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SECURITIES LAW—THE SECURITIES EXCHANGE ACT OF 1934—
"ROUND AND 'ROUND WE GO: THE SUPREME COURT AGAIN LIMITS
THE CIRCUMSTANCES IN WHICH FEDERAL COURTS MAY HOLD
SECONDARY ACTORS LIABLE UNDER SECTION 10(b) AND SEC
RULE 10B-5. STONERIDGE INVESTMENT PARTNERS, LLC v.

I. INTRODUCTION

Few areas in the field of securities law are as controversial or as
complex as implied rights of action under section 10(b) of the Securi-
ties Exchange Act of 19344 ("Exchange Act") and Securities and Ex-
change Commission (SEC) Rule 10b-5,2 its regulatory counterpart.3 In
recent years, the spectacular downfall of corporate giants such as
Enron, Worldcom, Sunbeam, Waste Management, and Xerox has
inspired plaintiffs to flood the federal courts with securities fraud
claims arising under section 10(b) of the Exchange Act.5 Over the last
few decades, the plaintiffs' bar—desperate to find deep pockets for
recovery—has developed new, creative theories of liability designed to
alleviate or even circumvent the inflexible elements necessary to es-
tablish a private right of action against secondary actors in the United
States' securities markets.6 These theories have further added to the
existing complexity of section 10(b) of the Exchange Act and SEC
Rule 10b-5.7

Presumably sympathetic to the plight of defrauded investors,
lower federal courts have historically accepted a number of alternative
theories of recovery under section 10(b), thereby allowing class-action
plaintiffs to recover vast sums of money from secondary actors that
help issuing companies mislead investors—even if the secondary ac-
tors did not themselves violate section 10(b) or SEC Rule 10b-5.8 Over

3. Edward A. Fallone, Section 10 and the Vagaries of Federal Common Law: The
Merits of Codifying the Private Cause of Action Under a Structuralist Approach, 1997
4. Larry E. Ribstein, Market vs. Regulatory Responses to Corporate Fraud: A
5. See Fallone, supra note 3, at 75. "As the years have passed . . . certain seg-
ments of the plaintiffs' bar have discharged their function as private attorneys . . . with
a zeal bordering upon obsession." Fallone, supra note 3, at 75.
6. See infra Part II.E.
7. See infra Part II.E.
8. See S. Scott Luton, The Ebb and Flow of Section 10 Jurisprudence: An Analy-
the last two decades, this approach has conflicted with the Supreme Court’s view of implied private rights of action under section 10(b).9 Beginning with the Rehnquist Court in 1972, the Supreme Court has systematically narrowed the reach of liability under section 10(b) and SEC Rule 10b-5.10

On January 15, 2008, in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.,11 the Supreme Court addressed the plaintiffs’ bar’s most recent theory for recovery against secondary actors under section 10(b): “scheme liability.”12 Rejecting the theory as beyond the scope of liability intended by Congress, the Court sharply narrowed the circumstances under which courts may hold secondary actors liable under section 10(b) and SEC Rule 10b-5.13 Although the holding in Stoneridge represents a victory for secondary actors in the United States’ securities markets and given the history of federal courts in relaxing the Supreme Court’s strict statutory approach,14 it is likely that the plaintiffs’ bar will develop fresh, novel theories designed to circumvent the stringent elements necessary to establish an implied private right of action against secondary actors under section 10(b) and SEC Rule 10b-5.15 Thus, the holding in Stoneridge is not likely to dam the flood of securities litigation that is currently permeating through the federal court system.16

This note begins by providing a background of securities fraud litigation under section 10(b) and SEC Rule 10b-5.17 Next, it examines the facts and reasoning of the Court’s holding in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.18 Finally, this note discusses the significance of Stoneridge and predicts the impact the case may have on future securities litigation under section 10(b) and SEC Rule 10b-5.19

9. Id. (stating that the “relationship between the courts has created an ebb and flow of section 10(b) jurisprudence, both expanding and restricting the scope of liability under the provision.”)
12. Id. at 770.
13. Id. at 771–72.
14. Luton, supra note 8, at 46–47.
15. See infra Part IV.C.
16. See infra Part IV.C.
17. See infra Part II.
18. See infra Part III.
19. See infra Part IV.
II. BACKGROUND

In 1907, a financial panic erupted in the United States after investors lost confidence in many New York banks. Investors believed that the banks were part of a group of stock market operators who were financially devastated after the stock of a copper mining company they controlled plummeted. This led to a dramatic decrease in prices on the New York Stock Exchange, which, in turn, led to a run on the banks. By the time investors regained their confidence in the financial markets, a recession cloaked the American economy.

The drastic downturn in the market forced many banks to shut their doors, and numerous small investors were financially destroyed. Citizens overwhelmingly believed that the stock operators and banks stood to gain from the collapse in prices and, believing that the price decreases precipitated the panic, the public called for government intervention. Scholars generally regard the panic of 1907 as the beginning of the movement for public control over the stock exchanges. Although the government took no action to regulate the stock exchanges for another two decades, the panic of 1907 proved to be the stepping stone for future governmental regulation of the securities markets.

This section first addresses the general background of federal securities law and the passage of the Exchange Act. It then discusses section 10(b) of the Exchange Act—an anti-fraud provision—and the SEC's implementation of Rule 10b-5. This section also addresses private rights of action for suits under section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. Next, this section discusses the holding of Central Bank of Denver v. First Interstate Bank of Den-

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21. Id.
22. Id. A "run on the bank" occurs when a large number of investors withdraw their deposits from a bank in fear that the bank is insolvent. Wikipedia, Bank Run, http://en.wikipedia.org/wiki/Run_on_the_bank (last visited on March 18, 2008).
23. Thel, supra note 20, at 395.
24. Thel, supra note 20, at 395.
25. Thel, supra note 20, at 395.
27. See generally Thel, supra note 20.
28. See infra Part II.A.
29. See infra Part II.B.
30. See infra Part II.C.
an important case in which the Supreme Court rejected an implied right of action under section 10(b) and SEC Rule 10b-5 for aiding and abetting liability. Finally, this section lays out the various alternative theories of primary liability under section 10(b) of the Exchange Act which are used by lower federal courts in the wake of Central Bank.

A. Lead Up to and Passage of the Exchange Act

This section discusses both the passage and the purpose of the Exchange Act. Following the panic of 1907, the American economy regained its footing and the stock market grew rapidly. As a result, calls for government intervention in the securities markets quieted until the stock market crashed in 1929. Prior to the 1930s the federal government left regulation of the security markets solely to the state. In the wake of the 1929 stock market crash, however, Congress passed expansive securities reform that provided for federal regulation of the securities markets. The two key pieces of legislation that were passed were the Securities Act of 1933 and the Exchange Act. Following the stock market crash of 1929, the Great Depression devastated the American economy. Congress was motivated, in part, to pass the Exchange Act due to the Great Depression's devastating economic and sociological effects and because it believed the Great Depression was the product of abuse in the securities markets. The tremendous boom in the stock market

32. See infra Part II.D.
33. See infra Part II.E.
34. Thel, supra note 20, at 406–07.
35. Thel, supra note 20, at 407. "Securities legislation has historically been the product of calamity." Thel, supra note 20, at 407.
37. Id.
38. Id.
40. Gordon III, supra note 36, at 64. This note will not delve into a discussion of the Securities Act of 1933, as it bears little on post-distribution securities fraud. The Securities Act of 1933 concerns itself with the securities distribution process, while the Exchange Act governs the post-distribution period. 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 226 (3d ed. 1989).
42. Gordon III, supra note 36, at 64. After the crash in 1929, rumors began to spread—as was the case in the panic of 1907—that bankers were short-selling shares
leading up to the 1929 crash, coupled with the sharp decline in prices that accompanied the crash, led many to think that speculation rather than sensible investment strategies was the force driving the securities markets. In the grips of the Great Depression, many believed—and Congress agreed—that the survival of the American economy depended on placing a stranglehold on speculation in the securities markets.

The stock market crash of 1929 was important broadly in the sense in that it shaped public and congressional perceptions of the securities markets. Much of the current securities law commentary stems from the notion that stock prices reflect the public's perception of issuing companies and that stock prices will portray those perceptions more accurately if better and more accurate information is available to the marketplace.

In accordance with this notion, the fundamental purpose of the Exchange Act was to steer away from the philosophy of caveat emptor and toward a philosophy of full disclosure. By promoting full disclosure, the Exchange Act increased investor confidence by ensuring honest securities markets. Although full disclosure was Congress's primary purposes, the Exchange Act also sought to rid the se-
securities markets of fraudulent activity by effectively regulating the markets.\(^{50}\)

B. The Anti-Fraud Provisions Under the Exchange Act

Consistent with its intent to rid the securities markets of fraud and speculation, Congress included in the Exchange Act section 10(b)\(^{51}\) — a very broad, far-reaching anti-fraud provision.\(^{52}\) This section first lays out the statutory requirement of section 10(b) of the Exchange Act. Next, this section addresses SEC Rule 10b-5, a regulation enacted by the SEC pursuant to express authority given in section 10(b).

Section 10(b) of the Exchange Act makes it unlawful

for any person, directly or indirectly, . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange[,] . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.\(^{53}\)

Congress structured the text of section 10(b) solely as an enabling provision.\(^{54}\) By itself, the text prohibits nothing.\(^{55}\) Rather, Congress chose to delegate its implementation and interpretation to the SEC.\(^{56}\)

Subsequently, the SEC, in accordance with the statutory powers granted to it by section 10(b), promulgated Rule 10b-5.\(^{57}\) SEC Rule 10b-5 states:

\(^{50}\) Loss & Seligman, supra note 40, at 226. The purpose of the Exchange Act was "to prevent and afford remedies for fraud in securities trading and manipulation of the markets; to regulate the securities markets; and to control the amount of the Nation's credit that goes into those markets." Loss & Seligman, supra note 40, at 226.


\(^{52}\) Ernst & Ernst v. Hochfelder, 425 U.S. 185, 203 (1976) (stating that this "section was described rightly as a 'catchall' clause to enable the Commission 'to deal with new manipulative (or cunning) devices.'").


\(^{54}\) Elizabeth A. Nowicki, 10(b) or Not 10(b)?: Yanking the Security Blanket for Attorneys in Securities Litigation, 2004 COLUM. BUS. L. REV. 637, 677–78 (2004).

\(^{55}\) Id.

\(^{56}\) Id. at 677–78, 678 n.172 (noting that the vagueness and deference was deliberate).

\(^{57}\) 17 C.F.R. § 240.10b-5 (2008).
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 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.  

According to the express provisions of both section 10(b) and SEC Rule 10b-5, neither Congress nor the SEC provided a private right of action for plaintiffs injured by securities fraud. Nevertheless, the Exchange Act contained eight other provisions that expressly provided for private rights of action. Thus, it is generally accepted that Congress did not originally intend to provide for a private right of action under section 10(b). Indeed, at the time of its implementation, the SEC believed that Rule 10b-5 would be used merely as an enforcement tool.

