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REASSESSING THE SCOPE OF CONDUCT PROHIBITED BY SECTION 10(b) AND THE ELEMENTS OF RULE 10b-5: REFLECTIONS ON SECURITIES FRAUD AND SECONDARY ACTORS

Andrew S. Gold[†]

I. INTRODUCTION

When the Supreme Court decision in *Central Bank, N.A. v. First Interstate Bank, N.A.*¹ rejected aiding and abetting liability for private actions under Section 10(b) of the Securities Exchange Act,² it produced a major upheaval in securities law.³ The *Central Bank* Court upended decades of lower court decisions that recognized aiding and abetting claims,⁴ and engendered substantial scholarly criticism.⁵

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1. 511 U.S. 164 (1994).

2. 15 U.S.C. § 78j (2000); *Central Bank*, 511 U.S. at 191 (rejecting aiding and abetting liability under § 10(b)).

3. See, e.g., Robert A. Prentice, *Locating that "Indistinct" and "Virtually Nonexistent" Line Between Primary and Secondary Liability Under Section 10(b)*, 75 N.C. L. REV. 691, 694-95 (1997) (noting that *Central Bank* "had the potential to effect a sea of change in . . . securities fraud litigation").

4. *Central Bank*, 511 U.S. at 192 n.1 (Stevens, J., dissenting) (citing examples of circuit court decisions from eleven federal circuits). Justice Stevens noted that hundreds of federal court and administrative proceedings recognized aiding and abetting liability prior to the *Central Bank* decision. *Id.* at 192.

5. See, e.g., Alan R. Bromberg, *Aiding and Abetting: Sudden Death and Possible Resurrection*, 27 SEC. & COMMODITIES REG. 133-34, 139-40 (1994); Donald C. Langevoort, *Words From on High About Rule 10b-5, Chiarella's History, Central Bank's Future*, 20 DEL. J. CORP. L. 865, 869 (1995); Prentice, *supra* note 3, at 694-96; James D. Redwood, *Toward a More Enlightened Securities Jurisprudence in the Supreme Court? Don't Bank on It Anytime Soon*, 32 HOUS. L. REV. 3, 6-7 (1995). This is by no means to suggest that the *Central Bank* decision was universally decried, however. See, e.g., Joseph A. Grundfest, *We Must Never Forget that It is an Inkblot We are Expounding: Section 10(b) as Rorschach Test*, 29 LOY. L.A. L. REV. 41, 44 (1995). Cf. Robert S. De Leon, *The Fault Lines Between Primary Liability and Aiding and Abetting Claims Under Rule 10b-5*, 22 J. CORP. L. 723 (1997). Professor Fischel argued, well before *Central Bank* was decided, that its result was required by the Court's earlier jurisprudence. See Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 CAL. L. REV. 80, 82 (1981).

Shortly thereafter, Congress enacted the Private Securities Litigation Reform Act of 1995⁶ (Reform Act), which significantly reworked the pleading requirements for Section 10(b) actions,⁷ and included an extension of the Securities and Exchange Commission's (SEC) enforcement authority to cover aiding and abetting cases.⁸ Several legislators also sought to permit aiding and abetting claims in private causes of action.⁹ The Reform Act, however, did not do so.¹⁰ When Congress passed the Sarbanes-Oxley Act in late 2002,¹¹ the distinction between enforcement and private actions was left intact.¹²

In the lower courts, however, the actual impact of *Central Bank* has been inconsistent.¹³ The *Central Bank* Court stated that secondary actors—for example, a securities issuer's accountant, law firm, or bank—may be primarily liable if all of the elements of securities fraud are met.¹⁴ The Court did not decide when secondary actors meet those elements,¹⁵ and ten years after *Central Bank*, the scope of liability for secondary actors remains unsettled.

High profile cases such as the *Enron* securities litigation have included substantial claims of wrongdoing by accounting firms, lawyers, and underwriters for allegedly engaging in fraudulent acts in conjunction with a securities issuer.¹⁶ Following *Central Bank*, the question is whether such secondary actors qualify for primary liability based on their participation in an issuer's fraud. In misrepresentation cases (on which this article will focus), lower courts have split into two schools of thought. Courts seeking to determine liability generally apply either a "bright

6. See Private Securities Litigation Reform Act of 1995, Pub. L. 104-67, 109 Stat. 737 (1995).

7. See *id.* at 109 Stat. 737-49.

8. See *id.* at 109 Stat. 757.

9. For example, Senator Bryan proposed an amendment designed to permit a private right of action against aiders and abettors. See 141 CONG. REC. S9182 (daily ed. June 27, 1995). For further discussion of legislative efforts to overrule *Central Bank* in the private litigation context, see Broady R. Hodder, Note, *Central Bank v. First Interstate Bank and Its Aftermath: Securities Professionals' Ever-Changing Liabilities*, 39 ARIZ. L. REV. 343, 357-58 (1997).

10. See Pub. L. 104-67, 109 Stat. 757.

11. Sarbanes-Oxley Act of 2002, H.R. 3763, 107th Cong. (2002).

12. See generally *id.* Section 703 of the Sarbanes-Oxley Act directed the SEC to study the conduct of lawyers and accountants in connection with aiding and abetting securities fraud. § 703(a).

13. See De Leon *supra* note 5, at 730-31.

14. See *Central Bank, N.A. v. Interstate Bank, N.A.*, 511 U.S. 164, 191 (1994) (citing Fischel, *supra* note 5, at 107-08).

15. See De Leon, *supra* note 5, at 726-29.

16. See *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 564 (2002).

line” test, which requires the secondary actor to actually make a fraudulent statement relied on by investors, or a “substantial participation” test, which only requires substantial participation in the creation of the issuer's statement.¹⁷

Two recent post-*Central Bank* developments merit particular attention. The SEC, in amicus briefs, has supported a form of the “participation” test, whereby a secondary actor is liable for securities fraud when its participation is such that it can be considered a “co-author” of the issuer's fraudulent statements, even if they are not attributed to the secondary actor itself.¹⁸ As a result, courts may conclude that the SEC's position merits judicial deference if the statute is ambiguous.¹⁹ For example, the *Enron* court apparently deferred to the SEC's interpretation.²⁰

In addition, in *SEC v. Zandford*,²¹ the Supreme Court embraced the entirety of Rule 10b-5,²² including parts (a) and (c), which permit “scheme” and “course of business” liability.²³ A recent proposal suggests that *Zandford* permits a broad reading of primary liability for secondary actors whenever they can be said to participate in a “fraudulent scheme,”²⁴ thus recasting issues of secondary participation in terms of an overarching primary liability. “Scheme” liability would not require a misstatement by a secondary actor to trigger liability.²⁵

The SEC's theory, although an elegant reading of *Central Bank* and Section 10(b), cannot be squared with statutory text as the Supreme

17. See De Leon, *supra* note 5, at 730-31.

18. See generally Amicus Curiae Brief of the Securities and Exchange Commission, *Klein v. Boyd*, 1998 Fed. Sec. L. Rep. (CCH) ¶ 90,136 (3d Cir. 1998), *rehearing en banc granted, judgment vacated* (Mar. 9, 1998) (Nos. 97-1143; 97-1261), available at <http://www.sec.gov/litigation/briefs/klein.txt>.

19. Cf. *Enron*, 235 F. Supp. 2d at 588-89.

20. *Id.* at 588 (“Because § 10(b) expressly delegated rule-making authority to the agency, which it exercised *inter alia* in promulgating Rule 10b-5, this Court accords considerable weight to the SEC's construction of the statute since the Court finds that construction is not arbitrary, capricious or manifestly contrary to the statute.”); *id.* at 589 (citing *United States v. Mead Corp.*, 533 U.S. 218, 229-30 (2001)); *id.* at 590-91 (“This Court finds that the SEC's approach to liability under § 10(b) and Rule 10b-5 is well reasoned and reasonable, balanced in its concern for protection for victimized investors as well as for meritlessly harassed defendants . . .”).

21. 535 U.S. 813 (2002).

22. 17 C.F.R. § 240.10b-5 (2003).

23. See *Zandford*, 535 U.S. at 819.

24. See, e.g., Amicus Curiae Memorandum of the State Attorneys General Relating to Defendant's Motion to Dismiss at 10, *In re Enron Corp. Sec. Litig.*, 235 F. Supp. 2d 549 (2002) (No. H-01-3624).

25. *Zandford*, 535 U.S. at 820.

Court has interpreted it.²⁶ “Co-authors” do not “make” misleading statements unless they communicate the misrepresentation, the statement is attributed to them at the time, or the actual maker of the statement serves as their agent.²⁷ Similarly, the *Zandford* case cannot be used to circumvent *Central Bank* in misrepresentation cases without effectively amending Section 10(b).²⁸ If participation in drafting misrepresentations created primary liability for fraudulent “schemes” or “courses of business,” *Central Bank* would be largely emptied of its meaning.²⁹ The SEC’s theory would unduly expand part (b) of Rule 10b-5, and the proposed application of *Zandford* would unduly expand parts (a) and (c).

Much of the commentary regarding primary liability post-*Central Bank* has explicitly or implicitly taken issue with the Court’s textualism. Yet, if one wishes to determine what *Central Bank* and its predecessor decisions mean for secondary actors, it is necessary to faithfully apply their rationale. The approach of this Article will follow the textualist philosophy applied by the Court in *Central Bank* in determining the scope of primary liability for secondary actors under Section 10(b).

This article concludes that the “bright line” test is the only interpretation of primary liability for secondary actors that is consistent with the reasoning of *Central Bank*, as it is the only test under which investors can be said to rely on statements made by the secondary actor, such that the secondary actor can be said to “use” or “employ” deceptive devices. Although certain forms of participation by secondary actors may meet this test for primary liability—participation as such, they cannot support a primary claim without conflicting with the text of Section 10(b).

Following textualist principles, moreover, *Chevron* deference³⁰ should not apply to the SEC’s interpretation of the scope of conduct prohibited by Section 10(b) in the private cause of action context, even if Section 10(b) were ambiguous as to the type of conduct prohibited. Pursuant to the Supreme Court’s explication of *Chevron* deference in *United States v. Mead Corp.*,³¹ such deference is based on presumed legislative intent to delegate interpretive authority to the relevant agency. As there is no evidence Congress contemplated a private cause of action, let alone delegation to the SEC to develop the bounds of that action, there is inadequate basis for *Chevron* deference. Because a private right of

26. See *infra* text accompanying notes 113-25.

27. See *infra* text accompanying notes 113-25.

28. See *infra* text accompanying notes 126-51.

29. See *infra* text accompanying notes 126-51.

30. See *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

31. 533 U.S. 218 (2001).

action was not originally part of the statute, but was instead created by courts, courts should construe the scope of prohibited conduct narrowly in the private litigation context.

Part II of this Article analyzes *Central Bank* and the lower court decisions that have applied its holding. Part III addresses the SEC's co-authorship test for primary liability. Part IV addresses the impact of *Zandford*. Part V argues for a narrow interpretation of the Section 10(b) private right of action even if the statutory text is considered ambiguous.

II. *CENTRAL BANK* AND LOWER COURT INTERPRETATIONS OF ITS HOLDING

A. *The Central Bank Decision*

Although private actions are frequently brought pursuant to Section 10(b) of the Securities Exchange Act, this provision does not actually prohibit conduct on its own. Section 10(b) authorizes the SEC to set forth rules making it unlawful:

[F]or 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 . . .

To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.³²

Essentially, Section 10(b) is a delegation to the SEC. Pursuant to this provision, in 1942 the SEC adopted Rule 10b-5, which made it unlawful for any person:

- (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.³³

While the Supreme Court has recognized an implied private right of action under Section 10(b) and Rule 10b-5 despite the absence of express

32. 15 U.S.C. § 78j (2000).

33. 17 C.F.R. § 240.10b-5 (2003).

textual support,³⁴ the Court also recognized the lack of evidence that such liability was intended by Congress.³⁵ Neither the text nor legislative history supported an implied private right of action.³⁶ Indeed, there is little to suggest that the SEC intended a private right of action when it drafted Rule 10b-5.³⁷

The existence (or non-existence) of congressional intent to create a private action is significant. The more recent holdings on implied rights of action require a determination that Congress intended a private right of action in order for courts to recognize one.³⁸ Courts may not infer such rights based on common law concepts or public policy.³⁹ No such intent is evident for Section 10(b).⁴⁰ Thus, if the Court were deciding on a blank slate whether Congress had implied a private right of action under Section 10(b) under modern precedent, it is probable that no implied right of action would be found.⁴¹ By the time the Supreme Court recognized a private right of action, decades after it was first implied by lower courts, the existence of the action was so prevalent it was a *fait accompli*.⁴²

34. See *Herman & McLean v. Huddleston*, 459 U.S. 375, 380 (1983) (describing the private right of action as “beyond peradventure”); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976) (describing the action as “well established”); *Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13, n. 9 (1971). The private right of action was first recognized in *Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946).

35. See *Hochfelder*, 425 U.S. at 196 (noting that Section 10(b) “does not by its terms create an express civil remedy for its violation, and there is no indication that Congress, or the Commission when adopting Rule 10b-5, contemplated such a remedy”). See also *Central Bank, N.A. v. Interstate Bank, N.A.*, 511 U.S. 164, 173 (1994) (noting that “determining the elements of the 10b-5 private liability scheme has posed difficulty because Congress did not create a private § 10(b) cause of action and had no occasion to provide guidance about the elements of a private liability scheme”).

