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Comment

Diminishing the Expected Impact of *Central Bank of Denver v. First Interstate Bank of Denver*: Secondary Liability Masquerading as Primary Liability Under Section 10(b)

I. INTRODUCTION

In 1994, the United States Supreme Court, in *Central Bank of Denver v. First Interstate Bank of Denver*, held that section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), and rule 10b-5, promulgated under the 1934 Act, do not support an implied private right of action for aiding and abetting a securities violation. This decision essentially overturned a judicially accepted theory of recovery under section 10(b) and rule 10b-5 that the lower federal courts allowed for approximately thirty years. Some commentators predicted that the *Central Bank* decision would greatly impact

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4. Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 191 (1994). See infra Part II.C (discussing the *Central Bank* decision). Aiding and abetting as a theory of liability enabled investors to recover damages from secondary actors such as attorneys, accountants and underwriters who typically performed activities such as issuing formal opinions, providing advice, performing audits, and preparing documents for Securities and Exchange Commission filings. See also David J. Baum, *The Aftermath of Central Bank of Denver: Private Aiding and Abetting Liability Under Section 10(b) and Rule 10b-5*, 44 AM. U.L. REV. 1817, 1819 (1995) (recognizing that aiding and abetting liability is a "widely used and effective weapon against securities fraud" and allows private-party plaintiffs to reach "collateral participants" such as accountants and lawyers). These individuals are generally referred to as "deep pockets" for plaintiffs seeking recovery because often, the primary actor is insolvent. Id.


5. *Central Bank*, 511 U.S. at 192 (Stevens, J., dissenting) (recognizing acceptance of aiding and abetting liability in the Courts of Appeals); see also infra Part II.B (discussing aiding and abetting liability).
securities litigation because it foreclosed an avenue of recovery that previously enabled injured investors to recover damages from secondary actors who assisted primary actors in the commission of a fraudulent act.\textsuperscript{6} Accordingly, plaintiffs have attempted to recharacterize their aiding and abetting claims against secondary actors as claims for primary liability, effectively circumventing \textit{Central Bank}. In turn, the lower federal courts have struggled with these attempts to expand the scope of primary liability.\textsuperscript{7} As the result of different \textit{Central Bank} interpretations, courts have created divergent approaches to define the scope of section 10(b) and rule 10b-5 liability.\textsuperscript{8} These approaches have diluted the expected limitations on liability as articulated by \textit{Central Bank}.

The two leading interpretations of \textit{Central Bank} are reflected in the Ninth Circuit decision, \textit{In re Software Toolworks},\textsuperscript{9} and the Tenth Circuit decision, \textit{Anixter v. Home-Stake Production Co.}\textsuperscript{10} Applying a more liberal interpretation to the Supreme Court's holding in \textit{Central Bank}, the Ninth Circuit in \textit{Software Toolworks} held that significant participation in the making of a misrepresentation concerning the sale of securities constituted a primary violation.\textsuperscript{11} However, in a narrower interpretation of \textit{Central Bank}, the Tenth Circuit in \textit{Anixter} held that an actor can only be liable for representations made by that actor and relied upon by the injured party.\textsuperscript{12} The conflicts resulting from these two interpretations have been demonstrated in several district court decisions, which exhibit confusion and inconsistency in delineating the boundaries of primary liability under section 10(b) and rule 10b-5.\textsuperscript{13}

This Comment examines the various federal appellate and district court interpretations of the \textit{Central Bank} decision. It does so first by

\textsuperscript{6} See Amy E. Badger, \textit{Precedent, Predictability, and Judicial Prerogative: Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A. and Jack K. Nabers}, 28 CREIGHTON L. REV. 419, 443 (1994-95) (stating that "[u]ndoubtedly, the Court's decision will have an impact on securities law"); Baum, supra note 4, at 1852 (concluding that \textit{Central Bank} "will have a tremendous impact on securities law litigation" because it "eliminated . . . one of the most heavily relied upon causes of action in private law suits").

\textsuperscript{7} See, e.g., \textit{In re MTC Elec. Techs. Shareholders Litig.}, 898 F. Supp. 974, 987 (E.D.N.Y. 1995) (noting that \textit{Central Bank} "has generated a fair amount of confusion in the lower courts . . . in identifying the line between primary liability and secondary liability . . . ").

\textsuperscript{8} See infra Part III (discussing the different approaches taken by the Ninth and Tenth Circuits, and reflected in the district courts).


\textsuperscript{10} 77 F.3d 1215 (10th Cir. 1996).

\textsuperscript{11} \textit{Software Toolworks}, 50 F.3d at 628 n.3.

\textsuperscript{12} See \textit{Anixter}, 77 F.3d at 1226.

\textsuperscript{13} See infra Parts III.A.2-B.I (discussing district court decisions after \textit{Central Bank}).
tracing the development of private rights of action for primary and secondary violations of section 10(b) and rule 10b-5. This Comment then discusses the Supreme Court's decision in *Central Bank*. Next, this Comment highlights both the liberal and the restrictive interpretations of *Central Bank* that have developed from the Ninth and Tenth Circuits, respectively, as well as the recent federal district court cases that have interpreted *Central Bank*. This Comment then analyzes the soundness of the reasoning behind each of these cases, concluding that the Tenth Circuit's holding in *Anixter* not only adheres to the Court's reasoning, but also provides a clearer guideline for establishing liability. Finally, this Comment proposes that, in the future, the lower federal courts should adhere to the Tenth Circuit's interpretation of *Central Bank*.

II. BACKGROUND

A. Establishing an Implied Private Right of Action for Primary Violations

Prompted by the stock market crash of 1929, Congress enacted both the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act"). The purpose of this statutory scheme was to promote full and fair disclosure to investors of securities, as well as to prevent fraudulent practices in the sale of securities. In order to achieve the principle aim of disclosure,
Congress incorporated various anti-fraud provisions throughout the Acts.\(^{23}\)

The most general anti-fraud provision\(^{24}\) is section 10(b) of the 1934 Act, which provides, in pertinent part, that: "[i]t shall be unlawful for any person, directly or indirectly, . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance."\(^{25}\) Commentators have noted that the exact scope of conduct prohibited by this language is still undefined.\(^{26}\) Specifically, the Supreme Court has observed that the legislative history of the 1934 Act provides little guidance in determining the intended scope of section 10(b).\(^{27}\) In spite of this lack of legislative history, the Court has interpreted the "manipulative or deceptive" language of section 10(b) to prohibit "intentional or willful conduct designed to deceive or defraud investors,"\(^{28}\) so long as the conduct occurs in the sale or purchase of a security.\(^{29}\)

Closely related to section 10(b) is rule 10b-5, which the Securities and Exchange Commission ("SEC") promulgated in 1942 under the authority granted to it in section 10(b).\(^{30}\) Rule 10b-5 provides, in pertinent part:

It shall be unlawful for any person, directly or indirectly . . .

(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


\(^{24}\) The Supreme Court has referred to section 10(b) as the "catchall clause" for the prevention of fraudulent practices. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 203 (1976).


\(^{26}\) See Steve Thel, The Original Conception of Section 10(b) of the Securities Exchange Act, 42 STAN. L. REV. 385, 386 (1990) (noting the difficulty in defining what conduct section 10(b) prohibits).

\(^{27}\) See Hochfelder, 425 U.S. at 202 (commenting that "the legislative history of the 1934 [Act] . . . deals primarily with other aspects of the legislation" and not with section 10(b)).

\(^{28}\) Id. at 199.

\(^{29}\) See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 754 (1975) (holding that conduct under section 10(b) does not extend to offers to sell or purchase a security).

\(^{30}\) 17 C.F.R. § 240.10b-5 (1996). Section 10(b) empowers the SEC to promulgate "such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b).
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.  

The Supreme Court noted that the scope of conduct prohibited under rule 10b-5 is no broader than conduct prohibited by section 10(b).  

Within rule 10b-5, however, the Court and some lower federal courts have recognized that the scope of liability under rules 10b-5(a) and (c) is broader than that under rule 10b-5(b).  

While rule 10b-5(b) specifically prohibits the making of a material misstatement or omission of a material fact, rules 10b-5(a) and (c) do not incorporate the material misstatement or omission language.  

Thus, federal courts have interpreted rules 10b-5(a) and (c) expansively to hold an individual who participated in a fraudulent scheme liable, absent the making of any material misstatements.  

Although neither section 10(b) nor rule 10b-5 expressly provides for a private right of action, courts have recognized an implied right to a remedy for section 10(b) and rule 10b-5 violations.  

Predicated on principles of tort law, an implied private right of action under section 10(b) was first recognized in 1946 by the United States District Court.

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31. 17 C.F.R. § 240.10b-5.  
32. Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 173 (1994). The Court stated that “the private plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b).” Id.  
33. See Affiliated Ute Citizens v. United States, 406 U.S. 128, 152-53 (1972) (noting that rules 10b-5(a) and (c) are not as restrictive as rule 10b-5(b)). The district court in In re ZZZZ Best Securities Litigation also observed the broader scope of rules 10b-5(a) and (c) and reasoned that an individual can be liable for another’s representations, even if the individual did not make a material misrepresentation or commit a manipulative or deceptive act. 864 F. Supp. 960, 967-71 (C.D. Cal.), summar. judgment granted in part, denied in part, 1994 U.S. Dist. LEXIS 18876 (C.D. Cal. 1994).  
35. See supra note 33.  
36. See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 729-30 (1975); Kardon v. National Gypsum Co., 69 F. Supp. 512, 513 (E.D. Pa. 1946). The court in Kardon stated: “It is also true that there is no provision in Sec. 10 or elsewhere expressly allowing civil suits by persons injured as a result of [a] violation of Sec. 10 or of the Rule [10b-5].” Kardon, 69 F. Supp. at 513.  
37. Central Bank, 511 U.S. at 171. The Court noted that “private plaintiffs may sue under . . . private rights of action we have found to be implied by the terms of § 10(b) . . . of the 1934 Act.” Id; see also Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) (noting that an implied private right of action is “established under § 10(b)’’); Hooper v. Mountain States Sec. Corp., 282 F.2d 195, 201 (5th Cir. 1960) (expressly recognizing a private right of action under section 10(b) and rule 10b-5); Fratt v. Robinson, 203 F.2d 627, 632 (9th Cir. 1953) (concluding that a civil cause of action exists under section 10(b) and rule 10b-5).
Court for the Eastern District of Pennsylvania. In *Kardon v. National Gypsum Co.*, the district court denied the defendants' motion to dismiss the plaintiffs' claim that the defendants allegedly conspired and made misrepresentations to induce the plaintiffs to sell shares for less than their true value. The court rejected the defendants' argument, based on statutory interpretation, that Congress intended to preclude a private right of action under section 10(b) since it provided for express rights of action in other provisions, but not in section 10(b). Instead, the court concluded that "the mere omission of an express provision for civil liability is not sufficient to negative what the general law implies."

The Supreme Court does not question the validity of an implied private right of action under section 10(b) and rule 10b-5. Rather, the Court views this right of action as "established." The Court, however, in *Touche Ross & Co. v. Redington*, rejected a reliance on tort principles for implying rights of action under the federal securities laws. Deeming a reliance on tort principles as "entirely misplaced," the Court instead stated that principles of statutory construction should be used to determine whether an implied right of action exists under provisions of the federal securities laws. Despite previous occasions

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38. *Kardon*, 69 F. Supp. at 512, 514. The court stated that:

[T]he "violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if; (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and (b) the interest invaded is one which the enactment is intended to protect." This rule is more than merely a canon of statutory interpretation. The disregard of the command of a statute is a wrongful act and a tort.

*Id.* at 513 (citing *RESTATEMENT OF TORTS* § 286 (1939)).


40. *Id.* at 513, 515.

41. *Id.* at 514.

42. *Id.*

43. *See infra* note 44.

44. Basic, Inc. v. Levinson, 485 U.S. 224, 231 (1988) (concluding that a private right of action under section 10(b) and rule 10b-5 "constitutes an essential tool for enforcement of the 1934 Act's requirements"); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976) (stating "the existence of a private [right] of action for violations of the statute and the Rule is now well established"); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) (stating that "[i]t is now established that a private right of action is implied under § 10(b)").


