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## A Framework for Analyzing Attorney Liability Under Section 10(b) and Rule 10b-5

Gary M. Bishop  
*New England Law School*

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# A Framework for Analyzing Attorney Liability Under Section 10(b) and Rule 10b-5

## **Abstract**

[Excerpt] “Lawyers who make their living representing securities issuers face a myriad of challenges. Securities lawyers must navigate and master an intricate body of statutory, regulatory, and case law at both the state and the federal level and ensure that their clients comply with the law. The compliance requirement, however, is not limited to the issuer clients. Defrauded investors will often seek recovery of their losses from both the issuer of the failed investment securities and from the lawyers who represent the issuer, which only exacerbates the complexity of the securities lawyer’s work. These securities fraud actions against lawyers raise serious questions about the proper scope of liability under the federal securities laws. Just as lawyers strive for clarity, consistency, and predictability in advising their clients on securities compliance issues, lawyers seek the same level of precision regarding their own compliance.

...

The Court has never directly addressed the issue of attorney liability under section 10(b) of the 34 Act and Rule 10b-5. However, the Court’s recent pronouncements on primary liability of secondary actors under Rule 10b-5 indicate that the standard for such liability is increasingly becoming one that attorneys acting in the traditional role of adviser and draftsman to securities issuers will not satisfy. This development does not give lawyers unbridled freedom or authority to commit securities fraud without fear of sanction, nor does it undermine the 34 Act’s purpose of insuring fairness and honesty in the securities markets. On the contrary, protecting lawyers who lend their expertise to the issuers and sellers of securities is consistent with insuring such fairness and honesty. Moreover, existing rules and standards governing attorney conduct and the concomitant penalties for violation of those rules provide the appropriate level of regulation for lawyers, and this article does not suggest otherwise. The article argues only that section 10(b) and Rule 10b-5 are inappropriate and, in most cases, inapposite means of redressing attorney misconduct in connection with a fraudulent securities transaction.

Part II of this article will provide some background on section 10(b) and Rule 10b-5 and will discuss how section 10(b) and Rule 10b-5 have been applied in the area of liability of outside service providers such as lawyers and other secondary actors. In addition, part II will review the most recent developments of the law in this area and discuss how these developments provide an increased level of protection for securities lawyers. Part III of this article will examine how other areas of federal and state law have addressed the issue of attorney liability and suggest that the concepts can be applied to the section 10(b) and Rule 10b-5 analysis. Part IV will briefly discuss the role of the securities lawyer and the influence of the market for legal services on the manner in which these lawyers sell their services to potential clients. The article will then argue that the potential liability of any person under section 10(b) and Rule 10b-5 must be defined in terms of conduct and not in terms of the person’s role in the particular transaction giving rise to the claim. That framework will permit the securities lawyer to more effectively fulfill his or her role because the standard for attorney liability in a private action under section 10(b) and Rule 10b-5 will be clearer.”

## **Keywords**

securities, legal representation, attorneys, SEC, fraud

## A Framework for Analyzing Attorney Liability Under Section 10(b) and Rule 10b-5

GARY M. BISHOP\*

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### I. INTRODUCTION

Lawyers who make their living representing securities issuers face a myriad of challenges. Securities lawyers must navigate and master an intricate body of statutory, regulatory, and case law at both the state and the

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\* Associate Professor and Director of Legal Research and Writing, New England Law | Boston. B.A., Stonehill College, 1987; J.D. Boston College Law School, 1990. The author wishes to thank Laura Shadallah for her invaluable research assistance on this article and the participants in the junior faculty colloquium at New England Law | Boston for their insightful comments on an earlier draft of this article.

federal level and ensure that their clients comply with the law. The compliance requirement, however, is not limited to the issuer clients. Defrauded investors will often seek recovery of their losses from both the issuer of the failed investment securities and from the lawyers who represent the issuer, which only exacerbates the complexity of the securities lawyer's work. These securities fraud actions against lawyers raise serious questions about the proper scope of liability under the federal securities laws. Just as lawyers strive for clarity, consistency, and predictability in advising their clients on securities compliance issues, lawyers seek the same level of precision regarding their own compliance.

Analysis of the legal questions in this area begins with the relevant federal statute. The stated purpose for the Securities Exchange Act of 1934 (34 Act) is to regulate and control transactions in securities, "to impose requirements necessary to make such regulation and control reasonably complete and effective, . . . and to insure the maintenance of fair and honest markets in [securities] transactions . . ." <sup>1</sup> In addition to providing for the compensation of defrauded investors, the 34 Act seeks to deter and prevent fraud in the securities markets and to ensure that all information relevant to an investment decision is fully and completely disclosed. <sup>2</sup> In recognition of this broad objective, the United States Supreme Court has repeatedly recognized that the securities laws must not be interpreted "technically and restrictively, but flexibly to effectuate [their] remedial purposes." <sup>3</sup> A competing but equally important principle is that the 34 Act should not be read to restrict conduct or to apply to a particular individual's conduct in a manner that is inconsistent with the statutory language or the overall statutory scheme. <sup>4</sup>

The Court has rejected the notion of aiding and abetting liability in a private action under the federal securities laws. <sup>5</sup> Thus, secondary actors, such as lawyers, accountants, banks, and mutual fund investment advisers, are civilly liable under section 10(b) of the 34 Act <sup>6</sup> and its corresponding Securities and Exchange Commission (SEC) rule, Rule 10b-5, <sup>7</sup> only when

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1. Securities Exchange Act of 1934 § 2, 15 U.S.C. § 78b (2006).

2. *Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986).

3. *Pinter v. Dahl*, 486 U.S. 622, 653 (1988) (quoting *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972)).

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

5. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 177, 191 (1994).

6. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2006). Section 10(b) provides, in pertinent part, as follows: "It shall be unlawful for any person, directly or indirectly . . . (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 . . ." *Id.*

7. 17 C.F.R. § 240.10b-5 (2011). Rule 10b-5 provides:

such persons or entities have satisfied the requirements for primary liability. However, the distinction between conduct that satisfies the requirements for an actionable primary violation and conduct that is non-actionable aiding and abetting is not entirely clear. The confusion creates problems for attorneys who provide advice and guidance to issuers because of the extent that attorneys are involved in the preparation of various disclosure documents and other types of documents that are produced in connection with the issuance and sale of securities.

The Court has never directly addressed the issue of attorney liability under section 10(b) of the 34 Act and Rule 10b-5. However, the Court's recent pronouncements on primary liability of secondary actors under Rule 10b-5 indicate that the standard for such liability is increasingly becoming one that attorneys acting in the traditional role of adviser and draftsman to securities issuers will not satisfy.<sup>8</sup> This development does not give lawyers unbridled freedom or authority to commit securities fraud without fear of sanction, nor does it undermine the 34 Act's purpose of insuring fairness and honesty in the securities markets. On the contrary, protecting lawyers who lend their expertise to the issuers and sellers of securities is consistent with insuring such fairness and honesty. Moreover, existing rules and standards governing attorney conduct and the concomitant penalties for violation of those rules provide the appropriate level of regulation for lawyers,<sup>9</sup> and this article does not suggest otherwise. The article argues only

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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,

(a) To employ any device, scheme, or artifice to defraud,

(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

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.

8. See *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2301 (2011) (holding that a mutual fund's investment adviser was not liable under Rule 10b-5 for false statements in the mutual fund's prospectuses because the investment adviser did not make the material misstatements in the prospectuses within the meaning of Rule 10b-5); *Pac. Inv. Mgmt. Co. LLC v. Mayer Brown LLP*, 603 F.3d 144, 148, 152, 158 (2d Cir. 2010), cert. denied., 131 S. Ct. 3021 (2011) (denial of certiorari from Circuit Court decision holding that a law firm was not liable under Rule 10b-5 for false statements that the attorneys allegedly created where the false statements were not attributed to the lawyers at the time of dissemination).

9. See Marianne C. Adams, Note, *Breaking Past the Parallax: Finding the True Place of Lawyers in Securities Fraud*, 37 *FORDHAM URB. L.J.* 953, 958-61 (2010) (discussion of the "panoply of rules and guiding principles" applicable to lawyers that impose "a fairly high level of professional ethical expectations"). In addition to the American Bar Association Model Rules of Professional Conduct, the SEC has adopted rules that articulate standards of conduct for attorneys who represent issuers and practice before the SEC. 17 C.F.R. §§ 205.1-205.7 (2009) (defining the standards of professional

that section 10(b) and Rule 10b-5 are inappropriate and, in most cases, inapposite means of redressing attorney misconduct in connection with a fraudulent securities transaction.

Part II of this article will provide some background on section 10(b) and Rule 10b-5 and will discuss how section 10(b) and Rule 10b-5 have been applied in the area of liability of outside service providers such as lawyers and other secondary actors.<sup>10</sup> In addition, part II will review the most recent developments of the law in this area and discuss how these developments provide an increased level of protection for securities lawyers. Part III of this article will examine how other areas of federal and state law have addressed the issue of attorney liability and suggest that the concepts can be applied to the section 10(b) and Rule 10b-5 analysis.<sup>11</sup> Part IV will briefly discuss the role of the securities lawyer and the influence of the market for legal services on the manner in which these lawyers sell their services to potential clients.<sup>12</sup> The article will then argue that the potential liability of any person under section 10(b) and Rule 10b-5 must be defined in terms of conduct and not in terms of the person's role in the particular transaction giving rise to the claim.<sup>13</sup> That framework will permit the securities lawyer to more effectively fulfill his or her role because the standard for attorney liability in a private action under section 10(b) and Rule 10b-5 will be clearer.

## II. SCOPE OF SECTION 10(B) OF THE 34 ACT AND RULE 10B-5

### A. *General Background of Section 10(b) and Rule 10b-5*

It is fairly common knowledge that Congress set out to regulate the securities industry in response to the stock market crash of 1929 and the unrestrained conduct in the industry that caused the crash.<sup>14</sup> The 34 Act is focused primarily on regulating the trading of securities on the various exchanges and markets after the initial distribution of the securities.<sup>15</sup> The accompanying piece of legislation that Congress passed during the same era, the Securities Act of 1933 (33 Act),<sup>16</sup> regulates the initial distribution

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conduct for attorneys appearing and practicing before the commission in the representation of an issuer). Attorneys who violate the SEC rules are subject to sanctions and discipline. *Id.* at § 205.6.

10. *See infra* text accompanying notes 14–220.

11. *See infra* text accompanying notes 221–73.

12. *See infra* text accompanying notes 274–280.

13. *See infra* text accompanying notes 281–87.

14. *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 170–71 (1994).

15. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 752 (1975).

16. 15 U.S.C. §§ 77a–77aa (2006).

of securities by requiring detailed disclosures in registration statements and prospectuses as a means of preventing unduly aggressive sales tactics and overpriced securities issuances.<sup>17</sup> Both the 34 Act and the 33 Act contain provisions designed to prevent fraud in the securities markets, but section 10(b) of the 34 Act is the most familiar of these antifraud provisions.<sup>18</sup>

Section 10(b) of the 34 Act makes it unlawful to use manipulation or deception “in connection with the purchase or sale of any security” insofar as such conduct is “in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”<sup>19</sup> In 1942, the SEC utilized its rulemaking authority set forth in section 10(b) to adopt Rule 10b-5<sup>20</sup> which prohibits fraudulent or misleading conduct in buying and selling securities in the most general sense.<sup>21</sup> The text of section 10(b) is silent on whether private individuals may bring a cause of action, but the Court has found an implied right of action in the statute and, more directly, in Rule 10b-5.<sup>22</sup> A plaintiff who brings a private action under section 10(b) and Rule 10b-5 must establish each of the following: “(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.”<sup>23</sup>

The reliance requirement, which is also known as transaction causation, establishes that but for the deceptive act or fraudulent misrepresentation or omission, the investor would not have engaged in the particular

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17. *Cent. Bank of Denver*, 511 U.S. at 171; *Blue Chip Stamps*, 421 U.S. at 727–28, 752–53. *But see* Therese H. Maynard, *Liability Under Section 12(2) of the Securities Act of 1933 for Fraudulent Trading in Postdistribution Markets*, 32 WM. & MARY L. REV. 847, 872–75 (1991) (arguing that Congress may have intended the protections of the 33 Act to apply to transactions in the post distribution trading markets because it is unclear whether Congress knew for certain at the time of adoption of the 33 Act that it would adopt the 34 Act to address the issue of fraud in these markets).

18. *Cent. Bank of Denver*, 511 U.S. at 171; *see* Ronald J. Colombo, *Cooperation with Securities Fraud*, 61 ALA. L. REV. 61, 66 (2009) (“At the forefront of [the antifraud] measures [in the federal securities laws] was § 10(b) of the 34 Securities Exchange Act.”). One commentator has described section 10(b) as “a catchall provision, . . . the most open-ended and the most important [of the antifraud measures in the federal securities laws].” ROBERT C. CLARK, *CORPORATE LAW* § 8.9, at 309 (1986); *see also* *Herpich v. Wallace*, 430 F.2d 792, 804 (5th Cir. 1970) (“All that [Rule 10b-5] requires for its violation is that someone ‘do something bad’ in connection with a purchase or sale of securities.” (quoting RICHARD W. JENNINGS & HAROLD MARSH, *SECURITIES REGULATION* 961 (2d ed. 1968)).

19. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2006).

20. *See supra* note 7 for the text of Rule 10b-5.

21. “When we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.” *Blue Chip Stamps*, 421 U.S. at 737.

22. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157 (2008); *see* Colombo, *supra* note 18, at 66 (individuals do not violate § 10(b) directly but only derivatively through conduct that contravenes Rule 10b-5).

23. *Stoneridge Inv. Partners, LLC*, 552 U.S. at 157 (citing *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005)).

securities transaction.<sup>24</sup> The reliance requirement is perhaps the best way to understand the concept of attorney liability under section 10(b) and Rule 10b-5 and to draw appropriate boundaries by obligating a Rule 10b-5 plaintiff to establish explicit attribution of the statement to the defendant as part of the reliance inquiry. Because of the nature of the work that securities lawyers do for issuers,<sup>25</sup> a section 10(b) plaintiff will almost never be able to satisfy the reliance element of a claim against a lawyer. The requirement that a statement be explicitly attributed to a secondary actor in order to establish the reliance element for a primary action under section 10(b) and Rule 10b-5<sup>26</sup> provides the appropriate degree of protection for securities lawyers<sup>27</sup> and permits them to work effectively on behalf of their clients.

#### B. *Liability of Secondary Actors*

##### 1. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*

In *Central Bank of Denver v. First Interstate Bank of Denver*,<sup>28</sup> the United States Supreme Court declined to impose civil liability on those who aid and abet a violation of section 10(b) and Rule 10b-5.<sup>29</sup> The decision in *Central Bank* was somewhat unexpected because of the large volume of existing federal case law recognizing civil liability for aiders and abettors under section 10(b) and Rule 10b-5.<sup>30</sup> The Court's exclusive reli-

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24. *Id.* at 171; *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 631 (3d Cir. 2011).

25. See ROBERT J. HAFT AND MICHELE H. HUDSON, LIABILITY OF ATTORNEYS AND ACCOUNTANTS FOR SECURITIES TRANSACTIONS § 3:2 (Westlaw Database Updated May 2010) (“[T]he attorney’s role usually consists of advising on disclosure issues and often (but not always) drafting, for the client’s consideration and modification, the offering documents to be issued in final form under the client’s (not attorney’s) name . . . .”); Scott M. Herpich, *Relying on Client-Supplied Information: An Attorney’s Liability Exposure Under Rule 10b-5*, 43 U. KAN. L. REV. 661–62 (1995) (breaking down the role of the securities lawyer into three distinct levels of attorney action: reviewing and revising client prepared documents, preparing and drafting documents, and drafting opinion letters, and analyzing each one in terms of the attorney’s potential liability under section 10(b) and Rule 10b-5).

26. *Affco Invs. 2001, L.L.C. v. Proskauer Rose, L.L.P.*, 625 F.3d 185, 193–95 (5th Cir. 2010); *Pac. Inv. Mgmt., Co. LLC v. Mayer Brown LLP*, 603 F.3d 144, 152–53 (2d Cir. 2010), *cert. denied*, 131 S. Ct. 3021 (2011); *Wilson v. Dalene*, 699 F. Supp. 2d 534, 548 (E.D.N.Y. 2010).

