

Attorney Liability Under the State Securities Laws: Landscapes and Minefields

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I. INTRODUCTION

In recent decades, the United States Supreme Court has limited liability for attorneys under the federal securities acts. Prior to restrictive Supreme Court decisions in the 1980s and 1990s,¹ attorneys regularly were sued as aiders and abettors under section 10(b) of the Securities Exchange Act of 1934² and rule 10b-5 promulgated thereunder³ and as sellers under section 12 of the Securities Act of 1933.⁴ Supreme Court decisions limiting the scope of these sections

1. *See, e.g.*, Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994) (holding no attorney liability for aiding and abetting in private Exchange Act § 10(b) actions); Gustafson v. Alloyd Co., 513 U.S. 561 (1995) (construing the term “prospectus” in Securities Act § 12(2) to be limited to public offerings); Pinter v. Dahl, 486 U.S. 622 (1988) (limiting the definition of the term “seller” under Securities Act § 12).

2. 15 U.S.C. § 78j(b) (2005); *see, e.g.*, Abell v. Potomac Ins. Co., 858 F.2d 1104 (5th Cir. 1988), *vacated on other grounds*, 492 U.S. 1104 (1989). Section 10(b) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

3. 17 C.F.R. § 240.10b-5 (2005). Rule 10b-5 provides:

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.

4. 15 U.S.C. § 771 (2005); *see, e.g.*, Croy v. Campbell, 624 F.2d 709 (5th Cir. 1980). Section 12(a) provides:

(a) Any person who—

(1) offers or sells a security in violation of section 5, or

(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraphs (2) and (14) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails,

have effectively precluded both avenues for attorney liability in private actions.⁵ For example, in *Pinter v. Dahl*,⁶ the Court held that, for purposes of section 12(a)(1), apart from the vendor of the security and its agent, a “seller” is one “who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner.”⁷ This definition, which does not encompass attorneys rendering customary legal services,⁸ has been adopted as well in the section 12(a)(2) context.⁹ Additionally, as a result of *Central Bank of Denver v. First Interstate Bank of Denver*,¹⁰ attorneys no longer face secondary liability as “aiders and abettors” in section 10(b) and rule 10b-5 private actions.¹¹ However, depending on the nature and extent of services performed, attorneys may face primary liability exposure under section 10(b) and rule 10b-5.¹²

Moreover, the Securities Litigation Uniform Standards Act (SLUSA) restricts the reach of state law.¹³ SLUSA preempts, with certain exceptions, recourse in state law for class actions involving nationally-traded securities.¹⁴

by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable subject to subsection (b), to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

5. See cases cited *supra* note 1.

6. *Pinter*, 486 U.S. at 622.

7. *Id.* at 651. The Supreme Court rejected the more expansive substantial factor test, in part, because “it might expose securities professionals, such as accountants and lawyers, whose involvement is only the performance of their professional services, to § 12(1) [now § 12(a)(1)] strict liability for rescission. The buyer does not, in any meaningful sense, ‘purchas[e] the security from’ such a person.”

8. See, e.g., *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124 (2d Cir. 1989).

9. See, e.g., *Moore v. Kayport Package Express*, 885 F.2d 531, 536 (9th Cir. 1989).

10. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

11. *Id.* at 173-80; see also *Ziemba v. Cascade Int’l, Inc.*, 256 F.3d 1194 (11th Cir. 2001).

12. See *Cent. Bank of Denver*, 511 U.S. at 191. The Supreme Court in *Central Bank* stated: The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities market are always free from liability under the Securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met.

Id.; see also *Rubin v. Shottenstein, Zox & Dunn*, 143 F.3d 263 (6th Cir. 1998); *Trust Co. of La. v. N.N.P. Inc.*, 104 F.3d 1478 (5th Cir. 1997); *Kline v. First W. Gov’t Sec., Inc.*, 24 F.3d 480 (3d Cir. 1994).

13. See authorities cited *infra* note 18.

14. *Id.*; see also MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW § 8.08 (3d ed. 2001):

Certain important exceptions [to the preemption of class actions involving nationally traded securities] exist, . . . thereby preserving state securities and common law in those situations. For example, derivative actions may be pursued under state law. State law also may be invoked in suits challenging the conduct of a subject issuer, any of its affiliates, or affected corporate fiduciaries with respect to specified actions—namely, going-private transactions,

The potential effect of SLUSA is that, outside of the derivative suit and merger and acquisition settings,¹⁵ complainants in class actions cannot invoke state securities and common law remedies.¹⁶ Hence, the parameters of federal laws normally confine attorney liability exposure in class actions involving nationally-traded securities.¹⁷

Nevertheless, unless preempted by SLUSA,¹⁸ plaintiffs frequently prefer the state court forum.¹⁹ While attorney liability under the federal securities laws has received close attention in both the courts and legal literature,²⁰ attorneys' exposure under the state securities laws remains relatively uncertain.²¹ Consequently, the limited but significant risks that attorneys face when complainants seek to invoke the state securities laws warrant an examination of counsel's liability under these state regimes.²²

This article surveys and analyzes attorney liability under state securities law. After presenting a succinct overview of applicable state law in Part II, the article then provides a more in-depth analysis of attorney liability exposure under these state statutes in Part III. The article concludes in Part IV with separate treatment of two frequently invoked state statutes—those of California and Texas.

II. OVERVIEW OF ATTORNEY LIABILITY UNDER STATE SECURITIES LAW

Perhaps surprisingly, the Uniform Securities Act of 1956 (USA) as interpreted creates a "liability gap" whereby attorneys may not be held liable in

tender offers, mergers, and the exercise of appraisal rights. Importantly, the Uniform Standards Act declines to preempt in any way the authority of the state securities commissions, thereby empowering the states to continue their investigatory and enforcement functions.

Id. at 243.

15. See sources cited *supra* note 14, *infra* note 18.

16. *Id.*

17. See, e.g., *In re Enron Corp. Sec. Litig.*, 235 F. Supp. 2d 549 (S.D. Tex. 2002). Note that individual actions seeking relief under state law or the federal Securities Act may continue to be brought in state courts. See authorities cited *supra* notes 14, *infra* note 18.

18. The Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998). See generally Lisa L. Casey, *Shutting the Doors to State Court: The Securities Litigation Uniform Standards Act of 1998*, 27 SEC. REG. L.J. 141 (1999); David M. Levine & Adam C. Pritchard, *The Securities Litigation Uniform Standards Act of 1998: The Sun Sets on California's Blue Sky Laws*, 54 BUS. LAW. 1 (1998); Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1 (1998).

19. See Marc I. Steinberg, *State Securities Laws: A Panacea for Investors?*, 22 SEC. REG. L.J. 53 (1994).

20. See, e.g., MARC I. STEINBERG, *CORPORATE AND SECURITIES MALPRACTICE* (1992); Douglas M. Branson, *Chasing the Rogue Professional After the Private Securities Litigation Reform Act of 1995*, 50 SMU L. REV. 91 (1996); Ann Maxey, *Competing Duties? Securities Lawyers' Liability After Central Bank*, 64 FORDHAM L. REV. 2185 (1996); Manning G. Warren, *The Primary Liability of Securities Lawyers*, 50 SMU L. REV. 383 (1996).

21. See generally JOSEPH C. LONG, *BLUE SKY LAW* (West Group 2004) (1985).

22. See Marc I. Steinberg, *The Ramifications of Recent U.S. Supreme Court Decisions on Federal and State Securities Regulation*, 70 NOTRE DAME L. REV. 489, 505-16 (1995).

private actions under the USA even when they knowingly assist their clients in committing illegal conduct.²³ As such, the scope of “seller” liability is often construed in accordance with the *Pinter* test for “sellers,” thereby ordinarily precluding attorneys from being saddled with primary liability.²⁴ While the USA expressly provides secondary liability for certain enumerated groups, including “agents,”²⁵ attorneys are not *per se* included within these categories. Under this interpretative framework, as long as counsel’s conduct is not such that he could be said to be “soliciting” or “effecting” the transaction, liability would not attach under the USA for a client’s securities law violation even if the attorney knew of, and assisted in, the client’s violation of the state’s securities act.²⁶ Nevertheless, attorneys may expose themselves to “seller” status under the state securities acts when they take an active role in the enterprise or transaction. As a generality, primary liability as a seller under state securities law may attach where the subject attorney would be considered a seller under the *Pinter* test.²⁷ Hence, circumstances may arise where attorneys may be primarily liable under section 10(b) and rule 10b-5, while neither primarily nor secondarily liable under the USA.²⁸

Secondary liability for attorneys under the USA can arise in a number of situations. While the USA expressly provides secondary liability for certain enumerated groups, including “agents,”²⁹ it does not include attorneys *per se* within these categories. Under this interpretative framework, as long as counsel’s conduct is not that of “soliciting” or “effecting” the transaction,

23. See *infra* notes 24, 28, 30, 64, 69-71 and accompanying text; see also CAL. CORP. CODE § 25504.1 (West 2005) (a non-Uniform Securities Act provision):

Any person who materially assists in any violation of Section 25110, 25120, 25130, 25133, or 25401, or a condition of qualification under Chapter 2 (commencing with Section 25110) of Part 2 of this division imposed pursuant to Section 25141, or a condition of qualification under Chapter 3 (commencing with Section 25120) of Part 2 of this division imposed pursuant to Section 25141, or an order suspending trading issued pursuant to Section 25219, with intent to deceive or defraud, is jointly and severally liable with any other person liable under this chapter for such violation.

24. See *infra* note 62.

25. UNIFORM SECURITIES ACT § 410(b) (1956).

26. See *infra* notes 61-64, 69-76 and accompanying text. Depending on the applicable state, liability under the common law (such as for aiding and abetting the primary violator’s breach of fiduciary duty) may attach. See *Laventhol, Krekstein, Horwath & Horwath v. Tuckman*, 372 A.2d 168, 170 (Del. 1976).

27. See Joseph C. Long, *Developments and Issues in Civil Liability Under Blue Sky Law*, 62 U. CIN. L. REV. 439, 443 n.25 (1993).

28. UNIFORM SECURITIES ACT § 410(b) (1956).

29. See, e.g., *CFT Seaside Inv. L.P. v. Hammet*, 868 F. Supp. 836 (D.S.C. 1994) (denying attorney defendant’s motion for summary judgment on § 10(b) and rule 10b-5 claims and granting attorney defendant’s motion for summary judgment on state securities law claims under South Carolina Uniform Securities Act, § 35-1-1490 (primary liability provision; attorneys not sellers), and § 35-1-1500 (secondary liability provision; attorneys not “employees” or “agents”)); see also *Wenneman v. Brown* 49 F. Supp. 2d 1283, 1291 (Utah 1999) (interpreting control person status under § 20(a) of the Exchange Act and Utah § 61-1-22(4)(a) (similar to USA § 410(b)) and allowing motion to dismiss attorneys as control persons, but denying motion to dismiss attorneys as primarily liable under § 10(b) and rule 10b-5).

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liability would not attach under the USA for a client's securities law violation—even if the attorney knew of, and assisted in, the client's violation of the state's securities act.³⁰ When an attorney does become involved in a client's business enterprise, state securities acts provide “status” liability—liability for partners, officers, and directors.³¹ An attorney involved in a client's enterprise as a partner, officer, or director is exposed to liability, not as a result of the attorney's status as counsel, but as a result of the attorney's role as a partner, officer, or director of the subject enterprise.³² Moreover, if an attorney becomes so involved in a client's enterprise that the attorney is deemed a “control person,”³³ the attorney faces liability exposure as a result of that involvement.³⁴ On another front, an attorney working as in-house counsel has potential liability due to the attorney's status as an “employee” of the corporate primary violator.³⁵ While the USA also provides potential liability for “every . . . agent who materially aids in the sale,”³⁶ attorneys generally are not held to be agents for purposes of the USA, unless they do “something more” to “effect” the sale.³⁷ Conceivably, a law firm under the USA could face secondary liability as a “control person” of an affiliated attorney's primary liability,³⁸ and law firm members could also be subject to secondary liability by virtue of being “partners” with the violative lawyer.³⁹

Significantly, several states have not adopted the USA or have modified its provisions.⁴⁰ In these states, attorney liability exposure often depends on more flexible “materially participating or aiding” language contained in the applicable statute. Under these statutes, secondary liability premised on aider principles may be imposed irrespective of the attorney's relationship with the primary violator.⁴¹

30. See *supra* note 26 and accompanying text.

31. Many state securities acts are based on the USA which provides such liability. State courts often have interpreted this liability to be “strict” based on status. See *infra* notes 88-92 and accompanying text.

32. “Status” liability does not generally *per se* include attorneys as an enumerated class of persons subject to liability. However, one can argue that attorneys are subject to status liability as “agents.” This argument has received mixed reactions. See *infra* notes 118-38 and accompanying text.

33. The USA provides for “control person” liability in section 410(b). However, the Act does not define “control person.” State courts generally have applied the federal test for “control person” liability. See *infra* notes 93-102 and accompanying text.

34. See *infra* note 106.

35. The USA provides secondary liability for employees who provide material aid. See UNIFORM SECURITIES ACT § 410(b). Courts have held that the determinative test for whether one is an employee is by reference to common law. See *infra* notes 118-20. As to whether the employee's aid is material, see *infra* notes 148-60 and accompanying text.

36. UNIFORM SECURITIES ACT § 410(b).

37. See, e.g., *Hines v. Data Line Sys., Inc.*, 787 P.2d 8, 20 (Wash. 1990).

38. See *infra* notes 103-12 and accompanying text.

39. See *infra* notes 107-12 and accompanying text.

40. See *infra* notes 52-59, 116-17, 148-60, 166, 184-94, 210-13 and accompanying text.

41. *Id.*

III. ATTORNEY LIABILITY UNDER THE UNIFORM SECURITIES ACT

*A. Primary Liability—Uniform Securities Act**1. Statutory Scheme*

The federal securities acts heavily influenced the Uniform Securities Act, which, in turn, laid the foundation for many of the current state securities acts.⁴² One of the main goals of the USA is to provide uniformity between state and federal securities laws.⁴³ Currently, there are three Uniform Securities Acts (collectively referred to herein as the USA). The most widely adopted is the Uniform Securities Act of 1956 (USA), which thirty-seven jurisdictions have adopted “at one time or another, in whole or in part.”⁴⁴ Nine jurisdictions have adopted the Revised Uniform Securities Act of 1985 (RUSA), in whole or in part.⁴⁵ Seven jurisdictions have enacted the most recent Uniform Securities Act of 2002 (2002 Act), in whole or in part, and several other states are considering its adoption.⁴⁶ Because some jurisdictions have replaced former adoptions with later versions, some version of the USA is in effect in approximately forty states. States that have not adopted some version of the USA include: Arizona, California, Florida, Georgia, Louisiana, New York, North Dakota, Ohio, Tennessee, and Texas.⁴⁷

Civil liability is express under the USA, RUSA, and 2002 Act.⁴⁸ While the

42. UNIFORM SECURITIES ACT § 410(a)(2) cmt. (noting that the clause was nearly identical to § 12(2) [now § 12(a)(2)] of the Securities Act of 1933).

43. UNIFORM SECURITIES ACT § 608 (2002); UNIFORM SECURITIES ACT §§ 704, 803 (1985); UNIFORM SECURITIES ACT § 415 (1956). The introductory comments to the 2002 Act state that it has three overarching themes:

First, Section 608 articulates in greater detail than the 1956 Act Section 415 the objectives of uniformity, cooperation among relevant state and federal governments and self-regulatory organizations, investor protection and, to the extent practicable, capital formation. Section 608 is the reciprocal of the instruction on these subjects given by Congress in 1996 to the Securities and Exchange Commission in Section 19(c) of the Securities Act of 1933. The theme of uniformity and the aspiration of coordination of federal and state securities law is particularly stressed in the Act and Official Comments. Section 602(f), consistent with the Federal Securities Litigation Uniform Standard Act of 1998, is a new provision encouraging reciprocal state enforcement assistance.

UNIFORM SECURITIES ACT § 608 introductory cmt. (2002).

44. UNIFORM SECURITIES ACT prefatory cmt. at 1 (2002).

45. UNIFORM SECURITIES ACT table of jurisdictions (1985).

46. See Uniform Law Commissioners, A Few Facts About the Uniform Securities Act, http://www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-usa.asp (adopted in Idaho, Iowa, Kansas, Missouri, Oklahoma, South Dakota, and the U.S. Virgin Islands).

47. For states that have adopted the 1956 Uniform Securities Act and the 1985 Revised Uniform Securities Act, see Legal Information Institute, Uniform Securities Act, <http://www.law.cornell.edu/uniform/vol7.html#secur> (last visited Apr. 4, 2006).

48. UNIFORM SECURITIES ACT § 410(h) (1956) (the official comments to this section and to § 101 make it clear that it was not intended to create private civil liability for § 101). In the event a particular jurisdiction has not enacted section 410(h), “the courts are split as to whether there is an implied cause of action under Section 101.” LONG, *supra* note 21, at 1:74 n.7 (citing cases). Courts may be influenced

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USA and the 2002 Act contain a provision similar to rule 10b-5,⁴⁹ neither Act provides private civil remedies for its violation.⁵⁰ Fundamentally different, RUSA provides primary liability in private actions based on a violation of a provision substantially similar to rule 10b-5.⁵¹

Some states that have based their securities acts on the USA have modified the USA's liability provisions. For example, some states provide express civil liability for violation of a provision similar to rule 10b-5.⁵² Moreover, a number of states subject "every person who participates or materially aids in the sale" giving rise to primary liability to secondary liability exposure.⁵³ For states that impose civil liability based on a provision that is rule 10b-5's counterpart, a key question is whether the provision is construed similarly to Securities Act section 17(a)(2) and (a)(3),⁵⁴ with respect to which negligence is

to imply a private right of action to protect defrauded sellers, as section 410 only protects defrauded buyers. Some states have modified this language to include defrauded sellers or have added an additional provision. *See* *Carothers v. Rice*, 633 F.2d 7, 10-12 (6th Cir. 1980) (implying a private right of action for defrauded sellers under Kentucky Securities Act, KRS § 292.320(1), Kentucky's version of USA § 101); *see also* Martin C. McWilliams, *Thoughts on Borrowing Federal Securities Jurisprudence Under the Uniform Securities Act*, 38 S.C. L. REV. 243, 270 (discussing the drafter's intent).