46. *Id.* at 568.

47. *Id.* Specifically, the Court determined whether an implied private right of action existed under section 17(a) of the 1934 Act. *Id; see also* 15 U.S.C. § 78q(a) (1994) (requiring certain persons to retain and file reports as prescribed by the SEC). In *Touche
where the Court implied private rights of action under provisions of the 1933 and 1934 Acts, the Court declined to imply a private right of action under the provision in question because the provision "neither confer[red] rights on private parties nor proscribe[d] conduct as unlawful."\textsuperscript{48}

Even though the Court shifted away from implying a private right of action by reliance on tort principles, the Court continued to recognize a private right of action for primary liability under section 10(b) and rule 10b-5.\textsuperscript{49} When asked to interpret section 10(b) on various occasions, the Court has developed five necessary elements to establish liability.\textsuperscript{50} To state a section 10(b) or rule 10b-5 cause of action\textsuperscript{51} for primary violations, a plaintiff must establish that: (1) a material misstatement or omission was made in connection with a purchase or sale of a security;\textsuperscript{52} (2) the misstatement or omission was made with scienter or

\textit{Ross}, the Supreme Court began its analysis by looking to the language of section 17(a). \textit{Touche Ross}, 442 U.S. at 568-69. Finding no evidence of congressional intent to create a private right of action, the Court looked to the statutory scheme which includes section 17(a). \textit{Id.} at 569-74. The Court found that some of the sections that accompany section 17(a) provide for private rights of action for misstatements made in reports required to be filed with the SEC. \textit{Id.} at 571-74. Specifically, the Court cited sections 16(b) and 18(a) of the 1934 Act. \textit{Id.} at 572; \textit{see also} 15 U.S.C. § 78p(b), r(a) (1994). The Court concluded that "[t]he ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law." \textit{Touche Ross}, 442 U.S. at 578.

\textsuperscript{48} \textit{Touche Ross}, 442 U.S. at 569. The Court observed that the reporting requirements of Section 17(a) allow "governmental authorities to perform their regulatory functions." \textit{Id.}

\textsuperscript{49} See supra note 44 and accompanying text (noting that the private right of action under section 10(b) is well-established).

\textsuperscript{50} See infra notes 51-56 and accompanying text for a discussion of the elements of a section 10(b) cause of action.

\textsuperscript{51} See Richard M. Weinroth, \textit{Overview of Civil and Criminal Liability of Clients and Attorneys for Federal and Arizona Securities Violations}, 26 ARIZ. ST. L.J. 1, 19-25 (1994) (providing a general summary of the elements, remedies and defenses available under sections 11 and 12(2) of the 1933 Act, and section 10(b) and rule 10b-5 under the 1934 Act).

Possible defenses to a section 10(b) and rule 10b-5 cause of action may include the absence of material misstatements or omissions, reliance, or requisite scienter. \textit{Id.} at 24-25. The expiration of the statute of limitations may also provide a defense. \textit{Id.} at 25; \textit{see also} Lampf v. Gilbertson, 501 U.S. 350 (1991). The applicable statute of limitations under section 10(b) is one year after discovery of the facts constituting the violation, but no longer than three years after the violation. \textit{Lampf}, 501 U.S. at 359-60.

\textsuperscript{52} The Supreme Court in \textit{Basic, Inc. v. Levinson} adopted the standard of materiality for section 10(b) and rule 10b-5 claims that it had set forth in an earlier case and articulated as follows: "an omitted fact [or misrepresentation] is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." 485 U.S. 224, 231 (1988) (citing \textit{TSC Industries, Inc. v. Northway, Inc.}, 426 U.S. 438, 449 (1976)); \textit{see also} \textit{Blue Chip Stamps v. Manor Drug
recklessness by the defendant;\(^5^3\) (3) the plaintiff relied on the misstatement or omission;\(^5^4\) (4) such reliance on the misstatement or omission proximately caused harm to the plaintiff;\(^5^5\) and (5) the plaintiff suffered damages.\(^5^6\)

In contrast to a section 10(b) claim that alleges a material misrepresentation, a section 10(b) claim that alleges an omission or non-disclosure of a material fact requires the plaintiff to also establish that an independent duty to disclose exists.\(^5^7\) The duty to disclose is a function of the particular fact situation.\(^5^8\)

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53. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (requiring scienter to maintain a section 10(b) and rule 10b-5 cause of action and holding that negligence is insufficient). Ernst & Ernst was an accounting firm retained to perform periodic audits for a brokerage firm that perpetrated a fraudulent scheme by inducing investors to invest in "escrow" accounts that never existed. Id. at 188-89. These accounts were never reflected on any of the books, records, or SEC filings. Id. at 189. Rather, the president of the firm used the investors' money for personal expenses. Id. Ernst & Ernst was alleged to have aided and abetted the violations by not conducting proper audits, thereby acting negligently. Id. at 190. The Supreme Court dismissed the claim because the history of section 10(b) "addressed . . . practices that involve some element of scienter . . . ." Id. at 201. The Court defined scienter as a "mental state embracing intent to deceive, manipulate, or defraud." Id. at 193-94 n.12.

Generally, courts allow a showing of recklessness when the defendant owes a duty to the plaintiff investor. See, e.g., Hackbart v. Holmes, 675 F.2d 1114, 1117 (10th Cir. 1982) (explicitly holding recklessness satisfies the scienter requirement for section 10(b) and rule 10b-5 liability), abrogated by Anixter v. Home-Stake Prod. Co., 939 F.2d 1420 (10th Cir. 1991); Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 44 (2d Cir. 1978) (holding recklessness satisfies the scienter requirement when the defendant owes a fiduciary duty to the injured party). See infra notes 86-93 and accompanying text for a discussion of the knowledge element of an aiding and abetting claim, which corresponds to the scienter requirement of a primary claim.

54. See Basic, Inc. v. Levinson, 485 U.S. 224, 243 (1988) (concluding that reliance is a necessary element of a section 10(b) and rule 10b-5 cause of action).

55. The plaintiff must prove that the misrepresentation was a proximate cause of plaintiff's loss. Gray v. First Winthrop Corp., 82 F.3d 877, 884 (9th Cir.), amended, 1996 U.S. App. LEXIS 14938 (9th Cir. Cal. 1996). There must be greater than a "but for" causal relation between the misrepresentation and plaintiff's loss. See, e.g., Bloor v. Carro, 754 F.2d 57, 63 (2d Cir. 1985) (affirming dismissal of plaintiff's section 10(b) claim against a law firm for not meeting the causation requirement).


57. See Chiarella v. United States, 445 U.S. 222, 235 (1980) (concluding that "[w]hen an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak").

58. See Woodward v. Metro Bank, 522 F.2d 84, 97 n.28 (5th Cir. 1975) (noting that the existence of a duty to disclose depends "on the circumstances of the case").
Chiarella v. United States,\textsuperscript{59} stated "the duty to disclose arises when one party has information 'that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.'\textsuperscript{60} In an omissions case, moreover, the plaintiff may be entitled to a rebuttable presumption of reliance.\textsuperscript{61}

\subsection*{B. Extending the Scope of Prohibited Conduct to Include Aiders and Abettors}

In contrast to primary liability, secondary liability imposes liability upon actors who do not directly violate a securities provision, but instead assist the primary violator to perpetrate a fraud.\textsuperscript{62} Thus, "[t]he key distinction between a primary and a secondary violator is that the primary violator does the central act proscribed by the statute or rule while the secondary violator assists or supports the violator's act or is liable for the act through a relationship with the violator."\textsuperscript{63} In particular, prior to Central Bank, aiding and abetting liability was recognized as one such form of secondary liability.\textsuperscript{64} Under this theory of liability, the scope of conduct prohibited by section 10(b) and rule 10b-5 expanded to include those who "give a degree of aid" to individuals who commit a fraudulent act.\textsuperscript{65} As a result, plaintiffs alleging section 10(b) and rule 10b-5 claims were able to recover damages from secondary actors such as underwriters, attorneys and accountants.\textsuperscript{66}

\textsuperscript{59} 445 U.S. 222 (1980).
\textsuperscript{60} Id. at 228 (citing RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (1976)) (alteration in original).
\textsuperscript{63} Id.
\textsuperscript{64} See Daniel R. Fischel, Secondary Liability Under Section 10(b) of the Securities Act of 1934, 69 CALIF. L. REV. 80, 80 n.4. (1981). Other forms of secondary liability include conspiracy, respondent superior, and controlling persons. Id. at 83; Kuehnle, supra note 62, at 314-15, 343-76 (providing further discussion of the various forms of secondary liability).
\textsuperscript{65} The Supreme Court in Central Bank noted that "aiding and abetting liability extends beyond persons who engage, even indirectly, in a proscribed activity; aiding and abetting liability reaches persons who do not engage in the proscribed activities at all, but who give a degree of aid to those who do." Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 176 (1994). See also Fischel, supra note 64, at 93 (noting that "[t]he question of secondary liability . . . involves expanding the scope of prohibited conduct under a statute").
\textsuperscript{66} See Baum, supra note 4, at 1819.
Significantly, just as no express private right of action exists under section 10(b) and rule 10b-5, no express private right of action existed against those who aided and abetted a primary violator in the commission of a securities violation. Relying on general principles of tort law, federal courts established an implied private right of action against aiders and abettors just as it had originally done against primary violators. The first judicial recognition of an implied private right of action for aiding and abetting liability under section 10(b) and rule 10b-5 arose in 1966 in Brennan v. Midwestern United Life Insurance Co. In Brennan, a brokerage firm sold shares of stock in various companies, including Midwestern United Life Insurance Company. The brokerage firm used the proceeds from the stocks as "working capital for speculation and other improper purposes" and never delivered the stocks to the plaintiffs. When the firm became bankrupt, the plaintiffs brought a section 10(b) and rule 10b-5 claim against Midwestern. The plaintiffs alleged that Midwestern's knowledge of the firm's activities and its failure to report those activities rendered Midwestern liable as an aider and abettor. The district court in Brennan relied on section 876 of the Restatement of Torts to imply that a private right of action existed against aiders and

67. See supra notes 36-42 and accompanying text for a discussion of an implied private right of action for primary violations.
68. Neither section 10(b) nor rule 10b-5 provides for a right to a remedy under any theory of secondary liability. In this regard, section 10(b) and rule 10b-5 differ from section 15 of the 1933 Act, which provides for controlling person liability, one form of secondary liability. 15 U.S.C. § 77o (1994). See also Weinroth, supra note 51, at 35-36.
69. See Alan R. Bromberg & Lewis D. Lowenfels, Aiding and Abetting Securities Fraud: A Critical Examination, 52 ALB. L. REV 637, 648 (1988) (providing a thorough analysis of the origins, elements and validity of aiding and abetting). Bromberg & Lowenfels consider aiding and abetting liability to be the product of what they label the "pre-1975 Expansion Era" of the federal securities laws. Id. During the Expansion Era, the Supreme Court broadly construed the federal securities laws, while the lower courts recognized additional private rights of action. Id. at 648 n.63.
70. See supra Part II.A for a discussion of the development of an implied private right of action for primary violations.
72. Brennan, 259 F. Supp. at 675. The brokerage firm sold stock in Midwestern valued at $2.9 million. Id.
73. Id.
74. Id. The brokerage firm used fraudulent misrepresentations to explain the delay in delivering the stock to the purchasers. Id.
75. Id.
76. Section 876 of the Restatement of Torts (1939) provides:
For harm resulting to a third person from the tortious conduct of another, a
abettors under section 10(b) and rule 10b-5 of the 1934 Act.\textsuperscript{77} Focusing on the Act’s principle purpose of disclosure, the court reasoned that the general principles of tort law “best fulfill the purposes of the [1934 Act] and are a logical and natural complement to the Kardon doctrine.”\textsuperscript{78} Under this reasoning, the court denied the defendant’s motion to dismiss, which contended that section 10(b) and rule 10b-5 did not support liability for an aider and abettor.\textsuperscript{79}

Since Brennan, and prior to Central Bank, all the federal courts of appeals that considered this issue recognized and adopted aiding and abetting liability as a valid theory of recovery under section 10(b) and rule 10b-5 of the 1934 Act.\textsuperscript{80} While the exact content of the elements necessary to allege an aiding and abetting claim varied, every circuit acknowledged three general elements.\textsuperscript{81} To succeed on a claim of

\textsuperscript{77} Brennan, 259 F. Supp. at 680.