C. Private Rights of Action Under Section 10(b) and SEC Rule 10b-5

Although neither section 10(b) nor Rule 10b-5 provided for a private right of action for plaintiffs injured by securities fraud, federal courts subsequently implied such a right from the text of the statute

58. Id.
60. Gordon III, supra note 36, at 64.
61. Joseph A. Grundfest, Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority, 107 HARV. L. REV. 961, 976 (1994) (stating that the implied private right of action under section 10(b) was “entirely unplanned by Congress when it enacted [s]ection 10(b)”).
62. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975). “[T]here is no indication that the Commission in adopting Rule 10b-5 considered the question of private civil remedies under this provision.” Id. (citing Birnbaum v. Newport Steel Corp., 193 F.2d 461, 463 (2d Cir. 1952)). “The rule's history . . . makes it abundantly clear that, as of the time of its adoption, 'nobody at the Commission table gave any indication that he was remotely thinking of civil liability.'” Grundfest, supra note 61, at 979 (citing VII LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 3404–21 (3d. ed. 1991).
and issued thousands of opinions attempting to define the right. This section first discusses the judicial creation of the implied right of action under section 10(b). Next, the section discusses the elements necessary to establish an implied private right of action under section 10(b), focusing primarily on the element of reliance. Finally, this section outlines the judicial expansion of implied private rights of action under section 10(b) from primary to secondary actors—namely,aiders and abettors.

1. The Judicial Creation of a Private Right of Action Under Section 10(b) for Primary Violators

One can trace the creation of implied private rights of action under federal statutes back to 1916. In Texas & Pacific Railway Company v. Rigsby, the United States Supreme Court held that although a federal statute implemented to improve employee safety failed to provide for an express private right of action, the statute conferred upon the employee an implied private right of action to recover under the statute. Citing common law, the court stated, “in every case, where a statute enacts or prohibits a thing for the benefit of a person, he shall have a remedy upon the same statute for the thing enacted for his advantage, or for the recompense of a wrong done to him.”

In 1946, just four years after the implementation of SEC Rule 10-5, a federal district court in Pennsylvania recognized an implied private right of action for plaintiffs to sue under section 10(b) and SEC Rule 10b-5. In Kardon v. National Gypsum Co., the plaintiffs sought to recover damages under section 10(b) of the Exchange Act and SEC Rule 10b-5. The plaintiffs in the case claimed that the defendants’ misrepresentations and suppressions of truth induced the plaintiffs to sell stock at less than fair market value. Although the court recog-

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64. See infra Part II.C.1.
65. See infra Part II.C.2.
66. See infra Part II.C.3.
68. Id.
69. Id. at 38–40.
70. Id. at 39. The court cited to the common law maxim of ubi jus ibi remedium.
73. Id. at 513.
74. Id.
nized that neither section 10(b) nor SEC Rule 10b-5 expressly provided for a private right of action, it stated that "[t]he disregard of the command of a statute is a wrongful act and a tort." Relying on common law tort principles, the court held that "the mere omission of an express provision for civil liability [was] not sufficient to negative what the general law imply[d]." Thus, the court became the first federal court to recognize the existence of an implied private right of action under section 10(b) of the Exchange Act and SEC Rule 10b-5.

Subsequent to Kardon, many other federal courts adopted its holding. As one commentator put it, "Rule 10b-5 . . . spawned a massive, intricate, ever-expanding federal jurisprudence that was entirely unplanned by Congress when it enacted [s]ection 10(b) and by the Commission when it adopted Rule 10b-5." Roughly three decades after Kardon, federal courts widely regarded the implied private right of action under section 10(b) of the Exchange Act and SEC Rule 10b-5 as a legitimate avenue for recovery for individuals injured by securities fraud.

If there was any doubt, however, as to the legitimacy of the implied right of action under section 10(b) and SEC Rule 10b-5, the Su-

75. Id. at 513. The court addressed the defendants' argument that other provisions in the Exchange Act expressly provided for private rights of action. Id. at 514. In effect, the defendants argued that the omission of a private right of action was evidence of Congress's intent not to provide a private right of action for plaintiffs injured by securities fraud. Id. Nevertheless, the court dismissed the argument, stating that only part of the issue was statutory construction. Id. The court stated that the real issue was "whether an intention [could] be implied to deny a remedy and to wipe out a liability which, normally, by virtue of basic principles of tort law[,] accompanies" a prohibited act. Id.

76. Id. at 513.

77. Id. at 514. The court relied on section 286 of the Restatement, Second, of Torts, which states that:


79. Id. at 513–14.

80. See Gordon III; supra note 36, at 68. Since Kardon, "the federal courts have issued thousands of decisions defining the scope of . . . private right[s] of action" under Rule 10b-5. Gordon III, supra note 36, at 62.

81. Grundfest, supra note 61, at 976.

82. Gordon III, supra note 36, at 68.
preme Court resolved the issue in 1971.\textsuperscript{83} In \textit{Superintendent of Insur-
ance of the State of New York v. Bankers Life and Casualty Co.},\textsuperscript{84} the
Supreme Court stated in a footnote to its opinion that "[i]t is now es-
tablished that a private right of action is implied under [section]
10(b)."\textsuperscript{85} Since \textit{Superintendent}, the Supreme Court has routinely af-
ferred the existence of the implied right of action under section 10(b)
and SEC Rule 10b-5, and the right now serves as a "linchpin" of fed-
eral securities laws.\textsuperscript{86} Thus, although section 10(b) of the Exchange
Act was originally intended as merely an enabling provision designed
to delegate the enforcement power and interpretation of securities
fraud to the SEC, the judiciary—exercising power from common law
tort theory—effectively expanded enforcement power of section 10(b)
to private citizens injured by securities fraud.\textsuperscript{87}

2. Elements Necessary to Establish an Implied Private Right of
Action Under Section 10(b) and Rule 10b-5

After the holding in \textit{Kardon}, federal courts issued thousands of
opinions defining the scope of the implied private right of action un-
der section 10(b) of the Exchange Act and SEC Rule 10b-5.\textsuperscript{88} This sec-
tion briefly lays out the elements necessary to establish an implied
right of action under section 10(b) and SEC Rule 10b-5, paying partic-
ular attention to the most litigated and, therefore, the most important
element of implied rights of private action under section 10(b) and
SEC Rule 10b-5: reliance.

Although the judiciary originally expanded the enforcement me-
chanism of section 10(b) by providing for an implied private right of
action to plaintiffs injured by primary violators of SEC Rule 10b-5, the
United States Supreme Court derived the elements necessary to estab-
lish an implied private right of action from both the federal judiciary
and from Congress.\textsuperscript{89} Piecing together various Supreme Court prece-
dents with a congressionally mandated economic loss requirement,\textsuperscript{90}
the Court in *Dura Pharmaceuticals, Inc. v. Broudo* laid out six elements necessary to establish an implied private right of action under section 10(b) and SEC Rule 10b-5. To establish a private right of action, the plaintiff must meet the following six elements: "(1) a material misrepresentation (or omission); (2) scienter, i.e., a wrongful state of mind; (3) a connection with the purchase or sale of a security, (4) reliance . . .; (5) economic loss; and (6) 'loss causation.'"

The reliance requirement is a purely subjective element. Unlike materiality—which is the objective counterpart to the reliance requirement—in order to meet the reliance requirement, a plaintiff must prove "that it actually based its decisions upon the defendants' misstatements or omissions. 'Reliance is a *causa sine qua non*, a type of 'but for' requirement: had the investor known the truth he would not have acted.'" The requirement ensures that a causal connection exists between the defendant's misrepresentation and the plaintiff's injury.

For plaintiffs dealing directly with defendants in suits under section 10(b) and SEC Rule 10b-5, the reliance requirement is not a formidable obstacle. Plaintiffs simply must prove that they considered a misrepresented fact, and that they relied upon that misrepresented fact when entering into a securities transaction. In the current securities market, however, the traditional theory of reliance has proven to be of little help to defrauded investors because of the vast number of players that assist in issuing financial statements.

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92. *Id.* at 341–342.
93. *Id.* (citations and original emphasis omitted); see also *In re Great Atl. & Pac. Tea Co. Sec. Litig.*, 103 Fed. Appx. 465, 468 (3d Cir. 2004); *Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1095 (10th Cir. 2003).
94. *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 413 (5th Cir. 2001).
95. *Id.* (quoting *Abell v. Potomac Ins., Co.*, 858 F.2d 1104, 1117–18 (5th Cir. 1988) (quoting *Huddleston v. Herman & MacLean*, 640 F.2d 534, 549 (5th Cir. 1981)).
98. *Id.*
99. *Blackie v. Barrack*, 524 F.2d 891, 907 (9th Cir. 1975) (stating that the reliance requirement "imposes an unreasonable . . . burden" on plaintiffs).
3. Judicial Expansion of Private Rights of Action Under Section 10(B) and SEC Rule 10b-5 to Aiding and Abetting Liability

At the time Congress enacted the securities laws, secondary liability was well established in civil common law.\textsuperscript{100} Therefore, it is reasonable to assume that Congress was aware of the doctrine when it enacted the Exchange Act.\textsuperscript{101} Nevertheless, just as Congress failed to provide for a private right of action for primary violations, neither section 10(b) nor SEC Rule 10b-5 expressly provides for a private right of action for plaintiffs injured by secondary actors.\textsuperscript{102} The federal courts, however, again applied concepts of common law tort theory to expand private rights of action for securities fraud under section 10(b) and SEC Rule 10b-5 to one class of secondary actors: aiders and abettors.\textsuperscript{103} This section first defines secondary liability, then it outlines the judicial creation of a private right of action under section 10(b) and SEC Rule 10b-5 for aiders and abettors.

Secondary liability is defined in terms of duty.\textsuperscript{104} An actor who violates a duty imposed by statute is the primary violator.\textsuperscript{105} But, due to the vast number of actors involved with the issuance and sale of securities, the concept of duty can be quite complex.\textsuperscript{106} Consequently, in certain situations it may be difficult to distinguish between the primary and secondary violators.\textsuperscript{107} One commentator stated that "[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{108}

"Aiding and abetting" liability is a term used in securities cases to describe secondary liability for those actors who participate with the primary actor in the violation of securities laws.\textsuperscript{109} Aiding and abetting

\textsuperscript{101} Id. at 316.
\textsuperscript{102} Id. at 321–22.
\textsuperscript{103} See infra notes 119–28.
\textsuperscript{104} Kuehnle, \textit{supra} note 100, at 318.
\textsuperscript{105} Kuehnle, \textit{supra} note 100, at 318.
\textsuperscript{106} Kuehnle, \textit{supra} note 100, at 318. "Securities transactions usually are more complex than the physical harms that are subject of most tort actions and thus greater difficulties can occur in applying secondary liability." Kuehnle, \textit{supra} note 100, at 318.
\textsuperscript{107} Kuehnle, \textit{supra} note 100, at 318.
\textsuperscript{108} Kuehnle, \textit{supra} note 100, at 318–19 (noting that "the distinction is recognized in tort law, agency law, and criminal law").
\textsuperscript{109} Kuehnle, \textit{supra} note 100, at 320–21.
is encompassed within the common law concept of joint tortfeasor liability. Although neither Congress nor the SEC provided for an express private right of action for aiding and abetting liability under section 10(b) and SEC Rule 10b-5, federal courts, consistent with their tendency to enlarge the scope of liability under the Exchange Act, implied a private right of action to aiders and abettors.

