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Second Circuit Affirms Dismissal Of Securities Fraud Claims Against Secondary Actors Because Alleged False Statements Were Not Attributed To Them

In *Pacific Investment Management Co. LLC v. Mayer Brown LLP*, No. 09-1619, 2010 WL 1659230 (2d Cir. Apr. 27, 2010), the United States Court of Appeals for the Second Circuit affirmed the dismissal of securities fraud claims asserted against outside counsel to Refco Inc. ("Refco"), holding that such secondary actors can be held liable for damages in a private securities fraud action only if the alleged false or misleading statements are attributed to that secondary actor at the time the statements were disseminated. Without a showing of this so-called "attribution requirement," secondary actors who participate in the preparation or creation of false statements can be guilty of no more than "aiding and abetting," which under *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), cannot form the basis of a securities fraud claim. This decision confirms the Second Circuit's strict application of *Central Bank* and *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), to limit securities fraud claims against secondary actors.

Defendants Mayer Brown LLP and one of its partners served as outside counsel to defendant Refco, a provider of brokerage and clearing services in the international derivatives, currency and futures markets. After suffering substantial losses in the late 1990s, Refco arranged a series of sham loan transactions in order to conceal the losses. Refco was forced to declare bankruptcy in 2005.

Plaintiffs were investors in Refco securities. After Refco went bankrupt, plaintiffs turned their attention to potential secondary actor defendants. Plaintiffs commenced an action against Mayer Brown for violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder, along with claims for controlling person liability under Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a).

Plaintiffs alleged that Mayer Brown participated in seventeen of the sham transactions between 2000 and 2005, negotiating the terms of the loans, drafting and revising loan documents, transmitting the documents to the participants, and retaining custody of and distributing the executed copies of the documents. Plaintiffs also alleged that the law firm was responsible for false statements appearing in three Refco documents: (1) an Offering Memorandum for an unregistered bond offering in July 2004 ("Offering Memorandum"), (2) a Registration Statement for a subsequent registered bond offering ("Registration Statement"), and (3) a Registration Statement for Refco's initial public offering of common stock in August

2005 (“IPO Registration Statement”). The documents were allegedly false or misleading because they failed to disclose Refco’s true financial condition, which was concealed by the sham loan transactions. Both the Offering Memorandum and the IPO Registration Statement bore statements that Mayer Brown represented Refco in connection with those transactions, but the Registration Statement did not. None of the documents specifically attributed any of the information contained therein to Mayer Brown or the partner involved in the matter.

Plaintiffs recognized that the Second Circuit generally, albeit inconsistently, applied the “attribution rule” to claims against secondary actors. They argued, however, that “attribution” was merely one means by which attorneys and other secondary actors could incur liability for securities fraud, proposed a “creator standard,” under which defendants would be liable “for creating a false statement that investors rely on, regardless of whether that statement is attributed to the defendant at the time of dissemination.” Defendants responded that attorneys who participated in the drafting of false statements could not be liable for a primary violation of Rule 10b-5(b) absent explicit attribution at the time of dissemination.

The United States District Court for the Southern District of New York dismissed plaintiffs’ claims against Mayer Brown and its partner. The district court held that, as no statements in Refco’s public documents were attributed to Mayer Brown or the partner, at most plaintiffs had alleged conduct akin to aiding and abetting — for which there is no private right of action under securities laws. *In re Refco, Inc. Sec. Litig.*, 609 F. Supp. 2d 304, 311-14 (S.D.N.Y. 2009) (following *Central Bank*, *supra*). The district court also dismissed plaintiffs’ Rule 10b-5(a) and (c) claims for “scheme liability,” concluding that theory of liability was foreclosed by the Supreme Court’s decision in *Stoneridge*, *supra*. *See Refco*, 609 F. Supp. 2d at 314-19. Finally, the district court dismissed plaintiffs’ Section 20(a) claim due to plaintiffs’ failure to adequately plead an underlying violation of federal securities law. *See id.* at 319.

The Second Circuit affirmed. The Court acknowledged two apparently contradictory lines of cases in the Second Circuit that discussed secondary actors’ liability. On one hand, pursuant to *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998), “a secondary actor cannot incur primary liability under [Rule 10b-5] for a statement not attributed to that actor at the time of its dissemination.” *Wright* involved claims against an accounting firm and allegations that the firm orally approved a corporation’s false and misleading financial statements, which were subsequently disseminated to the public. In ***Lattanzio v. Deloitte & Touche LLP***, 476 F.3d 147 (2d Cir. 2007), the Court confirmed the attribution requirement for secondary actors’ liability. However, pursuant to *In re Scholastic Corp. Securities Litigation*, 252 F.3d 63 (2d Cir. 2001), the Second Circuit found that a corporate officer may be liable for misrepresentations made by the corporation, notwithstanding the fact that none of the statements are specifically attributed to him at the time they are disseminated. In *Scholastic*, a vice president for finance and investor relations, who was primarily responsible for Scholastic’s communications with investors and who was involved in the drafting, producing, reviewing and/or disseminating of false and misleading statements, was found liable for the misrepresentations in the documents and statements issued by Scholastic. *Id*. at 75-76. Notably, *Scholastic* did not rely upon or cite to *Wright*.

In *Pacific Investment*, the Court affirmed the attribution requirement as articulated in *Wright* and *Lattanzio*. The Court held that the attribution requirement was consistent with the Supreme Court's emphasis on the element of reliance in *Stoneridge*, noting that "[a]ttribution is necessary to show reliance." The Court also noted that an attribution requirement was consistent with its preference for a "bright line" rule over a "substantial participation" rule as it had earlier stated in *Wright*. The Court explicitly declined to address distinctions between *Wright* and *Scholastic*, stating in a footnote that, as the present action did not involve claims against corporate insiders, it would "intimate no view on whether attribution is required for such claims or whether *Scholastic* can be meaningfully distinguished from *Wright* and *Lattanzio*."

The Court thus held that plaintiffs' failure to specifically attribute the false statements to Mayer Brown or its partner was, in effect, a failure to allege detrimental reliance on any false statements made by Mayer Brown or the partner. Accordingly, plaintiffs' Rule 10b-5(a) and (c) claims were properly dismissed. The Second Circuit rejected plaintiffs' argument that communication to the public of the ultimate result of a secondary actor's statements was sufficient to show reliance on the secondary actor's own deceptive conduct.

The Supreme Court's decisions in *Stoneridge* and *Central Bank* focus on the element of reliance as the critical factor in determining the scope of securities fraud liability beyond the corporate issuer and its senior management. Under these authorities, a plaintiff cannot show reliance upon the conduct of a secondary actor if the name of that secondary actor is not identified as the author of the alleged false statement. The Second Circuit applied the reliance principles of *Stoneridge* and *Central Bank* strictly to reaffirm the "attribution requirement," further limiting the ability of plaintiffs to seek recovery from secondary actors who often can be the only "deep pockets" left standing. We note that both houses of Congress are now considering bills to amend the securities laws to permit private actions against secondary actors for aiding and abetting (*see, e.g.*, here). Similar efforts were rebuffed in the aftermath of *Central Bank* and in the Sarbanes-Oxley Act of 2002. It is likely such efforts now will face substantial opposition.

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