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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE
COMMISSION,

No. C-08-4238 EMC

Plaintiff,

FINAL JURY INSTRUCTIONS

v.

(September 1, 2010)

MICHAEL C. PATTISON,

Defendant.

United States District Court
For the Northern District of California

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JURY INSTRUCTION NO. 1 – DUTY OF JURY (COURT READS AND PROVIDES WRITTEN INSTRUCTIONS AT END OF CASE)

Members of the Jury: Now that you have heard all of the evidence, it is my duty to instruct you as to the law of the case.

A copy of these instructions will be sent with you to the jury room when you deliberate.

You must not infer from these instructions or from anything I may say or do as indicating that I have an opinion regarding the evidence or what your verdict should be.

It is your duty to find the facts from all the evidence in the case. To those facts you will apply the law as I give it to you. You must follow the law as I give it to you whether you agree with it or not. And you must not be influenced by any personal likes or dislikes, opinions, prejudices, or sympathy. That means that you must decide the case solely on the evidence before you. You will recall that you took an oath to do so.

In following my instructions, you must follow all of them and not single out some and ignore others; they are all important.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.1C.

Court Comments: No objection by the parties.

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**JURY INSTRUCTION NO. [13] – BURDEN OF PROOF –
PREPONDERANCE OF THE EVIDENCE**

When a party has the burden of proof on any claim [or affirmative defense] by a preponderance of the evidence, it means you must be persuaded by the evidence that the claim [or affirmative defense] is more probably true than not true.

You should base your decision on all of the evidence, regardless of which party presented it.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.3.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [3] – WHAT IS EVIDENCE

The evidence you are to consider in deciding what the facts are consists of:

1. the sworn testimony of any witness;
2. the exhibits which are received into evidence; and
3. any facts to which the lawyers have agreed.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.6.

Court Comments: The parties stipulated to this instruction.

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JURY INSTRUCTION NO. [4] – WHAT IS NOT EVIDENCE

In reaching your verdict, you may consider only the testimony and exhibits received into evidence. Certain things are not evidence, and you may not consider them in deciding what the facts are. I will list them for you:

- (1) Arguments and statements by lawyers are not evidence. The lawyers are not witnesses. What they have said in their opening statements, [will say in their] closing arguments, and at other times is intended to help you interpret the evidence, but it is not evidence. If the facts as you remember them differ from the way the lawyers have stated them, your memory of them controls.
- (2) Questions and objections by lawyers are not evidence. Attorneys have a duty to their clients to object when they believe a question is improper under the rules of evidence. You should not be influenced by the objection or by the court’s ruling on it.
- (3) Testimony that has been excluded or stricken, or that you have been instructed to disregard, is not evidence and must not be considered. In addition sometimes testimony and exhibits are received only for a limited purpose; when I [give] [have given] a limiting instruction, you must follow it.
- (4) Anything you may have seen or heard when the court was not in session is not evidence. You are to decide the case solely on the evidence received at the trial.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.7.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [17] – USE OF INTERROGATORIES OF A PARTY

Evidence [will now be] [was] presented to you in the form of answers of one of the parties to written interrogatories submitted by the other side. These answers [have been] [were] given in writing and under oath, before the actual trial, in response to questions that were submitted in writing under established court procedures. You should consider the answers, insofar as possible, in the same way as if they were made from the witness stand.

Authority: 9th Cir. Model Civil Jury Instruction No. 2.10.

Court Comments: The parties stipulated to this instruction.

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JURY INSTRUCTION NO. [24] – EXPERT OPINION

Some witnesses, because of education or experience, are permitted to state opinions and the reasons for those opinions.

Opinion testimony should be judged just like any other testimony. You may accept it or reject it, and give it as much weight as you think it deserves, considering the witness’s education and experience, the reasons given for the opinion, and all the other evidence in the case.

Authority: 9th Cir. Model Civil Jury Instruction No. 2.11.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [28] – CHARTS AND SUMMARIES

NOT RECEIVED IN EVIDENCE

Certain charts and summaries not received in evidence [may be] [have been] shown to you in order to help explain the contents of books, records, documents, or other evidence in the case. They are not themselves evidence or proof of any facts. If they do not correctly reflect the facts or figures shown by the evidence in the case, you should disregard these charts and summaries and determine the facts from the underlying evidence.

Authority: 9th Cir. Model Civil Jury Instruction No. 2.12.

Court Comments: The parties stipulated to this instruction.

1 **JURY INSTRUCTION NO. [29] – CHARTS AND SUMMARIES RECEIVED IN EVIDENCE**

2 Certain charts and summaries [may be] [have been] received into evidence to illustrate
3 information brought out in the trial. Charts and summaries are only as good as the underlying
4 evidence that supports them. You should, therefore, give them only such weight as you think the
5 underlying evidence deserves.

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7 Authority: 9th Cir. Model Civil Jury Instruction No. 2.13.

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9 Court Comments: The parties stipulated to this instruction.

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JURY INSTRUCTION NO. [25P] – ADVERSE INFERENCE

CONDITIONAL INSTRUCTION

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3 You have heard evidence that the defendant refused to answer questions during his January
4 2008 SEC testimony, on the grounds that truthful answers would have tended to incriminate him.
5 Because this is a civil, and not a criminal, proceeding, you are allowed to draw an adverse inference
6 as to what the defendant’s answers would have been had he elected to answer them in 2008. That is,
7 you may, but need not, draw an inference that the defendant’s truthful answers in his 2008 SEC
8 testimony in fact would have tended to incriminate him, if such an inference is warranted by the
9 facts of this case.