36. See *Hochfelder*, 425 U.S. at 196, 201. See also Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961, 978-79 (1994).

37. *Hochfelder*, 425 U.S. at 196. See also Grundfest, *supra* note 36, at 980-81.

38. See *Touche Ross & Co. v. Redington*, 442 U.S. 560, 577-78 (1979); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 15-16 (1979).

39. See *Touche Ross*, 442 U.S. at 578 (“The ultimate question is one of congressional intent, not one of whether this Court thinks it can improve upon the statutory scheme that Congress enacted into law.”); *Transamerica Mortgage Advisors*, 444 U.S. at 15-16 (“The question whether a statute creates a cause of action, either expressly or by implication, is basically a matter of statutory construction.”). For a useful discussion of the evolution in the Court’s thinking on these questions, see Fischel, *supra* note 5, at 91-92.

40. See, e.g., Grundfest, *supra* note 36, at 978-79.

41. See Fischel, *supra* note 5, at 92 (“Since there is no evidence to suggest that Congress intended to create a private remedy under section 10(b), *Touche Ross* and *Transamerica* indicate that none should have been implied by the courts.”).

42. See *supra* note 34, and cases cited therein.

It is against this backdrop that *Central Bank* was decided. The Court reversed a Tenth Circuit ruling that found liability expressly on the basis of aiding and abetting.⁴³ The *Central Bank* Court relied on the absence of any textual reference to “aiding and abetting” in Section 10(b) to preclude such liability under Rule 10b-5, rejecting an implied right of action beyond the primary liability already established by the Court’s precedent.⁴⁴

In approaching the question of whether aiding and abetting liability was available, the *Central Bank* Court divided its precedent into two types of cases: first, cases that determine the scope of conduct prohibited by Section 10(b); and second, cases that interpret the elements of the Rule 10b-5 private liability scheme.⁴⁵

The *Central Bank* Court explained that in those instances where it has determined the elements of Rule 10b-5 for private actions, it has had to infer how the 1934 Congress would have addressed the issue had a 10b-5 action been included expressly in the Securities Exchange Act.⁴⁶ This inference is a natural product of the source of the private action—the

43. See *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994); see also *First Interstate Bank, N.A. v. Pring*, 969 F.2d 891 (10th Cir. 1992).

44. *Central Bank*, 511 U.S. at 176-77.

45. See *id.* at 172. Professor Seligman has taken issue with this distinction, and notes that virtually no lower court had drawn the distinction. See Joel Seligman, *The Implications of Central Bank*, 49 BUS. LAW. 1429, 1431-32 (1994). Seligman also contends that the distinction is based on legal fiction, as “Congress was no more precise in defining the scope of the conduct prohibited by section 10(b) than it was in delineating the elements of a section 10(b) claim.” *Id.* at 1432. Seligman cites the Supreme Court decisions in *Chiarella v. United States* and *Dirks v. SEC*, cases in which the Court turned to analysis from SEC precedent and common law understandings to fill in a text which was silent respecting the details of prohibited conduct. See *id.* However, such examples are not necessarily inconsistent with a holding that courts should not go beyond the text to *expand* the scope of prohibited conduct beyond what is textually prohibited. Cf. Fischel, *supra* note 5, at 93-94 n.81, explaining:

Reliance on the common law in *Chiarella* . . . was necessary to flesh out the scope of prohibited conduct under the ‘manipulative or deceptive’ practice language of § 10(b). It lends no support to the analysis in secondary liability cases where conduct has been prohibited under various common law doctrines without regard to whether such conduct was prohibited by the statute.

Id. Having concluded that the text of Section 10(b) only covered fraud, the *Chiarella* Court refused to expand Section 10(b) to cover other conduct. If Justice Kennedy’s citation to *Central Bank* in *Chiarella* arguably oversimplified the degree to which the Court has historically relied on text alone in interpreting the scope of conduct prohibited by Section 10(b), the basic premise that where the scope of conduct is concerned one may not exceed textual limits is still plausible, even if extratextual sources are necessary to fill in that text. See *Central Bank*, 511 U.S. at 174 (“We stated that ‘the 1934 Act cannot be read more broadly than its language and the statutory scheme reasonably permit’ . . .”) (citing *Chiarella*, 445 U.S. at 234). Filling in textual imprecision and expanding the text’s scope are distinct endeavors.

46. See *Central Bank*, 511 U.S. at 173.

private right of action was never expressly included in the Securities Exchange Act but rather found by implication.⁴⁷ The text on this subject, not surprisingly, has gaps.

In contrast, where the issue is the scope of conduct prohibited by Section 10(b), the *Central Bank* Court explained that “the text of the statute controls.”⁴⁸ Thus, while a private plaintiff may sue under Section 10(b), it “may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b).”⁴⁹ The aiding and abetting claim fell under this scope of conduct line of precedent, where congressional silence is dispositive.⁵⁰ Essentially, the issue for the Court was whether to imply an additional private right of action that Congress apparently had not intended, this time for assisting fraud.⁵¹

Once the Court settled on a textualist approach, its reasoning led ineluctably to a denial of aiding and abetting liability. The Court noted that the language of Section 10(b) “does not in terms mention aiding and abetting.”⁵² It further noted that Congress was perfectly capable of imposing aiding and abetting liability expressly, as it had done in other

47. *See id.*

48. *Id.*

49. *Id.* Technically, the language of Section 10(b) does not prohibit any conduct, except insofar as Rule 10b-5 does so. Section 10(b) creates liability based on actions “in contravention of such rules and regulations as the [SEC] may prescribe.” 15 U.S.C. § 78j(b) (2000). Nevertheless, Section 10(b) is not without content. For example, certain limitations on the breadth of Rule 10b-5, such as a scienter requirement for Rule 10b-5 actions, have been found in the text of Section 10(b). *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). *See also Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 472-73 (1977) (pointing out that Section 10(b) only extends to cases involving manipulative or deceptive conduct). This precedent addresses the conduct “covered” by Section 10(b). *Cf. Central Bank*, 511 U.S. at 175. For a theory that Section 10(b) was originally intended to give the SEC very broad power to regulate the securities markets, see generally Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385 (1990).

50. *See Central Bank*, 511 U.S. at 172-77.

51. It is evident that cases recognizing the implied right of action and *Central Bank* are in tension, although the different results can be harmonized. As Professor Fischel remarked regarding aiding and abetting:

In fact, the case for focusing solely upon congressional intent in analyzing secondary liability, and not upon tort law or any other common law doctrine, is even more compelling than in the implied remedies context. Implying a private remedy to redress violations of a statute requires recognition of a cause of action even though none has been expressly created by Congress. The conduct of the defendant, however, *has* been expressly prohibited by Congress. The question of secondary liability, in contrast, involves expanding the scope of prohibited conduct under a statute.

Fischel, *supra* note 5, at 93.

52. *Central Bank*, 511 U.S. at 175.

statutes.⁵³ Because the text did not provide for aiding and abetting liability, none was available.⁵⁴ The congressional silence meant that secondary liability was not part of the statute.⁵⁵

In reaching its holding, the *Central Bank* Court concluded that its reading of the text would not reach a bizarre result.⁵⁶ Subsequent legislative events reinforce this conclusion.⁵⁷ The Reform Act, by extending SEC enforcement actions to cover aiding and abetting liability, effectively overturned *Central Bank* in the enforcement context, while leaving intact the holding for private rights of action.⁵⁸ Such legislative

53. See *id.* at 176-77 (citing federal statutes which explicitly set forth aiding and abetting provisions).

54. *Id.* at 174-77. Efforts to limit the impact of *Central Bank* have noted the Supreme Court's buttressing of its textual argument with policy arguments. See, e.g., Jill E. Fisch, *The Scope of Private Securities Litigation: In Search of Liability Standards for Secondary Defendants*, 99 COLUM. L. REV. 1293, 1312 (1999). However, the *Central Bank* holding is not actually based on policy considerations, and the subsequent decision in *United States v. O'Hagan* does not hold otherwise. See *United States v. O'Hagan*, 521 U.S. 642, 664-65 (1997) (placing *Central Bank*'s reference to "purchasers or sellers" in the context of policy considerations discussed in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975)). The *Central Bank* Court explained that "[p]olicy considerations cannot override our interpretation of the text and structure of the Act, except to the extent that they may help to show that adherence to the text and structure would lead to a result 'so bizarre' that Congress could not have intended it." 511 U.S. at 188. This review of policy represents a confirmation of the Court's textual analysis, not a source of that analysis. Professor Eisenberg has argued that the willingness in *Central Bank* to consider a bizarre results exception is fundamentally inconsistent with textualism. See Melvin Aron Eisenberg, *Strict Textualism*, 29 LOY. L.A. L. REV. 13, 28 (1995) (noting that "under the exception, every case requires the strict-textualist judge to take account of extratextual considerations as a basis for a prudential judgment whether the result reached is bizarre"). For an account of how courts may effectively evade bizarre results without relying on the doctrine as presently conceived, see John F. Manning, *The Absurdity Doctrine*, 116 HARV. L. REV. 2387, 2455-56 (2003). The bizarre results exception was not applied in *Central Bank*, however, and therefore the text of Section 10(b) was decisive.

55. *Central Bank*, 511 U.S. at 177.

56. See *id.* at 188-90.

57. This is so at least to the extent one accepts that Congress's response to *Central Bank* was not "bizarre." The significance of that response to ratification arguments remains open to dispute. Compare *Herman & McLean v. Huddleston*, 459 U.S. 375, 385-86 (1983) ("In light of this well-established judicial interpretation, Congress' decision to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action."), with *Central Bank*, 511 U.S. at 185-87 (discussing theories of congressional ratification or acquiescence, and noting "[a]s a general matter, however, we have stated that these arguments deserve little weight in the interpretive process").

58. Another argument raised against the *Central Bank* decision is that its textualist approach is inconsistent with the way statutes were interpreted when the Securities Exchange Act was passed in 1934. See, e.g., *Central Bank*, 511 U.S. at 195-96 (Stevens, J., dissenting) ("There is a risk of anachronistic error in applying our current approach to implied causes of action . . . to a statute enacted when courts commonly read statutes of this kind broadly to accord with their remedial purposes and regularly approved rights to

inaction respecting private rights of action for aiding and abetting does not indicate the congressional intent in 1934.⁵⁹ Yet, it appears the Congress that enacted Section 10(b) did not contemplate a private action in the first place.⁶⁰

B. The "Bright Line" Test

In the wake of *Central Bank*, a number of lower courts settled on a test for primary liability that requires the secondary actor to engage in a misrepresentation on which a plaintiff relied, rather than merely participate in its creation.⁶¹ This typically means that the statement must be attributed to the secondary actor.⁶² Known broadly as the "bright line" test, this theory can be traced to language in *Central Bank* warning that if the Court accepted aiding and abetting liability, it would permit plaintiffs to circumvent the reliance element of the private right of action.⁶³

In misrepresentation cases, the reliance requirement supplies a necessary causal link between the alleged deceptive act and a plaintiff's injury: it is integral to primary liability.⁶⁴ Unless the secondary actor also "makes" the material misstatement, it is not the secondary actor's actions which have caused the plaintiff's injury from that misstatement, even if the secondary actor indirectly enabled the injury to occur.⁶⁵ The

sue despite statutory silence."). A flaw in this argument, whatever its merits in other contexts, is the lack of evidence that Congress anticipated a Section 10(b) private right of action when the Securities Exchange Act was enacted, and indeed there is a similar lack of evidence that it contemplated aiding and abetting liability. *Cf. id.* at 183. The risk of rejecting interpretive methodologies on which the enacting Congress relied is highly speculative in this context.

59. *Cf. id.* at 184-85.

60. *See supra* notes 35-36 and accompanying text.

61. *See, e.g.,* *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226 n.10 (10th Cir. 1996); *In re JWP Inc. Sec. Litig.*, 928 F. Supp. 1239, 1256 (S.D.N.Y. 1996); *Primavera Familienstiftung v. Askin*, 1996 WL 494904, at *6-7 (S.D.N.Y. Aug. 30, 1996); *In re Kendall Square Research Corp. Sec. Litig.*, 868 F. Supp. 26, 28 (D. Mass. 1994).

62. *Cf. Ziemba v. Cascade Intern'l, Inc.*, 256 F.3d 1194, 1205, 1207 (11th Cir. 2001) ("[I]n order for [a secondary actor] to be primarily liable under § 10(b) and Rule 10b-5, the alleged misstatement or omission upon which a plaintiff relied must have been publicly attributable to the defendant at the time that the plaintiff's investment decision was made.").

63. *Central Bank*, 511 U.S. at 180 ("Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements or actions Allowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases.") (citations omitted).

64. *See Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988).

65. *Cf. Wright*, 152 F.3d at 175.

deceptive words are typically someone else's words—and therefore the source of liability is typically someone else's action.

