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Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.: Substitution of Congressional Intent with Caveat Emptor

I. INTRODUCTION

CONTRARY TO THE PURPOSE AND INTENTION OF THE Securities Exchange Act of 1934 (Securities Exchange Act),¹ the United States Supreme Court in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*² has reached the presumptive peak of a succession of rulings that have dissolved the implied private cause of action against secondary actors of primary federal securities law violations.³ Holding that a defendant must have committed a primary violation of § 10(b) of the Securities Exchange Act,⁴ the Court inappropriately broadened the *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*⁵ limitation, which prohibited the private cause of action against secondary actors based on an aiding and abetting argument.⁶ While the limitation in *Central Bank* was restricted to aiders and abet-

* Associate Judge, Court of Special Appeals of Maryland. The author acknowledges the research and writing assistance of his judicial intern, M. Jason Brooke, a second-year student at the University of Maryland School of Law.

1. 15 U.S.C. §§ 78a–78oo (2006).

2. 128 S. Ct. 761 (2008).

3. See *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 194–95 (1994) (Stevens, J., dissenting) (“[T]he Court *sua sponte* directed the parties to address a question on which even the petitioner justifiably thought the law was settled, and reaches out to overturn a most considerable body of precedent.”).

4. Section 10(b) of the Securities Exchange Act of 1934 states:

It shall be unlawful for any person, directly or *indirectly*, by the use of any means or instrumentality . . . (b) [t]o use or employ, in connection with the purchase or sale of any security . . . *any manipulative or deceptive device* or contrivance in *contravention of such rules and regulations* as the [Securities Exchange] Commission may prescribe as necessary or appropriate in the public interest or *for the protection of investors*.

15 U.S.C. § 78j (emphasis added). As an application of § 10(b), the SEC prescribed, for the protection of investors, Rule 10b-5, which states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality . . . (a) [t]o employ any device, *scheme*, or artifice to defraud, . . . (c) [t]o 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 (1948) (emphasis added).

5. 511 U.S. 164 (1994).

6. See *id.* at 177, 180, 184–85, 191.

tors, the Court's ruling in *Stoneridge* further removed an established implied cause of action for alleged conspirators and principals identified under the theory of *respondeat superior*.⁷ The *Stoneridge* decision ultimately protects fraudulent business activities and leaves investors without the recourse § 10(b) was intended to provide.⁸

II. FACTS OF THE CASE

The issue in *Stoneridge* arose from a fraudulent scheme between cable operator Charter Communications, Inc., and the two respondents, Scientific-Atlanta, Inc. and Motorola, Inc., to manipulate Charter's public financial statements.⁹ Charter entered into contractual agreements with Scientific-Atlanta, and separately with Motorola, in which Charter agreed to overpay by \$20 per digital cable box for the duration of the year, "with the understanding that respondents would return the overpayment by purchasing advertising from Charter."¹⁰ To facilitate the scheme, Charter and the respective respondents back-dated the documents "to make it appear [that] the transactions were unrelated and conducted in the ordinary course of business."¹¹ These sham transactions enabled Charter to exaggerate significantly its revenue and cash flow in its public Securities Exchange Commission (SEC) filings¹² in order to meet Wall Street expectations.¹³ Petitioner brought a class action suit against respondents under § 10(b) and Rule 10b-5 on behalf of Charter investors.¹⁴

III. HISTORICAL CONTEXT OF THE FEDERAL SECURITIES LAWS

In response to the 1929 stock market crash, the 73rd Congress passed the Securities Act of 1933¹⁵ and the Securities Exchange Act, the purpose of which was to protect investors from fraudulent securities activities.¹⁶ Congress offered this protection

7. See *id.* at 200 n.12 (Stevens, J., dissenting) (predicting that "[t]he Court's rationale would [not only] sweep away the decisions recognizing that a defendant may be found liable in a private action for *conspiring* to violate § 10(b) and Rule 10b-5," but would also affect actions based on *respondeat superior*).

8. See *infra* Part V.

9. See *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 766–68 (2008).

10. *Id.* at 766. At the outset of the majority opinion, Justice Kennedy accepted the allegations as true and recognized that respondents participated in fraudulent business activity. *Id.* at 766. In justifying his conclusion, however, he represented respondents' conduct as "acting in concert with Charter in the ordinary course" of business and the sham transactions as "not so ordinary." *Id.* at 774.

11. *Id.* at 767. The Court described the back-dating of the documents as "important to convey the impression that the negotiations were unconnected," so that the financial auditors "would not discover [a] link." *Id.*

12. *Id.*

13. *Id.* at 766.

14. *Id.* at 767.

