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# PENDING LEGISLATION WOULD EXPAND SCOPE OF PARTIES THAT MAY BE SUED FOR SECURITIES FRAUD

## LIABILITY FOR AIDING AND ABETTING SECURITIES VIOLATIONS ACT OF 2009

On July 30, 2009, Senator Arlen Specter (D-PA) introduced Senate Bill 1551, "Liability for Aiding and Abetting Securities Violations Act of 2009." If passed, the legislation will permit private civil actions against secondary actors including accountants, investment bankers, and lawyers for aiding and abetting primary violators of the securities laws. Senate Bill 1551 effectively aims to overturn the U.S. Supreme Court's decisions in *Central Bank of Denver v. First Interstate Bank* and *Stoneridge Investment Partners v. Scientific-Atlanta*, both of which held that a private plaintiff may not bring a claim for aiding and abetting violations of the securities laws.

The status of Senate Bill 1551 should be of considerable significance to all companies and their directors and officers. If enacted, Senate Bill 1551 would, no doubt, create a new class of potential defendants in private securities fraud class actions. Additionally, the legislation will almost certainly raise the cost of business for companies.

## THE CURRENT LAW ON AIDING AND ABETTING

Under current law, private litigants may not bring aiding and abetting claims under the federal securities laws. Instead, Congress has vested sole authority to bring these claims with the Securities and Exchange Commission.

In 1994, the U.S. Supreme Court issued its landmark decision *Central Bank of Denver v. First Interstate Bank*, in which the Court held that "a private plaintiff may not maintain an aiding and abetting suit under § 10(b)." *Central Bank of Denver v. First Interstate Bank*, 511 U.S. 164, 191 (1994). The Court stated that, "[t]he absence of aiding and abetting liability does not mean that secondary actors ... are always

free from liability.... Any person or entity ... 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...." *Id*. Thus, secondary actors may be liable in a private action by showing that those actors were, in fact, primary violators, which requires satisfying all elements of primary liability. In a § 10(b) action, for example, a plaintiff must prove (1) a material misrepresentation or omission; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance; (5) economic loss; and (6) loss causation. *See Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005).

In 2008, the Supreme Court again addressed the issue of aiding and abetting in the securities law context in *Stoneridge Investment Partners*. In this case, the Court noted that, "*Central Bank* led to calls for Congress to create an express cause of action for aiding and abetting within the Securities Exchange Act.... Congress did not follow this course. Instead, in section 104 of the Private Securities Litigation Reform Act of 1995, it directed prosecution of aiders and abettors by the SEC. The § 10(b) implied private right of action does not extend to aiders and abettors." *Stoneridge Investment Partners v. Scientific-Atlanta*, 128 S.Ct. 761, 769 (2008) (citing 15 U.S.C. § 78t(e)).

## THE POTENTIAL EFFECTS OF SENATE BILL 1551

Under Senate Bill 1551, Section 20 of the 1934 Securities Exchange Act (15 U.S.C. 78t(e)) would be amended so that any person who knowingly or recklessly provides substantial assistance to another person would be subject to liability in a private action to the same extent as the person to whom such assistance is provided. In short, Senate Bill 1551 would overturn *Central Bank of Denver* and *Stoneridge* and thereby allow litigants to bring aiding and abetting causes of action in private securities fraud suits.

Senate Bill 1551 poses serious ramifications to all companies and their directors and officers. First, the pool of potential defendants would likely increase significantly should Senate Bill 1551 become law. As a result, the cost of doing business for these would-be defendants will presumably rise as insurers raise D&O insurance premiums to cover this new exposure. Specifically, accountants, investment banks, securities analysts, credit rating agencies, law firms, and others who previously found themselves on the sidelines of securities fraud lawsuits will undoubtedly now find themselves to be named defendants. Undoubtedly, lawyers, accountants, bankers, and others will raise fees for securities-related work to offset some of this new exposure.