27. *But see* Manning Gilbert Warren III, *The Primary Liability of Securities Lawyers*, 50 SMU L. REV. 383, 386–87 (1996) (arguing that securities lawyers involved in securities offerings are essential participants in such offerings and that lawyer misconduct in conjunction with fraudulent securities transactions arises in situations that satisfy the required elements for a primary violation of section 10(b) and Rule 10b-5).

28. 511 U.S. 164 (1994).

29. *Id.* at 177, 191.

30. Richard C. Mason, *Civil Liability for Aiding and Abetting*, 61 BUS. LAW. 1135, 1141 & n.32 (2006) (citing cases). Moreover, the primary focus of the decision was on the statutory language of § 10(b) of the 34 Act, and the opinion did not specify the extent to which it applied to Rule 10b-5 or to a



ance on the statutory language of section 10(b) led it to the conclusion that the statute applies only to persons who make material misstatements or omissions or who engage in manipulative or deceptive conduct in connection with the purchase or sale of a security and not to those who aid and abet such persons.<sup>31</sup>

The Central Bank of Denver was the indenture trustee for a public issue of bonds by the Colorado Springs-Stetson Hills Public Building Authority to finance improvements at a residential and commercial development.<sup>32</sup> The bond covenants required that the land securing the bonds be worth at least 160% of the bonds' outstanding principal and interest.<sup>33</sup> The real estate developer was required to provide the Central Bank of Denver with an annual report to verify that the 160% test was satisfied.<sup>34</sup>

In January 1988, the developer provided the Central Bank of Denver with an appraisal showing that the land values had remained virtually constant since the 1986 appraisal.<sup>35</sup> Soon after it received this appraisal, the Central Bank of Denver received a letter from the senior underwriter of the bond issue.<sup>36</sup> The underwriter noted that property values in the area were declining and that the appraisal was not up-to-date and expressed concern that the 160% test was not being met.<sup>37</sup> Central Bank of Denver's in house appraiser agreed that the values in the 1986 appraisal appeared optimistic

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particular subsection of Rule 10b-5. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 170 (1994) (stating that grant of certiorari was "to resolve the continuing confusion over the existence and scope of the § 10(b) aiding and abetting action."). In fact, the Court viewed the case as an occasion to determine the range of prohibited conduct under section 10(b), and it relied primarily on the text of the statute to make that determination. *Id.* at 172–73.

Even though the courts recognized civil aiding and abetting claims under section 10(b) and Rule 10b-5 prior to *Central Bank*, the standard for imposition of liability on lawyers under this theory was quite high. *See Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1127–28 (5th Cir. 1988) (rejecting the section 10(b) and Rule 10b-5 aiding and abetting claim against a law firm that assisted in preparation of an offering statement for a bond offering where the law firm lacked the requisite intent to violate the securities laws); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 492, 495–97 (7th Cir. 1986) (rejecting the section 10(b) and Rule 10b-5 aiding and abetting claim against a law firm that had advised a bond issuer whose materials for selling the bonds lacked essential information where the law firm did not act with intent to deceive any of the bonds' purchasers and did not intentionally or recklessly give bad advice to the bond issuer). *See infra* notes 244–46 and accompanying text for a more detailed discussion of the *Abell* case.

31. *Cent. Bank*, 511 U.S. at 177–78. The *Central Bank* court distinguished a primary violation of section 10(b) from an aiding and abetting violation based on the "critical element" of the defendant's representation, "either by statement or omission," and the plaintiff's reliance on that representation. *Anixter v. Home-Stake Prod.*, 77 F.3d 1215, 1225 (10th Cir. 1996). A plaintiff who relies only on the representation of a person providing substantial assistance to the defendant who is engaged in the primary violation cannot impose liability on such person. *Id.*

32. *Cent. Bank*, 511 U.S. at 167.

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.*

and advised the bank to hire an outside appraiser to conduct an independent review of the 1988 appraisal.<sup>38</sup>

An exchange of correspondence then took place between the developer and the Central Bank of Denver, and the bank agreed to delay the independent review of the appraisal until the end of the year, which was six months after the bond issue closed in June 1988.<sup>39</sup> However, before the outside appraiser completed its independent review, the public building authority defaulted on the bonds.<sup>40</sup> First Interstate Bank of Denver had purchased a substantial portion of the bonds and brought a section 10(b) action after the default against, among others, the Central Bank of Denver, alleging that the bank was secondarily liable under section 10(b) for aiding and abetting the fraud.<sup>41</sup>

In resolving the issue before it, the Court engendered further debate surrounding the liability of lawyers and other secondary actors under the federal securities laws. The source of much of that debate was language near the end of the *Central Bank* opinion regarding the liability of secondary actors. The language immediately followed the Court's statement of the holding in the case, which is that a private plaintiff is prohibited from bringing an action for aiding and abetting under section 10(b), and it is quoted in its entirety here:

The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. 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 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. In any complex securities fraud, moreover, there are likely to be multiple violators . . .<sup>42</sup>

The Court said nothing more about the standard for liability for these secondary actors other than to make clear that such actors are liable if they commit a section 10(b) violation. The Court was simply clarifying that any person, including a secondary actor, may face liability under section 10(b) if such person engages in conduct that satisfies the requirements for a

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38. *Cent. Bank*, 511 U.S. at 167-68.

39. *Id.* at 168.

40. *Id.*

41. *Id.*

42. *Id.* at 191 (internal citation omitted) (emphasis in original).

primary violation. In determining whether section 10(b) applies to a particular situation, the focus must be on whether the conduct satisfies the elements of a section 10(b) claim and not on the classification of the person whose conduct is at issue. Elimination of the phrase “including a lawyer, accountant, or bank” from this oft quoted passage from *Central Bank* reduces it to the very noncontroversial proposition that any person who satisfies all of the requirements for a Rule 10b-5 violation is liable for a Rule 10b-5 violation.

Courts, commentators, and securities lawyers have attempted to decipher the meaning of this language from *Central Bank* as they have addressed whether lawyers, accountants, underwriters, and other secondary actors may be held primarily liable under section 10(b).<sup>43</sup> Even though the statement can fairly be read as a clarifying point on the court’s holding, which is that the rejection of aiding and abetting liability under section 10(b) does not provide secondary actors with an outright exemption from section 10(b) primary liability, it has also generated some discussion as to the proper standard for liability of secondary actors under section 10(b).<sup>44</sup>

As one commentator has pointed out, the plaintiffs in *Central Bank* sought to hold the Central Bank of Denver liable for violating section 10(b) and Rule 10b-5 based solely on an aiding and abetting theory and never asserted that the Central Bank of Denver met the standard for a primary violation of section 10(b) and Rule 10b-5.<sup>45</sup> An assertion of a primary violation may have required the Court to consider the issue of scheme liability.<sup>46</sup> That issue came squarely before the court in *Stoneridge Invest-*

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43. *Pac. Inv. Mgmt. Co. LLC v. Mayer Brown LLP*, 603 F.3d 144, 152 (2d Cir. 2010), *cert. denied*, 131 S. Ct. 3021 (June 20, 2011); Brief of the Securities and Exchange Commission as Amicus Curiae Supporting Appellants at 6–7, *Pac. Inv. Mgmt. Co. LLC v. Mayer Brown LLP*, 603 F.3d 144 (2d Cir. 2010) (No. 09-1619-cv), 2009 WL 7768584 at \*6–7; Jill E. Fisch, *The Scope of Private Securities Litigation: In Search of Liability Standards for Secondary Defendants*, 99 COLUM. L. REV. 1293, 1294 (1999) (describing the Court’s observation about the imposition of primary liability on secondary actors as “somewhat cryptic” and lacking guidance); Ann Maxey, *Competing Duties? Securities Lawyers’ Liability after Central Bank*, 64 FORDHAM L. REV. 2185, 2210 (1996) (noting that *Central Bank* does not offer courts very much assistance in distinguishing between a lawyer’s act that constitutes a primary violation of Rule 10b-5 and an act that does not rise to that level).

44. See Joanna B. Apolinsky, *Is There Any Viability to Scheme Liability for Secondary Actors After Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*?, 58 CATH. U. L. REV. 411, 425 (2009) (“Although repudiating aiding and abetting liability, the *Central Bank* decision provided scant guidance for determining when a secondary actor had merely aided or abetted another’s fraud, as opposed to having engaged in fraud itself.”); Adams, *supra* note 9, at 965–66 (questioning whether *Central Bank*’s prohibition on aiding and abetting liability served the purpose of protecting those who do not commit section 10(b) violations but only give aid to those who do).

45. Colombo, *supra* note 18, at 119.

46. *Id.*; see Taavi Annus, Note, *Scheme Liability Under Section 10(b) of the Securities Exchange Act of 1934*, 72 MO. L. REV. 855, 861–62 (2007) (discussing scheme liability’s rise to prominence when *Central Bank* foreclosed aiding and abetting claims).

*ment Partners, LLC v. Scientific-Atlanta, Inc.*<sup>47</sup> The *Stoneridge* discussion will be more instructive if it is preceded by a brief discussion of the law after *Central Bank* and leading up to *Stoneridge*.

## 2. Liability of Secondary Actors After *Central Bank*

Two lines of cases developed after *Central Bank*. One line of cases adopted the substantial participation test, which states that third parties may be liable for statements made by others in which the defendant had significant participation or intricate involvement.<sup>48</sup> The factual scenarios in which liability is imposed under the substantial participation test illustrate that the conduct of the defendants in those cases really amounts to aiding and abetting and nothing more.<sup>49</sup> The substantial participation test is an example of the confusion that grew out of the pronouncement in *Central Bank* about liability of secondary actors such as lawyers and accountants under the federal securities laws:<sup>50</sup>

[W]ithout a clearer definition and a narrowing of the kind of conduct and circumstances required to constitute “substantial participation” or “intricate involvement,” the substantial participation test may fail to differentiate between primary liability and aiding and abetting, or even unrestricted conspiracy, and . . . the area of overlap may be significant under such an expansive test.<sup>51</sup>

The second line of cases adopted the bright line test, which provides that a third party’s review and approval of documents containing fraudu-

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47. 552 U.S. 148 (2008). The Court in *Stoneridge* also confirmed the validity of the language in *Central Bank* regarding section 10(b) liability of secondary actors for primary violations when it stated that “the implied right of action in section 10(b) continues to cover secondary actors who commit primary violations.” *Id.* at 166 (citing *Cent. Bank*, 511 U.S. at 191).

48. *E.g.*, *Dannenberg v. Painewebber Inc. (In re Software Toolworks, Inc. Sec. Litig.)*, 50 F.3d 615, 628 n.3 (9th Cir. 1994) (ruling that an accounting firm could be primarily liable under section 10(b) for the contents of a letter submitted to the SEC where it “played a significant role in drafting and editing the . . . letter” and that the decision in *Central Bank* did not protect the accounting firm from liability), *cert. denied*, 516 U.S. 907 (1995); *Carley Capital Grp. v. Deloitte & Touche, L.L.P.*, 27 F. Supp. 2d 1324, 1334 (N.D. Ga. 1998) (holding that “a secondary actor can be primarily liable when it, acting alone or with others, creates a misrepresentation even if the misrepresentation is not publicly attributed to it”); *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960, 970 (C.D. Cal. 1994) (ruling that the plaintiffs submitted sufficient evidence to suggest that an accounting firm’s participation in the creation of certain public statements was sufficiently extensive to attribute those misstatements and omissions to the accounting firm and thereby to establish that the accounting firm’s conduct was a direct violation of Rule 10b-5).

49. *But see* Travis S. Souza, Note, *Freedom to Defraud: Stoneridge, Primary Liability, and the Need to Properly Define Section 10(b)*, 57 DUKE L.J. 1179, 1187 (2008) (arguing that the substantial participation test is a more accurate determination than the bright line test of whether a person has made an untrue statement for Rule 10b-5 purposes).

50. *See supra* note 42 and accompanying text.

51. *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 585 (S.D. Tex. 2002).

lent statements is not actionable under section 10(b) because one must make the material misstatements or omission in order to be a primary violator.<sup>52</sup> In most adaptations of the bright line test, it also requires proof that the allegedly misleading statement was made by and attributed at the time of its issuance to the defendant being sued.<sup>53</sup> In addition to being easier for compliance and application purposes, the bright line test anticipated the later emphasis on attribution as an essential component of the reliance element of a section 10(b) and Rule 10b-5 action. The bright line test is also more consistent with the reasoning of *Central Bank* and assesses liability based on the alleged offender's conduct and not his or her occupation.

A third rule for primary liability of a secondary party under section 10(b), which was proposed by the SEC in connection with the Enron litigation<sup>54</sup> and numerous other cases,<sup>55</sup> provides that when a person, acting alone or with others, creates a misrepresentation on which an investor-plaintiff relies, the person can be liable as a primary violator of section 10(b) if he or she acts with the requisite scienter. Under this test, a person could be liable as a primary violator even though the person is not publicly associated with the misstatement that he or she created.<sup>56</sup> Thus, it does not require attribution and is really a slightly more restricted formulation of the substantial participation test.

### C. Reliance, Attribution, and Narrowly Defining the Maker of a Statement

The three decisions that are discussed in this section are the cornerstones of the current state of the law regarding the liability of secondary

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52. *E.g.*, *Ziamba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205–07 (11th Cir. 2001) (ruling that primary liability under section 10(b) and Rule 10b-5 requires the alleged misstatement or omission upon which the plaintiff relied to have been “publicly attributable to the defendant at the time that the plaintiff’s investment decision was made”); *Wright v. Ernst & Young LLP*, 152 F.3d 169, 174–75 (2d Cir. 1998) (ruling that a person does not incur primary liability under section 10(b) unless the person makes the material misstatement or omission, which must be directly attributed to the maker at the time of dissemination), *cert. denied*, 525 U.S. 1104 (1999); *Shapiro v. Cantor*, 123 F.3d 717, 720–21 (2d Cir. 1997) (ruling that “[a]llegations of ‘assisting,’ ‘participating in,’ ‘complicity in’ and similar synonyms . . . all fall within the prohibitive bar of *Central Bank*” and that a section 10(b) claim requires the defendant to have made a material misstatement or omission); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1223–27 & nn.7–12 (10th Cir. 1996) (ruling that in order for accountants to commit a primary violation of section 10(b) and Rule 10b-5, “they must themselves make a false or misleading statement (or omission)[.]” which requires more than providing significant or substantial assistance to another’s misrepresentation).

53. *Winkler v. NRD Mining, LTD*, 198 F.R.D. 355, 364 (E.D.N.Y. 2000).

54. *In re Enron Corp.*, 235 F. Supp. 2d at 588.

55. *See infra* note 202.

56. *SEC v. Lucent Techs. Inc.*, 363 F. Supp. 2d 708, 722, 724 (D.N.J. 2005). It is not entirely clear, however, that an attorney acting in the traditional role of adviser and draftsman to a securities issuer would satisfy this standard. *See* Brief of the Securities and Exchange Commission as Amicus Curiae Supporting Appellants at 7, *infra* note 202, for a more detailed explanation of the standard.

actors under section 10(b) and Rule 10b-5. Taken as a synthesized whole, the decisions make clear that the reliance element of a Rule 10b-5 claim will not be satisfied in the absence of direct attribution of the statement to the statement's maker and that a person or entity does not make a statement at all without ultimate authority over the content and means of communicating the statement. The rules that emerge provide an increased level of protection and certainty for securities lawyers who advise and counsel securities issuers and make it less likely that such attorneys will be held liable for securities fraud under section 10(b) and Rule 10b-5.

