

Stoneridge & The Meaning of "Deception"

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When a public company mischaracterizes its value, and an investor, relying upon the integrity of the company's statements, trades in the company's stock and incurs a loss, the investor may turn to § 10(b) of the Securities Exchange Act to seek redress. Section 10(b) prohibits "manipulative or deceptive" conduct in connection with trading in securities.¹ When a *third party*—who never was identified to the investor and thus played no role in the investor's decision to trade—engages in transactions with the company, which the company uses to mischaracterize its value, can the third party be liable under § 10(b)? Did the third party *deceive* the investor? This question will be answered when the Supreme Court decides *Stoneridge Investment v. Scientific-Atlanta, Inc.*,² and the stakes are high for the landscape of securities litigation, and commerce more broadly. Banks, auditors, advisors and anyone transacting business with public companies potentially could be exposed to claims of securities fraud merely by their dealings—however anonymous or tangential—with those companies.

In *Stoneridge*, Charter Communications, Inc.'s shareholders sued two of Charter's vendors, not because the shareholders relied upon any statements (or omissions)

made by the vendors—indeed, the shareholders do not allege that the vendors made any statements to them or owed them any duty—but because the vendors engaged in business transactions with Charter knowing that Charter would account for them improperly. This, the shareholders allege, constituted participation in a "scheme to defraud." The Eighth Circuit disagreed, holding that the vendors' conduct was not "deceptive."³ The Supreme Court granted *certiorari* to consider whether claims under § 10(b) may lie where secondary actors like the vendors "themselves made no public

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statements concerning those transactions.” The case was argued on October 9 and, although it is always difficult to predict outcomes from arguments, there did not appear to be majority support among the Justices for extending the reach of Section 10(b) in the manner proposed by the *Stoneridge* shareholders.

The issue, simply put, is whether a § 10(b) claim lies against a party that did not reasonably create a misleading expectation—whether by statement, omission or otherwise—in another. The securities plaintiffs’ bar seeks a broad interpretation of the statute, enabling plaintiffs to reach new deep pockets otherwise not exposed to private lawsuits since the Supreme Court’s decision in *Central Bank of Denver v. First Interstate Bank of Denver*⁴ barring private § 10(b) actions for mere “aiding and abetting.” And the Bush administration has its own angle: The U.S. Solicitor General filed an *amicus* brief urging the Court to adopt a broad definition of “deception,” which would enable the SEC and the DOJ to bring enforcement actions or prosecute third parties based on allegations like those against the vendors in *Stoneridge*. (The SEC and DOJ, unlike private plaintiffs, are authorized to bring aiding and abetting claims, but a broad interpretation of deception undoubtedly would expand their enforcement powers.) At the same time, as discussed below, the Solicitor General’s proposed test would bar private § 10(b) claims, such as those against the *Stoneridge* vendors, where plaintiffs cannot satisfy the reliance and causation requirements that the government need not show.⁵

The issue, simply put, is whether a § 10(b) claim lies against a party that did not reasonably create a misleading expectation—whether by statement, omission or otherwise—in another.

But the *Stoneridge* case, in which the shareholders do not even allege that they knew about the

vendors’ business dealings with Charter—let alone that they expected some different conduct from the vendors or were misled by them—shows why under any plausible definition of “deceptive,” such conduct is not within the ambit of § 10(b). “Deception” does not occur in a vacuum; a defendant’s conduct cannot be deceptive unless it (1) creates an expectation or understanding by the plaintiff (or alleged victim in an SEC enforcement action or criminal prosecution), and (2) violates it.

