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Where Were the Lawyers and Accountants? Primary liability under Section 10(b) of the Exchange Act

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WHERE WERE THE LAWYERS AND ACCOUNTANTS?

PRIMARY LIABILITY UNDER SECTION 10(b) OF THE EXCHANGE ACT

I. INTRODUCTION

Section 10(b) ("§ 10(b)") of the Securities Exchange Act of 1934 (the "Exchange Act") provides the best-known and most often invoked basis for liability in connection with the purchase or sale of securities. Congress adopted § 10(b) to serve as a deterrent for, and a remedy against, the fraudulent securities practices that largely contributed to the Great Depression. The broad antifraud provisions of § 10(b), and Rule 10b-5 promulgated thereunder, have long presented the courts with the challenge of striking an appropriate balance between curbing vexatious litigation and providing an adequate remedy against manipulative and deceptive conduct in the sale of securities. In 1994, the Supreme Court attempted to strike that balance in broad strokes by significantly narrowing the scope of conduct prohibited by § 10(b). In *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), the Court ruled that secondary actors, such as accountants, investment bankers, and lawyers, are not subject to aiding and abetting liability in private lawsuits brought under § 10(b). Rather, a plaintiff must prove a primary violation of § 10(b) for each defendant. In the two decades that followed *Central Bank,* the Court continued to narrow the scope of conduct prohibited by § 10(b). In 2008, on the eve of the Great Recession, the Court adopted a formidable standard for proving reliance. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148 161-2, 128 S. Ct. 761, 169 L. Ed. 2d 627 (2008). Three years later, the Court adopted a bright line test for distinguishing primary and secondary violations of § 10(b). *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 131 S. Crt. 2296, 180 L. Ed. 2d 166 (2011). This paper discusses the evolution of primary liability for secondary actors after the *Central Bank* decision, with a focus on legal developments in the post-*Janus* world.

II. SECTION 10(b) OF THE EXCHANGE ACT AND RULE 10b-5

Since its passage during the new deal era, § 10(b) has provided 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 in contravention of such rules and regulations as the [U.S. Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. 78j. On its face, § 10(b) enables the U.S. Securities and Exchange Commission (the "SEC") to bring civil enforcement actions for material misstatements and deceptive schemes. In the event the SEC refers a case to the Department of Justice, § 10(b) can also form the basis for criminal liability. More significantly, however, the U.S. Supreme Court has long recognized § 10(b) as the source of an implied private right of action, thereby enabling private plaintiffs to bring suit directly against violators of § 10(b). Under the authority of § 10(b), the SEC promulgated Rule 10b-5 which provides that:

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

17 C.F.R. § 240.10b-5. Rule 10b-5 conceptually prohibits two categories of conduct. Subsection (b) of Rule 10b-5 specifically addresses material misstatements and omissions ("Misstatement Liability"), whereas subsections (a) and (c) of Rule 10b-5 more generally address the use of manipulative or deceptive devices ("Scheme Liability").

In their infancy, § 10(b) and Rule 10b-5 provided the basis for both public and private remedies against a broad scope of conduct, including direct liability of primary actors and aiding and abetting liability for secondary actors. Over the past two decades, however, the Supreme Court has incrementally narrowed the scope of conduct that creates liability in a private cause of action brought under § 10(b) and Rule 10b-5.

a. <u>Central Bank</u>

In *Central Bank*, the Supreme Court significantly curtailed the private cause of action under § 10(b) by holding that aiding and abetting liability under § 10(b) is only available in public causes of action. Central Bank of Denver ("Central Bank") was the indenture trustee of two bond issues of a public building authority. 511 U.S. at 167. The bond covenants specified a minimum collateralization threshold and, when questions arose regarding the value of the collateral, Central Bank allegedly delayed its independent appraisal until after the second offering closed. Before the independent appraisal was complete, the public building authority defaulted on the second bond issue. In response, the purchaser of the bonds sued Central Bank, asserting secondary liability under § 10(b) for aiding and abetting fraud by the public building authority and other defendants. On appeal from an order on a motion for summary judgment, the Supreme Court overruled "*hundreds* of judicial and administrative proceedings in every Circuit in the federal system" by holding that private civil liability under § 10(b) is only available for primary violations of § 10(b). *Id*. at 192 (Stevens, J., dissenting) (emphasis in original). In other words, accountants, lawyers and investment advisors would no longer be liable in private suits for merely aiding and abetting a violation of § 10(b).

