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BREAKING PAST THE PARALLAX: FINDING THE TRUE PLACE OF LAWYERS IN SECURITIES FRAUD

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Cover Page Footnote
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[*] J.D. Candidate, 2011, Fordham University School of Law. I am grateful to Professor Caroline Gentile for her invaluable insight and guidance in the process of preparing this Note.

INTRODUCTION

In October 2005, investors discovered that Refco, Inc., a popular brokerage firm, had for years engaged in fraudulent transactions designed to create a semblance of financial success.[1] To cover up, rather than write off, poorly made loans that became uncollectible, Refco engaged in a series of complex "round-trip" transactions in which it made loans to third-parties and then had the third-parties make loans to its entities.[2] As a result of this scheme, the appearance of Refco's balance sheets improved dramatically. No one was the wiser when the company went public until months later when Refco stated that its balance sheets should not be relied upon.[3] As it turned out, Refco's financial situation, covered up by the fraud, left it on the precipice of collapse, which imminently followed,[4] causing tremendous losses to investors and forcing Refco to declare bankruptcy.[5]

In the course of its "round-trip" fraud, Refco used a well-known law firm to help it prepare key documents[6] and explain the structure of the "round-trip" transactions to third-party participants in the scheme.[7] The law firm was also involved in the creation of a series of securities offerings in which the prospectuses contained information that it knew to be false.[8]

1. *In re* Refco, Inc. Sec. Litig. (*Refco I*), 503 F. Supp. 2d 611, 620 (S.D.N.Y. 2007).
2. *In re* Refco, Inc. Sec. Litig. (*Refco II*), 609 F. Supp. 2d 304, 306-07 (S.D.N.Y. 2009).
3. *Refco I*, 503 F. Supp. 2d at 621.
4. *See id.*
5. *Id.*
6. *See Refco II*, 609 F. Supp. 2d at 307-08.
7. *Id.*
8. *Id.* at 308-09.

Not surprisingly, investors sued the law firm claiming that it knew or should have known about the fraud, and thus ought to be held liable.[9] The firm moved for dismissal.[10] Granting the motion to dismiss, United States District Court Judge Lynch wrote that, given the present state of the law, he had no choice but to dismiss the action against the law firm.[11] In dicta, however, Judge Lynch expressed his concern with the laws under which he had to decide the case, as well as his opinion that the system is ripe for a change so that such actions could, at a minimum, be heard in court.[12]

Lawyers often play an integral part in business transactions and securities offerings. This puts lawyers on the sidelines of not only great business successes, but also, every so often, tremendous failures.[13] Because they are viewed by many as gatekeepers, and in that role provide a degree of assurance (with their reputational capital) that gross illegalities will not occur,[14] a series of questions arise in the minds of many when illegalities do happen on attorneys' watch.[15] This Note analyzes the legal standards that are in play and those that should be imposed when lawyers aid or abet a fraud.

Part I sets out the historical and theoretical background against which the analysis of attorney liability is undertaken. This Part traces the relevant underlying principles and defines the unique position that a lawyer

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9. *Id.*

10. *Id.* at 305.

11. *Id.* at 318-19.

12. *Id.* at 319 n.15.

13. *See, e.g.*, Thomas Lee Hazen, *Administrative Law Controls on Attorney Practice-A Look at the Securities and Exchange Commission's Lawyer Conduct Rules*, 55 ADMIN. L. REV. 323, 339 (2003) ("The role lawyers play in facilitating securities fraud, albeit unwittingly in many cases, should not be ignored. This has been a recent concern of the roles lawyers play as a result of failures such as Enron, WorldCom, and Tyco. However, this is not a new concern.").

14. For a discussion on gatekeepers and attorneys as gatekeepers, see *infra* Part I.A.2.

15. "Where were the lawyers?" is a question that was once famously asked in Judge Sporkin's opinion in *Lincoln Savings & Loan Ass'n v. Wall*. 743 F. Supp. 901, 920 (D.D.C. 1990) ("Where were these professionals. . . . Where were the . . . attorneys when these transactions were effectuated?"). Today, this question has reached a near-classic status, and is frequently asked after major financial frauds. *See, e.g., Accountability Issues: Lessons Learned from Enron's Fall: Hearing Before the Sen. Judiciary Comm.*, 107th Cong. 38 (2002) (statement of Susan P. Koniak, Professor of Law, Boston Univ. Sch. of Law) (addressing "Where were the Lawyers? Behind the Curtain Wearing Their Magic Caps"); Cassandra Burke Robertson, *Judgment, Identity and Independence*, 42 CONN. L. REV. 1, 3 (2009) ("Whenever corporate or governmental scandals erupt, onlookers are quick to ask, 'Where were the lawyers?'"); Donald C. Langevoort, *Where Were the Lawyers? A Behavioral Inquiry into Lawyers' Responsibility for Clients' Fraud*, 46 VAND. L. REV. 75, 76 (1993) ("Where were the lawyers? Perhaps rhetorical, even sarcastic, this question is being asked all too frequently after large financial frauds.").

occupies under securities laws as he or she plays the dual role of client advocate and corporate gatekeeper. It then discusses the changes to attorney liability that were brought about by judicial decisions and legislative actions over the past two decades. Part II discusses the contrasting views on the issue, both those calling for the reintroduction of aiding and abetting liability and those calling for a continuation of the status quo. Finally, Part III offers a new approach for resolving the debate, proposing a statutory amendment that balances competing policy considerations; specifically, the need for liability and the need to curb the potential explosion of litigation such liability may cause.

I. BACKGROUND

The discussion that follows in this section provides the background information which forms the basis for the current debate on whether to impose aiding and abetting liability on attorneys. Part I.A provides a brief overview of the ethical and professional rules governing attorneys' conduct and then discusses attorneys' status as gatekeepers. Part I.B reviews the history of aiding and abetting liability in the United States prior to the Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver*.[16] Part I.C discusses the limits placed on aiding and abetting liability by *Central Bank* and the following congressional expansion of such liability with the passage of Private Securities Litigation Reform Act of 1995.[17] Thereafter, Part I.D reviews the changes to attorneys' gatekeeper role brought about by the Sarbanes-Oxley Act of 2002[18] in the wake of the Enron scandal, and Part I.E discusses the Supreme Court's decision in *Stoneridge Investment Partners v. Scientific-Atlanta, Inc.*[19] and its elimination of scheme liability[20]—one of the options used by investors as an alternative to the overruled aiding and abetting liability claim. Lastly, Part I.F discusses the congressional response to the *Stoneridge* decision and the frauds that accompanied the recent recession via the proposed bill entitled Liability for Aiding and Abetting Securities Violations Act of 2009.[21]

16. 511 U.S. 164 (1994).

17. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 18 U.S.C.).

18. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 U.S.C.).

19. 552 U.S. 148 (2008).

20. For a definition and discussion of scheme liability, see *infra* Part I.E.

21. Liability for Aiding and Abetting Securities Violations Act of 2009, S. 1551, 111th Cong. (2009).

A. Cast in Dual Roles: The Role of the Lawyer

Much of the impetus to impose aiding and abetting liability on lawyers stems from their gatekeeper role in securities law and corporate contexts,[22] and the belief that there is a need to ensure that they continue in that function.[23] It is therefore helpful to begin the discussion of attorney aiding and abetting liability with an overview of the dual roles that lawyers play.

As counsel, an attorney is both a corporate gatekeeper thereby possessing a set of responsibilities to the general public,[24] and an advocate constrained by a duty to the client and responsibilities that come with client representations.[25] The dual roles that attorneys play are governed by different standards. On the one hand, attorneys must abide by professional rules governing their obligations to clients[26] and the profession;[27] on the other hand, they must meet certain expectations associated with their gatekeeper role.[28] The attorney-client relationship is further complicated by an important interest at stake for the attorney: continued client representation and thereby continued financial benefit, which, in turn, is

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22. For an overview of gatekeeper functions, see *infra* Part II.A.1. Whether or not lawyers do, or should, play the gatekeeper role has been, and still is, widely debated. *Compare* John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 353 (2004) [hereinafter *Gatekeeper Failure*] (urging the imposition of several client-monitoring responsibilities on lawyers as a result of their gatekeeper function), *and* Langevoort, *supra* note 15, at 79-80 (discussing lawyers' gatekeeper position), *with* Jill E. Fisch & Kenneth M. Rosen, Symposium, *Lessons from Enron, How did Corporate and Securities Law Fail? Is There a Role for Lawyers in Preventing Future Enrons?*, 48 VILL. L. REV. 1097, 1138 (2003) (arguing against the utility of imposing client-monitoring responsibilities on lawyers).

23. *See, e.g.*, *Gatekeeper Failure*, *supra* note 22.

24. SEC v. Nat'l Student Mktg., 457 F. Supp. 682, 713 (D.D.C. 1978); *see also* Schware v. Bd. of Bar Exam'rs, 353 U.S. 232, 247 (1957) (Frankfurter, J., concurring) ("From a profession charged with such responsibilities there must be exacted those qualities of truth-speaking, of a high sense of honor, of granite discretion, of the strictest observance of fiduciary responsibility, that have, throughout the centuries, been compendiously described as 'moral character.'"); *Gatekeeper Failure*, *supra* note 22. This responsibility is also imposed on lawyers by the less focal, but nonetheless important, ethical obligations as officers of the court.

25. Numerous rules and principals govern the attorney-client relationship. *See infra* Part I.A.1. These obligations to the client are of great importance, for instance, attorney-client privilege—one of such client obligations—is widely debated when the proposition of imposing gatekeeper liability on attorneys is discussed. *See, e.g.*, Paul S. Atkins, *The Preservation of the Age-Old Attorney-Client Privilege*, 43 ADVOC. (TEX.) 20 (2008).

26. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.6 (2007) (imposing strict rules on attorneys with respect to confidential information obtained from their client in the course of representation); *see also infra* Part I.A.1.

27. *See generally* MODEL RULES OF PROF'L CONDUCT (2007).

28. *See, e.g.*, *Gatekeeper Failure*, *supra* note 22, at 309.

important for both a law firm's reputational capital[29] and its financial well-being. This goal of client retention, however, in spite of its benefits,[30] can impair an attorney's judgment of what is ethically necessary,[31] increasing the need for appropriately tailored rules governing attorney conduct.

1. Professional Rules Governing Attorney Conduct

Many of the existing ethical and professional principles that guide attorney behavior are reflected in the American Bar Association Model Rules of Professional Conduct (the "Rules"), which have been adopted in one form or another in over forty states.[32] These and other attorney conduct rules take into account attorneys' dual roles and contain guidelines designed to help attorneys meet both obligations to their clients and any obligations they may have to the public as a result of their clients' actions. The main obligation of a lawyer, however, is the one owed to the client, which the Rules reflect through their explicit imposition of such duties.[33] By contrast, the obligation to the public is more theoretical and stems from general ethical principles rather than specific relationships.[34]

Because of the overarching significance of the duty to the client, any outside obligations that may conflict with this duty inevitably complicate client representation. In the case of gatekeeper obligations, the chief complicating factor, apart from the duty of confidentiality, is the doctrine

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29. Continued representation and growing experience are key to growing reputational capital, and therefore becoming a more popular firm and desirable gatekeeper. *See, e.g.*, *id.* at 308-11. For a discussion on the value of reputational capital to securities attorneys, see Karl S. Okamoto, *Reputation and the Value of Lawyers*, 74 OR. L. REV. 15, 18-19 (1995).

30. Such benefits may include increased client loyalty, quality of performance and diligence, as well as increased performance efficiency.

31. *See* Deborah L. Rhode & Paul D. Paton, *Lawyers, Ethics, and Enron*, 8 STAN. J.L. BUS. & FIN. 9, 26 (2002) ("Increased competition from within and outside the bar has led to increased pressure on firms to favor responsiveness to client demands over broader societal concerns. Allegiance to management's short-term financial interests may compromise obligations to the broader public, as well as to the entity itself, which is, at least in theory, the lawyer's client.").

32. *See* ABA/BNA LAWYERS' MANUAL ON PROF'L CONDUCT § 1:3 (2006) (setting forth details on every state).

33. For instance, ABA Model Rule 1.6 forbids a lawyer from disclosing confidential information except with the client's informed consent. MODEL RULES OF PROF'L CONDUCT R. 1.6 (2007). The comment to Model Rule 1.3 states that a lawyer must protect a client's interests despite "opposition, obstruction or personal inconvenience to the lawyer." MODEL RULES OF PROF'L CONDUCT R. 1.3 cmt. (2007).

34. *See, e.g.*, Richard W. Painter & Jennifer E. Duggan, *Lawyer Disclosure of Corporate Fraud: Establishing a Firm Foundation*, 50 SMU L. REV. 225 (1996). There does, however, exist a concrete duty to a known third party beneficiary. *See, e.g.*, Stephen Gillers, *Virtual Clients: An Idea in Search of a Theory (With Limits)*, 42 VAL. U. L. REV. 797, 820-21 (2008).

of attorney-client privilege.[35] The purpose of the doctrine is to protect communications between clients and their attorneys in the course of legal counseling, thus fostering more open communication.[36] The privilege, however, is deemed waived upon disclosure of protected information that is not meant for the general public,[37] which, in turn, also raises concerns for client confidentiality.[38] Absent an exception, in the fulfillment of his or her gatekeeper obligations, the lawyer is restricted to avenues not involving disclosure. To allow for circumstances where attorneys may need to reveal certain information, and to spare attorneys from necessary noncompliance with their broader ethical obligations, the Rules allow for disclosure in cases where it is necessary in order to "prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another, and in furtherance of which the client has used or is using the lawyer's services."[39] The duty to the client thus comes with exceptions that assist attorneys in their functions as officers of the court and gatekeepers, in addition to their advocate role.

