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## ARTICLES

### The Ramifications of Recent U.S. Supreme Court Decisions on Federal and State Securities Regulation

Marc I. Steinberg\*

#### I. INTRODUCTION

In a decision that delighted "deep pockets," shocked the plaintiffs' bar, and befuddled neutral observers,<sup>1</sup> the Supreme Court in *Central Bank of Denver v. First Interstate Bank of Denver*<sup>2</sup> held that aiding and abetting liability in private actions may not be imposed under section 10(b) of the Securities Exchange Act of 1934<sup>3</sup> ("Exchange Act") or under rule 10b-5.<sup>4</sup> The Court's decision swept away decades of lower court precedent that nearly universally recognized the propriety of such secondary liability under the statute and rule.<sup>5</sup> Unless Congress swiftly acts to counter the Court's decision,<sup>6</sup> *Central Bank of Denver* will adversely affect the

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1 See Linda Greenhouse, *High Court Ruling Sharply Curbs Suits on Securities Fraud*, N.Y. TIMES, April 20, 1994, at A1; John F. Olson, et al., *The End of the Section 10(b) Aiding and Abetting Liability Fiction*, 8 INSIGHTS 3 (June 1994); Amy Stevens, *'Aiding-and-Abetting' Ruling by High Court is Gift to Some Firms*, WALL ST. J., April 22, 1994, at B3; see also Paul M. Barrett, *Justices Deal Investors a Blow in Certain Suits*, WALL ST. J., April 20, 1994, at A2.

2 114 S. Ct. 1439 (1994).

3 15 U.S.C. § 78j(b) (1988).

4 17 C.F.R. § 240.10b-5 (1994).

5 See, e.g., *Cleary v. Perfecttune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *IIT v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799-800 (3d Cir. 1978), cert. denied, 439 U.S. 930 (1978); *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); Olson, *supra* note 1, at 3 ("The Court's decision overruled decisions from 11 federal courts of appeals which had recognized Section 10(b) aiding and abetting liability.").

6 See Barrett, *supra* note 1, at A2 ("In Congress, the SEC's backers were wary of attacking the high court's action for fear they would open the door to attempts to further

Securities and Exchange Commission's ("SEC") enforcement program<sup>7</sup> and the ability of private claimants to receive just recompense from blameworthy collateral participants.<sup>8</sup>

The Court's decision displays a rigidity and callousness that is disconcerting. While supposedly adhering to a strict statutory construction,<sup>9</sup> the Court misconstrues its own precedent.<sup>10</sup> Along with other recent high court decisions that narrow the scope of the federal securities laws,<sup>11</sup> *Central Bank of Denver* will increasingly prompt allegedly aggrieved litigants to bring suit in state courts.<sup>12</sup> Perhaps this tact has been the Court's objective for well over a decade. If so, the Court is effectuating this strategy with mechanistic efficiency.<sup>13</sup>

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limit investors' rights to sue."). Legislation has been introduced in Congress covering other aspects of securities litigation, including section 10(b)'s statute of limitations and attorneys' fees. See S. 1976, 103d Cong., 2d Sess. § 104 (1994), discussed in 26 Sec. Reg. & L. Rep. (BNA) 440 (1994); *infra* notes 159-63 and accompanying text.

7 See *infra* notes 86-95 and accompanying text. On the contrary, the SEC's General Counsel Simon Lorne has opined that the decision "was not likely to 'affect fundamentally the commission's enforcement program.'" Greenhouse, *supra* note 1, at C6 (quoting SEC General Counsel Simon Lorne).

8 Greenhouse, *supra* note 1, at A1 (paraphrasing former SEC Commissioner A.A. Sommer, Jr.). See *infra* notes 86-102 and accompanying text.

9 See 114 S. Ct. 1439, 1446-48 (1994).

10 *Id.* at 1449-50, 1452-53. See *infra* notes 34-51 and accompanying text. The Court misconstrues the following decisions: *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988); *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983); and *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353 (1982). Professor Bromberg likewise has criticized the Court's "simplistic and overly literal rationale, . . . indifference to legislative history, disdain for lower court precedent, and highly selective use of the Court's own precedents with little or no effort to distinguish its cases that point the other way." Alan R. Bromberg, *Aiding and Abetting: Sudden Death and Possible Resurrection*, 24 REV. SEC. & COMM. REG. 133, 139 (1994). See also Marc I. Steinberg, *The Propriety and Scope of Cumulative Remedies Under the Federal Securities Laws*, 67 CORNELL L. REV. 557 (1982).

11 See, e.g., *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 359-61 (1991) (adopting statute of limitations of one year after discovery and no longer than three years after the violation for § 10(b) actions), *reh'g denied*, 501 U.S. 1277 (1991); *Chiarella v. United States*, 445 U.S. 222, 235 (1980) (holding that absent a duty to disclose based on a fiduciary or similar relationship, silence does not give rise to liability); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) (requiring that scienter be shown in § 10(b) private actions), *reh'g denied*, 425 U.S. 986 (1976); see generally ALAN R. BROMBERG & LOUIS LOWENFELS, *SECURITIES FRAUD AND COMMODITIES FRAUD* (1994); 5B ARNOLD S. JACOBS, *LITIGATION AND PRACTICE UNDER RULE 10b-5* (1994).

12 See Marc I. Steinberg, *The Emergence of State Securities Laws: Partly Sunny Skies for Investors*, 62 U. CIN. L. REV. 395, 418-28 (1993) (presented as the Inaugural Visiting Charles F. Hartsock Professor of Law); *infra* notes 103-58 and accompanying text.

13 See 114 S. Ct. 1439, 1454 (1994) (referring to the "uncertainty" and "excessive litigation" of § 10(b) actions); *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1096 (1991) (stating that recognizing plaintiff's causation theory under § 14(a) would produce hazy issues, giving rise to protracted litigation); *Marine Bank v. Weaver*, 455 U.S. 551,

This Article focuses on recent Supreme Court decisions construing the federal securities laws and thereafter turns to the ramifications of those decisions from both a government enforcement and private complainant perspective. Theories and strategies that should be pursued by such litigants are addressed. The federal-state relationship, invoking notions of federalism, remains a key ingredient in this mix.

## II. ADHERENCE TO A STRICT STATUTORY APPROACH

In the last two decades, the Supreme Court has adhered to a strict statutory approach with varying degrees of enthusiasm. For example, in *Ernst & Ernst v. Hochfelder*,<sup>14</sup> the Court principally focused on the language of section 10(b) to hold that scienter<sup>15</sup> must be proven in private actions brought under that provision.<sup>16</sup> Four years later, the Court relied on a strict linguistic approach in *Aaron v. SEC*<sup>17</sup> to require that the SEC show scienter in its enforcement actions based on alleged violations of section 10(b).<sup>18</sup> In the implied rights area, the Court similarly embraced strict construction, opining in *Touche Ross & Co. v. Redington*<sup>19</sup> that "[t]he central inquiry remains whether Congress intended to create, ei-

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556 (1982) (stating that "Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud."); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975) (stating that "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general."), *reh'g denied*, 423 U.S. 884 (1975).

14 425 U.S. 185 (1976), *reh'g denied*, 425 U.S. 986 (1976).

15 The Court defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud." *Id.* at 193. See *Aaron v. SEC*, 446 U.S. 680, 690 (1980). A question left open in both *Aaron* and *Hochfelder* was whether reckless conduct constitutes scienter. See *Aaron*, 446 U.S. at 686 n.5; *Hochfelder*, 425 U.S. at 193 n.12. With respect to principal liability, the lower federal courts overwhelmingly, if not unanimously, have affirmatively answered this question. See, e.g., *Fine v. American Solar King Corp.*, 919 F.2d 290, 296 (5th Cir. 1990); *IIT v. Cornfeld*, 619 F.2d 909, 923 (2d Cir. 1980); *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1039-40 (7th Cir. 1977); MARC I. STEINBERG, *SECURITIES REGULATION: LIABILITIES AND REMEDIES* § 7.02 (1994) (cases cited).

16 425 U.S. at 197 (stating that "the words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct.").

17 446 U.S. 680 (1980).

18 *Id.* at 689-95 (stating that based on the rationale of *Hochfelder*, "plain meaning of the language of § 10(b) . . . ineluctably leads to the conclusion that scienter is an element of a violation of § 10(b) and Rule 10b-5, regardless of the identity of the plaintiff or the nature of the relief sought.").

19 442 U.S. 560 (1979) (declining to imply a private remedy under § 17(a) of the Exchange Act).

ther expressly or by implication, a private cause of action."<sup>20</sup> More recently in *Virginia Bankshares*, the Court gave approbation to this approach.<sup>21</sup>

Nonetheless, a number of the Court's decisions took an approach grounded in significant part on policy concerns and flexible use of legislative history. *United States v. Naftalin*<sup>22</sup> is a key example. Holding that the scope of section 17(a) of the Securities Act of 1933<sup>23</sup> reached the defendant's conduct,<sup>24</sup> the Court (relying in part on statutory language) turned to Congress' broad predominant objectives in enacting the Securities Act: protecting investors and achieving ethical standards in the securities industry.<sup>25</sup> Application of a broader policy-based standard premised on more flexible principles of statutory construction is also exemplified by the Court's decision in *Herman & MacLean v.*

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20 *Id.* at 575. *Accord* Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 24 (1979) (asserting that "[t]he dispositive question remains whether Congress intended to create any such remedy [and] . . . [h]aving answered that question in the negative, our inquiry is at an end.").

For a more expansive decision during that era, which applied the principles of *Cort v. Ash*, 422 U.S. 66, 78 (1975), see *Cannon v. University of Chicago*, 441 U.S. 677 (1979) (implying a private right of action under Title IX of the Education Amendments of 1972). For a key appellate court decision that followed somewhat uncertain Supreme Court precedent during this period in the securities law area, see *Landry v. All Am. Assurance Co.*, 688 F.2d 381 (5th Cir. 1982) (declining to imply private right of action under § 17(a) of the Securities Act). *See., e.g.*, Tamar Frankel, *Implied Rights of Action*, 67 VA. L. REV. 553 (1981); Thomas L. Hazen, *Implied Private Remedies Under Federal Statutes: Neither a Death Knell Nor a Moratorium - Civil Rights, Securities Regulation, and Beyond*, 33 VAND. L. REV. 1333 (1980); Marc I. Steinberg, *Implied Private Rights of Action Under Federal Law*, 55 NOTRE DAME LAW. 33 (1979).

21 *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1102 (1991) (stating that "[t]he rule that has emerged . . . is that recognition of any private right of action for violating a federal statute must ultimately rest on congressional intent to provide a private remedy."). *See* *Thompson v. Thompson*, 484 U.S. 174, 189 (1988) (Scalia, J., concurring) (citations omitted) ("[W]e effectively overruled the *Cort v. Ash* analysis in *Touche Ross & Co. v. Redington and Transamerica Mortgage Advisors, Inc. v. Lewis*, converting one of [Cort's] four factors (congressional intent) into the determinative factor, with the other three merely indicative of its presence or absence."); Marc I. Steinberg & William A. Reece, *The Supreme Court, Implied Rights of Action and Proxy Regulation*, 54 OHIO ST. L.J. 67, 81 (1993) (stating that, with respect to the view held by some that the *Cort* test retained vitality, the Court's *Virginia Bankshares* decision "appears to have vitiated this perception.").

