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The Private Action Against a Securities Fraud Aider and Abettor: Silent and Inactive Conduct

Clyde A. Billings, Jr.

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NOTES

The Private Action Against a Securities Fraud Aider and Abettor: Silent and Inactive Conduct

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I. INTRODUCTION

Liability for aiding and abetting a violation of the antifraud provisions of the federal securities acts¹ recently has received considerable attention in the courts. The specific issue has been whether a cause of action for aiding and abetting based solely on the silence and inaction of the alleged aider and abettor can survive

1. The Securities Act of 1933, 15 U.S.C. § 77a (1970), and the Securities Exchange Act of 1934, 15 U.S.C. § 78a (1970), are the only securities statutes considered in this Note, and discussion will center primarily upon § 10(b) of the 1934 Act, 15 U.S.C. § 78j (1970), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1975), promulgated thereunder. Analysis of the issues under Rule 10b-5 is analogous to the situations presented in the other antifraud sections, § 17(a) of the 1933 Act, 15 U.S.C. § 77q (1970), and § 14(e) of the 1934 Act, 15 U.S.C. § 78n (1970). Emphasis is placed upon private civil actions for damages.

motions to dismiss² for failure to state a claim upon which relief can be granted and for lack of jurisdiction over the subject matter. Federal courts of appeals in seven circuits and a district court in an additional circuit, either directly or in dictum, have reached quite different results.³

A theory of liability based upon the passive conduct⁴ of an aider and abettor initially appeared in a 1963 opinion⁵ that failed to discuss or dispose of the theory. Three years later in *Brennan v. Midwestern United Life Insurance Co.*⁶ another federal district court

2. FED. R. CIV. P. 12(b)(6), (1).

3. See Part III.B. *infra*. Over the last 3 years more than 2 dozen cases have been decided on this issue. The major cases in each circuit that have reached the aiding and abetting issue include: 2d Circuit—*Lowenschuss v. Kane*, 520 F.2d 255 (2d Cir. 1975); *Fischer v. New York Stock Exch.*, 408 F. Supp. 745 (S.D.N.Y. 1976), *commented in* 29 VAND. L. REV. 880 (1976); 3d Circuit—*Rochez Bros. v. Rhoades*, 527 F.2d 880 (3d Cir. 1975); *Landy v. Federal Deposit Ins. Corp.*, 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); 5th Circuit—*Woodward v. Metro Bank*, 522 F.2d 84 (5th Cir. 1975); 6th Circuit—*SEC v. Coffey*, 493 F.2d 1304 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975); 7th Circuit—*Hochfelder v. Ernst & Ernst*, 503 F.2d 1100 (7th Cir. 1974), *rev'd*, 96 S.Ct. 1375 (1976) (holding limited to issue of negligence in a Rule 10b-5 suit); *Hochfelder v. Midwest Stock Exch.*, 503 F.2d 364 (7th Cir.), *cert. denied*, 419 U.S. 875 (1974); *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969); 8th Circuit—*Anderson v. Francis I. duPont Co.*, 291 F. Supp. 705 (D. Minn. 1968); 9th Circuit—*Grimes, Hooper & Messer, Inc. v. Pierce*, 519 F.2d 1089 (9th Cir. 1975); *Strong v. France*, 474 F.2d 747 (9th Cir. 1973); *Wessel v. Buhler*, 437 F.2d 279 (9th Cir. 1971); *Green v. Jonhop, Inc.*, 358 F. Supp. 413 (D. Ore. 1973); 10th Circuit—*Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731 (10th Cir. 1974); *Zabriskie v. Lewis*, 507 F.2d 546 (10th Cir. 1974).

4. Throughout this Note the term "passive conduct" will be used interchangeably with "silence and inaction" to indicate the conduct of the aider and abettor that is actionable under the recent cases. Of course, at some point in time there was a connection involving active conduct between the aider and abettor and the primary wrongdoer. This conduct may have consisted of a normal business relation, a friendly chat, or some other non-actionable event. At that time, the potential aider and abettor was not liable to plaintiff because an element of the aiding and abetting cause of action was missing: either no primary violation had occurred, the "in connection with" requirement was lacking, or no duty was then owing to plaintiff. See Part IV.A. *infra*. Time passed, after which the aider and abettor did nothing to plaintiff. The aider and abettor did have some contact, not with plaintiff, but with the primary wrongdoer, and plaintiff seeks to base his cause of action on this link in the chain of events. Plaintiff thus seeks to hold the aider and abettor liable for the wrongful acts of another, which allegedly would not have resulted in harm to plaintiff had not the aider and abettor failed to speak or act. This theory of liability is not based upon Rule 10b-5(2). There a material "omission" is actionable only when prior statements made by defendant (active conduct) would otherwise be misleading.

5. *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963). In addition to a general allegation of conspiracy in count one of the complaint, plaintiffs claimed that defendants "aided, abetted, and assisted the illegal distribution . . . by failing to take the necessary disciplinary action against abusive conduct and practices of which they knew or should have known." *Id.* at 28. Despite this claim, the court did not otherwise mention or dispose of it.

6. 259 F. Supp. 673 (N.D. Ind. 1966) (motion to dismiss), 286 F. Supp. 702 (N.D. Ind. 1968) (trial on merits), *aff'd*, 417 F.2d 147 (7th Cir. 1969) (finding of both silence and affirmative acts), *cert. denied*, 397 U.S. 989 (1970).

accepted the theory, stating that an aider and abettor could give the requisite assistance or encouragement to the primary wrongdoer, an element of the aiding and abetting cause of action,⁷ merely by failing to take action. Finding affirmative conduct by the defendant, the Seventh Circuit affirmed⁸ without reaching the merits of the district court's holding on the question of liability solely for silence and inaction.

The issue remained dormant until the Ninth Circuit in 1971 stated that no cause of action for aiding and abetting existed under Rule 10b-5⁹ against a person whose conduct consisted solely of inaction.¹⁰ In the last two years a flood of cases reaching varying results on the issue has been reported, and in January 1976 a judge in the Southern District of New York specifically held in *Fischer v. New York Stock Exchange*¹¹ that liability can attach solely on the basis of a failure to act. Although the potential application of the aiding and abetting offense is very broad, certain classes of defendants, including accountants,¹² attorneys,¹³ broker-dealers and under-

7. One of the elements of the aiding and abetting cause of action is termed "substantial assistance or encouragement." See Parts IV.A.(3) & IV.B. *infra*. The *Brennan-Fischer* line of cases indicates that "silence and inaction" is sufficient to satisfy this element.

8. 417 F.2d 147 (7th Cir. 1969).

9. 17 C.F.R. § 240.10b-5 (1975). The Rule states:

It shall be unlawful for any person, directly or indirectly . . .

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

10. *Wessel v. Buhler*, 437 F.2d 279 (9th Cir. 1971).

11. 408 F. Supp. 745 (S.D.N.Y. 1976). *Contra*, *Seligson v. New York Produce Exch.*, 394 F. Supp. 125 (S.D.N.Y. 1975).

