," and lower courts have rejected – and harshly criticized – the SEC's theories of primary liability for "using" false statements made by someone else, for making "implied" statements, and (as in this case) for "creating" statements that were actually made by and attributed to someone else. As those decisions have repeatedly emphasized, the liability standards proposed by the SEC would condemn conduct that is merely aiding and abetting, create uncertainty about the bounds of liability, and discourage desirable conduct by auditors and other outside professionals.

The proponents of expansive definitions of primary violations argue that broad liability standards are desirable as a policy matter in order to deter secondary actors from participating in fraudulent activities. Those policy considerations, however, cannot override the congressional judgments reflected in the statute, and overlook many other sanctions that deter outside professionals from aiding deception by their clients. Policy considerations in any event point in the opposite direction. If auditors face potential liability for statements that they have not made and that have not been attributed to them, the substantial cost of defending meritless securities claims will

deter them from providing services that are beneficial to corporations and investors, or prompt them to charge more for doing so. In addition, auditor liability for a statement made by the company but not expressly attributed to the auditor would encourage investors to rely on the incorrect assumption that an auditor must have endorsed *every* statement a company makes, merely because the auditor opines (after completing a rigorous audit) on the company's financial statements, taken as a whole. Investor interests would be best served by emphasizing, rather than obscuring, the difference between statements that have been made by an auditor and those that have not. The broad and nebulous liability standards that the government advocates would disserve the interests of the investing public.

ARGUMENT

In *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), this Court held that there is no implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b). Some lower courts had created such an implied right of action, but this Court held that liability for aiding and abetting was foreclosed by the "text and structure" of the statute. 511 U.S. at 188. That holding rested, in part, on the requirement that private plaintiffs must prove reliance on the defendant's misstatement or omission. If a defendant could be liable merely for aiding and abetting the misstatement or omission of another, "the defendant could be liable without any showing that the plaintiff relied upon *the aider and abettor's* statements or actions." *Id.* at 180 (emphasis added).

The decision in *Central Bank* was controversial in some quarters, and the SEC (among others) urged Congress to create a private cause of action for aiding and abetting. Congress refused. Instead, in Section 104 of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. No. 104-67, 109 Stat. 737, 757 (1995), it authorized the SEC to prosecute aiders and abettors, but deliberately refrained from extending liability in private actions to parties that did not themselves engage in a primary violation. See 15 U.S.C. § 78t(e). In light of that congressional action, this Court has refused to "revive in substance" liability against aiders and abettors, because doing so "would undermine Congress' determination that this class of defendants should be pursued by the SEC and not by private litigants." *Stoneridge Investment Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 162-163 (2008).

Congress revisited this issue in 2010. Senator Specter proposed legislation to extend liability in private cases to those who "knowingly provide substantial assistance" to violators of Section 10(b). See, *e.g.*, 156 Cong. Rec. S3618-S3619 (daily ed. May 12, 2010); 156 Cong. Rec. S3664-S3665, S3670 (daily ed. May 13, 2010). Again, Congress refused to do so. Instead, in the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress enhanced the SEC's enforcement powers, so that the SEC (but not private plaintiffs) could bring actions not only against those who "knowingly" provided substantial assistance, but also against those who "recklessly" did so. Pub. L. No. 111-203, § 929O, 124 Stat. 1376, 1862 (2010). The 2010 legislation thus reflected the same congressional determination manifested in the PSLRA – that

this class of defendants should be pursued by the SEC and not by private litigants.

Central Bank did not hold that secondary actors are always free from liability under Section 10(b). The opinion specifically noted that "a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator." 511 U.S. at 191. To establish liability, however, a private plaintiff must prove "*all* of the requirements for primary liability." *Ibid*. Those requirements include "a material misrepresentation or omission by the defendant" and the plaintiff's "reliance upon the misrepresentation or omission." *Stoneridge*, 552 U.S. at 157.

