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# 10(b) or Not 10(b): Central Bank of Denver v. First Interstate Bank of Denver

Glen Wallace Roberts II

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## 10(b) or Not 10(b): *Central Bank of Denver v. First Interstate Bank of Denver*

Securities enjoy the distinction of being perhaps the most disingenuously named product available.<sup>1</sup> From the time of their creation,<sup>2</sup> through the great crash of 1929, up until the savings and loan debacle of the 1980s, securities have not been particularly “secure.”<sup>3</sup> In the wake of the largely unregulated speculation leading up to the crash of 1929, the federal government implemented a comprehensive set of disclosure regulations that sought, by minimizing the risk of inaccurate information, to limit the risk undertaken by investors to that risk *inherent* in the investment instrument itself.<sup>4</sup> Most significantly, this regulation included the Securities Act of 1933, which regulates initial offerings of stock to the public,<sup>5</sup> and the Securities Exchange Act of 1934, which purports to regulate most other aspects of the sale and resale of securities.<sup>6</sup>

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1. “Security” means:

any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights . . . or, in general, any interest or instrument commonly known as a “security,” or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Securities Act of 1933, 15 U.S.C. § 77b(1) (1988). For further background on the modern statutory definition of a security, see Gary S. Rosin, *Historical Perspectives on the Definition of a Security*, 28 S. TEX. L. REV. 575 *passim* (1987).

2. While the origins of secured transactions are obscured by the mists of time, they are known to have been a feature of commerce in Greco-Roman antiquity. See JULES TOUTAIN, *THE ECONOMIC LIFE OF THE ANCIENT WORLD* 74 (1930) (citing 2 CHARLES DAREMBERG, ET AL., *DICTIONNAIRE DES ANTIQUITES GRECQUES ET ROMAINES* 1214 (Paris, Librairie Hachette, 1896)).

3. Securities markets are not exempt from the effects of human frailties that influence other commercial transactions. “[T]he problems at which modern securities regulation is directed are as old as the cupidity of sellers and the gullibility of buyers.” LOUIS LOSS, *SECURITIES REGULATION* 3 (1951).

4. THOMAS L. HAZEN, *THE LAW OF SECURITIES REGULATION* § 1.2, at 6-9 (2d ed. 1990 & Supp. 1994) (Practitioner’s ed.).

5. 15 U.S.C. § 77a-77bbb (1988) (hereinafter referred to as the 1933 Act).

6. 15 U.S.C. § 78a-78lll (1988) (hereinafter referred to as the 1934 Act).

While these Acts provide explicitly for various means of enforcement,<sup>7</sup> they have also been the source of private remedies implied by the judiciary. These implied remedies have become potent weapons for both private and state plaintiffs seeking to redress grievances arising from transactions in the securities marketplace.<sup>8</sup> In light of both the clear utility of implied remedies and their well-established place in the securities enforcement arsenal, the United States Supreme Court's recent holding in *Central Bank of Denver v. First Interstate Bank of Denver*<sup>9</sup> is surprising and troubling. In *Central Bank*, the Court struck down the ability of a private plaintiff to maintain an action under Securities and Exchange Commission (SEC) rule 10b-5<sup>10</sup> against those persons alleged to have aided and abetted persons engaging in "manipulative and deceptive" practices as defined by rule 10b-5.<sup>11</sup> This decision may well serve as a turning point, not only in the Court's securities jurisprudence, but in its entire approach to statutory construction.

At issue in *Central Bank* was whether or not a private action could be maintained against one alleged to have aided and abetted in the violation of section 10(b) of the Securities Exchange Act of 1934,<sup>12</sup> a question that the Court had twice before declined to decide.<sup>13</sup> The Court in *Central Bank* held that such an action could

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7. See, e.g., 15 U.S.C. § 77k (1988) (providing for civil liability on account of false registration statements); 15 U.S.C. § 77l (1988) (mandating civil penalties for violations of rules governing securities prospectuses and solicitations).

8. For example, 15% of the SEC's 1992 civil enforcement actions contained claims of aiding and abetting. *Central Bank of Denver v. First Interstate Bank of Denver*, 114 S. Ct. 1439, 1460 n.11 (1994) (Stevens, J., dissenting).

9. 114 S. Ct. 1439 (1994).

10. 17 C.F.R. § 240.10b-5 (1994).

11. *Central Bank*, 114 S. Ct. at 1455 ("[W]e hold that a private plaintiff may not maintain an aiding and abetting suit under § 10(b).").

12. Section 10(b) of the Securities and Exchange Act of 1934 reads, in pertinent part: 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, 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.

15 U.S.C. § 78j(b) (1988) (corresponds to Securities Exchange Act of 1934, ch. 404, title I, § 10, 48 Stat. 991).

13. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 191 n.7 (1976) ("[W]e need not consider whether civil liability for aiding and abetting is appropriate under the section and the Rule."); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 379 n.5 (1983) ("While

not be maintained, basing its holding on a strictly literalist reading of the statute at issue.<sup>14</sup> In refusing to uphold the existence of an implied cause of action, the court overturned the rule of law as it existed in all federal appellate circuits.<sup>15</sup> In a dissent joined by three Justices, Justice Stevens noted this departure and made clear that the rationale of the court sets an unsettling precedent and poses a significant threat to other entrenched forms of secondary liability.<sup>16</sup>

This Note first discusses the facts of *Central Bank* and examines the reasoning of the majority and dissenting opinions.<sup>17</sup> It then charts the evolution of the implied remedy under rule 10b-5 and outlines the development of aiding and abetting liability.<sup>18</sup> Next, the Note analyzes *Central Bank's* decision to eliminate aiding and abetting liability<sup>19</sup>—an activist result paradoxically supported by the opinion's “textualist” rationale—and explores its ramifications. The Note then concludes that, while the Court's action will initially lead to a reduction in the number of prosecutions for secondary liability, lower courts, wary of treading on the uncertain terrain of implied federal remedies, will likely expand their usage of state law aider-abettor liability.<sup>20</sup>

Petitioner Central Bank of Denver was the indenture trustee<sup>21</sup>

several Courts of Appeals have permitted aider-and-abettor liability[,] . . . we specifically reserved this issue in *Ernst & Ernst v. Hochfelder*.”)

14. *Central Bank*, 114 S. Ct. at 1446. (“[T]he text of the statute controls our decision.”).

15. *Id.* at 1456 n.1 (Stevens, J., dissenting) (citing federal circuit court opinions accepting private aider-abettor liability).

16. *Id.* at 1456 (Stevens, J., dissenting). Secondary liability is a term of art, and as Professor Fischel noted:

[T]he distinction between primary and secondary liability is essential. Secondary liability under the securities laws is used to describe the judicially implied civil liability which has been imposed on defendants who have not themselves violated the express prohibition of the securities statute at issue, but who have some relationship with the primary wrongdoer. Courts have imposed this type of liability on defendants who aid-abet, conspire with, or employ a defendant who does violate the express prohibition of a statute.

Daniel R. Fischel, *Secondary Liability under Section 10(b) of the Securities Act of 1934*, 69 CAL. L. REV. 80, 80 n.4 (1981).

17. See *infra* notes 21-91 and accompanying text.

18. See *infra* notes 92-180 and accompanying text.

19. See *infra* notes 181-210 and accompanying text.

20. See *infra* notes 210-217 and accompanying text.

21. An indenture is “a written agreement under which bonds and debentures are issued.”<sup>21.12</sup>

. . . [An indenture can be a] mortgage [or] deed of trust . . . under which there is outstanding a security . . . constituting a claim against the debtor, a claim secured by a lien on any of the debtor's property.” BLACK'S LAW DICTIONARY 770 (6th ed. 1990). An

for a public building authority's two bond issues.<sup>22</sup> The Colorado Springs-Stetson Hills Public Building Authority issued the bonds in 1986 to finance public improvements in a proposed commercial and residential development, Stetson Hills.<sup>23</sup> The Authority issued a total of \$26 million in bonds, in turn secured by landowner assessment liens.<sup>24</sup> The 1986 bond issue covered roughly 250 acres, and the 1988 bond issue covered about 272 acres.<sup>25</sup> The bond covenants mandated that the "land subject to the liens be worth at least 160% of the bonds' outstanding principal and interest."<sup>26</sup> Moreover, the bond covenants required the developer, AmWest Development, to submit a report to Central Bank annually, proving that the "160% test" was being met.<sup>27</sup> In January 1988, in compliance with its obligation, AmWest gave to Central Bank both an "updated" appraisal of the land securing the 1986 bonds and a valuation of the land securing the 1988 bonds.<sup>28</sup> Central Bank initially rejected the updated appraisal because the appraiser had combined the property securing both the 1986 *and* the 1988 bonds.<sup>29</sup> Upon their being properly separated, however, it became clear that the land values given for the property securing both bond issues had not changed significantly in the two years since the 1986 appraisal.<sup>30</sup> The senior underwriter of the 1986 bonds wrote to Central Bank, expressing concern about Central Bank's reliance on an appraisal that was almost a year and a half old, especially in light of the contemporary fall in property values in the Colorado Springs area.<sup>31</sup>

Central Bank's "in-house" appraiser was called in to examine the 1988 appraisal, and he concurred with the underwriter's concern that the values given were excessive in light of the real estate market.<sup>32</sup> In addition, he questioned the methodology used to prepare the

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indenture trustee is the "person or institution named in a trust indenture and charged with holding legal title to the trust property and with carrying out the terms of the indenture."  
*Id.*

22. *Central Bank*, 114 S. Ct. at 1443.

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*

29. *First Interstate Bank of Denver v. Pring*, 969 F.2d 891, 894 n.4 (10th Cir. 1992), *rev'd sub nom. Central Bank of Denver v. First Interstate Bank of Denver*, 114 S. Ct. 1439 (1994).

30. *Central Bank*, 114 S. Ct. at 1443.

31. *Id.*

32. *Id.*

appraisal,<sup>33</sup> and recommended that an independent appraiser be engaged to study the 1988 appraisal.<sup>34</sup> Central Bank, after proposing such a review to AmWest, ultimately acquiesced to the entreaties of the developer and delayed an outside, independent reappraisal of the land securing the bonds until the end of the year, *after* the issuance of a second series of bonds in June 1988.<sup>35</sup> Before completion of the independent review of the appraisal, the public building authority defaulted on the 1988 bonds, and respondents First Interstate Bank of Denver, N.A. and Jack Naber—who between them held \$2.1 million worth of the 1988 bonds—filed suit against the building authority, the underwriters, the developer, and the indenture trustee.<sup>36</sup> Their complaint “alleged that the Authority, the underwriter defendants, and [an] AmWest director had violated section 10(b)” of the 1934 Act.<sup>37</sup> The action against Central Bank was premised on SEC Rule 10b-5,<sup>38</sup> and alleged that the bank’s conduct in agreeing to defer the reassessment exposed the bank to secondary liability under section 10(b) for aiding and abetting securities fraud.<sup>39</sup> The District Court for the District of Colorado granted summary judgment to Central Bank.<sup>40</sup> The United States Court of Appeals for the Tenth Circuit reversed, holding that summary judgment had been erroneously granted because there was a genuine issue of material fact as to whether Central Bank, by not

33. *Pring*, 969 F.2d at 893 n.4.

