No. 07–1384

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff–Appellant,

v.

JAMES TAMBONE; ROBERT HUSSEY,

Defendants–Appellees.

On Appeal from the United States District Court
for the District of Massachusetts

BRIEF FOR SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS AMICUS CURIAE SUPPORTING APPELLEES

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CORPORATE DISCLOSURE STATEMENT

The Securities Industry and Financial Markets Association (SIFMA) is a trade association that brings together the shared interests of more than 600 securities firms, banks, and asset managers. SIFMA has no parent corporation, and no publicly held corporation holds 10% or more of its stock.

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INTEREST OF *AMICUS CURIAE*

SIFMA brings together the shared interests of more than 600 securities firms, banks, and asset managers locally and globally through offices in New York, Washington, D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA's mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets, and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring, and upholding the public's trust in the industry and the markets. More information about SIFMA is available at http://www.sifma.org.

SIFMA submits this brief in response to the Court's July 22, 2009 order inviting amici to address the Rule 10b–5(b) issues. Because the SEC seeks an atextual expansion of Rule 10b–5(b), inconsistent with the Supreme Court's repeated warnings not to stray from the text when imposing liability under the securities laws, SIFMA supports an affirmance of the district court's dismissal of the SEC's claims of

primary liability under Rule 10b–5(b). All parties have consented to the filing of this brief.

SUMMARY OF ARGUMENT

In this enforcement action, the SEC seeks to impose primary liability under Rule 10b–5(b) on individuals who did not themselves make a false or misleading statement. Despite the amount of ink spilt on the issue, the question presented is straightforward: Do the SEC's general allegations that Tambone and Hussey "used" false or misleading prospectuses to sell securities by "allowing" the dissemination of those prospectuses suffice to show that they "made" a statement supporting primary liability under Rule 10b–5(b)? Under the plain language of Rule 10b–5(b) and controlling Supreme Court precedent, the answer is equally straightforward: Absent an actual false or misleading statement by the defendant, there can be no primary liability under Rule 10b–5(b).

The SEC concedes—as it must—that Tambone and Hussey did not "literal[ly]" make any false or misleading statements, SEC Opening Br. 31, but attempts to avoid the obvious implication of that concession by arguing that Tambone and Hussey either made *implied* statements or adopted the *issuer's* statements in the prospectuses. Both theories conflict with the text of Rule 10b–5(b), the Supreme Court's repeated

admonition that courts must not expand the § 10(b) right of action, and the established rule that silence is not actionable absent a duty to disclose arising from a relationship of trust or confidence. And neither theory cures the fundamental defect in the SEC's complaint: its failure to allege at all—much less with the particularity required by Rule 9(b)—that Tambone or Hussey made a false or misleading statement. The *en banc* Court should affirm the district court's dismissal of the SEC's claims of primary liability under Rule 10b–5(b).

ARGUMENT

THE SEC FAILED TO STATE A CLAIM OF PRIMARY LIABILITY UNDER RULE 10b–5(b).

A. Tambone and Hussey Did Not Make a "Statement" Within the Meaning of Rule 10b–5(b)

Because the SEC has not pursued claims under Rule 10b–5(a) or (c) on appeal, *see* SEC Reply Br. 8 n.3, primary liability in this case turns solely on whether it adequately alleged a cause of action under Rule 10b–5(b). To state a claim of primary liability under Rule 10b–5(b), the SEC must allege that Tambone and Hussey "*ma[d]e* a[n] untrue statement of a material fact" or "omit[ted] to state a material fact necessary in order to make the statements *made*, in the light of the circumstances under which they were made, not misleading." 17 C.F.R.

