EXPANDING THE SCOPE OF SECURITIES FRAUD? THE SHIFTING SANDS OF *CENTRAL BANK*

*Cecil C. Kuhne, III**

TABLE OF CONTENTS

I. Introduction 25
II. The Holding in *Central Bank* 29
III. The "Bright Line" Test 33
IV. The "Substantial Participation" Test 37
V. Widening the Liability Horizon 42
A. Express Language of the Act 42
B. Reliance 43
C. Policy Considerations 45
VI. Conclusion 46

I. INTRODUCTION

With the increasing array of egregious securities fraud and other corporate scandals (*à la* Enron and its progeny) being exposed on the national scene in a highly visible way, the important and potentially perplexing issue of who are primary and who are secondary actors in the sale of securities has taken on renewed significance to the courts in their attempts to ascribe liability for violation of the securities laws, and it is fair to say that (unfortunately) the judicial results have often been less than consistent. In the pivotal case of *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*,[1] the Supreme Court considered the question of whether liability under section 10(b) of the Securities Exchange

* Mr. Kuhne is counsel in the Dallas office of Fulbright & Jaworski L.L.P.

1. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994) [hereinafter *Central Bank*].

Act of 1934[2] extends to those who do not directly commit a manipulative or deceptive act within the meaning of section 10(b) but who instead only aid and abet the violation.[3] The Court recognized the basic premise that to be deemed a primary violator under Rule 10b-5,[4] a defendant must "make" a material misstatement or omission,[5] and stated that there is no private cause of action for aiding and abetting under the Act.[6] However, the Court did not exclusively exempt secondary actors, such as lawyers, accountants, or investment bankers from liability, who may be found liable if all the requirements of primary liability are established.[7] After a lengthy analysis of why the statute can in good conscience be read no other way,[8] the Court forcefully asserted that a private plaintiff cannot maintain an aiding and

---

2. Securities and Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2000).

3. *Central Bank*, 511 U.S. at 167.

4. 17 C.F.R. § 240.10b-5 (2003).

5. Section 10(b) of the Act prohibits the use of any "manipulative or deceptive device or contrivance" in connection with the sale of a security. 15 U.S.C. § 78j(b). Rule 10b-5, adopted by the SEC to implement section 10(b), provides:

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

17 C.F.R. § 240.10b-5.

6. *Central Bank*, 511 U.S. at 191.

7. *Id.* The Court in *Central Bank* framed the issue as thus: "In this case, we must answer a question reserved in two earlier discussions: whether private civil liability under § 10(b) extends as well to those who do not engage in the manipulative or deceptive practice, but who aid and abet the violation." *Id.* at 166-67.

8. *Id.* at 175-77. In deciding whether conduct violates Rule 10b-5, the Court has stated: "[W]e turn first to the language of § 10(b) because the starting point in every case involving construction of a statute is the language of the statute itself." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976) (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975)). It should be noted that neither section 10(b) nor Rule 10b-5 specifically mentions the terms "primary violator" or "secondary actor." *See* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

abetting suit under section 10(b).[9] The Court stated:

> We reach the uncontroversial conclusion, accepted even by those courts recognizing a § 10(b) aiding and abetting cause of action, that the text of the 1934 Act does not itself reach those who aid and abet a § 10(b) violation. Unlike those courts, however, we think the conclusion resolves the case. It is inconsistent with settled methodology in § 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text. To be sure, aiding and abetting a wrongdoer ought to be actionable in certain instances. . . . The issue, however, is not whether imposing private civil liability on aiders and abettors is good policy but whether aiding and abetting is covered by the statute.[10]

The Court therefore concluded from a study of the text of the Act that Congress never intended to impose secondary liability under section 10(b) and that the Act thus "does not itself reach those who aid and abet" but "prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act."[11]

However, after this irrefutable pronouncement that aiding and abetting is not prohibited under the Act, the Court at the end of the opinion did, in the minds of some, slightly temper its language with the following qualification, from which arises what has become the thorny issue of when secondary actors may assume primary liability for securities fraud:

> The absence of § 10(b) aiding and abetting does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met. In any complex securities fraud, moreover, there are likely to be multiple violators . . . .[12]

This small linguistic concession has emboldened some courts and

9. *Central Bank*, 511 U.S. at 191.

10. *Id.* at 177; *see* SEC v. Seaboard Corp., 677 F.2d 1301, 1311 n.12 (9th Cir. 1982) ("The Supreme Court has rejected [the] justification for an expansive reading of the statutes and instead prescribed a strict statutory construction approach to determining liability under the acts.") (citations omitted).

11. *Central Bank*, 511 U.S. at 177.

12. *Id.* at 191 (citations omitted).

commentators to promote a more liberal interpretation of the act—one that allows a secondary actor to be held liable as a primary violator for "participation" in the making of a material misstatement—even though that individual was never identified in any way to the public.[13] On the other hand, others would argue that the Court's statement simply means that a secondary actor will be held to the same standards as a primary actor if actually "making" the material misstatement to the public.[14]

Regardless of their interpretation of the language in *Central Bank*, the courts are in agreement that in order to state a valid claim for primary liability under section 10(b) and Rule 10b-5, a plaintiff must prove the following elements:[15] The defendant (1) made a misstatement (or omission) of a material fact,[16] (2) with scienter,[17] (3) in connection with the purchase or sale of a security,[18] (4) upon which plaintiff reasonably relied,[19] and (5) that plaintiff's reliance was the proximate cause of his or her injury.[20] As to the first element—the making of a false statement or

13. *See, e.g.*, Wright v. Ernst & Young L.L.P., 152 F.3d 169, 177 (2d Cir. 1998) (discussing whether an accountant is primarily liable); Employers Ins. of Wausau v. Musick, Peeler & Garret, 871 F. Supp. 381, 389-90 (S.D. Cal. 1994) (holding that an accountant need not be named in a document to be held liable as a primary actor). As exemplified by these cases, the vast majority of cases considering the expansion of liability to secondary actors has dealt with accountants, typically for their work with financial statements or audits that would have revealed the corporation in a more negative light, had the information been made available to the public.

14. *See generally* Ben D. Orlanski, *Whose Representations Are These Anyway?: Attorney Prospectus Liability After* Central Bank, 42 UCLA L. REV. 885, 895-96 (1995).