Although attorneys' obligations to their clients are paramount, their obligations to third parties do not lack significance. The *Restatement (Third) of the Law Governing Lawyers* recommends that a lawyer be "subject to liability to a client or nonclient when a nonlawyer would be in similar circumstances"[40] and suggests the existence of and need for imposing aiding and abetting liability.[41] Against this thematic backdrop, the Rules require a degree of attorney attention to possible client

35. For an overview of attorney-client privilege in corporate context, see ATTORNEY-CLIENT PRIVILEGE IN CIVIL LITIGATION: PROTECTING AND DEFENDING CONFIDENTIALITY (Vincent S. Walkowiak ed., 2004); PRACTICING LAW INSTITUTE, CORPORATE DISCLOSURE AND ATTORNEY-CLIENT PRIVILEGE (Dennis J. Block & Jerold S. Solovy eds., 1984).

36. *See generally Developments in the Law—Privileged Communications*, 98 HARV. L. REV. 1450, 1501-29 (1985) (outlining rationales for the attorney-client privilege).

37. *Id.* at 1515.

38. Once waived, all information conveyed to counsel by the client is subject to disclosure. *But see* William H. Simon, *After Confidentiality: Rethinking the Professional Responsibilities of the Business Lawyer*, 75 FORDHAM L. REV. 1453, 1471 (2006) (arguing that lawyers should catch up with the current reality of business representation and adopt a less formalistic take on confidentiality).

39. MODEL RULES OF PROF'L CONDUCT R. 1.6(b)(2) (2007).

40. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 56 (2000).

41. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 94 (2000) (providing limitations on attorney assistance to a client, particularly prohibiting assistance of client action that may be fraudulent, and explicitly providing for liability if an attorney assists a client in activity that may violate the rights of third parties).

misconduct,[42] and set forth guidelines that prohibit attorney participation in fraud. For instance, Rule 1.2(d) urges that a lawyer not assist a client in fraudulent conduct,[43] and by its text suggests a prohibition on aiding and abetting a fraud; Rule 1.13(b) requires that an attorney report to higher authorities when the lawyer knows that a corporate employee is acting or plans to act unlawfully;[44] and Rule 4.1 prohibits knowingly making false statements to third parties.[45] These Rules are not meant to be an exhaustive checklist for attorney behavior, and the "Scope of the Rules" section provides that a certain degree of personal judgment and ethical consideration must also come into play because "no worthwhile human activity can be completely defined by legal rules."[46] This notion is further echoed in the preamble to the Rules, which explicitly states that in the practice of law, apart from the guidance set forth in the Rules, a "lawyer [should] also [be] guided by personal conscience."[47]

This panoply of rules and guiding principles suggests that a fairly high level of professional ethical expectations is in place, which is consistent with the goal of preventing attorney aiding and abetting of securities fraud.[48] All else aside, "an attorney's loyalty [to the client] is subject to the

42. The Rules, however, do not impose a duty to investigate a client. *See Report of the New York City Bar Association Task Force on the Lawyer's Role in Corporate Governance*, 62 BUS. LAW. 427, 453 (2007) [hereinafter *Task Force Report*].

43. *See* MODEL RULES OF PROF'L CONDUCT R. 1.2(d) (2007) ("A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.").

44. MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2007) ("Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law."). Under this rule, the obligations stem only from misconduct "related to [the lawyer's] representation." *Id.* Importantly, the premise underlying this rule is that the lawyer represents the organization, and therefore has to protect the organization and its shareholders from harm, rather than individual agents of the corporations or directors.

45. MODEL RULES OF PROF'L CONDUCT R. 4.1 (2007). Rule 1.0(f) defines "knowingly" as having actual knowledge. Furthermore, knowledge may be "inferred from circumstances" according to the rules. MODEL RULES OF PROF'L CONDUCT R. 1.0(f) (2007).

46. MODEL RULES OF PROF'L CONDUCT pmbl. (2007).

47. *Id*. This appeal to ethical guidance from outside the text of the Rules does not end with the preamble and continues in the Rules themselves. For instance, Rule 2.1 states that in the course of advising a client "a lawyer may refer not only to law but to other considerations such as moral, economic, [and other] factors" to the extent they are relevant in the situation. MODEL RULES OF PROF'L CONDUCT R. 2.1 (2006).

48. Note, however, that the Model Rules do not impose on the attorney a duty to investigate the client if the attorney suspects client wrongdoing. *Task Force Report*, *supra*

overriding general norm, in both ethics and law, that lawyers must not knowingly give substantial assistance to client fraud."[49]

2. Attorneys as Gatekeepers

In addition to their professional obligations, both to their clients and the public, attorneys also act as corporate gatekeepers. The gatekeeper role has been defined in different ways. Originally, a gatekeeper was conceived to be someone who was in a position to stop a given fraudulent, or otherwise legally problematic, transaction.[50] The definition was later refined, and a corporate gatekeeper is now understood to be someone who serves as a reputational intermediary between the issuer and the public.[51] Under this new definition, the gatekeeper fulfills its role by staking its own reputational capital as a form of assurance to the investing public of the quality of their investments.[52] Because a gatekeeper does not stand to gain as much financially as the issuer, but risks a substantial decline in reputational capital, a gatekeeper would be less likely to violate or assist in violating the law.[53] As a result, investors rely on the gatekeeper and expect that the gatekeeper will not risk overlooking fraud or other misconduct for fear of losing its hard-earned reputational capital.[54] In other words,

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note 42. Accordingly, an attorney's knowledge of a client's involvement in fraud would seem to have to come from the course of the attorney's work, rather than from any kind of independent investigation after a proverbial red flag has been uncovered. *But see* RESTATEMENT (THIRD) OF AGENCY §7.01 cmt. D (2006) (noting that an agent may have a duty to inquire further into information provided by the principal in "circumstances that make it unreasonable to rely on the information provided without further inquiry"); Roger C. Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 BUS. LAW. 143, 152 (2002) ("Probably the most unsettled and controverted question is whether a lawyer must investigate suspicious circumstances that suggest fraud or follow on the allegations of fraud.").

49. Langevoort, *supra* note 15, at 78; *see also* MODEL RULES OF PROF'L CONDUCT pmbl. (2007).

50. Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 53 (1986) (defining gatekeepers as "private parties who are able to disrupt misconduct by withholding their cooperation from wrongdoers").

51. For an overview of the gatekeeper concept and relevant literature, see JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 1-4 (2006) [hereinafter COFFEE, GATEKEEPERS]; *Gatekeeper Failure, supra* note 22, at 308-09.

52. *See, e.g.*, COFFEE, GATEKEEPERS, *supra* note 51, at 2 ("[A gatekeeper] is an agent who acts as a reputational intermediary to assure investors as to the quality of the 'signal' sent by the corporate issuer."); Aegis J. Frumento, *Misrepresentations of Secondary Actors in the Sale of Securities: Does* In Re Enron *Square with* Central Bank*?*, 59 BUS. LAW. 975, 977 (2005) (describing gatekeepers' reputational intermediary function).

53. *See, e.g.*, COFFEE, GATEKEEPERS, *supra* note 51, at 5.

54. *Gatekeeper Failure*, *supra* note 22, at 308-09.

gatekeepers are expected to either stop the fraud, or at a minimum, not participate in it.

Lawyers act as gatekeepers alongside other professionals, such as accountants, auditors, brokers, and other actors.[55] As a gatekeeper, by placing its name on a transaction or document, a reputable law firm[56] often dispels whatever degree of insecurity that an investor might otherwise feel. The firm's name and reputation provide investors with assurance that the firm would all but guarantee the legality of the transaction. This assurance is important since attorneys' clients—the issuing corporations—are likely prone to more risk-taking than the lawyers because they usually have a substantially greater financial interest at stake.[57] Because a law firm typically derives only a small percentage of its business from any given client, it is capable of being a functional gatekeeper. Withdrawal as counsel from one client would not be financially fatal to the firm, thus simplifying the choice between the loss of one client and greater loss of reputational capital.

B. The World Before *Central Bank*

Aider and abettor liability is neither a novel nor a recent concept in the United States. In fact, criminal liability has been imposed on aiders and abettors of federal crimes in the United States for over one hundred years.[58] Aiding and abetting liability also has a history in the civil law context. For example, the *Restatement (Second) of Torts* instructs that such liability

55. *Gatekeeper Failure*, *supra* note 22. Not everyone agrees, however, that casting lawyers in the gatekeeper role is appropriate. *See, e.g.*, COFFEE, GATEKEEPERS, *supra* note 51, at 192 ("[T]he concept has never truly been accepted by the organized bar, which prefers to view the attorney as an advocate, whose sole duty is the zealous representation of the client."); John C. Coffee, Jr., *Understanding Enron: "It's About The Gatekeepers, Stupid,"* 57 BUS. LAW. 1403, 1406-19 (2002) [hereinafter Coffee, *Understanding Enron*] (discussing gatekeepers' role and the role of attorneys); Fisch & Rosen, *supra* note 22 (arguing that attorneys should not serve as corporate gatekeepers).

56. Almost exclusively the law firms chosen to represent the transactions of public companies and oversee their affairs are elite. These firms are chosen not necessarily because of their superior service over lesser known or smaller firms, but because the reputation of these firms provides a reputational capital guarantee. *See, e.g.*, Okamoto, *supra* note 29, at 37.

57. COFFEE, GATEKEEPERS, *supra* note 51, at 5 ("Because the gatekeeper is inherently an agent of its principal, its expected fee or commission is likely to be far less than the gain that the principal itself expects to make from the transaction."); John C. Coffee, Jr., *Can Lawyers Wear Blinders? Gatekeepers and Third-Party Opinions*, 84 TEX. L. REV. 59, 71 (2005) [hereinafter Coffee, *Can Lawyers Wear Blinders?*].

58. *See* 18 U.S.C. § 2 (1909). In fact, such liability extends even further back in time to English criminal law of the eighteenth century. *See* 1 M. HALE, PLEAS OF THE CROWN 615 (1736).

would attach to one who "knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other."[59]

Securities law embodied such liability under its own statutory scheme, namely Section 10(b) of the Securities Exchange Act of 1934[60] (the "'34 Act") and Rule 10b-5,[61] promulgated under its authority.[62] Indeed, until the Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver*[63] such liability routinely attached to accountants, attorneys, underwriters, banks, and others[64] in every federal circuit.[65] Although securities statutes and regulations do not explicitly include aiding and abetting liability,[66] "courts quickly adopted the position that to further the '34 Act's basic philosophy . . . private parties, as well as governmental entities could impose liability under Section 10(b) on those who do no more than aid and abet violations of that section."[67] This judicial presumption is in line with the view that the writers of the '34 Act

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59. RESTATEMENT (SECOND) OF TORTS § 876(b) (1977). In practice, civil aiding and abetting liability existed primarily in securities regulation and labor law contexts. Eugene J. Schiltz, *Civil Liability for Aiding and Abetting: Should Lawyers Be "Privileged" to Assist Their Clients' Wrongdoing?*, 29 PACE L. REV. 75, 84 (2008). For a discussion of the history of aiding and abetting liability, see *id.* at 80-85.

60. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. §78j (2000). The statutory text states:

> [It is] unlawful for any person, directly or indirectly, . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.

61. 17 C.F.R. § 240.10b-5 (2006).

62. Securities Exchange Act of 1934 § 21, 15 U.S.C. § 78u (2002). The authority granted to the SEC to promulgate rules also gave it enforcing authority. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71, 78-79 (2006).

63. 511 U.S. 164 (1994).

64. *See* JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 760 (6th ed. 2009) (noting that aiding and abetting was "itself a violation" of Section 10(b) and Rule 10b-5 for three decades preceding *Central Bank*).

65. *Central Bank*, 511 U.S. at 192 (Stevens, J., dissenting) (stating that in "*hundreds* of judicial and administrative proceedings in every Circuit in the federal system" courts and the SEC found aiding and abetting liability); *see also* Celia R. Taylor, *Breaking the Bank: Reconsidering* Central Bank of Denver *After Enron and Sarbanes-Oxley*, 71 MO. L. REV. 367, 370 (2006) ("From the time Section 10(b) and Rule 10b-5 came into being in the 1930s until the mid-1990s, federal courts uniformly recognized a private cause of action for aiding and abetting under Section 10(b), the general anti-fraud provision of the Securities Exchange Act of 1934.").

66. *See Central Bank*, 511 U.S. at 184.

67. Taylor, *supra* note 65.

presupposed that such liability would attach because the law at that time recognized accomplice liability for mere participation in a fraud, making inclusion of a provision that would explicitly impose such liability redundant.[68] Recognition of aiding and abetting liability, both before and after the passage of the '34 Act, has therefore been on our books and part of our legal history for many decades preceding *Central Bank*.

