CENTRAL BANK V. FIRST INTERSTATE BANK AND ITS AFTERMATH: SECURITIES PROFESSIONALS' EVER-CHANGING LIABILITIES

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I. INTRODUCTION

Parties to complex securities transactions regularly seek advice on aspects of the transactions requiring specialized technical and legal expertise from outside professionals, such as accounting firms, banks, lawyers and investment bankers.[1] In fact, the professionals' advice is "frequently the red or green light to the consummation of a securities transaction."[2] When the transactions sour, these professionals are often the only deep-pocket defendants available from which injured plaintiffs can recover.[3]

Historically, courts allowed causes of action for aiding and abetting securities fraud, a secondary securities violation implied under section 10(b) of the Securities Exchange Act of 1934[4] and Securities Exchange Commission ("SEC") Rule 10b–5,[5] to proceed when the professionals' advice led to fraudulent conduct by their clients. Parties liable for aiding and abetting were those who knowingly and substantially assisted in the commission of a primary violation.[6] Aiding and abetting liability was secondary to the liability of defendants who committed a primary securities violation under the code.[7]

Under the doctrine of "joint and several" liability, these aiders and abettors were subject to all of the liability imposed upon the primary violators.[8] The threat that they could be held accountable for all of the damage caused by

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1. Joel Seligman, *The Implications of* Central Bank, 49 BUS. LAW. 1429, 1438–39 (1994).
2. Marc I. Steinberg, *Attorney Liability for Client Fraud*, 1991 COLUM. BUS. L. REV. 1 (quoting Samuel H. Gruenbaum, *Corporate/Securities Lawyers: Disclosure, Responsibility, Liability to Investors, and* National Student Marketing Corp., 54 NOTRE DAME LAW. 795, 804 (1979)).
3. *See* Seligman, *supra* note 1, at 1441–44.
4. 15 U.S.C. § 78j(b) (1995). For the text of section 10(b), see *infra* note 27.
5. 17 C.F.R. § 240.10b–5 (1995). For the text of Rule 10b–5, see *infra* note 28.
6. *See* SEC v. National Student Mktg. Corp., 457 F. Supp. 682, 712 (D.D.C. 1978) (citing SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974)).
7. *Id.*
8. David S. Ruder, *The Future of Aiding and Abetting and Rule 10b–5 After* Central Bank of Denver, 49 BUS. LAW. 1479, 1482 n.21 (1994). Defendants were allowed to seek contribution from the primary violators, but the primary violators often did not have sufficient funds to cover the claims against them. *Id.*

the primary violators usually led to settlements for significant sums.[9]

In 1994, the United States Supreme Court issued a ruling that drastically reduces the chances of advisory professionals being held secondarily liable for a client's fraudulent conduct. The Court held in *Central Bank v. First Interstate Bank*[10] that no implied private cause of action for aiding and abetting liability may be maintained under section 10(b).[11]

The *Central Bank* decision reversed decades of almost unanimous lower court precedent recognizing an implied cause of action for aiding and abetting securities fraud in private actions against secondary parties[12] under section 10(b).[13] Moreover, the reasoning used by the majority in *Central Bank* threatens the ability of private plaintiffs to recover for wrongs committed by secondary parties, such as securities professionals, under other implied causes of action pursuant to the securities laws.[14]

This Note will analyze: (1) the statutory provisions pertaining to securities fraud liability;[15] (2) the historical development of the implied private cause of action for aiding and abetting securities fraud along with the elements that must be present to prevail;[16] (3) the Supreme Court's decision in *Central Bank*;[17] and (4) the impact of *Central Bank* on causes of action against secondary parties for violations of section 10(b).[18]

II. STATUTORY BACKGROUND

After the stock market crash of 1929 and amid widespread abuses in the securities markets, Congress passed the Securities Act of 1933[19] ("1933 Act") and the Securities Exchange Act of 1934[20] ("1934 Act"). The 1933 Act governs the initial distribution of securities, while the 1934 Act regulates post-distribution trading.[21]

In order to fall under the 1933 and 1934 Acts, transactions first must involve the purchase or sale of a "security," defined to include "virtually any instrument that might be sold as an investment."[22] Often, the securities involved are stocks.[23] In fact, the Supreme Court has held that transactions are "always...investment[s] if [they have] the economic characteristics traditionally

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9. *Id.* at 1482.
10. 511 U.S. 164 (1994).
11. *Id.* at 191.
12. For purposes of this Note, "secondary parties" refers to any parties who have not violated the express provisions of the securities laws themselves, but who allegedly have provided assistance to the primary violator. Secondary parties are usually accountants, lawyers, investment bankers and other professionals who are peripherally involved in the client's securities transactions.
13. *See generally* Marc I. Steinberg, *The Ramifications of Recent U.S. Supreme Court Decisions on Federal and State Securities Regulation*, 70 NOTRE DAME L. REV. 489 (1995).
14. *See* Seligman, *supra* note 1, at 1434–41.
15. *See infra* notes 19–39 and accompanying text.
16. *See infra* notes 40–86 and accompanying text.
17. *See infra* notes 87–165 and accompanying text.
18. *See infra* notes 166–215 and accompanying text.
19. 15 U.S.C. § 77 (1994).
20. *Id.* § 78.
21. Central Bank v. First Interstate Bank, 511 U.S. 164, 171 (1994).
22. Reves v. Ernst & Young, 494 U.S. 56, 61 (1990).
23. *Id.* at 62.

associated with stock."[24] Other investments, such as time deposits, partnership interests, and demand notes, have also been found to be "securities" based on the "economic realit[ies]" of the transaction.[25]

One of the central tenets of federal securities regulation has been the prevention of fraud in securities transactions.[26] The primary anti-fraud provisions of the acts are section 10(b) of the 1934 Act[27] and Securities Exchange Commission Rule 10b–5.[28] Together, section 10(b) and Rule 10b–5 forbid any "person"[29] from engaging in certain proscribed activities.[30]

Primarily section 10(b) applies to fraud perpetrated in connection with the sale of purchase of securities.[31] In enacting section 10(b), Congress intended

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24. *Id.* (citing Landreth Timber Co. v. Landreth, 471 U.S. 681, 687, 693 (1985)).

25. SEC v. W.J. Howey Co., 328 U.S. 293, 298, 300 (1946). *See also* 15 U.S.C. § 78c(a)(10) (1994). The term "security" as defined in the 1934 Act includes:

> any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Id.

26. *See* 69 AM. JUR. 2D *Securities Regulation—Federal* § 460 (1995).

27. 15 U.S.C. § 78j (1994). Section 10 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange—
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> ....
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> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.

28. 17 C.F.R. § 240.10b–5 (1996). Rule 10b–5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
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> (a) To employ any device, scheme or artifice to defraud,
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> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
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> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
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> in connection with the purchase or sale of any security.

Id.

29. The 1934 Act defines "person" as "a natural person, company, government, or political subdivision, agency, or instrumentality of a government." 15 U.S.C. § 78c(a)(9) (1994).

30. *See supra* notes 27–28 and accompanying text.