1. *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*

In the wake of the substantial disagreement over the meaning of *Central Bank*, the issue of scheme liability came before the Court in *Stoneridge* when the lead plaintiff in the class action suit filed by investors, Stoneridge Investment Partners, LLC, asserted that the defendants had engaged in a scheme to misrepresent the revenue of the company in which Stoneridge had invested.<sup>57</sup> In *Stoneridge*, the Court held that entities who were both customers and suppliers of a cable operator whose stock the plaintiffs had purchased were not liable to the plaintiffs under section 10(b) and Rule 10b-5 for agreeing to certain arrangements with the cable operator that permitted the cable operator to mislead its auditor and issue a misleading financial statement that impacted the stock price.<sup>58</sup> Charter Communica-

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57. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 153, 159–60 (2008). In its brief to the Supreme Court, Stoneridge Investment Partners argued that section 10(b) applies to “those who defraud investors indirectly via a scheme.” Brief for Petitioner at 19, *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008) (No. 06-43), 2007 WL 1701941 at \*19. Stoneridge characterized the holding of the Eighth Circuit Court of Appeals as erroneously focused on Rule 10b-5(b) and as “effectively nullifying Rule 10b-5(a) and (c).” *Id.* at 24, 2007 WL 1701941 at \*24.

Also, the petition for certiorari filed in *Stoneridge* specified that the issue in the case arose under section 10(b) and Rule 10b-5(a) and (c). Petition for a Writ of Certiorari at i, *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008) (No. 06-43), 2006 WL 1909677 at \*i. The Supreme Court, however, mentioned neither section in its discussion of the case. *Stoneridge*, 552 U.S. at 152 (general reference to Rule 10b-5). The Court quoted the text of Rule 10b-5 in the opinion but never specified whether its analysis was focused on any particular subsection of the rule. *Id.* at 156–57; see also Columbo, *supra* note 18, at 87 n.210 (pointing out the reference to sections (a) and (c) of Rule 10b-5 in the petition for certiorari in *Stoneridge* and the Court’s failure to discuss those sections in the text of the opinion); Robert John Grubb II, *Attorneys, Accountants, and Bankers, Oh My! Primary Liability for Secondary Actors in the Wake of Stoneridge*, 62 VAND. L. REV. 275, 295 (2009) (characterizing the result in *Stoneridge* as “crippl[ing] plaintiffs’ ability to bring creative scheme-to-defraud claims under Rule 10b-5(a) and (c).”).

58. *Stoneridge*, 552 U.S. at 152-53. One commentator described *Stoneridge* as “one of the most contentious securities law decisions handed down by the United States Supreme Court in recent years[,]” and part of the reason for that was the understanding “that the Supreme Court’s decision would impact accountants, lawyers, investment bankers, and the like . . . .” Franklin A. Gevurtz, *Law*

tions, Inc., the cable operator, made an arrangement with its customers/suppliers, Scientific-Atlanta, Inc. and Motorola, Inc., to overpay by twenty dollars for each digital cable converter that Charter purchased from Scientific-Atlanta and Motorola during a certain time period.<sup>59</sup> The arrangement required Scientific-Atlanta and Motorola to pay the twenty dollars back to Charter by purchasing advertising from Charter.<sup>60</sup>

In violation of generally accepted accounting principles, Charter recorded the advertising purchases from Scientific-Atlanta and Motorola as revenue, thereby deceiving Charter's auditor, Arthur Andersen, into approving a financial statement showing that it had met its projected numbers on revenue and operating cash flow.<sup>61</sup> The entities prepared legal documentation that made it appear as if the increased payments for the cable boxes and the advertising purchases were unrelated, ordinary course of business transactions, which prevented Arthur Andersen from uncovering the link between the two.<sup>62</sup> Scientific-Atlanta's contract with Charter provided for a twenty dollar increase in the price of the cable boxes purchased by Charter for the remainder of the year 2000, and Motorola's contract with Charter required Charter to purchase a specified number of cable boxes and to pay twenty dollars in liquidated damages for each unit that Charter did not accept.<sup>63</sup> Both Scientific-Atlanta and Motorola sent the additional money from the cable boxes back to Charter by entering into contracts with Charter for the purchase of advertising time at a price exceeding the fair value.<sup>64</sup>

The parties were careful to backdate the agreements for the purchase of the cable boxes to create the appearance that the agreements were negotiated a month prior to the advertising agreements.<sup>65</sup> The backdating was critical to creating the appearance that there was no connection between the negotiations for the cable box purchases and the advertising purchases, which was necessary for Arthur Andersen to treat the transactions separately.<sup>66</sup> The advertising payments inflated Charter's revenue and operating cash flow by approximately seventeen million dollars, and the inflated

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*Upside Down: A Critical Essay on Stoneridge Investment Partners, LLC v. Scientific Atlanta, Inc.*, 103 N.W. U.L. REV. COLLOQUY 448, 448 (2009).

59. *Stoneridge*, 552 U.S. at 153–54.

60. *Id.* at 154.

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.* at 154–55.

65. *Stoneridge*, 552 U.S. at 155.

66. *Id.*

number appeared on financial statements filed with the SEC and reported to the public.<sup>67</sup>

Neither Scientific-Atlanta nor Motorola had any role in the preparation or distribution of Charter's financial statements, and both companies booked the transactions as a wash on their own financial statements under generally accepted accounting principles.<sup>68</sup> A securities fraud class action ensued under section 10(b) and Rule 10b-5 based on the allegations that Scientific-Atlanta and Motorola either knew about or recklessly disregarded Charter's intention to inflate its revenues with these transactions, and knew that research analysts and investors would rely upon the resulting financial statements that Charter issued.<sup>69</sup> The district court granted the motion to dismiss of Scientific-Atlanta and Motorola, and the United States Court of Appeals for the Eighth Circuit affirmed.<sup>70</sup>

The Court affirmed the judgment of the Eighth Circuit Court of Appeals, holding that Scientific-Atlanta and Motorola were not liable to the investors under section 10(b) and Rule 10b-5 because the investors had not relied upon the acts or statements of Scientific-Atlanta and Motorola.<sup>71</sup> To establish liability in a private action under section 10(b) and Rule 10b-5, it is essential for the plaintiff to have relied upon the defendant's deceptive conduct.<sup>72</sup> In addition, because neither Scientific-Atlanta nor Motorola had a duty to disclose, nor were their deceptive acts communicated to the public under the fraud on the market doctrine, neither of these two rebuttable presumptions of reliance applied.<sup>73</sup> None of the investors had any knowledge of the conduct of Scientific-Atlanta and Motorola and, there-

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67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.* The United States District Court for the Eastern District of Missouri ruled that the plaintiffs' claims were barred by the Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), as claims for aiding and abetting liability under section 10(b) and Rule 10b-5. *In re Charter Commc'ns, Inc. Sec. Litig.*, No. MDL 1506, 4:02-CV-1186 CAS, 2004 WL 3826761, at \*5 (E.D. Mo. Oct. 12, 2004). The United States Court of Appeals for the Eighth Circuit affirmed, reasoning that liability under section 10(b) and Rule 10b-5 does not extend to "a business that entered into an arm's length non-securities transaction with an entity that then used the transaction to publish false and misleading statements to its investors and analysts." *In re Charter Commc'ns, Inc. Sec. Litig.*, 443 F.3d 987, 992 (8th Cir. 2006).

71. *Stoneridge*, 552 U.S. at 158–59.

72. *Id.* at 159.

73. *Id.* The fraud on the market theory presumes that most publicly available information about the value of a security is reflected in the market price for the security, which means that an investor who brings an action under section 10(b) and Rule 10b-5 is presumed to have relied on "any public material misrepresentations" about the security. *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988). The theory is a recognition that although individual investors do not in all cases personally evaluate and analyze all of the available information about a particular investment, false statements about the investment that are made available to the general investing public adversely affect those investors because the investors will trade in the security at a market price that is other than what it should be. CLARK, *supra* note 18, § 8.10.5, at 330.



fore, any reliance on that conduct was “in an indirect chain . . . too remote for liability.”<sup>74</sup>

Despite the absence of any public statement by either Scientific-Atlanta or Motorola, Stoneridge sought to impose liability on them based on scheme liability because they acted purposefully and “creat[ed] a false appearance of material fact to further a scheme to misrepresent Charter’s revenue.”<sup>75</sup> Stoneridge argued that there was a sufficient causal link between the deceptive conduct of Scientific-Atlanta and Motorola and the release of Charter’s inaccurate financial statements to the public to satisfy the fraud on the market doctrine because Charter would not have been able to deceive its auditor with the financial statements without the assistance of Scientific-Atlanta and Motorola.<sup>76</sup> Noting that the reliance element of a private action under section 10(b) and Rule 10b-5 is tied to the causation element, the Court reasoned that the deceptive conduct of Scientific-Atlanta and Motorola was too remote to satisfy the reliance requirement because Charter misled the auditor and released the inaccurate financial statements, and “nothing [Scientific-Atlanta and Motorola] did made it necessary or inevitable for Charter to record the transactions as it did.”<sup>77</sup>

As part of the rationale for its view that Stoneridge had failed to state a viable claim under section 10(b) and Rule 10b-5, the Court characterized the claim as an effort to apply a federal securities law cause of action to a situation that is governed by state law, which is the sphere of business contracts for the purchase and sale of goods and services.<sup>78</sup> The Court was unwilling to expand the federal power associated with securities litigation to an area with its own well-developed state law protections.<sup>79</sup> Emphasizing the distinction between a federal securities law claim under section 10(b) and Rule 10b-5 and a state law claim of common law fraud, the Court stated that “[s]ection 10(b) does not incorporate common-law fraud into federal law.”<sup>80</sup>

The Court also supported its ruling by reference to a provision of the 34 Act that was part of the Private Securities Litigation Reform Act of

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74. *Stoneridge*, 552 U.S. at 159; see Donald C. Langevoort, *Reading Stoneridge Carefully: A Duty-Based Approach to Reliance and Third Party Liability Under Rule 10b-5*, 158 U. PA. L. REV. 2125, 2129–38 (2010) (discussion and analysis of how the Court in *Stoneridge* made reliance the determinative issue in evaluating scheme liability).

75. *Stoneridge*, 552 U.S. at 159–60.

76. *Id.* at 160.

77. *Id.* at 160–61.

78. *Id.* at 161. “Unconventional as the arrangement [between Charter and Scientific-Atlanta and Motorola] was, it took place in the marketplace for goods and services, not in the investment sphere.” *Id.* at 166.

79. *Id.* at 161.

80. *Id.* at 162.

1995 (the PSLRA),<sup>81</sup> a provision that authorized the SEC, and not private parties, to bring enforcement actions against those who aid and abet violations of the federal securities laws.<sup>82</sup> The Court reasoned that adoption of Stoneridge's view of primary liability under section 10(b) and Rule 10b-5 would revive the aiding and abetting cause of action against any party who committed a deceptive act in the process of providing assistance to the primary violator.<sup>83</sup> The Court deferred to the judgment of Congress, as expressed in § 104 of the PSLRA, that only the SEC had the authority to bring actions against aiders and abettors.<sup>84</sup>

In dissent, Justice Stevens argued that Charter could not have misstated its revenue numbers without the “knowingly fraudulent actions of Scientific-Atlanta and Motorola” and that the investors relied upon those fraudu-

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81. Pub. L. No. 104-67, § 104, 109 Stat. 737 (1995).

82. *Stoneridge*, 552 U.S. at 158, 162–63. The codified provision of the PSLRA provides that in any action brought by the SEC for either injunctive relief or monetary penalties, “any person that knowingly provides substantial assistance to another person in violation of a provision of [the 34 Act], or of any rule or regulation issued [thereunder], shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.” 15 U.S.C. § 78t(e) (2006). Congress added this provision to the 34 Act as part of the PSLRA, which was a set of amendments to various sections of the federal securities laws. Pub. L. No. 104-67, § 104, 109 Stat. 737 (1995). Thus, Congress explicitly gave the SEC the power to bring enforcement actions against individuals who aid and abet violations of the securities laws, but Congress has never provided individuals with the power to bring private rights of action for such conduct. See *SEC v. U.S. Envtl., Inc.*, 155 F.3d 107, 113 (2d Cir. 1998) (stating that enactment of Pub. L. No. 104-67 gives the SEC, and not private plaintiffs, the authority to bring aiding and abetting actions under section 10(b)); *Wright v. Ernst & Young LLP*, 152 F.3d 169, 176 (2d Cir. 1998) (stating that Congressional authorization of SEC enforcement action against those who aid and abet securities law violations did not create a private cause of action for such conduct). The SEC has utilized this power in enforcement actions. See *SEC Sues Federal Loan Executives for Fraud*, BOSTON GLOBE, Dec. 17, 2011, at A1; *Ex-Fannie and Freddie Chiefs Accused of Deception*, N.Y. TIMES, Dec. 17, 2011, at B1. One of the claims for relief in this action is a claim for aiding and abetting violations of section 10(b) and Rule 10b-5. Complaint at 44–45, ¶¶ 128–33, *SEC v. Syron*, (S.D.N.Y. Dec. 16, 2011) (No. 11-Civ-9201).

83. *Stoneridge*, 552 U.S. at 162–63.

84. *Id.* at 163. The Court also supported its holding with reference to the history of the private right of action under section 10(b) and Rule 10b-5, emphasizing that the action is a judicially created one and not one that Congress enacted in the statutory text. *Id.* at 164. In the Court's statement of the issue before it in the first sentence of the opinion, the Court signaled the importance that it would place upon the fact that the section 10(b) private right of action is not authorized in the statute itself: “We consider the reach of the private right of action the Court has found implied in § 10(b) of the Securities Exchange Act of 1934 . . . and SEC Rule 10b-5 . . . .” *Id.* at 152 (emphasis added). Noting the concerns associated with a judicially created private cause of action, the Court declined to further expand the section 10(b) private cause of action. *Id.* at 164–65. In the Court's view, any further expansion of the section 10(b) private right of action should come from Congress, which is the body with the power to control the availability of remedies under the federal statutes. *Id.* at 165. On July 30, 2009, approximately six months after the Court's decision in *Stoneridge*, Senator Arlen Specter introduced a proposed amendment to section 20 of the 34 Act entitled “Liability for Aiding and Abetting Securities Violations Act of 2009.” S. 1551, 111th Cong. (1st Sess. 2009). The proposed bill would have allowed private individuals to bring civil actions against individuals who aid and abet violations of the securities laws. *Id.* § (2). The Judiciary Committee never reported the bill to the full Senate for consideration. GOVTRACK.US, <http://www.govtrack.us/congress/bill.xpd?bill=s111-1551> (last visited July 11, 2012); see Adams, *supra* note 9, at 972–73 (discussing proposed amendment to 34 Act).

lent actions when they relied on Charter's revenue statements to make their investment decision.<sup>85</sup> Justice Stevens viewed the conduct of Scientific-Atlanta and Motorola as a deceptive device within the meaning of section 10(b), thereby satisfying the requirements of section 10(b) and taking the case out of the *Central Bank* prohibition on aiding and abetting liability.<sup>86</sup> Though deceptive, the conduct did not satisfy the reliance requirements of a section 10(b) action because the defendants' conduct was never communicated to the public.

## 2. *The Landscape After Stoneridge*

Approximately two months after the Supreme Court's decision in *Stoneridge*, where it reiterated the importance of the *Central Bank* Court's holding that secondary actors face liability under section 10(b) when they engage in conduct that constitutes a primary violation of section 10(b),<sup>87</sup> the United States District Court for the Eastern District of California in *Lopes v. Vieira*<sup>88</sup> denied a law firm's motion to dismiss a section 10(b) and Rule 10b-5 action brought against it in connection with alleged misstatements regarding the securities that were the subject of an offering memorandum prepared by the firm.<sup>89</sup> The law firm argued for the dismissal because it had neither sold the securities nor made any of the statements in the offering memorandum in that the statements were not directly attributed to the firm.<sup>90</sup> The court discussed the concept of substantial participation in the preparation of the fraudulent statements as the basis for primary liability of a secondary actor, but the denial of the motion to dismiss was based on the court's inability to resolve at the pleading stage whether the law firm had any duty to the investors.<sup>91</sup> The court analogized the attorney's role in a securities offering to the role of an independent accountant, which consists of conducting an independent investigation into the issuer's financial health and certifying the accuracy of the issuer's financial statements, all of which may be relied upon by non-client investors.<sup>92</sup> In the court's view, the law firm's potential section 10(b) liability to the investors would depend upon whether the law firm had a similar duty to non-client investors.<sup>93</sup>

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85. *Stoneridge*, 552 U.S. at 167 (Stevens, J., dissenting).

86. *Id.*

87. *Id.* at 166.

