STONERIDGE – ESCAPE FROM SECURITIES LIABILITY NOTWITHSTANDING ACTIVE, INTENTIONAL, DECEPTIVE CONDUCT

[The Willing, Knowing, Third-Party ("Secondary Actor") Who Directly Participates In a Sham Transaction Ought to be Within the Reach of Rule 10b-5 but the Supreme Court Decides Otherwise]

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INTRODUCTION

Rather than deny the applicability of *Central Bank of Denver*,[1] how do we navigate its subtleties? That is, how do we present/plead in a complaint that what the third-party did (i.e., the CPA, the investment banker, the attorney, the business partner, the supplier, the customer) made her not just one who was merely standing nearby while the fraudulent scheme was actively going on, i.e., an "aider and abettor," but a party to the scheme that actually did something within the realm of Section 10(b)[2] and Rule 10b-5[3] and ought to get caught up in their reach?

How does this close advisor/professional/conspirator/facilitator/vendor/participant (for convenience often referred to herein by the nom de guerre "third-party defendants," "third-party defendant vendors" or merely "third-party(ies))," fall within the rubric of "primary violator" as *Central Bank* continues to be cited as demanding. How does Rule 10b-5 reach the facilitating and ever-so-willing-to-help third parties who usually participate for a good deal of money and work hard to make sure the main perpetrator can start and keep his scheme going to fool, trick, deceive, yes, in fact – defraud someone else – usually the main perpetrator's investors or creditors? Put another way, should primary responsibility be attached to those who acted "*deliberately*" "*whether by word or by deed*," but be forgiven (treated as merely "aiders and abettors") if they acted only "*inadvertently*" [4] (e.g., negligenty, mistakenly or due to a misunderstanding)?

How do we get at these companions to the principal perpetrators and make them responsible for the conspiracy in which they, more-often than not, intentionally, knowingly, willingly and, yes, deliberately, and not by inadvertence, negligence, mistake or misunderstanding participate? How, if at all, can liability for third parties be found when it is clear they understood the reason for the transactions in which they participated was to further a scheme to falsify financial results and reports that would be released to the public.

I. EQUAL PARTICIPANTS IN THE WRONGDOING ESCAPE LIABILITY

It appears such third party(ies) perpetrators have found friends in high places. Who says the guilty can't escape liability? Corporate culprits and co-conspirators should find great solace in the Supreme Court's recent 5 to 3 decision in *Stoneridge Investment Partners LLC v. Scientific-Atlanta, Inc.*[5]

Notwithstanding the majority's decision, the defendant participants in *Stoneridge* were not merely standing by. Their actions were not merely tangential to the fraud involving Charter Communications (the public company and issuer of the stock involved) ("Charter").

Charter has been described as the principal culprit because it was the issuer, the company reporting its financial results to the SEC and the public. However, the co-participants, Scientific-Atlanta and Motorola, defendants in *Stoneridge,* were also principal players. The only purpose

[1] Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994) held that the implied right of action under §10(b) did not encompass mere "aiders and abettors."
[2] Securities Exchange Act of 1934 §10(b), 15 U.S.C. §78 j(b).
[3] SEC Rule 10b-5, 17 C.F.R. §240.10b-5.
[4] Modified reference "**Gates of Repentance**," the New Union Prayerbook for the Days of Awe (1978 [5738]), p. 324 (emphasis added).
[5] Stoneridge Investment Partners LLC v. Scientific-Atlanta, Inc., et al.,128 S. Ct. 761, 761 (2008).

of the entire scam was to deceive Charter's shareholders - to give Charter the wherewithal to issue misleading financial statements to the plaintiff stockholders, the intended victims of the co-conspiracy.

These co-participants were as "primarily" liable as Charter and should have been so held. The Supreme Court's pro-business conservative majority however saw fit to, in effect, conclude they were nothing more than "aiders and abettors" and thereby, according to its reading of *Central Bank,* free from liability under §10(b) and its Rule 10b-5.

Since neither Scientific-Atlanta nor Motorola made any oral or written public statements to Charter's shareholders or to the investing public, the majority of the Supreme Court in *Stoneridge* said "[w]e conclude the implied right of action does not reach [these two defendants] because the investors did not rely upon their statements or representations."[6]

The Supreme Court minimized precedent and case law that could have been the basis for finding the element of "reliance." Such a finding could quite rationally have been made even if the defendants did not communicate/make themselves oral or written (mis)statements to the public or the shareholders. However, the Supreme Court in *Stoneridge* made clear it would require a direct communication to the public markets by a defendant before finding it a primary violator falling within the gambit of §10(b).[7]

Here defendants, though understandably not ones likely to make public comment about Charter's business, not only willingly and knowingly agreed to participate in the deceptive conduct intended to inflate Charter's revenues, but also produced false documents as part of that scheme and backdated those documents to mislead Charter's auditors.[8] Here defendants had to know their actions were deceptive and would result in misstatements that would be in the mix of financial information that Charter would issue to the public and to the Securities and Exchange Commission ("SEC") in the near future. After all, the whole purpose of this scheme was to misstate financial results to the investing public. Scientific-Atlanta and Motorola were willing participants in that scheme, principal actors with clear intent to defraud.

Nevertheless, the majority of the Supreme Court in *Stoneridge* insists that the plaintiff must prove it relied upon a material public misrepresentation by the defendants before such defendants can become primary violators of §10(b).

The *Stoneridge* majority also said the defendant companies violated no duty to disclose.[9] This author questions that reasoning. Since when does an equally participating, co-conspirator thief need to have a preexisting duty to the victim to be found liable for joining the plan to cheat, defraud her?

II. THE DISSENT IN *STONERIDGE*

The dissent in *Stoneridge* made clear that the majority had based its views on "faulty premises."[10] One of which was a misreading of *Central Bank*. The dissent indicated that the *Central Bank* defendant was not alleged to have engaged in its own deceptive conduct. The issue there was whether a defendant who had not engaged in deceptive conduct could still be

[6] *Id*. see majority decision at its p. 766.
[7] *Id*. at 766, 769.
[8] *Id*. at 767.
[9] *Id*. at 769.
[10] *Id.* at 774 (Stevens, J. dissenting).

found liable as an aider and abettor.[11] The dissent in *Stoneridge* said, in contrast to *Central Bank*'s finding that the defendant there had not engaged in manipulative or deceptive conduct, that Scientific-Atlanta and Motorola's acts were " 'a deceptive device' prohibited by §10(b)."[12] That is, these parties were primary participants engaging in their own deceptive acts intended to deceive. They were not mere aiders and abettors.