31. *See* 69 AM. JUR. 2D, *Securities Regulation—Federal* § 462 (1995).

to preserve the integrity of the securities markets[32] and to create a high standard of ethics in the industry by promoting a policy of full disclosure.[33] As the Supreme Court observed in *Central Bank*, section 10(b) "embrace[s] a fundamental purpose...to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*."[34]

This section is not self-executing. The terminology of 10(b) only prohibits those "manipulative or deceptive device(s) or contrivance(s)" which contravene rules and regulations promulgated by the SEC.[35] Thus, section 10(b) principally serves as a grant of rule-making authority to the SEC.[36] Further, nothing in the section provides investors who are injured by the type of fraudulent conduct the section is directed at with a private right of action against the alleged perpetrators.[37]

Under its rule-making authority granted under section 10(b), the SEC set forth its regulations for section 10(b) in Rule 10b–5.[38] The rule prohibits three types of conduct: (1) the use of any device, scheme, or artifice to defraud; (2) misstatements or omissions of material fact; and (3) acts, practices, or courses of business operating as a fraud or deceit.[39]

III. AIDER-ABETTOR LIABILITY BEFORE *CENTRAL BANK*

Prior to *Central Bank*, the lower federal courts universally held that the imposition of aiding and abetting liability in private actions was appropriate under section 10(b) and Rule 10b–5.[40]

A. Development of the Private Right of Action for Aiding and Abetting

For nearly three decades, federal courts permitted the SEC and private parties to bring suit against "secondary parties"[41] under the federal securities laws.[42] A suit usually sought to impose liability upon the defendants for aiding and abetting a third party in the commitment of a primary securities fraud.[43]

32. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971).
33. Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977).
34. Central Bank v. First Interstate Bank, 511 U.S. 164, 171 (1995).
35. *See* 69 AM. JUR. 2D, *Securities Regulation—Federal* § 462 (1995).
36. *Id.*
37. *See* 15 U.S.C. § 78j(b) (1994). For the text of section 10(b), see *supra* note 27.
38. *See* 17 C.F.R. § 240.10b–5 (1996). For the text of section 10(b), see *supra* note 28.
39. 17 C.F.R. § 240.10b–5 (1994).
40. *See* Cleary v. Perfectune, 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); Schatz v. Rosenberg, 943 F.2d 485, 495–96 (4th Cir. 1991), *cert. denied sub nom.* Schatz v. Weinberg & Green, 503 U.S. 936 (1992); Fine v. American Solar King Corp., 919 F.2d 290, 300 (5th Cir. 1990), *cert. dismissed*, 502 U.S. 976 (1991); Moore v. Fenex, Inc., 809 F.2d 297, 303 (6th Cir. 1987), *cert. denied*, 483 U.S. 1006 (1987); Schlifke v. Seafirst Corp., 866 F.2d 935, 946-47 (7th Cir. 1989); K & S Partnership v. Continental Bank, 952 F.2d 971, 977 (8th Cir. 1991), *cert. denied*, 505 U.S. 1205 (1992); Levine v. Diamanthuset, Inc., 950 F.2d 1478, 1483 (9th Cir. 1991); Farlow v. Peat, Marwick, Mitchell & Co., 956 F.2d 982, 986 (10th Cir. 1992); Schneberger v. Wheeler, 859 F.2d 1477, 1480 (11th Cir. 1988), *cert. denied sub nom.* Schneberger v. U.S. Trust Co., 490 U.S. 1091 (1989).
41. *See supra* note 12.
42. *See, e.g.*, Monsen v. Consolidated Dressed Beef Co., 579 F.2d at 793; *Brennan*, 259 F. Supp. at 673.
43. SEC v. Coffey, 493 F.2d 1304, 1316 (6th Cir. 1974).

Thus, liability for aiding and abetting was "secondary" to the liability of defendants who committed a primary securities violation.[44]

In the beginning, courts had to infer a private right of action for purchasers and sellers of securities against even primary violators since the text of section 10(b) of the 1934 Act did not expressly provide an action for private plaintiffs.[45] Courts inferred such a right under section 10(b) based on the maxim *ubi jus ibi remedium* or "where there is a right there is a remedy."[46]

Recognition of the private right of action against primary violators first appeared in *Kardon v. National Gypsum Co.*[47] Almost twenty-five years later in *Superintendent of Insurance v. Bankers Life & Casualty Co.*, the Supreme Court confirmed the existence of the private right of action.[48]

In 1966 the private cause of action for aiding and abetting a securities law violation of section 10(b) and Rule 10b–5 first appeared when an Indiana federal district court held that an insurance company had aided and abetted a scheme by a securities broker.[49] The broker had committed fraud in failing to purchase securities of the insurance company after taking orders for the securities from customers.[50] The court found that the insurance company aided and abetted the primary violation by passing customer complaints to the broker who could then hide his fraud by distributing securities to those complaining investors, but not the others.[51]

With the judicial construction of section 10(b) allowing liability for aiding and abetting in both SEC enforcement actions and private suits, plaintiffs attempted to impose liability against a wide range of secondary parties, including accountants, attorneys and investment bankers.[52] However, since liability for aiding and abetting was a judicial construct rather than statutorily provided, courts had to flesh out the elements of the cause of action on their own.[53]

B. Elements of Aiding and Abetting Liability

Although the exact content of the various elements giving rise to aiding

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44. Steinberg, *supra* note 13, at 489.

45. *See generally* John A. Maher, *Implied Private Rights of Action and the Federal Securities Laws: A Historical Perspective*, 37 WASH. & LEE L. REV. 783 (1980).

46. Paul Dmitri Zier, Central Bank of Denver v. First Interstate Bank*: Pruning the Judicial Oak by Severing the Aiding and Abetting Branch*, 72 DENV. U. L. REV. 191, 193 (1994).

47. 69 F. Supp. 512, 514 (E.D. Pa. 1946).

48. 404 U.S. 6, 13–14 (1971).

49. Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673, 676 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

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

51. *Id.* at 154.

52. *See* Landy v. FDIC, 486 F.2d 139, 153 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974) (alleging that several secondary defendants, including accountants, aided and abetted fraud committed by corporation's president). *See also* Strong v. France, 474 F.2d 747, 752 (9th Cir. 1973) (attempting to hold an automobile racing association and its president liable for aiding and abetting); Lanza v. Drexel & Co., 479 F.2d 1277, 1301, 1303–04 (2d. Cir. 1973) (en banc) (holding that a member of a corporation's board of directors could be liable for aiding and abetting); Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135, 144 (7th Cir. 1968), *cert. denied*, 396 U.S. 838 (1969) (allowing an aiding and abetting cause of action to proceed against a brokerage firm).