\textsuperscript{78} Id. For a discussion of the Kardon doctrine, see supra notes 38-42 and accompanying text.

\textsuperscript{79} Brennan, 259 F. Supp. at 675-76, 685. In a later opinion, the district court found Midwestern liable as an aider and abettor for its knowledge of the brokerage firm’s fraudulent practices, and its failure to report the brokerage firm’s activities. Brennan v. Midwestern United Life Ins. Co., 286 F. Supp. 702 (N.D. Ind. 1968), aff’d, 417 F.2d 147 (7th Cir. 1969).

\textsuperscript{80} See Badger, supra note 6, at 436; Moore v. Fenex, Inc., 809 F.2d 297, 303 (6th Cir. 1987) (setting forth requirements for holding a person liable as an aider and abettor); Walck v. American Stock Exch., Inc., 687 F.2d 778, 790-91 (3d Cir. 1982) (noting that the third circuit has recognized aiding and abetting liability under section 10(b) and rule 10b-5 since 1973); Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 44 (2d Cir. 1978) (adopting aiding and abetting liability under section 10(b) and rule 10b-5); Landy v. Federal Deposit Ins. Corp., 486 F.2d 139, 162-63 (3d Cir. 1973) (articulating elements of a claim for aiding and abetting liability).

\textsuperscript{81} The Ninth Circuit required: “(1) the existence of an independent primary wrong; (2) actual knowledge by the alleged aider and abettor of the wrong and of his or her role in furthering it; and (3) substantial assistance in the wrong.” Harmsen v. Smith, 693 F.2d 932, 943 (9th Cir. 1982). Bromberg & Lowenfels classify this formulation as more stringent than the majority view. Bromberg & Lowenfels, supra note 69, at 662-63. For the majority view, see infra note 82 and accompanying text.

The first, fifth, sixth, eleventh, and D.C. Circuits utilized a less stringent formula. These circuits required a general awareness by the alleged aider and abettor of his role and knowing and substantial assistance in the commission of the fraudulent activity. See, e.g., Rudolph v. Arthur Anderson & Co., 800 F.2d 1040, 1045 (11th Cir. 1986); Moore, 809 F.2d at 303; Securities & Exch. Comm’n v. Falstaff Brewing Corp., 629 F.2d 62, 72 (D.C. Cir. 1980); Securities & Exch. Comm’n v. Coffey, 493 F.2d 1304, 1316 (6th Cir. 1974).

For a thorough discussion of the different formulas of the elements of an aiding and
aiding and abetting, a plaintiff must have shown: (1) the existence of a primary violation; (2) knowledge of the primary violation by the alleged aider and abettor; and (3) substantial assistance by the alleged aider and abettor in the commission of the primary violation. In addition to these elements, if a plaintiff alleged that a defendant was liable as an aider and abettor for an omission of a material fact, the plaintiff generally had to show that an independent duty to disclose existed. On its own, silence could not create liability under section 10(b) and rule 10b-5. Significantly, unlike the requisite elements for establishing primary liability under section 10(b) and rule 10b-5, a plaintiff stating a claim for aiding and abetting was not required to establish his reliance on the defendant’s alleged misrepresentations.

Despite this difference, the treatment of the knowledge and substantial assistance components of an aiding and abetting claim was similar to the scien
ter and causation elements of a claim for primary liability under section 10(b) and rule 10b-5. Courts treated the second element of an aiding and abetting claim, the knowledge

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83. See Woodward v. Metro Bank, 522 F.2d 84, 97 (5th Cir. 1975); Landy, 486 F.2d at 163-64. See ROBERT J. HAFT, LIABILITY OF ATTORNEYS AND ACCOUNTANTS FOR SECURITIES TRANSACTIONS, §§ 3.02-03 (1996-97) for a discussion of an attorney’s and accountant’s duty to disclose to material facts.

84. Basic, Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988). The Supreme Court stated that “[t]o be actionable, of course, a statement must be misleading. Silence, absent a duty to disclose, is not misleading under Rule 10b-5.” Id. See also Chiarella v. United States, 445 U.S. 222, 227-28, 230 (1980) (liability for non-disclosure or omissions of material facts arise when duty to disclose exists).

85. See supra note 54 and accompanying text for a discussion of the reliance requirement. The Supreme Court in Central Bank commented on the absence of a reliance element in an aiding and abetting claim, as compared with the presence of a reliance element in a claim for a primary violation. Central Bank, 511 U.S. at 180.

86. See infra notes 87-97 and accompanying text (discussing knowledge and substantial assistance elements of an aiding and abetting claim). The first element of an aiding and abetting claim, the existence of a primary violation, generally posed little problem for the courts. See Bromberg & Lowenfels, supra note 69, at 669 (observing that courts have not devoted any discussion to the first element, and noting that “an independent violation is easy to establish in most aiding and abetting cases”); Kuehnle, supra note 62, at 322 (stating that the first element “is given relatively little consideration in case law” because “[t]he existence of the primary violation usually has been decided at the point at which aiding and abetting liability is being considered”).
component, in essentially the same manner as the scienter component under a primary liability claim. In interpreting Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), the Second Circuit concluded, "the basic holding of Hochfelder, that scienter is an element of the § 10(b)/rule 10b-5 cause of action, also establishes the standard for aiding and abetting liability." Rolf, 570 F.2d at 44. See also Woods v. Barnett Bank, 765 F.2d 1004, 1010 (11th Cir. 1985); Stokes v. Lokken, 644 F.2d 779, 783 (8th Cir. 1981); International Inv. Trust v. Cornfeld, 619 F.2d 909, 923-25 (2d Cir. 1980).

88. See infra notes 89-93 and accompanying text for the variations of what standard is necessary to satisfy the knowledge component of an aiding and abetting claim.


90. See Woods, 765 F.2d at 1010 (holding that "severe recklessness" satisfies the scienter requirement "where the alleged aider and abettor owes a duty to the defrauded party"); Armstrong v. McAlpin, 699 F.2d 79, 91 (2d Cir. 1983) (concluding that "if the alleged aider and abettor owes a fiduciary duty to the plaintiff, recklessness is enough"); Rolf, 570 F.2d at 47 (holding that where, at least, a fiduciary duty exists between alleged aider and abettor and plaintiff, recklessness fulfills the scienter requirement). See also Bromberg & Lowenfels, supra note 69, 678-86 for a discussion of satisfying the scienter requirement with recklessness accompanied with a duty to disclose.

91. See Woods, 765 F.2d at 1011 (applying recklessness standard to accountants who issued certified financial statements "foreseeably relied upon by investors"); Mishkin v. Peat, Marwick, Mitchell & Co., 658 F. Supp. 271, 273-75 (S.D.N.Y. 1987) (applying recklessness standard to accountants who certified financial statements on which it was reasonably foreseeable that the broker and "purchasing public" would rely). For a further discussion of an accountant's duty to disclose, see HAFt, supra note 83, at § 3.02[2].
been aware of it." Without a duty to the plaintiff, however, most courts required actual knowledge on the part of the defendant aider and abettor to establish liability under section 10(b) and rule 10b-5.93

The third element of establishing an aiding and abetting claim, substantial assistance, remained relatively undefined by the federal courts of appeals.94 What constituted "substantial" depended on the circumstances of the case.95 Nonetheless, substantial assistance was generally determined by a causation analysis similar to the causation requirement for primary liability.96 As such, courts held that proof of a "but for" causal relation was insufficient to maintain an aiding and abetting claim.97


The road to the United States Supreme Court's decision to eliminate aiding and abetting as a theory of liability under section 10(b) and rule 10b-5 of the 1934 Act came after approximately twenty years of the
Court strictly construing the federal securities laws.98 Beginning with Blue Chip Stamps v. Manor Drug Stores,99 the Supreme Court emphasized adherence to the statutory language to resolve questions regarding the scope of liability under section 10(b) and rule 10b-5. In Blue Chip, the Court held that section 10(b) only prohibited fraudulent conduct in the actual sale or purchase of a security and did not cover the attempt to sell or purchase a security.100 As a result, the Court limited the number of potential plaintiffs who could sue under the Acts to either purchasers or sellers of securities.101 Adherence to the text of section 10(b) and rule 10b-5 for determining the statute’s prohibited conduct continued in later cases, which further restricted the scope of conduct of section 10(b) and rule 10b-5.102

Despite this textualist approach, the Court on two occasions prior to Central Bank reserved consideration of whether the conduct prohibited by section 10(b) and rule 10b-5 extended to aiding and abetting a securities violation.103 First, in Ernst & Ernst v. Hochfelder,104 the plaintiff alleged that an accounting firm was negligent in conducting audits of a company’s financial condition.105 When Ernst & Ernst failed to discover the primary violator’s fraud, the plaintiff alleged that the accounting firm was liable as an aider and abettor.106 The Court dismissed the claim and premised its holding by reasoning that the text of section 10(b) does not support liability for negligent conduct.107 In light of its ruling, the Court declined to consider the propriety of holding a defendant liable under an aiding and abetting theory.108

98. Bromberg & Lowenfels, supra note 69, at 648 n.64 refer to this period as the “Contraction Era,” a time when the Court began to express concern over the expanded scope of conduct prohibited under the federal securities laws. Id.
100. Id. at 754; see also id. at 756-57 (Powell, J., concurring).
101. Id. at 730-36, 754-55.
102. See Santa Fe Indus. v. Green, 430 U.S. 462, 470-73 (1977) (limiting liability for breaches of fiduciary duty by majority shareholders against minority shareholders to state corporations law absent any “charge of misrepresentation or lack of disclosure”); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193, 197-201 (1976) (holding that the statute’s text does not support liability for negligent conduct); see also supra note 53, and infra text accompanying notes 104-08, for a discussion of the Hochfelder decision.
105. Id. at 190.
106. Id.
107. Id. at 193.
108. Id. at 191-92 n.7.
In *Herman & MacLean v. Huddleston*, the Court again chose not to address the validity of aiding and abetting liability. In *Herman*, the purchasers of securities of a company, which became bankrupt, alleged that an accounting firm violated section 10(b) and rule 10b-5 by making misrepresentations concerning the company’s financial condition. The Court noted that the trial court found that the accounting firm committed both primary violations of section 10(b) and rule 10b-5, as well as aiding and abetting violations. While the Court recognized the lower federal courts’ acceptance of aiding and abetting liability and cited *Hochfelder*, the Court once again reserved consideration of the existence of aiding and abetting liability under section 10(b) and rule 10b-5.

Even though the Court twice declined to consider the validity of the existence of a private right of action for aiding and abetting liability under section 10(b) and rule 10b-5, some commentators and courts questioned its viability. In 1994, after approximately thirty years of judicial recognition and acceptance of aiding and abetting liability by

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110. *Id.* at 379 n.5.
111. *Id.* at 378.
112. *Id.* at 379, 379 n.5. The trial court found that the accounting firm made fraudulent misrepresentations of the company’s financial condition in an opinion it issued. *Id.* at 378-79. The accounting firm’s opinion was subsequently contained in the company’s registration statement. *Id.* The trial court held that this conduct was a primary violation of section 10(b) and rule 10b-5. *Id.* The Supreme Court did not discuss what conduct by the accounting firm constituted aiding and abetting section 10(b) and rule 10b-5 violations. *Id.*
113. *Id.* at 379 n.5. Instead, the Court addressed two other issues: (1) the ability of a plaintiff to bring an implied section 10(b) cause of action for conduct that is “subject to express civil liability” under another provision of the Securities Act of 1933, and (2) the applicable standard of proof under a section 10(b) and rule 10b-5 cause of action. *Id.* at 379.
114. Fischel, *supra* note 64, at 82 (proposing that the “theory of secondary liability is no longer viable in light of recent Supreme Court decisions strictly interpreting the federal securities laws”); Bromberg & Lowenfels, *supra* note 69, at 650 (noting that “the securities dicta . . . cast considerable doubt on an implied private action for aiding-abetting”). *See also* Akin v. Q-L Invs., Inc., 959 F.2d 521 (5th Cir. 1992). The *Akin* court noted:

The added layer of liability . . . for aiding and abetting [a section 10(b) and rule 10b-5] violation is particularly problematic. . . [and] resort to this theory presents greater risks of frustrating the congressional scheme of securities regulation. . . . There is a powerful argument that [these risks] are such that aider and abettor liability should not be enforceable by private parties.