15. *See, e.g.*, Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1281 (11th Cir. 1999) (setting forth the elements of a valid claim for primary liability).

16. *See In re* Kendall Square Research Corp. Sec. Litig., 868 F. Supp. 26, 28 (D. Mass. 1994) (holding that an accountant, who did not issue a report on company's financial statements but merely "reviewed and approved" them, could not be held liable for material misstatement).

17. Scienter, or knowledge, for purposes of securities fraud requires a showing of "a mental state embracing intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). A "showing of severe recklessness satisfies the scienter requirement." McDonald v. Alan Bush Brokerage Co., 863 F.2d 809, 814 (11th Cir. 1989).

18. Farlow v. Peat, Marwick, Mitchell & Co., 956 F.2d 982, 986 (10th Cir. 1992).

19. *Central Bank* noted that liability cannot attach "when at least one element critical for recovery under 10b-5 is absent: reliance." *Central Bank*, 511 U.S. 164, 180 (1994).

20. *See* Castellano v. Young & Rubicam, Inc., 257 F.3d 171, 186 (2d Cir. 2001) (stating that "loss causation has often been described as proximate cause"). These elements contrast with aider and abettor liability, which requires a plaintiff to prove (1)

omission of a material fact—the issue is whether an undisclosed investment bank, law firm, or other secondary actor can be liable as a primary violator if it has a substantial role in helping to "create" the misstatement or omission. Assuming that a defendant has knowledge of the fraud, the next question concerns the reliance element—whether a plaintiff can "rely" on the so-called statement of the secondary actor who was never disclosed.

The definition of "make" in Rule 10b-5 is therefore critical. If *Central Bank* held that there is no liability under the Act for aiding and abetting securities fraud, is expanding the definition in order to transmute what was formerly a secondary actor into a primary one merely a rhetorical device being used by the Court to avoid the aiding and abetting limitation? Of similar importance is the definition of reliance. If an undisclosed actor is liable for a material misrepresentation, can a plaintiff reasonably claim to have "relied" on the statement when never even aware of the undisclosed party?

II. THE HOLDING IN *CENTRAL BANK*

In its 1994 decision in *Central Bank*, the Supreme Court, in spite of a long line of appellate decisions to the contrary, specifically restricted the reach of section 10(b) by concluding that, based on the language and legislative history of the statute, there is no liability under the 1934 Securities Exchange Act for aiding and abetting a violation of the general antifraud provision.[21] The plaintiff in that case, a purchaser of notes issued by a public building authority, filed suit against the authority, the underwriters, the developer, and the indenture trustee, alleging specifically that the indenture trustee delayed an independent appraisal of the property, despite warnings that the notes were undersecured, long enough for the bond issue to close and the authority to default on its obligations to the holders.[22] Rejecting a long line of cases that recognized aiding and

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. Farlow v. Peat, Marwick, Mitchell & Co., 956 F.2d at 986.

21. *Central Bank*, 511 U.S. at 191 ("Because of our conclusion that there is no private aiding and abetting liability under §10(b), Central Bank may not be held liable as an aider and abettor."); *see* Wright v. Ernst & Young L.L.P., 152 F.3d 169, 175 (2d Cir. 1998) (stating that holding defendant liable would "effectively revive aiding and abetting under a different name, and would therefore run afoul of the Supreme Court's holding in *Central Bank*").

22. *Central Bank*, 511 U.S. at 167-68. The Supreme Court reversed the opinion of the Tenth Circuit, which held that plaintiffs had established a genuine issue

abetting liability under section 10(b),[23] the Court held that the absence of any mention of such liability in the statute precluded its imposition.[24] Accordingly, the Court dismissed the aiding and abetting claim against the indenture trustee.[25] The Court bolstered its conclusion by explaining that permitting liability for aiding and abetting would expose defendants to liability "without any showing that the plaintiff *relied* upon the aider and abettor's statements or actions."[26]

The Court in *Central Bank* therefore construed the general antifraud provision of section 10(b) as prohibiting "only the *making* of a material misstatement (or omission) or the commission of a manipulative act."[27] As a result, the Court reasoned that the statute does not prohibit giving aid to another, who then commits a primary section 10(b) violation.[28] The Court further emphasized that none of the express private causes of action in either the Securities Act of 1933 or the Securities Exchange Act of 1934 imposes liability on one who aids or abets such primary violators.[29] The

of material fact regarding the recklessness element of aiding and abetting liability and that a reasonable fact-finder could conclude that Central Bank had rendered substantial assistance by delaying the independent review of the appraisal. *Id.* at 191-92 (overruling First Interstate Bank of Denver, N.A. v. Pring, 969 F.2d 891, 900 (10th Cir. 1992)).

23. *See, e.g.*, Akin v. Q-L Invs., Inc., 959 F.2d 521, 526 (5th Cir. 1992); Roberts v. Peat, Marwick, Mitchell & Co., 857 F.2d 646, 652-53 (9th Cir. 1988); Rudolph v. Arthur Andersen & Co., 800 F.2d 1040, 1044 (11th Cir. 1986); Cleary v. Perfectune, Inc., 700 F.2d 774, 777 (1st Cir. 1983); Kerbs v. Fall River Indus., Inc., 502 F.2d 731, 740 (10th Cir. 1974); Brennan v. Midwestern United Ins. Co., 259 F. Supp. 673, 682 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970). Other cases, however, accurately predicted the holding in *Central Bank*. *See, e.g.*, Farlow v. Peat, Marwick, Mitchell & Co., 956 F.2d at 988; DiLeo v. Ernst & Young, 901 F.2d 624, 629 (7th Cir. 1990).

24. *Central Bank*, 511 U.S. at 177 (holding that the Act "does not itself reach those who aid and abet" but "prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act"); *see* Robert A. Prentice, *Locating That "Indistinct" and "Virtually Nonexistent" Line Between Primary and Secondary Liability Under Section 10(b)*, 75 N.C. L. REV. 691, 760 (1997) (explaining that silence is not actionable if there is not a duty to speak).

25. *Central Bank*, 511 U.S. at 191-92.