The Court predominately based its conclusion on the lack of aiding and abetting language in § 10(b), despite arguments that § 10(b)'s inclusion of the phrase "directly or indirectly" encompassed aiding and abetting. *Id*. at 175. The Court also reasoned that aiding and abetting liability could allow plaintiffs to circumvent the element of reliance required under Rule 10b-5. *Id*. at 180. In conclusion, the Court held 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, assuming *all* of the requirements of primary liability under Rule 10b-5 are met." *Id*. at 191, (emphasis in original).

As a result of *Central Bank*, the characterization of conduct as a "primary" violation became the key factor in determining whether the conduct of lawyers, accountants, investment bankers and other third parties have liability under § 10(b) and Rule 10b-5. During the ten years that followed *Central Bank*, three notable tests developed for determining who is a primary violator with regard to Misstatement Liability: a bright line test, a substantial participation test and a creation test.

b. Misstatements and Omissions after Central Bank

Subsequent to *Central Bank*, two conflicting tests developed for defining the types of misstatements or omissions by secondary actors that satisfy the requirements of primary liability under § 10(b). The Second and Eleventh Circuits adopted a "bright line test" that limited Misstatement Liability to the person or persons to whom the false statement or omission was publically attributed. *Wright v. Ernst & Young*, 152 F.3d 169, 175 (2d Cir. 1998)(holding that the defendant must actually make a statement, and that statement must "be attributed to that specific actor at the time of public dissemination, that is, in advance of the investment decision."); *Ziemba v. Cascade Intern., Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001)(holding "that, in light of *Central Bank,* in order for the defendant to be primarily liable under § 10(b) and Rule 10b-5, the alleged misstatement or omission upon which a plaintiff relied must have been publicly attributable to the defendant at the time that the plaintiff's investment decision was made."). Similarly, the Tenth Circuit adopted a modification of the bright line test in holding that a defendant must actually make a statement and that statement must "be attributed to that specific actor at the time of public dissemination, that is, in advance of the investment decision." *Anixter v. Home-Stake Production Co.*, 77 F.3d 1215, 1226 (10th Cir. 1996). In contrast, the Ninth Circuit adopted a broader "substantial participation test" that provided Misstatement Liability for each secondary actor that significantly participated in the making of a false statement or omission. *In re Software Toolworks, Inc.*, 50 F.3d 615, 625 (9th Cir. 1994). The SEC, however, took the position that even the substantial participation test was too narrow, advocating an even broader "creation test." In 2002, the United States District Court for the Southern District of Texas adopted the creation test proposed by the SEC, in the SEC's role as *amicus curiae*. *In re Enron Corp. Secs., Deriv. & ERISA Litig.*, 235 F. Supp. 2d 549, 590 (S.D. Tex. 2002). Under the creation test, a secondary actor may be liable as a primary violator for creating a misrepresentation on which an investor relies. *Id*. With the Great Recession looming and an apparent erosion of the balance struck in *Central Bank*, further clarification from the Supreme Court was imminent.

In a divided 5-4 decision, the Supreme Court resolved the circuit split in favor of a bright line test. *Janus*, 564 U.S. 135, 131 S. Crt. at 2302. *Janus* involved a class action brought by stockholders of Janus Capital Group, Inc. ("JCG") against JCG and its subsidiary, Janus Capital Management LLC ("JCM"), alleging that JCG and JCM made false statements in prospectuses issued by Janus Investment Fund. The prospectuses in question stated that the funds were not suitable for market timing and could be read to suggest that JCM, as the investment advisor of

Janus Investment Fund, would implement policies to curb market timing trades. In 2003, the Attorney General of the State of New York filed a complaint against JCG and JCM, alleging they entered into a secret agreement to permit market timing. In response, investors withdrew significant amounts from Janus Investment Fund, thereby decreasing the potential management fee revenues of JCM and JCG and driving down the price of stock in JCG. The district court dismissed the plaintiffs' complaint for failure to state a claim. The Fourth Circuit reversed, holding that plaintiffs' complaint sufficiently alleged facts showing that JCM and JCG had substantially participated in the material misstatement. On appeal to the Supreme Court, plaintiffs took the position that JCM substantially participated in the material misstatement as the investment advisor of Janus Investment Fund and the author of the prospectuses. The plaintiffs further posited that JCG was liable as a control person under Section 20(a) of the Exchange Act.

