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Dodd-Frank's Impact on SEC Enforcement Actions in Light of Janus Capital Group Inc. v. First Derivative Traders

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J.D. Candidate, Fordham University School of Law, 2014. I would like to thank my family and friends for their support. I would also like to thank the editorial staff and members of the Fordham Journal of Corporate and Financial Law for their hard work.

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INTRODUCTION

Congress enacted the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act," and collectively, "Securities Acts") in response to the stock market crash of 1929, which devastated financial markets and plunged the nation into the Great Depression.[1] Securities and Exchange Commission's ("SEC" or "Commission") enforcement under these laws is generally concerned with those who are "primarily liable:" a person or entity that violates a specific provision of the securities laws.[2] However, the SEC has also

1. Erin L. Massey, *Control Person Liability Under Section 20(a): Striking A Balance of Interests for Plaintiffs and Defendants*, 6 HOUS. BUS. & TAX L.J. 109, 111–12 (2005).
2. George E. Van Hoey, *Liability for "Causing" Violations of the Federal Securities Laws: Defining the SEC's Next Counterattack in the Battle of Central Bank*, 60 WASH. & LEE L. REV. 248, 254 (2003).

taken action against those who are secondarily liable.[3] That is, those who were in a "control relationship" with the perpetrator, or they aided and abetted the violations.[4]

The SEC has multiple rationales for pursuing secondary actors. First, secondary actors often serve as "gate-keepers" (e.g., accountants, lawyers, auditors, and others who can possibly detect and deter fraudulent activity before it happens).[5] Second, in cases of companies such as Enron or WorldCom, the primary actor is bankrupt by the time their wrongdoing is discovered, leaving defrauded investors with no way to recoup their losses.[6]

Recognizing the need for increased liability for secondary actors after the financial crisis of 2008, Congress included provisions in the Dodd-Frank Act ("Dodd-Frank"), which made it easier for the SEC to pursue both aiders and abettors and control persons.[7] The extent to which these new powers will be used relies largely on how courts interpret the Supreme Court's recent decision in *Janus Capital Group Inc. v. First Derivative Traders*.[8]

Part I of this Note will explain the statutory authority the SEC uses to pursue secondary actors before Dodd-Frank. Part II will examine the degree to which administrative and federal courts have demanded the SEC prove each element of liability. Part III will explain statutory changes brought by Dodd-Frank. Finally, Part IV will explain the implications of the *Janus* decision, and its impact on SEC enforcement for secondary actors.

I. SECONDARY LIABILITY IN THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934

This Part will lay out the legal remedies the SEC sought in pursuing aiders, abettors, and control persons prior to the changes implemented in Dodd-Frank, as well as the legislative history underlying the language of the statutes.

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3. *Id.*
4. *Id.* at 265.
5. Shuenn (Patrick) Ho, *A Missed Opportunity for "Wall Street Reform": Secondary Liability for Securities Fraud After the Dodd-Frank Act*, 49 HARV. J. ON LEGIS. 175, 183–84 (2012).
6. *Id.* at 185.
7. *See infra* Part III.
8. Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296 (2011).

A. AIDING AND ABETTING LIABILITY IN THE SECURITIES ACTS

Initially, the SEC had very limited authority to bring aiding and abetting actions.[9] The only provision under the Securities Acts that imposed liability for aiding and abetting was section 15(b)(4) of the 1934 Act and pertained only to broker-dealers.[10] The SEC still brought aiding and abetting charges, however, by using formulations of tort law and criminal law to justify its authority.[11] The actions generally accompanied charges of Section 10(b), the SEC's catchall provision on fraud charges, and Rule 10b-5,[12] the SEC rule promulgated pursuant to Section 10(b).[13]

In the decades following the passage of the Securities Acts, numerous attempts were made to amend them to explicitly prohibit aiding and abetting.[14] However, the SEC did not officially gain statutory authority to pursue aiders and abettors until 1995, when Congress passed the Private Securities Litigation and Reform Act ("PSLRA").[15] The PSLRA added Section 20(e), which, prior to the changes implemented by Dodd-Frank, provided:

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9. Alan R. Bromberg & Lewis D. Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 ALB. L. REV. 637, 639–41 (1988) [hereinafter Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud*].

10. Securities Exchange Act of 1934, 15 U.S.C. § 78o(b)(4) (2012).

11. *See, e.g.*, SEC v. Timetrust, Inc., 28 F. Supp. 34, 43 (N.D. Cal. 1939) (allowing aiding and abetting due to criminal law formulation of aiding and abetting theory).

12. Section 10(b) of the Securities Exchange Act of 1934 prohibits the use "in connection with the purchase or sale of any security . . . [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe." Rule 10b–5 of the SEC, promulgated under section 10(b), makes it unlawful for any person to "employ any device, scheme, or artifice to defraud," or 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." Chiarella v. United States, 445 U.S. 222, 225–26 (1980).

13. *Id.*; *see, e.g.*, *Timetrust*, 28 F. Supp. at 43 (allowing aiding and abetting due to criminal law formulation of aiding and abetting theory).

14. Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud*, *supra* note 9, at 641–42.

15. Private Securities Litigation Reform Act of 1995, Pub. L. No.104–67, 109 Stat. 737 (1995) ("For purposes of any action brought by the Commission under paragraph (1) or (3) of section 21(d), any person that knowingly provides substantial assistance to another person in violation of a provision of this title, or of any rule or regulation issued

For purposes of any action brought by the Commission under paragraph (1) or (3) of section 21(d), any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of this title, or of any rule or regulation issued under this title, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.[16]

As will be discussed later, the portion of the PSLRA granting the SEC explicit authority to pursue aiders and abettors was in large part a reaction to the Supreme Court's decision in *Central Bank v. Denver*, which cast doubt on the ability of the SEC to pursue enforcement actions against aiders and abettors.[17]

B. CONTROL PERSON LIABILITY IN THE SECURITIES ACTS

The Securities Acts each have specific provisions aimed at imposing liability on those who were in a control relationship with those who committed illegal acts.[18] The addition of provisions creating liability for this behavior were a result of the general sentiment that many of those who had contributed most to the crash were shielded from liability because of the regulatory scheme at the time.[19] Section 15 of the 1933 Act provides:

> Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more persons by or through stock ownership, or otherwise, controls any person liable under sections [11 or 12] of this title shall be also liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the

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under this title, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.").

16. *Id.*

17. *See infra* Part II.

18. Alan R. Bromberg & Lewis D. Lowenfels, *Controlling Person Liability Under Section 20(a) of the Securities Exchange Act and Section 15 of the Securities Act*, 53 BUS. LAW. 1, 7 (1997) [hereinafter Bromberg & Lowenfels, *Controlling Person Liability*].

19. *See id.*

> existence of the facts by reasons of which the liability of the controlled person is alleged to exist.[20]

Section 20(a) of the 1934 Act contains similar language, and it has been recognized to have been modeled on the 1933 Act:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable (including to the Commission in any action brought under paragraph (1) or (3) of section 78u(d) of this title), unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.[21]

The legislative history behind the 1934 Act makes it clear that the purpose of these sections was to prevent those who were actually ordering the illegal behavior from escaping liability.[22] As Congressman Lea explained on the House floor, the purpose of the provision was "to catch the man who stands behind the scenes and controls the man who is in a nominal position of authority."[23] In order to ensure that the statute covered the myriad ways in which control could be asserted, Congress intentionally omitted a definition of "control" from the statutory language.[24] In response to criticism from the securities industry that the definition of control person was too broad, Congress added the "no knowledge" or "reasonable ground" defense to the 1933 Act, and the "good faith" defense to the 1934 Act.[25] The part of the provision explicitly granting power to the Commission was not in the

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20. Securities Act of 1933, 15 U.S.C § 770(a)-(b) (2012) ("[A]ny person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of this subchapter, or of any rule or regulation issued under this subchapter, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.").

21. Securities Exchange Act of 1934, 15 U.S.C. § 78t(a) (2012).

22. Bromberg & Lowenfels, *Controlling Person Liability*, *supra* note 18, at 3.

23. *Id.*

24. H.R. REP. NO. 73-1383, at 26 (1934) ("It would be difficult if not impossible to enumerate or to anticipate the many ways in which actual control may be exerted.").

25. Bromberg & Lowenfels, *Controlling Person Liability*, *supra* note 18, at 3.

original acts, leading to some dispute as to whether or not the Commission was covered.[26]

II. SECONDARY LIABILITY ENFORCEMENT PRIOR TO DODD-FRANK

In order to understand the impact the changes to Dodd-Frank could have on the SEC's ability to bring enforcement actions against secondary actors, a review of the level of scrutiny demanded by federal courts and administrative law judges is necessary. This Part will discuss the elements required to show aiding and abetting in both federal courts and SEC administrative proceedings,[27] and discuss the impact of the Supreme Court's decision in *Central Bank of Denver v. First Interstate Bank of Denver*[28] and the PSLRA on those elements. It will then discuss the ambiguity as to the SEC's ability to bring actions against control persons prior to Dodd-Frank.