The liability standards adopted by the Fourth Circuit in this case, if applied to outside professionals such as auditors, are inconsistent with both of those requirements.

I. AUDIT FIRMS AND OTHER OUTSIDE PROFESSIONALS MAY COMMIT A PRIMARY VIOLATION ONLY THROUGH THEIR OWN STATEMENTS AND OMISSIONS, NOT THROUGH THE STATEMENTS AND OMISSIONS OF THEIR CLIENTS

The core holding of *Central Bank* – that private plaintiffs may not recover from defendants that aided and abetted a violation, but did not themselves commit a violation – requires liability standards that draw a clear distinction between a defendant's own statements and the statements of others. As the Second Circuit has explained, "if *Central Bank* is to have any real meaning, a defendant must actually make a

false or misleading statement in order to be held liable under Section 10(b). Anything 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)." *Shapiro* v. *Cantor*, 123 F.3d 717, 720 (2d Cir. 1997) (quotation marks and citation omitted).

The Fourth Circuit acknowledged that respondent's securities fraud claim requires proof of a material misrepresentation or omission "'*by* the defendant.'" *First Derivative Traders* v. *Janus Capital Group Inc. (In re Mutual Funds Inv. Litig.)*, 566 F.3d 111, 121 (4th Cir. 2009) (quoting *Stoneridge*, 552 U.S. at 157). It held, though, that this element had been sufficiently pleaded because the "essence of plaintiffs' complaint" is that petitioners "helped draft the misleading prospectuses" and, "by participating in the writing and dissemination of the prospectuses, *made* the misleading statements contained in the documents." *Ibid*. The government defends this standard. In its *amicus* brief urging that certiorari be denied, it asserts that primary liability may arise if a defendant "has participated to a sufficient degree in the drafting or dissemination of misleading statements" or if a defendant, "acting alone or with others, creates a misrepresentation." U.S. Inv. Br. 11.

This elastic definition of "making" a statement cannot be reconciled with *Central Bank*. Indeed, the definition is virtually indistinguishable from pre-*Central Bank* definitions of aiding and abetting. According to Judge Learned Hand's influential formulation, criminal aiding and abetting requires that the defendant must "in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his ac-

tion to make it succeed." *United States* v. *Peoni*, 100 F.2d 401, 402 (2d Cir. 1938).

Aiding-and-abetting violations of Section 10(b), as conceived by lower courts before *Central Bank*, involved "knowledge" of a primary violation and "substantial assistance" in achieving the primary violation. See Alan R. Bromberg & Lewis D. Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 ALB. L. REV. 637, 662 (1988). "Substantial assistance" could take many forms, including aiding in the preparation of misstatements or executing transactions on behalf of the principal. See, *e.g.*, *id.* at 701-739; *Cumis Ins. Society, Inc.* v. *E.F. Hutton & Co.*, 457 F. Supp. 1380, 1386 (S.D.N.Y. 1978). Indeed, the assistance element of aiding and abetting was described as requiring that the defendant "substantially participated in the wrongdoing." *Gilmore* v. *Berg*, 761 F. Supp. 358, 373 (D.N.J. 1991). To say, in the words the Fourth Circuit used in the present case, that the defendant "helped draft" and "participat[ed] in the writing and dissemination of the prospectuses" (566 F.3d at 121) is to say merely that the defendant aided and abetted.

By reviving in substance liability for aiding and abetting, the Fourth Circuit's endorsement of liability for "participating" in the "creation" of a statement – when the defendant does not actually make a statement of its own – would greatly expand the opportunities for private plaintiffs to bring meritless cases against auditors and other outside professionals, and would make it exceedingly difficult for such defendants to obtain dismissal of those cases before trial. Public companies are likely to seek advice from outside professionals on any difficult accounting or legal issue that may be material to the company's financial

condition, and class action plaintiffs are virtually certain to allege that, by providing such advice, the outside professionals "participated" in the drafting or dissemination of any statement the company made after receiving such advice.