15. 15 U.S.C. §§ 77a–77aa (2006).

16. See *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977) ("[T]he fundamental purpose of the [Securities Exchange] Act [was] to substitute a philosophy of full disclosure for the philosophy of caveat emptor") (internal quotation marks omitted); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976) ("The Securities Act of 1933 . . . was designed to provide investors with full disclosure of material information

through “numerous carefully drawn express civil remedies and criminal penalties,” yet integral to investor protection was a flexibility required to prevent “a rigid statutory program.”¹⁷ To create this flexibility, Congress designed § 10(b) of the Securities Exchange Act as “a ‘catchall’ antifraud provision”¹⁸ and authorized the SEC to create regulations necessary to enforce the purpose of the law.¹⁹ As a result, the SEC established Rule 10b-5 in 1942 under the authority of § 10(b).²⁰ Shortly after the SEC created Rule 10b-5, the United States District Court for the Eastern District of Pennsylvania established a judicially implied, private cause of action under the rule.²¹ The subsequent fifty years saw an expansion of this implied private cause of action and court-derived sculpting of the scope of § 10(b).²² As the end of the twentieth century approached, the Supreme Court in *Central Bank* suddenly reversed an established body of legal precedent,²³ eliminating the private cause of action against aiders and abettors of § 10(b) violations.²⁴ Subsequent rulings continued the Court’s restrictive grip on injured investors, culminating in the holding in *Stoneridge*.²⁵

concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing. . . . The [Securities Exchange] Act was intended principally to protect investors against manipulation of stock prices through regulation of transactions.”).

17. *Hochfelder*, 425 U.S. at 195; see also *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386–87 (1983) (stating that “[t]he effectiveness of the broad proscription against fraud in § 10(b) would be undermined if its scope were restricted,” noting the importance of the flexibility to enable the “remedial purposes,” and “reject[ing] an interpretation of the securities laws that displaces an action under § 10(b)”).

18. *Huddleston*, 459 U.S. at 382 (citing *Chiarella v. United States*, 445 U.S. 222, 234–35 (1980)).

19. See *supra* note 4; *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 766 (1975) (Blackmun, J., dissenting) (quoting testimony in 1934 before the House Committee on Interstate and Foreign Commerce, which identified § 10(b) as “a catch-all clause to prevent” fraudulent schemes and a necessary tool for the SEC “to deal with new manipulative devices”).

20. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 768 (2008); *Blue Chip*, 421 U.S. at 729.

21. *Blue Chip*, 421 U.S. at 730 (citing *Kardon v. Nat’l Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946)).

22. See *Stoneridge*, 128 S. Ct. at 781 (Stevens, J., dissenting).

23. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 193 (1994) (Stevens, J., dissenting) (“In hundreds of judicial and administrative proceedings in every Circuit in the federal system, the courts and the SEC have concluded that aiders and abettors are subject to liability under § 10(b) and Rule 10b-5. . . . [A]ll 11 Courts of Appeals to have considered the question have recognized a private cause of action against aiders and abettors . . .”).

24. See *id.* at 191.

25. See *Glaser v. Enzo Biochem, Inc.*, 126 F. App’x 593, 599 (4th Cir. 2005) (“The rationale of *Central Bank* with respect to aiding and abetting applies equally to civil conspiracy.”); *Gariety v. Grant Thornton, LLP*, 368 F.3d 356, 369 (4th Cir. 2004) (“[I]n order to rely on presumed reliance flowing from an application of the fraud-on-the-market theory . . . a misrepresentation must be directly attributable to [defendant] and not to some other person.”); *Ziemba v. Cascade Int’l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001) (determining that allegations that defendant had a “significant role in drafting, creating, reviewing or editing allegedly fraudulent letters or press releases” were barred by *Central Bank*); *In re Comshare, Inc. Sec. Litig.*, 183 F.3d 542, 553 (6th Cir. 1999) (“[F]ailure to follow [Generally Accepted Accounting Principles] is, by itself, insufficient to state a securities fraud claim.”); cf. *Schultz v. R.I. Hosp. Trust Nat’l Bank, N.A.*, 94 F.3d 721, 731 (1st Cir. 1996) (“[R]eserv[ing] to another day the issue of whether *Central Bank* necessarily implies that aiding and abetting securities fraud cannot be a ‘racketeering activity’ within the meaning of [18 U.S.C.] § 1961(1).”).