Focusing on the definition of the verb "to make," the Supreme Court held that only the "maker" of a statement can be held liable for alleged misrepresentations and omissions under subsection (b) of Rule 10b-5. *Id.* at 2302. The Supreme Court explained that the "maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Id.* The Supreme Court also clarified that "[o]ne who prepares or publishes a statement on behalf of another is not its maker." *Id.* Furthermore, the Supreme Court wrote, "in the ordinary case, attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by -- and only by -- the party to whom it is attributed." *Id.* Accordingly, JCM could not be regarded as a "maker" because Janus Investment Fund, and not JCM, signed and filed the prospectuses. In reaching its decision, the Court noted that, Janus Investment Fund was owned entirely by its investors and that the board of trustees of Janus Investment Fund, and not JCM, had ultimate authority over the prospectuses. *Id.* at 2304. Notably, only one member of Janus Investment Fund's board of trustees was associated with JCM. *Id.* at 2299. The Court likened JCM to a speechwriter and noted that assisting Janus Investment Fund with crafting the prospectuses did not make JCM a "maker" for purposes of subsection (b) of Rule 10b-5. *Id.* at 2304-05. Since JCM was not a "maker," JCG could not be a "control person" under Section 20(a) of the Exchange Act. As a practical matter, the bright line test adopted in *Janus* is anticipated to bolster the ability of secondary actors to obtain dismissal of vexatious claims for Misstatement Liability at the pleading stage, but the implications of *Janus* on Scheme Liability may also be significant, given another recent Supreme Court case.

c. Clarifying the Reliance Element to Scheme Liability

Three years before deciding *Janus*, the Supreme Court reinforced the significance of reliance in distinguishing primary and secondary violations. In *Stoneridge*, the Court clarified the reliance requirement as it relates to Scheme Liability. *Stoneridge* involved a private right of action against "entities who...agreed to arrangements that allowed the investors' company [Charter] to mislead its auditor and issue a misleading financial statement affecting the stock price." *Id*. at 152-3. The defendants allegedly knew of Charter's intention to use *quid pro quo* transactions with inflated prices as a means to inflate revenues in the financial statements Charter would issue to investors. *Id*. at 155. Plaintiffs essentially argued that the defendants had "engaged in conduct with the purpose and effect of creating a false appearance of material fact to further a scheme to misrepresent Charter's revenue..." *Id*. at 160. The Court determined that plaintiffs had failed to satisfy the reliance element of a § 10(b) claim because the proximate

causation between the defendants' conduct and the plaintiffs' reliance on Charter's misstatement was too attenuated. *Id*. at 160-61. The Court also expressed reluctance to adopt a concept of reliance that indicated "investors rely not only upon the public statements relating to a security but also upon the transactions those statements reflect." *Id*. To do so, the Court reasoned, would undermine the purpose of the reliance requirement because it was Charter, and not the defendants, who misled the auditor and filed fraudulent financial statements. *Id.* In the Court's view, "nothing [the defendants] did made it necessary or inevitable for Charter to record the transactions as it did." *Id*. at 161. In other words, Scheme Liability requires that the defendant's conduct made it inevitable that the plaintiff would be exposed to the deceptive scheme prior to making the investment decision. As discussed below, the holdings in *Janus* and *Stoneridge*, taken together, have perpetuated the narrowing of the scope of liability in private actions brought under § 10(b).

III. PRIMARY VIOLATIONS IN THE POST-*JANUS* WORLD

After Janus, determining who is a primary violator remains the key determination under § 10(b) and subsection (b) of Rule 10b-5, but the focus of the inquiry has turned to the exercise of "ultimate authority." The cases interpreting *Janus* have reached disparate conclusions in applying the new test to facts involving both unrelated third-party professionals and corporate insiders. In addition, plaintiffs' efforts to re-characterize traditional Misstatement Liability as Scheme Liability have prompted courts to draw a clearer distinction between conduct actionable under subsection (b) of Rule 10b-5 and conduct actionable under subsections (a) and (c) of Rule 10b-5.