Prior to *Kardon* and the promulgation of SEC Rule 10b-5, in *Securities Exchange Commission v. Timetrust, Inc.*, the District Court for the Northern District of California granted a request by the SEC to enjoin aiders and abettors under the Securities Act of 1933. While the suit did not seek civil damages—and thus did not directly address private rights of action for aiding and abetting liability under either the Securities Act of 1933 or section 10(b) of the Exchange Act—the court's holding was influential to later federal courts that implied a private right of action for aiders and abettors under section 10(b) and SEC Rule 10b-5.

In *Timetrust*, the SEC alleged that the defendants were involved in fraudulent activities in violation of section 17(a) of the Securities Act of 1933, an anti-fraud provision, and unless enjoined, they would continue to aid and abet in the fraudulent activities. In reaching its decision, the court looked to the United States Criminal Code and asserted that criminal law makes no distinction between actors who aid and abet in the commission of a crime and the principal violator. Using an analogy to criminal law principles, the court held that an injunction was appropriate under the statute, reasoning that “[p]ersons charged with aiding and abetting a criminal offense in violation of [section] 17(a) may be joined as defendants, and no good reason ap-

110. Kuehnle, supra note 100, at 321.
111. Luton, supra note 8, at 46–47. Scott Luton stated, “[T]he lower federal courts have historically tempered the harshness of the Supreme Court’s strict statutory approach by adopting alternative theories of recovery. This antithetic relationship between the courts has created an ebb and flow of section 10(b) jurisprudence, both expanding and restricting the scope of liability under the provision.” Luton, supra note 8, at 46–47.
112. 28 F. Supp. 34 (N.D. Cal. 1939).
113. Id. at 36.
115. 15 U.S.C. § 77q(a) (2000). Section 17(a) of the Securities Act of 1933 mirrors SEC Rule 10b-5 in generally prohibiting individuals from “employ[ing] any device, scheme, or artifice to defraud” in the sale of securities. *Id.*
117. *Id.* at 43 (citing 18 U.S.C.A § 550 (West 2000).
pears why this same rule should not apply in an injunctive proceeding[] to restrain a violation of the same statute.”

In 1966, twenty-seven years after *Timetrust* and twenty years after *Kardon*, a federal district court in Indiana held that a private right of action existed under section 10(b) and Rule 10b-5 against aiders and abettors. In *Brennan v. Midwestern United Life Insurance Co.*, plaintiffs brought a class-action seeking civil damages from the defendant for aiding and abetting under section 10(b) of the Exchange Act. The plaintiffs' complaint alleged that the defendant failed to report the fraudulent activities of a broker firm that sold stock to the defendant, which resulted in injury to the plaintiff. Even though the plaintiff conceded that the defendant was not primarily liable under section 10(b) or Rule 10b-5, the plaintiff contended that the defendant should be held liable as a secondary actor—an aider and abettor—for failing to disclose the primary violator's fraudulent activities to the SEC or the state securities commission.

In reaching its conclusion, the court stated that although neither section 10(b) nor SEC Rule 10b-5 expressly provided for a private cause of action for aiding and abetting, the court in *Timetrust* applied section 10(b) of the Exchange Act to aiders and abettors in an injunction action twenty-seven years earlier. Furthermore, the court asserted that implied rights of action for primary violations of section 10(b) and SEC Rule 10b-5 had become well established since the holding in *Kardon*. Relying on general tort principles for secondary liability—although a different Restatement section than the court in *Kardon* relied upon—the court held that an implied private right of action existed under section 10(b) and SEC Rule 10b-5 against aiders and abettors. The court stated that “principles as stated in . . . Time-

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118. *Id.*
121. *Id.* at 675.
122. *Id.*
123. *Id.*
124. *Id.* at 676.
125. *Id.* at 676.
126. *See supra* note 77.
127. *Brennan*, 259 F. Supp. at 681–82. The court relied upon section 876 of the Restatement, Second, of Torts. *Id.* at 681. That section states as follows:

> For harm resulting to a third person from the tortious conduct of another, a person is liable if he . . . (b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or (c) gives substantial assistance to the other
trust . . . and formulated in the Restatement of Torts surely best fulfill the purposes of the Securities Exchange Act of 1934 and are a logical and natural complement to the Kardon doctrine.”

Subsequent to the holding in Brennan, a vast number of plaintiffs claimed an implied private right of action under section 10(b) and SEC Rule 10b-5 against aiders and abettors. Furthermore, for nearly three decades following Brennan, federal courts almost universally recognized implied private rights of action under section 10(b) and SEC Rule 10b-5 for aiders and abettors by relying on general tort law governing secondary liability. The federal courts had thus taken section 10(b) and SEC Rule 10b-5—neither of which were originally intended to provide for private rights of action for primary violations—and extended the implied private right of action to reach aiders and abettors.

4. **Central Bank: The End of the Road for Private Rights of Action Under Section 10(b) and SEC Rule 10b-5 for Aiders and Abettors**

Prior to the Supreme Court’s holding in Central Bank of Denver v. First Interstate Bank of Denver, every federal circuit court held that there was an implied private right of action for aiding and abetting liability under section 10(b) and SEC Rule 10b-5. Although the Supreme Court twice reserved the issue of aiding and abetting liability under the Exchange Act to lower federal courts, in Central Bank the Supreme Court directly addressed the issue. In a five-to-four decision, the Court held that no implied private right of action existed as to aiders and abettors under section 10(b) and Rule 10b-5. This sec-

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RESTATEMENT (SECOND) OF TORTS § 876 (1939).

129. See Kuehnle, supra note 100, at 321–22.
130. Kuehnle, supra note 100.
131. See supra notes 59–62.
133. Luton, supra note 8, at 46 (stating that Central Bank “overturned established case law in the jurisdictions of all eleven United States circuit courts of appeal”).
134. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (reserving the issue of whether a private right of action under section 10(b) and SEC Rule 10b-5 existed as to aiders and abettors); see also Herman & MacLean v. Huddleston, 459 U.S. 375, 379 n.5 (1983).
136. Id. at 191–92.
tion first outlines the facts and holding in Central Bank, and it concludes by discussing the congressional response to Central Bank.

Central Bank of Denver, N.A. (Central Bank) served as an indenture trustee on bond issues brought to market in both 1986 and 1989 by the Colorado Springs-Stetson Hills Public Building Authority ("the Authority") to finance public improvements at Stetson Hills, a planned commercial and residential development in Colorado Springs. Landowner assessment liens on over 500 acres of land secured the two bond issues. The bond covenants required that the fair market value of the land securing the bond issues be worth at least 160% of the outstanding value of the principle and interest for both bond issues. The covenants required AmWest Development ("AmWest") to deliver to Central Bank an annual report evidencing compliance with the 160% fair market value requirement.

In the annual report delivered to Central Bank that preceded the 1988 bond issue, AmWest reported that the fair market value of the land was nearly unchanged from the 1986 appraisal. Soon afterwards, however, a senior underwriter for the 1986 bonds sent Central Bank a letter indicating that land values in the Colorado Springs area were declining. Additionally, the underwriter informed Central Bank that the appraisal in the 1988 annual report was over sixteen months old, and he expressed concern that the 160% criterion was not being met. Although Central Bank's in-house appraiser concluded that the appraisal contained in the 1988 annual report was "optimistic considering the local real estate market," Central Bank decided to delay independent review until after the 1988 bond issue.

Before an independent appraiser could review the land value, the Authority defaulted on the 1988 bond issue. First Interstate Bank of Denver, in conjunction with a man by the name of Jack Naber (together as Respondents), purchased $2.1 million of the 1988 bonds. Following the Authority's default, Respondents sued the Authority, the 1988 underwriter, a junior underwriter, an AmWest director, and

137. Id. at 167.
138. Id.
139. Id.
140. Id.
142. Id.
143. Id. at 167.
144. Id. at 167-68.
145. Id. at 168.
146. Id.
Central Bank for violations of [section] 10(b) of the Securities Exchange Act of 1934. 147 Additionally, the complaint alleged that Central Bank was liable under section 10(b) as an aider and abettor for failing to disclose that the appraisal in the 1988 annual report was outdated. 148

Although the issue presented on the writ of certiorari regarded the standard of scienter required for aiding and abetting liability under section 10(b) and SEC Rule 10b-5, 149 the Supreme Court sua sponte directed the parties to address the issue of the legitimacy of aiding and abetting liability under section 10(b) and SEC Rule 10b-5. 150 In a five-to-four decision, the Supreme Court held that no implied right of action existed under section 10(b) and SEC Rule 10b-5. 151

Writing for the Court, Justice Kennedy commenced his opinion by emphasizing that strict statutory construction controlled the scope of section 10(b). 152 Recognizing that section 10(b) prohibited only misstatements, omissions, or the commission of a deceptive act, Justice Kennedy rejected an extension of liability under section 10(b) to actors who merely aided in primary violations. 153 Justice Kennedy stated, "We cannot amend the statute to create liability for acts that are not themselves manipulative or deceptive within meaning of the statute." 154

The Court also addressed the petitioner’s argument that Congress intended the Exchange Act to provide for aiding and abetting liability by including the phrase “directly or indirectly” in section 10(b). 155 The

149. Luton, supra note 8, at 55–56. "Central Bank filed a writ of certiorari to the United States Supreme Court seeking review of 'whether an indenture trustee could be found liable as an aider-and-abettor . . . based only on a showing of recklessness.'" Luton, supra note 8, at 55–56. The Tenth Circuit set forth the elements of a section 10(b) aiding and abetting claim as follows: "(1) the existence of a primary violation of the securities law by another; (2) knowledge of the primary violation by the alleged aider-and-abettor; and (3) substantial assistance by the alleged aider-and-abettor in achieving the primary violation." First Interstate Bank of Denver, 969 F.2d at 898.
152. Id. at 166, 173.
153. Id. at 177–78.
154. Id.
155. Id. at 176.
Court rejected this argument, reasoning that "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." Additionally, the Court stated that numerous other provisions in the Exchange Act included the language "directly or indirectly" in a way that did not impose aiding and abetting liability. Therefore, the Court concluded that the language of section 10(b) failed to indicate Congress's intent to provide for an implied right of action for aiding and abetting liability under section 10(b).

The Court confirmed its reasoning by examining the reliance requirement of implied private rights of action for primary violators of section 10(b). In order to establish a private right of action under section 10(b), the plaintiff must prove that it relied upon the defendant's misstatement or omission. The Court stated that "[w]ere [it] 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." The Court concluded that allowing the circumvention of the reliance requirement would ignore the careful limits on recovery under section 10(b) and SEC Rule 10b-5 that were mandated by earlier cases.