IV. THE COURT'S REASONING FOR SHIELDING FRAUDULENT BUSINESS PRACTICES

Writing for the majority in *Stoneridge*, Justice Kennedy held: 1) that fraudulent activity, on the part of a customer or vendor who enables primary violations of the Securities Exchange Act, is immune from the implied private cause of action for failure to demonstrate reliance on the secondary actor's participation in the fraudulent scheme;²⁶ and 2) that liability for violations of § 10(b) applies to a secondary actor only when evidence of a primary violation exists with respect to that actor.²⁷

The Court emphasized the importance of the reliance element of a § 10(b) private cause of action,²⁸ noting that the element shows the necessary "causal connection between a defendant's misrepresentation and a plaintiff's injury . . ." ²⁹ The Court recognized that reliance is presumed, yet rebuttable, where 1) a duty exists to disclose a material omission and 2) fraud-on-the-market results in public misrepresentations.³⁰ Justice Kennedy arbitrarily decided that neither of these situations was applicable in *Stoneridge* and that any reliance that might be shown was a result of "an indirect chain that [was] too remote for liability."³¹ The Court also rejected the application of the "scheme liability" theory, concluding that reliance based on that theory lacks authority.³² Scheme liability suggests, the Court summarized, that "investors rely not only upon the public statements relating to a security but also upon the transactions those statements reflect."³³ Without providing a foundation for its conclusion, the Court reasoned that such a basis for reliance would extend liability to all with whom the primary violator does business.³⁴

In an attempt to bolster his conclusions, Justice Kennedy suggested that a finding of liability in *Stoneridge* contradicts the precedent established in *Central Bank* and the congressional intent of legislation that followed.³⁵ Such a finding "would revive . . . the implied cause of action against all aiders and abettors except those who committed *no deceptive act* in the process of facilitating the fraud."³⁶ The Court

26. *Stoneridge*, 128 S. Ct. at 766.

27. *Id.* at 769.

28. *Id.* at 768, 769 (describing the elements of "a typical § 10(b) private action" as requiring a showing of "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation").

29. *Id.* at 769 (internal quotation marks omitted).

30. *Id.*

31. *Id.*

32. *Id.* at 770.

33. *Id.*

34. *Id.*

35. *Id.* at 771–72. Following the ruling in *Central Bank*, Congress enacted section 104 of the Private Securities Litigation Reform Act of 1995, which authorized the SEC to enforce securities fraud violations against aiders and abettors. *Id.* at 768–69. The Court mistakenly interpreted express SEC enforcement as Congress's intent to limit the implied private cause of action for aiding and abetting a primary securities fraud violation. *Id.* at 771.

36. *Id.* at 771 (emphasis added).

warned that the implied private cause of action under § 10(b) runs counter to Congress' intent to give the SEC sole enforcement authority for secondary actors who aid and abet primary violations.³⁷ Presenting limited historical context, Justice Kennedy identified “[t]he history of the § 10(b) private right and the careful approach the Court has taken before proceeding without congressional direction” as additional justifications for the majority’s conclusions.³⁸ Although the opinion recognized the existence of an implied private right of action under § 10(b) as a result of recent congressional approval,³⁹ the Court concluded that expansion of that right is the charge of Congress.⁴⁰

Finally, the Court presented its policy justifications, beginning with the concern that such secondary actors would be subjected to “extensive discovery and the potential for uncertainty and disruption” to their business that would “allow plaintiffs with weak claims to extort settlements from innocent companies.”⁴¹ In extending this logic, Justice Kennedy asserted, citing little tangible evidence, that the increased “costs of doing business” would prevent foreign investment in the United States.⁴² Additionally, the Court briefly addressed the criminal and civil consequences for secondary actors who violate the securities laws, concluding that the former is “a strong deterrent” and the latter, primarily manifested as SEC enforcement power, “is not toothless.”⁴³ As proof of the strength and effectiveness of civil enforcement, the Court indicated that, since 2002, the SEC has recovered “over \$10 billion in disgorgement and penalties,” most of which has been divided among investors.⁴⁴ The Court also noted that other private causes of action against secondary actors remain.⁴⁵ The majority ultimately concluded that where a company’s conduct falls within the ordinary course of business as a vendor, or where such conduct “evolve[s] in the not so ordinary course, as customers,” the private cause of action implied from § 10(b) does not impose liability on the secondary actor because the relationship exists “in the marketplace for goods and services, not in the investment sphere.”⁴⁶

37. *Id.*

38. *Id.* at 772.

39. *See id.* at 773 (identifying Congress’s recent enactment of “heightened pleading requirements and a loss causation requirement upon ‘any private action’ arising from the Securities Exchange Act” as “clear[ly] . . . touch[ing] upon the implied right of action, which is now a prominent feature of federal securities regulation”).

40. *Id.*

41. *Id.* at 772 (citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740–41 (1975)).

42. *Id.*

43. *Id.* at 773.

