COMMENTS

THE AFTERMATH OF *CENTRAL BANK OF DENVER*: PRIVATE AIDING AND ABETTING LIABILITY UNDER SECTION 10(b) AND RULE 10b-5

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INTRODUCTION

Section 10(b) of the Securities Exchange Act of 1934[1] (the 1934 Act) and Securities and Exchange Commission (SEC) Rule 10b-5[2] prohibit the fraudulent sale or purchase of any security.[3] Specifically, section 10(b) prohibits the direct and indirect use of any manipulative or deceptive means to buy or sell a security.[4] Securities trading is further regulated by Rule 10b-5, which prohibits the use of any device or scheme to defraud,[5] the making of any material misrepresentation or omission of fact,[6] and the engagement in any activity or practice that serves to defraud.[7] Though section 10(b) and Rule 10b-5 do not expressly provide for private civil remedies, the courts have recognized a private right of action in connection with primary violations of these statutes for almost fifty years.[8] For the past twenty-five years, the courts have expanded the reach of section 10(b) and Rule 10b-5 to include secondary participants in addition to the "controlling

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1. Section 10(b) provides:

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

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

15 U.S.C. § 78j(b) (1988).

2. Rule 10b-5 provides:

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

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1994). Rule 10b-5 was promulgated by the SEC under its authority as established in § 10(b). *See* Basic Inc. v. Levinson, 485 U.S. 224, 230-31 (1988) (explaining background of § 10(b)).

3. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

4. 15 U.S.C. § 78j(b).

5. 17 C.F.R. § 240.10b-5(a).

6. *Id.* § 240.10b-5(b).

7. *Id.* § 240.10b-5(c).

8. *See* Kardon v. National Gypsum Co., 69 F. Supp. 512, 513 (E.D. Pa. 1946) (stating that implied private right of action under § 10(b) is based upon tort law); *see also* Superintendent v. Bankers Life & Casualty Co., 404 U.S. 6, 13 n.9 (1971) (stating that private right of action exists under § 10(b)).

persons"[9] expressly provided for in both the Securities Act of 1933 (the 1933 Act)[10] and the 1934 Act.[11] Since 1968, aiding and abetting liability has been a widely used and effective weapon against securities fraud, allowing private plaintiffs to recover damages from collateral participants such as accountants,[12] lawyers,[13] and bankers.[14] Frequently referred to as "deep pockets," these professionals were favorite targets of plaintiffs seeking large recoveries or, as was often the case, the only source of recovery when the primary violator was insolvent.[15]

Years of judicial acceptance of private aiding and abetting liability under section 10(b) and Rule 10b-5, however, recently ended with the Supreme Court's decision in *Central Bank of Denver v. First Interstate Bank of Denver*.[16] In its decision, the Court overturned years of lower court precedent by holding that aiding and abetting liability as a

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9. *See* 15 U.S.C. § 78t(a) (defining "controlling person" as person who "directly or indirectly, controls any person liable under any provision of [the Securities Exchange Act of 1934] or of any rule or regulation thereunder . . . unless the controlling person acted in good faith and did not directly or indirectly induce . . . the violation"); *id.* § 77o (defining "controlling persons" as person who "by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77*l* of [Securities Act of 1933]"); *see also* Wiley v. Hughes Capital Corp., 746 F. Supp. 1264, 1277 (D.N.J. 1990) (broadening basic definition of "controlling persons" found in § 77o); Babst v. Morgan Keegan Co., 687 F. Supp. 255, 262 (E.D. La. 1988) (expanding § 77o definition of controlling persons); Johns Hopkins Univ. v. Hutton, 297 F. Supp. 1165, 1212 (C.D. Md. 1968) (detailing "controlling persons" standard of § 77o as supplementing respondeat superior and principles of agency), *rev'd in part on other grounds*, 422 F.2d 1124 (4th Cir. 1970).

10. 15 U.S.C. §§ 77a-77aa (1988 & Supp. V 1993).

11. *See id.* § 77o (outlining liability of "controlling persons"); *id.* § 78t (defining term "controlling person" for purposes of securities laws); *see also* Brennan v. Midwestern United Life Ins. Co., 286 F. Supp. 702, 728 (N.D. Ind. 1968) (implying aiding and abetting liability against insurance company under § 10(b) of 1934 Act), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

12. *See, e.g.*, Roberts v. Peat, Marwick, Mitchell & Co., 857 F.2d 646, 652-53 (9th Cir. 1988) (finding that claim of aiding and abetting violation of § 10(b) and Rule 10b-5 against accountant is valid cause of action), *cert. denied*, 439 U.S. 1002 (1989); Rudolph v. Arthur Andersen & Co., 800 F.2d 1040, 1045 (11th Cir. 1986) (reversing lower court ruling holding that accountant cannot be held liable for aiding and abetting securities violation), *cert. denied*, 480 U.S. 946 (1987).

13. *Cf.* Camp v. Dema, 948 F.2d 455, 463-64 (8th Cir. 1991) (alleging that attorney aided and abetted securities fraud by helping to conceal fact that corporation was for sale); Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 492 (7th Cir. 1989) (alleging law firm aided and abetted securities fraud by rendering services to corporation that committed fraud).

14. *See* Levine v. Diamanthuset, Inc., 950 F.2d 1478, 1485 (9th Cir. 1991) (finding bank could be held liable as aider and abettor of securities fraud); Woods v. Barnett Bank, 765 F.2d 1004, 1013 (11th Cir. 1985) (holding bank liable as aider and abettor); *see also* First Va. Bankshares v. Benson, 559 F.2d 1307, 1310 (5th Cir. 1977) (affirming judgment of liability for commercial lending institution), *cert. denied*, 435 U.S. 952 (1978).

15. *See* Harvey L. Pitt, *The Demise of Implied Aiding and Abetting Liability*, N.Y. L.J., May 2, 1994, at 1 (claiming that aiding and abetting suits were brought against securities professionals primarily for "size of insurance policy" rather than for such professionals' activities).

16. 114 S. Ct. 1439 (1994).

cause of action under section 10(b) and Rule 10b-5 was unavailable to private plaintiffs.[17] This decision continued the Court's recent trend of strictly construing statutes and of limiting the scope of the securities laws. Hailed by some and condemned by others,[18] the Supreme Court's decision in *Central Bank* has fundamentally altered the means by which private investors can be compensated for an injury and the means by which secondary participants in these frauds can be held accountable. This Comment will explore these changes and make recommendations for improving the current situation.

Part I of this Comment describes aiding and abetting liability before *Central Bank*. It examines the development of private causes of action under the securities laws, the development of aiding and abetting liability under section 10(b), and the elements that make up this cause of action. Part II discusses the Supreme Court's decision in *Central Bank*, including a review of decisions preceding the case. Part III concerns *Central Bank*'s immediate and long term impact. In its examination, Part III looks at aiding and abetting liability as both a private cause of action and a deterrent, and also explores the effect of *Central Bank* on alternative forms of secondary liability. Part IV recommends that Congress legislatively overrule the decision in *Central Bank*, and in so doing, reform private securities litigation with respect to secondary liability.

I. BEFORE *CENTRAL BANK*: PRIVATE AIDING AND ABETTING LIABILITY UNDER SECTION 10(B)

A. Development of a Private Right of Action

In interpreting the federal securities laws, the courts originally relied on tort law to imply private rights of action.[19] In 1946, a federal district court in Pennsylvania became the first court to

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17. Central Bank v. First Interstate Bank, 114 S. Ct. 1439 (1994).

18. Paul M. Barrett, *Justices Deal Investors a Blow in Certain Suits*, WALL ST. J., Apr. 20, 1994, at A2. Seen as a boon to accountants, lawyers, and financial service advisors who are "commonly swept into securities-fraud suits even if their roles were tangential," the decision was condemned by Rep. Edward Markey (D-Mass.), then-Chairman of the House Telecommunications and Finance Subcommittee, as well as those who favored the rights of shareholders. *Id.*

19. *See* Kardon v. National Gypsum Co., 69 F. Supp. 512, 513 (E.D. Pa. 1946) (holding that, based on principles of *Restatement of Torts*, person who violates legislative enactment is liable to party that legislation was intended to protect); *see also* Dasho v. Susquehanna Corp., 380 F.2d 262 (7th Cir.) (using common law conspiracy theory in sale and control case to find liability under § 10(b)), *cert. denied*, 389 U.S. 977 (1967); Texas Continental Life Ins. Co. v. Dunne, 307 F.2d 242 (6th Cir. 1962) (relying on common law concepts to find that peripheral defendant could be liable under securities laws); Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 CAL. L. REV. 80, 80 (1981) (indicating that courts have relied upon tort common law principles to imply private rights of action and impose secondary liability).

recognize a private remedy under section 10(b) and Rule 10b-5 in *Kardon v. National Gypsum Co.*[20] The court based its finding of an implied right of private action on the tort maxim of *ubi jus ibi remedium*[21]—where there is a right, there is a remedy.[22]

Since the decision in *Kardon*, an implied private right of action under section 10(b) has become largely accepted as part of the federal securities laws. Though the Supreme Court has rejected reliance on tort law to imply private rights of action,[23] now relying instead on congressional intent,[24] the Court has continued to recognize the existence of an implied private remedy under section 10(b) and Rule 10b-5.[25] Indeed, the Court has described such an implied private remedy as "well established"[26] and "beyond peradventure."[27] In fact, the Court has held that private actions are a necessary supplement to SEC enforcement proceedings[28] and, where implied, are consistent with Congress' intent in adopting the 1934 Act.[29] Though the implied right of action found in *Kardon* concerned a primary violation of the securities laws,[30] after the *Kardon*

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20. 69 F. Supp. 512 (E.D. Pa. 1946).

21. Kardon v. National Gypsum Co., 69 F. Supp. 512, 513 (E.D. Pa. 1946).

22. Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673, 680 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

23. *See* Touche Ross & Co. v. Redington, 442 U.S. 560, 568 (1979) (finding reliance on tort law to imply private right of action to be entirely "misplaced" in case reversing award of damages against accounting firm for alleged breach of duty).

24. *See id.* at 575 (finding that central question in determining whether private remedy exists is "whether Congress intended to create, either expressly or by implication, a private cause of action"); *see also* Transamerica Mortgage Advisors v. Lewis, 444 U.S. 11, 24 (1979) (stating that "dispositive question" is whether Congress intended to create private remedy).

25. *See, e.g.*, Superintendent v. Bankers Life & Casualty Co., 404 U.S. 6, 13 n.9 (1971) (stating that private right of action is implied under § 10(b) of Securities Exchange Act of 1934); *see also* Basic Inc. v. Levinson, 485 U.S. 224, 230-31 (1988) (indicating that judicial decisions have left little doubt that private cause of action exists for violations of § 10(b) and Rule 10b-5); Herman & MacLean v. Huddleston, 459 U.S. 375, 380 n.10 (1983) (explaining that private remedy for violations of § 10(b) and Rule 10b-5 has been recognized for over 35 years); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976) (stating that private cause of action for § 10(b) and Rule 10b-5 violations is well established despite lack of express provision or clear congressional intent).

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

27. *Huddleston*, 459 U.S. at 380.

28. *See Basic*, 485 U.S. at 231 (asserting that private cause of action under § 10(b) and Rule 10b-5 is "essential tool for enforcement of the 1934 Act's requirements"); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975) (finding that private enforcement of securities laws provides necessary supplement to SEC action).

29. *See* Santa Fe Indus. v. Green, 430 U.S. 462, 477-78 (1977) (suggesting that private actions are implied where they are necessary to ensure fulfillment of "fundamental purpose" of 1934 Act, which is philosophy of full and fair disclosure in securities transactions).

30. *Kardon*, 69 F. Supp. at 513 (involving suit to recover damages against corporation and other codefendants for conspiring to fraudulently induce plaintiffs into selling their stock in two corporations for less than its true market value).

decision, courts eventually began to extend this implied private right of action to cases involving secondary liability.[31]

B. Development of Aiding and Abetting Liability

Neither section 10(b) of the 1934 Act nor Rule 10b-5 contain any explicit basis for, or reference to, aiding and abetting liability in private actions.[32] Instead, aiding and abetting liability in private securities suits developed from tort law in a manner akin to the original development of an implied private right of action under section 10(b).[33] Courts initially found a basis for aiding and abetting liability by relying on the *Restatement of Torts* section 876(b)[34] and

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31. *See infra* note 47 and accompanying text (summarizing development of right to action under § 10(b) and Rule 10b-5 in federal circuit courts).

32. *See* 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, 321 (1989) (explaining that aiding and abetting liability is generally not expressly provided for in federal securities laws); Don J. McDermott, Jr., *Liability for Aiding and Abetting Violations of Rule 10b-5: The Recklessness Standard in Civil Damage Actions*, 62 TEX. L. REV. 1087, 1091 n.24 (1984) (stating that though aiding and abetting is mentioned elsewhere in federal securities statutes, aiding and abetting liability is not mentioned in § 10(b) or Rule 10b-5).

Aiding and abetting is mentioned twice in the 1934 Act, in §§ 15 and 21. *See* 15 U.S.C. § 78o(b)(4)(E) (1988) (allowing SEC to limit activities of broker-dealers who have willfully aided and abetted violations of securities laws); *id.* § 78u-2(a)(2) (1988 & Supp. V 1993) (permitting civil penalties in administrative proceedings against any person aiding and abetting violations of securities laws). Aiding and abetting is also mentioned twice in the Investment Company Act of 1940. *See id.* § 80a-9(b)(3) (explaining that SEC may prevent any person from working for investment company if that person was found to have willfully aided and abetted violations of securities laws); *id.* § 80a-9(d)(1)(B) (permitting SEC to impose civil penalties in administrative hearings against persons serving investment companies if they have willfully aided and abetted violations of securities laws). Finally, aiding and abetting liability is mentioned four times in the Investment Advisors Act of 1940. *See id.* § 80b-3(e)(5) (allowing SEC to limit activities of investment advisors who have willfully aided and abetted violations of securities laws); *id.* § 80b-3(e)(7)(C) (permitting SEC to limit activities of investment advisors who have been found by foreign authorities to have aided and abetted violations of foreign securities laws); *id.* § 80b-3(i)(1)(B) (permitting SEC to impose civil penalties in administrative hearings against investment advisors if they have willfully aided and abetted violations of securities laws); *id.* § 80b-9(d) (allowing SEC to pursue injunctions in district court against investment advisors who are aiding and abetting violations of securities laws); *see also* SEC v. Coffey, 493 F.2d 1304, 1316 (6th Cir. 1974) (finding no other basis for secondary liability than "controlling persons" provision of § 20 of 1934 Act), *cert. denied*, 420 U.S. 908 (1975).