Statutory Background & Supreme Court Precedent: Securities Fraud & “Deception”

Section 10(b) provides that it is unlawful to “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.” The SEC’s Rule 10b-5, enacted thereunder, provides that “[i]t shall be unlawful for any person, directly or indirectly:”

- (a) To employ any device, scheme, or artifice to defraud,
- (b) To 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 the light of the circumstances under which they were made, not misleading, or
- (c) To 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.⁶

The quintessential “securities fraud” claim pursuant to § 10(b) is one alleging a material misrepresentation or omission (*e.g.*, by a public company that files its financial statements with the SEC), which would fall under Rule 10b-5(b). Only recently have plaintiffs sought to explore claims for so-called “scheme” liability, citing Rule 10b-5(a) and (c) based not upon a misrepresentation or omission but upon some other conduct which plaintiffs allege is equally fraudulent. There is little

law, however, regarding what kind of “scheme” or conduct, outside a misrepresentation or omission, constitutes a violation of § 10(b). Whether a claim is brought under Rule 10b-5(a), (b) or (c), it still fundamentally must allege “manipulative or deceptive” conduct to create liability under § 10(b).

“Manipulative” conduct, in connection with securities trading, is a “term of art” that the Supreme Court has defined as conduct “intended to mislead investors by artificially affecting market activity” by controlling securities prices in specific ways, *e.g.*, through wash sales, matched orders or rigged prices.⁷ Although not the subject of this article or at issue in the *Stoneridge* case, the Supreme Court’s interpretation of manipulation offers a helpful backdrop when analyzing the meaning of “deception.” The Court has held that “manipulative” conduct must “mislead” investors to give rise to § 10(b) liability.⁸ In other words, unless the defendant’s conduct creates some expectation in others (regarding the value of shares) that is not fulfilled, there can be no § 10(b) liability under a “manipulation” theory.

Congress also did not define “deception.” And, because most § 10(b) claims have been based upon alleged misrepresentations or omissions, the Supreme Court has not had an opportunity to clarify the outer bounds of the term, *e.g.*, what, if anything, it covers beyond misrepresentations and omissions by persons with a duty to speak. Various of the Court’s decisions provide some guidance, however. In *Affiliated Ute Citizens v. United States*, for example, Native American tribal members sued a transfer agent for allegedly encouraging them to sell tribal stock without informing them of restrictions on the sale. The Court ruled for the tribe, explaining that although Rule 10b-5(b) is premised on “making an untrue statement of material fact,” subsections (a) and (c) “are not so restricted.”⁹ In arriving at its decision, the Court observed that the statutory language of 10(b), with its repeated use of the word “any” (*i.e.*, “any manipulative act,” “by use of any means”) is meant to be broad and inclusive. The securities laws, the Court held, should be

“construed not technically and restrictively, but flexibly to effectuate its remedial purpose.”¹⁰

In *Central Bank*, the Supreme Court rejected private “aiding and abetting” claims under § 10(b). In that case, purchasers of bonds issued by a housing authority sued the bank that served as indenture trustee for the bonds. The purchasers alleged that the bank knew the authority had published an inflated appraisal of the land securing the bonds, but postponed an independent appraisal until after the authority issued a second set of bonds. The authority then defaulted on the bonds. The purchasers alleged that the bank was “secondarily liable” under § 10(b) by aiding and abetting the authority.¹¹ In rejecting a private cause of action for aiding and abetting, the Court stressed that what is “critical for recovery” in a private § 10(b) claim is a “showing that the plaintiff *relied* upon the aider and abettor’s statements or actions.”¹²

In an effort to provide guidance regarding the scope of liability against so-called secondary actors in a fraud, the Court went on to say that “[a]ny person,... 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.”¹³ The Court’s replacement of “deceptive” conduct with “material misstatement (or omission)” may either be defining—meaning that all other conduct is, at most, aiding and abetting and not actionable in private civil litigation—or *dicta*. The result in *Stoneridge* could turn on the current Court’s interpretation of this language in *Central Bank*.

In an effort to provide guidance regarding the scope of liability against so-called secondary actors in a fraud, the Court went on to say that “[a]ny person, ... 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 [...]”

