No. 06-43

In The
Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,

Petitioner,

v.

SCIENTIFIC-ATLANTA, INC. and MOTOROLA, INC.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

BRIEF OF *AMICI CURIAE* AMERICAN INSURANCE ASSOCIATION AND PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA IN SUPPORT OF RESPONDENTS

JOHN E. MCKEEVER
Counsel of Record
RONALD P. SCHILLER
DAVID CLARKE, JR.
LAURA A. BIANCKE
DLA PIPER US LLP
One Liberty Place, Suite 4900
1650 Market Street
Philadelphia, PA 19103
(215) 656-3300

Counsel for Amici Curiae American Insurance Association and Property Casualty Insurers Association of America

August 15, 2007

TABLE OF CONTENTS

TABLE OF AUTHORITIES

INTEREST OF *AMICI CURIAE*[1]

The American Insurance Association ("AIA") and the Property Casualty Insurers Association of America ("PCI") are the major national associations of property and casualty ("P&C") insurance companies. AIA and PCI members collectively write a great majority of the P&C insurance market in the United States, including all types of commercial and personal lines of business. AIA and PCI members, ranging in size from the largest multinational insurers writing business in all states and globally to small insurers writing business in one state or region, include companies doing business as publicly traded stock companies and mutual companies. AIA and PCI seek to promote a healthy and competitive P&C insurance marketplace through advocacy before federal and state policymakers and participation as *amici* in cases that are significant to the P&C insurance industry.

AIA and PCI have a keen interest in the outcome of this case because reversal of the decision below could adversely affect the cost and availability of insurance for businesses and the cost of services from outside vendors with whom insurers contract. It could also threaten unreasonably insurers' obligations to maintain the confidentiality of information collected in the normal course of business about their publicly traded insureds.

---

[1] Counsel for a party has not authored this brief in whole or in part, and no person or entity, other than *amici curiae* or their counsel, has made a monetary contribution to the preparation or submission of this brief. Respondents have consented by letter (attached) to the filing of this brief, and Petitioner's letter of consent is on file with the Court.

SUMMARY OF ARGUMENT

In *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994), this Court held that a securities fraud plaintiff does not have a civil cause of action under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and the Securities and Exchange Commission's implementing regulation, Rule 10b-5, 17 C.F.R. § 240.10b-5, against one who aids and abets a section 10(b) violation. Petitioner and its supporting *amici* seek to relitigate that ruling *sub silentio*, or at least to limit it, by essentially arguing that some aiders and abettors (or, as some *amici* argue, all knowing participants) are liable as primary violators when there is a scheme to defraud. That approach would effectively overrule *Central Bank* in many securities cases.

Whatever a plaintiff's theory of liability, *Central Bank* requires the courts to dismiss parties who are solely aiders and abettors (*i.e.*, those who are solicited by the primary violators to assist in the scheme), even where, as here, the plaintiff alleges that a number of defendants participated in a "scheme to defraud."

Allowing a private action against all parties who are alleged to be knowing participants in a scheme to defraud, including those who "substantially assist" the primary violators – the test for aiding and abetting liability – would have a serious negative impact on the insurance industry. It would expose a whole new class of financial institutions to expensive litigation and potentially extortionate class action settlement demands. And significantly, it would adversely affect property and casualty insurance companies and markets. The result would be higher premiums for insureds, potentially putting adequate coverage outside the reach of many businesses, particularly those that are small or mid-size or in higher-risk industries. Moreover, it would leave insurers unclear about their duties to disclose to the Government or to the public information regarding their publicly traded insureds.

ARGUMENT

I. PETITIONER IMPROPERLY SEEKS TO EXTEND LIABILITY UNDER SECTION 10(b) WHENEVER A "SCHEME TO DEFRAUD" IS ALLEGED TO THOSE WHO, AT MOST, HAVE SOLELY AIDED AND ABETTED A SECURITIES VIOLATION.

Central Bank holds that "there is no private aiding and abetting liability under § 10(b)." *Central Bank*, 511 U.S. at 191. Petitioner does not contest that, Brief for Petitioner at 14-15, and the question on which certiorari was granted does not request – at least explicitly – that the Court overrule *Central Bank*.

In an effort to avoid *Central Bank*, Petitioner and several *amici* supporting it propose that as long as there is a "scheme to defraud," *Central Bank* does not apply. Some *amici* go so far as to argue that all participants in the scheme are liable in a private civil action. But *Central Bank* itself involved an alleged scheme to defraud. Thus, reversal of the decision below would effectively overrule *Central Bank* in many if not most securities cases, since a creative plaintiff's lawyer could almost always allege a "scheme" to defraud.