A. ELEMENTS OF AIDING AND ABETTING IN FEDERAL COURTS PRIOR TO DODD-FRANK

1. Aiding and Abetting Prior to Central Bank

The SEC first used its powers against an aider and abettor in 1939, in *SEC v. Timetrust*.[29] The case concerned fraudulent activity on the part of Timetrust Corporation, but the aiding and abetting action was against several individuals and Bank of America.[30] The SEC cited no provision to include the aiding and abetting defendants. Instead, it relied on general principles of criminal law, arguing that in a criminal proceeding, anyone who aided and abetted a crime could be charged as a co-defendant.[31] Therefore, it stood to reason the same rationale should

26. *See infra* Part III.
27. While the primary focus of this Note is enforcement actions in federal courts, as *Janus* and Dodd-Frank will affect the SEC's abilities to seek disciplinary action in administrative proceedings, a brief discussion of the elements necessary to impose liability in administrative proceedings is necessary.
28. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994).
29. SEC v. Timetrust, Inc., 28 F. Supp. 34 (N.D. Cal. 1939).
30. *Id.* at 36.
31. *Id.*

apply in an administrative proceeding for a violation of the securities laws.[32] The court agreed with this argument.[33]

The next case crucial to the development of the formulation of aiding and abetting liability in a federal case was actually a private action case. In *Brennan v. Midwestern United Life*, the court found for the plaintiff in an action against an issuer of securities who aided and abetted a Section 10(b) violation.[34] The court rejected the defense's argument that the lack of explicit language pertaining to aiding and abetting in the Securities Acts meant that there was no remedy for aiding and abetting.[35] The court indicated that the federal securities laws were intended to be applied with "broad and remedial" purposes.[36] By limiting their application too narrowly, courts would be unable to apply them to the various new situations that could present themselves.[37] Therefore, the court found, courts should apply liability for aiding and abetting pursuant to Rule 10b-5.[38]

The court also pointed out that the legislative history actually indicated that the SEC should have power to pursue aiders and abettors:

> If it was then generally understood that the SEC had injunctive power against aiders and abettors under the 1934 Act, as the legislative hearings on the proposed amendments indicate, the defendant here cannot successfully contend that the failure to pass the clarifying amendment shows a Congressional intent that the Act has no applicability to aiders and abettors.[39]

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32. *Id.* at 43.
33. *Id.*
34. Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673, 680–81 (N.D. Ind. 1966).
35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.* ("[A] statue with a broad and remedial purpose such as the Securities Exchange Act of 1934 should not easily be rendered impotent to deal with new and unique situations within the scope of the evils intended to be eliminated. In the absence of a clear legislative expression to the contrary, the statute must be flexibly applied so as to implement its policies and purposes. In this regard, it cannot be said that civil liability for damages, so well established under the Securities Exchange Act of 1934, may never under any circumstances be imposed upon persons who do no more than aid and abet a violation of Section 10(b) and Rule 10b-5.").
39. *Id.* at 678.

The court went on to find liability, citing the Third Restatement of Torts' language on liability for those acts that aid in the tortious conduct of a third party.[40]

Courts continued to use the combination of tort law and criminal law to find secondary actors liable for aiding and abetting violations of the securities laws, and eventually, a three-part test was accepted by all circuit courts with regards to the elements needed to prove aiding and abetting liability.[41] First set forth by the Sixth Circuit in *SEC v. Coffey*, the test for establishing liability demanded (1) the existence of a securities law violation by the primary party, (2) knowledge of the violation by the aider and abettor in the achievement of the primary violation, and (3) "substantial assistance" by the aider and abettor in the achievement of the primary violation.[42]

2. Central Bank *and Its Impact on Aiding and Abetting Liability*

The Supreme Court first considered the issue of civil liability for aiders and abettors in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver*, *N.A.*[43] A primary reason the Court granted certiorari was to resolve the circuit split with respect to what level of scienter satisfies the "knowledge of violation" prong.[44] The Court, however, struck down the private right of action for aiding and abetting section 10(b) violations altogether.[45]

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40. *Id.* ("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 in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person.").

41. 4 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 12.25 (2004).

42. SEC v. Coffey, 493 F.3d 1304, 1316 (6th Cir. 1974).

43. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994).

44. SEC v. Peretz, 317 F. Supp. 2d 58, 63 (D. Mass. 2004) (citing Dinsmore v. Squadron, Ellenoff, Plelent, Sheinfeld & Sorkin, 125 F.3d 837, 844 (2d Cir. 1998) ("[O]ne of the question on which the Supreme Court granted certiorari in *Central Bank* was whether recklessness satisfies the scienter requirement for aiding and abetting in the absence of a duty to disclose or act.")).

45. *Cent. Bank of Denver*, 511 U.S. at 164.

The case concerned an issuance of bonds by the Colorado Springs-Stetson Hills Public Building Authority.[46] These bonds were backed by landowner liens, supposedly worth 160% of the bonds' outstanding principal and interest.[47] Central Bank, which was serving as trustee for the bond issue, received notice that the property values for the land backing the bonds was dropping, but delayed making an independent appraisal.[48] Before they were able to do so, the Authority defaulted on the bond.[49] Shareholders brought suit against, among others, Central Bank, alleging it was secondarily liable under section 10(b) for its conduct in aiding and abetting the fraud.[50] In a 5-4 decision, the Court ruled that the language of section 10(b) did not allow private litigants to reach aiders and abettors in derivative actions.[51]

The Court's holding was structured on a strict reading of the language of the 1934 Act. Justice Kennedy, writing for the majority, indicated that Congress had the opportunity to include the language "aid and abet" in the statutory language.[52] Its decision not to do so, Justice Kennedy concluded, implied that it did not intend aiding and abetting violations to be covered.[53] Justice Kennedy also pointed out that provisions in the 1934 Act included a separate section specifically establishing liability for aiding and abetting for broker-dealers, bolstering his argument that Congress did not implicitly intend for aiding and abetting liability to attach to section 10(b).[54] Finally, the Court acknowledged criminal law's doctrine on aiders and abettors, but rejected its application to section 10(b).[55] Warning of the potential consequences of applying civil liability to a section 10(b) action, Justice Kennedy argued that attaching civil liability to aiding and abetting section 10(b) violations would imply that a civil cause of action could be

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46. *Id.* at 167.
47. *Id.*
48. *Id.*
49. *Id.*
50. *Id.* at 168.
51. *Id.* at 191.
52. *Id.* at 177 ("[I]f . . . Congress intended to impose aiding and abetting liability, we presume it would have used the words 'aid' and 'abet' in the statutory test. But it did not.").
53. *Id.*
54. *Id.* at 183.
55. *Id.* at 190–191.

attached to not only every provision of the Securities Acts, but to any criminal statute.[56]

The majority opinion also stressed that this holding did not exempt secondary actors from liability.[57] The simple solution to imposing liability on secondary actors, the Court explained, was to charge them with a primary violation.[58] Any secondary actor, the Court pointed out, who meaningfully participated in some sort of fraudulent scheme, could potentially be charged under Section 10b-5 or another provision in the Securities Acts.[59]

Justice Stevens, writing for the dissent, took issue with the majority's statement that the holding was limited to private rights of action.[60] Justice Stevens warned that the majority's interpretation of section 10(b) would have far-reaching impact, arguing that the language of the opinion could easily be interpreted to limit the SEC from pursuing liability under section 10(b).[61] Justice Stevens also warned that the language of the majority could be interpreted to extend beyond section 10(b) actions, arguing that the analysis posited by the majority could be applied to any form of secondary liability not explicitly spelled out in the Securities Acts' statutes.[62]

Justice Stevens was correct to be wary of the decision's impact on SEC actions. In *Ernst & Ernst v. Hochfolder*,[63] the Court held that in order for a plaintiff to win damages in a section 10(b) action, he must

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56. *Id.* ("[W]e would also have to hold that a civil aiding and abetting cause of action is available for every provision of the Act. There would be no logical stopping point to this line of reasoning: Every criminal statute passed for the benefit of some particular class of persons would carry with it a concomitant civil damages cause of action.").

57. *Id.* at 191.

58. *Id.*

59. *Id.*

60. *Id.* at 200 (Stevens, J., dissenting)

61. *Id.* (Stevens, J., dissenting) ("The majority leaves little doubt that the Exchange Act does not even permit the SEC to pursue aiders and abettors in civil enforcement actions under § 10(b). . . .").

62. *Id.* (Stevens, J., dissenting) ("Moreover, the majority's approach to aiding and abetting at the very least casts serious doubt, both for private and SEC actions, on *other* forms of secondary liability that, like the aiding and abetting theory, have long been recognized by the SEC and the courts but are not expressly spelled out in the securities statutes.").

63. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).

prove that the violator had the requisite scienter.[64] In a subsequent SEC enforcement action, the Court applied the same burden to the SEC, using the same rationale.[65] The majority in *Central Bank*, like that in *Hochfelder*, was using a strict statutory construction, which could easily be interpreted by courts as being applied to the SEC.[66] As it happened, in the immediate aftermath of the *Central Bank* decision, the SEC amended twenty-six aiding and abetting complaints.[67]

3. Private Securities Litigation Reform Act

The impact of the decision in *Central Bank,* however, was not lost in Congress. Almost immediately, it passed the Private Securities Litigation Reform Act of 1995.[68] Section 104 of the PSLRA amended the 1934 Act to add section 20(e), which provided:

> [F]or purposes of any act brought by the Commission . . . any person that knowingly provides substantial assistance to another person in violation of a provision of this chapter, or of any rule or regulation issued under this chapter, or of any rule or regulation issued under this chapter, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.[69]

Despite the clear language of the statute, the SEC's ability to bring actions was nonetheless challenged almost immediately.

In *SEC v. Fehn*, the SEC brought charges against an attorney for aiding and abetting numerous securities laws by filing Form 10-Q,

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64. *Id.* at 185–86.

65. Aaron v. SEC, 446 U.S. 680 (1980).

66. *Cent. Bank of Denver*, 511 U.S. at 200 (Stevens, J., dissenting) ("The principle the Court espouses today—that liability may not be imposed on parties who are not within the scope of § 10(b)'s plain language—is inconsistent with long-established SEC and judicial precedent . . . . judicial restraint does not always favor the narrowest possible interpretation of rights derived from federal statutes.").

67. Scott M. Murray, *Central Bank of Denver v. First Interstate Bank of Denver: The Supreme Court Chops a Bough from the Judicial Oak: There is No Implied Private Remedy to Sue for Aiding and Abetting Under Section 10(b) and SEC Rule 10b*-5, 30 NEW ENG. L. REV. 475, 540 (1996).

68. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104–67, 109 Stat 737 (1995).