22 441 U.S. 768 (1979).

23 15 U.S.C. § 77q(a) (1988).

24 441 U.S. at 773-78.

25 *Id.* at 775-76 (citing SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186-87 (1963) (Investment Advisors Act of 1940 intended to mandate disclosure (rather than *caveat emptor*) to achieve high ethical standards in securities industry)). For further discussion addressing *Naftalin's* ramifications, see Marc I. Steinberg, *Section 17(a) of the Securities Act of 1933 After Naftalin and Redington*, 68 GEO. L.J. 163 (1979).

*Huddleston*.<sup>26</sup> There, the Court applied this approach to hold that the plaintiff could institute an action under section 10(b) even though section 11 of the Securities Act<sup>27</sup> covered the same type of conduct.<sup>28</sup> Furthermore, the *Huddleston* court embraced the congressional reenactment theory.<sup>29</sup>

The Supreme Court reaffirmed its restrictive approach in its 1994 decision in *Central Bank of Denver*.<sup>30</sup> The Court's five-member majority adhered to a strict statutory construction in holding that aiding and abetting liability cannot be invoked in private actions under section 10(b). Assessing the statute's language, the Court reasoned that "the statutory text controls the definition of conduct covered by § 10(b)."<sup>31</sup> Because the text of the Exchange Act "does not itself" encompass aiders and abettors, "that conclusion resolves the case."<sup>32</sup> Accordingly, "the statute itself" is determinative that liability cannot be imposed upon aiders and abettors.<sup>33</sup>

In reaching this conclusion, the Court found it unnecessary to examine the pertinent legislative history<sup>34</sup> since the applicable statute's text resolved the issue.<sup>35</sup> Policy considerations cannot override a court's interpretation of a statute's (or Act's) text and structure unless such considerations indicate that "adherence to the text and structure would lead to a result 'so bizarre' that Con-

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26 459 U.S. 375 (1983).

27 15 U.S.C. § 77k (1988).

28 459 U.S. at 383 ("It would be anomalous indeed if the special protection afforded to purchasers in a registered offering by the 1933 Act were deemed to deprive such purchasers of the protections against manipulation and deception that Section 10(b) makes available to all persons who deal in securities.").

29 *Id.* at 383-87. See *infra* notes 37-51 and accompanying text.

30 114 S. Ct. 1439 (1994).

31 *Id.* at 1447.

32 *Id.* at 1448. See Bromberg, *supra* note 10, at 139 (asserting that the Court's opinion was "flawed" and "based on a simplistic and overly literal rationale: if it's not explicit in the statute, it doesn't exist.").

33 114 S. Ct. at 1447-48 (citing *Mertens v. Hewitt Assocs.*, 113 S. Ct. 2063 (1993); *Pinter v. Dahl*, 486 U.S. 622 (1988); *Chiarella v. United States*, 445 U.S. 222 (1980); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975)).

34 114 S. Ct. at 1448.

35 The pertinent legislative history evidently is that of the Congress which enacted the legislation. 114 S. Ct. at 1448 ("When the text of § 10(b) does not resolve a particular issue, we attempt to infer 'how the 1934 Congress would have addressed the issue had the 10b-5 action been included as an express provision in the 1934 Act.'" (quoting *Musick Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085 (1993))). Note, however, that under certain limited circumstances, subsequent legislative history and policy considerations may be taken into account. See 114 S. Ct. at 1452-55.

gress could not have intended it."<sup>36</sup> In sum, the Court's rationale in *Central Bank of Denver* embraces a strict textual approach, which militates against implication of private rights of action.

Although not specifically addressing the implication of private rights of action, the Supreme Court's decision in *Central Bank of Denver* evidently constricts the congressional reenactment doctrine. This doctrine was set forth in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*.<sup>37</sup>

[W]e must examine Congress' perception of the law that it was shaping and reshaping. When Congress enacts new legislation, the question is whether Congress intended to create a private remedy as a supplement to the express enforcement provisions of the statute. When Congress acts in a statutory context in which an implied private remedy has already been recognized by the courts, however, the inquiry logically is different. Congress need not have intended to create a new remedy, since one already existed; the question is whether Congress intended to preserve the preexisting remedy.<sup>38</sup>

The Court's decision in *Central Bank of Denver* may be read as a repudiation of the doctrine broadly enunciated in *Curran* and reaffirmed in *Huddleston*.<sup>39</sup> Rather than focusing on the 1975 Amendments which constituted a significant revision of the federal securities laws,<sup>40</sup> the majority in *Central Bank of Denver* ascertained whether Congress had reenacted the language of the statute at

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36 114 S. Ct. at 1454 (quoting *Demarest v. Manspeaker*, 498 U.S. 184, 191 (1991)).

37 456 U.S. 353 (1982).

38 *Id.* at 378-79. The Court reaffirmed the congressional reenactment theory in *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983). Opting for a cumulative construction of section 10(b) of the Securities Exchange Act, the Court reasoned:

[W]hen Congress comprehensively revised the securities laws in 1975, a consistent line of judicial decisions had permitted plaintiffs to sue under Section 10(b) regardless of the availability of express remedies. In 1975 Congress enacted the 'most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act of 1934.' . . . When Congress acted, federal courts had consistently and routinely permitted a plaintiff to proceed under Section 10(b) even where express remedies under Section 11 or other provisions were available. In light of this well-established judicial interpretation, Congress' decision to leave Section 10(b) intact suggests that Congress ratified the cumulative nature of the Section 10(b) action.

*Id.* at 384-85 (citations omitted). See Marc I. Steinberg, *The Propriety and Scope of Cumulative Remedies Under the Federal Securities Laws*, 67 CORNELL L. REV. 557 (1982).

39 See 114 S. Ct. at 1452-53; *infra* notes 40-51 and accompanying text.

40 See *supra* notes 37-38 and accompanying text.

issue, namely, section 10(b).<sup>41</sup> Since Congress had not done so, the congressional reenactment doctrine was deemed unavailing.<sup>42</sup>

This narrow construction of the doctrine, focusing on the particular statutory provision at issue rather than the Securities Acts in general, would eviscerate the doctrine if followed in subsequent cases. A situation would rarely arise which would call for the doctrine's application. As set forth in *Central Bank of Denver*, the congressional reenactment doctrine applies only in situations where Congress has reenacted the particular provision.<sup>43</sup> Generally, such reenactment occurs when Congress attempts to make a relatively minor modification, such as a clarifying or technical change in a particular statute<sup>44</sup> or when Congress makes a more substantive revision.<sup>45</sup> In the first situation, it belies reality to assert that Congress, when it enacts such clarifying or technical amendments, is aware of the applicable case law. In the latter scenario, Congress focuses on the particular statutory provision from a substantive standpoint and amends that provision to reflect its intent.<sup>46</sup> Accordingly, the statute and its accompanying legisla-

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41 114 S. Ct. at 1452 ("When Congress reenacts statutory language that has been given a consistent judicial construction, we often adhere to that construction in interpreting the reenacted statutory language." (citing *Keene Corp. v. United States*, 113 S. Ct. 2035 (1993); *Pierce v. Underwood*, 487 U.S. 552, 567 (1988); *Lorillard v. Pons*, 434 U.S. 575, 580-81 (1978))).

The Court acknowledged that "our cases have not been consistent in rejecting arguments such as these [citing *Curran* among other cases] . . . . We therefore reject them." 114 S. Ct. at 1453 (citations omitted). Although unlikely to succeed, it may be argued that *Central Bank of Denver* construed the scope of section 10(b) and not the implication of a private right of action. *Id.* at 1452-53. Therefore, the assertion may be made that the congressional reenactment doctrine and the decisions reflecting the doctrine, such as *Curran* and *Huddleston*, remain viable if the issue at bar concerns the implication of a federal right of action. On the other hand, the court made clear that its "observations on the acquiescence doctrine indicate [the doctrine's] limitations as an expression of congressional intent." *Id.* at 1453. This and similar language along with the tenor of the Court's opinion compel the conclusion that the doctrine, as reflected in *Curran* and *Huddleston*, is in dire need of resuscitation.

42 114 S. Ct. at 1452 ("Congress has not reenacted the language of § 10(b) since 1934, however, so we need not determine whether the other conditions for applying the reenactment doctrine are present").

43 *Id.* at 1452-53. See *supra* notes 41-42 and accompanying text.

44 See, e.g., Securities Enforcement Remedies and Penny Stock Reform Act of 1990, S. 647, 101st Cong., 2d Sess. § 507 (1990), amending, Securities Exchange Act of 1934 § 29(b), 15 U.S.C. § 78cc(b) (1988 & Supp. V 1993).

45 See, e.g., Insider Trading Sanctions Act, H.R. 559, 98th Cong., 2d Sess. § 4 (1984), amending, Securities Exchange Act of 1934 § 15(c)(4), 15 U.S.C. § 78o(c)(4) (1988) (amending § 15(c)(4) to enable the SEC to proceed against any person who is deemed a "cause" of a subject party's failure to comply).

46 See *Landry v. All Am. Assurance Co.*, 688 F.2d 381, 390 (5th Cir. 1982).



tive history<sup>47</sup> usually will set forth the revisions, thereby making resort to the legislative reenactment doctrine superfluous.

On a related subject, language in *Central Bank of Denver* indicates that legislative history of even the Congress that enacted the pertinent legislation is immaterial unless the text of the statutory provision fails to resolve the matter at issue.<sup>48</sup> By foreclosing aiding and abetting liability in private actions under section 10(b) based solely on the text of the statute,<sup>49</sup> the Court adhered to this restrictive proposition. This confining rationale dictates that Congress must include every eventuality when enacting a particular statute, or risk that the judiciary will hold that the statute fails to encompass the relief requested, even if such relief is favorably viewed by that and subsequent Congresses.<sup>50</sup> Such a wooden construction ignores the realities of the political process, demands a "crystal ball" approach from the Congress enacting the legislation, ill serves a body as eminent as the Supreme Court, and frustrates the effectuation of legitimate, if not sometimes noble, public policy objectives.<sup>51</sup>

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47 Following *Central Bank of Denver's* rationale, if the text of the statute resolves the issue, the legislative history is not material. 114 S. Ct. at 1446-48; *infra* notes 48-51 and accompanying text. Moreover, the Court in *Central Bank of Denver* reaffirmed its distaste for reliance on legislative history of a subsequent Congress: "We have observed on more than one occasion that the interpretation given by one Congress (or a committee or Member thereof) to an earlier statute is of little assistance in discerning the meaning of that statute." 114 S. Ct. at 1452 (quoting *Public Employees Retirement Sys. of Ohio v. Betts*, 492 U.S. 158, 168 (1989)).

48 114 S. Ct. at 1448.

49 *Id.* (stating that "the text of the 1934 Act does not itself reach those who aid and abet a § 10(b) violation [and] we think that conclusion resolves the case.").

50 *Id.* ("It is inconsistent with settled methodology in § 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text."). See *supra* notes 43-47 and accompanying text.