The Court's holding in Central Bank rejected the universally recognized existence of implied rights of action for aiding and abetting liability under section 10(b) and SEC Rule 10b-5 in federal courts. The Court made clear, however, that the elimination of the implied

156. Id.
158. Id. (noting that "Congress knew how to impose aiding and abetting liability when it chose to do so."). The Court also addressed Petitioner's argument that Congress's silence and inaction inferred congressional approval as to aiding and abetting liability under section 10(b). Id. at 183–85. The Court stated that "[e]ven assuming, moreover, a deeply rooted background of aiding and abetting tort liability, it [did] not follow that Congress intended to apply that kind of liability to the private causes of action in the securities Acts." Id. at 184. The Court concluded that "[i]n sum, it [was] not plausible to interpret the statutory silence as tantamount to an implicit congressional intent to impose [section] 10(b) aiding and abetting liability." Id. at 185.
159. Id. at 180.
160. Id. (citing Basic Inc. v. Levinson, 485 U.S. 244, 243 (1988)).
161. Id.
162. Id.
163. See Luton, supra note 8, at 46.
private right of action under section 10(b) for aiding and abetting liability did not mean that secondary actors were always free from liability under the Exchange Act. In order to hold a secondary actor liable under section 10(b) and SEC Rule 10b-5, however, plaintiffs must prove every element necessary to establish primary liability under Rule 10b-5.

In 1995, just one year after the decision in Central Bank, Congress passed the Private Securities Litigation Reform Act (PSLRA). The PLSRA contained numerous provisions that addressed secondary liability. Rather than expressly providing for private rights of action for aiding and abetting liability under section 10(b), however, the 1995 Amendments to the PLSRA added section 20(e) to the Exchange Act. Section 20(e) delegated the responsibility of enforcing aiding and abetting liability under section 10(b) to the SEC. Thus, Congress did not expressly disapprove of the holding in Central Bank.

D. Alternative Theories for Primary Liability in the Wake of Central Bank

Traditionally, federal courts shaped the scope of liability under federal securities laws. Central Bank made it quite clear that to establish a private right of action under section 10(b) and SEC Rule 10b-5 as to secondary actors, plaintiffs must prove that the secondary actor's conduct satisfies all of the elements necessary to establish primary liability. The Court in Central Bank, however, failed to elaborate on the elements required to establish primary liability. Thus, the holding of Central Bank forced federal courts to readdress the circumstances under which secondary actors could be held primarily liable under section 10(b) and SEC Rule 10b-5.

165. Id.
167. Id. at 1304.
169. Id.
171. Fisch, supra note 166, at 1294.
173. Fisch, supra note 166, at 1294.
174. Fisch, supra note 166, at 1299.
federal courts' tendencies to relax the Supreme Court's strict statutory approach, the federal courts again expanded the scope of liability under section 10(b) and SEC Rule 10b-5, this time turning to alternative theories of primary liability that eased or eliminated the reliance requirement as applied to secondary actors.

This section discusses three theories of primary liability available to plaintiffs in the wake of *Central Bank* that were designed to circumvent the reliance and causation requirements of primary liability under section 10(b) and SEC Rule 10b-5. This section first discusses the *Affiliated Ute* theory. Next, this section addresses the "Fraud-on-the-Market" theory. Finally, this section concludes with a discussion of the "Scheme Liability" theory.

1. The Affiliated Ute Theory

The traditional element of reliance required to establish an implied private right of action under section 10(b) and SEC Rule 10b-5 is wholly subjective. The reliance element requires that the plaintiffs actually relied upon a defendant's misstatement or omission in the course of buying or selling securities. In *Affiliated Ute Citizens of Utah v. United States*, the United States Supreme Court examined the traditional requirement of reliance and determined that, in cases involving nondisclosure, the traditional rule was "too restrictive," and therefore, a presumption of reliance should be afforded to plaintiffs if the facts withheld by the defendant were material.

In *Affiliated Ute*, the plaintiffs sued a bank and two of its employees under SEC Rule 10b-5. The bank acted as a transfer agent for stock of a corporation formed for the purpose of distributing assets to individual members of the Ute tribe. Although the corporation's attorney advised the bank to discourage the sale of the stock held by

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175. Luton, supra note 8, at 46-47.
177. See infra Part II.E.1-3.
178. See infra Part II.E.1.
179. See infra Part II.E.2.
180. See infra Part II.E.3.
181. See supra note 89-91.
182. See supra notes 94-96.
184. Id. at 150-54.
185. Black, supra note 176, at 444.
186. Black, supra note 176, at 444.
the corporation's stockholders, two bank employees facilitated a scheme to transfer the stock to themselves and others, actively encouraged a secondary market for the stock, and precipitated the sale of the plaintiff's stock at less than fair market value. The Court held that the defendants—as "market makers"—possessed an affirmative duty to disclose to plaintiffs any material facts that would have influenced the plaintiffs' decision to sell the stock. Rejecting the court of appeals' reasoning that "there was no violation of [Rule 10b-5] unless the record disclosed evidence of reliance on material fact misrepresentations," the Supreme Court held that when a party possesses a duty to disclose, lack of proof of plaintiffs' reliance is not a bar to recovery.

The Court reasoned that the fundamental purpose of the Exchange Act was to move from a philosophy of caveat emptor to a philosophy of a full disclosure in order to inject a higher degree of integrity into the security markets. Thus, in light of the congressional purpose of the Exchange Act, the Court stated that Rule 10b-5 should not be read too narrowly. Indeed, the Court stated that although paragraph two of Rule 10b-5 premised liability on "the making of an untrue statement of a material fact and the omission to state a material fact," the other two paragraphs were broader, encompassing "a 'course of business' or 'device, scheme or artifice' that operates as a fraud" upon the plaintiffs. The Court concluded that if the defendant had a duty to disclose material facts and failed to disclose those material facts, "[t]his obligation to disclose and this withholding of a material fact establish[ed] the requisite element of causation in fact."

After Affiliated Ute, federal courts widely interpreted the holding as eliminating the plaintiff's duty to establish the element of reliance in nondisclosure cases. Based upon the decision in Affiliated Ute, federal courts in nondisclosure cases afforded plaintiffs a presumption of reliance and shifted the burden to the defendants to prove that the plaintiffs did not rely.

188. Id. at 153.
189. Id. at 152.
190. Id. at 153.
191. Id. at 151.
192. Id.
194. Id. at 154.
195. Black, supra note 176, at 444.
196. Id. at 444–45. Additionally, "[s]ome courts extend[ed] Affiliated Ute further and h[e]ld that, in open market transactions involving misrepresentations, [the] plain-
2. "Fraud-on-the-Market" Theory

In the wake of Central Bank, the "fraud-on-the-market" theory became another popular theory used by plaintiffs in federal courts to circumvent the traditional element of reliance. Although the traditional common law reliance requirement focuses on the effect that the misstatement or omission had on the plaintiff, the "fraud-on-the-market" theory shifts the focus to the effect that the misstatement or omission has on the marketplace as a whole.

The Court of Appeals for the Ninth Circuit is generally credited as the first court to establish the "fraud-on-the-market" theory in 1975. In Blackie v. Barrack, the court granted class certification to plaintiffs who purchased the stock of a publicly traded company. Plaintiffs alleged that the defendants released misleading information to the public in the form of reports to shareholders, SEC filings, and press releases. In addressing the defendants' contention that the plaintiffs never actually relied upon the misleading information, the court cited Affiliated Ute for the proposition that subjective reliance is not a critical element of claims under section 10(b) and SEC Rule 10b-5. Additionally, the court held that in cases in which plaintiffs claim injury for deceptions that inflate the prices of stock on the open market, the reliance element—and thus, causation—is established if the plaintiff can assert facts that prove both the context of the purchase of the securities and the materiality of the misrepresentations. The court stated further that investors generally rely on the fact that market prices are valid and legitimate representations of the financial health of the issuing company, and investors indirectly rely on the truth of any representations made that support the price of the securities. The court concluded by stating that "whether he is aware of it ififf need prove only materiality, thus eliminating the distinction between misrepresentations and omissions." Id. at 445.

197. Id. at 435.
199. Id. at 1066.
200. 524 F.2d 891 (9th Cir. 1975).
201. Id. at 894, 900–01.
202. Id. at 895.
203. Id. at 905 (citing Affiliated Ute, 406 U.S. at 153–54).
204. Id. at 906.
205. Id. at 907.
or not, the price [the investor] pays reflects material misrepresentations.

Subsequent to the holding in *Blackie*, lower federal courts began to address the scope and application of the "fraud-on-the-market" theory. If there was any doubt as to the legitimacy of the theory, however, the Supreme Court resolved the issue. In *Basic, Inc. v. Levinson*, the Supreme Court endorsed the "fraud-on-the-market theory." In facts similar to those in *Blackie*, the Court held that transactions in the current securities market differed from the face-to-face transactions typical of earlier fraud cases, and thus, the reliance requirement under Rule 10b-5 must account for these differences. Citing recent studies showing that the market prices of securities reflected all information available to the public, the Court held that actual reliance was not necessary for purposes of a Rule 10b-5 action where the plaintiff relied on any misrepresentations made publicly by the defendant.

3. "Scheme Liability"

In light of the recent waves of corporate scandals, plaintiffs' attorneys—motivated to find solvent defendants—created a theory that is now known as "scheme liability." The "scheme liability" theory developed as a way to circumvent the requirement of a public misstatement or omission, thereby requiring plaintiffs to prove only that defendants engaged in a "scheme to defraud" that was subsequently

206. Blackie v. Barrack, 524 F.2d 891, 907 (9th Cir. 1975). In effect, the court’s holding parallels the “efficient market” thesis. See Black, supra note 176, at 437–38. This theory supposes that “in free and actively traded markets, stock prices will fully reflect all available information about the corporation.” Black, supra note 176, at 437–38.


208. See infra notes 209–12.
210. Id.
211. Id. at 244–45.
212. Id. at 246–48. The majority held that the presumption was rebuttable by "rebut[ting] proof of the elements giving rise to the presumption, or [by] show[ing] that the misrepresentation in fact did not lead to a distortion of price or that an individual plaintiff traded or would have traded despite his knowing that the statement was false." Id. at 248.
misrepresented by the issuing company. Federal circuit courts, however, were split as to the scope and legitimacy of the theory. In *Simpson v. AOL Time Warner Inc.*, the Court of Appeals for the Ninth Circuit adopted the theory of "scheme liability." *Simpson* was a class action case involving claims that multiple actors created a fraudulent scheme for the purpose of inflating the revenues of an internet company.