a. Misstatement Liability

1. *Lawyers, Accountants, Investment Bankers and other Professionals*

One recent decision suggests that the "ultimate authority" standard set forth in *Janus* may insulate third-party professionals who act as "yes men" in preparing false or misleading statements at the direction of their clients. A recent decision from the District Court for the District of Oregon illustrates this line of reasoning. The alleged fraud in *In re Galena Biopharma, Inc. Secs. Litig.*, 2015 U.S. Dist. LEXIS 102250 (D. Or. Aug. 5, 2015) was a "pump and dump" scheme whereby Galena allegedly hired DreamTeam Group LLC ("DreamTeam") to artificially inflate Galena's stock price by drafting and publishing bullish articles, comments, blogs, posts, and email blasts without including the required disclosure that DreamTeam was being paid by Galena to publish such commentaries. *Id.* at *7-15. The court held that only Galena, and not DreamTeam, could be the "maker" of each commentary drafted and published by DreamTeam because Galena allegedly required DreamTeam to submit each draft commentary to Galena for approval before publication. *Id.* at *87-94. The court also found significant that Galena had allegedly instructed DreamTeam to omit the compensation disclosure from all of the commentaries. *Id.* The court reasoned that, because Galena and DreamTeam were separate legal entities, if Galena retained the ultimate authority over the content and publication of the articles, then DreamTeam necessarily did not have ultimate authority over those same articles, and vice versa. *Id*. at *90-94. As discussed below, however, *Janus* did not insulate DreamTeam from Scheme Liability for the purported scheme.

Recent decisions by other courts have interpreted *Janus* to permit third parties and issuers to share "ultimate authority" when they participate in the drafting and approval of the statements in question. In *In re Puda Coal Sec. Inc.*, 30 F. Supp. 3d 261 (S.D.N.Y. 2014), the plaintiffs filed a complaint against the underwriters in a public offering of securities in Puda Coal Inc. ("Puda"). The complaint alleged that the underwriters learned, during their due diligence, that Puda no longer owned the assets it purported to own in its registration statement. The court held that misstatements in prospectuses could be attributed to the underwriters as "makers" because the complaint alleged that (i) the prospectuses were prepared by, and required the approval of, the underwriters, (ii) the prospectuses prominently display the underwriters' names, even though neither underwriter signed them and (iii) the underwriters solicited investors for the offering and distributed prospectuses to those investors. *Id.* at 267-68; *see also Sharette v. Credit Suisse Int'l*, No. 14-cv-8486 (VM), 2015 U.S. Dist. LEXIS 111966, at *71 (S.D.N.Y. Aug. 20, 2015) (following the attribution analysis provided in *In re Puda*, but concluding that the complaint failed to sufficiently allege that the defendant participated in and approved the prospectus).

2. *Shareholders and Other Corporate Insiders*

Courts have also reached conflicting results in applying *Janus* to transactions involving the participation of corporate insiders. For example, the court in *City of Roseville Emples. Ret. Sys. v. EnergySolutions, Inc.*, 814 F. Supp. 2d 395, 417-18 (S.D.N.Y. 2011), declined to dismiss a complaint against ENV Holdings, Inc. ("ENV"), for misstatements in a registration statement filed by, and expressly attributed to, EnergySolutions, Inc. ("ES"). The court distinguished ENV from the investment advisor in *Janus* based on ENV's ownership of ES at the time the registration statement was filed, ENV's direct control over all corporate transactions, and ENV's authority to determine when and whether to sell the shares being sold by ENV pursuant to ES's registration statement. *Id.* at 418. The court reasoned that, "[a]lthough the [r]egistration [s]tatements did speak in the voice of ES and were signed by [other defendants] in their capacities as directors or officers of ES, these explicit attributions did not preclude attribution to ENV as well" because "*Janus* recognized that attribution could be implicit from surrounding circumstances." *Id.* (internal citations omitted). The court held that the facts alleged could support a finding that ENV's role went well beyond that of a speechwriter drafting a speech, because, with regard to ES's sales of shares owned by ENV, ENV had control over the content of the message, the underlying subject matter of the message, and the ultimate decision of whether to communicate the message. *Id.* Under *City of Roseville*, both ES and ENV could be regarded as "makers" of the registration statements. *Id.*

Conversely, the court in *In re Optimal U.S. Litig.*, 2011 U.S. Dist. LEXIS 119141, at *1 (S.D.N.Y. Oct. 13, 2011), dismissed a complaint against Optimal Investment Management Services, S.A. ("OIS"), the investment manager of Optimal Strategic U.S. Equity ("Optimal"), a feeder fund that funneled investments to Bernard L. Madoff. The plaintiffs asserted that OIS was liable for allegedly materially misleading statements and omissions in explanatory memoranda ("EMs") issued by Optimal Multiadvisors, Ltd. ("Multiadvisors"), a 100% subsidiary of OIS. The court held that the board of directors of Multiadvisors, and not OIS, had "ultimate authority" of the contents of, and the decision to issue, the EMs. *Id.* at *16-17. The court reasoned that the board of Multiadvisors had authority to alter the EMs without consulting OIS, despite allegations that OIS's in-house counsel had "suggested changes to the EMs, which Multiadvisors adopted." *Id.* The court also noted that *Janus* refused to extend Misstatement

Liability where Congress had created a statutory remedy. *Id.* at 18-19. Even if OIS in fact exercised control over Multiadvisors as its 100% shareholder, the court reasoned that Congress has already provided for control person liability under Section 20(a) of the Exchange Act.