10
11 Authority: *See SEC v. Colello*, 139 F.3d 674, 677 (9th Cir. 1998) (stating that “[p]arties are free to
12 invoke the Fifth Amendment in civil cases, but the court is equally free to draw adverse inferences
13 from their failure of proof”); *SEC v. Trabulse*, 526 F. Supp. 2d 1001, 1007 n.4 (N.D. Cal. 2007)
14 (noting that defendant refused to answer questions propounded by the SEC pursuant to an
15 investigative subpoena and that, based on that refusal, “[t]he Court is entitled to make an adverse
16 inference, this being a civil action”).

17
18 Court Comments: At the pretrial conference, Judge Breyer held that there would be no reference to
19 the defendant’s invocation of the Fifth Amendment during trial unless the issue became relevant –
20 *e.g.*, if the defendant testified that he had been forthcoming, honest, and direct throughout the
21 proceedings. *See* Docket No. 173 (Tr. at 12). Given this ruling, the Court will not give the
22 requested instruction unless there is testimony by the defendant or his witnesses that makes the issue
23 relevant.

JURY INSTRUCTION NO. [27] – STIPULATIONS OF FACT

1
2 The parties have agreed to certain facts that will be read to you. You should therefore treat
3 these facts as having been proved.

4 1. Defendant Michael C. Pattison served as Embarcadero’s controller from
5 approximately January 2000 through July 2005. The defendant is a certified public accountant.

6 2. Embarcadero is a corporation located in San Francisco, California, that makes
7 software. From approximately April 2000 through June 25, 2007, Embarcadero was a “public
8 company,” meaning that its common stock was registered with the SEC and was publicly traded on
9 the NASDAQ National Market, also called the NASDAQ Global Market. In June 2007, the
10 company was acquired by private investors.

11 3. Exhibit 653 describes, for each date that Embarcadero’s stock was traded when it was
12 a public company, the stock’s closing prices. A “closing price” is the last price reported on an
13 exchange (in this case, the NASDAQ) as a sales price in a transaction for the purchase and sale of
14 shares of stock.

15 4. From approximately June 2000 through January 2007, Stephen R. Wong, a
16 co-founder of Embarcadero, served as its chief executive officer (or “CEO”). Also, from January
17 2000 through October 2005, Raj P. Sabhlok served as Embarcadero’s chief financial officer (or
18 “CFO”).

19 5. As a public company, Embarcadero made quarterly and annual reports to
20 shareholders
21 about its financial condition on certain forms.

22 6. Embarcadero filed three quarterly reports to shareholders each year on a form called a
23 “Form 10-Q.” The first quarterly period each year covered the three months that ended March 31;
24 the second covered the three months that ended June 30; and the third covered the three months that
25 ended September 30. Embarcadero’s fiscal year ended on December 31. Instead of filing a fourth
26 quarterly report, Embarcadero included information about the last three months of every year in its
27 annual reports.
28

1 7. Embarcadero’s annual reports to shareholders were filed on a form called a “Form
2 10-K.”

3 8. From late 2000 through the third quarter of 2004, Embarcadero regularly granted
4 stock options to its employees and executives as a form of compensation.

5 9. Each stock option gave the person granted the option the right to buy Embarcadero’s
6 common stock in the future from Embarcadero at a set price, called the “exercise” price or the
7 “strike” price.

8 10. The stock options Embarcadero granted had terms describing when the employee
9 could exercise the option by paying the exercise price, and when the option would expire if
10 the employee did not exercise it. Those terms were called the vesting schedule. At Embarcadero,
11 employee stock options generally vested over a four-year period and employees could not exercise
12 stock options for at least one year from the grant date.

13 11. In approximately October 2000, Embarcadero’s Compensation Committee authorized
14 the CEO, Mr. Wong, to grant options to employees who were not officers or directors of
15 Embarcadero.

16
17 Authority: 9th Cir. Model Civil Jury Instruction No. 2.2.

18
19 **Court Comments: The Court has included as part of this instruction the facts that the parties**
20 **stipulated to in their Joint Proposed Pretrial Order (located at Docket No. 161).**

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JURY INSTRUCTION NO. [33P & 33D] – SECURITIES –

DEFINITION OF RECURRING TERMS

1 Congress has enacted securities laws designed to protect the integrity of financial markets.

2
3 There are terms concerning securities laws that have a specific legal meaning. The
4 following definitions apply throughout these instructions, unless noted otherwise.

5 A security is an investment of money in a commercial, financial or other business
6 enterprise, with the expectation of profit or other gain produced by the efforts of others. **One**
7 **common type of security is a stock.**

8
9 The buying and selling of securities is controlled by the Securities Laws. Many of these
10 laws are administered by the SEC.

11 An instrumentality of interstate commerce includes the postal mails, e-mails, telephone,
12 telegraph, telefax, interstate highway system, Internet and similar methods of communication and
13 travel from one state to another within the United States.

14
15 Authority: 9th Cir. Model Civil Jury Instruction No. 18.0 (modified).