34. *Central Bank*, 114 S. Ct. at 1443.

35. *Id.*

36. *Id.*

37. *Id.*

38. *See id.* at 1445. Rule 10b-5 states:

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,

- (a) To employ any device, scheme, or artifice to defraud,
  - (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
  - (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
- in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1994).

39. *Central Bank*, 114 S. Ct. at 1443. *See generally* David S. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. PA. L. REV. 597 (1972) (offering the seminal survey of secondary liability under the securities laws).

40. *Central Bank*, 114 S. Ct. at 1443.

insisting upon an immediate independent appraisal, had "substantially assisted"<sup>41</sup> the parties accused of the primary violation of section 10(b).<sup>42</sup>

On appeal to the Supreme Court, Central Bank initially asserted that it had not breached any duty owed to the purchasers of the bonds for which it served as indenture trustee, and that mere recklessness would not satisfy the scienter requirement for aiding and abetting liability.<sup>43</sup> The Court, in granting certiorari, chose not to hear the "breach of duty" question and instead commanded the parties to brief the issue of "[w]hether there is an implied private right of action for aiding and abetting violations of section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5."<sup>44</sup> Although the appeals court,<sup>45</sup> and indeed the petitioner-bank,<sup>46</sup> had no doubt as to the viability of such a cause of action, the Court's *sua sponte* command that the parties brief the question of section 10(b) aiding and abetting liability indicated that the issue was not so clear.

The Supreme Court reversed the Tenth Circuit's decision, holding that a private plaintiff may not bring an aiding and abetting action under section 10(b).<sup>47</sup> In delivering the opinion of the majority,<sup>48</sup> Justice Kennedy first acknowledged that such lawsuits had indeed been viable in the federal courts,<sup>49</sup> beginning with *Brennan v. Midwestern Life Insurance Co.*<sup>50</sup> in 1966. However, the majority continued, the propriety of these actions began to fall into question only ten years later, with the Court's holdings in *Ernst & Ernst v. Hochfelder*<sup>51</sup> and *Santa Fe Industries v. Green*,<sup>52</sup> both of which

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41. See *infra* note 122 and accompanying text (describing elements of § 10(b) aiding and abetting action).

42. *First Interstate Bank of Denver v. Pring*, 969 F.2d 891, 904-05 (10th Cir. 1992), *rev'd sub nom.* *Central Bank of Denver v. First Interstate Bank of Denver*, 114 S. Ct. 1439 (1994).

43. Petition for Writ of Certiorari of Defendant-Appellant at i, *Central Bank* (No. 92-854), *cert. granted*, 113 S. Ct. 2927 (1993) (mem.).

44. *Central Bank of Denver v. First Interest Bank of Denver*, 113 S. Ct. 2927 (1993) (mem.) (granting the petition for certiorari).

45. See *Pring*, 969 F.2d at 898.

46. Petition for Writ of Certiorari of Defendant-Appellant, *Central Bank*, 114 S. Ct. 1439 (1994) (No. 92-854).

47. *Central Bank*, 114 S. Ct. at 1455.

48. *Id.* at 1442. Chief Justice Rehnquist and Justices O'Connor, Scalia, and Thomas joined the majority opinion. *Id.*

49. *Id.* at 1444.

50. 259 F. Supp. 673 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

51. 425 U.S. 185, 199-201 (1976) (holding that negligence will not suffice to meet the "scienter" requirement of liability under § 10(b) and Rule 10b-5, because statutory

closely scrutinized the boundaries of the conduct proscribed by section 10(b).<sup>53</sup> Lower federal courts, according to Justice Kennedy, had since that time been doubtful as to the legitimacy of aiding and abetting liability.<sup>54</sup>

The Court canvassed its decisions concerning section 10(b) and Rule 10b-5.<sup>55</sup> Justice Kennedy found that in those cases the Court had determined two primary issues: (1) the scope of conduct prohibited by section 10(b),<sup>56</sup> and (2) the proper elements of the private liability scheme once a violation of the statute has been established.<sup>57</sup> Because section 10(b) grants no express private right of action and thus provides no commands concerning the elements of a private liability scheme, the Court has answered questions concerning the elements of the private liability scheme by inferring "how the 1934 Congress would have addressed the issue[s] had the 10b-5 action been included as an express provision in the 1934 act."<sup>58</sup> The majority acknowledged that section 10(b), the "general antifraud provision of the 1934 Act," is the most prominent source of *implied* private rights of action.<sup>59</sup>

Although the proper elements of the liability scheme are subject to greater judicial manipulation when they are implied rather than express, Justice Kennedy stated that the Court has operated under far more significant restraints in determining the scope of conduct proscribed by section 10(b). Prior precedent inevitably leads to the determination that "the text of the statute controls our decision,"<sup>60</sup>

language such as "manipulative," "device," and "contrivance" indicates concern with regulating conduct far more willful than mere negligence).

52. 430 U.S. 462, 473-74 (1977) (holding that conduct not "manipulative" or "deceptive" falls outside the purview of § 10(b) and Rule 10b-5).

53. *Central Bank*, 114 S. Ct. at 1444.

54. *Id.* at 1445-55 (citing as examples of this doubt *Little v. Valley National Bank of Arizona*, 650 F.2d 218, 220 n.3 (9th Cir. 1981) (indicating that the "status of aiding and abetting as a basis for liability under the securities laws [was] in some doubt") and *Benoay v. Decker*, 517 F. Supp. 490, 495, *aff'd*, 735 F.2d 1363 (6th Cir. 1984) ("[It is] doubtful that a claim for 'aiding and abetting' . . . will continue to exist under § 10(b).").

55. *Id.*

56. *See supra* notes 51-53 and accompanying text.

57. *See, e.g., Musick, Peeler & Garrett v. Employers Ins.*, 113 S. Ct. 2085, 2092 (1993) (holding that a right of contribution may be implied in 10b-5 actions); *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 359 (1991) (holding that an action implied under § 10(b) should be governed by statute of limitations provision found in the Act from which it is implied, rather than by state law borrowing principles).

58. *Central Bank*, 114 S. Ct. at 1446 (quoting *Musick, Peeler & Garrett v. Employers Ins.*, 113 S. Ct. 2085, 2090 (1993)).

59. *Id.* at 1445.

60. *Id.* at 1446.



and that text, he concluded, does not mention aider and abettor liability.<sup>61</sup>

Moreover, the majority asserted, such strict literalist construction is consistent with the Court's decisions regarding provisions of securities legislation other than 10(b).<sup>62</sup> In a not-so-subtle bit of foreshadowing, the majority noted that the absence of any legislative language concerning aiding and abetting "bode[d] ill for respondents."<sup>63</sup> Both respondents and the Securities and Exchange Commission—which filed an amicus curiae brief—"hinted" that the "directly or indirectly" language of section 10(b) should be read to include aiding and abetting liability.<sup>64</sup> The Court rejected this argument, pointing out that those federal courts imposing aiding and abetting liability have not done so in reliance on that statutory language and that none of the other occurrences of the phrase "directly or indirectly" within the 1934 Act supports the thesis that secondary liability is meant to be encompassed by such language.<sup>65</sup> The paucity of textual evidence, as well as the existence of specific "aiding and abetting" language and liability elsewhere in the United States Code, prompted the Court to conclude that "Congress knew how to impose aiding and abetting liability when it chose to do so," and that in the case of section 10(b), it did not so choose.<sup>66</sup> The Court then reiterated its holding in *Santa Fe Industries v. Green*<sup>67</sup> that section 10(b) enjoins only the "making of a material misstatement (or omission) or the commission of a manipulative act."<sup>68</sup>

Perhaps in recognition of the sweeping nature of its conclusion, the Court then set forth alternative rationales for the holding. Borrowing from a case it decided the previous term, *Musick, Peeler*

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61. *Id.* at 1447; see *supra* note 12 (quoting 15 U.S.C. § 78j(b) (1988)).

62. *Central Bank*, 114 S. Ct. at 1447 (citing *Pinter v. Dahl*, 486 U.S. 622 (1988), where the Court determined the meaning of the word "seller" in § 12(l) of the 1934 Act by "look[ing] first at the language of the statute" and rejected appeals to consider a broader definition derived from tort law).

63. *Id.*

64. *Id.* (quoting Brief for Respondents at 15, *Central Bank* (No. 92-854), which advocates that "[i]nclusion of those who act 'indirectly' suggests a legislative purpose fully consistent with the prohibition of aiding and abetting," and from Brief for SEC as Amicus Curiae at 8, *Central Bank* (No. 92-854), stating that "we think that when read in context [§ 10(b)] is broad enough to encompass liability for such indirect violations").

65. *Id.* at 1447-48 (citing, *inter alia*, 15 U.S.C. § 78g(f)(2)(C) (1988) (direct or indirect ownership of stock) and 15 U.S.C. § 78i(b)(2)-(3) (1988) (direct or indirect interest in put, call, straddle, option, or privilege)).

66. *Id.* at 1448.

67. 430 U.S. 462 (1977)

68. *Id.*

& *Garrett v. Employers Insurance*,<sup>69</sup> the Court outlined the appropriate methodology for analyzing section 10(b) issues not answered clearly in the text.<sup>70</sup> *Musick* recognized that the primary textual source is the legislation itself. It also held, however, that because section 10(b) does not expressly create a private right of action, courts must sometimes necessarily infer “how the 1934 Congress would have addressed the issue had the 10b-5 action been included as an express provision in the 1934 Act.”<sup>71</sup> To do this the Court examined other *express* causes of action in the Act, reasoning that, had the Seventy-third Congress chosen to enact a private section 10(b) aiding and abetting cause of action in 1934, it probably would have fashioned it in a manner similar to other private rights of action found in the Securities Acts.<sup>72</sup> The majority found that other relevant statutes provide explicit guidelines for culpable conduct and that none of the express causes of action in the 1934 Act imposes liability on those who aid and abet violations of the securities laws.<sup>73</sup>

Justice Kennedy then addressed the “broad based notion of congressional intent” argument put forth by both the respondent and the SEC.<sup>74</sup> He rejected the notion that Congress intended to incorporate, by implication, common law principles of aiding and abetting into the 1934 Act.<sup>75</sup> Rather, he noted, although Congress had enacted a general federal criminal aiding and abetting statute,<sup>76</sup> no matching statute provides for *civil* liability.<sup>77</sup> The majority viewed this fact, along with the specific enactment of aiding and abetting liability in other statutes,<sup>78</sup> as supporting its holding that no such liability should exist under section 10(b). The Court then rebuffed both sides’ arguments claiming the post-1934 actions and inaction of the Congress for their cause.<sup>79</sup> According to the Court, the mere existence of “Congressional inaction cannot amend a duly enacted

69. 113 S. Ct. 2085 (1993).