§ 240.10b–5(b) (emphasis added). In other words, the SEC must show, among the other elements of a claim, that Tambone and Hussey themselves each made a false statement or a statement that was misleadingly incomplete. Either way, the SEC must at a bare minimum allege that Tambone and Hussey made a statement. *See Morrison v. Nat'l Australia Bank Ltd.*, 547 F.3d 167, 176 (2d Cir. 2008) ("Liability under Rule 10b–5(b) requires a false or misleading statement."), *petition for cert. filed*, 77 U.S.L.W. 3562 (Mar. 23, 2009) (No. 08-1191); *Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 384 n.20 (5th Cir. 2007), *cert denied*, 128 S. Ct. 1120 (2008); *Smith v. Ayres*, 845 F.2d 1360, 1363 (5th Cir. 1988) (a Rule 10b–5(b) "claim always rests upon an affirmative statement of some sort").

The SEC's complaint fails to satisfy this most basic requirement. Nowhere does the SEC allege that Tambone or Hussey made a false or misleading statement. Instead, it asserts that Tambone and Hussey "used" false or misleading prospectuses to sell securities. But to "use" a prospectus is not to "make" a statement. *See, e.g., Webster's Third New International Dictionary* 1363 (1993) ("make" means to "cause to exist,

occur, or appear," or "CREATE [or] CAUSE"). Even the SEC concedes that Tambone and Hussey did not make a statement "'in a literal sense.'" SEC Opening Br. 31 (quoting *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 370 (2d Cir. 1973)); SEC Reply Br. 10 (same). Indeed, throughout its briefs on appeal, the SEC contends that Tambone and Hussey "made" a statement only when it is asserting a bald legal conclusion; when describing defendants' *actual conduct*, the SEC uses some other, more natural formulation, such as that they "used" the prospectuses to sell securities or sold securities "by means of" the prospectuses. *See Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) ("Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice.").

The SEC's concession that Tambone and Hussey did not literally make a statement should end the matter. As the Supreme Court has instructed, non-technical words in the securities laws must be given their ordinary meaning. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 n.19 (1976). The Supreme Court has repeatedly stressed that courts should not extend liability beyond the text of § 10(b) and Rule 10b–5. *See, e.g., Central Bank of Denver, N.A. v. First Interstate Bank*

of Denver, N.A., 511 U.S. 164, 173 (1994) ("the text of the statute controls"). Adhering to the legal text helps maintain the "'certainty and predictability'" that is critical in the securities industry. *Id.* at 188. "[U]ncertainty [in] the governing rules" could prompt companies, "as a business judgment, to abandon substantial defenses and to pay settlements in order to avoid the expense and risk of going to trial." *Id.* at 189.

Disregarding this "settled methodology" of being faithful to the text, *id.* at 177, the SEC argues that Tambone and Hussey should be deemed to have made a statement even though they did not actually make one. The SEC advances two theories in an attempt to transform Tambone and Hussey's alleged use of the prospectuses into a statement subject to Rule 10b–5(b), thus vastly expanding the scope of primary liability thereunder. First, the SEC argues that by using the prospectuses to sell securities, Tambone and Hussey made an implied statement that they had a reasonable basis to believe that the prospectuses were accurate and complete. Second, the SEC argues that Tambone and Hussey adopted the statements made by the issuer in the prospectuses. Neither theory has merit.

B. The SEC's Implied Statement Theory Should Be Rejected

As explained in SIFMA's Brief in Support of Rehearing En Banc, the SEC's implied-statement theory is unfounded, unprecedented, unworkable, and unnecessary. SIFMA En Banc Br. 4-23. The implied-statement theory conflicts with the text of both § 10(b) and Rule 10b–5(b); ignores the Supreme Court's repeated call for judicial restraint in this area; expands the private right of action by creating a duty to disclose absent a relationship of trust or confidence; collapses the critical distinction between primary and secondary liability; and creates uncertainty that private plaintiffs will exploit by bringing costly nuisance suits of the kind that Congress and the Supreme Court have taken pains to eliminate—all without adding appreciably to the SEC's already well-stocked arsenal for pursuing the kind of misconduct alleged in this case.