As to the "reliance" element, although the majority indicated it was not shown, the dissent pointed out that in *Basic Inc. v. Levinson*,[13] the Supreme Court years ago had held "that the 'fraud-on-the-market' theory provides adequate support for a presumption in private securities actions that shareholders . . . in publicly traded companies *rely* on public material misstatements that affect the price of the company's stock."[14]

The dissent in *Stoneridge* further stated to counter the majority that, "[t]his Court *has not held* that investors must be aware of the specific deceptive act which violates §10(b) to demonstrate reliance."[15]

The dissent also stated that when, as here, petitioner alleges that the respondents (Scientific-Atlanta and Motorola) "proximately caused" Charter's financial misstatements, and knew their deceptive acts would influence the market price for Charter's stock, "on which shareholders would rely. . . respondents' acts had the foreseeable effect of causing petitioner to engage in the relevant securities transactions."[16]

The dissent further stated that the majority's "view of reliance is unduly stringent and unmoored from authority."[17]

The majority opined that allowing lawsuits against those doing business with the issuer would open up §10(b) actions against everyone who does business with that issuer. The dissent countered by saying "that liability only attaches when the company doing business with the issuing company has *itself* violated §10(b)."[18]

The dissent then addressed the majority's comment that, in response to *Central Bank's* decision that prohibited actions against aiders and abettors, Congress adopted in the Private Securities Litigation Reform Act of 1995 ("PSLRA")[19], a section that allows a cause of action for aiding or abetting to be brought by the SEC[20], but did not incorporate a comparable provision allowing lawsuits for aiding and abetting by private litigants. The majority had indicated that such action revealed Congress's unwillingness to provide such a private cause of action to

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[11] *Id*. at 768 (citing *Central Bank,* 511 U.S. at 167, in which that Court said in 1994, that the question before it was "whether private civil liability under §10(b) extends as well to those who do not engage in the manipulation or deceptive practice, but who aid and abet the violation").

[12] *Id.* at 774, "Investors relied on Charter's revenue statements . . . and in so doing relied on respondents' fraud, which was itself a 'deceptive device' prohibited by §10(b) . . . This is enough to satisfy the requirements of §10(b) and enough to distinguish the case from *Central Bank* . . . ."

[13] 485 U.S. 224, 248 (1988).

[14] *Stoneridge*, 128 S. Ct. at 776 (citing *Basic Inc.,* 485 US at 248 (emphasis added)).

[15] *Id.* at 776 (emphasis added).

[16] *Id.* at 777.

[17] *Id*.

[18] *Id*. (emphasis in original); *see also* dissent's n.4, indicating that "(b)ecause the kind of sham transactions alleged in this complaint are unquestionably isolated departures from the ordinary course of business in the American marketplace, it is hyperbolic for the [majority] to conclude that petitioner's concept of reliance would authorize actions "against the entire marketplace in which the issuing company operates." (The footnote refers to majority opinion, at 771.)

[19] 109 Stat 757.

[20] See 15 U.S.C. §78(t)(e).

private plaintiffs. In response, the dissent stated that *Central Bank* had only concluded "aiding and abetting" was not encompassed within private actions otherwise allowed under §10(b), and that the compromise worked out by Congress in the PSLRA did not "immunize … actual violators of §10(b) from [other] liability in private litigation."[21] That is, participants in schemes who were more than aiders and abettors, as here, could still be liable as primary violators under §10(b) in actions brought by private parties.

Those who are more than mere aiders and abettors, and who are direct and primary violators, such as those alleged in *Stoneridge*, are granted no implied imprimatur by PSLRA to be free of liability under *Central Bank*. Accordingly, the fact that PSLRA did not authorize private actions under §10(b) for aiders and abettors, was no indication that Congress intended that primary violators would be free of §10(b) private litigation. That is, if Scientific-Atlanta's and Motorola's own acts and participation rose to the level of primary violations, and petitioner's pleadings in this case in the opinion of the dissent did adequately plead such acts and participation, then such violators were not immunized from action under *Central Bank's* precedent nor by any implication in the PSLRA.

III. *STONERIDGE* – ITS HISTORY BELOW - THE DECISION IN THE EIGHTH CIRCUIT

The Eighth Circuit in *Stoneridge Investment Partners LLS v. Scientific-Atlanta, Inc.,*[22] explained that the Plaintiff investors brought a securities fraud class action against not only the main culprit, Charter Communications and its various executives, but also against third-parties including the independent auditor and two of the corporation's vendors, Motorola and Scientific-Atlanta. The Plaintiff alleged that these third-party vendor defendants deliberately, intentionally, and knowing the likely result of what their participation would cause (i.e., the issuance of false financial results) entered into sham transactions with the main culprit in order to help it inflate its revenues and cash flow to meet quarterly expectations of Wall Street analysts. The Eighth Circuit referring to the majority opinion in *Central Bank,* conceded that although the Supreme Court there did not find the third-party in that case to be a primary violator but only an "aider and abettor," it had added "an important caveat," i.e., "[t]he absence of §10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the Securities Acts. Any person or entity, including a lawyer, accountant or banker, 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 under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met."[23] The Eighth Circuit in *Stoneridge* stated "[t]his is one of many cases that have tested the boundaries of that [*Central Bank*] caveat."[24] Although the *Stoneridge* appellate court gave lip service *to Central Bank*'s caveat, its holding totally missed the subtlety.

