06-2902-cv

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

TEAMSTERS LOCAL 445 FREIGHT DIVISION PENSION FUND,
on its own behalf/on behalf of all others similarly situated,

Plaintiff-Appellee,

—v.—

DYNEX CAPITAL INC. and MERIT SECURITIES CORPORATION,

Defendants-Appellants,

STEPHEN J. BENEDETTI, THOMAS H. POTTS, LEHMAN BROTHERS, INC. and GREENWICH CAPITAL MARKETS, INC.,

Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR *AMICI CURIAE* THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, AND THE BUSINESS ROUNDTABLE IN SUPPORT OF DEFENDANTS-APPELLANTS

CARTER G. PHILLIPS
RICHARD D. BERNSTEIN
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000

A. ROBERT PIETRZAK
DANIEL A. MCLAUGHLIN
SIDLEY AUSTIN LLP
787 Seventh Avenue
New York, New York 10019
(212) 839-5300

Attorneys for Amici Curiae The Securities Industry and Financial Markets Association, The Chamber of Commerce of the United States of America, and The Business Roundtable

(Counsel continued on inside front cover)

MARJORIE GROSS
SECURITIES INDUSTRY AND FINANCIAL
MARKETS ASSOCIATION
360 Madison Avenue
New York, New York 10017
(646) 637-9204

ROBIN S. CONRAD
AMAR D. SARWAL
NATIONAL CHAMBER LITIGATION
CENTER, INC.
1615 H Street, N.W.
Washington, D.C. 20062
(202) 463-5337

MARIA GHAZAL
BUSINESS ROUNDTABLE
1717 Rhode Island Avenue, N.W.
Suite 800
Washington, D.C. 20036
(202) 496-3268

Attorneys for Amici Curiae The Securities Industry and Financial Markets Association, The Chamber of Commerce of the United States of America, and The Business Roundtable

RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Amici curiae the Securities Industry and Financial Markets Association, The Chamber of Commerce of the United States of America, and The Business Roundtable state that they are not subsidiaries of other corporations, and no publicly held corporation owns more than 10% of their stock.

TABLE OF CONTENTS

Page

RULE 29(C)(3) STATEMENT 1

SUMMARY OF ARGUMENT 2

ARGUMENT 4

I. COLLECTIVE SCIENTER WOULD IMPROPERLY RESURRECT CORPORATE NEGLIGENCE LIABILITY 4

A. Section 10(b) Liability Is Limited To Manipulative Or Deceptive Acts And Does Not Extend To Negligence. 5

B. Collective Scienter Imposes A Negligence-Type "Duty of Inquiry" ... 7

II. COLLECTIVE SCIENTER IS INCONSISTENT WITH EXISTING PRECEDENT 9

A. This Court's Precedents Focus On The Officials Who Make And Issue Corporate Statements. 9

B. This Court's "Motive and Opportunity" Precedents Are Also Inconsistent With Collective Scienter. 11

C. Seven Other Circuits Have Rejected "Collective Scienter." 14

D. Collective Scienter Is Contrary To Precedent In "Opinion" Cases.... 16

E. Collective Scienter Is Inconsistent With Common Law Precedents.. 17

III. COLLECTIVE SCIENTER WOULD IMPOSE SIGNIFICANT COSTS WITHOUT CORRESPONDING BENEFITS 21

A. Collective Scienter Permits Abusive Discovery 22

B. Collective Scienter Allows Low-Level Or Rogue Employees To Victimize The Corporation And Its Shareholders Twice, While Doing Nothing To Remedy Serious Fraud. 23

C. A Negligence-Like Standard Will Further Discourage Companies From Listing Shares In United States Public Markets. 26

CONCLUSION 29

TABLE OF AUTHORITIES

CASES

Acito v. IMCERA Group,
47 F.3d 47 (2d Cir. 1995) 12

In re Alpharma, Inc. Sec. Litigation,
372 F.3d 137 (3d Cir. 2004) 12, 15

In re Apple Computers, Inc.,
127 Fed. Appx. 296 (9th Cir. 2005) 14

Bank of China v. NBM LLC,
359 F.3d 171 (2d Cir. 2004), cert. dismissed, 126 S. Ct. 675 (2005) 20

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723 (1975) 7, 21, 22, 24

Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994) 5, 7, 28

In re Cerner Corp. Sec. Litigation,
425 F.2d 1079 (8th Cir. 2005) 17

Chiarella v. United States,
445 U.S. 222 (1980) 6

Chill v. General Electric Co.,
101 F.3d 263 (2d Cir. 1996) 8

City of Monroe Empl. Retirement System v. Bridgestone Corp.,
399 F.3d 651 (6th Cir.), cert. denied, 126 S. Ct. 423 (2005) 16

Dura Pharm., Inc. v. Broudo,
544 U.S. 336 (2005) 17, 18, 24

In re Dynex Cap., Inc. Sec. Litigation,
No. 05 Civ. 1897, 2006 WL. 1517580 (S.D.N.Y. June 2, 2006) 1

In re Dynex Cap., Inc. Sec. Litigation,
No. 05 Civ. 1897, 2006 WL. 314524 (S.D.N.Y. Feb. 10, 2006)..... 1

Elkind v. Liggett & Myers, Inc.,
635 F.2d 156 (2d Cir. 1980)..... 10

Ernst & Ernst v. Hochfelder,
425 U.S. 185 (1976)..... 5, 6, 8

Ezra Charitable Trust v. Tyco International Ltd.,
466 F.3d 1 (1st Cir. 2006)..... 12, 15

First Equity Corp. v. Standard & Poor's Corp.,
690 F. Supp. 256 (S.D.N.Y. 1988), aff'd, 869 F.2d 175 (2d Cir. 1989) 18, 19

Garfield v. NDC Health Corp.,
466 F.3d 1255 (11th Cir. 2006) 15

Gerstle v. Gamble-Skogmo, Inc.,
478 F.2d 1281 (2d Cir. 1973) 9, 10, 21

In re Global Crossing, Ltd. Sec. Litigation,
No. 02 Civ. 910, 2006 WL 1628469 (S.D.N.Y. June 13, 2006) 19

In re IBM Corp. Sec. Litigation,
163 F.3d 102 (2d Cir. 1998)..... 10, 11, 17

Inland Freight Lines v. United States,
191 F.2d 313 (10th Cir. 1951) 19

Kalnit v. Eichler,
264 F.3d 131 (2d Cir. 2001)..... 6, 11

Kushner v. Beverly Enterprise, Inc.,
317 F.3d 820 (8th Cir. 2003) 15

Lilley v. Charren,
17 Fed. Appx. 603 (9th Cir. 2001) 16

Marx & Co., Inc. v. Diner's Club, Inc.,
550 F.2d 505 (2d Cir. 1977) 6

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit,
126 S. Ct. 1503 (2006) 22