By definition, an aider and abettor knowingly provides substantial assistance to the perpetration of a primary violator's scheme to defraud. *See* 15 U.S.C. § 78t(e) ("persons who aid and abet" are those "that knowingly provide[ ] substantial assistance to another person in violation of [Title 15]"); *see also*, *e.g.*, *Monsen v. Consolidated Dressed Beef Co*., 579 F.2d 793, 799 (3d Cir.) (aiding and abetting requires, *inter alia*, "that the aider-abettor knowingly and substantially participated in the wrongdoing"), *petition for cert. denied sub nom. First Pennsylvania Bank v. Monsen*, 439 U.S. 930 (1978). The existence of a scheme does not negate the applicability of the holding in *Central Bank*, or the reasons for the holding, that aiders and abettors are not liable in a private civil action under section 10(b). *See Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040 (9th Cir. 2006) (recognizing use of "scheme to defraud" as basis for primary liability, but affirming dismissal of complaint because it failed to allege primary liability), *petition for cert. filed*, 75 U.S.L.W. 1030 (U.S. Oct. 19, 2006) (No. 06-560).

The test for primary liability under section 10(b) which Petitioner and its *amici* propose is too broad. To do as Petitioner asks would require the Court to overrule *Central Bank*, at least in large part, thereby creating an artificial distinction between two types of securities cases: those where a scheme to defraud is alleged, and those where the alleged misrepresentation (or omission) is not part of a "scheme to defraud." One is hard put to imagine a case fitting only the latter category.

II. THE RELITIGATION OF *CENTRAL BANK* SOUGHT BY PETITIONER THREATENS TO DISRUPT INSURANCE MARKETS AND THE RELATIONSHIPS BETWEEN INSURERS AND THEIR COMMERCIAL POLICYHOLDERS AND VENDORS.

The policy arguments made in support of Petitioner's position make clear that those arguments are a thinly-veiled attempt to relitigate *Central Bank*. *See*, *e.g.*, Brief of the North American Securities Administrators Association, Inc. as *Amicus Curiae* in Support of Petitioner at 4-5 ("A decision that holds *all* parties accountable for their role in a fraudulent scheme . . . will help repair the damage done to investors and deter future violations") (emphasis added); Brief of AARP, Consumer Federation of America, and U.S. PIRG as *Amici Curiae* in Support of Petitioner ("AARP Brief") at 4 ("Investors in major securities fraud cases will often be denied a remedy for their losses when outside actors are not held liable for violating § 10(b) . . . ").[2] In *Central Bank*, the Court considered and rejected the exact same policy arguments. *Central Bank*, 511 U.S. at 188 (noting that the SEC's policy arguments in support of a Rule 10b-5 aiding and abetting cause of action included "deter[ring] secondary actors from contributing to fraudulent activities and ensur[ing] that defrauded plaintiffs are made whole"). As the Court there stated, "[p]olicy

[2] Other policy arguments are directed toward the issue of whether "deceptive devices" that are actionable under section 10(b) should include "schemes to defraud." *See* Brief for Petitioner at 34-36. As discussed, *supra* at 3-4, even if a scheme to defraud is actionable under section 10(b), the propriety of Petitioner's claims against Respondents turns on whether Respondents were primary movers in the scheme, or instead were aiders and abettors.

considerations cannot override our interpretation of the text and structure of the Act. . . . " *Id*.

Were the Court to allow private actions against parties who substantially assist another's scheme to defraud, companies will become potential defendants any time they do business with a publicly held entity that is later sued for securities fraud as long as plaintiffs allege knowledge of the scheme. The result urged by Petitioner would create new and uncertain duties for any business that contracts with a publicly traded company. That includes insurers.

Insurers, who must invest premiums to back obligations to policyholders, are among the largest investors in equities in the nation. As a result, the insurance industry is second to none in fostering appropriate safeguards to assure the protection of investors, sound corporate governance, and ethical business practices. Nevertheless, unique aspects of the property and casualty insurance industry would make those insurers prime targets of securities class action litigation under Petitioner's broad theory of scheme liability.

The most immediate impact on the insurance industry would be to dramatically increase the exposure of insurers that issue directors and officers liability policies ("D&O policies"), which often provide coverage for securities claims. That would inevitably increase the premiums for those policies. Not only would insurers be subject to expanded claims for losses related to coverage for securities lawsuits, but, where appropriate, they would have to defend against the claims brought against alleged insured aiders and abettors as well as against the alleged insured primary violators who conceived and executed the claimed scheme.

The great majority of class action lawsuits are never tried because defense costs in those cases are substantial. As *amici* AARP, *et al.*, argue, "defense costs in securities fraud cases often quickly exhaust" the D&O coverage available (AARP Brief at 11-12), even though "[m]ost large U.S. companies carry D&O policies with coverage limits of between $100 and $200 million. . . ." *Id.* at 11. Thus, defendants often settle to escape the ruinous costs of defense. The result is that, "[w]hile D&O policies fund much of the plaintiffs' and class members' recovery in garden-variety fraud cases, they do the victims of major frauds involving insolvent stock issuers little good in most cases." *Id*. at 9-10 (citation omitted). Thus, one result of limiting *Central Bank* to "non-scheme" cases would be to increase D&O insurance premiums (and lead to more insurance coverage litigation), with little or no benefit to defrauded investors (as distinguished from their attorneys). To the extent that such policies cover the new exposure, the resulting premiums may eventually place them beyond the reach of many smaller or mid-size businesses and those in higher-risk industries, leading to more rather than less harm to investors.

