COMMENT ON "JUST DESERTS FOR ACCOUNTANTS"

Simon Lorne*

Let me react on a couple of bases, the first of which, Jim,[1] is that if you feel so strongly about *Central Bank*[2] I would hate to listen to you about *Gustafson*.[3] As near as I can tell, the basic holding, or the fundamental holding, of *Central Bank* really is that legislative history doesn't matter. The fundamental holding of *Gustafson* is that statutory language doesn't matter much either. All of which makes it very difficult to project what this new legislation might mean given that we can't pay too much attention to any of the words in either the statute or the conference manager's statement. I would also like to know who feeds Justice Kennedy what for breakfast.

In any event, let me talk about some of the theses you suggest. In terms of the direct contact test and replacing, if you will, the theory of aiding and abetting, it seems to me clear that the movement is in that direction. And indeed in a world in which it becomes important to find primary violators, which is not the world we had pre-*Central Bank*, it seems to me that even cases such as *Roberts v. Peat, Marwick*,[4] may now come down differently. It appears that it is not a terribly difficult stretch to say that when a company is purchasing property from affiliates at inflated prices, those prices should be accounted for partially as compensation to the affiliates and a lower price should be carried on the balance sheet as the asset value. One might then find misrepresentation in the financial statement, if it is important to find misrepresentations, so that Peat, Marwick could be attacked as a primary violator. I'm not sure how many cases there are, but I agree completely with the point you make at the end; that it is very important, and always has been, to securities laws that we monitor the people we have always viewed as the gate keepers to the securities markets. There is a role for the ancillary players, the side players if you will, that is critically important and it is crucial that we not simply ignore the issue of liability against them.

I would like to think that you [Professor Cox] are right, that the accounting provisions of the new legislation would increase to some extent the

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1. James D. Cox, *Just Deserts for Accountants and Attorneys after* Bank of Denver, 38 ARIZ. L. REV. 519 (1996).
2. Central Bank of Denver v. First Interstate Bank, 114 S. Ct. 1439 (1994).
3. Gustafson v. Alloyd Co., 115 S. Ct. 1061 (1995).
4. Roberts v. Peat, Marwick, Mitchell & Co., 857 F.2d 646 (9th Cir. 1988), *cert. denied*, 493 U.S. 1002 (1989).

exposure of accountants in this area. But I must note that that's not the trend of the last few Supreme Court cases and we are not moving towards finding new rights of actions implied. Indeed the new legislation specifically says that public accountants have no private liability for conclusions or statements that are made in the reports that are required. And it seems to me very easy for a court to read that to say that they are not going to find liability for statements that aren't made in the report, either. Thus, I can't share your optimism, although time may change my views.

In terms of the pre-existing relationship discussion, I have noticed with *Schatz*[5] and *Rosenberg*[6] and more recently with *Bryan*[7] and *ReBrook*,[8] that the Fourth Circuit is quickly becoming the reciprocal of the Ninth Circuit. On the average they come out about right—but my God, the individual cases are horrible. I like one no better than the other. It seems to me that there is, as you suggest, significant danger in focusing too much on *Chiarella*[9]–type fiduciary duties. I did once make an observation that has never been picked up, so I will make it again, that if one begins to focus on fiduciary duties as the critical element of disclosure obligations, then I think one comes to a different view as to how companies should treat good news from how they should treat bad news. If companies fail to disclose bad news, then it seems to me that the people who are hurt by that are people who are buying into the company and not existing shareholders and so there may be no duty to those people. But a failure to disclose good news means that existing shareholders are selling at artificially low prices and there may be a duty in that context. If one starts to get into that kind of differentiation based on fiduciary duty, I think it destroys much of the efficacy of the securities law.

On the conspiracy side, it seems to me that there is a cogent argument to be made post-*Central Bank* that conspiracy is the right place to draw the line. In *Central Bank* the Court said the statute doesn't go to aiding and abetting, since it doesn't say aiding and abetting; but the statute does says directly and indirectly. The term "indirectly" has to have some meaning, and it seems to me that indirectly, by definition, means there are people who have a responsibility beyond the direct participation test. And so if we know that the set that includes aiders and abettors is too large but that the set has to be larger than direct participants, conspiracy may be the right place to draw that line. We could then say that the "indirectly" language in section 10(b) moves us past direct participants and as far as conspirators but not as far as aiders and abettors.