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[21] *Stoneridge* at 778.
[22] 443 F.3d 987 (8th Cir. 2006).
[23] *Id*. at 991 (emphasis in original) (the Eighth Circuit citing *Central Bank,* 511 U.S. at 191). See *infra* "*O'Hagan*'s clarifications of *Central Bank*" and accompanying notes 40-44.
[24] *Id.*

IV. DOES §10(B) AND RULE 10B-5 IN PRIVATE CIVIL ACTIONS FIND DEFENDANTS AS "PRIMARY VIOLATORS" ONLY IF THEY MAKE THEIR OWN MISSTATEMENTS OR OMISSIONS?

The Eighth Circuit in *Stoneridge* indicated it looked at the law[25] (but which that court then went on to ignore). The Eighth Circuit, referring to §10(b) and Rule 10b-5, repeating wording from each provision stated that §10(b) made it unlawful, directly or indirectly, "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe."[26] The appellate court also went on to say that "Rule 10b-5 provides: [i]t shall be unlawful for any person, directly or indirectly … (a) *[t]o employ any device*, scheme or artifice to defraud, (b) *[t]o make any untrue statement* of a material fact *or to omit* to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading or (c) *[t]o engage in any act, practice or course of business* which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security."[27]

In *Central Bank*, the Supreme Court stated that a "private plaintiff may not bring a [Rule] 10b-5 suit against a defendant for acts not prohibited by the text of §10(b)."[28] The Eighth Circuit in *Stoneridge* in its analysis of the history of the word "deceptive" said: "[i]n earlier cases the [Supreme] Court held that 'deceptive' conduct involves *either a misstatement or a failure to disclose by one who has a duty to disclose*."[29] Of course, the Eighth Circuit's view that only a misstatement or failure to disclose violates §10(b) and Rule 10b-5, totally ignores much of what especially Rule 10b-5 actually states in its subsections (a) and (c).[30] Rule 10b-5's very own words make clear that *misstatements or omissions* [see Rule 10b-5 subsection (b)] are only one category of wrongdoing prohibited by §10(b) and Rule 10b-5.

The Ninth Circuit in *Simpson v. AOL Time Warner*[31] in 2006, held that a defendant could be "liable as a primary violator of §10(b) for [its own] participation in a 'scheme to defraud'" where it "engaged in [its own] conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme."

In *In re Parmalat Sec. Litig*.[32] Judge Kaplan, of the Southern District of New York, said in 2005 that "the [defendant] banks made no relevant misrepresentations to those markets, but they knew the very purpose of certain of their transactions was to allow Parmalat to make such misrepresentations." Referring then to the acts of the financial institutions that committed their own deceptive acts to advance Parmalat's misrepresentations to the markets, Judge Kaplan said "where, as alleged here, a financial institution enters into deceptive transactions as part of a scheme in violation of Rule 10b-5(a) and (c) that causes foreseeable losses … that institution is subject to private liability under Section 10(b) and Rule 10b-5."[33]

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[25] *Id*.
[26] *Id*. at 990 (citing 15 U.S.C. §78j(b)).
[27] *Id*. (citing 17 CFR §240.10b-5) (emphasis added).
[28] *Central Bank*, 511 U.S. at 173.
[29] *Stoneridge*, 443 F.3d at 990 (emphasis added).
[30] See n. 27; *infra*, 17 C.F.R. §240.10b-5(a),(c).
[31] 452 F.3d 1040, 1048 (9th Cir. 2006).
[32] 376 F. Supp. 2d 472, 509-10 (S.D.N.Y. 2005).
[33] *Id*. at 510.

V. PRIMARY VIOLATORS

The Eighth Circuit in *Stoneridge* found that the defendant third-parties' conduct did not fall within the reach of §10(b) and Rule 10b-5, i.e., were not primary violators, simply because they did not "make or affirmatively cause to be made a fraudulent misstatement or omission"; "[t]hey did not issue any misstatement relied upon by the investing public nor were they under a duty to such other investors … to disclose information useful in evaluating Charter's true financial condition."[34] Notwithstanding this appellate court's simple test, it seems that the subtleties of *Central Bank* could permit a court to conclude that the separate conduct of a third-party(ies) engaged in to intentionally and deliberately deceive a known class of persons is within §10(b). One who knowingly works with the main perpetrator, for instance, to issue false financial reports, ought to be deemed a "primary violator." In *Stoneridge*, each conspired with the other, each engaged in its own acts, the natural and easily foreseeable consequence and result of which is deception of investors.[35] In this author's view, a third-party(ies) (e.g., the investment banker, the attorney, the CPA, the vendor), who knows of the illegal scheme and deliberately took part in it by means of her own specific actions to further its perpetration and keep it going, in fact should be considered as directly participating, and a "primary violator" even though not directly communicating with the shareholders or financial analysts.

Who/what should be considered by the courts as a primary part of the "plot," the "action," the activities, the deceptive conduct, that make up the "scheme" and contributed to its perpetration? That is, should a third-party, non-issuer, who is instrumental to the scheme, even if not in initiating the scheme, be liable for consciously, deliberating, knowingly, joining in the fraudulent conduct? Certainly starting the scheme with the main culprit, or keeping the scheme going, by participation which is essential to, and without which, the scheme could not exist, continue or be successfully perpetrated, seems to fit under the rubric and words of Rule 10b-5's subsections (a) and (c), even if such co-plotter did not make her own statement to investors or to the public markets.

In *Stoneridge*, it is clear (except to the Eighth Circuit and the Supreme Court) that Motorola and Scientific-Atlanta were each a "primary violator" of the securities laws because they violated Rule 10b-5(a) and (c) by directly participating in a "scheme or artifice to defraud" and by knowingly and willing participating in a

> course of business which operated … as a fraud or deceit." Rule 10b-5(a) and (c) are broadly worded and Rule 10b-5 begins with "[i]t shall be unlawful for *any person* directly *or indirectly* …. (a) [t]o employ *any* … scheme … to defraud, … or (c) … engage in *any act*, practice, *or course of business which operates* or would operate as a fraud or deceit *upon any person* in connection with the purchase or sale of any security." (Emphasis added.)

Neither §10(b) nor Rule 10b-5 limit liability to merely the spokesperson for the co-conspirators and in fact Rule 10b-5 refers to "any person" who "directly or indirectly"

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[34] 443 F.3d at 992.