New York Times Co. v. Sullivan,
376 U.S. 254 (1964) 20

Nolte v. Capital One Finance Corp.,
390 F.3d 311 (4th Cir. 2004) 15, 17

Nordstrom, Inc. v. Chubb & Son, Inc.,
54 F.3d 1424 (9th Cir. 1995) 14

Ottmann v. Hanger Orthopedic Group, Inc.,
353 F.3d 338 (4th Cir. 2003) 12

In re PEC Solutions, Inc. Sec. Litigation,
418 F.3d 379 (4th Cir. 2005) 12, 16

Rolf v. Blyth, Eastman & Dillon & Co.,
570 F.2d 38 (2d Cir. 1978) 7

Rothman v. Gregor,
220 F.3d 81 (2d Cir. 2000) 11

SEC v. Tex. Gulf Sulphur Co.,
401 F.2d 833 (2d Cir. 1968) 9, 21

Saba v. Compagnie Nationale Air France,
78 F.3d 664 (D.C. Cir. 1996) 18, 19

San Leandro Emergency Medical Group Profit Sharing Plan v. Philip Morris Cos.,
75 F.3d 801 (2d Cir. 1996) 12, 13, 17

Santa Fe Industries v. Green,
430 U.S. 462 (1977) 6, 7, 26

Schoenbaum v. Firstbrook,
405 F.2d 200 (2d Cir. 1968) 20, 21

In re Scholastic Corp. Sec. Litigation,
252 F.3d 63 (2d Cir. 2001) 13

In re Silicon Graphics, Inc. Sec. Litigation,
183 F.3d 970 (9th Cir. 1999) 11

Southland Sec. Corp. v. Inspire Insurance Solutions, Inc.,
365 F.3d 353 (5th Cir. 2004) 14

State Teachers Retirement Board v. Fluor Corp.,
654 F.2d 843 (2d Cir. 1981) 11

Stevelman v. Alias Corp.,
174 F.3d 79 (2d Cir. 1999) 13

Suez Equity Investment, L.P. v. Toronto-Dominion Bank,
250 F.3d 87 (2d Cir. 2001) 10, 13

Ultramares Corp. v. Touche,
174 N.E. 441 (N.Y. 1931) 28

United States v. Bank of New England,
821 F.2d 844 (1st Cir. 1987) 18, 19

United States v. LBS Bank-N.Y., Inc.,
757 F. Supp. 496 (E.D. Pa. 1990) 18

STATUTES AND LEGISLATIVE HISTORY

15 U.S.C. § 78j(b) 5

15 U.S.C. § 78u-4(b)(2) 7

15 U.S.C. § 78u-5(c)(1)(B) 7

143 Cong. Rec. S10475, S10477 (daily ed. 1997) 26

H.R. Rep. No. 104-50 (1995) 26

15 U.S.C. § 78j(b) 1

MISCELLANEOUS

Anjan V. Thakor, Jeffrey Nielsen, & David A. Gulley, The Economic Reality of Securities Class Action Litigation, available at http://www.instituteforlegalreform.com/pdfs/EconomicRealityNavigant.pdf. 25

Anjan V. Thakor, The Unintended Consequences of Securities Litigation, available at http://www.instituteforlegalreform.com/pdfs/UnintendedConsequencesThakor.pdf 24

Charles E. Schumer & Michael R. Bloomberg, To Save New York, Learn From London, Wall St. J., Nov. 1, 2006, at A18 27

Frank H. Easterbrook & Daniel R. Fischel, Optimal Damages in Securities Cases, 52 Chi. L. Rev. 611 (1985) 24

Interim Report of the Committee on Capital Markets Regulation (Nov. 30, 2006) 27, 28

John C. Coffee, Jr., Reforming the Securities Class Action: An Essay On Deterrence and Its Implementation, 106 Colum. L. Rev. 1534, 1534 (2006) 25

Remarks by Treasury Secretary Henry M. Paulson on the Competitiveness of U.S. Capital Markets, Nov. 20, 2006, available at http://www.ustreasury.gov/press/releases/hp174.htm 26

Restatement (Third) of Agency § 5.03 cmt. d(2) (2005) 18

Sean Bajkowski & Kimberly R. Thompson, Criminal Corporate Liability, 34 Am. Crim. L. Rev. 445, 454 (1997) 18

Thomas A. Hagemann & Joseph Grinstein, The Mythology of Aggregate Corporate Knowledge: A Deconstruction, 65 Geo. Wash. L. Rev. 210, 224-37 (1996) 19

RULE 29(c)(3) STATEMENT

The court below held that a civil complaint alleging violations of Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j(b), may "allege[ ] scienter on the part of a corporate defendant without pleading scienter against any particular employees of the corporation." In re Dynex Cap., Inc. Sec. Litig., No. 05 Civ. 1897, 2006 WL 314524, at *9 (S.D.N.Y. Feb. 10, 2006). The court sustained claims against an issuer of asset-backed bonds and its corporate parent on allegations that "regional sales offices" that purchased the mobile home loans serving as collateral for the bonds disregarded the loans' creditworthiness. Id. at *7-10. Thus, the court found scienter alleged against the corporations without a proper scienter allegation against any employee, let alone anyone involved in the allegedly misleading prospectus disclosures. The court certified its order to enable this Court to resolve "the permissibility of pleading corporate or collective scienter." In re Dynex Cap., Inc. Sec. Litig., No. 05 Civ. 1897, 2006 WL 1517580, at *3 (S.D.N.Y. June 2, 2006).

Amici The Securities Industry and Financial Markets Association, The Chamber of Commerce of the United States of America, and The Business Roundtable support Defendants' position that pleading and proving corporate scienter under Section 10(b) requires pleading and proving that one or more of the

corporate employees or agents responsible for a misstatement had scienter. The interests of *amici* are set forth more fully in the accompanying motion.

SUMMARY OF ARGUMENT

This interlocutory appeal asks this Court to choose between two competing rules for pleading and proving a corporation's intent. Under the "collective scienter" rule applied by the court below, a corporation can be charged with fraud if one employee, acting in good faith, makes a statement while another employee – however low-ranking or distant from the person making the statement – knows contradictory facts or holds a contradictory opinion. Under the proper approach, by contrast, a corporation cannot commit fraud unless one or more of the employees responsible for a misstatement had fraudulent intent.