70. *Central Bank*, 114 S. Ct. at 1448.

71. *Id.* at 1447 (quoting *Musick*, 113 S. Ct. at 2089-90 (1993)).

72. *Id.* at 1449 (citation omitted).

73. *Id.*

74. *Id.* at 1450.

75. *Id.*

76. 18 U.S.C. § 2 (1988).

77. *Central Bank*, 114 S. Ct. at 1450.

78. *Id.* at 1451 (citing I.R.C. § 6701 (1988 & Supp. IV 1992) (governing aiding and abetting liability); 7 U.S.C. § 25(a)(1) (1988) (granting an express private right of action for aiding and abetting a violation of the Commodity Exchange Act)).

79. *Id.* at 1452-53.

statute,” and thus “deserves little weight in the interpretive process.”<sup>80</sup>

The Court next dismissed the SEC’s policy-based arguments for upholding aiding and abetting liability, again noting that the text and structure of the 1934 Act must control its interpretation of the statute, except when such adherence would lead to a result “so bizarre that Congress could not have intended it.”<sup>81</sup> The Court itself offered several policy arguments against the existence of aiding and abetting liability and, although conceding that there might also be reasonable justifications for it, concluded that it is far from clear that Congress in 1934 would have approved of the enactment of private aider and abettor liability.<sup>82</sup> Finally, the Court rejected the SEC’s argument that the provisions in the securities law providing criminal sanctions for aiding and abetting could be relied upon to provide a textual basis for civil liability as well.<sup>83</sup>

The dissent, written by Justice Stevens,<sup>84</sup> rejected the majority’s treatment of the “long history of aider and abettor liability under section 10(b) and Rule 10b-5” and warned that the Court’s reasoning would threaten the existence of other forms of secondary liability.<sup>85</sup> The dissent presented significant evidence of the well-established position of aiding and abetting liability under section 10(b).<sup>86</sup> Addressing the Court’s interpretive methodology, the dissent stated that the approach of courts at the time of the passage of the 1934 Act should control the Act’s interpretation, and that such courts would have construed section 10(b) broadly in light of the Act’s remedial purposes.<sup>87</sup> Justice Stevens argued that, even if the majority chose

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80. *Id.* at 1453 (quoting *Patterson v. McLean Credit Union*, 491 U.S. 164, 175 n.1 (1989)).

81. *Id.* at 1454 (quoting *Demarest v. Manspeaker*, 498 U.S. 184, 191 (1991)).

82. *Id.* The Court suggested that aider and abettor liability creates costs that “may disserve the goals of fair dealing and efficiency in the securities markets.” *Id.* Furthermore, the court concluded that “the rules for determining aiding and abetting liability are unclear,” and that the possibility of aiding and abetting liability leads to “strike suits” against professionals, many of whom might then increase the rates they charge to their corporate clients, thus taking away from the company’s investors, the ultimate “intended beneficiaries of the statute.” *Id.* The Court noted that favorable policy arguments “can also be advanced,” although it did not consider any in its opinion. *Id.*

83. *Id.* at 1454-55.

84. *Id.* at 1455 (Stevens, J., dissenting). Justices Blackmun, Souter, and Ginsburg joined Justice Stevens’s dissent. *Id.* (Stevens, J., dissenting).

85. *Id.* at 1456 (Stevens, J., dissenting).

86. *Id.* at 1456 & n.1 (Stevens, J., dissenting).

87. *Id.* at 1457 (Stevens, J., dissenting) (“There is a risk of anachronistic error in applying our current approach to implied causes of action to a statute enacted when courts

to disregard the judicial bias toward the implication of remedies prevalent at the time of the 1934 Act's enactment, the Court's own precedent militated against upsetting the well-established judicial creation of aiding and abetting liability, except by legislative action.<sup>88</sup> According to the dissent, the Court's statement that "the text of the 1934 Act does not itself reach those who aid and abet a section 10(b) violation" leaves no room for the existence of *any* federal right of action against aiders and abettors, whether private or public.<sup>89</sup> Furthermore, the statement throws into question the very existence of the other forms of secondary liability upon which both the SEC and the courts have long relied.<sup>90</sup> Judicial restraint, Justice Stevens asserted, requires equal reticence when a court eliminates or creates a cause of action.<sup>91</sup>

Although the Court's decision in *Central Bank* may at first seem simply to be the result of the most natural and obvious manner of statutory interpretation, an examination of the recent history of securities regulation in America makes clear that the *Central Bank* decision was by no means a *sine qua non*. The enactment of federal securities legislation in the 1930s, coming on the heels of the most spectacular economic disaster in the history of the United States, was intended to promote an entirely new attitude toward the capital markets; this attitude was to "add . . . to the ancient rule of caveat emptor, the further doctrine 'let the seller also beware.' [The latter doctrine] puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence."<sup>92</sup> Thus the policy of "full disclosure"<sup>93</sup>

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commonly read statutes of this kind broadly to accord with their remedial purposes and regularly approved rights to sue despite statutory silence.").

88. *Id.* at 1457-58 (Stevens, J., dissenting) ("[A] 'settled construction of an important federal statute should not be disturbed unless and until Congress so decides.' ") (quoting *Reves v. Ernst & Young*, 494 U.S. 56, 74 (1990) (Stevens, J., concurring)).

89. *Central Bank*, 114 S. Ct. at 1460.

90. *Id.* at 1460 (Stevens, J., dissenting). The first case to acknowledge the existence of a private right of action under § 10(b) involved the implication of secondary liability, namely the right of a private plaintiff to bring a conspiracy action under § 10(b) and Rule 10b-5. *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 513-14 (E.D. Pa. 1946). The dissent supposed that the Court's holding endangers such conspiracy liability. *Central Bank*, 114 S. Ct. at 1460 & n.12 (Stevens, J., dissenting). The *Central Bank* decision seems to have had just such a chilling effect on SEC enforcement actions. See Christi Harlan, *SEC Voluntarily Dropping Charges in Certain Cases*, WALL ST. J., May 6, 1994, at C15.

91. *Central Bank*, 114 S. Ct. at 1460 (Stevens, J., dissenting).

92. President Franklin D. Roosevelt, *quoted in* 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 178-79 (3d ed. 1989) (citing S. REP. NO. 47 at 6-7 and H.R. REP. at 1-2, 73d Cong., 1st Sess. (1933)).

came to be embodied in the Securities Act of 1933 and the Securities Exchange Act of 1934.

To enforce this policy, both Acts contain explicit private rights of action. The 1933 Act, which governs the initial sale of securities, includes two sections creating actions that permit recovery of damages for misrepresentation in connection with the sale of a security.<sup>94</sup> Furthermore, the 1933 Act contains a general antifraud provision that does not explicitly create a private right of action.<sup>95</sup> Unlike the 1933 Act, which only safeguards buyers, the 1934 Act protects both purchasers and purveyors of securities. The anti-fraud provision of the 1934 Act is found in section 10(b), which makes it unlawful to "use or employ . . . in connection with the purchase or sale of any security . . . any manipulative or deceptive device . . . in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe."<sup>96</sup> In 1942 the SEC promulgated Rule 10b-5,<sup>97</sup> mimicking to a great degree the anti-fraud provision of the 1933 Act, section 17(a). Although its promulgation appears to have been the impromptu result of a need to patch a hole in the existing regulations,<sup>98</sup> Rule 10b-5 has become one of the most potent weapons in the SEC anti-fraud arsenal.

It is well accepted that one who aids another in the violation of

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93. Louis Brandeis, later Associate Justice Brandeis of the United States Supreme Court, wrote eloquently in favor of adequate disclosure of information in *OTHER PEOPLE'S MONEY passim* (Frederick A. Stokes Co. 1932) (1914). "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." *Id.* at 92.

94. Securities Act of 1933, §§ 11, 12(2) (codified at 15 U.S.C. §§ 77k, 77l(2) (1988)). See generally HAZEN, *supra* note 4, at §§ 7.2-7.5 (surveying aspects of civil liability for misstatements by sellers of securities under the 1933 Act).

95. Securities Act of 1933 (codified at § 17(a); 15 U.S.C. § 77q(a) (1988)). Some courts have implied a private remedy from § 17(a). See Thomas L. Hazen, *A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of The Securities Act of 1933*, 64 VA. L. REV. 641 (1978).

96. For an excerpt of the pertinent parts of the statute, see *supra* note 12.

97. 17 C.F.R. § 240.10b-5 (1994); see also *supra* note 38 (giving text of Rule 10b-5).

98. Milton Freeman described the birth of Rule 10b-5 as follows:

I went to work one day in May, 1942, and I did my normal job as an Assistant Solicitor of the SEC. Somebody called me and said there is something wrong going on in Boston (a company president was buying in shares from his own shareholders without telling them of much improved earnings). He asked what we could do about it. I wasted no time; I got some people in, we drafted a rule, we presented it to the Commission, and, without any hesitation, the Commission tossed the paper on the table saying they were in favor of it. One Commission member said, "Well, we're against fraud, aren't we?" So, before the sun was down, we had the rule that is now Rule 10b-5.

Milton V. Freeman, Foreword, Colloquium, *Happy Birthday 10b-5: 50 Years of Antifraud Regulation*, 61 FORDHAM L. REV., May 1993, at S1 (1993).

civil or criminal laws often will have to answer not only for the act of rendering such assistance, but also for any harm arising from the resultant wrongdoing.<sup>99</sup> The use of the aiding and abetting action in the securities field is especially fruitful, as it provides for joint and several liability amongst all defendants, and so permits plaintiffs to increase their chances of recovering any money damages they might be awarded.<sup>100</sup> Aiding and abetting liability did not, however, spring full grown into the law of securities regulation, but rather grew over time, along with other forms of relief implied under Rule 10b-5. Its history, then, is necessarily intertwined with that of other doctrines.