*Id.* at 525. *See also* Securities & Exch. Comm’n v. Seaboard Corp., 677 F.2d 1301, 1311 n.12 (9th Cir. 1982) (declining to address existence of aiding and abetting liability and noting the Court’s rejection of justifying aiding and abetting liability under section 10(b) and rule 10b-5 on policy objections).
the lower federal courts, the Supreme Court addressed the issue in *Central Bank of Denver v. First Interstate Bank of Denver*. In doing so, the Court held that aiding and abetting liability was not a cognizable claim under section 10(b) and rule 10b-5.

In *Central Bank*, the Colorado Springs-Stetson Hills Public Building Authority ("PBA") issued bonds worth twenty-six million dollars in 1986 and 1988 to finance public improvements of a residential and commercial development project. Pursuant to bond covenants, the bonds were secured by real estate that was required to be worth 160% of the bonds' outstanding principal and interest. Central Bank served as the indenture trustee for the bonds. A January 1988 appraisal of both the land secured in 1986 and the proposed land for the 1988 bonds showed that the land values remained almost the same as in the 1986 appraisal. The senior underwriter for the 1986 bonds, however, expressed concern to Central Bank that the land values may not meet the 160% requirement in light of declining land values and a sixteen-month-old appraisal. Although Central Bank's in-house appraiser believed the appraisal values seemed optimistic, he suggested that Central Bank retain an outside appraiser to review the 1988 appraisal. Central Bank and the project developer decided to delay the appraisal until after the 1988 bonds were issued. Unfortunately, before the appraisal was reviewed, the PBA defaulted on the 1988 bonds.

Under section 10(b) of the Securities and Exchange Act of 1934, the purchasers of 2.1 million dollars of the 1988 bonds brought a cause of action alleging that Central Bank aided and abetted the PBA in committing fraud and was, therefore, secondarily liable. The

116. Id. at 191.
117. Id. at 167.
118. Id.
119. Id.. An indenture trustee carries out the terms of an indenture. BLACK'S LAW DICTIONARY 770 (6th ed. 1990). An indenture is defined as “a written agreement under which bonds and debentures are issued.” Id.
120. Central Bank, 511 U.S. at 167.
121. An underwriter is “[a]ny person, banker, or syndicate that guarantees to furnish a definite sum of money . . . to a business . . . entity in return for an issue of bonds or stock.” BLACK'S LAW DICTIONARY 1527 (6th ed. 1990).
122. Central Bank, 511 U.S. at 167.
123. Id. at 167-68.
124. Id. at 168.
125. Id.
126. Id. The bond purchasers also sued the PBA, the 1988 underwriter, a junior underwriter, and the project developer for section 10(b) violations. Id.
district court granted summary judgment in favor of Central Bank, holding that the "plaintiffs failed to raise a genuine issue as to the element of scienter."127 The Court of Appeals for the Tenth Circuit disagreed, however, and reversed the district court's judgment.128 Analyzing the three elements of aiding and abetting liability,129 the Tenth Circuit addressed the issue of whether recklessness, absent a duty to disclose, satisfied the scienter requirement.130 The Tenth Circuit concluded that recklessness could satisfy the scienter element and reasoned a genuine issue of material fact existed as to Central Bank's recklessness.131 The Court determined that Central Bank's delay in acquiring an independent review of the land values and its knowledge of the use of a potentially inadequate appraisal to evaluate the collateral for the bonds established a genuine issue of material fact regarding the scienter element.132 In its decision, the Tenth Circuit did not question the existence of aiding and abetting liability; rather, it assumed its existence and sought to determine whether recklessness satisfied the scienter element of aiding and abetting.133 In granting certiorari the Supreme Court did not consider the issues that the Tenth Circuit addressed.134 Instead, the Court framed the issue before it as whether section 10(b) and rule 10b-5 afforded a private right of action for aiding and abetting liability.135

Consistent with a number of prior cases addressing the scope of conduct under section 10(b),136 the Court employed strict statutory construction to conclude that the scope of section 10(b) and rule 10b-5

128. Pring, 969 F.2d at 904-05.
129. See supra note 82 and accompanying text for a discussion of the elements of an aiding and abetting claim.
130. Pring, 969 F.2d at 902-03.
131. Id. at 898-904. Recklessness, in some circuits, is sufficient to establish the scienter requirement for aiding and abetting liability. Id. at 901. See supra notes 89-93 and accompanying text (discussing recklessness as satisfying the scienter requirement).
132. Pring, 969 F.2d at 903-04.
133. Id. at 901-02; Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 194 (10th Cir. 1992) (Stevens, J., dissenting) (noting that "petitioner assumed the existence of a right of action against aiders and abettors . . . ").
134. Central Bank, 511 U.S. at 194-95 (Stevens, J., dissenting) (stating that "the Court sua sponte directed the parties to address" whether aiding and abetting liability existed under section 10(b)).
135. See supra notes 133-34.
136. See supra notes 99-102 and accompanying text (highlighting cases in which the Court employed a textualist approach in interpreting section 10(b) and rule 10b-5).
does not include aiding and abetting liability. First, the Court noted that the statute's text does not mention aiding and abetting. Next, the Court rejected the plaintiff's argument that the phrase "directly or indirectly" in section 10(b) implies the imposition of aiding and abetting liability because it "extends beyond persons who engage, even indirectly, in a proscribed activity." In addition, the Court referenced other securities' provisions in which Congress explicitly provided for private causes of action. In contrast to these provisions, the Court reasoned that the absence of express language regarding liability for aiding and abetting in section 10(b) revealed a congressional intent not to impose aiding and abetting liability. Underlying the Court's reasoning was the recognition that aiding and abetting can impose liability upon an individual whose representations or acts were not relied upon by a plaintiff, a necessary element which the Court has held is necessary to establishing liability under section 10(b) and rule 10b-5. The Court reiterated its conclusion that the "statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act...[and] does not include

137. *Central Bank*, 511 U.S. at 173. The Court stated that its "cases considering the scope of conduct prohibited by § 10(b) in private suits have emphasized adherence to the statutory language." *Id.*

138. *Id.* at 175.

139. *Id.* at 175-76. Section 10(b) specifically states: "It shall be unlawful for any person, directly or indirectly, . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device . . . ." 15 U.S.C. § 78j (b) (1994). The Court pointed out that courts imposing aiding and abetting liability have not relied on the "directly or indirectly" language of section 10(b) of the 1934 Act. *Central Bank*, 511 U.S. at 176.

140. *Central Bank*, 511 U.S. at 179. Specifically, the Court mentioned section 11 of the 1933 Act, prohibiting material misstatements or omissions of fact in registration statements; section 12 of the 1933 Act, prohibiting material misstatements or omissions of fact in the sale of securities; section 9 of the 1934 Act, prohibiting manipulative pricing practices; section 16 of the 1934 Act, prohibiting short-swing trading by owners, directors and officers; section 18 of the 1934 Act, prohibiting misleading statements in SEC report filings; and section 20A, prohibiting insider trading. *Id.* The Court noted each of these sections prohibits some type of conduct and provides for an express cause of action, but none imposes liability on an aider and abettor. *Id.*; see 15 U.S.C. §§ 77k (amended 1995), 77l (amended 1995), 78i, 78p, 78r, 78t-1 (1994).

141. *Central Bank*, 511 U.S. at 179-80. The Court reasoned that Congress "[knows] how to impose aiding and abetting liability," and the Court "cannot amend the statute to create liability for acts that are not themselves manipulative or deceptive within the meaning of the statute." *Id.* at 176-78.

142. *Id.* at 180.

143. See *supra* note 54 and accompanying text for a discussion of the reliance element of a claim for a primary violation of section 10(b) and rule 10b-5.
giving aid to a person who commits a manipulative or deceptive act.'144

In his dissent, Justice Stevens argued that the majority's adherence to the statutory text and congressional intent did not warrant the elimination of such a well-established and recognized right of action.145 Justice Stevens observed that the development of aiding and abetting liability under section 10(b) and rule 10b-5 occurred against a “backdrop of liberal construction of remedial statutes and judicial favor toward implied rights of actions,” and he emphasized the fact that all eleven Courts of Appeals that have considered aiding and abetting under section 10(b) and rule 10b-5 have recognized it as giving rise to an implied private right of action.146 While conceding that the language of the statute does not expressly provide for a right of action, Justice Stevens noted that the judges who imposed aiding and abetting liability were “closer to the times and climate of the 73rd Congress,” and the judges “concluded that holding aiders and abettors liable was consonant with the [1934] Act’s purpose to strengthen the antifraud remedies of the common law.”147 Deeming a private right of action for aiding and abetting liability as a settled construction of section 10(b), Justice Stevens reasoned it should only be changed by Congress.148 Justice Stevens also reasoned, however, that Congress’ failure to disturb case law that approved liability for aiding and abetting when it undertook a comprehensive revision of the 1934 Act evidenced

144. Central Bank, 511 U.S. at 177 (citation omitted). Additionally, the Court rejected policy arguments that favored imposing aiding and abetting liability, such as the SEC’s argument that extending liability to aiders and abettors deters such actors from engaging in fraudulent activities and ensures that injured parties are made whole. Id. at 188-90. While the Court acknowledged that aiding and abetting liability would make the remedy available under section 10(b) greater, it reasoned that the objectives of the federal securities laws would not necessarily be better served. Id. at 188. Thus, rather than discussing and accepting the arguments for the imposition of aiding and abetting liability, the Court instead highlighted the public policy reasons against the imposition of aiding and abetting liability, such as concerns of “excessive litigation” and uncertainty in the rules governing aiding and abetting liability. Id. at 188-89. The Court reasoned that this uncertainty “leads to the undesirable result of decisions ‘made on an ad hoc basis, offering little predictive value’ to those who provide services to participants in the securities business.” Id. at 188 (quoting Pinter v. Dahl, 486 U.S. 622, 652 (1988)).

145. Id. at 192 (Stevens, J., dissenting). Justices Blackmun, Souter and Ginsburg joined Justice Stevens’ dissent. Id.

146. Id. at 192, 196 (Stevens, J., dissenting).

147. Id. at 193 (Stevens, J., dissenting).

148. Id. at 196 (Stevens, J., dissenting) (citing Reves v. Ernst & Young, 494 U.S. 56, 74 (1990) (Stevens, J., concurring)).
While the Court held that section 10(b) and rule 10b-5 do not include liability for aiding and abetting a securities violation, the Court made clear that secondary actors are not necessarily free from liability. The Court stated that "[a]ny person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5. . . ." While the Court's holding is clear and apparently unambiguous, this statement provided an opportunity for courts to interpret the Central Bank decision in various ways.

III. DISCUSSION

Prior to the Supreme Court's decision in Central Bank, plaintiffs would plead both primary and aiding and abetting claims as alternative theories of recovery. Without aiding and abetting as an available theory of recovery, however, it became critical for lower federal courts to carefully delineate the boundaries of primary liability. As a result, distinguishing primary liability from aiding and abetting liability has generated varied standards for determining the scope of conduct for primary violations of section 10(b) and rule 10b-5 among the lower courts. The majority of circuits that have addressed section 10(b) and rule 10b-5 claims in the post-Central Bank era have affirmed dismissals of claims expressly alleging aiding and abetting.  