69. SEC v. Fehn, 97 F.3d 1276, 1282–83 (9th Cir. 1996).

which mischaracterized the role of the director.[70] Fehn challenged the SEC's ability to bring the case, citing, as Justice Stevens warned, the decision in *Central Bank* for the proposition that there was no liability for aiding and abetting violations of the 1934 Act.[71] The Ninth Circuit, however, quoted the clear language of the statute, and numerous parts of the legislative history, and held that the PSLRA had reversed the impact of *Central Bank* on SEC enforcement actions.[72] The court also rejected Fehn's argument that the statute did not apply to his action because it was not passed until after the litigation proceeded.[73] The court pointed out that prior to *Central Bank*, which was not decided at the time of Fehn's actions, the SEC had authority to pursue aiding and abetting violations.[74] Furthermore, the court found that the language of the PSLRA with respect to aiding and abetting mirrored that of existing case law, which indicated that it was the intent of Congress to keep in place the definition of aiding and abetting that existed prior to *Central Bank*.[75]

4. Circuit Split on the Knowledge Requirement After PSLRA

As this section will explain, although the PSLRA established that the SEC had the ability to bring aiding and abetting claims, it did not resolve all ambiguities as to the standard necessary for bringing such claims. Despite the fact that the statute provides that the level of scienter necessary for knowledge of a primary violation is "knowingly," the circuits were split over whether this standard was limited to situations where the defendants had actual knowledge of the primary violation, or whether they should have known of the primary violation.

The court in *Fehn,* the first circuit court to discuss this matter, came to the conclusion that "knowingly" did, in fact, refer to actual knowledge.[76] The Ninth Circuit based this decision, in part, on the fact

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70. *Id.* at 1282.

71. *Id.*

72. *Id.* at 1283 ("Legislative history confirms that Section 104 was intended to override *Central Bank* 's apparent elimination of the SEC's power to enjoin the aiding and abetting of securities law violations.").

73. *Id.*

74. *Id.* at 1284.

75. *Id.*

76. SEC v. Fehn, 97 F.3d 1276, 1295 (9th Cir. 1996).

that the level of scienter needed for establishing liability for aiding and abetting section 10(b) violations traditionally was "knowingly."[77]

The Second Circuit also acknowledged that the SEC had authority to assert aiding and abetting actions under section 10(b), but limited liability to situations regarding actual knowledge.[78] Although the Second Circuit based its rationale on a simple textual reading of the statute,[79] in *SEC v. KPMG*, the Southern District of New York went further into depth about the rationale for limiting liability to cases involving actual knowledge.[80] The case concerned an accounting fraud perpetrated by the Xerox Corporation, in which Xerox misstated revenues by over $6 billion.[81] The SEC filed an enforcement action against KPMG, Xerox's auditors, and four individuals who were KPMG partners at the time of the audit.[82] Although the SEC settled its case against KPMG, it continued its enforcement action against the individual partners for aiding and abetting Xerox's violations of the 1934 Act.[83] In doing so, the SEC argued that "recklessly" should be read into the PSLRA provisions.[84]

In discussing the SEC's claim against Thomas Yoho, a KPMG partner, for aiding and abetting, the court stated that the new provision provided for in the PSLRA should include cases where the person aiding and abetting *should have known* the primary violation was taking place.[85] The court pointed out that "knowingly" had been defined as actual knowledge in the other places in the PSLRA, leading to the presumption that it should be applied in a similar way to the subsection regarding SEC actions as well.[86]

The court also pointed to the PSLRA's legislative history, which indicated that the Senate actually rejected an amendment that would

77. *Id.*

78. *See* SEC v. United States Envtl., Inc., 155 F.3d 107, 113 (2d Cir. 1998) (acknowledging that the SEC had the authority under the Private Securities Litigation Reform Act to pursue aiders and abettors but choosing not to address the issue of whether it address prior conduct because the SEC had not used argument in lower court decision).

79. *Id.*

80. *See* SEC v. KPMG, LLP, 412 F. Supp. 2d 349 (S.D.N.Y. 2006).

81. *Id.* at 353.

82. *Id.*

83. *Id.*

84. *Id.* at 382–83.

85. *Id.* at 383.

86. *Id.*

have included a recklessness standard.[87] In an attempt to expand the SEC's authority further, Senator Robert Bryan attempted to amend the bill to explicitly add a recklessness standard.[88] The Bryan Amendment was ultimately voted down.[89] The court in *KPMG* interpreted the rejection of the amendment to mean that Congress intended actual knowledge to be necessary for an aiding and abetting action, and therefore rejected the SEC's argument.[90] Other courts employed a similar rationale to conclude that the standard was "knowingly."[91]

Despite the reasoning of the *KPMG* and *Fehn* courts*,* other circuits came to the conclusion that the language in the PSLRA did include a recklessness standard.[92] In *SEC v. Tambone*, the First Circuit found that recklessness was indeed covered.[93] In *Tambone*, the SEC alleged that executives of a mutual fund, Columbia Funds Distributor, aided and abetted in misrepresentations made in fund prospectuses.[94] The court found that because the defendants had a duty to disclose the violations, recklessness was indeed sufficient to meet the "knowingly" prong of the PSLRA.[95] The D.C. Circuit agreed with the First Circuit in *Graham v. SEC*, finding that recklessness was sufficient to meet the scienter requirement.[96]

5. "Substantial Assistance" Element in Federal Courts

Prior to 2012, the element of substantial assistance hinged on proximate cause.[97] This was illustrated best in a Second Circuit case concerning a former Connecticut State Senator, Joe DiBella.[98] DiBella had served on the Investment Advisor Council, which oversaw decisions made by the Connecticut State Treasurer.[99] The SEC alleged that the

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87. *Id.* at 357.
88. *Id.*
89. *Id.*
90. *Id.* at 383.
91. Bromberg & Lowenfels, *Controlling Person Liability*, *supra* note 18, at 10.
92. *See, e.g.*, SEC v. Tambone, 550 F.3d 106 (1st Cir. 2008).
93. *Id.* at 144.
94. *Id.* at 110.
95. *Id.* at 144.
96. Graham v. SEC, 222 F.3d 994, 1004 (D.C. Cir. 2000).
97. *See infra* Part IV.
98. *See* SEC v. DiBella, 587 F.3d 553, 566 (2d Cir. 2009).
99. *Id.* at 558.
99. *Id.*

State Treasurer, Paul Silvester, had made an agreement to invest $75 million of Connecticut's pension fund with an asset management firm in exchange for fees for himself and DiBella.[100] Silvester eventually pled guilty to Federal Racketeering charges; and DiBella was charged, among other things, with aiding and abetting Silvester in engaging in a fraudulent scheme contrary to Rule 10b-5 for his part in the fraud.[101]

In evaluating DiBella's actions, the court explained in order to satisfy the *substantial assistance* prong to show aiding and abetting liability, the SEC had to show that the aider and abettor proximately caused the violation.[102] It was clear to the court that DiBella fit this role.[103] DiBella had arranged the meeting, knew that the Silvester was required to present all investment opportunities to the Investment Advisor Council, and knew that he had in fact not done so.[104] Moreover, when prodded by the asset management firm, Dibella convinced Silvester to raise Connecticut's stake in the firm by $25 million.[105] Thus, the court held, there was substantial evidence that DiBella knowingly aided and abetted Silvestre in violating Section 10(b) and Rule 10b-5.[106] This analysis represented the typical analysis of the *substantial assistance* prong prior to 2012.[107]

6. Elements of Aiding and Abetting in Administrative Proceedings

The primary difference between SEC administrative proceedings and enforcement actions is that the former are adjudicated by administrative law judges rather than federal district court judges.[108] Under this arrangement, either the defendant or the agency can appeal

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99. *Id.*
100. *Id.* at 559–60.
101. *Id.* at 560.
102. *Id.* at 566.
103. *Id.*
104. *Id.* at 567.
105. *Id.* at 566–67.
106. *Id.* at 567.
107. *See also* SEC v. Benger, 697 F.Supp.2d 932, 942–43 (N.D. Ill. 2010).
108. SEC administrative proceedings differ from enforcement actions in that they are heard initially by an administrative law judge rather than a federal district court judge. For a brief discussion of the differences between two, see *How Investigations Work*, SEC, http://www.sec.gov/News/Article/Detail/Article/1356125787012#.Us3kOJETFuY (last visited July 15, 2013).

the initial decision to the Commission itself.[109] Depending on what end it seeks to achieve, the SEC can bring both enforcement and administrative actions.[110] Historically, the SEC has taken a more lenient view as to the elements required to find liability for aiding and abetting in administrative proceedings.[111]

Initially, the theory of liability argued by the SEC for aiders and abettors was as undefined as those in federal courts.[112] In one of the earliest cases, the SEC found that a broker-dealer knowingly aided-abetted his partner's fraud on his investors.[113] In finding liability, the administrative law judge determined that the defendant had *reason to know* that the actions he took would allow his co-defendant to effect fraud.[114] Therefore, it is apparent that in early cases the knowledge requirement for aiding and abetting liability was merely constructive knowledge that some sort of impropriety was taking place.[115]

In *Investors Research Corp. v. SEC*, however, the D.C. Circuit rejected the SEC's imposing this lower threshold for knowledge.[116] The SEC had sought disciplinary actions against brokers for aiding and abetting a violation of section 17(e)(1).[117] After the defendant appealed the decision from the administrative law judge, the Commission tried to impose a mere negligence requirement.[118] The D.C. Circuit rejected this formulation, finding that a mere negligence standard could impose liability on those who were innocently part of a fraudulent scheme.[119] The court then established a similar standard as that in *Coffey*, finding

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109. *Id.*

110. *Id.*

111. Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud*, *supra* note 9, at 752–53.

112. *Id* at 753.

113. *In re* Burley & Co., Release No. 34-3838, 23 SEC 461 (Aug. 5, 1946), *available at* 1946 WL 24142.

114. *Id.* at *2.

115. Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud*, *supra* note 9, at 753.

116. Investors Research Corp. v. SEC, 628 F.2d, 168, 179 (D.C. Cir. 1980).

117. *Id.* at 170.

118. *Id.* at 177–78. (The SEC argued that that aiders and abettors should be held liable "whenever [they] should have been able to conclude that [their] act was likely to be used in furtherance of illegal conduct").

119. *Id.*

that this test balanced the need to protect the public interest of avoiding fraud, without overburdening the securities industry with regulation.[120]

Not long after the decision in *Investors Research*, the Commission used this formulation in the course of an administrative proceeding. In re *William R. Carter* concerned two lawyers who allegedly abetted the securities violations of a telephone equipment rental company.[121] The SEC brought an administrative proceeding alleging that the defendants misrepresented the financial condition of the company to both the SEC and stockholders under the SEC's Rule (2)(e); had they been found guilty, they would be barred from appearing before the Commission.[122] The Commission, following the decision in *Investors Research*, found that while actual knowledge was too high a standard, negligence would be too harsh and would actually impose liability on those who were innocently a party to fraudulent schemes.[123] Thus, while the standard in administrative proceedings did not rise to the level of actual knowledge as in some circuits, recklessness was still required.

