



An in-depth analysis of cases and emerging legal issues

March 12, 2010

First Circuit Rejects Primary Rule 10b-5 Liability for Underwriters

By Richard Bernstein, Barry Barbash, and Frank Scaduto, Willkie Farr & Gallagher LLP

In a major victory for investment banks and the mutual fund industry, the First Circuit Court of Appeals, in an *en banc* decision in *SEC v. Tambone*, held that underwriters do not make implied statements that could support primary Rule 10b-5(b) liability when they distribute prospectuses. In reaching this result, the First Circuit adopted a number of arguments presented by the National Chamber Litigation Center (NCLC), through its co-counsel Willkie Farr & Gallagher LLP, in *amicus* briefs.

Tambone arose from allegations by the SEC that two senior executives of a mutual fund underwriter distributed prospectuses that contained false statements about the funds' market-timing practices, which the executives allegedly knew to be false. The SEC asserted claims of primary liability under Rule 10b-5, as well as secondary aiding and abetting liability. In support of primary liability, the SEC argued that defendants "made" implied false statements within the meaning of Rule 10b-5(b) by underwriting offerings and distributing prospectuses to sell the mutual funds. The SEC also argued that the defendants engaged in deceptive conduct within the meaning of Rules 10b-5(a) and (c) by participating in the drafting of the prospectuses.

The district court dismissed the SEC's complaint. On appeal, the SEC argued that defendants implicitly "made" a statement under Rule 10b-5(b), but abandoned the drafting allegations under Rule 10b-5(a) and (c). A divided three-judge panel of the First Circuit initially reversed the dismissal, holding that the defendants made "implied statements" as to the truthfulness of the prospectuses that were actionable under Rule 10b-5(b). Following defendants' successful request for re-hearing *en banc*, which was aided by *amicus* briefing from NCLC, the First Circuit *en banc* rejected any basis for primary liability under Rule 10b-5(b) in a 4-2 decision.

Citing "helpful submissions by an array of *amici*," the First Circuit's *en banc* opinion specifically adopted a number of NCLC's arguments. First, the *en banc* opinion recognized that the SEC's "implied statement" theory "effectively imposed upon securities professionals who work for underwriters an unprecedented duty to disclose." The First Circuit held that under existing Supreme Court precedent, a duty to disclose arises only from a fiduciary duty between the parties and that underwriters lacked such a duty. Thus, the *en banc* decision rejected "the SEC's implied statement theory [because it] would pave the way for suits against securities professionals for nondisclosure of material information without the required showing of a fiduciary relationship." Second, the SEC's position would have allowed private plaintiffs to sue defendants

that only aid and abet the statements of others, in violation of the limits adopted by Congress in 1995 in the Private Securities Litigation Reform Act. Third, as a concurrence joined by two of the four judges in the majority noted, the SEC's position would have created a Rule 10b-5 claim that lacked "important limitations" on private suits against underwriters that are present under sections 11 and 12 of the Securities Act of 1933. The concurrence explained that courts should not override such limitations because "the cost" of securities liabilities "initially borne by those who raise capital . . . gets passed along to the public."

The practical implications of the First Circuit's rejection of the "implied statement" theory are important. Had the panel decision been affirmed, underwriters that are currently suable under sections 11 and 12 of the Securities Act by those purchasing in securities offerings also would have become suable under Rule 10b-5 by secondary market purchasers that could allege recklessness. The *en banc* decision thus places a roadblock in front of class action plaintiffs that would seek to drag underwriters into 10b-5 litigation.

* * *

For further information, please contact Richard Bernstein, Barry Barbash, or Frank Scaduto at (202) 303-1000.

The National Chamber Litigation Center (NCLC) is the leading voice of business in the courts. For more information about this and other securities litigation, please contact Amar Sarwal, (202) 463-5337, asarwal@uschamber.com.