12. Accountants not only are part of the self-regulating mechanism of the securities industry with an accompanying duty of disclosure, see *Touche, Niven & Co.*, 37 S.E.C. 629, 670-71 (1957); Part IV.A.(3) *infra*, but also are subject to their own professional standards—generally accepted accounting principles and generally accepted auditing standards—which require extensive disclosure. See *Strother, The Establishment of Generally Accepted Accounting Principles and Generally Accepted Auditing Standards*, 28 *VAND. L. REV.* 201 (1975). After *Hochfelder* negligence consisting of the breach of a duty of inquiry is no longer actionable, but actual knowledge and reckless conduct apparently are. If an accountant has knowledge of a securities fraud and fails to disclose, then liability should ensue.

Landy v. Federal Deposit Ins. Corp., 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974), and *Fischer v. Kletz*, 266 F. Supp. 180 (S.D.N.Y. 1967), indicate that when the accountant steps out of his role as an independent, certified public accountant and performs some function for a corporation that is not required to be disclosed to the public, and the accountant does not know of an intended fraudulent use of his figures, no liability will result.

13. The attorney is a key figure, necessary to the proper functioning of the statutory scheme of the securities acts. As the drafter of prospectuses, corporate advisor, board mem-

writers,¹⁴ stock exchanges,¹⁵ corporate officers and directors,¹⁶ and banks,¹⁷ are more likely to be charged with aiding and abetting due to their relationship to the securities market and the attendant duties to the public.

This Note will examine the origins of the aiding and abetting cause of action and the development of a theory of liability based solely upon passive conduct. After an examination of the elements of the cause of action and defenses, a proposed definition of "aiding and abetting" will be offered. The effect of the recent Supreme

ber, and as in-house counsel, the attorney obtains much confidential information. When this information contains evidence of fraud and when the attorney participates in the securities transaction, liability should result.

An example of participation that will lead to liability is the drafting of an opinion letter on the basis of which unregistered securities will be sold. *SEC v. Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973) (negligence is the standard of conduct in an SEC enforcement suit). Commentators have argued that "[u]nless an attorney has a pre-existing duty of care which runs to . . . the investing public, . . . he should not be held liable . . . for negligence in the performance of his duties." Daley & Karmel, *Attorneys' Responsibilities: Adversaries at the Bar of the SEC*, 24 EMORY L. J. 747, 778 (1975). See also Doty, *Application of the Antifraud Provisions of the Federal Securities Laws to Exempt Offerings: Duties of Underwriters and Counsel*, 16 B.C. IND. & COM. L. REV. 393 (1975).

14. *Landy v. Federal Deposit Ins. Corp.*, 486 F.2d 139 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974), the primary case dealing with broker-dealers, required a "special relationship" between the broker and plaintiff. The broker-dealer is a pivotal connection in the securities markets, and although he possesses certain duties and must obey rules such as the New York Stock Exchange's "Know Your Customer Rule" (NYSE Rule 405), he must be allowed to proceed with his general business operations. Absent knowledge of the fraud, no liability should be imposed merely because the broker-dealer was trading in the securities. But see *SEC v. First Securities Co.*, 463 F.2d 981 (7th Cir.), cert. denied, 409 U.S. 880 (1972).

On the subject of underwriters' liabilities see Doty, *supra* note 13.

15. See, e.g., *Fischer v. New York Stock Exch.*, 408 F. Supp. 745 (S.D.N.Y. 1976), commented in 29 VAND. L. REV. 880 (1976); Comment, *Exchange Liability for Improper Enforcement of Its Constitution and Rules: The Investor's Right of Action Under the Securities Exchange Act of 1934*, 24 EMORY L.J. 865 (1975). The problem in holding an exchange liable for nondisclosure is that the exchange has a conflicting duty to assist in the rehabilitation of financially troubled member firms; disclosure to the public of disciplinary action taken by the exchange undermines public confidence in the firm and impedes rehabilitation of the firm. In a different context the *Woodward* court recognized a similar conflict of duties. See text accompanying notes 135-36 *infra*.

16. Joffe, *The Outside Director: Standards of Care Under the Securities Laws*, 24 EMORY L.J. 669 (1975); Comment, *The Liability of "Outside" Directors as Aiders and Abettors Under Rule 10b-5*, 28 SW. L.J. 391 (1974); see *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973). Officers and directors also have potential liability as control persons under § 20(a) of the 1934 Act.

17. Passive aiding and abetting is possible with respect to a bank, but the standard of culpability is unclear. See *Woodward v. Metro Bank*, 522 F.2d 84 (5th Cir. 1975); *Grimes, Hooper & Messer, Inc.*, 519 F.2d 1089 (9th Cir. 1975); *Odette v. Shearson, Hammill & Co.*, 394 F. Supp. 946 (S.D.N.Y. 1975); *Rosen v. Dick*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,786 (S.D.N.Y. 1974). See also *H.L. Federman & Co. v. Greenberg*, 405 F. Supp. 1332, 1337 n.1 (S.D.N.Y. 1975).

Court decision *Ernst & Ernst v. Hochfelder*¹⁸ upon aiding and abetting liability, the scienter requirement, and the duties owed by potential aiders and abettors will be discussed. Treatment of aiding and abetting by the Federal Securities Code¹⁹ also is mentioned.

II. BACKGROUND OF AIDING AND ABETTING LIABILITY

A. Origins

The federal securities acts mention "aiding and abetting" in only three places: twice in a 1960 amendment²⁰ to the Investment Advisers Act of 1940²¹ and once in a 1964 amendment²² to the Securities Exchange Act of 1934.²³ The latter amendment deals with the powers of the Securities Exchange Commission (SEC) to censure, limit the activities of, or revoke the registration of a broker-dealer who willfully aids and abets the violation by any other person of the provisions of the 1933, 1934, or 1940 Acts. None of these provisions is relevant to a private civil action for aiding and abetting.²⁴ Prior to 1960 several bills²⁵ dealing with aiding and abetting had been introduced to amend section 20(b) or 21(e) of the 1934 Act, but none was enacted. The primary intent of Congress apparently was to strengthen the *injunctive* power of the SEC²⁶ and not to create a statutory private cause of action.

18. 96 S.Ct. 1375 (1976); see notes 32-33, 58, 78-79, 119, 147-48, 155, 190-91 *infra* and accompanying text.

19. The Federal Securities Code is an American Law Institute project under the direction of Reporter Louis Loss. The first Tentative Draft appeared in April 1972, and additional drafts have appeared annually thereafter. The goal of the writers is to combine and revise the seven statutes dealing with federal securities law into one unified code.

20. 15 U.S.C. §§ 80b-3(e)(5), 9(e) (1970). The SEC is given the power in § 80b-3(e)(5) to censure, deny registration to, or suspend any investment adviser who has aided, abetted, counselled, commanded, induced, or procured a violation of the 1933 or 1934 Acts by anyone else. Section 80b-9(e) gives the SEC the power to bring an action to enjoin violations of the Act by aiders and abettors. The SEC has implemented these sections and the section mentioned in note 22 *infra* through its Rules of Practice. 17 C.F.R. § 201.2(e) (1975). Under Rule 2(e) anyone who willfully violates or who willfully aids and abets a violation of any provision of the federal securities laws, rules, or regulations may be denied the privilege of appearing before the SEC, suspended, or censured. 17 C.F.R. § 201.2(e)(1), (e)(3)(i)(b), (e)(3)(iii).