C. *Central Bank* and the Congressional Response it Prompted

Against this backdrop, coming on the heels of an aiding and abetting litigation explosion,[69] the Supreme Court decided *Central Bank*,[70] eliminating such liability and substantially changing the legal landscape. *Central Bank* involved claims arising out of bond offerings made by the Colorado Springs-Stetson Hill Public Building Authority (the "Authority") in 1986 and 1988 for which Central Bank of Denver served as the indenture trustee.[71] The bond covenants required that the bonds be secured by real estate having an appraised value of at least 160% of the outstanding principal and interest.[72] The first offering occurred without a problem.[73] Thereafter, although the real estate market in Colorado experienced a decline, the appraisal of the collateral for the second offering indicated that the value had remained essentially unchanged.[74] Central Bank decided that an independent appraisal was necessary, but before any independent review came to pass, the Authority defaulted on the bonds and the purchaser of

68. Robert A. Prentice, Stoneridge, *Securities Fraud Litigation, and the Supreme Court*, 45 AM. BUS. L.J. 611, 622-30 (2008) (discussing the role of aiding and abetting in the '34 Act's drafters' time and the understanding that it would attach, and noting that "[i]t is undeniable that, given the state of the law in 1934, a Congress contemplating a private right of action absolutely must have expected liability to be visited upon [aider and abettor] defendants"). A review of cases predating the '34 Act suggests that this judicial treatment of the Act is an extension of a then-existing presumption that aiding and abetting liability would attach and is not merely the result of an independent inquiry into the legislative intent of the '34 Act's drafters. *See, e.g.*, Lewis v. McClure, 16 P.2d 166, 171 (Cal. 1932) (holding that fraud liability can be imposed upon each defendant shown to have participated in the fraud); Purdum v. Edwards, 141 A. 550, 553 (Md. 1928) (participants in deceit playing different roles are held jointly liable); Frank Shepard Co. v. Zachary P. Taylor Publ'g Co., 198 A.D. 638, 190 N.Y.S. 837, 840 (App. Div. 1921) (holding participation to be the standard for fraud liability); Hotaling v. A.B. Leach & Co., 214 N.Y.S. 452, 458 (Mun. Ct. 1926) (holding all promoters, officers, and directors who participated in preparing and circulating a corporation's false prospectus liable, including the man who was the "moving spirit" behind circulation).

69. Schiltz, *supra* note 59, at 85.

70. 511 U.S. 164 (1994).

71. *Id.* at 167.

72. *See id.*

73. *Id.*

74. *Id.*

two million dollars in bonds sued.[75] The suit alleged that Central Bank of Denver had aided and abetted the Authority's fraudulent scheme by failing to obtain an accurate appraisal of the collateral.[76]

The Supreme Court, in a 5-4 decision, read the text of the '34 Act strictly and interpreted it not to include a private right of action for aiding and abetting fraud.[77] In its analysis, the Court noted that the particular words "aid" and "abet" did not appear in the text of the '34 Act and rejected the SEC's argument that the phrase "directly or indirectly" in Section 10(b) of the '34 Act indicated Congressional intent to include aiding and abetting liability.[78] The Court employed the classic argument that Congress knew how to articulate its wishes, and the absence of explicit text indicates the absence of that specific intent.[79]

Not everyone agrees with the Court's understanding of the meaning of the statute's words.[80] A counter-argument to the Court is that Congress did know how to say "aid" and "abet," but found those words would be redundant if included in the statute.[81] Professor Prentice argues that:

> [g]iven the state of the law in 1934, a Congress wishing to impose liability upon defendants who aided[,] or aided and abetted[,] securities fraud would most probably *not* have included a specific provision for aiding and abetting. While Congress could have done so, of course, it would not have deemed such action necessary or natural because in 1934 all who knowingly aided, abetted, counseled, approved, procured, countenanced, commanded, or participated in common law or blue sky fraud in some other meaningful way would have been held fully liable as joint tortfeasors with no distinction drawn between primary and secondary liability.[82]

The *Central Bank* Court, however, was concerned that allowing aiding and abetting liability would open up liability's reach to parties who "do not engage in the proscribed activities at all, but who give a degree of aid to those who do."[83] Whether or not this purpose was served by the opinion is

75. *Id.* at 168.
76. *Id.*
77. *See id.* at 191.
78. *Id.* at 176.
79. *Id.* at 176-77
80. *See* Prentice, *supra* note 68, at 619-48 (analyzing the state of the law in the 1930s, concluding that *Central Bank* interpreted the law incorrectly).
81. *See id*.
82. *Id.* at 644.
83. *Central Bank*, 511 U.S. at 176.

debatable.[84] The Court's holding that "[t]he absence of [Section] 10(b) aiding and abetting liability does not mean that secondary actors in the Securities markets are always free from liability under the securities Acts"[85] left open the possibility for gatekeeper liability as a "primary violator," so long as "*all* of the requirements for primary liability under Rule 10b-5 are met."[86] Essentially, then, gatekeepers could still be found liable "if their conduct is sufficiently pro-active that they can be characterized as a primary violator."[87] And, as a result of the *Central Bank* holding, a plaintiff is entitled to remedies for gatekeeper actions if she proves all the elements of Rule 10b-5, which include proving that the defendant: "(1) made a misstatement or omission; (2) of a material fact; (3) with scienter; (4) on which the plaintiff relied; (5) in connection with the purchase or sale of a security; and (6) the plaintiff's reliance caused the plaintiff's injury."[88]

Congress responded to the issues underlying *Central Bank*, and the *Central Bank* decision itself, by passing, over presidential veto,[89] the Private Securities Litigation Reform Act of 1995 (PSLRA).[90] The PSLRA amended the '34 Act by adding Section 20(e),[91] and restored private aiding and abetting liability with the following language:

> Prosecution of Persons Who Aid And Abet Violations.—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 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.[92]

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84. Taylor, *supra* note 65, at 372 ("[T]he Court did not protect corporate gatekeepers from *all* liability." (emphasis added)); *cf.* John C. Coffee, Jr., *For Accountants, The Supreme Court's* Central Bank *Decision is Likely to be The Victory That Wasn't; For Lawyers, The Result is More Ambiguous*, NAT'L L.J., July 11, 1994, at B4.

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

86. *Id.* at 191 (emphasis in the original).

87. Taylor, *supra* note 65, at 372.

88. Taylor, *supra* note 65, at 372-73.

89. PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995—VETO MESSAGE FROM THE PRESIDENT OF THE UNITED STATES, H.R. DOC. NO 104-150 (1995); *see also, e.g.*, Securities Exchange Act of 1934 §20(e), 15 U.S.C. § 78t(e) (2000).

90. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 104, 109 Stat. 737, 757 (1995).

91. This section, as a general matter, substantially limited private securities actions and settlements.

92. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737, 757 (codified as amended at 15 U.S.C. §78t(e)).

The amendment explicitly permitted the SEC to bring aiding and abetting actions against gatekeepers but limited this right exclusively to the SEC.[93] Notably, this right was established only for "knowing" violations,[94] "reckless" violations were left out.[95] To date, this provision has not been utilized frequently and there have not been a substantial number of cases brought under its authority.[96]

The main legislative goal of the PSLRA itself, however, has been to rein in excessive or frivolous securities litigation.[97] To that end, the PSLRA introduced a combination of "three separate mechanisms: raising the bar as to what constitutes securities fraud, empowering lead plaintiffs to rein in their lawyers in class actions, and requiring judges to sanction securities lawyers for frivolous litigation."[98] Thus the PSLRA brought dramatic reform to securities law, including heightened pleading standards,[99] restrictive lead plaintiff provisions,[100] and other fundamental changes to the securities litigation process. Although the main goals of the PSLRA were to curb excessive litigation, these goals were balanced with the goals of investor protection, indicating that Congress was seeking to strike a balance between allowing for the punishment of wrongdoers and keeping the judicial system from becoming a routine stop on the path of disgruntled investors.

While the legislation brought about substantial reforms, some believe it did not go far enough. In fact, President Clinton vetoed the bill, citing (among other factors) that he believed it was not expansive enough and did

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93. *Id.*

94. 15 U.S.C. § 78(t)(e).

95. *Id.*

96. *See, e.g.*, Transcript, *The Fifth Driker Forum for Excellence in the Law Corporate Citizenship and the Law, November 8, 2004, Spencer M. Partrich Auditorium, Wayne State University Law School*, 51 WAYNE L. REV. 1015, 1060 (2005) (including commentary by Professor Cramton stating that "the SEC lacks the personnel or resources to go after law firms and has brought only a handful of cases over many years").

97. *See generally* H.R. REP. NO. 104-369 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730. Empirically, however, it is difficult to determine whether the PSLRA has accomplished its goals. In the first decade after its passage, the number of law suits filed has not gone down and the rate of dismissal of cases appears to be statistically unchanged. *See* Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1496-98 (2006) (citing several studies reflecting this conclusion).

98. Choi & Thompson, *supra* note 97, at 1489, 1490-95.

99. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 101, 109 Stat. 737, 737-49.

100. *Id.*

not create enough protection for the investors.[101] Part of his expressed discontent was his concern for the exclusion of the private aiding and abetting cause of action.[102] Thus the legal flux surrounding private aiding and abetting liability was only beginning. Though the natural conclusion from the passage of this legislation is that "Congress enacted [the law] to strengthen investor protection from its post-*Central Bank* state, not to weaken it,"[103] and the view of the legislature and executive was that more liability was necessary under our securities laws than existed before 1995.

D. Enron and Sarbanes-Oxley

Despite the strides that the PSLRA made to protect investors and improve securities laws, it soon became apparent that additional reform was necessary. In 2002, in the wake of the infamous Enron scandal, Congress passed the Public Company Accounting Reform and Investor Protection Act of 2002, which was sponsored by Senator Sarbanes and Representative Oxley ("SOX" or the "Sarbanes-Oxley Act").[104] The Sarbanes-Oxley Act was passed primarily with an eye toward gatekeepers.[105] SOX imposed a new set of requirements on corporations and their accounting firms, complete with an accounting oversight board, disciplinary rules, and reviews.[106]

While SOX primarily targeted accountants, it also reached attorneys.[107] The reason for including attorneys in the law is apparent from

101. President Clinton pointed out that he was not "willing to sign legislation that will have the effect of closing the courthouse door on investors who have legitimate claims. Those who are the victims of fraud should have recourse in our courts." PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995—VETO MESSAGE FROM THE PRESIDENT OF THE UNITED STATES, H.R. DOC. NO 104-150, at 1 (1995).

102. In his veto, President Clinton wrote, "I made clear my willingness to support the bill passed by the Senate with appropriate 'safe harbor' language, even though it did not include certain provisions that I favor—such as enhanced provisions with respect to joint and several liability, *aider and abettor liability*, and statute of limitations." *Id.* (emphasis added).

103. Prentice, *supra* note 68, at 651.

104. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 U.S.C.).

105. Taylor, *supra* note 65, at 379 ("There is no doubt that one of the purposes of SOX is to enhance gatekeeper liability.").

106. SOX created the Public Company Accounting Oversight Board (PCAOB), a new entity created for the purpose of preventing "future Enrons," given broad regulatory and enforcements powers by Congress to facilitate that goal. Sarbanes-Oxley Act §§ 101, 102-105, 15 U.S.C. §§ 7211(a), 7213-15 (2000 & Supp. 2002).

107. Sarbanes-Oxley Act § 307, 15 U.S.C. § 7245 (2002) (defining its purpose as "setting forth minimum standards of professional conduct for attorneys appearing . . . before the [SEC]").

congressional statements made during the passage of SOX.[108] Senator Jon Corzine, who was previously a chief executive at Goldman Sachs, pointed out that executives and accountants routinely work with lawyers, which "means [that] when executives and accountants have been engaged in wrongdoing, there have been some other folks at the scene of the crime—and generally they are lawyers."[109] The resulting Section 307 of the Sarbanes-Oxley Act,[110] and Rule 205 promulgated under it,[111] require attorneys to "report up" the corporate ladder any discovered violations.[112] Under the Rule, an attorney first has to report findings of misconduct to the chief legal counsel of the client, and in the event this person does not provide an "appropriate response" to the reported violation, the attorney must report further "up the ladder" to the company's audit committee or another wholly independent committee, and finally to the board of directors; though, at this point, the lawyers may even report to the SEC.[113]

In addition to the "reporting up and out" requirement, the SEC also implemented an alternative structure in Rule 205. Instead of reporting up, an attorney could report violations to a Qualified Legal Compliance Committee (QLCC) if the particular corporation had established one.[114] The QLCC was designed to serve an independent committee function within the corporation, taking the investigation and monitoring of response to corporate fraud out of the busy hands of the attorneys, and placing it into the hands of an independent committee.[115] Unlike the reporting up and out procedure, a report to the QLCC ends the reporting obligation of the lawyer, and eliminates the requirement that the reporting lawyers monitor the attention given to the report, as well as the need to report out.[116] As a

108. *See, e.g.*, 148 CONG. REC. S6524 (daily ed. July 10, 2002) (statements of Sen. Enzi & Sen. Corzine).

109. 148 CONG. REC. S6524 (daily ed. July 10, 2002) (statement of Sen. Corzine).

110. Sarbanes-Oxley Act § 307, 15 U.S.C. § 7245.

111. Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer, 17 C.F.R. § 205 (2003).

112. *Id.* § 205.3.

113. *Id.*; *see also* Sarbanes-Oxley Act § 307, 15 U.S.C. § 7245 (2002).

114. Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer, 17 C.F.R. § 205.3.

115. The QLCC has to be created by the board of directors of the issuer, and composed of at least two independent directors and at least one audit committee member. It has to be empowered to commence necessary investigations of misconduct and retain necessary experts; and report its findings to the audit committee, the board of directors, and officers. *See id.* § 205.2(k).

116. *Id.* § 205.3(c)(1).

result, a QLCC report relieves the attorney from his or her gatekeeper obligations.[117]

The changes that the Sarbanes-Oxley Act brought about for attorneys were not uncontroversial. The reporting-up requirement triggered much debate on its merits.[118] The QLCC and its utility have also been criticized on several grounds, including its effectiveness and cost.[119] Not the least of these criticisms was presented by attorneys representing corporations, who advised their clients against establishment of such committees.[120] As a result, by September 2005, only "456 entities formed QLCCs. Thus, 97.5% of issuers have not . . . adopted this means of corporate governance . . . ."[121] Putting the merit of these changes aside, SOX demonstrates congressional concern with attorneys' role in securities fraud, and Section 307 was a way to address those worries.