Moreover, reversal of the decision below would put all property and casualty insurers at risk. Insurers could be especially vulnerable to being added as "deep pocket" defendants in securities fraud lawsuits. Reversal could subject insurers to class action liabilities arising from even routine business activities.

In the normal course of their business, insurers often collect confidential business information, including information on financial risks, from potential insureds in the underwriting process and from current clients in the claims process. The standard proposed by Petitioner multiplies the opportunities for securities class action litigators to devise creative arguments alleging scheme liability.

The claims in a lawsuit or a series of related lawsuits against a publicly traded company can exceed the company's insurance coverage. Where an insurer is aware of a substantial risk faced by a public company that is not fully covered by insurance, is the insurer required to make certain that its insured reports the exposure properly in its financial statements, at the risk of possibly becoming a defendant in a securities fraud lawsuit if the insured does not do so?

For example, when a product liability claim is asserted against an insured manufacturer, the insurer commonly investigates the design of the product involved. That investigation may reveal that the product was in fact poorly designed, or was marketed with inadequate warnings (or even using false representations). Regardless of what the insurer does, the manufacturer may face liabilities for products already on the market that exceed the insurance policy's limits. After the insurer responds to damage claims up to the policy's limits, would the insurer be exposed to a claim that it participated in a scheme to defraud if the manufacturer does not disclose a material uninsured exposure in the manufacturer's financial statements?

Similarly, must a surety bond issuer take steps to determine whether a publicly traded contractor covered by the bond discloses its financial difficulties when the insurer is required to step in and complete a project which the contractor is financially unable to complete, to avoid the risk that the surety will be forced to defend against a claim that by not speaking it participated in a scheme to defraud the contractor's shareholders? What if a fidelity bond issuer reimburses its insured for the dishonest acts of a highly placed employee in a public corporation: must the fidelity bond insurer take steps to make certain that the dishonesty is disclosed in the insured's financial statements, or risk being sued as a participant in a scheme to hide the truth from the insured's investors?

The point is that, by virtue of the nature of the insurance relationship, insurers often acquire significant knowledge of an insured's business and its attendant risks. If the Court were to hold that the mere allegation of a scheme to defraud is sufficient to take the case out of *Central Bank*, insurers may be particularly vulnerable to claims that they participated in an actionable scheme to defraud by not publicly disclosing those risks. And because insurers are required to maintain state-mandated levels of assets to cover their obligations to policyholders and to continue writing insurance, insurers are especially attractive targets of plaintiffs' attorneys, who know that they need not be concerned with whether the potential defendant has insurance.

The resulting cost of such expanded liability would be borne by insurers' business customers in every industry, without in any way enhancing the availability of commercial coverages. Enforcement action by the SEC remains available in appropriate cases, 15 U.S.C. § 78t(e), as does criminal liability in egregious situations. 15 U.S.C. § 78ff; 18 U.S.C. § 2. Insurers also are subject to strict financial regulation and market conduct oversight by regulators in all 50 states and the District of Columbia. Insurers and insurance markets should not run the additional risk of incurring the substantial costs of defending against private actions under section 10(b) whenever creative counsel for a plaintiff is able to allege that there was a scheme to defraud and that someone other than the primary violator facilitated the scheme.

Finally, the insurance industry does business with a large number of service suppliers. The extension of liability sought by Petitioner would (1) increase the chances that an insurer might unwittingly enter into a contract that is later claimed to be part of a scheme to defraud perpetrated by the insurer's contractor, or (2) make potential service suppliers wary of doing business with publicly traded insurers, thereby reducing the pool of willing suppliers or increasing the insurer's cost of doing business with them.

In short, Petitioner's argument would essentially create new risks for anyone who deals with a publicly traded entity. Those who deal with publicly traded companies should not be made, in effect, insurers of the accuracy of such companies' financial statements.

Were the Court inclined to limit *Central Bank*, it should do so very carefully, lest a Pandora's Box of vastly increased securities litigation inadvertently result. The Court in *Central Bank* indicated that eliminating section 10(b) aiding and abetting liability "does not mean that secondary actors . . . are always free from liability under the securities Acts." *Central Bank*, 511 U.S. at 191. The

Court specifically referred to several categories of actors – "a lawyer, accountant, or bank," *id.* – as likely candidates. Each of those categories has an especially unique relationship with a securities issuer and occupies a place of trust that sets them apart from routine vendors whose relationship is episodic rather than being one of a close and trusted adviser. They may owe duties that transcend the normal business relationship. That is not the case for routine vendors such as insurers.

CONCLUSION

WHEREFORE, for the foregoing reasons, *Amici Curiae* American Insurance Association and the Property Casualty Insurers Association of America respectfully urge the Court to affirm the Order of the court of appeals.

Respectfully submitted,

JOHN E. MCKEEVER
Counsel of Record
RONALD P. SCHILLER
DAVID CLARKE, JR.
LAURA A. BIANCKE
DLA PIPER US LLP
One Liberty Place, Suite 4900
1650 Market Street
Philadelphia, PA 19103
(215) 656-3300

Counsel for Amici Curiae
American Insurance Association
and Property Casualty Insurers
Association of America

August 15, 2007