In *Basic Inc. v. Levinson*, the Supreme Court concluded that a plaintiff's reliance is a necessary element to proving a Section 10(b) claim based on a misrepresentation.⁶⁶ Similarly, the *Central Bank* Court explained that:

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.⁶⁷

Courts applying the “bright line” test have focused on this reliance requirement in mandating that the secondary actor must make a misrepresentation rather than merely participate in its creation.⁶⁸

In addition to a strict reading of the reliance requirement, courts have looked to the nature of aiding and abetting liability, and concluded that mere participation is, inherently, to aid and abet a primary misrepresentation.⁶⁹ As the Second Circuit concluded:

[I]f *Central Bank* is to have any real meaning, a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b).⁷⁰

A definition of primary liability that collapses aiding and abetting liability into a subset of primary liability would empty *Central Bank* of all significance.⁷¹ The “bright line” courts thus seek to give meaningful effect to the *Central Bank* holding that Section 10(b) does not cover

66. See *Basic*, 485 U.S. at 243 (“We agree that reliance is an element of a Rule 10b-5 cause of action.”).

67. *Central Bank*, 511 U.S. at 191 (emphasis added).

68. E.g., *Wright*, 152 F.3d at 175.

69. See *Shapiro v. Cantor*, 123 F.3d 717, 720 (2nd Cir. 1997). (“Allegations of ‘assisting,’ ‘participating in,’ ‘complicity in,’ and similar synonyms used throughout the complaint all fall within the prohibitive bar of *Central Bank*.”). See also *Fisch*, *supra* note 54, at 1302 (“[P]remising liability upon a professional’s participation in a collective process appears perilously close to the liability standard rejected by *Central Bank*.”).

70. See *Shapiro*, 123 F.3d at 720 (quoting *In re MTC Electronic Technologies Shareholders Litig.*, 898 F. Supp. 974, 987 (E.D.N.Y. 1995)). See also *Wright*, 152 F.3d at 175 (concluding that a holding contrary to the bright line test “would effectively revive aiding and abetting liability under a different name, and would therefore run afoul of the Supreme Court’s holding in *Central Bank*”).

71. See *Wright*, 152 F.3d at 175.

aiding and abetting, and to ensure satisfaction of the reliance element of a Rule 10b-5 claim.

C. The "Substantial Participation" Test

Other courts have taken a broad view of primary liability, and concluded that secondary actors that participated in a misrepresentation could be liable for securities fraud. For example, in one of the early post-*Central Bank* decisions, the district court in *In re ZZZZ Best Securities Litigation* concluded that an accountant, Ernst & Young, could be primarily liable based on its role in the creation, review, or issuance of allegedly fraudulent statements.⁷² The *ZZZZ Best* court concluded that *Central Bank* required a secondary actor to commit deceptive acts, but that Ernst & Young's participation in the misrepresentation was extensive enough to attribute the misstatements to them.⁷³

The *ZZZZ Best* court largely relied on pre-*Central Bank* decisions that found primary liability in such contexts.⁷⁴ The court also argued, however, that even if the investing public were "not . . . able to reasonably attribute the additional misstatements and omissions to Ernst & Young, the securities market still relied on those public statements and anyone intricately involved in their creation and the resulting deception should be liable under Section 10(b)/Rule 10b-5."⁷⁵ This attribution of misrepresentations to secondary actors, with varying degrees of participation required, has since been adopted by a number of courts, including the Ninth Circuit.⁷⁶

72. *In re ZZZZ Best Sec. Litig.*, 864 F.Supp. 960, 964, 976 (C.D. Cal. 1994).

73. *See id.* at 969-70.

74. *See id.* at 970.

75. *Id.* Professor Prentice has argued that this latter reasoning is appropriate in light of the Supreme Court's acceptance of the fraud on the market theory:

If the fraud on the market theory can be used by plaintiffs to establish the reliance element vis-à-vis communications they have never seen, it should be equally available to establish reliance upon the substantial participation of defendants in those communications when that substantial participation has been visible to the market, even though perhaps not to the particular plaintiffs.

Prentice, *supra* note 3, at 747. This reasoning overextends the application of the fraud on the market theory, however. It requires courts to equate the general reliance the market might have placed on a secondary actor's reputation to a reliance on the participant's specific doings. This argument could capture secondary actors that fail to blow the whistle, let alone secondary actors that participate in a fraud. Prentice concedes that a whistle blowing duty was implicitly rejected in *Central Bank*. *See id.* at 765. This reasoning ignores the requirement that the secondary actor's fraudulent acts must be relied upon (here, the alleged creation of the misrepresentation)—the actor's mere presence is not a deceptive act.

76. *In re Software Toolworks Inc.*, 50 F.3d 615, 628 n.3, 629 (9th Cir. 1994); *McNamara v. Bre-X Minerals, Ltd.*, 57 F. Supp. 2d 396, 427 (E.D. Tex. 1999); *Cashman v. Coopers & Lybrand*, 877 F. Supp. 425, 432-34 (N.D. Ill. 1995).

One of the strongest arguments for this position is the common law basis for a participation theory.⁷⁷ As Professor Prentice notes, the 1943 *Corpus Juris Secundum* recognized fraud liability for those that participate in a misrepresentation,⁷⁸ and precedents exist to support a participation standard prior to the enactment of the Securities Exchange Act.⁷⁹ It is generally accepted that the federal securities laws were intended to provide greater protections against securities fraud than the common law of the era.⁸⁰ Commentators have proposed that the most broad interpretation of the common law is appropriate in light of Congress's desire to improve upon common law protections against securities fraud.⁸¹ In addition, the Supreme Court has at times followed the common law of fraud in fleshing out the conduct prohibited under Section 10(b).⁸²

D. The Mandate of the Bright Line Test

Although a participation theory is reasonable as an intuitive matter—knowing participants in the creation of fraudulent statements participate in a wrongful act—it does not follow that participants in the creation of

77. See Prentice, *supra* note 3, at 751-52.

78. According to the *Corpus Juris Secundum*:

One who, by fraudulent representations, induces another to act to his damage is liable for the damages suffered, and it is not essential that there should have been privity of contract or personal dealings; but a person cannot be held liable for a fraudulent misrepresentation unless he made it himself or authorized another to make it for him or in some way participated therein.

Id. (citing 37 C.J.S., *Fraud* § 61, at 346 (1943)).

79. For a review of pre-1934 cases evidencing the participation theory, see Prentice, *supra* note 3, at 752 n.266. For additional commentary respecting the common law and secondary liability, see generally William H. Kuehnle, *Secondary Liability Under the Federal Securities Laws—Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common-Law Principles and the Statutory Scheme*, 14 J. CORP. L. 313 (1988); David S. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. PA. L. REV. 597 (1972).

80. See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 389 (1983) (concluding that “an important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry”). See also *Basic Inc. v. Levinson*, 485 U.S. 224, 244 n.22 (1988) (“Actions under Rule 10b-5 are distinct from common-law deceit and misrepresentation claims . . . and are in part designed to add to the protections provided investors by the common law.”).

81. See, e.g., Prentice, *supra* note 3, at 714-15; Margaret V. Sachs, *The Relevance of Tort Law Doctrines to Rule 10b-5: Should Careless Plaintiffs Be Denied Recovery?*, 71 CORNELL L. REV. 96, 138 (1986) (“Congress’s determination that common law protections were deficient suggests that in the face of divided common law opinions, the most liberal common law views of 1934 should govern.”).

82. See, e.g., *Chiarella v. United States*, 445 U.S. 222, 227-28 (1980).

fraudulent statements themselves commit acts that are relied upon. Supporters of the participation theory attempt to avoid the strictures of the reliance requirement by suggesting that the plaintiff has relied on a misrepresentation, in part caused by the participant's acts, even if the secondary actor did not make the statement at issue.⁸³ This tends to make the debate over secondary liability into a debate over proximate cause.⁸⁴ However, all aiders and abettors in some sense cause the misstatement that is relied upon, and there is no readily apparent rationale to distinguish distant causes from more proximate ones.⁸⁵

More important, the text of Section 10(b) requires the "bright line" test. Section 10(b) only covers those who "use" or "employ" a manipulative or deceptive device or contrivance.⁸⁶ The natural reading of "use" or "employ" in the context of Section 10(b) means to use or employ the device or contrivance *in order to* manipulate or deceive.⁸⁷ If one could "use" or "employ" a misrepresentation in the statutory sense merely by being involved in the device's creation, then Section 10(b) defendants could include individuals who did not intend to manipulate or

83. See, e.g., Amicus Curiae Brief of the Securities and Exchange Commission at 13, *Klein v. Boyd*, 1998 Fed. Sec. L. Rep. (CCH) ¶ 90,136 (3d Cir. 1998), *rehearing en banc granted, judgment vacated* (Mar. 9, 1998) (Nos. 97-1143; 97-1261), available at <http://www.sec.gov/litigation/briefs/klein.txt> ("The reliance a plaintiff in a securities fraud action must plead is reliance on a misrepresentation, not on the fact that a particular person made that representation."); cf. Prentice, *supra* note 3, at 757 n.293 ("If the misstatement or omission is attributable to defendant, as it should be if the defendant participated substantially in its preparation or communication, then the defendant is liable to a plaintiff who relied upon the misstatement or omission regardless of whether plaintiff knew of defendant's role at the time of the transaction. Any other holding would, inconsistent with the common law of fraud and deceit, reward those who can successfully cover their tracks, at least for a time.").

84. See, e.g., Langevoort, *supra* note 5, at 892 (arguing for participation defined in terms of proximate causation).

85. Cf. Fisch, *supra* note 54, at 1302 ("[I]mposing liability upon outside professionals based upon their level of participation is unpredictable and subject to an ad hoc fact-based evaluation. The *Central Bank* Court expressly identified an unpredictable standard of liability for outside professionals as undesirable."); Prentice, *supra* note 3, at 756 ("Certainly, the term 'to participate' is vague and confusion can arise from various formulations of the test . . . Does drafting a client's communication satisfy the test? Does partial drafting? How about editing? Proofreading? These are troubling questions, especially given how far they run from the Supreme Court's desired bright line."). Cf. *Central Bank*, 511 U.S. at 188.

86. 15 U.S.C. § 78j (2000); see also *supra* note 32 and accompanying text.

87. See De Leon, *supra* note 5, at 739 ("The focus of the statutory text is not on the preparation of misleading information but on putting such information to some purpose. When a professional who is independent of a securities issuer reviews, edits, drafts or otherwise helps prepare documents that are used by the issuer to mislead investors, the professional himself or herself probably is not 'using or employing' a deceptive device in violation of section 10(b).").

deceive.⁸⁸ Even if intent to deceive were present, participation in the creation of a deceptive device is distinct from its use.

The Supreme Court has implicitly recognized that “use” and “employ” have a particular meaning when read in context. In *Ernst & Ernst v. Hochfelder*,⁸⁹ the Court concluded that Section 10(b) actions required a showing of scienter.⁹⁰ It also noted that this interpretation of Section 10(b) was supported by the terms “to use or employ.”⁹¹ That is, the Court implicitly connected these verbs to their objects, manipulative or deceptive devices or contrivances.⁹² The words “use” or “employ” support an intent requirement because to “use” or “employ” is to use or employ in order to defraud.

Consider some hypothetical cases of attenuated participation. Suppose a press profits by disseminating an issuer’s fraudulent disclosures. Or suppose a word processor assists with the issuer’s computer programs, indirectly enabling the fraud to occur. The role in the deception in each case is incidental, even if the parties should have known (or did know) that the statements were false. As a semantic matter, these parties have in some attenuated sense “used” the deceptive device, for profit even, but these parties have not “used” a deceptive device in the sense of Section 10(b). It is not these parties’ “use” of deception, but rather their participation in someone else’s fraud, which can be said to cause injury.

Even where the participation is more impressive, and the causation more proximate, the same weakness will exist. For example, an accountant with an unattributed role in preparing an issuer’s misleading disclosure has not “used” a deceptive device. Whatever degree of participation is demonstrated, if someone else’s statements do the deceiving, the participant still cannot be said to “use” the device to

88. Cf. Fischel, *supra* note 5, at 88 (“The Supreme Court [in Hochfelder] reversed the Seventh Circuit’s holding that the accounting firm was liable as an aider and abettor because the plaintiff had failed to allege that it had acted with scienter as required by the ‘manipulative or deceptive’ language of section 10(b). However, under a strict aiding and abetting analysis, it is irrelevant whether an aider and abettor has engaged in a manipulative or deceptive practice within the meaning of section 10(b).”). Under a “participation” analysis, the same holds true. It is irrelevant whether the participant has engaged in a manipulative or deceptive practice; instead the manipulative or deceptive practice is attributed to the secondary actor as if it had manipulated or deceived. *See id.* at 108 & n.152 (noting that deceptive conduct by secondary actors should still continue to be prohibited by section 10(b)).

89. 425 U.S. 185 (1976).

90. *Id.* at 201.

91. *Id.* at 199 n.20 (“The Commission also ignores the use of the terms ‘[t]o use or employ,’ language that is supportive of the view that Congress did not intend § 10(b) to embrace negligent conduct.”).

92. *See id.*

deceive. Judicial attribution of a misleading statement will still require that the party *made* the statement.