E. The Supreme Court Weighs In Again: *Stoneridge v. Scientific-Atlanta*

Despite these legislative efforts, the key holding of *Central Bank*—the elimination of a private right of action for aiding and abetting—was unaffected. Despite *Central Bank,* in civil actions courts still could (and did) find accountants, attorneys, and other secondary actors liable under the '34 Act's provisions, but only if they were "primary participants" in the defrauding scheme. The circuits split in defining that threshold term.[122] Courts came up with two ways of interpreting the term, namely the "bright

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117. Jill E. Fisch & Caroline M. Gentile, *The Qualified Legal Compliance Committee: Using the Attorney Conduct Rules to Restructure the Board of Directors*, 53 DUKE L.J. 517, 536 (2003) ("[Because the attorney can simply report evidence of misconduct to the QLCC] [t]he attorney is relieved of any obligation to consider the strength of the evidence, the seriousness of the misconduct, or the appropriateness of the issuer's response.").

118. *See, e.g.*, Susan Saab Fortney, *National Symposium on the Role of a Corporate Lawyer: Chicken Little Lives: The Anticipated and Actual Effect of Sarbanes-Oxley on Corporate Lawyers' Conduct*, 33 CAP. U. L. REV. 61, 66 (2004); Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC*, 103 COLUM. L. REV. 1236, 1270-71 (2003); Darlene M. Robertson & Anthony A. Tortora, *Reporting Requirements for Lawyers under Sarbanes-Oxley: Has Congress Really Changed Anything?*, 16 GEO. J. LEGAL ETHICS 785 (2003).

119. *See, e.g.*, Fisch & Gentile, *supra* note 117, at 534-66.

120. *See, e.g.*, Robert Eli Rosen, *Resistances to Reforming Corporate Governance: The Diffusion of QLCCs*, 74 FORDHAM L. REV. 1251, 1277-1304 (2005).

121. *Id.* at 1252. For additional information on this statistic, as well as how it was calculated, see *id.* at 1258-61.

122. *See* COX ET AL., *supra* note 64 (discussing the different standards applied across the circuits).

line" and "substantial participation" tests.[123] In addition, plaintiffs found a solution to the limited scope of liability by pleading a separate concept of "scheme liability," which was embraced by the Ninth Circuit. Scheme liability relied not on the idea of statements made by an attorney that the primary participant analysis rested on,[124] but rather included as a primary violator anyone who "commit[s] a manipulative or deceptive act in furtherance of" a scheme to defraud.[125]

In 2008 however, the Supreme Court decided *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*,[126] the majority opinion of which "has been characterized as the *Roe v. Wade* of securities law and the securities fraud case of the decade."[127] *Stoneridge* effectively rejected scheme liability,[128] holding that for liability to attach there must be a statement or representation made by the defendant.[129]

Unlike *Central Bank*, which did not involve a primary violator, *Stoneridge* had a clear violator in Charter Communications, Inc.

123. The "bright line" test emerged as the majority rule, *see* Taylor, *supra* note 65, at 373, and it requires that the gatekeeper "make" a false or misleading statement in order to qualify as a primary violator. *See, e.g.*, Ziemba v. Cascade Int'l, Inc., 256 F.3d 1194, 1205 (11th Cir. 2001); Wright v. Ernst & Young LLP, 152 F.3d 169, 175 (2d Cir. 1998) ("Anything short [of a misleading statement] is merely aiding and abetting . . . ."); Shapiro v. Cantor, 123 F.3d 717, 720-21 (2d Cir. 1997). Practically, under the "bright line" test a gatekeeper could avoid liability by not making public statements. Taylor, *supra* note 65, at 374 ("As long as actors remain behind the scenes, they cannot be characterized as primary actors and will not incur liability."). The alternative "substantial participation" test was pioneered by the Ninth Circuit and is the less restrictive of the two tests. Under this test, the court looks at gatekeeper behavior to determine whether the gatekeeper has participated in a fraud in a "substantial" way. *See, e.g.*, *In re* Software Toolworks Inc. Sec. Litig., 50 F.3d 615, 628 n.3 (9th Cir. 1994); *In re* ZZZZ Best Sec. Litig., 864 F. Supp. 960, 971 (C.D. Cal. 1994). In the words of the Sixth Circuit, what this means with respect to attorneys is that "while an attorney representing the seller in a securities transaction may not always be under an independent duty to volunteer information about the financial condition of his client, he assumes a duty to provide complete and non-misleading information with respect to subjects on which he undertakes to speak." Rubin v. Schottenstein, Zox & Dunn, 143 F.3d 263, 268 (6th Cir. 1998). The main difference between the tests is that under the "substantial participation" test, a gatekeeper need not be named or have any public statements attributed to her, participating in the creation of misleading or false information is enough. *See* Howard v. Everex Sys., Inc., 228 F.3d 1057, 1061 n.5 (9th Cir. 2000).

124. *See supra* note 123 and accompanying text.

125. Simpson v. AOL Time Warner Inc., 452 F.3d 1040, 1048 (9th Cir. 2006) (internal citations omitted).

126. 552 U.S. 148 (2008).

127. Prentice, *supra* note 68, at 612 (internal quotation marks and citations omitted).

128. *See* Albert J. Matricciani, Jr., Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*: Substitution of Congressional Intent With Caveat Emptor*, 4 J. BUS. & TECH. L. 187, 190 (2009) ("The Court also rejected the application of the 'scheme liability' theory, concluding that reliance based on that theory lacks authority.").

129. 552 U.S. 148 (2008).

("Charter"). Charter was a cable television operator and had been consistently missing Wall Street expectations for cash flow and subscription growth.[130] To combat that reality, Charter engaged in a variety of fraudulent activities in an attempt to meet Wall Street expectations.[131] However, such fraudulent practices proved to be insufficient so Charter turned to Scientific-Atlanta and Motorola, the cable box suppliers for Charter (and the defendants in the *Stoneridge* action), to create a more elaborate scheme.[132] The scheme involved an additional payment by Charter for each cable box, and in return Scientific-Atlanta and Motorola then purchased advertisements with Charter for the total amount of the premium.[133] This allowed Charter, as a result of Scientific-Atlanta's and Motorola's voluntary participation in the scheme, to deceive its auditors and report the advertisement revenue as income.[134] In striking down scheme liability, the Supreme Court held that the key inquiry is whether "any deceptive statement or act [on the part of the defendants had] the requisite proximate relation to the investors' harm."[135] Because the plaintiffs in *Stoneridge* were unaware of the defendants' identity during the fraud, proving reliance was impossible.[136] The decision created a flurry of negative and positive reaction.[137]

What the decision meant for attorneys remained an unanswered question, but it represented a step by the Court that eliminated at least one loophole for bringing actions against gatekeepers that remained after *Central Bank*. In part as a response to this decision, Congress once again proposed an amendment to the '34 Act, this time to explicitly reinstate a private right of action for aiding and abetting liability.[138]

F. Recent Congressional Action

On July 30, 2009, Senator Arlen Specter introduced in Congress S. 1551, the "Liability for Aiding and Abetting Securities Violations Act of

130. *Id.* at 153.

131. *Id.*

132. *Id.* at 153-54.

133. *Id.* at 154.

134. *See id.* at 153, 155.

135. *Id.* at 153, 158-59.

136. *Id.* at 153, 159.

137. *Compare* Franklin A. Gevurtz, *Law Upside Down: A Critical Essay On* Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., 103 NW. U. L. REV. COLLOQUY 448 (2009) (criticizing the decision), *with* Atkins, *supra* note 25, at 20 (celebrating *Stoneridge* as a great triumph).

138. Liability for Aiding and Abetting Securities Violations Act of 2009, S. 1551, 111th Cong.

2009."[139] The bill's purpose is to reestablish a private right of action for aiding and abetting securities fraud. If passed, S. 1551 would amend Section 20(e) of the '34 Act to include language explicitly permitting a private right of action, as follows:

> PRIVATE CIVIL ACTIONS—For purposes of any private civil action implied under this title, any person that knowingly or recklessly provides substantial assistance to another person in violation of this title, or of any rule or regulation issued under this title, shall be deemed to be in violation of this title to the same extent as the person to whom such assistance is provided.[140]

On September 17, 2009 a hearing on this bill was held before the Subcommittee on Crime and Drugs of the United States Senate Committee on the Judiciary. In his opening remarks, Senator Patrick Leahy, the Chairman of the Committee, stated that the focus of the hearing was the Supreme Court misinterpreting congressional intent and the need to hold those who assist frauds accountable.[141] Several prominent academics and legal practitioners testified, with the majority favoring the bill, and the testimony presented different views on both the pending legislation and aiding and abetting liability generally. While the future of the legislation is unclear, its introduction and discussion in Congress indicates the importance of this issue and underscores the need to make room for private aiding and abetting liability in our securities laws.

139. *Id.* The text of this bill has subsequently been introduced as part of other proposed legislation in both the House of Representatives and the Senate, which underscores the importance of this issue. *See, e.g.*, Liability for Aiding and Abetting Securities Violations Act of 2010, H.R. 5042, 111th Cong.; Investors Rights and Corporate Accountability Act of 2009, S. 2813, 111th Cong. While this Note's discussion focuses on S. 1551, the civil aiding and abetting liability provisions in these acts are virtually identical, and the passage of any of these bills would bring the same change to aiding and abetting liability law. To be clear, this Note refers only to S. 1551 in discussing current congressional consideration of this issue because it was the first bill to introduce the issue and it is the only one, at the time of this Note's publication, that has seen activity since being assigned to a committee.

140. Liability for Aiding and Abetting Securities Violations Act of 2009, S. 1551, 111th Cong.

141. *The Liability for Aiding and Abetting Securities Violations Act of 2009: Hearing on S. 1551 Before the Subcomm. on Crime and Drugs of the Comm. on the Judiciary*, 111th Cong. (2009) [hereinafter *Hearing on S. 1551*] (statement of Sen. Patrick Leahy, Chairman, S. Comm. on the Judiciary), *available at* http://judiciary.senate.gov/hearings/testimony.cfm?id=4052&wit_id=2629.

II. THE PARALLAX VIEW: TOO MUCH, OR NOT ENOUGH, LIABILITY ON LAWYERS IS A MATTER OF PERSPECTIVE

As a result of the recent *Stoneridge* decision, financial scandals, and congressional action, private aiding and abetting liability and support for its merits have gained import. This section surveys some of the different views that exist on both sides of the attorney liability debate, and how, or whether, it should attach to lawyers. The proper outcome inevitably depends on one's view of attorneys' roles. Part II.A reviews the arguments on the side favoring liability, usually espoused by academics, investors, and the legislature. Part II.B analyzes the arguments usually made by bar associations, judges, and practicing lawyers[142] for less liability, warning of the detrimental effects that aiding and abetting liability may have on attorneys.

A. Arguments for Liability

Dismissing an action against the law firm that represented Refco,[143] whose partner was later criminally convicted of securities fraud, United States District Judge Gerald Lynch noted that although the defendant firm was well aware of the "round-trip" transactions, he had no choice but to dismiss the case against the law firm in light of *Central Bank* and its progeny.[144] In dicta, Judge Lynch expressed his true concern with the state of the law. He wrote:

> It is perhaps dismaying that participants in a fraudulent scheme who may even have committed criminal acts are not answerable in damages to the victims of the fraud . . . . While the impulse to protect professionals and other marginal actors who may too easily be drawn into securities litigation may well be sound, a bright line between principals and accomplices may not be appropriate.[145]

Echoing that sentiment, during the hearing on the 2009 bill to reinstate aiding and abetting liability,[146] Professor John Coffee pointed out in his

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142. This siding is not surprising, as bar associations represent attorneys and not clients or investors. *See, e.g.*, COFFEE, GATEKEEPERS, *supra* note 51, at 103-04 (stating that "the legal profession continues to resist attempts to impose broader gatekeeping obligations on it"); Coffee, *Can Lawyers Wear Blinders?*, *supra* note 57, at 62 ("The bar associations' efforts to insulate attorneys should not be surprising; after all, their constituency is attorneys, not clients.").

143. *See supra* notes 1-11 and accompanying text.

144. *In re* Refco, Inc. Sec. Litig. (*Refco II*), 609 F. Supp. 2d 304, 314 (S.D.N.Y. 2009).

145. *Id.* at 318 n.15.

146. Liability for Aiding and Abetting Securities Violations Act of 2009, S. 1551, 111th Cong.

testimony that "it is anomalous that one could be criminally liable for aiding a securities law violation, but not civilly liable for the same conduct in a private suit."[147] Particularly because "gatekeepers are critical actors without whom many corporate and securities transactions cannot be completed unless they do give their approval . . . ."[148] Several different theories are proposed in support of holding attorneys to stricter standards, which accompany and support reintroducing the private aiding and abetting liability claim.

1. *The Gatekeeper Argument*

The question on everyone's lips after Enron, and really after many corporate or securities scandals, "where were the lawyers?" has an answer.[149] Lawyers were there, but failed to play the role they were expected to play. Indeed, "[l]aws and precedent intended to deter bad actions were plentiful at the time that Enron and WorldCom imploded . . . ."[150] What was not in place was a deterrence system that ensured lawyers and other gatekeepers would fulfill their gatekeeping function.[151] Several explanations for gatekeeper failure exist,[152] but regardless of which explanation is accurate, gatekeepers are said to have become the weakest link in corporate governance during the 1990s.[153] Supporters of aiding and abetting liability believe it is good practice, if not a necessity, to make certain that functioning laws exist to ensure gatekeepers' effectiveness[154] because "[i]f there is no watchdog," or no effective watchdog, "it cannot bark when the thief comes in the night."[155] Reinstating aiding and abetting liability makes gatekeepers more effective by increasing the likelihood of meaningful deterrence as well as investor confidence. Furthermore, reintroducing such liability will add an additional set of monitors over

147. *Hearing on S. 1551*, *supra* note 141 (statement of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia Law School), *available at* http://judiciary.senate.gov/pdf/09-09-17%20Coffee%20Testimony.pdf.