44. *Id.*

45. *Id.* at 773–74 (noting the existence of “an express private right of action against accountants and underwriters in certain circumstances . . . and the implied right of action in § 10(b) [against] secondary actors who commit primary violations”).

46. *Id.* at 774.

V. A CRITICAL ANALYSIS CANNOT SUPPORT IMMUNITY FOR SECONDARY ACTORS OF SECURITIES FRAUD VIOLATIONS

A. *The Court Ignores the Validity of Scheme Liability as Justification for Reliance*

Although the Court rejects the argument,⁴⁷ the theory of “scheme liability” for § 10(b) violations presents a viable justification for reliance,⁴⁸ drawing its foundation in the text of Rule 10b-5 and the intent of § 10(b).⁴⁹ The theory imposes liability on any actor who participates in a scheme to defraud investors.⁵⁰ The justification for allowing scheme liability flows from the ordinary meaning of the terms used in § 10(b) at the time of enactment⁵¹ and the long-accepted intent of the framers of the securities laws.⁵² Furthermore, the SEC used its express authority to implement Rule 10b-5, which provided additional clarification as to what constitutes a violation.⁵³ Opponents of scheme liability argue that the word “scheme” was not used in the text of § 10(b) and, therefore, use of the word in Rule 10b-5 goes beyond the reach of the statute.⁵⁴ Deference should be paid, however, to the authority vested in the SEC and to the intent of the framers as manifested in the ordinary meaning of the terms used in the statute.⁵⁵

More than three decades ago, the United States Supreme Court accepted the premise that “§ 10(b) and Rule 10b-5 prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a

47. See *supra* Part IV.

48. See *In re Enron Corp. Sec. Litig.*, 529 F. Supp. 2d 644, 702 (S.D. Tex. 2006) (“This Court has accepted the pleading of scheme liability based on nonrepresentational conduct in this litigation, but recognizes that the controversy about its viability persists.”); see also *Middlesex Ret. Sys. v. Quest Software Inc.*, 527 F. Supp. 2d 1164, 1191 (C.D. Cal. 2007) (“The Court finds that Plaintiff has adequately alleged scheme liability.”).

49. See *supra* note 4.

50. See *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 328 (S.D.N.Y. 2004) (“[T]he more general provisions of Rule 10b-5 . . . prohibit the use of ‘any device, scheme, or artifice to defraud’ or the participation ‘in any act, practice, or course of business’ that would perpetrate fraud on investors.”).

51. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 n.20 (1976). The Court in *Ernst & Ernst* rejected negligence as a standard by looking to the contemporary dictionary definitions of the terms used in § 10(b) to interpret Congress’s intent. *Id.* The Court found that “Webster’s International Dictionary (2d ed. 1934) defines ‘device’ as ‘(t)hat which is devised, or formed by design; a contrivance; . . . *scheme*; often, a *scheme to deceive*; a stratagem; an artifice,’ and ‘contrivance’ in pertinent part as ‘(a) thing contrived or used in contriving; a *scheme*, plan, or artifice.’” *Id.* (emphasis added) (alterations in original). The Court also observed that “‘con-*trive*’ in pertinent part is defined as ‘(t)o devise; to plan; to plot . . . (t)o fabricate . . . design; invent . . . *to scheme*.”” *Id.* (emphasis added) (alterations in original). These definitions were a sufficient basis for the Court to impose a higher standard than negligent conduct in 1976. *Id.* The *Central Bank* and *Stoneridge* Courts, however, failed to consider these definitions two to three decades later.

52. See *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 195–96 (1994) (Stevens, J., dissenting) (cautioning that to “apply[] our current approach . . . to a statute enacted when courts commonly read statutes . . . broadly to accord with their remedial purposes and regularly approved rights to sue despite statutory silence” would be to “risk . . . anachronistic error”).

53. See *supra* note 4.

54. See *Central Bank*, 511 U.S. at 173 (“[T]he private plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b).”).

55. See generally Securities Exchange Act of 1934, H.R. 9323, 73d Cong. (enacted); H.R. REP. NO. 1838 (1934) (Conf. Rep.).

garden type variety of fraud, or present a unique form of deception.⁵⁶ Although the fraudulent scheme in *Stoneridge* was not the garden variety that Congress may have anticipated when passing the Securities Exchange Act, “[n]ovel or atypical methods should not provide immunity from the securities laws.”⁵⁷ As the Court recalled in *Superintendent of Insurance of New York v. Bankers Life & Casualty Co.*,⁵⁸ Congress believed that the “broad discretionary powers in the regulatory agency” are “*practically essential*” to preserve the intent of the securities laws.⁵⁹ The Court reiterated the need for flexible interpretation of § 10(b) given Congress’ recognition of ever-changing business practices and the potential for those legitimate practices to become fraudulent.⁶⁰