51 For this author's critique of the Supreme Court's unduly restrictive approach in the implied rights and securities law areas, see, e.g., Marc I. Steinberg, *Implied Private Rights of Action Under Federal Law*, 55 NOTRE DAME LAW. 33, 44-52 (1979); Marc I. Steinberg, *The Propriety and Scope of Cumulative Remedies Under the Federal Securities Laws*, 67 CORNELL L. REV. 557, 560-71 (1982); Marc I. Steinberg & William E. Kaulbach, *The Supreme Court and the Definition of 'Security': The 'Context' Clause, 'Investment Contract' Analysis, and Their Ramifications*, 40 VAND. L. REV. 489, 503-39 (1987); Marc I. Steinberg & William A. Reece, *The Supreme Court, Implied Rights of Action, and Proxy Regulation*, 54 OHIO ST. L.J. 67 (1993).

### III. GENERAL PRECLUSION OF AIDING AND ABETTING LIABILITY UNDER THE FEDERAL SECURITIES LAWS

As noted in *Central Bank of Denver*, the Supreme Court held that section 10(b) of the Exchange Act does not provide for the imposition of aiding and abetting liability in private litigation.<sup>52</sup> The Court clarified that its decision was based on "a strict statutory construction"<sup>53</sup> and that the issue before it involved "the scope of conduct prohibited by § 10(b)."<sup>54</sup> Importantly, the Court's rationale precludes imposition of aiding and abetting liability by private plaintiffs for alleged violations of other federal securities law provisions.<sup>55</sup> Moreover, the Court's restrictive approach may extend to the SEC, thereby precluding the Commission from bringing enforcement actions premised on aider and abettor liability (except where a statute expressly provides for such liability).<sup>56</sup>

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52 114 S. Ct. at 1446-55. For law review commentary prior to *Central Bank of Denver*, see Douglas M. Branson, *Collateral Participant Liability Under the Securities Laws - Charting the Proper Course*, 65 OR. L. REV. 327 (1986); Alan R. Bromberg & Lewis D. Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 ALB. L. REV. 637 (1988); William H. Kuehnle, *Secondary Liability Under the Federal Securities Laws - Aiding and Abetting, Conspiracy, Controlling Person and Agency: Common-Law Principles and the Statutory Scheme*, 14 J. CORP. L. 313 (1988); Dennis S. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. PA. L. REV. 597 (1972).

53 114 S. Ct. at 1446-48.

54 *Id.*

55 After examining sections 11 and 12 of the Securities Act and sections 9, 16, 18, and 20A of the Exchange Act, the Court concluded that none of these express causes of actions provided for aider and abettor liability. *Id.* at 1448-50. Moreover, the Court's analysis in *Central Bank of Denver* certainly should extend to other implied causes of action, such as section 14(a) of the Exchange Act. Indeed, the statutory language of section 14(a), like that of section 10(b), "controls" and "bodes ill" for litigants who seek to hold collateral parties liable as aiders and abettors. *Id.* at 1447. The same holds true for SEC enforcement actions based on violation of section 17(a) of the Securities Act.

The Court's decision should also preclude use of the common law theories of conspiracy and respondeat superior. As Justice Stevens pointed out in his dissent, lower court decisions recognizing these theories of liability "appear unlikely to survive the Court's decision." *Id.* at 1460 n.12. See generally David Waksman, Comment, *Causation Concerns in Civil Conspiracy to Violate Rule 10b-5*, 66 N.Y.U. L. REV. 1505 (1991); sources cited *supra* note 52.

56 See Thomas O. Gorman, *Who's Afraid of 10b-5? The Scope of a Section 10(b) Cause of Action After Central Bank of Denver*, 22 SEC. REG. L.J. 247 (1994); Olson, *supra* note 1, at 5; see generally Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961 (1994). But see Bromberg, *supra* note 10, at 138 (stating that "[a] likely rationale [for holding that the Commission has authority to pursue aiders and abettors] is that the criminal aid-abet statute gives sufficient support for government enforcement when it does not for private civil

Notwithstanding the holding in *Central Bank of Denver*, discussion of aider and abettor liability principles should be undertaken for a number of reasons. First, the SEC arguably may pursue aiders and abettors since it may not be limited by *Central Bank of Denver*. In any event, the SEC has statutory authority to proceed administratively against broker-dealers (and associated persons) who aid and abet securities law violations.<sup>57</sup> Second, the SEC may also procure injunctions against those who aid and abet violations of the Investment Advisers Act.<sup>58</sup> Third, although the SEC's cease and desist power against those who are a "cause" of an alleged violation evidently is more expansive than aider and abettor liability principles,<sup>59</sup> the SEC still may draw on some of these principles to ascertain the parameters of the liability net. Fourth, a number of state securities statutes provide for aiding and abetting liability.<sup>60</sup>

Prior to *Central Bank of Denver*, the lower federal courts overwhelmingly held that aiding and abetting liability was appropriate under section 10(b) of the Exchange Act.<sup>61</sup> Although courts differed on the precise content of the various elements of aiding and abetting liability,<sup>62</sup> three basic prerequisites emerged: (1) a prima-

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enforcement.").

57 See Securities Exchange Act of 1934 §§ 15(b)(4)(E), 15(b)(6)(A)(i), 15 U.S.C. §§ 78o(b)(4)(E), 78o(b)(6)(A)(i) (1988 & Supp. V 1993); *infra* notes 98-100 and accompanying text; see also 15 U.S.C. § 78u-2 (1988 & Supp. V 1993) (civil penalty may be assessed against broker-dealer aiding and abetting certain violations of the Exchange Act).

58 See Investment Advisers Act of 1940 § 209(d), 15 U.S.C. § 80b-9(d) (1988 & Supp. IV 1992); see also SEC Rule 2(e), 17 C.F.R. § 201.2(e) (1994) (providing, *inter alia*, that the SEC may suspend or bar any person from practicing before it if such person is found by the Commission to have willfully aided and abetted a violation of any federal securities statute, rule, or regulation). Under this provision, SEC case law has developed with respect to the requirements for finding aider and abettor liability. See *In re Carter & Johnson*, Exchange Act Release No. 17,597 [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847 (Feb. 21, 1981). After *Central Bank of Denver*, parties may challenge that the SEC has no authority to discipline aiders and abettors under Rule 2(e). Cf. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(d) (1992) (prohibiting an attorney from aiding and abetting a client's fraudulent conduct).

59 See Alan A. Martin, et al., *SEC Enforcement Powers and Remedies Are Greatly Expanded*, 19 SEC. REG. L.J. 19, 23 (1991) (stating that the concept of a "cause" of a violation in relation to the SEC's cease and desist authority "would appear to go far beyond traditional concepts of aiding and abetting violations.").

60 See, e.g., TEX. REV. CIV. STAT. ANN. art. 581-33(F)(2) (West 1977); JOSEPH C. LONG, BLUE SKY LAW § 7.08 (1993). A number of state statutes are more expansive and impose liabilities on those who "materially aid" the sale. See *infra* notes 143-46 and accompanying text.

61 See cases cited *supra* note 5.

62 Compare *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir. 1978), with *Schatz v. Rosenberg*, 943 F.2d 485 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 1475 (1992).

ry securities law violation by another; (2) substantial assistance by the alleged aider and abettor in the commission of the primary violation; and (3) requisite "knowledge" on the part of such alleged aider and abettor that his conduct was improper.<sup>63</sup>

In determining whether the requisite knowledge had been shown,<sup>64</sup> reckless conduct<sup>65</sup> sufficed if a fiduciary relationship existed between the complainant and the alleged aider and abettor.<sup>66</sup> Absent a fiduciary relationship, a number of courts required conscious intent,<sup>67</sup> particularly if the alleged violator's role constituted "the daily grist of the mill."<sup>68</sup> In contrast, other courts found recklessness to suffice where the alleged aider and abettor had reason to foresee that third parties would be relying on her conduct<sup>69</sup> or where she derived financial benefit from the wrongdoing.<sup>70</sup> Still other courts, as a general principle, allowed reckless conduct to satisfy the "knowledge" requirement.<sup>71</sup>

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Moreover, the Seventh Circuit required that the plaintiff "show that each person alleged to be an aider, abettor, or conspirator himself committed one of the 'manipulative or deceptive' acts or otherwise met the standards of direct liability." *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986).

63 See, e.g., 114 S. Ct. 1439, 1456 n.1 (1994) (Stevens, J., dissenting) (cases cited); *supra* note 5.

64 Questions also arose as to whether the defendant's conduct constituted "substantial assistance." For a narrow view, see *Schatz v. Rosenberg*, 943 F.2d 485 (4th Cir. 1991) (lawyer drafting of key documents was not substantial assistance), *cert. denied*, 112 S. Ct. 1475 (1992). This narrow view was largely rejected, even by those courts which otherwise adhered to a restrictive approach. See, e.g., *Abell v. Potomac Ins. Co.*, 858 F.2d 1104 (5th Cir. 1988), *vacated on other grounds*, 492 U.S. 914 (1989), *cert. denied*, 492 U.S. 918 (1989). For a case dealing with whether a bank's participation constituted substantial assistance, see *K & S Partnership v. Continental Bank, N.A.*, 952 F.2d 971, 979-80 (8th Cir. 1991), *cert. denied*, 112 S. Ct. 2993 (1992).

65 Courts generally have adopted the "highly" reckless standard, defined as conduct that represents "an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569-70 (9th Cir. 1990) (en banc) (cases cited).

66 See, e.g., *Abell*, 858 F.2d 1104.

67 See, e.g., *Schatz*, 943 F.2d 485.

68 *Camp v. Dema*, 948 F.2d 455, 464 (8th Cir. 1991) (quoting *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975)). See, e.g., *Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982 (10th Cir. 1992); *Abell*, 858 F.2d 1104.

69 See, e.g., *Breard v. Sachnoff & Weaver, Ltd.*, 941 F.2d 142 (2d Cir. 1991); *SEC v. Electronics Warehouse, Inc.*, 689 F. Supp. 53 (D. Conn. 1988), *aff'd*, 891 F.2d 457 (2d Cir. 1989), *cert. denied*, 496 U.S. 942 (1990); *Andreo v. Friedlander, Gaines, Cohen, Rosenthal & Rosenberg*, 660 F. Supp. 1362 (D. Conn. 1987).

70 See, e.g., *Walck v. American Stock Exch.*, 687 F.2d 778, 791 n.18 (3d Cir. 1982), *cert. denied*, 461 U.S. 942 (1983); *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761, 780 (3d Cir. 1976).