Congress has confirmed the holding of *Central Bank*. In the Private Securities Litigation Reform Act of 1995 (PSLRA), Congress clarified the Exchange Act by vesting in the SEC the sole authority to pursue aiding and abetting claims.¹⁴ Congress was invited to extend such claims to private investors, but specifically declined because doing so would be “contrary to [the Act’s] goal of reducing meritless securities litigation.”¹⁵

Interpretations of Central Bank: Theories about the Meaning of “Deception”

The Bright Line Test: Misstatements or Omissions

Some courts, including the Eighth Circuit in *Stoneridge*, have interpreted *Central Bank* as holding that, absent an allegation that the defendant made a misstatement, or an omission in the face of a duty to speak, a private cause of action under § 10(b) will not lie. The Fifth Circuit recently reversed class certification of Enron shareholders’ § 10(b) claims against three investment banks for engaging in various business transactions with Enron that allegedly enabled Enron to account for certain liabilities and revenues improperly. The court held that an act cannot be “deceptive” under § 10(b), even pursuant to Rule 10b-5(a) or (c), where “the actor has no duty to disclose.”¹⁶

The court reasoned that, “[p]resuming plaintiffs’ allegations to be true, Enron committed fraud by misstating its accounts, but the banks only aided [and] abetted that fraud by engaging in transactions to make it more plausible; they owed no duty to Enron’s shareholders.”¹⁷ (The plaintiffs have sought review by the Supreme Court.)

Other courts, believing that § 10(b) does or should extend liability to those who have some involvement in a “scheme” by which investors are misled, have adopted an array of standards while endeavoring to remain consistent with *Central Bank*.

“Substantial Participation”

Some courts have extended liability under § 10(b) not for the making of a misstatement, but where the defendant’s participation in another’s statement may be so substantial that the defendant is “deemed” to have made the statement. In *Carley Capital v. Deloitte & Touche, L.L.P.*, investors sued an accounting firm providing consulting services to a company for allegedly making misstatements concerning the company’s true financial condition, even though it was the company that *actually* made the statements (and did so without any reference to the accounting firm).¹⁸ Because the accounting firm “(1) occupied and continually staffed offices at [the company]; (2) had unlimited access to all of [the company’s] records and documents; [and] (3) attended meetings of [the company’s] Board of Directors and the Audit Committee of the Board,” the court in the Northern District of Georgia held that “[m]ore than mere participation, complicity, or assistance, the Plaintiffs have essentially alleged that the [the accounting firm] was the author of the alleged misstatement.” The defendant in *Carley Capital* did not challenge the plaintiffs’ reliance on the “fraud on the market” doctrine to show reliance,¹⁹ so the Court did not address whether the investors had to demonstrate that they relied upon—or even knew about—the accounting firm’s involvement with the company that made the alleged misstatements.

Similarly, other courts have extended liability to secondary actors such as an accounting firm only where it is “appropriate to infer that... investors reasonably attributed the statements to” *that ac-*

tor, such that the actor “substantially participates in a manipulative or deceptive scheme by directly or indirectly employing a manipulative or deceptive device... intended to mislead investors.”²⁰ Under this theory, as described by Judge Gerard E. Lynch of the Southern District of New York in *In re Global Crossing, Ltd. Securities Litigation*, liability is appropriate “where the defendant’s participation is substantial enough that s/he may be deemed to have made the statement, and where investors are sufficiently aware of defendant’s participation that they may be found to have relied on it as if the statement had been attributed to the defendant.”²¹ In *Global Crossing*, Judge Lynch held that allegations that a company’s investors clearly were aware of its long-time auditor, and that the auditor “helped create” (even though its name was not attached to) the company’s *unaudited* financial statements, are sufficient to state a claim under § 10(b).