The *Simpson* court commenced its analysis by stating that part of the purpose of section 10(b) was to prohibit the employment of deceptive schemes in connection with the purchase or sale of securities. Noting that *Central Bank* mandated that liability under section 10(b) extended only to primary violators, the court stated that primary liability may nevertheless arise by substantial participation or involvement in the preparation of financial statements, even if that participation did not involve any misstatements or omissions that would have violated section 10(b) or SEC Rule 10b-5. Thus, the court stated that the necessary inquiry was, "what conduct constitute[d] a manipulative or deceptive act in furtherance of a scheme to defraud sufficient to render the defendant a 'primary violator' of [section] 10(b)."

Borrowing an argument set forth by the SEC in its amicus brief, the court concluded that,

to be liable as a primary violator of [section] 10(b) for participation in a 'scheme to defraud,' the defendant must have engaged in conduct that had the principal purpose and effect of creating a false

214. *Id.* at 631; Gorman, *supra* note 168, at 208. The phrase "scheme to defraud" does not appear in section 10(b), but does appear in Rule 10b-5, which states that it is unlawful "to employ any device, scheme, or artifice to defraud." 17 C.F.R. § 240.10b-5(a) (2008).

215. Compare *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040 (9th Cir. 2006) (adopting the theory of "scheme liability") and Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA) Inc., 482 F.3d 372 (5th Cir. 2007) (reversing the district court's decision based on the theory of "scheme liability").

216. 452 F.3d 1040 (9th Cir. 2006).

217. *Id.* at 1043, 1048.

218. *Id.* at 1042. The name of the internet company was Homestore.com. *Id.* Plaintiffs alleged that Homestore.com entered into fraudulent transactions with various defendants so that Homestore.com could purchase revenue for itself and record it in a manner that violated SEC accounting rules. *Id.*


220. *Id.* at 1047–48 (quoting Howard v. Everex Sys., Inc., 228 F.3d 1057, 1061 n.5 (9th Cir. 2000)).

221. *Id.* at 1048.
appearance of fact in furtherance of the scheme. It is not enough that a transaction in which a defendant was involved had a deceptive purpose and effect; the defendant’s own conduct contributing to the transaction or overall scheme must have had a deceptive purpose and effect.222

The court rejected the defendant’s contention that imposing liability on actors who failed to make a public misstatement or omission violated the holding of Central Bank.223 The court emphasized that the focus was on the deceptive nature of the defendant’s own conduct, which ensured that only primary violators would be held liable under section 10(b) and SEC Rule 10b-5.224

In Regents of University of California v. Credit Suisse First Boston (USA), Inc.,225 however, the Court of Appeals for the Fifth Circuit rejected the theory of scheme liability.226 Regents involved a securities class action in the wake of the Enron collapse.227 The plaintiffs claimed that multiple defendants entered into a scheme that enabled Enron to temporarily decrease its liabilities while simultaneously recording revenues, thus allowing Enron to misstate its financial condition.228

The court stated that the manner in which the district court conceived a “deceptive act” was in contravention to the Supreme Court’s holding in Central Bank.229 Refusing to adopt the reasoning in Simpson, the court held that to be liable under section 10(b) and SEC Rule 10b-5, defendants must have engaged in conduct that was deceptive within the meaning of the statute.230 Deceptive conduct involved either a misstatement or an omission from one with a duty to disclose.”231 The court concluded by stating that “[s]trict construction of [section] 10(b) against inputting aiding and abetting liability for secondary actors under the rubric of ‘deceptive acts’ or ‘schemes’ gives rise to the certainty that the Court sought in Central Bank.”232 Thus, the Fifth Circuit rejected the theory of “scheme liability,” deciding instead to

222. Simpson v. AOL Time Warner Inc., 452 F.3d 1040, 1048 (9th Cir. 2006).
223. Id. at 1049.
224. Id.
225. 482 F.3d 372 (5th Cir. 2007).
226. Id. at 385–90.
227. Id. at 376–77.
228. Id. at 377.
229. Id. at 386.
230. Id. at 389.
231. Regents of Univ. of Cal. v. Credit Suisse First Boston (USA), Inc., 482 F.3d 372, 388 (5th Cir. 2007) (citing In re Charter Commc’ns, Inc., Sec. Litig. v. Scientific-Atlanta Inc., 443 F.3d 987, 990 (8th Cir. 2006)).
232. Id. at 392.
adopt the strict statutory approach that the Supreme Court used in *Central Bank.* The alternative conclusions reached in *Simpson* and *Regents* created a split in the federal circuit courts as to the legitimacy of "scheme liability." Shortly thereafter, the United States Supreme Court resolved the split in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*

III. THE CASE

In 2000, Charter Communications, Inc. ("Charter"), one of the nation's largest cable service providers, engaged in a number of fraudulent accounting practices designed to inflate the numbers presented in its quarterly financial reports for the purpose of meeting Wall Street's expectations for subscriber growth and operating cash flow. Realizing that these efforts would nevertheless prove too little and too late—and desperate for additional revenue and cash to meet projections—Charter entered into transactions with both Scientific-Atlanta, Inc. ("Scientific-Atlanta"), and Motorola, Inc. ("Motorola") (together as "Respondents"), both then-existing suppliers of Charter's cable television hardware. The transactions constituted a scheme that ultimately led to criminal indictments of four Charter executives, criminal and civil proceedings against Respondents, and pre-
cipitated the United States Supreme Court’s recent decision in *Stonebridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, which is the subject of this note. In *Stonebridge*, investors of Charter’s common stock sued Respondents for securities fraud under section 10(b) of the Exchange Act, seeking to recoup losses from Respondents for their role in entering into various transactions that enabled Charter to issue misleading financial statements.

This section first presents the apparent reason for the transactions’ implementation and explains in detail the transactions entered into between Charter and Respondents. Next, the section discusses the procedural history of the case and how it came to be argued at the United States Supreme Court. Finally, it discusses the Supreme Court’s holding in *Stoneridge*, the reasoning employed by the majority in rendering its decision, and the alternative conclusions reached in the dissenting opinion.

A. Facts

This section first discusses Charter’s financial condition that led to its transactions with Respondents. It also explains the details of the transactions and the effect those transactions had on both Charter and Respondent companies. Finally, the section concludes with a discussion of the holdings of both the district and appellate courts.

1. Charter’s Financial Condition

In the late 1990s, an increase in cable network installation costs took its toll on the cable provider market. During this period, it was not at all unusual for operating expenses to exceed revenues, thereby cutting into profit margins. Thus, rather than value cable providers based upon more traditional earnings measures, Wall Street analysts

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242. *Id.* at 766.
244. *See infra* Part III.A.3.
245. *See infra* Part III.B.
"valued cable companies based upon whether they were achieving significant growth in revenues, indicating increasing market share . . . and cash flow." \[251\]

In 2000, Charter had close to 295 million shares of outstanding common stock. \[252\] Given the volatile marketplace, Charter knew that missing Wall Street's projections for revenue and operating cash flow would ravage the price of Charter's stock. \[253\] To avoid this outcome, Charter engaged in a variety of fraudulent reporting activities to inflate its quarterly numbers. \[254\] Despite these efforts, however, in late 2000, "Charter executives realized that . . . the company would miss projected operating cash flow numbers by $15 to $20 million." \[255\] In an attempt to avoid the inevitable, Charter made a proposal to Respondents that they alter their existing arrangements. \[256\]

2. The Scheme

As a cable provider, Charter "provide[d] video, data, interactive and private business network services to millions of customers across the country through its broadband network of coaxial and fiber-optic cables." \[257\] Respondents manufactured and supplied set-top boxes to Charter for its use in providing cable services to its customers. \[258\] Feeling the pressure to meet Wall Street's expectations, Charter and Respondents entered into an arrangement by which Charter agreed to pay Respondents twenty dollars above the market price of each set-top box until the end of the year. \[259\] In return, Respondents agreed to purchase advertising from Charter with the additional funds gained from the sale of set-top boxes. \[260\] In violation of generally accepted account-
ing principles, Charter capitalized the cost of purchasing the set top boxes—enabling Charter to spread the cost of the set-top boxes over a number of years—and immediately recorded the sale of advertising to Respondents as revenue in its current quarter. The fraudulent reporting of the transaction allowed Charter to meet its quarterly projections.

Knowing that Charter's auditor, Arthur Andersen, would not sign off on the transactions as legitimate without altering the timeline of events, the parties drafted documents giving the false appearance that the contracts for purchase of set-top boxes and the contracts for sale of advertising were separate and distinct—therefore, legitimate—transactions, negotiated at fair value at two distinct periods of time. Charter subsequently recorded the sale of advertising as revenue in its current quarter—increasing quarterly revenue by $17 million—and submitted to the SEC the inflated quarterly financial reports. Respondents properly reported the transactions as a wash under generally

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that Charter made to Respondents: Motorola would pay $10,800,000 and Scientific-Atlanta $6,730,000." Brief for Petitioner, supra note 240, at *8. Charter was "an important customer of Scientific-Atlanta and Motorola, the two largest manufacturers of such converter boxes and other equipment used by cable companies," thus making it difficult for Respondents to turn down the proposed transactions. In re Charter Commc'ns I, 2004 WL 3826761, at *3.


262. Stoneridge, 128 S. Ct. at 767.

263. Brief for Respondents, supra note 239, at *6. "Anderson allegedly advised Charter that it should not recognize the [Respondents'] payments as advertising revenue because 'they appeared integrally related to the cost increases being paid by Charter.'" Brief for Respondents, supra note 239, at *6. Charter's auditor stated that it would approve the transactions "only if the set-top box payments and advertising fees were at fair market value, unrelated, and negotiated at least a month apart." Brief for Respondents, supra note 239, at *6.

264. Stoneridge, 128 S. Ct. at 767. Scientific-Atlanta sent Charter a "pricing increase notification letter" falsely stating the reason for the increase in cost. Brief for Petitioner, supra note 240, at *6-7. Additionally, Charter sent Motorola a contract that enabled Motorola to collect liquidated damages of twenty dollars for each set-top box Charter failed to purchase with the expectation that Charter would fail to purchase enough set-top boxes to cover Motorola's cost of purchasing advertising from Charter. Stoneridge, 128 S. Ct. at 767. To give the appearance that the contracts for set-top boxes and the contracts for sale of advertising were not related, Respondents backdated the contracts for set-top boxes to August 2000. Brief for Petitioner, supra note 240, at *8-9.