26. *Id.* at 180 (emphasis added) (citation omitted) ("Our reasoning is confirmed by the fact that [plaintiff's] argument would impose 10b-5 aiding and abetting liability when at least one element critical for recovery under 10b-5 is absent: reliance. A plaintiff must show reliance on the defendant's misstatement or omission to recover under 10b-5.").

27. *Id.* at 177 (emphasis added) (citations omitted).

28. *Id.*

29. *Id.* at 179 (citing 15 U.S.C. § 77k; 7 U.S.C. § 25(a)(1) (1988 & Supp. IV)).

Court suggested that "[t]here is no reason to think that Congress would have attached aiding and abetting liability only to § 10(b) and not to any of the express private rights of action in the Act."[30] The Court also noted that it would be "'anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.'"[31]

The Court additionally rejected as implausible the argument that silence in the statute constituted an implicit intent to impose section 10(b) aiding and abetting liability.[32] Nor did the Court find that anything in the legislative history "even implies that aiding and abetting was covered by the statutory prohibition on manipulative and deceptive conduct."[33] Furthermore, the Court pointed out that a critical element for recovery under Rule 10b-5—reliance—would be ignored if liability were imposed for aiding and abetting.[34]

> A plaintiff must show reliance on the defendant's misstatement or omission to recover under 10b-5. Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements or actions. Allowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases.[35]

Nevertheless, the Court did state in passing that secondary actors such as lawyers, accountants, banks, and underwriters were not ipso facto shielded from section 10(b) liability:

> Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met.[36]

---

30. *Id.* at 180.
31. *Id.* (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 736 (1975)).
32. *Id.* at 180, 183.
33. *Id.* at 183.
34. *See id.* at 180 ("Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements or actions.").
35. *Id.* (citations omitted).
36. *Id.* at 191; *see* Shapiro v. Cantor, 123 F.3d 717, 721 (2d Cir. 1977) ("We

Although the Court's opinion concedes the possibility that a secondary actor, by its conduct, can expose itself to primary liability, the opinion did not provide any further guidelines to imposing such liability.[37] Following the *Central Bank* decision, Congress did not, as it could have, reinstitute via legislation liability for aiding and abetting in private securities litigation. In fact, to the contrary, in 1995 Congress enacted the Private Securities Litigation Reform Act (PSLRA),[38] which generally limited the scope of private securities fraud actions and imposed stringent requirements for the assertion of securities fraud claims.[39]

In sum, the Supreme Court in *Central Bank*—while firmly maintaining that aiders and abettors are not liable under the Act—did leave open the possibility that a particular secondary actor may in some circumstances rise to the level of a primary violator.[40] As a result, two very divergent judicial standards—the "bright line" test and the "substantial participation" test—have emerged in the aftermath.[41]

---

agree that an accountant shares in an insider's duty to disclose if the accountant exchanges his or her role for a role as an insider who vends the company's securities.").

37. *See Central Bank*, 511 U.S. at 191; *see also* Anixter v. Home-Stake Prod. Co., 77 F.3d 1215, 1224 (10th Cir. 1996) ("Unfortunately, deciding when conduct constituting aiding and abetting rises to the level of prohibited primary conduct is not well settled. Appellant and appellees both rely on *Central Bank of Denver* to illuminate the distinctions.").

38. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in 15 U.S.C. §§ 77k, 77l, 77z-1, 77z-2, 78a, 78j-1, 78t, 78u, 78u-4, and 78u-5 (2000)).

39. *Id.* The PSLRA authorized the Securities Exchange Commission (SEC) to bring enforcement actions against those who "knowingly provide[] substantial assistance to another person in violation" of the federal securities laws, but did not provide a private cause of action. 15 U.S.C. § 78t (2000).

40. *See Central Bank*, 511 U.S. at 191 (determining that "[t]he absence of § 10(b) aiding and abetting liability does not mean that secondary actors . . . are always free from liability").

41. *See In re* MTC Elec. Techs. S'holders Litig., 898 F. Supp. 974, 986 (E.D.N.Y. 1995) ("Some courts have held that a third party's review and approval of documents containing fraudulent statements is not actionable under Section 10(b) because one must *make* the material misstatement or omission in order to be a primary violator. . . . Other cases have held that third parties may be primarily liable for statements made by others in which the defendant had significant participation."); *see also* Anixter v. Home-Stake Prod. Co., 77 F.3d at 1226-27 ("[T]his rule, though far from a bright line, provides more guidance to litigants than a rule allowing liability to attach to an accountant or other outside professional who provided 'significant' or 'substantial' assistance to the representations of others."). Considering the simplicity of the language used in the statute and its accompanying administrative rule—as well as the holding in *Central Bank*—it is notable how the courts can reach such disparate results.

III. THE "BRIGHT LINE" TEST

Under a strict "bright line" standard for liability, courts have maintained that in order for the conduct of a secondary actor to rise to the level of a primary violation, the secondary actor must not only actually make a material misstatement or omission, but the misrepresentation must be attributed to that specific actor at the time of public dissemination (i.e., in advance of the investment decision) so as not to undermine the element of reliance required for section 10(b) liability.[42] The Second Circuit has routinely followed the reasoning of the bright line test.[43] In *Shapiro v. Cantor*,[44] plaintiffs sued the accounting firm of Touche Ross claiming that the firm had participated in defendants' fraudulent scheme by providing accounting, auditing, and financial analysis in preparation of an offering memorandum.[45] The court noted that a 1995 decision from the Eastern District of New York held:

> "[I]f *Central Bank* is to have any real meaning, a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b)."[46]

The court, relying upon a Tenth Circuit decision, also observed that because section 10(b) and Rule 10b-5 focus on fraud made in connection

42. *See* Wright v. Ernst & Young L.L.P., 152 F.3d 169, 175 (2d Cir. 1998); *see also* Shapiro v. Cantor, 123 F.3d 717, 720 (2d Cir. 1997) ("'[I]f *Central Bank* is to have any real meaning, a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b).'") (quoting *In re* MTC Elec. Techs. S'holders Litig., 898 F. Supp. at 987) (alteration by *Shapiro* court).