Aiding and abetting claims also raise the possibility that private companies will be sued for securities fraud. The introduction of private companies to securities lawsuits raises a host of thorny issues given that most private company D&O insurance policies contain securities claim exclusions.

## COMMITTEE HEARING ON SENATE BILL 1551

On September 17, 2009, the Subcommittee on Crime and Drugs of the United States Senate Committee on the Judiciary held a hearing on Senate Bill 1551. The hearing opened with a statement from Chairman Patrick Leahy (D-VT). Senator Leahy's statement offers insight into the lens through which the Democratic Congress is likely to view this bill:

> In the wake of scandals like Enron, the Madoff case, and the widespread financial fraud that contributed to our current economic crisis, we need to start holding those who take part in fraud accountable.... The Supreme Court has made this issue more difficult to address in the wake of their divided decision in *Stoneridge v. Scientific Atlanta*.... We should continue to act and make sure that those who aid in fraudulent behavior are caught and held fully accountable and that individuals are not held to a lower standard than corporations.

Five witnesses testified at hearing, offering differing views on the merits of Senate Bill 1551.

Arguing in favor of passage were (1) Patrick J. Szymanski, General Counsel of Change to Win (an alliance of Unions) and (2) Tanya Solov on behalf of the North American Securities Administrators Association. Solov argued: "[g]iven

the complexity of corporate activity, secondary actors such as accountants and lawyers now play a critical role in the preparation and dissemination of public information. If they are allowed to avoid liability for their actions, there will be no deterrent to prevent them from engaging in fraudulent schemes."

Professor John C. Coffee, Jr. of Columbia University Law School also argued in favor of passage of Senate Bill 1551, but he recommended caps on damages that could be assessed against secondary actors. Coffee suggested that in the case of a natural person, the ceiling should be $2,000,000; in the case of a public corporation (such as an investment bank or a rating agency), the maximum ceiling should be $50,000,000.

Arguing against passage of Senate Bill 1551 were (1) Professor Adam C. Pritchard of the University of Michigan Law School and (2) Robert Giuffra, Jr., Partner, Sullivan & Cromwell LLP, Former Chief Counsel, U.S. Senate Banking Committee (1995–1996). Giuffra argued that Senate Bill 1551 "would hurt the competitiveness of U.S. capital markets and financial centers and vastly expand the potential liability and defense costs of innocent third parties that do business with public companies."

Additionally, Giuffra noted that Senate Bill 1551 employs a vague and amorphous standard of "recklessness" that would lower the pleading threshold to something akin to negligence or gross negligence so that cases that now are dismissed would survive. This, combined with an undefined "substantial assistance" term, would create such uncertainty about the applicable legal standard that the pressure to settle cases would be "overwhelming."

Professor Pritchard added that, "the balance struck by the PSLRA is a sensible compromise.... By vesting authority to pursue aiders and abettors in the SEC, Congress recognized that securities class actions are not the primary vehicle for deterring fraud. Civil sanctions imposed by the SEC, criminal prosecution by the Justice Department, and both civil and criminal cases brought by state attorneys general are the primary deterrent of fraud in the securities markets. Private class actions move a lot of money around, but add little deterrence at the margin."

## THE FUTURE OF SENATE BILL 1551

It is not clear whether Senate Bill 1551 will go to the full Senate for a vote. The 111th U.S. Congress and the President are currently focused on health care reform and foreign conflicts, among other issues. However, given the seismic economic changes that have transpired in the past two years, there is a strong possibility that this bill will progress, as outcries for corporate accountability grow louder. The Financial Crisis Inquiry Commission, established to examine the causes of the current financial and economic crisis in the United States, will undoubtedly add to the cry for reform. Indeed, in the wake of the Madoff scandal and the *Bank of America* case, there are many who question whether it is enough to leave responsibility for aiding and abetting enforcement solely to the SEC. In all events, with overwhelming Democratic majorities in Congress and a Democratic President, the possibility of Senate Bill 1551 passing becomes even more likely.

## LAWYER CONTACTS

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