265. Stoneridge, 128 S. Ct. at 767.
accepted accounting principles and took "no role in preparing or disseminating Charter's financial statements."266

Subsequent to the formation of the scheme, the public became aware of the economic reality of the transactions, thereby forcing Charter to restate its financial reports for the preceding periods in accordance with generally accepted accounting principles.267 Due to this restatement, the market value of Charter's common stock decreased drastically.268 Additionally, the United States indicted four Charter executives,269 the SEC brought a cease-and-desist order against Charter,270 the Department of Justice brought criminal charges against Respondents,271 and the SEC instituted both civil proceedings272 and a cease-and-desist order against Motorola and two executives at Scientific-Atlanta.273

3. Procedural History

Reeling from the devastating financial effects caused by the drastic decrease in Charter's stock price in the aftermath of the criminal and civil indictments of both Charter and Respondents, Stonebridge Investment Partners, ("Petitioner")—representing investors holding Charter's securities from November 8, 1999, through July 17, 2002, (the class period)—filed a putative securities class action under section 10(b) of Exchange Act and SEC Rule 10b-5(b) against Charter, Res-

266. Id.
267. Brief for Petitioner, supra note 240, at *9. This restatement was not only the result of Charter's transactions with Respondents but for all fraudulent activities engaged in by Charter in previous periods. Brief for Respondents, supra note 239, at *7-8.
268. Brief for Petitioner, supra note 240, at *9. "A restatement by Charter of its financial reports issued in April 2003 indicated that Charter's operating cash flow had been inflated by $292 million in 2001 and $195 million in 2000, for a total of $487 million." Brief for Respondents, supra note 239, at *7. This drove down the price of Charter's common stock from a class period high of $26.31 per share to a mere $0.76 by October 2002. Brief for Respondents, supra note 239, at *7-8. Respondents noted that the increase in revenue attributable to the transactions entered into with both Respondents "inflated Charter's cash flow for a single quarter by $17 million, i.e., only 3.5% of the total inflation alleged." Brief for Respondents, supra note 239, at *8.
271. Brief for Petitioner, supra note 240, at *3.
272. Brief for Petitioner, supra note 240, at *3.
273. Brief for Petitioner, supra note 240, at *11.
pondents, and current and former executives of Arthur Anderson. Petitioner sought to impose liability on Respondents for alleged losses suffered from the decrease in value of Charter's common stock. This section turns to the procedural history of the case. It first discusses the district court's finding in favor of Respondents. Next, this section examines the Eighth Circuit's holding in favor of Petitioner, as well as the reasoning behind the court's ruling.

a. The district court's decision

The United States District Court for the Eastern District of Missouri granted Respondents' motion to dismiss for failure to state a claim on which relief could be granted. The court concluded that, at most, Petitioner's claims against Respondents constituted claims of aiding and abetting, which are precluded by the Supreme Court's holding in Central Bank. According to the court, "[t]he critical element separating primary from aiding and abetting violations is the existence of a representation, either by statement or by omission, made by the defendant, that is relied upon by the plaintiff." Additionally, the court found that Petitioner's complaint failed to allege that Respondents made any public representations concerning the transactions or that investors relied upon any statements made by Respondents.

276. See infra Part III.A.3.a.
277. See infra Part III.A.3.b.
279. Id. at *5.
280. Id. (quoting Anixter v. Home-Stake Prod. Co., 77 F.3d 1215, 1225 (10th Cir. 1996)).
281. Id.
Consequently, the court granted Respondents' motion to dismiss for failure to state a claim. Petitioner then appealed the ruling to the United States Court of Appeals for the Eighth Circuit.

b. Eighth Circuit Court of Appeals

The United States Court of Appeals for the Eighth Circuit affirmed the district court's ruling, holding that the district court properly ruled that Petitioner's claims against Respondents amounted to claims of aiding and abetting, which are barred by Central Bank. The court reiterated the district court's reasoning that Petitioners failed to claim that Respondents directly engaged in any deceptive act on which Petitioner relied. The court stated that

any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under [Exchange Act] [section] 10(b) or any subpart of [SEC] Rule 10b-5.

Petitioner appealed the Eighth Circuit's holding, and the Supreme Court of the United States granted Petitioner's petition for writ of certiorari.

B. Reasoning

In Stoneridge, the Supreme Court, in a five to three decision, affirmed the Eighth Circuit's holding that the transactions entered into with Charter did not expose Respondents to civil liability for losses claimed by investors holding Charter's common stock. The majority first concluded that "[t]he [section] 10(b) implied private right of action [did] not extend to aiders and abettors." Next, the majority held

285. Id. at 992. The court also affirmed the district court's denial of Petitioner's motion to amend the complaint. Id.
286. Id.
287. Id.
290. Id. at 769.
that Petitioner did not rely on Respondents’ actions, which precluded a theory of primary liability under section 10(b) of the Exchange Act.\textsuperscript{291} Finally, the majority rejected Petitioner’s theory of “scheme liability,” again holding that Respondents’ actions did not invoke Petitioner’s requisite reliance on those transactions in its decision to purchase Charter’s securities.\textsuperscript{292}

1. \textit{Majority Opinion}

The majority commenced its analysis of the issues with an examination of private rights of action for violations of section 10(b) of the Exchange Act.\textsuperscript{293} Examining the text of both section 10(b) of the Exchange Act and SEC Rule 10b-5, the Court stated that although “the text of the Securities Exchange Act does not provide for a private cause of action for [section] 10(b) violations, the Court has found a right of action implied in the words of the statute and its implementing regulation.”\textsuperscript{294} The majority asserted, however, that its holding in \textit{Central Bank} specifically barred a private right of action against those who merely aid and abet primary violators of the securities law.\textsuperscript{295}

Subsequent to the holding in \textit{Central Bank}, industry leaders pushed Congress to include an express cause of action for aiding and abetting in the Exchange Act.\textsuperscript{296} The majority underscored the fact that Congress failed to take the proposed action.\textsuperscript{297} Instead, Congress assigned prosecutorial duties solely to the SEC.\textsuperscript{298} Implying from this congressional intent, the majority again reaffirmed the fact that “[t]he [section] 10(b) implied private right of action [did] not extend to aiders and abettors.”\textsuperscript{299} To establish an implied right of action under section 10(b) and SEC Rule 10b-5, a plaintiff must establish that the secondary actor’s conduct meets each and every element or precondition for liability.\textsuperscript{300}

\begin{itemize}
  \item \textsuperscript{291} \textit{Id.}
  \item \textsuperscript{292} \textit{Id.} at 770–74.
  \item \textsuperscript{293} \textit{Id.} at 768.
  \item \textsuperscript{294} \textit{Id.} “The Court [in \textit{Central Bank}] found the scope of [section] 10(b) to be delimited by the text, which makes no mention of aiding and abetting liability.” \textit{Id.} (citing Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 177 (1994)).
  \item \textsuperscript{295} \textit{Stoneridge}, 128 S. Ct. at 768.
  \item \textsuperscript{296} \textit{Id.} at 768–69.
  \item \textsuperscript{297} \textit{Id.} at 769.
  \item \textsuperscript{298} \textit{Id.}
  \item \textsuperscript{299} \textit{Id.}
  \item \textsuperscript{300} \textit{Id.}
\end{itemize}
After establishing that an implied private right of action under section 10(b) failed to reach Respondents as aiders and abettors, the majority's analysis turned to whether Respondents, as secondary actors, were primarily liable under the Exchange Act.  Although several elements are necessary for a plaintiff to bring a successful section 10(b) private action claim, the majority limited its analysis to the only element at issue in this case: Petitioner's reliance upon Respondents' misrepresentation or omission.

In analyzing the issue of reliance, the majority first asserted that it is unnecessary for a plaintiff to provide specific proof of reliance in two instances: (1) "if there is an omission of a material fact by one with a duty to disclose" and (2) "under the fraud-on-the-market doctrine, reliance is presumed when the statements at issue become public." If either of these two circumstances exists, a rebuttable presumption of reliance arises. The majority concluded that neither circumstance applied to the specific facts alleged by Petitioner in the case. The majority reasoned that, "Respondents had no duty to disclose; and their deceptive acts were not communicated to the public. No member of the investing public had knowledge, either actual or presumed, of [R]espondents' deceptive acts during the relevant times." Based on these facts, the majority concluded that Petitioner failed to assert proof of the requisite reliance to successfully claim an implied private right of action under section 10(b) of the Exchange Act.

302. *Id.* at 768. "In a typical section 10(b) private action a plaintiff must prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Id.*
303. *Id.* at 769. The majority stated that the reliance element "ensures that, for liability to arise, the 'requisite causal connection between a defendant's misrepresentation and a plaintiff's injury' exists as a predicate for liability." *Id.* (quoting Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988)).
304. *Id.*
305. *Id.* As to the fraud-on-the-market doctrine, reliance is presumed because "[t]he public information is reflected in the market price of the security. Then it can be assumed that an investor who buys or sells stock at the market price relies upon the statement." *Id.*
306. *Id.*
Despite the absence of either a duty to disclose or a public statement made by Respondents, Petitioner nonetheless sought to impose liability upon Respondents by circumventing the reliance requirement under a theory known as "scheme liability." The crux of Petitioner's argument was that "the financial statement Charter released to the public was a natural and expected consequence of [R]espondents' deceptive acts." Petitioner asserted that absent Respondents' misleading acts, Charter's financial statement would have more accurately reflected the economic reality of Charter's financial health. Petitioner argued that this causal link should be sufficient to raise a rebuttable presumption of Petitioner's reliance.

In effect, Petitioner argued that by relying on the express statements contained in financial reports relating to securities, investors necessarily rely on the transactions underlying the financial numbers stated therein.

The majority rejected Petitioner's argument of "scheme liability," warning that if the Court adopted this concept of reliance, "the implied cause of action would reach the whole marketplace in which the issuing company does business; and there is no authority for this rule." Underscoring the fact that the reliance element's purpose is linked to causation, the majority stated that the appropriate inquiry was whether "[R]espondents' acts were immediate or remote to the injury." Because it was Charter and not Respondents, who deceived Charter's auditor into signing off on the inflated financial statements, the majority concluded that Respondents' acts were too remote to justify a finding that Petitioner relied on Respondents' private actions, reasoning that "nothing [R]espondents did made it necessary or inevitable for Charter to record the transactions as it did."

Additionally, the Court rejected "scheme liability" based on concepts of federalism. The majority urged that Petitioner was attempting to invoke a private cause of action for securities fraud—the realm of financing business—and apply it to the realm of ordinary business operations. According to the Court, state law primarily governs the

309. Id. at 769–70; see infra Part II.E.3.
310. Stoneridge, 128 S. Ct. at 770.
311. Id.
312. Id.
313. Id. at 770.
314. Id.
315. Id.
316. Stoneridge, 128 S. Ct. at 770.
317. Id. at 770–71.
318. Id. at 770.
latter.\(^{319}\) Thus, the majority stated that an extension of the private cause of action for securities fraud would risk that "federal power would be used to invite litigation beyond the immediate sphere of securities litigation and in areas already governed by functioning and effective state-law guarantees."\(^{320}\) According to the majority, precedent warned against such extensions.\(^{321}\)

The majority's analysis on Petitioner's theory of "scheme liability" next proceeded to an examination of congressional intent.\(^{322}\) In response to the Court's holding in *Central Bank*, Congress—despite industry pressure to include in the Exchange Act an express cause of action for aiding and abetting\(^{323}\)—limited prosecutorial duties solely to the SEC.\(^{324}\) Asserting that Petitioner's theory of primary liability "ma[de] any aider or abettor liable under [section] 10(b) if he or she committed a deceptive act in the process of providing assistance," the majority concluded that Petitioner's theory "would revive in substance the implied cause of action against all aiders and abettors except those who committed no deceptive act in the process of facilitating the fraud; and we would undermine Congress'[s] determination that this class of defendants should be pursued by the SEC and not by private litigants."\(^{325}\) Thus, the majority concluded that Congress's decision not to include an express cause of action for aiding and abetting in the Exchange Act supported the majority's decision to reject the expansion of private rights of action under section 10(b) to aiders and abettors under Petitioner's theory of "scheme liability."\(^{326}\)

Continuing its argument, the majority proceeded to discuss the consequences of implementing an expansion of private rights of action to aiders and abettors under a theory of "scheme liability."\(^{327}\) The ma-
jority stated that an expansion could increase litigation by allowing plaintiffs to assert weak claims in an attempt to extort settlements from innocent defendants. Consequently, the increase in litigation would necessarily increase the cost of doing business as the risk of liability would force companies to defend frivolous claims. Additionally, an expansion of liability may deter overseas firms from doing business in America." The Court warned that these consequences could lead to rising industry prices, making it less profitable to invest in American markets.