88. 543 F. Supp. 2d 1149 (E.D. Cal. 2008).

89. *Id.* at 1178.

90. *Id.* at 1175–76.

91. *Id.* at 1177.

92. *Id.*

93. *Id.*

Analogizing the attorney's role in a securities offering to that of an accountant is questionable because of the attorney's ethical duty not to disclose the client's confidences<sup>94</sup> and to provide advice to the client that is generally not intended for the benefit of non-clients.<sup>95</sup> Moreover, the decision in *Lopes* is inconsistent with the rationale for declining to impose liability on the cable operator's customers/suppliers in *Stoneridge*: that the deceptive conduct of the customers/suppliers was too remote from the cable operator's issuance of the fraudulent financial statements to satisfy the reliance element of an action under section 10(b) and Rule 10b-5.<sup>96</sup> The court in *Lopes* relied on the oft-quoted language from the *Central Bank* decision regarding the liability of lawyers under Rule 10b-5<sup>97</sup> to support its denial of the law firm's motion to dismiss.<sup>98</sup>

When securities lawyers go beyond advising clients on securities law compliance issues and drafting the offering documents for their clients, the lawyer risks engaging in conduct that satisfies the elements of a section 10(b) and Rule 10b-5 violation. In *Thompson v. Paul*,<sup>99</sup> a case that was argued two days after the Supreme Court's decision in *Stoneridge*, which was the United States Court of Appeals for the Ninth Circuit held that an attorney who makes factual representations about an issuer to prospective purchasers of the issuer's securities has an obligation under section 10(b) and Rule 10b-5 to avoid making material misstatements or omissions about the securities.<sup>100</sup>

In *Thompson*, attorneys representing a publicly traded company and the CEO of the company in litigation between the company and the former CFO, who had resigned, became aware that the CEO was a target of a

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94. See MODEL RULES OF PROF'L CONDUCT R. 1.6(a) (2011) (defining confidentiality of information related to an attorney's representation of a client).

95. See MODEL RULES OF PROF'L CONDUCT R. 2.3(a) (2011) (allowing a lawyer to evaluate a matter affecting a client for the use of a third party "if the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client."); see also RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51(2)-(4) (2000) (description of the situations where a lawyer owes a duty of care to nonclients). One question is whether attorneys should be treated differently from other defendants in securities fraud cases because of the unique duty of confidentiality that attorneys owe to their clients. *Rubin v. Schottenstein, Zox & Dunn*, 143 F.3d 263, 272 (6th Cir. 1998) (Kennedy, J., dissenting).

96. See *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 160-61 (2008). That *Stoneridge* involved a claim of scheme liability and deceptive conduct under Rule 10b-5(a) and (c), see *supra* note 55, and *Lopes* involved a claim of an untrue statement of fact in a written securities offering document, *Lopes*, 543 F. Supp. 2d at 1171, does not explain the inconsistency between the two cases. In fact, the court in *Lopes* stated that the "recent Supreme Court opinion" in *Stoneridge* would not alter the result in the case but provided no explanation of the distinction between the two cases beyond a brief statement of the holding in *Stoneridge*. *Id.* at 1177-78.

97. See *supra* note 42 and accompanying text for the full quotation.

98. *Lopes*, 543 F. Supp. 2d at 1177.

99. 547 F.3d 1055 (9th Cir. 2008).

100. *Id.* at 1063.

criminal investigation with several federal agencies.<sup>101</sup> In a settlement of the litigation with the former CFO, a settlement that included the former CFO's receipt of common stock in the company, the attorneys represented that there was no criminal investigation of the CEO.<sup>102</sup> The court held that section 10(b) imposes upon "[a]n attorney who undertakes to make representations to prospective purchasers of securities . . . an obligation . . . to tell the truth about those securities."<sup>103</sup>

The factual scenario in *Thompson* is clearly distinguishable from the scenarios in *Central Bank* and *Stoneridge*. However, the case is a good illustration of the imposition of primary liability on a secondary actor, a lawyer, whose conduct satisfied the requirements for primary liability under section 10(b) and Rule 10b-5. The *Thompson* court's rejection of the attorneys' argument that their representation of the securities issuer provided protection from liability under section 10(b) and Rule 10b-5<sup>104</sup> was consistent with the ruling of *Central Bank* that any person, including an attorney, may be primarily liable under section 10(b) and Rule 10b-5 if all of the requirements for primary liability are met.<sup>105</sup>

In a case that tacitly endorsed the explicit attribution requirement,<sup>106</sup> while phrasing its decision in terms of the substantial participation test, the United States District Court for the Northern District of California held that the plaintiffs met the heightened pleading standard for an allegation of a materially misleading statement under section 10(b) and Rule 10b-5(b) against Berry, who was the vice president, general counsel, and corporate secretary of the issuer.<sup>107</sup> The plaintiffs alleged that Berry satisfied the substantial participation test by drafting the issuer's 2003 proxy statement and signing her name to it and by signing her name to the issuer's notes registration statement, both of which contained false and misleading information.<sup>108</sup> The plaintiffs' allegation that Berry was substantially in-

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101. *Id.* at 1057. The attorneys became aware of this information in connection with their representation of the company's alter ego in another matter. *Id.*

102. *Id.* at 1057–58. The representation was in the form of an oral statement by one of the lawyers at a settlement meeting. *Id.* at 1063.

103. *Id.* Section 10(b) imposes no duty on an attorney who becomes aware of an issuer's fraudulent misconduct to disclose the misconduct where the attorney has not provided an opinion or certified statement on the matter or has not invited the investing public to rely on the lawyer's judgment. *Wilson v. Dalene*, 699 F. Supp. 2d 534, 548 (E.D.N.Y. 2010).

104. *Thompson*, 547 F.3d at 1063.

105. *Cent. Bank*, 511 U.S. at 191; *see supra* note 42 and accompanying text.

106. *See infra* notes 184–89, 206–212 and accompanying text.

107. *N.Y.C. Emps. Ret. Sys. v. Berry*, 616 F. Supp. 2d 987, 989, 994–95 (N.D. Cal. 2009); *see also Allstate Life Ins. Co. v. Robert W. Baird & Co.*, 756 F. Supp. 2d 1113, 1123, 1140–41 (D. Ariz. 2010) (holding that plaintiff investors pled sufficient facts under the substantial participation test to place responsibility for alleged omissions in the offering documents for the sale of revenue bonds upon two law firms that prepared and drafted most of the language in the documents).

108. *N.Y.C. Emps. Ret. Sys.*, 616 F. Supp. 2d at 993–95.

volved in the preparation of other documents containing material misrepresentations was, standing alone, insufficient to satisfy the substantial participation test because the allegation failed to identify Berry's specific role in the preparation of the documents.<sup>109</sup> The court also ruled that the plaintiffs had successfully alleged a claim for scheme liability against Berry under Rule 10b-5(a) and (c) for Berry's conduct in coordinating a practice of backdating the reported grant dates of the issuer's stock options and disguising this practice through falsification of the issuer's corporate records.<sup>110</sup>

By distinguishing the statements to which Berry signed her name from those that did not identify Berry's specific role in their preparation, the court endorsed the notion that fraudulent statements must be explicitly attributed to the issuer in order to satisfy the reliance requirement of a section 10(b) action. The court did not use the exact terminology, but it is clear that substantial participation is not sufficient in the absence of explicit attribution.

The United States Court of Appeals for the Fifth Circuit in *Affco Invs. 2001, LLC v. Proskauer Rose, LLP*<sup>111</sup> endorsed the explicit attribution requirement and held that a law firm was not liable for participating in the creation of a false statement or misstatement upon which investors relied because the false statement or misstatement was not explicitly attributed to the law firm at the time of its dissemination.<sup>112</sup> In *Affco Investments*, an accounting firm solicited the plaintiffs to participate in a tax avoidance strategy and represented the strategy as a legitimate investment vehicle and tax shelter.<sup>113</sup> In order to market the tax strategy to potential investors, the accounting firm "promised to provide independent opinions from several major national law firms that had analyzed and approved the tax strategy."<sup>114</sup> The plaintiffs allege that the defendant law firm, Proskauer Rose, LLP (Proskauer), worked with the accounting firm to prepare advance

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109. *Id.* at 994–95.

110. *Id.* at 995–97. The court distinguished the conduct of Berry, which met the standard for actionable primary liability, from the non-actionable conduct of the customers/suppliers in *Stoneridge*, who played no role in the cable operator's dissemination of the false financial information. *Id.* at 997; see *Stoneridge*, 552 U.S. at 157, 160–61 (2008) (holding that the cable operator recorded transactions falsely and released the financial information to the investing public, and the conduct of the customers/suppliers was never disclosed to the investing public.).

111. 625 F.3d 185 (5th Cir. 2010).

112. *Id.* at 193–95. The court in *Affco Investments* discussed the decision of the Second Circuit Court of Appeals in *Pacific Investment Management* and noted that it found the Second Circuit's reasoning persuasive. *Id.* at 194. See *infra* notes 184–216 for a complete discussion *Pacific Investment Management*. The plaintiffs in both cases failed to satisfy the reliance requirement of a 10b-5 action because the statements at issue were not attributed to the defendant law firms.

113. *Affco Invs.*, 625 F.3d at 188.

114. *Id.* (internal quotation marks omitted).

model legal opinions that vouched for the legitimacy of the tax scheme.<sup>115</sup> The plaintiffs agreed to invest in the tax strategy.<sup>116</sup> After consummation of the necessary transactions, the plaintiffs claimed losses from the tax scheme on their 2001 income tax returns but failed to report their participation in the scheme itself.<sup>117</sup> An IRS investigation into the plaintiffs' participation in an abusive tax shelter ensued, and the plaintiffs were required to pay millions of dollars in back taxes, interest, and penalties.<sup>118</sup>

Similar to the argument made by the plaintiffs in *Stoneridge*, the plaintiffs in *Affco Investments* argued that Proskauer could be held liable for participating in the creation of the false statement upon which the investors relied even though the statement was not attributed to Proskauer when it was disseminated.<sup>119</sup> The court rejected the plaintiffs' argument based on its interpretation of *Stoneridge* that the investor must have knowledge of the secondary actor's conduct or statement in order for the investor to rely on it and thereby satisfy the reliance element of a section 10(b) and Rule 10b-5 action.<sup>120</sup> The court then concluded that the reliance element of a section 10(b) action is not satisfied in the absence of explicit attribution.<sup>121</sup> The accounting firm's advertisement of the tax scheme with support from "major national law firms" made the case closer than it would have been without the characterization, but it still failed to meet the requirement of showing that the plaintiffs relied on Proskauer itself.<sup>122</sup>

The court said the following on the importance of attribution for the reliance element of a section 10(b) action:

Knowing the identity of the speaker is essential to show reliance because a word of assurance is only as good as its giver. Clients engage "name brand" law firms at premium prices because of the security that comes from the general reputations of such firms for

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115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. *Affco Invs.*, 625 F.3d at 193–94.

120. *Id.* at 194.

121. *Id.*

122. *Id.* Subsequent to the plaintiffs' participation in the tax scheme and consummation of the necessary transactions, the IRS issued two separate notices regarding certain prohibited transactions. *Id.* at 188. The plaintiffs became concerned about the effect of the notices on the tax scheme and sought tax opinions from Proskauer, and Proskauer's opinions concluded that the transactions in which the plaintiffs had engaged were not substantially similar to the prohibited transactions set out in the IRS notices. *Id.* The plaintiffs' decision to claim losses from the tax scheme on their 2001 tax returns and failure to report their participation in the scheme itself was based on Proskauer's advice. *Affco Invs.*, 625 F.3d at 188. Because Proskauer rendered these opinions after the plaintiffs purchased their investment interests in the tax scheme, the opinions could not form the basis for liability under Rule 10b-5, as there was no connection between the misrepresentation and the purchase of the investment interest. *Id.* at 195 n.7 (citing *Stoneridge*, 552 U.S. at 157).

giving sound advice, or for winning trials. Specific attribution to a reputable source also induces reliance because of the ability to hold such a party responsible should things go awry.<sup>123</sup>

Although Proskauer was involved in the planning of the tax scheme, the plaintiffs never made any allegation that they knew of Proskauer's role in it prior to making their investment.<sup>124</sup> Without such knowledge, the plaintiffs failed to satisfy the reliance requirement of their section 10(b) and Rule 10b-5 claim against Proskauer.<sup>125</sup> The attribution requirement sets a clear boundary between primary violators, who are subject to section 10(b) and Rule 10b-5 liability in actions brought by private parties, and aiders and abettors, who are immune from private actions under section 10(b) and Rule 10b-5.<sup>126</sup>

In *In re DVI, Inc. Securities Litigation*,<sup>127</sup> a case involving a scheme liability claim brought against a law firm under Rule 10b-5(a) and (c) based on the law firm's advice to the issuer regarding necessary disclosures in a 10-Q, the court held that the plaintiff investors could not invoke the fraud on the market presumption of reliance to impose liability on the law firm where the law firm's deceptive conduct was not publicly attributed to it.<sup>128</sup> The law firm advised the issuer not to release a prepared version of a 10-Q that revealed material weaknesses in the issuer's internal controls for monitoring non-performing assets and evaluating troubled loans.<sup>129</sup> The version of the 10-Q that was released did not discuss any material weaknesses in the issuer's internal controls.<sup>130</sup> Citing both *Stoneridge* and the Second Circuit's decision in *Pacific Investment Management Co. v. Mayer Brown LLP*<sup>131</sup> with approval, the court in *In re DVI* reasoned that it is insufficient for a plaintiff to demonstrate that a secondary actor's deceptive conduct

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123. *Id.* at 194.

124. *Id.* at 195.

125. *Id.*

126. *Id.* The court also questioned the reasoning of the United States Court of Appeals for the Fourth Circuit regarding the attribution requirement in *In re Mutual Funds Investment Litigation*, 566 F.3d 111 (4th Cir. 2009). *Affco Invs.*, 625 F.3d at 196 n. 8. The court distinguished the case *sub judice* from *In re Mutual Funds* based on the Fourth Circuit's limitation of its holding regarding the attribution standard to the fraud on the market context. *Id.* The court in *Affco Investments* expressed skepticism of the Fourth Circuit's standard and questioned whether, if faced with issue, it would adopt the same standard. *Id.* The court's uncertainty about the Fourth Circuit's decision proved to be correct when the United States Supreme Court reversed the *In re Mutual Funds* decision in *Janus Capital Group Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2301 (2011). See *infra* notes 126–77 and accompanying text (providing a discussion of the *Janus* decision, including the decisions at both the circuit court and district court level.).

127. 639 F.3d 623 (3d Cir. 2011).

128. *Id.* at 642–43, 646–49.

129. *Id.* at 642.

130. *Id.*

131. See *infra* notes 184–216 and accompanying text.



was publicly released through other statements or conduct if the public is not aware of the secondary actor's acts through explicit attribution.<sup>132</sup>

The preceding discussion demonstrates that even though some courts continued to endorse and apply the substantial participation test that developed after the *Central Bank* decision, the courts either engaged in questionable reasoning or applied the test in situations where the attorneys acted outside the scope of their role of adviser and draftsman. Requiring the investor to have direct knowledge of the attorney's role in the transaction in order to allege reliance on the attorney for purposes of a Rule 10b-5 action strikes the appropriate balance between protecting the investor and adequately insulating the attorney from liability.

### 3. Janus Capital Group, Inc. v. First Derivative Traders

In the span of one week, the Supreme Court made two significant decisions that expanded the protections for securities lawyers in the transactional and advisory setting. First, in *Janus Capital Group, Inc. v. First Derivatives Traders*,<sup>133</sup> the Court held that a mutual fund's investment adviser did not make the material misstatements in the mutual fund's prospectuses within the meaning of Rule 10b-5 and, therefore, was not liable for the false statements under Rule 10b-5.<sup>134</sup> Second, just one week after the *Janus* decision was announced, the Court denied certiorari in *Pacific Investment Management*, a Second Circuit Court of Appeals decision holding that a law firm was not liable under Rule 10b-5 for false statements that the attorneys allegedly created where the false statements were not attributed to the lawyers at the time of dissemination.<sup>135</sup>

Although the *Janus* case did not directly address the issue of attorney liability, its holding—"that the maker of a statement is the entity with authority over the content of the statement and whether and how to communicate it"<sup>136</sup>—provides a comfort zone to securities lawyers who are involved in the preparation of various disclosure documents on behalf of clients who are selling securities to the public. The denial of certiorari in *Pacific Investment Management* provided confirmation of the implicit protection for lawyers in *Janus*, making clear that the failure to attribute an

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132. *In re DVI, Inc.*, 639 F.3d at 648.