This aspect of *Global Crossing*, however, cannot survive the Second Circuit’s holding in *Lattanzio v. Deloitte & Touche LLP* that an accounting firm may not be liable under § 10(b) for helping to compile and reviewing (but not auditing) the issuer’s interim financial statements included in Form 10-Qs, when the issuer attributed no statement made in the Form 10-Qs to the firm.²² The auditor’s duty under SEC regulations to review the 10-Qs does not “associate [the accounting firm] with those statements to such a degree that they became [the accounting firm’s] statements, or that the review created a regulatory duty to correct, the breach of which qualifies as a statement under § 10(b).”²³ Thus, the Second Circuit held, to state a § 10(b) claim against an issuer’s accountant, a plaintiff must allege “a misstatement that is attributed to the accountant,” and not mere drafting assistance.²⁴ And, citing the page in *Central Bank* containing the statement that § 10(b) extends only to “a manipulative device” or a “material misstatement (or omission),” the *Lattanzio* Court also stated: “Public understanding that an accountant is at work behind the scenes does not create an exception to the requirement that an actionable misstatement be made by the accountant.... Unless the public’s understanding is based on the accountant’s articulated state-

ment, the source for that understanding—whether it be a regulation, an accounting practice, or something else—does not matter.”²⁵ And, as we argue below, similar reasoning should inform the Supreme Court’s analysis of the scope of § 10(b)’s proscription of “deception” in *Stoneridge*.

Conduct “By Nature” Deceptive

In *Global Crossing*, Judge Lynch also outlined an alternative theory of § 10(b) liability, holding that allegations that the accounting firm “masterminded the misleading accounting” by the company were sufficient to state a claim under Rule 10b-5(a) and (c) “for behavior that constitutes participation in a fraudulent scheme, even absent a fraudulent statement by the defendant.”²⁶ Judge Lynch did not, however, indicate the basis upon which the company’s investors, when making investment decisions based upon the company’s unaudited financial statements in which the accounting firm’s name did not appear, were deceived *by the accounting firm*. In other words, there was no explanation of how investors reasonably could have formed a legitimate expectation of some particular conduct from the firm. Under these circumstances, it is difficult to see how the investors were deceived by the accounting firm itself (rather than, at most, the company), and thus how the accounting firm itself acted “to defraud” anyone (Rule 10b-5(a)) or how its conduct “would operate as a fraud or deceit upon any person” (Rule 10b-5(c)).²⁷

In another decision from the Southern District of New York, *In re Parmalat Securities Litigation*, Judge Lewis A. Kaplan held that banks which securitized a company’s bonds, allegedly knowing that the assets securing the bonds were worthless, could be held liable under Rule 10b-5(a) and (c) for participating in a fraudulent scheme even though the banks’ involvement was not public.²⁸ After *Central Bank*, Judge Kaplan noted, it has been difficult for plaintiffs to bring Rule 10b-5(a) and (c) claims against those previously sued as aiders and abettors, because plaintiffs generally have no dealings with consultants and bankers working with public companies, making it hard to prove reliance on anything other than a company’s public statements. Judge Kaplan attempted to ease this burden by holding that “[t]he transactions in which

the [banks] engaged were by nature deceptive.... It is impossible to separate the deceptive nature of the transactions from the deception actually practiced upon Parmalat's investors. Neither the statute nor the rule requires such a distinction."²⁹ In other words, according to Judge Kaplan, the fraudulent act included both the company's misstatement, upon which investors relied, and all conduct by all parties involved in the "scheme" which led to the statement. On the facts before him, Judge Kaplan held that a bank's securitization of "worthless" invoices, combined with the fact that the issuer improperly accounted for the invoices on its financial statements, was a sufficiently "deceptive" device or contrivance by the bank for purposes of § 10(b). It is hard to see why this description of such "involvement" is not equivalent to mere aiding and abetting, however. Moreover, it is unclear from the decision how the investors relied upon the banks—*i.e.*, what the investors expected, but did not receive, from the banks.