Next, the majority examined the history of the section 10(b) private right of action and the judicial approach of expanding the private right of action beyond the parameters set out by Congress. Stating the rule that an implied cause of action only exists if a court can infer from the text of the statute congressional intent to create an implied right, the majority—reiterating its argument that Congress’s action in not expanding the private right of action when pressed to do so precluded an argument that Congress intended the right to be expanded—concluded that if the implied private right of action under section 10(b) should be expanded, it should be expanded by Congress only and not by the judiciary.

The majority concluded its opinion with a reminder that the enforcement powers against aiders and abettors of primary section 10(b) violators "is not toothless"—secondary actors are nevertheless subject to both criminal charges and civil penalties, which are enforced by the appropriate governmental agency. The majority also asserted that the standards for liability of some secondary actors—accountants, lawyers, underwriters, etc.—are expressly set out in the Exchange Act. Additionally, the majority stated that secondary actors may still be liable if they commit primary violations.

328. Stoneridge, 128 S. Ct. at 772.
329. Id.
330. Id.
331. Id. at 772.
332. Id. at 772–73.
333. Id.
334. Stoneridge, 128 S. Ct. at 773. The majority stated that "[s]ince September 30, 2002, SEC enforcement actions have collected over $10 billion in disgorgement and penalties, much of it for distribution to injured investors." Id.
335. Id.
336. Id. at 773–74.
2. Dissenting Opinion

Justice Stevens authored the dissenting opinion, which Justices Souter and Ginsberg joined. The dissent argued that the majority's holding was faulty on two premises: "(1) the Court's overly broad reading of Central Bank, and (2) the view that reliance requires a kind of super-causation." The dissenting opinion first distinguished the case at hand with that of Central Bank. Justice Stevens argued that by backdating and executing documents that provided false reasons for the increase in cost, Respondents' actions clearly met the language of section 10(b) because Respondents' actions "plainly describe[d] 'deceptive devices' under any standard reading of the phrase." Justice Stevens stated, however, that in Central Bank the defendant never engaged in any act arising to the level of a primary violation of section 10(b). Thus, according to the dissent, "Central Bank . . . pose[d] no obstacle to [P]etitioner's argument that it has alleged a cause of action under [section] 10(b)."

Next, the dissent argued that the majority's conclusion that Petitioner failed to demonstrate reliance was erroneous and unnecessary given that the Eighth Circuit did not base its conclusion on reliance grounds. Relying on the Court's decision in Basic, Inc. v. Levinson, which created the "fraud-on-the-market presumption" of reliance, the dissent argued that the majority's view of reliance was "unduly stringent and unmoored from authority." The dissent argued that instead of first examining the "fraud-on-the-market presumption," the majority should have first examined the causation required. Justice Stevens argued that the majority's perception of causation was faul-

337. Id. at 774. (Stevens, J., dissenting).
338. Id.
339. Id. at 775.
340. Stoneridge, 128 S. Ct. at 775 (Stevens, J., dissenting).
341. Id.
342. Id.
343. Id. at 775–76.
345. Id. at 250.
347. Id. at 776. The dissent conceded that "the Court is right that a fraud-on-the-market presumption coupled with its view on causation would not support petitioner's view of reliance." Id.
ty.\textsuperscript{348} Asserting that the "causation necessary to demonstrate reliance [was] not a difficult hurdle to clear," the dissent argued that by first looking to causation before proceeding to the "fraud-on-the-market presumption" of reliance, the Petitioner's burden of pleading reliance clearly was met.\textsuperscript{349}

Next, the dissent rebutted the majority's argument that extending the private cause of action to aiders and abettors of primary violators of section 10(b) would wreak havoc on the marketplace.\textsuperscript{350} The dissent disposed of the majority's argument by illustrating that only aiders and abettors who were themselves violators of section 10(b) would be liable under the Exchange Act.\textsuperscript{351} The dissent stated that, contrary to the majority's view, "[h]olding liable wrongdoers who actively engage in fraudulent conduct that lacks a legitimate business purpose does not hinder, but rather enhances, the integrity of our markets and our economy."\textsuperscript{352}

As to the majority's argument that Congress did not intend for the extension of private causes of action for section 10(b) violations, Justice Stevens focused on Congress's compromise in not undoing the decision in \textit{Central Bank}.\textsuperscript{353} Thus, the dissent argued that by expressly recognizing the need for enforcement in this area—that is, by delegating prosecutorial duties of enforcement of aiding and abetting liability to the SEC—Congress surely did not mean "to immunize an undefined class of actual violators of [section] 10(b) from liability in private litigation."\textsuperscript{354} The dissent stated that even Congress recognized that private litigation under the Exchange Act continues to serve a pivotal role in ensuring the integrity of security markets.\textsuperscript{355}

The dissent concluded its opinion with the history and importance of the implied cause of action under section 10(b) of the Exchange Act.\textsuperscript{356} Justice Stevens explained that the majority's hostility towards private rights of action was mistaken, stating that "[a] basic principle

\begin{itemize}
\item \textsuperscript{348} \textit{Id}. The dissent asserted that the causation requirement was similar to "but-for" causation. \textit{Id}. And the dissent concluded that "[R]espondents' acts had the foreseeable effect of causing petitioner to engage in the relevant securities transactions." \textit{Id}. at 777.
\item \textsuperscript{349} \textit{Id}. at 776–77.
\item \textsuperscript{350} \textit{Id}.
\item \textsuperscript{351} \textit{Id}. The dissent also rebutted the majority's argument that common law notions of reliance were not applicable under section 10(b). \textit{Id}.
\item \textsuperscript{352} \textit{Stoneridge}, 128 S. Ct. at 779 n.10 (Stevens, J., dissenting).
\item \textsuperscript{353} \textit{Id}. at 778.
\item \textsuperscript{354} \textit{Id}.
\item \textsuperscript{355} \textit{Id}..
\item \textsuperscript{356} \textit{Id}. at 779.
\end{itemize}
animating our jurisprudence was enshrined in state constitution provisions guaranteeing, in substance, that ‘every wrong shall have a remedy.’” 357 Justice Stevens concluded by stating, “Congress enacted [section] 10(b) with the understanding that federal courts respected the principle that every wrong would have a remedy.” 358 The dissent urged that the majority’s holding merely cuts back on Congress’s intended remedy. 359

IV. SIGNIFICANCE

Many consider the holding in Stoneridge to be the most significant securities case decided in the last few decades. 360 One legal professor went so far as to describe the case as “the business community’s equivalent of Roe v. Wade.” 361 The bulk of Stoneridge’s importance lies in the holding’s implications on both individual investors and the United States securities markets, 362 as well as on accountants, underwriters, and other secondary actors in the securities markets. 363 Although it is presently unclear whether the holding in Stoneridge is a victory or a defeat for either individual investors or the United States securities markets as a whole, it represents a significant victory for secondary actors by severely limiting the circumstances in which courts may hold secondary actors liable under section 10(b). 364 Due to the tendencies of federal courts to temper the harshness of Supreme Court decisions, 365 however, it is likely that plaintiffs will successfully develop fresh, novel theories designed to circumvent the elements necessary to establish an implied private right of action under section 10(b) and SEC Rule 10b–5 as to secondary actors. 366 Consequently, it

357. Id. at 779 (Stevens, J., dissenting).
358. Stoneridge, 128 S. Ct. at 782 (Stevens, J., dissenting).
359. Id.
360. John Engler, Say No to Trial Lawyers, USA TODAY, Oct. 8, 2007, at 12A.
361. Carrie Johnson & Robert Barnes, High Court’s Fraud Case Widely Seen as Stand-In for Enron, THE WASHINGTON POST, Oct. 5, 2007, at D01; see Roe v. Wade, 410 U.S. 113, 164 (1973) (holding that Texas abortion statutes prohibiting a mother to have an abortion at any stage in the pregnancy except to save the mother’s life are unconstitutional).
362. See infra Part IV.A.
363. See infra Part IV.B. In part, the holding is also significant because it resolved the split in the federal circuit courts regarding the legitimacy of the theory of “scheme liability.” See supra Part II.E.3.
366. See infra Part IV.C.
is unlikely that Stoneridge will put an end to private securities litigation as many commentators predict. 367

A. Individual Investors and the United States Securities Markets

Much of the debate surrounding Stoneridge centers on the effects that the holding will have on both individual investors and the United States securities markets as a whole. 368 This section first outlines the competing arguments as to whether Stoneridge represents a victory or a defeat for individual investors. 369 Next, this section concludes by discussing alternative views as to whether the holding in Stoneridge will positively or negatively affect the United States' securities markets. 370

1. Investors

The holding in Stoneridge is significant to individual investors injured by securities fraud who are now barred from bringing suits against non-speaking secondary actors. 371 Whether Stoneridge will positively or negatively impact individual investors as a whole is an issue of debate. 372 On one side of the coin, the plaintiff's bar sees the holding in Stoneridge as a major setback to investors. 373 It argues that investors are left with inadequate remedies and avenues for recouping losses incurred as a result of securities fraud. 374 The significance of this setback is most immediately evident in the wake of Enron's collapse. Although plaintiffs have recovered more than seven billion dollars from the investment banks that gave assistance to Enron in misleading its investors, another forty billion dollars of losses remain unclaimed. 375 The holding in Stoneridge makes it likely that the forty billion dollars of outstanding losses will remain unclaimed, leaving many investors without remedy. 376 As the dissent in Stoneridge stated, however, it is a

368. See infra Part IV.A.1–2.
369. See infra Part IV.A.1.
370. See infra Part IV.A.2.
371. See supra Part III.B.
372. See infra notes 370–79.
374. Id.
376. Id.; Rugen, supra note 364. Subsequent to the holding in Stoneridge, in a case stemming from Enron's collapse, the Supreme Court denied plaintiff's certiorari peti-
staple of American jurisprudence that "every wrong shall have a remedy." Thus, many investors will likely look down upon Stoneridge with contempt, disenchanted by a regulatory system that leaves investors vulnerable.