The court in *In re Optimal* also rejected the plaintiffs' argument that the EMs could be attributed to OIS based on references to OIS contained therein. The court noted that references to OIS on cover pages of the EMs did not support attribution because Multiadvisors was listed as the issuer whereas OIS was listed alongside support professionals, such as auditors, lawyers and custodians, specifically in OIS's capacity as investment advisor. *Id.* at *23-24. Further, allegedly false statements in the EMs made by a director of Multiadvisors could not be attributed to OIS even though said director was also the CEO of OIS. *Id.* at *26.

3. *Corporate Officers*

Following *Janus*, courts have interpreted the attribution element of *Janus* to reach corporate officers who are quoted in press releases or sign SEC filings and other disclosures. *See La. Mun. Police Emples. Ret. Sys. v. KPMG, LLC*, No. 1:10cv01461, 2012 U.S. Dist. LEXIS 124082, at *18-19 (N.D. Ohio Aug. 31, 2012) (holding that corporate officers who sign public filings or are quoted in press releases are "makers"); *In Re Merck & Co., Inc. Sec., Derivative & ERISA Litig*., 2011 U.S. Dist. LEXIS 87578, 2011 WL 3444199 at *25 (D.N.J. Aug. 8, 2011) (noting *Janus* does not limit liability where the defendant signed SEC forms and was quoted in articles and reports in his capacity as executive vice president); *and In re Pfizer Secs. Litig.*, 2012 U.S. Dist. LEXIS 39454, at *20-21 (holding that executive defendants could be liable for statements in press releases because the executives were allegedly involved in drafting, reviewing and/or disseminating those statements, approved or ratified those statements and, therefore, adopted them as their own). At the pleading stage, a conclusory statement that a corporate officer has made the pertinent misstatement or omission may be sufficient. *See Owens v. Jastrow*, 789 F.3d 529, 547 (5th Cir. 2015) (noting in dicta that "allegations that a corporate officer made statements are sufficient to state a claim that the officer is a "maker" of the statements.").

Courts have also found *Janus* to affect the availability of Misstatement Liability for corporate officers who do not sign the pertinent SEC filings and other disclosure documents. For example, in *Louisiana Municipal Police*, the court dismissed a Misstatement Liability claim against Miller, the Director of Corporate Accounting at Diebold Inc. ("Diebold"), despite Miller's alleged intimate involvement in (i) preparing financial reports with false information and (ii) causing Diebold to include such false information in public press releases and SEC filings. 2012 U.S. Dist. LEXIS 124082, at *8-9. The plaintiffs specifically alleged that Miller made false accounting entries to Diebold's books, redrafted form sales contracts, made false off-setting journal entries and made improper entries that resulted in improper capitalization of expenses. *Id.* All of these alleged acts resulted in Diebold's false or misleading statements, but Miller did not publish the press releases or file the financial statements with the SEC. *Id.* Rather, the court held that Miller could not have "ultimate authority" because Miller reported to Diebold's executive corporate officers, who in turn signed the filings and made the press releases. *Id.*

Other courts have interpreted *Janus* to permit Misstatement Liability where an executive ratifies and approves his company's statement. *Comprehensive Inv. Servs. v. Mudd (In re Fannie Mae 2008 Sec. Litig.)*, 891 F. Supp. 2d 458, 473 (S.D.N.Y. 2012) (holding that, while a chief risk officer did not sign the disclosures, his knowledge of his company's risks, participation in drafting the disclosures and sub-certification of the SEC filings created a question of fact as to whether he had ultimate authority over, or ratified and approved, the misstatements contained in the SEC filings); *City of Pontiac Gen. Emples. Ret. Sys. v. Lockheed Martin Corp.*, 875 F. Supp. 2d 359, 374 (S.D.N.Y. 2012) (interpreting *Janus* to permit the imposition of Misstatement Liability jointly upon corporate officers of the same entity with joint authority to "make" an SEC filing); *But see Glickenhaus & Co. v. Household Int'l, Inc.*, 787 F.3d 408, 425 n.10 (7th Cir. 2015) (holding that *Janus* requires a showing that a corporate officer actually exercised control over the content of the statement ***and*** whether and how it was communicated). Given these developments, it remains unclear under what circumstances in-house counsel could be liable for their internal review and approval of securities disclosures under *Janus*.