133. 131 S. Ct. 2296, 2305 (2011).

134. *Id.* at 2305. The news media took an interest in the *Janus* decision. See Adam Liptak, *In 5-4 Vote, Supreme Court Limits Securities Fraud Suits*, N.Y. TIMES, June 14, 2011, at B3; A *Thwarted Liability Scheme*, WALL ST. J. (June 14, 2011), <http://online.wsj.com/article/SB10001424052702303714704576383640212008736.html>.

135. *Pac. Inv. Mgmt. Co. LLC v. Mayer Brown LLP*, 603 F.3d 144, 148, 152 (2d Cir. 2010), cert. denied, 131 S. Ct. 3021 (June 20, 2011).

136. *Janus Capital Grp., Inc.*, 131 S. Ct. at 2303.

allegedly false statement to a lawyer at the time of its dissemination precludes a plaintiff from establishing reliance on such statement.<sup>137</sup> It also served as a tacit endorsement of lower court decisions adopting the explicit attribution requirement. A full discussion of the cases will elucidate their combined significance to securities lawyers.

*Janus Capital Group* involved a family of mutual funds organized in a Massachusetts business trust, the Janus Investment Fund (the Fund).<sup>138</sup> Janus Capital Group, Inc. (JCG), a publicly traded company, created the Fund, and the Fund retained JCG's wholly owned subsidiary, Janus Capital Management LLC (JCM), as its investment adviser.<sup>139</sup> Investors acquired ownership of all of the Fund's assets by purchasing investment shares in the Fund.<sup>140</sup> The investment advisory services provided to the Fund by JCM included the necessary management and administrative services for the Fund to operate, but the Fund and JCM were independent legal entities.<sup>141</sup> The officers were common to each one, but the members of the respective boards of trustees were independent, as required by the relevant provisions of the Investment Company Act of 1940 (the 40 Act).<sup>142</sup>

In compliance with the 40 Act, the Fund issued prospectuses to investors that described the investment strategy and operations of the various individual mutual funds that comprised the Fund.<sup>143</sup> The prospectuses for several of these funds contained statements that could be interpreted to mean that JCM would implement policies and procedures to limit the ability of the funds' managers to engage in market timing, a practice that is legal but harmful to other fund's investors.<sup>144</sup>

In September of 2003, allegations against JCG and JCM of secret agreements to permit market timing in several of the funds run by JCM became known to the public, causing investors to withdraw significant amounts of money from several of the individual funds.<sup>145</sup> JCM's management fee, which the Fund paid based on the total value of the funds, comprised a significant percentage of JCG's income.<sup>146</sup> Thus, the Fund's loss in value also negatively impacted JCG's value, and JCG's stock price fell approximately 25 percent in the month of September 2003.<sup>147</sup> JCG

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137. *Pac. Inv. Mgmt.*, 603 F.3d at 148.

138. *Janus Capital Grp.*, 131 S. Ct. at 2299.

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.* at 2299–300.

143. *Id.* at 2300.

144. *Janus Capital Grp.*, 131 S. Ct. at 2300.

145. *Id.*

146. *Id.*

147. *Id.*

stockholders filed a class action against JCG and JCM, bringing claims under section 10(b) and Rule 10b-5.<sup>148</sup>

The JCG stockholders alleged that the statements in the prospectuses regarding the implementation of measures to curb market timing in the funds were misleading and that JCG and JCM by causing the prospectuses to be issued and made available to investors were responsible for the misleading impression.<sup>149</sup> The plaintiffs further contended that JCG and JCM had “materially misled” investors who relied upon the market price of JCG securities as accurately reflecting all of the market information applicable to JCG and JCM.<sup>150</sup> The United States District Court for the District of Maryland dismissed the plaintiffs’ complaint for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6), based on the direct attribution requirement.<sup>151</sup> The United States Court of Appeals for the Fourth Circuit reversed.<sup>152</sup>

The Supreme Court granted certiorari in the case to resolve whether JCM could be held liable under section 10(b) and Rule 10b-5 for the false statements in the prospectuses of the various individual mutual funds that

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148. *Id.*

149. *Id.*

150. *Janus Capital Grp.*, 131 S. Ct. at 2301.

151. *Id.* The District Court reasoned that in order to establish a defendant’s direct violation of the federal securities laws, as opposed to non-actionable aiding and abetting, the misrepresentation must be “directly attributable to the defendant.” *In re Mut. Funds Inv. Litig.*, 487 F. Supp. 2d 618, 621 (D. Md. 2007). The District Court dismissed the complaint with respect to JCG because the complaint failed to allege that any of the statements set forth in the prospectuses were directly attributable to JCG. *Id.* The District Court rejected the plaintiffs’ argument that JCG bore responsibility for the allegedly misleading statements in the prospectuses based on the appearance of the Janus logo, name, and website on the prospectuses. *Id.* The direct attribution rule will be discussed further in the text accompanying notes 184–89, 206–12, *infra*.

The District Court also dismissed the claim against JCM, reasoning that JCM owned no duty to the shareholders of JCG because those shareholders never purchased shares in any of the individual mutual funds that comprised the Fund. *In re Mut. Funds Inv. Litig.*, 487 F. Supp. 2d at 622–23. Therefore, reasoned the District Court, there was “no nexus between the plaintiffs, as JCG shareholders, and JCM, the funds’ investment adviser.” *Id.* at 623.

152. *Janus Capital Grp.*, 131 S. Ct. at 2301. The Fourth Circuit Court of Appeals held that the plaintiffs had pled a section 10(b) primary liability claim against JCM that was sufficient to survive the defendants’ motion to dismiss. *In re Mut. Funds Inv. Litig.*, 566 F.3d 111, 115 (4th Cir. 2009). The court ruled that JCM’s and JCG’s alleged participation in writing and disseminating the prospectuses was sufficient to allege that JCM and JCG made the misleading statements. *Id.* at 121. Because the allegedly misleading statements became public when they appeared in the funds’ prospectuses, the plaintiffs satisfied the first part of the fraud on the market theory. *Id.* As for the second requirement of the fraud on the market theory, that the allegedly misleading statements be sufficiently attributable to the defendants, the court held that an interested investor with an understanding of a mutual fund’s organizational structure would have inferred that JCM must have at least approved the statements in the prospectuses regarding market timing even if JCM did not write the policies. *Id.* at 121, 126–27. The court then ruled that the allegations of attribution were not sufficient to implicate JCG because it may not have been apparent to an interested investor that the parent company of the investment adviser had participated in drafting or approving the individual funds’ prospectuses. *Id.* at 127–28.

comprised the Fund.<sup>153</sup> Citing the language of Rule 10b-5 requiring a person “[t]o make any untrue statement of a material fact”<sup>154</sup> in order to be liable thereunder, the Court held that JCM was not liable because it had not made the statements in the prospectuses that created the misleading impression regarding market timing.<sup>155</sup> Echoing the *Stoneridge* Court’s concerns about the expansion of a judicially created private right of action,<sup>156</sup> the *Janus* Court made clear that in analyzing the issue before it, it would be cognizant of the fact that Congress neither authorized a private right of action when it first enacted section 10(b) nor expanded the private right of action when it amended the federal securities laws in 1995.<sup>157</sup>

The Court began its analysis of the issue with the noncontroversial assertion that “[o]ne ‘makes’ a statement by stating it.”<sup>158</sup> Thus, reasoned the Court, the person who makes a statement for purposes of Rule 10b-5 “is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.”<sup>159</sup> A person or entity who has no authority or control over the statement or who prepares the statement at the behest of another is not making the statement.<sup>160</sup> Also, if a statement is attributed to a party, either directly or by implication based on the circumstances in which the statement was made, the attribution is a strong indicator that the party to whom the statement was attributed made the statement.<sup>161</sup>

In the Court’s view, the rule that it announced in *Janus* followed from its holdings in both *Central Bank* and *Stoneridge*.<sup>162</sup> To define persons or entities without the ultimate control over a statement’s content as the makers of the statement would significantly undermine *Central Bank*’s prohibition on private rights of action against aiders and abettors of section 10(b)

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153. *Janus Capital Grp.*, 131 S. Ct. at 2301. The petition for certiorari raised two issues with the holding of the Fourth Circuit Court of Appeals. First, JCM and JCG asserted that by allowing a private action under section 10(b) and Rule 10b-5 to proceed against a defendant that had not made a misstatement but had only helped to draft a misstatement made by another, the Fourth Circuit had authorized an aiding and abetting action in direct contravention of *Central Bank*. Petition for a Writ of Certiorari at 8-9, *Janus Capital Grp., v. First Derivative Traders*, 131 S. Ct. 2296 (2011) (No. 09-525), 2009 WL 3614467 at \*8-9. Second, JCM and JCG asserted that the Fourth Circuit’s holding rejected the rule in a majority of the other circuits requiring that a statement be directly attributed to a particular defendant in order to invoke the presumption of reliance against that defendant under the fraud on the market theory. *Id.* at 9, 2009 WL 3614467 at \*9.

154. 17 C.F.R. § 240.10b-5(b) (2011).

155. *Janus Capital Grp.*, 131 S. Ct. at 2301.

156. *See supra* note 84.

157. *Janus Capital Grp.*, 131 S. Ct. at 2301-02.

158. *Id.* at 2302.

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.* at 2302-03.

and Rule 10b-5 violations,<sup>163</sup> because such a broad definition of “maker” would render aiders and abettors almost nonexistent.<sup>164</sup> In addition, the dismissal of the action in *Stoneridge* because of the absence of investors’ reliance on the equipment suppliers’ undisclosed deceptive conduct, conduct that did not in any way necessitate the cable operator’s recording of inflated revenue numbers on its financial statements,<sup>165</sup> was the precursor to a rule that one must have authority over the content of a statement in order to have made that statement.<sup>166</sup> The lack of such authority negates the inevitability to the statement setting forth any falsehood.<sup>167</sup>

The Court rejected the government’s argument that a person or entity that creates a statement should be regarded as the maker of the statement for purposes of section 10(b) and Rule 10b-5 liability.<sup>168</sup> Adoption of such a broad definition of “make” would run counter to the holding in *Stoneridge*, reasoned the Court, that entities involved in deceptive transactions were not liable under section 10(b) and Rule 10b-5 even when information about the deceptive transactions was subsequently included in false statements that were made public.<sup>169</sup> The Court equated the participation in the drafting of a false statement with the engagement in deceptive transactions “when each is merely an undisclosed act preceding the decision of an independent entity to make a public statement.”<sup>170</sup>

The Court also rejected the argument that the uniquely close relationship between mutual funds and their investment advisers necessarily means that the investment adviser is the maker of any statements by the mutual fund.<sup>171</sup> The Court acknowledged the “significant influence” of investment advisers over their mutual fund clients but declined to disregard the fact that JCM and the Fund are “legally separate entities.”<sup>172</sup> The imposition of liability on the investment adviser based solely on its close relationship with the mutual funds that it advises would, in the Court’s view, create a theory of liability that was inconsistent with the *Stoneridge* decision.<sup>173</sup>

Thus, as the entity with the statutory obligation to file the prospectuses with the SEC, the Fund, and not JCM, made the statements in the Fund’s prospectuses.<sup>174</sup> In addition, nothing in the prospectuses indicated that

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163. *Cent. Bank*, 511 U.S. at 177, 191; *see supra* notes 5, 29–31 and accompanying text.

164. *Janus Capital Grp.*, 131 S. Ct. at 2302.

165. *Stoneridge*, 552 U.S. at 159–61; *see supra* notes 56–76 and accompanying text.

166. *Janus Capital Grp.*, 131 S. Ct. at 2303.

167. *Id.*

168. *Id.*

169. *Id.* at 2303–04.

170. *Id.* at 2304.

171. *Id.*

172. *Janus Capital Grp.*, 131 S. Ct. at 2304.

173. *Id.*

174. *Id.*

JCM made any of the statements set out therein.<sup>175</sup> Despite any assistance that JCM may have provided to the Fund in preparing the prospectuses, JCM did not make the statements in the prospectuses within the meaning of Rule 10b-5.<sup>176</sup>

The dissenting opinion took issue with the majority's interpretation of the word "make" as limited in scope "to those with ultimate authority over a statement's content."<sup>177</sup> The dissent also argued that neither the English language nor the Court's relevant precedent supported the majority's position.<sup>178</sup> The dissent distinguished *Central Bank*, a case dealing with whether liability could be imposed on an entity that aided and abetted the primary violator,<sup>179</sup> from the case before it, which dealt with imposition of liability on the primary violator that was alleged to have made statements within the meaning of Rule 10b-5.<sup>180</sup> The dissent also distinguished *Stoneridge*, where the Court dismissed the action not because the equipment suppliers had failed to make any false statements, but rather because the investors had not relied on those statements,<sup>181</sup> from the case before it that dealt with whether one or more persons had made statements that were part of the public securities markets and upon which investors relied.<sup>182</sup>

The dissent argued that the allegations in the complaint were sufficient to reach the conclusion that JCM made the false statements in the prospectuses.<sup>183</sup> The dissent cited to examples of individuals facing primary liability under section 10(b) and Rule 10b-5 when those individuals did not have ultimate control over the issued statements or when they made the statements through innocent persons acting as conduits.<sup>184</sup> Ultimately, the close relationship between JCM and the Fund compelled the dissent to conclude that JCM was sufficiently involved in the preparation and writing of the

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175. *Id.* at 2305.

176. *Id.*

177. *Id.* at 2306 (Breyer, J., dissenting).

178. *Janus Capital Grp.*, 131 S. Ct. at 2307.

179. *Cent. Bank*, 511 U.S. at 177, 191; *see supra* notes 5, 29–31 and accompanying text.

180. *Janus Capital Grp.*, 131 S. Ct. at 2307–08 (Breyer, J., dissenting).

181. *Stoneridge*, 552 U.S. at 159–61; *see supra* notes 57–77 and accompanying text.

182. *Janus Capital Grp.*, 131 S. Ct. at 2308–09 (Breyer, J., dissenting).

183. *Id.* at 2311. The dissent relied in part on *Herman & MacLean v. Huddleston*, 459 U.S. 375, 377, 386–87 (1983), where the Court held that purchasers of registered securities who were allegedly defrauded by misrepresentations in the registration statement could maintain an action under section 10(b) and Rule 10b-5 despite the existence of an express remedy for the alleged fraud in section 11 of the '33 Act. The Court in *Herman & MacLean* pointed out that individuals other than those listed in section 11 of the '33 Act as subject to liability for misrepresentations in the registration statement may engage in fraud in the preparation of the registration statement, which would exempt those individuals from any liability for such fraud if they were beyond the reach of section 10(b) and Rule 10b-5. *Id.* at 689 n.22. Thus, the dissent reasoned, those individuals who participated in the preparation of the registration statement would be deemed to have made the statements therein for purposes of § 10(b) and Rule 10b-5. *Janus Capital Grp.*, 131 S. Ct. at 2311 (Breyer, J., dissenting).

184. *Janus Capital Grp.*, 131 S. Ct. at 2311–12 (Breyer, J., dissenting).

allegedly false statements to subject it to a claim of primary liability under section 10(b) and Rule 10b-5.<sup>185</sup>

#### 4. *Pacific Investment Management Co. LLC v. Mayer Brown LLP*

One week after *Janus* was decided, the next significant decision in this area was *Pacific Investment Management*, where the Supreme Court denied certiorari from a Second Circuit Court of Appeals decision that held a law firm was not liable under Rule 10b-5 for false statements that the attorneys allegedly created where the false statements were not attributed to the lawyers at the time of dissemination.<sup>186</sup> The denial of the petition for certiorari was not a decision on the merits of the case,<sup>187</sup> and this article's analysis of recent developments in the law governing attorney liability under section 10(b) and Rule 10b-5 does not suggest otherwise. Because of the Court's discretionary jurisdiction, however, at least one commentator has suggested: "[I]f [certiorari denials] are treated as hints of courses not fully charted, they can be used to develop new approaches and to give the careful observer some evidence of how the Justices, as individuals, have analyzed a problem in the past."<sup>188</sup> Thus, the Court's denial of the certiorari petition in *Pacific Investment Management* may be a hint of the Court's approach to this issue and may provide some evidence of the Justices' thinking on it. That the certiorari denial came one week after the Court's decision in *Janus* reinforces that view.