53. *See* Steinberg, *supra* note 13, at 489.

and abetting liability was uncertain, the courts generally set forth three requirements to hold a secondary party liable for aiding and abetting a securities laws violation.[54] First, a third party must have committed a primary securities law violation.[55] Second, the alleged aider and abettor must have possessed knowledge that the primary violation was taking place.[56] Third, the accused aider and abettor must have "substantially assisted" the achievement of the primary violation.[57]

1. The Primary Violation Requirement

In order for a defendant to have been held liable for aiding and abetting, a primary violation of section 10(b) and Rule 10b–5 by a third party actor must have existed.[58] If no primary violation was shown, there could logically be no secondary violation.[59]

For primary liability to have been found under section 10(b) and Rule 10b–5, the presence of several elements was required. First, the plaintiff must have been an actual purchaser or seller of the securities to which the fraud related.[60] Second, the defendant had to have made misstatements or omissions of material fact regarding the securities.[61] Third, the defendant must have acted with scienter or "a mental state embracing intent to deceive, manipulate, or defraud."[62] Mere negligence was insufficient.[63] In many jurisdictions, reckless behavior satisfied the scienter requirement for civil liability; however, the Supreme Court left the question undecided.[64] Recklessness, when allowed to satisfy the scienter requirement, was defined as highly unreasonable conduct which is "an extreme departure from the standards of ordinary care."[65] Fourth, the claimed fraud must have occurred "in connection with" the purchase or sale of securities.[66] Fifth, the plaintiff must have relied on the fact that was misrepresented or omitted by the defendant.[67] In cases that involved an affirmative misrepresentation[68] by the defendant, the plaintiff had the benefit of

54. Schatz v. Rosenberg, 943 F.2d 485, 495 (4th Cir. 1991), *cert. denied sub nom.* Schatz v. Weinberg & Green, 503 U.S. 936 (1992).

55. *Id.*; Farlow v. Peat, Marwick, Mitchell & Co., 956 F.2d 982, 986 (10th Cir. 1992).

56. *Rosenberg*, 943 F.2d at 495.

57. *Id.*

58. *Id.*

59. *See, e.g.*, Stone v. Mehlberg, 728 F. Supp. 1341, 1355 (W.D. Mich. 1989) (aiding and abetting claim dismissed due to plaintiffs' failure to establish a primary violation).

60. *See, e.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

61. Basic Inc. v. Levinson, 485 U.S. 224, 230–31 (1988). A fact is considered material if there is a substantial likelihood that a reasonable investor would consider it important. *Id.* at 231.

62. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). The Court argued that "[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct." *Id.* at 197.

63. *Id.* at 201.

64. *Id.* at 193 n.12.

65. Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977), *cert. denied*, 434 U.S. 875 (1977).

66. 17 C.F.R. § 240.10b–5(c) (1996). *See generally* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 10 (1971) (discusses the scope of the "in connection with" requirement).

67. *Sundstrand*, 553 F.2d at 1048.

68. An affirmative misrepresentation occurred where a party made a misleading statement to another in order to secure a sale of securities. In contrast, an omission resulted when a party

a presumption of reliance on the defendant's fraud which was then rebuttable by the defendant.[69] Sixth, the omission or misrepresentation must have proximately caused the injury to the plaintiff.[70] Last, the defendant may be required to have used jurisdictional means in committing the violation.[71] Jurisdictional means include interstate commerce, the mails, or a facility of a national securities exchange.[72]

2. The Knowledge Requirement

In addition to the existence of a primary violation, the defendant must have had knowledge that the third party's conduct was a primary violation of the securities laws.[73] This knowledge requirement paralleled the scienter requirement for a primary violation.[74]

Under the aiding and abetting test, an evaluation of whether the defendant possessed the requisite "knowledge" usually turned upon whether the defendant owed a fiduciary or comparable duty to the plaintiff.[75] Where there was no duty running from the alleged aider and abettor to the plaintiff, the defendant had to possess a "high conscious intent" and a "conscious and specific motivation" to aid in the fraud.[76] Where there was a fiduciary or comparable duty, such as a duty to disclose,[77] owed to the complainant, reckless conduct usually satisfied the "knowledge" requirement.[78] In addition, recklessness may have been sufficient when the alleged aider and abettor derived an economic benefit from the wrongdoing.[79]

3. Substantial Assistance Requirement

In order to satisfy the third prong of the test, a plaintiff had to prove that an aiding and abetting defendant rendered "substantial assistance" to the primary securities law violation, not merely to the person committing the

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failed to disclose facts that were contrary to known assumptions of another.

69. Basic Inc. v. Levinson, 485 U.S. 224, 244–49 (1988). The Court adopted the "fraud on the market" theory which presumed reliance by purchasers of securities. *Id.* It was recognized that not every purchaser had actually read or been informed of the available information on the securities, but that this information was reflected in the securities' price since those who had the available information likely influenced the market price. *Id.*

70. Huddleston v. Herman & MacLean, 640 F.2d 534, 549 (5th Cir. 1981), *rev'd in part on other grounds*, 459 U.S. 375 (1983).

71. *See* 15 U.S.C. § 78j (1995) (section 10(b)) and 17 C.F.R. § 240.10b–5 (1996) (Rule 10b–5); *see also* Affiliated Ute Citizens v. United States, 406 U.S. 128, 148 (1972).

72. *See* 15 U.S.C. § 78j (1995) (section 10(b)) and 17 C.F.R. § 240.10b–5 (1996) (Rule 10b–5).

73. Schatz v. Rosenberg, 943 F.2d 485, 496 (4th Cir. 1991), *cert. denied*, 503 U.S. 936 (1992). Some courts, however, have merely required that the defendant have a general awareness that his role was part of an improper activity. *See, e.g.*, SEC v. Coffey, 493 F.2d 1304, 1314 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975).

74. *Rosenberg*, 943 F.2d at 496. After the Supreme Court required actions under Rule 10b–5 to allege scienter, the knowledge requirement of the aiding and abetting test merged into the scienter requirement to be liable for a primary violation. Ernst & Ernst v. Hochfelder 425 U.S. 185, 193 (1976).

75. *Rosenberg*, 943 F.2d at 496.

76. *Id.*

77. *Id.*

78. *See* Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 44 (2d Cir. 1978), *cert. denied*, 439 U.S. 1039 (1978); IIT v. Cornfeld, 619 F.2d 909, 923–25 (2d Cir. 1980).

79. Walck v. American Stock Exch., Inc., 687 F.2d 778, 791 n.18 (3d Cir. 1982).

violation.[80] To determine whether conduct of secondary parties amounted to "substantial assistance," the courts weighed several factors, including: the amount of assistance given by the defendant; the defendant's presence or absence at the time of the tort; the defendant's relation to the primary violators; and the defendant's state of mind.[81] In cases where the defendant was under a duty to disclose, silence or other inaction could have constituted "substantial assistance."[82]

To illustrate, in the case of a lawyer, the "substantial assistance" element required that a lawyer did more than draft documents containing misleading statements or omissions for a client.[83] The lawyer must have actively participated in the solicitation of sales or the negotiation of the terms of the deal on behalf of a client to have "substantially assisted" a securities violation.[84] Where a lawyer offered no legal opinions or affirmative misrepresentations to the potential investors, the attorney was not liable as a matter of law for aiding and abetting under the securities laws.[85] In order for liability to exist, there had to be a conscious intent by the attorney to violate federal securities laws.[86]

IV. *CENTRAL BANK V. FIRST INTERSTATE BANK*

A. The Facts

In *Central Bank v. First Interstate Bank*,[87] the Central Bank of Denver ("Central Bank") was the indenture trustee for a total of $26 million in bonds.[88] The Colorado Springs Stetson Hills Public Building Authority ("Building Authority") issued the bonds in 1986 and again in 1988 for public improvements in Stetson Hills, a planned residential and commercial development.[89]