Collective scienter also allows the corporation and its shareholders to be victimized twice by the misconduct of employees far removed from shareholder communications. Consider an example: a low-level employee loses a large sum of money in trading hidden from others at the company. That employee has nothing to do with the company's public statements. Management issues financial statements that are revealed to be materially inaccurate when the hidden trades are discovered. Under a collective scienter standard, suit can be filed, imposing losses for a second time at the expense of the current, innocent shareholders.

This is not a slippery-slope anomaly; it is one of several common-place occurrences (ranging from internal miscommunications to simple differences of opinion within a company) that would vastly expand securities fraud liability under a collective scienter approach. Such a wholly unjustified expansion would contradict precedent. The Supreme Court has long held that Section 10(b) civil liability must be carefully circumscribed to avoid three outer limits: liability must not exceed the statutory language; courts should not disregard traditional common-law rules that provide the foundation for the judicially implied cause of action; and courts should leave to Congress the expansion of liabilities that may impose significant new duties or uncertainties on businesses or that present undue costs and complexities to litigate.

Collective scienter is not compatible with the language of Section 10(b), which addresses intentional fraudulent misstatement. It would substitute a negligence-like liability rule in which a corporation is liable for mere failures of oversight or internal investigation. Seven other Circuits have rejected collective scienter; none has expressly adopted it. Collective scienter is likewise inconsistent with common law principles regarding agency and intent. Because a corporation acts only through its agents, it piles legal fiction on legal fiction to say that it *intended* fraud when no agent of the corporation who had responsibility for its statements had that intent.

A collective scienter rule would also be difficult to administer in practice, presenting courts with complex questions about whose knowledge, beliefs, and motives can be attributed to the company when employees have conflicting views. Discovery and trial become unmanageable where the search for evidence encompasses every employee of a large corporation rather than the state of mind of those individuals responsible for the statements at issue.

Finally, the vast expansion of liability that would flow from collective scienter is bad policy. America's capital markets already face unprecedented competition from foreign markets to attract new public offerings. Foreign issuers in particular often cite American securities class actions – which uniquely plague the U.S. among major financial centers – as a reason to avoid the U.S. market, and one reason is the uncertainty over the standards for showing scienter. A collective scienter rule is simply not needed to deter and punish *actual* fraud. This Court should not bless a rule that creates essentially negligence class actions challenging the daily communications of today's public companies.

ARGUMENT

I. COLLECTIVE SCIENTER WOULD IMPROPERLY RESURRECT CORPORATE NEGLIGENCE LIABILITY

Collective scienter is inconsistent with the plain language of Section 10(b), which aims at intentional misstatements. It would mark a departure from the long

tradition of careful limitation of Section 10(b) liability and substitute a standard indistinguishable in practice from negligence liability.

A. Section 10(b) Liability Is Limited To Manipulative Or Deceptive Acts And Does Not Extend To Negligence.

Section 10(b) makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance." 15 U.S.C. § 78j(b).[1] The statute therefore "prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act . . . . We cannot amend the statute to create liability for acts that are not themselves manipulative or deceptive within the meaning of the statute." Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 175 (1994).

In determining the state of mind requirement for a Section 10(b) violation, the Supreme Court refused to water down Congress's use of the statutory terms "'manipulative,' 'device,' and 'contrivance'" – "the commonly understood terminology of intentional wrongdoing." These words, the Court held, render "unmistakable a congressional intent to proscribe a type of conduct quite different from negligence." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199, 214 (1976). Thus, the Court rejected liability based upon "a common-law and statutory duty of inquiry" and held instead that liability under Section 10(b) requires proof of

[1] Emphasis is supplied unless otherwise indicated.

scienter: "a mental state embracing intent to deceive, manipulate, or defraud." Id. at 192, 194. The Court also refused to define corporate mismanagement as "manipulative" or "deceptive" conduct, see Santa Fe Indus. v. Green, 430 U.S. 462, 479 (1977), or to expand the statutory definition of "deceptive" beyond conduct traditionally actionable as fraud at common law. See Chiarella v. United States, 445 U.S. 222, 230, 234-35 (1980).

Fraudulent intent thus means the intent with which a material misstatement to shareholders was made, not bad intent in some other corporate activity. See Ernst, 425 U.S. at 199 & n. 20 & 21 (finding "especially significant" the use of the word "manipulative," which "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities"); Kalnit v. Eichler, 264 F.3d 131, 141 (2d Cir. 2001) (concealment of information from proposed merger partner "cannot be conflated with an intent to defraud the shareholders" by omission); Marx & Co., Inc. v. Diner's Club, Inc., 550 F.2d 505, 515 (2d Cir. 1977) ("[P]laintiffs ha[ve] the burden of showing that, in making these predictions as to the takeover, defendants acted with scienter . . ."). The Private Securities Litigation Reform Act of 1995 ("PSLRA") further emphasized the link between scienter and those making alleged misstatements, providing that

> In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

15 U.S.C. § 78u-4(b)(2). A plaintiff cannot plead that a corporation "acted with the required state of mind" unless the person who made the alleged corporate misstatements had scienter, and still less so if *nobody* at the corporation had scienter.[2]

B. Collective Scienter Imposes A Negligence-Type "Duty of Inquiry."

Any decision to expand securities liability must be left to Congress. See Central Bank, 511 U.S. at 176-78, 188-90; Santa Fe, 430 U.S. at 479-80; Blue Chip

---

[2] The PSLRA's "safe harbor for forward-looking statements" imposes a heightened standard of pleading, requiring allegations that a responsible executive officer had "actual knowledge" of the misrepresentations or omissions. See 15 U.S.C. § 78u-5(c)(1)(B). Contrary to the arguments of plaintiffs here and other cases, this language would not be surplusage if Section 10(b) already required pleading the scienter of a specific corporate officer. The "actual knowledge" safe harbor precludes liability "in any private action" for misrepresentations or omissions; thus, it applies not only to Section 10(b) but also to Section 18 of the 1934 Act and Sections 11 and 12 of the 1933 Act, none of which requires proof of scienter. See id. §§ 77z-2(c)(1), 78u-5(c)(1). Moreover, the safe harbor provision requires "actual knowledge" of falsity, whereas this and other Circuits have long permitted Section 10(b) liability for recklessness. See, e.g., Rolf v. Blyth, Eastman & Dillon & Co., 570 F.2d 38, 44-47 (2d Cir. 1978). Accordingly, the safe harbor increases the mental state required when liability is based on qualifying forward-looking statements. It does not change the corporate officials whose mental states are examined by the courts.