16
17 **Court Comments: With respect to the defendant’s first objection, the Court shall define the phrase**
18 **“in connection with” as part of Instruction No. [34], which deals with the 10b-5 claim specifically.**

19 **As for the second objection, the Court shall not include a statement that another common**
20 **type of security is an option to purchase stock. Although options are securities, defining the term**
21 **“security” in that way could mislead the jury into focusing on whether there was a misstatement or**
22 **omission involved in the grant or exercise of the options rather than on the alleged misstatements or**
23 **omissions in the subsequent financial reporting which is the core of the SEC’s case.**

24 **Finally, the Court deems the third objection (*i.e.*, that the instruction “does not indicate that**
25 **the jurors must agree that the same securities were involved in a misrepresentation or omission,”**
26 **Def.’s Obj. at 3) waived. The defendant never brought this issue up in its original submission on**
27 **jury instructions. Moreover, the Court is persuaded by the case law cited by the SEC that such an**

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United States District Court
For the Northern District of California

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instruction is not necessary. Furthermore, the Court has amended Instruction No. [30] to make clear
unanimity is required as to each claim.

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JURY INSTRUCTION NO. ____ – CLAIMS ASSERTED BY THE PLAINTIFF

The SEC claims that the defendant has violated various provisions of federal securities law, in particular the Exchange Act and the Securities Act. The specific claims asserted by the SEC are as follows:

- (1) Violation of Rule 10b-5 of the Exchange Act.
- (2) Aiding and abetting violation of Rule 10b-5.
- (3) Aiding and abetting violation of Section 13(a) of the Exchange Act.
- (4) Violation of Section 13(b)(5) of the Exchange Act.
- (5) Violation of Rule 13b2-1 of the Exchange Act.

Authority: See Joint Proposed Pretrial Order at 6-12.

Court Comments: This instruction provides a helpful roadmap for the jury. The above list reflects that SEC’s voluntary dismissal of certain claims. See Docket No. 257 (order).

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JURY INSTRUCTION NO. [55D] – SECURITIES – BACKDATING OF STOCK OPTIONS

“Backdating” – insofar as that term means pricing stock options on a day prior to the date of the grant – is not in and of itself a violation of the federal securities law. However, evidence of such practices may be considered by you, along with other evidence, in connection with the claims asserted against the defendant. In other words, you may consider evidence of retroactive pricing, or “backdating,” in light of the specific elements that must be proved in connection with each of the claims asserted.

Court Comments: The SEC has objected to this instruction. The SEC’s basic argument is that this case is different from *Jensen*. While that may be true, the bottom line is that the term “backdating” and its legality is likely to be bandied about during the trial, and therefore a definition and clarification would be helpful to the jury.

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JURY INSTRUCTION NO. [56D] – SECURITIES – ACCOUNTING GUIDELINES

You have heard reference at times during the trial to generally accepted accounting principles ('GAAP'), Accounting Principles Board Opinion No. 25 ('APB 25'), Financial Accounting Standard 123 ('FAS 123') and Financial Accounting Standards Board Interpretation No. 44 ('FIN 44'). Except where otherwise provided, a violation of these principles, opinion, standards, or guidelines in and of itself, does not establish a violation of the securities law. However, evidence of such accounting violations may be considered by you, along with other evidence, in connection with the violations alleged.

Court Comments: The defendant has objected to this instruction, noting that the SEC has now dropped, *inter alia*, the Section 13(b)(2)(B) claim. But the Rule 13b2-1 claim is still in (which does not require scienter), so the defendant's citation to authority discussing GAAP and scienter are not on point.

VIOLATION OF RULE 10b-5

JURY INSTRUCTION NO. [34] – RULE 10b-5 CLAIM – ESSENTIAL ELEMENTS

A “10b-5 claim” is a claim brought under a federal statute, Section 10(b) of the Exchange Act, which in essence prohibits acts of deception in connection with the purchase or sale of a security and in violation of rules and regulations that the SEC has the duty and power to issue. A corresponding SEC Rule, Rule 10b-5, prohibits the misrepresentation of material facts and the omission of material facts in connection with the purchase or sale of securities. A person or business entity who violates the securities laws, including Rule 10b-5, may be liable for the violation.

The SEC alleges that the defendant violated Rule 10b-5 by participating in a scheme to defraud shareholders of Embarcadero and making, or helping others make, material misrepresentations and omissions of fact regarding how Embarcadero granted and accounted for employee stock options.

On this claim, the SEC has the burden of proving each of the following elements by a preponderance of the evidence:

1. The defendant did any of the following things in connection with the purchase or sale of securities: (a) employed a device, scheme or artifice to defraud; or (b) made an untrue statement of a material fact; or omitted a material fact necessary under the circumstances to keep the statements that were made from being misleading; or (c) engaged in an act, practice or course of business that operated as a fraud or deceit;
2. The defendant acted knowingly or recklessly; and
3. The defendant used or caused the use of an instrumentality of interstate commerce, such as mail or telephone facility of a national securities exchange in connection with the purchase or sale of securities, regardless whether the instrumentality or facility itself was used to make an untrue statement or a material omission. In connection with means that there was some nexus or relationship between the allegedly fraudulent conduct and the sale or purchase of the securities.

1 If you find that the SEC has proved all of the above elements, your verdict should be for the
2 SEC. If, on the other hand, you find that the SEC has failed to prove one or more of these
3 elements, your verdict should be for the defendant.