[35] In *Stoneridge*, 443 F.3d at 991, Plaintiffs had argued that "Rule 10b-5(a) and (c) are broadly worded and, unlike Rule 10b-5(b), do not require proof of a fraudulent misrepresentation or failure to disclose. Plaintiffs' cited as support, Simpson v. AOL Time Warner, Inc., 452 F.3d 1040 (9th Cir. 2006) and *In re* Parmalat Sec Litig., 376 F. Supp. 2d 472, 492, 503 (S.D.N.Y. 2005), for the proposition that *Central Bank*'s analysis did not affect the scope of primary liability under subsections (a) and (c). The Eighth Circuit (and the majority of the Supreme Court in No. 06-43 in its affirmance of the Eighth Circuit's views) merely ignored the analyses in both *Simpson* and *Parmalat*.

engages in, not merely conduct covered only under Rule 10b-5(b) [misstatement or omission of a material fact] but also any conduct or actions directly or indirectly violating subsections (a) and (c).

Defendants Motorola's and Scientific-Atlanta's activities clearly fall within any rational reading of Rule 10b-5(a) and (c) above as they did not only act "indirectly" but in fact they did it directly. They acted directly with Charter. They obviously knew they would be deceiving someone and that was the very direct and intended purpose of their acts! Is that not a "primary violator"?

Again, §10(b) makes it unlawful, "directly or indirectly," "to use in connection with the purchase or sale of any security … any … deceptive device …." Even if Motorola's or Scientific-Atlanta's acts are somehow not considered "direct" vis-à-vis the defrauded purchasers of the stock, §10(b) is actually very clear in that it also uses the word "indirectly." The third-party(ies) defendants in *Stoneridge* engaged at least indirectly in "deceptive" conduct involving or resulting in the natural and intended consequence of their acts, i.e., either misstatements or failures to disclose to a foreseeable group, buyers of the stock.

Furthermore, and again it seems it needs repeating, Rule 10b-5 prohibits not only the making of a material misstatement (or omission) covered in its subsection (b), but also "courses of business" (certainly including improper, non-arm's length business practices), which operate to deceive a very foreseeable group of victims (covered in Rule 10b-5 (c)), and these *Stoneridge* defendants did exactly that. Even though they did not directly make the statements to the market, they directly contributed to the inclusion of materially incorrect information, misstatements (or omissions), in the financial statements. In addition they surely committed acts and engaged in business practices, "courses of business" that they had reason to know would deceive and be relied upon by present and future investors. It was easily foreseeable that their acts would contribute to publication and dissemination of the results of the scheme (i.e., false financial information to be reported to the market and investors). Here it is clear others besides the actual spokesperson, i.e., Charter, engaged in deceptive practices intended to defraud a readily foreseeable group.

Therefore, these third-party(ies) participants met all the requirements for primary liability. All the factors plaintiff must assert to show primary liability could be adequately pled. The intentional, knowing, wrongful misconduct, and acts of Motorola and Scientific-Atlanta, create the "primary liability." It was their participation that was material and essential to the scheme; that deliberate participation was essential to the creation and intended dissemination and publication of the false statements. A buyer of Charter's stock was entitled to rely that it would be investing into an efficient and honest market for Charter's stock unaffected by such false statements. Accordingly, Motorola and Scientific-Atlanta should be deemed equally responsible parties for being direct contributors to those false statements.

VI. THE SCHEME

The *Stoneridge* appellate court described that Charter Communications requested that the third-party defendant vendors, Motorola and Scientific-Atlanta, join in the scheme.[36] They did join the scheme, in Scientific-Atlanta's case, under a new and backdated contract, to accept from Charter an additional $20 per tv set–top cable box that they were already selling to Charter under existing contracts. That is, for no bona fide business reason Charter would pay Scientific-Atlanta

[36] 443 F.3d at 989.

$20 more per box than the then-in-effect contract called for. In exchange, Scientific-Atlanta would return the additional payments to Charter in the form of advertising fees. In other words, Charter came up with the scheme whereby it would pay $20 more for the tv set cable boxes that it was then already buying from Scientific-Atlanta and Scientific-Atlanta would return those funds to Charter by buying advertising time on Charter's stations.

The scam with Motorola was different. Charter and Motorola entered into a backdated contract (which was never intended to be honored) whereby Charter agreed to buy a certain additional number of boxes from Motorola. For every box not purchased, Charter would pay $20 as "liquidated damages." As planned, Charter failed to buy the boxes and paid Motorola $20 for every box it failed to take. Motorola then used that exact sum to also buy advertising time from Charter.

Since these arrangements were considered as equipment purchases by Charter, Charter would capitalize the increased equipment cost and therefore such costs would not show up on its quarterly financial statement as a current expense offsetting income. Charter then treated the faked advertising fees as immediate revenue. So, in effect, Charter, with the help of its active, knowing co-conspirators, came up with a scheme which provided itself $17,000,000 more of revenue and cash flow in the fourth quarter of 2000 in order to meet the revenue and operating cash flow expectations of Wall Street analysts. [37]

VII. FILED TO BE A CLASS ACTION

Stoneridge had been filed as a securities fraud class action on behalf of those who purchased Charter Communication's stock during a certain time period and included Motorola and Scientific-Atlanta as named defendants. The plaintiffs alleged that these third-party defendant vendors, i.e., Motorola and Scientific-Atlanta, entered into these sham transactions obviously knowing that Charter intended to account for them improperly and that analysts would rely on the inflated revenue and operating cash flow in making stock recommendations. However, plaintiffs did not allege in their complaint that the third-party vendors played any roll in preparing or disseminating the fraudulent and misleading information, that is, financial statements or press releases that were publicly communicated by Charter to its analysts and investors.[38]

VIII. THE RESULTS OF ACTS OF MOTOROLA AND SCIENTIFIC-ATLANTA

Motorola and Scientific-Atlanta intentionally engaged in acts (that surely were not merely "inadvertent") to directly facilitate Charter's fraud. Due to their willingness to participate in the scheme, they ought to be liable to the investors who relied upon the false "favorable" information that was generated as part of, and as a direct result of, the conspiracy between Charter and these third-party defendant vendors. It would hardly take a first year accounting student or finance major to realize that by participating in the scheme they, Motorola and Scientific-Atlanta, were helping the main perpetrator (i.e., Charter) to manipulate its financial story. They had to know they were helping to create a deceptive, materially untrue story. Now if they knew or should have realized, or had reason to believe, that Charter was using the arrangement to intentionally and wrongfully misstate its financial results, they are not just