***Stoneridge*: "Purpose and Effect"**

In *Stoneridge*, the shareholder petitioners propose the following test for whether a person's conduct is part of a deceptive "scheme" under Rule 10b-5(a) and/or (c): "if the purpose and effect of his conduct is to create a false appearance of material fact in furtherance of that scheme."³⁰ The U.S. Solicitor General suggests a similar test, arguing that "the phrase 'deceptive device or contrivance'" includes "conduct that has the effect of conveying a false appearance of material fact concerning a transaction into which the person has entered."³¹ The crux of the problem with these proposed tests is their ambiguity and overbreadth. Either test would extend § 10(b) liability in a manner that is inherently inconsistent with *Central Bank* and a common sense definition of deception. Charter's vendors did not give any "appearance" at all to Charter's shareholders. The vendors did not create, take any part in creating, or take any responsibility for, Charter's financial statements upon which the shareholders allege they relied. Calling the vendors' conduct in and of itself "deceptive" is thus illogical, and this is underscored by the fact that, had the vendors engaged in exactly the same transactions with

Charter, even believing that Charter would issue misleading financial statements, but Charter accounted for the transactions properly, the shareholders would have no complaint at all.

Indeed, Charter's shareholders do not even allege that they knew the vendors were involved with Charter. With no privity between the vendors and the shareholders in this manner, the vendors could not have deceived them. The essence of the shareholders' claim is that Charter issued financial statements that deceived them, while the vendors engaged in transactions that allowed Charter to do so. It is—at best—a claim that the vendors aided and abetted Charter and thus is not a proper basis for a private § 10(b) action under *Central Bank*.

In addition, the tests proposed by the plaintiffs and the Solicitor General are inconsistent with Congress' intent in enacting the securities laws. As the Senate Report accompanying the Exchange Act explained:

The purpose of this bill is to protect the investing public and honest business.... The aim is to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion....³²

By focusing the Exchange Act on those who "place" or "present" information "before the investor," or who "promote" or "misrepresent" the value of a security, Congress intended to prevent a defendant, through communication or some other interaction or connection with the investor, from creating a misleading expectation in that investor. That does not describe the vendors in *Stoneridge*, who themselves did not communicate with, have any contact with or owe any duty to—and thus could not have misled—Charter's investors.³³

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Finally, based on statements from various Supreme Court cases, such as the acknowledgement in *Affiliated Ute* that Rule 10b-5(a) and (c) are not “restricted” to “making an untrue statement of material fact,” the investors in *Stoneridge* argue that the term “deception” in § 10(b) “was obviously chosen to reach beyond verbal misrepresentations” or an omission in the face of a duty to speak. This *may* be true, but it does not support the investors’ argument that § 10(b) covers any acts which have “the purpose and effect of furthering [a] fraudulent scheme,” where “active participation was material to its accomplishment and the consequences foreseeable.”³⁴ Whether or not the Supreme Court holds that § 10(b) may apply to non-verbal conduct, the conduct still must be deceptive. The vendors in *Stoneridge*, in fact, “do not dispute that communicative conduct—for example, presenting potential investors with a misleading display that makes nonfunctional factory equipment appear operational—*may* amount to a ‘deceptive device or contrivance.’”³⁵ What the *Stoneridge* petitioners overlook is that, whatever the conduct, the common denominator remains the same: The conduct still must be deceptive. The defendant must have some communication, interaction or connection with the plaintiff, such that the defendant reasonably fostered an expectation by the plaintiff, but failed to deliver on it. Without that understanding between the par-

ties, a plaintiff cannot rely upon—or be deceived by—the defendant, and there is no fraud by the defendant under § 10(b).

A Workable Definition of “Deception”: Creating, and Violating, an Expectation

A series of criminal cases against New York Stock Exchange trading specialists illustrates the dividing lines in the debate. In these cases, the government’s theory is that the specialists engaged in “deceit” under § 10(b) by trading from their proprietary accounts instead of matching customers with appropriate buyers or sellers for the best price, in violation of NYSE rules. Two district judges in the Southern District of New York have reached somewhat different conclusions on whether such conduct can constitute a violation of § 10(b) and Rule 10b-5(a) and (c), and appeals in both cases currently are pending before the Second Circuit. In *United States v. Bongiorno*, Judge Sidney H. Stein denied the specialists’ motion to dismiss their indictments for allegedly undertaking a fraudulent scheme in violation of Rule 10b-5(a) and (c), even though the government did not allege that they made material misstatements or omissions. Judge Stein assumed that “defendants’ customers were led to believe one thing when another was true,” and reasoned that he was unconstrained by *Central Bank* because the specialists’ conduct was not alleged to be “aiding and abetting,” but was alleged to be a primary violation.³⁶ The opinion does not, however, explain *how* any customers allegedly formed a reasonable expectation regarding the specialists’ conduct—*i.e.*, whether, for example, the specialists directed the customers to the NYSE standards as governing how trades must be handled—and it is not clear whether the court’s assumption about customer expectations even was alleged in the indictment. The judge also later refused to grant an acquittal after hearing the evidence, and the defendants argue on appeal of their conviction that the government failed to adduce any proof of customer expectations.³⁷