149. Id. at 197-98 (Stevens, J., dissenting).
150. Id. at 191.
151. Id.
152. See, e.g., Anixter v. Home-Stake Prod. Co., 77 F.3d 1215, 1219 (10th Cir. 1996) (alleging both primary and aiding and abetting liability for an auditor's alleged participation in or aiding and abetting a section 10(b) and rule 10b-5 violation).
153. See Anixter, 77 F.3d at 1230 (noting that the "distinction in conduct between primary and secondary liability . . . is pivotal").
154. See infra Parts III.A-B (discussing lower courts decisions).
155. In most of the cases arising in the circuits, the complaints alleged that the defendants had aided and abetted primary violators, instead of alleging that the defendants were primary violators, which would require the circuit courts to define the scope of primary liability under section 10(b). See, e.g., Schultz v. Rhode Island Hosp. Trust Nat'l Bank, 94 F.3d 721 (1st Cir. 1996) (affirming dismissal of aiding and abetting claim against bank which served as an escrow agent in a failed development project); In re Ivan F. Boesky Sec. Litig., 36 F.3d 255 (2d Cir. 1994) (affirming dismissal of aiding and abetting claim); Teague v. Bakker, 35 F.3d 978 (4th Cir. 1994) (affirming dismissal of aiding and abetting claim against accounting firm), cert. denied, 115 S. Ct. 1107 (1995); Melder v. Morris, 27 F.3d 1097 (5th Cir. 1994) (affirming dismissal of federal securities fraud claims on the grounds that the plaintiff failed to
However, plaintiffs alleging primary liability under section 10(b) and rule 10b-5 based on conduct resembling aiding and abetting have caused divergent approaches in the courts.\textsuperscript{156} Shortly after the Court issued its decision in \textit{Central Bank}, the Ninth Circuit held that significant participation in the making of alleged misrepresentations constituted a primary violation of section 10(b) and rule 10b-5.\textsuperscript{157} Several district courts adopted the Ninth Circuit’s expansive interpretation of \textit{Central Bank}.\textsuperscript{158} Other district courts acknowledged this expansive approach, but incorporated a narrower interpretation of \textit{Central Bank}.\textsuperscript{159} Most recently, the Tenth Circuit addressed these divergent approaches and sought to develop a guideline for courts to follow premised on the plain language of section 10(b).\textsuperscript{160}

\textbf{A. Disguising Secondary Liability as Primary Liability?}

1. The Ninth Circuit’s Approach: Establishing an Expansive Scope of Conduct for Primary Violations

During the post-\textit{Central Bank} era, the Ninth Circuit in \textit{In re Software Toolworks}\textsuperscript{161} became the first circuit to address a claim for primary liability in which the plaintiff alleged liability based upon the defendant’s participation in the making of various representations.\textsuperscript{162} In \textit{Software Toolworks}, a producer of computer and game system

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\item plead fraud with particularity and noting that any alleged aiding and abetting claims were foreclosed; Twiss v. Kury, 25 F.3d 1551 (11th Cir. 1994) (affirming dismissal of aiding and abetting claim).
\item In addition, a few courts encountering claims based on conspiracy as a theory of liability under section 10(b) and rule 10b-5 have extended the reasoning and holding of \textit{Central Bank} to hold that a cause of action premised on conspiracy cannot be maintained. See, e.g., \textit{In re Glenfed, Inc. Sec. Litig.}, 60 F.3d 591, 592 (9th Cir. 1995) (affirming dismissal of claims based on conspiracy liability); Van de Velde v. Coopers & Lybrand, 899 F. Supp. 731, 738 (D. Mass. 1995) (stating that “[t]o the extent . . . this [claim] constitutes a distinct claim for conspiracy to violate the securities laws . . . this claim is barred by \textit{Central Bank}”); \textit{In re MTC Elec. Tech. Shareholders Litig.}, 898 F. Supp. 974, 981-82 (E.D.N.Y. 1995) (dismissing claim alleging conspiracy liability under section 10(b) and stating “every reason cited by the Supreme Court, in rejecting the implied right of action for aiding and abetting also applies to actions alleging conspiracies”). See supra note 64 and accompanying text (addressing types of secondary liability).
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\textsuperscript{156} See infra Part III.A-B.

\textsuperscript{157} See infra Part III.A.1 (discussing the Ninth Circuit’s approach).

\textsuperscript{158} See infra Part III.A.2 (discussing cases following the Ninth Circuit).

\textsuperscript{159} See infra Part III.B.1 (discussing cases declining to follow the Ninth Circuit).

\textsuperscript{160} See infra Part III.B.2 (discussing the Tenth Circuit’s approach).


\textsuperscript{162} Id. at 626-29.
software conducted a public offering of common stock. The market price of the stock steadily declined, from $18.50 per share at the time it was offered to $2.375 per share four months later. One day after Toolworks issued a press release announcing substantial losses, several investors brought suit against Toolworks, auditor Deloitte & Touche ("Deloitte"), and the underwriters, alleging various violations of sections 11 and 12(2) of the 1933 Act, and violations of section 10(b) and rule 10b-5 by all three defendants. Toolworks settled with the plaintiffs for $26.5 million. The plaintiffs continued their claims against the underwriters and Deloitte. See infra note 167 for a discussion of the claims against the underwriters, and see infra notes 169-78 and accompanying text for a discussion of the claims against Deloitte.

The plaintiffs alleged violations of sections 11 and 12(2) of the 1933 Act, and violations of section 10(b) and rule 10b-5 by all three defendants. Toolworks, 50 F.3d at 620. In these allegations, the plaintiffs claimed that the defendants violated sections 11 and 12(2) by issuing a false and misleading prospectus and SEC registration statement. Id. See supra note 23 for a discussion of what is prohibited by sections 11 and 12(2). In particular, the plaintiffs claimed that the defendants:

1. falsified audited financial statements for fiscal 1990 by reporting as revenue sales to . . . manufacturers ("OEMs") with whom Toolworks had no binding agreements,
2. fabricated large consignment sales in order for Toolworks to meet financial projections for the first quarter of fiscal 1991 ("the June quarter"), and
3. lied to the [SEC] in response to inquiries made before the registration statement became effective.

The Ninth Circuit affirmed the district court's granting of summary judgment in favor of the underwriters on the sections 11 and 12(2) claims concerning statements made in Toolworks' prospectus and representations made in financial statements. Id. at 622-24. Due diligence provides a defense to sections 11 and 12(2) claims, and the Ninth Circuit found that no genuine issue of material fact existed as to the underwriter's due diligence in ensuring the accuracy of the representations. Id. at 622-23. The Ninth Circuit, however, found that the district court erred in granting summary judgment on issues of the underwriters' due diligence between the time the preliminary prospectus was filed and the effective date of the offering. Id. at 625. The plaintiffs listed three issues in which they alleged that the underwriters should have done more to satisfy the due diligence test. Id. The court analyzed each issue and found summary judgment was inappropriate in two of the three issues. Id. at 625-26. The court found material issues of fact existed regarding whether the underwriters participated in drafting documents to the SEC concerning Toolworks' June quarter performance, in which, plaintiffs claimed, Toolworks falsified its anticipated revenues. Id. at 625.

Finally, the plaintiffs alleged that the underwriters violated section 10(b) and rule 10b-5 by assisting in the drafting of documents to the SEC estimating Toolworks' anticipated revenue for the June quarter. Id. at 626. The Ninth Circuit reversed the district court's grant of summary judgment in favor of the underwriters on these claims. Id. Although the plaintiffs did not allege that the underwriters acted with the scienter required for section 10(b) and rule 10b-5 claims, the Ninth Circuit held that the evidence permitted a reasonable inference that the underwriters had access to the information and "deliberately chose to conceal the truth." Id. at 625.
violations of the securities laws, including section 10(b) and rule 10b-5.\textsuperscript{168}

The plaintiffs alleged three section 10(b) and rule 10b-5 claims against Deloitte, two for primary violations and one for aiding and abetting.\textsuperscript{169} The first claim alleged that Deloitte made inaccurate representations in a certified financial statement, which Toolworks incorporated in a prospectus.\textsuperscript{170} The Ninth Circuit affirmed the grant of summary judgment in favor of Deloitte on this claim, holding that the plaintiffs did not satisfy the scienter requirement of a primary liability claim.\textsuperscript{171} The court also affirmed summary judgment in favor of Deloitte on the third claim, which the plaintiffs conceded had alleged that Deloitte aided and abetted Toolworks' primary violation of section 10(b).\textsuperscript{172} Citing Central Bank, the court simply stated that these claims were "no longer viable."\textsuperscript{173}

The Ninth Circuit, however, did reverse the district court on the second claim, declaring summary judgment inappropriate on the issue of Deloitte's participation in the drafting of two letters to the SEC, both of which contained allegedly misleading information on anticipated revenues and contracts.\textsuperscript{174} While the plaintiffs claimed Deloitte was primarily liable for the misrepresentations, the district court analyzed this issue as an aiding and abetting claim.\textsuperscript{175} At the time the district court addressed the plaintiffs' claim, aiding and abetting liability was considered a valid theory under section 10(b).\textsuperscript{176} The Supreme Court

\textsuperscript{168} See supra note 167 for a discussion of plaintiffs' claims against all three defendants.

\textsuperscript{169} Software Toolworks, 50 F.3d at 627-29.

\textsuperscript{170} Id. at 627. The plaintiffs alleged that Deloitte "improperly describ[ed] Toolworks' OEM revenues and [failed] to discover Toolworks' price reductions and return policies." Id.

\textsuperscript{171} Id. at 627-28. See supra notes 53, 87-93 and accompanying text for a discussion of the scienter requirement.

\textsuperscript{172} Software Toolworks, 50 F.3d at 629.

\textsuperscript{173} Id.

\textsuperscript{174} Id. at 628. A July 4, 1990, letter included information regarding Toolworks' June quarter performance in which Toolworks estimated its revenues because it did not have preliminary financial data available. Id. at 625. The plaintiffs alleged that Toolworks falsified the estimates because it actually did have the data available. Id. A July 1, 1990, letter included "model" contracts that Toolworks used in its agreements with original equipment manufacturers, which the plaintiffs alleged differed from the contracts actually used. Id. at 629. Therefore, the plaintiffs alleged that this letter was also misleading. Id. The Ninth Circuit noted that Deloitte's actions with regard to the July 1, 1990, SEC letter consisted of discussions and a review with Toolworks before the letter was prepared and did not consist of any drafting or editing of the letter. Id. at 628 n.3, 629.

\textsuperscript{175} Id. at 628 n.3.

\textsuperscript{176} Id.
decided *Central Bank* after the district court issued its opinion.\(^7\) Noting the district court's aiding and abetting analysis and acknowledging the *Central Bank* decision, the Ninth Circuit concluded *Central Bank* did not preclude plaintiffs’ claim because it established a claim for primary liability.\(^7\)

The Ninth Circuit focused on the accountants' role in preparing the letters, instead of whether the accountants, themselves, made any misrepresentations of fact.\(^7\) The Ninth Circuit reasoned that since one of the SEC letters was prepared after "extensive review and discussions" with Deloitte and that Deloitte played a "significant role in [the] drafting and editing" of the other SEC letter, primary liability was sufficiently alleged.\(^8\) Additionally, the Ninth Circuit concentrated on Deloitte's knowledge that the letters contained allegedly false and misleading representations regarding financial projections and agreements.\(^8\) In particular, the Ninth Circuit explained that even though Deloitte did not "draft, or even see, the model agreement," Deloitte did see the SEC letter that incorporated the alleged misrepresentations contained in the agreements.\(^8\) Accordingly, the Ninth Circuit held that Deloitte's participation in the making of the alleged misrepresentations established primary liability under section 10(b) and rule 10b-5.\(^8\)

2. District Courts Following the *Software Toolworks* Interpretation

Since the *Software Toolworks* opinion was issued shortly after *Central Bank*,\(^8\) it set a precedent that enabled district courts to broaden the scope of conduct for which defendants can be held liable under section 10(b).\(^8\) Some district courts have interpreted the Ninth Circuit decision in *Software Toolworks* to mean that individuals who do not make representations of fact themselves, but who substantially

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177. *Id.* See supra Part II.C for a discussion of the *Central Bank* decision.
178. *Software Toolworks*, 50 F.3d at 628 n.3.
179. *Id.*
180. *Id.*
181. *Id.* at 628-29. See supra note 174 (discussing the SEC letters).
182. *Software Toolworks*, 50 F.3d at 629. See supra note 174 (discussing the SEC letters).
183. *Software Toolworks*, 50 F.3d at 628 n.3, 628-29.
185. See infra notes 188-209 and accompanying text.
assist in the representations of others, may be primarily liable for those representations. Courts that have adopted this interpretation also justify their position by analyzing their cases under rules 10b-5(a) and (c). For example, in *In re ZZZZ Best Securities Litigation*, the plaintiffs alleged that the corporation perpetrated a massive fraud by issuing false statements about its finances, management and business prospects in connection with a December 1986 public stock offering. The plaintiffs also alleged that Ernst & Young, an accounting firm hired to review ZZZZ Best’s financial statements, violated section 10(b) and rule 10b-5 when it participated in the creation of publicly released statements, issued a review report, and failed to disclose additional material facts unrelated to the review report.