I should note that there is an adverse decision after *Central Bank* as it applies both to the SEC and conspiracy. In *SEC v. U.S. Environmental*,[10] the Southern District of New York dismissed, with very little discussion, the SEC charges based on conspiracy under that court's reading of *Central Bank*. I was going to say "a *Central Bank* theory," but the district court didn't go as far as to express a theory, it just said on the "basis" of *Central Bank*. And as to one of

5. Schatz v. Rosenberg, 943 F.2d 485 (4th Cir. 1991), *cert. denied*, 503 U.S. 936 (1992).
6. Rosenberg v. Microdyne Corp., 26 F.3d 471 (4th Cir. 1994).
7. United States v. Bryan, 58 F.3d 933 (4th Cir. 1995).
8. United States v. ReBrook, 58 F.3d 961 (4th Cir.), *cert. denied*, 116 S. Ct. 431 (1995).
9. Chiarella v. United States, 445 U.S. 222 (1980).
10. SEC v. U.S. Envtl., Inc., 897 F. Supp. 117 (S.D.N.Y. 1995).

the defendants in the case, conspiracy was the only charge made, and there is now pending a Rule 54 motion to see about an appeal as to that defendant.[11] In that appeal we would expect to make both the conspiracy argument that I just made as well as the argument you suggest is of historical interest, and that is the argument I made elsewhere; that *Central Bank* did not preclude SEC enforcement actions against aiders and abettors.[12] That argument has been made in two appellate cases. In the Eleventh Circuit, *SEC v. Scherm*,[13] the case was remanded to the district court without decision on that issue. A decision on this argument is also pending in the Ninth Circuit in *SEC v. Fehn*,[14] which I argued in October.

As you suggest, assuming the new bill is signed, that becomes a matter of historical interest. It seems that because it's only of historical interest, whatever happens in the Ninth Circuit is not terribly likely to go up to the Supreme Court. So now I'm clearly hoping for a win there. There was a time I thought it might be better losing in the Ninth Circuit just because that would set the stage better for Justice Kennedy. But we see in any event that the new legislation provides in section 104 that for purposes of any actions brought by the Commission under paragraphs 1 or 3 under section 21(d), any person who knowingly provides substantial assistance in violation of a provision of this title shall be deemed to be in violation of such provision to the same extent.

The one question of course that comes out of that statutory analysis is what "knowingly" means in this context. Many of you will recall that when *Central Bank* came up to the Supreme Court, *certiorari* was granted on the question of the level of scienter in an aiding and abetting context. In a senate hearing on the question I made the mistake, I guess, of saying it seemed to me foolish not to answer that question in the legislation if the legislation was going to address SEC power, so they answered it for me. Now we have to make the argument that I alluded to yesterday,[15] which is, that at least in this context, "knowingly" does not exclude recklessness, but that the question is evidentiary: recklessness provides evidence of the knowing state of mind. One can argue that the language used is different from the language in the proportionate liability provision, and that such an interpretation should apply only in this context.

Finally, in terms of joint and several versus proportionate liability, I think we all recognize that there are some significant questions, but those questions have disappeared into the ether as people have focused on safe harbor provisions and other provisions of the legislation. I might note that in the legislation, one of the provisions that has gotten very little attention is the one that eliminates damages based on expectation or reasonable expectation of where the security price would have been had people not lied. This strikes me as a dangerous provision that could turn out to be one of the most important provisions, in fact, of the new legislation.

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11. With the ultimate adoption of the Securities Litigation Reform Act, the motion was subsequently withdrawn.
12. Simon Lorne, *Central Bank of Denver v. SEC*, 49 BUS. LAW. 1467 (1994).
13. SEC v. Scherm, 854 F. Supp. 900 (N.D. Ga. 1993).
14. SEC v. Fehn, No. 94–16136 (9th Cir. filed Nov. 1994).
15. Simon Lorne, *A Comment on "Capping Damages," Bounty Hunters and Modifying Behavior*, 38 ARIZ. L. REV. 671 (1996).