[37] *Id*. at 990.
[38] *Id*.

standing nearby on the sidelines; they are not simply innocent onlookers; they each engaged in direct conspiratorial acts to do wrong that should be within the reach of §10(b) and Rule 10b-5. They were "primary violators."[39]

IX. THE SUPREME COURT'S AND THE EIGHTH CIRCUIT'S STILTED VIEWS IN *STONERIDGE*

What did *Central Bank* really mean? The Supreme Court in *Central Bank*, so the Eighth Circuit in *Stoneridge* indicated, aside from limiting liability to only those that made either a direct misstatement or omission to the investors or the market, further limited the range of §10(b) and stated that the word "manipulative" was a special term of art that referred only to illegal trading practices such as "wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity."[40] So according to the Eighth Circuit, there was no "manipulative" conduct and with the definition of "deceptive" as stilted and narrow as the Eighth Circuit, and now the Supreme Court, in *Stoneridge* described, i.e., including only a direct misstatement or omission, §10(b) and Rule 10b-5 now seem to have little range or coverage when applied to the facts of private §10(b) actions.

However, the Eighth Circuit's 2006 decision and the Supreme Court's 2008 decision in *Stoneridge* are clearly wrong and failed to discern that *Central Bank*'s words were only in the context of the facts before it. *Central Bank* did not intend to limit violation of §10(b) to only a person that made a direct misstatement (or omission). In *Central Bank*, the defendant took no affirmative acts to help the bond issuer create false information. Central Bank, the defendant, engaged in no conspiratorial conduct with the principal culprit, there the bond issuer. It did not actively engage in sham transactions. It might have been reckless (in that it should have ordered a new appraisal of certain land securing the issued bonds rather than delay it) but its poor decision was not as a result of a conspiracy or an agreement with the principal defendant, the bond issuer. The defendant bank simply ignored and put off what perhaps it should have done – negligence, mistake or perhaps even recklessness, but not intentionally deceptive conduct in a conspiracy with the principal defendant intended to result in false information being provided to the investors and the market, to effect the price of a security, which would surely cause losses when the fraud came to light, as was clearly the situation in *Stoneridge*.

X. *O'HAGAN*'S CLARIFICATIONS OF *CENTRAL BANK*

In *United States v. O'Hagan*,[41] the Supreme Court, referring back to its words in *Central Bank*, indicated it did not mean in that case to limit liability under §10(b) to only direct misstatements (or omissions) attributable to a defendant. The *O'Hagan* Court said:

> The Eighth Circuit isolated the statement [made in *Central Bank*, "or makes a material misstatement (or omission),"] and drew from it the conclusion that § 10(b) covers only deceptive statements or omissions … however that this Court,

[39] Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 191 (1994) ("Any person or entity, including 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 under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met.").
[40] *Stoneridge*, 443 F.3d at 990 (citing Santa Fe Industries v. Green, 430 U.S. 462, 476-77 (1977).
[41] United States v. O'Hagan, 521 U.S. 642 (1997).

> in the quoted passage, sought only to clarify that secondary actors, although not subject to aiding and abetting liability, remain subject to primary liability under § 10(b) and Rule 10b-5 for *certain conduct*.[42]

Surely the Supreme Court in *O'Hagan* meant that "certain [other] conduct," not merely misstatements or omissions, can be the basis of liability under §10(b) and Rule 10(b)(5).[43] *Central Bank's* points were: there is no aiding and abetting liability encompassed within §10(b) and for what little the defendant had done in *Central Bank*, the defendant was not involved in deceptive conduct or a primary violator. The Court in *Central Bank* used the "makes no misstatement (or omission)" terminology as only an example of what could be deemed deceptive conduct under §10(b) and Rule 10b-5. The *Central Bank* Supreme Court decision did not intend to limit the term "deceptive"[44] to merely misstatements or omissions; other conduct could also be violative.

In *O'Hagan*, the Supreme Court made an effort to clarify its words contained in *Central Bank* by making clear "deceptive" was still a part of the statute and that §10(b) prohibits "using any deceptive device." [45] The *O'Hagan* Court said "rather, the statute reaches any deceptive device used 'in connection with the purchase or sale of any security.'" [46]

The actions of the *Stoneridge* defendants, Motorola and Scientific-Atlanta, which were so essential and instrumental to the "deception," to the scam, i.e., it could not have occurred at all without their participation, should be deemed "deceptive conduct"; that is, the other "certain conduct" the Supreme Court referred in *O'Hagan*. Even if a court believes misstatement (or omission) is still required, it should deem the acts of the defendant-vendors part and parcel of the publication and dissemination – so interconnected, so intertwined, that such intended publication by others and its falsity could not have occurred without their direct and deliberate actions. The speaker should be considered merely the speaker for all who actively participated in the scam.

Ignoring logic, and who was also to blame for investors being cheated and their losses, the Eighth Circuit in *Stoneridge*, without reference to *O'Hagan's* clarifications, indicated that *Central Bank* supported the position that Rule 10b-5 does not reach those who merely aid in the violation of §10(b) and repeated words from *Central Bank*: "we again conclude that the statute prohibits only the making of material misstatement (or omission) or the commission of a manipulative act."[47] But again, *Stoneridge*, with a simple swipe of the hand, refuses to attempt to discern both the Court's clarification in *O'Hagan* and facts - i.e., when one has embroiled herself by her own conduct in her own violation and gone beyond "aiding and abetting," even if such defendant never spoke, Rule 10b-5 still has the range to punish acts other than direct misstatements.

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[42] *Id*. at 664 (emphasis added).
[43] *Id*.
[44] SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.
[45] *Id.* at 651.
[46] *Id*.
[47] *Stoneridge,* 443 F.3d at 990 (citing *Central Bank*, 511 U.S. at 177).