148. *Id.* at 4.

149. *See* Lincoln Sav. & Loan Ass'n v. Wall, 743 F. Supp. 901, 920 (D.D.C. 1990); Langevoort, *supra* note 15, at 76; Robertson, *supra* note 15, at 3.

150. Taylor, *supra* note 65, at 385.

151. COFFEE, GATEKEEPERS, *supra* note 51, at 6 (stating that gatekeepers became the weakest link in corporate governance in the 1990s).

152. For a discussion of gatekeeper failure, see COFFEE, GATEKEEPERS, *supra* note 51, at 55-70. Among the explanations for gatekeeper failure are the theory of decline in deterrence, increase in managerial pressure, and the market bubble theory. *Id.* at 55-56.

153. COFFEE, GATEKEEPERS, *supra* note 51, at 7.

154. For a discussion of gatekeepers' role, see *supra* Part I.A.2.

155. COFFEE, GATEKEEPERS, *supra* note 51, at 34.

gatekeepers in the form of private actors, in addition to the finite resources of the SEC.

But does the argument for stronger gatekeeper incentives necessarily reach lawyers? A gatekeeper, once established in its role, has to be an independent professional. Proponents of imposing aiding and abetting liability on attorneys argue that while other gatekeepers can certainly fulfill the gatekeeper role, attorneys are uniquely positioned because of the professional obligations imposed on them by the rules governing their conduct.[156] Furthermore, attorneys "have reputational capital and are often in a position to block or delay transactions or governmental approvals that are vital to their corporate clients."[157] Attorneys' roles are therefore critical not only because they can function as an additional gatekeeper,[158] but also because of their legal qualifications and the role they have in document preparation.[159]

A question of balancing attorneys' dual roles—those of advocate and gatekeeper—complicates the gatekeeper argument for imposing private aiding and abetting liability. Proponents of imposing liability on gatekeepers and attorneys counter these concerns by arguing that while attorneys have a duty to zealously represent their clients, corporate lawyers differ dramatically from litigators.[160] This difference allows corporate attorneys to be well positioned to serve as gatekeepers both because of their role in corporate transactions and because they are not bound by the same adversarial structures as the litigators.[161] Outside corporate lawyers are also unique gatekeepers, and cannot be replaced by the corporation's in-house counsel, because in-house attorneys are inherently more likely to feel

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156. For a discussion of these professional obligations, see *supra* Part I.A.

157. John C. Coffee, Jr., *Regulating the Lawyer: Past Efforts and Future Possibilities: The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1298 (2003) [hereinafter Coffee, *Attorney as Gatekeeper*].

158. Additional gatekeepers are necessary to increase the chance of overcoming situations where the corporation might try to conceal material evidence of fraud from gatekeepers. COFFEE, GATEKEEPERS, *supra* note 51, at 34 (discussing how Enron intentionally kept independent gatekeepers at a distance).

159. "To commit most complex corporate frauds, companies need legal help. The trick is to make everything look legitimate, and lawyers are critical to that task." Koniak, *supra* note 118, at 1239.

160. COFFEE, GATEKEEPERS, *supra* note 51, at 193 ("In truth, the world of the corporate lawyer probably more closely borders on that of the accountant than that of the litigator/advocate.").

161. For a discussion of the differences between corporate attorneys, litigators, and why the difference between them matters, see *id.* at 192-93.

beholden to, and constrained by, the corporation due to their role within its structure.[162]

In addition to the outside corporate lawyer's unique position in transactions, lawyers are also well equipped for their gatekeeper function because a set of rules already exists imposing ethical obligations on attorneys that are consistent with what should be expected from a gatekeeper.[163] Stricter liability standards therefore do not interfere with the duties attorneys already face and would only improve attorneys' functionality as gatekeepers, which has been weakening over the past decade.[164]

2. *The Deterrence Argument*

A closely related argument for restoring aiding and abetting liability concerns the increase in fraud deterrence which would result from increased liability. Deterrence has recently been recognized as the only sound benefit of private litigation and the best rationale for securities class actions.[165] Lawyers' and other gatekeepers' deterrent function is unique in that they find themselves as both the party to be deterred and the deterrent at the same time. On the one hand, they need to be disincentivized from participating in frauds, yet on the other hand they need to be encouraged to take action to keep corporate fraud from occurring, even if in a minimal way.

Deterrence in the gatekeeper context should be easier to implement. Unlike corporations, gatekeepers "can be more easily deterred than the primary violator because they do not stand to receive the same gain as the primary violator."[166] Consequently, if the prize is not as great as that of the primary violators the risk of losing one's reputational capital by way of losing or being named in a private aiding and abetting suit may not be worthwhile. Because gatekeepers effectively stand at the gate to the

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162. *Id.* at 195; Sung Hui Kim, *The Banality of Fraud: Re-Situating the Inside Counsel as Gatekeeper*, 74 FORDHAM L. REV. 983, 996-99 (2005) ("To understand why an inside lawyer makes unethical choices . . . ask her where she sits on the organizational chart . . . .").

163. *See supra* Part I.A.1.

164. *See* COFFEE, GATEKEEPERS, *supra* note 51, at 7.

165. *See, e.g.*, Matthew C. Stephenson, *Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies*, 91 VA. L. REV. 93, 103-04 (2005) (discussing extensive scholarship that indicates that private actions are recognized by the courts for their deterrent abilities, rather than as means for compensation or redress).

166. *Hearing on S. 1551*, *supra* note 141 (statement of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia Law School), *available at* http://judiciary.senate.gov/pdf/09-09-17%20Coffee%20Testimony.pdf.

transaction and can prevent a potential harm even if the primary violators would want to proceed with a fraudulent transaction, deterring the gatekeepers from facilitating such conduct should deter the fraud as a whole.[167] Thus the deterrence effect emerges. And, "[a]lthough [such] private enforcement has its flaws, it is entrepreneurially motivated and thus will pursue secondary participants with predictable zeal."[168]

3. The Compensation Argument

Another argument for reintroducing aiding and abetting liability is rooted in compensation theory. Traditionally, private actions under Rule 10b-5 aim to accomplish investor compensation, deterrence, or both.[169] The compensation argument is generally criticized, and the criticism is now widely embraced on the grounds that shareholders are not better off with private rights of action because such actions merely result in a form of pocket-shifting: although an investor is compensated, the payment in class actions under Rule 10b-5 often comes from the very pool of assets of which he or she is a shareholder.[170]

Proponents of gatekeeper liability cite compensation as a clear possibility in actions against gatekeepers. Because aiding and abetting actions do not target the company the investor is a shareholder of, or which has other shareholders that do not deserve to suffer as a result of the pocket-shifting problem, the resulting recovery would not come as a consequence of pocket-shifting, and therefore avoids the widely criticized pocket-shifting problem.[171] Reinstating aiding and abetting liability for secondary actors is therefore said to allow shareholders to be truly compensated. With aiding and abetting liability, investors would likewise

167. *Id.* ("[I]f the gatekeepers are adequately deterred, they will block transactions, even though the primary violator would willingly proceed with them. Thus, to give these gatekeepers immunity from private liability is to abandon what logically is the most efficient technique for deterrence . . . .").

168. *Id.* at 5.

169. *See* Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1307-25 (2008) (tracing the history of 10b-5 and its purpose).

170. *See, e.g.*, John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1558 (2006); Janet Cooper Alexander, *Rethinking Damages In Securities Class Actions*, 48 STAN. L. REV. 1487, 1503-04 (1996).

171. *Hearing on S. 1551*, *supra* note 141 (statement of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia Law School), *available at* http://judiciary.senate.gov/pdf/09-09-17%20Coffee%20Testimony.pdf ("Pocket-shifting wealth transfers do not occur. Thus, in a very real sense, recoveries from secondary participants uniquely provide compensation to shareholders, while recoveries from issuer corporations may seldom do so.").

be compensated even if the corporation that was the primary perpetrator of fraud is unable to pay.[172] Because gatekeepers would be exposed damages in cases where malfeasance or nonfeasance occurred, shareholders would be able to recover damages in cases where the corporation goes bankrupt, enters receivership, or faces other similar financial conditions that would render plaintiff recovery from the primary actor impossible.

4. The Client Protection Argument

Another argument in support of imposing aiding and abetting liability on gatekeepers stems from the understanding of who the lawyers' client actually is in business transactions.[173] Undoubtedly, the client is the corporation as a whole and not the independent management members or other individual agents. This understanding makes it apparent that the imposition of aiding and abetting liability and measures a gatekeeper may take to avoid liability, such as disclosing suspicion of corporate fraud, in fact protect the company and can therefore be viewed as beneficial to the client. Thus, the benefit of increased client protection is another reason for reintroducing the private aiding and abetting right of action.

Within this understanding, client loyalty, in the sense of duties owed to the management (rather than the company as a whole), has to take the back seat; otherwise, "the lawyer [would be required] to remain silent in the face of conduct that was both unlawful and harmful to her organizational client."[174] Preventing lawyers from interfering to "prevent lawless harm to the client would affront all the values that give dignity to the professional role."[175] While this notion may not seem surprising, the attorney-client relationship can distort the perception of who the client is in the eyes of corporate attorneys. Because it is generally the management that stands at the center of the relationship, it is the management who dictates the extent of business given to the lawyer. Thus, the client in the day-to-day course of an attorney's practice is the management, and not the faceless corporate entity.[176] Reintroducing aiding and abetting liability would streamline the client protection that can get lost due to this practical attorney-client

172. For instance, investors of companies like Enron would have a viable course of recovery from actors who did not initiate the fraud, but who assisted it and did not take any actions to stop it.

173. Simon, *supra* note 38, at 1464-70 (discussing the concept of client loyalty and how that depends on the identity of the client).

174. *Id.* at 1468.

175. *Id.*

176. See *supra* Part III.A for a solution that should help avoid this problem.

dynamic and therefore carries great benefit to the organizational client as well as to the investors and the public.

B. The Anti-Liability Side: "Clients [W]ant [C]hampions, [N]ot [C]haperones"[177]

Those opposed to aiding and abetting liability tend to disagree that attorneys play a gatekeeper role, provide explanations for securities fraud that do not lend themselves to resolution through the implementation of aiding and abetting liability, or warn about potential consequences for attorneys that may outweigh the marginal benefits of liability. For example, Peter Gruenberger, a partner from the New York law office of Weil, Gotshal & Manges, noted during a panel discussion at an American Bar Association's symposium:

> Merely to be named in an SEC or private plaintiff proceeding often spells disaster (real or imagined) for the lawyer or firm involved. Most lawyers, even more so than their clients, believe that the charge is never-forgotten headline news, that the rebuttal (his defense), if any, receives one-half a column on page 30, and that the retraction (even in the form of victory) gets a box at the bottom of page 56 (which no one reads).[178]

In an area where client marketing is an endless cycle, either by way of results or direct marketing, a stain on a lawyer's reputation can be very detrimental to that lawyer's business and ability to act as the very gatekeeper, a result which proponents of such liability encourage.[179] The sections below address the myriad of other reasons why attorney liability for aiding and abetting should not be restored.

1. The Strict Reading of Statutory Text Argument

The position of the Supreme Court is that the statutory language of Section 10(b) has never explicitly established aiding and abetting liability or even a private right of action.[180] Congress knew how to write the language for such liability and could have created a section in the '34 Act that would directly address the fate of aiders and abettors. But Congress neither included a private right of action for aiding and abetting liability in

177. Coffee, *Can Lawyers Wear Blinders?*, *supra* note 57, at 73.

178. A.B.A., LAWYERS AND ACCOUNTANTS ON TRIAL: PROFESSIONAL LIABILITY 48 (Charles H. Wilson & James R. Phelps eds., 1974).

179. Painter & Duggan, *supra* note 34, at 179 ("Even a law suit that never results in a judgment can have a potentially ruinous effect on a lawyer's reputation and career.").

180. *See* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008); Central Bank of Denver, N.A. v. First Interstate Bank of Denver, 511 U.S. 164, 167-77 (1994).

the original text of the law, nor amended the '34 Act to explicitly impose such liability for private plaintiffs in the course of its many amendments to the Act.[181] Private aiding and abetting liability is therefore a form of judicial activism which first expanded and then contracted the scope of such liability,[182] until the *Central Bank* decision. In response to the volume of such litigation, *Central Bank* ended aiding and abetting liability as a cause of action.[183] Although counterarguments regarding the original intent of the drafters of the '34 Act exist,[184] the peculiar refusal to amend the '34 Act to add a private right of action for aiding and abetting liability remains a steady reminder that Congress, for one reason or another, did not find such liability desirable.

2. The Attorney-Client Privilege/Confidentiality Argument

Attorney-client privilege and confidentiality concerns offer some of the biggest reasons to oppose aiding and abetting liability.[185] If aiding and abetting liability was reestablished and an attorney's only saving grace would be to make evidence of fraud public (either directly or through the SEC), the very goal of attorney-client privilege would be undermined, if not the privilege itself.[186] Attorney-client privilege was created to facilitate communication between an attorney and client, allowing for an extra level of candor that would promote more thorough fact-gathering, efficiency, and better quality representation by the lawyer.[187] The argument against imposing aiding and abetting liability on lawyers posits that if such liability were reestablished, clients would simply avoid disclosing certain information that the lawyer would be required or able to report. This chill to the attorney-client conversation could lead to more difficult and less

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181. Current attempts notwithstanding. *See supra* Part I.F.