43. *See, e.g.*, Wright v. Ernst & Young L.L.P., 152 F.3d at 175 (following the "bright line" test). *But see* SEC v. First Jersey Sec., 101 F.3d 1450, 1471 (2d Cir. 1996) ("[P]rimary liability may be imposed not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration.") (citation omitted), *cert. denied*, 522 U.S. 812 (1997). The Court in *Wright* distinguished *First Jersey Securities* on the basis that defendant there was a "controlling person" of the corporation, not outside accountants who cannot be held liable for mere knowledge and assistance of the fraud. Wright v. Ernst & Young L.L.P., 152 F.3d at 176.

44. Shapiro v. Cantor, 123 F.3d 717 (2d Cir. 1997).

45. *Id.* at 719 ("The [district] court [in *Shapiro*] stressed that Touche Ross did not issue an opinion or certification as to the prospectus.").

46. *Id.* at 720 (quoting *In re* MTC Elec. Techs. S'holders Litig., 898 F. Supp. at 987) (alteration by *Shapiro* court).

with the purchase or sale of securities, a defendant must "know or should know" that his or her representation will be communicated to investors if the defendant is to be found liable.[47] The court found that words such as "assisting," "participating in," and "complicity in," alleged in the complaint "all fall within the prohibitive bar of *Central Bank*."[48]

In the Second Circuit case of *Wright v. Ernst & Young L.L.P.*,[49] the court took notice of the fact that the defendant, Ernst & Young, which had acted as an outside auditor, was never mentioned in the press release at issue (which actually stated that an audit had not been completed), thereby removing any basis for plaintiff to complain that Ernst & Young had endorsed the accuracy of the financial results.[50] The court concluded that finding liability under such circumstances would "'effectively revive aiding and abetting liability under a different name, and would therefore run afoul of the Supreme Court's holding in *Central Bank*.'"[51] The court also required as a basis for liability that the actor "'knew or should have known that his representation would be'" disseminated to investors.[52]

Likewise, the Tenth Circuit in *Anixter v. Home-Stake Production Co.*[53] required that the misrepresentation actually be communicated by the defendant to be actionable under section 10(b):

47. *Id.* (quoting Anixter v. Home-Stake Prod. Co., 77 F.3d 1215, 1226-27 (10th Cir. 1996)). *But see* Anixter v. Home-Stake Prod. Co., 77 F.3d at 1226 ("There is no requirement that the alleged violator directly communicate misrepresentations to [investors] for primary liability to attach.").

48. Shapiro v. Cantor, 123 F.3d at 720.

49. Wright v. Ernst & Young L.L.P., 152 F.3d 169 (2d Cir. 1998), *cert. denied*, 525 U.S. 1104 (1999).

50. *Id.* at 175. The court phrased the issue in the case thus: "[W]hether, under the Act, persons who purchase stock in a company that issued a press release containing false and misleading financial information, with a notation that the information is unaudited and without mention of its outside auditor, can recover from the auditor for its private approval of the information contained in the press release." *Id.* at 171.

51. *Id*. (quoting Wright v. Ernst & Young L.L.P., No. 97 CIV. 2189(SAS), 1997 WL 563782, at *3 (S.D.N.Y. Sept. 10, 1997). The court stated that the defendant "neither directly nor indirectly communicated misrepresentations to investors. Therefore, the amended complaint failed to allege that Ernst & Young made 'a material misstatement (or omission) on which a purchaser or seller of securities relie[d].'" *Id.* (quoting *Central Bank*, 511 U.S. 164, 191 (1994)).

52. *Id.* (quoting Shapiro v. Cantor, 123 F.3d at 720). There is no requirement, however, that the actor communicate the misrepresentation directly to the investors. *Id*.

53. Anixter v. Home-Stake Prod. Co., 77 F.3d 1215 (10th Cir. 1996).

> [F]or an accountant's misrepresentation to be actionable as a primary violation, there must be a showing that he knew or should have known that his representation would be communicated to investors because § 10(b) and Rule 10b-5 focus on fraud made "in connection with the sale or purchase" of a security.[54]

The court reasoned that this requirement of actual communication arises because the securities statute must be strictly construed:

> Reading the language of § 10(b) and 10b-5 through the lens of *Central Bank of Denver*, we conclude that in order for accountants to "use or employ" a "deception" actionable under the antifraud law, they must themselves make a false or misleading statement (or omission) that they know or should know will reach potential investors.[55]

The court in *Anixter* also specifically criticized the less stringent "substantial participation" test as inconsistent with *Central Bank*'s prohibition against aiding and abetting liability.[56]

In the Eleventh Circuit case of *Ziemba v. Cascade International, Inc.*,[57] the plaintiffs never contended that the defendant law firm directly made any misrepresentations, but rather claimed that the law firm had a "significant role in drafting, creating, reviewing, or editing allegedly fraudulent letters or press releases."[58] The court insisted that for liability to attach, the alleged misstatement must be publicly attributable to the defendant at the time plaintiffs' investment decision was made.[59] The court dismissed the action, stating that to do otherwise would avoid the "reliance" requirement and effectively restore an action for aiding and abetting.[60]

A number of district courts have also outlined the type of behavior that is insufficient to subject a peripheral party to liability under section

54. *Id.* at 1226 (citing Frymire-Brinati v. KPMG Peat Marwick, 2 F.3d 183, 189-90 (7th Cir. 1993); Akin v. Q-L Invs., Inc., 959 F.2d 521, 526-27 (5th Cir. 1992); Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 34-35 (D.C. Cir. 1987)).

55. *Id.*

56. *Id.* at 1226 n.10 ("To the extent these [substantial participation] cases allow liability to attach without requiring a representation be made by defendant, and reformulate the 'substantial assistance' element of aiding and abetting liability into primary liability, they do not comport with *Central Bank of Denver*.").

57. Ziemba v. Cascade Int'l, Inc., 256 F.3d 1194 (11th Cir. 2001).

58. *Id.* at 1205.

59. *Id.*

60. *Id.* at 1206.