21. 15 U.S.C. § 80b (1970).

22. 15 U.S.C. § 78o(b)(5)(E) (1970). This section gives the SEC remedial power over broker-dealers for willful aiding and abetting.

23. 15 U.S.C. § 78a (1970).

24. The Federal Securities Code contains sections imposing civil liability for aiding and abetting. ALI FED. SEC. CODE §§ 1419(b), 1704(b); see note 195 *infra*.

25. Bills were introduced in 1956, 1957, and 1959-1960. *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 677-80 (N.D. Ind. 1966); 1 L. LOSS, SECURITIES REGULATION 205-06 n.80 (2d ed. 1961) [hereinafter cited as Loss].

26. *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 678-79 (N.D. Ind. 1966).

Aiding and abetting, therefore, is an implied cause of action that depends upon a finding by the court of a primary violation by another.²⁷ The primary violation, involving fraudulent conduct, separately would form the basis of a private civil action, also by implication, under Rule 10b-5.²⁸ *Kardon v. National Gypsum Co.*²⁹ was the first decision supporting an implied cause of action for a violation of Rule 10b-5.³⁰ The court's decision rested on several different grounds: (1) the tort law concept that violation of a statute makes the actor liable if the intent of the statute was to protect the interest of another as an individual and if the legislature intended the interest invaded to be protected;³¹ (2) the reasoning that the legislature expressly would have denied the right to a civil action if it had so intended; and (3) a breach of contract theory—section 29(b), making contracts in violation of a securities statute void, implies a right to sue the violator. The Supreme Court recently has recognized and endorsed the implied private right of action under Rule 10b-5,³² although it expressly reserved the question whether an aiding and abetting action may be based upon the Rule.³³ No court has addressed directly the issue of an implied cause of action for aiding and abetting; rather, defendant's conduct is spoken of in terms of "secondary" liability, and the court proceeds to analogize to criminal law, tort law, or both.³⁴

The earliest reported case³⁵ dealing with a cause of action for

27. See *Iroquois Indus., Inc. v. Syracuse China Corp.*, 417 F.2d 963 (2d Cir. 1969). An independent violation of the securities laws by the "primary wrongdoer" is an element of the aiding and abetting action. See Part IV.A. *infra*.

28. For an extensive discussion of implied civil remedies under the securities laws, see 3 Loss, *supra* note 25, at 1623, 1682, 1757-71; 6 Loss, *supra* note 25, at 3864-98 (Supp. to 2d ed. 1969). See generally Note, *Implying Civil Remedies from Federal Regulatory Statutes*, 77 HARV. L. REV. 285 (1963).

29. 69 F. Supp. 512 (E.D. Pa. 1946) (motion to dismiss), 73 F. Supp. 798 (E.D. Pa. 1947) (trial on merits); see Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 NW. U.L. REV. 627 (1963) [hereinafter cited as Ruder, *Civil Liability*].

30. 2 A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10b-5, at § 8.5(542) (1975) [hereinafter cited as BROMBERG].

31. "The disregard of the command of a statute is a wrongful act and a tort." *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 513 (E.D. Pa. 1946). The source of the court's statements is the RESTATEMENT OF TORTS § 286 (1939).

32. *Ernst & Ernst v. Hochfelder*, 96 S.Ct. 1375 (1976); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971).

33. *Ernst & Ernst v. Hochfelder*, 96 S.Ct. 1375, 1380 n.7 (1976). Also, the Supreme Court has granted certiorari in *Chris Craft v. Bangor Punta*, 426 F.2d 569 (1970), *cert. granted*, 44 U.S.L.W. 3564 (U.S. April 6, 1976).

34. *E.g.*, *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975); *Landy v. Federal Deposit Ins. Corp.*, 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

35. *SEC v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Cal. 1939), *rev'd on other grounds*,

aiding and abetting analogized to the criminal law.³⁶ The SEC was seeking an injunction against aiders and abettors of a section 17(a) violation. The court stated that such a suit "sounds in fraud, and is similar in many respects to a criminal prosecution."³⁷ Citing precedent for enjoining aiders and abettors of a criminal offense in violation of section 17(a), the court could find no reason why the same rule should not apply in an injunctive proceeding to restrain violations of the same statute and enjoined the defendants.

In the course of its opinion the court referred to 18 U.S.C. § 550 [now § 2], which states:

(a) Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal.

(b) Whoever willfully causes an act to be done which if directly performed by him or another would be an offense against the United States, is punishable as a principal.³⁸

Commentators have taken quite different stances on discussions of this section. Professor Bromberg, while mentioning that the aiding and abetting concept is borrowed from criminal law, states that "it is now federally codified as 18 U.S.C.A. § 2(a)."³⁹ Professor Ruder, on the other hand, says it is highly unlikely that this criminal code section will be used *directly* to imply a private right of action.⁴⁰ In practice, however, most courts have used and apparently will continue to use this statute as a reference for developing the aiding and abetting cause of action. Criminal law elements such as knowledge and intent may be considered by the courts and may prove helpful in the analogy, but the courts should not feel compelled to find these

142 F.2d 744 (9th Cir. 1944) (no evidence of the participation of the alleged aiders and abettors).

36. As early as 1765 Blackstone referred to a criminal offense termed "aiding and abetting." 4 BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 34 (1765), cited in W. LAFAYE & A. SCOTT, HANDBOOK ON CRIMINAL LAW § 63, at 498 (1972). Interestingly, "aid" appears to be a redundancy since "aiding" is included within the concept of "abetting." "'Abet' contemplates aid combined with mens rea, while the term 'aid' standing alone is insufficient in that it does not suggest the necessity for a mental state in addition to conduct." *Id.* Accomplice liability exists when the proof indicates that defendant gave assistance or encouragement, or failed to perform a legal duty, and had the intent to promote or facilitate commission of the crime. *Id.* § 64, at 502. See also R. PERKINS, CRIMINAL LAW 643-48 (1969).

37. SEC v. Timetrust, Inc., 28 F. Supp. 34, 43 (N.D. Cal. 1939), *rev'd on other grounds*, 142 F.2d 744 (9th Cir. 1944).

38. 18 U.S.C. § 2 (1970).