Section 509(m) of the 2002 Act expressly states that the Act "does not create a cause of action not specified in this section or Section 411(e)." UNIFORM SECURITIES ACT (2002). Comment 7 to section 501 of the 2002 Act states: "There is no private cause of action, express or implied, under Section 501. Section 509(m) expressly provides that only Section 509 provides a private cause of action for conduct that could violate Section 501." UNIFORM SECURITIES ACT § 501 cmt. 7 (2002).

49. UNIFORM SECURITIES ACT § 101 (1956); UNIFORM SECURITIES ACT § 501 (1985); UNIFORM SECURITIES ACT § 501 (2002):

It is unlawful for a person, in connection with the offer, sale, or purchase of a security, directly or indirectly:

- (1) to employ a device, scheme, or artifice to defraud;
- (2) to make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
- (3) to engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.

50. *See supra* note 48. *See generally* Jeannette Filippone, Comment., *Clearer Skies for Investors: Clearing Firm Liability Under the Uniform Securities Act*, 39 SAN DIEGO L. REV. 1327, 1349 (2002).

51. UNIFORM SECURITIES ACT § 605(a) (1985); *see supra* note 49.

52. *See, e.g.*, GA. CODE ANN. § 10-5-12(a)(2) (2004) (similar to rule 10b-5); civil liability in § 10-5-14(a). Section 10-15-14(c) is substantially similar to USA § 410(b) (providing joint and several secondary liability). *See also* WASH. REV. CODE § 21.20.010 (2005) (similar to rule 10b-5), civil liability is provided in § 21.20.430 (includes primary and secondary liability for purchasers and sellers). Section 21.20.430(3) is substantially similar to USA § 410(b) (providing joint and several secondary liability).

53. *See, e.g.*, OR. REV. STAT. § 59.115(3) (2002); TEX. REV. CIV. STAT. ANN. art. 581-33F(2) (Vernon 2005).

54. 15 U.S.C. § 77q(a)(2)-(3) (2005). Section 17(a) provides:

(a) It shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—

- (1) to employ any device, scheme, or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
- (3) to engage in any transaction, practice, or course of business which operates or would

the requisite mental state for liability,⁵⁵ or interpreted similar to Exchange Act section 10(b) which requires scienter for liability.⁵⁶

The civil liability provisions contained in the USA only protect buyers;⁵⁷ however, the 2002 Act has a parallel provision providing relief to sellers.⁵⁸ In accordance with this change, some states have modified the language of the USA's primary liability provision to apply to both sellers and buyers, and some states have enacted parallel provisions protecting buyers as well as sellers.⁵⁹

The USA sets forth civil liabilities and remedies in section 410. Section 410(a)(1), similar to Securities Act section 12(a)(1), applies when the offer or sale of a security results in a registration violation. Section 410(a)(2) is nearly identical to Securities Act section 12(a)(2) but is more expansive in that it has no prospectus limitation.⁶⁰ Significantly, courts have refused to read such a

operate as a fraud or deceit upon the purchaser.

55. See *Aaron v. SEC*, 446 U.S. 680 (1980). For cases interpreting state law, see, for example, *In re Sahlen & Associates, Inc. Sec. Litig.*, 773 F. Supp. 342, 371 (S.D. Fla. 1991) (interpreting Florida Securities Investors Protection Act (F.S.I.P.A.), Fla. Stat. § 517.211 (providing violations, similar to rule 10b-5) and 517.301 (providing civil remedies for a breach of § 517.211)) ("Stating a cause of action under the F.S.I.P.A. or Florida common law fraud is virtually identical to stating a claim under Rule 10b-5 except that the scienter requirement under Florida law is satisfied by a showing of mere negligence, whereas the minimum showing under Rule 10b-5 is reckless disregard.") (quoting *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1046 (11th Cir. 1987)); *Gohler v. Wood*, 919 P.2d 561, 565 (Utah 1996) (refusing to require a reliance element in actions brought under Utah Uniform Securities Act, § 61-1-22 (similar to USA § 410(a)), and making actionable a violation of § 61-1-22 (similar to rule 10b-5) because, as opposed to the federal implied cause of action "a cause of action under the Utah Act's antifraud provisions has express elements. Consequently, this court has no need to define these elements. Indeed, it would be inappropriate to do so when the legislature has already done so."). See generally Keith A. Rowley, *Muddy Waters, Blue Skies: Civil Liability Under the Mississippi Securities Act*, 70 MISS. L.J. 683 (2000) (analyzing civil liability provisions under the Mississippi Securities Act); Comment., *Proof of Fault in Actions for Securities Fraud: A Cloud in Pennsylvania's Blue Sky*, 46 U. PITT. L. REV. 1083 (1985) (arguing that the Pennsylvania's Securities Act does not require scienter in a civil action brought under a provision similar to rule 10b-5; rather the provision should be interpreted in line with Securities Act § 17(a)).

56. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). For cases interpreting state law, see, for example, *In re Infocure Sec. Litig.*, 210 F. Supp. 2d 1331, 1366 (N.D. Ga. 2002) (interpreting Georgia civil liability provision, Georgia Investor Protection Act, O.C.G.A. § 10-5-12(a)(2)) ("The Georgia Act is similar to Rule 10b-5, and requires the same elements of proof.") (citing *Pelletier v. Zweifel*, 921 F.2d 1465, 1511 (11th Cir. 1991)). See also *In re CINAR Corp. Sec. Litig.*, 186 F. Supp. 2d 279, 322 (E.D.N.Y. 2002) (rejecting aiding and abetting liability under the North Carolina Securities Act, § 78A-8 (substantially similar to rule 10b-5), in light of the Supreme Court's rejection of aiding and abetting liability in § 10(b) and rule 10b-5 claims in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994) (citing *Teague v. Bakker*, 35 F.3d 978 (4th Cir.1994))).

57. UNIFORM SECURITIES ACT § 410(a)(2) (2002).

58. *Id.* The 2002 Act also provides secondary liability for violations of this provision in section 509(g): (g)(1) control person, (g)(2) "managing partner, executive officer, or director of a person liable," (g)(3) "employee of or associated with a person liable," and (g)(4) "broker-dealer, agent, investment adviser, or investment adviser representative that materially aids the conduct giving rise to the liability." § 509(g).

59. See, e.g., PA. STAT. ANN. tit. 70, § 1-501(a) (2005) (seller liable to purchaser), PA. STAT. ANN. tit. 70, § 1-501(b) (2005) (purchaser liable to seller); TEX. REV. CIV. STAT. ANN. art. 581-33A(1)-(2) (Vernon 2005) (seller liable to purchaser), and 581-33B (Vernon 2005) (purchaser liable to seller).

60. UNIFORM SECURITIES ACT § 410(a) official cmts. (2002). Section 410(a)(2) provides:

(a) Any Person who . . .

(2) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the

limitation into the respective state securities acts.⁶¹

2. *Post-Pinter Sellers*

State courts often follow federal interpretations of similarly worded statutes.⁶² Since the USA was based on the federal securities acts, and USA section 410(a)(2) significantly parallels Securities Act section 12(a)(2),⁶³ state courts generally have found the U.S. Supreme Court's decision in *Pinter* persuasive in defining the term "seller" and have rejected more expansive standards, including the "substantial factor" test.⁶⁴ Some state courts, however,

light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission, is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six percent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he no longer owns the security. Damages are the amount that would be recoverable upon a tender less the value of the security when the buyer disposed of it and interest at six percent per year from the date of disposition.

61. See, e.g., *Anheuser-Busch Cos. v. Summit Coffee Co.*, 934 S.W.2d 705, 708 (Tex. App. 1996).

62. See, e.g., *Biales v. Young*, 432 S.E.2d 482, 484 (S.C. 1993) (adopting the *Pinter* test for sellers: "Section 35-1-1490(2) [of the South Carolina Securities Act, S.C. Code 1976 § 35-1-1490(2)] is substantially similar to section 12 of the Federal Securities Act. Accordingly, federal precedent, although not binding, may be applied as guidance in interpretation."); *In re Infocure Sec. Litig.*, 210 F. Supp. 2d at 1364-65 (attorneys are not liable as sellers under North Carolina Securities Act, N.C. Gen. Stat. § 78A-56(a)(2) because it "closely resembles Section 12 of the 1933 Securities Act" so the *Pinter* test applies; attorneys are also not liable as "employees" or "agents" under N.C. Gen. Stat. § 78A-56(c)). *Infocure* interprets Mich. Comp. Laws § 451.810(a)(2) (primary liability provision), as being in line with *Pinter* test for sellers as "Michigan courts have acknowledged interpretation of the federal statute offers valuable guidance as to the interpretation of the state statute." *Id.* at 1365 (citing *Kirkland v. E.F. Hutton & Co.*, 564 F. Supp. 427, 444 (E.D. Mich. 1983)). See also *California Amplifier, Inc. v. RLI Ins. Co.*, 94 Cal. App. 4th 102, 114-15 (Cal. Ct. App. 2001) (stating that "California courts may look to federal statutes for guidance in interpreting a closely analogous state statute"). But see *Siporin v. Carrington*, 23 P.3d 92, 98 (Ariz. Ct. App. 2001):

Although Arizona courts have consistently been guided by the federal courts' interpretation of the 1933 and 1934 federal Acts when applying the Arizona Securities Act, we will not defer to federal case law when, by doing so, we would be taking a position inconsistent with the policies embraced by our own legislature. We will depart from those federal decisions that do not advance the Arizona policy of protecting the public from unscrupulous investment promoters.

See also *FDIC v. First Interstate Bank of Denver*, 937 F. Supp. 1461, 1473 (D. Colo. 1996):

The Colorado Supreme Court once held that federal precedent is persuasive in construing similar language in Colorado securities law. *People v. Riley*, 708 P.2d 1359, 1363 (Colo. 1985). This is no longer the case. Rather, when construing a Colorado securities statute, fundamental principles of statutory construction are employed before resorting to case law regarding similar federal law

Moreover, state courts may find persuasive the interpretations of other states. See *Lehn v. Dailey*, 825 A.2d 140, 147 (Conn. App. Ct. 2003) ("Additionally, because the Connecticut Uniform Securities Act, General Statutes §§ 36b-2 to 36b-33, is a substantial adoption of the major provisions of the 1956 Uniform Securities Act, we may look to interpretations of that act in interpreting analogous language in our own statutes.").

63. See *supra* note 62.

64. Generally, the substantial factor test classified one as a seller if such person was substantially involved in or integrally connected with the subject transaction. See *Hines v. Data Line Sys., Inc.*, 787 P.2d 8, 20 (Wash. 1990). For pre-*Pinter* federal court decisions adopting the substantial factor test, see,

have embraced broader interpretations.⁶⁵ For instance, the Washington Supreme Court declined to adhere to the *Pinter* test for purposes of the Washington Securities Act,⁶⁶ opting for a “substantial contributive factor” test.⁶⁷

For jurisdictions that have adopted the *Pinter* test for sellers, activities that do not expose attorneys to liability as a “seller” under the Securities Act section 12 generally do not subject attorneys to “seller” status under the state securities acts.⁶⁸ Just as in the federal cases, state courts have generally not considered attorneys who solely provide legal services to be sellers.⁶⁹ Thus,

for example, *Davis v. Avco Fin. Servs., Inc.*, 739 F.2d 1057 (6th Cir. 1984); *Croy v. Campbell*, 624 F.2d 709 (5th Cir. 1980).

Adoption by state courts of the *Pinter* test may represent the current prevailing view. See, e.g., *In re Infocure Sec. Litig.*, 210 F. Supp. 2d 1331 (N.D. Ga. 2002) (applying *Pinter* test to South Carolina, North Carolina, Michigan, and Florida); *Meyers v. Lott*, 993 P.2d 609, 613 (Idaho 2000) (adopting the “financial benefit test” of *Pinter*); *Wilson v. Misko*, 508 N.W.2d 238, 248 (Neb. 1993) (“Following *Pinter*, we hold that liability under the Securities Act of Nebraska...extends only to a person who successfully solicits [the] purchase of securities, motivated at least in part by desire to serve his or her own financial interests or those of the securities owner.”); *Biales*, 432 S.E.2d at 169 (adopting *Pinter* approach and stating: “Section 35-1-1490(2) is substantially similar to section 12 of the Federal Securities Act. Accordingly, federal precedent, although not binding, may be applied as guidance in interpretation.”); *Gohler v. Wood*, 919 P.2d 561, 565 (Utah 1996) (stating that UTAH CODE ANN. § 61-1-22(1)(a) requires privity, that no reliance is required, without discussing *Pinter*); *Shavin v. Commonwealth*, 437 S.E.2d 411 (Va. 1993) (applying *Pinter* test for sellers under the Virginia Securities Act); see also Long, *supra* note 27, at 444-46 (discussing acceptance of *Pinter*).

65. Several states apparently have not adopted *Pinter*. See *State ex rel. Mays v. Ridenhour*, 811 P.2d 1220, 1234 (Kan. 1991); *State ex rel. Goettsch v. Diacide Distrib., Inc.*, 561 N.W.2d 369 (Iowa 1997); *Foster v. Jessup & Lamont Sec. Co.*, 482 So. 2d 1201 (Ala. 1986); *Anders v. Dakota Land & Dev. Co.*, 380 N.W.2d 862, 867-68 (Minn. Ct. App. 1980); *Cook v. Pepisco, Inc.*, [1987-1988 Transfer Binder] Blue Sec. L. Rep. (CCH) § 72,694 (Okla. Dist. Ct. 1987); *Price v. Brydon*, 764 P.2d 1370 (1988); *Wade v. Skipper's Inc.*, 915 F.2d 1324, 1327-28 (9th Cir. 1990) (applying Washington law); *Hines v. Data Line Sys., Inc.*, 787 P.2d 8, 20 (Wash. 1990); *Hoffer v. State*, 776 P.2d 963, 964-65 (Wash. 1989); *Haberman v. WPPSS*, 744 P.2d 1032, 1051-52 (Wash. 1988). *But see* Victor v. Thomas White & Co., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 94,548, at p. 93,509 (N.D. Cal. 1989) (interpreting California law, limiting the term “seller” to one who is in privity of contract with the purchaser); *accord* *Admiralty Fund v. Jones*, 677 F.2d 1289, 1296 (9th Cir. 1982) (interpreting California law).

66. *Hoffer v. State*, 776 P.2d 963, 964 (Wash. 1989) (reaffirming position in *Haberman v. Washington Pub. Power Supply Sys.*, 744 P.2d 1032 (Wash. 1987)).

67. *Hines*, 787 P.2d at 20 (Wash. 1990) (quoting *Haberman*, 744 P.2d at 1052):

Factors to be considered in determining whether a defendant's conduct is a substantial contributive factor in the sales transaction include: (1) the number of other factors which contribute to the sale and the extent of the effect which they have in producing it; (2) whether the defendant's conduct has created a force or series of forces which are in continuous and active operation up to the time of the sale, or has created a situation harmless unless acted upon by other forces for which the actor is not responsible; and (3) lapse of time.

68. See, e.g., *In re Infocure Sec. Litig.*, 210 F. Supp. 2d 1331, 1365 (N.D. Ga. 2002) (interpreting Mich. Comp. Laws § 451.810(a)(2) (primary liability provision), in line with *Pinter* test for sellers as “Michigan courts have acknowledged interpretation of the federal statute offers valuable guidance as to the interpretation of the state statute.”) (citing *Kirkland v. E.F. Hutton & Co.*, 564 F. Supp. 427, 444 (D. Mich. 1983)).

69. *Waterside Capital Corp. v. Nat'l Assisted Living*, 2002 WL 31990278, at *3 (Va. Cir. Ct. Sept. 19, 2002):

A law firm representing a securities issuer has no liability if it provides only legal services. If it solicits the sale for its client, it may. The Supreme Court in *Pinter* did not exempt lawyers from liability if they are motivated to serve the financial interests of the issuer of the securities. A law firm representing a securities issuer is vulnerable to allegations of solicitation when it allows its partners to mix their personal interests with their professional

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lawyers have not been deemed sellers for the preparation of offering documents that contained disclosure deficiencies.⁷⁰ Likewise, courts normally do not impose seller status on counsel based on the rendering of legal advice or the issuance of opinion letters.⁷¹

Even under the “substantial contributive factor” test to ascertain “seller” status, “something more” must be established than counsel’s performance of routine advisory drafting and related services.⁷² Accordingly, courts draw a distinction between rendering routine professional services with respect to an offering and actively participating in sale transactions.⁷³ Applying this standard, the Washington Supreme Court held that advice rendered by counsel regarding the materiality of a contemplated disclosure constituted routine legal services.⁷⁴ Because counsel’s services thus were customary professional services and no evidence suggested that counsel participated in the solicitation process, the subject attorneys were not a “substantial contributive factor” and were therefore not deemed “sellers.”⁷⁵

B. Secondary Liability (Status, Control Person, and Aider Liability)—Uniform Securities Acts

The USA provides secondary liability for an enumerated list of persons

responsibilities to the client. When such a law firm goes further and represents both sides of a securities transaction, it makes itself a most tempting target for a former client whose investment has become worthless.

Federal courts likewise hold that attorneys performing their professional services are not liable as “sellers.” See *supra* note 8 and accompanying text.