33. *See supra* note 19 and accompanying text (citing cases showing reliance on *Restatement of Torts* in developing implied private rights of action under federal securities laws).

34. Section 876(b) states:

> For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he
> (a) does a tortious act in concert with the other or pursuant to a common design with him, or
> (b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or
> (c) gives substantial assistance or encouragement to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person.

other tort law principles.[35]

The first major case to rely on tort law in finding aiding and abetting liability in securities fraud was *Brennan v. Midwestern United Life Insurance Co.*[36] Described as the most important and influential securities case involving secondary liability to date,[37] *Brennan* embraced the principles laid out by the *Restatement of Torts*.[38] The case involved a class action suit by stock purchasers who never received delivery of their purchased stock.[39] They alleged that Midwestern United Life Insurance Company was civilly liable under section 10(b) for aiding and abetting the fraud of a broker, Dobich Securities.[40] The plaintiffs claimed that Midwestern failed to report Dobich's activities even though it was aware of Dobich's scheme,[41] and that by permitting the scheme to continue, Midwestern benefited from the artificial build-up of the market for its stock.[42]

The district court found that Midwestern could be civilly liable as an aider and abettor of Dobich's violation of section 10(b).[43] Using section 876 of the *Restatement of Torts* as a foundation, the court in *Brennan* held that implying aiding and abetting liability based on common law tort principles was a "logical and natural complement"

RESTATEMENT (SECOND) OF TORTS § 876 (1977).

35. *See Coffey*, 493 F.2d at 1316 (stating that courts have defined aiding and abetting liability using RESTATEMENT OF TORTS § 876 and 18 U.S.C. § 2 of criminal code); Landy v. FDIC, 486 F.2d 139, 162 (3d Cir. 1973) (using RESTATEMENT OF TORTS § 876 as basis for elements of aiding and abetting liability), *cert. denied*, 416 U.S. 960 (1974); Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673, 680 (N.D. Ind. 1966) (holding that aiding and abetting liability arises from principles of *Restatement of Torts*, fulfills purposes of 1934 Act, and complements private right of action doctrine established in *Kardon*), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

36. 259 F. Supp. 673 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

37. *See* Fischel, *supra* note 19, at 83 (describing *Brennan* as leading case on aiding and abetting liability); 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, 620 (1972) (referring to *Brennan* as most important securities law case dealing with secondary liability).

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

39. *Id.* at 675.

40. *Id.*

41. *Id.*

42. *Brennan*, 417 F.2d at 150-54. Dobich had created an artificially high market price for Midwestern stock through abnormal selling activities involving a large amount of the total shares sold of Midwestern stock. *Id.* at 153. In order to cover all of its short sales, Dobich used its customers' money as working capital. *Id.* at 150. Dobich then concealed this scheme by delaying deliveries of Midwestern stock. *Id.* Customers complaining to Midwestern about late deliveries were referred to Dobich. *Id.* at 152-53. When asked about these delays, Dobich responded by lying about the reasons for the late deliveries. *Id.* at 152. When the scheme finally collapsed, almost three million dollars worth of purchased Midwestern stock remained undelivered. *Brennan*, 259 F. Supp. at 675.

43. *Brennan*, 259 F. Supp. at 675.

to the implication of a private right of action under Rule 10b-5.[44] Fusing tort law into securities law, the district court found that a cause of action did exist and refused to dismiss the complaint.[45]

Since the *Brennan* decision in 1968 and its subsequent approval by the Seventh Circuit Court of Appeals in 1969,[46] aiding and abetting liability for securities fraud under section 10(b) has been acknowledged by every circuit court that has considered the issue.[47] Most courts followed the tort law approach and adopted the same rationale that was used in *Brennan*.[48] Relying heavily on the *Restatement of Torts*, these courts found that actors with knowledge of another's fraud who rendered substantial assistance to the party committing the fraud could be held liable as aiders and abettors.[49] Other courts

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44. *Id.* at 680; *see supra* note 19 and accompanying text (explaining that private rights of action under Rule 10b-5 were also developed from general principles of tort law).

45. *Brennan*, 259 F. Supp. at 675.

46. *Brennan*, 417 F.2d at 155.

47. *See* Schatz v. Rosenberg, 943 F.2d 485, 495 (4th Cir. 1991) (recognizing aiding and abetting liability as cause of action under § 10(b) of 1934 Act), *cert. denied*, 503 U.S. 936 (1992); Robin v. Arthur Young & Co., 915 F.2d 1120, 1123 (7th Cir. 1990) (stating that circuit recognizes cause of action for aiding and abetting violations of § 10(b) and Rule 10b-5), *cert. denied*, 499 U.S. 923 (1991); Moore v. Fenex, Inc., 809 F.2d 297, 303 (6th Cir.) (indicating that one can be found liable as aider and abettor if "'some other party has committed a securities law violation, if the accused party had general awareness that his role was part of an overall activity that is improper, and if the accused aider-abettor knowingly and substantially assisted the violation'" (quoting SEC v. Washington County, 676 F.2d 218, 224 (6th Cir. 1984))), *cert. denied*, 483 U.S. 1006 (1987); Woods v. Barnett Bank, 765 F.2d 1004, 1009 (11th Cir. 1985) (stating that circuit precedent had established elements required for aiding and abetting liability under § 10(b) and Rule 10b-5); Cleary v. Perfectune, Inc., 700 F.2d 774, 777 (1st Cir. 1983) (stating test for aiding and abetting liability in securities fraud is well-settled in First Circuit); Harmsen v. Smith, 693 F.2d 932, 943 (9th Cir. 1982) (listing elements of aiding and abetting liability under § 10(b) as: "(1) the existence of an independent primary wrong; (2) actual knowledge by the alleged aider and abettor of the wrong and of his or her role in furthering it; and (3) substantial assistance in the wrong"), *cert. denied*, 464 U.S. 822 (1983); Stokes v. Lokken, 644 F.2d 779, 782 (8th Cir. 1981) (indicating that circuit court has developed three-part test for imposing aiding and abetting liability under § 10(b) and Rule 10b-5); IIT v. Cornfeld, 619 F.2d 909, 922 (2d Cir. 1980) (listing three prerequisites necessary for aiding and abetting liability); Monsen v. Consolidated Dressed Beef Co., 579 F.2d 793, 799 (3d Cir.) (finding aiding and abetting when plaintiff establishes: "(1) that there has been a commission of a wrongful act—an underlying securities violation; (2) that the alleged aider-abettor had knowledge of that act; and (3) that the aider-abettor knowingly and substantially participated in the wrong doing"), *cert. denied*, 439 U.S. 930 (1978); Woodward v. Metro Bank, 522 F.2d 84, 97 (5th Cir. 1975) (stating that for aiding and abetting liability under Rule 10b-5 to be established, "another party must have violated the securities laws, the alleged aider-abettor must be generally aware of his role in improper activity, and he must knowingly render substantial assistance"); Zabriskie v. Lewis, 507 F.2d 546, 553 (10th Cir. 1974) (finding aiding and abetting violation of § 10(b) is sufficient for imposition of liability); SEC v. Coffey, 493 F.2d 1304, 1316 (6th Cir. 1974) (finding that one may be held liable as aider and abettor if three elements are met), *cert. denied*, 420 U.S. 908 (1975).

48. *See infra* note 56 (citing cases adopting aiding and abetting liability elements based on tort principles); *see also* Mary T. Doherty, Note, *Aiding and Abetting Securities Fraud*, 25 IND. L. REV. 829, 835 (1992) (explaining that tort law approach to § 10(b) aiding and abetting liability is majority approach among circuits).

49. *See supra* note 35 (citing cases relying on *Restatement of Torts*); *infra* note 56 (listing cases adopting elements of aiding and abetting liability based on *Restatement of Torts*).

applied criminal law principles to achieve essentially the same result.[50] Under this approach, the courts focus on the actor's intent to participate in and further the fraud of another.[51] Finally, some courts combine both criminal and tort law principles to support aiding and abetting liability in securities fraud.[52]

C. Elements of Aiding and Abetting Liability

First articulated by the Third Circuit Court of Appeals in *Landy v. FDIC*,[53] the three generally recognized elements of aiding and abetting liability in securities fraud are: (1) existence of a securities law violation by a primary party; (2) knowledge of the violation by the aider and abettor; and (3) substantial assistance by the aider and abettor in the achievement of the primary violation.[54] This formulation of the elements of aiding and abetting liability closely resembles section 876(b) of the *Restatement of Torts*[55] and has been adopted by

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50. *See Coffey*, 493 F.2d at 1315 (stating that courts have relied on both *Restatement of Torts* and 18 U.S.C. § 2 of criminal code when developing aiding and abetting liability); *see also* 18 U.S.C. § 2(a) (1988) (stating that whoever "aids, abets, counsels, commands, induces or procures [the] commission [of an offense], is punishable as a principal").

Additionally, many courts have cited the definition for aiding and abetting liability in the criminal context as set forth by the Supreme Court in Nye & Nissen v. United States, 336 U.S. 613, 619-20 (1949). *See* Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 35-36 (D.C. Cir. 1987) (endorsing principle delineated by *Nye & Nissen* that in order to aid and abet, one must be involved with venture, has reason for participating in venture, and seeks by his action to make venture succeed); *Woodward*, 522 F.2d at 95 n.23 (comparing *Nye & Nissen* definition of aiding and abetting liability, that one needs to be involved or associated with enterprise in order to aid and abet, with *Restatement of Torts*, which states that in order to aid and abet, one must have knowledge of breach and render substantial assistance); Landy v. FDIC, 486 F.2d 139, 163-64 (3d Cir. 1973) (examining *Nye & Nissen* definition that one must associate himself with activities involved in order to aid and abet, as it applied to aiding and abetting liability in criminal context), *cert. denied*, 416 U.S. 960 (1974). Quoting Judge Learned Hand, the Supreme Court stated in *Nye & Nissen*:

> In order to aid and abet another to commit a crime it is necessary that a defendant "in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed."

Nye & Nissen, 336 U.S. at 619 (quoting United States v. Peoni, 100 F.2d 401, 402 (2d Cir. 1938) (opinion of Hand, J.)).

51. *See Nye & Nissen*, 336 U.S. at 619 (stating that defendant must participate or further success of venture in order to impose aiding and abetting liability).

52. *See* IIT v. Cornfeld, 619 F.2d 909, 922 (2d Cir. 1980) (using criminal law concepts to describe aiding and abetting liability, but determining defendant's actual liability for aiding and abetting securities fraud using tort law model); *Coffey*, 493 F.2d at 1315 (stating that courts have relied on both *Restatement of Torts* and 18 U.S.C. § 2 of criminal code when developing aiding and abetting liability).

53. 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

54. *See* Landy v. FDIC, 486 F.2d 139, 162-63 (3d Cir. 1973) (holding elements for liability under aiding and abetting theory to be: "(1) that an independent wrong exist; (2) that the aider or abettor know of that wrong's existence; and (3) that substantial assistance be given in effecting that wrong"), *cert. denied*, 416 U.S. 960 (1974).

55. *See supra* notes 34-35 and accompanying text (citing *Restatement of Torts* and cases demonstrating aiding and abetting liabilities basis in tort law).

virtually every circuit court, with some variation from circuit to circuit.[56]

The first element, the existence of a primary violation of the securities laws,[57] has not been a problematic issue in suits alleging aiding and abetting liability. In fact, there is very little discussion of this element in any case law.[58] Despite variations among the circuits in the exact language used to describe the first element, any primary violation of the securities laws has generally satisfied its scope.[59]

The second and third elements, knowledge and substantial

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56. *See* Farlow v. Peat, Marwick, Mitchell & Co., 956 F.2d 982, 986 (10th Cir. 1992) (requiring that "fraud in the sale of securities by the primary violator, knowledge of that fraud," and "'substantial assistance'" be shown to establish aiding and abetting liability (quoting Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 496 (7th Cir. 1986))); K & S Partnership v. Continental Bank, 952 F.2d 971, 977 (8th Cir. 1991) (holding that three-part test for aiding and abetting liability requires "existence of a securities law violation by the primary party, . . . 'knowledge' of the violation" by aider-abettor, and "'substantial assistance'" in achieving primary violation (quoting FDK v. First Interstate Bank, 885 F.2d 423, 429 (8th Cir. 1989))), *cert. denied*, 112 S. Ct. 2993 (1992); Levine v. Diamanthuset, Inc., 950 F.2d 1478, 1483 (9th Cir. 1991) (indicating that aiding and abetting claim must show "existence of an independent primary wrong, . . . actual knowledge or reckless disregard" of wrong and of role in it, and "substantial assistance" in furthering wrong); Schatz v. Rosenberg, 943 F.2d 485, 495 (4th Cir. 1991) (requiring "primary violation by another person, . . . aider and abettor's 'knowledge' of the primary violation," and "substantial assistance" for aiding and abetting liability); Fine v. American Solar King Corp., 919 F.2d 290, 300 (5th Cir. 1990) (holding that to establish aiding and abetting liability, plaintiff must prove "securities violation by a primary party, . . . aider and abettor had a general awareness of its role in the violation, . . . [and that the] aider and abettor knowingly rendered substantial assistance"); Moore v. Fenex, Inc., 809 F.2d 297, 303 (6th Cir. 1987) (finding aiding and abetting liability when "'some other party has committed a securities law violation, if the accused party had general awareness that his role was part of an overall activity that is improper, and if the accused aider-abettor knowingly and substantially assisted the violation'" (quoting SEC v. Washington County, 676 F.2d 218, 224 (6th Cir. 1982))); Cleary v. Perfectune, Inc., 700 F.2d 774, 777 (1st Cir. 1983) (holding that plaintiff must show primary violation, aider and abettor was generally aware of violation and plaintiff's role in it, and aider and abettor knowingly and substantially assisted to establish liability); IIT v. Cornfeld, 619 F.2d 909, 922 (2d Cir. 1980) (listing requirements for aiding and abetting liability as primary violation of securities laws, knowledge of violation by aider and abettor, and substantial assistance); Monsen v. Consolidated Dressed Beef Co., 579 F.2d 793, 799 (3d Cir.) (finding aiding and abetting when plaintiff establishes "(1) that there has been a commission of a wrongful act—an underlying securities violation; (2) that the alleged aider-abettor had knowledge of that act; and (3) that the aider-abettor knowingly and substantially participated in the wrong doing"), *cert. denied*, 439 U.S. 930 (1978).