39. BROMBERG, *supra* note 30, at § 8.5(530).

40. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. PA. L. REV. 597, 626-28 (1972) [hereinafter cited as Ruder].

elements.⁴¹ The cause of action is civil, not criminal.⁴²

A second independent source for the aiding and abetting cause of action is tort law.⁴³ No aiding and abetting tort existed at common law,⁴⁴ but courts have found a cause of action by analogizing to tort theory.⁴⁵ One court has even sustained against a stock exchange as a "joint tortfeasor" a claim that alleged joint and concerted action, knowingly committed with knowledge of a purpose to accomplish an alleged wrong.⁴⁶ The Restatement of Torts section 876 is the source of most language used by the courts.⁴⁷ That section states:

For harm resulting to a third person from the tortious conduct of another, a person is liable if he

... (b) *Knows* that the other's conduct constitutes a breach of duty and *gives substantial assistance or encouragement* to the other so to conduct himself, or

(c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person.⁴⁸ (emphasis added)

Comments to clause (b) indicate that such conduct by the aider and abettor will operate as moral support to the tortfeasor and has the same effect upon liability as participation or physical assistance. For liability to result, the assistance must be substantial. Factors the courts should consider in assessing the substantiality of the assistance include: the nature of the act encouraged, the amount of assistance given, defendant's location at the time of the tort, defendant's relation to the other parties, and defendant's state of mind. Liability should not be grounded upon unforeseeable acts by

41. See, e.g., *Woodward v. Metro Bank*, 522 F.2d 84, 95 n.23 (5th Cir. 1975). The *Woodward* court quoted an opinion of the Supreme Court dealing with *criminal* aiding and abetting:

In order to aid and abet another to commit a crime it is necessary that a defendant "in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed." *Nye & Nissen v. United States*, 336 U.S. 613, 619 (1949).

42. Of course, a civil aiding and abetting defendant can also violate the criminal statute when his conduct falls within that prohibited.

43. BROMBERG, *supra* note 30, at § 8.5(130, 530); Ruder, *supra* note 40, at 620-22; see cases cited in notes 45-47 *infra*.

44. 6 Loss, *supra* note 25, at 3892 (Supp. to 2d ed. 1969).

45. *Fischer v. Kletz*, 266 F. Supp. 180 (S.D.N.Y. 1967).

46. *Wyndham Assoc. v. Bintliff*, [1966-1967 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,016 (S.D.N.Y. 1967), *aff'd*, 398 F.2d 614 (2d Cir.), *cert. denied*, 393 U.S. 977 (1968).

47. E.g., *SEC v. Coffey*, 493 F.2d 1304 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975); *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673 (N.D. Ind. 1966); *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963). Professor Ruder states that this section should be rejected as an independent source of liability under the securities laws. Ruder, *supra* note 40, at 621-22.

48. RESTATEMENT OF TORTS § 876, at 435-36 (1939).

the principal tortfeasor.⁴⁹ Comments to clause (c) indicate that if an agreement exists leading to harm, the defendant is liable if his act alone is substantial and constitutes a breach of duty, regardless of whether he knows his or the other's act is tortious.⁵⁰

Aiding and abetting should be distinguished from other theories of secondary liability—conspiracy, participation, *respondeat superior*, and section 20(a) liability for control persons.⁵¹ At a minimum aiding and abetting includes the following elements: a primary securities law violation by another, knowledge thereof by the aider and abettor, and some form of "substantial assistance."⁵² The essence of conspiracy, on the other hand, is an agreement between the primary wrongdoer and the defendant.⁵³ Participation apparently lies somewhere between a primary violation and aiding and abetting and involvement in the fraudulent conduct is more direct than with conspiracy or aiding and abetting.⁵⁴ *Respondeat superior* is a theory of liability based upon agency law under which the employer is liable for his agent's tortious acts committed in connection with the service of the employer.⁵⁵ Section 20(a) liability is analogous to agency law. Under this section any person controlling another who is liable under the securities acts is jointly and severally liable also unless the control person acted in good faith and did not induce the acts constituting the violation.⁵⁶

49. *Id.* § 876, comment on clause (b), at 436-37 (1939).

50. *Id.* § 876, comment on clause (c), at 439-40, (1939).

51. Additional categories of liability include tippee liability and deceit. Ruder, however, states that these are categories of primary liability. Ruder, *supra* note 40, at 610-13; see *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969); *Fischer v. Kletz*, 266 F. Supp. 180 (S.D.N.Y. 1967). In addition, the entire area is clouded by the fact that privity is no longer required between plaintiff and defendant. BROMBERG, *supra* note 30, at § 8.5(511). For an early statement to this effect in a case dealing with aiding and abetting see *Burley & Co.*, 23 S.E.C. 461, 468 n.11 (1946).

52. See, e.g., *SEC v. Coffey*, 493 F.2d 1304 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975).

53. BROMBERG, *supra* note 30, at § 8.5(540-49); Ruder, *supra* note 40, at 627; see *Dasho v. Susquehanna Corp.*, 380 F.2d 262 (7th Cir. 1967); *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946).

54. BROMBERG, *supra* note 30, at § 8.5(520-29); see *Fischer v. Kletz*, 266 F. Supp. 180 (S.D.N.Y. 1967); *SEC v. Scott Taylor & Co.*, 183 F. Supp. 904 (S.D.N.Y. 1959). The courts have not specified the requirements of this theory of liability. Some conduct, however, appears to be sufficiently culpable to support an independent cause of action. See BROMBERG, *supra* note 30, at § 8.5 (595).

55. W. SEAVEY, *HANDBOOK OF THE LAW OF AGENCY* § 83 (1964); Ruder, *supra* note 40, at 601-05.

56. 15 U.S.C. § 78t (1970); see *Johns Hopkins Univ. v. Hutton*, 297 F. Supp. 1165 (D. Md. 1968). An issue under the controlling person theory is whether a plaintiff suing defendant based upon conduct falling within § 20(a) must proceed under that section or whether he can ground his complaint on aiding and abetting. If § 20(a) is "exclusive," defendant has a good

B. Early Cases

The early cases dealing with aiding and abetting were SEC enforcement suits and disciplinary proceedings, primarily against broker-dealers.⁵⁷ Since this Note's primary focus is on private actions, extensive treatment of SEC disciplinary and injunctive suits is unnecessary. The standards in suits brought by the SEC are different in quality from standards in private actions.⁵⁸ The SEC has construed the term "aider and abettor" very broadly to reach conduct that probably would not result in liability in a private suit, since apparently a negligence standard may be the rule in injunctive suits.⁵⁹

The first private action for damages for aiding and abetting a section 10(b) violation is not known. *Fry v. Schumaker*,⁶⁰ however, a 1947 decision, involved conduct that today would be called aiding and abetting, although the court did not use the term. One set of defendants in *Schumaker* was composed of brokers who sent letters in connection with a solicitation. The court stated that they would be subject to common law fraud liability even if they merely had mailed letters without knowledge of the contents or had supplied stationery, *if* they knew that they were rendering a service essential to or were participating in a scheme to defraud. Since such a count states a claim, said the court, a count based on Rules 10b-3 and 10b-5 is also valid because the securities laws are broader than the common law. *Kardon v. National Gypsum Co.*⁶¹ is another early case that supports a section 10(b) aiding and abetting claim for damages, as is *Pettit v. American Stock Exchange*.⁶²

faith defense. *Woodward v. Metro Bank*, 522 F.2d 84 (5th Cir. 1975) (citing *Gordon v. Burr*, 366 F. Supp. 156 (S.D.N.Y. 1973), *aff'd*, 506 F.2d 1080 (2d Cir. 1974)).

57. See, e.g., *SEC v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Cal. 1939), 39 F. Supp. 145 (N.D. Cal. 1940) (suit brought by SEC to enjoin aiders and abettors of a violation of § 17(a) of the 1933 Act); *Burley & Co.*, 23 S.E.C. 461 (1946) (disciplinary suit for a willful violation of §§ 10(b) and 15(c)(1) of the 1934 Act and § 17(a) of the 1933 Act, and the aiding and abetting thereof); *SEC v. Scott Taylor & Co.*, 183 F. Supp. 904 (S.D.N.Y. 1959).