4
5 Authority: 9th Cir. Model Civil Jury Instruction No. 18.0 (modified); 9th Cir. Model Civil Jury
6 Instruction No. 18.1 (modified).

7
8 **Court Comments: As noted above with respect to Instruction No. [33], the Court has included a**
9 **definition of the phrase “in connection with.”**

10 **In addition, the Court has decided to include the phrase “or recklessly” as the parties had**
11 **originally proposed in their joint proposed jury instructions. See Docket No. 159 (joint proposed**
12 **jury instructions). The Court has made this decision based on its conclusion that, for the relevant**
13 **period, the aiding and abetting claims require actual knowledge and not mere recklessness.**

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JURY INSTRUCTION NO. [36P, 36D & 37D] – RULE 10b-5 CLAIM –

MISREPRESENTATIONS OR OMISSIONS – MATERIALITY

The SEC must prove by a preponderance of the evidence that the misrepresentation or omission of the defendant was material.

A factual representation concerning a security is material if there is a substantial likelihood a reasonable investor would consider the fact important in deciding whether or not to buy or sell that security.

An omission concerning a security is material if there is a substantial likelihood that a reasonable investor would have regarded what was not disclosed to [him] [her] as having significantly altered the total mix of information [he] [she] took into account in deciding whether to buy or sell the security.

You must decide whether something was material based on the circumstances as they existed at the time of the statement or omission.

Authority: 9th Cir. Model Civil Jury Instruction No. 18.2.

Court Comments: The Court’s prior proposed instruction was the Ninth Circuit model instruction. However, the defendant’s requested modification is fair based on Ninth Circuit case law. See *McGonigle v. Combs*, 968 F.2d 810, 817 (9th Cir. 1992) (“A fact is material if there is a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder.”) (internal quotation marks omitted).

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JURY INSTRUCTION NO. [35] – RULE 10b-5 CLAIM – KNOWINGLY OR RECKLESSLY

A defendant acts knowingly when he makes an untrue statement with the knowledge that the statement was false or with reckless disregard for whether the statement was true. A defendant acts knowingly if he omits necessary information with the knowledge that the omission would make the statement false or misleading or with reckless disregard for whether the omission would make the statement false or misleading.

“Reckless” means highly unreasonable conduct that is an extreme departure from ordinary care, presenting a danger of misleading investors, which is either known to the defendant or is so obvious that the defendant must have been aware of it.

Authority: 9th Cir. Model Civil Jury Instruction No. 18.3.

Court Comments: Consistent with Instruction No. [34] above, the Court has added to the title of this instruction “or recklessly.”

1 **JURY INSTRUCTION NO. [38P & 38D] – RULE 10b-5 CLAIM – KNOWINGLY –**
2 **DELIBERATE IGNORANCE**
3 **[CONDITIONAL INSTRUCTION]**

4 You may find that the defendant acted knowingly if you find by a preponderance of the
5 evidence that the defendant:

- 6 1. was aware of a high probability that Embarcadero’s public disclosures were false, and
- 7 2. deliberately avoided learning the truth.

8 You may not find such knowledge, however, if you find that the defendant actually believed
9 that Embarcadero’s public disclosures were accurate, or if you find that the defendant was simply
10 careless.

11
12 Authority: 9th Cir. Model *Criminal* Jury Instruction No. 5.7 (modified).

13
14 **Court Comments: The defendant has objected to this instruction. According to the defendant, “it is**
15 **totally unwarranted under the facts alleged and discovered in this case.” Def.’s Obj. at 5. The Court**
16 **shall defer on this instruction depending on what the evidence reveals. Presumably, however, the**
17 **SEC has an argument in favor of deliberate ignorance based on the defendant’s being a CPA, etc.**

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AIDING AND ABETTING VIOLATION OF RULE 10b-5

JURY INSTRUCTION NO. [39] – AIDING AND ABETTING VIOLATION OF RULE 10b-5
– ESSENTIAL ELEMENTS

The SEC also claims that the defendant aided and abetted another person’s violations of Rule 10b-5. To prove this aiding and abetting claim, the SEC must establish by a preponderance of the evidence that:

1. Another person (*i.e.*, someone other than the defendant **engaging in conduct of his or her own will**) violated Rule 10b-5 by knowingly **or recklessly** participating in a scheme to defraud or making material misrepresentations or omissions of fact (known as the “primary violation”); and
2. the defendant had actual knowledge of both the primary violation and of his role in furthering it; and
3. the defendant provided substantial assistance in the primary violation.

The SEC must establish all of the elements listed in Instruction No. ____ for each claimed primary violation.

Authority: *SEC v. Fehn*, 97 F.3d 1276, 1288 (9th Cir. 1996) (stating that elements of claim for aiding and abetting violation under Section 10(b) are as follows: “(1) the existence of an independent primary violation; (2) actual knowledge by the alleged aider and abettor of the primary violation and of his or her own role in furthering it; and (3) ‘substantial assistance’ by the defendant in the commission of the primary violation”).

Court Comments: The Court has modified this instruction to make Instruction No. [40D] unnecessary. In addition, consistent with Instruction No. [34] above, the Court has added the phrase “or recklessly.”