The above arguments do not entirely eliminate liability for secondary actors participating in a misrepresentation. Secondary actors may also make primary statements, such as when an accountant certifies a fraudulent SEC filing.⁹³ Similarly, if a secondary actor has had direct contact with the defrauded party, and if these acts give the impression that the secondary actor specifically vouches for the misstatements, then the secondary actor's participation may qualify for primary liability, to the extent that the secondary actor has made the misstatements his or her own.⁹⁴ The source of the primary liability is that the secondary actor in a sense made the statement relied upon, even though its express utterance comes from the issuer.⁹⁵

A secondary actor may also be liable when it uses the maker of a statement as its agent.⁹⁶ In this case, one may rightly say that the principal made the statement, albeit through an "indirect" source.⁹⁷

93. See, e.g., *DiLeo v. Ernst & Young*, 901 F.2d 624, 628 (7th Cir. 1990) ("When an accountant certifies that a firm's financial statements 'present fairly' its financial position . . . it is certifying the absence of materially misleading omissions, a source of primary liability. If it acts with the necessary mental state, the case for direct liability is complete.").

94. Cf. *Langevoort*, *supra* note 5, at 888-89.

95. Prior to *Central Bank*, the Sixth Circuit had described a "direct contact" test for determining when there is a primary violation. See e.g., *Molecular Tech. Corp. v. Valentine*, 925 F.2d 910, 917 (6th Cir. 1991). Such a theory can be squared with *Central Bank* to the extent there is deceptive conduct by the secondary actor—not mere reliance on a secondary actor simply because it is the issuer's accountant or law firm. The statute requires a manipulative or deceptive device or contrivance.

96. See, e.g., *Suez Equity Investors v. Toronto-Dominion Bank*, 250 F.3d 87, 101 (2d Cir. 2001) (finding corporate defendants liable based on misrepresentations made by their agent, and noting "[t]he fact that DeRoziere, or any other agent of the corporate defendants, may have supplied the report does not preclude them from primary liability. A corporation can only act through its employees and agents . . . and an allegation that a particular agent may have doctored or conveyed the report will not immunize the principals from liability for a knowing deception."). Agency liability should not be confused with *respondeat superior* liability, which is secondary liability and incompatible with the holding in *Central Bank*. Cf. *Fischel*, *supra* note 5, at 106-07 n.145 (noting absence of manipulative or deceptive act in *respondeat superior* cases). The *respondeat superior* theory is not based on a showing that an employer made a misrepresentation, but rather shifts responsibility for the misrepresentations of employees. Employers are still potentially subject to liability for misrepresentations made by corporate employees, which Congress addressed through the "controlling person" provision of the Exchange Act, section 20(a).

97. It is debatable whether an alleged conspiracy may fit into this mold. For a broad interpretation of conspiracy liability along these lines, see James D. Cox, *Just Deserts for Accountants and Attorneys After Bank of Denver*, 38 ARIZ. L. REV. 519, 528-32 (1996). It is certainly arguable that under a conspiracy to commit fraud, the fraudulent acts can be attributed to a co-conspirator. However, in the typical case of secondary actors (other

Indeed, recognition of agency liability appropriately gives meaning to the terms “directly or indirectly,” found in Section 10(b).⁹⁸ Such agency liability, however, would not apply to the typical instance of an accountant, lawyer, or underwriter involved in the disclosure process. To the contrary, these secondary actors are agents of the issuer, not the other way around.

The existence of liability for some secondary actors is consistent with a strict reading of the scope of Section 10(b), requiring that the participant commit a deceptive act that was relied upon. In contrast, the mere creation or facilitation of a deceptive device that someone else will use to deceive is not the same thing as using the deceptive device. As noted in *Central Bank*, participants may be liable to the extent that they *independently* meet the elements for primary liability.⁹⁹

E. The Common Law of Fraud

Nonetheless, some may argue that the scope of Section 10(b) should include participants because they were included within the scope of common law fraud. Where the common law fills in the gaps left by the concise language in Section 10(b), it is appropriate to turn to it for insight, inasmuch as the statute indicates a common law grounding. This

than control persons within the corporation), this form of conspiracy would not exist. Accountants, for example, do not generally reach agreements to defraud the public, even in those cases where they knowingly assist in creating a misrepresentation. Also troubling is the possibility of recasting every aiding and abetting claim as a conspiracy claim—a concern recognized by the lower courts. *Cf. Dinsmore v. Squadron, Ellenoff, Plesent, Sheinfeld & Sorkin*, 135 F.3d 837, 843 (2d Cir. 1998) (“[R]ecognition of a cause of action for conspiracy would not only conflict with the reasoning of the Supreme Court in *Central Bank*, but would largely undo the effect of that decision itself, inasmuch as many aiding and abetting claims would simply be pleaded as conspiracy claims.”). A conspiracy liability premised on tacit agreement to aid someone who is committing fraud would likely run afoul of *Central Bank*’s restrictions. If conspiracy liability were viable in this context, it would entail a test sufficiently stringent that the typical aiding and abetting claim would be excluded.

98. In *Central Bank*, the Court rejected an apparent argument by the SEC that Congress’s provision for Section 10(b) liability, where the defendant acted “directly or indirectly”, provided a textual basis for aiding and abetting liability. *See Central Bank*, 511 U.S. at 176 (“The problem, of course, is that aiding and abetting liability extends beyond persons who engage, even indirectly, in a proscribed activity; aiding and abetting liability reaches persons who do not engage in the proscribed activities at all, but who give a degree of aid to those who do.”). The language has since been argued as support for an agency theory. *Cf. Prentice, supra* note 3, at 730-32; Thomas L. Riesenber, *Fraud Claims Against Professionals After Central Bank*, *INSIGHTS*, 9, 14 (Feb. 1995). Professor Fischel notes a plausible alternative meaning for the language, however—“that it allows liability to be imposed upon a defendant even though such defendant does not himself use the jurisdictional means (*i.e.*, mail a letter in interstate commerce).” Fischel, *supra* note 5, at 95 n.83.

99. *See Central Bank*, 511 U.S. at 191.

occurred in the case of *United States v. Chiarella*, for example.¹⁰⁰ There, the Court concluded, following the common law of fraud, that a securities fraud defendant in a nondisclosure case must owe a duty to the plaintiff in order for there to be liability.¹⁰¹

On the other hand, when the text sets forth a narrower, more limited regime than that recognized at common law, the text prevails, as it did in *Central Bank*.¹⁰² Congress is often understood to legislate against a pre-existing common law understanding of statutory terms of art. Even so, statutory text need not track common law causes of action, and sometimes does not. The *Central Bank* case, for example, rejected a common law theory for an implied aiding and abetting action.¹⁰³

Where the text actually conflicts with common law understandings, courts should not distort the statutory language to bring it into harmony with the common law. Professor Prentice has argued for a broad "participation" test on the theory that common law courts recognized such liability as primary before the *Central Bank* decision.¹⁰⁴ Post-enactment cases, of course, provide limited insight into what Congress meant in 1934, when Section 10(b) was enacted.¹⁰⁵ Even pre-enactment common law decisions, however, conflict with the text of Section 10(b) to the extent they avoid the statutory requirement that a securities defendant use or employ a deceptive device or contrivance.¹⁰⁶

The efforts to advocate a broad participation standard based on common law understandings of primary liability bear a strong resemblance to arguments rejected by the Supreme Court in *Mertens v. Hewitt Associates*.¹⁰⁷ There, the Court addressed the question of whether ERISA plan participants could bring actions to obtain money damages against nonfiduciaries who knowingly participated in a fiduciary's breach of duty.¹⁰⁸ The Court concluded that such damages did not constitute "appropriate equitable relief" as set forth by the relevant statutory

100. See *Chiarella v. United States*, 445 U.S. 222, 227-28 (1980).

101. See *id.* at 227-28 (looking to, among other things, the common law and Restatement (Second) of Torts to support a holding that omission claims are only available against individuals with a duty to disclose).

102. Cf. *Central Bank*, 511 U.S. at 181-84.

103. *Id.* ("Even assuming, moreover, a deeply rooted background of aiding and abetting tort liability, it does not follow that Congress intended to apply that kind of liability to the private causes of action in the securities Acts.")

104. See Prentice, *supra* note 3, at 751-52.

105. Cf. *id.* at 752 n.267 (citing post-1934 cases finding liability for participants in fraud).

106. Cf. *supra* note 79.

107. 508 U.S. 248, 261-63 (1993).

108. *Id.* at 249-50.

provision, and accordingly, that they were unavailable.¹⁰⁹ In so holding, the Court rejected an argument that its strict textual interpretation of “equitable relief” was incorrect because money damages would have been available at common law.¹¹⁰

The *Mertens* Court found the statutory text decisive. It was thus untroubled by the possibility that ERISA actually offered less protection to beneficiaries than the pre-existing common law.¹¹¹ As the Court noted, “vague notions of a statute’s ‘basic purpose’ are nonetheless inadequate to overcome the words of its text regarding the *specific* issue under consideration.”¹¹²

III. THE SEC’S CO-AUTHORSHIP TEST

A recent effort to expand liability to participants emphasizes the degree of a secondary actor’s participation.¹¹³ In 1995, Professor Langevoort proposed a “participation” test based on the extent of a secondary party’s participation in drafting a misleading statement. As he explained:

My suggestion is that the notion of participation or involvement in these cases be redefined in terms of proximate causation or a broad notion of “co-authorship.” Any person who plays a significant role in the formulation of a disclosure document or other form of publicity that contains a material misstatement or omission should be liable as a primary violator if he or she acted with the requisite degree of scienter and all the other requirements for Rule 10b-5 liability are met. A significant role is one in which the person is invited, expected, or is otherwise in a position to affect the form or content of the disclosure—where the person has the ability to influence its capacity to deceive. This could take the form of drafting, editing, or providing information.¹¹⁴

109. *See id.* at 255-61.

110. *See id.* at 255-60. As the Court stated:

Regarding “equitable” relief in § 502(a)(3) to mean “all relief available for breach of trust at common law” would also require us either to give the term a different meaning there than it bears elsewhere in ERISA, or to deprive of all meaning the distinction Congress drew between “equitable” and “remedial” relief in § 409(a)

Id. at 258.

111. *See id.* at 261-62.

112. *Id.* at 261.

113. Langevoort, *supra* note 5, at 891-92.

114. *See id.* at 892. Professor Langevoort appears to recognize that his interpretation is in tension with *Central Bank*, and even in conflict with *Central Bank* dicta regarding primary liability. *See id.* at 891 (stating that holdings that use a broader approach to

The SEC has since adopted a co-authorship theory. In *Klein v. Boyd*,¹¹⁵ a Third Circuit panel applied this reasoning to hold a secondary party liable for an issuer's misrepresentation.¹¹⁶ The Third Circuit granted rehearing en banc, vacating the panel's opinion.¹¹⁷ As amicus, the SEC filed a brief supporting the co-authorship view.¹¹⁸ Although the parties settled prior to a decision by the full circuit, this brief was subsequently incorporated into the SEC's amicus brief in the *Enron* litigation.¹¹⁹

As with other participation theories, the reliance requirement is fatal to this theory because creation of a misrepresentation alone does not cause deception. In the context of a misrepresentation case, the misrepresentation itself is the deceptive device. The rough draft of the misrepresentation as such, no matter if every word were written by a secondary actor, is not a deceptive device. As noted, one might seek to avoid this requirement by showing that the actions of the party that made the misrepresentation were attributable as actions of the secondary party.¹²⁰ However, the SEC's proposed theory of "co-authorship" is not based on a premise that the party that actually made the misrepresentations was the agent of the secondary actor.¹²¹

The appeal of the co-authorship test is that it superficially appears to fit into the requirements of *Central Bank*. Rule 10b-5, subsection (b), sets forth liability where a party "make[s]" a misleading statement.¹²² The *Central Bank* Court, when it noted that secondary actors could be

primary liability "allow for substantial revisionism."); *id.* at 892 (suggesting that the proposed participation test may not be entirely faithful to Justice Kennedy's apparent intent in *Central Bank*).

115. *Klein v. Boyd*, 1998 Fed. Sec. L. Rep. (CCH) ¶ 90,136 (3d Cir. 1998), *rehearing en banc granted, judgment vacated* (Mar. 9, 1998).

116. *Id.* at 90, 318.

117. *Id.*

118. Amicus Curiae Brief of the Securities and Exchange Commission, *Klein v. Boyd*, 1998 Fed. Sec. L. Rep. (CCH) ¶ 90,136 (3d Cir. 1998), *rehearing en banc granted, judgment vacated* (Mar. 9, 1998) (Nos. 97-1143; 97-1261), available at <http://www.sec.gov/litigation/briefs/klein.txt>.

119. See *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 585-86 (S.D. Tex. 2002) ("The majority of [the SEC's] pleading is a submission filed on behalf of the plaintiffs in a case that was pending in the Third Circuit, but which was settled before that appellate court could review the issue *en banc*.").

120. See *supra* note 96 and accompanying text.

121. See Amicus Curiae Brief of the Securities and Exchange Commission at 10, (setting forth the broad view that "[a] person who creates a misrepresentation, but takes care not to be identified publicly with it, 'indirectly' uses or employs a deceptive device or contrivance and should be liable").