[D]eception takes at least two parties who stand in privity: a plaintiff (or alleged victim in an SEC enforcement action or criminal prosecution) must have been led, falsely, by the defendant's affirmative conduct to expect something from the defendant.

By contrast, in *United States v. Finnerty*, Judge Denny Chin set aside the jury's verdict against a specialist and granted a judgment of acquittal based on a similar claim, holding that "proof of customer expectations was required to show that the customers were deceived" about the manner in which the specialist was required to execute trades on their behalf.³⁸ Judge Chin stated that determining which conduct

may 'fairly be viewed as deceptive' will generally depend upon the circumstances of the particular person or class allegedly deceived... . [B]efore the court can ask 'Was the conduct deceptive?', it must first ascertain 'To whom?' It makes sense, then, that in securities fraud cases the Government generally is required to provide proof of customer expectations, i.e., proof of what customers "think they are getting"; otherwise, a juror has no way of concluding whether customers were deceived by a defendant's conduct."³⁹

At trial, the government did not prove what expectations the customers had formed, or how the specialist created those expectations. The government thus failed to show that the specialist deceived anyone. "A rational juror would only be able to reach that conclusion [that the customers were deceived] by speculating – impermissibly – as to what customers expected."⁴⁰

Most recently, Judge Lynch, who is overseeing the *Refco* litigations pending in the Southern District of New York, conducted an extensive discussion of claims under Rule 10b-5(a) and (c),

dismissing class action claims against a securities brokerage by its customers for failing to allege deceptive conduct sufficiently.⁴¹ Judge Lynch started with the proposition that guided his decision in *Global Crossing*, i.e., that a claim under Rule 10b-5(a) and (c) lies "for behavior that constitutes participation in a fraudulent scheme, even absent a fraudulent statement by the defendant."⁴² But Judge Lynch went on to highlight the underpinning for such a claim: "Indeed, the most basic element of all fraud claims is that the victim must be deceived by the perpetrator's words or actions." Judge Lynch recognized "several kinds of cognizable deception," including "misleading statements or material omissions" under Rule 10b-5(b), "market manipulation" under Rule 10b-5(a) and (c) (in which "instead of deceiving investors by making false statements, fraudsters... deceive investors by causing the market to make their false statements for them") and claims that are "inconsistent with a fiduciary duty" (in which case "the fiduciary duty serves as a sort of standing false representation by the fraudster, who deceives the victim by violating the commitment associated with her fiduciary duty"). As Judge Lynch summarized eloquently, citing *Finnerty*:

The point is that there must be some conduct or representation by the fraudster that deceives the victim – that is, the defendant's conduct must create in the victim a sense that things are otherwise than they are....

In order to coherently allege deceptive conduct, plaintiffs must identify (1) the source of the understanding falsely created by defendants (that is, a fiduciary duty, prior representation, or some other reason why they believed defendants would act otherwise than they did), and (2) conduct that violated that understanding.⁴³

The plaintiffs in *Refco*, Judge Lynch held, did neither. Among their allegations, the brokerage customers complained that the Refco brokerage "diverted" funds in the customers' accounts to other Refco entities, but didn't describe "how customers'

assets were managed in the normal course of business, which makes it difficult to understand what the word ‘diverted’ means,” nor did the complaint describe any agreements by which the brokerage promised to handle those assets. Without pointing to any requirement to which the brokerage “claimed it would adhere that prohibited its actual use of funds in the allegedly fraudulent manner, “[t]he complaint therefore provides no reason why plaintiffs could reasonably have expected [the brokerage] not to use their assets in the manner it did.”⁴⁴