71 See, e.g., *Stern v. American Bankshares Corp.*, 429 F. Supp. 818 (E.D. Wis. 1977);

In view of the Supreme Court's decision in *Central Bank of Denver*, private parties and the SEC increasingly will assert theories of liability based on primary violations. Hence, where a party makes an affirmative statement, such as an attorney rendering an opinion letter,<sup>72</sup> primary liability exposure is clear.<sup>73</sup> When one solicits the purchase for the financial benefit of the securities owner or one's own financial benefit, then liability under section 12 of the Securities Act may be incurred.<sup>74</sup> In addition, because executive officers "make policy and generally carry authority to bind the corporation[,] . . . . [t]heir action in behalf of the corporation is therefore primary . . . ."<sup>75</sup>

Similarly, under the "group published" theory, those officers who are actively involved in a corporation's affairs may be subject to primary liability for disclosure deficiencies contained in such entity's prospectuses, press releases, and documents filed with the SEC.<sup>76</sup> The Sixth Circuit's "direct contacts" test also will allow complainants to assert that those who are deemed to have "furnished" documents to investors are subject to liability as primary participants.<sup>77</sup> This rationale encompasses attorneys who draft

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see also, *SEC v. Coven*, 581 F.2d 1020 (2d Cir. 1978), *cert. denied*, 440 U.S. 950 (1979); *SEC v. Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973). *Coven* and *Spectrum* stand for the proposition that in SEC injunctive actions, if the primary violation does not require scienter, neither does the secondary aiding and abetting violation. These cases evidently are no longer good law.

72 See, e.g., *Kline v. First W. Gov't Sec., Inc.*, 24 F.3d 480 (3d Cir. 1994), *petition for cert. filed*, 63 U.S.L.W. 3161 (Aug. 29, 1994); see generally SCOTT FITZGIBBON & DONALD W. GLAZER, *LEGAL OPINIONS* (1992); MARC I. STEINBERG, *CORPORATE AND SECURITIES MALPRACTICE* (1992); Darrel A. Rice & Marc I. Steinberg, *Legal Opinions in Securities Transactions*, 16 J. CORP. L. 375 (1991).

73 See, e.g., *Ackerman v. Schwartz*, 947 F.2d 841 (7th Cir. 1991) (attorney who rendered opinion letter subject to liability under § 10(b) as primary violator); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1125 (5th Cir. 1988) (stating that "an attorney is rarely liable to any third party for his or her legal work unless the attorney has prepared a signed 'opinion' letter designed for the use of a third party."), *vacated on other grounds*, 492 U.S. 914 (1989), *cert. denied*, 492 U.S. 918 (1989).

74 See *Pinter v. Dahl*, 486 U.S. 622, 647 (1988) (defining a seller as including one "who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner").

75 *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 182 n.8 (3d Cir. 1981) (citing *Holmes v. Bateson*, 583 F.2d 542, 561 (1st Cir. 1978)).

76 See, e.g., *Wool v. Tandem Computers Inc.*, 818 F.2d 1433 (9th Cir. 1987); *Morse v. Abbott Lab.*, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,139 (N.D. Ill. 1994). See also *In re Medeva Sec. Litig.*, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,323 (C.D. Cal. 1994) ("group published" doctrine used to state claim under Exchange Act controlling person provision § 20(a)).

77 *SEC v. Washington County Util. Dist.*, 676 F.2d 218 (6th Cir. 1982).

documents with the anticipation that such documents will be provided to investors.<sup>78</sup>

Another approach focuses primary liability exposure on those persons who sufficiently participate in the making of the allegedly offensive statement (or omission) so as to be deemed a party who in fact "made" such statement (or omission).<sup>79</sup> Hence, while uncertainty prevails regarding whether certain of these theories will be embraced by the federal courts on a widespread basis, the fact remains that private litigants and the SEC will seek to devise effective strategies in their efforts to emerge victorious.

#### IV. THE REJECTION OF RESPONDEAT SUPERIOR LIABILITY?

Today, the overwhelming majority of federal appellate courts have accepted the common law doctrine of respondeat superior in the federal securities law context.<sup>80</sup> In view of the Supreme

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<sup>78</sup> See, e.g., *Molecular Technology Corp. v. Valentine*, 925 F.2d 910 (6th Cir. 1991); *In re Rospatch Sec. Litig.*, 802 F.Supp. 110 (W.D. Mich. 1992). As the Sixth Circuit set forth in *Molecular Technology*:

Applying section 10(b)/rule 10b-5 principles to [the attorney] Snyder's involvement with the SDE shell transaction leads us to conclude that sufficient evidence was introduced to create a triable fact issue for the jury. [Attorney] Snyder drafted the merger agreement between State Die and Extra Production at the August 11, 1983 meeting between himself, Al Valentine and DeWorth Williams. At that meeting, Snyder took notes which indicated that Snyder knew that 60,000 shares (representing about 90% of the outstanding shares) of State Die stock were in escrow; Snyder was aware that the title to the real property of State Die, which was part of the consideration in the merger with Extra Production, was held by an unrelated leasing company and, thus, not transferable; Snyder contemplated obtaining State Die's most recent annual report, a corporate certificate of good standing, tax returns, etc. (although he never obtained any such documents); and Snyder knew that State Die had substantial debts, including one \$194,000 bank debt. Snyder did not disclose any of this information in the amended offering circular. Taking this evidence in the light most favorable to the plaintiffs, a reasonable jury could find that [the attorney] Snyder knew certain information in the amended offering circular was misleading and that Snyder had a duty to disclose that information to investors such as the plaintiffs under 10(b)/rule 10b-5. Furthermore, Snyder's participation in editing the information statement prepared for the purpose of marketing SDE's stock in the OCT market, and in drafting an opinion letter for SDE's board of directors regarding the tradeability of common stock, while not overwhelming, also implicated him in the alleged fraudulent scheme.

*Molecular Technology*, 925 F.2d at 918.

<sup>79</sup> See John C. Coffee, *Securities Law*, NAT'L L.J., July 11, 1994, at B4, B7.

<sup>80</sup> See, e.g., *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990) (en banc) (cases cited); MARC I. STEINBERG, *SECURITIES REGULATION: LIABILITIES AND REMEDIES* § 10.04 (1994) (cases cited).

Court's *Central Bank of Denver* decision, the continued vitality of respondeat superior liability is open to debate, if not emasculated. *Central Bank of Denver* disallows private actions based on aiding and abetting under section 10(b). The Court's language and tenor signify that other common law theories of liability, unless provided for by statute, likewise will be rejected.<sup>81</sup>

This assertion is evidenced further by the Supreme Court's focus on the statutorily provided controlling person provision of the Exchange Act. In this regard, the Court stated:

Congress did not overlook secondary liability when it created the private rights of action in the 1934 Act. Section 20 of the 1934 Act imposes liability on "controlling persons" . . . . This suggests that "[w]hen Congress wished to create such [secondary] liability, it had little trouble doing so . . . ."<sup>82</sup>

As Justice Stevens recognized in his dissent, the majority's rationale suggests that lower court decisions recognizing respondeat superior liability "appear unlikely to survive."<sup>83</sup>

Even if the federal courts ultimately reject the doctrine of respondeat superior liability, it may be useful to examine this issue from the standpoint of state securities law.<sup>84</sup> Moreover, when executive officers of a corporation or persons of similar status in any like enterprise improperly act with actual or apparent authority within the course and scope of their employment, such enterprise may well be held primarily liable. As stated by the Third Circuit, executive officers make policy and generally have the authority to bind the corporation; therefore, "[t]heir action in behalf of the corporation is . . . primary, and holding a corporation liable for their actions does not require respondeat superior."<sup>85</sup>

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81 See Richard A. Booth, *Vicarious Liability and Securities Fraud*, 22 SEC. REG. L.J. 347 (1995); Arthur F. Mathews, *Securities Laws*, NAT'L L.J., May 23, 1994, at B4, B6.

82 114 S. Ct. 1439, 1451-52 (1994).

83 *Id.* at 1460 n.12 (Stevens, J., dissenting). The same holds true for the common law theory of conspiracy. *Id.*

84 See, e.g., TEX. REV. CIV. STAT. ANN. art. 581-33M (West 1994) ("The rights and remedies provided by this Act are in addition to any other rights (including exemplary or punitive damages) or remedies that may exist at law or in equity.").

85 *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 182 n.8 (3d Cir. 1981) (citing *Holmes v. Bateson*, 583 F.2d 542, 560-61 (1st Cir. 1978), *cert. denied*, 455 U.S. 938 (1982)).

## V. RAMIFICATIONS ON SEC ENFORCEMENT

As a general proposition, in view of the Supreme Court's decision in *Central Bank of Denver*, a persuasive argument exists that the SEC may not bring an enforcement action premised on aider and abettor liability. Although the Court's holding was confined to private parties, its rationale may extend to SEC actions.<sup>86</sup> The Court's strict statutory construction in *Central Bank of Denver*<sup>87</sup> is akin to the situation present in *Ernst & Ernst v. Hochfelder*.<sup>88</sup> There, the Court, applying a strict statutory construction to ascertain the requisite mental state in private actions for damages under section 10(b), held that scienter must be shown.<sup>89</sup> Thereafter, applying *Hochfelder's* rationale, the Court in *Aaron v. SEC*<sup>90</sup> held that scienter must be proven in SEC enforcement actions for violation of section 10(b).<sup>91</sup> Following this logic, it appears that the SEC, except where a statute so provides (such as with respect to the broker-dealer and investment adviser contexts), may no longer institute an enforcement action based on aider and abettor liability. Nonetheless, unlike the *Hochfelder/Aaron* scienter scenario, aiding and abetting a federal securities law violation statutorily gives rise to criminal liability exposure. Accordingly, under this rationale, the criminal aid-abet statute provides ample authority for the SEC to pursue aiders and abettors.<sup>92</sup>

The Supreme Court's strict statutory rationale in *Central Bank of Denver* may well extend to other common law theories of liability. These theories include conspiracy and respondeat superior.<sup>93</sup> As Justice Stevens pointed out in his dissent, lower court decisions which recognize liability based upon conspiracy and respondeat

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86 See sources cited *supra* note 56. But see Bromberg, *supra* note 10, at 133.

87 114 S. Ct. at 1446-47.

88 425 U.S. 185 (1976).

89 *Id.* at 201.

90 446 U.S. 680 (1980).

91 *Id.* at 689-95.

92 See 18 U.S.C. § 2(a) (1988) ("Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal."); *Overtaking Central Bank Seen Part of Litigation Reform Process*, 26 Sec. Reg. & L. Rep. (BNA) 1121 (1994) (remarks of SEC General Counsel Simon Lorne); Bromberg, *supra* note 10, at 136 (pointing to criminal aid-abet statute as grounds for recognizing SEC authority to pursue aiders and abettors); *supra* notes 57-59 and accompanying text.

93 See, e.g., *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974).



superior "appear unlikely to survive the Court's decision."<sup>94</sup> In light of these developments, it remains to be seen the degree to which parties subject to SEC injunctions will seek to dissolve such injunctions based on a change in the governing law.<sup>95</sup>

Irrespective of the discussion above, the SEC retains an impressive enforcement arsenal. Foremost, the SEC may bring an administrative cease and desist proceeding against persons who are a "cause" of the alleged violation. This enforcement weapon encompasses those persons who "should have known" that their conduct "would contribute" to such violation.<sup>96</sup> Hence, even though the SEC must proceed administratively, it should be able to spread the liability net as to embrace such persons who should have known their conduct would contribute to a violation. After all, establishing one as a "cause" of a violation should be easier than proving aider and abettor liability.<sup>97</sup>

Additionally, in view of section 15(b)(4)(E) and section 15(b)(6)(A) of the Exchange Act,<sup>98</sup> the Commission has express statutory authority to proceed against brokers and dealers (and associated persons) who aid and abet securities law violations.<sup>99</sup> Hence, *Central Bank of Denver* should have minimal impact on the SEC's enforcement program directed at financial intermediaries. This is especially true given the Commission's rigorous use of the controlling person and failure to supervise provisions to hold broker-dealer executives, supervisors, and branch managers accountable.<sup>100</sup>

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94 114 S. Ct. 1439, 1460 n.12 (1994) (Stevens, J., dissenting).