7. Substantial Assistance in Administrative Proceedings

SEC administrative proceedings require a lower standard for liability than federal courts.[124] In an early case, In re *Richard Bruce & Company*, the SEC sought aiding and abetting liability against the vice-president of Transition Systems, Stanley Gross.[125] Transition Systems had sold thousands of shares on reports that it had a "correlator" ready for market.[126] The correlator allegedly could monitor the body conditions of astronauts while in orbit, and the American Medical Association was interested in it for its ability to detect cancer.[127] While Gross had nothing to do with the representations, the tribunal barred him from association with broker-dealers anyway, finding that through his

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120. *Id.* at 178.

121. *In re* William R. Carter, Release No. 34-17597, 22 SEC 292 (Feb. 28, 1981), *available at* 1981 WL 384414.

122. *Id.* at *4.

123. *Id.* at *24–25.

124. Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud*, *supra* note 9, at 753.

125. *In re* Richard Bruce & Co., Release No. 34-8303, 43 SEC 777, *3 (1968), *available at* 1968 WL 86058.

126. *Id.* at *1.

127. *Id.*

attendance at sales meeting, share of the profits, and general participation in the company's operations, Gross *knew*, or at least *should have known*, of the illicit activities taking place.[128] Thus, the SEC was applying a reckless standard of knowledge, and limited action in furtherance of the illegal activity.[129]

The case In re *Glen Copeland* also demonstrates the lower standard necessary in administrative proceedings. In that case, the company defrauded its customers by misrepresenting its profits.[130] Copeland had operated the company's computer program.[131] Each day, the company's senior vice-president, Dennis Greenman, asked Copeland to multiply all account balances by an arbitrary number, in order to conceal the fact that all of the accounts were actually losing money.[132] Although Copeland argued he had no idea that Greenman was telling him to do this to conceal losses, the SEC found liability for aiding and abetting, stating that while he may not have been intimately involved in the planning of the scheme, sufficient red flags were present to alert Copeland that he was involved in illegal conduct.[133] This standard is indicative of the one taken in administrative proceedings. The court simply required significant involvement, not proximate cause.[134]

B. Elements of Control Person Liability Prior to Dodd-Frank

Congress intentionally left *control* undefined because it can take so many forms.[135] Given the lack of clear language or congressional directive, the SEC attempted to add clarity for the purposes of administrative proceedings by defining *control* explicitly as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through

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128. *Id.* at *3.

129. *Id.*

130. *In re* Glen Copeland, Release No. 34-22213, 48 SEC 193, 197–98 (1985), *available at* 1983 WL 108674.

131. *Id.* at 196.

132. *Id.*

133. *Id.* at 196–97.

134. *See also In re* Del Mar Fin. Servs., Release No. 188, 75 SEC 1473 (2001), *available at* 2001 WL 919968.

135. William H. Kuehnle, *Secondary Liability Under the Federal Securities Laws-Aiding and Abetting Conspiracy, Controlling Person, and Agency: Common-Law Principles and the Statutory Scheme*, 14 J. CORP. L. 313, 356 (1989).

the ownership of voting securities, by contract, or otherwise."[136] The SEC's definition has been accepted by several courts.[137] As this section will discuss, there is still substantial disagreement, however, over when control person liability is supposed to attach,[138] and whether the SEC even has the authority to bring actions.[139] The D.C. Circuit has made note of the fact that courts' interpretation of section 20 has been inconsistent, particularly in the context of SEC enforcement actions.[140]

1. SEC's Ability to Bring an Action

As this section will demonstrate, ambiguity under section 20(a) was not limited to the definition of control or when a control person was liable. In *SEC v. Coffey*, the Sixth Circuit denied the SEC the right to bring enforcement actions under section 20(a).[141] It reasoned that because section 20(b) "set forth the standard of lawfulness to which a controlling person may conform, on penalty of liability in injunction to the SEC or criminal prosecution . . . . [§ 20(a)] was meant only to specify the liability of controlling persons to private persons suing to vindicate their interest."[142] Furthermore, the SEC was not a *person* as required by Section 20(a).[143] Therefore, the SEC's ability to bring an action was limited to Section 20(b) violations.[144]

Most circuits, however, did not follow the decision in *Coffey*, particularly after the Securities Act of 1975, which amended the definition of *person* under the Exchange Act to include "a natural person, company, government, or political subdivision, agency, or instrumentality of a government."[145]

In *SEC v. First Jersey*, the SEC initiated an enforcement action against both a broker-dealer and its principal.[146] First Jersey convinced

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136. 17 C.F.R. § 230.405 (2014).
137. *See, e.g.*, SEC v. First Jersey Sec., Inc, 101 F.3d 1450, 1472–73 (2d Cir. 1996); Maher v. Durango Metals, Inc., 144 F.3d 1302, 1305 (10th Cir. 1998).
138. *See infra* Part II.B.b.
139. *See id.*
140. SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1169 (D.C. Cir. 1978).
141. SEC v. Coffey, 493 F.2d 1304, 1318 (6th Cir. 1974).
142. *Id.*
143. *Id.*
144. *Id.*
145. 15 U.S.C. § 78c (2012).
146. SEC v. First Jersey Sec., Inc. 101 F.3d 1450, 1456 (2d Cir. 1996).

customers to buy securities at excessively high prices, making more than $27 million in illegal profits.[147] The action was against both First Jersey and Robert Brennan, the director and 100% owner.[148] The Second Circuit found that even if Brennan wasn't found primarily liable for the fraudulent actions, the SEC could still prosecute him under § 20(a).[149] The court held that section 20(a) was available as an enforcement mechanism to "any person to whom such controlled person is liable" and stated that the new language in the 1934 Act could be interpreted to find that the SEC was included in the definition of *person*.[150]

The Third Circuit agreed with this decision.[151] While it did not disagree with the reasoning of *Coffey* at the time it was decided, the court pointed out that the *Coffey* decision was undermined by the 1975 amendments to the Exchange Act, which modified the definition of *person* from "an individual, corporation, partnership, association, joint stock company, business trust, or unincorporated organization" to a "natural person, company, government, or political subdivision, agency or instrumentality of a government."[152] Therefore, the court found that section 20(a) explicitly applied to the SEC.[153]

Prior to Dodd-Frank, however, not all courts followed the reasoning that the SEC had the ability to bring an action under section 20(a).[154] In *SEC v. Stringer*, an Oregon district court rejected the SEC's argument that the agency had authority to pursue an enforcement action under section 20(a), choosing instead to follow the reasoning in *Coffey*.[155] Unlike *Coffey*, however, *Stringer* took into account the 1975 amendments, but chose to ignore them.[156] In response to the SEC's citation to the amendments to prove they were indeed a *person* who could bring an action, the court responded that even with the new language of the amendments, there still existed an "escape clause" allowing courts to ignore the definitions when context suggested

147. *Id.*
148. *Id.* at 1458.
149. *Id.* at 1472.
150. *Id.*
151. SEC v. J.W. Barclay & Co., 442 F.3d 834, 842–43 (3d Cir. 2006).
152. *Id.* at 842.
153. *Id.*
154. *See, e.g.*, SEC v. Stringer, CIV. 02-1341-ST, 2003 WL 23538011, *4 (D. Ore. Sept. 3, 2003).
155. *Id.* at *4.
156. *Id.* at *5–6.

otherwise.[157] The court went on to explain how the SEC should not be defined as a person in this context, pointing out that for a party to be a *person* under the statutory definition, secondary actors had to be jointly and severally liable to the party.[158] In other words, the *person* needed to be an injured party.[159] Since the SEC is a government agency rather than a party that can be injured by a secondary actor, the court found it would be stretching the statutory language too far to consider the SEC a *person*.[160] The court then pointed out that there was little in the legislative history of the 1975 amendments indicating any desire by Congress to allow the SEC to pursue enforcement actions under section 20(a).[161] The court concluded that although securities laws were meant to be interpreted in accordance with their broad remedial purposes, the text and legislative history simply did not indicate any authority for the SEC to pursue section 20(a) violations.[162]

2. Elements Necessary to Prove Control Person Liability

In addition to the authority granted to the SEC to bring an action under section 20(a), there is a split among the circuits over what would constitute *liability*.[163] The SEC has codified an official definition in order to establish a uniform standard.[164] The definition provides that control is "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership or voting securities, by contract, or otherwise."[165] Even circuits that have adopted the SEC's definition have not done so word for word, and some have rejected it altogether. The two primary

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157. *Id.* at *6.
158. *Id.*
159. *Id.*
160. *Id.* ("The issue is not simply whether the SEC falls within the statutory definition of the word 'person.' Instead, the issue is whether the SEC constitutes a "person to whom such controlled person is liable," not only generally but 'jointly and severally.' It strains the statute to characterize a secondary actor as 'liable to' the SEC. The SEC is the government agency tasked with enforcing the federal securities laws. It is not an injured party.").
161. *Id.*
162. *Id.* at *13.
163. *See In re* WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d 392, 414 (S.D.N.Y. 2003) (explaining ambiguous state of law as to control person liability under § 20(a)).
164. 17 C.F.R. §§ 230.405 (2014).
165. *Id.*

methods by which control is defined are the "potential control" test, and the "culpable participation test".

a. Culpable Participation Test

The Second, Third, and Fourth Circuits apply the "culpable participation" test.[166] The Second Circuit applied this test in *First Jersey*, explaining that "a plaintiff must show a primary violation by the controlled person and control of the primary violator by the targeted defendant, and show that the controlling person was in some meaningful sense a culpable participant in the fraud perpetrated by the controlled person."[167] The court also proffered a defense that could be made to a section 20(a) charge, explaining that a control person could show good faith by proving he put in place and enforced a "reasonable, proper system of supervision and internal controls."[168] Thus, in order to escape liability for First Jersey's fraudulent activity, Robert Brennan would have had to show that he had a system in place to detect and prevent the conduct that was committed and personnel had just evaded the system. In the matter at hand, the court found that First Jersey's methods were not genuinely designed to prevent fraud.[169]

b. Potential Control Test

The majority standard for control person liability is the "potential control" test.[170] Although it exists in different iterations across the circuits, the most common standard is the one articulated by the Eighth Circuit.[171] In order to show potential control, the plaintiff must prove that the defendant participated in the operations of the corporation in question.[172] The plaintiff then must prove "that the defendant possessed