57. *See supra* note 54 and accompanying text (indicating that first element of aiding and abetting liability is primary violation of securities laws); *see also* Alan R. Bromberg & Lewis D. Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 ALB. L. REV. 637, 668-69 (1988) (stating that first element of aiding and abetting liability is existence of securities law violation by another). A primary violation of the federal securities law can include, for example, any "misrepresentation, omission, scheme to defraud, or fraudulent course of business, or any of the more specific acts included within the general terms, such as manipulation or churning." *Id.* at 670.

58. *See* Bromberg & Lowenfels, *supra* note 57, at 669; Kuehnle, *supra* note 32, at 322.

59. *See* Bromberg & Lowenfels, *supra* note 57, at 669-70 (indicating that any independent, illegal act can satisfy first element); *see also* Elizabeth Sager, Comment, *The Recognition of Aiding and Abetting in the Federal Securities Laws*, 23 HOUS. L. REV. 821, 829 (1986) (stating that generally "any securities law violation" satisfies first element of aiding and abetting liability).

assistance, have proven to be more difficult to define.[60] Over the years, several tests, with varying standards for knowledge and assistance, were developed in the different circuits.[61] One such formulation, often referred to as the majority view, requires that the alleged aider and abettor have knowledge of the primary violation and that the aider and abettor perform acts that substantially assisted the violation.[62] A variation of the majority test uses a slightly higher standard for both knowledge and assistance, requiring the aider and abettor to have a "general awareness" of his role in an improper activity and to have knowingly and substantially assisted in the violation.[63] A third test, developed by the Seventh Circuit, has

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60. *See ITT*, 619 F.2d at 922 ("Although the list of prerequisites has become commonplace, the exact content of the rather vague phrases, especially 'knowledge' and 'substantial assistance,' is still being delineated by the courts."); *see also* Sager, *supra* note 59, at 829 (finding that courts have yet to agree on parameters of knowledge and assistance).

61. *See* Doherty, *supra* note 48, at 840-41 (dividing different aiding and abetting tests into three basic formulations: majority rule, "general awareness" test, and Seventh Circuit test).

62. This test is used in the Second, Third, Eighth, and Tenth Circuits. *See* DBLKM, Inc. v. Resolution Trust Corp., 969 F.2d 905, 908 (10th Cir. 1992) (stating that elements for aiding and abetting liability are primary violation, knowledge of primary violation, and substantial assistance); Stokes v. Lokken, 644 F.2d 779, 782-83 (8th Cir. 1981) (requiring primary violation, knowledge of violation, and substantial assistance as prerequisites for aiding and abetting liability); Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47-48 (2d Cir.) (finding aiding and abetting liability requires primary violation, knowledge of violation, and substantial assistance in achieving violation), *cert. denied*, 439 U.S. 1039 (1978); Landy v. FDIC, 486 F.2d 139, 162-63 (3d Cir. 1973) (requiring knowledge of existing wrong and substantial assistance in effecting that wrong), *cert. denied*, 416 U.S. 960 (1974); *see also* National Union Fire Ins. Co. v. Turtur, 892 F.2d 199, 206-07 (2d Cir. 1989) (requiring primary securities violation, scienter by aider and abettor, and substantial assistance by aider and abettor); Walck v. American Stock Exch., 687 F.2d 778, 791 (3d Cir. 1982) (holding that elements for aiding and abetting liability are independent wrong, knowledge of wrong, and substantial assistance in furthering wrong), *cert. denied*, 461 U.S. 942 (1983).

The Ninth Circuit's test is also similar. *See* Harmsen v. Smith, 693 F.2d 932, 943 (9th Cir. 1982) (requiring existence of independent wrong, actual knowledge by aider and abettor of wrong and of role in furthering wrong, and substantial assistance in wrong), *cert. denied*, 464 U.S. 822 (1983).

63. This version of the aiding and abetting test is used by the First, Fifth, Sixth, and Eleventh Circuits. *See* Fine v. American Solar King Corp., 919 F.2d 290, 300 (5th Cir. 1990) (stating that in order to have primary securities violation, "general awareness" by aider and abettor of role and "knowingly rendered" substantial assistance is required), *cert. granted sub nom.* Hurdman v. Fine, 501 U.S 1229, *cert. dismissed*, 502 U.S. 976 (1991); Moore v. Fenex, Inc., 809 F.2d 297, 303 (6th Cir.) (requiring primary violation, general awareness of role in violation, and knowing and substantial assistance), *cert. denied*, 483 U.S. 1006 (1987); Woods v. Barnett Bank, 765 F.2d 1004, 1009 (11th Cir. 1985) (stating that aiding and abetting liability under § 10(b) attaches "if some other party has committed a securities law violation, if the accused [had] general awareness that his role was part of an over all activity that [was] improper, and if [he] knowingly and substantially assisted the violation"); Cleary v. Perfectune, Inc., 700 F.2d 774, 777 (1st Cir. 1983) (finding that for aiding and abetting liability, plaintiff must show primary violation, that aider and abettor was generally aware of violation and his role, and that aider and abettor knowingly and substantially assisted); Woodward v. Metro Bank, 522 F.2d 84, 94-97 (5th Cir. 1975) (stating that for aiding and abetting liability under Rule 10b-5 to be established, "another party must have violated the securities laws, the alleged aider-abettor must be generally aware of his role in improper activity, and he must knowingly render substantial assistance"); SEC v. Coffey, 493 F.2d 1304, 1316 (6th Cir. 1974) (finding aiding and abetting liability when

proven to be the most stringent by requiring a manipulative or deceptive act proscribed by section 10(b) or Rule 10b-5 to have been committed with the same degree of scienter required for primary liability.[64]

Of the three elements of aiding and abetting liability, knowledge or scienter is the most important.[65] Following the Supreme Court's decision in *Ernst & Ernst v. Hochfelder*,[66] proof of scienter was required to maintain a cause of action under Rule 10b-5.[67] Since the decision in *Hochfelder*, all of the lower courts deciding aiding and abetting claims have found the knowledge element and the scienter requirement to be essentially identical.[68] What standard satisfies knowledge or scienter, however, remains unsettled.[69]

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primary violation by other party, general awareness of violation and of role in violation by aider and abettor, and aider and abettor's knowing and substantial assistance), *cert. denied*, 420 U.S. 908 (1975).

The D.C. Circuit's test for aiding and abetting liability is similar, though it has not been specifically applied in § 10(b) and Rule 10b-5 securities fraud cases. *See* SEC v. Falstaff Brewing Corp., 629 F.2d 62, 72 (D.C. Cir. 1980) (stating that "[t]o hold that a defendant aided and abetted another's violation, a court must conclude that a wrongful act occurred, that the defendant was aware of it, and that he knowingly and substantially participated in it").

64. *See* Robin v. Arthur Young & Co., 915 F.2d 1120, 1123 (7th Cir. 1990) (requiring that aider and abettor act with equivalent degree of scienter as primary liability requires), *cert. denied*, 499 U.S. 923 (1991); Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 495 (7th Cir. 1986) (interpreting *Hochfelder* and *Huddleston* to require aiders and abettors to have same mental state required for primary liability); *see also* Central Bank v. First Interstate Bank, 114 S. Ct. 1439, 1444 (1994) (stating that Seventh Circuit test foreclosed liability for aiders and abettors).

65. *See Woodward*, 522 F.2d at 97 (recognizing that without requirement of knowledge, numerous people would face liability for some role in facilitating fraud in cases of ordinary and honest actions).

66. 425 U.S. 185, 193 (1976) (holding that private cause of action will not lie under § 10(b) or Rule 10b-5 in absence of scienter).

67. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12 (1976). The Court defined "scienter" as "a mental state embracing intent to deceive, manipulate or defraud." *Id.*

68. *See* Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 44 (2d Cir.) (noting that "basic holding of *Hochfelder*, that scienter is an element of the Section 10(b)/Rule 10b-5 cause of action, also establishes the standard for aiding and abetting liability"), *cert. denied*, 439 U.S. 1039 (1978); *see also* Metge v. Bachlee, 762 F.2d 621, 624 (8th Cir. 1985) (discussing what evidence must be shown to meet requisite "knowledge or scienter"), *cert. denied*, 474 U.S. 1057 (1986); Stokes v. Lokken, 644 F.2d 779, 783 (8th Cir. 1981) (discussing what degree of knowledge requirement will meet scienter requirement); IIT v. Cornfeld, 619 F.2d 909, 922-24 (2d Cir. 1980) (referring to knowledge requirement as scienter requirement).

69. *See Hochfelder*, 425 U.S. at 193 n.12 (reserving decision on question of whether in some circumstances reckless behavior is sufficient for civil liability under § 10(b)).

The issue of whether recklessness satisfied the knowledge/scienter requirement was the question originally petitioned for certiorari to the Supreme Court in the *Central Bank* case. *See High Court Agrees To Consider Aiding and Abetting Questions*, Sec. L. Daily (BNA) 1, 1 (June 8, 1993) (indicating that parties believed that availability of aiding and abetting liability was settled and that issue requested for certiorari was scope). In fact, the SEC had requested that the Supreme Court grant certiorari in order to resolve the recklessness issue. *Id.*

Some courts have held that proof of recklessness is sufficient to establish scienter,[70] while others have insisted on the more stringent requirement of actual knowledge.[71] Recklessness usually satisfied the scienter requirement in an aiding and abetting case when the alleged aider and abettor owed an independent duty of disclosure to the defrauded party.[72] Absent an independent duty to disclose, however, these courts would not apply the recklessness standard, and instead, would apply an actual knowledge standard.[73] Other courts ignored this distinction and held that the recklessness standard satisfied the scienter requirement even in the absence of a duty to disclose.[74]

Though aiding and abetting liability under section 10(b) had been accepted and extensively used by the lower courts for over twenty-five years, the Supreme Court never directly addressed the actual availability of aiding and abetting liability until the *Central Bank*

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70. *See IIT*, 619 F.2d at 923 (finding recklessness generally satisfies scienter requirement); *Rolf*, 570 F.2d at 44 (concluding that where aider and abetter owes fiduciary duty, recklessness satisfies scienter requirement).

71. *See Melge*, 762 F.2d at 625 (requiring higher standard of intent in cases where aider and abetter has no duty to act or disclose); *IIT*, 619 F.2d at 925 (finding that scienter requirement becomes more stringent where no fiduciary duty is owed).

72. *See* Robin v. Arthur Young & Co., 915 F.2d 1120, 1126 (7th Cir. 1990) (finding reckless conduct sufficient to satisfy wrongful intent requirement), *cert. denied*, 499 U.S. 923 (1991); Decker v. Massey-Ferguson, Ltd., 681 F.2d 111, 119 (2d Cir. 1982) ("There is some indication in this Circuit . . . that an aider and abettor's liability can be predicated on recklessness only where the defendant owed a fiduciary duty to the plaintiff."); Woodward v. Metro Bank, 522 F.2d 84, 97 (5th Cir. 1975) (finding liability possible with degree of scienter less than high conscious intent when duty of disclosure is involved).

73. *See* Ross v. Bolton, 904 F.2d 819, 824 (2d Cir. 1990) (holding that where no fiduciary duty is owed, plaintiff must show defendant acted with actual intent to defraud); Edwards & Hanly v. Wells Fargo Sec. Clearance Corp., 602 F.2d 478, 485 (2d Cir.) (finding that showing of actual intent to defraud is necessary in absence of fiduciary relationship), *cert. denied*, 444 U.S. 1045 (1979); Kahn v. Chase Manhattan Bank, N.A., 760 F. Supp. 369, 374 (S.D.N.Y. 1991) (stating that when alleged aider and abettor owes no fiduciary duty to plaintiff, knowledge requirement is not satisfied by recklessness but rather "scales upward"); *see also* Bromberg & Lowenfels, *supra* note 57, at 671 (stating that when there is no duty, knowledge requirement is said to "scale upward," thereby elevating to more stringent standard of full scienter with intent to defraud, rather than recklessness).