On the flip side of the coin, other commentators hail the Stoneridge holding as a clear victory for individual investors as a whole. These commentators emphasize the fact that investors as a group do not benefit from frivolous lawsuits against companies that fail to make or have no duty to make representations to investors. When companies pay out capital in the form of settlements or compensation, in one form or another the money comes from the investors themselves. One commentator stated that "[w]hen a company pays a large (supposedly pro-investor) judgment, that money comes out of the hide of existing shareholders." Consequently, these commentators argue that Stoneridge represents a clear victory for investors as a whole, in that an expansion of private securities litigation more commonly increases, rather than decreases, the economic burden on individual investors.

2. The United States Securities Markets

There is a growing consensus among experts that the supremacy of the United States securities markets is declining. Consequently, it is of no surprise that a large number of parties, concerned over the impact that Stoneridge might have on the well-being of the United States securities markets, filed an unprecedented number of amicus briefs on both sides of the issue. On one side of the argument, com-

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378. See Engler, supra note 360, at 12A.
380. Engler, supra note 360, at 12A.
381. Engler, supra note 360, at 12A.
382. See Engler, supra note 360, at 12A.
mentators praise Stoneridge as a triumph for the United States securities markets. These commentators urge that Stoneridge greatly benefits the marketplace by decreasing overall litigation costs. According to the Washington Legal Foundation, from 1997 to 2004, the dollar value of securities class-action claims increased from $150 million to over $9.6 billion. Thus, these commentators assert that the holding in Stoneridge was a crucial victory for the United States securities markets at a time when foreign investors are beginning to move their investments out of the United States and into other foreign markets. As one commentator asserted, "the wrong ruling would have unleashed a tsunami of damaging side effects, infecting the entire [United States] economy."

On the other side of the argument, some commentators believe that Stoneridge insulates many culprits from the consequences of their actions. Although the SEC retains enforcement power under section 10(b) and Rule 10b-5 against aiders and abettors, the Supreme Court has repeatedly emphasized that "implied private actions provide 'a most effective weapon in the enforcement' of the securities law and are a 'necessary supplement to Commission action.'" Given that the holding in Stoneridge makes it clear that the SEC now operates as the sole regulatory mechanism for aiding and abetting liability under sec-

enforcement officials took different positions on the case, and the current SEC was divided three-to-two on the proper resolution of the matter." Id.

385. See Johnson & Barnes, supra note 361, at D01; Yates, supra note 384, at 14.

386. Stewart, supra note 383 (asserting that the two main culprits to the decline in the primacy of the United States securities markets are the increasing costs in regulatory compliance and liability risks associated with doing business in the United States).

387. Johnson & Barnes, supra note 361, at D01.

388. Stewart, supra note 383.

389. High Court Rejects 'Scheme Liability' Under Antifraud Provisions of 1934 Act, supra note 379. This is particularly true in light of the recent surge of mortgage defaults and foreclosures stemming from the collapse of the sub-prime mortgage industry. Arthur N. Lambert & Marc R. Lepelstat, Claims from Sale of Collateral Mortgage Obligations, 239 N.Y. L.J. 4 (2008), available at 2/15/2008 N.Y. L.J. 4 (Col. 4). Losses resulting from mortgage-backed securities are likely to lead to a wave of litigation against investment banks and other secondary entities under section 10(b) and SEC Rule 10b-5. Id. Had the Supreme Court gone the other way in Stoneridge, the sub-prime mortgage meltdown would have added to the increase in litigation costs already infecting the United States securities markets. See id.

390. High Court Rejects 'Scheme Liability' Under Antifraud Provisions of 1934 Act, supra note 379.

tion 10(b) and SEC Rule 10b-5, one retired SEC attorney commented that the SEC lacks the funding “to be in a position to take up the slack.” Thus, many argue that the holding in *Stoneridge* leaves a gap in the regulatory framework that decreases the integrity of the United States securities markets. In turn, this lack of integrity makes the United States securities markets less desirable in the eyes of foreign investors. As the dissent in *Stoneridge* stated, “investor faith in the safety and integrity of our markets is their strength. The fact that our markets are the safest in the world has helped make them the strongest in the world.”

B. Secondary Actors

Although it is currently too early to tell whether the outcome of *Stoneridge* will have a positive or negative effect on either individual investors or the United States securities markets as a whole, it is unquestionable that *Stoneridge* represents a major victory to accountants, underwriters, and other secondary actors in the securities markets. The Supreme Court’s holding in *Stoneridge* sharply limits the scope of relief available under section 10(b) and SEC Rule 10b-5 to defrauded shareholders. The plaintiff’s bar initially downplayed the significance of the *Stoneridge*, arguing that the holding could be narrowly confined to apply only to secondary actors who played no role in the “investment sphere.” A few days subsequent to its holding in *Stoneridge*, however, the Supreme Court denied certiorari to a class action against investment banks relating to the downfall of Enron. Additionally, on the same day that the Court denied certiorari in the Enron case, it simultaneously granted certiorari in *Avis Budget Group, Inc. v. California State Teacher’s Retirement System,* vacated the


393. *Stoneridge*, 128 S. Ct. at 779 n.10 (Stevens, J., dissenting).

394. *Id.*

395. *Id.* at 779.


397. *Id.*

398. *Id.*


judgment of the Ninth Circuit Court of Appeals that had accepted "scheme liability," and remanded for further consideration in light of the holding in Stoneridge.\textsuperscript{401}

Many commentators believe that the denial of certiorari in the Enron case, coupled with the ruling in Avis, sent a strong message to lower federal courts that secondary actors are not liable under section 10(b) or SEC Rule 10b-5 absent some sort of public misstatement or omission—regardless of whether the defendants acted within the "investment sphere."\textsuperscript{402} This is very beneficial to secondary actors that transact with issuing companies.\textsuperscript{403} First, due to the fact that Stoneridge makes it more difficult for plaintiffs to assert liability under section 10(b) and SEC Rule 10b-5, secondary actors in the securities markets will spend less money defending frivolous lawsuits.\textsuperscript{404} Consequently, secondary actors will not only pay out less money in the form of compensation or settlement agreements, but may also save additional capital by paying less insurance premiums from carriers who would otherwise be forced to foot the bill.\textsuperscript{405}

Additionally, had the Court in Stoneridge accepted "scheme liability," any secondary actor supplying goods or services to a public company could be vulnerable to liability if the issuing company misstated its financial earnings and mislead its investors.\textsuperscript{406} This would undoubtedly increase the cost of doing business for secondary actors, as they would be forced to conduct arduous due diligence investigations into public companies before entering into routine business transactions.\textsuperscript{407} Finally, for the reasons stated, the acceptance of "scheme liability" would have decreased the availability of and increased the cost of professional services.\textsuperscript{408}

It should be noted, however, that although the holding in Stoneridge represents a clear victory for secondary actors, the public should


\textsuperscript{402} See Rugen, supra note 364; Yates, supra note 384.

\textsuperscript{403} See supra notes 401–02.


\textsuperscript{405} Id.


\textsuperscript{407} Id.

\textsuperscript{408} Yates, supra note 384.
not perceive it as an invitation to aid or abet fraud. The SEC retains enforcement power to bring regulatory actions against secondary actors, and state and federal criminal regulatory sanctions remain as significant deterrents for those that help issuing companies mislead investors. Additionally, the holding in Stoneridge sheds little light on the liability of officers or professionals that play a significant role in preparing an issuing company's financial statements, even though their roles may be unknown to investors. Nonetheless, commentators unanimously agree that Stoneridge represents a significant victory to secondary actors in the securities markets.

C. Not So Fast

Although Stoneridge clearly limits the circumstances in which federal courts may hold secondary actors liable under section 10(b) and SEC Rule 10b-5, lower federal courts have historically alleviated the harshness of the Supreme Court's approach to securities litigation by accepting alternative theories of recovery. Thus, creative plaintiffs' attorneys are likely to continue to develop fresh, novel theories designed to circumvent the requirements necessary to establish prima

410. Id.
411. Rugen, supra note 364. Although the holding clearly limits the circumstances in which courts can hold secondary actors liable under section 10(b) and SEC Rule 10b-5, Stoneridge "draws a line that leaves a significant area of liability open to those who more actively participate in the financial fraud." High Court Rejects 'Scheme Liability' Under Antifraud Provisions of 1934 Act, supra note 379. The majority in Stoneridge reasoned that Respondents were not liable because nothing they did made it "necessary or inevitable" for Charter to record the transactions in the way in which it did. Stoneridge Inv. Partners v. Scientific-Atlanta, Inc., 128 S. Ct. 761, 770 (2008). Thus, an exception may exist if those who aid and abet securities fraud made the fraud "necessary or inevitable." Barker, Baum, Jenkins, Ballard, Redburn & Seyedin-Noor, supra note 10.
412. The significance of the holding in Stoneridge as to secondary actors is most immediately apparent in light of the wave of litigation that has accompanied the meltdown of the sub-prime mortgage industry. Rugen, supra note 364; see also Lambert & Lepelstat, supra note 389. "Investment banks and other financial institutions played a host of different roles in creating, distributing, and servicing [mortgaged-backed securities], yet most never made any public statements that might for the basis of primary liability under [s]ection 10(b)." Rugen, supra note 364. In light of the holding in Stoneridge, secondary actors in the sub-prime mortgage industry can now breathe a little easier, knowing that plaintiffs' burden in bringing claims under section 10(b) against secondary actors is nearly insurmountable absent some sort of public misstattement. Rugen, supra note 364.
413. Luton, supra note 8, at 46-47.
ry liability under section 10(b) and SEC Rule 10b-5. Although it is not likely that plaintiffs will bring the same type of claims—for example, claims like “scheme liability,” which attempt to circumvent the reliance requirement—the massive amount of money at stake in securities class-actions, as well as the perilous financial condition of most primary violators, will likely sustain the amount of litigation brought in federal courts against secondary actors.414 Furthermore, it is also likely that lower federal courts, discouraged by what they perceive as inadequate protection afforded to sympathetic investors under the current regulatory scheme, will accept these new theories as legitimate or will at least allow these claims to survive a motion to dismiss.

Secondary actors, therefore, need not put their guards down. Unless Congress steps in and more adequately defines the scope of primary liability under section 10(b), secondary actors may face a wave of lawsuits under alternative theories of liability. Given that these new theories are likely to be different from the theory of “scheme liability” put forth in Stoneridge and given the fact that federal courts have been historically sympathetic to alternative theories of liability under section 10(b) and SEC Rule 10b-5, secondary actors may find it difficult to dismiss these suits for failure to state a claim. If the plaintiffs’ bar is creative enough to concoct theories that enable plaintiffs to survive motions to dismiss, these theories are likely to force defendants to continue to settle lawsuits, and money will continue to flow to the plaintiffs’ class-action bar.415

W. Taylor Marshall*

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414. See Barker, Baum, Jenkins, Ballard, Redburn & Seyedin-Noor, supra note 10; Rugen, supra note 364.

415. See Barker, Baum, Jenkins, Ballard, Redburn & Seyedin-Noor, supra note 10.

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