122. See 17 C.F.R. § 240.10b-5 (2003) (stating in subsection (b) that it shall be unlawful "[t]o 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").

liable, suggested that parties would be liable if they “make[] a material misstatement” on which a purchaser or seller of securities relies.¹²³ The *Central Bank* majority’s use of the word “make” almost certainly meant to “communicate” or “utter” the misstatement. Nevertheless, it is semantically possible to say that a creator of a statement “makes” the statement.¹²⁴

The SEC argued, in effect, that “creating” a statement is equivalent to “making” a statement.¹²⁵ In context, this understanding is implausible. If one asks who made the statements in this article, the answer is the author, not the publisher or an anonymous ghostwriter. If the President gives a speech, and someone asks who made his statements, the answer is that the President made the statements, even if they were drafted by a speech writer. The same goes for judicial opinions, drafted sometimes by law clerks. To “make” a statement is to utter it (or the printed equivalent)—no matter who drafted the words. In short, the “co-authorship” test is not different in kind from the other participation tests. One who participates a great deal in preparing a misstatement, but does nothing more than participate, cannot be primarily liable.

IV. RULE 10b-5 AND THE *ZANDFORD* DECISION

Another possible means to avoid the ambit of *Central Bank* is to look to subsections (a) and (c) of Rule 10b-5.¹²⁶ Because “scheme” and “course of business” liability under those subsections does not require misrepresentations, a secondary actor may arguably be found to commit fraudulent acts by participating in the creation of a misrepresentation without making a misrepresentation himself. The participation would allegedly qualify as part of a scheme or course of business, which acted as a fraud. Since the scheme or course of business is relied upon, reliance on the statements of the secondary actors is unnecessary.

123. See *Central Bank*, 511 U.S. at 191 (“Any person or entity, including a lawyer, accountant, or bank, who . . . makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under Rule 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met.”). The SEC in effect severs the maker of the statement from the making of the statement. See *SEC Brief*, *supra* note 18, at 13 (“[T]he [*Central Bank*] Court placed the focus on the misrepresentation, not on the fact that a particular person made it.”).

124. Such a rule still entails limits. See, e.g., *Tricontinental Indus., Ltd. v. Anixter*, 256 F.Supp. 2d 806, 807 (N.D. Ill. 2003).

125. See *Amicus Curiae Brief of the Securities and Exchange Commission* at 16 (“The Commission believes that a test that looks to what a secondary actor does in ‘creating a misrepresentation’ provides the appropriate focus for determining when the secondary actor ‘makes’ a misrepresentation.”).

126. 17 C.F.R. § 240.10b-5 (2003).

A number of State Attorneys General filed an amicus brief in the *Enron* litigation, arguing that secondary actors could be liable based on participation in Enron's alleged fraud, under parts (a) and (c) of Rule 10b-5.¹²⁷ The *Enron* Court rejected this theory to the extent that it sought to extend liability to participants in a scheme based on others' conduct even if the participants did not commit a key act that itself violated Section 10(b) and Rule 10b-5.¹²⁸ However, the Court agreed that "liability is not limited to the making of a material misstatement or omission, nor to a few very technical forms of manipulation."¹²⁹ The theory that section (a) and (c) of Rule 10b-5 can expand liability to secondary actors in misrepresentation cases is not new.¹³⁰ A new development is the Supreme Court's recent opinion in *SEC v. Zandford*,¹³¹ which endorsed all three subsections of Rule 10b-5.¹³²

In *Zandford*, the Court addressed the requirement under Section 10(b) that a manipulative or deceptive act be made "in connection with" the purchase or sale of a security.¹³³ The respondent broker, Zandford, had defrauded an elderly man, Mr. Wood, who had opened an investment account for himself and his daughter.¹³⁴ Zandford misappropriated

127. See Amicus Curiae Memorandum of the State Attorneys General Relating to Defendant's Motion to Dismiss at 10-16, *In re Enron Corp. Sec. Litig.*, 235 F. Supp. 2d 549 (2002) (No. H-01-3624); 17 C.F.R. § 240.10b-5 (2003).

128. See *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 589 n.31 (S.D. Tex. 2002).

129. See *id.*

130. See, e.g., *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960, 971-72 (C.D. Cal. 1994); see also Prentice, *supra* note 3, at 754 (citing subsections (a) and (c) for the proposition that participation theories are acceptable readings of the statutory text).

131. *SEC v. Zandford*, 535 U.S. 813 (2002).

132. See *id.* at 819-20, 825. Cf. Amicus Curiae Memorandum of the State Attorneys General Relating to Defendant's Motion to Dismiss at 10, *In re Enron Corp. Sec. Litig.*, 235 F. Supp. 2d 549 (2002) (No. H-01-3624). The brief stated:

The Supreme Court just one week ago [in *Zandford*] reaffirmed what the Court and the federal circuit courts of appeals have long recognized—that the scope of liability under subsections (a) and (c) of Rule 10b-5 is broader than that under subsection (b) and that those who engage in a fraudulent scheme may be held liable in the absence of misrepresentations and omissions.

Id. But cf. De Leon, *supra* note 5, at 728. As Mr. De Leon explained:

In the context of Rule 10b-5 actions alleging misleading disclosure by securities issuers, the language of the second subsection—'make [an] untrue statement of a material fact or . . . omit to state a material fact'—appears to define the widest scope of conduct prohibited by a third party professional under Rule 10b-5. The first and third subsections of Rule 10b-5, which use the verbs 'employ' and 'engage,' have narrower meanings than the second subsection.

Id.

133. *Zandford*, 535 U.S. at 819.

134. *Id.* at 815.

Wood's money by selling the securities in the account and then transferring the proceeds to his own account.¹³⁵

The SEC claimed that Zandford engaged in a fraudulent scheme in which he made sales of his customer's securities for his own benefit.¹³⁶ Zandford defended himself against claims of securities fraud on the theory that the sales themselves were lawful, and that the subsequent misappropriation, although fraudulent, did not have a connection with the sale of the securities.¹³⁷ He compared his scheme to a mere theft of cash from an investment account.¹³⁸ The Supreme Court disagreed.

According to the *Zandford* court, "[t]he securities sales and respondent's fraudulent practices were not independent events."¹³⁹ Instead, the fraud perpetrated by the respondent was directly linked to the sales themselves.¹⁴⁰ In so holding, the Court applied sections (a) and (c) of Rule 10b-5, which address "scheme" and "course of business" liability.¹⁴¹ It is this latter, unremarkable aspect of *Zandford* which is apparently urged as proof that the Supreme Court recognizes a broad reading of Rule 10b-5 that would include participation theories of liability.

The State Attorneys General amicus brief in the *Enron* litigation noted that *Zandford* had confirmed the existence of "scheme" liability.¹⁴² The brief added that the Court had expressly approved all subsections of Rule 10b-5 when it stated that "[t]he scope of Rule 10b-5 is coextensive with the coverage of § 10(b)."¹⁴³ This judicial approval, however, may not expand Section 10(b)'s scope via acceptance of an extensive Rule 10b-5.

As the *Hochfelder* decision makes clear, Section 10(b) controls the proper reading of Rule 10b-5, not the reverse.¹⁴⁴ The real issue posed by adoption of subsections (a) and (c) is what type of "scheme" or "course of business" will satisfy the strictures of Section 10(b). In this regard,

135. *Id.*

136. *Id.* at 820.

137. *Id.*

138. *Id.*

139. *Id.* at 820.

140. *Id.*

141. *Id.* at 819 (quoting subsections (a) and (c) of Rule 10b-5).

142. Amicus Curiae Memorandum of the State Attorneys General Relating to Defendant's Motion to Dismiss at 12, *In re Enron Corp. Sec. Litig.*, 235 F. Supp. 2d 549 (2002) (No. H-01-3624).

143. *Id.* (quoting *Zandford*, 535 U.S. at 816 n.1).

144. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976) ("[d]espite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b)."). The *Hochfelder* Court was addressing an overly broad reading of subsections (a) and (c) when it made this point.

Zandford is simply not on point.¹⁴⁵ *Zandford* was not a case that tested the limits of subsections (a) and (c) of Rule 10b-5 for secondary actors. Although Rule 10b-5 can be read broadly when all of its subsections are adopted, *Zandford* addressed a different issue under Section 10(b)—the “in connection with” requirement.¹⁴⁶

Nothing in the *Zandford* opinion suggests that the Court would accept “scheme” or “course of business” liability as a means of regulating secondary actors that assist in the creation of another actor’s misrepresentation. Both subsections can readily be understood to prohibit deceptive conduct that does not involve misrepresentations, or even prohibit misrepresentations that are part of a scheme, without also prohibiting participation in misrepresentations.¹⁴⁷ *Zandford* was a unanimous decision,¹⁴⁸ joined by all five justices in the *Central Bank* majority.¹⁴⁹ It is unlikely these justices used *Zandford* as an opportunity to curtail their holding in *Central Bank*.

The key to resolving whether a secondary actor’s involvement creates primary liability is the same regardless of which provision of rule 10b-5 is at issue. One must determine what conduct was manipulative or deceptive, and then determine whether the secondary actor used or employed the manipulative or deceptive conduct. In the context of a misrepresentation, the secondary actor’s actions will typically be relied upon only in those instances where the secondary actor made an independent statement or the misrepresentation is attributable through the law of agency.¹⁵⁰

145. See *Zandford*, 535 U.S. at 815 (stating that the issue was “whether the alleged fraudulent conduct was ‘in connection with the purchase or sale of any security’ within the meaning of the statute and the Rule”). Cf. *Tricontinental Industries*, 256 F.Supp.2d at 807.

146. See *Zandford*, 535 U.S. at 822 (“The question presented is whether the alleged fraudulent conduct was ‘in connection with the purchase or sale of any security’ within the meaning of the statute and the Rule.”).

147. Cf. *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp.2d 161, 173 (D. Mass. 2003). *Lernout* noted:

[T]he better reading of § 10(b) and Rule 10b-5 is that they impose primary liability on any person who substantially participates in a manipulative or deceptive scheme by directly or indirectly employing a manipulative or deceptive device (like the creation or financing of a sham entity) intended to mislead investors, even if a material misstatement by another person creates the nexus between the scheme and the securities market.

Id.

148. *Zandford*, 535 U.S. at 814.

149. *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 166 (1994).

150. Cf. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153 (1972) (“[u]nder the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery.”). In non-misrepresentation cases involving a failure to disclose, reliance is presumed. *Id.* at 153-54. But such cases involve an obligation to disclose combined with a withholding of material facts that amounts to

If a secondary actor did not make a misstatement, yet participated in a fraudulent scheme, the defrauded party must still have relied upon some act by the secondary actor. As one court aptly noted:

[T]he only way for a plaintiff to prevail against a defendant that does not make a false and misleading statement is to identify another of its actions, such as a “deceptive device or fraud,” that triggers liability under one of 10b-5’s other two prongs.

....

In short, subsections (a) and (c) of Rule 10b-5 do not create a short cut to circumvent *Central Bank’s* limitations on liability for a secondary actor’s involvement in preparing misleading documents.¹⁵¹

In other words, if it is a misrepresentation that deceived the plaintiff, then subsections (a) and (c) do not expand the potential parties subject to liability.

V. AMBIGUITY IN SECTION 10(b) AND JUDICIAL DEFERENCE

A. *The Problem of Ambiguity in Section 10(b)*

It is conceivable that courts, including the Supreme Court, will find Section 10(b) ambiguous on the question of liability for secondary actors. Such a finding of ambiguity would be unsurprising.¹⁵² The common law precedent discussed above could encourage this conclusion. Moreover, though the text and relevant Supreme Court precedents are sufficiently clear to preclude a participation theory, participation theories are not absolutely excluded by the statutory language. For reasons developed below, any such ambiguity should be construed narrowly, to limit the private action.

1. *Chevron Deference after the Mead Decision*

An initial issue in addressing this question is the level of deference due the SEC’s interpretation. The *Enron* court apparently applied some form of deference to the SEC’s interpretation on liability for secondary

causation in fact. *Id.* at 154. In misrepresentation cases, the Supreme Court has made clear that reliance is a requirement for private actions. If one expands the *Affiliated Ute* theory broadly enough to encompass assistance in a misrepresentation, aiding and abetting liability is readily subsumed within primary liability. This result would be inconsistent with *Central Bank*.

151. *In re Lernout*, 230 F. Supp. 2d 161, 174-75 (D. Mass. 2003).

152. A proposed reason for the broad participation theories of liability in lower courts is an “equilibrium” theory. See Langevoort, *supra* note 5, at 887. If accurate, this theory suggests that it is not so much ambiguity that created the circuit split, as a judicial skepticism with *Central Bank*, producing an effort by lower courts to return to the status quo.

actors.¹⁵³ In appropriate cases the agency's interpretation of ambiguous or silent text is owed deference if it is reasonable.¹⁵⁴ The *Zandford* Court, in an SEC civil action, accepted this proposition when interpreting ambiguities in Section 10(b).¹⁵⁵

The usual starting point for addressing agency interpretations of ambiguous statutes administered by the agency is the Supreme Court's guidance in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*¹⁵⁶ *Chevron* set forth a two step process for resolving such questions.¹⁵⁷ First, the Court considers whether Congress has directly addressed the specific question at issue in the case: "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."¹⁵⁸ Second, if the statute is ambiguous or silent as to the specific issue, then the court must defer to a reasonable agency interpretation of the statute, even if that interpretation is not the one which the court would choose.¹⁵⁹

Commentators have proffered several justifications for the holding in *Chevron*. Some argue that *Chevron* is a judicially-created, prudential canon of interpretation,¹⁶⁰ while others assert that separation-of-powers

153. See *supra* note 20. It is unclear from the *Enron* opinion precisely how much deference may have been granted. The court cites to *Bragdon v. Abbott*, 524 U.S. 624, 642 (1998); *Chevron*, 467 U.S. at 842-44, *Mead*, 533 U.S. at 226-27, and *Zandford*. These cases do not all stand for the same level of judicial deference. The *Bragdon* cite suggests a more limited deference, see *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), while *Chevron* and *Zandford* imply the *Enron* court applied *Chevron* deference. *Mead*, as discussed below, addresses both standards. See *infra* notes 162-69 and accompanying text.