74. *See* Herm v. Stafford, 663 F.2d 669, 684 (6th Cir. 1981) (noting that recklessness is "sufficient" to satisfy knowledge requirement in case involving aiding and abetting liability); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1024 n.22 (6th Cir. 1979) (finding no reason to limit adoption of recklessness standard to defendant's owing fiduciary duty to plaintiff); *see also* Andreo v. Friedlander, Gaines, Cohen, Rosenthal & Rosenberg, 660 F. Supp. 1362, 1367-68 (D. Conn. 1987) (finding that fiduciary duty is not required for application of recklessness standard to satisfy knowledge element of aiding and abetting liability and holding that complaint alleging law firm's reckless disregard for truth, rather than actual knowledge, is sufficient); Resnick v. Touche Ross & Co., 470 F. Supp. 1020, 1023 (S.D.N.Y. 1979) (indicating that knowledge or scienter requirement is satisfied by recklessness).

case.[75] In fact, when faced with the question on two previous occasions, the Supreme Court reserved judgement on the issue.[76]

II. *CENTRAL BANK*: THE ELIMINATION OF AIDING AND ABETTING LIABILITY UNDER SECTION 10(B)

A. *The Road to* Central Bank*: The Gradual Narrowing of the Securities Laws*

Despite an initial period of expansion,[77] the Supreme Court began to narrow the scope of federal securities laws in a series of cases beginning in 1975.[78] Starting with *Blue Chip Stamps v. Manor Drug Stores*,[79] the Court began to place a greater emphasis on statutory language restricting the reach of section 10(b) and Rule 10b-5 by denying new implied private actions and restricting older implied private actions.[80] This trend, a result of the Court's concern over the expansion of securities liability and its desire to curb vexatious litigation,[81] set the stage for the Court's decision in *Central Bank*.[82]

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75. *See* Central Bank v. First Interstate Bank, 114 S. Ct. 1439, 1443 (1994) (acknowledging reservation of deciding issue of aiding and abetting in two earlier cases, *Huddleston* and *Hochfelder*).

76. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 379 n.5 (1983) (noting that Court has reserved decision on issue of availability of aiding and abetting liability); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 191 n.7 (1976) (noting that Court need not consider whether civil liability for aiding and abetting is appropriate in light of Court's holding that intent to deceive, manipulate, or defraud is required for civil liability under § 10(b) and Rule 10b-5).

77. *See* Bromberg & Lowenfels, *supra* note 57, at 648 n.63 (stating that Supreme Court broadly construed § 10(b), Rule 10b-5, and securities laws generally, and lower courts repeatedly recognized private rights of action under them during "Expansion Era," which ended in 1974).

78. *See* Bromberg & Lowenfels, *supra* note 57, at 648 n.64 (stating that during "Contraction Era," beginning around 1975, Supreme Court refused to recognize new implied rights of action, restricted old implied rights of action, criticized all implied rights of action, and cut back on SEC's enforcement powers); *see also* Benoay v. Decker, 517 F. Supp. 490, 495 (E.D. Mich. 1981) (holding that Supreme Court's decision in *Hochfelder* requiring scienter to state § 10(b) claim is indication that aiding and abetting liability will not exist apart from liability for direct violation).

79. 421 U.S. 723 (1975).

80. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730-31 (1975) (holding that only person who purchases or sells securities in fraudulent transaction has standing to sue under Rule 10b-5); *see also* Santa Fe Indus. v. Green, 430 U.S. 462, 477 (1977) (holding that Rule 10b-5 is limited to situations involving actual deception, and thus, transactions that are unfair, but where material facts are adequately disclosed, cannot be attacked under Rule 10b-5); *Hochfelder*, 425 U.S. at 193 n.12 (holding that private plaintiff must allege and prove "scienter," which is "mental state embracing intent to deceive, manipulate or defraud"); Roberta S. Karmel, *Implications of the 'Central Bank of Denver'* Case, N.Y. L.J., June 16, 1994, at 3 (indicating that restrictive interpretation of Rule 10b-5 began with *Blue Chip*). *But see Huddleston*, 459 U.S. at 387 (holding that availability of express remedy under Securities Act of 1933 does not preclude defrauded purchasers of stock from maintaining action under Rule 10b-5).

81. *See* Bromberg & Lowenfels, *supra* note 57, at 648 n.64 (stating that Supreme Court was concerned over expansion of securities liability and was determined to keep it in check); *see also Blue Chip*, 421 U.S. at 739-40 (recognizing that unduly expansive impositions of liability under federal securities laws will lead not only to vexatious litigation, but also to larger judgments, that

Blue Chip was a case in which the Court restrictively interpreted Rule 10b-5.[83] In this case, the Court limited the field of potential plaintiffs in a Rule 10b-5 suit by holding that a plaintiff had to be either a purchaser or a seller of securities.[84] Relying on statutory language, the Court found that section 10(b) only prohibited manipulative or deceptive acts "in connection with the [actual] purchase or sale of any security,"[85] not any attempt to sell or purchase a security.[86] The Court based its restrictive reading of the 1934 Act on both congressional intent and public policy grounds, noting that securities litigation had a propensity to be vexatious.[87]

This restrictive trend continued in *Ernst & Ernst v. Hochfelder*,[88] where the Supreme Court held that scienter was a required element of a Rule 10b-5 suit.[89] The Court stated that the words in the statute, "manipulative," "device," and "contrivance," showed a clear congressional intent that negligence was not a sufficient threshold.[90] *Hochfelder* weakened the third clause of Rule 10b-5, which on its face seems to prohibit "any act" that is fraudulent.[91] Instead, the Court eliminated the clause's coverage of fraudulent conduct not committed with scienter or specific intent to deceive, again limiting the conduct actionable under Rule 10b-5.[92]

Additionally, in *Santa Fe Industries v. Green*,[93] the Court held that breaches of fiduciary duty by corporate directors were covered by state

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will be paid "in the last analysis" by innocent investors).

82. *See* Central Bank v. First Interstate Bank, 114 S. Ct. 1439, 1446 (1994) (stating that Court has always refused to allow Rule 10b-5 challenges to conduct not prohibited by text of statute).

83. *See* Karmel, *supra* note 80, at 3 (explaining that *Blue Chip* is first Supreme Court case to interpret Rule 10b-5 restrictively rather than liberally).

84. *See Blue Chip*, 421 U.S. at 730-36 (discussing justifications for restricting plaintiff's class under § 10(b)).

85. *See id.* at 732 (explaining SEC's failed attempts to change statutory language of § 10(b)).

86. *See id.* at 756 (Powell, J., concurring) (stating that statute is starting point for case involving statutory construction); *see also* Fischel, *supra* note 19, at 95 (stating that prohibited conduct had to be connected with actual, not attempted, purchase or sale of any security).

87. *See Blue Chip*, 421 U.S. at 739 (noting widespread recognition of danger posed by vexatious litigation under securities laws, which is different in degrees and kind from general litigation, which may result from expansive interpretation of federal securities laws).

88. 425 U.S. 185 (1976).

89. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976) (addressing issue raised by customers of brokerage firm who invested in securities scheme that ultimately was revealed as fraudulent).

90. *Id.* at 199; *see* Fischel, *supra* note 19, at 95-96 (explaining that Court in *Hochfelder* found implying negligence would be adding gloss to statute not intended by Congress).

91. *See supra* note 2 (describing third clause of Rule 10b-5).

92. *See Hochfelder*, 425 U.S. at 193 (holding that scienter is required in order to institute private cause of action under § 10(b) or Rule 10b-5); Karmel, *supra* note 80, at 3 (explaining that *Hochfelder* limited scope of third clause of Rule 10b-5 to acts committed with scienter).

93. 430 U.S. 462 (1977).

corporation law, not federal securities law, and, therefore, were not actionable under Rule 10b-5.[94] According to the Court, the purpose of the federal securities laws was to prevent deception and manipulation in the securities markets, and not to regulate corporate fiduciary breaches.[95] The Court stated that "[t]he language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception."[96]

The last time the Court directly dealt with secondary liability under the federal securities laws before the decision in *Central Bank* was in *Pinter v. Dahl*.[97] In *Pinter*, the Court again limited the scope of the securities laws, this time by narrowing the reach of section 12 "seller" liability.[98] The Court held that only a "seller" of securities could be liable for the sale of an unregistered security and simultaneously applied a narrow construction to the term "seller."[99] In order to determine congressional intent, the Court relied upon the statute's language.[100] This analysis suggested that the Court would look closely at statutory language when determining the range of those liable.[101]

In addition, the Supreme Court also began to question the use of tort law principles to imply private rights of action under the securities laws, suggesting that such reliance was "misplaced."[102] Instead, the Court stated that the existence of a private right of action must be based on statutory construction and an analysis of congressional intent.[103] Though not addressed directly, the Court's emphasis

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94. *See* Santa Fe Indus. v. Green, 430 U.S. 462, 478-79 (1977) (addressing situation where minority shareholders brought action against majority shareholders who had entered into transaction to eliminate minority interest); *see also* Karmel, *supra* note 80, at 3 (stating that in *Santa Fe*, Court found state corporation law covered breaches of fiduciary duty by corporate directors and federal securities law covered deception and fraud in stock market).

95. *Santa Fe*, 430 U.S. at 478-79.

96. *Id.* at 473.

97. 486 U.S. 622 (1988). *Pinter* involved an action brought by investors in oil and gas leases against the seller for violation of federal securities laws. Pinter v. Dahl, 486 U.S. 622, 622 (1988).

98. *Id.* at 641-55. The Court held that persons cannot be liable as "sellers" under § 12(1) of the Securities Act of 1933 unless they either pass title to a security or solicit a sale of the security with a requisite financial motive. *Id.* at 647.

99. *See id.* at 650 (refusing to extend § 12(1) liability beyond express language of statute); *see also supra* note 98.

100. *See Pinter*, 486 U.S. at 650 (concluding that absence of express liability in § 12 indicated that Congress did not intend to impose § 12 liability on "participants" collateral to offer or sale).

101. *See id.* at 652-53 (stating that while Court has construed federal securities laws flexibly to advance their remedial purposes, Court has placed primary emphasis on statute's language and on assumption that "Congress meant what it said" when ascertaining scope of liability).

102. *See* Touche Ross & Co. v. Redington, 442 U.S. 560, 568 (1979) (rejecting argument implying private right of action under § 17(a) of 1934 Act, which was based upon tort law principles, as "entirely misplaced").

103. *Id.*

on statutory construction also called into question reliance on criminal law concepts to imply private rights of action.[104]

This trend of strictly construing the federal securities laws and the labeling of tort and criminal law as a "misplaced" basis for implied private actions caused some commentators[105] and courts[106] to question the continued viability of aiding and abetting liability under section 10(b) and Rule 10b-5. As a result of this trend, the question of whether aiding and abetting liability was available as a private right of action under section 10(b) was ripe for review.[107]

B. Central Bank of Denver v. First Interstate Bank of Denver

In a landmark 5-4 decision,[108] a divided Supreme Court continued the trend of strictly construing the securities laws[109] that began almost twenty years earlier in *Blue Chip*.[110] In *Central Bank of Denver v. First Interstate Bank of Denver*, the Court held there was no private remedy for aiding and abetting a violation of section 10(b) of the 1934 Act.[111] The facts in *Central Bank* involved disputes arising from depreciating real estate used to secure a series of Colorado development bonds.[112] In 1986 and 1988, the Colorado Springs-Stetson Hills Public Building Authority (Authority) issued bonds totaling twenty-six billion dollars to finance public improvements to a planned

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104. *See* Fischel, *supra* note 19, at 93 n.81 (stating that common law doctrines can be relied upon to determine conduct prohibited under statute).

105. *See* Bromberg & Lowenfels, *supra* note 57, at 639-61 (discussing uncertainty surrounding validity of aiding and abetting liability as implied private action); Doherty, *supra* note 48, at 836-37 (questioning whether aiding and abetting liability was still available following Supreme Court's trend of narrowing securities laws); Fischel, *supra* note 19, at 93-94 (questioning whether tort law principles form viable basis for imposing secondary liability in light of Supreme Court's shift from tort law to congressional intent in implying private rights of action).

106. *See* Congregation of the Passion, Holy Cross Province v. Kidder Peabody & Co., 800 F.2d 177, 183 (7th Cir. 1986) (stating that "there is some ambiguity about the existence of a civil cause of action for aiding and abetting a section 10(b) and Rule 10b-5 violation"); Little v. Valley Nat'l Bank, 650 F.2d 218, 220 n.3 (9th Cir. 1981) (expressing doubt as to basis of aiding and abetting liability); Seattle-First Nat'l Bank v. Carlstedt, 101 F.R.D. 715, 722-23 (W.D. Okla. 1984) ("The notion that aiding and abetting securities fraud constitutes a justiciable violation of law is itself a questionable assertion."), *rev'd*, 800 F.2d 1008 (10th Cir. 1986); Benoay v. Decker, 517 F. Supp. 490, 495 (E.D. Mich. 1981) ("It is . . . doubtful that a claim for 'aiding and abetting' . . . will continue to exist under 10(b)."), *aff'd mem.*, 735 F.2d 1363 (6th Cir. 1984).

107. *See* Doherty, *supra* note 48, at 837.

108. Central Bank v. First Interstate Bank, 114 S. Ct. 1439, 1442 (1994). Justice Blackmun's recent retirement from the Court and replacement by Justice Breyer should not affect the balance of the Court in this decision because Justice Blackmun voted with the dissent. *See id.* at 1455 (Stevens, J., dissenting, joined by Blackmun, J.).

109. *See id.* at 1444 (referring to *Santa Fe* and *Hochfelder* as indication of Court's strict constructionist approach).

110. *See* Blue Chip Stamps v. Manor Drug Sales, 421 U.S. 723, 731-32 (1975) (limiting class of plaintiffs who may bring Rule 10b-5 suit by way of strict statutory construction of Rule 10b-5).