Stamps v. Manor Drug Stores, 421 U.S. 723, 738-39, 748-49 (1975). Congress provided express – but very restricted – negligence-based remedies under Sections 11 and 12 of the Securities Act of 1933. As Ernst held, the "restrictions" on these remedies would be rendered meaningless if judicially implied civil liability under Section 10(b) were extended to allow negligence-type liability in other circumstances. Ernst, 425 U.S. at 198-201, 206-11.

Collective scienter is a legal fiction more akin to the "duty of inquiry" rejected in Ernst than to truly intentional conduct. See Chill v. Gen. Elec. Co., 101 F.3d 263, 270 (2d Cir. 1996) ("Fraud cannot be inferred simply because GE might have been more curious or concerned [about a subsidiary's revenues]."). Avoiding liability would require corporations to institute affirmative procedures to share information among their employees and to investigate employees. Imposing liability for deficiencies in such procedures would also – in conflict with Santa Fe – essentially federalize corporate mismanagement. While regulatory duties of this nature are sometimes appropriately imposed by Congress, they are inconsistent with Section 10(b)'s focus on fraud and should not be judicially implied absent a statutory command.

II. COLLECTIVE SCIENTER IS INCONSISTENT WITH EXISTING PRECEDENT.

Collective scienter is inconsistent with precedent in this Circuit regarding corporate scienter. The overwhelming trend in the Circuits to consider the question has been to reject collective scienter; none has expressly adopted it.

A. This Court's Precedents Focus On The Officials Who Make And Issue Corporate Statements.

Even before Ernst, Judge Friendly wrote that a scienter requirement was necessary to prevent the "frightening" prospect for corporations that a "failure properly to amass or weigh the facts – all judged in the bright gleam of hindsight – will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers." SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, J., concurring). He expanded on this concern in Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281 (2d Cir. 1973):

> We recognize that this court has on occasion phrased the test of scienter in terms of whether the defendant had knowledge of the facts that were omitted or misstated, and the conceptual problem . . . that such a test, as applied to the corporation issuing a false or misleading proxy statement, would result in virtually absolute liability because of the agency doctrine that a corporation is charged with the knowledge of all its agents. However, it seems to us that in this type of case the scienter issue would revolve around the intent with which the proxy statement is prepared, and whether it was willfully misleading or merely negligently drafted.

Id. at 1301 n.20. Judge Friendly's description of the correct standard properly focuses on the intent with which a statement is prepared by those corporate officials charged with doing so.

This Court's post-Ernst decisions have recognized the need to identify intentional misconduct by the particular officials responsible for a misstatement in order to plead and prove a Section 10(b) claim against a corporation. In Suez Equity Investment, L.P. v. Toronto-Dominion Bank, 250 F.3d 87 (2d Cir. 2001), for example, six related corporate entities were sued over negotiations in which the plaintiffs were given a fraudulently altered report. This Court held that a claim was stated against three of the entities because the complaint alleged "conscious misbehavior" by their agent. Id. at 100. But this Court dismissed claims against the direct and indirect parent companies of these entities because "[n]othing in the complaint suggests that [a named officer] or anyone else at [the parent corporation] knew the contents of the [undoctored report] or that anyone in the employ of [the parent] recklessly misbehaved while negotiating with plaintiffs." Id.[3]

In In re IBM Corp. Sec. Litig., 163 F.3d 102 (2d Cir. 1998), this Court took care to identify whose mental state counts. The plaintiffs asserted that IBM had spoken falsely in claiming that it had no plans to cut its dividend, despite an

[3] Accord Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 167-68 (2d Cir. 1980) (distinguishing between two disclosures to analysts where evidence showed "knowing misconduct" of the speaker, including knowledge that disclosure was material to analysts, only as to one disclosure).

undisclosed proposal by IBM's Treasurer to do just that. The court rejected this argument because "the proposal was never presented or recommended to the Board, much less adopted by it." Id. at 108.[4]

B. This Court's "Motive and Opportunity" Precedents Are Also Inconsistent With Collective Scienter.

Plaintiffs, opposing the Petition, cited pleading cases involving "motive and opportunity" to argue that courts in this Circuit permit collective scienter. The corporate motive precedents are fully reconcilable with rejection of collective scienter.[5] The proper approach permits plaintiffs to allege with particularity that specific officials responsible for corporate statements had scienter because they had a sufficiently personal and concrete motive and opportunity. See, e.g., Rothman v. Gregor, 220 F.3d 81, 92-93 (2d Cir. 2000) (corporation had motive because individual directors and officers had a "concrete" and "particularized" motive to withhold material information regarding stock price in order to advance acquisition of specific companies); see also Kalnit, 264 F.3d at 139-42 (corporation could have motive when individual directors and officers have a "concrete and

---

[4] As discussed in more detail by Defendants, State Teachers Ret. Bd. v. Fluor Corp., 654 F.2d 843, 853 (2d Cir. 1981), implicitly requires proof of the intent of responsible corporate employees.

[5] Certain other Circuits have held the PSLRA eliminated "motive and opportunity" pleading. See, e.g., In re Silicon Graphics, Inc. Sec. Litig., 183 F.3d 970, 979 (9th Cir. 1999). The issue in this appeal is not whether motive and opportunity should be the standard but whether this Court's decisions are consistent with collective scienter; they are not.

personal" motive, beyond mere general interest in maintaining appearance of corporate profitability, to withhold material information). Indeed, several of the Circuits that reject collective scienter consider "motive and opportunity" as at least a factor at the pleading stage.[6]

Most important, this Court's "motive and opportunity" precedents concerning when corporate scienter may be inferred from "suspicious" insider stock sales are flatly inconsistent with collective scienter. Corporate scienter cannot be inferred merely because one insider sold when others held or purchased more stock. San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., 75 F.3d 801, 813-14 & n.14 (2d Cir. 1996) ("[W]e conclude that the sale of stock by one company executive does not give rise to a strong inference of the company's fraudulent intent; the fact that other defendants did not sell their shares during the relevant class period sufficiently undermines plaintiffs' claim regarding motive."); accord Acito v. IMCERA Group, 47 F.3d 47, 54 (2d Cir. 1995); PEC, 418 F.3d at 390; Alpharma, 372 F.3d at 152. Rather, insider stock sales permit an inference of corporate scienter only when, under suspicious circumstances, multiple officers and directors responsible for corporate disclosures

[6] See Ezra Charitable Trust v. Tyco Int'l Ltd., 466 F.3d 1, 10 (1st Cir. 2006); In re PEC Solutions, Inc. Sec. Litig., 418 F.3d 379, 390 (4th Cir. 2005); In re Alpharma, Inc. Sec. Litig., 372 F.3d 137, 149, 152 (3d Cir. 2004); see also Ottmann v. Hanger Orthopedic Group, Inc., 353 F.3d 338, 344-46 (4th Cir. 2003) (discussing how First, Third, Fourth, Fifth, and Eighth Circuits allow "motive and opportunity" as at least a pleading factor).

sold, see, e.g., Stevelman v. Alias Corp., 174 F.3d 79, 85-86 (2d Cir. 1999), or the officer primarily responsible for a particular disclosure sold, see, e.g., In re Scholastic Corp. Sec. Litig., 252 F.3d 63, 74-76 (2d Cir. 2001).