95 See, e.g., *Rufo v. Inmates of Suffolk County Jail*, 502 U.S. 367 (1992); *United States v. Swift & Co.*, 286 U.S. 106 (1934); *SEC v. Warren*, 583 F.2d 115 (3d Cir. 1978); *King-Seeley Thermos Co. v. Alladin Indus., Inc.*, 418 F.2d 31 (2d Cir. 1969); Marc I. Steinberg, *SEC and Other Permanent Injunctions - Standards for Their Imposition, Modification and Dissolution*, 66 CORNELL L. REV. 27 (1980).

96 See MARC I. STEINBERG & R. FERRARA, *SECURITIES PRACTICE: FEDERAL AND STATE ENFORCEMENT* § 5A:01 et seq. (1985 & 1994 Supp.).

97 See Martin, *supra* note 59, at 23.

98 15 U.S.C. § 78o(b)(4)(E), 78o(b)(6)(A)(i) (1988 & Supp. V 1993).

99 *Id.* See also 15 U.S.C. § 78u-2 (1988 & Supp. V 1993) (civil penalty may be assessed against broker-dealer aiding and abetting certain violations of 1934 Act). Those who aid and abet violations of the Investment Advisors Act also are subject to SEC enforcement action. 15 U.S.C. § 80b-9(d) (1988).

100 See, e.g., *In re Goldman Sachs & Co.*, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,312 (1994); *In re Prudential Securities, Inc.*, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,238 (1993); *In re PaineWebber, Inc.*, [1992-1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,110 (1993); *In re Gutfreund*, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,067 (1992); Martin L. Budd & Sharon S. Tisher, *Supervisory Liability*, 26 REV. SEC. & COMM. REG. 109 (1993); Ralph S. Janvey, *The Feuerstein*

Prior to *Central Bank of Denver*, the Commission was content in many cases to allege aider and abettor liability. Now, one may expect the SEC to seek an expansion of conduct that constitutes primary liability. For example, the Sixth Circuit's "direct contacts" test provides the Commission (and private plaintiffs) an opportunity to assert primary liability against professionals who, through their participation in the drafting of documents, are deemed to have "furnished" such documents to investors, thereby becoming primary participants.<sup>101</sup> In sum, although *Central Bank of Denver* will have an adverse effect, the SEC's enforcement program will remain vigorous.<sup>102</sup>

## VI. BLUE SKY LAWS: A PREFERRED ROUTE FOR INVESTOR-LITIGANTS?

Due to the restrictive decisions handed down by the Supreme Court under the federal securities laws,<sup>103</sup> the question arises whether investors should consider pursuing state law actions with greater vigor. If claims are brought in state court, plaintiffs may join their federal Securities Act causes of action.<sup>104</sup> The defen-

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*Report of Investigation: Supervisory Responsibilities of Legal and Compliance Officers of Brokerage Firms*, 21 SEC. REG. L.J. 166 (1993); John H. Sturc & Josiah O. Hatch, III, *From Counselor to Supervisor: The Feuerstein Section 21(a) Report Expands Liability for Inside Counsel*, 26 REV. SEC. & COMM. REG. 45 (1993).

101 See *Central Bank of Denver*, 114 S. Ct. at 1455 ("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 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."); *supra* notes 72-79 and accompanying text.

102 See Barrett, *supra*, note 1, at A2. On the other hand, see *Central Bank of Denver*, 114 S. Ct. at 1460 n.11 (Stevens, J., dissenting) (quoting Brief for the SEC as Amicus Curiae: "The Commission reports that it asserted aiding and abetting claims in fifteen percent of its civil enforcement proceedings in fiscal year 1992, and that elimination of aiding and abetting would 'sharply diminish the effectiveness of Commission actions.'").

103 See *supra* notes 14-21, 30-36 and accompanying text. Under the applicable state's definition of the term "security," it is possible that a security may exist under state but not federal law (or under federal but not state law). See *Riedel v. Bancam, S.A.*, 792 F.2d 587, 593-94 (6th Cir. 1986) (although CDs issued by a Mexican bank are not a security under federal law, CDs were securities "under the broadly drafted" Ohio Securities Act); *Saunders, Lewis & Ray v. Evans*, 512 N.E.2d 59 (Ill. App. Ct. 1989) (even though corporate stock is a security under federal law, it is not a security under state law unless acquiror is a "passive investor"). See generally JOSEPH C. LONG, BLUE SKY LAW § 2.01 et seq. (1993); Douglas M. Branson & Niarl S. Okamoto, *The Supreme Court's Literalism and the Definition of "Security" in the State Courts*, 50 WASH. & LEE L. REV. 1043 (1993); Manning G. Warren, III, *The Treatment of Reves "Notes" and Other Securities Under the State Blue Sky Laws*, 47 BUS. LAW. 321 (1991).

104 Such Securities Act causes of action include those provided by sections 11, 12,

dants, in turn, have no right to remove the case to federal court.<sup>105</sup>

In some situations, plaintiffs should pursue their grievances under the federal securities acts. For example, the state of New York declines to recognize a private right of action for violation of its securities laws.<sup>106</sup> In addition, other state statutes provide private redress for purchasers only,<sup>107</sup> allow for a shorter statute of limitations than that prescribed by federal law<sup>108</sup> and do not recognize aider and abettor liability against certain collateral parties.<sup>109</sup> Moreover, by premising liability upon the status of the primary violator as a seller, many of these statutes arguably cannot be invoked against a corporate defendant and its fiduciaries in secondary market frauds, such as when a company allegedly issues a deliberately false press release or earnings statement.<sup>110</sup> Adoption of a sufficiently broad definition of "seller" in this context would expand the statute's scope to encompass such situations.<sup>111</sup>

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and 15. Most courts decline to imply a private right of action under section 17(a) of the Act. See, e.g., *Landry v. All Am. Assurance Co.*, 688 F.2d 381 (5th Cir. 1982).

105 See Securities Act of 1933 § 22(a), 15 U.S.C. § 77v(a) (1988); *Carson v. Prudential-Bache Securities, Inc.*, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,816 (D. Kan. 1990); see also *Tafflin v. Levitt*, 493 U.S. 455 (1990) (holding that state courts have concurrent jurisdiction over civil RICO claims).

On the other hand, actions raising Securities Exchange Act claims (e.g., such as § 10(b) claims) are subject to exclusive federal jurisdiction. See Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (1988); *infra* notes 52-55 and accompanying text. See also *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 382 (1985) (observing that "[i]f state preclusion includes this requirement of prior jurisdictional competency, which is generally true, a state judgment will not have claim preclusive effect on a cause of action within the exclusive jurisdiction of the federal courts").

106 See *CPC Int'l v. McKesson Corp.*, 514 N.E.2d 116 (N.Y. 1987).

107 See, e.g., N.D. CENT. CODE § 10-04-17 (1991), construed in *Weidner v. Engelhart*, 176 N.W.2d 509, 513 (N.D. 1970); OHIO REV. CODE ANN. § 1707.43 (Anderson 1992); see also UNIF. SECURITIES ACT § 410(a), 7B U.L.A. 643 (1985), reprinted in 1 Blue Sky L. Rep. (CCH) ¶ 5500, at 1566 (1985).

108 See, e.g., GA. CODE ANN. § 97-114(d) (1994); MO. ANN. STAT. § 409.411(e) (Vernon 1994); N.C. GEN. STAT. § 78A-56(f) (1993); VA. CODE ANN. § 13.1-522(D) (Michie 1993); *Clouser v. Temporaries, Inc.*, 730 F. Supp. 1127 (D.D.C. 1989) (holding claim was barred by the two-year District of Columbia blue sky statute of limitations, D.C. CODE ANN. § 2-2613(e) (1994)).

109 See, e.g., *Mercer v. Jaffe, Snider, Raitt and Heuer, P.C.*, 713 F. Supp. 1019, 1027-28 (W.D. Mich. 1989), *aff'd*, 933 F.2d 1008 (6th Cir. 1991) (interpreting Michigan Uniform Securities Act); *Allen v. Columbia Financial Management, Ltd.*, 377 S.E. 2d 352, 356 (S.C. Ct. App. 1988).

110 Hence, many states have adopted the section 12(2) counterpart but have declined to provide a private remedy for the rule 10b-5 counterpart. Compare TEX. REV. CIV. STAT. ANN. art. 581-33A(2) (West 1994) (section 12(2) counterpart), with WASH. REV. CODE ANN. § 21.20.010 (West 1989) (rule 10b-5 counterpart).

111 For example, holding that a company issuing a materially misleading press release

Another significant disadvantage to state law involves class action litigation. Unlike federal law which recognizes the fraud-on-the-market theory to create a presumption of reliance<sup>112</sup> which facilitates use of the class action mechanism,<sup>113</sup> a number of state courts have declined to adopt this doctrine with respect to actions alleging common law fraud.<sup>114</sup> The consequence is that individu-

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aided the sale, played an integral role in the sale, or solicited the transaction for its financial benefit would, depending upon the standard adopted, confer "seller" status upon the entity, thereby subjecting it to liability exposure in secondary open market transactions.

112 *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). In *Basic*, the Court concluded:

An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.

*Id.* at 247.

Because many of the blue sky remedial statutes do not have a reliance requirement, this issue under state law most frequently arises with respect to common law fraud claims. See *infra* notes 112-19 and accompanying text.

113 485 U.S. at 242-47. See MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW 139-40 (1989):

The Supreme Court's decision in *Basic* recognized the reality of the modern securities markets involving the trading of hundreds of millions of shares on a daily basis and that most ordinary investors do not read corporate reports or press releases. Acknowledging the presence of impersonal trading markets, the Court relied in part on economic theory and empirical studies to support its holding. In so ruling, the Court promoted the use of the class action to redress Section 10(b) violations. If the Court had required positive proof of individualized reliance from each plaintiff, individual issues may have predominated over the common ones, thereby precluding the pursuit of class actions in this context. Hence, the Court's decision looked to policy grounds as well to help ensure that ordinary investors have a viable recourse when they are defrauded in the impersonal trading markets.

*Id.* at 139-40. See generally Roger D. Dennis, *Materiality and the Efficient Capital Market Model: A Recipe for the Total Mix*, 25 WM. & MARY L. REV. 373 (1984); C. Edward Fletcher, III, *Sophisticated Investors Under the Federal Securities Laws*, 1988 DUKE L.J. 1081.