70. See, e.g., *Baker, Watts & Co. v. Miles & Stockbridge*, 620 A.2d 356 (Md. Ct. Spec. App. 1993). Applying the *Pinter* test to the Maryland Securities Act, MD. CORPS. & ASS’NS CODE ANN. § 11-703(a) (1993), the court held that the defendant law firm’s “preparation of the offering memorandum and [its] fees for services rendered” did not bring the firm within the *Pinter* test for sellers; the law firm did nothing “more than perform its professional services.” *Id.* at 375. The plaintiff (Baker Watts) brought the action for contribution against its attorneys. Baker Watts had earlier been found liable to investors who “alleged that the Confidential Offering Memorandum contained material omissions in violation of section 12(2) of the Securities Act of 1933 and § 11-703(a)(1)(ii) of the Maryland Securities Act.” *Id.* at 362.

71. See, e.g., *In re Infocure Sec. Litig.*, 210 F. Supp. 2d at 1363-64 (applying *Pinter* test for sellers under the South Carolina Uniform Security Act, S.C. CODE ANN. § 35-1-1490(2)):

In this case, [the defendant law firm] did not sell or offer to sell Infocure’s stock to the Medfax Plaintiffs. Although it may have prepared certain documents and even provided an opinion as to facts relevant to the transaction, settled law shows that these acts are insufficient to create liability under Section 1490. To hold otherwise would impose possible liability for every professional in a transactional setting.

See *Ackerman v. Schwartz*, 733 F. Supp. 1231, 1245 (N.D. Ind. 1989) (applying *Pinter* test to for sellers) (“The court believes liability under Section 12 generally requires more active participation in the solicitation than the mere drafting of an opinion letter.” (citing *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 494 (7th Cir. 1986))), *aff’d in part and rev’d in part on other grounds*, 947 F.2d 841 (7th Cir. 1991); see also, *Allyn v. Wortman*, 725 So. 2d 94 (Miss. 1998) (construing California, Florida, Mississippi, and Utah law).

72. *Hines v. Data Sys., Inc.*, 787 P.2d 8, 20 (Wash. 1990).

73. *Id.*

74. *Id.*

75. *Id.*

in section 410(b):

Every person who directly or indirectly controls a seller liable under subsection (a), every partner, officer, or director of such a seller, every person occupying a similar status or performing similar functions, every employee of such a seller who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with and to the same extent as the seller, unless the non-seller who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.⁷⁶

The USA thus sets forth exposure to secondary liability for five groups: (1) control persons; (2) partners, officers, and directors; (3) persons performing similar functions; (4) employees who materially aid; and (5) broker-dealers or agents who materially aid.⁷⁷ These five groups have a “quasi due diligence”⁷⁸ affirmative defense—that they could not have known of “the existence of the facts by which liability” arose if they had exercised reasonable care.⁷⁹ For liability to attach to the first three groups, there is no condition that they provide material aid or otherwise participate in the transaction.⁸⁰

RUSA’s secondary liability provision is similar to that of the USA, except RUSA replaces the term “agent” with “sales representative.”⁸¹ By comparison,

76. UNIFORM SECURITIES ACT § 410(b) (1956).

77. See *Kirchoff v. Selby*, 703 N.E.2d 644, 651 (Ind. 1998) (interpreting Indiana Securities Act. Ind. Code 23-2-1-19(d) (based on UNIFORM SECURITIES ACT § 410(b))).

78. See LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4211-18 (3d ed. 1992) (referring to this defense in the context of Securities Act § 12(a)(2) claims). See generally UNIFORM SECURITIES ACT § 410(b) cmt. (1956):

The defense of lack of knowledge is modeled on § 15 of the Securities Act of 1933, and § 20(a) of the Securities Exchange Act of 1934. The last sentence, with reference to contribution, is a safeguard to avoid the common-law rule which prohibits contribution among joint tort-feasors.

79. See *Conn. Nat’l Bank v. Giacomi*, 699 A.2d 101, 108 (Conn. 1997).

80. See *Kirchoff*, 703 N.E.2d at 651:

As the Court of Appeals held in *Arnold v. Dirrim*, 398 N.E.2d 426 (Ind. Ct. App. 1979), only the fourth and fifth categories require personal participation in the transaction. The statute does not require a partner, officer, director or controlling person to materially aid a violation to be liable. [I]t seems apparent that this statutory provision imposes absolute liability upon the director of a corporation to purchasers of securities sold in violation of the Securities Act based on his position as a director unless he proves the statutory defense. It should be observed that the clause in question [materially aids] obviously relates only to employees of the seller, broker-dealers or agents. *Id.* at 433-34. Other jurisdictions have construed statutes identical to Indiana Code § 23-2-1-19(d) in a similar fashion. See *Moerman v. Zipco, Inc.*, 302 F. Supp. 439 (E.D.N.Y. 1969), *aff’d* 422 F.2d 871 (2d Cir. 1970) (employee must materially aid the sale to be liable but there are no restrictions on the liability of a partner, officer or director); *Foelker v. Kwake*, 568 P.2d 1369 (Or. 1977) (personal participation not necessary to impose liability on officer of corporation); *Mitchell v. Beard*, 513 S.W.2d 905 (Ark. 1974) (an employee, broker or agent must materially aid in the sale before becoming liable, but that requirement is not applicable to a partner); *Rzepka v. Farm Estates, Inc.*, 269 N.W.2d 270 (Mich. Ct. App. 1978) (directors and officers liable where they did not establish statutory defense of lack of knowledge).

81. UNIFORM SECURITIES ACT § 605(d) (1985):

A person who directly or indirectly controls another person who is liable under subsection (a) or (c), a partner, officer, or director of the person liable, a person occupying a similar status or performing similar functions, an employee of the person liable if the employee materially aids

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the 2002 Act contains four separate provisions setting forth secondary liability exposure for different groups: (1) control persons; (2) “managing partner[s], executive officer[s], or director[s] of a person liable;” (3) “employee[s] of or associated with a person liable . . . who materially aid[] the conduct giving rise to the liability;” and (4) “broker-dealer[s], agent[s], investment adviser[s], or investment adviser representative[s] that materially aid[s] the conduct giving rise to the liability.”⁸²

Secondary liability under the state securities acts is derivative: if the seller cannot be held liable, then the non-seller is not liable.⁸³ Consequently,

in the act, omission, or transaction constituting the violation, and a broker-dealer or sales representative who materially aids in the act, omission, or transaction constituting the violation, are also liable jointly and severally with and to the same extent as the other person, but it is a defense that the person did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by which the liability is alleged to exist. With respect to a person who, directly or indirectly, controls another person who is liable under subsection (c), it is also a defense that the controlling person acted in good faith and did not, directly or indirectly, induce the act, omission, or transaction constituting the violation. Contribution among the several persons liable is the same as in cases arising out of breach of contract.

82. UNIFORM SECURITIES ACT § 509(g) (2002) (§ 509(b) is the primary liability provision providing liability for a material misrepresentation or half-truth in the sale of securities, and § 509(c) is a parallel provision providing liability for purchasers):

(g) The following persons are liable jointly and severally with and to the same extent as persons liable under subsections (b) through (f):

(1) a person that directly or indirectly controls a person liable under subsections (b) through (f), unless the controlling person sustains the burden of proof that the person did not know, and in the exercise of reasonable care could not have known, of the existence of conduct by reason of which the liability is alleged to exist;

(2) an individual who is a managing partner, executive officer, or director of a person liable under subsections (b) through (f), including an individual having a similar status or performing similar functions, unless the individual sustains the burden of proof that the individual did not know and, in the exercise of reasonable care could not have known, of the existence of conduct by reason of which the liability is alleged to exist;

(3) an individual who is an employee of or associated with a person liable under subsections (b) through (f) and who materially aids the conduct giving rise to the liability, unless the individual sustains the burden of proof that the individual did not know and, in the exercise of reasonable care could not have known, of the existence of conduct by reason of which the liability is alleged to exist; and

(4) a person that is a broker-dealer, agent, investment adviser, or investment adviser representative that materially aids the conduct giving rise to the liability under subsections (b) through (f), unless the person sustains the burden of proof that the person did not know and, in the exercise of reasonable care could not have known, of the existence of conduct by reason of which liability is alleged to exist.

83. *See, e.g., S.W. Okla. Dev. Auth. v. Sullivan Engine Works, Inc.*, 910 P.2d 1052, 1054 (Okla. 1996) (interpreting 71 OKLA. STAT. § 408(b) (repealed by Laws 2003, c. 347, at 53, eff. July 1, 2004), which provided secondary liability for a violation of section 408(a)):

We find material participants are jointly and severally liable with the seller under the terms of § 408(b) and that “primary liability” need not be adjudged by a court before bringing an action against the material participant or aider. Rather, we conclude that a plaintiff need only show that seller committed the prohibited acts of § 408(a) in its action against the material participant or aider, and may recover damages from the material participant without obtaining a judgment from seller or recovering from seller.

See Summers v. Welltech, 935 S.W.2d 228, 232-33 (Tex. 1996) (It is “[u]nnecessary to join the seller as a party as long as the evidence showed the defendant's control over the seller and a violation of the Securities Act by the seller.”); *Daniel Boone Area Sch. Dist. v. Lehman Bros., Inc.*, 187 F. Supp. 2d 400, 410 (W.D. Pa. 2002) (holding that for a secondary actor to be liable under 70 PA. CONS. STAT.

secondary actors can be liable to the same extent as the primary violator.⁸⁴ States are divided on whether this limitation requires a primary violator to be held liable and whether it requires a plaintiff to bring an action against the primary violator.⁸⁵ As secondary liability is predicated on the existence of a primary violation, non-sellers should arguably be able to assert both the statutory defenses available to non-sellers as well as those provided to sellers.⁸⁶

1. No Participation Required for Liability

a. Status Liability—Partners, Officers, and Directors

Courts have interpreted the USA as imposing liability on partners, officers, and directors, including attorneys who serve as directors,⁸⁷ unless they satisfy the burden of an affirmative defense.⁸⁸ Control person status or the degree of participation does not determine liability for such persons;⁸⁹ rather, status as a

ANN. § 1-503(a) the primary must be adjudicated liable under § 501); *Baker, Watts & Co. v. Miles & Stockbridge*, 620 A.2d 356, 369 (Md. Ct. Spec. App. 1993) (stating that for a control person to be liable under Maryland Securities Act § 11-703(c)(1), a primary violator must be adjudicated liable).

84. UNIFORM SECURITIES ACT § 410(b) (1956).

85. See sources cited *supra* note 83.

86. For example, the Texas Securities Act provides different defenses to the levying of secondary liability than what is provided for primary liability. Compare TEX. REV. CIV. STAT. ANN. art. § 581-33A(2) (Vernon 2005), with § 581-33F.

87. See generally MARC I. STEINBERG, *LAWYERING AND ETHICS FOR THE BUSINESS ATTORNEY* 131-47 (2002); Micalyn S. Harris & Karen L. Valihura, *Outside Counsel as Director: The Pros and Potential Pitfalls of Dual Service*, 53 BUS. LAW. 479 (1998); Susanna M. Kim, *Dual Identities and Dueling Obligations: Preserving Independence in Corporate Representations*, 68 TENN. L. REV. 179 (2001); Committee on Ethics and Professional Responsibility, *Lawyer Serving as Director of Client Corporation*, A.B.A. FORMAL ETHICS OPINION 98-410 (1998) (discussing lawyers serving as directors of client corporations).

88. See *Michelson v. Voison*, 658 N.W.2d 188, 192 (Mich. Ct. App. 2003) (holding officers “clearly liable” under Michigan Uniform Securities Act, M.C.L. § 451.810(b) (based on USA § 410(b)); *Kirchoff v. Selby*, 703 N.E.2d 644, 651 (Ind. 1998) (citing cases); *Taylor v. Perdition Minerals Group, Ltd.*, 766 P.2d 805, 809 (Kan. 1988) (citing cases) (“The states that have passed § 410(b) of the Uniform Securities Act have consistently interpreted the statute to impose strict liability on partners, officers, and directors unless the statutory defense of lack of knowledge is proven.”) (holding K.S.A. 17-1268(b) (Supp. 1987) “is substantially similar to § 410(b) of the Uniform Securities Act, 7B U.L.A. 643 (1958),” *id.* at 806).

Courts sometimes interpret the defense in a similar fashion to the “good faith” defense in the federal securities acts for control persons. See *Dellastatious v. Williams*, 242 F.3d 191 (4th Cir. 2001) (interpreting VA. CODE ANN. § 13.1-522(C) (West 2005) (holding that directors acted reasonably in relying on internal reporting systems and therefore sustained the burden of proof on a “good faith defense”).

89. See *Hines v. Data Sys., Inc.*, 787 P.2d 8, 16-17 (Wash. 1990) (citing *Moerman v. ZIPCO Inc.*, 302 F. Supp. 439 (E.D.N.Y. 1969); *Mitchell v. Beard*, 513 S.W.2d 905 (Ark. 1974); *Taylor v. Perdition Minerals Group Ltd*, 766 P.2d 805 (Kan. 1988); *Rzepka v. Farm States, Inc.*, 269 N.W.2d 270 (Mich. Ct. App. 1978); *Foelker v. Kwake*, 568 P.2d 1369 (Or. 1977)) (applying WASH. REV. CODE § 21.20.430(3) (2005) which is substantially similar to USA § 410(b)).

RCW 21.20.430(3) expressly makes all directors of an issuing corporation liable to the same extent as the seller who violates the State Securities Act, subject to the due diligence defense which each director bears the burden of proving. . . .

The statute clearly does not distinguish between “inside” and “outside” directors, and liability may exist without control person status. While no Washington case directly addresses

partner, officer or director is the basis for liability.⁹⁰ Nonetheless, if a material modification to the structure of the provision is enacted by a subject jurisdiction, a different result may eventuate.⁹¹ For instance, North Dakota refuses to impose status liability in this context, requiring officers or directors to have “participated or aided” in the sale giving rise to the violation.⁹²

b. Control Person Liability

While both the federal securities acts⁹³ and the USA expressly define

the specific language in question, the courts of several other states with Blue Sky laws substantially identical to Washington's have addressed this precise question and have concluded that the plain language should be given its obvious meaning.

90. See *Hines*, 787 P.2d at 16-17; *Steenblik v. Lichfield*, 906 P.2d 872, 879 (Utah 1995) (applying Utah Uniform Securities Act, UTAH CODE ANN. § 61-1-22(2)) (“Ignorance of a particular transaction is not exculpatory because officers and directors are liable if, in the exercise of reasonable care, they could have known.”); sources cited *supra* note 89. The Official Comments to the 2002 Act indicate a continuation of status liability, without a requirement of participation. UNIFORM SECURITIES ACT § 509 cmt. 10 (2002):

Under Section 509(g)(2) partners, officers, and directors are liable, subject to the defense afforded by that subsection, without proof that they aided in the sale. In Section 509(g)(2), the term “partner” is intended to be limited to partners with management responsibilities, rather than a partner with a passive investment.

91. See *Naranjo v. Paull*, 803 P.2d 254, 265 (N.M. Ct. App. 1990) (interpreting, N.M. STAT. ANN. § 58-13-42 (1978) (repealed) (replaced by N.M. STAT. ANN. § 58-13B-40(F), current statute is based on USA § 605 (1985) (citation omitted)):

After stating that every sale of securities made in violation of the Act is voidable at the election of the purchaser, the Act provides, “The person making such sale . . . and every director, officer, salesman or agent of or for such seller who participated or aided in any way in making such sale, shall be jointly and severally liable to such purchaser” There may be sound policy reasons for interpreting the words “participated or aided in any way” broadly in favor of liability. But those words would be deprived of meaning if we held that every director and officer, solely by reason of his or her position, is liable under this provision.

The current version of this provision in the New Mexico Securities Act contains different language not limiting liability for directors and officers by participation. As such it would likely render a different result: A person who directly or indirectly controls another person who is liable under Subsection A, B, C, D or E of this section, a partner, officer or director of the person liable, a person occupying a similar status or performing similar functions, any agent of the person liable, an employee of the person liable if the employee materially aids in the act, omission or transaction constituting the violation and a broker-dealer or sales representative who materially aids in the act, omission or transaction constituting the violation, are also liable jointly and severally with and to the same extent as the other person, but it is a defense that they did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by which the liability exists. Contribution among the several persons liable is the same as in cases arising out of breach of contract. N.M. STAT. ANN. § 58-13B-40(F) (West 2003).

92. North Dakota Securities Act, N.D. CENT. CODE § 10-04-17 (2005): “[E]very director, officer, or agent of or for such seller who shall have participated or aided in any way in making such sale. . . .” See *Narum v. Faxe Foods, Inc.*, 590 N.W.2d 454, 459 (N.D. 1999) (“If corporate securities are sold in violation of the [North Dakota] Securities Act, the corporate directors may incur liability to the purchasers of the securities, irrespective of the care and diligence they exercised, if they participated or aided in any way in making the illegal sales.”).