Ernst & Young argued that *Central Bank* absolved it of liability on all claims except for its issuance of a review report, because it did not make the alleged misrepresentations and its conduct constituted aiding and abetting. The district court acknowledged the Supreme Court’s elimination of aiding and abetting liability, but rejected defendant’s argument. Instead, the district court agreed with the plaintiffs’ argument that if evidence demonstrating that Ernst & Young’s participation in the creation of representations “was extensive enough to attribute those misstatements and omissions to [Ernst & Young],”

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186. See infra notes 188-209 and accompanying text for a discussion of district courts following the Ninth Circuit’s approach.
187. See infra notes 195-209 and accompanying text; see also supra notes 32-35 and accompanying text for a discussion of rules 10b-5(a) and (c).
189. *Id.* at 964.
190. *Id.* at 964-65. Ernst & Young did not conduct any of the corporation’s audits. *Id.* at 973. Rather, it issued a “review report” that it prepared after it reviewed the corporation’s interim financial information for the period ending July 31, 1986. *Id.* at 964. This report was included in the corporation’s prospectus for its 1986 public stock offering. *Id.*

Between October, 1986 and June, 1987, ZZZZ Best issued approximately 13 statements to the public, which the plaintiffs claim related to the fraudulent scheme. *Id.* at 964-65. The court noted that the plaintiffs did not provide any facts that attributed any of the statements to Ernst & Young or indicated that Ernst & Young was involved in the making of the statements. *Id.* at 965.
191. *Id.* at 968. Ernst & Young did not contend that *Central Bank* eliminated any claim for primary liability under section 10(b) for statements it made in the review report. *Id.* at 965.
192. *Id.* at 969-70.
then primary liability exists under section 10(b) and rule 10b-5. The court relied on Ninth Circuit precedent, which held that primary liability exists if an individual's participation in the alleged activity is "direct." Additionally, the district court addressed Ernst & Young's liability under rules 10b-5(a) and (c). The district court observed that the scope of liability under these rules is not restricted to material misstatements or omissions of fact. Consequently, the court reasoned that the facts raised as to Ernst & Young's participation and knowledge could render it liable under a scheme to defraud. The ZZZZ Best court also addressed whether the plaintiffs could establish reliance on Ernst & Young's representations. The district court determined that even if the investing public could not attribute the particular misrepresentations to Ernst & Young, if the market relied on the public representations, anyone who significantly participated in the making of those representations could be found primarily liable. Furthermore, to establish reliance under rules 10b-5(a) and (c), the district court stated that the "[p]laintiffs or the market need only rely on the underlying fraudulent scheme in which [Ernst & Young] allegedly participated." As such, the district court denied the defendant's motion for summary judgment because it held that an accountant can still be primarily liable for its "intricate[ ] involve[ment] in the creation, review or issuance" of another's representations.

193. Id. at 970.
194. Id. The court cited Securities & Exchange Commission v. Seaboard, 677 F.2d 1301, 1312 (9th Cir. 1982), which held that "[a]n accountant may be liable for direct violation of [rule 10b-5] if its participation in the misrepresentation is direct and if it knows or is reckless in not knowing that the facts reported . . . [are] materially misrepresent[ed]." Id.
196. Id. at 972.
197. Id.
198. Id. at 970, 972.
199. Id. at 970. See HAFT, supra note 83, § 3.05[1], at 44 (stating that "[w]ith one stroke, the court eliminated both the requirement . . . that the defendant 'make' a statement and that the defendant's statement be relied upon by investors").
201. Id. at 965, 973. Other district courts have come to similar conclusions. For example, in Cashman v. Coopers & Lybrand, the district court denied an accounting firm's motion to dismiss because it concluded that the firm's involvement in restructuring a limited partnership could render it primarily liable when the firm provided advice and recommendations, and made representations that the partnership incorporated into its prospectus and agreements. 877 F. Supp. 425, 429-30, 433 (N.D. Ill. 1995), sum. judgment granted in part, 1996 U.S. Dist. LEXIS 2409 (N.D. Ill. Feb. 5, 1996). The Cashman court followed Seventh Circuit precedent which required an "accountant's alleged misstatement to be certified, audited, prepared or reported" to establish primary
Likewise, the district court in *Adam v. Silicon Valley Bancshares*\(^{202}\) adopted the expansive interpretation of section 10(b) and rule 10b-5 advanced by the Ninth Circuit and the *ZZZZ Best* court. When Silicon Valley Bancshares ("SVB") incurred substantial losses, it issued favorable press releases and interim financial statements containing allegedly misleading statements.\(^{203}\) SVB retained the accounting firm of Deloitte & Touche ("Deloitte") to conduct audits of its financial statements.\(^{204}\) The plaintiffs alleged Deloitte participated in a scheme to defraud the plaintiffs by its involvement with the corporation's press releases and financial statements.\(^{205}\)

The *Silicon Valley* court declined to follow the reasoning of other district court decisions which held that under section 10(b) and rule 10b-5, secondary actors, such as accountants, are primarily liable only for statements they made which were in turn relied upon by the injured

liability. *Id.* at 432. In addition, the court held that "preparation of the allegedly misstated information requires 'central involvement' by the accountants." *Id.*

The District Court for the Western District of Michigan also denied a defendant accounting firm's motion to dismiss, finding that its review and assistance in drafting reports were sufficient to attribute the representations to the firm for purposes of establishing primary liability. *O'Neil v. Appel*, 897 F. Supp. 995, 1000 (W.D. Mich. 1995). The *O'Neil* district court acknowledged *In re Kendall Square Research Corp.*, 868 F. Supp. 26 (D. Mass. 1994), in which a Massachusetts district court determined that reviewing and approving the representations of another is not sufficient to establish primary liability. *Id.* However, the district court in *O'Neil* distinguished *Kendall Square* on the basis that assistance in drafting raises the level of conduct so that it constitutes a primary violation of section 10(b) and rule 10b-5. *Id.*

A California district court in *Employers Insurance v. Musick, Peeler & Garrett*, also denied both the attorneys' and accountants' motions to dismiss. 871 F. Supp. 381, 391 (S.D. Cal. 1994), *amended* by 948 F. Supp. 942 (S.D. Cal. 1995). In *Employers Insurance*, the plaintiffs alleged that both the attorneys and accountants should be primarily liable for their participation in drafting a prospectus. *Id.* at 388. The court cited *Software Toolworks* and a pre-Central Bank case, *Securities & Exchange Commission v. Seaboard Corp.*, 677 F.2d 1301 (9th Cir. 1982), to support its ruling that an accountant and attorney (secondary actors) may be primarily liable for their "significant role[s]" in preparing representations made by others. *Employers Ins.*, 871 F. Supp. at 389-90 (citing *In re Software Toolworks*, 38 F.3d 1078, 1081 (9th Cir.), *amended* and *superseded* by, 50 F.3d 615 (9th Cir. 1994) (amended 1995), cert. denied, 116 S. Ct. 274 (1995)).


203. *Id.* The plaintiffs alleged that SVB suffered losses because it had "inadequate monitoring and loss recognition procedures." *Id.* at 1399. The plaintiffs settled its claims with SVB, its directors and officers, but continued its claims against the accounting firm. *Id.*

204. *Id.*

205. *Id.* at 1401. The plaintiffs alleged that Deloitte knew of the inadequate controls and deviated from conducting its audits in accordance with generally accepted auditing standards. *Id.* at 1399. The "scheme to defraud" approach is encompassed under rule 10b-5(a). See *supra* text accompanying note 31 for pertinent language of rule 10b-5.
party. 206 Instead, the Silicon Valley court followed Ninth Circuit precedent which "indicated that an accounting firm can be primarily liable for representations made by others." 207 In addition, the district court reasoned that the Supreme Court's announcement in Central Bank that accountants would not be beyond the reach of section 10(b) and rule 10b-5 liability supported its holding. 208 The district court denied Deloitte's motion to dismiss because it found that its participation in the preparation of SVB's statements was part of a scheme to defraud, making Deloitte & Touche primarily liable under rule 10b-5(a). 209

B. Adopting a Restrictive Approach to Section 10(b) and Rule 10b-5 Liability

1. District Court's Rejection of the Ninth Circuit's Expansive Interpretation

Recognizing that the Ninth Circuit, and district courts following its approach adopted an expansive interpretation of section 10(b) and rule 10b-5 that essentially included "substantial assistance" as giving rise to primary liability, 210 other district courts adopted a narrower scope of prohibited conduct under section 10(b) and rule 10b-5. 211 These district courts sought to define exactly what behavior would subject a defendant to primary liability under section 10(b) and rule 10b-5. 212

206. See infra Part III.B.1 (discussing cases taking a literalist approach in interpreting the scope of liability under section 10(b) and rule 10b-5).
207. Silicon Valley, 884 F. Supp. at 1401. While the court followed the expansive approach of the Ninth Circuit in interpreting Central Bank, Deloitte had argued for a much narrower interpretation of the "in connection with the purchase or sale of securities" requirement than was advanced by the Ninth Circuit. Id. at 1401-02. Deloitte argued that an accountant could only be liable for a statement made in documents used to effectuate a sale. Id. This argument would have relieved Deloitte of any potential liability because the statements it made in its 1990 audit, and those arguably attributed to it, were not used in "selling documents," but in statements to current investors. Id.
208. Id. at 1401. The district court focused on the Supreme Court's statement that the elimination of aiding and abetting liability would not render secondary actors free from liability. Id. See also supra Part II.C (discussing the Supreme Court's decision in Central Bank).
210. See supra Part III.A.2 for a discussion of courts adopting this expansive interpretation.
211. See infra notes 214-17 and accompanying text (discussing district court cases that adopt a literalist approach to section 10(b) and rule 10b-5).
Adopting reasoning similar to that employed by the Supreme Court in Central Bank, some district courts addressed allegations of primary violations against secondary actors using a literalist approach to section 10(b) and rule 10b-5.\textsuperscript{213}

In In re MTC Electronic Technologies Shareholders Litigation,\textsuperscript{214} for example, the plaintiff shareholders alleged that underwriters were primarily liable under section 10(b) and rule 10b-5 for their role in "drafting and circulating" MTC Electronic Technologies Company's ("MTC") prospectus.\textsuperscript{215} After discussing Central Bank, the MTC court analyzed decisions rendered by other district courts only to find that those courts unsuccessfully and inconsistently distinguished primary liability from secondary liability.\textsuperscript{216} Accordingly, the court in MTC concluded that "if [Central Bank] is to have any real meaning, a defendant must actually make a false or misleading statement" for liability to attach.\textsuperscript{217} As such, the district court dismissed this claim,\textsuperscript{218} but stopped short of dismissing the entire case because the plaintiffs had also alleged that the underwriters made misrepresentations in a research report they had disseminated.\textsuperscript{219}


Acknowledging that the Ninth Circuit and some district courts had taken differing approaches in determining the boundaries of primary liability under section 10(b) and rule 10b-5 of the 1934 Act in light of

\footnotesize{(concluding that giving advice and consulting on an accounting firm's clients' matters was "insufficient to support any claim other than one for aider and abettor liability").}

\textsuperscript{213} See infra notes 214-16 and accompanying text for an example of a court adhering to a literalist approach in delineating the boundaries of primary liability under section 10(b) and rule 10b-5.