Landowner assessment liens covering approximately 250 acres for the 1986 bond issue and 272 acres for the 1988 bond issue secured the bonds for the creditors.[90] Further, the bond covenants covering both offerings required the developer, AmWest Development ("AmWest"), to provide an annual report demonstrating that the land was worth at least 160% of the bonds' outstanding principal and interest.[91]

In January 1988, AmWest provided Central Bank an annual updated appraisal of the land securing the bond issue indicating that the land values were almost unchanged from the 1986 appraisal.[92] However, noting that property

80. *Rosenberg*, 943 F.2d at 497.
81. *See, e.g.*, Monsen v. Consolidated Dressed Beef Co., 579 F.2d 793, 800 (3rd Cir. 1978), *cert. denied*, 439 U.S. 930 (1978).
82. *See Walck*, 687 F.2d at 791.
83. *Rosenberg*, 943 F.2d at 497.
84. *Id.*
85. *Id.* at 496–97.
86. *Id.* at 497; *see generally* Woodward v. Metro Bank of Dallas, 522 F.2d 84, 97 (5th Cir. 1975) (court was "loathe to find 10b–5 liability without clear proof of intent to violate the securities laws").
87. 511 U.S. 164 (1994).
88. *Id.* at 167.
89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*

values were declining in Colorado Springs and that the appraisal provided in 1988 was sixteen months old, the senior underwriter for the 1986 bonds expressed concern that the 160% requirement was not being satisfied.[93] Central Bank asked its in-house appraiser to review the updated 1988 appraisal.[94] After reviewing the appraisal, the appraiser recommended the retention of an outside appraiser for an independent review.[95] However, correspondence between Central Bank and AmWest resulted in a delay of the review until the end of the year, six months after the closing on the 1988 bond issue.[96] Before the independent review was completed, the Building Authority defaulted on the 1988 bonds.[97]

First Interstate Bank and Jack Naber (collectively "First Interstate Bank") had purchased $2.1 million of the 1988 bonds.[98] After the default, First Interstate Bank sued the Building Authority, the 1988 underwriter, a junior underwriter, an AmWest director, and Central Bank for violations of section 10(b) of the Securities Exchange Act of 1934.[99] The complaint alleged that the Building Authority, the underwriters, and the AmWest directors had committed primary violations of section 10(b).[100] Additionally, the complaint claimed that Central Bank was "secondarily liable under § 10(b) for its reckless conduct in aiding and abetting the fraud."[101]

B. The District and Appellate Court Decisions

The United States District Court for the District of Colorado granted Central Bank's motion for summary judgment on the grounds that recklessness did not support the scienter requirement of an aiding and abetting claim.[102] The United States Court of Appeals for the Tenth Circuit reversed the lower court's decision.[103]

The court of appeals first laid out the requirements of a cause of action for aiding and abetting in the Tenth Circuit: (1) the existence of a primary violation of section 10(b); (2) recklessness as to the existence of a primary violation by the aider and abettor; and, (3) substantial assistance to the primary violator.[104] Applying the test, the court of appeals found that Central Bank knew that the sale of the 1988 bonds was imminent and that the purchasers were relying on the 1988 appraisal to evaluate the collateral for the bonds.[105] Under the circumstances, the court said, the awareness by Central Bank of the inadequacies of the updated 1988 appraisal could support a finding of recklessness or an extreme departure from standards of ordinary care.[106] The

93. *Id.* The underwriter expressed his concern in a letter to Central Bank soon after receiving the 1988 updated appraisal of the land. *Id.*
94. *Id.*
95. *Id.* at 167–68.
96. *Id.* at 168. The closing on the 1988 bond issue occurred in June of 1988. *Id.*
97. *Id.*
98. *Id.* Jack Naber, who was an individual investor, was also a plaintiff. *Id.*
99. *Id.*
100. *Id.*
101. *Id.* The claim centered on Central Bank's alleged knowledge of the inadequacies of the 1988 appraisal update. *Id.*
102. *Id.*
103. First Interstate Bank v. Pring, 969 F.2d 891 (10th Cir. 1992).
104. *Id.* at 898–903.
105. *Id.* at 904.
106. *Id.*

court held that the plaintiffs had established a genuine issue of material fact regarding the recklessness element of aiding and abetting liability.[107]

Additionally, the court of appeals held that a trier of fact could find that Central Bank had provided substantial assistance to the primary violator by delaying the independent review of the appraisal.[108] Thus, a jury could reasonably conclude that Central Bank aided and abetted a securities violation under section 10(b).[109]

C. The Supreme Court Decision

The Supreme Court granted certiorari to resolve the issue of whether an implied cause of action for aiding and abetting actions exists under section 10(b), and if so, what the scope of the action encompasses.[110] In an opinion written by Justice Kennedy, a 5–4 majority of the Supreme Court held that no private cause of action exists against a defendant for aiding and abetting a securities violation under section 10(b) of the 1934 Securities Exchange Act or Rule 10b–5.[111]

1. The Textual Limitation on the Scope of Section 10(b)

The Court first focused on the text of section 10(b) to define the range of conduct prohibited by the statute.[112] The Court concluded that the scope of section 10(b) is limited to a prohibition of the making of a material misstatement or omission, or the commission of a "manipulative act."[113] According to the Court, the limited extent of the statute does not prohibit the mere giving of aid to a person who commits the deceptive or manipulative act.[114]

The Court defined the scope by inferring from the textual language of the statute what conduct Congress intended to prohibit when it enacted section 10(b).[115] The Court emphasized that private plaintiffs could not bring a Rule 10b–5 suit against a defendant based on conduct that was not prohibited by the text of section 10(b).[116] In its past decisions regarding the scope of conduct prohibited by section 10(b) in private suits, the Court noted that it had emphasized adherence to the express statutory language of the section.[117] The Court recognized that it had previously utilized strict textual interpretations in rejecting causes of action under section 10(b) and Rule 10b–5 based on negligence,[118] breach of a fiduciary duty by majority shareholders without

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107. *Id.*
108. *Id.*
109. *Id.*
110. Central Bank v. First Interstate Bank, 511 U.S. 164, 166–67 (1994). The parties had petitioned the Court to review questions of whether a party could be found liable for aiding and abetting on a showing of mere recklessness. *Id.* at 194. However, the Court, sua sponte, directed the parties to address whether private actions allowed under section 10(b) extend to aiders and abettors, a question on which both parties thought the law was settled. *Id.* at 194–95.
111. *Id.* at 191.
112. *Id.* at 190–91.
113. *Id.* at 177.
114. *Id.*
115. *Id.* at 173.
116. *Id.* at 191.
117. *Id.* at 173.
118. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976).

allegations of misrepresentation or lack of disclosure,[119] and insider trading.[120]

Using a strict textual interpretation, the Court concluded that section 10(b) does not reach those who aid and abet a primary violation.[121] This conclusion was based on the fact that Congress had used language in other acts to impose aiding and abetting liability when it had chosen to do so.[122] Since Congress had shown that it "knew how to impose" aiding and abetting liability, the Court presumed that Congress would have employed specific language to do so if that was its intent.[123]