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**JURY INSTRUCTION NO. [40D] – AIDING AND ABETTING VIOLATION OF
RULE 10b-5 – ANOTHER PERSON**

As stated in Instruction No. _____, to prove that the defendant aided and abetted any securities violation, the SEC must prove that “another person” committed a securities violation. Thus, unless you find that some person other than the defendant caused Embarcadero’s financial records or disclosures to be inaccurate, you cannot find that the defendant was guilty of aiding and abetting.

Court Comments: In light of the modification to Instruction No. [39], this instruction is repetitive.

1 **JURY INSTRUCTION NO. [41D] – AIDING AND ABETTING VIOLATION OF**
2 **RULE 10b-5 – ACTUAL KNOWLEDGE**

3 For any aiding and abetting claim, the SEC must prove that the defendant had actual
4 knowledge of both the primary violation and of his role in furthering it; recklessness is not enough.

5
6 **Court Comments: The Court has decided to include an instruction on actual knowledge based on its**
7 **conclusion that the aiding and abetting claims require actual knowledge and not just mere**
8 **recklessness.**

9 From 2000 to 2005, the relevant provision of the Securities Exchange Act provided for
10 aiding and abetting liability for “any person that knowingly provides substantial assistance to
11 another person in violation of a provision of this title, or of any rule or regulation issued under this
12 title.” 15 U.S.C. § 78t(e) (2000-2005).

13 In July 2010, the Securities Exchange Act was amended so that the phrase “or recklessly”
14 was added. 15 U.S.C. § 78t(e) (2010). In other words, there is aiding and abetting liability for “any
15 person that knowingly or recklessly provides substantial assistance to another person in violation of
16 a provision of this title [15 U.S.C. §§ 78a et seq.], or of any rule or regulation issued under this title
17 [15 U.S.C. §§ 78a et seq.].” *Id.*

18 Unfortunately, it is not clear whether this change was simply a clarification that recklessness
19 was good enough to prove actual knowledge -- or rather a change in the law making recklessness,
20 and not just knowledge, a basis for liability. The legislative history is inconclusive.

21 Prior to the amendment, courts differed as to whether recklessness was good enough to prove
22 actual knowledge. Some courts held that recklessness was not enough. *See, e.g., SEC v. Espuelas,*
23 *579 F. Supp. 2d 461, 470-71 (S.D.N.Y. 2008) (agreeing with opinion of another judge in the same*
24 *district that “knowingly” as used in the statute refers to “actual knowledge” and not “recklessness”;*
25 *relying in particular on fact that “the Senate considered and rejected an amendment that would have*
26 *added recklessness to the standard, and that it is unlikely that the Congress intended to codify the*
27 *existing scienter standards for aiding and abetting, given its awareness of divergent approaches*
28 *among the Circuits”). Others held to the contrary. *See, e.g., Voss v. SEC,* 222 F.3d 994, 1004 (D.C.*

1 Cir. 2004) (asking “did Graham assist Broumas with the requisite scienter?” and noting that “[w]e
2 have held that knowledge or recklessness is sufficient to satisfy that requirement”); *SEC v.*
3 *Intelliquis Int’l, Inc.*, No. 2:02-CV-674 PGC, 2003 U.S. Dist. LEXIS 27131, at *39 (D. Utah Dec.
4 11, 2003) (noting that, the Tenth Circuit [in *Geman v. SEC*, 334 F.3d 1183, 1195, 1196 (10th Cir.
5 2003),] indicated that recklessness still is sufficient to satisfy the state-of-mind requirement for
6 aiding and abetting in this circuit”).

7 Prior to the 2010 amendment, the Ninth Circuit indicated in *United States SEC v. Fehn*, 97
8 F.3d 1276 (9th Cir. 1996), that recklessness is enough to prove actual knowledge in an enforcement
9 action brought by the SEC for aiding and abetting. The Ninth Circuit noted that “other decisions by
10 this Court have defined this element [of aiding and abetting] as ‘actual knowledge or reckless
11 disregard.’ We do not address this discrepancy because Section 104, by its plain terms, requires
12 ‘knowledge’ as an element of aiding and abetting.” *Id.* at 1288 n.11 (emphasis added). The Ninth
13 Circuit thus rejected recklessness as sufficient to prove actual knowledge in an enforcement action
14 under § 104. See *SEC v. Sandifur*, No. C05-1631C, 2006 U.S. Dist. LEXIS 12243, at *35 (W.D.
15 Wash. Mar. 2, 2006) (interpreting *Fehn* as requiring actual knowledge).

1 **JURY INSTRUCTION NO. [42D] – AIDING AND ABETTING VIOLATION OF**
2 **RULE 10b-5 – SUBSTANTIAL ASSISTANCE**

3 As stated in Instruction No. _____, to prove that the defendant aided and abetted any
4 securities violation, the SEC must prove that the defendant “substantially assisted” someone else in
5 committing a securities violation.

6 “Substantially assisted” means that the defendant’s assistance was a substantial factor in
7 causing the securities violation.

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9 Authority: *K & S P’ship v. Continental Bank, N.A.*, 952 F.2d 971, 979 (8th Cir. 1991) (in case
10 involving claim for aiding and abetting a securities violation, stating that, to establish substantial
11 assistance, the plaintiff must “show that the secondary party proximately caused the violation, or, in
12 other words, that the encouragement or assistance was a substantial factor in causing the tort”).