58. See, e.g., *Ernst & Ernst v. Hochfelder*, 96 S.Ct. 1375, 1381 n.12 (1976), in which the court did not decide whether scienter was required in an action for injunctive relief. For a recent SEC suit involving willful aiding and abetting, see *SEC v. Cooper*, 402 F. Supp. 516 (S.D.N.Y. 1975).

59. *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 541 (2d Cir. 1973); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 854-55 (2d Cir. 1968); *Ruder*, *supra* note 40, at 624.

60. 83 F. Supp. 476 (E.D. Pa. 1947).

61. 69 F. Supp. 512 (E.D. Pa. 1946); see notes 29-31 *supra* and accompanying text.

62. 217 F. Supp. 21 (S.D.N.Y. 1963). In *Pettit* the court, in discussing an aiding and abetting allegation, stated that "knowing assistance of or participation in a fraudulent scheme under section 10(b), gives rise to liability equal to that of the perpetrators themselves." *Id.* at 28.

A great deal of confusion regarding the aiding and abetting cause of action has arisen because plaintiffs in the early and even recent cases allege primary violations, aiding and abetting, conspiracy, and fraud against the same defendant for the same conduct.⁶³ Although inconsistent pleading is permissible under the federal rules,⁶⁴ one defendant can not be a primary wrongdoer and an aider and abettor for the same act or failure to act; one defendant can, however, at one point in time violate the securities laws directly and at a different time aid and abet another's violation. The basis of the problem ultimately is lack of judicial clarity.⁶⁵ Some courts fail to dispose of all claims in the course of an opinion⁶⁶ or do not distinguish which facts apply to which claim⁶⁷ or interchange terms unintentionally.⁶⁸ An additional element of the problem is that since no precise definitions for the terms exist, some overlap in the underlying concepts may occur.⁶⁹

C. Securities Law Policies

In the securities marketplace Congress substituted a philosophy of full disclosure for the older principle of *caveat emptor*.⁷⁰ The Supreme Court has added that securities legislation must be interpreted flexibly to effectuate its remedial purpose and to achieve a high standard of business ethics in the securities industry.⁷¹ The policy goals of the 1933 Act are the promotion of free and open markets and the protection of the investing public. The Act at-

63. See, e.g., *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir.), cert. denied, 396 U.S. 838 (1969) (primary participant and aiding and abetting); *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963) (conspiracy and aiding and abetting); *SEC v. Scott Taylor & Co.*, 183 F. Supp. 904 (S.D.N.Y. 1959) (participation and aiding and abetting); *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946) (conspiracy and fraud); *SEC v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Cal. 1939) (aiding and abetting and participation).

64. FED. R. CIV. P. 8(e)(2).

65. BROMBERG, *supra* note 30, at § 8.5(515); Ruder, *supra* note 40, at 600.

66. E.g., *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963) (aiding and abetting claim left unresolved).

67. E.g., *Holloway v. Howerdd*, 377 F. Supp. 754 (M.D. Tenn. 1973); see *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir.), cert. denied, 396 U.S. 838 (1969).

68. *Donlon Indus., Inc. v. Forte*, 402 F.2d 935 (2d Cir. 1968).

69. Some courts are careless in their choice of conjunction between "aid and abet," interchanging "and" and "or." Although such mislabelling of the term "aid and abet" is probably due to inadvertence, precision is desired in an area that is so imprecise.

70. See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963); 1 Loss, *supra* note 25, at 6.

71. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

tempts to effectuate this policy by requiring full disclosure and by prohibiting fraudulent practices.⁷² Though addressed to specific problems, the 1934 Act of course includes a general antifraud provision, section 10(b), which until recently had been construed liberally.⁷³ Rule 10b-5, promulgated pursuant to section 10(b), has six functions according to Professor Bromberg: equalization of bargaining power, disclosure, prevention of fraud, control of insider activities, fairness, and market-informing.⁷⁴ Two recent Supreme Court cases, *Blue Chip Stamps v. Manor Drug Stores*⁷⁵ and *Ernst & Ernst v. Hochfelder*,⁷⁶ may represent a decision by the Court to constrict Rule 10b-5 before it exceeds all reasonable boundaries. *Blue Chip* returned to the *Birnbaum* rule,⁷⁷ which provides that the plaintiff class is limited to actual purchasers or sellers. *Hochfelder* refused to indorse the no-negligence position of the SEC and limited actions for section 10(b) violations by requiring scienter: intentionally fraudulent, deceptive, or manipulative conduct.⁷⁸ Since the Court in *Hochfelder* did not reach the question whether an aiding and abetting claim may be brought under section 10(b), the immediate impact of the case will be upon the knowledge/scienter element of the cause of action.⁷⁹

Several policy considerations directed primarily at aiding and abetting also must be considered. Aiding and abetting is termed "secondary" liability by the courts and commentators—primarily because of its tangential relation to the primary wrong. As long as the aider and abettor's liability is joint and several with an allowance for contribution, then any knowledge, scienter, and intent requirements imposed on the aider and abettor should be no less than those imposed on the primary wrongdoer,⁸⁰ and it should be plaintiff's burden to prove each element. The possibility of a good faith defense for aiding and abetting should be considered⁸¹ since the

72. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 858-59 (2d Cir. 1968).

73. See text accompanying notes 75-79 *infra*.

74. BROMBERG, *supra* note 30, at §§ 12.1-12.8; See *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968).

75. 421 U.S. 723 (1975).

76. 96 S. Ct. 1375 (1976).

77. *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

78. The SEC position is found in note 18 of the opinion. The question whether recklessness is actionable under § 10(b) was left open by the Court.

79. 96 S. Ct. at 1380 n.7; see Part IV.A. *infra*. In note 7 the Court expressly stated that it was not reaching the question whether liability for aiding and abetting through active or passive conduct exists under § 10(b).

80. See Daley & Karmel, *supra* note 13, at 778-79; Ruder, *supra* note 40, at 632-38.

81. See Part IV.A. *infra*, which deals with the exclusivity of § 20(a).

aider and abettor is not always a guarantor against fraud by the primary wrongdoer.⁸² The securities acts, however, do impose special duties on certain persons.⁸³ Thus the key to liability should be an examination of defendant's knowledge and the duties defendant owes to a nonprivity plaintiff and to the public because of his status. When plaintiff is unknown to defendant, and possibly unforeseeable, what is defendant required to do? An individual may not be in a position to make the disclosures required: only an insider can obtain a corporate news release, and a corporation could sue defendant if the disclosure were unnecessary or harmful to it.⁸⁴ In addition, a plaintiff could be misled by several "unofficial" disclosures. On the other hand, the violation of duties owed by professionals may cause liability independently of any secondary liability theories.⁸⁵ Thus the ultimate decision is whether an expansive use of civil liability to deter fraudulent conduct is worth the loss in legitimate trading and investment⁸⁶ and worth the possible disruption of legitimate business practice and corporate systems of delegation of authority and accountability.⁸⁷ Definite limits, ascertainable prior to any actionable conduct, also must be developed.⁸⁸ Furthermore, one must consider the need for a separate cause of action for aiding and abetting in light of the possible use of 18 U.S.C. § 2, which makes the aider and abettor a direct participant in the wrong, and the liberalization of the "in connection with" requirement.⁸⁹