In response, the SEC makes five arguments, none of which has merit. First, the SEC asserts that it stated a claim of primary liability under § 10(b) because Tambone and Hussey engaged in deceptive conduct. SEC En Banc Reply Br. 3–4. The SEC relies on the Supreme Court's observation in *Stoneridge Inv. Partners, LLC v. Scientific-*

Atlanta, Inc., that a "specific oral or written statement" is not necessary for liability under Rule 10b–5 because "[c]onduct itself can be deceptive." 128 S. Ct. 761, 769 (2008). But *Stoneridge* did not say that deceptive conduct alone qualifies as a statement under Rule 10b–5(b); indeed, there was no claim under Rule 10b–5(b) at issue in *Stoneridge*. As the SEC itself acknowledged earlier in this case, the question in *Stoneridge* was whether "non-verbal deceptive conduct is covered by [subsection (a) and (c) of Rule 10b–5]," not whether such conduct constitutes a statement under subsection (b)—the only subsection at issue here. SEC Reply Br. 8 n.3. *Stoneridge* thus provides no support for the proposition that deceptive conduct is actionable under Rule 10b–5(b) absent a false or misleading statement by the defendant.[1]

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[1] Subsections (a) and (c) reach certain types of manipulative or deceptive conduct, including market manipulation and, in certain cases, insider trading. *See* 17 C.F.R. § 240.10b–5(a) (making it unlawful "[t]o employ any device, scheme, or artifice to defraud"); *id.* § 240.10b–5(c) (prohibiting any fraudulent or deceitful "act, practice, or course of business"). They have also long been held to reach omissions when a duty to disclose exists. Subsection (b), by contrast, prohibits *only* false or misleading *statements*. If anything, the distinctions among the subsections shows that the Rule was intended to be precise with each formulation and establish different standards and predicates under each subsection. Because only subsection (b) is at issue here, the Court need not decide whether Tambone and Hussey engaged in deceptive conduct actionable under subsection (a) or (c).

Second, the SEC invokes the so-called "shingle theory," under which certain courts have held that broker-dealers may violate § 10(b) if they charge customers excessive markups without proper disclosure. SEC En Banc Reply Br. 6–7. Neither the Supreme Court nor this Court has ever endorsed the shingle theory as a legitimate basis for § 10(b) liability. To the extent that the shingle theory purports to impose primary liability under Rule 10b–5(b) based on judicially implied as opposed to actual statements, it suffers from the same defects as the SEC's theories here and should be rejected for the same reasons.

The Court need not, however, decide whether the shingle theory is an appropriate basis for § 10(b) liability, because it provides no support for the SEC's position here. The shingle theory is based on a retail relationship between broker-dealers and their customers that may, in certain circumstances, carry a sufficient degree of trust and confidence to justify an "implied duty to disclose." *Grandon v. Merrill Lynch & Co.*, 147 F.3d 184, 192 (2d Cir. 1998).[2] No such relationship exists between

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[2] *See also United States v. Szur*, 289 F.3d 200, 211 (2d Cir. 2002) ("[A] relationship of trust and confidence does exist between a broker and a customer with respect to those matters that have been entrusted to the broker."); *Charles Hughes & Co. v. SEC*, 139 F.2d 434, 437 (2d Cir. 1943); *Duker & Duker*, 6 S.E.C. 386 (1939), *available at* 1939 WL 36426,

executives of an underwriting firm and mutual-fund investors, nor has the SEC even attempted to show one. *See* SIFMA En Banc Br. 12–16. Absent a relationship of trust and confidence, there is no duty to speak and hence no liability for failure to disclose. *See Chiarella v. United States*, 445 U.S. 222, 228 (1980) ("[T]he duty to disclose arises when one party has information that the other party is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.") (internal quotations & alterations omitted); *Cent. Bank*, 511 U.S. at 180 (nondisclosure "actionable only where duty to disclose arises from specific relationship between two parties").