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14 Court Comments: An instruction on “substantial assistance” has been offered by the defendant only.
15 The Court agrees that the phrase “substantial assistance” is somewhat of a term of art such that a
16 definition for the jury would be helpful. That being said, the definition offered by the defendant has
17 problems – in particular, its use of another term of art (*i.e.*, proximate cause) and its suggestion that
18 substantial assistance means but-for causation.

AIDING AND ABETTING VIOLATION OF SECTION 13(a)

JURY INSTRUCTION NO. [47P & 47D] – AIDING AND ABETTING VIOLATION OF SECTION 13(a) – ESSENTIAL ELEMENTS

The SEC claims that the defendant also aided and abetted Embarcadero’s violations of Section 13(a) of the Exchange Act. Section 13(a) and its rules require public companies, such as Embarcadero, to file periodic reports to shareholders quarterly and annually that describe their financial condition, and to timely file current reports as needed. In particular, public companies are required to file annual reports on Forms 10-K, quarterly reports on Forms 10-Q, and current reports on Forms 8-K. The reports must not be materially inaccurate or misleading.

To prove this aiding and abetting claim, the SEC must establish by a preponderance of the evidence that:

1. Embarcadero filed a materially inaccurate or misleading Form 10-K, or Form 10-Q, or Form 8-K (known as the “primary violation”);
2. the defendant had actual knowledge of both the primary violation and of his role in furthering it; and
3. the defendant provided substantial assistance in the primary violation.

The elements of aiding and abetting that are included in Instructions Nos. ____ apply equally to this aiding and abetting claim.

The term “material” is defined in Instruction No. ____ above.

There is no requirement that Embarcadero knowingly (as defined in Instruction No. ____ above) filed a materially inaccurate or misleading report. However, the SEC must still prove that the defendant had actual knowledge of the primary violation and his role in furthering it.

Authority: 15 U.S.C. § 78m(a) (providing that “[e]very issuer of a security registered pursuant to section 12 of this title [15 U.S.C. § 78l] shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security – (1) such information and

1 documents (and such copies thereof) as the Commission shall require to keep reasonably current the
2 information and documents required to be included in or filed with an application or registration
3 statement filed pursuant to section 12 [15 U.S.C. § 78I], . . . (2) such annual reports (and such copies
4 thereof), certified if required by the rules and regulations of the Commission by independent public
5 accountants, and such quarterly reports (and such copies thereof), as the Commission may
6 prescribe”); 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, 240.13a-13; 15 U.S.C. § 78t(e)
7 (providing that, “[f]or purposes of any action brought by the Commission under paragraph (1) or (3)
8 of section 21(d) [15 U.S.C. § 78u(d)(1) or (3)], any person that knowingly provides substantial
9 assistance to another person in violation of a provision of this title [15 U.S.C. §§ 78a et seq.], or of
10 any rule or regulation issued under this title [15 U.S.C. §§ 78a et seq.], shall be deemed to be in
11 violation of such provision to the same extent as the person to whom such assistance is provided”);
12 *Ponce v. SEC*, 345 F.3d 722, 737 (9th Cir. 2003) (stating that, “[i]n order to find that Ponce aided
13 and abetted [the company’s] violation of federal securities laws, it must be found that: (1) [the
14 company] violated the relevant securities laws; (2) Ponce had knowledge of the primary violation
15 and of his or her own role in furthering it; and (3) Ponce provided substantial assistance in the
16 primary violation”); *SEC v. McNulty*, 137 F.3d 732, 741 (2d Cir. 1998) (stating that “scienter is not
17 an element of civil claims under” Section 13(a)); *SEC v. Todd*, No. 03CV2230 BEN (WMc), 2007
18 U.S. Dist. LEXIS 38985, at *42 (S.D. Cal. May 30, 2007) (stating that “[s]cienter is not required to
19 find aiding and abetting liability under § 13(a) and Rules 12b-20 and 13a-13”).

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21 **Court Comments: The Court intends to reference Instructions Nos. [41D] and [42D] which provide**
22 **guidance as to aiding and abetting for the 10b-5 claim.**

23 **As for the defendant’s objection on the ground that the instruction “does not indicate that the**
24 **jurors must agree that the [same] public filing is misleading, which would constitute a primary**
25 **violation Defendant allegedly aided and abetted,” Def.’s Obj. at 6, that objection is deemed waived.**

26 **Moreover, the case law cited by the SEC is persuasive. Cf. *United States v. Kim*, 196 F.3d 1079,**
27 **1082 (9th Cir. 1999) (in a criminal case, noting that “a general unanimity instruction suffices” and**
28 **that “[a] specific unanimity instruction is required only when it appears that there is a genuine**

1 possibility of jury confusion or that a conviction may occur as the result of different jurors
2 concluding that the defendant committed different acts”) (internal quotation marks omitted). As
3 noted above, the Court has amended Instruction No. [30] to clarify unanimity is required on each
4 claim.

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VIOLATION OF SECTION 13(b)(5)

JURY INSTRUCTION NO. [48] – SECTION 13(b)(5) CLAIM – ESSENTIAL ELEMENTS

The SEC claims that the defendant knowingly falsified one or more of Embarcadero’s books, records, or accounts described below. The SEC also claims that the defendant knowingly circumvented or knowingly failed to implement a system of internal accounting controls.