In urging denial of certiorari, the government attempted to justify this liability standard by emphasizing the ways in which petitioner JCM, as an investment adviser, is "materially unlike outside service providers such as law firms and accounting firms." U.S. Inv. Br. 22 n.10. The government emphasizes that a mutual fund's investment adviser typically creates the fund (*id*. at 10), manages it (*id*. at 8, 9, 10, 12, 13, 16, 18), and controls it (*id*. at 9, 10, 12, 13, 16). An investment manager "typically exercises control over the fund that is at least equivalent to that exercised by internal management in other corporations" (*id*. at 16), and petitioner JCM "controlled the drafting and dissemination of the misleading prospectuses as one aspect of its general control over the Funds' affairs" (*id*. at 12). For those reasons, the government argues, cases involving outside professional advisers such as auditing firms have little bearing on this case. See *id*. at 8, 9, 12, 18, 19, 20, 21, 22 n.10.

Unfortunately, the liability standards endorsed by the government reach far beyond the narrow justification that is offered to support them. The government argues that "a defendant" – evidently *any* defendant – that has "participated" in the "drafting or dissemination" of misleading statements can be liable for a primary violation. U.S. Inv. Br. 11. The government offers its assurance that "not *every* form of assistance to an unlawful securities fraud will constitute a primary violation." *Id*. at 13. But the govern-

ment provides only one limiting principle to distinguish between primary liability and aiding and abetting. Primary liability, the government unhelpfully explains, arises only if the defendant has "participated *to a sufficient degree*." *Id.* at 11 (emphasis added).

Nebulous concepts such as "participating" to a "sufficient" degree in the "drafting" or "dissemination" of a statement provide no meaningful guidance to fact finders who must ultimately decide whether a violation has occurred. As a practical matter, making liability turn on such imprecise standards would make it exceedingly difficult for any outside professional to obtain dismissal of a securities complaint if the professional had even the most fleeting and tangential involvement in the allegedly misleading statement. Even if the government is correct that the defendant in this case controlled both the drafting of the statement and the fund's decision to issue the statement, the "participation" standard as articulated by the government and the Fourth Circuit contains no explicit limitation that would restrict its application to cases like this one. Without such limitations, the standard would expand liability far beyond the narrow circumstances presented here, and would encompass conduct that is, at most, aiding and abetting.

II. INVESTORS CANNOT REASONABLY RELY ON THE IMPLIED IMPRIMATUR OF AUDITORS AND OTHER OUTSIDE PROFESSIONALS BASED ON STATEMENTS THAT HAVE NOT BEEN EXPRESSLY ATTRIBUTED TO THOSE PROFESSIONALS

Central Bank, and the requirement that private plaintiffs must prove reasonable reliance on the defendant's misleading statement or omission, also require, by logical implication, that private plaintiffs suing outside professionals must prove not merely a statement *by* those professionals, but explicit public attribution of the statement *to* them. The Fourth Circuit acknowledged that plaintiffs could not establish reliance unless the misleading statements were attributed to the defendants. It held, however, that *actual* attribution was unnecessary, and that a plaintiff could sufficiently allege reliance by alleging facts from which a court, "on a case-by-case basis," could plausibly infer that "interested investors (and therefore the market at large) would attribute the allegedly misleading statement to the defendant." 566 F.3d at 124. Such allegations are sufficient, according to the Fourth Circuit, "even if the statement on its face is not directly attributed to the defendant." *Ibid*. The government agrees with the Fourth Circuit that such allegations are sufficient, but argues that they are not always necessary. According to the government, there is no "categorical requirement that the alleged false statement must have been attributed to the defendant when it was issued." U.S. Inv. Br. 15.