93. Securities Exchange Act of 1934 § 20(a), 15 U.S.C.A. § 78t(a) (2005):

Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

Securities Act of 1933 § 15, 15 U.S.C.A. § 77o (2005):

Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to

control person liability,⁹⁴ none define the term “control.”⁹⁵ Federal courts generally interpret the different language of the Securities Act’s⁹⁶ and the Exchange Act’s⁹⁷ control person provisions identically. Likewise, federal courts normally construe state securities control person provisions in conformity with the federal interpretations.⁹⁸ Similarly, when the state courts define the term “control,” they generally refer to federal court interpretations.⁹⁹ While these interpretations may differ from the language of the applicable statutes, they promote the coordination of the federal and state securities laws.¹⁰⁰

Under the USA, a control person carries the burden to establish a “good faith” defense.¹⁰¹ For example, in construing the statutory language for control person liability under that state’s securities act, the Washington Supreme Court opined:

[T]he investors need show only that the defendant “directly or indirectly control[led] [the] seller.” The statute does not require the plaintiff to prove that the defendant “culpably participated” in the alleged violation. Instead, the statute clearly shifts the burden onto the defendant to prove that “he or she did not know,

or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 11 or 12 [15 U.S.C. § 77k or 77l of this title], shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

94. See UNIFORM SECURITIES ACT § 410(b) (1956); *supra* note 76 and accompanying text.

95. Federal and state courts have referred to the definition of “control” used by the U.S. Securities and Exchange Commission (SEC). See, e.g., *Neely v. Bar Harbor Bankshares*, 270 F. Supp. 2d 50, 53 (D. Me. 2003) (quoting 17 C.F.R. § 230.405(f) (“control” means “the possession, direct or indirect, of the power to direct or to cause the direction of the management and policies of [an entity], whether through the ownership of voting securities, by contract, or otherwise.”)); *Baker, Watts & Co. v. Miles & Stockbridge*, 620 A.2d 356, 371 (Md. Ct. Spec. App. 1993) (quoting 17 C.F.R. § 230.405). The SEC defines “control” as:

The term “control” (including the terms “controlling,” “controlled by” and “under common control with”) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

17 C.F.R. § 240.12b-2 (2005).

96. 15 U.S.C.A. § 77o (2005); *supra* note 93.

97. See 15 U.S.C. § 78t(a) (2005); *supra* note 93; see, e.g., *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1578 (9th Cir. 1990) (“Although § 15 [of the Securities Act] is not identical to § 20(a) [of the Exchange Act], the controlling person analysis is the same.”).

98. See *supra* note 62.

99. *Baker*, 620 A.2d at 369-72. Federal courts are apt to do so as well. See *Neely*, 270 F. Supp. 2d at 53 (defending “good faith” for Revised Maine Securities Act, 32 ME. REV. STAT. § 10605(3)); *Stat-Tech Liquidating Trust v. Fenster*, 981 F. Supp. 1325, 1337 (D. Colo. 1997) (The language of COLO. REV. STAT.11-51-604(5)(b) [Colorado Securities Act control person provision] is substantially similar to that employed in USA § 20(a) (1934) of the 1934 Act, and federal precedent is persuasive in construing parallel provisions of the Colorado Securities Act.).

100. See *supra* note 43.

101. See *E. Vanguard Forex Ltd. v. Ariz. Corp. Comm’n*, 79 P.3d 86, 99 (Ariz. Ct. App. 2003); *Semrad v. Edina Realty, Inc.*, 493 N.W.2d 528, 532 (Minn. 1992); see also *Metge v. Baehler*, 762 F.2d 621, 631 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057 (1986).

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and in the exercise of reasonable care could not have known” of the liability-producing facts.¹⁰²

c. Attorney Liability Due to Status

An attorney becoming involved in a client’s enterprise as a partner, officer, or director is exposed to liability under the Uniform Securities Act not as a result of the attorney’s status as an attorney but as a result of the attorney’s status as a partner, officer, or director. In this context, attorneys and law firms face potential secondary liability on two different fronts as a result of being a partner, officer, or director of a primary violator, being a control person, or under the doctrine of respondeat superior.¹⁰³ The first situation arises when a

102. *Hines v. Data Sys., Inc.*, 787 P.2d 8, 14 (Wash. 1990) (interpreting RCW 21.20.430(3), rejecting the “culpable participation” test as used in *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 889-890 (3d Cir. 1975)), and noting with approval the analysis of *Metge*, 762 F.2d at 631); see also *Stat-Tech*, 981 F. Supp. at 1337 (interpreting Colorado Securities Act control person provision, COLO. REV. STAT. § 11-51-604(5)(b) (2005)):

In order to establish a prima facie case of control person liability, the plaintiff must present evidence from which a reasonable fact finder could conclude that (a) a primary violation of the securities laws occurred; and (b) the defendant controlled the person or entity committing the primary violation. Once the plaintiff has established a prima facie case of control person liability, the defendant has the burden of showing that it acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

103. A law firm potentially faces imputed liability under *respondeat superior* as a result of a securities law violation committed by its attorney in the ordinary course of business. Note that where a partner of a law firm also serves as an officer or director of a company, the partner “may be acting in both capacities simultaneously where certain business transactions are being conducted.” *Schneider v. CTI Indus. Corp.*, 1987 U.S. Dist. LEXIS 5022, at *5-6 (N.D. Ill. Jan. 20, 1987) (denying defendant law firm’s motion to dismiss for failure to state a claim for law firm’s “vicarious” liability); *In re Rospach Sec. Litig.*, 1991 WL 671073, at *2-3 (W.D. Mich. Nov. 13, 1991) (denying defendant law firm’s motion to dismiss as there is a factual question whether [a partner], in acting as a director, was acting in the ordinary course of [the law firm’s] business or with the authority of his copartners”).

Based on the Exchange Act’s express secondary liability in the form of control person liability, section 20(a), lower federal courts have addressed whether that provision supplants or supplements the doctrine of respondeat superior. See, e.g., *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1576-78 (9th Cir. 1990) (en banc) (“[W]e now join several other circuits in holding that § 20(a) was intended to supplement, and not to supplant, the common law theory of *respondeat superior* as a basis for vicarious liability in securities cases.”). This same issue could emerge in the context of the USA, which provides express secondary liability in greater detail; however, the 2002 Act, for instance, has a “saving provision.” UNIFORM SECURITIES ACT § 509(m) (2002) (“The rights and remedies provided by this [Act] are in addition to any other rights or remedies that may exist, but this [Act] does not create a cause of action not specified in this section or Section 411(e).”). Furthermore, *respondeat superior* may be viewed as qualitatively different than the statutory liability: *respondeat superior* holds “principals or employers vicariously liable for acts of their agents or employees in the scope of their authority or employment.” *Meyer v. Holley*, 537 U.S. 280, 285 (2003); *accord* *FDIC v. First Interstate Bank of Denver, N.A.*, 937 F. Supp. 1461, 1471 (D. Colo. 1996):

Principles of *respondeat superior* impose liability on a corporation as employer for the acts of an employee which have been assigned to her by the employer or if she is doing what is necessarily incidental to her assigned work. Under respondeat superior, an employee’s actions are imputed to the employer.

See also *id.* at 1473 (holding *respondeat superior* applicable under Colorado Securities Act).

Without directly addressing the issue, the Supreme Court arguably assumed the application of *respondeat superior* in federal securities cases. *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 154 (1972) (“The liability of the bank, of course, is coextensive with that of [the bank employees]”); see also Robert A. Prentice, *Conceiving the Inconceivable and Implementing the Preposterous: The Premature Demise of Respondeat Superior Liability Under Section 10(b)*, 58 OHIO

client allegedly is primarily liable either for selling unregistered securities or for selling securities based on a material misrepresentation or half-truth. Client's counsel faces control person liability exposure because counsel allegedly has the ability to ensure that the registration requirements are adhered to and can control the veracity of statements made in the offering document. Accordingly, if the primary violator fails to comply with the registration mandates or to truthfully disclose material information in the offering document, counsel ostensibly has the ability to control such a deficiency. The Washington Supreme Court refused to find attorneys liable as control persons under this rationale.¹⁰⁴ Likewise, federal courts generally decline to hold attorneys liable under this approach for the purposes of the control person provisions of the federal securities laws.¹⁰⁵ However, depending on the circumstances, a law firm may be deemed a controlling person based on its heavy involvement in the corporation's affairs, including law firm counsel serving on the alleged primary violator's board of directors.¹⁰⁶

The second situation in which control person liability exposure arises for a law firm is when an alleged primary violator is a member of the firm. When a law firm attorney commits a primary securities law violation during the course of representing a subject client, the firm is likewise subject to liability

ST. L.J. 1325, 1357 (1997) ("More importantly, the Supreme Court itself has repeatedly decided Section 10(b) and Rule 10b-5 cases where the defendants were entities that could be held liable only on agency principles.") (discussing cases). However, the Supreme Court's decision in *Central Bank* called into question the continued viability of respondeat superior liability in cases brought under section 10(b) of the Exchange Act and rule 10b-5 thereunder. Justice Stevens's dissent noted that the majority's approach "at the very least casts serious doubt . . . on other forms of secondary liability" and lower court decisions that "controlling person" liability supplemented rather than supplanted "respondeat superior and other common-law agency principles. . . ." *Id.* at 201 n.12 (Stevens, J., dissenting). Despite this, *respondeat superior* continues to be applied in federal securities cases. *See, e.g.,* *Seolas v. Bilzerian*, 951 F. Supp. 978 (D. Utah 1997).

104. *Hines*, 787 P.2d at 20-21.

105. *See* *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 494 (7th Cir. 1986) (applying control person provisions of federal securities acts, the law firm's "ability to persuade and give counsel is not the same thing as 'control,' which almost always means the practical ability to direct the actions of the people who issue or sell the securities."). *But see* *Seidel v. Pub. Serv. Co.*, 616 F. Supp. 1342, 1362 (D.N.H. 1985) (rejecting law firm's motion to dismiss and allowing claims under the federal securities acts control person provisions to proceed: "Attorneys fall within the ambit of 'controlling persons' when they are in some sense culpable participants in the acts perpetrated by the controlled person.") (citing *Westlake v. Abrams*, 565 F. Supp. 1330, 1350 (N.D. Ga. 1983); *Westlake v. Abrams*, 504 F. Supp. 337, 349 (N.D. Ga. 1980); *Felts v. Nat'l Account Sys. Assoc., Inc.*, 469 F. Supp. 54, 68 (N.D. Miss. 1978)). It is difficult to perceive that a corporation and its board of directors would not follow the advice of counsel in situations concerning documents to be issued for examination by prospective investors, particularly where such documents bear the imprimatur of expertise on the part of such counsel.

106. *See In re Rospatch Sec. Litig.*, 760 F. Supp. 1239, 1250 (W.D. Mich. 1991) (holding that, where a managing partner was on the board of directors and his law firm "was heavily involved" in the corporation's affairs, the managing partner and law firm had "substantial power to influence" the primary violator and could be control persons for purposes of the federal securities laws); *In re Rospatch Sec. Litig.*, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,939 at 93,981 (W.D. Mich. 1992) ("A jury could reasonably conclude that [the law firm and managing partner] in their role as lawyers exercised effective control of [defendant corporation] for purposes of Section 20.").

exposure.¹⁰⁷ A different issue arises when a member of a law firm engages in business dealings with the subject client. Such business relationships may be viewed as both outside the ordinary course of business of the law firm and not done on behalf of the firm.¹⁰⁸ As such, as a generalization, it should not be sufficient in this setting that a law firm merely controlled a member's practice to impose control person liability on that firm.¹⁰⁹ For instance, in *Semrad v. Edina Realty, Inc.*,¹¹⁰ a real estate broker had an extensive side business dealing in unregistered mortgage-based securities. Absolving the real estate brokerage from liability as a control person for the broker's primary liability under the Minnesota Uniform Securities Act, the court opined: "[W]here the employer is not in the securities business, it would seem inappropriate to find the requisite control based only on the employer's supervision of the employee in carrying out the employer's business."¹¹¹ Another court similarly held that, absent evidence that the defendant law firm "knew or should have known that [the former partner] was selling securities, [the law firm] cannot be held to have 'directly or indirectly control[led]' his actions within the meaning of the statute."¹¹²

2. Participation Required For Liability—Material Aiders

The USA sets forth secondary liability exposure for employees of the seller, broker-dealers, and agents if they materially aid in the sale.¹¹³ For an attorney to be liable under USA section 410(b), an attorney must be a member of these enumerated groups and be deemed to have "materially aid[ed] in the sale."¹¹⁴ In jurisdictions that have adopted this provision without modification,

107. Such liability may be premised on agency principles, partnership law, control person analysis, and respondeat superior doctrine. See, e.g., *Sheinkopf v. Stone*, 972 F.2d 1259, 1268 (1st Cir. 1991); *Hollinger*, 914 F.2d at 1572-78 (9th Cir. 1990) (en banc); *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 185 (3d Cir. 1981).

108. See *Sheinkopf*, 972 F.2d at 1268 ("It is theoretically possible that, even in the absence of an attorney-client relationship, a law firm could be liable for a partner's actions in spheres beyond the practice of law if the firm authorized those actions to be taken on its behalf."). With respect to business transactions between counsel and client, see MODEL RULES OF PROF'L CONDUCT R. 1.8 (2004); Committee on Ethics and Professional Responsibility, *Acquiring Ownership Interest in a Client in Connection with Legal Services*, A.B.A. FORMAL ETHICS OPINION 00-418 (2002) (on acquiring ownership interest in a client connection with legal services); Poonam Puri, *Taking Stock of Taking Stock*, 87 CORNELL L. REV. 99 (2001).

109. See *Sheinkopf*, 972 F.2d at 1265 ("The fact that a person is a lawyer . . . does not mean that every relationship he undertakes is, or reasonably can be perceived as being, in his professional capacity.").

110. 493 N.W.2d 528 (Minn. 1992).

111. *Id.* at 533. Applying the *Metge* test, 762 F.2d at 631 (8th Cir. 1985), to MINN. STAT. ANN. § 80A.23(3), the court opined that "defendants lacked the practical ability to control the activities that constituted [the real estate broker's] securities violations. Consequently, the second prong of the *Metge* test has not been established."

112. *Heath v. Craighill, Rendleman, Ingle & Blythe, PA.*, 388 S.E.2d 178, 183 (N.C. App. 1990).

113. UNIFORM SECURITIES ACT § 410(b) (1956); *supra* note 76 and accompanying text.

114. § 410(b).

an attorney who serves as in-house counsel is subject to liability risk.¹¹⁵

Another key issue is whether attorneys may be liable as “agents” under USA section 410(b). Moreover, in certain states such as Oregon, where the secondary liability provision deviates from the USA by providing liability for “every person who participates or materially aids in the sale,”¹¹⁶ attention may focus on whether an attorney’s normal professional services constitute material aid.¹¹⁷

a. Attorneys Potentially Liable for Providing Material Aid

Attorneys are potentially liable under the USA as material aiders when they, like anyone else, fall into one of the three statutory categories. Section 410(b) provides for secondary liability exposure for employees of the seller, broker-dealers, and agents if they “materially aid” in the sale. Broker-dealers and agents are defined groups under the USA. Status as an employee is determined by reference to common law.¹¹⁸ Normally, in-house counsel is deemed an employee,¹¹⁹ and outside counsel is viewed as an independent contractor, not an employee.¹²⁰

Of these three categories, outside counsel faces the greatest likelihood of

115. Certainly, inside counsel normally are employees of the subject corporation. See Marc I. Steinberg, *The Role of Inside Counsel in the 1990s: A View from Outside*, 49 SMU L. REV. 483, 484-85 (1996).

116. OR. REV. STAT. § 59.115(3) (2005):

Every person who directly or indirectly controls a seller liable under subsection (1) of this section, every partner, limited liability company manager, including a member who is a manager, officer or director of such seller, every person occupying a similar status or performing similar functions, and every person who participates or materially aids in the sale is also liable jointly and severally with and to the same extent as the seller, unless the nonseller sustains the burden of proof that the nonseller did not know, and, in the exercise of reasonable care, could not have known, of the existence of facts on which the liability is based. Any person held liable under this section shall be entitled to contribution from those jointly and severally liable with that person.

“‘Every person,’ as used in that statute, includes attorneys, and no privilege for statements of attorneys who participate or materially aid in an unlawful sale of securities has been recognized by the courts.” *Towery v. Lucas*, 876 P.2d 814, 819 (Or. Ct. App. 1994) (noting that “every person” includes attorneys and that the courts have recognized no privilege for attorneys who participate or materially aid in an unlawful sale of securities) (citing *Prince v. Brydon*, 764 P.2d 1370, 1371-72 (Or. 1988)); *Adams v. Am. W. Sec.*, 510 P.2d 838 (Or. 1973).

117. See *Prince*, 764 P.2d at 1371; *infra* notes 152-60 and accompanying text.

118. See LONG, *supra* note 21, § 9.88, at 449 (citing *Kirchoff*, 703 N.E.2d 644) (defining employee by reference to common law).

119. By reference to common law, in-house counsel, as opposed to outside counsel, would likely be deemed an employee rather than an independent contractor. See *supra* note 120.

120. See *CFT Seaside Inv. L.P. v. Hammet*, 868 F. Supp. 836 (D.S.C. 1994) (granting motion for summary judgment against outside attorney defendants under South Carolina Uniform Securities Act, § 35-1-1500); *Baker, Watts & Co. v. Miles & Stockbridge*, 620 A.2d 356, 373 (Md. App. 1993) (holding defendant law firm was an independent contractor and not an “employee” under the Maryland Securities Act, § 11-703(c)); *Allen v. Columbia Fin. Mgmt., Ltd.*, 377 S.E.2d 352, 356-357 (S.C. Ct. App. 1988) (determining outside attorneys were not “employees” under South Carolina provision similar to USA § 410(b), stating “[t]he principal factor that makes one an employee, or servant, rather than an independent contractor is the right of the employer, or master, to control and direct the particular work or undertaking as to the means or manner of its accomplishment”).