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166. Massey, *supra* note 1, at 114–15.
167. SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1472 (2d Cir. 1996).
168. *Id.*
169. *Id.* at 1461 (quoting SEC v. First Jersey Sec., Inc., 890 F. Supp. 1185, 1202 (S.D.N.Y 1995)).
170. Bromberg & Lowenfels, *Controlling Person Liability*, *supra* note 18, at 10.
171. *Id.* at 14.
172. *Id.* at 14–15.

the power to control the specific transaction upon which the primary violation is predicated."[173]

C. *Janus Capital Group v. First Derivative Traders* and Its Application to SEC Enforcement for Secondary Liability

This section will discuss the impact of the Supreme Court's decision in *Janus Capital Group. v. First Derivative Traders* and its impact on the SEC's strategy for bringing enforcement actions. First, this section will explain the background of the case and the language of the majority decision as well as that of the Justice Breyer's dissent. It will then explain how the *Janus* decision has been interpreted by courts thus far. Finally, it will discuss how the decision will affect the SEC's enforcement strategy given the new remedies afforded them by Dodd-Frank.

1. Janus Capital Group v. First Derivative Traders

Like *Central Bank*, the most recent Supreme Court case to have possible implications on SEC enforcement actually concerned a private right of action. In *Janus Capital Group. v. First Derivative Traders*, a class of stockholders filed suit under section 10(b) and Rule 10b-5.[174] The suit alleged that Janus Capital Management ("JCG") and its wholly owned subsidiary, Janus Capital Management ("JCM"), made false statements in mutual fund prospectuses filed by Janus Investment Funds (a separate legal entity owned entirely by its investors, for which Janus Capital Management was the investment adviser and administrator).[175] Specifically, the investors argued that prospectuses issued by Janus Investment Fund stated that JCM would implement policies to curb market timing, while in fact they entered into agreements encouraging it.[176] When a New York Attorney General's investigation revealed the secret agreements, investors withdrew significant amounts of money from Janus Investment Fund mutual funds, which in turn caused JCG's

173. *Id.* at 10 (quoting Brown v. Enstar Grp., Inc., 84 F.3d 393, 396 (11th Cir. 1996)).
174. Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2300 (2011).
175. *Id.* at 2299.
176. Market timing is a trading strategy that exploits time delay in mutual funds' daily valuation system. *See id.* at 2296 n.1.

stock price to drop nearly 25%.[177] The plaintiffs in this action previously owned JCG stock and argued that by claiming they would take measures to curb market timing, JCG and JCM "materially misled" the public.[178] The plaintiffs also alleged that JCG should be held liable as the control person for Janus Investment Funds. The Supreme Court granted certiorari as to whether JCM *made* the material misstatements in the prospectuses.[179]

The majority opinion, written by Justice Thomas, found that JCM did not *make* the misstatement.[180] Justice Thomas cited the Oxford English Dictionary in explaining that to "make a statement" one must have "ultimate authority over the statement,"[181] and compared the role of JCG to that of a speechwriter.[182] Justice Thomas also stated that a broader reading of *make* would undermine *Central Bank's* holding that there is no private right of action against aiders and abettors, while acknowledging that those actions could still be brought by the SEC.[183]

The majority also denied First Derivative's argument that the significant influence JCM wielded over Janus Investment Funds made it liable.[184] The Court declined to extend liability in this way, explaining that it was "undisputed" that JCM and Janus investment fund were legally separate entities.[185]

2. Justice Breyer's Dissent and Warning About Implications

Justice Breyer, writing for the dissent, took issue with the majority's definition of "make," pointing out that "every day, hosts of corporate officials make statements with content that more senior officials or the board of directors have 'authority to control.'"[186] Justice

177. *Id.* at 2300.
178. *Id.*
179. *Id* at 2301.
180. *Id.*
181. *Id* at 2302.
182. *Id.* ("Even when a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it. And it is the speaker who takes credit-or blame-for what is ultimately said.").
183. *Id.*
184. *Id.* at 2304. ("First Derivative's theory of liability based on a relationship of influence resembles the liability imposed by Congress for control.").
185. *Id.*
186. *Id.* at 2307 (Breyer, J., dissenting).

Breyer argued that a contextual, case-by-case determination, was a better test for whether someone "made" a statement.[187]

Justice Breyer also pointed out that *Central Bank* was distinguishable because it dealt with issues of secondary liability, whereas the case before the court concerned primary liability.[188] Breyer cited portions of *Central Bank* that discussed how secondary actors may be liable, and pointed out that by ruling in favor of JCM, the majority's decision essentially extends *Central Bank's* holding to those who are not liable, given that Janus Management easily fell into the category of those who were meant to be held liable.[189]

Much like the dissent in *Central Bank*, the dissent in *Janus* shows concern that the majority opinion might reach further than the private rights of action to which the opinion is ostensibly limited. As Justice Breyer points out, given the majority's holding made it exceedingly difficult to find a single party who "made" a statement in cases similar to *Janus*."[190] The SEC's ability to pursue actions for aiding and abetting would thereby be reduced as well, given need for a primary violation when bringing an aiding and abetting charge.[191] Justice Breyer also argued that while the majority's decision was based on their professed desire to avoid undermining *Central Bank,*[192] by removing liability from entities such as JCM, the majority was doing just that—it ignored explicit restrictions the *Central Bank* decision gave on the interpretation of its holding.[193]

*3. Post-*Janus *Jurisprudence*

At first glance, it is difficult to tell the impact of *Janus*. While there is no doubt the decision limits the ability of private entities to seek

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187. *Id.* at 2306 (Breyer, J., dissenting).

188. *Id.* at 2308 (Breyer, J., dissenting). Justice Thomas responded to this argument in a footnote to the majority opinion, acknowledging that *Central Bank* was indeed about secondary liability. Justice Thomas explains that "[f]or Central Bank to have any meaning, there must be some distinction between those who are primarily liable (and thus may be pursued in private suits) and those who are secondarily liable (and thus may not be pursued in private suits)." *Id.* at 2302 n.6.

189. *Id.* at 2307–08. (Breyer, J., dissenting).

190. *Id.* at 2311 (Breyer, J., dissenting).

191. *Id.* at 2310 (Breyer, J., dissenting).

192. *Id.* (Breyer, J., dissenting).

193. *Id.* at 2308 (Breyer, J., dissenting).

damages under Section 10b-5, as this section will discuss, there is also some indication that it will have an impact on SEC enforcement cases, particularly in their pursuit of liability against secondary actors. Therefore, the SEC's strategy in pursing secondary actors to a large degree depends on how expansively courts view the *Janus* holding. While there have been few post-*Janus* cases, the ones that have been decided indicate the diverging views that courts are taking towards the holding. [194]

a. Broad Interpretation of Janus

The Southern District of New York was the first court to analyze the *Janus* decision in the context of an SEC enforcement action.[195] *SEC v. Kelly* concerned an enforcement action against former senior executives at AOL Time Warner.[196] The SEC charged that AOL had paid inflated prices for goods and services, which were offset by large "purchases" of online advertising, thereby artificially inflating AOL Time Warner's bottom line.[197] The Commission asserted that each of the defendants were aware of, and in some way contributed to, the fraudulent activity, and brought charges under section 10(b), Rule 10b-5, section 17(a)(1), [198] as well as for aiding and abetting those violations.[199]

After *Janus* was decided, however, defendants Wovsaniker and Rinder moved for judgment on the pleadings given that the new

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194. *See, e.g.* SEC v. Kelly, 765 F. Supp. 2d 301 (S.D.N.Y. 201); SEC v. Daifotis 874 F. Supp. 2d 870 (N.D. Cal. 2012); SEC v. Pentagon Capital Mgmt., PLC, 844 F. Supp. 2d 377 (S.D.N.Y. 2012).

195. SEC v. Kelly, 765 F. Supp. 2d 301 (S.D.N.Y. 2011).

196. *Id.*

197. *Id.* at 307.

198. Section 17(a) of the Securities Act makes it unlawful in the offer or sale of any security, using the mails or an instrumentality of interstate commerce, directly or indirectly

(1) to employ any device, scheme or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. §77q(a) (2012).

199. *Kelly*, 765 F. Supp. 2d at 321–22.

standard for *make* foreclosed the SEC's claims against them with regards to section 10(b) and Rule 10b-5 violations.[200] In an indication of the impact of *Janus* on enforcement actions, the SEC acknowledged that it could not proceed under Rule 10 b-5(b).[201] However, the SEC argued that it could still proceed under "scheme liability" under subsections 10b-5(a) and 10b-5(c).[202]

The court rejected this argument.[203] While it acknowledged that the *Janus* decision did not discuss scheme liability, it found that recasting Rule 10b-5(b) claims as Rule 10b-5(a) and (c) claims was simply a "back door into liability" meant to avoid limitations on Rule 10b-5(b) actions.[204] The court relied heavily on Justice Thomas's footnote in response to Justice Breyer[205] to argue that the decision in *Janus* was made in order to preserve the distinction between primary liability and secondary liability.[206] While the SEC had offered a mechanism to assert its claim, the fact remained that none of the defendants had made a misstatement as required by *Janus*, and therefore, the court argued, they should not be held liable.[207] The SEC's approach would allow plaintiffs to bring actions based on conduct the *Janus* court had found as insufficient to establish primary liability.[208]

The court in *Kelly* also found that the *Janus* analysis was not restricted to actions taken under Section 10(b) and Rule 10b-5.[209] The

200. *Kelly*, 765 F. Supp. 2d at 342.

201. *Id.*

202. *Id.* Whereas Rule 10b-5(b), which was the provision of Rule 10b-5 discussed in the *Janus* decision, makes it illegal 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, Rule 10b-5(a) bars the use of "any device, scheme or artifice to defraud" while Rule10b-5(c) prohibits engaging in "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b–5 (2014).