In so holding, this Circuit has emphasized that the test is not just motive but motive *and opportunity*: only those individuals with knowledge of the undisclosed facts *and* involvement in the alleged misrepresentations can be said to have an opportunity to commit the alleged fraud. See San Leandro, 75 F.3d at 814 n.14 (complaint failed to allege that single director "acting alone had the opportunity to manipulate Philip Morris' plans"); see also Scholastic, 252 F.3d at 75-76 (vice president for finance and investor relations had opportunity because of access to information, ability "to control the extent to which it was released to the public," and involvement in the misrepresentations); Suez Equity, 250 F.3d at 100 (corporate affiliates did not have opportunity to commit fraud). Thus, "motive and opportunity" pleading requires pleading the scienter of those individuals responsible for the alleged misstatements.

These precedents would be effectively overruled by a collective scienter approach. Under collective scienter, the sale of stock by an insider prior to the release of damaging information would *always* support corporate scienter, even if that insider was not involved in the alleged misstatements or lacked knowledge of the bad news. But that is clearly contrary to existing precedent.

C. Seven Other Circuits Have Rejected "Collective Scienter."

Seven Circuits have rejected collective scienter. None has expressly adopted it.

The Fifth Circuit held it "appropriate to look to the state of mind of the individual corporate official or officials who make or issue the statement," citing

> the general common law rule that where, as in fraud, an essentially subjective state of mind is an element of a cause of action also involving some sort of conduct, such as a misrepresentation, the required state of mind must actually exist in the individual making (or being a cause of the making of) the misrepresentation, and may not simply be imputed to that individual on general principles of agency.

Southland Sec. Corp. v. Inspire Ins. Solutions, Inc., 365 F.3d 353, 366-67 (5th Cir. 2004) (collecting cases and citing the Restatement (Second) of Agency).

Nordstrom, Inc. v. Chubb & Son, Inc., 54 F.3d 1424, 1435 (9th Cir. 1995), stressed that because Section 10(b) liability requires at least recklessness, defined as conduct the defendant knew to present a danger of misleading buyers or sellers of securities,

> corporate scienter relies heavily on the awareness of the directors and officers, who – unlike the public relations or personnel departments – are necessarily aware of the requirements of SEC regulations and state law and the dangers of misleading buyers and sellers.

Id. at 1435-36 (quotation omitted).[7]

[7] The Ninth Circuit has subsequently reaffirmed that Nordstrom "squarely

Kushner v. Beverly Enterprise, Inc., 317 F.3d 820, 827-30 (8th Cir. 2003), held that scienter could not be inferred from the fact that individual employees involved in a fraudulent scheme "reported" to one named officer. In re Alpharma, Inc. Sec. Litig., 372 F.3d 137, 149-53 (3d Cir. 2004), likewise held that the knowledge of subordinates would not be imputed to the corporation: "the mere fact that [allegations of accounting irregularities were] sent to Alpharma's headquarters and therefore w[ere] available for review by the individual defendants is insufficient to" plead scienter against the company. See also Garfield v. NDC Health Corp., 466 F.3d 1255, 1263-67 (11th Cir. 2006) (scienter was not pleaded where complaint did not allege specifically that officers who signed Sarbanes-Oxley-required certifications were presented with reasons to doubt the financial statements, even though a "management level employee" notified outside auditors of revenue recognition problems); Ezra Charitable Trust v. Tyco Int'l Ltd., 466 F.3d 1, 5-11 (1st Cir. 2006) (examining knowledge of corporate managers who made statements to determine whether corporation had scienter in understating prior misconduct within corporation); Nolte v. Capital One Fin. Corp., 390 F.3d 311, 313-16 (4th Cir. 2004) (scienter was not pleaded by alleged widespread

---

reject[ed] the concept of 'collective scienter.'" In re Apple Computers, Inc., 127 Fed. Appx. 296, 303 (9th Cir. 2005) ("A corporation is deemed to have the requisite scienter for fraud only if the individual corporate officer making the statement has the requisite level of scienter at the time that he or she makes the statement.").

knowledge within company of problems without an allegation that problems were known to the managers who made public statements).[8]

This Court should not become the first to expressly adopt collective scienter.[9]

D. Collective Scienter Is Contrary To Precedent In "Opinion" Cases.

Section 10(b) cases are often based on a statement of opinion or prediction – such as that a product or business line would be successful – that turned out to be wrong. As the Ninth Circuit explained in holding that corporate scienter could not be based on the doubts of "lower-level employees" that a new product would work:

> [I]n any large corporation there will be differences of opinion expressed. The key fact that the district court found undisputed was that Kenetech reasonably relied on its senior engineering personnel, and that "no reasonable jury could find defendants' reliance unreasonable." This . . . represents our settled law that looks to whether there was a reasonable basis for Kenetech's predictive statements of belief.

Lilley v. Charren, 17 Fed. Appx. 603, 607 (9th Cir. 2001).

---

8 Accord PEC, 418 F.3d at 388-89 (refusing to attribute to a company's senior officers the knowledge of a confidential witness not alleged to be a director or officer making public statements).

9 The lone Circuit-level decision sometimes miscited as supporting collective scienter is City of Monroe Empl. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 686-90 (6th Cir.), cert. denied, 126 S. Ct. 423 (2005), which imputed to the corporation the knowledge of an Executive Vice President of the corporation (and CEO of the subsidiary whose operations were the subject of the statement), but dismissed the claims against that officer for failure to allege his involvement in making the misstatements. *Amici* are aware of no court that has read Bridgestone to permit collective scienter.