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being considered an agent.¹²¹ Whether attorneys are “agents” *per se* for purposes of the statute is a matter of some dispute.¹²² “Agents” are a defined group in the USA—individuals who effect or attempt to effect securities transactions.¹²³ The prevailing view is that counsel does not meet this definition because counsel does not “effect” the purchase or sale.¹²⁴ Thus, under this approach, attorneys are not “agents” under the USA for drafting disclosures in offering documents¹²⁵ or rendering opinion letters.¹²⁶

Two lines of reasoning support the prevailing view that attorneys who provide their normal professional services are not “agents” under the USA.¹²⁷

121. See *supra* note 118 and accompanying text.

122. See discussion *infra* notes 127-38 and accompanying text. Compare *Powell v. H.E.F. P'ship*, 835 F. Supp. 762, 765 (D. Vt. 1993) (“For purposes of the Vermont Securities Act ‘agent’ is defined as ‘salesman,’ in addition to its ordinary meaning. VT. STAT. ANN. tit. 9, § 4202(1). Plaintiffs are correct in asserting that an attorney acting on behalf of a client does so as the client’s agent.”), with *Arthur Young & Co. v. Mariner Corp.*, 630 So. 2d 1199, 1204 (Fla. Dist. Ct. App. 1994) (“In light of both the legislative purpose and the context of the surrounding body of law into which section 517.211 and ‘agent’ must be integrated, we conclude that its use in this section means to incorporate the common law definition of agency.”).

123. UNIFORM SECURITIES ACT § 401(b) (1956).

124. See *Baker*, 620 A.2d at 368:

Although the definition of “agent” in the state securities laws . . . may vary to differing degrees from the definition in § 11-101(b), they each have one thing in common: they do not impose liability upon an attorney who merely provides legal services or prepares documents for his or her client. To impose liability, the attorney must do something more than act as legal counsel.

See *In re Infocure Sec. Litig.*, 210 F. Supp. 2d 1331, 1366 (N.D. Ga. 2002) (“[I]t is my opinion that attorneys for the seller, who perform duties within the normal ambit of transactional professionals, may not be held liable as an ‘employee’ or ‘agent’ of the seller who materially aided in the sale of securities.” (interpreting secondary liability provision of Michigan Securities Act, MICH. COMP. LAWS § 451.810(b) as similar to USA § 410(b)).

125. See *Baker*, 620 A.2d at 368:

Therefore, we hold that an attorney could conceivably be considered an agent if he or she “represents a broker-dealer or issuer in effecting or attempting to effect the purchase or sale of securities.” In order to be considered an “agent,” an attorney must act in a manner that goes beyond legal representation. The definition of “agent” in § 11-101(b) does not include attorneys who merely provide legal services, draft documents for use in the purchase or sale of securities, or engage in their profession’s traditional advisory functions. To rise to the level of effecting the purchase or sale of securities, the attorney must actively assist in offering securities for sale, solicit offers to buy, or actually perform the sale.

126. See *Ackerman v. Schwartz*, 733 F. Supp. 1231, 1252 (N.D. Ind. 1989), *aff’d in part and rev’d in part on other grounds*, 947 F.2d 841 (7th Cir. 1991) (interpreting secondary liability provision of Indiana Securities Act, IND. CODE § 23-2-1-19(b), attorney and law firm not liable as “agent” as “no evidence suggests that [the attorney] or his firm personally and actively employed the opinion letter to solicit investors. In other words, [the attorney] and his firm cannot be said to have effected or attempted to effect the sale of a security. Liability under the Indiana Securities Act requires something more than the mere drafting of an opinion letter.”).

127. Criticisms of the two approaches include that the first rationale is contrary to the drafters’ intent—the implication of the prefatory phrase “unless the context otherwise requires” to the definitional sections of the three acts. *Arthur Young & Co.*, 630 So. 2d at 1202 (concluding that this prefatory language “permits the court to consider the context of the use of the word ‘agent’ and to reject the statutory definition if it does not fit the context.”); Long, *supra* note 27, at 466 n.157. As to the second analytical approach, it has been noted that it is not entirely inconsistent to apply the common law definition to section 410(b) while not to the section requiring agents to be registered. See *Baker*, 620 A.2d at 167-68, 171. In further support of that proposition could be noted the prefatory phrase to the definitional section, “unless the context otherwise requires,” which would allow flexibility in

The first approach posits that the statutory definition of “agent” controls. Therefore, for an attorney to be an “agent” under the statute, the attorney must “effect” the purchase or sale.¹²⁸ Hence, the scope of the term “agent” encompasses “any individual other than a broker-dealer who represents a broker-dealer or issuer in effecting or attempting to effect purchases or sales of securities. . . .”¹²⁹ For example, in *Johnson v. Colip*,¹³⁰ the court addressed the definition of “agent” in the state’s securities act, reasoning:

[W]hile one must be a common law agent to be an ‘agent’ under the Act, we perceive the Act as containing additional requirements as well. That is, whether [an attorney] is an agent within the meaning of the Act turns on whether he effected or attempted to effect purchases or sales of securities.¹³¹

applying the definitions in different parts of the Act. *Id.*

128. See, e.g., *In re Infocure Sec. Litig.*, 210 F. Supp. 2d at 1364:

As to the agency argument, the South Carolina Uniform Securities Act provides its own definition for the term “agent” as: [A]ny individual, other than a broker-dealer, who represents a broker-dealer or issuer in effecting or attempting to effect purchases or sales of securities A partner, officer or director of a broker-dealer or issuer, or a person occupying a similar status or performing similar functions, is an agent if he or she is within this definition.

S.C. CODE ANN. § 35-1-20(2). The district court in *CFT Seaside* held that this definition does not cover professionals such as attorneys engaged in their traditional advisory functions. *CFT Seaside*, 868 F. Supp. at 844. The definition, instead, “covers persons who assist directly in offering securities for sale, soliciting offers to buy, or performing the sale, but who do not fit the definition of broker-dealer.” *Id.* Nothing in the record here suggests that MM & M stepped outside the bounds of attorneys in a run-of-the-mill merger transaction. It is clear to me that MM & M is not subject to liability under the provisions of Section 1500. The Plaintiffs’ request for summary judgment is denied as to the South Carolina Uniform Securities Act, and the Defendant’s motion is granted.

See also *Kirchoff v. Selby*, 703 N.E.2d 644, 651 (Ind. 1998):

Whether a person is an officer or director, a controlling person, or an employee is a question of fact governed by common law. In contrast, ‘agent’ and ‘broker-dealer’ are defined terms, and the determination of who is an agent or broker-dealer is governed by the statute Accordingly, common law agents for some purposes are not necessarily ‘agents’ as used in the statute.

129. UNIFORM SECURITIES ACT § 401(b) (1956); see also *CFT Seaside Inv. L.P. v. Hammet*, 868 F. Supp. 836 (D.S.C. 1994) (denying motion for summary judgment on § 10(b) and rule 10b-5 claims against attorney defendants; granting motion for summary judgment against attorney defendants under South Carolina Uniform Securities Act, § 35-1-1490 (attorneys not sellers) and § 35-1-1500 (attorneys not “employees” or “agents”)); sources cited *supra* note 128; *infra* notes 130-34 and accompanying text. 130. 658 N.E.2d 575, 577 (Ind. 1995).

131. *Id.* “At issue is whether a genuine issue of material fact exists as to whether [the attorney] was an agent of the other defendants and, if so, whether he “materially aided in the sale of securities herein and was, therefore, liable to plaintiffs under the Act.” *Id.* at 576 (quoting IND. CODE § 23-2-1-19 (2005) (based on USA § 410(b)). The issue arose in the context of an attorney who participated in meetings with prospective investors, and although he drafted the prospectuses alleged to contain material misstatements or omissions, his potential liability arose from his alleged acts to effect sales during the meetings and not his legal work. *Id.* at 576. In affirming the reversal of summary judgment for the defendant-attorney, the court held for purposes of Indiana Code section 410(b):

[A]n attorney is an agent if [his] or her affirmative conduct or failure to act when reasonably expected to do so at a meeting of prospective investors made it more likely than not that the investors would purchase the securities than they would have been without such conduct or failure to act.

Id. at 578. Applying this standard, the Indiana Supreme Court viewed whether the attorney was an agent as “a genuine issue of fact” based on the primary purpose of such attorney’s role:

For example, if when called upon at the meetings, [the attorney Colip] primarily reassured investors that risks about which they expressed concern were unlikely to materialize, such

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The second approach is premised on statutory construction. Since the USA requires “agents,” but not attorneys, to be registered, attorneys cannot be “agents” within the scope of the USA.¹³² Courts sometimes apply both analytical approaches. For instance, in *CFT Seaside Inv. Ltd. Partnership v. Hammet*,¹³³ the court opined:

The definition of “agent” in [South Carolina Uniform Securities Act] § 35-1-20(2) does not include attorneys who merely render legal advice or draft documents for use in securities transactions. The definition covers persons who assist directly in offering securities for sale, soliciting offers to buy, or performing the sale, but who do not fit the definition of broker-dealer. It is not intended to cover professionals such as attorneys engaging in their traditional advisory functions. This is shown by § 35-1-410 which provides: “It is unlawful for any person to transact business in this state as a broker-dealer or agent unless so licensed under this chapter.” Nowhere does Title 35 require attorneys who merely advise persons involved in a securities transaction to be licensed before providing that advice. Nor do the regulations of the South Carolina Secretary of State, Securities Division. . . . Therefore, Defendants are not liable as “agents” under § 35-1-1500.¹³⁴

Substantively consistent with the courts’ use of the statutory definition for

behavior made it more likely than not that the investors would purchase the securities and constituted an attempt to effect a purchase or sale. On the other hand, if Colip’s principal function at the meeting was to either temper the exuberance of the principal promoters (a frequent reason why lawyers are asked to accompany “road shows” promoting new securities’ offerings) or to discuss the technical aspects of the partnership agreement or its tax consequences with counsel for prospective investors (much as would occur in the negotiations in any reasonably sophisticated business transaction), we think these facts are not susceptible to the inference that an attempt to effect the purchase or sale of a security occurred. We hold that a genuine issue of material fact remains as to whether Colip’s affirmative conduct or failure to act when reasonably expected to do so at a meeting with prospective investors made it more likely than not that the investors would purchase the securities and therefore constituted an attempt to effect the purchase or sale of the securities.

Id. at 578-79.

132. *See, e.g., Rendler v. Markos*, 453 N.W.2d 202, 206-07 (Wis. Ct. App. 1990) (interpreting “agent” under the Wisconsin Securities Act, which adopted the USA).

133. 868 F. Supp. at 844.

134. *Id.*; *see also Baker, Watts & Co. v. Miles & Stockbridge*, 620 A.2d 356, 368 (Md. App. 1993) (construing “agent” within Maryland’s version of § 410(b) of the USA, for attorneys (citing MD. CODE ANN. CORPS. & ASS’NS § 11-101(b) (West 2003))) (the operative definition is identical to that of the USA, § 401(a)):

[W]e hold that an attorney could conceivably be considered an agent if he or she “represents a broker-dealer or issuer in effecting or attempting to effect the purchase or sale of securities.” In order to be considered an “agent,” an attorney must act in a manner that goes beyond legal representation. The definition of “agent” in § 11-101(b) does not include attorneys who merely provide legal services, draft documents for use in the purchase or sale of securities, or engage in their profession’s traditional advisory functions. To rise to the level of “effecting” the purchase or sale of securities, the attorney must actively assist in offering securities for sale, solicit offers to buy, or actually perform the sale.

Id. The court reviewed cases construing “agent” in other jurisdictions and found the following:

Although the definition of “agent” in the state securities laws discussed above may vary to differing degrees from the definition in § 11-101(b), they each have one thing in common: they do not impose liability upon an attorney who merely provides legal services or prepares documents for his or her client. To impose liability, the attorney must do something more than act as legal counsel.

Id.

“agent,” RUSA replaces the term “agent” with “sales representative.”¹³⁵ RUSA’s definition of “sales representative” is identical to the USA’s definition of “agent.”¹³⁶ The 2002 Act reverts to the use of the term “agent”¹³⁷ rather than “sales representative.”¹³⁸ Nonetheless, the 2002 Act contains a provision which may encompass outside attorneys. The 2002 Act subjects not only employees to secondary liability exposure but also individuals who are “associated with a person liable.”¹³⁹ It can be argued that the language “an individual who is an employee of or associated with a person liable”¹⁴⁰ covers employees as well as independent contractors. Interestingly, neither the comments nor the definitions of the 2002 Act provide interpretative guidance with respect to this subject. Therefore, attorney liability under this provision remains possible.

b. What Can Be Material Aid?

Reference may be made to the former “substantial factor” test¹⁴¹ under Securities Act section 12. In *Foster v. Jesup & Lamont Securities Co.*,¹⁴² the Eleventh Circuit certified questions to the Alabama Supreme Court regarding Alabama’s blue sky law, including a question regarding the standard for “material aid” in a provision “based almost verbatim on § 410(b) of the

135. UNIFORM SECURITIES ACT § 610(d) (1985).

136. § 101(14).

137. “Agent” is defined in section 102(2) of the 2002 Act similarly to its definition in the USA, except that the 2002 Act no longer provides exclusions in the definition as did the USA. The 2002 Act adds eight exemptions from registration for “agents” while the USA has none. The term “agent” is defined in the 2002 Act as follows:

“Agent” means an individual, other than a broker-dealer, who represents a broker-dealer in effecting or attempting to effect purchases or sales of securities or represents an issuer in effecting or attempting to effect purchases or sales of the issuer’s securities. But a partner, officer, or director of a broker-dealer or issuer, or an individual having a similar status or performing similar functions is an agent only if the individual otherwise comes within the term. The term does not include an individual excluded by rule adopted or order issued under this [Act].

UNIFORM SECURITIES ACT § 102(2) (2002); see Official Comment to the definition of Agent, § 102(2), which states: “An individual whose acts are solely clerical or ministerial would not be an agent under Section 102(2). Cf. Section 402(b)(8). Ministerial or clerical acts might include preparing written communications or responding to inquiries.” § 102(2), official cmt.

138. See *supra* note 82; UNIFORM SECURITIES ACT § 509(g)(4) (2002):

(4) a person that is a broker-dealer, agent, investment adviser, or investment adviser representative that materially aids the conduct giving rise to the liability under subsections (b) through (f), unless the person sustains the burden of proof that the person did not know and, in the exercise of reasonable care could not have known, of the existence of conduct by reason of which liability is alleged to exist.

139. UNIFORM SECURITIES ACT § 509(g)(3) (2002):

(3) an individual who is an employee of or associated with a person liable under subsections (b) through (f) and who materially aids the conduct giving rise to the liability, unless the individual sustains the burden of proof that the individual did not know and, in the exercise of reasonable care could not have known, of the existence of conduct by reason of which the liability is alleged to exist.

140. *Id.*

141. See discussion *supra* notes 62-75 and accompanying text.

142. 482 So. 2d 1201, 1207 (Ala. 1986).

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Uniform Securities Act.”¹⁴³ The Alabama Supreme Court held that “material aid” is a lower standard than the former “substantial factor” test under Securities Act section 12.¹⁴⁴

Although state courts generally find federal court interpretations to be reliable guides when construing similarly worded statutes,¹⁴⁵ the USA specifies who should be held liable and under what conditions liability should attach.¹⁴⁶ Since the federal acts do not define the term “materially aids,” it does not necessarily follow that the federal courts’ usage of the “substantial assistance” or “substantial factor” test should be persuasive to state courts.¹⁴⁷

According to a number of state courts, an attorney’s normal professional services constitute “material aid.”¹⁴⁸ For example, under an Oregon statute

143. *Id.*

144. *Id.* at 1207-08:

Jesup & Lamont’s argument to the effect that its activities must be a “substantial factor” in the sale to Foster is misplaced. It is true that the Eleventh Circuit has held that one may be liable under § 12 of the Securities Act as a seller if his activities are a substantial factor in the sale. It is also true that the Eleventh Circuit here held as a matter of law that Jesup & Lamont’s activities were not a substantial factor in the sale to Foster. That, however, casts no light on the question of whether Jesup & Lamont materially aided the sale within the meaning of the Alabama Act.

Our response to the first question is affirmative. Under the facts of this case, a jury was justified in finding that Jesup & Lamont materially aided the sale to Foster, and it is, therefore, secondarily liable under § 8-6-19(b), ALA. CODE 1975 [(current version at ALA CODE § 8-16-19(c) (Ala. Code 1975))].

See also Conn. Nat’l Bank v. Giacomi, 699 A.2d 101, 122 (Conn. 1997) (interpreting “material aid” within the Connecticut Uniform Securities Act, to have “a natural tendency to influence, or [being] capable of influencing the decision of the purchaser”) (citing CONN. GEN. STAT. (Rev. to 1993) § 36-498(c) (Rev. to 1995), current version at CONN. GEN. STAT. § 36b-29(c)). For another case interpreting the term “materially aid,” see *Kirchoff v. Selby*, 703 N.E.2d 644, 653 n.7 (Ind. 1998):

The standard for “materially aids” under state securities laws has been found by some courts to be different from federal aider and abettor liability. Compare *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799-800 (3d Cir. 1978) (Federal aider and abettor liability requires a showing of (1) existence of a securities law violation by the primary party; (2) knowledge of that violation by the aider and abettor; and (3) substantial assistance by the aider and abettor in the achievement of that violation. Substantial assistance is determined by: (a) the amount of assistance given by the person; (b) the person’s presence or absence at the time of the violation; (c) the person’s relation to the person committing the violation; and (d) the person’s state of mind.), and *Saltzman v. Zern*, 407 F. Supp. 49, 53 (E.D. Pa. 1976) (applying three prong test for federal aider and abettor liability), with Conn. Nat’l Bank v. Giacomi, 699 A.2d 101, 121-122 (Conn. 1997) (Violation of “materially aids” provision requires showing of (1) violation of securities act and (2) material assistance by aider and abettor. Material assistance is aid that has a natural tendency to influence or is capable of influencing the decision of the purchaser.), *Foley v. Allard*, 427 N.W.2d 647, 651 (Minn. 1988) (adopting three-prong federal test for aider and abettor liability but defining substantial assistance in prong three as a substantial causal connection between the culpable conduct of the alleged aider and abettor and the harm to the plaintiff), and *Mendelsohn v. Capital Underwriters Inc.*, 490 F. Supp. 1069, 1084 (N.D. Cal. 1979) (applying substantial causal connection standard to state aider and abettor violation).