III. DEVELOPMENT OF A CAUSE OF ACTION FOR PASSIVE CONDUCT

A. *Brennan, Wessel, and the Commentators*

Ten years ago a federal district court decided for the first time⁹⁰ whether conduct consisting solely of silence and inaction could constitute actionable aiding and abetting of a federal securities law fraud. In *Brennan v. Midwestern United Life Insurance Co.*,⁹¹ a class

82. See BROMBERG, *supra* note 30, at § 8.5(582).

83. See, e.g., *Woodward v. Metro Bank*, 522 F.2d 84, 95-96 (5th Cir. 1975).

84. Recent Development, *Liability for Failure to Disclose Under Rule 10b-5*, 20 STAN. L. REV. 347 (1968).

85. Ruder, *supra* note 40, at 618; see *Touche, Niven & Co.*, 37 S.E.C. 629, 670-71 (1957).

86. Recent Development, *supra* note 84, at 359.

87. See *SEC v. Coffey*, 493 F.2d 1304, 1315 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975).

88. See *id.* at 1317.

89. See *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971).

90. See text accompanying note 6 *supra*.

91. 259 F. Supp. 673 (N.D. Ind. 1966) (motion to dismiss), 286 F. Supp. 702 (N.D. Ind. 1968) (trial on merits), *aff'd*, 417 F.2d 147 (7th Cir. 1969) (court affirmed on basis of finding of silence plus affirmative acts), *cert. denied*, 397 U.S. 989 (1970); see Note, 35 U. Mo. K.C.L. Rev. 320 (1967).

action on behalf of defendant's shareholders, plaintiff claimed that defendant was liable for "aiding, abetting, and assisting" a Rule 10b-5 violation by a brokerage firm in connection with the sale of shares of defendant's stock.⁹² Defendant's conduct allegedly consisted of knowledge of the brokerage firm's improper activities and the failure to report the firm to the SEC or to the state securities commission. Plaintiff further claimed that defendant benefitted from the market activity in its shares caused by the brokerage firm because, as the price of defendant's stock rose, defendant would be able to obtain a more favorable exchange ratio during subsequent merger negotiations. On a motion to dismiss for failure to state a claim, defendant argued that aiding and abetting requires an affirmative act and therefore defendant could not be liable for mere silence and inaction. The court, after quoting the Restatement of Torts section 876, examining the legislative history of several unadopted amendments to the 1934 Act, and noting that the statute must be flexibly applied, stressed that the statute "imposed a duty upon persons and corporations who are in a superior position to know crucial and material facts not to take advantage of those who are not in such a position."⁹³ Recognizing that not everyone with knowledge of the improper activities is required to report them, the court stated:

duties are often found to arise in the face of special relationships, and there are circumstances under which a person or corporation may give the requisite assistance or encouragement to a wrongdoer so as to constitute an aiding and abetting by merely failing to take action.⁹⁴

The court held that whether defendant's silence and inaction was sufficient assistance or encouragement was a question of fact to be decided at trial. On the merits the court found affirmative conduct by defendant, but reemphasized its earlier position that failure to act may constitute the requisite assistance in some circumstances.⁹⁵ On appeal the Seventh Circuit held that defendant's "acquiescence through silence in the fraudulent conduct of [the brokerage firm] combined with its affirmative acts was a form of aiding and abetting cognizable under Section 10(b) and Rule 10b-5."⁹⁶

92. The brokerage firm allegedly failed to deliver stock certificates to plaintiffs and used plaintiffs' money to speculate prior to the firm's bankruptcy.

93. 259 F. Supp. at 681; see 6 Loss, *supra* note 25, at 3892-93 (Supp. to 2d ed. 1969).

94. 259 F. Supp. at 681-82.

95. 286 F. Supp. 702 (N.D. Ind. 1968).

96. 417 F.2d 147, 154 (7th Cir. 1969). Defendant's affirmative act consisted of mailing letters to shareholders that told them to refer complaints first to the brokerage firm and then to the state securities commissioner.

The *Brennan* case produced considerable discussion. One commentator thought that *Brennan* along with two other cases⁹⁷ represented a new form of strict liability under Rule 10b-5. The theory was that if defendant knew of the fraudulent conduct and was in a position to take effective action to ameliorate the harm, then defendant would be strictly liable for failure to act.⁹⁸ Another commentator, Professor Bromberg, saw "frightening implications" in *Brennan* and was concerned that extension of liability to include nonfeasance might not be suitable for a defendant whose role in the overall scheme was less than that of a "participant." Bromberg concluded that the question whether a "special relationship" is essential to the aiding and abetting cause of action based on silence and inaction is unresolved.⁹⁹ Professor Ruder noted the court's use of the Restatement of Torts section 876 and rejected it as an independent source of liability under the securities laws. He believed that the *Brennan* case *could* be read as saying that an affirmative obligation to disclose corporate activities (inside information) exists, but that such a conclusion would extend direct liability too far. Rather, he preferred that *Brennan* be viewed "as a landmark case establishing that liability may be imposed upon a defendant who himself was not a primary participant in a securities law fraud, but who assisted or conspired with the primary participant."¹⁰⁰ Ruder recognized that the case left open the question of liability based solely on inaction, and he proceeded to answer the question by comparing *Brennan* with a subsequent case in the Ninth Circuit, *Wessel v. Buhler*,¹⁰¹ which held that Rule 10b-5 imposes no liability for conduct consisting solely of inaction. His conclusion was that the two cases were reconcilable because in each the real question was whether defendant had violated an independent duty owed to plaintiff. If defendant had violated a duty, then his inaction (failure to disclose) would give rise to Rule 10b-5 liability because of the breach of duty and not because of aiding and abetting theory.¹⁰²

An examination at this point of the facts of *Wessel* will facilitate subsequent discussion of the aiding and abetting cause of ac-

97. *Fischer v. Kletz*, 266 F. Supp. 180 (S.D.N.Y. 1967); *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963).

98. Recent Development, *supra* note 84, at 354-55. *Ross v. Licht*, 263 F. Supp. 395 (S.D.N.Y. 1967), also was discussed. The court in *Ross* equated tippee status and aiding and abetting, saying that failure to disclose and participation were actionable.

99. BROMBERG, *supra* note 30, at § 8.5(533).

100. Ruder, *supra* note 40, at 623.

101. 437 F.2d 279 (9th Cir. 1971).