203. *Kelly*, 817 F. Supp. 2d at 343.

204. *Id.*

205. *See supra* note 188.

206. *Kelly*, 817 F. Supp. 2d at 343.

207. "The court explained that the alleged round trip transactions by AOL between 2000 and 2003 are deceptive only because of AOL's subsequent public misrepresentations. . . . It is the manner in which those transactions were accounted for by AOL and reported to the public- AOL's alleged improper recognition of advertising revenue from such transactions - that is deceptive, and not the act of engaging in such transactions itself." *Id.* at 344.

208. *Id.*

209. *Id.* at 345.

court rejected the SEC's argument that actions were restricted to those claims, finding that given the similar purposes with regards to primary liability, application of *Janus* as to section 17(a) should be consistent with application to Rule 10b-5(b).[210] Thus, the SEC was still required to show that the defendants "made" the misleading statements.[211] Since the SEC did not plead as such, the court found it could not impose liability and dismissed all claims.[212]

This decision was likely troubling to the SEC and to those who feared that *Janus* could be interpreted too broadly. By extending its application to both scheme liability and section 17(a), the decision in *Kelly* indicated that the window through which not only private parties, but also the SEC could bring charges against secondary actors, was far narrower than it had been before. The Central District of California has followed this reasoning to extend *Janus* beyond Rule 10b-5(b) as well.[213]

b. Broad Interpretation of *Janus* in Administrative Proceedings

In another troubling sign, in one of the few administrative proceedings to consider the impact that *Janus* had on SEC enforcement actions, an administrative law judge chose to apply the *Janus* standard to scheme liability and section 17(a) charges.[214] The SEC had brought an administrative proceeding accusing the defendants, executives at State Street, of misleading or making insufficient disclosures to investors as to the extent of mortgage back securities held in their accounts.[215] The administrative law judge cited the decision in *Kelly* to find that *Janus* did in fact apply, meaning that the SEC had to show that the defendants had ultimate authority over the fraudulent statements.[216] Thus, the

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210. *Id.*
211. *Id.*
212. *Id.* at 346.
213. SEC v. Perry, CV-11-1309 R, 2012 WL 1959566 1, at *8 (C.D. Cal. May 31, 2012) (applying *Janus* to section 17(a) actions).
214. *In re* Flannery, Release No. 677, 101 SEC 1973 (Oct. 28, 2011), *available at* 2011 WL 10564337 (holding that under the *Janus* standard, defendants did not meet the test of "ultimate authority or responsibility" for documents in which misstatements were made).
215. *Perry*, 2012 WL 1959566, at *2.
216. *Id.*

SEC's ability to bring action was not simply limited to enforcement actions in federal courts.

c. Narrow Interpretation of *Janus*

However, just months after the decision in *SEC v. Kelly*, a district court in the Northern District of California interpreted *Janus* differently.[217] In *SEC v. Daifotis*, the SEC brought an enforcement action against two former Schwab YieldPlus Fund (a subsidiary of Charles Schwab) executive officers, Randall Merk and Kimon P. Daifotis.[218] Daifotis was the lead portfolio manager of the YieldPlus Fund, and he reported to Charles Schwab Investment Management, where Merk was President.[219] The SEC alleged that Daifotis and Merk each made misleading statements about the safety of YieldPlus as an investment vehicle, and made misleading statements to investors to dissuade them from redeeming their investment when the Fund began to decline in value.[220]

While the case was pending, *Janus* was decided. The defendants therefore moved for reconsideration, hoping to have certain alleged misstatements dismissed.[221] While the SEC maintained that the defendants were still liable for the misstatements defendants sought to dismiss, it did not contest the dismissal of the bulk of the allegations.[222] Thus, as in *SEC v. Kelly*, the Commission essentially conceded its reduced ability to pursue actions under section 10(b) and Rule 10b-5 after *Janus*.[223]

The court, however, rejected Daifotis's argument that *Janus* applied to section 17(a).[224] In doing so, the court pointed out how precisely the

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217. SEC v. Daifotis, 874 F. Supp. 2d 870 (N.D. Cal. 2012).

218. *Id.* at 873–74.

219. SEC v. Daifotis, No. C 11-00137 WHA, 2011 WL 4714250, at *1 (N.D. Cal. Oct. 7, 2011).

220. *Id.*

221. *Id*. The defendants conceded that under *Janus*, they had "made" certain statements, such as a set of questions and answers listing Merk as the author on Schwab's website, or statements made by Daifotis in a series of conference calls. *Id.* at *2–3.

222. *Id.* at *4 ("[T]he Commission does not oppose that *Janus* renders all other alleged misstatements in the complaint ineligible to serve as a base for claim one liability against either defendant.").

223. *Id.*

224. *Id.* at *5.

Janus majority parsed the language of § 10(b) and distinguished it from section 17(a), pointing out that the word "make," which was the primary statutory language discussed in *Janus*, did not exist in the language of section 17(a).[225]

The court also rejected Daifotis's defense that *Janus* should apply to section 34(b) of the Investment Companies Act,[226] despite the fact that that provision actually includes the word "make."[227] The court points out that *Janus* was limited to consideration of section 10(b) and Rule 10b-5.[228] It held that applying *Janus* to all statutes would, in effect, give the decision far too much weight and ignore the purpose of the decision.[229] Thus, the court did not extend *Janus's* holding beyond Rule 10b-5.[230]

Cases after *Daifotis* and *Kelly* have shown a trend towards adopting the rationale of the former. For example, in the Southern District of New York, in *SEC v. Pentagon Capital Management PLC*,[231] the court did not even acknowledge *Kelly*, and instead relied on *Daifotis* to find the lack of the word "make" in section 17(a) to mean that *Janus* should not apply to enforcement actions under section 17(a), or scheme liability pursuant to Rule 10b-5(a) or (c).[232] In doing so, the court also emphasized the fact that *Janus* was a private suit as opposed to an enforcement action, stating that it saw no indication from the Supreme Court, or from Congress, that the *Janus* decision should extend beyond Rule 10b-5.[233] Moreover, the Second Circuit on appeal declined to conclusively discuss the extent to which *Janus* should apply, although it acknowledged that Rule 10b-5(b) was the sole provision the Supreme Court gave guidance on.[234] Other cases have followed the same

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225. *Id.*

226. *Id.*

227. 15 U.S.C. § 80a-33 (2012) ("It shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this subchapter or the keeping of which is required pursuant to section 80a-30(a) . . . .").

228. *Daifotis*, 2011 WL 3295139, at *6.

229. *Id.* ("*Janus* was not a touch stone to change myriad laws that happen to use the word 'make'; it was decision interpreting primary liability under Rule 10b-5.").

230. *Id.*

231. SEC v. Pentagon Capital Mgmt., PLC, 844 F. Supp. 2d 377 (S.D.N.Y. 2012).

232. *Id.* at 422.

233. *Id.*

234. SEC v. Pentagon Capital Mgmt., PLC, 725 F.3d 279, 287 (2d Cir. 2013).

rationale to find that *Janus* does not extend to other provisions of the Securities Acts.[235]

The Southern District of New York has also explicitly rejected the idea posited in *Kelly* that asserting scheme liability is simply a "back-door" method of evading the *Janus* holding.[236] In *SEC v. Landberg*, the court considered an enforcement action against the management of an unregistered investment advisory for misleading investors as to the security of their funds.[237] The court rejected the defendant's argument that *Janus* prohibited the SEC from bringing a Rule 10b-5 action, pointing out that subsection (b) was not the only provision of section 10(b).[238] Thus, given the decisions in *Kelly*, *Landberg,* and *Pentagon Capital Management*, there is a split in the Second Circuit as to whether *Janus* applies to SEC enforcement actions pursuant to Rule 10b-5(a) and (c), and whether it applies beyond Rule 10b-5.

Some courts have questioned whether *Janus* should apply to SEC enforcement actions at all.[239] In *SEC v. Brown*, the Commission brought an enforcement action against two former employees of Integral, a publicly traded company that manufactures satellite systems and software.[240] It alleged that defendant Elaine Brown, in her capacity as Chief Financial Officer and Principal Accounting Officer, had violated section 13(a) of the 1934 Act[241] by failing to state in documents with the SEC that Integral had re-hired a former executive who had been found guilty of earlier securities violations.[242] Brown argued that by narrowing the private right of action under Rule 10b-5, the court in *Janus* was implicitly suggesting that courts should not go beyond the plain language of a statute to create individual liability where it does not

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235. *See, e.g.*, SEC v. Stoker, 865 F. Supp. 2d 457, 465(S.D.N.Y. 2012) ("*Janus* implicitly suggests that Section 17(a)(2) should be read differently from, and more broadly than, Section 10(b)."); SEC v. Mercury Interactive, LLC, No. 5:07-cv-02822-WHA, 2011 WL 5871020, at *3 (N.D. Cal. Nov. 22, 2011) ("The operative language of §§ 14(a) and 17(a) does not require that the defendant "make" a statement in order to be liable.").

236. SEC v. Kelly, 817 F. Supp. 2d 340, 344 (S.D.N.Y. 2011).

237. SEC v. Landberg, 836 F. Supp. 2d. 148, 151 (S.D.N.Y. 2011).

238. *Id.* at 154.

239. *See, e.g.*, SEC v. Brown, 878 F. Supp. 2d 109, 118 (D.D.C. 2012); SEC v. Sentinel Mgmt. Grp., No. 07 C 4684, 2012 WL 1079961, at *14–15 (N.D. Ill. Mar. 30, 2012).

240. *Id.* at 112.