The Fourth Circuit's standard of imputed attribution makes no sense when applied to outside professionals such as auditors. Investors cannot reasonably rely on an independent professional's supposed imprimatur based on a public statement that is neither made by nor attributed to the independent professional. Without attribution of such a statement to an outside professional, investors have no way to know whether the outside professional has *in fact* endorsed the statement, what kind of assurance (if any) the professional intended to provide, what procedures (if any) the professional employed to form an opinion, or even whether the professional had the slightest knowledge of, or involvement in, the statement's substance or issuance. The Second and Eleventh Circuits have held that such attribution is required in private suits against outside professionals, and the First and Tenth Circuits have favorably discussed that requirement in *dicta*. *PIMCO* v. *Mayer Brown LLP*, 603 F.3d 144, 155 (2d Cir. 2010); *Ziemba* v. *Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001); *SEC* v. *Tambone*, 597 F.3d 436, 447 (1st Cir. 2010) (en banc); *SEC* v. *Wolfson*, 539 F.3d 1249, 1258-1260 (10th Cir. 2008).

The government's position with respect to attribution, like the Fourth Circuit's, also fails to account for the distinct roles of outside professional advisers. The government argues that attribution should not be required because, in *this* case, "[t]here is no reason to suppose that the investing public's willingness to rely on [the Fund's] statements would have depended on whether the public attributed those statements to JCM or solely to the Funds' own employees." U.S. Inv. Br. 16. Because an investment adviser typically manages and controls the fund, "investors would

naturally infer that statements in a fund's prospectus bear the imprimatur of the fund's manager." *Ibid.*

That rationale could not be more mistaken when applied to outside professionals like auditors. Auditors provide many services – for example, providing advice on the appropriate accounting treatment of business transactions, and providing opinions to non-audit clients – that typically do not result in public statements that are made by or attributed to the auditor. To the extent that public statements are made in connection with such matters, the statements are made by the corporate client or by its executives, who control the statements that are made by the corporation, and whose own words and conduct may be attributed to their corporation as a matter of law. Unlike those corporate insiders, auditors do not control the statements made by a corporation or its executives, and typically do not speak on their behalf. It is precisely because audit reports are publicly attributed to their authors (rather than the company), and because those authors are *independent* of their clients, that investors choose to rely on the representations made. As the government itself recognizes, investors "'are more likely to credit the accuracy of' an issuer's statements when those statements have been given the 'imprimatur' of a 'supposedly impartial assessment' by 'a well-known national law or accounting firm.'" U.S. Inv. Br. 20 (quoting *PIMCO*, 603 F.3d at 156).

When it is the fact of the defendant's independence from a company that induces investor reliance, a statement by the company that has not been expressly attributed to the defendant provides no basis for reliance. Attributing an unspoken imprimatur to an independent auditor is inherently unreasonable.

See *PIMCO*, 603 F.3d at 156 ("Without explicit attribution * * * reliance on that firm's participation can only be shown through 'an indirect chain * * * too remote for liability.'") (quoting *Stoneridge*, 552 U.S. at 159). Auditors are – and should be – responsible for their own statements. If a statement has not been expressly attributed to an auditor, however, investors cannot reasonably rely on an assumption that the statement has been approved or endorsed by the auditor.

The government opposes an express-attribution rule in this particular case because it views the fund, in essence, as the alter ego of its investment adviser. But the government apparently would eschew an express-attribution requirement even in those cases where reliance is predicated not on the theory that the defendant and the issuer are one and the same, but on the theory that the defendant is an impartial and independent entity deserving credence for that very reason. The Fourth Circuit, too, emphasized JCM's control over the fund that issued the misleading prospectus in holding that express attribution is unnecessary, but its liability standard draws no distinction between corporate insiders and professional advisers whose very independence is the foundation of investor reliance. Indeed, the Fourth Circuit's discussion of attribution relies largely on cases against auditors and other outside professionals. For such defendants, there can be no reasonable reliance in the absence of express attribution.