The Court rejected the respondents' and the SEC's argument that the inclusion of the phrase "directly or indirectly" in the text of section 10(b) covers aiding and abetting liability.[124] The "directly or indirectly" phrase could not encompass aiding and abetting, argued the Court, since liability for aiding and abetting would have extended beyond persons who engaged, even indirectly, in a proscribed activity to include those who merely gave some degree of aid to primary violators.[125] Additionally, the Court observed that the terminology had been used several times throughout the 1934 Act in a way not imposing aiding and abetting liability.[126]

2. An Alternative Rationale for Limiting Liability

Next, the Court explained that even if the text of the statute was ambiguous, it would reach the same result.[127] When the text of section 10(b) does not resolve an issue, the Court attempts to infer how Congress, in 1934, would have addressed the issue by analyzing the express private causes of action contained in the 1933 and 1934 Acts.[128] In *Central Bank*, the Court noted that each of the express causes of action in the Acts specified certain types of conduct for which defendants may be held liable.[129] Also, the express causes of action either stated specific categories of defendants that could be liable or imposed liability on "any person" who committed the prohibited acts.[130] However, the Court emphasized, Congress did not attach private aiding and abetting liability to any of the express causes of action.[131] From this fact, the

119. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 470 (1977). The Court there held that the "language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception." *Id.* at 473.

120. Chiarella v. United States, 445 U.S. 222 (1980). "[T]he 1934 Act cannot be read 'more broadly than its language and the statutory scheme reasonably permit.'" *Id.* at 234 (quoting Touche Ross & Co. v. Redington, 442 U.S. 560, 578 (1979)).

121. Central Bank v. First Interstate Bank, 511 U.S. 164, 177 (1994).

122. *Id.* at 176. *See, e.g.*, Act of Mar. 4, 1909, § 332, 35 Stat. 1152 (codified as amended at 18 U.S.C. § 2 (1994)) (general criminal aiding and abetting statute); Packers and Stockyards Act, 1921, ch. 64, § 202, 42 Stat. 161 (codified as amended at 7 U.S.C. § 192(g) (1994)) (civil aiding and abetting provision).

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

124. *Id.* at 176.

125. *Id.*

126. *Id. See also* 15 U.S.C. § 78g(f)(2)(C) (1994) (direct or indirect ownership of stock); 15 U.S.C. § 78m(d)(1) (1994) (direct or indirect ownership).

127. *Central Bank*, 511 U.S. at 178.

128. *Id.* at 178–79.

129. *Id.* at 179.

130. *Id.*

131. *Id.* For the express causes of action, see 15 U.S.C. § 77k (1994) (prohibiting false statements or omissions of material fact in registration statements); 15 U.S.C. § 77*l* (1994) (prohibiting the sale of unregistered as well as registered, nonexempt securities by means of a

Court inferred that Congress did not intend to impose such liability on secondary parties.[132]

3. Rejection of Arguments Supporting Aiding and Abetting Liability

The Court rejected several arguments made in support of the imposition of aiding and abetting liability.[133] One argument in favor of imposing liability was that at the time Congress passed the 1934 Act, general tort principles including aiding and abetting liability were well established. Thus, Congress had intended to include aiding and abetting liability in the 1934 Act.[134] However, the Court argued that there were several factors indicating that the statutory silence was not equal to implicit Congressional intent to impose aiding and abetting liability.[135]

First, Congress had not enacted a general civil aiding and abetting statute, either for suits by the SEC (when the SEC sues for civil penalties) or for suits by private parties.[136] Instead, Congress traditionally imposed such liability on a statute by statute basis.[137]

In the 1933 and 1934 Acts, the various provisions that specifically prohibited aiding and abetting limited the scope of liability to enforcement actions brought by the SEC.[138] Therefore, when Congress enacted a statute under which private plaintiffs could sue and recover damages from defendants, there was no general presumption that the plaintiff could also sue and recover from aiders and abettors.[139] Further, the provisions for other forms of secondary liability in the Acts indicate that the omission of one providing for aiding and abetting liability was a "deliberate congressional choice" with which courts should not interfere.[140]

Next, First Interstate Bank argued that Congress had "acquiesced" to the judicial interpretations imposing aiding and abetting liability under section 10(b) by remaining silent while the doctrine developed despite having several

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material misstatement or omission); 15 U.S.C. § 78p (1994) (prohibiting short-swing trading by owners, directors and officers); and, 15 U.S.C. § 78r (1994) (prohibiting any person from making misleading statements in reports filed with the SEC).

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

133. *Id.* at 180.

134. *Id.* at 181.

135. *Id.*

136. *Id.* at 182.

137. *Id. See, e.g.*, 26 U.S.C. § 6701 (1994) (Internal Revenue Code contains a full section governing aiding and abetting liability); 7 U.S.C. § 25(a)(1) (1994) (Commodity Exchange Act contains an explicit aiding and abetting provision that applies to private suits brought under that Act); 12 U.S.C. § 93(b)(8) (1994) (National Bank Act defines violations to include "aiding & abetting"); 12 U.S.C. § 504(h) (1994) (Federal Reserve Act defines violations to include "aiding & abetting").

138. *See, e.g.*, 15 U.S.C. § 78o(b)(4)(E) (1994) (SEC may proceed against brokers and dealers who aid and abet a violation of the securities laws); Insider Trading Sanctions Act of 1984, Pub. L. No. 98–376, 98 Stat. 1264 (codified as amended at 15 U.S.C. §§ 78c, 78o, 78t, 78u, 78ff) (civil penalty provision added for SEC to pursue against those who aid and abet insider trading violations); 15 U.S.C. § 78u–2 (1994) (civil penalty provision, enforceable by the SEC, added in 1990, applicable to brokers and dealers who aid and abet various violations of the Act).

139. *Central Bank*, 511 U.S. at 182.

140. *Id.* at 184. For an example, section 20 of the 1934 Act imposes secondary liability on "controlling persons"—persons who "control[] any person liable under any provision of this chapter or of any rule or regulation thereunder." 15 U.S.C. § 78t(a) (1994).

chances to statutorily preclude it.[141] The Court rejected this argument by noting that Congress' failure to overturn a judicial precedent is not a reason for the Court to adhere to it.[142] Moreover, Congress may legislate, the Court pointed out, only "through passage of a bill which is approved by both Houses and signed by the President," so any "acquiescence" by Congress would have no effect on the statute.[143]

The SEC offered several policy arguments in support of the Rule 10b–5 aiding and abetting causes of action.[144] However, the Court stated that policy considerations could not override an interpretation of the text of a statute, except when they may help to "show that adherence to the text and structure would lead to a result 'so bizarre' that Congress could not have intended it."[145] Additionally, the Court noted that competing arguments could be made on both sides of the issue, so public policy was not clearly in favor of aiding and abetting liability.[146] One policy argument against imposition of aiding and abetting liability is that the resulting unpredictability and increased litigation costs would result in severe ripple effects throughout the market.[147]

Last, the Court rejected the argument that the existence of a statutory prohibition on aiding and abetting a criminal securities law violation inferred a private cause of action.[148] The Court feared that if there were such a rule "[e]very criminal statute passed for the benefit of some particular class of persons would carry with it a concomitant civil damages cause of action."[149]