XI. RULE 10B-5 HAS THREE SUBSECTIONS - WHY DOES *STONERIDGE* RECOGNIZE ONLY ONE?

If Rule 10b-5 has three subsections, as it does, i.e., (a), (b) and (c), and only one, i.e., "(b)" includes the words "[t]o make any untrue statement of a material fact or omit to state a fact …," why does the Eighth Circuit (and the Supreme Court) in the *Stoneridge* decision in effect limit the other subsections, (a) and (c) to also requiring the very same wrong as is only contained in (b), i.e., the making of "a material misstatement (or omission)"?[48] Why is it, as *Stoneridge* seems to say, the separate words in the separate subsections have no meaning and reach of their own? It is clear they mean something else and were meant to cover different wrongs. Why else, in fact, would there be subsections (a) and (c) if not meant to cover some acts different, and totally apart, from (b)?

XII. PERHAPS *STONERIDGE* PLAINTIFFS SHOULD HAVE PLEADED DIFFERENTLY

In *Stoneridge*, plaintiffs should have alleged that Motorola and Scientific-Atlanta were directly involved in creating false information and engaging in non-arm's length transactions, the results of which would and were intended to generate false and misleading public financial statements that were specifically intended for the investors. Such financial statements conveyed to the intended victims, i.e., investors, false and misleading results upon which they relied. Motorola and Scientific-Atlanta were, if not directly, at least "indirectly," involved in providing false information to the defrauded investors. Again, and it seems to need constant repeating, both §10(b) and Rule 10b-5 contain the words "directly or indirectly" in describing prohibited acts. Surely "indirectly" means something.[49]

XIII. THE SCAM WAS INTENDED TO DECEIVE

In fact, in the *Stoneridge* case, plaintiffs could have alleged that Motorola and Scientific-Atlanta, because it was so obvious what the scam was intended to do, i.e., misstate financial results and deceive investors, **directly** and intentionally engaged in, facilitated, and were in fact essential to, the main culprit's misstatements; indeed Motorola and Scientific-Atlanta took action to assure the plot would be successfully perpetrated. Their conduct was knowing, willing, intentional and committed by means of prior/premeditated planning to accomplish the intended wrongful acts. They actively and directly engaged in the plot/scheme to deceive others (and they knew, or should have known, the deception would be accomplished by false financial statements and press releases that would be released to the public). This is far different from the facts in *Central Bank*, in which that defendant participated in no act or plot with the issuer.

Plaintiffs in *Stoneridge* should have also asserted that Motorola and Scientific-Atlanta, even though no statement or omission may be "directly" attributable to them, at least "indirectly" contributed to the making of such misleading statements and to misleading the public. It was

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[48] *Id.* at 990-991 (citing *Central Bank,* 511 U.S. at 191).

[49] *See* 17 C.F.R. § 240.10b-5 ("It shall be unlawful for any person, directly or *indirectly*… [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made…not misleading.. . .") (emphasis added). Section 10(b) also makes it unlawful "directly or *indirectly*." 15 U.S.C. § 78j (emphasis added). *Stoneridge* would have been the perfect scenario in which to apply the "indirectly" part of the statute and the rule.

foreseeable that the premeditated results of their action (the creation of false information) would end up in public statements and, when finally revealed, would cause losses to those who purchased at that time. Those public statements were intended to and did adversely affect, deceive and defraud a very foreseeable group of people. The complaint should also have alleged that the plaintiffs necessarily relied when making their decisions to buy on the existence of an honest and efficient market. All the defendants perverted, misstated and concealed; such acts adversely affected the operation of an efficient market system upon which the plaintiffs were entitled to rely.[50] Plaintiffs should have alleged the defendants knew purchasers of the stock would see or rely on analysts' reports containing such misleading information and their conduct would pervert the efficient market for information about the stock.

In *Stoneridge*, notwithstanding there was no direct statement to the investors/shareholders or to the market by Motorola or Scientific-Atlanta, a jury could well conclude the plot/scheme they engaged in with Charter was obviously going to, and was intended to, adversely effect, i.e., deceive, trick, fool such investors and the entire market process. The adverse effect was obviously foreseeable by such third-party(ies) and was in fact *the* intended purpose of such plot/scheme. Is it any wonder defendants do not want these factual situations being put to a jury?

XIV. A DUTY?

If plaintiffs must also allege that Motorola and Scientific-Atlanta, these active participants to the fraud, had a duty to the investors, it might be argued such defendants should not be deemed out of the realm of responsibility (i.e., "a duty"), under Rule 10b-5(a) and (c), to a group which was the intended and foreseeable recipient of the fraudulent information the defendants co-created. Where it is known by the conspirators that the falsified information is going to be distributed to the public and potential investors, that ought to be the basis for the creation of a "duty" to that group, a duty not to deceive them; not to defraud them. Is there not a natural and all pervasive law that we all have an obligation ("duty") not to harm or defraud others?[51] Here Motorola's and Scientific-Atlanta's "actions in connection with the relevant transactions actually and foreseeably caused losses" as a result of the tainted information they helped create.[52]

Motorola's and Scientific-Atlanta's acts and the consequences of those acts were intended to naturally and foreseeable deceive the buyers and sellers of Charter's securities. In *Simpson*, the Ninth Circuit said "the defendants' *own conduct* contributing to the transaction or overall scheme must have had a deceptive purpose and effect."[53] In *Stoneridge*, defendants' acts were clearly intended and were going to influence and be relied upon by investors and shareholders in both their decisions to buy and sell. Does one need a pre-existing "duty" to a bank not to rob it? If a court feels a defendant needs to have a pre-existing "duty" as a factor, it could be the ever-present natural law/duty not to harm the foreseeable victims of a perpetrator's own deceptive acts.

