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Second Circuit Affirms Bright Line Attribution Test for Secondary Actor Liability in Private Securities Fraud Actions

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In *Pacific Investment Management Co.,* the Second Circuit embraced a "bright line" test for Rule 10b-5 liability for secondary actors in private securities actions. The Court held that "those who sign or otherwise allow a [false] statement to be attributed to them expose themselves to liability. Those who do not are beyond the reach of Rule 10b-5's private right of action."[1] In so doing, the Court reaffirmed the distinction between primary liability and mere aiding and abetting or secondary liability, which "no matter how substantial that aid may be, is not enough to trigger liability."[2] While "secondary actors" typically include lawyers and accountants who assist in preparing public statements, they also can include other entities and individuals not employed by the public company who are involved in the public company's activities. A concurring opinion stressed the importance of the attribution issue, noted a split of authority and the lack of clarity in other Second Circuit precedent, and suggested that further clarification through *en banc* or Supreme Court consideration was needed.

In *Pacific Investment,* Refco shareholders brought a federal securities class action against a major law firm and its former partner for their alleged role in the Refco demise. In July 2009, the former partner was convicted of securities fraud, wire fraud, and conspiracy in connection with his legal work for Refco, and was sentenced to 7 years in prison. The plaintiffs in the class action alleged that, in their role as primary outside counsel to Refco, the law firm and its former partner violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 by facilitating 17 fraudulent transactions between Refco and third parties to conceal the company's uncollectible debt, and by drafting portions of Refco's prospectus containing false statements. The plaintiffs further alleged that the partner and other attorneys knew that the statements they helped to draft and disseminate were false. The district court dismissed, noting that even if the defendants had "created" false statements that Refco's investors relied upon, none of those statements were expressly attributed to the law firm or the partner.

The Second Circuit affirmed the dismissal. By embracing a "bright line" attribution rule, the Court specifically rejected the SEC's position, urged in an *amicus curiae* brief, that the Court adopt a "creator" standard, under which a defendant is liable for "creating" a false statement, regardless of whether it is expressly attributed to the defendant. In repudiating the SEC's "creator" standard, the Court reasoned that a requirement of express attribution was more consistent with Supreme Court guidance on secondary actor liability.

The Court also examined the Supreme Court's 2008 decision in *Stoneridge Investment Partners*[3] and that decision's central proposition that reliance is "the critical element in private actions under Rule 10b-5." Under *Stoneridge,* a plaintiff must rely on a secondary actor's *own* deceptive conduct. Thus, the Second Circuit held that a plaintiff must rely on a secondary actor's *own* deceptive statements – and not statements disseminated by others. The Court concluded that a bright line attribution requirement is more likely to promote certainty in regulating capital markets and reducing unnecessary litigation. The Court further held that the plaintiffs' "scheme" claims – that defendants participated in a scheme to defraud investors – should also be dismissed under *Stoneridge*.

Significantly, the Court expressly left open the question of whether corporate insiders may be held liable without having statements specifically attributed to them personally. It noted, however, that investors might well reasonably rely on the role those insiders play in issuing public statements - sending a message about the way it might decide that question if confronted with it in the future.

In a separate concurring opinion, Judge Barrington Parker noted the anomalous result of the announced bright line rule, in that it ultimately shields the partner and his law firm from damages, even though the lawyer was responsible for the misleading statements and was criminally convicted for his role. In a sign that the Court's decision may not be the final word on the matter, Judge Parker wrote, "In light of the importance . . . of an attribution requirement to the securities laws, the bar, and the securities industry, this case could provide our full Court, as well as, perhaps, the Supreme Court, with an opportunity" to revisit the issue.[4]

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[1] *Pacific Investment Management Company,* Slip Opinion, at 18.

[2] *Pacific Investment Management Company,* Slip Opinion, at 11.

[3] 552 U.S. 148 (2008).

[4] *Pacific Investment Management Company,* concurring opinion, at 2.