\textsuperscript{215} Id. at 987.


\textsuperscript{217} MTC, 898 F. Supp. at 987.

\textsuperscript{218} Id. The Court observed that "this is precisely the sort of role in an alleged 10(b) violation that, according to Central Bank, is no longer actionable." Id.

\textsuperscript{219} Id.
Secondary Liability Masquerading Under Section 10(b)

Central Bank, the Tenth Circuit undertook the task of developing a new guideline in Anixter v. Home-State Production Co. Anixter involved a fraudulent investment scheme perpetrated by Home-Stake Production Co. ("Home-Stake") in which Home-Stake sold interests in annual oil and gas drilling programs to investors, and used money generated by the sale of investments in late-year programs to pay off earlier-year investors. By the time the scheme collapsed, investors lost tens of millions of dollars.

Investors in the programs alleged both primary and aiding and abetting violations of section 10(b) and rule 10b-5 against the defendant, Home-Stake's auditor, for material misstatements and omissions made in documents disseminated to investors. The auditor, Norman J. Cross, Jr., prepared financial statements and prospectuses, issued opinions regarding Home-Stake's financial health, and assisted in the preparation of registration statements filed with the SEC. In addition, Home-Stake allegedly included financial statements audited by Cross in "Program Books," which Home-Stake distributed to investors and used to solicit new investors. The books were not filed with the SEC, and the information contained was either inconsistent with, or contradicted, information filed with the SEC.

220. 77 F.3d 1215, 1225-27 (10th Cir. 1996). The plaintiffs first filed the case in March, 1973. Id. at 1219. The court certified nine separate plaintiff classes and trial began in 1988. Id. The plaintiffs eventually won jury verdicts of approximately $130 million in 1988 and 1989. Id. The court noted that this case "has been affected by four Supreme Court cases," and provided a brief synopsis of how the Supreme Court cases affected the instant case. Id. at 1221. The plaintiffs' claims were twice dismissed and twice reinstated because of Supreme Court rulings regarding the applicable statute of limitations of section 10(b) claims, the retroactive effect of Supreme Court decisions to pending cases, and the constitutionality of section 27A of the Securities Exchange Act of 1934, as applied in the Anixter case. Id.

221. Id. at 1218. The circuit court referred to this scheme as a "classic Ponzi swindle." Id. For each year between 1964 and 1972, Home-Stake established oil production subsidiaries known as Program Operating Corporations and sold interests in each oil and gas drilling program. Id. Income from individuals who made investments in "later-year Programs" was used to pay early-year investors. Id.

222. Id.

223. Id. at 1219-20. The plaintiffs also alleged a number of securities violations against the primary officers and directors of Home-Stake, some broker-dealers, and the outside attorneys and auditors. Id. at 1219. Due to settlements made by the parties, the only claims left were against Home-Stake's auditor. Id.

224. Id. Cross served as Home-Stake's auditor from 1968 to 1971. Id.

225. Id. at 1220. The documents "included descriptions of specific oil recovery programs, [and] estimates of anticipated returns." Id.

226. Id.
The district court instructed the jury on both primary and aiding and abetting liability, and the jury returned a general verdict against the auditor. While the district court considered post-judgment motions, the Supreme Court decided *Central Bank*, which eliminated aiding and abetting liability. In light of *Central Bank*, the Tenth Circuit proceeded to consider what conduct constituted a primary violation versus aiding and abetting a section 10(b) and rule 10b-5 violation. In considering this issue, the Tenth Circuit focused on the language of section 10(b), as well as the Supreme Court’s conclusion in *Central Bank* that “§ 10(b) 'prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act.'” The Tenth Circuit also referred to the Court’s announcement that secondary actors would not escape liability under the securities acts. Rather, the Tenth Circuit noted that the Supreme Court’s conclusion centered on the representations made and relied upon by a purchaser or seller, not on the peripheral position of such individuals as accountants and attorneys.

Observing that underlying the Court’s conclusion was the absence of a reliance element in establishing aiding and abetting liability, the Tenth Circuit contrasted the elements necessary to establish primary liability with those for establishing aiding and abetting liability. It determined that the “critical element” distinguishing primary liability from aiding and abetting liability was the existence of a representation made by the defendant and relied upon by the plaintiff. Therefore, the *Anixter* court reasoned that for liability to attach, the defendant must have made the misrepresentation and the plaintiff must have relied on it. It emphasized that the representation need not be

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227. *Id.* at 1227-29.
228. *Id.* at 1221.
229. *Id.* at 1222.
230. *Id.* at 1224 (quoting *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 177 (1994)).
231. *Id.*
232. *Id.*
233. *Central Bank*, 511 U.S. at 181. The Supreme Court stated that “were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor’s statements or actions.” *Id.* at 180.
235. *Anixter*, 77 F.3d. at 1225.
236. *Id.* The court stated that “[r]eliance only on representations made by others cannot itself form the basis of liability.” *Id.* The Tenth Circuit noted that “[i]n the extent these cases allow liability to attach without requiring a representation to be made
directly communicated to the plaintiffs, but rather that the individual "must . . . [know] or should have known that his representation would be communicated to investors." After reviewing the divergent approaches of the Ninth Circuit and the district courts, the Tenth Circuit, in Anixter, then concluded that peripheral actors can be liable for statements they make and which they know will reach potential investors. Peripheral actors cannot, however, be liable for "significant" or "substantial" assistance in the representations of others.

In light of its interpretation of Central Bank and the general verdict, the Tenth Circuit analyzed the evidence and found that the auditor may have been primarily liable under section 10(b) and rule 10b-5. The Tenth Circuit reasoned, however, that a jury instruction on aiding and abetting tainted the verdict because it was unclear whether the jury found the auditor liable as a primary violator or as an aider and abettor. Accordingly, the Tenth Circuit adhered to the reasoning of the Supreme Court in Central Bank and hesitantly remanded the case to the district court.

IV. ANALYSIS

The Supreme Court in Central Bank of Denver v. First Interstate Bank of Denver observed that the theory of aiding and abetting liability lacks the "certainty and predictability" necessary to securities law.
Certainty and predictability, the Court noted, are required in order to prevent ad hoc decisions with little “predictive value.” However, despite the Court’s strict interpretation of section 10(b) and rule 10b-5, and its elimination of aiding and abetting liability, the Court did not provide “certainty and predictability” to section 10(b) and rule 10b-5 litigation. Confusion as to the scope of section 10(b) and rule 10b-5 continues, and courts are currently faced with defining the boundaries of primary liability under section 10(b). While this is not a new issue for the federal courts, the Supreme Court’s foreclosure of aiding and abetting liability as an alternative theory of recovery has given new importance to the distinction between primary and secondary liability. Moreover, the Court’s textualist approach to interpreting section 10(b) and rule 10b-5 also calls upon courts to define what constitutes “making” a misstatement.

In defining these issues, courts have diverged in their approaches and rationales, creating nearly as much uncertainty as existed prior to Central Bank. Some courts have adopted an expansive definition encompassing conduct that resembles aiding and abetting. Other courts have adhered to a narrow construction of section 10(b) and rule 10b-5, following the reasoning which led the Supreme Court to overturn years of judicial recognition of aiding and abetting liability. Therefore, considering the Court’s rejection of policy considerations, the absence of language in section 10(b) extending

(1994). The Court stated that the “rules for determining aiding and abetting liability are unclear.” Id. See also supra note 144 (discussing the Court’s treatment of proposed policy arguments).


247. Id.

248. See supra Part III (discussing cases determining the scope of liability under section 10(b) and rule 10b-5).

249. Anixter, 77 F.3d at 1230. The court stated: “Prior to Central Bank the distinction [between primary and secondary liability] was academic. Now it is pivotal.” Id. See also In re MTC Elec. Tech. Shareholders Litig., 898 F. Supp. 974, 985 (E.D.N.Y. 1995) (observing that Central Bank “elevated this distinction [between primary and secondary liability] by eliminating secondary liability under Section 10(b)”).

250. See HAFT, supra note 83, at § 3.05[1] (observing that courts in the post-Central Bank era must address the issue of who makes a material misstatement).

251. See supra Part III (discussing the different approaches among the courts).

252. See MTC, 898 F. Supp. at 986-87 (noting the confusion in the lower courts in discerning primary liability from secondary liability).

253. See supra Part III.A (discussing cases adopting an expansive scope of conduct under section 10(b) and rule 10b-5).

254. See supra Part III.B (discussing cases adopting a narrow construction of section 10(b) and rule 10b-5).

255. See supra note 144 (discussing the Supreme Court’s rejection of policy
liability to those who assist, and the need to demonstrate reliance to establish primary liability, the lower federal courts' inclusion of substantial assistance as a primary violation fails to comport with the reasoning and holding of Central Bank.

The Supreme Court in Central Bank justified its holding on a strict textual analysis of section 10(b) of the Securities and Exchange Act of 1934, which revealed that section 10(b) failed to mention any liability for aiding and abetting. The absence of such language suggests that Congress did not intend to impose liability upon those who aid and abet another individual in the commission of a fraudulent act. Accordingly, the Supreme Court reached the conclusion that section 10(b) "prohibits only the making of a material misstatement or (omission) of fact or the commission of a manipulative act."

To conclude that Congress intended to broaden the scope of conduct prohibited by section 10(b) to encompass those who assist primary violators, courts would have to resort to policy-based rationales. One policy argument that encourages a broad interpretation of conduct prohibited by section 10(b) and rule 10b-5 is that many plaintiffs may be denied recovery due to the insolvency of the primary violators. In many cases, the primary violator becomes bankrupt as a result of the fraudulent activities, and the theory of aiding and abetting liability enables injured parties to reach the "deep pocket" parties, such as

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256. See supra notes 138-41 and accompanying text (discussing the Supreme Court's analysis of the text of section 10(b)).

257. See Basic, Inc. v. Levinson, 485 U.S. 224 (1988) (establishing reliance as a necessary element for primary liability); see also Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 180 (1994) (determining that "allowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases").

258. Central Bank, 511 U.S. at 175-77. The Court stated that "[t]he proscription does not include giving aid to a person who commits a manipulative or deceptive act." Id. at 177. The Court further commented that it could not "amend the statute to create liability for acts that are not themselves manipulative or deceptive within the meaning of the statute." Id. at 177-78.


260. Central Bank, 511 U.S. at 177.

261. Assisting a primary violator in the commission of a securities violation led the courts to incorporate aiding and abetting liability. See supra Part II.B. This incorporation was largely based on tort principles and adherence to the policy objectives of the securities laws. See supra Part II.B; see also infra note 271 and accompanying text.

262. See Baum, supra note 4, at 1839 (concluding that "[w]ithout aiding and abetting liability, private plaintiffs may not be able to reach those actors often in the best position to provide a remedy — those with 'deep pockets'").
accountants and attorneys, to recover damages.\textsuperscript{263} Therefore, an expansive scope of prohibited conduct under section 10(b) and rule 10b-5 "ensures that defrauded plaintiffs are made whole."\textsuperscript{264} Such policy-based rationales, however, were explicitly rejected by the Court as a means of implying private rights of action under the federal securities laws and as grounds for creating a cause of action for aiding and abetting liability.\textsuperscript{265} The Court acknowledged the "far-reaching" effects of extending section 10(b) and rule 10b-5 to aiders and abettors, but stated that "policy considerations cannot override" statutory interpretation.\textsuperscript{266} The Court, however, expressly stated that secondary actors would not escape liability, and that such actors would be subject to primary liability if they "employ[ed] a manipulative device" or made material misrepresentations or omissions of fact upon which a securities purchaser or seller relied.\textsuperscript{267}

A. The Ninth Circuit's Interpretation Violates Dictates of Central Bank

Accordingly, the Ninth Circuit's decision in \textit{In re Software Toolworks},\textsuperscript{268} and the district courts that follow this decision, fail to adhere to the plain language of section 10(b) and the reasoning of the Court in \textit{Central Bank}.\textsuperscript{269} The Ninth Circuit neither provided its own rationale for its conclusion nor did it refer to \textit{Central Bank}'s reasoning for support.\textsuperscript{270} Rather, the Ninth Circuit used an expansive

\textsuperscript{263} See Abandonment of the Private Right of Action for Aiding and Abetting Securities Fraud/Staff Report on Private Securities Litigation: Hearings on the Recent Securities Law Decisions by the U.S. Supreme Court, Central Bank of Denver vs. First Interstate Bank of Denver Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, 103d Cong., 2d Sess. 46 (1994) (statement of Arthur Levitt, Chairman, SEC) (advocating the necessity for legislation to allow private aiding and abetting liability claims "to preserve . . . a vehicle for compensating private investors"); see also Edward Brodsky, Liability for Aiding and Abetting under § 10(b), N.Y.L.J., May 8, 1996, at 3 (observing that "[p]rior to Central Bank, deep-pocket third parties such as outside auditors, underwriters and law firms were often named as aiders and abettors in § 10(b) cases").