182. *Central Bank*, 511 U.S. at 169-70.

183. *Id.* at 177-78.

184. *See supra* note 80 and accompanying text.

185. *See, e.g.*, *Attorney as Gatekeeper*, *supra* note 157, at 1307 ("The most important argument against imposing gatekeeper obligations on securities attorneys is that attorneys may be less able to communicate freely with their clients."); Robert A. Desilets, Jr., *The Model Rules of Professional Conduct and the Securities Attorney: Confidentiality Confusion and the Need for Change*, 23 CAP. U. L. REV. 611, 612 (1994) (discussing confidentiality issues in attorney representations involving securities and calling for more protection of confidentiality rules); Katerina P. Lewinbuk, *Let's Sue All The Lawyers: The Rise of Claims Against Lawyers For Aiding and Abetting a Client's Breach of Fiduciary Duty*, 40 ARIZ. ST. L.J. 135, 170 (2008); *Report of the New York City Bar Association Task Force on the Lawyer's Role in Corporate Governance*, 62 BUS. LAW. 427 (2007).

186. *Attorney as Gatekeeper*, *supra* note 157, at 1307.

187. *See supra* Part I.A.1 (discussing the privilege and the rules governing such attorneys' confidentiality duties).

effective client representation, in addition to significantly less effective gatekeeper monitoring as it would be much harder for lawyers to detect and prevent fraud.

3. The Floodgates of Litigation Argument

Another key argument against reintroducing aiding and abetting liability involves the fear of flooding the court system with litigation. Adding any cause of action typically poses this risk, and the prevalence of bounty-hunter attorneys further increases the likelihood of this result.[188] Concern over excessive litigation and abuse of the legal system was one of the key reasons for the passage of the PSLRA.[189] Although the PSLRA addressed problems with stricter litigation rules and other processes, aiding and abetting liability could still carry with it a risk of, at a minimum, an increase in the number of filed complaints, even if the additional complaints do not evolve into actual lawsuits. Allowing private aiding and abetting actions opens up the possibility of suits not only against every attorney or firm that represents a given primary actor, but also any and all other gatekeepers and other actors who may have aided and abetted the primary actors. Consequently, many more actors could suffer the harm of being taken to court, and the court system itself could suffer from the burdens of this new litigation if aiding and abetting liability is restored without recognizing this concern.

4. The Bubble Theory and Increased Costs for Gatekeeper Services Arguments

Opponents of aiding and abetting liability argue that although gatekeeper failure may have occurred, it is explained by the market "bubble" theory, and that any such failure is self-correcting upon the end of the "bubble." According to the theory, gatekeepers fall victim to so-called "market euphoria" and unwillingly lose their functionality during an economic "bubble."[190] For opponents of liability, the solution is largely to wait for the market to self-correct. Although gatekeepers are more likely to fail during a "bubble," after the "bubble" bursts, gatekeepers regain their power and therefore no external action to the general market activity is

188. *See Hearing on S. 1551*, *supra* note 141 (statement of Robert J. Giuffra, Jr., Partner, Sullivan & Cromwell LLP), *available at* http://judiciary.senate.gov/pdf/09-09-17%20Giuffra%20Testimony.pdf.

189. *See supra* note 97 and accompanying text.

190. *See* Coffee, *Understanding Enron*, *supra* note 55.

necessary.[191] Gatekeepers' return to serving their function is a natural product of the burst. Consequently, for purposes of gatekeeper functionality, whether aiding and abetting liability exists is largely irrelevant. Investors would not sue during a bubble, and attorneys would not be as vigilant as the law would like because they would not foresee the catastrophe they are supposed to prevent. Because the harm is invisible, there would not be an impetus to protect the public against it.

If aiding and abetting liability existed, however, gatekeeper liability would increase, and gatekeepers would seek to offset the cost of potential liability and risk by increasing their client fees. Concurrently, increased liability could increase professional insurance costs, which would be passed on to clients in the form of higher fees. There are those who argue that this is not true, however, because gatekeepers already build the cost of this risk into their fees due to already existing uncertainty regarding the scope of liability.[192]

The many arguments that exist both for and against liability, offered by both those who view lawyers as gatekeepers and those that believe their role should focus on client representation rather than investor protection, present a number of factors to consider in determining what role a lawyer has to play and what changes, if any, must come to the legal landscape guiding their conduct.

III. IN SEARCH OF THE MIDDLE: WHAT ROLE SHOULD A LAWYER REALLY PLAY, AND WHAT LEVEL OF LIABILITY MEETS THE GOALS OF FAIRNESS?

The medical profession's rule of "first, do no harm" is perhaps one of the most well known professional principles, and one that is echoed in the Hippocratic Oath that all medical doctors practicing in the United States take.[193] Although lawyers in this country do not take a similar ancient

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191. *See generally* Alan Greenspan, Chairman, Fed. Reserve Bd., Remarks at the Stern School of Business, New York University: Corporate Governance (Mar. 26, 2002), http://www.federalreserve.gov/boarddocs/speeches/2002/200203262/default.htm.

192. Taylor, *supra* note 65, at 389 ("Under the current regime, gatekeepers face uncertainty as to their potential liability. That uncertainty must be compensated for, meaning that gatekeepers already build that cost into their fees.").

193. The text of the Hippocratic Oath itself does not include these precise words, but it does embody this maxim in its pledge to neither over-treat nor under-treat the patient. For a discussion of the origin of the maxim, see Michael K. Gottlieb, *Executions and Torture: The Consequences of Overriding Professional Ethics*, 6 YALE J. HEALTH POL'Y L. & ETHICS 351, 376 (2006).

pledge,[194] they too enter their profession with a certain set of obligations implying that lawyers' professional position will not be used to do harm.[195] Yet, most lawyers enter law school speaking about justice, but leave talking about jobs,[196] and proceed in their careers talking about profits and successes.[197] Corporate lawyers in particular are first and foremost in a fee-generating business. In the course of their careers their focus shifts, perhaps justifiably, from their duties as officers of the court to the goal of achieving financial and professional success.

Inevitably, due to their role in business transactions, corporate lawyers find themselves connected to almost all major frauds.[198] However, as facilitators in most transactions,[199] lawyers are also capable of being effective gatekeepers and could play a key role in stifling fraud, either through client counseling or disclosure.[200] Furthermore, because many reforms at the corporate board level have already taken place, proposed solutions at this juncture should focus on gatekeepers, including lawyers, rather than their client companies. In 2004, in a book stressing the need for greater gatekeeper monitoring, Professor John Coffee wrote that

> [n]o doubt further improvements [at the board level] are possible, but it is increasingly questionable whether any further movement in the direction of increased independence can improve firm performance. . . . [M]ost of what can conceivably be done to make the board more active and more independent has already been done. Yet, independent boards proved

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194. Unlike doctors, lawyers also do not face the same expectation of providing critical, quasi-social service. Some states, however, have imposed oaths on their attorneys, requiring them to attest that they will counsel their client with the aim of promoting justice. For a discussion of this development, see Susan D. Carle, *Lawyers' Duty to Do Justice: A New Look at the History of the 1908 Canons*, 24 LAW & SOC. INQUIRY 1, 16-17 (1999).

195. *See supra* Part I.A.1 (discussing the ethical expectations imposed on lawyers).

196. Rhode & Paton, *supra* note 31, at 37.

197. In fact, law firms are ranked based on their profits-per-partner, rather than actual legal success, ethical accomplishments, or other statistics. *See, e.g.*, *Am Law 100*, AM. LAW., May 1, 2009, *available at* http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202430073120 (describing its firm ranking methodology, and listing firm profits and profits-per-partner as the focal criteria).

198. *See supra* Part II; *see also* Rhode & Paton, *supra* note 31, at 9 ("[S]crutiny of lawyers' conduct is equally critical. Too many members of the legal profession were part of the [Enron] problem, rather than the solution."); Simon, *supra* note 38, at 1453 (noting that lawyers have been major participants in recent corporate disclosure and tax evasion controversies).

199. *See, e.g.*, *Hearing on S. 1551*, *supra* note 141 (testimony of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia Law School), *available at* http://judiciary.senate.gov/pdf/09-09-17%20Coffee%20Testimony.pdf.

200. *See supra* Part II.A.1.

> unable to detect or prevent the wave of financial irregularities that surfaced in 2000 to 2002.[201]

With respect to gatekeepers, several systemic improvements are possible. Gatekeepers face less liability than they did before 1994,[202] and one of the fundamental deterrents that keeps gatekeepers from participating in fraud—protection of reputational capital—is believed to no longer function adequately.[203]

Particularly in the legal profession, the dichotomy between firms' and attorneys' interests in client representation makes reputational capital protection less effective.[204] Although firms do aim to protect their reputation and a loss of one client in the name of reputation would not be problematic to a firm, it is the individual partner responsible for the client, who is generally in the best position to know if anything fraudulent occurs and the one who suffers consequences if the fraud materializes. To the individual attorney in the new, tournament-style firm structure,[205] the loss of one big client could potentially spell career-ending consequences, creating a Hobson's choice: the lawyer could report and lose both her job and the client; or, not report and potentially risk being implicated in the fraud and losing her job.[206] Although signs of questionable client conduct may or may not result in fraud liability and loss of employment, reporting the client to authorities would most certainly result in losing that client to another firm. With only one choice having certain devastating consequences, the decision not to report fraud becomes easier to understand. But, if the fraud is discovered, and the client's attorney is implicated, the consequences to this lawyer's firm are less severe than to the individual lawyer. Although these scandals are certainly detrimental to a firm's practice, individual attorneys' falls have historically been survived by their law firms without fatal damage to the firm's reputation.[207] Thus,

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201. COFFEE, GATEKEEPERS, *supra* note 51, at 7-8.

202. Gatekeeper liability all but ended in 1994 with the Supreme Court's ruling in *Central Bank*, which eliminated aiding and abetting liability. *See supra* Part I.C.

203. *See, e.g.*, COFFEE, GATEKEEPERS, *supra* note 51, at 7-8 (discussing gatekeepers' position as the weakest link in fraud prevention).

204. *Id.* at 9.

205. For a discussion of law firms' evolution towards tournament-style practice where competition and "eat what you kill" structure prevail, see generally MARC GALANTER & THOMAS PALAY, TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM (Univ. of Chi. Press 1991).

206. *See id.*

207. The law firm involved in the Refco scandal still exists, and came out of the scandal virtually unscathed. *In re* Refco, Inc. Sec. Litig. (*Refco II*), 609 F. Supp. 2d 304 (S.D.N.Y. 2009). Additional firms that have survived big scandals include firms such as Vinson & Elkins LLP and Kirkland & Ellis, both of whom were advising parties involved in the Enron

to the extent that a firm's survival is concerned, there is less incentive to create rules that would make attorneys more vigilant because the firm may have the option of distancing itself from the particular individual lawyer who allowed fraud to occur.

Consequently, the goal is to find a balance where attorneys are not forced to forego their right to be good business people and generate profits, yet where their pursuit of these goals does not come at the expense of the public good. A solution would have to encompass a dual set of rules: it would have to protect attorneys by providing meaningful avenues when they encounter possible fraud and sheltering them from being targets of litigation; it would also need to impose liability on those lawyers who choose not to take appropriate action. Part III.A proposes a solution that takes account of these considerations. Part III.B provides a survey of some of the suggested solutions that exist in the current literature and outlines how the proposed solution raises fewer concerns.

A. Proposed Solution

To address the complex set of problems that aiding and abetting liability presents, this Note proposes a statute amending the '34 Act. The proposed statute would reinstate a private right of action for aiding and abetting securities fraud and would direct the SEC to create a special Oversight and Review Committee (the "Committee") for the purpose of investigating reported fraud. The statute would also create a safe harbor for reporting gatekeepers, allowing for reports of evidence of fraud or material misrepresentation to the Committee, which would free the reporting person from aiding and abetting liability in civil actions.

The proposed amendment would add the following provision to Section 20(e) of the '34 Act:

> PRIVATE CIVIL ACTIONS—For purposes of any private civil action implied under this title, any person who knowingly or recklessly provides substantial assistance to another person or persons in violation of this title, or in violation of any rule or regulation issued under this title, shall be

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scandal. Another example is Milbank, Tweed, Hadley & McLoy LLP, whose partner John Gellene was sentenced to a prison term following his representation of Bycurus in its bankruptcy which resulted in a scandal. Milton C. Regan notes in the epilogue of his book on the plight of John Gellene that Milbank has become "one of the most profitable law firms in the country." MILTON C. REGAN, JR., EAT WHAT YOU KILL 353 (Univ. of Mich. Press 2004).

> deemed to be in violation of this title to the same extent as the person to whom such assistance is provided.[208]
>
> (1) EXCEPTION—Any person who has made a good faith report of evidence of fraud or material misstatement or omission to the Oversight and Review Committee shall not be deemed in violation of this title for purposes of private civil actions. This exception shall not apply to actions brought by the Commission[209] and shall not be construed to apply to any other section under this title.