10(b). For example, in *Vosgerichian v. Commodore International*,[61] the court held that allegations regarding an accountant who "advised" a client who then in turn made an allegedly fraudulent misrepresentation were insufficient for liability.[62] *In re Kendall Square Research Corp. Securities Litigation*[63] held that an accountant's mere review and approval of misleading financial statements, without the issuance of a report, cannot rise to a 10b-5 violation:

> Because Price Waterhouse did not actually engage in the reporting of the financial statements and Prospectuses, but merely reviewed and approved them, the statements are not attributable to Price Waterhouse and thus Price Waterhouse cannot be found liable for *making* a material misstatement.[64]

The court in *In re Cascade International Securities Litigation*[65] agreed that an accountant must actually make the misstatement in order to be liable for securities fraud:

> [I]f an accountant does not issue a public opinion about a company, although it may have conducted internal audits or reviews for portions of the company, the accountant cannot subsequently be held responsible for the company's public statements issued later merely because the accountant may know those statements are likely untrue. It follows therefore that an accountant who has not publicly expressed support for the company's financial statements . . . has no duty to alert the public to the content, even if inaccurate, of those statements in the future.[66]

Furthermore, in *In re MTC Electronic Technologies Shareholders Litigation*,[67] the district court acknowledged that *Central Bank* had created some confusion, but concluded:

> [I]f *Central Bank* is to have any real meaning, a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding

61. Vosgerichian v. Commodore Int'l, 862 F. Supp. 1371 (E.D. Pa. 1994).
62. *Id.* at 1378.
63. *In re* Kendall Square Research Corp. Sec. Litig., 868 F. Supp. 26 (D. Mass. 1994).
64. *Id.* at 28.
65. *In re* Cascade Int'l Sec. Litig., 894 F. Supp. 437 (S.D. Fla. 1995).
66. *Id.* at 443.
67. *In re* MTC Elec. Techs. S'holders Litig., 898 F. Supp. 974 (E.D.N.Y. 1995).

and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b).[68]

IV. THE "SUBSTANTIAL PARTICIPATION" TEST

Under the more lenient "substantial participation" standard, a secondary party intricately involved in the preparation of fraudulent statements may be held primarily liable for a securities violation without the necessity of actually *making* the statements.[69] Under this expansive definition of "make," a person will be deemed a primary violator when "creating" a misrepresentation, and a secondary actor can therefore become a primary violator if writing misrepresentations for inclusion in a document given to investors, even if the idea for those misleading disclosures came from someone else.[70] In other words, under this test, the secondary actor need not (a) sign the document containing the misrepresentation, (b) disseminate the misrepresentation to investors, or (c) be identified to investors.[71]

The Ninth Circuit has been the most vocal proponent of expanding liability to secondary actors under the guise of a substantial participation test. In the case of *In re Software Toolworks Inc.*,[72] the plaintiffs contended that the accounting firm of Deloitte & Touche violated section 10(b) by participating in the preparation of two fraudulent letters that the issuer sent to the SEC.[73] The court concluded that there was sufficient evidence

68. *Id.* at 987; *see In re* JWP Inc. Sec. Litig., 928 F. Supp. 1239, 1255-56 (S.D.N.Y. 1996) (dismissing plaintiffs' section 10(b) claims against audit committee defendants who did not actually make misrepresentations).

69. Howard v. Everex Sys., Inc., 228 F.3d 1057, 1061 n.5 (9th Cir. 2000). The move toward a substantial participation test takes solace in the words of *Central Bank* that a secondary actor "may be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met." *Central Bank*, 511 U.S. 164, 191 (1994).

70. *See* Carley Capital Group v. Deloitte & Touche, L.L.P., 27 F. Supp. 2d 1324, 1334 (N.D. Ga. 1998) ("The SEC believes that the test should look to what a secondary actor does in 'creating a misrepresentation' to determine when that actor makes a misrepresentation in violation of Section 10(b). The views of the SEC are entitled to consideration and some deference.").

71. *Id. But see* Cashman v. Coopers & Lybrand, 877 F. Supp. 425, 432 (N.D. Ill. 1995) (holding that when a court applies the substantial participation test, an accounting firm may not incur liability for misstatement unless the statement is "certified, audited, prepared or reported").

72. *In re* Software Toolworks Inc., 50 F.3d 615 (9th Cir. 1994), *cert. denied sub nom.* Montgomery Sec. v. Dannenberg, 516 U.S. 907 (1995).

73. *Id.* at 620.

to find the accounting firm was primarily liable based upon its "significant role in drafting and editing" the letter that misled the plaintiffs.[74] And in *Howard v. Everex Systems, Inc.*,[75] the issue was whether the chief executive officer who signed a SEC filing containing misrepresentations, but who did not actually participate in the drafting of the document, had "made" a statement so as to be primarily liable under section 10(b).[76] The Ninth Circuit found liability under these circumstances[77] and was adamant in the public policy rationale for expanding such liability:

> Key corporate officers should not be allowed to make important false financial statements knowingly or recklessly, yet still shield themselves from liability to investors simply by failing to be involved in the preparation of those statements. Otherwise, the securities laws would be significantly weakened, because corporate officers could stay out of the loop such that, under *Central Bank*, only the SEC could bring suit against them in an individual capacity for their misrepresentations.[78]

Several district courts have also applied this substantial participation test. For example, the court in *In re ZZZZ Best Securities Litigation*[79] attached primary liability to an accounting firm which was "intricately involved" in the creation of false documents.[80] The court noted that the reliance element had in fact been met: "While the investing public may not be able to reasonably attribute the additional misstatements and omissions to [the defendant], the securities market still relied on those public statements and anyone intricately involved in their creation and the resulting deception should be liable under Section 10(b)/Rule 10b-5."[81] In

74. *Id.* at 628 n.3.

75. Howard v. Everex Sys., Inc., 228 F.3d 1057 (9th Cir. 2000).

76. *Id.* at 1061.

77. *Id.* The court also noted: "Conversely, we have held that substantial participation or intricate involvement in the preparation of fraudulent statements is grounds for primary liability even though that participation might not lead to the actor's actual making of the statements." *Id.* at n.5 (citing *In re* Software Toolworks Inc., 50 F.3d at 628-29 & n.3).

78. *Id.* at 1062 (citations omitted). In *Howard*, there was evidence that the CEO and chairman of the board acted recklessly by signing financial statements "in the face of potentially alarming information concerning Everex's financial condition." *Id.* at 1064.

79. *In re* ZZZZ Best Sec. Litig., 864 F. Supp. 960 (C.D. Cal. 1994).

80. *Id.* at 970 (noting that "this case creates a close call and perhaps one of first impression"); *see* Employers Ins. of Wausau v. Musick, Peeler & Garrett, 871 F. Supp. 381, 389-90 (S.D. Cal. 1994) (holding that an accountant need not be named in a document in order to be liable as a primary actor).