C. Dissenting Opinion

In *Central Bank*, four justices dissented from the majority's opinion.[150] The dissent cited two problems it had with the majority's formulation of its opinion.[151] First, the dissent believed that the majority did not give the long history of aiding and abetting liability under section 10(b) and Rule 10b–5 due consideration.[152] Second, the dissent was concerned that the rationale used to defeat aiding and abetting liability also endangered other well established forms of secondary liability.[153]

The dissent first argued that the majority should not have interfered with

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141. *Central Bank*, 511 U.S. at 186.
142. *Id.*
143. *Id.*
144. *Id.* at 188. Two of the SEC's policy arguments were that aiding and abetting liability deters secondary parties from contributing to fraudulent activities and it increases victims' chances of being made whole again by providing additional defendants from whom plaintiffs may recover. *Id.*
145. *Id.* (citing Demarest v. Manspeaker, 498 U.S. 184, 191 (1991)).
146. *Id.* at 189–90.
147. *Id.* at 189. For example, aiding and abetting liability may make it more difficult for newer and smaller companies to obtain advice regarding securities transactions from professionals who would be afraid to expose themselves to the liability resulting from the greater likelihood of business failure of these types of firms. *Id.*
148. *Id.* at 190.
149. *Id.* at 191.
150. *Id.* at 192 (Stevens, J., dissenting). Justice Stevens wrote the dissenting opinion and was joined by Justices Blackmun, Souter, and Ginsburg. *Id.*
151. *Id.*
152. *Id.*
153. *Id.*

settled law.[154] Although not expressly provided for in section 10(b), the courts and the SEC had concluded that aiders and abettors should be subject to liability in hundreds of judicial and administrative proceedings, involving all eleven courts of appeals.[155] The dissent noted that if indeed there had been "continuing confusion" concerning the private right of action against aiders and abettors, the confusion did not center on the formulation of liability or its existence, both of which were already settled.[156] In fact, in *Central Bank* the petitioner (defendants) *assumed* that the cause of action against aiders and abettors existed and sought review only upon clarifications of who could be held liable under the doctrine.[157]

Further, the dissent contended that under a "policy of respect" for consistency in judicial interpretations, the Court should leave it to Congress to assess settled law and to make necessary changes.[158] The dissent emphasized that a "'settled construction of an important federal statute should not be disturbed unless and until Congress so decides.'"[159] In 1975, Congress revised the Securities Exchange Act, but decided to leave the case law approving aiding and abetting in private actions untouched; therefore, the dissent maintained, since Congress did not change the doctrine when it could have, the majority should not have eliminated it.[160]

If it was shown that aiding and abetting liability had reduced the effectiveness of the operations of securities laws, the majority's opinion would have been on "firmer footing" with the dissent.[161] However, the dissent felt that the decisions recognizing aiding and abetting liability suffered "from no such infirmities."[162]

Next, the dissent argued that the rationale used by the majority in its opinion would eliminate other forms of secondary liability under the Acts.[163] For example, even though the holding of the majority was limited to private parties, the dissent noted that the rationale used would not permit the SEC to pursue aiders and abettors in civil enforcement actions, an important part of the SEC's enforcement arsenal.[164] Further, the dissent maintained that the rationale would at the very least cast serious doubts over, if not eliminate, other forms of secondary liability not expressly provided for in the Acts, but recognized by the courts and the SEC.[165]

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154. *Id.* at 194–95.
155. *Id.* at 192. *See also* cases cited *supra* note 40.
156. *Central Bank*, 511 U.S. at 194 (Stevens, J., dissenting).
157. *Id.* (Stevens, J., dissenting).
158. *Id.* at 196 (Stevens, J., dissenting).
159. *Id.* (Stevens, J., dissenting) (quoting Reves v. Ernst & Young, 494 U.S. 56, 74 (1990)).
160. *Id.* at 197–98 (Stevens, J., dissenting). Not amending the Act to exclude a private cause of action for aiding and abetting liability implied that Congress found the Court's reasoning satisfactory. *Id.* (Stevens, J., dissenting).
161. *Id.* at 198 (Stevens, J., dissenting).
162. *Id.* (Stevens, J., dissenting).
163. *Id.* at 200 (Stevens, J., dissenting).
164. *Id.* In 1992, the SEC reported that it asserted aiding and abetting claims in fifteen percent of its civil enforcement proceedings during the year. *Id.* at 200 n.11 (Stevens, J., dissenting). However, the SEC is not expressly granted the authority to pursue aiding and abetting liability under section 10(b). *Id.* at 200 (Stevens, J., dissenting).
165. *Id.* at 200–01 (Stevens, J., dissenting). A cause of action for conspiring to violate section 10(b) could be eliminated as could claims based upon respondeat superior and other

V. THE AFTERMATH OF *CENTRAL BANK*

The majority's opinion drew strong criticism from securities law commentators almost immediately.[166] The criticism has been directed as much at the reasoning used by the majority as for the actual holding itself.[167] Commentators fear that the "textualist method" used by the majority threatens to place strong restrictions on the effectiveness of the securities fraud provisions.[168]

As a result, many have urged Congress to amend section 10(b) to include an express private cause of action for aiding and abetting.[169] However, when Congress overrode a presidential veto to enact the Private Securities Litigation Reform Act of 1995 ("1995 Act"),[170] they chose not to include any provision for a private cause of action against aiders and abettors.[171] In both the House of Representatives and the Senate, amendments allowing for a private cause of action against aiders and abettors were proposed to be inserted in the respective bills, but both were defeated.[172]

The debate over the amendment to the Senate's version of the Act highlighted the public policy concerns on both sides of the issue.[173] Proponents of allowing private causes of action against aiders and abettors argue that it is needed to keep the securities markets safe for investors and to maintain high investor confidence.[174] Also, they do not believe that public policy should allow aiders and abettors to avoid liability.[175]

Opponents argue that aiding and abetting liability holds professionals to an "incredibly high standard, particularly when they can be held liable for damages that are far greater than any damage that they have caused."[176] Further, they claim that the doctrine encourages frivolous lawsuits by plaintiffs

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common-law agency principles. *Id.* at 200 n.12 (Stevens, J., dissenting).

166. *See, e.g.*, Seligman, *supra* note 1, at 1432–33; Steinberg, *supra* note 13, at 489; Ruder, *supra* note 8, at 1486.

167. *See, e.g.*, Seligman, *supra* note 1, at 1432–33; Ruder, *supra* note 8, at 1486.

168. *See, e.g.*, Ruder, *supra* note 8, at 1486.

169. Ruder, *supra* note 8, at 1483–85 (recommending possible amendments that Congress could implement).

170. Pub. L. No. 104–67, 109 Stat. 737 (1995) (codified at scattered sections of 15 U.S.C.).

171. *See id.* The 1995 Act does grant the SEC express authority to pursue injunctions or civil penalties under section 21(d) of the 1934 Act against secondary parties who knowingly provide substantial assistance, or aid and abet, primary wrongdoers. 15 U.S.C. § 78t(f) (1994). Arguably, however, secondary parties who are guilty of only reckless misconduct are not liable for aiding and abetting in SEC actions since the language of the enacted section does not expressly provide as such. *See id.*

172. 141 CONG. REC. S9109–9116 (daily ed. June 27, 1995). In the Senate, Senator Bryan's Amendment 1474 proposed to add the following language to the Act:

> [A]ny person who *knowingly or recklessly* provides *substantial assistance* to another person in violation of a provision of this title, or of any rule or regulation promulgated under this title, shall be deemed to violate such provision to the same extent as the person to whom such assistance is provided.