102. Ruder, *supra* note 40, at 620-23, 641-44.

tion and the duty analysis in Part IV *infra*. Plaintiff shareholders sued the corporation's president for an alleged violation of Rule 10b-5. Plaintiffs also sued the corporation's independent certified public accountant for aiding and abetting the violation by participating indirectly in the production of a misleading prospectus, and by breaching a duty owed to prospective investors to disclose irregular corporate conduct and financial records. Defendant accountant had been retained by the corporation on three occasions to prepare financial statements, which he delivered directly to the board of directors. The court found that some of defendant's figures had been selectively incorporated into misleading prospectuses issued by the corporation and relied upon by plaintiffs. The court dismissed the first aiding and abetting claim, stating that no evidence existed that defendant failed to act in accordance with good accounting practice; in addition, even if the figures were misleading, the court found no evidence that defendant was in any way responsible for their appearance in the prospectus. The court also dismissed plaintiffs' claim that defendant had aided and abetted the corporate management's fraud by breaching a duty to disclose:

[W]e find nothing in Rule 10b-5 that purports to impose liability on anyone whose conduct consists solely of inaction [T]he exposure of independent accountants and others to such vistas of liability, limited only by the ingenuity of investors and their counsel, would lead to serious mischief.¹⁰³

Ruder reconciled *Brennan* with *Wessel* by examining the duties owed by the defendant aider and abettor in each case and determining whether the duty was breached and whether plaintiff was within the scope of the duty.¹⁰⁴ Federal district and circuit courts over the last five years have not found the solution so simple. Among the approximately two dozen decisions since 1971, some courts have adopted Ruder's view, some have relied upon the Restatement of Torts section 876, and some have created hybrid forms of aiding and abetting. In the following pages the significant cases will be examined briefly and a discussion of the implications of the developing trend in this area of Rule 10b-5 liability will follow.

B. Recent Cases

Since judicial treatment of the subject of civil liability for damages for passive conduct has followed no clear pattern among the circuits over the last several years, discussion of the cases will proceed chronologically.

103. 437 F.2d at 283.

104. Ruder, *supra* note 40, at 643-44.

(1) 1966-1972

In the period from 1966 through 1972 only a handful of courts other than *Brennan* and *Wessel* considered the issue of aiding and abetting by means of passive conduct, and all stated that a valid cause of action existed. The opinions differed primarily on the elements required to state the cause of action and on the theory of liability. One court equated tippee status with aiding and abetting and found that defendants had breached a duty of disclosure.¹⁰⁵ Another court based liability of a brokerage firm on its joint action coupled with its knowledge of a wrongful purpose and called defendant a joint tortfeasor.¹⁰⁶ In the same case the court gave plaintiff time to amend a defective complaint against a stock exchange, which was based on the exchange's failure to take prompt action to stop an alleged manipulation of which it had knowledge. The court indicated that an allegation of defendant's participation, knowledge of the wrongful acts, or special relationship with plaintiff would cure the defect. In the only aiding and abetting case decided to date in the Eighth Circuit, the Minnesota District Court in a commodities fraud case held liable for aiding and abetting a brokerage firm that allowed the primary wrongdoer to use their office and telephone, permitted him to engage in extensive trading, allowed him to duplicate certain market materials, and allowed him to bring visitors to their offices.¹⁰⁷ The court stated that defendants' conduct amounted to the lending of their business reputations to the primary wrongdoer when they knew or should have known of the illegal acts, and added that liability may attach even though the assistance consists of mere silence and inaction. A district court in Oregon found silence and inaction sufficient for aiding and abetting a Rule 10b-5 violation when defendant's conduct consisted merely of allowing use of his name on a prospectus containing misrepresentations by others.¹⁰⁸ Defendant was listed as a financial advisor who received a fee, but defendant did not otherwise profit from the misrepresentations. Additionally, defendant failed to investigate the accuracy of statements in the prospectus, thereby violating a duty of investigation.

105. *Ross v. Licht*, 263 F. Supp. 395 (S.D.N.Y. 1967).

106. *Wyndham Associates v. Bintliff*, [1966-1967 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,016 (S.D.N.Y. 1967), *aff'd*, 398 F.2d 614 (2d Cir.), *cert. denied*, 393 U.S. 977 (1968).

107. *Anderson v. Francis I. duPont Co.*, 291 F. Supp. 705 (D. Minn. 1968). Today, the jurisdiction of the SEC over commodities futures trading is far from clear, and the Commodity Futures Trading Commission is claiming jurisdiction in this area. See Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 VAND. L. REV. 1 (1976).

108. *Blakely v. Lisac*, 357 F. Supp. 255 (D. Ore. 1972).

In contrast the Seventh Circuit found a brokerage firm liable when it allowed a broker-dealer whom it knew was using fraudulently converted property to open an account and trade.¹⁰⁹ The court based liability upon defendant's conduct, which enabled the client to speculate improperly, on its knowledge of the client's wrongdoing, and on the benefit it received from the client's trading activities. In one final case during this period a court in the Southern District of New York indicated in dictum that, absent an independent duty to disclose (and possibly a special relationship), no basis exists for transforming silence into actionable aiding and abetting.¹¹⁰

(2) 1973

The most significant of the three cases decided in 1973 is *Landy v. Federal Deposit Insurance Corp.*¹¹¹ Plaintiffs were purchasers of stock of a bank whose president had misused funds to speculate in the market. Defendants included the president, brokerage firms through which the president executed transactions, and an accounting firm that conducted surprise examinations of the bank. As to the brokerage firms the court recognized three issues: the nature of their connection with plaintiffs; whether they owed an independent duty to disclose the president's scheme; and whether they were closely enough connected to the scheme to be aiders and abettors. Stating that aiding and abetting required an independent wrong, knowledge of the existence of that wrong, and substantial assistance, the court found the third element defective. The court looked to the Restatement of Torts¹¹² and said considerations regarding the "substantial assistance" element include the amount of defendant's assistance, his presence, his relation to the other party, and his state of mind. The court held that liability for inaction could be premised only on a showing of a special relationship between the parties, and found no such relationship to exist. The accounting firm was found not liable for misstatements in the bank's financial statements because plaintiffs failed to show that the firm knew or expected that its financial report would be exhibited to investors in the bank's

109. *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir.), cert. denied, 396 U.S. 838 (1969).

110. *Fischer v. Kletz*, 266 F. Supp. 180, 191-96 (S.D.N.Y. 1967). The court stated that no special relationship existed between investors in a corporation and the corporation's auditor who merely issued interim statements to the corporation. For such acts, the auditor was performing a different role than that of an independent certified public accountant of the firm's books.

111. 486 F.2d 139 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974).

112. RESTATEMENT OF TORTS § 436 (1939).

stock. Also no reliance by plaintiffs was shown. The court recognized that the common law could be used as a guidepost, but that its precepts were not determinative of federal securities law liability.