To prove this claim, the SEC must show by a preponderance of the evidence that the defendant knowingly either:

1. falsified any of Embarcadero’s books, records, or accounts that reflect the transactions and disposition of Embarcadero’s assets; or
2. circumvented Embarcadero’s system of internal accounting controls; or
3. failed to implement a system of internal accounting controls at Embarcadero.

The term “knowingly” as used in § 13(b)(5) means intentionally; recklessness is not sufficient.

The terms “books, records, or accounts” mean accounts, correspondence, memoranda, tapes, discs, papers, books, and other documents or transcribed information of any type, whether expressed in ordinary or machine language. The SEC must prove that the book, record, or account does not, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the company’s assets.

The phrase “system of internal accounting controls” means a system sufficient to provide reasonable assurances that transactions are recorded as necessary to prepare financial statements that conform to generally accepted accounting principles and to account for assets.

Authority: 15 U.S.C. § 78m(b)(5) (providing that “[n]o person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph (2)”); *id.* § 78m(b)(2) (providing that certain issuers “shall – (A) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly

1 reflect the transactions and dispositions of the assets of the issuer; (B) devise and maintain a system
2 of internal accounting records sufficient to provide [certain] reasonable assurances”); *id.* § 78c(37)
3 (defining records as “accounts, correspondence, memorandums, tapes, discs, papers, books, and
4 other documents or transcribed information of any type, whether expressed in ordinary or machine
5 language”).

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7 **Court Comments: The defendant has objected to this instruction. According to the defendant, the**
8 **“third basis of liability is inapplicable to this case because it was not alleged in the Complaint.”**
9 **Def.’s Obj. at 7. The objection is deemed overruled. As previously stated, the parties provided a**
10 **stipulated instruction to which the Court made only minor modifications.**

11 **The defendant has also objected on the basis that the instruction should include a provision**
12 **that the jury must find that the same book, record, or account was falsified. Again, the objection is**
13 **deemed waived. Moreover, for the reasons previously stated, a separate specific instruction on**
14 **unanimity is not required here.**

15 **Finally, the Court has added a definition for the term “knowingly” to address the defendant’s**
16 **concern raised in conjunction with Instruction No. [49D]. See, e.g., *SEC v. Leslie*, No. C 07-3444,**
17 **2010 U.S. Dist. LEXIS 76826, at *80-81 (N.D. Cal. July 29, 2010) (noting that recklessness cannot**
18 **be equated with knowledge for purposes of a claimed § 13(b)(5) violation); *SEC v. Stanard*, No. 06**
19 **Civ. 7736 (GEL), 2009 U.S. Dist. LEXIS 6068 (S.D.N.Y. Jan. 27, 2009) (noting the same).**

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JURY INSTRUCTION NO. [49D] – SECTION 13(b)(5) CLAIM – FALSIFY

The SEC claims that the defendant violated Section 13(b)(5) by falsifying books, records, and accounts. In order for you to find the defendant liable for falsifying books, records, and accounts, the SEC must prove that each falsification was intentional, and not the result of errors or oversights.

Authority: 15 U.S.C. § 78m(b)(5) (providing that “[n]o person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph (2)”).

Court Comments: The defendant’s concerns about the “knowingly” standard are addressed above.

JURY INSTRUCTION NO. [50D] – SECTION 13(b)(5) CLAIM –

IMPLEMENTATION OF INTERNAL CONTROLS

As stated in Instruction No. ____ above, the SEC claims that the defendant failed to implement a system of internal accounting controls. For all such claims, the SEC must also prove that the defendant was responsible for implementing such controls.

Authority: *SEC v. Cedric Kushner Promotions, Inc.*, 417 F. Supp. 2d 326, 337 (S.D.N.Y. 2006) (granting summary judgment to defendant on section 13(b)(2)(B) aider and abettor claim when plaintiff produced no evidence that defendant “was responsible for . . . maintaining adequate controls, or that he aided or abetted any violation with respect to [that] requirement[]”); *Marsden v. Select Med. Corp.*, No. Civ. A. 04-4020, 2006 U.S. Dist. LEXIS 16795, at *15 (E.D. Pa. Apr. 6, 2006) (granting motion to dismiss section 13(b)(2)(B) claim because “[p]laintiffs fail[ed] to connect the litany of alleged wrongdoings to any control or type of control that, if properly established, would have prevented the same”), *vacated in part on other grounds*, 2007 U.S. Dist. LEXIS 9893 (E.D. Pa. Feb. 6, 2007); *SEC v. Intelliquis Int’l, Inc.*, No. 2:02-CV-764 PGC, 2003 U.S. Dist. LEXIS 27131, at *13 (D. Utah Dec. 11, 2003) (granting summary judgment to SEC on section 13(b)(2)(B) aider and abettor claim where complaint adequately alleged primary violation, alleged that one defendant permitted company to record certain transactions as sales while knowing that they did not qualify as such, and alleged that second defendant, retained to audit financial statements, “essentially abandoned all responsibility for this job”).

Court Comments: The SEC has objected to this instruction. The Court shall consider the SEC’s objection because the SEC has made a sufficient showing that its failure to object earlier was the result of an inadvertent error. See SEC’s Obj. at 4 n.1 (stating that the instruction was inadvertently overlooked because the SEC did not receive the defendant’s disputed instructions until 1/14/2010, the day that the instructions and briefs were due, and many arrived after the close of business on 1/14/2010).