114 Hence, because many blue sky remedial statutes do not have a reliance requirement, this issue most frequently arises with respect to common law fraud claims. See, e.g., *Peil v. Speiser*, 806 F.2d 1154, 1163 n.17 (3d Cir. 1986) ("While the fraud on the market theory is good law with respect to the Securities Acts, no state courts have adopted the theory, and thus direct reliance remains a requirement of a common law securities fraud claim."); *Colaprico v. Sun Microsystems, Inc.*, 758 F. Supp. 1335 (N.D. Cal. 1991) (same); *Antonson v. Robertson*, 141 F.R.D. 501, 508 (E.D. Kan. 1991); *Mirkin v. Wasserman*, 858 P.2d 568 (Cal. 1993); *Gaffin v. Teledyne, Inc.*, 611 A.2d 467, 474 (Del. 1992). But see *In re ZZZZ Best Sec. Litig.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,485 (C.D. Cal. 1989) (interpreting California law); *Hurley v. Federal Deposit Ins. Corp.*, 719 F. Supp. 27, 34 n.4 (D. Mass. 1989); OHIO REV. CODE ANN. § 1707.43 (Anderson 1992) (no reliance requirement); *Arnold v. Dirrim*, 398 N.E.2d 426 (Ind. Ct. App. 1979).

alized proof of reliance is required, which militates against class certification. For example, the California Supreme Court rejected the fraud-on-the-market theory in cases alleging common law fraud because it would eliminate the reliance requirement.<sup>115</sup> Similarly, the Delaware Supreme Court has held that "[a] class action may not be maintained in a purely common law or equitable fraud case since individual questions of law or fact, particularly as to the element of justifiable reliance, will inevitably predominate over common questions of law or fact."<sup>116</sup>

The availability of classwide treatment for plaintiff-investors in state securities and common law fraud cases has taken on greater significance with the Supreme Court's determination that section 10(b) actions have a relatively short statute of limitations.<sup>117</sup> The practical consequence of state court cases mandating individualized proof of reliance is that investors whose federal and state securities law claims are time-barred will also be prevented from obtaining class certification to bring their state common law action. This result is correct in cases where prospective complainants sit on their rights. Such a result is unjust, however, in cases of fraudulent concealment where aggrieved investors may not learn of the fraud

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115 *Mirkin v. Wasserman*, 858 P.2d 568 (Cal. 1993). Importantly, the court recognized that the state securities law provisions discussed at bar contained no reliance requirement. See *supra* notes 113-14; *infra* notes 147-49 and accompanying text.

116 *Gaffin v. Teledyne, Inc.*, 611 A.2d 467, 474 (Del. 1992). As stated by a federal court interpreting state law: "[I]n the absence of an analogous state law doctrine of fraud on the market, each individual plaintiff would be required to prove his or her individual reliance, causing individual questions of fact to predominate in the case." *Antonson v. Robertson*, 141 F.R.D. 501, 508 (E.D. Kan. 1991). See *Peil v. Speiser*, 806 F.2d 1154, 1163 n.17 (3d Cir. 1986) ("While the fraud on the market theory is good law with respect to the Securities Acts, no state courts have adopted the theory, and thus direct reliance remains a requirement of a common law securities fraud claim."). But see *Arnold v. Dirrim*, 398 N.E.2d 426 (Ind. Ct. App. 1979). Accord *Hurley v. Federal Deposit Ins. Corp.*, 719 F. Supp. 27, 34 n.4 (D. Mass. 1989) ("Defendants' argument that the fraud on the market substitute for actual reliance only applies to the federal securities fraud claim, not the common law fraud claim, is unavailing."); cases cited *supra* note 114.

Another downside is that at this time there is a relative scarcity of state court reported decisions addressing the blue sky laws. See Wayne Klein, *The Idaho Securities Act: An Analysis of Idaho Courts' Securities Opinions*, 29 IDAHO L. REV. 95, 111 (1992-1993) ("Securities litigation at the state level generally yields relatively few reported decisions.").

117 See *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991) (construing statute of limitations for § 10(b) (1934 Act) claims to be within one year after discovery and in no event more than three years after the violation), *reh'g denied*, 501 U.S. 1277 (1991); see also Securities Act of 1933 § 13, 15 U.S.C. § 77m (1988) (providing statute of limitations for §§ 11 and 12(2) claims of one year after plaintiffs knew or should have known of the violation and in no event more than three years after such violation).

until several years (and even decades) after the event.<sup>118</sup> Given this reality, state courts and legislatures should recognize that using the fraud-on-the-market theory in common law fraud actions ensures that unsophisticated investors have a forum to redress their grievances.<sup>119</sup>

On the other hand, there may be several distinct advantages for plaintiffs who bring state blue sky and common law claims.<sup>120</sup> Importantly, many state securities acts provide that, if appropriate, successful plaintiffs may recover reasonable attorneys' fees and punitive damages.<sup>121</sup> Another significant advantage relates to the statute of limitations issue. In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,<sup>122</sup> the Supreme Court held that the statute of limitations under section 10(b) is one year from the date that

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118 See, e.g., *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (fraud discovered decades later).

119 See cases cited *supra* note 114. Thus, a number of recent cases provide plaintiffs with some hope of receiving class certification of their common law claims. In one such decision, *In re College Bound Consol. Litig.*, [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,328 (S.D.N.Y. 1994), the Court stated:

Defendants contend that . . . the named plaintiffs' claims are untypical of the proposed class . . . . [D]efendants argue that the named plaintiffs' manner of reliance on the alleged misrepresentations and omissions — that is, reliance on the market price of College Bound stock is not typical of the reliance of other members of the proposed class. Similarly, defendants argue that the state common law fraud claims are unsuitable for class certification because they raise individualized issues of reliance. However, the existence of individualized issues of reliance cannot defeat a motion for class certification. If necessary, this court can conduct separate trials on the issue of reliance. Therefore, there is no need to address at this time the existence of different theories of reliance, much less address the merits of any particular theory.

*Id.* at 90,268 (citations omitted), *relying on* *Green v. Wolf Corp.*, 406 F.2d 291, 301 (2d Cir. 1968); *Garfinkel v. Memory Metals, Inc.*, 695 F. Supp. 1397, 1403 (D. Conn. 1988).

120 See Douglas M. Branson, *Collateral Participant Liability Under State Securities Laws*, 19 PEPP. L. REV. 1027 (1992).

121 See, e.g., UNIF. SECURITIES ACT § 410(a), *supra* note 107, at 1566; ARIZ. REV. STAT. ANN. § 44-2001 (1994); WASH. REV. CODE § 21.20.430(1), (2) (West 1989). Punitive damages also may be awarded in appropriate situations, such as where malice or egregious fraud is shown. See OHIO REV. CODE ANN. § 2315.21(B) (Anderson 1992); *Price v. Griffin*, 359 A.2d 582, 589-90 (D.C. Ct. App. 1976); see also UTAH CODE ANN. § 61-1-22(2) (1993) (providing for the award of treble damages if violation was reckless or intentional). Moreover, little RICO and related statutes may be invoked in certain states. See, e.g., DOUGLAS E. ABRAMS, *THE LAW OF CIVIL RICO* 411-505 (1991). As another example, treble damages may be available under Texas law pursuant to that state's Deceptive Trade Practices-Consumer Protection Act (DTPA). See TEX. BUS. & COM. CODE ANN. §§ 17.41-63 (West 1987); see also *E.F. Hutton & Company v. Youngblood*, 741 S.W.2d 363 (Tex. 1987) (argument that DTPA does not apply to securities transactions not timely raised).

122 501 U.S. 350 (1991).

the plaintiff discovered the facts constituting the violation and in no event more than three years after the violation.<sup>123</sup> Equitable tolling, the Court held, is not permitted.<sup>124</sup>

A similar statute of limitations applies to claims brought under the Securities Act, including those brought pursuant to section 12(2).<sup>125</sup> By contrast, under "section 12(2)/section 10(b) types" of statutes, many of the state blue sky statutes contain a longer statute of limitations. For example, Texas has a three year/five year limitations period. The Texas statute provides a statute of limitations barring such an action "more than three years after discovery of the untruth or omission, or after discovery should have been made by the exercise of reasonable diligence; or more than five years after the sale [or purchase]."<sup>126</sup> Other more flexible statutes of limitations include those of Florida (two year/five year),<sup>127</sup> Michigan (two year/four year),<sup>128</sup> Ohio (two year/four year),<sup>129</sup> California (one year/four year),<sup>130</sup> and Pennsylvania (one year/four year).<sup>131</sup> As to outside limits, there appears to be no equitable tolling allowed.<sup>132</sup> Nonetheless, for those statutes

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123 *Id.* at 360-61 (selecting § 9(e) of the Exchange Act as the language to govern the limitations period for § 10(b) actions).

124 *Id.* at 363. The Court reasoned that the three-year outside limit was incompatible with equitable tolling principles.

125 *See* Securities Act of 1933 § 13, 15 U.S.C. § 77m (1988) (providing statute of limitations for §§ 11 and 12(2) claims of one year after plaintiffs knew or should have known of the violation and in no event more than three years after such violation).

126 TEX. REV. CIV. STAT. ANN. art. 581-33H(2), (3) (West 1994). In addition, the Texas statute provides a limitations period of three years for registration violations. *Id.* art. 581-33H(1). By contrast, the Securities Act generally provides a one-year statute of limitations for actions brought under section 12(1) for registration violations. *See* Securities Act of 1933 § 13, 15 U.S.C. § 77m (1988).

127 FLA. STAT. ANN. § 95.11(4)(e) (West 1982 & Supp. 1994). *Accord* N.M. STAT. ANN. § 58-13B-41 (Michie 1978) (two year/five year).

128 MICH. COMP. LAWS § 451.810(e) (1989).

129 OHIO REV. CODE ANN. § 1707.43 (Anderson 1992). For the two-year period in the statute, at least under some circumstances, that period "begins to run upon the actual discovery of the defect." *Eastman v. Benchmark Minerals, Inc.*, 518 N.E.2d 23, 25 (Ohio Ct. App. 1986).

130 CAL. CORP. CODE § 25506 (West 1977 & Supp. 1994).

131 PA. STAT. ANN. tit. 70, § 1-504(a) (1993).

132 *See, e.g.*, SEC v. Seaboard Corp., 677 F.2d 1301, 1308 (9th Cir. 1982) (interpreting California statute); Gilbert Family Partnership v. NIDO Corp., 679 F. Supp. 679, 685 (E.D. Mich. 1988) (interpreting Michigan statute); Bull v. American Bank & Trust Co., 641 F. Supp. 62, 67 (E.D. Pa. 1986) (interpreting Pennsylvania statute); Puchner v. Bache Halsey Stuart, Inc., 553 So.2d 216, 218 (Fla. Dist. Ct. App. 1989); Sorenson v. Tenuta, 577 N.E.2d 408, 411 (Ohio Ct. App. 1989). *But see* HAROLD MARSH, JR. & ROBERT H. VOLK, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS § 14.08[2][a], at 14-67 (1991) (taking the position that equitable tolling may be permitted under the California statute).

that contain a flat period (for example, that suit must be brought within two years after the transaction), there is some authority that the statute may be tolled due to the defendant's fraudulent concealment.<sup>133</sup> In cases of common law fraud, it is well established that the statute of limitations may be equitably tolled.<sup>134</sup>

Another example is that many state securities statutes provide for monetary damages based on negligent material misrepresentations or omissions made in the initial offering context as well as in the secondary trading markets.<sup>135</sup> Under federal law, if section 10(b) is invoked, scienter must be shown.<sup>136</sup> In addition, many state securities statutory counterparts are more expansive than section 12(2). Accordingly, under a number of these statutes, plaintiffs may have a four or five-year limitation period to bring an

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133 See, e.g., *Barton v. Peterson*, 733 F. Supp. 1482, 1492-93 (N.D. Ga. 1990) (interpreting Georgia law); *Platis v. E.F. Hutton & Co., Inc.*, 642 F. Supp. 1277, 1304-05 (W.D. Mich. 1986) (construing § 410(e) of the Michigan Uniform Securities Act), *aff'd*, 829 F.2d 13 (6th Cir. 1987); *McIntyre v. ILB Inv. Corp.*, 412 A.2d 810, 812-14 (N.J. Super. Ct. 1979). But see *Cors v. Langham*, 683 F. Supp. 1056, 1058 (E.D. Va. 1988) (no tolling of statute of limitations under Virginia Securities Act); *Norden v. Friedman*, 756 S.W.2d 158, 163 (Mo. 1988) (en banc) (two-year statute of limitations is absolute under Missouri securities statute).