81. *In re* ZZZZ Best Sec. Litig., 864 F. Supp at 970.

Cashman v. Coopers & Lybrand,[82] the court found liability for an accountant who had played a "central role in the drafting and formation of the alleged misstatements" that were incorporated into the prospectus.[83] And *Carley Capital Group v. Deloitte & Touche, L.L.P.*[84] held that an accounting firm was liable for overstatement of earnings in a quarterly financial report, even though the misrepresentations were not publicly attributed to it:

> The Court finds that the Plaintiffs have alleged more than aiding and abetting and have sufficiently alleged a primary violation of Rule 10b-5 against the Defendant with respect to the 1996 first quarter financial report of Medaphis. While the 1996 first quarter report does not identify the Defendant or otherwise attribute the inclusion of $12.5 million to the Defendant, the Plaintiffs have sufficiently alleged that the Defendant created the misrepresentation by directing Medaphis to include that revenue and income in the report. More than mere participation, complicity, or assistance, the Plaintiffs have essentially alleged that the Defendant was the author of the alleged misstatement.[85]

Those espousing a more liberal interpretation of Rule 10b-5, including the SEC, argue that the court should look to what a secondary actor does in "creating" the misrepresentation—rather than "making" the misrepresentation—to determine whether the actor is in violation of section 10(b).[86] These courts typically note that the views of the SEC in

82. Cashman v. Coopers & Lybrand, 877 F. Supp. 425 (N.D. Ill. 1995).

83. *Id.* at 432-34. However, the court noted that an accounting firm may not incur primary liability for a misstatement unless that statement is "certified, audited, prepared or reported." *Id.* at 432; *see* Adam v. Silicon Valley Bank Shares, 884 F. Supp. 1398, 1400 (N.D. Cal. 1995) (stating that "an accounting firm can be primarily liable for representations made by others" so long as they "played a significant role in drafting and editing" the representation).

84. Carley Capital Group v. Deloitte & Touche, L.L.P., 27 F. Supp. 2d 1324 (N.D. Ga. 1998).

85. *Id.* at 1334-35. The court reasoned:

> [T]here is nothing in *Central Bank* with regard to its use of the terms "makes" or "making a material misstatement" that limits liability to those individuals who sign documents or are otherwise identified to investors. The standard adopted by the Court is consistent with the "directly or indirectly" language in Section 10(b).

Id. at 1334; *see also* McNamara v. Bre-X Minerals, Inc., 57 F. Supp. 2d 396, 426 (E.D. Tex. 1996) (alleging misrepresentations through misstatement of resource calculations).

86. *See* Carley Capital Group v. Deloitte & Touche, L.L.P., 27 F. Supp. 2d at

this regard are entitled to much deference:

> The SEC believes that the test should look to what a secondary actor does in "creating a misrepresentation" to determine when that actor makes a misrepresentation in violation of Section 10(b). . . . This Court adopts the standard urged by the SEC and concludes that a secondary actor can be primarily liable when it, acting alone or with others, creates a misrepresentation even if the misrepresentation is not publicly attributed to it.[87]

Proponents of the substantial participation test also contend that such a standard is more consistent with the words "directly or indirectly" in Rule 10b-5, which makes it unlawful "for any person, *directly or indirectly* . . . [t]o employ . . . any device, scheme or artifice to defraud."[88] Under this view, any requirement that the misrepresenter be specifically identified to investors at the time of dissemination would have the consequence of providing a safe harbor for everyone except those identified with the statements by name.[89]

As for the requirement of reliance, the argument is that plaintiffs need only prove that they relied on the statements made—not on the specific actor making the statement. The court in *In re ZZZZ Best Securities Litigation* reasoned:

1334; *see also In re* Enron Corp. Sec., Derivative & ERISA Litig., 235 F. Supp. 2d 549, 587 (S.D. Tex. 2002) (acknowledging the SEC's proposal that "creates" is the proper synonym for "makes" because "'[a] person who creates a misrepresentation but takes care not to be identified publicly with it, "indirectly" uses or employs a deceptive device or contrivance and should be liable' under § 10(b)") (quoting SEC brief at 14).

87. Carley Capital Group v. Deloitte & Touche, L.L.P., 27 F. Supp. 2d at 1334. It is interesting to note, however, that the SEC has not seen fit to change the rules interpreting section 10(b) to reflect this interpretation. Section 10(b) makes it "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance *in contravention of such rules and regulations as the [SEC] may prescribe.*" 15 U.S.C. § 78(j) (2000) (emphasis added).

88. 17 C.F.R. § 240.10b-5 (2003) (emphasis added); *see* Carley Capital Group v. Deloitte & Touche, L.L.P., 27 F. Supp. 2d at 1334. The Supreme Court in *Central Bank* rejected this argument: "[Plaintiff's] interpretation of the 'directly or indirectly' language fails to support their suggestion that the text of § 10(b) itself prohibits aiding and abetting." *Central Bank*, 511 U.S. 164, 176 (1994).

89. *See* Howard v. Everex Sys., Inc., 228 F.3d 1057, 1062 (9th Cir. 2000) ("[S]ecurities laws would be significantly weakened, because corporate officers could stay out of the loop such that, under *Central Bank*, only the SEC could bring suit against them in an individual capacity for their misrepresentations.").

> Plaintiffs . . . need only rely on the underlying fraudulent scheme in which [the defendant accountant] allegedly participated. The individual statements or omissions alleged by Plaintiffs are not in and of themselves the focus for the reliance . . . . Instead, the market's overall reliance on the [defendant corporation's] fraudulent scheme, or at least the additional statements as released and issued by [the defendant corporation], is sufficient to satisfy the reliance element in the Rule 10b-5(a) & (c) claims.[90]

The courts advocating the substantial participation standard also note that its abuse is unlikely because third-party defendants are still substantially protected from frivolous suits by the requirement that plaintiffs plead and ultimately prove all other elements of a section 10(b) claim, including, perhaps most importantly, scienter.[91] These courts have also rejected the contention that a defendant who participates in a scheme to defraud will be liable for damages caused by the other participants, because the Private Securities Litigation Reform Act provides for joint and several liability *only* if the defendant is found to have knowingly committed the fraud; otherwise, the defendant who is found to have acted recklessly is liable only for the percentage of his or her proportionate responsibility for the fraud.[92]

Lastly, those courts following the substantial participation test state that imposition of liability under the test is less rigid and technical than the bright line test.[93] Accordingly, these courts opine that the substantial participation test better effectuates the statute's broad remedial purposes.[94]

---

90. *In re* ZZZZ Best Sec. Litig., 864 F. Supp. 960, 973 (C.D. Cal. 1994).