III. CLEAR LIABILITY STANDARDS ARE ESSENTIAL TO PROTECT OUTSIDE PROFESSIONALS AGAINST UNWARRANTED, BUT PERSISTENT, EFFORTS TO EXPAND THE SCOPE OF PRIMARY LIABILITY

This Court has emphasized that the scope of liability of Section 10(b) "demands certainty and predictability." *Pinter* v. *Dahl*, 486 U.S. 622, 652 (1988). "'[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.'" *Central Bank*, 511 U.S. at 188 (quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 755 (1975)).

Certainty and predictability are provided by straightforward rules that outside professionals cannot be liable for damages in private securities cases unless they actually make a misleading statement or omission themselves, and that investors cannot reasonably rely on an implied imprimatur of outside professionals if no public statement has been expressly attributed to them. When auditors issue an audit report, they state precisely which of the company's statements they are opining on, the level of assurance that the opinion provides, and the limitations of that opinion. In contrast, a standard that subjects outside professionals to liability for "participating" to a "sufficient" degree in formulating a misleading statement that is actually made by someone else, or one that requires courts to speculate on a case by case basis whether "interested investors" relied upon the im-

plied imprimatur of independent professionals, even though no misleading statement or omission has been attributed to those professionals, guarantees *un*certainty and *un*predictability. If the latter standards require something more than aiding and abetting, the government and the Fourth Circuit are extraordinarily vague about what that might be.

Clear liability rules are especially important for auditors because auditors are frequently targeted as defendants in securities class actions for reasons unrelated to the merits of those cases. Auditing firms provide "deep pocket" targets for investors trying to recoup their losses. The company that actually made the deceptive statement is often bankrupt or otherwise unable to afford a substantial settlement payment, making it a less attractive target for class action plaintiffs and their counsel. Therefore, even if the auditor played only a secondary role – reviewing (but not auditing and opining on) allegedly misleading financial statements, or merely answering an accounting question in a brief telephone call – the auditor may be the prime target of class action plaintiffs.

The need for clear liability standards is also reinforced by the aftermath of this Court's decision in *Central Bank*. That decision should have confirmed beyond any doubt that secondary actors cannot be sued by private plaintiffs because of statements that were neither made by nor attributed to the defendants. Instead, the class action bar and other proponents of secondary liability, including the SEC, responded by putting old wine into new bottles, persistently urging the lower courts to impose liability for conduct that is aiding and abetting (at most) by redefining the scope of primary liability to encompass such conduct.

For example, in *Simpson* v. *AOL Time Warner Inc.*, 452 F.3d 1040 (9th Cir. 2006), plaintiffs alleged that defendants had entered into sham business transactions with Homestore, in order to create the illusion of revenue. As *amicus curiae*, the SEC supported the theory that Homestore's business partners were primary violators of Section 10(b), because they had entered into a "scheme to defraud" investors. See Brief for SEC as *Amicus Curiae*, *Simpson* v. *Homestore.com, Inc.*, No. 04-55665, 2004 WL 5469571 (9th Cir. Oct. 2004). The Ninth Circuit adopted the SEC's position. *Simpson*, 452 F.3d at 1048.

This Court then granted certiorari in *Stoneridge*, a case presenting the same issue as *Simpson*, and, just as it had in *Central Bank*, rejected the concept of broad liability for secondary actors.[2] *Stoneridge* rejected the theory that defendants who allegedly enabled an issuer's misleading statements – but who did not themselves actually make any public statement – are primary violators. "Were we to adopt [the suggested] construction of § 10(b), it would revive in substance the implied cause of action against all aiders and abettors except those who committed no deceptive act in the process of facilitating the fraud." 552 U.S. at 162-163. That result, this Court concluded, would be inconsistent with the congressional decision that only the SEC may bring an action against aiders and abettors (*id.* at 163), and would

[2] In this Court, the Solicitor General stated that the SEC's *amicus* brief in *Simpson* was "inconsistent with *Central Bank*" and "does not reflect the views of the United States." Brief for the United States as *Amicus Curiae*, *Stoneridge Investment Partners, LLC* v. *Scientific-Atlanta, Inc.*, No. 06-43, 2007 WL 2329639, at *23 n.13 (August 15, 2007).

allow plaintiffs with weak claims to extort settlements from innocent companies (*ibid.*).