Neither §10(b) nor Rule 10b-5 include words that require any person who directly or indirectly engages in a scheme must have a pre-existing duty to the defrauded. However, it is

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[50] *See* Basic, Inc. v. Levinson, 485 U.S. 228, 243-44 (1988) (describing and adopting the "fraud-on-the-market" theory).
[51] *Stoneridge*, 128 S.Ct. at 779 (dissent) (referring to "jurisprudence" that "every wrong should have a remedy.")
[52] *In re* Parmalat, 376 F. Supp. 2d 472, 509 (S.D.N.Y. 2005).
[53] *See* Simpson v. AOL Time Warner Inc., 452 F. 3d 1040, 1048 (9th Cir. 2006) (emphasis in original). In effect the court was laying responsibility on those whose "own conduct" contributed to the causes for the losses.

clear that if some scheme would defraud a specific foreseeable group, then this ought to create the duty to such group: a duty not to defraud. It is obvious these defendants could not help but know the defrauded would be buyers and sellers of Charter's securities.

XV. IGNORING THE FAULT OF OTHERS

The *Stoneridge* defendants were not merely negligent or even reckless, nor were their actions "inadvertent."[54] Those words do not connote purposely fraudulent, intentional or malevolent acts rising to the level of "deceptive." Here, however, the acts were intentional, willful, and deliberately meant to be deceptive; an obvious scam in the true sense of the word, and could lead to nothing but fraud. The defendants knew Charter was perpetrating a scheme. Their acts were not merely aiding and abetting. They joined in the scheme as equal violators - equal deceivers.

In reality the financial misrepresentations were actually "made" as much by the defendant vendors as by Charter itself. Both Charter and the defendant vendors equally carried out the deception. Therefore, the defendant conspirator-vendors' joint participation was not only aiding and abetting, but also active, central and direct. Without the defendant vendors' joint participation, inflated revenues and overstated cash flows would not have occurred.

XVI. RELIANCE AND CAUSATION

In Petitioner's (Plaintiff's) Brief to the U.S. Supreme Court in *Stoneridge*, counsel cited *Simpson v. AOL Time Warner, Inc.*, in which the Ninth Circuit held that Rule 10b-5(a) and (c) could have their own independent significance.[55] *Simpson* said investors "may be presumed to have *relied* on [this] scheme to defraud if a misrepresentation, which necessarily resulted from the scheme and the defendant's conduct therein, was disseminated into an efficient market and was reflected in the market price."[56]

Petitioner's Supreme Court Brief in *Stoneridge* also referred to *In re Lernout & Hauspie Sec. Litig*, and argued that "where the deception is 'a natural consequence of'" or "necessarily resulted from" the defendant's own deceptive acts, "but for" causation is established, "[e]ven if a material misstatement by another person creates the nexus between the scheme and the securities market."[57]

Petitioner's Supreme Court Brief in *Stoneridge* also referred to *In re Parmalat* to demonstrate that a misstatement or omission need not be made by the secondary actor itself, and in which the Southern District of New York said:

> The banks made no relevant misrepresentations to those markets, *but they knew* that the very purpose of certain of their transactions was to allow Parmalat to make such misrepresentations. In these circumstances, both the banks and Parmalat are alleged causes of the losses in question . . .[and] both may be liable.[58]

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[54] Modified reference "**Gates of Repentance**," the New Union Prayerbook for the Days of Awe (1978 [5738]), p. 324 (emphasis added).

[55] Brief for Petitioner at 39, Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 128 S. Ct. 761 (2008) (citing *Simpson,* 452 F.3d at 1051-52).

[56] *Id*. (citing *Simpson,* 452 F.3d at 1052) (emphasis added).

[57] *Id*. (citing *In re* Lernout & Hauspie Sec. Litig*,* 236 F. Supp. 2d 161, 173 (D. Mass. 2003)).

[58] *Id.* (quoting *In re* Parmalat Sec. Litig, 376 F. Supp. 2d 472, 509 (S.D.N.Y. 2005) (emphasis added)).

Petitioner's Brief further argued that its complaint alleged that "but for" the deceptive acts of Motorola and Scientific-Atlanta, Charter could not have succeeded in publishing the false financial statements. That is, Petitioner argued "causation" was adequately pled. Petitioner further reasoned that "the false misrepresentations Charter made in its financial statements necessarily resulted from and were the natural consequence of Respondents' [Motorola's and Scientific-Atlanta's] own deceptive conduct, constituting 'a sufficient step in the causal chain to support a finding of reliance.' "[59]

XVII. ARM'S LENGTH TRANSACTION – SURELY NOT HERE!

In the *Stoneridge* case, the Eighth Circuit discussed and made much of the notion that where a third-party business partner has entered into an "*arm's length business transaction*" and "*day-to-day business dealings*" with the issuer, and that issuer then in effect uses the results of that transaction to publish false and misleading statements to its investors, the third-party(ies) have no responsibilities under §10(b) or Rule 10b-5.[60] However, in *Stoneridge* there is evidence of clear intent on the part of the third-party defendant vendors to knowingly participate in a purposeful, outright fraud and even illegal scam, surely not an arm's length transactions in anyone's view. The Eighth Circuit indicated, however, that "[t]o impose liability for securities fraud on one party to an arm's-length business transaction in goods or services other than securities because that party knew or should have known that the other party would use the transaction to mislead investors … would introduce potentially far-reaching duties and uncertainties…."[61]

Most obviously, the Eighth Circuit based its views on a faulty premise. Here there was no *arm's-length* business transaction. If liability for one participating in any fraud, securities or otherwise, depends on whether there was at least an attempt at a bona fide arm's length business transaction, then liability is clear in this case. Here the transactions were clearly and outright non-arm's-length. Here they were non-bona fide transactions meant primarily to deceive all those who would view or experience their results and intended consequences. This intentional fraud was aimed at the investing public – it was meant to deceive them and affect the stock price and it did deceive purchasers. The fact that the defendant vendors in *Stoneridge* were not involved in any direct communication with their foreseeable and intended victims should not relieve these co-conspirator-culprits of blame for the fraud they knowingly and willingly participated in and the foreseeable harm they directly caused and for which they should have at least joint primary responsibility.