145. See *supra* note 62.

146. See *supra* note 48; see also TEX. REV. CIV. STAT. ANN. art. 581 § 33 cmts. (Vernon 2005).

147. See cases cited *supra* note 65.

148. See generally cases cited *supra* note 122 (inferring attorney’s normal professional services constitute material aid); *infra* note 151.

where “every person who participates or materially aids in the sale”¹⁴⁹ may be secondarily liable, counsel’s normal services constitute material aid.¹⁵⁰ Federal case law provides further support in the construction of aiding and abetting liability under section 10(b) prior to *Central Bank*.¹⁵¹

The Oregon Supreme Court in *Prince v. Brydon* distinguished “participates” from “materially aids,” asserting they “are separate concepts, not synonyms.”¹⁵² A person may participate without materially aiding or materially aid without participating.¹⁵³ Essentially, “material aid” encompasses aid that may not “effect” the sale but that makes the sale possible.¹⁵⁴ The court in *Prince* implied that “aids” has the broadest scope practicable and the limitation on a potential aider’s liability is whether the assistance is “material.”¹⁵⁵ “Typing, reproducing, and delivering sales documents may all be essential to a sale, but they could be performed by anyone; it is a drafter’s knowledge, judgment, and assertions reflected in the contents of the documents that are ‘material’ to the sale.”¹⁵⁶ In giving the term “aids” a broad scope and then limiting it with the concept “material,” the *Prince* court rejected the argument that a lawyer is a mere “scrivener.”¹⁵⁷ In this regard, Oregon law normally deems attorneys providing their customary professional services within the

149. See OR. REV. STAT. § 59.115(3) (2003); see *supra* note 116.

150. See generally *infra* text accompanying notes 158-60.

151. See, e.g., *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1126-28 (5th Cir. 1988) (reversing jury verdict that law firm aided and abetted § 10(b) violation), *vacated on other grounds*, 492 U.S. 1104 (1989); *Powell v. H.E.F. P’ship*, 835 F. Supp. 762, 768 (D. Vt. 1993) (denying law firm’s motion to dismiss because firm provided “substantial assistance” in drafting materially misleading documents for purposes of aiding and abetting liability under § 10(b) of the Exchange Act). The *Powell* court also held that the law firm was also an “agent” within the secondary liability provisions of Vermont’s Securities Act and provided “aid” by drafting documents. Even if “material aid” is held to be “substantial assistance,” the court found the standard to be satisfied within aiding and abetting analysis under § 10(b). *Id.* at 765. See *Metge v. Baehler*, 762 F.2d 621, 624-30 (8th Cir. 1985) (applying former aider and abettor liability under § 10(b) and rule 10b-5), *cert. denied*, 474 U.S. 1057 (1986). See generally ALAN R. BROMBERG & LEWIS D. LOWENFELS, *BROMBERG AND LOWENFELS ON SECURITIES FRAUD AND COMMODITIES FRAUD* §§ 7:319-7:323 (2d ed. 2003) (discussing the former “substantial assistance” test in private actions under § 10(b) and rule 10b-5).

152. 764 P.2d at 1371.

153. *Id.*; see Long, *supra* note 27, at 462.

154. See *Filippone*, *supra* note 50, at 1353 (arguing that “material aid” is broader than the substantial factor test for “sellers”); see also Long, *supra* note 27, at 461 (stating the substantial factor test “focuses on the sales activities causing the sale” whereas, aiding “focuses upon activities which do not directly lead to the sale, but make it possible”).

155. *Filippone*, *supra* note 50, at 1354, relying on *Prince v. Brydon*, 764 P.2d 1370, 1371 (Or. 1988).

156. *Prince*, 764 P.2d at 1371.

157. See Gary M. Berne & Neil Bregenzler, *Participants’ Liability Under the Oregon Securities Law After Prince v. Brydon*, 68 OR. L. REV. 885, 895 (1989) (also providing an interesting discussion of the etymology of “scrivener”); see also *Prince v. Brydon*, 748 P.2d 158, 161 (Or. Ct. App.) (“Because defendant only rendered routine legal services to the partnership, he is not liable under ORS 59.115(3) for participating or materially aiding in Brydon’s illegal sale to plaintiff.”), *rev’d en banc*, 764 P.2d 1370 (Or. 1988). *But see* *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991) (stating that the defendant’s law firm merely “paper[ed] the deal”). See generally Keith A. Rowley, *They Toil Not, Neither Do They Spin: Civil Liability Under the Oregon Securities Law*, 37 WILLAMETTE L. REV. 335 (2001).

scope of the provision.¹⁵⁸

Interestingly, comparing a state statute, such as Oregon's, that has a broad secondary liability provision to a state statute that employs a "substantial contributive factor" test to broadly define "seller," the same actions by an

158. *Prince*, 764 P.2d at 1371. Aid or participation may be determined by a factual inquiry; see *Luallin v. Koehler*, 644 N.W.2d 591, 596 (N.D. 2002) ("What constitutes participation or aid in any way in making a sale of securities is determined upon the facts of each case and not by a fixed rule of law."); see also North Dakota Securities Act Civil Remedies, N.D. CENT. CODE § 10-04-17 (2005):

Every sale or contract for sale made in violation of any of the provisions of this chapter, or of any rule or order issued by the commissioner under any provisions of this chapter, shall be voidable at the election of the purchaser. The person making such sale or contract for sale, and every director, officer, or agent of or for such seller who shall have participated or aided in any way in making such sale shall be jointly and severally liable to such purchaser

Prince, 764 P.2d at 1371 (Aid or participation may be determined by a factual inquiry); *Luallin*, 644 N.W.2d at 596 ("What constitutes participation or aid in any way in making a sale of securities is determined upon the facts of each case and not by a fixed rule of law."); *Hogg v. Jerry*, 773 S.W.2d 84, 88 (Ark. 1989) (holding material aid is a question of fact); *Michelson v. Voison*, 658 N.W.2d 188, 192 (Mich. Ct. App. 2003) (holding defendant named as the purchase administrator of unregistered securities provided "material aid" under Michigan Uniform Securities Act, M.C.L. § 451.810(b) (based on USA § 410(b)); *Black & Co. v. Nova-Tech, Inc.*, 333 F. Supp. 468, 472 (D. Or. 1971) (citations omitted):

A person need not have actual knowledge of an illegal securities transaction in order to become a "participant" in such sale. The fact that a defendant did not know, and could not have known, of the illegal quality of a securities transaction, while relevant to the issue of his liability, is not relevant to the issue of his participation. . . . Further, a person may be a "participant" in an illegal securities transaction without having communicated with the purchaser.

It is not disputed that defendant Barton of the Nossaman firm prepared the legal papers necessary for Nova-Tech to complete the sale of its securities. Even if Barton did not know and could not have known of Nova-Tech's failure to register the securities, he was a participant in the sale because, without his assistance, the sale would not have been accomplished.

The other Nossaman defendants argue that they did not have a hand in the preparation of documents, but it is undisputed that the Nossaman firm authorized Nova-Tech to include its name as corporate counsel on Nova-Tech's 1968 and 1969 annual reports. In line with the Oregon court's broad construction of the Blue Sky Law in *Adamson*, I hold that the Nossaman firm's designation on Nova-Tech's published reports as Nova-Tech's corporate counsel is enough, for purposes of ORS 59.115(3) and 59.155, to make the firm's partners "participants" in any unlawful securities transaction in which the annual reports were used for promotional purposes.

Hirata Corp. v. J.B. Oxford & Co., 193 F.R.D. 589, 600 (S.D. Ind. 2000) (denying motion to dismiss claim against clearing brokerage under Indiana Securities Act, § 23-2-1-19, based on § 410(b) of the USA):

Our research of interpretations of other jurisdictions' codifications of § 410 of the Uniform Act leads us to two conclusions: First, those courts interpreting § 410 of the Uniform Act have not applied liability for "materially aiding" to one who merely performed "ministerial functions." See, e.g., *Robertson v. White*, 635 F. Supp. 851 (W.D. Ark. 1986) (interpreting precursor to Arkansas Code § 23-42-10); *Denson v. Bear, Stearns Sec. Corp.*, 682 So. 2d 69, 71 (Ala. 1996) (interpreting Alabama Code § 8-6-19(b)); *Prince v. Brydon*, 764 P.2d 1370, 1372 (Or. 1988) (interpreting Oregon Code § 59.115(3)). Second, the question of whether a party has "materially aided" in a violation of the security code is a question of fact properly to be considered once the parties have had an opportunity to adduce their evidence. See *Denson*, 682 So. 2d at 71; *Hogg v. Jerry*, 773 S.W.2d 84, 88 (Ark. 1989); *Titan Oil & Gas v. Shipley*, 257 Ark. 278, 517 S.W.2d 210, 222 (Ark. 1974); *Metal Tech. Corp. v. Metal Techniques Co.*, 703 P.2d 237, 245 (Or. App. 1985). These two principles do not define all the contours of "material aid" under the Indiana statute, but they suffice to resolve the pending motion.

See also *Black & Co.*, 333 F. Supp. at 472.

attorney may not incur liability in both states. The “substantial contributive factor” test rests largely on tort concepts of causation, while the “materiality” of aid standard focuses more on the nature of the aid.¹⁵⁹ Hence, while routine legal services may not be a “substantial contributive factor,” they may constitute “material aid” as “it is a drafter’s knowledge, judgment, and assertions reflected in the contents of the documents that are ‘material’ to the sale.”¹⁶⁰

This position is eminently sensible. Offering and related disclosure documents normally are essential for inducing investor comfort and closing of transactions. In this context, the attorney is not a mere scrivener. Rather, as a gatekeeper to the consummation of deals, counsel plays an integral role in effectuating adequate disclosure.¹⁶¹

159. See *supra* note 154.

160. *Prince*, 764 P.2d at 1371; see also *Excalibur Oil v. Sullivan*, 616 F. Supp. 458, 467 (N.D. Ill. 1985); *Hogg*, 773 S.W.2d at 88; *Young v. Kwock*, 474 P.2d 285, 287 (Haw. 1970). In *Young*, the Hawaii Supreme Court stated:

[Corporate officer] argues that “aids” means inducing the purchaser to buy and that the facts indicate that she took no part in the “selling” effort. Though some jurisdictions have followed such reasoning, no such restricted interpretation on the liability section seems warranted. The plaintiffs did not allege fraud in the inducement, but rather the sale of unregistered securities. Therefore, not merely the salesmen who induced the purchase but all officers, directors and agents who in any way contributed to the disposition of the securities are liable.

474 P.2d at 287. HAW. REV. STAT. § 485-20 (2003) provides:

Every sale made in violation of this chapter shall be voidable at the election of the purchaser, and the person making the sale and every director, officer, or agent or for the seller, if the director, officer, or agent has personally participated or aided in any way in making the sale, shall be jointly and severally liable . . .

Within the Chapter, HAW. REV. STAT. § 485-25(a)(1)-(3), is modeled on section 101 of the USA, which in turn is modeled on rule 10b-5. Interestingly, the definition section of HAW. REV. STAT. § 485-1 (2003) does not include a definition of the term “agent.”

In *Hines v. Data Line Systems, Inc.*, 787 P.2d 8 (Wash. 1990), the investors appealed a summary judgment in favor of the defendant attorneys which the court of appeals had upheld. The investors brought the action against the attorney defendants under WASH. REV. CODE § 21.20.430 for a violation of WASH. REV. CODE § 21.20.010, a provision similar to SEC rule 10b-5. The civil liability provision, section 21.20.430(1), provides primary liability for sellers, and section 21.20.430(3) provides secondary liability for:

Every person who directly or indirectly controls a seller or buyer [that is primarily liable], every partner, officer, director or person who occupies a similar status or performs a similar function of such seller or buyer, every employee of such a seller or buyer who materially aids in the transaction, and every broker-dealer, salesperson, or person exempt [from registration] who materially aids in the transaction . . .

Id.; § 21.20.430(3).

The Washington State Supreme Court upheld the summary judgment in favor of the attorney defendants on the basis that the attorney defendants’ advice was insufficient “participation in the sales transaction” to rise to the level of being a “substantial contributive factor” sufficient to hold them liable as sellers. *Hines*, 787 P.2d at 19-21. The court further upheld the summary judgment in favor of the attorney defendants with respect to secondary liability on the basis that no issue of material fact was presented that the attorney defendants fit one of the categories necessary for secondary liability. *Id.*

161. See, e.g., *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir. 1964) (stating that “the lawyer’s opinion can be [an] instrument for inflicting pecuniary loss more potent than the chisel or the crowbar”); *SEC v. Nat’l Student Mktg. Corp.*, 457 F. Supp. 682 (D.D.C. 1978) (noting importance of attorney in advising client with respect to disclosures); *In re Fields*, [1972-1973 Transfer Binder] Fed Sec. L. Rep. (CCH) ¶ 79,407, at 83,174-83,175 n.20 (SEC 1973), *aff’d without opinion*, 495 F.2d 1075 (D.C. Cir. 1974) (observing that a securities lawyer “works in his office where he prepares

3. Statutory Havens For Attorneys

By statute, a few states have excluded attorneys who provide their normal professional services from liability as aiders. The Arizona and Ohio statutes, for example, encompass every person who “participated in” the subject transaction¹⁶² but contain language that excludes from liability attorneys who render traditional legal services.¹⁶³ The Florida statute as construed constricts the liability of secondary actors by requiring proof that such persons solicited the transaction.¹⁶⁴ Doing so significantly alleviates secondary liability for attorneys because secondary actors appear to be liable only under circumstances that would cause them to be primarily liable as sellers under the *Pinter* test.¹⁶⁵

prospectuses, proxy statements, opinions of counsel, and other documents that we, our staff, the financial community, and the investing public must take on faith”).

162. ARIZ. REV. STAT. ANN. § 44-2003(A) (West 2004); OHIO REV. CODE ANN. § 1707.43(A) (West 2003) (cited in *Riedel v. Acutote of Colorado*, 773 F. Supp. 1055, 1066 (S.D. Ohio), *aff'd* 947 F.2d 945 (6th Cir. 1991)) (stating that “every person that has participated in or aided the seller in any way in making such sale or contract for sale, are jointly and severally liable to the purchaser”).

163. ARIZ. REV. STAT. ANN. § 44-2003(A) (West 2004) (“No person shall be deemed to have participated in any sale or purchase solely by reason of having acted in the ordinary course of that person’s professional capacity in connection with that sale or purchase.”); OHIO REV. CODE ANN. § 1707.431(A) (West 2005) (insulating attorneys, accountants and engineers “whose performance is incidental to the practice of [such] person’s profession” from being “deemed to have effected, participated in, or aided the seller in any way in making a sale or contract of sale in violation of the [Act]”); *cf.* *Standard Chartered PLC v. Price Waterhouse*, 945 P.2d 317 (Ariz. Ct. App. 1997) (holding accounting firm not liable under statute when it engaged in its normal functions). *See generally* Richard G. Himelrick, *Arizona Securities Fraud Liability: Charting a Non-Federal Path*, 32 ARIZ. ST. L.J. 203 (2000). Note that an attorney can lose the statutory immunity by participating in the sales transaction. *See, e.g.*, *Gerlach v. Wergowski*, 584 N.E.2d 1220, 1223 (Ohio Ct. App. 1989); *Perkowski v. Megas Corp.*, 563 N.E. 2d 378, 379-80 (Ohio Ct. App. 1990). *See generally* Thomas E. Geyer, Michael P. Miglets, & Keith A. Rowley, *Civil Liability and Remedies in Ohio Securities Transactions*, 70 U. CIN. L. REV. 939 (2002).

164. Florida provides secondary liability for “[a]ny person . . . selling a security in violation of § 517.301 and every other director, officer, partner, or agent of or for the seller, if the director, officer, partner, or agent has personally participated or aided in making the sale.” FLA. STAT. ANN. § 517.211(2) (West 2004). Section 301 is nearly identical to rule 10b-5. However, the extent of this apparent secondary liability is limited:

[T]his Court holds that a plaintiff may recover under § 517.211 from either (1) his seller, who he is in privity with, as well as (2) any officer, director, partner or agent of such a seller who has solicited the sale of the securities on his own behalf or on behalf of the seller.

In re Sahlen & Assocs, Inc. Sec. Litig., 773 F. Supp. 342, 372 (S.D. Fla. 1991). “[T]his Court determines that conduct sufficient to constitute solicitation for purposes of § 517.211 liability is similar to that deemed sufficient by the Supreme Court in *Pinter v. Dahl*, [486 U.S. 622 (1988)] to hold one liable as ‘seller’ under § 12(2) of the Securities Act of 1933.” *Id.* at n.40. Therefore, an attorney “must be shown to have provided more than standard legal services to [the primary violator] in order to impose liability as an agent under § 517.211.” *Bailey v. Trenam*, 938 F. Supp. 825, 828 (S.D. Fla. 1996); *see* *Ruben v. Medalie*, 294 So. 2d 403 (Fla. Dist. Ct. App. 1974); *Hughes v. Bie*, 183 So. 2d 281 (Fla. Dist. Ct. App. 1966); *see also* *State v. Williams*, 390 S.E.2d 746 (N.C. App. 1990).

165. *See* cases cited *supra* note 164.

IV. ATTORNEY LIABILITY UNDER MORE “FLEXIBLE” STATE SECURITIES STATUTES

As discussed above, several states have departed from the parameters of the USA with respect to “aider” liability. Pursuant to these statutes, an attorney may be held liable for materially participating in or aiding the primary violation even if the attorney is not an agent, control person, director, employee, officer, or partner of the subject primary violator. Hence, under these statutes, secondary liability based on aider principles may arise regardless of counsel’s relationship with a primary violator.¹⁶⁶

The following discussion covers two such states, California and Texas. In these states, attorney liability exposure departs from the USA, leaving for exploration some significant issues.