Third, the SEC argues that courts have "found implied representations in other contexts as well." SEC En Banc Reply Br. 7. None of the authorities the SEC cites (at SEC En Banc Reply Br. 8) imposes primary liability under Rule 10b–5(b) without a false or misleading statement by the defendant. For example, the SEC quotes

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*3. Even courts that accept the shingle theory have cautioned—consistent with the common law approach to such duties—that any duties imposed thereunder are specific to the particular facts of a relationship or transaction. *See, e.g., Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 535–37 (2d Cir. 1999). The scope of a broker-dealer's potential obligations under the shingle theory is likewise not at issue here.

the D.C. Circuit's statement in *Weiss v. SEC*, 468 F.3d 849 (D.C. Cir. 2006), that "a statement of opinion includes an implied representation that the speaker rendered the opinion in good faith and with a reasonable basis." *Id.* at 855. Similarly, the SEC relies on the Supreme Court's statement in *Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*, 532 U.S. 588 (2001), that entering into a contract while secretly intending not to perform is misleading because "'a promise necessarily carries with it the implied assertion of an intention to perform.'" *Id.* at 596 (internal quotation marks omitted). But neither *Weiss* nor *Wharf* supports the SEC's position because both cases involved express statements. To say that an affirmative statement (such as the statement of opinion in *Weiss* or the promise to perform in *Wharf*) carries with it an implied representation that the statement is not misleading is both unremarkable and a far cry from what the SEC proposes here—to impose liability under Rule 10b–5(b) without any statement at all.

Fourth, the SEC argues that its implied-statement theory is consistent with "the well established common law principle that an implied representation may give rise to liability for misrepresentation."

SEC En Banc Reply Br. 5; *see also id.* at 8–9. But the SEC cites no authority for the proposition that § 10(b) as a whole, or Rule 10b–5(b) in particular, codifies common-law fraud or any other basis for such implied liabilities. Indeed, the Supreme Court has flatly rejected that argument: "Section 10(b) does not incorporate common-law fraud into federal law." *Stoneridge*, 128 S. Ct. at 771. In *Central Bank*, for example, the Court refused to imply a private right of action for aiding and abetting that had no basis in the statute's text, notwithstanding the "deeply rooted background of aiding and abetting tort liability." 511 U.S. at 184. Likewise here, the SEC's resort to the common law only underscores its failure to come to grips with the text of Rule 10b–5(b).[3]

Finally, the SEC argues that even if Tambone and Hussey did not make any implied statements, they nonetheless had a "duty to correct" any misleading statements in the prospectuses. SEC En Banc Reply Br. 12. The only authority the SEC cites for that proposition is the Second Circuit's decision in *SEC v. Manor Nursing Centers, Inc.*, 458

[3] For the same reason, the SEC's reliance on the Seventh Circuit's decision in *Midwest Commerce Banking Co. v. Elkhart City Centre*, 4 F.3d 521 (7th Cir. 1993), is misplaced. That case was a "common law fraud action," *id.* at 523, not an action under § 10(b).

F.2d 1082, 1097 (2d Cir. 1972)—a case that long preceded both *Chiarella*'s holding that there is no duty to disclose absent a relationship of trust or confidence and *Central Bank*'s holding that § 10(b) does not provide a cause of action for aiding and abetting. The SEC also neglects to mention the Second Circuit's subsequent holding that a duty to correct applies only to the defendant's own statements. *See Overton v. Todman & Co.*, 478 F.3d 479, 486–88 (2d Cir. 2007). Acting as if these landmark decisions never happened, the SEC attempts to create a new category of § 10(b) liability. But this newfangled "duty-to-correct" doctrine is functionally indistinguishable from the duty-to-disclose doctrine; the only difference is that it lacks the limitations the Supreme Court has imposed to preserve the distinction between primary and secondary liability. The Court should reject the SEC's proposed end-run around the duty-to-disclose doctrine.