Id. at S9182 (emphasis added). The amendment was designed to overrule *Central Bank* and to provide for a private right of action against aiders and abettors. *Id.* at S9109–S9110 (statement of Sen. Bryan).

173. *Id.* at S9109–9116.

174. *Id.* at S9109–9110 (statement of Sen. Bryan).

175. *Id.*

176. *Id.* at S9110 (statement of Sen. D'Amato).

who hope to attain large settlements from defendants wanting to avoid the risk and expense of going to trial.[177]

In spite of the controversy, the decision in *Central Bank* makes one thing clear: private plaintiffs can no longer hold defendants liable for aiding and abetting a primary securities violation under section 10(b).[178] However, in some cases, the parties that have been held liable as aiders and abettors could also have been held liable as primary violators.[179] Thus, plaintiffs' lawyers are apt to now attempt to bring claims formerly labeled as aiding and abetting as claims for primary violations.[180] Additionally, using the logic from *Central Bank,* courts are likely to eliminate other forms of secondary liability not expressly provided for in the securities Acts.[181]

A. Bringing Former Aiding and Abetting Claims as Claims for Primary Violations

The majority's opinion in *Central Bank* makes it clear that only primary violators, those who make a material misstatement or omission or commit a manipulative act in regards to the purchase or sale of securities, are now subject to private suit under section 10(b).[182] However, the absence of section 10(b) aiding and abetting liability does not mean that secondary parties in the securities markets will always be free from liability under the securities Acts.[183]

In the wake of *Central Bank,* plaintiffs will be more likely to ask courts to construe actions previously brought as aiding and abetting claims as primary violations of section 10(b) and Rule 10b–5.[184] The holding in *Central Bank* does not prohibit this strategy because as the Court stated,

> [a]ny person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b–5, assuming *all* of the requirements for primary liability under Rule 10b–5 are met.[185]

On the other hand, to avoid liability, secondary party defendants will probably make the opposite argument—that their conduct constitutes unactionable aiding and abetting instead of a primary violation of section

177. *Id.* at S9111.

178. *See* Twiss v. Kury, 25 F.3d 1551, 1558 (11th Cir. 1994); *In re* Cascade Int'l Sec. Litig., 894 F. Supp. 437, 444 (S.D. Fla. 1995).

179. *See* Seligman, *supra* note 1, at 1438–39.

180. *See infra* notes 182–208 and accompanying text.

181. *See infra* notes 209–15 and accompanying text.

182. *In re* Kendall Square Research Corp. Sec. Litig., 868 F. Supp. 26, 28 (D. Mass. 1994). Where an accounting firm did not actually engage in the reporting of the financial statements and prospectuses, but merely reviewed and approved them, the statements were not attributable to it; thus, the firm could not be found liable for making a material misstatement because its activities did not rise to the level of actionable conduct as set forth by the Supreme Court in *Central Bank. Id.*

183. *In re* MTC Elec. Techs. Shareholders Litig., 898 F. Supp. 974, 985 (E.D.N.Y. 1995) (secondary party could be held liable for a primary securities law violation).

184. *See* Ruder, *supra* note 8 at 1486. *See also In re* Ivan F. Boesky Sec. Litig., 36 F.3d 255, 264 (2d Cir. 1994).

185. Central Bank v. First Interstate Bank, 511 U.S. 164, 191 (1994) (emphasis in original). *See supra* notes 60–72 and accompanying text (discussing the requirements for primary liability).

10(b).[186]

This change in strategy after *Central Bank* will leave lower courts to attempt to identify what conduct constitutes a primary violation versus mere aiding and abetting, a task that has already generated much confusion.[187] Cases decided since *Central Bank* have outlined two different approaches in determining whether conduct by secondary parties constitutes a primary violation for making a material misstatement.[188] Some courts have adopted the rigid rule that if defendants do not actually make the misleading statement themselves, they cannot be held primarily liable no matter how much assistance they provided to those who did.[189] Other courts have opted for a more flexible rule that centers on the extent of help rendered by the defendants.[190] Under this approach, defendants may be found primarily liable for the misstatements of others in which those defendants "substantially participated."[191] However, the difference between the two approaches is not distinct.[192] Some of the courts taking the more rigid approach suggest that if defendants assist in the preparation of a draft of a fraudulent statement, they can be held primarily liable even if the final version is not a statement actually made by them.[193]

Under either approach, to establish liability for failure to disclose or omission of a material fact, the defendant must be under a duty to disclose.[194] However, plaintiffs should have no problem establishing the existence of this duty in suits against securities professionals. Generally "[w]hen a representation is made by professionals or 'those with greater access to information or having a special relationship to investors making use of the information,' there is an obligation to disclose data indicating that the opinion or forecast may be

186. *See* Seeman v. Arthur Andersen & Co., 896 F. Supp. 250, 259 (D. Conn. 1995) (stating that the defendant was "free to raise at a later stage the argument that the facts at worst support[ed] nothing more than a claim of aiding and abetting" and "that they did not commit any manipulative or deceptive acts, but rather, only gave aid to other[s] who committed manipulative or deceptive acts").

187. *In re MTC Elec. Techs.*, 898 F. Supp. at 985–87.

188. *Id.* at 986.

189. *Id.* at 987. *See also In re* Kendall Square Research Corp. Sec. Litig., 868 F. Supp. 26, 28 (D. Mass. 1994) (an accountant's "review and approval" of financial statements and prospectuses was insufficient for primary liability); Vosgerichian v. Commodore Int'l, 862 F. Supp. 1371, 1378 (E.D. Pa. 1994) (allegations were insufficient for primary liability where the plaintiff alleged that a party "advised" and "guid[ed]" a client in making fraudulent misrepresentations).

190. *In re MTC Elec. Techs.*, 898 F. Supp. at 986.

191. *See In re* Software Toolworks, Inc. Sec. Litig., 38 F.3d 1078, 1090 n.3 (9th Cir. 1994) (court found that accounting firm's significant participation in drafting misleading letters to the SEC was sufficient conduct to support a claim of primary liability); *In re* ZZZZ Best Sec. Litig., 864 F. Supp. 960, 970 (C.D. Cal. 1994) (an accounting firm that was intricately involved in the creation of false documents and the resulting fraud is a primary violator of section 10(b)); Adam v. Silicon Valley Bancshares, 884 F. Supp. 1398, 1400 (N.D. Cal. 1995) (accountant may be found primarily liable based on his or her drafting of the issuer's reports and financial and press statements); Cashman v. Coopers & Lybrand, 877 F. Supp. 425, 433 (N.D. Ill. 1995) (primary liability properly alleged where accountant was charged with playing a central role in the drafting and formation of the alleged misstatements); Employers Ins. v. Musick, Peeler & Garrett, 871 F. Supp. 381, 389–90 (S.D. Cal. 1994) (attorneys and accountants can be held primarily liable for assisting in the preparation of false statements of the issuer).