Judge Lynch’s decision in *Refco* demonstrates that for deception to occur, the defendant’s conduct must cause the plaintiff to expect something (*i.e.*, something on which the plaintiff can *rely*) and also must violate that expectation. Anything less than that, even if perhaps “untoward,” does not give rise to liability under § 10(b). “Stealing a stranger’s car,” Judge Lynch noted, “does not deceive the victim; it merely deprives him of his car.”⁴⁵ And yet, the dichotomy between the *Refco* decision, on the one hand, and Judge Lynch’s conclusion in *Global Crossing* that an accounting firm which made no statement to shareholders and undertook no duty to audit a company could be liable under § 10(b) for misleading the company’s shareholders, on the other hand, proves the need for Supreme Court guidance.

Conclusion

Although the current debate is fueled by a lack of clear precedent from the Supreme Court regarding the meaning of “deception,” both sides seem to find support from the same underlying dictionary definition of the term. As Judge Kaplan pointed out in *Parmalat*, the Supreme Court has in a somewhat different context cited a dictionary defining “deceptive” as “having power to mislead.”⁴⁶ In *Bongiorno*, Judge Stein relied on dictionaries using that definition and another defining “to deceive” as “to take unawares esp[ecially] by craft or trickery... to deprive esp[ecially] by fraud or stealth . . . [or] to cause to believe the false....”⁴⁷ The petitioners in *Stoneridge* cite these same definitions, as well as *Black’s Law Dictionary*, which defines “deception” as “‘intentional misleading by falsehood,’ whether ‘spoken or acted.’”⁴⁸

Whatever spin is put on these definitions, the common thread is that deception takes at least two parties who stand in privity: a plaintiff (or alleged victim in an SEC enforcement action or criminal prosecution) must have been led, falsely, by the defendant’s affirmative conduct to expect something from the defendant. However one might describe the conduct of the vendors in *Stoneridge*, or the specialists in the criminal prosecutions, there is no suggestion in any of these cases that the defendants’ conduct *led* the plaintiffs to expect something specific from the defendants, but which the defendants failed to deliver. Without creating such an understanding—whether by statement, omission, fiduciary duty or other conduct—then breaching it, conduct is not “deceptive” under § 10(b). *Stoneridge* offers the Supreme Court a chance to confirm that basic underpinning of § 10(b) and put an end to the vast and vague expansion that some have proposed.

NOTES

1. 15 U.S.C. § 78j.
2. *Stoneridge Investment v. Scientific-Atlanta, Inc.*, 127 S. Ct. 1813 (2007).
3. *In re Charter Communications*, 443 F.3d 987 (8th Cir. 2006).
4. 511 U.S. 164 (1994).
5. Brief for the United States as Amicus Curiae, *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, No. 06-43, at 8-30.
6. 17 C.F.R. § 240.10b-5.
7. *Santa Fe Indus. v. Green*, 430 U.S. 462, 476 (1977).
8. *Id.*
9. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 133, 152-53 (1972).
10. *Id.* at 151.
11. 511 U.S. at 168.
12. *Id.* at 180 (emphasis added).
13. *Id.* at 191 (emphasis added).
14. 15 U.S.C. § 78t(e).
15. See S. Rep. No. 104-98, at 19 (1995).
16. See *Regents of Univ. of Cal. v. Credit Suisse First Boston (USA) Inc.*, 482 F.3d 372, 385 (5th Cir. 2007).
17. *Id.* at 386.
18. *Carley Capital Group v. Deloitte & Touche, L.L.P.*, 27 F. Supp. 2d 1324, 1329, 1334-35 (N.D. Ga. 1998).
19. *Id.* at 1333.