Justice Kennedy presented the fraudulent scheme in *Stoneridge* as one that began “in the ordinary course as [vendors]” and “evolved in the *not so ordinary* course, as customers.”⁶¹ This generous interpretation ignores the impact of active participation in a scheme to defraud investors in violation of § 10(b) and the clear causal connection necessary to demonstrate reliance.⁶² In justifying the fraud-on-the-market presumption of reliance, the Court in *Basic Inc. v. Levinson*⁶³ described Congress’ understanding of the impact of misrepresentations on the market and the need to legislate to maintain market integrity.⁶⁴ The Court quoted Congress as stating that “[n]o investor . . . can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities” and that in the same way that “artificial manipulation tends to upset the true function of an open market, so [too does] the hiding and secreting of important information”⁶⁵ The unconventional arrangement that Justice Kennedy described as having occurred “in the marketplace for goods and services”⁶⁶ cannot be divorced from the impact that active participation in a “scheme to defraud” has on the market and its investors.⁶⁷ The secreting of fraudulent contract agreements designed to manipulate the financial status of a company is vital information for investors to judge the value of that company. Respondents’ active participation in such a fraud “had the same effect . . . as a false entry directly on . . . [Charter’s] . . . books.”⁶⁸ Thus, the Court should presume investor reliance on market integrity

56. *Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 11 n.7 (1971) (citing *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)) (emphasis added).

57. *Id.* (citing *A.T. Brod & Co.*, 375 F.2d at 397).

58. *Id.*

59. *Id.* at 12 (emphasis added) (internal quotation marks omitted) (citing H.R. REP. NO. 73-1383, at 7 (1934)).

60. *Id.*

61. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 774 (2008) (emphasis added).

62. *See id.* at 776 (Stevens, J., dissenting).

63. 485 U.S. 224 (1988).

64. *Id.* at 245–46.

65. *Id.* at 246 (quoting H.R. REP. NO. 73-1383, at 11 (1934)).

66. *Stoneridge*, 128 S. Ct. at 774.

67. *See id.* at 776 (Stevens, J., dissenting).

68. *See id.* at 777.

when a secondary actor— independent of its status as a vendor, customer, director, or accountant— actively participates in § 10(b) primary violations.

B. The Court Fails to Recognize Congressional Intent and Legal Precedent Prior to Central Bank that Established the § 10(b) Implied Private Cause of Action

Prior to *Central Bank*, each of the Courts of Appeal recognized a private cause of action against secondary actors, especially aiders and abettors, of primary securities laws violations.⁶⁹ The Circuits established a three-part test for determining aiding and abetting liability: first, a primary violation of § 10(b) or Rule 10b-5 must exist; second, the secondary actor must have known (or in some Circuits, should have known) of the primary violation; and finally, the secondary actor must have assisted substantially in the primary violation.⁷⁰ In *Central Bank*, the majority recognized that “numerous courts have taken the same position” as *Brennan v. Midwestern United Life Insurance Co.*,⁷¹ which concluded that the Securities Exchange Act “must be flexibly applied so as to implement its policies and purposes.”⁷² Yet the Supreme Court has slowly eroded the purpose of the Securities Exchange Act by applying its modern, conservative perspective and strictly interpreting the statute.⁷³

In determining “the elements of the 10b-5 private liability scheme,” the *Central Bank* Court stated that they “have had to infer how the 1934 Congress would have

69. See *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983) (noting that the test for aiding and abetting “a violation of § 10(b) or rule 10b-5 is now well-settled”); *Nat’l Union Fire Ins. Co. of Pittsburgh, Pa. v. Turtur*, 892 F.2d 199, 206–07 (2d Cir. 1989) (stipulating the three elements of an aiding and abetting securities violation and reiterating that even “inaction can provide a basis for liability, in the absence of a duty to act” when the inaction is “designed intentionally to aid the primary fraud”) (internal citations and quotation marks omitted); *Rochez Bros. v. Rhoades*, 527 F.2d 880, 886 (3d Cir. 1975) (identifying the three elements necessary to establish liability for an aider and abettor of a primary securities law violation); *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991) (restating the three elements of aiding and abettors); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975) (summarizing the three elements necessary to catch “someone . . . within the net of aiding and abetting liability under Rule 10b-5”); *Molecular Tech. Corp. v. Valentine*, 925 F.2d 910, 917 (6th Cir. 1991) (“Secondary liability . . . may be premised on any one of several theories, including aiding and abetting a securities violation.”); *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1123 (7th Cir. 1990) (stating that “[t]his circuit recognizes a cause of action for aiding and abetting violations of § 10(b) and rule 10b-5,” although the test requires the aider or abettor to commit an act prohibited by § 10(b) and Rule 10b-5); *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir. 1985) (indicating that the circuit had “previously set forth a three-pronged test to establish aiding-and-abetting liability”); *Levine v. Diamantheset, Inc.*, 950 F.2d 1478, 1483 (9th Cir. 1991) (identifying the three elements necessary “[t]o state a claim of aiding and abetting securities fraud”); *Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982, 986 (10th Cir. 1992) (expressing the three necessary elements “to establish secondary liability under Section 10(b)”); *Woods v. Barnett Bank of Fort Lauderdale*, 765 F.2d 1004, 1012 (11th Cir. 1985) (establishing an inference of the “knowing assistance” element of an aiding and abetting claim from “atypical business actions”).

70. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 194 (1994) (Stevens, J., dissenting).

71. 259 F. Supp. 673 (N.D. Ind. 1966), *aff’d*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

72. *Central Bank*, 511 U.S. at 169 (quoting *Brennan*, 259 F. Supp. at 680–81).

73. See *id.* at 170 (citing *SEC v. Seaboard Corp.*, 677 F.2d 1301, 1311 n.12 (1982)).

addressed the issue(s) had the 10b-5 action been included as an express provision in the [Securities Exchange] Act.”⁷⁴ The Securities Exchange Act, however, expressly states that it is “unlawful for any person, directly or indirectly, . . . to use . . . any manipulative or deceptive device . . . in contravention of such *rules and regulations as the [SEC] may prescribe*.”⁷⁵ Rule 10b-5 makes it unlawful “to engage in any . . . course of business [that] operates or would operate as a fraud or deceit upon any person.”⁷⁶ It is problematic for the Supreme Court to impose its new perspective more than sixty years after the 73rd Congress explicitly gave the SEC the power to determine the rules and regulations necessary to protect against fraudulent securities transactions. The SEC did exactly that when it adopted Rule 10b-5 only eight years after Congress granted it the power to protect the public interest and private investors. Even as the Court attempted to interpret the 73rd Congress’ intent, the SEC continued to espouse the application of Rule 10b-5 in aiding and abetting violations, the authority of which the Court erroneously ignored.⁷⁷

In defining “the scope of conduct prohibited by § 10(b),” the *Central Bank* Court stated that the statutory language controls and that a “private plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b).”⁷⁸ In several cases, the Court used this logic for its conclusion that § 10(b) does not apply to negligent acts,⁷⁹ “breaches of fiduciary duty . . . without any charge of misrepresentation or lack of disclosure,”⁸⁰ or trading of securities based on inside information where the trader lacks a duty to disclose.⁸¹ The *Central Bank* Court noted “that none of the express causes of action in the [Securities Exchange] Act . . . imposes liability on one who aids or abets a violation” and concluded from this “that Congress likely would not have attached aiding and abetting liability to § 10(b) had it provided a private § 10(b) cause of action.”⁸² While the Court’s conclusion may be a valid inference, it is also reasonable to infer, as many courts have,⁸³ that Congress intended to imply aiding and abetting liability or to allow the SEC to determine whether such a cause of action was necessary to protect investors. The Court in *Stoneridge* used the *Central Bank* line of reasoning to justify its ruling,

74. *Id.* at 173 (internal quotation marks omitted) (citing *Musick, Peeler, & Garrett v. Employers Ins. of Wausau*, 508 U.S. 286, 294 (1993)).

75. 15 U.S.C. § 78j (2006) (emphasis added).

76. 17 C.F.R. § 240.10b-5(c) (1948).

77. See *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 775 n.2 (2008) (Stevens, J., dissenting) (citing Brief for SEC, Amicus Curiae in Support of Positions that Favor Appellant at 21, *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040 (9th Cir. 2006) (No. 04-55665)).

78. *Central Bank*, 511 U.S. at 173.

79. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976).

80. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 470 (1977) (citing *Green v. Santa Fe Indus., Inc.*, 533 F.2d 1283, 1287 (1976)).

81. *Chiarella v. United States*, 445 U.S. 222, 234–35 (1980).

82. *Central Bank*, 511 U.S. at 179.