In *Tambone*, the SEC advanced a different theory for expanding the scope of primary liability. It argued that liability could arise from a defendant's "use" of a false statement to sell securities, even if the statement was crafted entirely by someone else, or from the defendant's "implied" statement of belief that representations in a prospectus are truthful and complete. 597 F.3d at 442. The First Circuit, *en banc*, emphatically rejected that theory. It described the theory as an attempt "to impose primary liability on the defendants for conduct that constitutes, at most, aiding and abetting." *Id.* at 446.

Judge Boudin's concurring opinion was more blunt. The SEC's position was "alarmingly ambitious." 597 F.3d at 450. It had "no obvious stopping point: virtually anyone involved in the underwriting process might under the SEC's 'making a statement' theory be charged and subject to liability in a suit under section 10(b)." *Id.* at 452. "The argument against so sweeping a position begins with [the] language [of Rule 10b-5], but it does not end there: congressional policy, Supreme Court precedent, practical consequences and the nearly uniform view of circuit courts that have spoken all argue against the SEC's proposed interpretation." *Id.* at 451. "No one sophisticated about markets believes that multiplying liability is free of cost. And the cost, initially borne by those who raise capital or provide audit or other services to companies, gets passed along to the public." *Id.* at 452-453.

In *PIMCO*, the SEC tried again to expand the scope of primary liability, notwithstanding *Central*

Bank. The Second Circuit's previous decisions in *Wright* and *Lattanzio* required both (1) that a defendant make an *actual* statement, *and* (2) that the statement be attributed to the defendant. *Wright* v. *Ernst & Young LLP*, 152 F.3d 169, 174 (2d Cir. 1998); *Lattanzio* v. *Deloitte & Touche LLP*, 476 F.3d 147, 153 (2d Cir. 2007). Disregarding that circuit precedent, the SEC argued that a defendant commits a primary violation "'if he provides the false or misleading information that another person then puts into the statement'" – even if the defendant himself made no statement at all, and even if the false or misleading statement is never attributed to him. 603 F.3d at 151 (quoting Brief for SEC as *Amicus Curiae* at 7).

The Second Circuit rejected that "creator" standard, for reasons that are by now familiar. "A creator standard establishes no clear boundary between primary violators and aiders and abettors, and it is uncertain what level of involvement might expose an individual to liability." 603 F.3d at 157. The creator standard would lead to "protracted litigation and discovery aimed at learning the identity of each person or entity that had some connection, however tenuous, to the creation of an allegedly false statement." *Ibid*. And it "would inevitably lead to uncertainty regarding the scope of Rule 10b-5 liability and potentially deter beneficial conduct." *Ibid*. The Second Circuit therefore reaffirmed that secondary actors such as auditors "cannot incur primary liability * * * for a statement not attributed to that actor at the time of

its dissemination." *Id.* at 158 (quoting *Wright*, 152 F.3d at 175).[3]

Given this history, and class action plaintiffs' continuing efforts to recover their investment losses from outside professionals, even when no misleading statement or omission was made by or attributed to those professionals, this Court should state clearly that such professionals can be sued for primary violations only for their own statements, and that investors' claims of reliance may not rest merely on the assumption that outside professionals have given some implied and undefined imprimatur to statements that have not been expressly attributed to them.

IV. EXPANDING THE SCOPE OF PRIMARY LIABILITY FOR OUTSIDE PROFESSIONALS WILL BE HARMFUL TO INVESTORS

The principle that outside professionals may incur private liability only for a material misstatement or omission that is made by and attributed to them is opposed by some (including the SEC) on policy grounds, for the same reason they have advocated private liability for aiding and abetting. They argue that a more expansive definition of primary violations "deters secondary actors from contributing to fraudulent activities and ensures that defrauded plaintiffs are made whole." *Central Bank*, 511 U.S. at 188. The CAQ shares those goals, but worthy goals do not ensure sound liability standards. In the CAQ's view, the policy arguments advanced by the proponents of

[3] The Second Circuit explicitly refrained from deciding whether attribution is required for claims against corporate insiders. 603 F.3d at 158 n.6.

broader liability for secondary actors are misguided for multiple reasons.