134 See *Willis v. Maverick*, 760 S.W.2d 642, 644-45 (Tex. 1988); *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 378 (1991) (Kennedy, J., dissenting) ("Only a small minority of States constrain fraud actions with absolute periods of repose . . ."), *reh'g denied*, 501 U.S. 1277 (1991).

135 For example, the Washington Supreme Court in *Kittilson v. Ford*, 608 P.2d 264 (Wash. 1980) which involved a civil action for damages, rejected the *Hochfelder* scienter standard. In distinguishing *Hochfelder* and holding that negligence is sufficient to impose liability, the *Kittilson* court reasoned:

We believe the holding in *Ernst & Ernst v. Hochfelder* [425 U.S. 185 (1976)] . . . [is] inapplicable to our Securities Act. First, the "manipulative or deceptive" language of Section 10(b) of the 1934 Act is not included in the Washington act. Secondly, in contrast to the federal scheme, the language of Rule 10b-5 is not derivative but is the statute in Washington. Finally, no legislative history similar or analogous to Congressional legislative history exists in Washington.

*Id.* at 265. See *Crook v. Shearson Loeb Rhodes, Inc.*, 591 F. Supp. 40, 49 (N.D. Ind. 1983) (interpreting Indiana law); *Merrill Lynch, Pierce, Fenner & Smith v. Byrne*, 320 So.2d 436, 440 (Fla. Dist. Ct. App. 1975), *writ discharged*, 341 So.2d 498 (Fla. 1976); *Fakhrdai v. Mason*, 696 P.2d 1164, 1166-1167 (Or. Ct. App. 1985); see also *Molecular Technology Corp. v. Valentine*, 925 F.2d 910, 920 n.7 (6th Cir. 1991); Branson, *supra* note 120, at 1047 ("Under state securities laws' general antifraud statutes, allegation and proof of mere negligence is the general state of mind requirement").

136 *Aaron v. SEC*, 446 U.S. 680 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).



action based on negligently made statements in the secondary markets.<sup>137</sup>

Although some state courts have followed the Supreme Court's decision in *Pinter v. Dahl*<sup>138</sup> for defining who is a "seller" under the applicable state securities statute,<sup>139</sup> a number of states adhere to the more expansive "substantial factor" test.<sup>140</sup> This standard was used by several lower federal courts prior to *Pinter* for defining the term "seller" under section 12 of the Securities Act.<sup>141</sup> Under this test, one is deemed a "seller" if his or her actions played an integral role or were a substantial contributing factor in the transaction.<sup>142</sup> Certainly, the liability net extends farther under this definition of "seller."

A number of the state statutes extend liability exposure to those who materially aid in consummating the transaction.<sup>143</sup>

137 See *supra* notes 126-31, 135 and accompanying text.

138 486 U.S. 622, 623 (1988) (defining seller under § 12(1) of the Securities Act as extending to one "who successfully solicits a purchase, . . . motivated at least in part by a desire to serve his own financial interests or those of the securities owner"). Lower federal courts overwhelmingly have applied *Pinter* to section 12(2) actions. See, e.g., *In re Craftmatic Sec. Litig.*, 890 F.2d 628, 635-36 (3d Cir. 1989); *Moore v. Kayport Package Express, Inc.*, 885 F.2d 531, 536 (9th Cir. 1989); *Capri v. Murphy*, 856 F.2d 473, 478 (2d Cir. 1988).

139 See, e.g., *Baker, Watts & Co., v. Miles & Stockbridge*, 620 A.2d 356 (Md. Ct. Spec. App. 1993); *State v. Williams*, 390 S.E.2d 746, 749 (N.C. Ct. App. 1990); *Biales v. Young*, 432 S.E.2d 482 (S.C. 1993); *Allen v. Columbia Financial Management, Ltd.*, 377 S.E.2d 352, 355-56 (S.C. Ct. App. 1988). In addition, a number of federal courts, interpreting state law, have adhered to the *Pinter* standard. See, e.g., *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1130-31 (5th Cir. 1988) (interpreting Louisiana law), *vacated on other grounds*, 492 U.S. 914 (1989), *cert. denied*, 492 U.S. 918 (1989); *Capri v. Murphy*, 856 F.2d 473, 479 (2d Cir. 1988) (interpreting Connecticut law). But see *Lutheran Bhd. v. Kidder Peabody & Co.*, 829 S.W.2d 300, 306 (Tex. Ct. App. 1992), *set aside on other grounds*, 840 S.W.2d 384 (Tex. 1992) (stating that Texas' § 12(2) counterpart, art. 581-33(A)(2) "applies if the defendant was any link in the chain of the selling process.").

140 See, e.g., *Anders v. Dakota Land & Development Co.*, 380 N.W.2d 862, 867-68 (Minn. Ct. App. 1986); *Price v. Brydon*, 764 P.2d 1370 (Or. 1988); *Wade v. Skipper's, Inc.*, 915 F.2d 1324, 1327-28 (9th Cir. 1990) (applying Washington law); *Hines v. Data Line Sys., Inc.*, 787 P.2d 8, 20 (Wash. 1990); *Hoffer v. State*, 776 P.2d 963, 964-65 (Wash. 1989); *Haberman v. Washington Pub. Power Supply Sys.*, 744 P.2d 1032, 1051-52 (Wash. 1988).

An even more expansive definition of "seller" may have been recognized in *Lutheran Bhd. v. Kidder Peabody & Co.*, 829 S.W.2d at 306. See *supra* note 139. But see *Victor v. Thomas White & Co.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,548, at 93,509 (N.D. Cal. 1989) (interpreting California law, court limited the term "seller" to one who is in privity of contract with the purchaser). *Accord Admiralty Fund v. Jones*, 677 F.2d 1289, 1296 (9th Cir. 1982) (interpreting California law).

141 See, e.g., *Davis v. Avco Fin. Serv., Inc.*, 739 F.2d 1057, 1067-68 (6th Cir. 1984) (defining a seller as one who is integrally connected with or substantially involved in the transaction).

142 *Id.*

143 See, e.g., ARIZ. REV. STAT. ANN. § 44-2003 (1994); OR. REV. STAT. § 59.115(3)

This concept of secondary liability is particularly important in view of the Supreme Court's decision in *Central Bank of Denver* which foreclosed aiding and abetting liability in private actions under section 10(b).<sup>144</sup> Indeed, one who materially aids a sale under such a state statute is subject to liability unless he or she meets the reasonable care defense.<sup>145</sup> This standard may enable a plain-

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(1980). The Arizona and Oregon statutes are discussed in Branson, *supra* note 120, at 1039, 1059-62. Ohio's statute may even be broader because it uses the term "aided" without the qualification "materially." See OHIO REV. CODE ANN. § 1707.43 (Anderson 1992). As stated in *Riedel v. Acutote of Colorado*, 773 F. Supp. 1055 (S.D. Ohio), *aff'd*, 947 F.2d 945 (6th Cir. 1991):

Section 1707.43 permits a buyer, at his option, to void a sale of securities which violated any part of Ohio's securities laws . . . . As section 1707.43 applies to anyone who "participated in or aided the seller in any way" in a sale violating Ohio's securities laws, this provision is much broader than the parallel federal provision . . . . Trivial violations [however,] do not trigger this remedy . . . .

*Id.* at 1066 (citations omitted). In *Roger v. Lehman Brothers Kuhn Loeb, Inc.*, 621 F. Supp. 114, 118 (S.D. Ohio 1985), the court stated: "To recover under § 1707.43, Plaintiff must establish that there has been a sale of a security in violation of the securities chapter, and that the violation materially affects the protection contemplated by the violated provision." See *Callaghan v. Class One, Inc.*, 567 N.E.2d 1036 (Ohio 1991); *Pencheff v. Adams*, 449 N.E.2d 1277 (Ohio 1983); *Baker v. Conlan*, 585 N.E.2d 543 (Ohio Ct. App. 1990); *Obenauf v. Cidco Investment Services, Inc.*, 561 N.E.2d 1070 (Ohio Ct. App. 1990); *Perkowski v. Megas Corporation*, 563 N.E.2d 378 (Ohio Ct. App. 1990); *James B. Farmer & Toba J. Feldman, Fraud in Securities Transactions: A Comparison of Civil Remedies Under the Ohio Securities Act, the Uniform Securities Act, and the Federal Securities Acts*, 49 U. CIN. L. REV. 814, 821 (1980) ("The coverage of section 1707.43 is as broad as the antifraud remedies available to the Ohio Division of Securities. Neither reliance nor scienter need be shown; both of these elements are subsumed in an objective materiality test.").

See also, UNIF. SECURITIES ACT § 410(a), *supra* note 107, which provides:

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

Consistent with federal law, state securities statutes provide for control person liability. See, e.g., GA. CODE ANN. § 10-5-14(c) (1994); N.M. STAT. ANN. § 58-13B-40F (Michie 1994); TEX. REV. CIV. STAT. ANN. art. 581-33F(1) (West 1994); see generally JOSEPH C. LONG, BLUE SKY LAW § 7.08 (1993).

144 *Central Bank of Denver v. First Interstate Bank of Denver*, 114 S. Ct. 1439 (1994). See *supra* notes 30-36 and accompanying text.

145 See sources cited *supra* note 143. For application of the reasonable care standard as an affirmative defense, see, e.g., *Arnold v. Dirrim*, 398 N.E.2d 426, 434-35 (Ind. Ct. App. 1979); *McGarrity v. Craighill*, 349 S.E.2d 311, 314-15 (N.C. Ct. App. 1986); *Everts v.*

tiff to successfully reach certain parties who would avoid liability under the federal securities laws either because they were not "sellers" under the *Pinter* test or because they were aiders and abettors rather than primary violators.<sup>146</sup>

State securities provisions offer other key advantages to plaintiffs. For example, many states hold that applicable blue sky statutes do not require a showing of reliance,<sup>147</sup> thereby facilitating class action certification.<sup>148</sup> Plaintiffs may also dispense with proof of loss causation in a number of states.<sup>149</sup> This more relaxed liability framework prompted one commentator to poignantly observe:

It would seem that a plaintiff bringing a suit under [the Florida statute] could rescind [the transaction] without a showing of proximate cause, or any damage, or any scienter on the part of the defendant . . . . Was the intent of the Florida legislature to create a system of investor insurance?<sup>150</sup>

In addition to their state blue sky claims, investors may emerge victorious when seeking relief on grounds of common law fraud, negligent misrepresentation, and breach of fiduciary duty. For example, in *Virginia Bankshares*, although defeated on their federal and state securities law claims, the plaintiffs were awarded

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Holtmann, 672 P.2d 1193 (Or. Ct. App. 1983); *Hines v. Data Line Sys., Inc.*, 787 P.2d 8, 17-18 (Wash. 1990).