As the Court noted in *Central Bank*, neither the language of section 10(b) nor Rule 10b-5 creates a private right of action.<sup>101</sup> Nonetheless, within four years of Rule 10b-5's promulgation, a federal court upheld the existence of a private remedy under Rule 10b-5 for stockholders seeking damages arising out of an alleged fraudulent conspiracy in *Kardon v. National Gypsum Co.*<sup>102</sup> Notwithstanding the absence of any statutory provision for a private action, "[t]he disregard of the command of a statute is a wrongful act and a tort," and so the existence of a right was found to require the recognition of a remedy.<sup>103</sup> The *Kardon* court's allusion to the existence of a "general law" indicates that Rule 10b-5, rather than itself inspiring an implied right of action, may simply have been the beneficiary of the

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99. Dean Prosser explained the principle of aider-abetter liability as follows:

All those who, in pursuance of a common plan or design to commit a tortious act, actively take part in it, or further it by cooperation or request, or who lend aid or encouragement to the wrongdoer, or ratify and adopt the wrongdoer's acts done for their benefit, are equally liable.

W. PROSSER AND W. PAGE KEETON, HANDBOOK OF THE LAW OF TORTS § 46, at 323 (5th ed. 1984) (footnotes omitted); see also RESTATEMENT (SECOND) OF TORTS §§ 876(b), 877 (1979) (mandating liability for persons who commit torts in concert or by directing or permitting the conduct of another).

100. See David S. Ruder, *The Future of Aiding and Abetting and Rule 10b-5 After Central Bank of Denver*, 49 BUS. LAW. 1479, 1482 n. 21 (1994) ("[P]rimary wrongdoers often do not have sufficient funds to cover the claims against them."); see also Note, *Liability for Aiding and Abetting Violations of Rule 10b-5: The Recklessness Standard in Civil Damages Actions*, 62 TEX. L. REV. 1087, 1088-89 (1984) ("Because the primary wrongdoer often is insolvent or bankrupt when the fraud is discovered, plaintiffs typically sue all of the parties connected with a transaction, even when the connection is highly attenuated, in search of a 'deep pocket.'") (footnotes omitted).

101. *Central Bank*, 114 S. Ct. at 1446 (1994).

102. 69 F. Supp. 512 (E.D. Pa. 1946).

103. *Id.* at 514. ("[T]he mere omission of an express provision for civil liability is not sufficient to negative what the general law implies.")

judge's belief in the need for a remedy.<sup>104</sup> Nonetheless, *Kardon* is generally recognized as the first significant use of section 10(b) and Rule 10b-5 to imply a private remedy.<sup>105</sup>

The earliest aiding and abetting actions were brought, not privately, but by the SEC in civil enforcement actions.<sup>106</sup> These cases show the courts analogizing civil aiding and abetting liability to tort law and also to criminal fraud.<sup>107</sup> Among the early private action cases,<sup>108</sup> *Brennan v. Midwestern Life Insurance Co.*<sup>109</sup> has been the most influential. In *Brennan*, stockholders brought a class-action suit against a corporation for its failure to report the violations of a brokerage house that later went bankrupt. The brokerage took money paid for the purpose of purchasing defendant-corporation's stock and used it instead for speculation on its own account.<sup>110</sup> It also used fraudulent means to explain the delay in its delivery of certain stock.<sup>111</sup> The plaintiffs alleged that the defendant corporation had violated Rule 10b-5 by permitting the fraudulent activities of the brokerage to continue, and that the corporation was motivated by hopes that the brokerage's artificial inflation of the market for its stock would have a favorable impact on the price of its stock.<sup>112</sup> The corporation moved to dismiss for failure to state a claim, arguing that an aider and abettor could not be civilly liable under section 10(b) and Rule 10b-5.<sup>113</sup> The *Brennan* court acknowledged the principle of civil liability under Rule 10b-5 as established in "the landmark case" of *Kardon*,<sup>114</sup> and discussed numerous

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104. John A. Maher, *Implied Private Rights of Action and the Federal Securities Laws: A Historical Perspective*, 37 WASH. & LEE L. REV. 783, 792 (1980).

105. See HAROLD S. BLOOMENTHAL, SECURITIES LAW HANDBOOK § 15.01, at 15-2 to 15-3 (1993).

106. See, e.g., *In re Bruns, Nordeman & Co.*, 40 S.E.C. 652 (1961); *In re Southeastern Sec. Corp.*, 29 S.E.C. 609 (1949).

107. See, e.g., *SEC v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Cal. 1939). The court described the injunction sought by the SEC under § 17(a) of the 1933 Act as "sound[ing] in fraud, and . . . similar in many respects to a criminal prosecution." *Id.* at 43.

108. See, e.g., *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963) (suit by corporate reorganization trustee against stock exchange, dealers, and others alleging conspiracy that resulted in fraudulent distribution of corporate stock to the public).

109. 259 F. Supp. 673 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

110. *Id.* at 675.

111. *Id.*

112. *Id.*

113. *Id.* at 675-76.

114. *Id.* at 676 (citing *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946)). The court noted that "[d]efendant concedes that the complaint sufficiently alleges a violation of Section 10(b) and Rule 10b-5 by Dobich Securities Corporation. Nor has

other cases confronting the issue of aider and abettor liability and Rule 10b-5.<sup>115</sup> The court's most important contribution, however, was its use of the *Restatement of Torts* provision governing the liability of those giving knowing assistance to a fraudulent scheme.<sup>116</sup> According to the *Brennan* court, the principles "formulated in the Restatement of Torts surely best fulfill the purposes of the Securities Exchange Act of 1934 and are a logical and natural complement to the *Kardon* doctrine."<sup>117</sup> Unlike the *Central Bank* Court, the *Brennan* court clearly saw the purpose of the Act as being relevant to its interpretation of the statute, and thus did not read section 10(b) as excluding aiding and abetting.<sup>118</sup>

Because liability under 10b-5 had been implied by the judiciary rather than expressly provided for in the statute, courts had to flesh out the elements of the aiding and abetting cause of action on their own.<sup>119</sup> The Sixth Circuit Court of Appeals, clearly showing the

the defendant challenged the proposition that civil liability for damages arises under the cited section and rule." *Id.*

115. *Id.* at 676-77. The Court listed the following cases in *Brennan* as approving of aider-abettor liability (in order of discussion): *SEC v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Cal. 1939); *SEC v. Scott Taylor & Co.*, 183 F. Supp. 476 (S.D.N.Y. 1959); *Fry v. Schumaker*, 83 F. Supp. 476 (E.D. Pa. 1947); and *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963). *Id.*

116. *Brennan*, 259 F. Supp. at 680. The 1939 Restatement recommends imposition of secondary liability as follows:

For harm resulting to a third person from the tortious conduct of another, a person is liable if he . . .

- (b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or
- (c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to a third person.

RESTATEMENT OF TORTS § 876 (1939).

117. *Brennan*, 259 F. Supp. at 680.

118. Espousing a view of statutory interpretation clearly at odds with the *Central Bank* result, the *Brennan* court stated that:

[A] statute with a broad and remedial purpose such as the Securities Exchange Act of 1934 should not easily be rendered impotent to deal with new and unique situations within the scope of the evils intended to be eliminated. In the absence of a clear legislative expression to the contrary, the statute must be flexibly applied so as to implement its policies and purposes. In this regard, it cannot be said that civil liability for damages, so well established under the . . . Act of 1934, may never under any circumstances be imposed upon persons who do no more than aid and abet a violation of section 10(b) and Rule 10b-5.

*Id.* at 680-81.

119. One of the only aspects of a 10b-5 claim that the courts did not define entirely by themselves was the requirement, codified in the Federal Rules of Civil Procedure, that all fraud claims must be pleaded with particularity. FED. R. CIV. P. 9(b); see also HAZEN,



influence of *Brennan*, attempted to formulate definitively the elements of an aiding and abetting cause of action under Rule 10b-5:

[A] person may be held as an aider and abettor only if some other person has committed a securities law violation, if the accused party has a general awareness that his role was part of an overall activity that is improper, and if the accused aider-abettor knowingly and substantially assisted the violation.<sup>120</sup>

To establish liability for aiding and abetting, a plaintiff first had to show that a violation<sup>121</sup> of a provision of the federal securities laws had occurred. This required a plaintiff initially to prove the customary elements of a civil claim under section 10(b) and Rule 10b-5.<sup>122</sup> The alleged primary violator had to be identified so that the court could determine which parties potentially were liable for aiding and abetting.<sup>123</sup> Failure to show a primary violation neces-

*supra* note 4, § 13.2.1, at 66 (examining interaction of particularity requirement and 10b-5 claims).

120. *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975). This test had been adopted by all federal circuit courts of appeal. *See, e.g.*, *Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982, 986 (10th Cir. 1992); *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 1475 (1992); *D.C.D. Programs, Ltd. v. Leighton*, 833 F.2d 183, 188 (9th Cir. 1987); *Moore v. Fenex, Inc.*, 809 F.2d 297, 303 (6th Cir. 1987), *cert. denied*, 483 U.S. 1006 (1987); *Rudolph v. Arthur Andersen & Co.*, 800 F.2d 1040, 1045 (11th Cir. 1986), *cert. denied*, 480 U.S. 946 (1987); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986); *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057 (1986); *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 776-77 (1st Cir. 1983); *Decker v. Massey-Ferguson, Ltd.*, 681 F.2d 111, 119 (2d Cir. 1982); *Dirks v. S.E.C.*, 681 F.2d 824, 844 (D.C. Cir. 1982), *rev'd on other grounds*, 463 U.S. 646 (1983); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799 (3d Cir. 1978), *cert. denied*, 439 U.S. 930 (1978); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 96 (5th Cir. 1975).

121. *See supra* note 16 (distinguishing between primary and secondary violator).

122. The elements of a 10b-5 private cause of action include:

a misrepresentation or omission or other fraudulent device, the plaintiff's purchase or sale of securities in connection with the fraudulent device, the materiality of the misrepresentation or omission, the defendant's scienter in making the representation or omission, the plaintiff's justifiable reliance on the device (or due diligence against it), and the plaintiff's damages resulting from the fraudulent device.

*Cameron v. Outdoor Resorts of Am., Inc.*, 608 F.2d 187, 193-94 (5th Cir. 1979), *vacated in part on other grounds on reh'g*, 611 F.2d 105 (5th Cir. 1980); *see also Lampf v. Gilbertson*, 501 U.S. 350, 377-78 (1991) (Kennedy, J., dissenting) (describing elements of 10(b) action as "a false or misleading statement or material omission . . . reliance thereon . . . damages caused by the wrongdoing . . . and scienter on the part of the defendant" (citations omitted)).