In *Pacific Investment Management*, the absence of attribution precluded the plaintiffs, who purchased securities during the period of the law firm's alleged fraud,<sup>189</sup> from demonstrating that they relied on the law

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185. *Id.* at 2312.

186. *Pac. Inv. Mgmt., Co.*, 603 F.3d at 148, 152, *cert. denied*, 131 S. Ct. 3021 (2011). The United States District Court for the Southern District of New York had previously granted the law firm's motion to dismiss the section 10(b) and Rule 10b-5 claim against it based on the lack of attribution of the statements in the documents at issue to the law firm. *In re Refco, Inc. Sec. Litig.*, 609 F. Supp. 2d 304, 312 (S.D.N.Y. 2009). To hold the law firm liable in the absence of attribution would circumvent the reliance requirement of a claim under section 10(b) and Rule 10b-5. *Id.* at 314. The court similarly rejected the plaintiffs' alternate theory of liability, also known as scheme liability, under Rule 10b-5(a) and (c) because of the plaintiff's lack of reliance on the law firm's conduct. *Id.* at 314–19.

187; see *Darr v. Burford*, 339 U.S. 200, 226 (1950) (Frankfurter, J., dissenting) (affirming the lower court's refusal to grant a writ of habeas corpus and stating that a denial of certiorari "has no legal significance whatever bearing on the merits of the claim."). Justice Frankfurter expressed a similar view in another case where the Court denied the petition for certiorari:

Inasmuch, therefore, as all that a denial of a petition for a writ of certiorari means is that fewer than four members of the Court thought it should be granted, this Court has rigorously insisted that such a denial carries with it no implication whatever regarding the Court's views on the merits of a case which it has declined to review.

*Maryland v. Balt. Radio Show*, 338 U.S. 912, 919 (1950).

188. Peter Linzer, *The Meaning of Certiorari Denials*, 79 COLUM. L. REV. 1227, 1229 (1979).

189. 603 F.3d at 150.

firm's own false statements.<sup>190</sup> To the extent that the law firm had participated in the creation of the statements at issue, the conduct "amount[ed], at most, to aiding and abetting securities fraud."<sup>191</sup>

The litigation in *Pacific Investment Management* arose out of the collapse of a large brokerage firm, Refco, Inc.<sup>192</sup> The defendant in the case, Mayer Brown LLP, was Refco's primary outside counsel from 1994 until the company collapsed in 2005.<sup>193</sup> Part of Refco's business involved lending money to its customers so that the customers could then trade in securities with the borrowed money, a process known as trading on "margin."<sup>194</sup> When these Refco customers incurred significant losses from their securities trading in the late 1990s, the customers did not have the money to repay hundreds of millions of dollars of margin loans that Refco had extended them.<sup>195</sup> Refco became concerned that an accurate accounting for these debts as "write-offs" would jeopardize the company's existence and, allegedly with Mayer Brown's assistance, arranged a series of bogus transactions with the goal of concealing the losses.<sup>196</sup>

The plaintiffs' complaint alleged that Refco transferred the uncollectible debts to another Refco entity, Refco Group Holdings, Inc. (RGHI), and RGHI sent back to Refco a receivable that it purportedly owed to Refco.<sup>197</sup> In order to avoid the suspicion associated with having a large debt owed to it by a related entity, Refco then engaged in a series of circular and fraudulent loan transactions with RGHI and various third parties to make it appear as if the third parties, and not RGHI, owed receivables to Refco.<sup>198</sup> The plaintiffs also alleged that Mayer Brown was involved in a number of these transactions over a five-year period by "negotiating the terms of the loans, drafting and revising the documents relating to the loans, transmitting the documents to the participants, and retaining custody of and distributing the executed copies of the documents."<sup>199</sup>

In addition, the plaintiffs alleged that Mayer Brown was responsible for false or misleading statements in a Refco offering memorandum and

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190. *Id.* at 148.

191. *Id.*

192. *Id.* at 148–49.

193. *Id.* at 149.

194. *Pac. Inv. Mgmt., Co.*, 603 F.3d at 149.

195. *Id.*

196. *Id.*

197. *Id.*

198. *Id.* The specific allegations were that after transferring the uncollectible debts to RGHI in exchange for the receivable from RGHI, Refco then indirectly loaned RGHI the money to pay off Refco's receivable by first lending the money to third parties, who would then lend the money to RGHI to pay off the receivable. *Id.* At the close of the fiscal period, all of the loans were repaid, and the third parties received a fee for participating in the scheme. *Pac. Inv. Mgmt., Co.*, 603 F.3d at 149.

199. *Id.*



two Refco registration statements.<sup>200</sup> The failure of each of the documents to describe accurately Refco's financial condition that had been partially obfuscated by the fraudulent loan transactions was the basis for the assertion that the documents contained false or misleading statements.<sup>201</sup> Furthermore, Mayer Brown was directly involved in the preparation of the documents through drafting sections of certain documents, reviewing and revising sections of others, and reviewing comment letters from the SEC on one of the registration statements.<sup>202</sup> The offering memorandum and one of the registration statements disclosed that Mayer Brown represented Refco on the transactions, but none of the documents directly attributed any of the information in the documents to Mayer Brown.<sup>203</sup>

The plaintiffs argued that the absence of attribution of the statements to Mayer Brown did not preclude the imposition of section 10(b) and Rule 10b-5 liability upon Mayer Brown because the firm had created a false statement upon which the investors had relied.<sup>204</sup> The court rejected the creator standard for liability of secondary actors, reasoning that it was essentially identical to the standard that imposed liability on actors who played a significant role in drafting or reviewing a fraudulent statement or who were intricately involved in the process.<sup>205</sup> As the Second Circuit had previously rejected that significant role standard,<sup>206</sup> it similarly rejected the creator standard.<sup>207</sup>

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200. *Id.*

201. *Id.*

202. *Id.* at 149–50.

203. *Pac. Inv. Mgmt., Co.*, 603 F.3d at 150. For a discussion of the District Court's reliance on the lack of attribution in the court's dismissal of the plaintiff's claims, see *supra* note 184 and accompanying text.

204. *Pac. Inv. Mgmt., Co.*, 603 F.3d at 151, 154–55. In an amicus curiae brief, the SEC also urged the court to adopt a standard that would impose liability on parties for creating false statements. *Id.*; see Brief of Sec. & Exch. Comm'n, Amicus Curiae, in Support of the Position of Plaintiffs-Appellants on the Issue Addressed and in Support of Neither Affirmance Nor Reversal, *Pac. Inv. Mgmt. Co. v. Mayer Brown LLP*, 603 F.3d 144 (2d Cir. 2010) (No. 09-1619-cv), 2009 WL 7768584, at \*7. In the SEC's view, a person creates a statement for purposes of Rule 10b-5 liability if the person writes or speaks the statement, provides false or misleading information to another person for placement into the statement, or allows the statement to be attributed to him or her. *Id.* The SEC has previously argued for the adoption of this standard. See Brief of the Sec. & Exch. Comm'n as Amicus Curiae at 9, *Klein v. Boyd*, Fed. Sec. Law. Rep. ¶ 90,136 (3d Cir. Feb. 12, 1998), *vacated and rehearing en banc granted*, 1998 U.S. App. LEXIS 4121 (3d Cir. Mar. 9, 1998) (Nos. 97-1143; 97-1261) (“A person who creates a misrepresentation, but who takes care not to be identified publicly with it, ‘indirectly’ uses or employs a deceptive device or contrivance and should be liable.”).

205. *Pac. Inv. Mgmt., Co.*, 603 F.3d at 155–56.

206. See *Wright v. Ernst & Young LLP*, 152 F.3d 169, 174–75 (2d Cir. 1998) (discussing the court's adherence to a test requiring a party to actually make a material misstatement or omission to incur primary liability under section 10(b) and Rule 10b-5, as opposed to a test imposing liability on parties who significantly participate in the creation of a statement made by another party).

207. *Pac. Inv. Mgmt., Co.*, 603 F.3d at 155–56. The court went on to express concern that “a creator standard would be even *less rigorous than*” a standard that required a defendant's substantial participa-

After reviewing the history of the attribution requirement in the second circuit, the court concluded that secondary actors such as Mayer Brown are not liable in a private action for Rule 10b-5 securities fraud in the absence of attribution.<sup>208</sup> The court relied on *Central Bank's* prohibition on aiding and abetting liability, reasoning that a secondary actor who assists or participates in the making of a material misstatement or omission under section 10(b) and Rule 10b-5, even if that assistance or participation is substantial, has merely aided and abetted the misleading statement and has not actually made it.<sup>209</sup>

The requirement that the false statement be attributed to the defendant at the time of dissemination in order to hold the defendant liable was based on the reliance requirement for an action under section 10(b) and Rule 10b-5.<sup>210</sup> In the absence of attribution, a plaintiff would be seeking to impose liability on a defendant for a representation made by another party, which would not satisfy the reliance requirement of an action under section 10(b) and Rule 10b-5.<sup>211</sup>

In the court's view, the attribution requirement was also consistent with the reasoning that resulted in the Supreme Court's rejection of the plaintiffs' claims in *Stoneridge* that were based on the plaintiffs' reliance on the financial statements issued by Charter Communications, Inc., the cable operator, and not on the deceptive conduct of the defendants, Scientific-Atlanta, Inc. and Motorola, Inc., who were both customers and suppliers of Charter.<sup>212</sup> In addition, the attribution requirement established a distinct boundary between primary violators of section 10(b) and Rule 10b-5 and aiders and abettors.<sup>213</sup> The ease with which trial courts are able to apply the attribution requirement avoids protracted and expensive litigation and discovery, and it also brings a degree of certainty and predictability to securities law.<sup>214</sup>

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tion because the creator standard could potentially impose liability on a defendant "for almost any involvement in the creation of false statements." *Id.* at 156 & n.4 (alteration in original).

208. *Id.* at 152.

209. *Pac. Inv. Mgmt., Co.*, 603 F.3d at 153.

210. *Id.*

211. *Id.*; see *Cent. Bank*, 511 U.S. at 180 (reasoning that imposing Rule 10b-5 liability on an aider and abettor would be the equivalent of allowing the plaintiff to hold the defendant liable with no showing of reliance on the defendant's own statements or actions); *Wright*, 152 F.3d at 175 ("[A] secondary actor cannot incur primary liability under the [34] Act for a statement not attributed to that actor at the time of its dissemination [because s]uch a holding would circumvent the reliance requirements of the [34] Act . . ."); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1225 (10th Cir. 1996) ("Reliance only on representations made by others cannot itself form the basis of [section 10(b) and Rule 10b-5] liability.").

212. *Pac. Inv. Mgmt., Co.*, 603 F.3d at 155–56; see *supra* notes 58, 71–77 and accompanying text for a discussion of this aspect of the *Stoneridge* decision.

213. *Pac. Inv. Mgmt., Co.*, 603 F.3d at 156–57.

214. *Id.* at 157.

The court also relied on *Stoneridge* in affirming the District Court's dismissal of plaintiffs' claims against Mayer Brown under Rule 10b-5(a) and 10b-5(c).<sup>215</sup> The allegation that Mayer Brown's participation in Refco's fraudulent loan transactions allowed Refco to hide its true financial condition from investors was analogous, in the court's view, to the allegations of the defendants in *Stoneridge* that the defendants' deceptive conduct allowed the cable operator to issue a misleading financial statement.<sup>216</sup> The plaintiffs' lack of awareness of Mayer Brown's conduct at the time they purchased the Refco securities negated any claim that the plaintiffs relied on Mayer Brown's conduct in making the purchase.<sup>217</sup> In addition, with approval, the court quoted the District Court's observation that "unlike in *Stoneridge*, 'the Mayer Brown Defendants were not even the counter-party to the fraudulent transactions; they merely participated in drafting the documents to effect those transactions.'"<sup>218</sup>

The fact that a defrauded investor will not satisfy the reliance element of a section 10(b) and Rule 10b-5 action unless an alleged fraudulent statement is directly attributed to the statement's maker or the alleged deceptive conduct is directly communicated to the investor, certainly shrinks the pool of potential defendants in such actions. The pool becomes even smaller when the narrow definition of a maker of a statement for purposes of Rule 10b-5 is considered: "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it".<sup>219</sup> An attorney who counsels a securities issuer by providing legal advice and drafting disclosure documents does not have ultimate authority over the contents of the statement and the means of communicating it.<sup>220</sup> Providing attorneys with a higher degree of protection from liability under section 10(b) and Rule 10b-5 does not place investors in the securities markets at greater risk. It simply means that a defrauded investor must bring a Rule 10b-5 action against the party who made the fraudulent statement or engaged in the fraudulent conduct in connection with the particular securities transaction.

In fact, the equilibrium has swung back to the point where the Court in *Central Bank* intended to bring it when it prohibited the imposition of aiding and abetting liability in a private action under section 10(b) and Rule

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215. *Id.* at 158; *see supra* note 184.

216. *Pac. Inv. Mgmt. Co.*, 603 F.3d at 158–59; *see supra* notes 70–76 and accompanying text.

217. *Pac. Inv. Mgmt. Co.*, 603 F.3d at 159.

218. *Id.* at 160 (quoting *In re Refco, Inc. Sec. Litig.*, 609 F. Supp. 2d at 316).

219. *Janus Capital Group, Inc.*, 131 S. Ct. at 2302.

220. *See* HAFT AND HUDSON, *supra* note 25; *cf.* *Thompson v. Paul*, 547 F.3d 1055, 1063 (9th Cir. 2008) (holding that section 10(b) imposes upon an "[a]n attorney who undertakes to make representations to prospective purchasers of securities . . . an obligation . . . to tell the truth about those securities").

10b-5.<sup>221</sup> Under *Central Bank*, primary liability under section 10(b) and Rule 10b-5 depends upon satisfaction of the requirements for such liability and not upon the alleged violator's status or occupation.<sup>222</sup> A person or entity who substantially participates in the creation of a fraudulent statement or who engages in conduct that is not communicated to investors has not satisfied those requirements, just as a person who aids and abets a Rule 10b-5 violation has not satisfied those requirements.

### III. SEEKING GUIDANCE FROM OTHER SOURCES

The prior discussion points out that there has been considerable disagreement on the proper standard for assessing liability of secondary actors, including attorneys, under section 10(b) and Rule 10b-5. Even though the law has moved toward clarifying this standard, perhaps an additional way to find some common ground is to examine how other areas of the law have addressed the issue of attorney liability. This discussion will make clear that it is possible to distinguish between actionable attorney conduct and non-actionable attorney conduct in a way that permits plaintiffs to recover without unduly expanding the category of defendants.

This discussion is not intended to suggest that the 34 Act should simply adopt one or more of the standards presented from these other areas. Though somewhat related, these are distinct bodies of law with their own unique issues and nuances. The intent is merely to provide some relevant information that will cultivate discourse on this issue.

This section first discusses how the 33 Act has addressed the issue.<sup>223</sup> Next, it discusses how states with securities laws that are analogous to the 33 Act and the 34 Act have addressed the issue.<sup>224</sup> Also, the Fair Debt Collection Practices Act (FDCPA) has an interesting and instructive history on whether attorneys who collect debts, either through litigation or through traditional debt collection methods, fall within the scope of the

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221. *Cent. Bank*, 511 U.S. at 177, 191; see *supra* notes 29–44 and accompanying text.

222. *Cent. Bank*, 511 U.S. at 191.