146 See, e.g., *Price v. Brydon*, 764 P.2d 1370 (Or. 1988) (holding that attorney's actions in an offering could be viewed as materially aiding the sale). But see *Riedel v. Acutate of Colorado*, 773 F. Supp. 1055, 1066 (S.D. Ohio), *aff'd*, 947 F.2d 955 (6th Cir. 1991) (interpreting Ohio law, court stated that "an attorney providing professional services is not liable under Section 1707.43"), *relying on* OHIO REV. CODE ANN. § 1707.431(A) (Anderson 1992); *Leeth v. Decorator's Mfg., Inc.*, 425 N.E.2d 920, 923 (Ohio Ct. App. 1979). *Accord* *Biales v. Young*, 432 S.E.2d 482 (S.C. 1993) (holding attorney performing professional services not a seller under state securities statute); *Baker, Watts & Co. v. Miles & Stockbridge*, 620 A.2d 356 (Md. Ct. Spec. App. 1993) (same); see generally MARC I. STEINBERG, CORPORATE AND SECURITIES MALPRACTICE (1992); Gary M. Berne & Neil Bregenzer, *Participants' Liability Under the Oregon Securities Law After Prince v. Brydon*, 68 OR. L. REV. 885 (1989); Joseph C. Long, *Developments and Issues in Civil Liability Under Blue Sky Law*, 62 U. CIN. L. REV. 439 (1993).

147 See, e.g., CAL. CORP. CODE §§ 25400, 25500 (West 1977); *Mirkin v. Wasserman*, 858 P.2d 568 (Cal. 1993); OHIO REV. CODE ANN. § 1707.43 (Anderson 1992); *Roger v. Lehman Bros. Kuhn Loeb, Inc.*, 621 F. Supp. 114, 118 (S.D. Ohio 1985) (interpreting OHIO REV. CODE ANN. § 1707.43); TEX. REV. CIV. STAT. ANN. art. 581-33A(2) (West 1994); *Anderson v. Vinson Exploration, Inc.*, 832 S.W.2d 657 (Tex. Ct. App. 1992).

148 See *supra* notes 112-19 and accompanying text.

149 See *E.F. Hutton & Co., Inc. v. Rouseff*, 537 So.2d 978, 981 (Fla. 1989).

150 Marilyn B. Cane, *Proximate Causation in Securities Fraud Actions for Rescission*, FLA. BAR BUS. Q. REP., Spring 1989, at 14.

hefty damages on their breach of fiduciary duty claims.<sup>151</sup> In another case, even though not a purchaser or seller of stock, a shareholder was entitled to bring a common law action for fraud.<sup>152</sup> Similarly, the Eleventh Circuit held that, although unsuccessful on their federal and state securities law claims, the plaintiffs established a meritorious breach of fiduciary duty claim against their broker.<sup>153</sup> In so holding, the court asserted that "the [federal and state] securities fraud statutes do not co-opt the existence of separate claims under state fiduciary principles."<sup>154</sup>

Generally, the state securities laws are likely to be invoked by plaintiffs with greater frequency. Due to their more flexible construction, many of the state statutes provide the plaintiff with a right of action where such right may be lacking under federal law. Hence, the effect of the federal courts' restrictive approach with respect to the remedial provisions of the Securities Acts may well be to induce plaintiffs to file their actions in the state courts. Given the broad relief awarded in some of these state court proceedings, the result may ultimately be more detrimental to defendants. Indeed, it is ironic that many plaintiffs, by electing to bring suit in state court, may be better off than they were prior to the time that the federal courts embarked on their restrictive approach.

Although plaintiffs may elect to bring their state claims along with their federal securities law claims in federal district court,<sup>155</sup> an increasing number of complainants are declining this option.<sup>156</sup> Perhaps this result is due to perceptions that state judges

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151 See *Sandberg v. Virginia Bankshares, Inc.*, 979 F.2d 332, 342-48 (4th Cir. 1992).

152 See *Gutman v. Howard Savings Bank*, 748 F. Supp. 254, 266 (D.N.J. 1990) (interpreting New Jersey law, standing to bring common law fraud claim granted and reliance may be shown in regard thereto where alleged misstatements were made directly to the complainant); see also OR. REV. STAT. § 59.135 (1988) (granting standing to those injured by fraudulent conduct "in connection with . . . the conduct of a securities business" irrespective of whether the complainant purchased or sold securities), discussed in *Branson*, *supra* note 120, at 1045-46. But see *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (plaintiff must be a purchaser or seller to have standing to bring § 10(b) private damages action).

153 *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042 (11th Cir. 1987).

154 *Id.* at 1050 (interpreting Florida law).

155 Of course, there are situations where only state law claims are available, thus mandating that suit be brought in state court (unless the requirements of diversity of citizenship jurisdiction are met). See 28 U.S.C. § 1332 (1988). One such example is where the applicable statute of limitations has expired for the federal securities law claims but not for the state law claims. See *supra* notes 108, 122-34 and accompanying text.

156 By bringing the action in state court, a plaintiff therefore bypasses remedies af-

may be more inclined to permit issues to reach the jury and to the relatively large number of significant damage verdicts awarded in the state courts.<sup>157</sup> Moreover, as evidenced by a number of decisions, the concern may exist that federal courts will construe the state securities laws at bar consistently with and no broader than federal law.<sup>158</sup> Such holdings provide an additional incentive for plaintiffs to institute their actions in state court and seek more remedial interpretations.

## VII. CONCLUSION

The time is ripe for congressional action. From the plaintiff/litigant's standpoint, the Supreme Court's decisions in *Lampf*<sup>159</sup> (setting forth a relatively short statute of limitations for section 10(b) suits) and *Central Bank of Denver*<sup>160</sup> (precluding the imposition of aider and abettor liability in section 10(b) private actions) spell disaster. From the defense perspective, the daily fare of "cookie cutter" class action complaints routinely filed within hours after a disappointing earnings announcement and the corresponding price drop in a company's stock, smacks of vexatious

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forded by the Securities Exchange Act, such as section 10(b), due to that Act's provision for exclusive federal jurisdiction. See Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (1988 & Supp. V 1993); *supra* notes 104-05 and accompanying text. Electing to forego Exchange Act remedies and opting for the state court forum calls for counsel and client to address significant substantive and tactical questions.

157 See, e.g., Matt Moffett & Thomas Petzinger, Jr., *Pennzoil Wins \$10.53 Billion in Suit Against Texaco; Verdict Is Called Highest Civil Judgment in History*, WALL ST. J., Nov. 20, 1985, at 3.

With increasing frequency, the federal courts are granting motions to dismiss for failure to plead fraud with particularity pursuant to Rule 9(b) of the Federal Rules of Civil Procedure. This trend should further induce plaintiffs to file their actions in state court. For federal appellate decisions granting Rule 9(b) motions, see, e.g., *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061 (5th Cir. 1994); *Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982 (10th Cir. 1992); *DiLeo v. Ernst & Young*, 901 F.2d 624 (7th Cir. 1990); *Werner v. First Manhattan Co.*, 902 F.2d 169 (2d Cir. 1990). But see *Shapiro v. UJB Financial Corp.*, 964 F.2d 272 (3d Cir. 1992). See generally Richard E. Brodsky, *Pleading Requirements in Rule 10b-5 Actions*, 24 REV. SEC. & COMM. REG. 1 (1991); Richard G. Himelrick, *Pleading Securities Fraud*, 43 MD. L. REV. 342 (1984); William M. Richman, et al., *The Pleading of Fraud: Rhymes Without Reason*, 60 SO. CAL. L. REV. 959 (1987).

158 See, e.g., *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1130-31 (5th Cir. 1988) (interpreting Louisiana law), *vacated on other grounds*, 492 U.S. 914 (1989), *cert. denied*, 492 U.S. 918 (1989); *Capri v. Murphy*, 856 F.2d 473, 479 (2d Cir. 1988) (interpreting Connecticut law); see generally Marc I. Steinberg, *State Securities Laws: A Panacea for Investors?*, 22 SEC. REG. L.J. 53 (1994).

159 501 U.S. 1277 (1991).

160 114 S. Ct. 1439 (1994).

litigation.<sup>161</sup> In addition, deep pockets (such as accountants and attorneys) assert that the provision for joint and several liability under the federal securities laws<sup>162</sup> causes them an unduly onerous hit since the principal wrongdoers frequently are insolvent.<sup>163</sup> Given the competing interests of the combatants, the concept of "reform" remains ambiguous, if not unattainable. Nonetheless, legislative action is needed and compromise is an essential ingredient. The solution eventually reached, although partially unsatisfactory to all constituencies, should take a step forward to provide adequate redress to injured litigants without exacting undue costs.<sup>164</sup>

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161 See *Senate Panel Hears Views on Reducing Number of Frivolous Rule 10b-5 Actions*, 25 Sec. Reg. & L. Rep. (BNA) 847 (1993) (describing testimony of several corporate executives who asserted that "[s]uch lawsuits are prepared in advance of the events upon which the action is based, composed generically on a word processing system with fill-in-the-blanks for the corporate defendant's name and relevant dates, and stock values"); sources cited *supra* note 13.

162 See, e.g., Securities Act of 1933 §§ 11(f), 12, 15, 15 U.S.C. § 77k(f), l, o (1988); Securities Exchange Act of 1934 §§ 9(e), 18(a)-(b), 20(a), 15 U.S.C. §§ 78i(e), r(a)-(b), t(a) (1988). See also *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085 (1993) (implying private right of contribution under § 10(b) and Rule 10b-5).

163 See Brent Bowers & Udayan Gupta, *Shareholder Suits Beset More Small Companies*, WALL ST. J., March 9, 1994, at B1 ("Scouring the media for lower-than-projected earnings, a small number of law firms and their 'professional plaintiffs,' who own shares in many companies, file complaints that typically allege the defendant company fraudulently withheld or misrepresented important information."); *Witnesses, Lawmakers Debate Need for Securities Litigation Reforms*, 26 Sec. Reg. & L. Rep. (BNA) 1120 (1994) (referring to testimony of spokesperson for "Big Six" accounting firms who asserted that "joint and several liability plays a role in 'prompting [Rule 10b-5] litigation' against 'deep pocket' accounting firms and 'forc[es] settlements that bear no relation to the merits'").

164 A number of congressional proposals have been advanced. See, e.g., Common Sense Legal Reforms Act of 1995, H.R. 10, 104th Cong., 1st Sess. (1995); Private Securities Litigation Reform Act of 1994, S. 1976, 103rd Cong., 2d Sess. § 104 (1994); see generally Stephen Power, *Battle is Joined Over Securities-Fraud Bills*, WALL ST. J., Aug. 18, 1994, at B6.