\textsuperscript{264} \textit{Central Bank}, 511 U.S. at 188.

\textsuperscript{265} See Touche Ross & Co. v. Redington, 442 U.S. 560, 568 (1979) (rejecting a reliance on tort principles for implying rights of action under the federal securities laws); see supra notes 45-48 and accompanying text (discussing the Touche Ross decision).

\textsuperscript{266} \textit{Central Bank}, 511 U.S. at 188.

\textsuperscript{267} Id. at 191.


\textsuperscript{269} See supra Part III.A for a discussion of these cases.

\textsuperscript{270} \textit{Software Toolworks}, 50 F.3d at 628 n.3.
construction of section 10(b) and rule 10b-5: an approach justified by the "broad policy objectives of the securities acts." This approach was rejected by the Court when it shifted to a strict construction of section 10(b) and rule 10b-5.

By focusing on the defendant's role in preparing the letters to the SEC, the Ninth Circuit ignored two requirements for finding primary liability under section 10(b) and rule 10b-5: a representation or manipulative act made by the defendant, and reliance on that representation. First, the Ninth Circuit adopted an expansive scope of primary liability, which essentially reformulated the substantial assistance element of an aiding and abetting claim into sufficiently culpable conduct to warrant primary liability. The Ninth Circuit's holding suggested that an individual's participation in the creation of another's representation is sufficient to attribute that representation to that individual for purposes of section 10(b) and rule 10b-5 liability.

Second, by extending the scope of conduct of primary liability to include participation in the creation of another's representation, the Ninth Circuit essentially removed reliance on the participant's representation. The Supreme Court in Central Bank stressed the reliance requirement for primary liability and referred to reliance as "critical for recovery." The Ninth Circuit provided no discussion or reference as to how the plaintiff in Software Toolworks relied on any of defendant's actions.

Additionally, some district courts adopting an expansive scope of liability under section 10(b) and rule 10b-5 sought to justify their holdings by distinguishing among the rule 10b-5 sub-sections.

271. Securities & Exch. Comm'n v. Seaboard, 677 F.2d 1301, 1311 n.12 (9th Cir. 1982) (noting that recognition of aiding and abetting liability is often justified by the "broad policy objectives" of the 1933 and 1934 Acts).

272. See supra notes 98-102 and accompanying text for a discussion of the Court's shift to a strict constructionist approach.

273. Software Toolworks, 50 F.3d at 628 n.3. See also supra notes 54, 142-43 and accompanying text for a discussion of the reliance element of a primary liability claim under section 10(b) and rule 10b-5.

274. Software Toolworks, 50 F.3d at 628 n.3.

275. See Adam v. Silicon Valley Bancshares, 884 F. Supp. 1398, 1401 (N.D. Cal. 1995). See also HAFT, supra note 83, at § 3.05[1] for a discussion of what constitutes "making" a representation under section 10(b) after Central Bank.

276. See HAFT, supra note 83, at § 3.05[1] (discussing Software Toolworks).


279. See supra Part III.A.2 (discussing district court cases that distinguish the sub-
Only rule 10b-5(b) expressly prohibits a material misrepresentation or omission of fact, whereas rules 10b-5(a) and (c) prohibit the use of “any device, scheme or artifice to defraud” and the “engage[ment] in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.” Noticing that the Supreme Court in earlier cases recognized that rules 10b-5(a) and (c) are not as restrictive in scope as rule 10b-5(b), lower courts that advocate an expansive view of section 10(b) and rule 10b-5 justify a finding of liability for participation in the making of another’s representation by concluding that the individuals’ alleged participation was part of a “scheme to defraud.” The Court in Central Bank, however, did not distinguish among the sub-sections of rule 10b-5. It simply stated that section 10(b) and rule 10b-5 prohibit a material misrepresentation or omission of fact and a manipulative act, and that the scope of conduct prohibited by section 10(b) controls conduct prohibited by rule 10b-5. To hold actors liable based upon their participation in the making of a representation, not necessarily a manipulative act committed in an overall scheme to defraud, fails to follow the language of rule 10b-5(b). If a claim alleges that the violation is a material misrepresentation or omission, then rule 10b-5(b) governs because it expressly prohibits the making of a material misrepresentation.

The result of the Ninth Circuit and district court decisions is a conceivably limitless scope of liability under section 10(b) and rule 10b-5. The courts found primary liability when an individual reviews and approves another's representations, is involved in discussions, or provides advice and recommendations. Consequently, these decisions provide little guidance as to the dividing line between what conduct constitutes primary liability versus what conduct constitutes

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282. Id. § 240.10b-5(c) (1996).
283. See supra notes 33-35 and accompanying text for a discussion of the scope of rules 10b-5(a) and (c).
285. Central Bank, 511 U.S. at 173. The Court stated: “But the private plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b).” Id.
286. 17 C.F.R. § 240.10b-5(b).
287. See supra Part III.A (discussing cases adhering to an expansive interpretation of section 10(b) and rule 10b-5).
secondary liability. Such an expansive interpretation can lead to the ad hoc decision making that the Court in Central Bank cautioned against. In fact, its effect is to ignore Central Bank entirely.

B. The Tenth Circuit: Providing "Certainty and Predictability"

The Tenth Circuit's decision in Anixter v. Home-Stake Production Co. came two years after Central Bank and approximately one year after Software Toolworks. The Tenth Circuit, therefore, had the opportunity to analyze both the Central Bank and Software Toolworks decisions. The Tenth Circuit's conclusion that individuals can be liable for representations they make and know or should know will reach investors provides the guidance necessary to create the "certainty and predictability" in securities law, which the Court in Central Bank found absent in aiding and abetting liability.

The Tenth Circuit's conclusion conforms to the reasoning of the Court in Central Bank. The Tenth Circuit grounded its conclusion on the text of section 10(b) and rule 10b-5 and by reference to the Court's analysis in Central Bank. Thus, its approach is consistent with the Court's textualist approach to section 10(b) and rule 10b-5. As such, the Tenth Circuit's conclusion is restrictive in scope because it does not premise liability on a degree of assistance.

The restrictive approach advanced by the Tenth Circuit, however, runs the risk that secondary actors who should be held liable will escape liability. The Court in Central Bank recognized that "[i]n any complex securities fraud . . . there are likely to be multiple violators." Among these violators are secondary actors, which the Tenth Circuit's conclusion does not insulate from liability. However, the possibility that they will escape liability is greater with a restrictive approach because of the requirement that the individual must make the statement himself. Despite this possible shortcoming, the Tenth

288. Central Bank, 511 U.S. at 188.
289. 77 F.3d 1215 (10th Cir. 1996).
291. The Tenth Circuit analyzed Central Bank and noted the Ninth Circuit's expansive approach and the district courts that followed it. Anixter, 77 F.3d at 1224-27, 1226 n.10.
292. Central Bank, 511 U.S. at 188.
293. Anixter, 77 F.3d at 1224-27.
Circuit’s holding and reasoning are consistent with *Central Bank* and will not transform conduct typically considered aiding and abetting into conduct establishing primary liability.

V. PROPOSAL

In *Central Bank*, the Court stated, “Congress knew how to impose aiding and abetting when it chose to do so.” Since the Supreme Court’s decision in this case, Congress has restored to the SEC the right to hold individuals liable for aiding and abetting, but Congress has not yet chosen to create a private right of action for aiding and abetting liability. It is unlikely that Congress will create such a right of action, as it has declined to amend section 10(b) to prohibit aiding and abetting liability. Based on the lack of congressional action after *Central Bank*, and the Court’s adherence to a strict construction of section 10(b), courts should adopt the Tenth Circuit’s interpretation in *Anixter v. Home-Stake Production Co.* Widespread adoption of *Anixter* will conform to Supreme Court interpretation of section 10(b) and rule 10b-5, and create the predictability sought by the Court.

The Tenth Circuit in *Anixter* admitted that its holding—to be liable, an individual must make a misrepresentation which he knows will be communicated to investors—is not a “bright line” rule. Despite this, the Tenth Circuit’s holding provides a clearer standard for establishing primary liability than standards advanced by the Ninth Circuit and the district courts following it. The standards advanced by the Ninth Circuit and subsequent district court decisions find liability for conduct such as reviewing and approving documents, and participating in discussions of representations. The practical effect of the these standards is to restore the law to the pre-*Central Bank* state.

Although the Tenth Circuit’s approach could be characterized as rigid and restrictive, it does not insulate secondary actors from liability. Rather, it enables such actors to have a better understanding

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1996) (reasoning that “if too rigidly applied, . . . requiring secondary actors to actually ‘make’ a statement poses the danger of allowing culpable parties who knowingly draft false and misleading representations to avoid civil liability”).


297. *See supra* note 5.

298. *Central Bank*, 511 U.S. at 186-87. The Court noted that on three occasions bills were introduced that sought to amend the securities act to include aiding and abetting. *Id.* The bills, however, never passed. *Id.*

299. 77 F.3d 1215 (10th Cir. 1996).

300. *Id.* at 1227.

301. *See supra* Part III.A (discussing conduct found actionable under section 10(b) and rule 10b-5).
of what conduct may give rise to liability, whereas the vague standards of the Ninth Circuit provide little guidance as to what conduct constitutes primary liability. This conformity to the text of section 10(b) and rule 10b-5, and guidance for secondary actors will aid in providing the certainty and predictability sought by the Court in Central Bank. Accordingly, the Tenth Circuit conforms to the reasoning of Central Bank, and provides lower courts with a clearer standard of what conduct constitutes a primary violation of section 10(b) and rule 10b-5.302

VI. CONCLUSION

Since 1946, courts have accepted an implied right of action for primary violations of section 10(b) of the 1934 Act and rule 10b-5, promulgated thereunder.303 For decades, this right of action extended to those who "aided and abetted" a primary violation of section 10(b) and rule 10b-5.304 In Central Bank, the Supreme Court held that one could not be liable as an aider and abettor.305 Even though the decision in Central Bank appeared unambiguous, it did not resolve the uncertainty surrounding the scope and applicability of section 10(b) and rule 10b-5.306 The Court's decision failed to guide lower courts in determining the scope of liability under section 10(b) and rule 10b-5.307 On the one hand, the expansive approach of the Ninth Circuit diminishes the power of Central Bank to stabilize securities law because the inclusion of "substantial assistance" as a primary violation will create more uncertainty regarding the scope of liability under section 10(b) and rule 10b-5.308 The Tenth Circuit's approach, on the other hand, while seemingly restrictive, adheres to the reasoning of

302. Id.
303. See supra Part II.A.
305. Central Bank, 511 U.S. at 191. See generally supra Part II.C.
306. See supra Part II.C.
307. See supra Part II.C.
308. See supra Part III.A.1.
Central Bank, and it works to stabilize securities law. Because of the stability it will foster, and its conformance with the Court’s interpretation of section 10(b) and rule 10b-5, the Tenth Circuit’s approach should be adopted over the Ninth Circuit.

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309. See supra Part III.B.2.
310. See supra Part V.