The Eighth Circuit similarly rejected the assertion that sales forecasts were fraudulent because a regional sales manager found them "unattainable," In re Cerner Corp. Sec. Litig., 425 F.2d 1079, 1085-86 (8th Cir. 2005), and the Fourth Circuit rejected the allegation that management did not believe in the adequacy of financial reserves because of one non-speaking executive's opinion, Nolte, 390 F.3d at 315-16. As noted above, this Court has similarly held that "plans" not yet adopted by the Board of Directors do not constitute plans of the company, IBM, 163 F.3d at 107-08; San Leandro, 75 F.3d at 812, and has looked only to the individuals expressing opinions publicly on behalf of a corporation to determine whether their opinions were genuinely believed, IBM, 163 F.3d at 109.

Collective scienter would transform internal corporate differences of opinion – over GAAP accounting, technical feasibility, marketing plans, or other business judgments – into actionable fraud. This would both contradict precedent and massively expand Section 10(b) liability.

E. Collective Scienter Is Inconsistent With Common Law Precedents.

Because Section 10(b) civil liability is "a judicially implied cause of action with roots in the common law," courts should not expand liability beyond the "traditional elements." Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 343-46 (2005). Among other sources, the Supreme Court has looked to the Restatements of the

common law. Id. at 343-44. The current Restatement of Agency rejects collective scienter for fraud:

> [A] principal may not be subject to liability for fraud if one agent makes a statement, believing it to be true, while another agent knows facts that falsify the other agent's statement. Although notice is imputed to the principal of the facts known by the knowledgeable agent, the agent who made the false statement did not do so intending to defraud the person to whom the statement was made.

Restatement (Third) of Agency § 5.03 cmt. d(2) (2005). Indeed, the Restatement provides that even corporate liability for negligent misrepresentations turns on the conduct of the speaker: "[i]f the agent who made the false statement did so negligently, the principal may be subject to liability for negligent misrepresentation." Id.[10]

---

[10] This distinction between knowledge and intent explains why the doctrine of "collective knowledge," developed in criminal cases such as United States v. Bank of New England, 821 F.2d 844 (1st Cir. 1987), does not support collective scienter. Even authorities holding that "corporate knowledge of certain facts [may be] accumulated from the knowledge of various individuals" further recognize that "proscribed intent (willfulness) depend[s] on the wrongful intent of specific employees." Saba v. Compagnie Nationale Air France, 78 F.3d 664, 670 n.6 (D.C. Cir. 1996) (citing Bank of N.E., 821 F.2d at 855-56); see Sean Bajkowski & Kimberly R. Thompson, Criminal Corporate Liability, 34 Am. Crim. L. Rev. 445, 454 (1997); United States v. LBS Bank-N.Y., Inc., 757 F. Supp. 496, 501 n.7 (E.D. Pa. 1990) ("Although knowledge possessed by employees is aggregated so that a corporate defendant is considered to have acquired the collective knowledge of its employees, specific intent cannot be aggregated similarly."); First Equity Corp. v. Standard & Poor's Corp., 690 F. Supp. 256, 260 (S.D.N.Y. 1988) ("A corporation can be held to have a particular state of mind only when that state of mind is possessed by a single individual."), aff'd, 869

More generally, at common law, when no agent of a corporation can be liable, the corporation itself cannot be liable. For example, when plaintiffs release corporate agents, derivative claims against the company are extinguished. See In re Global Crossing, Ltd. Sec. Litig., No. 02 Civ. 910, 2006 WL 1628469, at *4-5 (S.D.N.Y. June 13, 2006) (citing Restatement (Third) of Torts). As Global Crossing concluded:

> Ultimately, [plaintiffs'] argument [for independent corporate liability] is nothing but a subtle attempt by plaintiffs to take the sweet without the bitter, to import common-law principles like respondeat superior into the federal securities context . . . while at the same time demanding that traditional limitations on those doctrines be ignored. Such selective adoption of common law principles cannot be justified.

Global Crossing, 2006 WL 1628469, at *5.

Likewise, the Supreme Court held that the "actual malice" required for a newspaper to be liable for defamation in publishing an intentional or reckless

---

F.2d 175 (2d Cir. 1989); see also Saba, 78 F.3d at 668-69 (analogizing "willful misconduct" to "recklessness" in securities law). Thus, without a finding of improper intent by a responsible official, collective knowledge will not result in liability. See also Thomas A. Hagemann & Joseph Grinstein, The Mythology of Aggregate Corporate Knowledge: A Deconstruction, 65 Geo. Wash. L. Rev. 210, 224-37 (1996) (stating that doctrine is applied only in cases in which responsible corporate officials were "willfully blind" to the violations); Bank of N.E., 821 F.2d at 856-57 (finding "flagrant indifference" on the part of the defendant); Inland Freight Lines v. United States, 191 F.2d 313, 316 (10th Cir. 1951) (reversing conviction, despite application of collective knowledge doctrine, based on lack of evidence of willful misconduct).

falsehood is the state of mind of the employees responsible for issuing the statement:

> [T]here is evidence that the Times published the advertisement without checking its accuracy against the news stories in the Times' own files. The mere presence of the stories in the files does not, of course, establish that the Times 'knew' the advertisement was false, since the state of mind required for actual malice would have to be brought home to the persons in the Times' organization having responsibility for the publication of the advertisement.

New York Times Co. v. Sullivan, 376 U.S. 254, 287 (1964).

This Court has recognized in an analogous setting that the knowledge of a corporation cannot be manufactured without the knowledge of its specific responsible agents. Thus, a corporate plaintiff in a fraud case "cannot rely on misrepresentations unless its agents or employees rely on those misrepresentations" because "[a]s an entity, [it] acts only through its officers and employees." Bank of China v. NBM LLC, 359 F.3d 171, 179 (2d Cir. 2004), cert. dismissed, 126 S. Ct. 675 (2005). The same rule applies to corporate Section 10(b) plaintiffs: "if the corporation's agents have not been deceived, neither has the corporation." Schoenbaum v. Firstbrook, 405 F.2d 200, 211 (2d Cir. 1968). The relevant mental state is that of the agents authorized to participate in securities transactions:

> If the persons entitled in the ordinary course to participate in authorizing a securities transaction on behalf of the corporation have not been fully informed, it may be said that the corporation has not been fully informed.

Id. So too, when the corporation is a securities defendant, the relevant mental state should be that of "the persons entitled in the ordinary course to participate in . . . securities [disclosures] on behalf of the corporation." Id.