20. *In re Lernout & Hauspie Sec. Litig.*, 230 F. Supp. 2d 152, 167 (D. Mass. 2002); see also *Lernout*, 236 F. Supp. 2d 161, 173 (D. Mass. 2003).
21. *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 333 (S.D.N.Y. 2004).
22. *Lattanzio v. Deloitte & Touche LLP*, 476 F.3d 147, 155 (2d Cir. 2007).
23. *Id.*
24. *Id.* at 153.
25. *Id.* at 155.
26. *Global Crossing*, 322 F. Supp. 2d at 335.
27. Judge Lynch in fact intimated that he was not relying upon the “deceptive” prong of § 10(b) at all, but upon the “manipulative” prong, concluding that the accounting firm, in effect, was a company insider which “was intimately involved in all of [the company’s] accounting functions, and... chief architect and executor” of the accounting fraud, and that the impact of the accounting firm’s conduct was “to artificially inflate the price of stocks by creating phantom revenue.” *Id.* at 337. Perhaps, then, Judge Lynch’s decision does not stand for the proposition that the accounting firm’s alleged conduct was “deceptive” at all. Still, it is difficult to reconcile such a finding of “manipulation” with the traditional term of art uniformly recognized by case law. See, e.g., *In re Refco Capital Markets, Ltd. Brokerage Customer Sec. Litig.*, No. 06 Civ. 643, 2007 WL 2694469, at *7 (S.D.N.Y. Sept. 13, 2007) (Lynch, J.) (“The gravamen of a market manipulation claim is that defendants’ actions convey to investors, via the market (which, absent manipulation, would produce a price that fairly reflects the value of securities), a false sense of a security’s value.”).
28. *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 504 (S.D.N.Y. 2005)
29. *Id.*
30. Brief of the Petitioners, *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, No. 06-43, at 32. This definition mirrors one used by the Ninth Circuit. See *Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006) (“to be liable as a primary violator of Section 10(b) for participation in a ‘scheme to defraud,’ the defendant must have engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme”).
31. Brief of the United States as *Amicus Curiae* in *Stoneridge*, at 16.
32. S. Rep. No. 47, 73rd Cong., 1st Sess., at 1 (1933) (emphasis added).
33. Moreover, if the shareholders in *Stoneridge* alleged not just that the vendors assisted Charter but instead that they controlled Charter’s conduct in publishing purportedly-deceptive financial statements, the shareholders’ claim would lie under Section 20(a) of the Securities Exchange Act. See 15 U.S.C. § 78t(a). Congress reserved Section 20(a) “control person liability” claims for such allegations. By failing to allege either that the vendors themselves committed a deceptive act on which the shareholders relied, or that the vendors controlled Charter’s purportedly deceptive conduct, allowing such a claim to lie under § 10(b) would enable an end-run around the securities laws.
34. Pet. Br., in *Stoneridge*, at 13-14.
35. Brief of the Respondents, *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, No. 06-43, at 22.
36. *United States v. Bongiorno*, No. 05 Cr. 390, 2006 WL 1140864 at *3, *7 (S.D.N.Y. May 1, 2006).
37. Brief of Michael Hayward, *United States v. Hayward et al.*, Nos. 07-0331-cr(L), 07-0336-cr(CON), at p. 37.
38. *United States v. Finnerty*, 474 F. Supp. 2d 530, 532 (S.D.N.Y. 2007).
39. *Id.* at 539 (internal quotations and citations omitted).
40. *Id.* at 540.
41. *Refco*, No. 06 Civ. 643, 2007 WL 2694469, at *8.
42. *Id.* at 14 (quoting *Global Crossing*, 322 F. Supp. 2d at 335).
43. *Id.* at 15, 17.
44. *Id.* at 4, 19.
45. *Id.* at 17.
46. *Parmalat*, 376 F. Supp. 2d at 502 (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 n.20 (1976)).
47. *Bongiorno*, 2006 WL 1140864 at *7 (ellipses and brackets in original).
48. Pet. Br., in *Stoneridge*, at 21 n.7.