1 The SEC's first objection is, in essence, that it is unnecessary to state that the defendant must
2 have been responsible for implementing controls given his role as controller. However, the Court
3 sees no harm in including such a statement, particularly because it is not clear as a matter of law
4 what the defendant's responsibilities were, title or not.

5 The Court, however, sustains the SEC's second objection. The SEC has provided a
6 persuasive argument that any statement that the controls would have prevented the claimed
7 wrongdoing is inconsistent with congressional intent. The SEC correctly points out that *Marsden v.*
8 *Select Med. Corp.*, No. Civ. A 04-4020, 2006 U.S. Dist. LEXIS 16795 (E.D. Pa. Apr. 6, 2006), is the
9 only authority to support the statement, and that *Marsden* involves a private right of action, not a
10 SEC action.

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VIOLETION OF RULE 13b2-1

JURY INSTRUCTION NO. [51P & 51D] – RULE 13b2-1 CLAIM –

ESSENTIAL ELEMENTS

The SEC claims that the defendant also violated Rule 13b2-1 of the Exchange Act. This rule prohibits anyone from falsifying any book, record, or account so that it does not, in reasonable detail, accurately and fairly reflect the transactions and the disposition of the assets of a company.

To prove this claim, the SEC must show by a preponderance of the evidence that the defendant, directly or indirectly, falsified, or caused to be falsified, any book, record, or account of Embarcadero such that it did not, in reasonable detail, accurately and fairly reflect the transactions and the disposition of Embarcadero’s assets.

The SEC need not prove that the defendant knowingly (as defined in Instruction No. ____) falsified or caused to be falsified any book, record, or account of Embarcadero. In addition, the SEC need not prove that the book, record, or account was materially (as defined in Instruction No. ____) false or inaccurate. **The SEC must prove that the books, records, and accounts did not, in reasonable detail, accurately and fairly reflect the transaction and disposition of the assets of Embarcadero.**

The terms “books, records, or accounts” are defined in Instruction No. ____ above.

Authority: 17 C.F.R. § 240.13b2-1 (providing that “[n]o person shall directly or indirectly, falsify or cause to be falsified, any book, record or account subject to section 13(b)(2)(A) of the Securities Exchange Act”); 15 U.S.C. § 78m(b)(2)(A) (providing that “[e]very issuer which has a class of securities registered pursuant to section 12 of this title [15 U.S.C. § 78l] and every issuer which is required to file reports pursuant to section 15(d) of this title [15 U.S.C. § 78o(d)] shall . . . make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer”).

Court Comments: The defendant has objected to this instruction. The defendant argues that the word “falsify” by itself means only deliberate, intentional conduct. See Def.’s Obj. at 8, 10 (arguing

1 such; also suggesting that Instruction No. 49 be given after Instruction No. 51). The defendant also
2 has a problem with the paragraph discussing materiality. Basically, these are the same issues that
3 the defendant raised in his prior briefing on jury instructions. The Court reiterates that, unlike §
4 13(b)(5), Rule 13b2-1 does not require that the act be done knowingly. The Court previously noted
5 the SEC comments and case law on this point.

6 To address the defendant's concerns, the Court shall reiterate that the statute does not require
7 perfection but only that books, records and accounts in reasonable detail, accurately and fairly
8 reflect the transactions and dispositions of the assets of the issuer.

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JURY INSTRUCTION NO. [30] – DUTY TO DELIBERATE

When you begin your deliberations, you should elect one member of the jury as your presiding juror. That person will preside over the deliberations and speak for you here in court.

You will then discuss the case with your fellow jurors to reach agreement if you can do so. Your verdict **with respect to each claim** must be unanimous.

Each of you must decide the case for yourself, but you should do so only after you have considered all of the evidence, discussed it fully with the other jurors, and listened to the views of your fellow jurors.

Do not hesitate to change your opinion if the discussion persuades you that you should. Do not come to a decision simply because other jurors think it is right.

It is important that you attempt to reach a unanimous verdict but, of course, only if each of you can do so after having made your own conscientious decision. Do not change an honest belief about the weight and effect of the evidence simply to reach a verdict.

Authority: 9th Cir. Model Civil Jury Instruction No. 3.1.

Court Comments: The Court has made a minor modification.

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JURY INSTRUCTION NO. [31] – COMMUNICATION WITH COURT

If it becomes necessary during your deliberations to communicate with me, you may send a note through the clerk, signed by your presiding juror or by one or more members of the jury. No member of the jury should ever attempt to communicate with me except by a signed writing; I will communicate with any member of the jury on anything concerning the case only in writing, or here in open court. If you send out a question, I will consult with the parties before answering it, which may take some time. You may continue your deliberations while waiting for the answer to any question. Remember that you are not to tell anyone – including me – how the jury stands, numerically or otherwise, until after you have reached a unanimous verdict or have been discharged. Do not disclose any vote count in any note to the court.

Authority: 9th Cir. Model Civil Jury Instruction No. 3.2.

Court Comments: The parties stipulated to this instruction.

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JURY INSTRUCTION NO. ____ – RETURN OF VERDICT

A verdict form has been prepared for you. After you have reached unanimous agreement on a verdict, your presiding juror will fill in the form that has been given to you, sign and date it, and advise the court that you are ready to return to the courtroom.

Authority: 9th Cir. Model Civil Jury Instruction No. 3.3.

Court Comments: The Court commonly gives this instruction.