123. *Ruder, supra* note 39, at 630 ("[E]xact identification . . . is essential in order to determine which persons should be subject to liability for giving knowing assistance to . . . the primary participants in the wrongdoing.").

sarily meant that there could be no secondary violation.<sup>124</sup>

The knowledge element had been, at least prior to the *Central Bank* decision, the most troublesome aspect of 10b-5 aiding and abetting liability. The Sixth Circuit's decision in *SEC v. Coffey*<sup>125</sup> required the defendant to have a general awareness that his role was part of an improper overall activity.<sup>126</sup> Other courts suggested that knowledge could be shown by circumstantial evidence or by reckless conduct.<sup>127</sup> Many, if not a majority, required that actual knowledge or intent to aid be shown.<sup>128</sup>

One decision held that important considerations in determining whether the knowledge requirement had been met included the type of transaction at issue, the kind of security involved, and the existence of any duties owed by the defendant arising out of the transaction or their relationship with the plaintiff.<sup>129</sup> Adding to the level of complexity then surrounding the knowledge requirement, in *Ernst & Ernst v. Hochfelder*<sup>130</sup> the Supreme Court required actions under Rule 10b-5 to allege "scienter."<sup>131</sup> As a result, the knowledge requirement articulated in *Coffey* was merged into, and perhaps subsumed by, this scienter requirement. The majority of courts prior

124. See, e.g., *Stone v. Mehlberg*, 728 F. Supp. 1341, 1355 (W.D. Mich. 1989) (aiding and abetting complaint dismissed with prejudice for failure to substantiate primary violation).

125. 493 F.2d 1304, 1314 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975) (holding that knowing omission of material facts in corporate financial statement was sufficient to establish violation of 10(b) and other securities laws).

126. *Id.* at 1316.

127. See, e.g., *Woodward v. Metro Bank*, 522 F.2d 84, 96 (5th Cir. 1975); *Kahn v. Chase Manhattan Bank*, 760 F. Supp. 369, 374 (S.D.N.Y. 1991) (requiring only recklessness when defendant owes fiduciary duty to plaintiff; otherwise, must show that assistance was substantial, and was rendered knowingly).

128. HAZEN, *supra* note 4, §13.16, at 203.

129. *Woodward*, 522 F.2d at 95-97. Perhaps the most frequently cited portion of the *Woodward* decision is the court's statement that "[i]f the evidence shows no more than transactions constituting the daily grist of the mill, we would be loath to find 10b-5 liability without clear proof of intent to violate the securities laws." *Id.* at 97.

130. 425 U.S. 185 (1976).

131. *Id.* at 193. The Court in *Hochfelder* held that the statute virtually called out for a scienter requirement because "[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct." *Id.* at 197. The term "scienter" has been subject of much discussion but little resolution; "[i]t has been said that the word 'scienter' is not a word of mystery or magic meaning, but is merely an expressive word . . . signifying . . . that the alleged crime or tort was done designedly, understandingly, knowingly, or with guilty knowledge." 79 C.J.S. *Scienter* (1952). *Scienter* is further defined, somewhat elliptically, as "such knowledge as charges a person with the consequences of his acts." 37 C.J.S. *Fraud* § 19 (1943).

to *Central Bank* had recognized reckless disregard of the truth as a sufficient level of scienter in 10b-5 actions,<sup>132</sup> and whether recklessness would suffice as scienter was one of the issues originally appealed to the Court in *Central Bank*.<sup>133</sup> Despite some consistency, however, the level of guilty knowledge sufficient to establish liability was often simply a fact-specific determination.<sup>134</sup>

The *Coffey* test for aiding and abetting liability required that the defendant "knowingly and substantially assist[]" in the fraud.<sup>135</sup> Courts noted the relationship of the knowledge and assistance prongs of the liability test,<sup>136</sup> and decisions seemed to turn on a case-by-case determination. One court defined substantiality as "more than just a little [assistance]";<sup>137</sup> another court held that a simple "but for" showing of causation failed the substantial assistance requirement.<sup>138</sup> Plaintiffs were generally required to prove proximate cause, namely that "[plaintiff's] injury was . . . a direct or reasonably foreseeable result of the [aider and abettor's] conduct."<sup>139</sup> In fleshing out the substantial assistance requirement, some courts found guidance in section 876 of the *Restatement of Torts*,<sup>140</sup> which listed some factors to be weighed in determining

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132. See HAZEN, *supra* note 4, § 13.4, at 82-83 & n.15 (surveying holdings of federal courts with regard to the definition of scienter and the level of scienter required in various factual circumstances).

133. Petition for Writ of Certiorari of Defendant-Appellant at 10, *Central Bank of Denver v. First Interstate Bank of Denver*, 114 S. Ct. 1439 (1994) (No. 92-854).

134. The uncertainty surrounding the scienter requirement prompted one commentator to remark: "Probably the most important step toward clarifying the law of *scienter* would be to ban the word." 3 ALAN R. BROMBERG, *SECURITIES FRAUD & COMMODITIES FRAUD* § 8.4 (503) (1971).

135. *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975).

136. See, e.g., *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057 (1986) ("[Knowledge and substantial assistance should not be] considered in isolation . . . [because] they vary inversely relative to one another and . . . [if] evidence of substantial assistance is slim, the requirement of knowledge or scienter is enhanced accordingly."); *Woodward v. Metro Bank*, 522 F.2d 84, 95 (1975) ("The scienter requirement scales upward when [fraud] is more remote.").

137. *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986) (citation omitted).

138. *The Limited, Inc. v. McCrory Corp.*, 683 F. Supp. 387, 401 (S.D.N.Y. 1988) ("'But for' causation does not satisfy the substantial assistance requirement.").

139. See *Bloor v. Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 57, 63 (2d Cir. 1985).

140. See, e.g., *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 800 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978) ("The Restatement . . . [requires us] to consider the following factors in determining whether a defendant's conduct constitutes substantial assistance: (1) the amount of assistance given by the defendant, (2) his presence or absence

whether any assistance rendered amounted to substantial assistance.<sup>141</sup>

Since *Marbury v. Madison*,<sup>142</sup> the scope of the United States Supreme Court's power to interpret Congressional statutes has been perhaps the most controversial arrow in the jurisprudential quiver of the High Bench.<sup>143</sup> The interpretive principles consistently advocated by the Court bear reviewing, as doing so brings to light how the *Central Bank* decision ignores or rejects many traditional precepts of statutory interpretation, while at the same time continuing the Court's ambivalent attitude toward implied securities actions.

First and foremost, as the *Central Bank* majority made clear, the Court has looked to the words of the statute it is interpreting to divine the intent of the legislature.<sup>144</sup> For a statute to have caused a dispute significant enough to reach the Supreme Court, however, it is unlikely that the words alone are sufficient to explicate the statute's

at the time of the tort, (3) his relation to the other person, and (4) his state of mind." Section 876 of the RESTATEMENT OF TORTS was incorporated into RESTATEMENT (SECOND) OF TORTS (1979) as § 436.

141. Of special interest, in light of the facts underlying the *Central Bank* case, was the question of whether *inaction* constitutes "substantial assistance." Most of the prior decisions turned on whether or not there was an independent duty of disclosure, in which case silence appeared sufficient to create aiding and abetting liability. See *Walck v. American Stock Exch., Inc.*, 687 F.2d 778, 791 (3d Cir. 1982) (finding inaction insufficient to cause liability), *cert. denied*, 461 U.S. 942 (1983); *Edwards & Hanly v. Wells Fargo Securities Clearance Corp.*, 602 F.2d 478, 484 (2d Cir. 1979), *cert. denied*, 444 U.S. 1045 (1980) (holding that absent an independent duty, silence is not sufficient to impose aiding and abetting liability). Even absent a duty to speak, silence could create aider and abettor liability if the defendant intended to promote the primary violation. See *Cleary v. Perfettune*, 700 F.2d 774, 778 (1st Cir. 1983).

142. 5 U.S. (1 Cranch) 137 (1803).

143. See generally ARTHUR S. MILLER, TOWARD INCREASED JUDICIAL ACTIVISM (1982) (a history of judicial activism); HORACE H. READ ET AL., MATERIALS ON LEGISLATION (3d ed. 1973) (textbook surveying role of legislation as an instrument of change and innovation in law); William N. Eskridge, Jr., *The Case of the Speluncian Explorers: Twentieth-Century Statutory Interpretation in a Nutshell*, 61 GEO. WASH. L. REV. 1731 (1993) (examining, as a "microcosm of this century's debates over the proper way to interpret statutes," the statutory interpretations offered by the Justices in Lon Fuller's landmark hypothetical, *The Case of the Speluncian Explorers*, 62 HARV. L. REV. 616 (1949)); William N. Eskridge, Jr., *Overriding Supreme Court Statutory Interpretation Decisions*, 101 YALE L.J. 331 (1991) (canvassing implications of recent congressional action taken in response to Supreme Court statutory construction); David L. Shapiro, *Continuity and Change in Statutory Interpretation*, 67 N.Y.U. L. REV. 921, 925-26 (1992) (surveying and endorsing traditional canons of statutory interpretation); *A Symposium on Statutory Construction*, 3 VAND. L. REV. 365 (1950) (surveying the methodology and rationales of statutory interpretation).

144. *Central Bank*, 114 S. Ct. at 1447-48; see also, e.g., *United States v. Wiltberger*, 18 U.S. (5 Wheat.) 76, 95 (1820) ("[t]he intention of the law maker must govern in the construction of . . . statutes.").

meaning. The Court has thus acknowledged that it must view the words within the context of the legislation as a whole and in light of the purpose that the legislation was meant to serve.<sup>145</sup> Two corollary rules of interpretation follow: "A thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers";<sup>146</sup> and "a thing may be . . . within [a statute's meaning] though not within its terms."<sup>147</sup> Clearly, then, these interpretive rules can, with nothing but judicial imagination to constrain them, give the Court a wide power to theorize as to the "intent" underlying the legislation at issue.