83. See *supra* note 69.

ignoring the obvious differences between the active participation in a scheme to defraud in the former, and the passive nature of the conduct in the latter.⁸⁴

The *Central Bank* Court tempered its prohibition of aiding and abetting claims by stating that “secondary actors . . . who employ[] a manipulative device or make[] a material misstatement . . . 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.”⁸⁵ Justice Stevens, with whom Justices Blackmun, Souter, and Ginsburg joined, dissented from the majority in *Central Bank* because the opinion gave “short shrift to a long history of aider and abettor liability under § 10(b) and Rule 10b-5, and because its rationale imperils other well-established forms of secondary liability not expressly addressed in the securities laws”⁸⁶ Justice Stevens explained that the petitioner rightfully “*assumed* the existence of a right of action against aiders and abettors” and only requested review of whether aider and abettor liability existed as a result of a secondary actor’s recklessness, which is the only substantive question on which there was “genuine disagreement in the Courts of Appeal[].”⁸⁷

Nearly a decade and a half after *Central Bank*, the *Stoneridge* Court reached the presumptive peak of its limitations on secondary liability claims, deciding that not only is aiding and abetting not a viable claim, but that in order to extend § 10(b) liability to secondary actors, those actors must have committed a primary violation, which is not met even when vendors or customers actively participate in the violation.⁸⁸ Justice Stevens predicted such an outcome as a virtual inevitability as a result of the ruling in *Central Bank* because it “cast serious doubt, both for 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 statutes.”⁸⁹ Stevens observed that, in addition to aiding and abetting, the *Central Bank* “rationale would sweep away the decisions recognizing . . . a private action for *conspiring* to violate § 10(b) and Rule 10b-5”⁹⁰ and potentially those “actions based upon *respondeat superior* and other common-law agency principles.”⁹¹ Although the minority was bound by the precedent created in *Central Bank*, Justice Stevens presented sound reasons for distinguishing *Stoneridge* and for justifying a presumption of reliance in cases where fraud on the market is combined with causation.⁹²

84. See *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 775 (Stevens, J., dissenting).

85. *Central Bank*, 511 U.S. at 191.

86. *Id.* at 192 (Stevens, J., dissenting).

87. *Id.* at 194.

88. *Stoneridge*, 128 S. Ct. at 769.

89. *Central Bank*, 511 U.S. at 200 (Stevens, J., dissenting).

90. *Id.* at 200 n.12.

91. *Id.*

92. See *Stoneridge*, 128 S. Ct. at 776–77 (Stevens, J., dissenting).

The *Stoneridge* decision cements into law the fears and predictions that Stevens presented in *Central Bank*, removing, in one fell swoop, the implied private cause of action for secondary liability.⁹³ A fine line exists between actions that aid and abet a primary violation of § 10(b) and those that constitute a conspiracy. In *U.S. Industries, Inc. v. Touche Ross & Co.*,⁹⁴ the Court of Appeals for the 10th Circuit used the terms virtually interchangeably in concluding that liability exists if “the defendant had conspired with, or aided and abetted, . . . any other individual or business entity that had participated in the conspiracy.”⁹⁵ The first case addressing a violation of Rule 10b-5 consisted of a conspiracy to defraud investors;⁹⁶ yet by *Stoneridge*’s rationale, liability would only apply to the conspirators who committed the primary violations. Such a ruling ignores the Congressional intent of those who enacted the Securities Exchange Act and the body of case law that followed for more than seventy years thereafter.

C. *The Court Over-Expands the Central Bank Limitation with the Result That it Protects Fraudulent Business Practices*

The Court reasoned that, based on a brief analysis, the history of the § 10(b) private cause of action and the Court’s approach to implied rights buttresses a finding of no liability for secondary actors who do not commit primary violations.⁹⁷ The Court reiterated its concern about broadening a private cause of action where Congress did not expressly provide one.⁹⁸ Justice Stevens observed in *Central Bank*, however, that:

*Our approach to implied causes of action, as to other matters of statutory construction, has changed markedly since the [Securities] Exchange Act’s passage in 1934. At that time, and indeed until quite recently, courts regularly assumed, in accord with the traditional common-law presumption, that a statute enacted for the benefit of a particular class conferred on members of that class the right to sue violators of that statute. Moreover, shortly before the [Securities] Exchange Act was passed, this Court instructed that such “remedial” legislation should receive “a broader and more liberal interpretation than that to be drawn from mere dictionary definitions of the words employed by Congress.”*⁹⁹

93. *Id.* at 769 (majority opinion).

94. 854 F.2d 1223 (10th Cir. 1988).

95. *Id.* at 1252.

96. *Kardon v. Nat’l Gypsum Co.*, 69 F. Supp. 512, 513 (E.D. Pa. 1946).

97. *Stoneridge*, 128 S. Ct. at 772.

98. *Id.* at 773.

99. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 195 (1994) (Stevens, J., dissenting) (quoting *Piedmont & N. Ry. Co. v. Interstate Commerce Comm’n*, 286 U.S. 299, 311 (1932)) (footnote omitted).

As Justice Stevens suggests in his *Central Bank* dissent, the Court failed to recognize the abundance of historical evidence that supports allowing the private cause of action against secondary actors of primary securities violations.¹⁰⁰

In addition to its brief historical analysis, the Court provides an inadequate assessment of the effect of the ruling on enforcement mechanisms left to remedy the fraudulent activities of secondary actors in connection with securities transactions.¹⁰¹ The Court noted that not only are criminal penalties applicable to these secondary actors, but the SEC has authority to enforce civil penalties as well.¹⁰² According to the Court, the SEC has recovered and distributed to investors over \$10 billion since 2002.¹⁰³ From this, the Court makes the bold conclusion that “enforcement power is not toothless.”¹⁰⁴

Such a claim loses strength when comparing the recovery obtained as a result of private actions. In approximately the same period that the Court cited, the victims that Enron Corp. defrauded were able to recover \$7.2 billion from settlements with various alleged secondary actors.¹⁰⁵ Between 2002 and 2005, private actions resulted in over \$6.1 billion in settlements from victims of the WorldCom fraudulent scheme.¹⁰⁶ Thus, the implied private right of action against secondary actors of two major fraudulent schemes led to recovery of 33% more funds than were recovered by the SEC in *all* of their enforcement actions in the same period.¹⁰⁷ The Court previously stated that “it would be disingenuous to suggest that either Congress in 1934 or the [SEC] in 1942 foreordained the present state of the law with respect to Rule 10b-5” and as a result, an analysis of § 10(b) cases warrants review of “policy considerations when . . . [interpreting] portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance.”¹⁰⁸ For the Court to suggest, however, that SEC enforcement is sufficient to remedy the wrongs imposed on innocent investors grossly underesti-

100. *Id.* at 197–98.

101. *Stoneridge*, 128 S. Ct. at 773–74.

102. *Id.* at 773.

103. *Id.*

104. *Id.*

105. See The Enron Fraud, <http://www.enronfraud.com/enr-cgi-bin/mil?templ=settlement.html> (last visited Sept. 15, 2008).

106. See WorldCom Securities Litigation, <http://www.worldcomlitigation.com/html/citisettlement.html> (last visited Sept. 15, 2008).

107. It is important to note that the majority in *Stoneridge* was primarily concerned with preventing “plaintiffs with weak claims [from] extort[ing] settlements from *innocent* companies.” *Stoneridge*, 128 S. Ct. at 772 (emphasis added). There is no doubt that the victims of the Enron and WorldCom disasters, who lost entire life-savings as a result of the companies’ fraudulent schemes, had robust claims and cannot be said to have participated in extortion. From its reasoning, the Court turns the victim into the criminal and holds out scheming corporations as innocent philanthropists. See *id.* The Court’s consistent protection of fraudulent business practices may ultimately be linked to recent mortgage loan catastrophes in the financial market. Undoubtedly, the investors of the various corporations that have begun to crumble will target secondary actors of securities fraud violations in order to recover for their injury. The Court’s decision in *Stoneridge*, however, will continue to impede the rights and protections Congress intended to confer on these victims.

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

mates the injury and ignores the purpose of the statutes Congress enacted more than seventy years ago.¹⁰⁹

VI. CONCLUSION

The United States Supreme Court in *Stoneridge* extended the limitation on the implied private cause of action against secondary actors of primary federal securities law violations. In holding that liability does not extend to a customer or vendor who enables primary violations of the Securities Exchange Act, the Court ignored the validity of scheme liability as justification for reliance on the part of the investor who brings suit against the party who participates in the fraudulent scheme.¹¹⁰ Additionally, the Court failed to recognize the intention of those who enacted the Securities Exchange Act and the overwhelming body of contemporary case law that interpreted an implied private cause of action under § 10(b).¹¹¹ Finally, while the Court is warranted in analyzing policy considerations, the presented justifications lack sufficient force to compel the conclusions that the Court drew.¹¹² The *Stoneridge* ruling provides immunity for secondary actors who actively participate in schemes to defraud investors, which ultimately protects fraudulent business practices, leaves investors without a legitimate remedy for an injury that the Securities Exchange Act was designed to prevent, and reverts a robust marketplace based on full disclosure back to the era of *caveat emptor*.

109. See *Stoneridge*, 128 S. Ct. at 773–74. But see *id.* at 774–75 (Stevens, J., dissenting).

110. See *supra* Part V.A.

111. See *supra* Part V.B.

112. See *supra* Part V.C.