154. See *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 588 (S.D. Tex. 2002) ("Because § 10(b) expressly delegated rule-making authority to the agency, which it exercised *inter alia* in promulgating Rule 10b-5, this Court accords considerable weight to the SEC's construction of the statute since the Court finds that construction is not arbitrary, capricious or manifestly contrary to the statute."); *id.* at 589 (citing *United States v. Mead Corp.*, 533 U.S. 218, 229-30 (2001)).

155. See *SEC v. Zandford*, 535 U.S. 813, 819-20 (2002) ("This [SEC] interpretation of the ambiguous text of § 10(b), in the context of formal adjudication, is entitled to deference if it is reasonable.")

156. See 467 U.S. 837, 842-43 (1984).

157. *Id.* at 842.

158. *Id.* at 842-43.

159. See *id.* at 843 ("If, however, the court determines that Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.")

160. Maureen B. Callahan, *Must Federal Courts Defer to Agency Interpretations of Statutes?: A New Doctrinal Basis for Chevron U.S.A. v. Natural Resources Defense Council*, 1991 WIS. L. REV. 1275, 1289-94 (1991).

concerns support placing the interpretive responsibility in this context with the executive branch.¹⁶¹ Finally, some contend that *Chevron* rests upon a judicial presumption of legislative intent.¹⁶²

The recent Supreme Court decision in *United States v. Mead Corp.*¹⁶³ grounds *Chevron* deference in the third understanding—congressional intent.¹⁶⁴ In *Mead*, the Court addressed the question of whether tariff classification rulings by the Customs Service merited *Chevron* deference.¹⁶⁵ The Court ultimately concluded that *Chevron* deference was not appropriate, but that a less-exacting form of deference, *Skidmore* deference, might apply.¹⁶⁶ *Chevron* deference applies only in cases where an agency interpretation has the “force of law.”¹⁶⁷ *Skidmore* deference, which effectively calls for courts to defer to agency interpretations that are persuasive, would apply based upon various factors, such as the agency’s specialized experience.¹⁶⁸

As the *Mead* Court explained *Chevron*, “administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority.”¹⁶⁹

161. See, e.g., Douglas W. Kmiec, *Judicial Deference to Executive Agencies and the Decline of the Nondelegation Doctrine*, 2 ADMIN. L.J. 269, 269, 280-04 (1988); Kenneth W. Starr, *Judicial Review in the Post-Chevron Era*, 3 YALE J. ON REG. 283, 308-09 (1986).

162. See Thomas W. Merrill & Kristin E. Hickman, *Chevron’s Domain*, 89 GEO. L.J. 833, 870-72 (2001). But cf. John F. Manning, *Constitutional Structure and Judicial Deference to Agency Interpretations of Agency Rules*, 96 COLUM. L. REV. 612, 625 (1996) (noting that *Chevron* applies retroactively to pre-*Chevron* statutes, and that “[w]hatever else one might say about a retroactive shift in interpretive norms, such a change cannot reflect a vindication of congressional expectations about the way its statutes will be construed.”).

163. *United States v. Mead Corp.*, 533 U.S. 218 (2001).

164. See *id.* at 229 (discussing Congress’s implicit expectation of deference based on generally conferred agency authority and other statutory circumstances). See also *id.* at 230 n.11 (quoting Merrill & Hickman, *supra* note 162, at 872, for the proposition that if *Chevron* rests on a presumption about congressional intent: “it is therefore important to determine whether a plausible case can be made that Congress would want such a delegation to mean that agencies enjoy primary interpretational authority”). For a more in depth discussion of the intent question in *Mead*, see Thomas W. Merrill, *The Mead Doctrine: Rules and Standards, Meta-Rules and Meta-Standards*, 54 ADMIN. L. REV. 807, 812-19 (2002).

165. *Mead*, 533 U.S. at 221.

166. *Id.* at 234-39. The more deferential *Skidmore* standard was first articulated in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

167. *Id.* at 226-27. See also Merrill, *supra* note 164, at 826-33 (proposing means to identify when Congress has delegated the power to act with the force of law).

168. *Mead*, 533 U.S. at 235.

169. *Id.* at 226-27.

2. Implications for Section 10(b)

Properly read, *Mead* is a potential limitation on the SEC's interpretive role in the private litigation context.¹⁷⁰ But this is not merely because the SEC amicus briefs lack the force of law.¹⁷¹ *Mead* squarely places *Chevron* deference within the rubric of congressional intent.¹⁷² The Supreme Court has made clear its understanding that an implied right of action under Section 10(b) does not reflect congressional intent.¹⁷³ To find that Congress intended to implicitly delegate to the SEC the authority to fill gaps in the judicially created private right of action is logically inconsistent.¹⁷⁴

This presents an interesting interpretive problem. The text of Section 10(b) provides a broad delegation of rulemaking authority to the SEC.¹⁷⁵ Section 10(b) is without effect, but for SEC rulemaking.¹⁷⁶ Generally speaking, appropriate SEC interpretations of Section 10(b) merit

170. *But cf. In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 588 n.29 (S.D. Tex. 2002) (citing *Mead* regarding *Chevron* deference).

171. *See supra* note 167 and accompanying text. *See also* Grundfest, *supra* note 36, at 984 n.89 (noting format concerns respecting SEC support of a private action "because the Commission has not incorporated its own position supporting private rights into Rule 10b-5, and because the Commission has expressed its position solely through amicus briefs, Congressional testimony, and speeches by Commissioners").

172. *Mead*, 533 U.S. at 229, 230 n.11, 231-32, 234, 236, 238 (referencing congressional intent). As Professor Merrill notes, "[t]hroughout the opinion, the Court refers to congressional intent, expectations, contemplations, thoughts, and objectives." Merrill, *supra* note 164, at 812.

173. *See supra* notes 35-36 and accompanying text.

174. A response might be that it is equally clear that Congress did not intend to delegate these questions to the courts. *Chevron* can be seen as a determination that interpretive lawmaking is better delegated to a more representative institution than the courts. *See* Manning, *supra* note 162, at 634 (suggesting that *Chevron* respects "a constitutional commitment to [lawmaking] by more, rather than less, representative institutions (agencies rather than courts)"). I would suggest that where the court has already engaged in such a self-delegation, by recognizing an unintended private right of action, it is not improper for the court to take on the concomitant responsibility of cabining the right of action within common law and statutory boundaries—e.g., limiting the opportunities for interpretive lawmaking. This is not an additional self-delegation by the judiciary, but rather a limitation of a delegation that already occurred. Should the SEC wish to further narrow those bounds, the text of Section 10(b) permits it to do so. *See* Grundfest, *supra* note 36, at 975-77. In addition, the Supreme Court has already determined that to some degree the elaboration of the private right of action is a judicial responsibility. *Musick, Peeler & Garrett v. Employers Ins.*, 508 U.S. 286, 292-93 (1993) ("We are not alone in recognizing a judicial authority to shape, within limits, the 10b-5 cause of action.").

175. Grundfest, *supra* note 36, at 1018-20.

176. Grundfest, *supra* note 5, at 56.

deference if they are reasonable, as the *Zandford* Court rightly noted.¹⁷⁷ To the extent that the private right of action is conceived as a suit for injury based on a violation of Rule 10b-5, the question of the scope of Section 10(b) could arguably invoke *Chevron* deference.¹⁷⁸

One might conclude that *Chevron* applies to the private right of action in all respects, through the indirect means of the SEC's authority to promulgate Rule 10b-5 and interpret Section 10(b). The distinction between deferring to the SEC in its interpretation of Section 10(b) generally, versus its interpretation of Section 10(b) in the context of a private cause of action, would then be illusory. From this perspective, the private cause of action is an empty vessel, filled by the content of the SEC's Rule 10b-5 interpretation.

This perspective, however, would overlook the judicial role in creating the private right of action.¹⁷⁹ Although the private right of action depends on the content of Rule 10b-5, a rule which is a product of a delegation to the SEC, the private action itself represents a product of judicial lawmaking rather than agency rulemaking. Congress delegated authority to the SEC to prohibit certain conduct—it did not delegate authority to create private rights of action. The question of how far to extend the private action is in essence a question of federal common law.

Recognition that this as a question for the courts does not encroach on the proper sphere of agencies.¹⁸⁰ A court deciding the question of whether to expand the implied action is constrained by the judicial doctrine that the scope of the private right should not “grow beyond the scope congressionally intended.”¹⁸¹ Agencies, by contrast, focus their concern on policy, and tend to interpret their authority expansively.¹⁸²

177. See, e.g., *SEC v. Zandford*, 535 U.S. 813, 819-20 (2002) (“This [SEC] interpretation of the ambiguous text of § 10(b), in the context of formal adjudication, is entitled to deference if it is reasonable.”). See also Nat Stern, *The Constitutionalization of Rule 10b-5*, 27 RUTGERS L.J. 1, 23-25 (1995) (arguing for deference to SEC's legislative interpretations where Section 10(b)'s meaning is uncertain unless they are arbitrary, capricious, or contrary to the statute).

178. Deference to agency interpretations of their own regulations involves a related doctrine, *Seminole Rock* deference. *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 413-14 (1945). See also Manning, *supra* note 162, at 654-55 (discussing separation of powers implications of *Seminole Rock*). However, as the question here involves the scope of conduct under Section 10(b), and not the proper interpretation of Rule 10b-5, *Seminole Rock* deference is not at issue.

179. See *supra* notes 34-39 and accompanying text.

180. Cf. Manning, *supra* note 162, at 626-27 (discussing the structural concern that policymaking discretion be vested in agencies, which are more accountable, rather than in courts).

181. *Virginia Bankshares v. Sandberg, Inc.*, 501 U.S. 1083, 1102 (1991).

182. Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 DUKE L.J. 945, 964 (1993) (discussing

Because of the unusual source of the private right of action (not based on congressional intent), the former interpretive concern should come prior to the agency's policy concerns.

A court does not self-delegate when it addresses the scope of the private action—the implication of the private action in the first place was the self-delegation. Discerning limits on the private action is potentially a form of judicial restraint. At the same time, a judicial holding respecting the scope of the private action should still leave discretion to the agency in deciding whether or not to extend private actions to all possible cases recognized as permissible by judicial interpretation of Section 10(b).¹⁸³

There is arguably precedent of non-deference in the private right of action context, albeit without discussion of the *Chevron* doctrine.¹⁸⁴ In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,¹⁸⁵ the Supreme Court considered what statute of limitations applied to the Section 10(b) private right of action.¹⁸⁶ The Court recognized that Section 10(b) was silent as to this issue,¹⁸⁷ and concluded that statutes of limitations used in parallel provisions of the Securities Exchange Act should be adopted.¹⁸⁸ It also rejected the SEC's contention that a different, five year statute of limitations, used in another section of the Securities Exchange Act, should be adopted.¹⁸⁹ In rejecting the SEC's interpretation, *Lampf* cannot readily be squared with *Chevron* deference.

It has been suggested that *Central Bank* presents a similar instance of non-deference.¹⁹⁰ Although the *Central Bank* Court reached its decision by relying on the text of Section 10(b), which it concluded was unambiguous, the Court noted that it would have reached the same

incentives of regulators to avoid bright line rules). There is also evidence in judicial opinions to suggest that the SEC has taken broad interpretations of its authority under Section 10(b). Grundfest, *supra* note 5, at 56 (noting “a substantial body of precedent suggesting that the agency has a tendency to construe its authority under section 10(b) far too generously”).

183. See generally Grundfest, *supra* note 36.

184. See Stern, *supra* note 177, at 27-28 (suggesting non-deference in several Supreme Court cases was in tension with *Chevron*).

185. 501 U.S. 350 (1991).

186. *Id.* at 352.

187. See *id.* at 358-59 (stating that in light of judicial creation of the private right of action, “[i]t is . . . no surprise that the provision contains no statute of limitations.”).

188. See *id.* at 359 (“We can imagine no clearer indication of how Congress would have balanced the policy considerations implicit in any limitations provision than the balance struck by the same Congress in limiting similar and related protections.”).

189. See *id.* at 361 (rejecting the five-year period contained in § 20A).

190. This argument is suggested by Stern, *supra* note 177, at 27-28.

conclusion if the text of Section 10(b) did not resolve the case.¹⁹¹ The Court also rejected the SEC's arguments for a broad interpretation that would permit aiding and abetting liability.¹⁹² It is possible that the Court considered the SEC's arguments to be unreasonable, but it is certainly plausible to conclude that, assuming the text did not control, the Court was unwilling to defer to the SEC's interpretation. This result would conflict with *Chevron* deference as well.

Further, not all gaps or ambiguities in a statutory scheme are equal. As Professors Merrill and Hickman note, "it has never been maintained that Congress would want courts to give *Chevron* deference to an agency's determination that it is entitled to *Chevron* deference."¹⁹³ Applying *Chevron* deference to an agency's interpretation of a statutory ambiguity that would expand the scope of its jurisdiction raises concerns respecting the law-interpreting role of courts.¹⁹⁴ These concerns intensify where the expansion would run contrary to the intent of Congress.