C. The SEC's Adopted Statement Theory Should Be Rejected

In the alternative, the SEC argues that even if Tambone and Hussey did not make any statements themselves, they should still be held primarily liable under Rule 10b–5(b) because they adopted the statements in the prospectuses and thereby made those statements

their own. Like the implied-statement theory, however, this "adopted-statement" theory is simply another countertextual, counterintuitive attempt to say that Tambone and Hussey made a statement when in fact they did not, and would vastly expand Rule 10b-5(b) far beyond its express language. Regardless of the label the SEC puts on its theory, a defendant who does not personally make an actual statement is not primarily liable under Rule 10b–5(b). The Supreme Court repeatedly has required fidelity to the text in securities cases and stressed the need to maintain "certainty and predictability" in the industry. *See, e.g.*, *Central Bank*, 511 U.S. at 188; *Stoneridge*, 128 S. Ct. at 772. This Court should therefore reject the SEC's attempt to effectuate an expansion in liability through the agency's *ad hoc* enforcement powers.

Moreover, even if a defendant who did not personally make a statement could be deemed to have made one by adoption, the SEC failed to plead any specific conduct showing that Tambone and Hussey adopted the market-timing statements in the prospectuses. Under Federal Rule of Civil Procedure 9(b), "[i]n alleging fraud . . . a party must state with particularity the circumstances constituting fraud . . ." Fed. R. Civ. P. 9(b) (2007). To satisfy this requirement, the SEC must

plead the "time, place, and content of the alleged misrepresentation with specificity." *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 193 (1st Cir. 1999). "This circuit has been notably strict and rigorous in applying the Rule 9(b) standard in securities fraud actions." *Id.*

The SEC's complaint does not come close to satisfying Rule 9(b)'s particularity requirement. It does not allege that Tambone or Hussey made any specific statements regarding the market-timing language in any particular prospectus, much less specify "when and in what context such statements were made." *Rodriguez-Ortiz v. Margo Caribe, Inc.*, 490 F.3d 92, 99 (1st Cir. 2007). Nor does the complaint allege any specific acts that Tambone or Hussey committed to adopt the market-timing statements or the times or places where any such acts were committed. Instead, it makes only generalized allegations regarding Tambone's and Hussey's roles in "allowing" distribution of the prospectuses. *See, e.g.*, Compl. ¶ 3 (alleging that Tambone and Hussey "were responsible for and directed the firm's efforts to sell the Columbia funds to investors" and "*allowed* Columbia Distributors to disseminate prospectuses") (emphasis added); *id.* ¶ 9 (alleging that Tambone and Hussey "used" the prospectuses "by *allowing* them to be disseminated

and by referring clients and potential clients to them for information on the funds") (emphasis added); *id.* ¶ 11 (alleging that Tambone and Hussey "assisted in the issuance of the misleading prospectuses by *allowing* them to be disseminated, by referring investors to the prospectuses in connection with their sales efforts, and by failing to correct the statements within the prospectuses") (emphasis added). Such "general allegation[s]" fall "far short of the requirement to specify the 'time, place, and content' of the alleged misrepresentations or misleading omissions." *Rodriguez-Ortiz*, 490 F.3d at 99. Accepting the SEC's allegations in this case as sufficient to plead a primary violation of Rule 10b–5(b) would adopt the implied-statement theory under a different name.

CONCLUSION

For the reasons set forth above and in SIFMA's amicus brief supporting rehearing *en banc*, the Court should reject the SEC's implied-statement and adopted-statement theories and affirm the dismissal of the SEC's claims for primary liability under Rule 10b–5(b).

Respectfully submitted,

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I hereby certify that on this 4th day of September, 2009, I caused two copies of the brief of the Securities Industry and Financial Markets Association As Amicus Curiae Supporting Appellees to be served on counsel for the parties and other amici who have previously appeared, by overnight courier for next day delivery, as follows; and delivered the requisite copies of such brief to the clerk by overnight courier:

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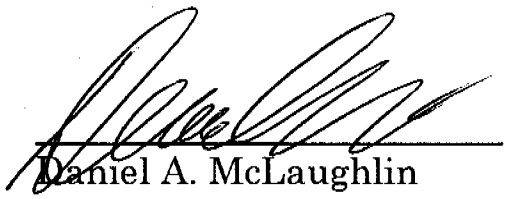

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