

PIMCO v. Mayer Brown: The Second Circuit Confirms The Strict “Attribution” Test For Section 10(b) Liability For Secondary Actors

On April 27, 2010, the Second Circuit issued *Pacific Investment Management Co. LLC (“PIMCO”) v. Mayer Brown LLP*, holding that a secondary actor can be held liable in a private damages action under Section 10(b) of the Exchange Act *only* for false statements “attributed” to the secondary-actor defendant at the time of dissemination.¹ In so holding, the Court of Appeals clarified its inconsistent prior precedents, and rejected a more relaxed standard for secondary actor liability advanced both by the plaintiffs and the SEC as an amicus. Notwithstanding the *PIMCO* panel’s unanimous ruling confirming the strict attribution standard, one judge issued a separate concurring opinion foreshadowing that the issue was ripe for the Court’s *en banc* consideration, and possibly Supreme Court review, based on continuing tension on the question both within and outside the Circuit.

I. *PIMCO v. Mayer Brown*

Background. *PIMCO* arises from the collapse of Refco Inc. (“Refco”), which had been one of the world’s largest broker-dealers in derivatives, currency and futures. The defendants in *PIMCO* were Refco’s outside law firm and the individual law firm partner who was in charge of the Refco account.

In 2005, it was revealed that Refco had been concealing massive amounts of debt in its financial statements principally by engaging in “round-trip” transactions that would temporarily move millions of dollars off its balance sheet at quarter-end. According to the plaintiff-investors, the defendants were involved in the transactions as the company’s lawyers and they also allegedly participated in drafting three Refco documents that misrepresented the amount of the company’s debt: a Refco bond Offering Memorandum, a Registration Statement for the bond offering, and a Registration Statement for Refco’s common stock IPO.

Plaintiffs filed a complaint in the Southern District of New York alleging that the defendants were liable for securities fraud under Section 10(b) because they allegedly drafted, reviewed and otherwise participated in creating false statements that were contained

¹ The slip opinion is available at <http://www.ca2.uscourts.gov/decisions>

in Refco's documents. The Offering Memorandum and the IPO Registration Statement identified the law firm as representing Refco in connection with the transactions. None of the documents, however, specifically attributed any of the information in them to the law firm or the individual partner.

The Decision. In *PIMCO*, the Second Circuit (Cabrane, J., joined by Parker, J. and Amon, J.) unanimously affirmed the district court's dismissal of plaintiffs' Section 10(b) claims against the defendants. Upon reviewing the Court's prior precedent and guidance provided by the Supreme Court, the panel concluded that a false statement must be attributed to a secondary actor – such as lawyers, accountants and banks – in order for the secondary actor-defendant to be liable in a private damages action for securities fraud under Section 10(b). In particular, the Court noted that in the absence of a statement being attributed to a secondary actor-defendant, a plaintiff could not demonstrate the critical element of “reliance” on the defendant's conduct. The Second Circuit thus held that dismissal of the complaint was proper because none of the allegedly false statements in Refco's documents were attributed to either defendant. The Court noted that two of the documents identified the law firm as representing the issuer in the transaction, but found that this could not “be considered an ‘an articulated statement’ by [the firm] adopting Refco's statements as its own.”

In adopting the “attribution” standard for secondary actor liability under Section 10(b), the Court endorsed the same standard it had previously applied in *Wright v. Ernst & Young LLP*, 152 F.3d 169 (2d Cir. 1998), which required attribution for Section 10(b) claims brought against an issuer's accountants. *Wright* had been called into question following the Circuit's subsequent decision in *In re Scholastic Corp. Securities Litigation*, 252 F.3d 63 (2d Cir. 2001), which held that an inside corporate officer could be liable for misrepresentations made by the corporation, notwithstanding the fact that none of the statements at issue were specifically attributed to him. *PIMCO* clarified that, regardless of whether *Scholastic* had continuing viability in the context of claims against corporate insiders, the attribution standard was the proper one when the Section 10(b) defendant is an outsider.

The Second Circuit also specifically rejected an alternate standard proposed by the plaintiffs and the SEC. Namely, these parties urged the Court to adopt “a creator standard” and hold that a defendant can 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. The Court rejected this argument under its prior precedent as well as the Supreme Court's reasoning in its recent *Stoneridge* decision, which held that to a state claim under Section 10(b) plaintiffs must rely on a defendant's *own* deceptive conduct.² The Second Circuit also noted that its bright-line attribution standard would have the benefit of

² See *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008). In *PIMCO*, the Court of Appeals also affirmed the dismissal of plaintiffs' “scheme liability” claims, which the Second Circuit held were foreclosed by *Stoneridge*.

resulting in greater certainty in the market and potentially avoiding protracted litigation and discovery aimed at learning the identity of each person or entity that had some connection, however tenuous, to the “creation” of an allegedly false statement.

The Concurrence. Judge Parker, who joined the majority decision in full, also issued a brief concurrence. In his concurring opinion, Judge Parker noted that notwithstanding the outcome in *PIMCO*, there was lingering tension between *Wright* and *Scholastic* that could justify the Court’s *en banc* review. Judge Parker also suggested that the issue was worthy of certiorari to the Supreme Court given the conflicting law of certain other Circuits, which had declined to adopt the attribution standard even in the secondary actor context.

II. Implications For Financial Institutions And Other Parties Who Participate In Securities Offerings By Issuing Firms

PIMCO clarifies that in the Second Circuit, secondary actors such as lawyers, accountants and underwriters, are not liable for private damages claims under Section 10(b) unless allegedly false statements were “attributed” to the secondary-actor defendant at the time of dissemination. Thus, even if plaintiff alleges that a secondary actor participated in “creating” a false statement contained in the issuer’s document, this assertion alone should be insufficient to survive a dismissal motion absent a plausible allegation that the statement was specifically attributed to the secondary actor-defendant. Although *PIMCO* affirms the bright-line attribution standard for secondary actors under Section 10(b), the decision explicitly leaves undecided whether some lower standard applies for corporate insiders.

Please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under any of the “Practices” section of our website (<http://www.clearygottlieb.com>) if you have any questions.

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