III. COLLECTIVE SCIENTER WOULD IMPOSE SIGNIFICANT COSTS WITHOUT CORRESPONDING BENEFITS.

As the Supreme Court observed in Blue Chip, given the judicial role in implying the Section 10(b) private cause of action, courts should avoid expansive interpretations that may impose significant costs and encourage non-meritorious lawsuits. 421 U.S. at 737-39, 748-49. By imposing a negligence-like standard of care on corporate managers, collective scienter would do just that.

Judge Friendly warned that the "frightening" prospect of negligence liability for regular corporate communications would deter management from offering voluntary disclosures to shareholders. Tex. Gulf Sulphur, 401 F.2d at 866-67; see also Gerstle, 478 F.2d at 1300. The Supreme Court echoed his concern that the costs of resulting lawsuits would be "'payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers.'" Blue Chip, 421 U.S. at 739 (quoting Tex. Gulf Sulphur, 401 F.2d at 867).

Today, those concerns are not theoretical. Securities litigation, rather than protecting the interests of investors, typically destroys value and imposes costs on innocent shareholders. Companies looking to raise capital are not just shying away from press releases: increasingly, they avoid the public U.S. market altogether, either by going abroad or turning to private equity. As discussed below, foreign companies often cite U.S. securities class actions as the main reason to do so – and uncertainties surrounding the scienter standard are a major reason why. Under such conditions, it is unwise to encourage the massive expansion of Section 10(b) lawsuits, costs, and liability that collective scienter would entail.

A. Collective Scienter Permits Abusive Discovery.

"[L]itigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general," in part because of abusive demands for "extensive deposition of the defendant's officers and associates and the concomitant opportunity for extensive discovery of business documents." Blue Chip, 421 U.S. at 739, 741. Congress's recognition of these discovery costs was a major impetus for passage of the PSLRA and subsequent reforms. See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 126 S. Ct. 1503, 1510-11 (2006).

Discovery of a corporate defendant's scienter is often crucial. The scope and expense of such discovery has increased exponentially with the proliferation of

information systems – email, spreadsheets, systems for inventory management, and myriad other functions of manufacturing, distribution, and services. If the state of mind of a corporation could be proven from the knowledge of *all* of its employees, however innocent or junior each one is, it would be nearly impossible for district courts to impose reasonable limits on discovery. By contrast, the proper approach allows meritless claims to be pruned by motions to dismiss or for summary judgment, discovery to focus on specific officials, trials to be simplified, and parties to come more swiftly to settlements based upon the merits rather than to avoid abusive discovery.

B. Collective Scienter Allows Low-Level Or Rogue Employees To Victimize The Corporation And Its Shareholders Twice, While Doing Nothing To Remedy Serious Fraud.

Collective scienter imposes other liabilities as far removed from securities fraud as negligent failure to supervise or difference of opinion. Consider the situation discussed at the beginning of this brief: trading losses hidden by a low-ranking employee. Management honestly believes its financial statements are accurate. With collective scienter, the low-level employee's misconduct is attributed to the company. The company is victimized twice – first by the trading losses and then by the securities lawsuits. This makes no sense.

The securities liability *of the company* would do nothing to deter the wrongdoing employee, who would already have been fired. But it would injure the

company's innocent shareholders. A recent study shows not only that securities suits impose defense costs on corporations, but that the mere filing of a securities class action causes, on average, a 3.5% drop in a company's share price, to the detriment of existing innocent shareholders.[11] Shareholders who purchased before the trading losses were hidden would receive no offsetting remedy. See Blue Chip, 421 U.S. at 754-55. For shareholders who purchased after the losses were hidden, the value of litigation is also questionable. They could recover only if they held until after the fraud was revealed, and then only if the stock price declined significantly. See Dura, 544 U.S. at 342-44. Moreover, for every *purchaser* at an inflated price, there must be a *seller* who benefits in an equal amount – usually another innocent outsider. See Frank H. Easterbrook & Daniel R. Fischel, Optimal Damages in Securities Cases, 52 Chi. L. Rev. 611, 639-41 (1985). "Over the long run, any reasonably diversified investor will be a buyer half the time and a seller half the time." Id. at 641. Thus, "[s]ecurities class actions . . . achieve little compensation and only limited deterrence . . . because of a basic circularity underlying the securities class action: When damages are imposed on the

---

[11] See Anjan V. Thakor, The Unintended Consequences of Securities Litigation, at 1, 4-6, 14 (working paper prepared for U.S. Chamber Institute for Legal Reform, October 2005), available at http://www.instituteforlegalreform.com/pdfs/UnintendedConsequencesThakor.pdf. These losses are not offset by gains to shareholder-plaintiffs; rather, Prof. Thakor estimates a deadweight capital loss of $24.7 billion for his studied sample of 482 companies covering the period 1995-2005. Id. at 14.

corporation, they essentially fall on diversified shareholders, thereby producing mainly pocket-shifting wealth transfers among shareholders." John C. Coffee, Jr., Reforming the Securities Class Action: An Essay On Deterrence and Its Implementation, 106 Colum. L. Rev. 1534, 1534 (2006). And, of course, substantial attorneys' fees.

A recent study of 482 class action settlements between 1995 and 2005 confirmed that not only do large, diversified institutional investors – the most frequent traders and the usual lead plaintiffs in securities class actions – break even over time from alleged frauds among their various investments, they generally break even from their purchases and sales of individual stocks allegedly affected by fraud.[12] For such investors, adding a recovery from litigation will *overcompensate* them for their losses in individual stocks, while imposing net losses on smaller, longer-term investors.

All of the above might be dismissed as necessary costs of enforcement if collective scienter was needed to punish the most damaging securities frauds. But precisely the opposite is true. For spectacular corporate frauds like Enron and WorldCom, there is no shortage of senior corporate insiders whose fraudulent

---

[12] See Anjan V. Thakor, Jeffrey Nielsen, & David A. Gulley, The Economic Reality of Securities Class Action Litigation, at 6, 12-15 & Appx. 1 (working paper prepared for U.S. Chamber Institute for Legal Reform, October 26, 2005), available at http://www.instituteforlegalreform.com/pdfs/EconomicRealityNavigant.pdf.

conduct can be specified. But where there is *no* evidence of *any* deliberate wrongdoing by management, the issue is corporate dysfunction and mismanagement – not fraud. The remedies for mismanaged companies have always been left to state corporate law and to the marketplace, and are not a proper subject for a federal securities fraud claim. See Santa Fe, 430 U.S. at 479.