The proposed statute should also contain a section creating the Committee and should include the following language:

> (a) OVERSIGHT AND REVIEW COMMITTEE—No later than 180 days since the enactment of this Act, the Commission shall establish, in consultation with the American Bar Association, an Oversight and Review Committee, as described in this section, for the purpose of review and investigation of reported evidence of securities fraud, and shall promulgate rules governing reports of such evidence and Committee operation.
>
> (b) COMMITTEE MEMBERSHIP—The Committee shall consist of five (5) members, appointed from among prominent individuals of integrity and reputation who have a demonstrated commitment to the interests of investors and the public. The Commission shall appoint two (2) members independently, two (2) members in consultation with the American Bar Association, and one (1) member with consent of the four appointed members.
>
> (c) COMMITTEE DUTIES—The Committee shall—
>
> > (1) conduct private investigations of reported evidence of fraud or material misstatements or omissions and shall—
> >
> > > (A) inform reporting persons of results of Committee investigations conducted pursuant to such reporting persons' reports;
> > >
> > > (B) recommend any action or forbearance that the Committee deems appropriate to reporting persons as a result of the completed investigation; and

208. This language has already been brought for consideration before Congress as part of the Liability for Aiding and Abetting Securities Violations Act of 2009, S. 1551, 111th Cong., and other proposed bills.

209. This language is drafted to comply with the defined terms provision of the current '34 Act, which defines "Commission" as the Securities and Exchange Commission. Securities Exchange Act of 1934 § 3, 15 U.S.C. § 78(C) (2006).

(C) report any findings of fraud or material misstatements or omissions, if such are made, for investigation and relevant action to the appropriate division of the Commission.

(2) perform such other duties or functions as the Committee (or the Commission, by rule or order) determines necessary or appropriate to improve the quality of securities fraud investigation and prevention, or otherwise to carry out its duties, in order to protect investors or further the public interest.

(d) COMMITTEE POWERS—The Commission shall grant the Committee all powers necessary to execute the Committee's duties in accordance with this title.

1. Strengths of the Proposal

The proposed statute strikes a balance between two competing interests: protecting the investing public, and protecting attorneys[210] from the floodgates of litigation. The statute explicitly reinstates a private right of action, which serves the investing public by deterring gatekeeper participation in fraud and serves the attorneys by providing a safe harbor for reporting persons, shielding them from private aiding and abetting suits upon filing such a report. To further the goal of improving investor protection, the proposed statute directs the SEC to create a special Oversight and Review Committee, whose purpose will be primarily to accept reports from attorneys and other gatekeepers[211] and investigate their substance. Law firms and lawyers need only report evidence of material misrepresentation or suspected fraud, allowing the Committee to focus on determining whether actual fraud has occurred, and whether a report to the SEC's Enforcement Division is necessary.[212] This structure recognizes the fact that fraud determination is often a difficult task, one that for gatekeepers may sometimes even be impossible.[213]

The Committee is designed to be composed of members whose relevant experience would provide protection to both the investors' and gatekeepers' interests. The SEC would be best suited to provide the

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210. Although the discussion in this Note focuses primarily on attorneys, the proposed statute is drafted to encompass all potential aiders and abettors of securities fraud.

211. Such other gatekeepers may include, for example, auditors, accountants, brokers, and managers. While the proposed statute is designed to focus primarily on lawyers, it is does not exclude reporting by other gatekeepers.

212. Although attorneys' (or other gatekeepers') obligations to the public would end when the report is made, the reporting party would be expected to cooperate to a reasonable extent with the Commission through the course of the investigation.

213. *See* Langevoort, *supra* note 15 (describing how attorneys can fall victim to cognitive blindness to their client's indiscretion and be unable to discern red flags when they appear).

Committee with members familiar with fraud evaluation and the regulatory structure governing securities law, because of its experience with fraud investigation and prosecution and independence from any one class of gatekeepers.[214] The American Bar Association's role in nominating members to the Committee, in turn, is designed to provide members who have additional legal perspectives and different experience that SEC nominees may not have. These members would be able to diversify the evaluation process and ensure that attorneys' and other gatekeepers' positions are recognized and taken into account during evaluations and recommendations made by the Committee. Although members of other gatekeeper professions are not explicitly included in the statutory language, they are not prevented from serving on the Committee and could be selected by either the SEC or the ABA. Because determining the presence or absence of fraud is primarily a legal question, there is less likely to be a need for the involvement of other professionals. Members of other professions, however, are still likely to be involved in the work of the Committee when their expertise becomes necessary during particular evaluations.

The proposed statute recognizes the risk of excessive litigation. The proposed statute includes a safe harbor provision to address the possibility that restoring private aiding and abetting liability would increase frivolous or excessive law suits. This provision provides that any party who has reported evidence of fraud or material misrepresentation to the Committee cannot be held liable for aiding and abetting securities fraud in private actions. While the language may initially appear to be redundant, since any actor reporting fraud is unlikely to meet the statutory requirement for aiding and abetting liability, it is included to ensure that reporting parties avoid the harms that come with merely being named in a law suit.[215] The statutory safe harbor is designed to eliminate the need for a legal battle at the motion to dismiss stage and function not only by shielding lawyers from liability, but also by saving them a trip to the courthouse.

The proposal also makes the choice currently faced by attorneys less difficult. Today, an attorney's decision to report suspected fraud comes at the risk of breaching confidentiality and waiving attorney-client privilege.[216] In the current system, when an attorney is wrong and the

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214. COFFEE, GATEKEEPERS, *supra* note 51, at 78 (pointing out the SEC's reputation for being one of the most aggressive market regulators in the world).

215. *See supra* notes 176-77 and accompanying text.

216. *See* Lisa H. Nicholson, *A Hobson's Choice for Securities Lawyers in the Post-Enron Environment: Striking a Balance Between the Obligation of Client Loyalty and Market Gatekeeper*, 16 GEO. J. LEGAL ETHICS 91, 129-36 (2002).

suspected fraud does not in fact rise to the level where disclosure is permitted, an attorney is not protected by professional rules. The attorney may then face allegations of breaching confidentiality and waiving attorney-client privilege, which carry professional consequences.[217] The proposed statute mitigates this risk.

The Committee's investigative role is designed to be confidential. As such, any investigations the Committee carries out would be done privately. The Committee would essentially be a de facto extension of the issuer's counsel during the investigation. The investigation would only be announced publicly if there are concrete findings of fraud, and at that point, the Committee would be required to report the fraud to the Enforcement Division of the SEC for investigation and prosecution, which, in turn, would cause the issuer to disclose the investigation in their public filings. This report from the Committee to the Enforcement Division does not contradict attorneys' professional principles because such an outside report by the Committee would be made when a clear risk of economic harm emerges, and an attorney herself is permitted to report such findings.[218] But although the proposed statute seeks to protect confidentiality, confidentiality should not be an impediment to the imposition of liability as courts routinely imposed liability on attorneys for aiding and abetting before *Central Bank* without letting attorney-client privilege or confidentiality stand in the way or suffer.[219]

The safe harbor provision and the proposed statute generally also do not make reporting mandatory. A law firm has the choice not to report any evidence of fraud at all. Although the law firm would then be exposed to liability in an amount unlimited by statute, it retains full control over its reporting and is free to use its own judgment as to what course of action is appropriate. The statute merely encourages law firms to report evidence of fraud as such reporting would drastically reduce their liability exposure.

In addition to protecting attorneys from harassing litigation, the importance of the safe harbor provision also lies in its incentive to monitor and report fraud. By allowing attorneys to avoid private action suits, the safe harbor provision operates to encourage vigilant monitoring of clients and reporting to the Committee, which would displace the responsibility of fraud investigation by shifting it to the Committee. Firms are likely to choose to report fraud because the benefits are so significant. However, since a

217. *See supra* Part I.A.1. *See generally* Nicholson, *supra* note 216.

218. *See supra* Part I.A.1. *See generally* Nicholson, *supra* note 216, at 129-36.

219. *See, e.g.*, Schiltz, *supra* note 59, at 83. For a contrary view, highlighting the need for the preservation of attorney-client privilege, see generally Atkins, *supra* note 25; Desilets, *supra* note 185.

report to the Committee carries with it a heightened risk of disintegrating the client relationship, heightened monitoring and investigation of the client on the attorney's part, along with perhaps a client discussion, will likely precede any such reports. As a result, evidence of fraud would be analyzed more frequently on both the counsel and Committee levels by individuals with specialized knowledge. More fraud would likely be detected at an earlier stage and more specialized determinations of fraud can be found. Moreover, such frequent review should have some deterrent effect on the issuers as well because the increased likelihood of discovery should make it more difficult to engage in fraud.

Consequently, the proposed statute grants to investors some recourse via private right of action against aiders and abettors, but not a carte blanche for litigation. Concurrently, the proposed statute increases fraud detection and investor protection before there is any need for them to go to court.

2. Weaknesses of the Proposal

Like any solution, this proposal carries with it certain risks. Reintroducing a private right of action for aiding and abetting liability may lead to less representation or more expensive representation by lawyers in the type of transactions that could lead to liability. Although the safe harbor provision is designed to counteract any such decrease in representation, it is plausible that some lawyers would rather forego practicing in this area than bear the higher monitoring and investigative burden. However, this change is likely to, at most, return us to the pre-*Central Bank* era's representation and fees, which has not been reported as an era of scarce or overly expensive representation.

Failure to report evidence of fraud to the Committee may marginally increase the costs of the fraud on the attorneys. Under the proposed scheme, attorneys who knowingly aid and abet the fraud will not only face liability, but would also face increased reputational damages. A firm is likely to suffer more from a law suit in a case where a safe harbor was available because the safe harbor functions as a safety mechanism, which would allow attorneys to report evidence or suspicion of fraud not sufficient to warrant open disclosure, or disclosure to the SEC's Enforcement Division. Because a report to the Committee carries few, if any, negative consequences to the reporting firm, failure to make such a report would raise questions about the firm's involvement in the fraud and its judgment.

The creation of the Committee and the reporting safe harbor provision could run the risk of failing to achieve the objectives of the proposal by simply failing to serve its function. This could happen, for example, if reports to the Committee occur, but the Committee does not detect the fraud any earlier than it would have been discovered otherwise. This outcome would be particularly troubling because attorneys and other gatekeepers would have presumably satisfied the reporting condition and would be free from civil liability, but the fraud would play out nonetheless. Apart from a pessimistic disposition towards the SEC, predicting this consequence would also have to presuppose that the Committee would not in fact have the necessary tools to conduct these investigations effectively. The Committee, however, is purposefully designed to be established by the SEC, which retains a great deal of authority to restructure the Committee if necessary. While it is possible that the Committee may not function flawlessly in the beginning, it is designed to be easily improved by additional SEC action and rules.

There may also be concerns that the Committee might simply mirror the functions of the Enforcement Division, and therefore will not add any meaningful expertise beyond a second layer of investigation. However, while the Enforcement Division operates on tips from the public and evidence it uncovers, the Committee would function in a more advisory capacity when the evidence of fraud is less certain and confidentiality is important. Additionally, due to their confidential nature, investigations performed by the Committee, unlike investigations performed by the Enforcement Division, would not have to be reported by the issuers in their public filings. The Committee would seek to capture reports of fraud before any substantial findings have been made, namely, in cases where the attorneys believe there is likely fraud, but their client either has not produced an explanation or has produced misleading explanations.

Because Committee investigations are designed to be conducted privately and confidentially, there could also be some concern that investors would not have the means of discovering whether a law firm has made a report to the Committee. Because even the mere naming of a firm or a lawyer in a suit bears consequences,[220] ideally, the system would ensure that law suits against reporting law firms are stopped before they reach the courthouse and not merely at the motion to dismiss stage. Potential plaintiffs and the plaintiffs' bar are likely to welcome such a system, as it would save them the costs of bringing an action. The ability of the plaintiff to learn whether a report has been made would depend on when the plaintiff files suit. Generally, a law suit is commenced either when the fraud has already been discovered or when the issuer's stock experiences a suspicious drop, but no concrete evidence of fraud has yet

220. *See supra* Part II.B; *see also supra* notes 176-77 and accompanying text.

surfaced. In the former cases, either an inquiry to the Committee or Enforcement Division, or even an inquiry with the issuer's counsel itself, could be an available step to potential plaintiffs and may not be objectionable from the perspective of confidentiality. The analysis in cases where investors want to sue on the basis of only a suspicious drop in stock price would be more complex. Requests for information directed at the Committee or the would-be defendant gatekeeper would have to receive specialized treatment in order to preserve confidentiality.

Another concern is that the proposed system would either create too much, or not enough, reporting. With respect to over-reporting, lawyers and law firms may choose to avail themselves of the safe harbor provision both in cases of true fraud suspicion and in cases of merely possible misconduct to ensure maximum liability protection. As a result, there is a possibility of overwhelming the Committee with irrelevant reports, making it less efficient. Generally, over-reporting is unlikely to occur because any report to the Committee would carry with it a risk of terminating or straining the client relationship. Consequently, a law firm is unlikely to risk such loss of business in cases where there is little or no evidence of misconduct. The over-reporting problem can only occur if an industry-wide practice of routine reporting emerges and the clients no longer have a choice to "counsel-shop" for law firms who would not make such routine reports. But, even if the over-reporting problem was to emerge, the SEC can promulgate rules establishing threshold standards for reports, or other measures to cure the problem because the rules surrounding the Committee's operation can be modified by the SEC. Furthermore, as time goes on, the Committee is likely to become adept at recognizing which reports have merit and which reports are made as part of a firm's routine practice, if such practices do emerge.