241. Securities Exchange Act of 1934 §13(a), 15 U.S.C. § 78m(a) (2012).

242. *Brown*, 878 F. Supp. 2d at 112–13.

exist.[243] The court in *Brown* outright rejected this argument, and pointed out that pursuant to section 21(d)(1) of the 1934 Act the SEC was authorized to bring actions in district courts to enjoin violations of any provision of its title.[244] Thus, the court considered whether the SEC's ability to bring enforcement actions should be affected by *Janus* at all.[245]

The Northern District of Illinois expanded on this concept in *SEC v. Sentinel Management Group*.[246] In discussing whether *Janus* should apply to actions taken pursuant to section 17(a), the court noted that the rationale behind the Court's decision in *Janus* was a concern that an overly expansive definition of "make" would expand the scope of *private* suits.[247] However, because section 17(a) did not create a private right of action, the Supreme Court's concerns were not implicated.[248] Therefore, the court found *Janus* did not apply to section 17(a) actions, while also strengthening the case for why it should not apply to SEC enforcement actions at all.[249]

Thus, the state of law as to whether *Janus* applies beyond a Rule 10b-5 action is unclear. Even within the Second Circuit, there is a split as to the extent in which it should apply.[250] Furthermore, there is a strong case to be made that the decision should never apply to SEC enforcement actions. [251]

III. IMPACT OF DODD-FRANK ON STATUTORY REMEDIES FOR SEC TO BRING ENFORCEMENT ACTIONS

Like the original securities laws, Dodd-Frank was enacted in response to public sentiment about inappropriate behavior on the part of the financial community—this time, the events leading up the financial

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243. *Id.* at 117–18.

244. *Id.* at 118 ("Brown has put forth no persuasive reason why this passage from *Janus*, specifically limiting the scope of private rights of action under Rule 10b-5, should be read to reach enforcement actions brought by the SEC pursuant to Rule 13a-14").

245. *Id.*

246. No. 07 C 4684, 2012 WL 1079961 (N.D. Ill. Mar. 30, 2012).

247. *Id.* at *15.

248. *Id.*

249. *Id.*

250. *Compare* SEC v. Kelly, 817 F. Supp. 2d 340, 344 (S.D.N.Y. 2011), *with* SEC v. Landberg, 836 F. Supp. 2d. 148, 151 (S.D.N.Y. 2011).

251. SEC v. Brown, 878 F. Supp. 2d 109, 118 (D.D.C. 2012).

crisis of 2008.[252] The legislative history indicates that Congress actually considered extending civil liability not only in SEC actions, but as a private cause of action as well.[253] While the drafters of Dodd-Frank ultimately declined to go that far, the statutory language does clarify those remedies available to the SEC.[254] This Part will discuss how the statutory language clarifies the remedies available to those seeking liability for violators of the Securities Acts. It will then discuss how these new remedies have affected the SEC's enforcement strategy giving the treatment of *Janus* by federal courts.

A. IMPACT ON AIDERS AND ABETTORS

Dodd-Frank greatly expanded the SEC's ability to pursue aiding and abetting violations.[255] The statutory language explicitly gave the SEC authority to pursue violations under section 15(b) of the Securities Act of 1933, as well as the Investment Advisers Act of 1940.[256] It also clarifies the ambiguity left by the PSLRA by explicitly stating that the SEC may prosecute anyone who "knowingly or recklessly" provides substantial assistance to another person who violates any provision of the 1934 Act.[257] This is, of course, a substantially lower bar for bringing claims than actual knowledge. While it remains to be seen the impact that Dodd-Frank will have on aiding and abetting actions, because they cannot be applied retroactively, it is clear that they will greatly increase the SEC's chances of success in those cases.[258]

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252. Helene Cooper, *Obama Signs Overhaul of Financial System*, N.Y. TIMES, July 22, 2010, at B3.

253. While it ultimately did not decide to extend a private right of action, Congress did commission a study by the Government Accountability Office to study whether or not one would be appropriate.

254. See *infra* Part III.A–B.

255. COMMERCE CLEARING HOUSE, DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT: LAW, EXPLANATION AND ANALYSIS (2010).

256. Dodd-Frank Act, Pub. L. No 11-203 §929O, 123 Stat. 1376, 1862 (2010) (amending Exchange Act § 20(e), 15 U.S.C. § 78t(e)).

257. *Id.*

258. *See* discussion *infra* Part IV.

B. IMPACT ON CONTROL PERSON LIABILITY

Dodd-Frank clarifies the SEC's ability to prosecute for control person liability under the Exchange Act.[259] The Act makes clear that the SEC may bring actions under control person liability in federal court by inserting language explicitly referencing SEC enforcement actions.[260] The control persons bear the burden of showing that they acted in good faith, and that "they did not directly or indirectly induce" the primary violation.[261] Thus, while a seemingly minor change, the SEC now has no doubt about its ability to bring control person actions.[262] The impact this could have on its enforcement strategy will be discussed in Section F.

C. OTHER DEVELOPMENTS IN SECONDARY LIABILITY POST DODD-FRANK AND *JANUS*

A recent decision in the Second Circuit clarifying the substantial assistance prong of aiding and abetting could affect the SEC's strategy post-*Janus* and Dodd-Frank. *SEC v. Apuzzo* concerned an action against Joseph Apuzzo, the Chief Financial Officer of a construction and mining equipment manufacturer, Terex.[263] In accordance with an arrangement with a second company, General Electric Credit Corporation, Apuzzo helped disguise a third company, United Rental Inc.'s ("URI") risks and financial obligations, and approved invoices he knew to be inflated.[264]

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259. Dodd-Frank Act, Pub. L. No 11-203 §929P, 123 Stat. 1376, 1865 (2010) (amending Exchange Act § 20(a), 15 U.S.C. § 78t(a)).

260. The new language states:

Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable (including to the Commission in any action brought under paragraph (1) or (3) of section 78u(d) of this title), unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a) (2012).

261. Bruce Hiler & Sharon Rose, *Analysis of Changes to the Securities and Exchange Commission's Enforcement Powers in the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 42 BNA INSIGHTS 48 (2010).

262. *See generally* CCH, *supra* note 253.

263. SEC v. Apuzzo, 689 F.3d 204 (2d Cir. 2012).

264. *Id.* at 207–08.

In addition, despite his knowledge that some of URI's equipment was overvalued, Apuzzo offered auditors a note indicating that "nothing ha[d] come to his attention" to make him question the valuation of URI's equipment.[265] In exchange, URI agreed to make substantial purchases of equipment from Terex.[266] The district court agreed with Apuzzo's argument that there was nothing to show that his conduct caused the primary violation.[267]

The Second Circuit reversed, however, using a classic definition of aiding and abetting drawn from criminal law to find that the "test for substantial assistance is that the aider and abettor "in some sort associated himself with the venture, that he participated in it as in something that he wished to bring about, and that he sought by his action to make succeed."[268] The court emphasized that due to *Central Bank* and the PSLRA, enforcement actions differed from private litigation, and clarified that the SEC did not have to show that an aider or abettor was the proximate cause of a primary securities law violation.[269]

In *Apuzzo*, Judge Rakoff also acknowledged the consequences of a standard for substantial assistance that was too high for the SEC to prove, arguing that given the lack of a private of a right of action for aiding and abetting violations,[270] imposing too high of a proximate cause requirement would essentially allow all aiders and abettors to avoid

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265. *Id.* at 209.

266. *Id.* at 207.

267. *Id.* at 211.

268. *Id.* at 213.

269. *Id.* ("We now clarify that . . . the SEC is not required to plead or prove that an aider an abettor proximately caused the primary securities law violation. . . 15 U.S.C. § 78t(e), was passed in the wake of *Central Bank* precisely to allow the SEC to pursue aiders and abettors . . . . This statutory mandate would be undercut if proximate causation were required for aider and abettor liability in SEC enforcement actions.").

270. Due to the decision in *Central Bank and Stoneridge v. Scientific-Atlanta*, private parties cannot bring actions for aiding and abetting. The Court in *Stonebridge* rejected the idea that secondary actors would escape liability if the private right of action was further diminished: "Since September 30, 2002, SEC enforcement actions have collected over 10 billion in disgorgement and penalties, much of it for distribution to injured investors. The inability to bring aiding and abetting actions and reduced ability to bring primary actions under 10(b) means investors may have to rely even more on SEC enforcement actions." Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, 552 U.S. 148, 166 (2008).

liability.[271] In doing so, Judge Rakoff was likely acknowledging the lack of remedies for pursuing aiders and abettors. With the SEC being the sole entity that could bring action against them, a burden that was too high would let those who aided and abetted escape without consequences far too often.[272]

D. SEC Enforcement in Aiding and Abetting Actions After *Janus* and Dodd-Frank

While even the SEC seems to have conceded the point that the narrow take on the definition of "make" has removed its ability to bring enforcement actions under Rule 10b-5(b), its series of victories after *Kelly* indicates that *Janus's* effect on its ability to pursue securities law violators under primary liability may be quite narrow. The post-*Janus* case law indicates that courts are somewhat reluctant to extend the definition of "make" beyond Rule 10b-5(b) actions. Rather than asserting liability under Rule 10b-5, the SEC will attempt to use other provisions in the federal securities laws, such as section 17(a) or "scheme liability" under Rule 10b-5(a) or (c).