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

112. *Id.* at 1443.

community in Colorado Springs.[113] The petitioner, Central Bank of Denver, was the indenture trustee for the two bond issues.[114]

The bond covenants required that the bonds be secured by land appraised at values of at least 160% of the outstanding principal and interest.[115] AmWest, the developer of the planned community, provided Central Bank with two appraisals, one in 1986 and one in 1988.[116] Despite significant declines in the local real estate market, the second appraisal, conducted prior to the second bond offering, indicated that land values securing the initial bonds had remained essentially the same since 1986.[117] The lead underwriter conveyed concerns that the 160% test was not being satisfied.[118] Central Bank referred the 1988 appraisal to its in-house appraiser who then suggested that an independent review of the new appraisal be conducted.[119] After communicating with AmWest, however, Central Bank decided to delay the review until after the second bond offering closed in June 1988.[120] Before the independent review could be completed, the Authority defaulted on the 1988 bonds.[121] First Interstate, which had purchased $2.1 million of the second issue bonds, sued alleging the offering was part of a fraudulent scheme, aided and abetted by Central Bank.[122] The district court granted Central Bank summary judgement,[123] but the Tenth Circuit Court of Appeals reversed, holding that even if an alleged aider and abettor owes no duty to plaintiffs, if that person affirmatively assists a primary violation, liability exists and proof of recklessness is sufficient to sustain it.[124] The parties assumed aiding and abetting liability existed, but disputed its scope.[125] On its own initiative, however, the Supreme Court asked the parties to address whether aiding and abetting liability was even available, an issue on which the Court had reserved judgment for over eighteen years.[126]

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113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.*
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.* at 1443-44.
125. *Id.* at 1457 (Stevens, J., dissenting); *see* Pitt, *supra* note 15, at 1 (stating that parties in *Central Bank* assumed existence of aiding and abetting liability in light of 25 years of precedent but disputed scope).
126. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.7 (1976) (deciding to reserve judgment on issue of whether aiding and abetting liability is valid private action); *see also* Thomas

In an opinion written by Justice Kennedy and joined by Chief Justice Rehnquist and Justices O'Connor, Scalia, and Thomas,[127] the Supreme Court reversed the Tenth Circuit, holding that a private right of action for aiding and abetting liability may not be implied under section 10(b) of the 1934 Act.[128] Strictly adhering to the statutory text, the Court held that the language of section 10(b) did not proscribe providing aid to a person who commits a manipulative or deceptive act in connection with the purchase or sale of a security.[129] Further, the Court rejected the SEC's argument as amicus curiae that the phrase "directly or indirectly" used in the text of the statute covered aiding and abetting.[130] The Court found that the reach of aiding and abetting liability encompassed more than just those who may have indirectly engaged in a fraudulent activity and therefore exceeded the scope of the "directly or indirectly" language.[131] The Court stated that section 10(b) only prohibits the making of a material misstatement or omission or the commission of a manipulative act, not the giving of aid to those that do.[132]

The Court's strict construction of the statute was coupled with the policy argument that securities litigation under section 10(b) and Rule 10b-5 presents a danger of vexatiousness over and above that of other litigation.[133] Suggesting that securities litigation had reached excessive proportions, the Court rejected the SEC's argument that aiding and abetting liability should be retained on policy grounds.[134] The SEC argued that such liability deterred secondary actors from contributing to fraudulent activities and enhanced the likelihood that defrauded parties would be made whole.[135] Declining to accept this argument, the Court commented on competing policy arguments such as the vexatious nature of such lawsuits and how minor participants in frauds are often forced to settle for large sums of money in order to avoid uncertain jury trials.[136]

L. Riesenberg, *Supreme Court To Examine Aiding and Abetting Liability Under Rule 10b-5*, 7 INSIGHTS (P-H) No. 8, at 34 (1993) (explaining that in granting certiorari, Supreme Court decided to examine not only knowledge issue, but also to review issue of aiding and abetting liability, which was not addressed by lower courts).

127. *Central Bank*, 114 S. Ct. at 1442.
128. *Id.* at 1455.
129. *Id.* at 1446-47.
130. *Id.* at 1447-48.
131. *Id.* at 1447.
132. *Id.* at 1448.
133. *Id.* at 1454 (quoting Blue Chip Stamps v. Manor Drug Stores, 721 U.S. 723, 739 (1975)).
134. *Id.* at 1453-54.
135. *Id.*
136. *Id.* at 1454. *See generally* Stephan D. Susman, *A Case For a Cease Fire*, TEX. LAW., May 23, 1994, at 18 (commenting on frivolous and blackmail nature of securities lawsuits).

The Court also noted that the rejection of a private aiding and abetting cause of action was consistent with congressional intent.[137] Based on the absence of aiding and abetting liability in any of the express causes of action found elsewhere in the securities laws, the Court stated that it would have been highly unlikely that Congress would have included aiding and abetting liability in section 10(b).[138] Additionally, while Congress specifically addressed secondary liability in the 1934 Act by imposing liability on "controlling persons," it chose not to impose the broader secondary liability of aiding and abetting.[139]

The Supreme Court also rejected the SEC's suggestion that a private cause of action for aiding and abetting liability under section 10(b) could be based on 18 U.S.C. § 2, a general aiding and abetting statute applicable to all federal criminal offenses.[140] Such an approach, the Court said, would imply private civil damage causes of action for every criminal statute passed for the benefit of some particular class of people.[141] The Court, therefore, rejected the argument as having far reaching consequences with "no logical stopping point."[142]

The dissent, written by Justice Stevens and joined by Justices Blackmun, Souter, and Ginsburg, accused the majority of giving "short shrift to a long history"[143] of section 10(b) aiding and abetting liability.[144] Conceding that the 1934 Act did not expressly mention aiding and abetting liability and that Congress knows how to legislate when it wants to, the dissent nevertheless argued that there was no reason to eliminate a private right of action recognized by all the federal circuit courts.[145] According to the dissent, the Court was not writing on a clean slate and "settled construction of an important federal statute should not be disturbed unless and until Congress so decides."[146] The dissent pointed out that Congress chose not to touch the "sizable body of law approving aiding and abetting liability

137. *See Central Bank*, 114 S. Ct. at 1448 (noting that statute itself resolves issue before Court and even if it did not, Court could look to congressional intent where same conclusion would be reached because if 73d Congress wanted to enact private cause of action for aiding and abetting it would have expressly designated such liability, like other private rights of actions under federal securities laws).

138. *Id.* at 1449.

139. *Id.* at 1451-52.

140. *Id.* at 1454-55.

141. *Id.* at 1455.

142. *Id.*

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

144. *Id.* (Stevens, J., dissenting).

145. *Id.* (Stevens, J., dissenting).

146. *Id.* at 1458 (Stevens, J., dissenting).

in private actions under section 10(b) and Rule 10b-5" when it revised the 1934 Act in 1975.[147] In short, the dissent argued that Congress, not the Court, should alter the laws if the legislature disagrees with the prevailing standard.[148] Finally, the statute's "broad" language, encompassing those "indirectly" involved in violating SEC anti-fraud rules, should, according to the dissent, be read "not technically and restrictively, but flexibly to effectuate its remedial purpose."[149]

The Supreme Court's decision in *Central Bank* continues the Court's trend of strictly construing the federal securities laws.[150] Though aiding and abetting liability is not supported by the text of section 10(b) or Rule 10b-5, eradicating it as a private cause of action is a potentially harmful decision as a matter of policy.[151] Concerned about excessive private securities litigation, the majority chose to stick strictly to the text of the statute instead of reading it more broadly as suggested by the dissent.[152] As a result, the Court's decision acted as a "blunt instrument" eliminating meritorious and nonmeritorious lawsuits alike.[153] Wide-ranging judicial decisions of this type affect broad categories of cases regardless of their merit and are not an appropriate substitute for legislation that is carefully crafted to affect only nonmeritorious suits.[154] Additionally, as the dissent argued, Congress chose not to disturb the extensive case law surrounding private aiding and abetting liability.[155] The Court, therefore, should have allowed Congress to tackle private securities litigation reform if and when it decided to do so. Although the Court's decision will

147. *Id.* (Stevens, J., dissenting).

148. *Id.* at 1459 (Stevens, J., dissenting).

149. *Id.* (Stevens, J., dissenting) (citing Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972)).

150. *See id.* at 1445 (emphasizing that adherence to statutory language is starting point in every case for determining scope of liability under § 10(b)).

151. *See id.* at 1460 (Stevens, J., dissenting) (noting effect of majority decision on SEC enforcement and liability for conspiracy to violate Rule 10b-5); *see also* Arthur F. Mathews & W. Hardy Callcott, *Securities Issues Confound Court Observers*, CONN. L. TRIB., Aug. 1, 1994, at 16 (finding that implication of *Central Bank* extends well beyond core issue decided to include: (1) lower courts' decisions implying aiding and abetting liability are no longer good law; (2) presumption that no one can be found civilly liable for conspiracy to commit Rule 10b-5 violations; and (3) potentially negative effect on SEC's enforcement actions under Rule 10b-5).

152. *See Central Bank*, 114 S. Ct. at 1459 (Stevens, J., dissenting) (arguing that recognition of private cause of action for aiding and abetting liability "fits comfortably" within statutory scheme).

153. *See Aiding and Abetting Liability Under the Federal Securities Laws: Hearings on the Impact of the Supreme Court's Decision in Central Bank Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 103d Cong., 2d Sess. (1994) [hereinafter *Aiding and Abetting Hearings*], *available in* 1994 WL 233142, at *2 (statement of Arthur Levitt, Chairman, SEC) (stating that decisions like *Central Bank* affect broad ranges of cases regardless of their merit).

154. *See id.* (suggesting that carefully tailored legislation should be used in place of sweeping judicial decisions).

155. *See Central Bank*, 114 S. Ct. at 1456-58 (Stevens, J., dissenting).

reduce vexatious litigation, the decision has the collateral effect of restricting the chances for recovery by injured investors in meritorious cases.

III. THE IMPACT OF *CENTRAL BANK*

A. Aiding and Abetting Liability as a Private Cause of Action

The most obvious and far reaching impact of *Central Bank* is the loss of aiding and abetting liability as a private cause of action under section 10(b).[156] This decision has eliminated a powerful weapon used by private plaintiffs to reach lawyers, accountants, bankers, and others who assisted in some degree, but may not have been directly involved in, securities fraud.[157] Since the Supreme Court's decision, numerous cases and complaints alleging aiding and abetting liability have been dismissed.[158] Law firms have been advising their clients to take advantage of the opportunity provided by *Central Bank* and seek final judgment in cases involving aiding and abetting claims before Congress, if it should so decide, passes legislation effectively turning back the clock.[159]

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156. *See id.* at 1455 (concluding that private plaintiff may not maintain lawsuit based upon aiding and abetting liability under § 10(b)); Joel Seligman, *The Implications of Central Bank*, 49 BUS. LAW. 1429, 1436 (1994) (indicating major significance of *Central Bank* appears to be in § 10(b) and Rule 10b-5 cases). The *Central Bank* decision, however, only addresses the issue of private causes of action for aiding and abetting liability under § 10(b). *Central Bank*, 114 S. Ct. at 1445. It does not address the issue of aiding and abetting liability under § 10(b) in regards to SEC enforcement actions. *See Congress Mulls Initiative To Restore Liability Suits*, INS. ACCT., May 30, 1994, at 4 (stating decision did not deal specifically with SEC enforcement actions). It is unclear whether *Central Bank* would apply to the SEC, but the dissent wrote that the majority opinion "leaves little doubt that the Exchange Act does not even permit the *Commission* to pursue aiders and abettors in civil enforcement actions under § 10(b) and Rule 10b-5." *Central Bank*, 114 S. Ct. at 1460 (Stevens, J., dissenting).

157. *High Court Rules No Private Remedy for Section 10(b) Aiding, Abetting Violation*, 26 Sec. Reg. & L. Rep. (BNA) No. 16, at 575, 575-76 (Apr. 22, 1994) [hereinafter *High Court Rules*] (stating that decision "reverses a long line of lower court decisions and derails Section 10(b) cases against parties, such as lawyers and accountants, alleged to have had secondary role in a securities fraud").

158. *See, e.g.*, FMC Corp. v. Boesky, 36 F.3d 255, 264 (2d Cir. 1994) (upholding dismissal of aiding and abetting claim based on *Central Bank* decision); Teague v. Bakker, 35 F.3d 978, 991-95 (4th Cir. 1994) (affirming dismissal based upon recent opinion in *Central Bank*); Melder v. Morris, 27 F.3d 1097, 1104 (5th Cir. 1994) (approving dismissal of aiding and abetting claim); Twiss v. Kury, 25 F.3d 1551, 1557-58 (11th Cir. 1994) (affirming lower court's decision to grant summary judgment in favor of defendant on aiding and abetting claim in light of *Central Bank*); Vosgerichian v. Commodore, Int'l, 862 F. Supp. 1371, 1375-78 (E.D. Pa. 1994) (dismissing aiding and abetting claim); Cortec Indus. v. Sum Holding, 839 F. Supp. 1021, 1029-30 (S.D.N.Y. 1994) (dismissing aiding and abetting complaint with prejudice); Schultz v. Rhode Island Hosp. Trust Nat'l Bank, No. CIV.A.88-2870-JLT, 1994 WL 326376, at *3 (D. Mass. May 24, 1994) (dismissing aiding and abetting claim following *Central Bank*).

159. *See* Karen Donovan, *Bill Would Reverse Central Bank*, NAT'L L.J., Aug. 29, 1994, at A14 (describing law firm's client memo urging defendants to avoid impact of legislation by seeking immediate judgment).