91. *See In re* Software Toolworks Inc., 50 F.3d 615, 627-28 (9th Cir. 1994) ("[P]laintiffs have not satisfied this [scienter] standard. At most, the evidence establishes that Deloitte was negligent in auditing Toolworks, not that Deloitte recklessly or knowingly falsified the financial statements.").

92. Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(f) (2000).

93. *See, e.g.*, *In re* Enron Corp. Sec., Derivative & ERISA Litig., 235 F. Supp. 2d 549, 589 (S.D. Tex. 2002) ("[T]he statute's imposition of liability on any person that directly or indirectly uses or employs any manipulative or deceptive device or contrivance in connection with the purchase or sale of security should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes.") (citations and internal quotation marks omitted).

94. *See id.*; *see also In re* ZZZZ Best Sec. Litig., 864 F. Supp. at 971 ("A plain reading of [Rule 10b-5] reveals that any deceptive acts or practices in connection with the sale of securities are prohibited. . . . Thus, the terms of the statute and rule extend liability to *all* participants in *any* scheme or device that operates as a fraud on investors."); *cf. Central Bank*, 511 U.S. 164, 177-78 (1994) (stating that while the Securities Exchange Act of 1934 does carry broad remedial purposes, the Act may not

V. WIDENING THE LIABILITY HORIZON

This Article takes the view that although the motives for expanding securities fraud liability to additional parties (who, just incidentally, may be able to satisfy a judgment) are certainly understandable and perhaps even laudable, the parameters of *Central Bank* are violated by taking an unsupportably broad view of the term "make" in Rule 10b-5, thereby turning those who have traditionally been known as aiders and abettors into primary actors. Congress has never expressed its intent to expand such liability, and has in fact indicated quite the contrary.[95] Secondly, imputing liability to secondary actors ignores the reliance requirement of section 10(b), because a plaintiff can hardly rely on the statement of an individual who was never identified.[96] Furthermore, secondary actors have reasonably depended upon the Supreme Court's pronunciation a decade ago in *Central Bank* that there is no such liability, and exposing them to such consequences now would be manifestly unfair. As *Central Bank* noted, if Congress wishes to expand the scope of securities fraud, so be it, but it is manifestly inappropriate for the courts to do so.[97]

A. *Express Language of the Act*

The Court's lengthy analysis in *Central Bank* concluded, from a study of the text of the Securities Act of 1934, that Congress never intended to impose secondary liability under section 10(b) and that the Act thus "does not itself reach those who aid and abet" but "prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act."[98] The Court concluded:

---

be "amend[ed] . . . to create liability for acts that are not themselves manipulative or deceptive *within the meaning of the statute*") (emphasis added).

95. In 1995, Congress authorized the SEC to bring enforcement actions against those who "knowingly provide substantial assistance to another person" in violation of the federal securities laws. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 104, 109 Stat. 737, 757 (codified at 15 U.S.C. § 78t (2000)). This congressional act did *not* create a private cause of action for these violations. Wright v. Ernst & Young L.L.P., 152 F.3d 169, 176 (2d Cir. 1998).

96. There is also the question of whether a duty arises on the part of the defendant toward the plaintiff. *See In re* Cascade Int'l Sec. Litig., 894 F. Supp. 437, 443 (S.D. Fla. 1995) ("'When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak.'") (quoting *Central Bank*, 511 U.S. at 174).

97. *Central Bank*, 511 U.S. at 177 ("The issue, however, is not whether imposing private civil liability on aiders and abettors is good policy but whether aiding and abetting is covered by the statute.").

98. *Id.* ("We reach the uncontroversial conclusion . . . that the text of the 1934 Act does not itself reach those who aid and abet a § 10(b) violation."); *see* Ernst &

> [W]e again conclude that the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act. The proscription does not include giving aid to a person who commits a manipulative or deceptive act. We cannot amend the statute to create liability for acts that are not themselves manipulative or deceptive within the meaning of the statute.[99]

The Court in *Central Bank* rejected the plaintiff's argument that the phrase "directly or indirectly" as used in section 10(b) covers aiding and abetting liability, because such an interpretation of the statute would extend liability to those "who do not engage in the proscribed activities at all, but who give a degree of aid to those who do."[100] The Court reasoned:

> The federal courts have not relied on the "directly or indirectly" language when imposing aiding and abetting liability under § 10(b), and with good reason. There is a basic flaw with this interpretation. . . . The problem, of course, is that aiding and abetting liability extends beyond persons who engage, even indirectly, in a proscribed activity; aiding and abetting liability reaches persons who do not engage in the proscribed activities at all, but who give a degree of aid to those who do. A further problem with respondents' interpretation of the "directly or indirectly" language is posed by the numerous provisions of the 1934 Act that use the term in a way that does not impose aiding and abetting liability.[101]

B. *Reliance*

Reliance is undeniably a required element for liability under a Rule 10b-5 cause of action.[102] In order for a secondary actor, such as a law firm or accountant, to be primarily liable under section 10(b), plaintiffs must show that they relied upon a defendant's misstatement in order to recover.[103] The Court in *Central Bank* was clear about the indispensable

Ernst v. Hochfelder, 425 U.S. 185, 197 (1975) (noting that the language of a statute is the starting point in its construction).

99. *Central Bank*, 511 U.S. at 177-78 (citations omitted).

100. *Id*. at 176.

101. *Id.*

102. *See* Basic Inc. v. Levinson, 485 U.S. 224, 243 (1987) (stating that "[r]eliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury") (citations omitted).