192. *In re MTC Elec. Techs.*, 898 F. Supp. at 986.

193. *Id. See also In re Kendall Square*, 868 F. Supp. at 28 (citing *In re* Software Toolworks, 38 F.3d 1078, 1090 n.3 (9th Cir. 1994)).

194. Basic Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988).

doubtful."[195]

In addition to defining the conduct that constitutes a primary violation, courts will also have to determine if secondary parties have the scienter necessary to be liable for a primary violation.[196] The Court in *Central Bank* did not address the scienter element.[197] Although the specific requirements vary by circuit, in order to establish scienter, a plaintiff must prove facts that either show that the defendant had a motive and opportunity to commit fraud or that the defendant acted knowingly or recklessly when under a duty to disclose or act.[198]

Interpreting the scienter requirement for professionals, one lower court held that a statement or representation must not be made with reckless disregard for its truth or falsity, or with a lack of genuine belief that the information disclosed is accurate and complete in all material respects.[199] Therefore, a plaintiff should be able to satisfy the scienter requirement by proving that the defendant lacked a genuine belief or reasonable basis for believing that the information was accurate and complete.[200]

Further, plaintiffs must be able to prove that they relied on the conduct of the secondary party in order to impose primary liability.[201] In some cases, the fraud-on-the-market theory[202] will act to replace individual proof of reliance with a class-wide presumption that the market has absorbed all public information.[203] However, the fraud-on-the-market presumption still requires that the market rely on statements or omissions made by the identified defendant.[204] Therefore, in cases where secondary parties are the defendants, plaintiffs need to establish that the party's participation in the preparation or issuance of the allegedly deficient statements was so extensive that the statements should reasonably be attributed to that party.[205] Then, they only need to prove that the market relied on the statements or omissions, not on the secondary party's participation therein.[206]

Overall, accountants may be more likely than other securities professionals to be held primarily liable since accountants often prepare and sign client's financial reports.[207] On the other hand, the elimination of aiding and abetting liability should benefit attorneys, broker-dealers, and such non-securities professionals as commercial bankers the most because their

195. Kline v. First Western Gov't Sec., Inc., 24 F.3d 480, 486 (3d Cir. 1994), *cert. denied sub nom.* Arvey, Hodes, Costello & Burman v. Kline, 115 S. Ct. 613 (1994) (quoting Eisenberg v. Gagnon, 766 F.2d 770, 776 (3d Cir. 1985), *cert. denied sub nom.* Wasserstrom v. Eisenberg, 474 U.S. 946 (1986)).

196. *See supra* notes 62–65 and accompanying text.

197. *See In re MTC Elec. Techs.*, 898 F. Supp. 974, 987 (E.D.N.Y. 1995).

198. *See supra* notes 62–65 and accompanying text. *See also* Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1128–30 (2d. Cir. 1994).

199. *Kline*, 24 F.3d at 486.

200. *Id. See also In re* Phar-Mor, Inc. Sec. Litig., 892 F. Supp. 676, 684 (W.D. Penn. 1995).

201. *See supra* notes 67–69 and accompanying text.

202. *See supra* note 69.

203. Basic Inc. v. Levinson, 485 U.S. 224, 246–47 (1988).

204. *Id.*

205. *In re* ZZZZ Best Sec. Litig., 864 F. Supp. 960, 973 (C.D. Cal. 1994).

206. *Id.*

207. Seligman, *supra* note 1, at 1439.

involvement usually does not meet the requirements of a primary violation.[208]

B. Central Bank's *Impact on Other Forms of Secondary Liability Under the Securities Acts*

After *Central Bank*, there appears to be no logical way to limit the majority's reasoning to section 10(b) private aiding and abetting claims.[209] As the dissent in *Central Bank* stated, "[t]he Court's rationale would sweep away the decisions recognizing that a defendant may be found liable in a private action for conspiring to violate section 10(b) and Rule 10b–5."[210]

Courts have already applied the reasoning of the majority in *Central Bank* to eliminate the private cause of action for conspiracy under section 10(b).[211] As one district court held, "the *Central Bank* rationale that prohibits implied aiding and abetting liability is applicable to implied conspiratorial liability and leads to the inevitable conclusion that conspiratorial liability for section 10(b) does not survive *Central Bank*."[212]

The district court noted that, like aiding and abetting, conspiracy is not expressly provided for in the text of Rule 10(b).[213] In addition, a claim of conspiracy does not require that the conspirator actually committed a manipulative or deceptive act him or herself, thus constituting the type of secondary liability condemned by *Central Bank*.[214] Therefore, the court concluded, "[i]t is beyond logic to maintain that although *Central Bank* prohibits aiding and abetting liability it permits plaintiffs to maintain the same cause of action by labeling it as a conspiracy."[215]

VI. CONCLUSION

All of the circuit courts of appeals recognized a private cause of action for aiding and abetting a primary violation of section 10(b) prior to the decision in *Central Bank*.[216] The Supreme Court's decision, relying strongly on a textual interpretation of section 10(b), turned widely accepted precedent on its head, signaling a possible end to actions created by judicial implication. The failure of Congress to enact statutory language overturning *Central Bank* marks the end of aiding and abetting liability under section 10(b) and Rule 10b–5.

In the future, the effect of the Court's decision will be a reduction in the number of suits against securities professionals in cases where the complaining parties cannot establish all of the elements of a primary violation. As a result,

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208. *Id.* at 1441.
209. *See id.* at 1435.
210. Central Bank v. First Interstate Bank, 511 U.S. 164, 200 n.12 (1994) (Stevens, J., dissenting).
211. *See In re* Glenfed, Inc. Sec. Litig., 60 F.3d 591, 592 (9th Cir. 1994) (en banc) ("The Court's rationale [in *Central Bank*] precludes a private right of action for 'conspiracy' liability."); *In re* MTC Elec. Techs. Shareholders Litig., 898 F. Supp. 974, 981 (E.D.N.Y. 1995) ("[The defendants] argue that the reasoning of *Central Bank* requires the conclusion that conspiracy liability is unavailable in private claims under section 10(b). I agree."); *In re* Syntex Corp. Sec. Litig., 855 F. Supp. 1086, 1098 (N.D. Cal. 1994) ("The Court's rationale in [*Central Bank*] also forecloses [a private civil] conspiracy liability theory.").
212. *In re* Ross Systems Sec. Litig., 1994 WL 583114, at *4 (N.D. Cal. July 21, 1994).
213. *Id.*
214. *Id.*
215. *Id.*
216. *See supra* note 40.

there could possibly be increased misconduct in securities transactions in the future.[217] Moreover, the reasoning used by the majority jeopardizes other causes of action implied under section 10(b) as evidenced by the subsequent elimination of the conspiracy action.[218]

The full impact of the decision will not be settled for many years. However, there is little doubt that with the *Central Bank* decision securities laws have undergone one of the most significant transformations in their sixty-two year history.[219]

217. This is uncertain, however, and only time can tell.
218. *See supra* notes 211–15 and accompanying text.
219. *See In re* Cascade Int'l Sec. Litig., 894 F. Supp. 437, 439 (S.D. Fla. 1995).

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