However, given the changes to Dodd-Frank, it behooves the SEC to add section 20(e) aiding and abetting charges in addition to charges of primary liability, particularly if other circuits follow the standard set by *Apuzzo*.[273] With the lowered standard of knowledge written into section 20(e) under Dodd-Frank, as well as the decision in *Apuzzo*, the SEC has a much clearer path to victory to aiding and abetting violations than they did prior to the Act. A recent case, *SEC v. Big Apple Consulting USA*, could signal the trend the SEC will take given the implications of the Janus ruling.[274]

In that case, the SEC sought an enforcement action against Big Apple, its wholly owned subsidiary, MJMM, and three executives for their connection to Cyberkey, a party who was not involved in the litigation, but who had had fraudulently reported a contract with the Department of Homeland Security.[275] The SEC initially alleged, among other violations, section 10(b), Rule 10b-5 and section 17(a)

271. *Id.*
272. *Apuzzo*, 689 F.3d at 213.
273. See *id*. at 213.
274. SEC v. Big Apple Consulting USA, Inc., 6:09-CV-1963-ORL-28, 2012 WL 3264512 (M.D. Fla. Aug. 9, 2012)
275. *Id.* at *2.

violations.[276] However, after *Janus* was decided, the SEC withdrew their section 10(b) and Rule 10b-5 charges, and added section 20(e) charges for aiding and abetting.[277] The court allowed the SEC to proceed on the section 17(a) claims, as well as the aiding and abetting claim.[278] This case is indicative of what the SEC's strategy maybe with its ability to use Rule 10b-5 diminished but new powers gained under Dodd-Frank.[279] With the Commission's ability to find primary liability diminished, it likely will assert secondary liability as an alternative option.[280]

The provisions relating to aiding and abetting cannot be applied retroactively.[281] The D.C. Circuit's opinion in *Graham v. SEC*,[282] while pre-Dodd Frank, could offer a perspective as to how courts could treat aiding and abetting defendants under the recklessness standard. In that case, the court found a broker liable for failing to notice that a customer was fraudulently trading in stocks.[283] The court noted, however, that it was not holding Graham liable for executing the fraudulent trades, but for failure to notice "numerous suspicious circumstances."[284] These trades included "economically irrational trading," the fact that she knew her client was experiencing financial difficulties, and the client's insistence on specifying the contra-broker with whom he wanted Graham to execute the trade.[285]

More recent cases demonstrate that a recklessness standard will make aiding and abetting violations a great deal easier than before. The Southern District of New York has found allegations of recklessness are met where the SEC showed that the defendant didn't fulfill its duty to monitor, or did not notice obvious signs of fraud.[286] In another case, the court found the defendant liable where the SEC was able to show that

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276. *Id.*
277. *Id.*
278. *Id.* at *3.
279. *See* SEC v. Life Partners Holdings, Inc. Litig., Release No. 22219, 102 SEC 2798 (Jan. 4, 2012), *available at* 2012 WL 8703670.
280. Maria Lokshin, *SEC Sees Spike in Aiding/Abetting, Control-Person Claims After* Janus, BLOOMBERG BNA, 45 SRLR ISSUE NO. 9.
281. SEC v. Daifotis, No. C 11-00137 WHA 2011 WL 3295139, at *5 (N.D. Cal. Aug. 1, 2011).
282. Graham v. SEC, 222 F.3d 994, 1005–06 (D.C Cir 1999).
283. *Id.*
284. *Id*. at 1004.
285. *Id.* at 1004–06.
286. SEC v. Landberg, 836 F. Supp. 2d 148, 155 (S.D.N.Y. 2011)

the defendant had access to information that demonstrated she *knew or should have known* that fraud was taking place.[287]

With regards to substantial assistance, the Southern District of New York has already used the *Apuzzo* standard successfully to find executive officers of the Federal National Mortgage Association liable under section 20(e) for aiding and abetting misrepresentations of their company's subprime mortgage exposure.[288] The court found that the officers fit the new standard because they reviewed periodic filings, commented on, discussed, and signed SEC filings in which fraudulent misrepresentations were made.[289]

Thus, not only does the SEC have a significantly lower burden for bringing aiding and abetting actions, but it also potentially has a wider net from which to seek liability for improper corporate activity.[290] The SEC should continue to use section 20(e) against both primary violators for whom it thinks the *Janus* standard might make it too difficult to succeed on a primary violation claim, and secondary violators such as accountants, lawyers, investment banks, and other entities who clearly could have put a stop to fraudulent activity.

E. LIMITATIONS

Of course, the increased ability to pursue aiders and abettors is not a cure-all for issues the SEC may have with enforcement after *Janus*. Although *Daifotis* was a victory for the SEC in its refusal to apply *Janus* beyond Rule 10b-5, the court also indicated that Justice Breyer's dissent might have been prophetic in its warning about the ability of the SEC to pursue secondary actors.[291] In charging Daifotis with aiding and abetting, the Commission alleged that the primary violator was Charles Schwab.[292] The court granted summary judgment as to aiding and

287. SEC v. Mudd, 885 F. Supp 2d 654 (S.D.N.Y. 2012)

288. *Id.* at 670–71.

289. *Id.* at 671.

290. See, e.g. SEC v. Big Apple Consulting USA, Inc., 6:09-CV-1963-ORL-28, 2012 WL 3264512 (M.D. Fla. Aug. 9, 2012); SEC v. Mudd, 885 F. Supp 2d 654 (S.D.N.Y. 2012); SEC v. Life Partners Holdings, Inc. Litig., Release No. 2221922219, 102 SEC 2798 (Jan. 4, 2012), *available at* 2012 WL 8703670.

291. SEC v. Daifotis, 874 F. Supp 2d 870, 876 (N.D. Cal. 2012)

292. *Id.* at 874 (stating that the SEC had not proved scienter on the part of anyone except the defendant).

abetting under section 10(b) and Rule 10b-5 pointing out that in order to show that Daifotis aided and abetted a primary violation, the SEC had to show scienter on the part of Charles Schwab, which it had not yet done.[293] The court also granted summary judgment as to violations of the Investment Advisers Act.[294]

Furthermore, as Judge Rakoff acknowledged in lowering the standard for substantial assistance in *Apuzzo*,[295] the SEC is the only one who can pursue aiding and abetting liability. It would be logistically impossible to pursue every person or company who can be found to have aided and abetted a securities law violation.[296] While the Dodd-Frank Act also demanded a study about the merit of a private right of action against aiders and abettors,[297] it is unlikely that any action will be taken on that soon.[298] Therefore, the SEC must carefully pick and choose who asserts aiding and abetting liability against.

F. CONTROL PERSON LIABILITY AFTER DODD-FRANK

It is difficult to assess the impact of control person liability after Dodd-Frank given the paucity of cases. However, despite the circuit split, shortly before Dodd-Frank was enacted, the SEC had brought control person liability suits in two high-profile cases.[299] Roughly a year before Dodd-Frank was enacted, the SEC brought charges against former AIG CEO Hank Greenberg for securities fraud violations made by the insurance company.[300] The case was eventually settled by a

293. *Id.* at 886–87.

294. *Id.* at 887.

295. SEC v. Apuzzo, 689 F.3d 204, 211 (2d Cir. 2012) ("Section 20(e) of the Securities Exchange Act allows the SEC, but not private litigants, to bring civil actions against aiders and abettors of securities fraud.").

296. For a discussion on the limitation on the SEC's to bring enforcement actions, see John C. Coffee, Jr., *SEC Enforcement: Talking the Talk, But Walking the Walk?*, CLS BLUE SKY BLOG (Nov. 25, 2013), http://clsbluesky.law.columbia.edu/2013/11/25/sec-enforcement-talking-the-talk-but-walking-the-walk/.

297. Dodd-Frank Wall Street Reform and Consumer Protection Act. Pub. L.No. 111-203, § 929Z(a), 124 Stat. 1376 (2010).

298. *See generally* Ho, *supra* note 5, at 184.

299. *See generally*, SEC v. Greenberg, Release No. AE-3032, 96 SEC 1702 (Aug. 6, 2009), *available at* 2009 WL 2413951;

300. SEC v. Greenberg, Release No. AE-3032, 96 SEC 1702 (Aug. 6, 2009), *available at* 2009 WL 2413951

consent agreement, in which Greenberg agreed to pay $15 million dollars.[301] The same month, the SEC brought control person charges against Nature's Sunshine Products, its CEO, Douglas Faggioli, and its former CFO, Craig D. Huff.[302] The defendants also all agreed to consent agreements, which enjoined them from future violations, and paid civil penalties as well.[303]

These cases demonstrate that the SEC was not afraid to use control person liability where it saw fit, even with its ability to bring actions ambiguous. With its ability to pursue control person actions clarified, the SEC is likely to assert control liability as an enforcement mechanism more often.[304] As one commentator has pointed out, given the typical enforcement action brought by the SEC, it is not difficult for the Commission to find one or more executives who *should have* been on notice for fraudulent activity going on.[305] However, because Dodd-Frank did not resolve the circuit split about the degree that a control person needed to be involved in order to be liable, it is still unclear how successful a control person action will be.

It is worth noting that since the settlement agreements reached in *Greenberg* and *National Securities Products*, there has been intense judicial scrutiny over SEC use of consent agreements whereby the Commission secures a fine from the defendant without demanding the defendant admits wrongdoing.[306] Judge Rakoff of the Southern District of New York, the most high-profile of these critics, set a new precedent by refusing to enforce a settlement agreement between the SEC and Citigroup over Citigroup's fraudulent activities in the period leading up to the final crisis.[307] The SEC, Judge Rakoff explained, was not acting in the public interest by simply allowing Citigroup to settle the action without demanding serious consequences or an admission of guilt.[308]

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301. *Id.*

302. SEC v. Nature's Sunshine Prods., Inc., Release No. LR-21162 (July 31, 2009), *available at* 2009 WL 5734301; SEC v. Nature's Sunshine Prods., Inc., Release No. LR-21162 (July 31, 2009), *available at* 2009 WL 5734301.

303. *Id.* at 2.

304. *See supra* note 294.

305. Bruce Hiler and Sharon Rose, *Expansion of the U.S.'s SEC Enforcement Powers Under the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 17 WORLD SEC. LAW REP. 1, 3–4 (2011).

306. SEC. v. Citigroup Global Mkts. Inc, 827 F. Supp. 2d 328, 331 (S.D.N.Y. 2011).

307. *Id.*

308. *Id.* at 332.

This decision is currently pending before the Second Circuit[309] and could have a significant impact on the way in which control person liability is pursued. If the Second Circuit finds that the no-admit settlements were against the public interest, as Judge Rakoff indicated, then the SEC may be less willing to bring actions. The cost of litigation for each and every control person enforcement action to its finality could prove prohibitive. However, these scenarios could also mean the SEC will seek severe consequences in the cases where they do assert control person liability.

CONCLUSION

The trend in courts indicates that courts are reluctant to extend *Janus* beyond Rule 10b-5 actions. However, with the new weapons to assert aiding and abetting liability against secondary actors, the SEC should nonetheless continue to add section 20(e) and section 20(a) violations to primary ones. While the diminished ability to bring section 10(b) and Rule 10b-5 actions will hurt chances of establishing a primary violation, the lower burdens of proof for secondary liability will give the Commission a greater chance of success in pursing secondary actors. Furthermore, given that private parties have even less recourse to assert any kind of liability against secondary actors, it is necessary for the SEC to fill in the gap.

309. SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158 (2nd Cir. 2011).