Although plaintiffs may attempt to invoke alternative theories to impose liability on secondary participants,[160] without aiding and abetting liability, it is likely that the number of securities fraud lawsuits will decrease substantially.[161] Without aiding and abetting liability, plaintiffs may be more reluctant to pursue securities fraud cases when the likelihood of recovery does not justify the anticipated litigation costs.[162] Before *Central Bank*, aiding and abetting liability was often a plaintiff's best chance of recovery in financial fraud cases because the person who actually perpetrated the fraud was usually bankrupt or otherwise judgment proof by the time the fraud was discovered.[163] Without aiding and abetting liability, private plaintiffs may not be able to reach those actors often in the best position to provide a remedy—those with "deep pockets."[164] Therefore, if plaintiffs are forced to pursue other avenues of liability with less certain outcomes, private plaintiffs may simply choose to bring fewer viable federal securities fraud cases.[165] By eliminating aiding and abetting liability in private actions, *Central Bank* fundamentally alters private securities litigation by restricting meritorious, as well as nonmeritorious actions.[166]

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160. *See* Arthur F. Mathews & W. Hardy Callcott, *Tightening Securities Laws*, 137 N.J. L.J. 1753, 1761 (1994) (stating that *Central Bank* decision will force plaintiffs to use new theories of liability); *see also* Lisa K. Wager & John E. Failla, *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.—The Beginning of an End, Or Will Less Lead to More?*, 49 BUS. LAW. 1451, 1462 (1994) (explaining that plaintiffs may replead aiding and abetting claims to rely upon other theories of secondary liability).

161. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Arthur Levitt, Chairman, SEC), *available in* 1994 WL 233142, at *7 (describing negative effect of decision on private actions for securities fraud). *But see* Mathews & Callcott, *supra* note 160, at 1761 (describing potential increases in RICO claims, Blue-Sky securities statutes, and common-law fraud actions); Wager & Failla, *supra* note 160, at 1456 (explaining that shift to alternative theories of secondary liability following demise of aiding and abetting liability will guarantee substantial litigation).

162. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Arthur Levitt, Chairman, SEC), *available in* 1994 WL 233142, at *7 (stating that without aiding and abetting liability, number of cases where expected recovery does not justify expected litigation costs will increase).

163. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Arthur Levitt, Chairman, SEC), *available in* 1994 WL 233142, at *7 (explaining that perpetrator of fraud usually becomes bankrupt before or shortly after fraud is discovered).

164. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Donald C. Langevoort), *available in* 1994 WL 233134, at *7 (stating that defendants are often named in pursuit of deep pocket); Pitt, *supra* note 15, at 6 (describing targets of aiding and abetting suits as "deep-pocketed").

165. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Arthur Levitt, Chairman, SEC), *available in* 1994 WL 233142, at *7 (claiming that plaintiffs may not bring federal securities fraud cases if it appears unlikely that liability can be established using theory other than aiding and abetting).

166. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Arthur Levitt, Chairman, SEC), *available in* 1994 WL 233142, at *2 (stating that decisions like *Central Bank* are "blunt instruments" affecting large numbers of cases regardless of merits).

B. Alternative Theories of Liability

Despite the loss of aiding and abetting liability as a private cause of action, other weapons remain at the disposal of the private plaintiff. Though perhaps not as effective as aiding and abetting liability in reaching traditional secondary participants, other possible theories include primary liability and alternative forms of secondary liability.[167] In the first instance, private plaintiffs may now try to pursue lawyers, accountants, and bankers as primary violators, instead of as aiders and abettors. The majority opinion in *Central Bank* expressly stated that secondary actors could, under appropriate circumstances, still be held liable as primary violators.[168] The dissent echoed this view.[169] Before *Central Bank*, the distinction between primary and secondary liability had little tangible significance because both classes of actors were jointly and severally liable for their misconduct.[170] As a result, the dividing line between these two theories had been described as "indistinct" and "virtually nonexistent."[171] Now, the courts will have to determine the boundaries of primary liability.[172] In addition, they will have to determine whether categories of actors formerly treated as aiders and abettors could remain liable as primary

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167. *See infra* notes 178-85 and accompanying text.

168. *Central Bank*, 114 S. Ct. at 1455. The Court stated:

> The absence of Section 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the Securities Acts. Any person or entity, including a lawyer, accountant, or bank who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met.

Id.

169. *Id.* at 1459 n.10 (Stevens, J., dissenting). The dissent further notes that this would include accountants, lawyers, and other individuals who make oral or written misrepresentations in connection with the purchase or sale of securities. *Id.*

170. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Arthur Levitt, Chairman, SEC), *available in* 1994 WL 233142, at *4 (explaining that uncertainty exists regarding difference between primary and secondary liability because prior to *Central Bank*, both types of violators were jointly and severally liable).

171. *See* Bromberg & Lowenfels, *supra* note 57, at 640 (indicating that line between primary liability and aiding and abetting liability is uncertain); *see also* Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 495-96 (7th Cir. 1986) (finding that aiders and abettors can only be found liable for securities fraud if they have same mental state required for primary liability).

172. *See* Seligman, *supra* note 156, at 1439 (explaining that *Central Bank* should at least force courts to sharpen distinction between primary and secondary liability under § 10(b)).

violators[173] and under what circumstances this would be appropriate.[174]

The courts may take an expansive view of primary liability in order to include actors heretofore subject to aiding and abetting liability. The few decisions that have addressed the distinction between primary and secondary liability have shown that primary liability can have a fairly broad scope.[175] It is far from certain, however, that the courts will choose to expand the coverage of primary liability. In fact, the Supreme Court's move towards a more restrictive interpretation of the securities laws and its suggestion in *Central Bank* that "vexatious litigation" influenced its decision[176] would seem to indicate that the courts will restrictively interpret primary liability as well.[177]

Alternative theories of secondary liability are also available.[178] For example, private plaintiffs could attempt to reach secondary actors through "controlling person,"[179] "respondeat superior,"[180] and

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173. *See* Seligman, *supra* note 156, at 1439-41 (arguing that certain types of actors are more likely to be held primarily liable than others, namely accountants, whereas lawyers, broker-dealers, and bankers are less likely). Accountants will more likely be held primarily liable compared to other professionals because they sign financial reports. *Id.*

174. *See* Wager & Failla, *supra* note 160, at 1456 (explaining that most significant obstacles to repleading aiding and abetting claims as primary violations will be requirements that plaintiff plead and prove that defendant owed duty to plaintiff, acted with scienter, and that plaintiff relied upon defendant's actions).

175. *See, e.g.*, Molecular Technology Corp. v. Valentine, 925 F.2d 910, 917-18 (6th Cir. 1991) (holding that attorney who reviewed and edited disclosure materials to assist client could be held liable as primary, not secondary, actor in alleged wrongdoing); *see also* SEC v. Washington County Util. Dist., 676 F.2d 218, 223-24 (6th Cir. 1982) (finding that primary liability does not require direct contact); *In re* Rospatch Sec. Litig., 802 F. Supp. 110, 115 (W.D. Mich. 1992) (refusing to dismiss complaint against law firm alleging primary and secondary liability for securities fraud).

176. *Central Bank*, 114 S. Ct. at 1454.

177. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Donald C. Langevoort), *available in* 1994 WL 233142, at *3 (suggesting courts may interpret scope of primary liability narrowly instead of expansively because of concern over excessive private securities litigation); Seligman, *supra* note 156, at 1439 (claiming that given recent trend of narrowing scope of securities laws, it is impossible to predict to what extent former aiders and abetters may be primarily liable).

Congress could preempt the courts and mandate a restrictive interpretation of primary liability even before the courts get a chance to consider the issue. H.R. 1058, passed by the House of Representatives on March 8, 1995, narrowly defines scienter so that "liability may be established only on proof that: (a) the defendant directly or indirectly made a fraudulent statement; (b) the defendant possessed the intention to deceive, manipulate, or defraud; and (c) the defendant made such fraudulent statement knowingly or recklessly." H.R. 1078, Sec. 4, § 10A(a)(1), 104th Cong., 1st Sess. (1995).

178. *See infra* notes 180-93 and accompanying text.

179. *See supra* notes 9-11 and accompanying text (defining controlling persons and control person liability); *see also* 15 U.S.C. § 77o (1988) (providing that any person who controls another party is liable for his actions unless control person has no knowledge or reasonable grounds for belief). Though control person liability might be able to replace aiding and abetting liability in some cases, it will not be able to do so entirely. Wager & Failla, *supra* note 160, at 1465. Specifically, it will be difficult to satisfy all of the elements of controlling person liability in suits against attorneys, outside directors, and bankers. *Id.*

conspiracy[181] theories of secondary liability. As the dissent suggested, however, *Central Bank* raised some doubt regarding the continued availability of these other forms of secondary liability,[182] particularly conspiracy and respondeat superior liability.[183] While "controlling persons" liability is specifically addressed in section 20(a) of the Securities Exchange Act, "respondeat superior" and other related agency theories are not, and therefore, remain at risk in light of the Supreme Court's reasoning in *Central Bank*.[184] In fact, at least one lower court has held that conspiracy liability, which is a form of agency theory, is no longer available as a cause of action in securities fraud.[185]

C. Aiding and Abetting Liability as a Deterrent

If private plaintiffs choose not to pursue their federal securities claims, many injured investors will be left without a remedy and the SEC will lose a "necessary supplement" to its enforcement efforts.[186]

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180. Fischel, *supra* note 19, at 86. "Respondeat superior" is a common law theory of secondary liability whereby "employers are strictly liable for the improper acts of their employees committed within the scope of their employment." *Id.* This theory allows plaintiffs to recover from employers for the actions of their employees regardless of whether the employer acted in "good faith" under § 15 and § 20(a) of the 1933 and 1934 Acts. *Id.*

181. Wager & Failla, *supra* note 160, at 1463. In order to establish a claim of conspiracy to violate § 10(b) and Rule 10b-5, the plaintiff must allege and prove that:

(1) An agreement between two or more persons to commit an unlawful act in an unlawful manner;
(2) An overt act committed by one of the persons to the agreement in furtherance of the common scheme; and
(3) Injury resulting from the overt act.

Id. (citing Halberstam v. Welch, 705 F.2d 472, 477 (D.C. Cir. 1983)).

182. *Central Bank*, 114 S. Ct. at 1460 (Stevens, J., dissenting). The dissent suggests that the "majority's approach to aiding and abetting at the very least casts serious doubt, both to private and SEC actions, on *other* forms of secondary liability that, like the aiding and abetting theory, have long been recognized by the SEC and the courts but are not expressly spelled out in the securities laws" such as conspiracy, respondeat superior, and other common law agency principles. *Id.*

183. Wager & Failla, *supra* note 160, at 1462 (suggesting that causes of action based on common law doctrine of respondeat superior and other related doctrines must be questioned if not rejected following *Central Bank*); *see also* Seligman, *supra* note 156, at 1435-36 (concluding that loss of conspiracy liability in securities fraud would be insignificant and that loss of respondeat superior liability would be only slightly more significant).

184. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Donald C. Langevoort), *available in* 1994 WL 233142, at *4 (finding respondeat superior and other common law theories of liability at risk following *Central Bank* because these theories are not specifically provided for by statute); Wager & Failla, *supra* note 160, at 1462-63 (claiming that Court's strict reliance on statute in *Central Bank* to define scope of conduct prohibited requires that liability based on common law secondary liability principles be rejected).

185. *See In re* Syntex Corp. Sec. Litig., 885 F. Supp. 1086, 1098 (N.D. Cal. 1994) (dismissing both aiding and abetting and conspiracy liability theory claims as result of *Central Bank*).

186. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Arthur Levitt, Chairman, SEC), *available in* 1994 WL 233142, at *10 (testifying that private actions have served to both complement SEC enforcement activities and compensate injured investors).

A situation that allows defrauded investors to go uncompensated due to a lack of effective and equitable private remedies may lead to decreased investor confidence in the "fairness of the securities markets."[187] Additionally, a decrease in meritorious lawsuits may significantly reduce the effectiveness of private actions as a means of deterrence.[188] Though the SEC devotes considerable resources to identifying and confronting violators of the federal securities laws, it is increasingly unable to proceed with every meritorious enforcement action.[189] Private actions, therefore, play a substantial role in deterring potential violators. These private plaintiffs act as "tens of thousands of private attorneys general" enforcing the securities laws.[190] Without aiding and abetting liability under section 10(b), the most prevalent private cause of action before *Central Bank*,[191] these "private attorneys general" will not be in the courts deterring fraudulent conduct.[192]

IV. RECOMMENDATIONS

A. Proposed Legislation

The decision in *Central Bank* eliminated a private cause of action widely used by investors and other securities market participants.[193] Further, it has created uncertainty as to aiding and abetting liability's continued availability to the SEC in public enforcement actions.[194]

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187. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Arthur Levitt, Chairman, SEC), *available in* 1994 WL 233142, at *10 (stating that effective private remedies are essential to investor confidence in fairness of securities markets).

188. *See* Seligman, *supra* note 156, at 1441 (suggesting that *Central Bank* decision will eliminate private and possibly SEC actions for aiding and abetting under § 10(b) and Rule 10b-5, which will reduce deterrent effect of these provisions for accountants, and for attorneys, broker-dealers, and bankers in particular).

189. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Arthur Levitt, Chairman, SEC), *available in* 1994 WL 233142, at *10-11 (testifying that despite devoting significant assets to confronting violations of securities laws, SEC cannot pursue every case).

190. *See High Court Rules*, *supra* note 157, at 575 (quoting Rep. Edward Markey (D-Mass.), then-Chairman of House Energy and Commerce Subcommittee on Telecommunications and Finance).

191. *See* Bromberg & Lowenfels, *supra* note 57, at 639 (stating that aiding and abetting liability is theory most widely used to hold nonprivity parties and other secondary participants responsible for violations of securities laws).

192. *See* Bromberg & Lowenfels, *supra* note 57, at 640-45 (discussing aiding and abetting liability).

193. *See supra* note 191 and accompanying text (discussing prevalence of aiding and abetting liability).

194. *See supra* note 156 (suggesting that even though *Central Bank* was limited to private actions, aiding and abetting liability is unavailable to SEC in enforcement actions). Though *Central Bank* did not specifically apply to the SEC, the SEC has chosen to voluntarily dismiss or withdraw most of its complaints alleging aiding and abetting liability. *See* Mathews & Callcott, *supra* note 160, at 1759 (indicating that SEC has dismissed or replaced aiding and abetting suits

To address these problems and other concerns raised by *Central Bank*, Congress should take action to ensure the continued smooth and effective operation of the federal securities laws.