First, of course, "[p]olicy considerations cannot override" the congressional judgment that is reflected in the "text and structure" of the statute, including the congressional determination that only the SEC, but not private plaintiffs, may sue aiders and abettors. *Central Bank*, 511 U.S. at 188.

Second, there are ample means, wholly apart from private suits under Section 10(b), to deter outside professionals from helping their clients engage in deceptive activities and to punish them if they do. In *Stoneridge*, 552 U.S. at 166, this Court identified some of those potential sanctions:

> Secondary actors are subject to criminal penalties, see, *e.g.*, 15 U.S.C. § 78ff, and civil enforcement by the SEC, see, *e.g.*, § 78t(e). * * * In addition some state securities laws permit state authorities to seek fines and restitution from aiders and abettors. * * * The securities statutes provide an express private right of action against accountants and underwriters in certain circumstances, see, 15 U.S.C. § 77k.

In addition, the PCAOB and fifty state boards of accountancy exercise ongoing oversight of auditors.

Third, liability untethered from any requirement that the auditor actually must make a statement, and that the statement must be attributed to the auditor, would be unfair to auditors and, ultimately, harmful to investors.

A regime that leaves auditors at risk of massive liability for statements made by their clients will inevitably influence the ability and the willingness of

auditors to provide services that are beneficial to companies and their shareholders. In the years immediately preceding passage of the PSLRA, rampant class action litigation made accounting firms increasingly unwilling to perform audits for clients perceived as risky, such as companies in financial distress, smaller or less-well-established companies (including startups), and companies operating in volatile industries. See Frederick L. Jones & K. Raghunandan, *Client Risk and Recent Changes in the Market for Audit Services*, 17 J. ACCT. & PUB. POL'Y 169, 179 (1998). Even when audit firms are willing to provide such services, the costs of securities litigation may be passed on to their clients, and indirectly to their clients' investors. See Jamie Pratt & James Stice, *The Effect of Client Characteristics on Auditor Litigation Risk Judgments, Required Audit Evidence, and Recommended Fees*, 69 ACCT. REV. 639, 655 (1994). This Court described those adverse effects of expansive liability rules in *Central Bank*. See 511 U.S. at 189. It did so again in *Stoneridge*. 552 U.S. at 163-164.

Investor interests are served by clear attribution rules for other reasons, as well. Investors whose valuation of securities may be influenced by the opinions of an independent auditor should understand that they rely at their peril on the mere *assumption* that "statements" have the implied imprimatur of an auditor, if no statement has been expressly attributed to the auditor. Courts should not lend credence to *incorrect* investor assumptions that an auditor must have endorsed *every* statement a company makes, merely because the auditor (after completion of a rigorous audit) opines on the company's annual financial statements, taken as a whole.

Expansive liability for auditors, based on misleading statements made by others and lacking any attribution to or endorsement by the auditor, would not promote the cause of more reliable financial reporting and would not serve the interests of investors. Auditors can and do make their own statements, and stand behind them. Those statements are explicit, precise, and appropriately qualified. Auditors should not be liable for statements they have not made, based on judicial inferences that "interested investors" would attribute to the auditor an undefined and unqualified imprimatur for someone else's statement. Investors are best served by bright-line standards that will emphasize, rather than obscure, the difference between those statements that *have*, and those statements that *have not*, been made by an auditor.

CONCLUSION

The Court should make clear that, to commit a violation of Section 10(b), secondary actors such as auditors must actually make a statement, and the statement must be attributed to them.

Respectfully submitted.

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