223. See *supra* notes 16–17 and accompanying text.

224. This methodology has support in the *Central Bank* decision. See *Central Bank*, 511 U.S. at 178 (examining the express causes of action in the 33 Act and the 34 Act as a guide for determining the scope of the cause of action under section 10(b)). For a detailed and thorough comparison of section 12(2) of the 33 Act to Rule 10b-5, see Martin I. Kaminsky, *An Analysis of Securities Litigation Under Section 12(2) and How it Compares with Rule 10b-5*, 13 HOUS. L. REV. 231 (1976). Section 12 of the 33 Act previously consisted of subsections (1) and (2) until an amendment to the act in 1995 designated those subsections as part of subsection (a) and added a subsection (b). Private Securities Litigation Reform Act of 1995, ch. 15, sec. 771, § 105(1)–(3), 109 Stat. 737 (1995).

FDCPA.<sup>225</sup> For that reason, a discussion of that portion of the FDCPA is set forth after the discussion of the 33 Act and the state securities laws.

#### A. Section 12 of the 1933 Act and Lawyer Liability

The 33 Act<sup>226</sup> regulates an issuer's initial distribution of securities by requiring detailed disclosures in registration statements and prospectuses in order to prevent overly aggressive sales tactics and overpriced securities issuances.<sup>227</sup> As one court described it, "[t]he design of the statute is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions."<sup>228</sup> The emphasis of the 33 Act on ensuring that potential investors have adequate and truthful information about issuers' securities offerings has been described as reflecting "a philosophy of full disclosure rather than . . . an ideal of substantive regulation."<sup>229</sup>

Section 12(a)(2) of the 33 Act, which expressly authorizes a private cause of action, provides, in pertinent part, as follows:

Any person who . . . offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading . . . shall be liable . . . to the person purchasing such security from him . . . .<sup>230</sup>

In addition, section 12(a)(1) of the 33 Act imposes liability on a person who offers or sells a security in the absence of an effective registration statement or who distributes a prospectus relating to any security unless the prospectus sets out the information required by the 33 Act.<sup>231</sup> Section 12 of the 33 Act applies only to public offerings of securities and not to private transactions.<sup>232</sup>

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225. 15 U.S.C. §§ 1692–1692p (2006).

226. 15 U.S.C. §§ 77a–77aa (2006).

227. *Central Bank*, 511 U.S. at 171; *Blue Chip Stamps*, 421 U.S. at 727–28, 752–53.

228. *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953).

229. *CLARK*, *supra* note 18, at 719–20.

230. Securities Act of 1933 § 12(a)(2), 15 U.S.C. § 77(a)(2) (2006).

231. *Id.* § 77(a)(1).

232. *Lewis v. Fresne*, 252 F.3d 352, 357 (5th Cir. 2001); *see Gustafson v. Alloyd Co.*, 513 U.S. 561, 580–81 (1995) (discussing the legislative history of the 33 Act, which provided that section 12 protects those who purchase securities that are covered by a registration statement).

Both section 10(b) of the 34 Act and Rule 10b-5 provide that “[i]t shall be unlawful for any person” to engage in the conduct proscribed by the statute and the rule,<sup>233</sup> respectively, but the standards in sections 12(a)(1) and 12(a)(2) of the 33 Act are limited to “[a]ny person who . . . offers or sells a security . . . .”<sup>234</sup> In *Pinter v. Dahl*,<sup>235</sup> the United States Supreme Court defined the term “seller” in section 12(a)(1) of the 33 Act in a matter involving investment in an oil and gas venture by an initial investor and subsequent purchases of participating interests in the venture by individuals who learned of the opportunity from the initial investor.<sup>236</sup> In *Pinter, Dahl*, the initial investor, told the other investors about the venture after he invested his own money, and he assisted the investors in completing the subscription agreement form that was prepared by the securities dealer, Pinter, from whom the interests were purchased.<sup>237</sup> Dahl did not receive a commission from Pinter for the purchases made by the other investors.<sup>238</sup> Each agreement stated that the participating interests had not been registered under the 33 Act.<sup>239</sup>

The Supreme Court defined a seller of securities under section 12 of the 33 Act as one who passes title to the buyer for value or one who solicits securities purchases for his or her own financial benefit or for the financial benefit of the securities owner.<sup>240</sup> The Court declined to adopt the substantial factor test espoused by the United States Court of Appeals for the Fifth Circuit, which included in the definition of seller those persons “whose participation in the buy-sell transaction [was] a substantial factor in causing the transaction to take place.”<sup>241</sup> The Court rejected the substantial factor test because an evaluation of whether a person should be categorized as a seller under the test is not grounded in the statutory language.<sup>242</sup> Even though application of the test would, in many situations, encompass those who pass title or who solicit securities purchases, it would also impose

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233. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2006); 17 C.F.R. § 240.10b-5 (2011).

234. *Royal Am. Managers, Inc. v. IRC Holding Corp.*, 885 F.2d 1011, 1017 (2d Cir. 1989).

235. 486 U.S. 622 (1988).

236. *Id.* at 625–26, 641–47 (1988).

237. *Id.* at 625–26.

238. *Id.* at 626.

239. *Id.*

240. *Id.* at 642, 646–47. The United States Court of Appeals for the Fifth Circuit held that Dahl was not a seller of the securities under section 12 of the 33 Act because even though he was a substantial factor in causing the other investors to purchase the participating interests from Pinter, Dahl did not benefit financially from his efforts. *Dahl v. Pinter*, 787 F.2d 985, 990–91 (5th Cir. 1986); see Fisch, *supra* note 43, at 1303 n. 67 (suggesting that courts could use the *Pinter* analysis and predicate primary liability under section 10(b), at least in part, on whether the defendant has a financial interest in the fraudulent transaction).

241. *Pinter*, 486 U.S. at 648–49 (quoting *Pharo v. Smith*, 621 F.2d 656, 667 (5th Cir. 1980)).

242. *Id.* at 651.

liability on individuals with an insignificant connection to the important aspects of the sales transaction.<sup>243</sup>

The Court then elaborated on this observation in language that has relevance to the issue of attorney liability under section 10(b) and Rule 10b-5: “Indeed, it might expose securities professionals, such as accountants and lawyers, *whose involvement is only the performance of their professional services*, to section 12(1) strict liability for rescission. The buyer does not, in any meaningful sense, ‘purchas[e] the security from’ such a person.”<sup>244</sup> The lack of meaningful guidelines in the substantial factor test for determining the appropriate level of involvement in a transaction to qualify someone as a seller means that decisions utilizing the test are made on a case by case basis, making it difficult for those engaged in securities transactions to comply with the statutory requirements.<sup>245</sup>

Six months after the Court’s decision in *Pinter*, in a case involving a bond offering in which the bond purchasers ultimately lost millions of dollars when the bond issuer went into bankruptcy, the United States Court of Appeals for the Fifth Circuit had the opportunity to decide whether the law firm that represented the underwriters of the bond issue was a “seller” under section 12(2) of the 33 Act.<sup>246</sup> Reasoning that the plaintiffs in the case had purchased bonds from brokers, previous owners, and perhaps even from the underwriters, the court held that that the law firm was not a “seller” under section 12(2) of the 33 Act because none of the plaintiffs had purchased bonds from the law firm that assisted in the preparation of the offering statement.<sup>247</sup> The court relied on the reasoning of the *Pinter* decision, despite the fact that *Pinter* dealt with the definition of “seller” under section 12(1) of the 33 Act as opposed to section 12(2) and even quoted with approval the language from *Pinter* regarding exposure of lawyers to liability under section 12.<sup>248</sup>

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243. *Id.*

244. *Id.* (emphasis added).

245. *Id.* at 652.

246. *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1109, 1113–15 (5th Cir. 1988).

247. *Id.* at 1114–15.

248. *Id.* at 1115; *see supra* note 242 and accompanying text. As the *Abell* case was decided six years prior to the Supreme Court’s decision in *Central Bank*, the plaintiffs in *Abell* also brought an aiding and abetting claim under section 10(b) and Rule 10b-5 against the law firm. *Abell*, 858 F.2d at 1123–24, 1126–28. The law firm knew that the SEC was investigating one of its clients for securities violations and that both the original underwriter’s counsel and original bond counsel had resigned from their representations, and it also made several material changes to the final bond offering statement with investigating the reasons for the changes. *Id.* at 1127. The court concluded that the law firm may have recklessly disregarded its duties to its clients and ignored indications that certain aspects of the bond offering were improper, but the conduct did not rise to the level of the necessary intent to violate the securities laws as an aider and abettor. *Id.* at 1128.

In a more recent action brought under section 12(a)(2) by investors in a fraudulent scheme against the lawyers who drafted the false and misleading prospectuses and other promotional materials for the investment, the court held that the investors failed to state a section 12(a)(2) claim against the lawyers.<sup>249</sup> The court dismissed the claim because of the investors' failure to allege that the lawyers had participated at all in soliciting the purchases of the securities.<sup>250</sup> The allegation was merely that the lawyers had "performed their professional services in their . . . capacit[y] as . . . lawyers."<sup>251</sup> Drafting documents such as an offering memorandum, even when the memorandum is used as part of the strategy to solicit investments, is "merely the performance of professional services" and does not subject the drafting attorney to liability under section 12(a)(2).<sup>252</sup>

Thus, the 33 Act has clearly shielded lawyers from primary liability when lawyers provide advice to securities issuers and draft documents such as offering materials on behalf of such issuers. Numerous district court decisions have followed this line of reasoning.<sup>253</sup> This shield provided to attorneys by the 33 Act is based on the same rationale as both the attribution requirement that a defrauded investor must meet in order to satisfy the reliance element of a Rule 10b-5 action and the narrow definition of a maker of a statement for purposes of Rule 10b-5.<sup>254</sup> An attorney who is acting in the role of legal representative of an issuer of securities by drafting documents and providing advice to the issuer is not a seller of securities under sections 12(a)(1) and 12(a)(2) of the 33 Act nor does that attorney have the ultimate authority over the contents or the means of communicating any statement made by the issuer in connection with the sale of the securities under section 10(b) and Rule 10b-5. The 33 Act and the 34 Act provide slightly different paths to the same destination for securities

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249. *Lopes v. Vieira*, 543 F. Supp. 2d 1149, 1170 (E.D. Cal. 2008).

250. *Id.*

251. *Id.*

252. *Id.* at 1171 (quoting *Rocchio v. Eagle Mission, Inc.*, No. 91-56111, 1993 WL 51193, at \*2 (9th Cir. Feb. 26, 1993)).

253. *See, e.g., Sassoon v. Altgelt, 777, Inc.*, 822 F. Supp. 1303, 1305-06 (N.D. Ill. 1993) (ruling that attorneys representing issuer of securities and acting in their role of legal representative of the issuer did not offer or sell a security to the plaintiffs within the meaning of section 12(2) of the 33 Act); *Scholes v. Stone, McGuire and Benjamin*, 786 F. Supp. 1385, 1399 (N.D. Ill. 1992) (ruling that attorneys who participated in the sales transaction and played a role in leading the investor plaintiffs to purchase securities were not sellers under section 12(2) of the 33 Act because the attorneys neither passed title to the securities nor solicited the purchase of the securities); *Sellin v. Rx Plus, Inc.*, 730 F. Supp. 1289, 1291-93 (S.D.N.Y. 1990) (ruling that law firm that drafted a private placement memorandum used in an allegedly fraudulent sale of securities was not liable under section 12 of the 33 Act in the absence of any evidence that the law firm was involved in the solicitation of the plaintiffs' purchase of the stock).

254. *Janus Capital Group, Inc.*, 131 S. Ct. 2296, 2302 (2011). A maker of a statement for purposes of Rule 10b-5 is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Id.*



lawyers, and the destination is the ability to fulfill the role of attorney to the fullest without fear of liability for a statement or conduct for which the attorney is, at best, secondarily responsible.

The notion that attorneys who are not selling securities when performing professional services in connection with a securities sales transaction, does not provide attorneys with an outright exemption from liability under section 12 of the 33 Act. An attorney who plays an active role in the sales transaction may be liable as a seller under section 12, and the courts have demonstrated a willingness to impose liability on attorneys whose conduct moves beyond providing professional services and into the realm of acting as a seller of securities.<sup>255</sup> The important point, which is also true of the analysis under section 10(b) and Rule 10b-5, is to examine the conduct itself and not the title or the status of the person engaged in the conduct.

## B. *Attorney Exemptions Outside of the Federal Securities Laws*

### 1. *State Securities Laws*

Another possible resolution to this issue is for Congress to provide lawyers with an outright statutory exemption from liability or, in the alternative, protection from liability in the performance of ordinary professional services such as advising securities issuers and drafting disclosure documents on behalf of issuers. Some state securities laws provide such exemptions or protections and could serve as models for revisions to the federal securities laws.<sup>256</sup> The statutes enacted in Arizona and Ohio are discussed below as examples.<sup>257</sup>

The Arizona statute provides that a civil action may be brought in connection with a sale of securities “against any person, including any dealer, salesman or agent, who made, participated in or induced the unlawful sale

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255. See, e.g., *Junker v. Crory*, 650 F.2d 1349, 1360 (5th Cir. 1981) (holding that an attorney who attempted to persuade shareholders to purchase stock pursuant to a merger and who made representations at a shareholders’ meeting regarding the feasibility of a merger was not a passive adviser but an active negotiator in the transaction, bringing the attorney within the scope of the seller definition of section 12(2) of the 33 Act); *Koehler v. Pulvers*, 606 F. Supp. 164, 166, 169 (S.D. Cal. 1985) (holding that issues of material fact existed as to the extent of the securities issuer’s attorney’s involvement in fraudulent business practices, fraudulent concealment, and misrepresentations and omissions in the sale of securities, thereby precluding grant of summary judgment on section 12(2) claim against the attorney).

256. Every state has a statute in place to protect investors against the fraudulent offering and sale of securities. JAMES D. COX & THOMAS LEE HAZEN, *CORPORATIONS* § 27.02 (2d ed. 2003). The state statutes are referred to as “blue sky laws” because they protect unsuspecting investors against issuers “having nothing behind their securities but water or blue sky.” *Id.*

257. For a comprehensive discussion and analysis of the issue of attorney liability under the state securities laws, see Mark I. Steinberg & Chris Claassen, *Attorney Liability Under the State Securities Laws: Landscapes and Minefields*, 3 BERKELEY BUS. L.J. 1 (2005).

or purchase [of securities],” but that a person shall not be “deemed to have participated in any sale or purchase solely by reason of having acted in the ordinary course of that person’s professional capacity in connection with that sale or purchase.”<sup>258</sup> The Arizona statute does not explicitly provide an exemption for lawyers, but the non-participatory status that it confers upon an individual who is performing professional services in connection with a securities purchase certainly provides a degree of protection to the securities lawyer. An attorney who deviates from the professional role of adviser and draftsperson risks liability under the Arizona statute because the statute exempts conduct and not attorneys or any other classification of persons.<sup>259</sup>

The Ohio statute is a good example of a statute providing an exemption to the attorney. It prevents “[a]ny attorney, accountant, or engineer whose performance is incidental to the practice of the person’s profession” from being deemed to have caused, taken part in or assisted the seller in any way in selling or agreeing to sell a security in violation of the statute.<sup>260</sup> An attorney who prepares documents for the securities transaction as well as counsels and advises his clients in connection with the transaction is “acting as legal counsel, and not as [a] sales [person]” and, therefore, is immune from liability for securities fraud under the Ohio statute.<sup>261</sup>

The Ohio statute codifies the principle that the case law interpreting the 33 Act has developed which is that attorneys who draft documents for, counsel, and advise securities issuers are not selling securities. Even as the Ohio statute seems to exempt attorneys from liability for securities fraud, the statute still defines the exemption in terms of the attorney’s specific conduct. The statute recognizes that transactions in securities require the extensive involvement of attorneys and other secondary actors and that such actors should not face liability as sellers of such securities for doing nothing more than practicing their respective professions.

## 2. *The Fair Debt Collection Practices Act*

The Fair Debt Collection Practices Act (FDCPA)<sup>262</sup> provides another example of a statutory scheme that had to address the issue of attorney liability. Congress passed the FDCPA in 1977 as an amendment to the Consumer Credit Protection Act in an effort to prohibit abusive practices

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258. ARIZ. REV. STAT. ANN. § 44-2003(A) (2012) (West).