1. Aiding and abetting liability

First, Congress should legislatively overrule the decision in *Central Bank*. Legislation should be introduced amending the 1934 Act making aiding and abetting liability available to both the SEC and to private plaintiffs under section 10(b) and Rule 10b-5.[195] Legislation similar to that introduced on July 22, 1994 by then-Sen. Howard Metzenbaum[196] would have satisfied this particular need. Congress, however, would be remiss if it simply stopped there. Merely adding the words "aiding and abetting liability" to the statute will not adequately address the scope of this important cause of action. Such language would allow restrictive interpretation by the courts. Without more precise language to guide them, the courts may interpret aiding and abetting liability so strictly as to make it barely distinguishable from primary liability, thereby rendering such legislation effectively meaningless.[197] Instead, Congress should provide guidance to the courts regarding the direction and development of aiding and

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in wake of *Central Bank*); *see also* SEC v. Patel, 1994 Fed. Sec. L. Rep. (CCH) ¶ 98,340 (S.D.N.Y. July 12, 1994) (allowing voluntary dismissal of aiding and abetting complaint by SEC); SEC v. Militano, 1994 Fed. Sec. L. Rep. (CCH) ¶ 98,330 (S.D.N.Y. June 23, 1994) (permitting SEC to voluntarily dismiss aiding and abetting complaint).

195. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Sen. Christopher Dodd), *available in* 1994 WL 233120, at *3 (calling for prompt, but carefully crafted, legislative response to *Central Bank*); *id.* (statement of Harvey Goldschmid), *available in* 1994 WL 233132, at *6 (recommending overruling *Central Bank* as quickly as practicable); *id.* (statement of Mark Griffin), *available in* 1994 WL 233147, at *7 (recommending limited legislation to overrule *Central Bank*); *id.* (statement of Arthur Levitt, Chairman, SEC), *available in* 1994 WL 233142, at *2 (suggesting that Congress pass legislation addressing decision in *Central Bank*); *id.* (statement of David Ruder), *available in* 1994 WL 233136, at *7-8 (suggesting that Congress pass more comprehensive legislation when reversing *Central Bank*); Seligman, *supra* note 156, at 1446 (recommending Congress adopt legislation restoring aiding and abetting liability in private and SEC § 10(b) cases).

196. *See* S. 2306, 103d Cong., 2d Sess. (1994) (amending 1934 Act to include aiding and abetting liability). Sen. Metzenbaum's bill, called the "Securities Fraud Fairness Act," sought to amend § 10(b) of the 1934 Act by inserting the words, "or to aid and abet the use or employ of any manipulative or deceptive device or contrivance," before the words "in contravention." *Id.*

197. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Sen. Christopher Dodd), *available in* 1994 WL 233120, at *3 (stating that any legislation responding to *Central Bank* must be carefully tailored so as to avoid new round of dismemberment by courts); *id.* (statement of David S. Ruder), *available in* 1994 WL 233136, at *7-8 (indicating that if Congress provides no guidance, courts may interpret aiding and abetting doctrine differently than what Congress would want); David S. Ruder, *The Future of Aiding and Abetting and Rule 10b-5 After Central Bank of Denver*, 49 BUS. LAW. 1479, 1485 (1994) (suggesting that Congress should codify elements of aiding and abetting liability because language of *Central Bank* suggests that Supreme Court may not agree with federal circuit courts in interpretation of aiding and abetting liability).

abetting liability, and thereby reduce the possibility of future problems or conflicts. H.R. 555,[198] a bill introduced by Rep. Edward Markey (D-Mass.) on January 18, 1995 to reform private securities legislation, made such an effort to guide the courts with the language it used to reinstate aiding and abetting liability in securities fraud.[199]

The elements of aiding and abetting liability should be clearly defined in legislation addressing this theory.[200] The three elements should be: (1) primary violation of the securities laws (section 10(b)/Rule 10b-5) by another party; (2) knowledge of the primary violation; and (3) substantial assistance in effecting the primary violation.[201] This formulation would codify the position held by a

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198. H.R. 555, 104th Cong., 1st Sess. (1995).

199. *See id.* sec. 103 (restoring aiding and abetting liability by amending 1933 Act, 1934 Act, Investment Company Act, and Investment Advisors Act). H.R. 555 attempted to restore aiding and abetting liability to each of the major securities acts by adding the following language:

> Prosecution of Persons Who Aid or Abet Violations. . . . [A]ny person who knowingly or recklessly provides substantial assistance to another person in the violation of a provision of this title, or of any rule or regulation hereunder, shall be deemed to violate such provision to the same extent as the person to whom such assistance is provided. No person shall be liable under this subsection based on an omission or failure to act unless such omission or failure constituted a breach of duty owed by such person.

Id.

Of the several private securities litigation reform bills that were before Congress this session, one other, H.R. 681, attempted to reinstate aiding and abetting liability in securities fraud. H.R. 681, 104th Cong., 1st Sess. sec. 3, § 20B(f) (1995). Introduced by Rep. Billy Tauzin (D-La.) on January 25, 1995, the bill sought to reinstate a more limited form of aiding and abetting liability than under H.R. 555. Specifically, H.R. 681 tried to reinstate aiding and abetting liability in securities fraud by adding the following language to § 20 of the 1934 Act:

> [A] defendant may be held liable as an aider and abettor only if the plaintiff proves that the defendant knew that another party had violated a provision of this Act and that the defendant, acting with deliberate intent to deceive, manipulate, or defraud for the defendant's own direct pecuniary benefit, provided substantial assistance to the other party's violation.

Id. Unlike H.R. 555, H.R. 681 effectively eliminated recklessness as a sufficient standard for scienter due to the deliberate intent requirement. Additionally, H.R. 681 tried to further limit those that could be held liable as aiders and abetters by including a requirement that the defendant received a direct pecuniary benefit, not to include "ordinary compensation for services provided." H.R. 681 sec. 3, § 20B(f).

200. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Harvey Goldschmid), *available in* 1994 WL 233132, at *6-7 (calling for legislation defining aiding and abetting liability by its traditional elements); Ruder, *supra* note 197, at 1484 (suggesting that one way Congress could react to *Central Bank* is to reinstate aiding and abetting liability and explicitly set forth elements of aiding and abetting liability in so doing).

201. *See* H.R. 555 sec. 103(a), § 20(f) (defining aider or abettor as "any person who knowingly or recklessly provides substantial assistance to another person in the violation of a provision of this title"); *see also Aiding and Abetting Hearings*, *supra* note 153 (statement of Harvey Goldschmid), *available in* 1994 WL 233132, at *6 (listing elements of aiding and abetting liability); *supra* note 54 and accompanying text (listing elements of aiding and abetting liability); *cf.* H.R. 681 Sec. 3, § 20B(f) (proposing that elements of aiding and abetting liability be that defendant knew another party had violated securities laws, defendant acted with deliberate intent to deceive, manipulate, or defraud for direct personal pecuniary benefit, and that defendant "provided substantial assistance to other party's violation").

majority of circuit courts[202] before the decision in *Central Bank.*

Congress should also delineate a uniform standard that satisfies the knowledge/scienter requirement.[203] To establish culpability as an aider and abettor under section 10(b), the amendment should indicate that "recklessness"[204] with respect to a primary violation satisfies the knowledge requirement, even absent a duty of disclosure to the defrauded party.[205] If, however, liability is premised on an omission or failure to act, as opposed to an affirmative act, a breach of duty to the defrauded party should be required for liability.[206]

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202. *See supra* notes 54-56 and accompanying text (discussing elements of aiding and abetting liability and majority view).

203. *See* Riesenberg, *supra* note 126 and accompanying text (indicating issue originally requested for certiorari was knowledge issue). The issue of whether recklessness or actual knowledge satisfied scienter under § 10(b) was the question originally petitioned for review by the Supreme Court in *Central Bank. Id.* When the Court decided in *Central Bank* that aiding and abetting liability is unavailable as a private cause of action, the issue regarding scienter was left unaddressed. *See Aiding and Abetting Hearings, supra* note 153 (statement of Harvey Goldschmid), *available in* 1994 WL 233132, at *6.

204. "Recklessness" should also be defined by statute, rather than being left up to judicial interpretation. The codified definition of recklessness should be based on a widely accepted and cited version. One such version describes recklessness as:

> a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.

Franke v. Midwestern Okla. Dev. Auth., 428 F. Supp. 719, 725 (W.D. Okla. 1976), *vacated on other grounds,* 619 F.2d 856 (10th Cir. 1980); *see* Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir.) (adopting *Franke* definition as standard), *cert. denied,* 434 U.S. 875 (1977); *see also* Camp v. Dema, 948 F.2d 455, 460-61 (8th Cir. 1991) (adopting *Sunstrand* standard); Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569 n.8 (9th Cir. 1990) (en banc) (following *Sundstrand* standard), *cert. denied,* 111 S. Ct. 1621 (1991); Broad v. Rockwell Int'l Corp., 642 F.2d 929, 961 (5th Cir.) (en banc) (adopting *Sunstrand* as controlling standard), *cert. denied,* 454 U.S. 965 (1981).

H.R. 1058, the only private securities litigation reform bill to be passed by the House of Representatives this session, incorporates a definition of recklessness drawn from *Sunstrand.* H.R. 1058, 104th Cong., 1st Sess., sec. 4, § 10A(a)(14) (1995); *see also House Amends and Passes Legislation to Reform Private Securities Litigation,* Daily Rep. for Executives (BNA), at A46 (Mar. 9, 1995) [hereinafter *House Passes Legislation*] (indicating definition in bill is based on *Sunstrand*). This definition details the standard of liability for reckless conduct in a primary violation under § 10(b) of the 1934 Act. *See House Passes Legislation, infra,* at A46 (explaining application of recklessness definition). Neither the bill's definition of recklessness nor the bill as a whole apply to or incorporate aiding and abetting liability.

205. *See* H.R. 555 sec. 103, § 20(f) (providing that one who "knowingly or recklessly" aids primary violation of securities laws will be liable as aider and abettor); *see also* McDermott, *supra* note 32, at 1112 (explaining that wholesale application of recklessness standard provides best protection for investor); Ruder, *supra* note 197, at 1485 (recommending that legislation indicate that recklessness satisfies scienter requirement but that recklessness must be so severe that it approaches intent to defraud). *But see* H.R. 681 sec. 3, § 20B(f) (requiring deliberate intent to deceive thereby effectively eliminating recklessness as sufficient standard for scienter in aiding and abetting liability); *cf.* H.R. 1058, sec. 4, § 10A(a) (proposing that both actual knowledge and recklessness be appropriate standards for scienter in primary action under § 10(b) but not providing for aiding and abetting liability).

206. Section 103 of H.R. 555 would also require that an omission or failure to act constitute a breach of duty owed to the defrauded party by the alleged aider and abetter in order for the omission or failure to act to be actionable under any of the amended sections of the securities

Recklessness is the appropriate standard for scienter because it discourages deliberate ignorance and prevents defendants from escaping liability because of what is often an impossible task of proving actual knowledge based on circumstantial evidence—usually the only type of evidence available.[207] Recklessness, as defined in this Comment,[208] would require a high degree of culpability in order to establish liability, but it would not be so limiting so as to impede the vigorous enforcement of the law.[209]

2. Limited securities litigation reform

Congress should also use this opportunity to pursue some form of limited private securities litigation reform. Specifically, Congress should abandon pure joint and several liability[210] in those lawsuits relying on aiding and abetting, and instead, adopt a system combining both proportionate and joint and several liability. For cases alleging a primary violation of the securities laws, joint and several liability for all primary violators should be left intact. Under this proposal, once a plaintiff has satisfied all of the elements of aiding and abetting liability and culpability has been established, the knowledge element would become the controlling factor with respect to damage apportionment.

In this respect, a two-tier approach combining both joint and several and proportionate liability should be adopted for resolving damage apportionment in those cases where the aider and abettor was only reckless.[211] If the knowledge element is satisfied by the minimum standard of recklessness, rather than the higher standard of actual knowledge, a second inquiry will need to be made: what was the aider and abettor's degree of fault?[212] Legislation should

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laws. H.R. 555 sec. 103.

207. Brief for the Securities and Exchange Commission as Amicus Curiae in Support of Respondents at 9, Central Bank v. First Interstate Bank, 114 S. Ct. 1439 (1994) (No. 92-854) [hereinafter SEC Brief].

208. *See supra* note 204 (defining "recklessness").

209. *See* SEC Brief, *supra* note 207 (indicating advantages of recklessness standard).

210. *See* STUART M. SPEISER ET AL., THE AMERICAN LAW OF TORTS § 3.6 (1983 & Supp. 1994) (explaining that joint and several liability is common law doctrine that holds each tortfeasor separately and personally liable for all damages arising from injury where harm to victim is indivisible, even though injury results from tortious acts of more than one tortfeasor).

211. *Cf.* Seligman, *supra* note 156, at 1446 (recommending that aiding and abetting liability be restored, but that all aiders and abetters be limited to proportionate liability except in circumstance where bankrupt primary violator has not been adequately insured).