b. Scheme Liability

The bright line test established in *Janus* appears to have prompted some plaintiffs to focus on Scheme Liability, in hopes of salvaging claims against defendants who have engaged in deceptive conduct but do not qualify as "makers" under *Janus*. The "maker" language relied on in *Janus* appears in subsection (b) of Rule 10b-5 but not in subsections (a) and (c) of Rule 10b-5, so a defendant need not be a "maker" of a statement to be liable as a primary actor under Scheme Liability. *SEC v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014); *SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 287 (2d Cir. 2013). A defendant may be liable under Scheme Liability for committing an "inherently deceptive or manipulative" act, even if that defendant is merely following orders in a scheme that has been masterminded by someone else. *SEC v. U.S. Evnvtl., Inc.*, 155 F.3d 107, 112 (2nd Cir. 1998). It is not enough, however, that a defendant's conduct becomes deceptive as the result of misstatements or omissions in disclosures. *SEC v. Kelly*, 817 F. Supp. 2d 340, 344 (S.D.N.Y. 2011). To succeed on a claim for Scheme Liability, courts require that plaintiffs establish deceptive or manipulative conduct other than misstatements and omissions. *Pub. Pension Fund Grp. v. KV Pharm. Co.*, 679 F.3d 972, 987 (8th Cir. 2012); *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057 (9th Cir. 2011); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005). Stated differently, Scheme Liability exists only when the deceptive conduct involves something more than misstatements and omissions, and the facts guiding this "something more" principle are open to interpretation. *Compare In re Galena Biopharma, Inc. Secs. Litig.*, 2015 U.S. Dist. LEXIS 102250, at *123-25 (refusing to dismiss a claim for Scheme Liability against DreamTeam, noting that, while not the "maker," DreamTeam's alleged actions directly caused certain false or misleading information to be publicly disseminated in the marketplace for the purpose of artificially inflating Galena's stock price and because DreamTeam subsequently attempted to cover up its involvement); *and In re Smith Barney Transfer Agent Litig.*, 884 F. Supp. 2d 152, 161 (S.D.N.Y. 2012) (holding that the defendant's alleged conduct was "inherently deceptive" in creating a wholly owned transfer agent in order to conceal a scheme designed to channel transfer agent cost savings away from the funds to which those savings rightfully belonged); *and SEC v. Coddington*, Civil Action No. 13-cv-03363-CMA-KMT, 2015 U.S. Dist. LEXIS 35815, at *18-19 (D. Colo. Mar. 4, 2015) (holding a defendant's alleged conduct inherently deceptive in directing investors to transfer their securities to a brokerage

account without restricting the broker's ability to sell or transfer those securities out of the account); and *Securities and Exchange Commission v. Geswein, et, al.*, U.S. District Court, N.D. Ohio, Fed. Sec. L. Rep. ¶97,842, at *5 (Mar. 5, 2014) (holding that the SEC's pleading were sufficient in alleging that Miller participated in a scheme to cause Diebold to engage in improper and fraudulent accounting practices which significantly inflated Diebold's reported earnings as set forth in periodic securities filings and in information disseminated to investors and the public); *with La. Mun. Police*, 2012 U.S. Dist. LEXIS 124082, at *14-15(holding that Miller's alleged conduct in falsifying statements and accounting entries did not constitute inherently deceptive conduct other than misstatements, precluding Scheme Liability); *and United States SEC v. St. Anselm Expl. Co.*, 936 F. Supp. 2d 1281, 1299 (D. Colo. 2013) (holding a defendant's alleged conduct was not inherently deceptive when that conduct, at most, bolstered an allegedly false impression created by the misrepresentations and omissions that formed the basis of a Misstatement Liability claim).