103. *Central Bank*, 511 U.S. at 180; *see also* Ziemba v. Cascade Int'l, Inc., 256 F.3d 1194, 1206 (11th Cir. 2001) (declining to allow plaintiffs to avoid the "'reliance' requirement for stating a claim under Rule 10b-5").

nature of this requirement:

> Our reasoning is confirmed by the fact that respondents' argument would impose 10b-5 aiding and abetting liability when at least one element critical for recovery under 10b-5 is absent: reliance. A plaintiff must show reliance on the defendant's misstatement or omission to recover under 10b-5. Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements or actions. Allowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases.[104]

In the later case of *Wright v. Ernst & Young L.L.P.*, the Second Circuit also stressed that a secondary actor cannot incur primary liability for a statement not attributed to him at the time of its dissemination.[105] In other words, "[r]eliance only on the representations made by others *cannot* form the basis of [section 10(b)] liability."[106]

Many of the courts advocating a more lenient standard of liability have also ignored the well-established legal principle that the duty to disclose information does not arise unless there is a fiduciary or similar relationship existing between the parties.[107] The court in *In re Cascade International Securities Litigation* provided a poignant reminder of that standard:

> The concept of a duty to disclose appears to stem from the extent of

104. *Central Bank*, 511 U.S. at 180 (citations omitted); *see* Basic Inc. v. Levinson, 485 U.S. at 243 (noting that "reliance" is a required element of a Rule 10b-5 cause of action).

105. Wright v. Ernst & Young L.L.P., 152 F.3d 169, 175 (2d Cir. 1998) ("Such a holding would circumvent the reliance requirements of the Act . . . ."); *see* Ziemba v. Cascade Int'l, Inc., 256 F.3d at 1206 ("To permit Plaintiffs' allegations against [Defendant] to survive a motion to dismiss would permit Plaintiffs to avoid the 'reliance' requirement for stating a claim under Rule 10b-5."); *In re* Kendall Square Research Corp. Sec. Litig., 868 F. Supp. 26, 29 (D. Mass. 1994) ("Motion to Dismiss is denied . . . on the ground that plaintiffs have alleged reliance on the materially false and misleading statements of Price Waterhouse.").

106. Anixter v. Home-Stake Prod. Co., 77 F.3d 1215, 1225 (10th Cir. 1996) (emphasis added).

107. *See* Dirks v. SEC, 463 U.S. 646, 654-55 (1983) (stating that not requiring a fiduciary relationship would amount to requiring a "general duty between all participants in market transactions"); Charella v. United States, 445 U.S. 222, 228 (1980) (holding that a failure to disclose material information is only fraud if there is a duty to disclose).

> reliance on the accountant's work made by the public and the expectations of the public. Clearly, in a situation in which the accountant "gives an opinion or certifies statements" about a company—statements which the accountant later discovers may not have been accurate . . . —then the accountant has a duty to disclose the fraud to the public. . . . Conversely, if an accountant does not issue a public opinion about a company, although it may have conducted internal audits or reviews for portions of the company, the accountant cannot subsequently be held responsible for the company's public statements issued later merely because the accountant may know those statements are likely untrue.[108]

C. *Policy Considerations*

The Supreme Court in *Central Bank* recognized that there may be good policy reasons for imposing civil liability on aiders and abettors under section 10(b),[109] but Congress has obviously determined that there are equally valid reasons for not imposing such liability.[110] For one thing, the uncertainty of liability and the prospects for litigation against professionals who advise companies can have negative results, one of which is that newer and smaller companies find it difficult to obtain advice because of the now higher costs of that advice. On the other hand, there are advantages to a bright line rule. The court in *Anixter* noted:

> In addition to being consistent with the language of the statute, this rule [that an accountant must actually make a misleading statement to be liable under 10b-5], though far from a bright line, provides more

108. *In re* Cascade Int'l Sec. Litig., 894 F. Supp. 437, 443 (S.D. Fla. 1995); *see* Pahmer v. Greenberg, 926 F. Supp. 287, 306 (E.D.N.Y. 1996), *aff'd sub nom.* Shapiro v. Cantor, 123 F.3d 717 (2d Cir. 1997) ("'[A]n accounting firm has no duty to disclose fraudulent misconduct . . . under Section 10(b) where it has not given some representation or certification, such as an opinion or certified statement, or has not invited the public to rely on the firm's financial judgment at the time.'") (quoting *In re* Gas Reclamation, Inc. Sec. Litig., 659 F. Supp. 493, 505 (S.D.N.Y. 1987)).

109. *See Central Bank*, 511 U.S. at 177 (stating that "[t]o be sure, aiding and abetting a wrongdoer ought to be actionable in certain instances"). The court in *In re Kendall Square* noted: "The Supreme Court's decision in *Central Bank* makes clear that the policy undergirding it is to constrict the ambit of private actions under Section 10(b) and to thereby reduce the number of parties implicated by that statute." *In re* Kendall Square Research Corp. Sec. Litig., 868 F. Supp. at 28. *See Central Bank*, 511 U.S. at 184 ("The fact that Congress chose to impose some forms of secondary liability, but not others, indicates a deliberate congressional choice with which the courts should not interfere.").

110. *See supra* note 95 and accompanying text.

> guidance to litigants than a rule allowing liability to attach to an accountant or other outside professional who provided “significant” or “substantial” assistance to the representations of others.[111]

Legal certainty is obviously valued in the marketplace, and professionals offering advice to companies are free to dispense advice if relieved of liability under a more ambiguous standard of securities fraud.

VI. CONCLUSION

An overly broad reading of the term “make” in Rule 10b-5 tends to render meaningless the pronouncement in *Central Bank* that the Securities Act of 1934 does not apply to aiders and abettors. As that opinion made apparent, a secondary actor, whether it be a lawyer, accountant, or investment banker, may be liable if *all* the requirements for primary liability under the rule are met—including the actual making of the material misstatement by the defendant and the reliance on those statements by the plaintiff. Since that decision, Congress has had the opportunity to expand the scope of liability to such secondary actors, but has not taken the opportunity to do so in light of the Supreme Court’s holding. Even the SEC, who under its rulemaking authority produced the present wording of Rule 10b-5, has declined to expand this scope of liability. An expansion of liability to secondary actors may be admirable in light of some of the reprehensible activities occurring in today’s financial world, but such circumstances hardly warrant a contrived verbal contortion never intended by Congress.

111. Anixter v. Home-Stake Prod. Co., 77 F.3d at 1226-27.