A. Texas

Similar to the USA and the federal Securities Act, the Texas Securities Act (TSA) imposes primary liability exposure upon sellers, who sell a security in violation of the TSA’s registration requirements or by means of a material misrepresentation or half-truth.¹⁶⁷ The Act also provides for primary liability exposure for purchasers who buy a security by means of a material misstatement or half-truth.¹⁶⁸ The TSA contains secondary liability provisions for control persons and for material aiders.¹⁶⁹

1. Attorney Liability as “Seller”

Since the 1977 enactment of the current TSA, the Texas Supreme Court has not interpreted the term “seller.” In a decision predating the current statute, the Texas Supreme Court in *Brown v. Cole* interpreted the term “seller” to

166. See *supra* notes 40-41, 52-59, 116-17, 148-60 and accompanying text; *infra* notes 185-94, 210-13 and accompanying text. Other than California and Texas, examples include IOWA CODE ANN. § 502.503 (West 2004); OKLA. STAT. tit. 71, § 408(b) (repealed 2004); OKLA. STAT. tit. 71, § 1-509G(5) (West 2004); OR. REV. STAT. § 59.115(3) (2004).

167. Compare TEX. REV. CIV. STAT. ANN. art. 581-33A (Vernon 2005), with 15 U.S.C.A. § 12(a)(1) (2005), and UNIFORM SECURITIES ACT § 410(a) (1956). See Bromberg, *Civil Liability Under Texas Securities Act §33 (1977) and Related Claims*, 32 S.W.L.J. 867 (1978); Keith A. Rowley, *The Sky Is Still Blue in Texas: State Law Alternatives to Federal Securities Remedies*, 50 BAYLOR L. REV. 99 (1998); Marc I. Steinberg, *The Texas Securities Act: A Plaintiff’s Preferred Route?*, 58 TEX. B.J. 1096 (1995).

168. TEX. REV. CIV. STAT. ANN. art. 581-33B (Vernon 2005).

169. Art. 581-33F(1)-(2) (F(1) for control person, and F(2) for material aiders). With respect to Texas’ enactment of securities legislation since 1913, see Bromberg, *Article in Tribute: Texas Business Organization and Commercial Law—Two Centuries of Development*, 55 SMU L. REV. 83, 99 (2001). The statute was enacted “because ‘numerous corporations . . . are selling . . . stocks throughout this State, many of which are worthless, and . . . the people of this State are being imposed upon by unscrupulous persons selling such worthless stocks. . . .’” (quoting 1912 Tex. Gen. Laws 66, 71). Or, as stated by Professor Bromberg: “The greedy or crooked sold to the greedy or gullible.” *Id.*

include persons who served as “any link in the chain of the selling process.”¹⁷⁰ It is open to debate whether this expansive definition, which by its terms may encompass attorneys rendering traditional services, retains validity under the TSA.

In one restrictive decision a Texas appellate court held that the seller provision in the TSA requires privity.¹⁷¹ On the other hand, a number of Texas appellate courts have indicated a continued acceptance of the *Brown v. Cole* “link in the chain” test.¹⁷² Still, the “link in the chain” standard may be no broader than the “substantial contributive factor” test since its scope may be limited by notions of “but for” causation.¹⁷³

For example, in *Lutheran Brotherhood v. Kidder Peabody & Co.*, the court applied *Brown v. Cole* and held that the subject underwriter was a seller.¹⁷⁴ However, the court ruled on the basis of the underwriter’s role in the preparation of the private placement memorandum and its active solicitation and placement of the securities.¹⁷⁵ *Joachim v. Magids* is the only reported Texas appellate case applying the “link in the chain” test to an attorney draftsman.¹⁷⁶ The court’s decision may be read to exclude an attorney providing customary professional services from being a “link in the chain,” and thereby avoiding seller status because of the application of causation principles.¹⁷⁷ However, the court also may have based its decision on the

170. 291 S.W.2d 704, 708 (Tex. 1956).

171. *Frank v. Bear, Stearns & Co.*, 11 S.W.3d 380 (Tex. App. 2000).

172. See *Texas Capital Sec., Inc. v. Sandefer*, 58 S.W.3d 760, 775 (Tex. Ct. App. 2001) (“The Act applies if the seller is any link in the chain of the selling process.”) (citing *Rio Grande Oil Co. v. State*, 539 S.W.2d 917, 922 (Tex. Ct. App. 1976)); *Lutheran Bhd. v. Kidder Peabody & Co.*, 829 S.W.2d 300, 306 (Tex. Ct. App. 1992), *set aside on other grounds*, 840 S.W.2d 384 (Tex. 1992) (declining to limit sellers to “those who pass title,” citing *Pinter v. Dahl*, 486 U.S. 622 (1989)). Instead, “[a]rticle 581-33A(2) applies if the defendant was any link in the chain of the selling process.”) See also *Pitman v. Lightfoot*, 937 S.W.2d 496, 531 (Tex. Ct. App. 1996) (applying the broad definition in TEX. REV. CIV. STAT. ANN. art. 581-4(E) (Vernon Supp. 1996), the court stated “[m]oreover, one who ‘offers or sells’ a security is not limited to those who pass title”) (citing *Pinter v. Dahl*, 486 U.S. 622 (1988)). For federal court interpretation of the term “seller” under the TSA, see *Huddleston v. Herman & MacLean*, 640 F.2d 534, 551 (5th Cir. 1981) (footnote omitted) (limiting “the TSA to those who are actively engaged in the sale process and prevents it from reaching those who merely participate in preparing an offering”); *Millcreek Associates, L.P. v. Bear, Stearns & Co.*, 205 F. Supp. 2d 664, 676 (W.D. Tex. 2002) (accepting the argument that “the Comments to the 1977 revisions to the Texas Securities Act expressly note that Section 33(a)(2) is a ‘privity’ provision ‘allowing a buyer to recover from his offeror or seller . . .’” (citing the Comment 1997 Amendment to the comments to the Texas Securities Act and *Frank v. Bear, Stearns & Co.*, 11 S.W.3d 380, 382 (Tex. Ct. App. 2000))).

173. See *Brown*, 291 S.W.2d at 709 (Tex. 1956) (“It is clear that but for Brown’s activities and repeated efforts the respondents would not have participated in the transaction.”).

174. 829 S.W.2d at 300.

175. *Id.* at 306-37 (“The Texas Act defines ‘sell’ as any act by which a sale is made, including a solicitation to sell, an offer to sell, or an attempt to sell. Article 581-33(A)(2) applies to a person who ‘offers or sells’ a security. It is undisputed here that the defendant acted as AABC’s agent in the preparation of the PPM’s and in the placement and offering of the bonds. In doing so, it dealt directly with the plaintiffs and was a seller within the meaning of the Act.”).

176. 737 S.W.2d 852 (Tex. App. 1987).

177. *Id.* at 856. The court declined to hold the attorney-draftsman liable as a seller for participating “in the transaction by performing ‘an act by which the sale is made,’ and that he was therefore a ‘link in

attorney defendant's satisfaction of the statutory defense for sellers—that the seller did not know about the disclosure deficiency and could not have known about it in the exercise of reasonable care. The court found no evidence or allegation that the attorney-draftsman was aware of the oral agreement containing the alleged misrepresentation.¹⁷⁸ Furthermore, the court found that the alleged oral agreement was contrary to the advice that the attorney would have given to the seller; in fact, an integral aspect of the stock purchase agreement that the attorney-defendant had drafted contradicted the alleged misrepresentation.¹⁷⁹

2. *Attorney Secondary Liability as Aider*

Significantly the Texas Securities Act (TSA) provides for secondary liability for control persons¹⁸⁰ and material aiders.¹⁸¹ The TSA imposes secondary liability upon control persons who cannot sustain the burden of the “quasi due diligence” defense.¹⁸² Liability pursuant to the TSA also is incurred

the chain of the selling process,’ which made him responsible for his client's actions. . . . The evidence conclusively shows that the appellee acted solely as an attorney-draftsman in the preparation of the stock purchase documents.” *Id.* (citation omitted).

178. *Id.* The facts of the case are as follows: the purchaser bought the company in reliance on an oral representation made by his selling brother, Mortimer, that conflicted with the terms of the stock purchase agreement. As part of the sale, the selling brother orally agreed to the purchasing brother that he would renew his personal guaranty on a line of credit for the business. This oral agreement was not in the stock purchase agreement. After the sale of the company, the selling brother did not renew his personal guaranty on the line of credit for the business. The purchasing brother brought a suit against his selling brother and against the selling brother's attorney as also being a seller. *Id.* at 853-54.

179. *Id.* at 854:

Appellee testified that he had never been told that Mortimer's guaranty was to continue after the sale of Mortimer's stock and that as Mortimer's counsel, appellee would have advised Mortimer against such action. Appellee testified that an “integral part of the agreement” was the understanding that Mortimer would not continue to guaranty the company's obligation at Houston National Bank.

180. TEX. REV. CIV. STAT. ANN. art. 581-33F(1) (Vernon 2005):

A person who directly or indirectly controls a seller, buyer, or issuer of a security is liable under Section 33A, 33B, or 33C jointly and severally with the seller, buyer, or issuer, and to the same extent as if he were the seller, buyer, or issuer, unless the controlling person sustains the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

For case law on control person liability under the TSA, see *Barnes v. Southwest Financial Servs.*, 97 S.W.3d 759, 763 (Tex. Ct. App. 2003); *Hagerty Partners P'ship v. Livingston*, 128 S.W.3d 416, 421 (Tex. Ct. App. 2004); *Texas Capital Securities Management, Inc. v. Sandefer*, 80 S.W.3d 260, 268 (Tex. Ct. App. 2002).

181. TEX. REV. CIV. STAT. ANN. art. 581-33F(2) (Vernon 2005):

A person who directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or the law materially aids a seller, buyer, or issuer of a security is liable under Section 33A, 33B, or 33C jointly and severally with the seller, buyer, or issuer, and to the same extent as if he were the seller, buyer, or issuer.

182. Art. 581-33F(1); art. 581-33F cmt. (stating that “§ 33F is new and derives in part from Uniform Securities Act § 410(b) and U.S. Securities Act § 15 U.S.C.A. § 77o. . . .” Section 33F(1) appears to be primarily derived from section 410(b) of the Uniform Securities Act and section 15 of the Securities Act. Section 33F(2) had no comparable statutory analogue in the federal securities acts and, while based on section 410(b) of the Uniform Securities Act, is broader in that it is not limited to specified persons who materially aid.”). See UNIFORM SECURITIES ACT § 410 (2002).

by anyone who provides material aid with the requisite scienter—“intent to deceive or defraud or with reckless disregard for the truth or the law.”¹⁸³ The ensuing discussion focuses on this latter provision.

The TSA departs from the USA regarding the scope of persons who can be held liable for providing material aid.¹⁸⁴ The differences include: first, the TSA makes potentially liable *anyone* who provides material aid, as opposed to the enumerated persons set forth in section 410(b) of the USA; and second, the TSA requires the plaintiff to prove the defendant’s scienter as opposed to the USA which gives the defendant an affirmative defense of inability to know about the violation through the exercise of reasonable care.¹⁸⁵ The pertinent Texas statute provides:

A person who directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or the law materially aids a seller, buyer, or issuer of a security is liable . . . jointly and severally with the seller, buyer, or issuer, and to the same extent as if he were the seller, buyer, or issuer.¹⁸⁶

Perhaps surprisingly, no Texas court decision has definitively settled whether the rendering of an attorney’s normal services, such as the drafting of an offering document, constitutes “material aid.” Due to the importance that offering and other disclosure documents have on investor decision-making and the closings of deals, attorneys who draft such documents should be deemed “material aiders” to the consummation of purchase and sale transactions given their gatekeeper role.¹⁸⁷

With respect to the requisite elements for aider liability that a plaintiff must establish, a number of Texas courts¹⁸⁸ have adopted the elements of former aider and abettor private liability under Exchange Act section 10(b).¹⁸⁹ Under this standard, a plaintiff must prove:

(1) that a primary violation of the securities laws occurred; (2) that the alleged aider had “general awareness” of its role in this violation; (3) that the actor rendered “substantial assistance” in this violation; and (4) that the alleged aider either a) intended to deceive [the] plaintiff or b) acted with reckless disregard for the truth of

183. TEX. REV. CIV. STAT. ANN. art. 581-33F(2) (Vernon 2005).

184. *Id.*; see cases cited *supra* note 172.

185. TEX. REV. CIV. STAT. ANN. art. 581-33F(2) (Vernon 2005).

186. *Id.*

187. See sources cited *supra* note 161; Fred Zacharias, *Lawyers as Gatekeepers*, 41 SAN DIEGO L. REV. 1387, 1389 (2004) (opining that “[l]awyers are gatekeepers and always have been”).

188. See *Goldstein v. Mortenson*, 113 S.W.3d 769, 776 (Tex. Ct. App. 2003) (citing *Frank v. Bear, Stearns & Co.*, 11 S.W.3d 380, 384 (Tex. Ct. App. 2000)); *Crescendo Invs., Inc. v. Brice*, 61 S.W.3d 465, 472 (Tex. Ct. App. 2001) (citing *Frank v. Bear, Stearns, & Co.*, 11 S.W.3d 380, 384 (Tex. Ct. App. 2000)); *In re Enron Corp. Sec. Litig.*, 235 F. Supp. 2d 549, 568 (S.D. Tex. 2002).

189. *Frank v. Bear, Stearns & Co.*, 11 S.W.3d 380, 384 (Tex. Ct. App. 2000); cases cited *supra* note 188; see also *Akin v. Q-L Investments, Inc.*, 959 F.2d 521, 532 (5th Cir. 1992) (citation omitted) (noting that that liability for material aiding under the TSA would not necessarily be commensurate with aiding and abetting liability under § 10(b) and rule 10b-5: “The Texas Securities Act recognizes on its face, however, that recklessness satisfies the scienter requirements for aider and abettor liability. Section 33F(2) holds liable any person, jointly and severally with the buyer, seller, or issuer, who ‘materially aids’ with ‘reckless disregard’ a violation of Sections 33A, B, or C”).

the representations made by the primary violator.¹⁹⁰

In *Sterling Trust Co. v. Adderley*,¹⁹¹ the Texas Supreme Court examined the requisite intent to hold one who materially aids liable under the Texas Securities Act. The court held that the TSA's requirement of "reckless disregard for the truth or law" signifies that an aider may be liable under that provision "only if it rendered assistance to the [defendant purchaser or] seller in the face of a perceived risk that its assistance would facilitate untruthful or illegal activity by the primary violator."¹⁹² Pursuant to this standard, the plaintiff need not prove that the alleged aider knew of the precise misrepresentation or omission made by the primary violator.¹⁹³ Rather, the aider's subjective awareness of such a primary violator's improper activity is deemed sufficient to establish the requisite intent for the imposition of liability.¹⁹⁴

B. California

California's securities laws¹⁹⁵ define prohibited transactions¹⁹⁶ and provide for a three-tiered civil, administrative, and criminal enforcement system.¹⁹⁷ The illegality of the subject misconduct is generally set forth in section 25401.¹⁹⁸ Separate sections contain private causes of action for the misconduct: section 25501 provides for primary liability for a seller in privity with the buyer,¹⁹⁹

190. *Goldstein*, 113 S.W.3d at 776 (citing *Frank v. Bear, Stearns & Co.*, 11 S.W.3d 380, 384 (Tex. Ct. App. 2000)).

191. 168 S.W.3d 837, 840-43 (Tex. 2005), *rev'g and remanding* 119 S.W.3d 312 (Tex. App. 2003).

192. *Id.* at 837 (interpreting TEX. REV. CIV. STAT. ANN. art. 581-33F(2) (Vernon 2005)).

193. *Id.*

194. *Id.* at 845:

The investors acknowledge that [alleged aider] Sterling may not have known the exact misrepresentations that [the primary violator] Cornelius was making to the investors, but they argue that Cornelius was operating an illegal pyramid scheme. We agree that knowledge of such an illegal scheme, if proven, could support a finding that Sterling acted 'with reckless disregard for the truth or the law' even if Sterling could not have known of the particular misrepresentation made by Cornelius.

195. CAL. CORP. CODE § 25000 (West 2005) (Corporate Securities Law of 1968).

196. *Id.*

197. See *People v. Simon*, 886 P.2d 1271, 1285-86 (Cal. 1995); MARSH & VOLK, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS § 14.02(1) (2d ed. 2003).

198. CAL. CORP. CODE § 25401 (West 2005):

It is unlawful for any purpose for any person to offer or sell a security in this state or buy or offer to buy a security in this state by means of any written or oral communication which includes an untrue statement of a material fact or omits 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.