Absent the availability of a presumption of reliance, plaintiffs also appear to have a heavy burden in proving reliance in Scheme Liability cases. The Fifth Circuit, for example, has expanded upon *Stoneridge* in holding that there cannot be "scheme liability" absent explicit attribution of conduct or statements to the defendant. *Affco Investments 2001 LLC v. Proskauer Rose L.L.P.*, 625 F.3d 185 (5th Cir. 2010). In *Affco*, plaintiffs sued a law firm after plaintiffs invested in an invalid KPMG tax shelter based on assurances that "several major national law firms" had vetted the shelter. *Id.* at 195. The Fifth Circuit affirmed dismissal based on a failure to show reliance on the involvement of the specific law firm. While it was clear the law firm was intimately involved in the tax shelter, the plaintiffs failed to allege that they knew of the law firm's role prior to the time of actual investment. The Fifth Circuit acknowledged that the causal chain between the law firm's conduct and the plaintiffs' injury was shorter than in *Stoneridge*, but the Fifth Circuit reasoned that plaintiffs "bear a heavy burden in showing that they in fact relied upon [the law firm's] own deceptive conduct." *Id.* at 193. Notably, the *Affco* opinion makes no distinction between Misstatement Liability and Scheme Liability, so it remains unclear how the Fifth Circuit would approach the reliance element in a case involving "inherently deceptive or manipulative" conduct other than misstatements and omissions. Still, the *Affco* opinion is not alone in requiring a showing of reliance greater than that described in *Stoneridge*. The Southern District of New York provides another example in *In re Smith Barney Transfer Agent Litig.*, 884 F. Supp. 2d 152, 162 (S.D.N.Y. 2012), where the court noted that, arguably, defendants' deceptive conduct made it "necessary or inevitable" that the funds would issue misleading prospectuses, providing a causal connection between the defendants' deceptive acts and the plaintiffs' losses that was proximately closer than the tenuous links rejected in *Stoneridge*. 884 F. Supp. 2d at 163. The court nonetheless dismissed the Scheme Liability claim because the plaintiffs failed to allege they had purchased or sold securities in reliance on *specific deceptive acts* of which they were aware. *Id. Louisiana Municipal Police*, discussed above, reached a similar conclusion on the Scheme Liability claim against Miller. In that case, the court noted that the plaintiffs had relied on the financial reports of Miller's employer, Diebold, and not Miller's financial reports in making plaintiffs' investment decisions. Miller was not the corporate officer who signed and filed Diebold's financial reports—with actual knowledge or reckless disregard for the misstatements inherent in those reports—so the court refused to find that Miller's conduct made it "inevitable" that Diebold would file allegedly fraudulent reports. *La. Mun. Police*, 2012 U.S. Dist. LEXIS 124082, at *12-15.

Demonstrating actual reliance would appear to be a daunting task for plaintiffs, but the Supreme Court recognizes a rebuttable presumption of reliance in two circumstances. *Stoneridge*, 552 U.S. at 159. First, under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 92 S. Ct. 1456, 31 L. Ed. 2d 741 (1972), courts presume reliance when a defendant fails to disclose material information that the defendant was obligated to share. *In re SLM Corp. Sec. Litig.*, No. 08 Civ. 1029 (WHP), 2012 U.S. Dist. LEXIS 8158, 2012 WL 209095, at *4 (S.D.N.Y. Jan. 24, 2012) (citing *Affiliated Ute*, 406 U.S. at 153-54). Second, under the "fraud-on-the-market" theory, "where a defendant has (1) publicly made (2) a material misrepresentation (3) about stock traded on an impersonal, well-developed (i.e., efficient) market, investors' reliance on those misrepresentations may be presumed." *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 481 (2d Cir. 2008) (*citing Basic v. Levinson*, 485 U.S. 224, 248 n.7, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988)). The later presumption, however, appears to require the same type of evidence that is necessary to support a finding that a defendant is the "maker" of a material statement or omission. *See In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 648 (3d Cir. 2011) (holding that, to invoke the fraud-on-the-market presumption of reliance against a secondary actor in a scheme liability action under § 10(b), the plaintiff must show the deceptive conduct was publicly attributed to that secondary actor) (*reversed on other grounds*). Absent circumstances where a secondary actor either violates a duty to disclose or directly interacts with the defendant, one has difficulty imagining a scenario where Scheme Liability is available and Misstatement Liability is not.

c. Practice Points

While *Janus* and *Stoneridge* appear to significantly narrow the scope of actionable conduct in private causes of action, the implications of these decisions may be less significant in the public context. First, the SEC retains its ability to pursue aiding and abetting liability for secondary actors under § 10(b) and Rule 10b-5. *See, e.g.*, *Securities and Exchange Commission v. Geswein, et, al.*, U.S. District Court, N.D. Ohio, Fed. Sec. L. Rep. ¶97,842, (Mar. 5, 2014). Accordingly, a person can still be liable to the SEC for aiding and abetting the "maker" of a material misstatement. In fact, the SEC pursued a civil enforcement action against Miller (in addition to the executive officers of Diebold), arguing that Miller aided and abetted the issuance of false financial reports by Diebold. *Id.* at *5. The SEC further asserted that Miller participated in a scheme to cause Diebold to engage in improper and fraudulent accounting practices which significantly inflated Diebold's reported earnings as set forth in periodic securities filings and in information disseminated to investors and the public. *Id.* The district court held that the SEC had alleged actionable claims against Miller in both respects. *Id.*