212. The degree of fault or responsibility will be determined by the jury, or the court if there is no jury. The method of making this determination could be very similar to that proposed in the Private Securities Litigation Reform Act of 1995, S. 240, 104th Cong., 1st Sess. sec. 203, and the Securities Litigation Reform Act, H.R. 1058, 104th Cong., 1st Sess. sec. 4, § 10A(e) (1995). Specific legislation should include language to the effect that if the knowledge element of an

indicate that if an aider and abettor is found to be more than twenty percent at fault for the fraud in relation to the other defendants, the aider and abettor will be jointly and severally liable. On the other hand, if the aider and abettor's degree of fault for the violation is twenty percent or less, the aider and abettor will only be liable for a proportion of the total damages equal to his relative degree of responsibility.[213] The cutoff level of twenty percent is an arbitrary figure above which the defendant should be considered a significant participant in the fraud, and below which a minor participant. This mixture of joint and several liability and proportionate liability closely resembles similar schemes established by some states to control damage liability in negligence or fault-based personal injury cases.[214]

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aiding and abetting violation is satisfied by recklessness:

> the court shall instruct the jury to answer special interrogatories, or if there is no jury, shall make findings, concerning the degree of responsibility of each person alleged to have caused or contributed to the violation of this title, including persons who have entered into settlements with the plaintiff. The interrogatories or findings shall specify the amount of damages the plaintiff is entitled to recover and the degree of responsibility, measured as a percentage of the total fault of all persons involved in the violation, of each person found to have caused or contributed to the damages incurred by the plaintiff or plaintiffs. In determining the degree of responsibility, the trier of fact shall consider-
>
> (1) the nature of the conduct of each person; and
>
> (2) the nature and extent of the causal relationship between that conduct and the damage claimed by the plaintiff.

S. 240 sec. 203, § 41(c); H.R. 1058 sec. 4, § 10A(e). Additionally, the Supreme Court recently affirmed a proportionate liability formula for nonsettling defendants in an admiralty case, McDermott, Inc. v. AmClyde, Inc., 114 S. Ct. 1461, 1464-66 (1994). This approach could also be used as a means of determining a defendant's proportionate share. *See* Seligman, *supra* note 156, at 1444-45 (discussing use of "proportionate share" approach in aiding and abetting liability).

213. This approach can best be illustrated by the following example. A securities fraud case is decided in which a $10 million judgment is entered against three defendants: *A*, *B*, and *C*. *A*, as the primary violator, is found to be 60% liable, while *B* and *C*, each an aider and abettor, are found to be 30% and 10% at fault, respectively. Before the judgment is collected, *A* is insolvent and declares bankruptcy. Under the legislation proposed in this Comment, assuming *C* was merely reckless, *C* would be liable for only its one million dollar proportionate share because its degree of responsibility is under 20%. *B*, on the other hand, as the more culpable defendant, would be liable for the remaining nine million dollars, made up of his proportionate share of three million dollars, as well as *A*'s six million dollar share. If, however, *C* was not reckless but had actual knowledge of the fraud, *C* would be joint and severally liable with *A* for the entire judgment. *See* STAFF OF SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 103D CONG., 2D SESS., REPORT ON PRIVATE SECURITIES LITIGATION 127-28 (Comm. Print 1994) [hereinafter STAFF REPORT ON LITIGATION REFORM] (demonstrating combined joint and several/proportionate liability approach). *But cf.* S. 240 sec. 203, § 41(b)(1) (proposing joint and several liability only for defendants who are primary wrongdoers, engaged in knowing securities fraud, or controlling primary wrongdoer, regardless of percentage of fault); H.R. 1058 sec. 4, § 10A(e) (proposing joint and several liability only for primary wrongdoers who knowingly engage in securities fraud regardless of total fault); H.R. 681 sec. 3, § 20B(a)(2) (proposing that defendant who does not engage in knowing securities fraud can only be liable to degree of his responsibility for violation, regardless of percentage of fault).

214. *See* STAFF REPORT ON LITIGATION REFORM, *supra* note 213, at 126 n.324 (indicating that in some states, proportionate liability applies when defendant's degree of responsibility falls

If, on the other hand, a defendant engages in "knowing securities fraud,"[215] then joint and several liability will apply.[216] This particular recommendation is consistent with more extensive attempts to reform private enforcement of the federal securities laws by Representatives Thomas Bliley (R-Va.), Jack Fields (R-Tex.), Christopher Cox (R-Cal.), and William Tauzin (D-La.),[217] and Senators Christopher Dodd (D-Conn.) and Pete Domenici (R-N.M.).[218] These bills, however, which are more limiting than the legislation proposed in this Comment,[219] specifically exclude recklessness from joint and several liability.[220] Such legislation would unfairly limit the compensation that an investor could receive for injuries caused by the reckless conduct of a substantial participant. Though a minor participant in a fraud should not be held entirely responsible for a judgment,

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below certain level); *see, e.g.*, ILL. REV. STAT. ch. 735, para. 5/2-1117 (1993) (allowing proportionate liability for defendants less than 25% responsible for nonmedical expenses in personal injury and product liability cases); IOWA CODE § 668.4 (1987) (imposing proportionate liability on defendants less than 50% responsible); OR. REV. STAT. § 18.485 (1993) (allowing proportionate liability only when defendant is less than 15% liable); W. VA. CODE § 29-12A-7 (1992) (indicating that proportionate liability will apply only when defendant is less than 25% responsible).

215. "Knowing securities fraud" as defined by proposed legislation in the Senate is either a "material representation with [defendant's] actual knowledge that the representation is false" or an omission, "with [defendant's] actual knowledge that, as a result of the omission, one of the defendant's material representations is false and [defendant] knows that other persons are likely to rely on that misrepresentation or omission." S. 240 sec. 203(a), § 41(b)(2)(B)(i). Under the legislation passed by the House of Representatives, a defendant "knowingly" makes a fraudulent statement if the defendant "knew that the statement of a material fact was untrue at the time it was made, or knew that an omitted fact was necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading." H.R. 1058 sec. 4, § 10A(a)(3).

216. *See* S. 240 sec. 3, § 20A(a)(1) (requiring that joint and several liability apply to those engaging in knowing securities fraud); H.R. 1058 sec. 4, § 10A(e)(1) (proposing that joint and several liability apply to those engaged in knowing securities fraud); H.R. 681 Sec. 3, § 20B(a)(1) (suggesting that joint and several liability apply to those engaging in knowing securities fraud).

217. *See* H.R. 1058 sec. 4, § 10A(e) (proposing several changes to private securities litigation including that only defendants engaging in knowing securities fraud be jointly and severally liable and those who are reckless be proportionately liable). H.R. 1058 was passed by the House of Representatives in a 325-99 vote on March 8, 1995. *House Passes Legislation*, *supra* note 204, at A46.

218. *See* S. 240 sec. 203(a), § 41 (proposing several changes to private securities litigation including that defendants engaging in knowing securities fraud, primary wrongdoers and those controlling primary wrongdoers, be jointly and severally liable). S. 240 was passed by the Senate in a 70-29 vote on June 28, 1995. *Much Debated Securities Litigation Bill Breezes Through Senate by 70 to 29 Vote*, Daily Report for Executives (BNA), at A125 (June 29, 1995).

219. In addition to specifically excluding all reckless conduct from joint and several liability, these bills fail to reinstate aiding and abetting liability. *See* S. 240 (failing to mention aiding and abetting liability); H.R. 1058 (failing to reinstate aiding and abetting liability anywhere in its provisions).

220. *See* S. 240 sec. 203, § 41(b)(2)(B)(i) (stating that "knowing securities fraud" does not include reckless conduct); H.R. 1058 sec. 4, § 10A(e)(1) (stating that defendant "may be liable jointly and severally only if the trier of fact specifically determines that the defendant acted knowingly"); H.R. 681 sec. 3, § 20B(a)(3) (stating that "reckless conduct by the defendant shall not be construed to constitute 'knowing securities fraud'").

a fraud should not be held entirely responsible for a judgment, neither should a substantial participant escape the responsibility of making an injured party whole simply because his conduct was merely reckless. If responsibility for damages is to fall upon the shoulders of a particular party, it should be on the more culpable significant participant and not on the innocent plaintiff or minor participant. Therefore, instead of eliminating joint and several liability in securities fraud cases involving reckless conduct altogether, Congress should merely limit it as proposed in this Comment.

Finally, this legislation should include two remaining provisions. First, a defendant's right to contribution[221] should be expressly provided for within the statute. This provision would codify the Supreme Court's holding in *Mussik, Peeler & Garrett v. Employers Insurance of Wausau*,[222] which found that defendants in a Rule 10b-5 suit have a right to seek contribution as a matter of federal law.[223] Second, this legislation should clearly indicate that the newly added aiding and abetting provisions of section 10(b) and the "controlling person" provisions of section 15 of the 1933 Act and section 20(a) of the 1934 Act are the exclusive means of establishing secondary liability and for providing remedies against persons other than primary violators in securities fraud cases.[224]

B. Advantages of Legislative Reform

The approach to civil liability in aiding and abetting securities fraud proposed in this Comment has several advantages. First, aiders and abettors on the fringe of a securities violation will be held responsible to the degree that they advanced or were responsible for the fraud, provided that their degree of responsibility is twenty percent or less.[225] Typically, aiding and abetting defendants are professionals whose roles in a fraud have been secondary.[226] In the past, such secondary participants had often been forced to pay entire judgments

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221. *See* STAFF REPORT ON LITIGATION REFORM, *supra* note 213, at 120 (describing doctrine of contribution). Under the doctrine of contribution, each tortfeasor (defendant) may seek reimbursement from the other persons who are jointly liable with him for a plaintiff's damages to recover any payment to the plaintiff for liability in excess of that tortfeasor's proportionate share based on fault. *Id.*

222. 113 S. Ct. 2085 (1993).

223. Musick, Peeler & Garrett v. Employers Ins., 113 S. Ct. 2085, 2089-92 (1993).

224. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of David S. Ruder), *available in* 1994 WL 233136, at *8 (recommending that Congress indicate in new legislation that aiding and abetting and "controlling person" theories are only theories of secondary liability in federal securities laws).

225. *See supra* notes 213-14 and accompanying text (discussing 20% liability cutoff).

226. *See* Sager, *supra* note 59, at 821 (indicating that lenders, brokers, accountants, and others in similar positions are usually targets of secondary liability allegations).

because they were jointly and severally liable with the primary violator and the primary violator was bankrupt.[227] Because these defendants could become responsible for all the damage caused by the primary violator, secondary defendants frequently settled for significant sums in order to avoid the onerous possibility of liability for the entire amount claimed.[228] With this change, true aiders and abettors will only be responsible to the extent that they furthered the violation, as long as their relative degree of responsibility is less than twenty percent. Secondary actors who significantly assist a violation will still face joint and several liability. As a result, innocent plaintiffs are still made whole by aiders and abettors who either had actual knowledge or were significant participants. Additionally, plaintiffs are able to recover proportionate damages from minor aiders and abettors. This change would serve to balance the objective in the measurement of damages in securities fraud litigation between compensation and deterrence.[229]

This change in damage liability for aiders and abettors under section 10(b) may also have a two-fold deterrent effect. First, by reinstating aiding and abetting liability, potential aiders and abettors of securities fraud will likely be deterred from assisting violations of the securities laws even though their damage liability could be limited.[230] Second, by limiting damage liability to a proportionate share in certain cases, nonmeritorious lawsuits will be discouraged as a result of the potentially smaller recovery, via settlement or otherwise, that a plaintiff could expect to receive from an aider and abettor.[231] Therefore, a combined proportionate/joint and several liability apportionment scheme may help stem the tide of vexatious litigation and focus the search by some plaintiffs for the so-called

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227. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of Arthur Levitt, Chairman, SEC), *available in* 1994 WL 233142, at *13 (explaining that often primary violator becomes insolvent by time fraud is discovered).

228. *See Aiding and Abetting Hearings*, *supra* note 153 (statement of David S. Ruder), *available in* 1994 WL 233134, at *4 (explaining that large securities suits have been settled for significant sums because of fear by defendants of being jointly and severally liable for entire amount claimed).

229. *Cf. Aiding and Abetting Hearings*, *supra* note 153 (statement of Donald C. Langevoort), *available in* 1994 WL 233134, at *8 (stating that move from joint and several liability to proportionate liability will shift nature of damages in securities suits from primarily compensatory to deterrence objective).

230. *Cf. Aiding and Abetting Hearings*, *supra* note 153 (statement of Donald C. Langevoort), *available in* 1994 WL 233134, at *8 (suggesting that carefully crafted liability scheme will be able to address fairness and disproportion without compromising deterrence).

231. *Cf. Aiding and Abetting Hearings*, *supra* note 153 (statement of Donald C. Langevoort), *available in* 1994 WL 233134, at *8-9 (stating that current litigation incentives are such that money spent in litigation and settlement of securities fraud cases is "untied to underlying merits of the actions").

"deep pocket" defendant on more culpable persons.

CONCLUSION

The Supreme Court's decision in *Central Bank* will have a tremendous impact on securities law litigation. It has eliminated what was previously one of the most heavily relied upon causes of action in private lawsuits. Without it, defrauded investors risk the inability to recover compensation and secondary participants in fraudulent activities no longer face what had been a usually effective deterrent. Therefore, in order to restore the private investors' ability to pursue meritorious aiding and abetting claims, Congress should act to restore this private cause of action, giving private investors the necessary tools to protect themselves from securities fraud, and in so doing, help maintain investor confidence in the fairness of the securities markets.

The proposals in this Comment do not seek to reform the entire system of private securities litigation. Instead, this proposed legislation is limited to tackling secondary liability in securities fraud. Unfortunately, the Securities Litigation Reform Act (H.R. 1058), which was passed by the House of Representatives on March 8, 1995, and the Private Securities Litigation Reform Act (S. 240), which was passed by the Senate of June 28, 1995, do not contain provisions reinstating aiding and abetting liability. Despite a last-minute effort by Senator Richard Bryan (D-Nev.) to amend S. 240 and include aiding and abetting liability,[232] the restoration of this cause of action has not been included in the current round of securities reform. Though aiding and abetting liability is not likely to be approved by the current Congress, every effort should be made to eventually restore aiding and abetting liability and legislatively overrule *Central Bank* before too many defrauded investors are left without a forum.

232. *Senate Defeats Major Proposed Amendments to Litigation Reform Measure*, Daily Report for Executives (BNA), at A-124 (June 28, 1995) (indicating Bryan Amendment that would have reinstated aiding and abetting liability and securities fraud was defeated by vote of 39 to 60).