

A Securities Law Update

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The Future of Aiding and Abetting Liability

In 1994, the Supreme Court ruled that Section 10(b) does not provide for aiding and abetting liability, and thus held that a private plaintiff may not maintain a secondary liability suit under Section 10(b). *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994). In 2008, the Court reaffirmed its ruling in *Central Bank* by extending the principle to bar not only a private right of action against aiders and abettors (such as lawyers, accountants and investment bankers), but also claims based upon "scheme liability" involving secondary parties. *Stoneridge Investment Partners LLC v. Scientific-Atlanta Inc.*, 552 U.S. 148 (2008).

Recent legislative and judicial action, however, could dramatically reshape securities litigation. In the summer of 2009, Senator Arlen Specter introduced legislation that would establish a private right of action for aiding and abetting violations of the Securities Exchange Act of 1934 (the "1934 Act"). The bill, entitled "Liability for Aiding and Abetting Securities Violations Act of 2009" (S. 1551), authorizes a private civil action against those who provide "substantial assistance" to violators of the 1934 Act. In part, the bill reads:

"Private Civil Actions. For purposes of any private civil action implied under this title, any person that knowingly or recklessly provides substantial assistance to another person in violation of this title, or of any rule or regulation issued under this title, shall be deemed to be in violation of this title to the same extent as the person to whom such assistance is provided."

Further, Senator Christopher Dodd introduced the "Restoring Financial Stability Act of 2009," which would similarly amend the 1934 Act and overrule *Central Bank* and *Stoneridge*, allowing plaintiffstopursuessecondaryliabilityclaims.

The Securities and Exchange Commission ("SEC") also recently filed an amicus curiae brief in support of aiding and abetting liability in private actions brought under Section 10(b) and Rule 10b-5. The SEC argued that "creating" a false statement is sufficient for liability, even if the defendant did not actually make the statement. Under the SEC's "creation" standard of liability, individuals might be held liable for the very acts that the Supreme Court held in *Central Bank* and *Stoneridge* could not be the basis of federal securities law liability. Although it is unclear how far the SEC intends to extend liability under the "creation" standard, this standard would sweep in an additional class of defendants.

Further, the Supreme Court itself recently signaled some willingness to reconsider the issue by inviting the Solicitor General of the United States to express the government's view whether the Court should review *Janus Capital Group v. First Derivative Traders*, 566 F.3d 111 (4th Cir. 2009), a decision that implicitly seeks to overturn *Stoneridge* and *Central Bank*. Although it is still unclear whether the Court will ultimately grant review, its request for briefing on the issue suggests that it is willing to reconsider its previous decisions.

As a result of *Stoneridge* and *Central Bank*, there is no liability for aiding and abetting under the 1934 Act. However, the attacks on current doctrine mentioned above, if approved, would reinstate aiding and abetting liability by eliminating the requirement that a defendant must make the alleged false or misleading statement in order to be liable. Plaintiffs presumably would not have to prove reliance on statements or representations of secondary actors of which they were unaware when purchasing or selling securities. Thus, mere participation in a scheme violative of the 1934 Act could result in liability for a secondary actor, potentially extending federal securities law liability to many others in the marketplace in which the issuing company operates.

The purported justification for amending federal law to allow for aiding and abetting liability lies in recent massive frauds, such as Enron, Worldcom and the Bernard Madoff Ponzi scheme, which demonstrated that secondary actors such as accountants, bankers and lawyers may actively participate in and, indeed, enable the issuer's fraud. Further, supporters of aiding and abetting liability argue that secondary liability suits would still be subject to the heightened pleading standards of the Private Securities Litigation Reform Act, which would mitigate the risk of an onslaught of aiding and abetting liability cases.

Opponents of aiding and abetting liability, on the other hand, argue that it is important to consider the implications of adding a new class of defendants. Allowing secondary liability would sweep into securities fraud cases an exponentially greater number of defendants, especially accountants, investment bankers and lawyers and, in general, will raise the cost of doing business in the United States.

In hearings on Senator Specter's bill, Adam Pritchard, Director of the Empirical Legal Studies Center at the University of Michigan, opposed the amendment, stating that the goal of the bill is merely to pull in more deep pocket defendants and offer up additional targets to plaintiffs' attorneys and the class action bar. Further, he argued that the amendment would impose a substantial burden on capital markets that ultimately would be born by shareholders, since professionals providing services to public companies will likely demand increased compensation for bearing greater risks of liability.

Although it is yet unknown whether aiding and abetting legislation will be enacted or the Supreme Court will overrule *Stoneridge* and *Central Bank*, the Madoff Ponzi scheme and other major financial scandals have resulted in enormous losses to shareholders, making lawmakers more receptive to changes in securities laws.

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