Second, the SEC has experienced success in pursuing Scheme Liability claims against defendants who are insulated from liability under the private right of action by the reliance requirement articulated in *Stoneridge*. For example, in *SEC v. Familant*, 910 F. Supp. 2d 83 (D.D.C. 2012), a district court refused to dismiss a Scheme Liability claim on facts substantially similar to those in *Stoneridge*, reasoning that policy considerations supporting the decision in *Stoneridge* were inapplicable to public enforcement actions. *Id.* at 93-97.

Third, the SEC can also bring enforcement actions under the antifraud provisions of Section 17(a) of the Securities Act of 1933 ("§ 17(a)"). With respect to the sale of securities, § 17(a) is interpreted in substantially the same manner as § 10(b), but courts have reached

conflicting positions on whether *Janus* applies to § 17(a) claims. *Compare SEC v. Perry*, No. CV-11-1309 R, 2012 U.S. Dist. LEXIS 76018, at *22 (C.D. Cal. May 31, 2012) (noting *Janus* applies to § 17(a)); *and SEC v. Kelly*, 817 F. Supp. 2d 340, 345-46 (S.D.N.Y. 2011) (noting *Janus* applies to § 17(a)); *with United States SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786, 795-97 (11th Cir. 2015) (holding that neither the textual analysis nor the public policy considerations in *Janus* support the extension of *Janus* to actions arising under § 17(a)); *and United States SEC v. Stoker*, 865 F. Supp. 2d 457, 465 (S.D.N.Y. 2012) (interpreting *Janus* to implicitly suggest that § 17(a) should be read differently from, and more broadly than, § 10(b)).

Finally, *Janus* appears to be inapplicable to criminal actions. *See Prousalis v. Moore*, 751 F.3d 272, 276-79 (4th Cir. 2014) (affirming a Rule 10b-5 criminal conviction of an attorney who prepared, but did not sign, false registration materials that were filed with the SEC). Accordingly, significant deterrents still exist to discourage secondary actors from acting as "yes men" when clients make unscrupulous requests.

IV. CONCLUSION

Nearly a century ago, Congress adopted the broad antifraud provisions of § 10(b) to serve as a deterrent for, and a remedy against, the fraudulent securities practices that largely contributed to the Great Depression. Over time, § 10(b) and Rule 10b-5 promulgated thereunder have become the most often invoked basis for liability in connection with the purchase or sale of securities, providing the basis for both a public cause of action and an implied private cause of action. In 1994, the *Central Bank* decision significantly narrowed the scope of conduct that may be actionable in the private right of action by requiring a plaintiff to prove a primary violation of § 10(b) for each defendant. In the two decades that followed *Central Bank,* the Court continued to narrow the scope of conduct prohibited by § 10(b). In 2008, on the eve of the Great Recession, the *Stoneridge* decision further narrowed the private cause of action by adopting a formidable standard for proving reliance and thereby inhibiting the Scheme Liability theory of recovery that had developed in response to *Central Bank*. Immediately after *Stoneridge*, the Great Recession brought forth a tidal wave of new securities fraud claims, and Congress responded by passing legislation aimed at reforming Wall Street. Notwithstanding these events, the Court continued to favor a narrower private right of action under § 10(b).

In *Janus*, a majority of the Court adopted a bright line test for determining who has committed a primary violation for purposes of Misstatement Liability, by limiting the scope of the private cause of action to those defendants with ultimate authority over the actionable statement, including both its content and whether and how to communicate it. In the early days of the post-*Janus* world, courts have found limited opportunity to recognize actionable private claims against lawyers, accountants and investment bankers who contribute to deceptive securities schemes, but that is not to say that such persons are insulated from liability altogether. *Central Bank*, *Stoneridge* and *Janus* have done little to narrow the scope of § 10(b) and Rule 10b-5 as they relate to enforcement actions brought by the SEC and criminal proceedings brought by the Department of Justice. Rather, the most significant takeaway from these cases, as they relate to lawyers, is that we are probably far less likely to find ourselves the target of a meritless suit for securities fraud.