Traditionally, however, the Court has considered numerous other factors when interpreting statutes, all aimed at discerning the wish of Congress, and thereby circumscribing what might otherwise be viewed as the Court's unfettered power of interpretation.<sup>148</sup> Such considerations include examining any records charting the legislation's development—the so-called "legislative history"<sup>149</sup>—and can extend to considerations of what provisions the Congress incorporated into a bill, as well as those it chose not to incorporate.<sup>150</sup> Also traditionally bearing on the Court's interpretation of a statute is the interpretation given that statute by the administrative agency charged with its enforcement<sup>151</sup> and the Congress's acquiescence in the administrative interpretation.<sup>152</sup> Long established, too, is the practice

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145. *Chapman v. Houston Welfare Rights Org.*, 441 U.S. 600, 608 (1979); *accord United States National Bank of Oregon v. Independent Ins. Agents*, 113 S. Ct. 2173, 2182 (1993).

146. *United Steelworkers of America v. Weber*, 443 U.S. 193, 201 (1979) (quoting *Holy Trinity Church v. United States*, 143 U.S. 457, 459 (1892)).

147. *Indianapolis & St. Louis R.R. Co. v. Horst*, 93 U.S. 291, 300 (1876).

148. What has been described as the "counter-majoritarian difficulty" created by the quasi-legislative pronouncements of an unelected judicial elite is nicely surveyed in ALEXANDER M. BICKEL, *THE LEAST DANGEROUS BRANCH: THE SUPREME COURT AT THE BAR OF POLITICS* (1962). Justice Antonin Scalia has said, "I think we have an obligation to conduct our exegesis in a fashion which fosters th[e] democratic process." *United States v. Taylor*, 487 U.S. 326, 346 (1988) (Scalia, J., concurring in part).

149. *See, e.g., NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 274-75 (1974).

150. *See, e.g., Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. 186, 200 (1974) (reasoning that the deletion of a provision from bill in Conference Committee "strongly militates against a judgment that Congress intended a result that it expressly declined to enact").

151. *See, e.g., Good Samaritan Hosp. v. Shalala*, 113 S. Ct. 2151, 2159 (1993); *Haig v. Agee*, 453 U.S. 280, 291 (1981); *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1969); *Costanzo v. Tillinghast*, 287 U.S. 341, 345 (1932).

152. *See, e.g., United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121, 136 (1985); *see also United States v. Rutherford*, 442 U.S. 544, 554 n.10 (1979) ("[O]nce an agency's statutory construction has been 'fully brought to the attention of the public and the Congress,' and the latter has not sought to alter that interpretation although it has

of referring not simply to legislative history, but also to the actual historical circumstances underlying the enactment of the statute.<sup>153</sup>

Section 10(b) does not explicitly provide for aiding and abetting liability.<sup>154</sup> Nor, however, does it set forth a private right of action, or a statute of limitations upon that action; yet section 10b-5's text has not stopped the Court from acknowledging their existence.<sup>155</sup> The Court has long mandated that the 1934 Act, because of its stature as "remedial legislation," must be construed broadly to effectuate its purposes.<sup>156</sup> To that end the Court has permitted the implication of private remedies for securities laws violations.<sup>157</sup> Section 10(b) of the 1934 Act was the subject of generous interpretation, because of its statutory role as a "catch-all" clause to prevent fraudulent securities practices.<sup>158</sup>

The implied private right of action under Rule 10b-5 has been called a "judicial oak which has grown from little more than a legislative acorn,"<sup>159</sup> and is generally thought to be responsible for

amended the statute in other respects, then presumably the legislative intent has been correctly discerned." (citation omitted)).

153. See, e.g., *United States v. Wise*, 370 U.S. 405, 411 (1962) ("[S]tatutes are construed by the courts with reference to the circumstances existing at the time of passage."); *Southeastern Community College v. Davis*, 442 U.S. 397, 411 (1979); *Preston v. Browder*, 14 U.S. (1 Wheat.) 115, 120-21 (1816).

154. See *supra* note 12 (setting forth relevant statutory text).

155. See *infra* notes 161-63 and accompanying text (discussing the Court's acknowledgment of private remedy) and note 178 and accompanying text (discussing Court's recognition of right of contribution).

156. See, e.g., *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983); *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

157. Initially, the Court dictated in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), that a remedy could be implied when to do so was consistent with the intent of the legislature and when such implied remedies aided in the SEC's enforcement efforts. *Id.* at 432-35 ("[F]ederal courts have the power to grant all necessary remedial relief. . ."). In an attempt to restrain the federal judiciary's imposition of remedies in the wake of *Borak's* generous mandate, the Court held in *Cort v. Ash*, 422 U.S. 66 (1975), that the implication of federal remedies was to be governed by a four-fold test. *Id.* at 78. The test called for consideration of: (1) whether the plaintiff is a member of "the class for whose *especial* benefit the statute was enacted"; (2) whether there is any indication of a legislative intent, "explicit or implicit," either to create or deny a remedy; (3) whether a private remedy would be consistent with the overall legislative "scheme"; and (4) whether the cause of action was "traditionally relegated" to state law. *Id.* This four-part test quickly became distilled to focus on a single factor—the intent of Congress. See *Texas Indus. v. Radcliff Materials, Inc.*, 451 U.S. 630, 639 (1981) ("Our focus . . . is on the intent of Congress . . . [which] may be discerned by looking into the legislative history and other factors: e.g., the identity of the class for whom the statute was enacted, the overall legislative scheme, and the traditional role of the states in providing relief.").

158. *Chiarella v. United States*, 445 U.S. 222, 226 (1980) (citation omitted).

159. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975).

more securities litigation than any other section of the federal securities laws. Early cases such as *Kardon*<sup>160</sup> relied on no single theory of judicial implication, leaving Rule 10b-5 actions to grow haphazardly in the federal courts; ultimately, the existence of a private remedy received the sanction of the Supreme Court in *Superintendent of Insurance v. Bankers Life & Casualty Co.*<sup>161</sup> Interestingly enough, in *Bankers Life*, where the Court first explicitly recognized and applied the 10b-5 doctrine,<sup>162</sup> the issue of statutory interpretation was for the most part ignored. What little was said, viewed in light of *Central Bank*, is somewhat astonishing; Justice Douglas, delivering the opinion of a unanimous court, stated that "section 10(b) must be read flexibly, not technically and restrictively."<sup>163</sup>

No sooner did the Court recognize the existence of the right of action, however, than it began to limit its scope. In *Ernst & Ernst v. Hochfelder*,<sup>164</sup> an accounting firm allegedly failed to conduct proper audits of a brokerage firm engaged in a fraudulent scheme. The *Hochfelder* Court explicitly reserved judgment as to whether the aiding and abetting action was *proper* under the Rule;<sup>165</sup> proper or not, the Court in *Hochfelder* nonetheless took the opportunity to circumscribe it, ruling that simple negligence would not suffice to fulfill the scienter requirement of the aiding and abetting action.<sup>166</sup> Moreover, the Court pronounced that "the existence of a private cause of action for violations of [section 10(b)] and [Rule 10b-5] is now well established."<sup>167</sup> This language falls ironically alongside the statement that "the starting point in every case involving construction of a statute is the language [of the statute] itself."<sup>168</sup>

The implied remedies available under Rule 10b-5 continued to appear before the Court, and generally the Court was willing to treat

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160. See *supra* notes 102-05 and accompanying text.

161. 404 U.S. 6 (1970).

162. *Id.* at 13 n.9 ("It is now established that a private right of action is implied under § 10(b).").

163. *Id.* at 12. The two *Banker's Life* Justices still sitting at the time of *Central Bank*, now-Chief Justice Rehnquist and Justice Blackmun, no longer agreed in their view of § 10(b), and signed on to different sides of the latter decision.

164. 425 U.S. 185 (1976). Decided the term after *Cort*, *Hochfelder* gave the Court a fresh opportunity to address the rights available under § 10(b) and Rule 10b-5.

165. *Id.* at 192 n.7.

166. In so ruling, of course, the Court helped contribute to the muddle surrounding scienter. See *supra* notes 129-34 and accompanying text.

167. *Hochfelder*, 425 U.S. at 196.

168. *Id.* at 197.

them with interpretive generosity.<sup>169</sup> In *Herman & MacLean v. Huddleston*,<sup>170</sup> the Court ruled that the implied remedy under section 10(b) was cumulative, meaning that claims could be brought under Rule 10b-5 in addition to any action brought under an explicit statutory authorization.<sup>171</sup> The Court again reiterated the importance of permitting an expansive interpretation of the securities statutes, in furtherance of the Acts' "broad remedial purposes."<sup>172</sup>

In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,<sup>173</sup> the Court held that an action brought under the section 10(b) implied right must be commenced within one year after discovery of the violation and within no more than three years after the violation occurs.<sup>174</sup> This holding departed from the normal rule that provides for the "borrowing" of the relevant state statute of limitations when Congress fails to provide one explicitly. In reaching its decision, the Supreme Court employed a new interpretive tool, seeking to infer how the Congress that enacted the 1934 Act would have addressed the statute of limitations problem *if* it had included an express 10b-5 private right of action in the Act.<sup>175</sup> Aware of the "awkward task" it faced, the Court looked toward analogous remedies within the same legislation, and asked how they dealt with the statute of limitations problem. Sections 9 and 18 of the 1934 Act, governing the willful manipulation of security prices and the filing of misleading registration statements, respectively, were found to be sufficiently analogous to the 10(b) fraud action that the congressionally enacted statutes of limitations govern any 10b-5 action.<sup>176</sup> Other recent cases involving the securities laws have also shown some willingness

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169. The Court's treatment of 10b-5 implied remedies was not uniformly expansive. See, e.g., *Santa Fe Indus. Inc. v. Green*, 430 U.S. 462, 473-74 (1977) (holding that behavior neither manipulative nor deceptive does not fall within the ambit of 10b-5 regulation and indicating that to hold otherwise would incorporate into federal regulation matters traditionally governed by the states).

170. 459 U.S. 375 (1983).

171. *Id.* at 387. So exuberant was the Court in *Huddleston* that it declared that "the existence of this [10b-5] implied remedy is simply beyond peradventure." *Id.* at 380.

172. *Id.* at 386.

173. 501 U.S. 350 (1991).

174. *Id.* at 364.

175. *Id.* at 359.