In *FDA v. Brown & Williamson Tobacco Corp.*,¹⁹⁵ the Court drew a distinction between "ordinary" gaps in statutory language and "extraordinary" ones.¹⁹⁶ The "extraordinary" gap in *Brown & Williamson* involved FDA authority to regulate tobacco, an authority which the Court concluded Congress had not provided.¹⁹⁷ In the case of such "extraordinary" gaps, *Chevron* deference may be unavailable.¹⁹⁸ One reading of *Brown & Williamson* proposes that the opinion supports non-deference where ambiguities exist respecting the scope of an agency's jurisdiction.¹⁹⁹ Whether the *Brown & Williamson* Court

191. See *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 178 (1994) ("Because this case concerns the conduct prohibited by § 10(b), the statute itself resolves the case, but even if it did not, we would reach the same result.").

192. See *id.* at 176, 188, 190-91.

193. See Merrill & Hickman, *supra* note 162, at 910.

194. *Cf. id.* at 909-912.

195. 529 U.S. 120 (2000).

196. See *id.* at 159. The Court explained:

Deference under *Chevron* to an agency's construction of a statute that it administers is premised on the theory that a statute's ambiguity constitutes an implicit delegation from Congress to the agency to fill in the statutory gaps. . . . In extraordinary cases, however, there may be reason to hesitate before concluding that Congress has intended such an implicit delegation.

Id. (citation omitted).

197. See *id.* at 159-61.

198. See *id.*

199. Professors Merrill and Hickman propose this interpretation as one of two readings of *Brown & Williamson*:

On this reading, the Court in effect said that the presumption of delegated interpretative power is overcome if the totality of the circumstances suggests Congress had a contrary intention. If the legal issue as to which Congress was

effectively created an exception to *Chevron* deference for such “extraordinary” gaps is debatable.²⁰⁰ However, the *Brown & Williamson* holding resulted from a conclusion that Congress did not intend the agency’s statutory interpretation.²⁰¹

In light of judicial precedent concluding that in 1934, Congress never contemplated a Section 10(b) private action,²⁰² any agency interpretation of the scope of prohibited conduct in the private litigation context is dubious to the extent it produces a new private action. The legislative silence in Section 10(b) on the issue of private actions can be characterized as an “extraordinary” instance of silence. If the Court had never created a private action, and the SEC instead had created one based on an alleged delegation of authority, *Chevron* deference would have been inappropriate.²⁰³

This view may be objected to on the grounds that the scope of conduct prohibited by Section 10(b) should be interpreted consistently for both private actions and enforcement actions.²⁰⁴ Congress amended Section

silent is an “ordinary” one, the usual presumption that Congress intended the agency to resolve such issue prevails. However, if the legal question as to which Congress is silent is “extraordinary,” then this congressional silence should be interpreted to mean that the agency is not entitled to mandatory deference.

Merrill & Hickman, *supra* note 162, at 845. Although the statutory circumstances are quite distinct as between *Brown & Williamson* and Section 10(b), the idea that congressional silence in certain instances should not be presumed to equal a delegation to agency resolution is certainly relevant to the issues addressed here.

200. See *id.* (proposing an alternative reading, that the *Brown & Williamson* Court was reinforcing its conclusion that the controversy was properly resolved at *Chevron* step one).

201. See *Brown & Williamson*, 529 U.S. at 159-60.

202. See *supra* note 35.

203. Justices Scalia and Brennan disputed whether *Chevron* applied to ambiguities in the scope of agency jurisdiction in *Mississippi Power & Light v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988). See Merrill & Hickman, *supra* note 162, at 909-10. The competing theories of liability for secondary actors could implicate this debate. I would contend that the context of an unintended private action tips the balance in Justice Brennan’s favor. Justice Scalia’s concern with the practical consequences for *Chevron* deference of an exception for scope of jurisdiction questions should be secondary to the desire to bring the textual interpretation as close as is reasonable to its original meaning. Cf. *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1110 (1991) (Scalia, J., concurring) (supporting departure from tort law doctrine in interpreting section 14(a) of the Exchange Act “because I think the federal cause of action at issue here was never enacted by Congress, . . . and hence the more narrow [the Court] make[s] it (within the bounds of rationality) the more faithful [the Court is] to [its] task.”) (citation omitted).

204. Cf. *Aaron v. SEC*, 446 U.S. 680, 691 (1980) (“In our view, the rationale of *Hochfelder* ineluctably leads to the conclusion that scienter is an element of a violation of § 10(b) and Rule 10b-5, regardless of the identity of the plaintiff or the nature of the relief sought.”). However, unlike *Aaron*, the issue here does not involve a statutory text that “was thought to be so unambiguous as to suggest that ‘further inquiry may be unnecessary.’” See *id.* at 690. Instead, the issue concerns potentially different treatments

10(b)'s scope to permit aiding and abetting claims in enforcement actions,²⁰⁵ but non-deference in the private action context could raise the possibility of an unduly narrow interpretation in the enforcement context.

However, private actions and enforcement actions are distinct, and not just because the Reform Act permits actions against aiders and abettors in enforcement actions.²⁰⁶ The elements of a private cause of action under Rule 10b-5 need not be coterminous with the elements in the enforcement context.²⁰⁷ For example, courts have long recognized a reliance requirement in private actions; courts have rejected this requirement for SEC enforcement actions.²⁰⁸ Indeed, the SEC itself has argued for different treatment of enforcement actions from private litigation under Rule 10b-5.²⁰⁹ Distinctions between enforcement actions and private actions are more strongly pronounced in light of the Reform Act's extension of SEC authority in aiding and abetting actions.²¹⁰

In *United States v. O'Hagan*,²¹¹ the Court addressed the misappropriation theory of insider trading in the criminal liability context.²¹² Confronted with language from *Central Bank*, which appeared to limit Section 10(b) to cases in which purchasers or sellers of securities relied on deceptive statements or omissions, the Court determined that case law limiting standing to purchasers or sellers of securities was confined to private actions.²¹³

Private actions raised concerns of litigation abuse and proof problems, and this had supported the purchaser/seller requirement in the Court's

for private and enforcement actions, in light of *Chevron*, where a statute is silent or ambiguous.

205. See 15 U.S.C. § 78t(e), (f) & cmts. (2000).

206. See, e.g., *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1363 (9th Cir. 1993) (discussing statutory differences).

207. See Grundfest, *supra* note 36, at 999-1000.

208. See, e.g., *United States v. Haddy*, 134 F.3d 542, 544 (3d Cir. 1998); *Rana Research*, 8 F.3d at 1363-64. Some courts also have concluded that no statute of limitations exists for SEC enforcement actions. See, e.g., *SEC v. Rind*, 991 F.2d 1486, 1490-92 (9th Cir. 1993). However, the issue is not settled. See generally *SEC v. Lorin*, 869 F. Supp. 1117, 1120-21 (S.D.N.Y. 1994), *aff'd in part and vacated in part, and remanded by* 76 F.3d 458 (2d Cir. 1996).

209. See Grundfest, *supra* note 36, at 999-1000 (discussing SEC arguments that "enforcement actions are significantly different from private damage actions") (quoting Brief of the United States Securities & Exchange Commission at 2, *S.E.C. v. Rind*, 991 F.2d 1486 (9th Cir. 1993) (No. 91-55972)).

210. See 15 U.S.C. § 78t(e), (f) (2000).

211. 521 U.S. 642 (1997).

212. *Id.* at 665.

213. See *id.* at 664.

Blue Chip Stamps decision.²¹⁴ That holding then led to the language respecting purchasers and sellers in *Central Bank*.²¹⁵ As the policy concerns that prompted the purchaser/seller requirement were not present in this context, the *O'Hagan* Court concluded that this rule was confined to private actions.²¹⁶ *O'Hagan* thus treats private actions differently, and implicitly interprets Section 10(b) differently, based on the unique aspects of private litigation.

The distinctive aspect of the private action from a textualist perspective is that the action is not contained in the text, and apparently was not intended by Congress. This distinction between private and enforcement actions is different in kind from the policy questions noted in *Blue Chip Stamps*, but no less significant. The concern that an overly broad reading of secondary liability would further exceed the intended scope of Section 10(b) is a fundamental interpretive concern. A court might defer to the SEC respecting enforcement actions, but not defer respecting private actions.

In sum, the extent to which the SEC's interpretation of the scope of conduct prohibited by Section 10(b) merits deference is dependent on the type of action. In the context of private securities litigation, such deference is not called for, even if it were appropriate in the enforcement context. The distinct policy concerns raised by private actions, the fact that Congress apparently did not intend private actions in the first place, and the distinction between the scope of Section 10(b) and elements of rule 10b-5 all suggest that an ambiguity in the meaning of primary liability should be interpreted to limit the private action. Even if deference (*Chevron* or *Skidmore*) would otherwise be appropriate in the context of private actions, it should not prevail over concerns that the private action not exceed the intended scope of Section 10(b).²¹⁷

214. *See id.*

215. *See id.* *Central Bank's* discussion "concerned only private civil litigation under § 10(b) and Rule 10b-5, not criminal liability. *Central Bank's* reference to purchasers or sellers of securities must be read in light of a longstanding limitation on private § 10(b) suits." *Id.* (noting that the Court in *Blue Chip Stamps* "confined the § 10(b) private right of action because of 'policy considerations,'" in particular "the abuse potential and proof problems inherent in suits by investors who neither bought nor sold"). *See also* *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737, 739-47 (1975).

216. *See id.* at 665 ("Criminal prosecutions do not present the dangers the Court addressed in *Blue Chip Stamps*, so that decision is 'inapplicable' to indictments for violations of § 10(b) and Rule 10b-5.").

217. This conclusion would apply, *a fortiori*, to *Skidmore* deference.

3. A Proposed Canon for Interpreting Ambiguities in the Scope of Section 10(b) Narrowly for Private Actions

The issues raised by judicial interpretation of the scope of Section 10(b) for private actions call for an interpretive canon. Various judicial canons of construction seek to avoid interpreting statutory ambiguities in ways that reach results that Congress would not intend.²¹⁸ Many of these canons are longstanding features of statutory interpretation.²¹⁹ Frequently, canons involve rules of syntax and grammar designed to derive statutory meaning from the placement of words in the text.²²⁰ Other canons, known as normative or substantive canons, involve policy choices.²²¹

For example, the absurdity doctrine assumes that Congress would not have drafted a statute with absurd results;²²² the *Charming Betsy* canon calls on courts to interpret ambiguous statutory language in a manner consistent with international law.²²³ Similarly, courts decline to decide constitutional questions arising out of a statutory ambiguity where they may choose an interpretation that does not raise constitutional concerns.²²⁴ There are many additional normative canons.²²⁵

Canons are not without their critics. Courts implementing the constitutional avoidance canon do not reach the constitutional issues involved in the case, and in the process they run the risk of assigning a

218. See, e.g., Stephen F. Ross, *Where Have You Gone, Karl Llewellyn? Should Congress Turn Its Lonely Eyes to You?*, 45 VAND. L. REV. 561, 563 (1992).

219. See *id.* at 562.

220. *Id.* at 563. *Ejusdem generis* is a classic example of this type of canon.

221. For discussion of the distinctions between descriptive and normative or substantive canons, see *id.* at 563. See also CASS R. SUNSTEIN, *AFTER THE RIGHTS REVOLUTION* 150-54 (1990).

222. The absurdity doctrine appears in *Central Bank, N.A. v. First Interstate Bank, N.A.* 511 U.S. 164, 188 (1994). For an extended treatment of the canon, see Manning, *supra* note 54, at 2388-92.

223. See *Murray v. Schooner Charming Betsy*, 6 U.S. (2 Cranch) 64, 118 (1804) (setting forth the canon of that name). See also Curtis A. Bradley, *The Charming Betsy Canon and Separation of Powers: Rethinking the Interpretive Role of International Law*, 86 GEO. L.J. 479, 482-91 (1998) (describing sources and application of *Charming Betsy* canon).

224. A recent decision which applied the constitutional avoidance canon is *Solid Waste Agency v. U.S. Army Corps of Engineers*, 531 U.S. 159, 172-73 (2001). This canon actually comes in two forms, one requiring courts to avoid an interpretation that raises constitutional questions, applied in *Solid Waste Agency*, and the other requiring courts to avoid an interpretation that is unconstitutional. Discussion of the latter can be found in *Rust v. Sullivan*, 500 U.S. 173, 190-91 (1991).

225. One notable group of normative canons are the various "clear statement" rules which require a clear statement of congressional intent to overcome a judicial presumption against a particular result. WILLIAM N. ESKRIDGE, JR., *DYNAMIC STATUTORY INTERPRETATION* 285 (1994) (describing clear statement rules); Bradley, *supra* note 223, at 506 n.140 (citing cases involving clear statement rules).

statutory meaning different from that intended by Congress.²²⁶ There are persuasive arguments against the absurdity doctrine on the theory that irrational results are unsurprising effects of legislative compromise.²²⁷ As customary international law has expanded and evolved, the *Charming Betsy* canon has also come under criticism.²²⁸ Canons generally have come under attack. Opponents have long argued that judges may pick and choose which canon to apply,²²⁹ and moreover, congressional intent often cannot be divined.²³⁰ These conclusions undermine the use of canons as a means to approach congressional intent.