199. Such liability also is imposed against a buyer in privity with the seller. *Id.*:

Any person who violates Section 25401 shall be liable to the person who purchases a security from him or sells a security to him, who may sue either for rescission or for damages (if the plaintiff or the defendant, as the case may be, no longer owns the security), unless the defendant proves that the plaintiff knew the facts concerning the untruth or omission or that the defendant exercised reasonable care and did not know (or if he had exercised reasonable care would not have known) of the untruth or omission. Upon rescission, a purchaser may

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section 25504 imposes secondary liability upon certain persons,²⁰⁰ section 25504.1 provides for secondary liability for persons who materially assist with the intent to deceive,²⁰¹ and section 25504.2 focuses on liability for professionals in certain situations involving expertised statements contained in offering materials.²⁰²

1. Attorney Primary Liability as Seller

Section 25401 makes the use of a material misrepresentation or half-truth in the purchase or sale of a security illegal, and section 25501 provides primary civil liability for a breach of section 25401.²⁰³ Section 25501 also provides two statutory defenses: that the purchaser knew about the misstatement or half-truth, and that the defendant could not have ascertained the disclosure deficiency through the exercise of reasonable care.²⁰⁴ The provision thus far has been construed to require strict privity between the buyer and seller.²⁰⁵

recover the consideration paid for the security, plus interest at the legal rate, less the amount of any income received on the security, upon tender of the security. Upon rescission, a seller may recover the security, upon tender of the consideration paid for the security plus interest at the legal rate, less the amount of any income received by the defendant on the security. Damages recoverable under this section by a purchaser shall be an amount equal to the difference between (a) the price at which the security was bought plus interest at the legal rate from the date of purchase and (b) the value of the security at the time it was disposed of by the plaintiff plus the amount of any income received on the security by the plaintiff. Damages recoverable under this section by a seller shall be an amount equal to the difference between (1) the value of the security at the time of the filing of the complaint plus the amount of any income received by the defendant on the security and (2) the price at which the security was sold plus interest at the legal rate from the date of sale. Any tender specified in this section may be made at any time before entry of judgment.

200. *Id.*:

Every person who directly or indirectly controls a person liable under Section 25501 or 25503, every partner in a firm so liable, every principal executive officer or director of a corporation so liable, every person occupying a similar status or performing similar functions, every employee of a person so liable who materially aids in the act or transaction constituting the violation, and every broker-dealer or agent who materially aids in the act or transaction constituting the violation, are also liable jointly and severally with and to the same extent as such person, unless the other person who is so liable had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist.

201. *Id.*:

Any person who materially assists in any violation of Section 25110, 25120, 25130, 25133, or 25401, or a condition of qualification under Chapter 2 (commencing with Section 25110) of Part 2 of this division imposed pursuant to Section 25141, or a condition of qualification under Chapter 3 (commencing with Section 25120) of Part 2 of this division imposed pursuant to Section 25141, or an order suspending trading issued pursuant to Section 25219, with intent to deceive or defraud, is jointly and severally liable with any other person liable under this chapter for such violation.

202. *Id.*

203. See, e.g., *In re Activision Sec. Litig.*, 621 F. Supp. 415, 427 (N.D. Cal. 1985) (“Section 25401 prohibits the offer or sale of a security by means of any oral or written communication which contains a materially false or misleading statement. Section 25501 creates the cause of action for a violation of § 25401.”).

204. See *supra* note 195.

205. See, e.g., *SEC v. Seaboard Corp.*, 677 F.2d 1289, 1296 (9th Cir. 1982) (quoting that portion of

If a strict privity approach is applied for determining who is primarily liable as a seller, the scope of persons potentially liable as sellers under California law is narrower than that under the *Pinter* test. The U.S. Supreme Court in *Pinter* crafted a test that includes some non-privity participants within the definition of seller, such as those who solicit the transaction for the vendor's benefit or for their own pecuniary gain. Pursuant to a strict privity regimen, such persons are excluded from primary liability as sellers in California. Under *Pinter*, attorneys performing their customary professional services are not section 12 sellers.²⁰⁶ Additionally, since the California test seems to be even more restrictive than the *Pinter* test, it is unlikely that attorneys providing their traditional professional services will be deemed sellers.²⁰⁷

2. Attorney Secondary Liability as Material Aider

In addition to control person²⁰⁸ and agent (and other status) liability exposure,²⁰⁹ California has broadened the scope of liability through legislative

Cal Corp. Code § 25501 which reads: "Any person who violates Section 25401 shall be liable to the person who purchases a security from him or sells a security to him . . ." *Id.* The court concluded that the statute limits sellers to being the "actual seller" or, put another way by the court, "the literal seller."; accord *In re ZZZZ Best Sec. Litig.*, No. CV 87-3574-RSWL, 1989 U.S. Dist. LEXIS 8083 (C.D. Cal. May 19, 1989); *In re Diasonics Sec. Litig.*, 599 F. Supp. 447, 458-59 (N.D. Cal. 1984).

206. 486 U.S. at 655 (1988), discussed *supra* note 2 and accompanying text.

207. See *Seaboard Corp.*, 677 F.2d at 1296 n.7 (9th Cir. 1982) (dismissing claim against attorney under § 25504.1 as it "was not in force at the time of the sale"; dismissing claim against attorney under section 25501 as the attorney was not the "actual seller"); see also *People v. Yanez*, 35 Cal. Rptr. 2d 867, 876 (Cal. App. 1994) ("[O]f course, an attorney who participates in an illegal offering . . . in a role as offeror or seller, certainly should not be shielded from . . . liability.").

208. CAL. CORP. CODE § 25504 (West 2005); see *supra* note 200; *In re ZZZZ Best Sec. Litig.*, 1994 U.S. Dist. LEXIS 19784, at *43 (C.D. Cal. Oct. 26, 1994):

Section 25504 imposes liability on those who "control" primary violators of Section 25401 (liability for those who offer to sell securities using untrue statement or omission of fact). Like Section 25401 itself, liability under Section 25504 requires a showing of strict privity between the buyer/plaintiff and the controlled seller.

See also *MARSH & VOLK*, *supra* note 197, at § 14.03(4)(c).

209. See CAL. CORP. CODE § 25504; *id.* § 25003(a) ("'Agent' means any individual, other than a broker-dealer or a partner of a licensed broker-dealer, who represents a broker-dealer or who for compensation represents an issuer in effecting or attempting to effect purchases or sales of securities in this state.") (emphasis added) (the emphasized portions are not in the definition of "agent" within § 401(b) of the USA); *Koehler v. Pulvers*, 614 F. Supp. 829, 844 (S.D. Cal. 1985):

Mr. Cheyne (an attorney) does not fall within the umbra of § 25504. That section's standard of care extends to partners, officers, directors, employees, broker-dealers, or agents of an entity issuing nonexempt unqualified securities. As CSCC's attorney, Mr. Cheyne does not fit within the plain meaning of the listed categories.

See also *In re ZZZZ Best Sec. Litig.*, No. CV 87-3574 RSWL, 1990 U.S. Dist. LEXIS 11867, at *72 (C.D. Cal. July 23, 1990) (allowing claim under CAL. CORP. CODE § 1507) (quoting 1 *Witkin California Procedure* § 53, at 73 (3d ed. 1985) ("[An attorney] will usually be the agent of his client in transactions in which he acts for him."). In dismissing the claim against the accountants under this same provision for failure to allege the accountants "represented the corporation in transactions with other parties" the court quoted CAL CIV. CODE § 2295 definition of agent, "one who represents another, called the principal, in dealings with third persons," and said: "There does not appear to be a general presumption of agency for accountants as there is with attorneys probably because an attorney is more likely to represent a client in 'dealings with third persons.'" *In re ZZZZ Best Sec. Litig.*, 1990 U.S. Dist.

action in sections 25504.1 and 25504.2. Section 25504.1, provides: “Any person who materially assists in any violation of Section . . . 25401 . . . with intent to deceive or defraud, is jointly and severally liable with any other person liable under this chapter for such violation.”²¹⁰ Under this provision, an attorney may be held secondarily liable if she intentionally, or perhaps recklessly, “materially assists” a person who violates section 25401.²¹¹ As thus far interpreted, the section requires more than a showing of recklessness.²¹² Hence, as compared to other state statutes with similar provisions, a plaintiff has a more onerous task in proving liability under the California statute.²¹³

3. Attorney Primary Liability as Expert

Liability exposure under section 25504.2 arises when a professional provides an opinion in a prospectus or offering circular used in the offer or sale of a security and that professional consents to be and has been named in such an offering document as having prepared or certified any part of the document, any written report, or any valuation used in connection therewith.²¹⁴ As part of the plaintiff’s prima facie case, both materiality and reliance must be proven.²¹⁵

LEXIS 11867, at *75.

210. CAL. CORP. CODE § 25501.1 (West 2005). Section 25504, which sets forth secondary liability upon certain persons, is contained in *supra* note 200. Note that an attorney who serves as in-house counsel generally is deemed an employee and, hence, may be subject to liability under section 25504. See *supra* notes 114-115 and accompanying text.

211. See *In re ZZZZ Best Sec. Litig.*, 1994 U.S. Dist. LEXIS 19784, at *43 (“Section 25504.1 imposes liability on those who aid and abet a primary Section 25401 violation (liability for those who offer to sell using untrue statements or omissions of fact.)”); *In re ZZZZ Best Sec. Litig.*, 1990 U.S. Dist. LEXIS 11867, at *52 (denying motion by law firm to dismiss claim under CAL. CORP. CODE § 25504.1 to the extent the claims were for actions “undertaken with ‘the intent to deceive or defraud.’”).

212. See *Orloff v. Allman*, 819 F.2d 904, 907-08 (9th Cir. 1987) (allegations of recklessness not sufficient under § 25504.1); *Lubin v. Sybedon Corp.*, 688 F. Supp. 1425, 1453 (S.D. Cal. 1988) (dismissing claim under § 25504.1 against attorneys for failure to plead “material assistance with intent to deceive or defraud”; maintaining the § 25504.2 claim against the attorneys because the plaintiff “alleged facts showing that [the attorneys] provided an offering document upon which the investors relied”); *Bitter v. Borton*, 2002 Cal. App. Unpub. LEXIS 8, at *4, *22 (Cal. App. Apr. 15, 2002) (dismissing claim under § 25504.1 against law firm for issuing a materially misleading opinion letter in an alleged “Ponzi Scheme” for failure to allege the opinion letter was issued “with the intent to deceive or defraud plaintiffs”).

213. See *Pulvers*, 614 F. Supp. at 844:

Liability for the qualification violation, however, does not extend to Mr. Cheyne. Aider and abettor liability under § 25504.1 requires material assistance of the violation “with intent to deceive or defraud.” Plaintiffs failed to prove requisite scienter as to Mr. Cheyne. Similarly, Mr. Cheyne does not fall within the umbra of § 25504. That section’s standard of care extends to partners, officers, directors, employees, broker-dealers, or agents of an entity issuing nonexempt unqualified securities. As CSCC’s attorney, Mr. Cheyne does not fit within the plain meaning of the listed categories.

For state statutes that have a less stringent standard, see *supra* notes 52-59, 116-17, 148-60, 166, 185-94 and accompanying text.

214. CAL. CORP. CODE § 25504.2, quoted *supra* note 202; see *MARSH & VOLK*, *supra* note 197, at § 14.03(4A).

215. CAL. CORP. CODE § 25504.2(a)(2) (West 2005); see *In re ZZZZ Best Sec. Litig.*, 1990 U.S. Dist. LEXIS 11867 (granting motion to dismiss against accountants for failure to allege reliance); *Lubin v. Prudential-Bache Sec., Inc.*, 740 F. Supp. 1460, 1466 (S.D. Cal. 1990) (citing *In re Rexplore, Inc.*

Like Securities Act section 11,²¹⁶ section 25504.2 provides the subject professional with a “reasonable investigation” (or due diligence) defense.²¹⁷

Generally, the scope of liability under section 25504.2 extends only to situations where the California qualification rules require the subject professional’s consent.²¹⁸ The effect is that experts in offerings that are not subject to the California qualification rules normally have no liability exposure under section 25504.2.²¹⁹ Significantly, the statute extends liability only to expertised portions of the prospectus or offering circular. Thus, under California securities law, an attorney who drafts the prospectus or offering circular normally would face potential liability under section 25504.2 only for the attorney’s attributed expertised portions.²²⁰

Regulations adopted by the California Commissioner of Corporations explicitly encompass attorneys as experts.²²¹ The regulations, in fact, contain specific requirements for attorney experts.²²² For example, the rules mandate

Sec. Litig., 685 F. Supp. 1132, 1147 (N.D. Cal. 1988)).

216. 15 U.S.C. § 77k (2004); see *In re Software Toolworks, Inc. Sec. Litig.*, 38 F.3d 1078 (9th Cir. 1994); *Weinberger v. Jackson*, No. C-89-2301-CAL, 1990 U.S. Dist. LEXIS 18394 (N.D. Cal. Oct. 11, 1990); *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968); SEC Rule 176, 17 C.F.R. § 230.176 (2004).

217. CAL. CORP. CODE § 25504.2(b)(1) (West 2005). Another defense available is that what was used in the prospectus or offering statement “did not fairly represent such person’s statement as an expert or was not a fair copy of or extract from such person’s report or valuation as an expert.” *Id.* at 25504.2(b)(2). See *supra* note 202.

218. The Commissioner’s regulations define “written consent” as that required by section 260.504.2.2. That section requires consent when the qualification rules so provide. CAL. CODE REGS. tit. 10, §§ 260.504.2.1(d), 260.504.2.2(a) (2004); MARSH & VOLK, *supra* note 197, at § 14.03(4A)(a); see also *Pulvers*, 614 F. Supp. at 846:

In addition to imposing a standard of care . . . the statute limits potential exposure to the expert who “pursuant to rule of the commissioner [of Corporations] has given written consent to be and has been named in any prospectus.” Cal. Corp. Code, subsection 25504.2(a). The Commissioner’s Rules require that such written consent be filed for any prospectus containing expertised material where the underlying offering is subject to qualification

With Mr. Cheyne’s [the subject attorney’s] consent, his written opinion to the 21-31 limited partnership interests’ exempt status accompanied the private placement memorandum, and his name appeared in the offering prospectus, again, with his consent. No “written consent” was filed with the Commissioner of Corporations, however, precisely because Mr. Cheyne advised that the offering should issue without qualification in an alleged exempt private placement. The Commissioner’s Rules only require the filing of written consent for use of expertised material where the offering is subject to qualification

Mr. Cheyne contends that because no written consent was filed, and because § 25504.2 limits exposure to instances where written consent is filed “pursuant to rule of the commissioner,” he is not liable under that section. His reasoning, however, advances a conclusion which the statute’s drafters did not likely intend. If it were followed, an attorney would never be liable under § 25504.2 where he negligently determined that a written consent need not be filed because he wrongly advised that an offering is exempt. This would preclude attorney liability where the public is most in need of protection.

219. See *Pulvers*, 614 F. Supp. at 846-47; MARSH & VOLK, *supra* note 197, at § 14.03(4A)(a); *supra* note 218.

220. CAL. CORP. CODE § 25504.2(c) (West 1977); MARSH & VOLK, *supra* note 197, at § 14.03(4A)(a).

221. CAL. CODE REGS. tit. 10, § 260.504.2.1 (2004).

222. *Id.* § 260.504.2.2(c)(2); see *Marsh & Volk*, *supra* note 197, at § 14.03(4A)(b)(iv).

the naming and filing of consent from a subject attorney “[w]hen a prospectus or offering circular contains an opinion of counsel as to the legality of the issue,”²²³ or when information is stated to be on “authority from an attorney,”²²⁴ including title opinions.²²⁵ The rules do not require the filing of a written consent on the basis of an attorney being named as representing “the underwriters or selling security holders.”²²⁶

Section 25504.2 evidently is a primary liability provision under which a professional’s potential liability is not derivative of another’s actions but such professional’s own material disclosure inadequacies. Both section 25401 (the general prohibition against material misstatements and half-truths) and section 25504.2 prohibit the use of material misstatements and half-truths in a prospectus or offering circular. The liability provided by section 25504.2, however, is limited to expertised materials and provides its own defenses and standard of liability different than the other liability provisions.²²⁷

V. CONCLUSION

Attorneys face significant liability exposure under the state securities laws. Attorneys can be held primarily liable when they are “sellers” of securities, or under some state statutes, like California, when they are experts. Depending on

223. CAL. CODE REGS. tit. 10 § 260.504.2.2(c)(2)(A) (2004).

224. *Id.* § 260.504.2.2(c)(2)(B).

225. *Id.* § 260.504.2.2(c)(2)(E).

226. *Id.* § 260.504.2.2(c)(2)(C). In its entirety, CAL. CODE REGS. tit. 10 § 260.504.2.2(c)(2) provides:
(2) Attorneys.

(A) When a prospectus or offering circular contains an opinion of counsel as to the legality of the issue, the written consent of the attorney furnishing the opinion must be filed. If any other attorney is also named as having prepared an opinion as to the legality of the issue, the written consent of such other attorney must also be filed, even though the opinion of such attorney is not included in the prospectus or offering circular.

(B) If any information contained in the prospectus, other than referred to above, is stated to be furnished upon the authority of an attorney, such attorney shall be named in the prospectus or offering circular and such attorney’s written consent to being so named shall be filed. Where the same attorney is named with respect to several parts of the prospectus, it is not necessary to file a separate written consent with respect to each such part but the consent filed must be broad enough to cover all matters with respect to which the attorney is named as having acted.

(C) When an attorney is named in a prospectus or offering circular as having acted for the underwriters or selling security holders, no consent will be required by reason of such attorney being named as having acted in such capacity.

(D) When the opinion of one attorney relies upon the opinion of another attorney, the written consent of the attorney who prepared the initial opinion must be filed if such attorney is named in the prospectus or offering circular.

(E) When information, such as the nature of title to properties, is stated in a prospectus or offering circular to be based on an opinion of counsel, the name of the attorney must be disclosed in the prospectus or offering circular and such attorney’s written consent must also be filed. The name of such attorney need not be set forth at the particular place where the information based on his or her opinion is given, provided such attorney is otherwise identified and named elsewhere in the prospectus or offering circular.

227. See MARSH & VOLK, *supra* note 197, at § 14.03(4A)(a); *supra* note 217 and accompanying text.

the applicable jurisdiction and counsel's status relative to the subject client, secondary liability may be incurred. In a number of states, counsel has liability exposure based on materially aiding the primary violator with the requisite intent. In view of the increasing number of actions being instituted against corporate and securities attorneys, future decisions by state courts hopefully will clarify many of the murky issues that await resolution.