C. A Negligence-Like Standard Will Further Discourage Companies From Listing Shares In United States Public Markets.

In today's global marketplace, securities liability rules do not exist in a vacuum. As the legislative history of the PSLRA and the Securities Litigation Uniform Standards Act indicates, Congress was concerned that if the burden of securities class actions becomes too onerous, companies will simply raise capital from abroad or from private sources.[13] Unfortunately, recent years have seen precisely such litigation-driven capital flight – and foreign companies are citing securities lawsuits (including the uncertain standards for scienter) as a major cause.

The public U.S. securities markets have been losing market share to foreign markets, attracting alarm across the political spectrum.[14] A recent report by the

---

13 See H.R. Rep. No. 104-50, at 20 (1995) ("Fear of litigation keeps companies out of the capital markets."); 143 Cong. Rec. S10475, S10477 (daily ed. 1997) ("[I]f our markets are to remain ahead of those in London, Frankfurt, Tokyo or Hong Kong, we must create uniformity and certainty.").

14 See Remarks by Treasury Secretary Henry M. Paulson on the Competitiveness of U.S. Capital Markets, November 20, 2006, available at http://www.ustreasury.gov/press/releases/hp174.htm (noting that total costs of U.S. legal system are "twice the relative cost in Germany and Japan, and

independent, bipartisan Committee on Capital Markets Regulation concluded that "the United States is losing its leading competitive position as compared to stock markets and financial centers abroad." Interim Report of the Committee on Capital Markets Regulation ix (Nov. 30, 2006), available at http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf. U.S. market share in global initial public offerings, by value, dropped from 50% in 2000 to 5% in 2005; in the past year, 24 of the 25 largest IPOs took place outside the U.S. Id. at 2-3, 29-34.[15] London has gained the most market share. Id. at 3. Yet foreign companies still seek to access capital in the U.S. through unregistered *private* equity offerings. Id. at 45-46.

"Foreign companies commonly cite the U.S. class action enforcement system as the most important reason why they do not want to list in the U.S. market." Id. at 11, 71. Among the factors cited for capital flight is one within this Court's ability to mitigate: uncertainties in the scienter standard. Id. at 12, 80-82.

It is not hard to see why companies are fleeing: the average U.S. listed company stands a 10% chance of facing a securities class action in any given five-

---

three times the level in the UK"); Charles E. Schumer & Michael R. Bloomberg, "To Save New York, Learn From London," Wall St. J., Nov. 1, 2006, at A18 (advocating "revisit[ing] the best way to reduce frivolous [securities] lawsuits without eliminating meritorious ones").

[15] Any loss to U.S. capital markets particularly affects New York; the securities industry alone accounts for 18.7% of total tax receipts for New York State and nearly 5% of all jobs in New York City. See id. at 26-28.

year period. Id. at 74. Such class actions do not exist in the U.K. or other competing markets, id. at 5, 11, 71, resulting in director and officer insurance rates six times higher in the U.S. than in Europe. Id. at 5, 11, 71, 78. "The modern securities class action lawsuit creates a heavy burden for public companies; without a substantial social benefit, this burden cannot be justified." Id. at 78.

The securities markets "'demand[] certainty and predictability.'" Central Bank, 511 U.S. at 188 (quoting Pinter v. Dahl, 486 U.S. 622, 652 (1988)). Unless securities liability is limited through reasonable and clear elements such as scienter, as Judge Cardozo presciently recognized 76 years ago:

> [t]he hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.

Ultramares Corp. v. Touche, 174 N.E. 441, 444 (N.Y. 1931), quoted in Ernst, 425 U.S. at 214 n.33. Accordingly, this Court should clarify that Section 10(b) litigation is reserved for actual fraud.

CONCLUSION

For the foregoing reasons, *amici* respectfully submit that the Court should require plaintiffs to plead and prove scienter on the part of an individual employee responsible for issuing or making the statement at issue in order to hold a corporation civilly liable under Section 10(b).

Dated: New York, New York
January 17, 2007

Respectfully Submitted,

SIDLEY AUSTIN LLP

By:_____

Carter G. Phillips
Richard D. Bernstein
1501 K Street, N.W.
Washington, D.C. 20005
202-736-8000
202-736-8711 (fax)

A. Robert Pietrzak
Daniel A. McLaughlin
787 Seventh Avenue
New York, New York 10019
(212) 839-5300
(212) 839-5599 (fax)

Marjorie Gross
Securities Industry and Financial Markets Association
360 Madison Avenue
New York NY 10017
(646) 637-9204

Robin S. Conrad
Amar D. Sarwal
National Chamber Litigation Center, Inc.
1615 H Street, N.W.
Washington, D.C. 20062
(202) 463-5337

Maria Ghazal
Business Roundtable
1717 Rhode Island Avenue, N.W.,
Suite 800
Washington, DC 20036
(202) 496-3268

Attorneys for Amici Curiae The Securities Industry and Financial Markets Association, The Chamber of Commerce of the United States of America, and The Business Roundtable

RELEVANT STATUTORY PROVISION

In addition to the statutory provision appended to the brief of Defendants-Appellees, *Amici* rely upon the following statute:

15 U.S.C. § 78j(b). Manipulative and deceptive devices

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –
>
> * * *
>
> > (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
>
> Rules promulgated under subsection (b) of this section that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) of this section and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities. Judicial precedents decided under section 77q(a) of this title and sections 78i, 78o, 78p, 78t, and 78u-1 of this title, and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities.

RULE 32(a)(7)(C) CERTIFICATION

Pursuant to Federal Rules of Appellate Procedure 29(d) and 32(a)(7)(C), the undersigned counsel for *Amici Curiae* The Securities Industry and Financial Markets Association, The Chamber of Commerce of the United States of America, and The Business Roundtable certifies that this brief complies with type-volume limitations of the Federal Rules of Appellate Procedure because this brief contains no more than 6,989 words, excluding the parts of the brief exempted by Rule 32(a)(7)(B)(iii).

Dated: New York, New York
January 17, 2007

Daniel A. McLaughlin (DM-2688)
Attorney for Amici Curiae The Securities Industry and Financial Markets Association, The Chamber of Commerce of the United States of America, and The Business Roundtable

ANTI-VIRUS CERTIFICATION

Case Name: Teamsters v. Dynex

Docket Number: 06-2902-cv

I, Natasha R. Monell, hereby certify that the Amicus Brief submitted in PDF form as an e-mail attachment to **briefs@ca2.uscourts.gov** in the above referenced case, was scanned using Norton Antivirus Professional Edition 2003 (with updated virus definition file as of 1/17/2007) and found to be VIRUS FREE.

_____
Natasha R. Monell, Esq.
Staff Counsel
Record Press, Inc.

Dated: January 17, 2007