Unlike the typical normative canon, however, interpretation of Section 10(b) operates against a background of a judicial expansion of the text.²³¹ This background suggests its own interpretive canon, which should trump *Chevron* deference, and should certainly trump policy concerns.²³² When there are two possible interpretations of the scope of conduct prohibited

226. See Richard A. Posner, *Statutory Interpretation—In the Classroom and in the Courtroom*, 50 U. CHI. L. REV. 800, 816 (1983). Judge Posner asserts:

Congress's practical ability to overrule a judicial decision misconstruing one of its statutes, given all the other matters pressing for its attention, is less today than ever before, and probably was never very great. The practical effect of interpreting statutes to avoid raising constitutional questions is therefore to enlarge the already vast reach of constitutional prohibition beyond even the most extravagant modern interpretation of the Constitution—to create a judge-made constitutional 'penumbra' that has much the same prohibitory effect as the judge-made (or at least judge-amplified) Constitution itself.

Id.

227. See Manning, *supra* note 54, at 2408-19 (discussing likelihood of awkward statutory results from legislative compromise, and implications of interest group theory for the absurdity doctrine). See also *Barnhart v. Sigmon Coal Co.*, 534 U.S. 438, 458-62 (2002) (rejecting claim of absurdity based on the workings of the legislative process).

228. See Bradley, *supra* note 223, at 495-504 (critiquing intent-based and internationalist theories supporting the canon).

229. See Karl N. Llewellyn, *Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are to Be Construed*, 3 VAND. L. REV. 395, 401 (1950) (claiming that "there are two opposing canons on almost every point."). *But cf.* ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 26-27 (1997) (questioning Llewellyn's examples).

230. See, e.g., Frank H. Easterbrook, *Legal Interpretation and the Power of the Judiciary*, 7 HARV. J. L. & PUB. POL'Y 87, 87-91 (1984).

231. See Grundfest, *supra* note 36, at 978-79.

232. Various canons have trumped *Chevron* deference. See Cass R. Sunstein, *Nondelegation Canons*, 67 U. CHI. L. REV. 315, 330 (2000) ("It is plain, however, that a variety of canons of construction—what I am calling nondelegation canons—trump *Chevron* itself."). Professor Sunstein provides as an example *Bowen v. Georgetown University Hospital*, 488 U.S. 204, 208-09, 212-13 (1988) (noting canon against interpreting a statute as retroactive and denying deference to agency counsel's interpretations when the agency articulated no position on the question). See also *DeBartolo Corp. v. Fla. Gulf Coast Bldg. of Constr. Trades Council*, 485 U.S. 568, 575-78 (1988) (denying deference in light of the canon of avoiding interpretation that raises constitutional questions).

by Section 10(b) for purposes of a private action, courts should choose the narrow interpretation. This interpretation deviates least from the original text.

In general terms, the need for a narrow reading of unintended private rights of action has already been noted by Justice Scalia in his concurrence in *Virginia Bankshares, Inc. v. Sandberg*.²³³ Also, Professor Grundfest has argued that the text of Section 10(b) is akin to an inkblot, as evidenced by the closely split decisions and often patternless vote groupings of Supreme Court justices.²³⁴ He rightly asks whether the Court should speculate over congressional intentions not contemplated by Congress.²³⁵ Grundfest therefore concludes that the statutory interpretation should be narrow:

No doubt, strict textualism suffers from a host of serious flaws, but so does every rule for interpreting a statute that presents itself as an inkblot. In order to avoid these intractable interpretive difficulties, the best the Court can do is adopt an avowedly narrow interpretive approach which gives section 10(b) the minimally necessary scope required for its practical existence as an implied private right of action. This result can be achieved through a wide variety of analytic techniques, of which strict textualism is but one.²³⁶

Although Grundfest's general approach is sensible, I would not ground this approach in pragmatism.²³⁷ Grundfest espouses narrow readings of the statute for lack of any other interpretive guide to address the vagueness of Section 10(b).²³⁸ Instead, a narrow reading of the ambiguity in the scope of Section 10(b) should be grounded solely in textual concerns. Given a statutory provision that raises serious doubts whether Congress intended to extend liability to unattributed participants in a misrepresentation, viewed in the context of a cause of action not based on text or legislative intent, any ambiguity should be read to restrict the scope of the private action.²³⁹

233. 501 U.S. 1083, 1110 (1991) (Scalia, J., concurring).

234. See Grundfest, *supra* note 5, at 47-50, 52-55.

235. See *id.* at 60.

236. *Id.* at 61.

237. Cf. *id.* ("My argument for narrow construction of section 10(b) is thus pragmatic at heart. Once the Court abandons a narrow construction of the statute, it is without any objective guidance as to how far it should stretch in defining the scope of the implied section 10(b) private remedy.")

238. See *id.* at 55-58, 60-61.

239. As noted, this result would have no impact in the enforcement context, where Congress has extended the SEC's authority to aiding and abetting actions. See 15 U.S.C. § 78t(e) (2000).

This approach would lessen the potential for expansion of the private cause of action beyond the intended scope of Section 10(b), an expansion recognized as unacceptable by the Supreme Court.²⁴⁰ As with the constitutional avoidance canon, the theory is that Congress would have intended the more limited reading of statutory language where the text supports this reading.²⁴¹ Unlike the constitutional avoidance canon, there is little reason to doubt the narrow reading reflects congressional intent, because Congress actually did not create the cause of action in the first place.

This resolution of a scope ambiguity is different from the situation presented in cases where the Court must fill gaps in the elements of the private cause of action. In *Bateman Eichler, Hill Richards, Inc. v. Berner*,²⁴² for example, the Supreme Court concluded that the Section 10(b) private cause of action included an *in pari delicto* defense.²⁴³ This defense went unmentioned in Section 10(b) or Rule 10b-5, and the court had to decide the contours of the defense without text to guide.²⁴⁴ The defendants in *Bateman Eichler* argued for a broad interpretation of the defense based on the common law because Congress only impliedly provided the private action.²⁴⁵ The Court, however, concluded that policy concerns, including the important role implied private actions play in enforcement, supported a more narrow version of the defense, which would provide greater protection to plaintiffs than a rigid common law interpretation.²⁴⁶

The *Bateman Eichler* Court's rejection of arguments for an expansive defense to a private cause of action presumably seeks to construe the Rule 10b-5 action so that it effectuates the goals of full disclosure and fraud prevention.²⁴⁷ However, in *Central Bank*, the Court noted that it seeks to determine the elements of the Rule 10b-5 action in terms of

240. See *Central Bank, N.A. v. First Interstate Bank, N.A.* 511 U.S. 164, 177 (1994); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 471-74 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201-06 (1976).

241. See, e.g., *DeBartolo Corp. v. Fla. Gulf Coast Bldg. of Constr. Trades Council*, 485 U.S. 568, 575 (1988) ("The courts will therefore not lightly assume that Congress intended to infringe constitutionally protected liberties or usurp power constitutionally forbidden it.").

242. 472 U.S. 299 (1985).

243. *Id.* at 309-11.

244. See *id.* at 309 (discussing *in pari delicto* defense in context of an implied private right of action).

245. See *id.*

246. See *id.* at 310.

247. See *id.* (citing *Herman & MacLean v. Huddleston*, 459 U.S. 375, 388-89 (1983), for the proposition that the securities laws "were intended 'to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry'").

what Congress would have enacted.²⁴⁸ This interpolation poses a distinct question from whether the text of Section 10(b) prohibits particular conduct. Cases like *Bateman Eichler* do not raise the risk of finding an implied cause of action based upon conduct not prohibited by the text of Section 10(b).

A possible objection is that the modern Court has shown a willingness to locate additional implied causes of action under Section 10(b). In *Musick, Peeler & Garrett v. Employers Insurance of Wasau*,²⁴⁹ the Court recognized a defendant's right of contribution.²⁵⁰ However, *Musick* is readily distinguishable. Justice Kennedy, who authored *Central Bank*, was explicit in *Musick* that the conduct at issue was already prohibited and actionable under the Court's precedent:

Even though we are being asked to recognize a cause of action that supports a suit against these parties, the duty is but the duty to contribute for having committed a wrong that courts have already deemed actionable under federal law. The violation of the securities laws gives rise to the 10b-5 private cause of action, and the question before us is the ancillary one of how damages are to be shared among persons or entities already subject to that liability. Having implied the underlying liability in the first place, to now disavow any authority to allocate it on the theory that Congress has not addressed the issue would be most unfair to those against whom damages are assessed.²⁵¹

Although the majority reasoning in *Musick* is in tension with the idea that new implied causes of action should not be found under Section 10(b),²⁵² the reasoning is consistent with the concept that new implied causes of action should not be recognized by expanding the scope of conduct prohibited by Section 10(b).

The scope of prohibited conduct poses the real issue in *Central Bank*. Assuming the scope question is unclear, whether the interpretive question is one of Section 10(b) scope, or one of Rule 10b-5 elements, is debatable. Recognizing that the scope of prohibited conduct should be interpreted narrowly in the context of a private action resolves this uncertainty. If a court construes Section 10(b) to require the "bright line" test, then the scope of Section 10(b) precludes a participation theory, even if participation would otherwise satisfy the common law elements of fraud.

248. See *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 173 (1994).

249. See *Musick, Peeler, & Garrett v. Employers Ins.*, 508 U.S. 286 (1993).

250. See *id.* at 298.

251. *Id.* at 292.

252. See *id.* at 298, 300 (Thomas, J., dissenting) (arguing that the majority improperly recognized an implied cause of action).

It is questionable whether *Central Bank* is directly on point where the statute is found to be ambiguous. The *Central Bank* Court interpreted congressional silence respecting secondary liability as decisive.²⁵³ But *Central Bank* is relevant to resolving the statutory interpretation problem. The question of Section 10(b) scope comes prior to that of Rule 10b-5 gap-filling—it is whether to interpolate a cause of action in the first place. If, as in *Central Bank*, it is improper to expand the private action to include secondary liability when Congress was silent, it is similarly improper to expansively interpret the private action to include participants in the creation of someone else's misrepresentation, absent a clear statement in Section 10(b) to that effect.

VI. CONCLUSION

The absence of statutory text explicitly excluding a participation theory should not encourage the taking of judicial liberties: "Congress' failure to act does not justify further judicial elaboration of the 10b-5 action."²⁵⁴ And, given recent legislative history, it is hard to say that Congress acquiesced in private actions against secondary actors based on their participation in creating a misrepresentation.²⁵⁵ Congress showed its ability to reverse *Central Bank* when it amended the Securities Exchange Act to permit the SEC to bring enforcement actions against aiders and abettors.²⁵⁶ Its failure to do the same for private litigation is noteworthy, and courts should pause before construing Section 10(b) to include secondary actors that participate in fraud without independently committing fraud.²⁵⁷

The securities fraud committed by issuers in the late 1990's was undeterred by either the threat of SEC enforcement or of private litigation, and it is conjecture what effect a different holding in *Central Bank* would have had on secondary actors. The ultimate fallout of the subsequent bankruptcies and lawsuits is also unclear, and the ensuing

253. See *Central Bank*, 511 U.S. at 176-77.

254. See *Musick, Peeler & Garrett v. Employers Ins.* 508 U.S. 286, 304 (1993) (Thomas, J., dissenting).

255. See *supra* notes 6-12, 57-60, and accompanying text.

256. See 15 U.S.C. 78t(e), (f) (2000).

257. Professor Fisch interprets this post-*Central Bank* development to support an expansive view of secondary liability. Fisch, *supra* note 54, at 1318. Although, if anything, the congressional choice not to create more expansive private actions supports a narrow reading of the statute, the text means whatever it originally meant respecting private actions, irrespective of Congress's decision to leave that text intact. Were it otherwise, the many instances of congressional silence would invite a constant threat of judicial legislation.

policy debate will no doubt occupy substantial commentary.²⁵⁸ The textual debate over Section 10(b), however, is also quite contentious and raises questions independent of policy.²⁵⁹

This article concludes that Section 10(b) precludes a participation theory. In light of the text of Section 10(b), the participation theories should generally be rejected, as secondary actors that participate in the creation of a misrepresentation do not typically “use” or “employ” a deceptive device or contrivance. But, if a court nonetheless found the text ambiguous, this ought not to be an invitation to defer to the SEC’s broad reading, whatever format the SEC interpretation might take.

The Supreme Court will likely have to resolve the circuit split regarding primary liability for secondary actors in private litigation. Should the Court do so, it will face the same concerns respecting secondary liability as it did in *Central Bank*. The possibility of a de facto aiding and abetting action recast in terms of “participation” is quite real. Judicial restraint counsels a restrictive reading of statutory ambiguity in this context. A narrow interpretation of the scope of conduct prohibited by Section 10(b) for private actions most closely follows the original text of Section 10(b), unadorned by judicial elaboration.

258. See, e.g., Mark Klock, *Two Possible Answers to the Enron Experience: Will it Be Regulation of Fortune Tellers or Rebirth of Secondary Liability?*, 28 J. CORP. L. 69, 74 (2002) (arguing for a legislative override of *Central Bank*).

259. Cf. *Central Bank*, 511 U.S. at 177.