A less likely, though possible, outcome would be under-reporting. If routine, industry-wide over-reporting does not develop, firms face two risks in the proposed structure: the risk of liability exposure and the risk of losing the client to a firm that does not report. Presuming that information on a firm's Committee reporting practice becomes known,[221] a firm with strict reporting practices is likely to have the same effect on clients as would reporting to the SEC in the system we have today. A client would

221. This, however, is unlikely due to the confidential nature these reports would have, and the fact that these reports are designed primarily as a safe harbor for gatekeepers. Providing reporting statistics on particular law firms either by the firms or the Committee is likely to expose, or at least lead to deduction of, the identity of the corporations that are suspected by the gatekeepers of engaging in fraud. This would go against the purpose of the reporting scheme.

simply prefer not to retain a firm with a reputation for frequent and/or unnecessary reporting.[222] Thus, to attract the most clients, unless an industry-wide practice of routine reporting emerges, firms might be disincentivized to report evidence except where they believe the risk of exposure to aiding and abetting liability is high. This, however, bears less consequence for the investing public because the private right of action will be available to investors to recover from any aiders and abettors. But, on balance, under-reporting is unlikely both because of the liability shield that the safe harbor provision offers and the other related incentives such as decreased professional insurance premiums.[223]

B. Existing Proposals

Numerous proposed treatments of the gatekeeper liability issue exist, but they fall short of capturing all of the proposed statute's advantages. Existing proposals include returning to the pre-*Central Bank* structure, reintroducing aiding and abetting liability but with concrete caps on plaintiff compensation, imposing stricter professional rules, as well as less radical solutions that might work within the current system, such as instituting a system where private actions are allowed, but only with SEC approval.[224]

*1. Return to pre-*Central Bank

One of the key proposals, both in its stand-alone form and as it functions in conjunction with other proposed measures, is a legislative re-introduction of private aiding and abetting liability with language similar to that of the PSLRA.[225] The bill currently pending in Congress embodies this view[226] and proposes language substantially similar to the PSLRA. One of the key advantages of amending the '34 Act in this manner and effectively returning to pre-*Central Bank* aiding and abetting law would be that lower courts have continued to use substantially the same phrasing in "articulating the elements of aiding and abetting under Section 10(b)"[227]

222. The client's investors are likely to query such a choice, and themselves draw conclusions of suspiciousness in the corporation's practice.

223. Some academics argue that if a disclosure requirement is accompanied by a statutory safe harbor for attorneys who comply with the requirement, professional insurance premiums would in fact go down. *See* Painter & Duggan, *supra* note 34, at 274.

224. *See generally* Rose, *supra* note 169.

225. Taylor, *supra* note 65, at 384-86.

226. Liability for Aiding and Abetting Securities Violations Act of 2009, S. 1551, 111th Cong.

227. Taylor, *supra* note 65, at 386 & n.113.

before *Central Bank* was decided. As a result of this similarity in language, there would be sufficient precedent to adjudicate precise standards, eliminating the risk of uncertainty in judicial interpretation.[228]

While this language alone may meet the needs of the investing public, it does not adequately protect gatekeepers from exposure to excessive litigation. This Note adopts the statutory language currently considered by Congress[229] and, therefore, captures the predictability advantage along with the additional benefit of restoring liability, but it also goes a step further. The statutory scheme proposed in this Note provides benefits beyond merely reintroducing aiding and abetting liability, as the proposed structure takes account of the risk of excessive litigation and protects gatekeepers from being exposed to unwarranted lawsuits.

2. Restoring a Private Right of Action with a Cap on Liability

Professor John Coffee[230] expressed concern that restoring the private right of action would result in excessive damage awards during the Congressional committee hearing on the proposed bill to reinstate aiding and abetting liability.[231] Professor Coffee recommended reinstating liability with a ceiling on damages for gatekeeper defendants so that gatekeepers' liability exposure is tempered by something more than just proportional liability of Section 21D(f) of the '34 Act.[232] Professor Coffee provided a five-point list of reasons for such a ceiling on gatekeeper liability: (1) gatekeepers do not need to face multi-billion dollar liability exposure in light of their marginally small gains compared to primary defendants; (2) some gatekeepers are professionals in highly concentrated services and the failure of one firm could disrupt the markets; (3) a ceiling on liability would allow smaller firms to obtain liability insurance; (4) a limit on damages would avoid unfair susceptibility to collapse by firms due to acts of select individual members; and (5) such a cap would safeguard firms from extortion settlements under the threat of billion dollar liability.[233] To serve these ends, Professor Coffee recommended that "[t]he

228. *See id.* at 386.

229. For the currently considered language, see Liability for Aiding and Abetting Securities Violations Act of 2009, S. 1551, 111th Cong.

230. *Hearing on S. 1551*, *supra* note 141 (statement of Professor John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia Law School), *available at* http://judiciary.senate.gov/pdf/09-09-17%20Coffee%20Testimony.pdf.

231. *Id.*

232. *Id.*

233. *Id.* at 9.

goal should be to devise a penalty that is sufficiently painful to deter, but not so large as to threaten insolvency."[234]

As a solution, Professor Coffee proposed a cap on liability in the amount of $2,000,000 for a natural person and $50,000,000 for a public company.[235] Professor Coffee also suggested that companies' liability should be subject to a percentage structure, with liability being either 10% or another percentage of (1) the defendant's annual income over the last three years; (2) the defendant's net worth as determined by its most recent audited financial statements; or (3) the defendant's market capitalization at the end of its last fiscal year.[236] This cap on liability would expose defendants in an aiding and abetting action to a potential damages award high enough "to induce the parties to settle for an amount beneath the ceiling,"[237] but would not put them out of business.

A different approach to capping liability was proposed by Professor Frank Partnoy. Professor Partnoy suggested a liability cap based not on the revenue of the firm, but on proportional share of damages incurred by the plaintiffs.[238] Professor Partnoy's suggested approach would embody a strict liability scheme with the scope specified by the professionals in an agreement with the issuers, and a minimum specified percentage set forth by Congress.[239]

While both versions of the cap ensure that private actions do not bankrupt the gatekeepers, there are certain advantages that this scheme does not capture which this Note's proposal might successfully achieve. For instance, plaintiffs are unlikely to forego filing a suit merely because there is a cap on damage awards. Thus, the number of law suits would not decrease. Furthermore, although a cap on damages helps make sure that gatekeeper firms are not left in financial ruin, it does not provide any reputational protection to the gatekeepers, particularly those that may not have participated in the fraud and just fell victim to eager litigation. This Note's proposal, by contrast, works to encompass solutions to these problems.

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234. *Id.* at 10.

235. *Id.*

236. *Id.*

237. *Id.*

238. *See* Frank Partnoy, *Barbarians at the Gatekeepers?: A Proposal for a Modified Strict Liability Regime*, 79 WASH. U. L.Q. 491, 540 (2001) (proposing that gatekeepers face strict liability with proportional damages).

239. *Id.*

3. Professional Rules Solution

A different proposed solution is to have a professional rule that would require lawyers to report misconduct.[240] Such a rule has already been proposed by the American Bar Association but did not pass the vote.[241] If reporting was mandatory, lawyers would presumably have no choice but to report evidence of fraud or material misrepresentation, and would take away the client's opportunity to shop for more lenient counsel.[242] This would not be a novel approach. Both England and Canada place greater weight on a lawyer's obligation as an officer of the court than the United States.[243] However, although mandatory reporting could accomplish certain deterrence goals, it would only provide recourse through actions by the bar. Furthermore, attorneys may or may not be able to determine that their client is engaging in fraud,[244] making the reporting requirement a heavy burden to bear, particularly in light of the difficulty attorneys can face in evaluating client behavior.[245] This Note's proposal is superior to a professional rules solution because it places evaluation of possible fraud in expert hands, but leaves open the possibility of a private suit. Thus it is more capable of meeting the needs of both the attorneys and the investing public.

4. Other Proposed Solutions

Several other proposals exist. One suggests that professional rules alone will not be sufficient to remedy gatekeeper failures, and that, at least as far as lawyers are concerned, there is a need to overhaul the incentive structure rather than merely impose rules.[246] There is also a suggestion to create an

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240. *See generally* DAVID LUBAN & DEBORAH L. RHODE, LEGAL ETHICS 359-65 (3d ed. 2001).

241. *Id.*

242. *See* DEBORAH L. RHODE, IN THE INTERESTS OF JUSTICE: REFORMING THE LEGAL PROFESSION 200 (2000).

243. Legal Profession Act, S.B.C. 1998, c. 9, s. 3 (Can.); LAW SOCIETY OF BRITISH COLUMBIA, PROF'L CONDUCT HANDBOOK, CANONS OF LEGAL ETHICS ch. 1 (2010); LAW SOCIETY OF UPPER CANADA RULES OF PROF'L CONDUCT R. 4.01(1)(2), 4.06(1); CHRISTINE PARKER, JUST LAWYERS 88-95 (1999); Rhode & Paton, *supra* note 31, at 32 (citing Christopher J. Whelan, *Ethical Conflicts in Legal Practice: Creating Professional Responsibility*, 52 S.C. L. REV. 697, 700-02 (2001)).

244. *See supra* note 15 and accompanying text.

245. *Id.*

246. *See, e.g.*, Lawrence A. Cunningham, *Beyond Liability: Rewarding Effective Gatekeepers*, 92 MINN. L. REV. 323-25 (2007) (discussing how psychology suggests that an incentive structure would be better than a liability structure at fostering effective gatekeeping); Rhode & Paton, *supra* note 31, at 25 ("[N]ew rules may not be sufficient to address root causes of the Enron problem if they fail to alter underlying reward structures.").

accountability review board, similar to the one created for accounting professionals in the United States and Canada,[247] to review questionable activity by lawyers. Yet, another solution is to allow for a private right of action in cases approved by the SEC, by making the plaintiff seek the SEC's approval in pursuit of lawsuits.[248] Another proposal would allow actions against secondary actors, but require aiders and abettors to merely disgorge the profits made from the fraud.[249] While all of these proposals might improve the current system if adopted, they do not strike the same balance between competing interests that this Note's proposal is designed to achieve.

Although there could be many ways to restructure the incentive system to encourage attorneys and other gatekeepers to better fulfill their obligation to the investing public, such a system may be more effective if liability remains part of the equation. This Note's proposal captures the incentive structure advantage but it also allows for an outside check on professionals who fail to report misconduct. Although the predominant motivation for reporting is likely to be a firm's desire to avoid liability, part of the incentive to report may be a form of reputational advantage that a firm may gain from a successfully thwarted fraud. Certainly there can still be room for additional incentives, but they can work along with the proposed statutory scheme.

The proposed independent review board may achieve similar results as the Committee, but there may be concerns in creating a review board similar to the PCAOB, in light of the constitutional issues that the PCAOB endured;[250] in addition, a stand-alone entity would not have the benefits of the SEC's expertise, resources, and monitoring. Additionally, this solution would focus on mandating behavior rather than creating incentives for it. The proposal creates a structure within which attorneys are incentivized, but not required to make reports. The ultimate decision of reporting or facing liability remains with them.

Allowing for a private right of action only with the SEC's permission would unduly burden the SEC, as many cases would have to be reviewed

247. Rhode & Paton, *supra* note 31, at 27-28 (suggesting that a review board created for attorneys, similar to the Public Company Accounting Oversight Board (PCAOB) in the U.S. or the Canadian Public Accountability Board, could increase accountability in the legal profession).

248. *In re* Refco, Inc. Sec. Litig. (*Refco II*), 609 F. Supp. 2d 304, 319 n.15 (S.D.N.Y. 2009); *cf.* Rose, *supra* note 169.

249. *Hearing on S. 1551, supra* note 141 (statement of Professor Adam C. Pritchard, Frances and George Skestos Professor of Law, University of Michigan), *available at* http://judiciary.senate.gov/pdf/09-09-17%20Pritchard%20Testimony.pdf.

250. *See* Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 130 S. Ct. 3138 (2010).

and either approved for filing or rejected. By comparison, the system proposed in this Note only imposes the Committee's functions on the SEC, and these burdens are unlikely to become extensive. Because the Committee's purpose is to evaluate evidence of fraud, rather than to serve as the clearing house for litigation, the Committee's job would be limited to review of cases where a suspicion of fraud arises. The number of such cases and the number of potential reporting persons is always going to be significantly smaller than the number of potential plaintiffs seeking to obtain permission to sue. Furthermore, although such an alternative presents many of the same advantages that this Note's proposal offers, such as a check on excessive litigation and gatekeeper protection from reputational harm, it does not capture the same deterrence advantages of this Note's proposal.

Lastly, allowing for mere disgorgement of profits, much like other liability cap alternatives, may not result in sufficient deterrence. The risk of aiding and abetting a fraud would be limited to the profits derived from the transaction. The possibility that the fraud would not be discovered, or discovered in time, may make aiding and abetting a fraud more likely. The unlimited liability of this Note's proposal, on the other hand, provides a stronger disincentive to aid and abet a fraud and is thus better suited for deterring gatekeeper misconduct.

CONCLUSION

Attorneys, by way of their professional status, are both counsel to their clients, owing a high degree of loyalty to the clients, and corporate gatekeepers, owing oversight duties to the investing public. As officers of the court and members of an ethics driven profession, lawyers should not be required to pick which of these two roles to play. Therefore, it is appropriate to impose on an attorney or law firm, a degree of responsibility for cases where the attorney's unique professional position does harm. Restoring civil aiding and abetting liability would provide a check on attorneys assisting their clients' misconduct. This liability, however, should not exist in a form where it can be routinely used by investors as compensation for their losses.

To protect attorneys from excessive litigation, while at the same time allowing investor recovery in cases where attorneys facilitated a fraud, this Note outlined a proposed statute that would reinstate a private right of action for aiding and abetting securities fraud with a reporting safe harbor provision. The proposal reinstates aiding and abetting liability, allowing recourse to investors, but at the same time, creates a safe harbor provision that would allow attorneys to shield themselves from law suits. The safe harbor provision, if utilized, facilitates discovery of fraud and will help detect fraud in addition to safeguarding the lawyers. Furthermore, because the proposed statute does not feature a cap on liability, attorneys will have an incentive to report evidence of fraud and will be deterred from assisting clients' misconduct.