176. More recently, the Court recognized a right to contribution as an element of the 10b-5 cause of action, employing the same sort of "legislative symmetry" or "putative intent" analysis employed in *Lampf*. *Musick, Peeler & Garrett v. Employers Ins.*, 113 S. Ct. 2085, 2090 (1993).



to recognize implied rights.<sup>177</sup>

Clearly, then, the United States Supreme Court has not shied away from operating outside the literal constraints of a statute. As recently as the 1993 term, having freely extended the 10b-5 action to include a right of contribution,<sup>178</sup> the Court recognized in *Musick* that, “ ‘where a legal structure of private statutory rights has developed without clear indications of congressional intent,’ a federal court has the limited power to define ‘the contours of that structure.’ ”<sup>179</sup> This notion carried forward the Court’s earlier philosophy of reading the securities laws broadly to accomplish the remedial purposes of the statutes.<sup>180</sup>

In order to sidestep its long history of generous statutory interpretation, the Court in *Central Bank* first sought to divide its precedent between those cases addressing the “scope of conduct prohibited by § 10(b)” and those presenting questions about the “elements of the 10b-5 private liability action.”<sup>181</sup> Yet this distinction is not a particularly meaningful one.<sup>182</sup> In *Musick*, the Court acknowledged that a right of contribution was normally “thought to be a separate or independent right of action.”<sup>183</sup> If contribution is a separate right of action, then it could hardly be described, as the Court in *Central Bank* sought to, as an “element” of another cause of action; the Court’s initial distinction does not in fact draw any salient precedential line.

The *Central Bank* majority, having set forth the dichotomy between “scope” and “elements,” then stated its interpretive credo:

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177. See, e.g., *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353, 388 (1982) (recognizing an implied remedy under the Commodity Exchange Act). *But cf.* *Touche Ross & Co. v. Redington*, 442 U.S. 560, 571 (1979) (denying existence of an implied private right of action under § 17(a) of the 1934 Act).

178. *Musick, Peeler & Garrett v. Employers Ins.*, 113 S. Ct. 2085 (1993). See Christopher R. Stone, Note, *Implying a Right of Contribution under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5: The Supreme Court Finds Power Where None Exists*, 35 B.C. L. REV. 175 (1993) (criticizing particularly the Court’s decision in *Musick*, and more generally the perceived leniency in the implication of private remedies).

179. *Musick*, 113 S. Ct. at 2089 (quoting *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2764 (1991)); see also *infra* note 186 and accompanying text (noting the Court’s statement in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975)).

180. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386 (1983).

181. *Central Bank*, 114 S. Ct. at 1445.

182. Joel Seligman, *The Implications of Central Bank*, 49 BUS. LAW. 1429, 1431 (1994) (“This is a troublesome distinction to credit. . . . Virtually no lower court had drawn this distinction in the section 10(b) aiding and abetting context.”).

183. *Musick*, 113 S. Ct. at 2088.

“[T]he text of the statute controls our decision.”<sup>184</sup> While this is a fair statement of elementary statutory interpretation, the Court’s prior decisions, especially those treating section 10(b), have not made statutory text the sole source of interpretive guidance. The statute in 10(b) cases has been, at best, a mere starting point in the statutory construction;<sup>185</sup> the Court had recognized that the 10(b) action, being a judicial creation, necessarily required courts to “flesh out the portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance.”<sup>186</sup> In the case of section 10(b), as the Court itself has remarked, the language of the statute is no place to look for guidance.<sup>187</sup>

The *Central Bank* majority cites cases proving that its strictly textualist creed is consistent with its treatment of section 10(b) and other provisions of the securities acts.<sup>188</sup> As the dissent points out, however, “none of the[se] cases . . . even arguably involved a settled course of lower court opinions.”<sup>189</sup> In the case of a statute subject to a single, well-established judicial reading, the Court has made clear that “settled construction of an important federal statute should not be disturbed unless and until Congress so decides.”<sup>190</sup> Although presented with significant evidence that the Congress had in fact

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184. *Central Bank*, 114 S. Ct. at 1446. The rationale given by the Court has not convinced all commentators. See, e.g., Seligman, *supra* note 182, at 1432 (describing Court’s reasoning as a “legal fiction”).

185. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976) (noting that statutory language is the “starting point in every case involving construction of a statute”); cf. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 383 (1983) (advocating broad reading of the provisions of section 10(b) in order to further “remedial purposes” of securities laws).

186. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975). As recently as *Musick*, the Court recognized the existence of judicial power to delineate “the contours of [an implied right’s] structure.” *Musick*, 113 S. Ct. at 2089 (citation omitted).

187. *Musick*, 113 S. Ct. at 2090 (“The text of § 10(b) provides little guidance where we are asked to specify elements or aspects of the 10b-5 apparatus.” (citation omitted)).

188. *Central Bank*, 114 S. Ct. at 1445-47 (citing, *inter alia*, *Pinter v. Dahl*, 486 U.S. 622, 641 (1988) (holding that text of securities Acts governed judicial determination of a word’s meaning) and *Mertens v. Hewitt Associates*, 113 S. Ct. 2063, 2067 (1993) (holding that failure of ERISA to set forth explicitly a cause of action against a nonfiduciary for its knowing participation in a breach of the fiduciary’s duty barred Court’s recognition of such an action)).

189. *Central Bank*, 114 S. Ct. at 1459 n.6 (Stevens, J., dissenting).

190. *Id.* at 1458 (Stevens, J., dissenting) (quoting *Reves v. Ernst & Young*, 494 U.S. 56, 74 (1990) (Stevens, J., concurring)).

acquiesced in the courts' interpretation of 10(b),<sup>191</sup> the majority in *Central Bank* stuck to its textualist guns, via a footnote from a more recent case: "Congressional inaction cannot amend a duly enacted statute."<sup>192</sup>

In its most recent previous encounter with section 10(b) the Court recognized a right of contribution under the statute, noting that neither federal courts nor the Securities and Exchange Commission had "suggested that . . . [contribution interferes with] the effectiveness of the 10b-5 implied action or . . . the operation of the securities laws."<sup>193</sup> While both of these factors militate overwhelmingly in favor of the recognition of aiding and abetting liability<sup>194</sup>—which has a far longer and more significant judicial and administrative history than the right to contribution—they clearly did not influence the Court toward recognizing the aiding and abetting action.

The Court in *Central Bank*, as an alternative form of textual analysis, sought to infer from other express causes of action in the Securities Acts of 1933 and 1934 how the Seventy-third Congress would have dealt with the issue of aiding and abetting liability.<sup>195</sup> In doing so, the Court embraced an interpretive methodology it has described as "not a promising venture as a general proposition."<sup>196</sup> Not finding any express statutes that provided for aiding and abetting liability, the Court concluded that the 1934 Congress "would not have attached aiding and abetting liability to § 10(b) had it provided a private § 10(b) cause of action."<sup>197</sup> The Court's newly preferred "putative-intent" analysis appears to represent an attempt to retain parts of a well-respected interpretive method—namely, examining the

191. See Brief of Amicus Curiae the Securities and Exchange Commission at 16, *Central Bank*, 114 S. Ct. 1439 (1994) (No. 92-854) (discussing various congressional hearings concerning, and amendments of, the securities laws, which indicate that Congress knew about, and approved of, the existence of implied aiding and abetting liability). The SEC asserted that "[t]he House Report particularly 'endorsed the judicial application of the concept of aiding and abetting liability to achieve the remedial purposes of the securities laws.'" *Id.* (quoting H.R. Rep. No. 355, 98th Cong., 2d Sess. 10 (1983)).

192. *Central Bank*, 114 S. Ct. at 1453 (citing *Patterson v. McLean Credit Union*, 491 U.S. 164, 175 n.1 (1989)). *Patterson* dealt with employment-discrimination claims and thus did not display the Court's traditional interpretive generosity when faced with securities law issues. *Patterson*, 491 U.S., at 175.

193. *Musick*, 113 S. Ct. 2085, 2091 (1993).

194. See *supra* notes 106-41 and accompanying text (describing history of aiding and abetting action); see also *supra* note 8 and accompanying text (noting that 15% of the SEC's 1992 civil enforcement actions contained claims of aiding and abetting).

195. *Central Bank*, 114 S. Ct. at 1448.

196. *Musick*, 113 S. Ct. at 2090.

197. *Central Bank*, 114 S. Ct. at 1449.

legislation as whole—while gouging out the very aim of that tool, which is to ascertain from the whole what *purpose* the legislation is meant to serve. The words of the statute alone are not always sufficient to truly illuminate the intent of Congress, and in light of the 1934 Act's clear purpose of promoting availability and exchange of accurate information in securities transactions,<sup>198</sup> it hardly seems sufficient for the Court to limit its interpretive analysis to a grammatical foray through the 1934 Act. Moreover, this conclusion ignores both the Court's long acceptance of implied remedies and the possibility that Congress (1) enacted the statute without any opinion on aiding and abetting liability generally,<sup>199</sup> or (2) simply assumed the general availability of an aider and abettor action.<sup>200</sup>

What makes *Central Bank* most remarkable, however, is that it is a judicial wolf in sheep's clothing, an act of extreme judicial activism carried out while purporting to employ the strictest possible interpretive means. To that extent, perhaps *Central Bank* can best be viewed as a victory of the jurisprudential philosophy of Justice Antonin Scalia, whose strict textualist views on statutory interpretation virtually require both the methodology and the outcome arrived at by the Court.<sup>201</sup> *Central Bank* certainly marks the first occasion on which a majority of the Court has employed Justice Scalia's method of statutory interpretation to tear down decades of federal law.<sup>202</sup> Justice Scalia's methodology is premised

198. See Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385 (1990). Professor Thel argues that section 10(b) "was intended to empower the Securities and Exchange Commission . . . to regulate any practice that might contribute to speculation in securities or tend to move security prices away from investment value." *Id.* at 385-86.

199. As the Court has noted, "the extensive legislative history of the 1934 Act is bereft of any explicit explanation of Congress' intent." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201 (1976).

200. *Central Bank*, 114 S. Ct. at 1456 n.2 (Stevens, J., dissenting) (reviewing turn-of-the-century prominence of aider-abettor liability).

201. See generally Bradley C. Karkkainen, "Plain Meaning": Justice Scalia's Jurisprudence of Strict Statutory Construction, 17 HARV. J.L. & PUB. POL'Y 401 (1994) (surveying Justice Scalia's approach to statutory interpretation); William D. Popkin, *An "Internal" Critique of Justice Scalia's Theory of Statutory Interpretation*, 76 MINN. L. REV. 1133 (1992) (criticizing Justice Scalia's interpretive approach); Arthur Stock, *Justice Scalia's Use of Sources in Statutory and Constitutional Interpretation: How Congress Always Loses*, 1990 DUKE L.J. 160 (1990) (examining separation-of-powers problems, and others, created by Justice Scalia's interpretive framework).