259. See *supra* notes 42-44 and accompanying text.

260. OHIO. REV. CODE. ANN. § 1707.431(A) (West 2011-2012).

261. *McCartney v. Universal Electr. Power Corp.*, No. 22417, 2005 WL 2020559, at \*2 (Ohio Ct. App. 2005).

262. Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692-1692p (2006).

by debt collectors.<sup>263</sup> The Congressional findings and declaration of purpose in the statute state that “[a]busive debt collection practices contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy” and that “[e]xisting laws and procedures for redressing these injuries are inadequate to protect consumers.”<sup>264</sup> As originally passed in 1977, the statute exempted attorneys from its operation by providing that the term “debt collector” did not include “any attorney-at-law collecting a debt as an attorney on behalf of and in the name of the client . . . .”<sup>265</sup> A 1986 amendment to the FDCPA removed the exclusion for attorneys.<sup>266</sup>

In 1995, the United States Supreme Court was faced with the issue of whether attorneys who regularly collect debts, either through litigation or through traditional debt collection methods, fall within the scope of the FDCPA.<sup>267</sup> The statutory definition of “debt collector” was inconclusive,<sup>268</sup> and the specific statutory exclusions no longer mentioned attorneys.<sup>269</sup> In an interesting use of legislative history, the Court reviewed Congress’s previous exclusion of attorneys from the definition of debt collector and subsequent removal of that exclusion, and concluded that the FDCPA applied to attorneys.<sup>270</sup>

The Court based its conclusion on the statutory definition of debt collector as any person who “regularly collects or attempts to collect, directly or indirectly, [consumer] debts owed or due or asserted to be owed or due another.”<sup>271</sup> The ordinary meaning of that definition would include lawyers who regularly try to obtain payment of consumer debts through legal proceedings.<sup>272</sup> The Court also relied on the repeal of the exemption for lawyers in 1986 and the absence of a “narrower, litigation-related, exemption to fill the void.”<sup>273</sup>

Congress removed the attorney exemption from the FDCPA to close a loophole in the statute that allowed persons engaged in traditional debt collection activities to escape the requirements of the FDCPA simply because they had a law degree.<sup>274</sup> Elimination of the attorney exemption was not intended to include within the purview of the term “debt collector”

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263. Fair Debt Collection Practices Act, Pub. L. No. 95–109, 91 Stat. 874 (1977).

264. Fair Debt Collection Practices Act, 15 U.S.C. § 1692(a)–(b) (2006).

265. Fair Debt Collection Practices Act, Pub. L. No. 95–109, 91 Stat. 874, 875 (1977).

266. Fair Debt Collection Practices Act, ch. 15, sec. 1692, § 803(6), 100 Stat. 768 (1986).

267. *Heintz v. Jenkins*, 514 U.S. 291, 292 (1995).

268. Fair Debt Collection Practices Act, 15 U.S.C. § 1692a(6) (2006).

269. *Id.* § 1692a(6)(A)–(F).

270. *Heintz*, 514 U.S. at 294–95.

271. *Id.* at 294; *See* 15 U.S.C. § 1692a(6).

272. *Heintz*, 514 U.S. at 294.

273. *Id.* at 294–95.

274. *Firemen’s Ins. Co. v. Keating*, 753 F. Supp. 1137, 1142 (S.D.N.Y. 1990).

those attorneys providing legal advice and counsel to clients.<sup>275</sup> Analogously, the Supreme Court's statement in *Central Bank* that lawyers are not exempt from liability under section 10(b) and Rule 10b-5 was not intended to impose liability on lawyers engaged in providing legal advice and drafting documents on behalf of issuers.

#### IV. SECURITY FOR THE SECURITIES LAWYER

##### A. *The Lawyer's Role*

The highly competitive environment in which lawyers operate requires them to market their services and areas of expertise aggressively.<sup>276</sup> A general survey of the web pages of some large, national law firms reveals that lawyers describe themselves as possessing various talents and abilities in an effort to attract clients.<sup>277</sup> It is interesting to review these law firms'

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275. *Id.* “Attorneys or law firms that engage in traditional debt collection activities (sending dunning letters, making collection calls to consumers) are covered by the FDCPA, but those whose practice is limited to legal activities are not covered.” *Id.* at 1143 (quoting Statements of General Policy or Interpretation Staff Commentary On the Fair Debt Collection Practices Act, 53 Fed. Reg. 50,097 (Dec. 13, 1988)). See *Nat'l Union Fire Ins. Co. v. Hartel*, 741 F. Supp. 1139, 1139–41 (S.D.N.Y. 1990) (holding that law firm “engaged in activities only of a purely legal nature” when it represented an insurance company seeking reimbursement for payments made on promissory notes that it had guaranteed on behalf of an investor in a limited partnership); *In re Cooper*, 253 B.R. 286, 294 (Bankr. N.D. Fla. 2000) (no liability imposed upon a law firm under the FDCPA where the law firm provided a legal defense to the debt collector but engaged in no debt collection activity itself).

276. Printed or published advertising by lawyers is protected speech under the commercial speech doctrine. See *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626, 644, 646 (1985) (holding that restrictions on attorney advertising were not narrowly crafted and would undermine First Amendment commercial speech protections if allowed to stand); *In re R.M.J.*, 455 U.S. 191, 202, 205–07 (1982) (holding that the state could not constitutionally discipline an attorney for deviating from certain government imposed advertising restrictions if the advertisement was truthful and neither deceptive nor inherently likely to deceive); *Bates v. State Bar*, 433 U.S. 350, 368–79 (1977) (rejecting each of the arguments offered in support of a state bar prohibition on the newspaper publication of two attorneys' truthful advertisement and holding the prohibition unconstitutional as a violation of the First Amendment); see also Gary M. Bishop, *Corporate Speech and the Right of Response in the Commercial Free Zone*, 54 WAYNE L. REV. 1149, 1170–76 (discussion of application of the commercial speech doctrine to attorney advertising).

277. E.g., BAKER & MCKENZIE, <http://www.bakermckenzie.com/aboutus/> (last visited Feb. 17, 2012) (“We understand the challenges of the global economy because we have been at the forefront of its evolution.”); BINGHAM, <http://www.bingham.com/> (last visited Nov. 15, 2011) (phrases, which are accompanied by clever, attention-grabbing photographs, such as “Legal Insight. Business Instinct.” “Navigate the Titanic Challenges of Today's Global Financial Markets.” “Is the SEC Scrutinizing You?” “The tougher the deal, the more we enjoy it.” “Legal obstacles: creative counsel finds a way.”); CRAVATH, SWAINE AND MOORE, LLP, <http://www.cravath.com/philosophy/> (last visited Nov. 15, 2011) (describing the firm's attorneys as possessing the following qualities: “intelligence, creativity, work ethic and a desire to excel.”); DLA PIPER, <http://www.dlapiper.com/global/about/everythingmatters/> (last visited Feb. 17, 2012) (“Nothing is beyond our reach. In terms of client service, everything matters.”) (emphasis in original); GIBSON DUNN, <http://www.gibsondunn.com/story/default.aspx> (last visited Feb. 17, 2012) (“IF THE ANSWER CAN'T BE SEEN, we ask the

descriptions in light of the developments in the law of attorney liability under section 10(b) and Rule 10b-5 as previously discussed. The standard has moved toward providing a greater level of protection for lawyers. Defrauded investors who seek to impose liability on the issuer's lawyers will have a more difficult task in demonstrating that the lawyer is the maker of the statement and that the investor relied on the statement. Thus, in ensuring their clients' compliance with the securities laws, securities lawyers now have a greater level of certainty as to the standard for their own compliance.

It is important, however, for attorneys to remain in the traditional role of planning, advising, drafting documents, and commenting upon documents for their clients who are selling securities. Adherence to that role provides lawyers with the greatest unlikelihood of making a material misstatement or omission on which a purchaser or seller of securities will rely.<sup>278</sup> Such avoidance will, in turn, minimize the risk of exposure to primary liability under Rule 10b-5.

In one commentator's view, "only the Enron scandal halted another development that had begun and was gathering momentum: The rise of multi-disciplinary professional firms that practiced law along with other professions such as accounting or consulting."<sup>279</sup> Such a development undoubtedly has given rise to new scenarios involving attorney conduct that the recent developments discussed in this article do not address. As it now stands, the risk of Rule 10b-5 liability for securities lawyers whose business is securities transactions should not discourage lawyers from marketing themselves as possessing "business instinct,"<sup>280</sup> as being "creative,"<sup>281</sup> or as being capable of providing ideas that are not "preconceived" or "off the shelf."<sup>282</sup> Attorneys can provide services that meet these standards and still remain well within the bounds of conduct that does not rise to the level of securities fraud. The explicit attribution requirement and the narrow definition of a maker of a statement for purposes of Rule 10b-5 ensure that

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question in a different way."); GOODWIN PROCTOR, <http://www.goodwinprocter.com/Our-Firm.aspx> (last visited Nov. 15, 2011) (describing the firm's attorneys as "nimble, creative and pragmatic . . . business-oriented . . . [and] prepared to do what it takes to defend and protect [the firm's] clients' interests."); MILBANK, <http://www.milbank.com/> (last visited Nov. 15, 2011) ("Clients don't come to us for preconceived, off-the-shelf ideas.").

278. See SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (2012).

279. JOHN C. COFFEE, JR., *GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE* 196 (2006).

280. BINGHAM, <http://www.bingham.com/> (last visited Nov. 15, 2011).

281. *Id.*; CRAVATH, SWAIN AND MOORE, LLP, <http://www.cravath.com/philosophy/> (last visited Nov. 15, 2011); GOODWIN PROCTOR, <http://www.goodwinprocter.com/Our-Firm.aspx> (last visited Nov. 15, 2011).

282. MILBANK, <http://www.milbank.com/> (last visited Nov. 15, 2011).

securities lawyers can practice at a high level and avoid Rule 10b-5 liability for fulfilling their professional obligations.

### B. Defining 10b-5 Liability in Terms of Conduct

It is vitally important for securities lawyers to limit themselves to advising securities issuers, drafting and preparing disclosure documents for the issuers, and to refrain from acting as agents of the issuers in the sale of securities. The former role is much less likely to bring the lawyer into conflict with section 10(b) and Rule 10b-5, and the latter role presents significant challenges for the lawyer in attempting to avoid such conflict.<sup>283</sup> One important way that securities lawyers who represent issuers can protect themselves from imposition of section 10(b) and Rule 10b-5 liabilities is to avoid direct contact and communication with potential investors in the issuer's securities.<sup>284</sup>

Providing an increased level of protection to securities lawyers does not undermine the 34 Act's power to deter and prevent fraud in the securities markets and to ensure the complete disclosure of material information for investment decisions.<sup>285</sup> As the Court in *Central Bank* made clear, sec-

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283. See *Bailey v. Trenam Simmons, Kemker, Scharf, Barkin, Frye & O'Neill, P.A.*, 938 F. Supp. 825, 828–29 (S.D. Fla. 1996) (holding that law firm must do more than provide standard legal services to the seller of securities in order to be subject to liability as an agent of the seller under the Florida state securities law); *Klein v. Boyd*, 949 F. Supp. 280, 284 (E.D. Pa. 1996) (interpreting definition of agent in Pennsylvania state securities laws and determining that a lawyer acting in traditional roles of advising and preparing documents is not an agent attempting to aid in the sale of securities).

284. See *Thompson v. Paul*, 547 F.3d 1055, 1063 (9th Cir. 2008) (holding that section 10(b) imposes upon an “[a]n attorney who undertakes to make representations to prospective purchasers of securities . . . an obligation . . . to tell the truth about those securities.”); *Rubin v. Schottenstein, Zox & Dunn*, 143 F.3d 263, 265, 267 (6th Cir. 1998) (reversing district court’s dismissal of plaintiffs’ claims where attorney representing issuer spoke directly with potential investors in the issuer and revealed material details about the proposed investment without revealing additional facts that were necessary to make his statements not misleading); *Trust Co. of Louisiana v. N.N.P. Inc.*, 104 F.3d 1478, 1481–83, 1490 (5th Cir. 1997) (attorney who agreed to act as custodian for certain Government National Mortgage Association Certificates (“GNMA’s”) for various investors had knowledge that the underlying securities transactions were not backed by any interest in the GNMA’s and wrote letters to imply that he held the GNMA’s in custody made a material misrepresentation within the meaning of Rule 10b-5); *Kline v. First W. Gov’t Sec., Inc.*, 24 F.3d 480, 481, 487–90 (3d Cir. 1994) (holding that a genuine issue of material fact existed as to whether plaintiff investors were reasonable in relying on a law firm’s opinion letters concerning the tax consequences of the investments), *cert. denied*, 513 U.S. 1032 (1994); *Ackerman v. Schwartz*, 947 F.2d 841, 843, 848 (7th Cir. 1991) (holding that attorney could not evade Rule 10b-5 liability where he wrote an opinion letter on the tax benefits of an investment and authorized the investment’s promoters to include the letter in the offering materials).

285. See *Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986) (describing 34 Act’s purpose of deterring fraud and ensuring full disclosure). *But see* Susan P. Koniak, *Corporate Fraud: See, Lawyers*, 26 HARV. J.L. & PUB. POL’Y 195, 222–23 (2003) (arguing that the “elimination of private suits for aiding and abetting dismantled one of the only working methods of regulating corporate lawyers and deterring bad conduct by members of this elite and powerful section of the bar” because actions against lawyers as primary violators of the securities laws are very difficult to make).

ondary actors such as lawyers face liability under section 10(b) and Rule 10b-5 when their conduct satisfies the standard for primary liability.<sup>286</sup> An interpretation of the liability standard under section 10(b) and Rule 10b-5 that requires an allegedly false or misleading statement to be attributed to the maker—and that narrowly defines the maker of the statement as the person with ultimate authority over it—is consistent with the deterrence of fraud and complete disclosure of information in the securities markets.

A clear, narrow, and well defined standard for attorney liability will encourage attorneys to counsel securities issuers on the proper disclosure standards and to become more involved in assuring that securities issuers are in compliance with the federal securities laws. It seems clear that the imposition of liability based on the substantial participation standard will discourage lawyers from participating, which will have a negative impact on the securities markets as a whole.<sup>287</sup> Moreover, “an award of damages under the securities laws is not the way to blaze the trail toward improved ethical standards in the legal . . . profession[.]”<sup>288</sup>

In addition to protecting those who invest in securities, which is of the utmost importance, and the securities lawyers who counsel and advise the issuers of those securities, which is the group with which this article is principally concerned:

[I]t must be kept in mind that the nation’s welfare depends upon the maintenance of a viable, vigorous business community . . . . Without further delineation [of the standard for civil liability under Rule 10b-5], civil liability is formless, and the area of proscribed activity could become so great that the beneficial aspects of the rule would not warrant the proscription.<sup>289</sup>

The negative consequences of imposing civil liability on securities lawyers for performing their professional obligations outweigh the benefits.

## V. CONCLUSION

The Supreme Court’s rulings in *Stoneridge* and *Janus* and its subsequent denial of certiorari in *PIMCO* are most likely an endorsement of the

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286. See *supra* notes 42–44 and accompanying text.

287. See *supra* notes 48–51 and accompanying text.

288. *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 497 (7th Cir. 1986).

289. *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 91 (5th Cir. 1975) (quoting *Herpich v. Wallace*, 430 F.2d 792, 804–05 (5th Cir. 1970)).

bright line test and a rejection of the substantial participation test for the determination of liability of secondary actors under section 10(b) and Rule 10b-5. These rulings are of great significance for securities lawyers who represent securities issuers. These lawyers do not function as advocates in the way that litigators and trial lawyers do. Rather, they are technicians who strive to ensure that their clients comply with the federal securities laws. As these lawyers advise their clients, draft documents on their behalf, and plan and structure transactions, the work is more effective if it is conducted without the overriding concern that the attorney's participation in the work will ultimately lead to becoming a defendant in a securities fraud action. That outcome is justified only if the attorney commits the securities fraud and independently meets the relevant standard.

Without the attribution requirement, a defrauded investor who brings a Rule 10b-5 action against the attorney who represents the issuer is simply suing the wrong defendant. The person with ultimate authority over the statement bears the responsibility, and it is incumbent upon courts that interpret and apply section 10(b) and Rule 10b-5 to recognize that fact.