XVIII. WHERE THERE IS AN ACTIVE, WILLING PARTICIPANT – LET IT GO TO THE JURY

Central Bank and its progeny may not require one to be a totally innocent bystander to escape §10(b) and Rule 10b-5 liability. Surely, however, where one is an active, direct and willing, even if not necessarily the initiator of the plot, co-conspirator and participant, in a non-

[59] *Id.* at p. 40 (quoting Brief of the S.E.C., Amicus Curiae, in Support of Positions That Favor Appellant at 22, Simpson v. Homestore.com, Inc., 452 F.3d 1040 (9th Cir. 2006) (No. 04-55665), 2004 WL 5469571; citing Simpson, 452 F.3d at 1052).
[60] *See Stoneridge*, 443 F.3d at 992-993 (emphases added).
[61] *Id*.

arm's length transaction, who not only helps, with her own deceptive conduct, the main culprit perpetrate its fraud, deceit and trickery, but is essential to it, in what is an obvious plot to deceive the investing public, there ought to be consequences under the securities laws for such a willing conspirator. It is up to the trier of fact in our system to determine if a participant reaches a level of culpability. Where the pleadings, as required by the PSLRA, and preliminary evidence can show a defendant's willing intent to knowingly participate in joint deceptive conduct, that more than likely was intended to mislead investors, the courts, rather than dismiss securities claims, should let these matters get to a jury.

XIX. PLEADINGS

Perhaps the subtlety that is necessary in a case against a third-party co-conspirator, at least for purposes of overcoming a motion to dismiss, is to plead that the defendant third-party(ies) participated in act(s) that were not "arm's-length transactions." The pleadings should also allege such third parties: were essential and principal contributors to the wrongful circumstances that produced the misstatements or omissions, they knew the investors would rely upon misstatements or omissions, they acted with the knowledge they would be deceiving someone, and such knowing participation created a duty: "thou shall not [intentionally]…" cheat, deceive, defraud, mislead.

XX. WHAT DO THE SECTION AND RULE REQUIRE?

It bears repeating that 10(b) and Rule 10b-5 contain a broad reach. In their own various wording they provide that "any person[s]" who "directly or indirectly" "use or employ in connection with the purchase or sale of any security any … *deceptive device" or* "make any untrue statement of material fact or omit to state a material fact necessary," *or* "*engage in any act which operates or would operate as a fraud or deceit* upon any person," are to be liable to "any person."[62] There is no indication in the Rule or the statute that there needs to be a direct misstatement made by, or an omission attributable, to the co-actor. Nor does the Rule or Section require a pre-existing duty to those who are intentionally mislead, and who in fact are the direct targets of the co-conspirator's deceit.

Accordingly, in *Stoneridge,* Motorola and Scientific-Atlanta had to know something was amiss when they were asked to, in effect, take $20 extra for what they were already selling Charter and then to give it back to Charter as advertising fees. Clearly they were party to a scheme. These third parties had to know, unless they were from another planet or otherwise seriously challenged, someone was deceiving innocent investors. They certainly were involved in the deception.[63]

XXI. THE WILLING PARTICIPANTS SHOULD BE LIABLE UNDER THE SECTION AND RULE

In *Stoneridge*, the third-party defendant vendors, i.e., Motorola and Scientific-Atlanta, worked directly with Charter, the main culprit, to cause the deceit. They were not even semi-innocent bystanders with little understanding of how their participation would more than likely

[62] SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (emphasis added).

[63] Here, Motorola and Scientific-Atlanta knowingly and intentionally signed bogus contracts and backdated them to deceive first the accountants, then analysts and the market.

affect the buyers of Charter's stock. They actively, directly and willingly participated with Charter to publish untrue results. They actively engaged in the trickery, the deceit. The natural victims of the deceit were buyers (and maybe even potential sellers of the stock; in the latter case those who would have immediately sold had they known the true facts).

The foreseeable cumulative effect of the willing participation of these third-party defendant vendor-accomplices was surely to deceive the putative class in *Stoneridge*, those buying the stock. That was both the intent and foreseeable consequence of the transactions, i.e., to deceive the market and the investors. Motorola and Scientific-Atlanta should not escape responsibility for their knowing acts. They surely were not just innocent bystanders, nor merely negligent or even reckless, and thus "aiders and abettors" in an otherwise "arm's-length" transaction as was the case in *Central Bank*.[64] Knowing, willing participation in a fraudulent scheme cannot be deemed to involve honest arm's-length transactions. Here Motorola and Scientific-Atlanta did not engage merely in some acts intended to be arm's-length, honest and non-fraudulent. Here Motorola and Scientific-Atlanta acted with the intent to deceive!

XXII. RELATIONSHIP TO PROFESSIONALS

Under *Stoneridge*, a professional can rest easy so long as the attorney, CPA, and investment banker make no statements to the public. It appears no matter their culpability, they will escape private civil liability under §10(b). As mere "aiders and abettors," *Stoneridge* excludes them from coverage under §10(b) and the Rule. The lawyer that works, plans and schemes with his client to deceive and defraud the investing public, but who is careful to make no public statements, is free of civil liability under the Eighth Circuit's and Supreme Court's current view as expressed in *Stoneridge*.[65]

CONCLUSION

Central Bank did not mean to say a direct misstatement (or omission) by a defendant is the only way a violation of §10 could occur, and the Eighth Circuit and the present can-find-no-evil majority in the Supreme Court in *Stoneridge* are in error. The Supreme Court has essentially written Rule 10b-5(a) and (c) out of the law and found them inapplicable to private civil suits unless the "act" or "course of business" committed by a defendant is also accompanied by his direct misstatement to investors or the market.[66] How else can ignoring the specific words of (a) and (c) and their intended coverage be explained? The Eighth Circuit decision and the 5-3 majority decision of the Supreme Court in *Stoneridge* were rejections of subsections (a) and (c) of Rule 10b-5. These decisions now seem to limit, in private actions involving third parties, the applicability of Rule 10b-5 to only its subsection (b).

[64] Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 165 (1994).
[65] Of course, 18 U.S.C. §2 makes it a felony to aid and abet criminal violations of federal laws, including various securities laws that can also impose criminal liability, i.e., §10 and Rule 10b-5. So lawyer-schemers can face criminal prosecution even if not private civil liability under the Section and Rule.
[66] Securities Exchange Act of 1934 §10(c).