202. Justice Scalia's philosophy of textual interpretation has generally been voiced only in concurring or dissenting opinions. Karkkainen, *supra* note 201 at 401. "Only Justices Anthony Kennedy and Clarence Thomas can be called adherents of Justice Scalia's plain meaning approach. Chief Justice Rehnquist and Justice O'Connor frequently join Justice

on an open hostility to the very basis upon which 10b-5 aiding and abetting liability was built—the notion that a poorly expressed congressional intent can be salvaged by the judiciary and wrought into a workable and just remedy. Justice Scalia has been very clear: “The principle of our democratic system is *not* that each legislature enacts a purpose.”<sup>203</sup> Although Justice Scalia himself has wavered from this position<sup>204</sup>—and it might be a great disservice to Justice Kennedy, as the author of the *Central Bank* opinion, to imply that he was merely parroting Justice Scalia’s interpretive line—the *Central Bank* opinion’s insistence on limiting any examination of the statute to the statutory language<sup>205</sup> in determining the existence of aiding and abetting liability exemplifies the interpretive school identified with Justice Scalia—what has been called the “new textualism.”<sup>206</sup> Not only did the *Central Bank* opinion not seek “outside help” from notions of legislative intent, it also failed to consider the SEC’s acceptance and usage of the aiding and abetting cause of action.<sup>207</sup> It thus went further than perhaps even Justice Scalia might have had

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Scalia’s opinions, but seldom rely on his approach in their own opinions.” *Id.* As the aforementioned Justices constitute the members of the *Central Bank* majority, *Central Bank*, 114 S. Ct. at 1442 (1994), it remains an open question as to whether Chief Justice Rehnquist and Justice O’Connor have “signed on” permanently to Scalia’s interpretive school, or whether their interpretive methodology will continue to differ when writing in their own names.

203. *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 325 (1988) (Scalia, J., concurring in part and dissenting in part) (emphasis added). Justice Scalia’s influence and the shift away from the use of legislative history and intent analysis in statutory interpretation are highlighted in Thomas W. Merrill, *Textualism and the Future of the Chevron Doctrine*, 72 WASH. U. L.Q. 351 (1994). Merrill points out that in the Court’s 1981 Term, it referred to legislative history in determining every one of the statutory interpretation cases put before them, while in the 1992 Term, they referred to legislative history in only 18% of the cases involving the interpretation of a statute. *Id.* at 355.

204. Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 DUKE L.J. 511, 515 (1989) (“[I]t seems to me that the ‘traditional tools of statutory construction’ include not merely text and legislative history but also, quite specifically, the consideration of policy consequences.”).

205. *Central Bank*, 114 S. Ct. at 1454 (refusing to examine policy considerations in statutory interpretation except when they show that “adherence to the text and structure would lead to a result ‘so bizarre’ that Congress could not have intended it.” (citations omitted)); see also William N. Eskridge, Jr., *The New Textualism*, 37 UCLA L. REV. 621, 623 (1990) (quoting from *Immigration & Naturalization Service v. Cardoza-Fonseca*, 480 U.S. 421, 452 (Scalia, J., concurring in the judgment) (suggesting that use of legislative history should be limited, and that “if the language of a statute is clear, that language must be given effect—at least in the absence of a patent absurdity.”)).

206. Eskridge, *supra* note 205, at 623.

207. See Scalia, *supra* note 204, at 518 (discussing weight given to administrative interpretation).

he written alone.<sup>208</sup>

Furthermore, the *Central Bank* decision represents the flowering of the jurisprudential seeds sown by Presidents Reagan and Bush.<sup>209</sup> Although the Court's dogmatic literalism is well suited to its conservative label, the Court's *Central Bank* decision puts its conservative reputation at risk, because, as Professor Archibald Cox has noted, "[c]onstitutionalism as practiced in the past . . . [cannot] survive if, as the result of a succession of carefully chosen Presidential appointments, the sentiment of a majority of the Justices shift[s] back and forth at five- or ten-year intervals so that rights . . . [are] alternately recognized and denied."<sup>210</sup> The doctrine of *stare decisis*, although not absolute, must have some meaning if the decisions of the Court are to be viewed as anything other than the results of simple judicial caprice.

The Court's *Central Bank* decision seems to signal one of two possibilities. Either *Central Bank* will stand as an "isolated deviation from the strong current of precedents—a derelict on the waters of the law,"<sup>211</sup> and will go on to be overruled by Congress or narrowly applied by the lower courts, or it will mark the sure end of implied secondary liability in the securities laws, and will threaten the existence of many other judicially implied remedies. The Court's decision has produced some immediate effects—the dismissal of both private and SEC actions<sup>212</sup> against alleged aiders and abettors, and congressional action in the form of the introduction of a bill that would reverse the Court's holding.<sup>213</sup> In the short term, it is quite

208. For Justice Scalia's views supporting reference to administrative interpretation when construing an *ambiguous* statute, see Scalia, *supra* note 204 *passim*. Of course, it can be argued both that there is nothing ambiguous about the statute at issue, and alternatively that every statute is ambiguous. Justices Stevens and Scalia argue illuminatingly about the administrative agency's role in statutory interpretation in *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837 *passim* (1984). See also Merrill, *supra* note 203, at 355-73 (examining role of deference to agency interpretation in recent Supreme Court jurisprudence).

209. Of the Justices deciding *Central Bank*, only Ruth Bader Ginsburg was appointed by a Democratic President.

210. Archibald Cox, *The Role of the Supreme Court: Judicial Activism or Self-Restraint?*, 47 MD. L. REV. 118, 137 (1987).

211. *Lambert v. California*, 355 U.S. 225, 232 (1957) (Frankfurter, J., dissenting).

212. See Harlan, *supra* note 90, at C15.

213. S. 2306, 103d Cong., 2d Sess. (1994). Senator Howard Metzenbaum, who introduced this bill, expressed concern that "[u]nless the . . . [*Central Bank*] decision is reversed by Congress, most defrauded investors will not recover their losses because, typically, the perpetrator of the fraud is insolvent by the time the case is filed or completed." 140 CONG. REC. S9460 (daily ed. July 21, 1994) (statement of Sen. Metzenbaum). While Senator Metzenbaum's bill seems to have expired with the end of the 103d Congress, the Republican majority of the newly-elected 104th Congress has shown itself

possible that some of the actions that have been dismissed will be brought again as assertions of primary violations of section 10(b),<sup>214</sup> something that will require the proof of additional elements to establish liability.<sup>215</sup> Plausible long-term effects of the decision include the possibility of an undertaking by the Court to eliminate other forms of implied liability. As the dissent warned, the majority's rationale and methodology "imperil[] other well established forms of secondary liability not expressly addressed in the securities laws."<sup>216</sup> It is not inconceivable that any implied right of action without an explicit statutory analog could be erased.<sup>217</sup> Moreover, the decision points the way toward a more conservative judicial interpretation of federal statutes generally, which could lead to a corresponding liberalization in the use of state securities laws as a means to shore up

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inclined to legislate in a manner consistent with the *Central Bank* majority. The Common Sense Legal Reform Act of 1995 includes a section, intended to prevent what it calls "fishing expedition" lawsuits, that fixes an uniform heightened scienter standard for all § 10(b) actions. H.R. 10, 104th Cong., 1st Sess. § 204 (1995). Such a heightened standard would probably have the effect of eliminating all Rule 10b-5 secondary liability claims based on less than "knowing" participation in a fraud.

214. Often, both actions were brought against the same party. See, e.g., *Herman & MacLean v. Huddleston*, 459 U.S. 375, 379 n.5 (1983).

215. Traditional elements for a primary fraud violation of § 10(b) are: (1) the use of an instrumentality of interstate commerce; (2) the making by the defendant of a material misrepresentation or omission; (3) the intent to deceive, manipulate or defraud; (4) reliance by the plaintiff on the defendant's misrepresentation; (5) causation; and (6) damages flowing from the defendant's conduct. See, e.g., *Weitzman v. Stein*, 436 F. Supp. 895, 902-04 (S.D.N.Y. 1977); see also Lisa Klein Wager & John E. Failla, *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.—The Beginning of an End, Or Will Less Lead to More?*, 49 BUS. LAW. 1451, 1456-61 (1994) (canvassing the difficulties presented when seeking to establish primary liability instead of bringing aiding and abetting actions).

216. *Central Bank*, 114 S. Ct. at 1456 (Stevens, J., dissenting).

217. Federal courts have developed numerous remedies providing for secondary liability. These include the common law doctrine of *respondeat superior*. See, e.g., *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980); *Holloway v. Howerdd*, 536 F.2d 690, 694-95 (6th Cir. 1976). Claims of a conspiracy to violate section 10(b) can also be alleged, but unlike aiding and abetting liability, they generally require levels of knowledge and participation closer to that required of a primary violator. Compare *Halberstam v. Welch*, 705 F.2d 472, 477 (D.C. Cir. 1983) (acknowledging that court may find a tacit agreement sufficient to impose conspiracy liability) with *Weitzman v. Stein*, 436 F. Supp. 895, 902-04 (S.D.N.Y. 1977) (requiring knowing agreement to, and participation in, a scheme to defraud in order to impose conspiracy liability). Like aiding and abetting liability, neither *respondeat superior* nor conspiracy have any basis in the statutory text. Recovery under theories of "controlling person liability," a statutorily based method of expanding liability for securities fraud, has also been suggested as a possible means of replacing aiding and abetting liability, although one fraught with significant difficulties. See Wager & Failla, *supra* note 215, at 1463-65.

the damage done by the *Central Bank* decision.<sup>218</sup>

The section 10(b) private liability doctrine, to be sure, was a judicial creation. Its long history, however, shows that the courts carefully guided its growth, keeping foremost in their collective minds that, for the securities laws to have any meaning, they must provide adequate remedies for the rights they seek to protect. Part of this judicial trend was the recognition of aiding and abetting liability under Rule 10b-5, a cause of action well suited for policing the gray periphery of securities law enforcement; otherwise liability might not attach to those lawyers, bankers and accountants who claim simply "all I did was the paperwork," notwithstanding their knowledge of how that paperwork would be put to use. Following the practice begun in *Hochfelder*, in *Central Bank* the Court began to chop away at the mighty oak that has grown from the legislative acorn of section 10(b). Although this is a proper use of the Court's power, if it fails to respect precedent and consistency in interpretation, the Court may find itself unable to control the direction in which the tree falls.

GLEN WALLACE ROBERTS II

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218. Many states have acknowledged the existence of aiding and abetting liability, either implied or explicit, under their respective *state* securities regulations. See, e.g., *Bayhi v. State*, 629 So. 2d 782, 792 (Ala. 1993); *State v. Superior Court of Maricopa County*, 599 P.2d 777, 784 (Ariz. 1979) (en banc); *Foley v. Allard*, 427 N.W.2d 647, 651 (Minn. 1988).