The Ninth Circuit in *Strong v. France*¹¹³ held that liability exists for silence and inaction only when a duty to disclose has arisen. The duty exists in three situations: when defendant possesses inside information; when he knowingly assists or participates in a fraudulent scheme; or when he consents to and approves of fraudulent practices by a director. Plaintiffs, who had never met defendant, invested because of the misrepresentations of others in a corporation to be formed in connection with another corporation of which defendant was the president. Even though defendant let the others use his name as a future director of the corporation to be formed, thus misleading plaintiff, the court found no duty owed to plaintiff by defendant. A subsequent case in an Oregon district court made no reference to a duty to disclose (possibly because *Strong* was decided only three weeks earlier) and found defendant corporation and its vice president liable for silence and inaction that “encouraged reliance by the public on the misrepresentations and omissions in [an underwriter’s] comment, since it was well known that [the underwriter dealt in the corporation’s] stock. Such acquiescence through silence is a form of aiding and abetting cognizable under section 10(b) and Rule 10b-5.”¹¹⁴

(3) 1974

In 1974 the Sixth, Seventh, and Tenth Circuits and the Southern District of New York faced the question of liability for passive conduct. The case with the biggest impact on subsequent decisions involving *private* civil actions was an *SEC injunctive* suit, *SEC v. Coffey*,¹¹⁵ which stated a clear definition for “aiding and abetting” that has been frequently quoted. On the issue of primary liability the court indicated that corporate officials could not be responsible for every securities law violation by subordinates. Finding that such responsibility would disrupt corporate systems of delegation of authority and accountability and would, *sub silentio*, repeal the protections contained in the “control persons” provision, the court re-

113. 474 F.2d 747 (9th Cir. 1973).

114. *Green v. Jonhop, Inc.*, 358 F. Supp. 413, 419 (D. Ore. 1973). As a qualification to its opinion the court did state that defendants also took *affirmative* action to encourage acceptance of the underwriter’s comment, but did not elaborate upon this fact.

115. 493 F.2d 1304 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975).

fused to impose such a duty in the absence of a special relationship between the buyer and seller of securities.¹¹⁶ On the issue of secondary liability the court held that

a person may be held as an aider and abettor only if some other party has committed a securities law violation, if the accused party had general awareness that his role was part of an overall activity that is improper, and if the accused aider-abettor knowingly and substantially assisted the violation.¹¹⁷

The court added that "inaction" constitutes the requisite assistance when it is shown that defendant's silence was consciously intended to aid the securities law violation. Knowledge¹¹⁸ may be proved by reliable and probative evidence, including circumstantial evidence. In *Coffey* the discussions of the corporation's vice president with the primary wrongdoer about the sale of corporate notes to the state of Ohio will lead to aiding and abetting liability if plaintiff shows on remand that defendant vice president had, in his conversation, learned that Ohio was being misled and then failed to act.

The Seventh Circuit, in a pair of decisions¹¹⁹ involving the same plaintiff against an exchange and an accounting firm, indicated that a cause of action based on inaction existed. Although the Supreme Court recently reversed the circuit court's decision against the accounting firm, the Supreme Court's holding was limited to the issue of negligence in a suit under section 10(b). Thus certain statements of the Seventh Circuit remain authoritative. A claim based upon inaction still exists, but more than an unwitting facilitation of another's wrongful acts must be shown. At a minimum plaintiff must prove that defendant had knowledge of the fraud and thereafter failed to act due to an improper motive or breach of a duty of disclosure.¹²⁰

The Tenth Circuit also stated that aiding and abetting liability

116. *Id.* at 1315.

117. *Id.* at 1316.

118. The point of departure of SEC suits from private actions may well be the knowledge element. Here the court phrased knowledge in terms of a "general awareness" of being a part of an improper activity. Such a requirement is far short of actual knowledge. The court does add, however, that for silence to be actionable, conscious intent is required. *But see* *Bienewski Ltd. Partnership v. Tising*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,865 (E.D. Wis. 1974), in which the court, in a private action, stated that a "general awareness" of overall improper conduct meets the requirements of FED. R. CIV. P. 9(b).

119. *Hochfelder v. Midwest Stock Exch.*, 503 F.2d 364 (7th Cir.), *cert. denied*, 419 U.S. 875 (1974); *Hochfelder v. Ernst & Ernst*, 503 F.2d 1100 (7th Cir. 1974), *rev'd*, 96 S. Ct. 1375 (1976) (reversal limited to issue of negligence); *see* notes 32-33, 58, 78-79 *supra*.

120. 503 F.2d at 374. The court's statement that liability could be premised on the fact that defendants *should have had* the requisite knowledge is probably no longer valid in light of the Supreme Court's opinion.

may be based upon silence and inaction.¹²¹ Its statement, however, was not necessary to the court's holding since defendant knowingly had participated and assisted in the fraud and had discussed with plaintiff the virtues of the corporation to which plaintiff had been fraudulently induced to loan money. In a later case that included direct plaintiff-defendant contact and affirmative misrepresentations, the court indicated that liability must be based upon substantial "knowing participation."¹²²

In a 1974 opinion the Southern District of New York stated that an aider and abettor could be found liable for nondisclosure despite the absence of a duty to disclose if the defendant had actual knowledge of the fraudulent scheme of another plus an intent to further the scheme and had given substantial assistance to the primary wrongdoer.¹²³ The court cited *Coffey* for its requirement that a defendant who has remained silent can be found liable only if he had a conscious intent to aid the securities law violation.

(4) 1975-1976

Although the Supreme Court avoided the issue in *Hochfelder*,¹²⁴ federal courts in the Second, Third, Fifth, Sixth, and Ninth Circuits faced the passive conduct question this past year, with most litigation occurring in the Southern District of New York. The Second Circuit, in a footnote to an opinion dealing with aiding and abetting fraud in connection with a tender offer, stated that some showing of culpability was necessary and that defendant would be liable if he assisted the primary wrongdoer with knowledge of a material misrepresentation, knowingly and substantially assisted the violation, or was reckless.¹²⁵ An inference that the court would apply the same standards to a Rule 10b-5 aiding and abetting action can be drawn from its citation of the *Coffey* opinion. The judges of the Southern District have reached inconsistent conclusions on the question of liability for passive conduct.¹²⁶ In March of 1975 Judge

121. *Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731 (10th Cir. 1974).

122. *Zabriskie v. Lewis*, 507 F.2d 546, 554 (10th Cir. 1974).

123. *Rosen v. Dick*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,786 (S.D.N.Y. 1974).

124. See notes 32-33, 58, 78-79, 119 *supra* & 147-48, 155, 190-91 *infra* and accompanying text.

125. *Lowenschuss v. Kane*, 520 F.2d 255, 268 n.10 (2d Cir. 1975). Section 14(e) of the 1934 Act prohibits fraudulent practices in connection with a tender offer. 15 U.S.C. § 78(a) (1970).

126. An additional opinion in the district that includes an aiding and abetting claim but that is not discussed in text is *Bondy v. Chemical Bank*, [Current] CCH FED. SEC. L. REP. ¶ 95,360 (S.D.N.Y. Oct. 30, 1975).

Carter rendered two opinions, the first¹²⁷ stating that a party may give substantial assistance without making a direct misrepresentation to the parties ultimately deceived, and the second¹²⁸ concluding that the law of the district and circuit apparently requires *affirmative* action in aid of the primary wrongdoer. The second statement is not only slightly inconsistent with the earlier case, but also a faulty prediction of the development of the law in the district. The first opinion referred to, *Odette v. Shearson, Hammill & Co.*, does not clearly articulate a position with regard to the type of conduct—active or passive—necessary to create liability. In *Odette* the alleged aider and abettor told the other defendant that it would not report any misrepresentations and that it would corroborate the false statements. Then it falsified its books “to assist” the other defendant, but plaintiffs in fact did not allege examination of or reliance on the books. If anything, defendant’s conduct in *Odette* may have been encouragement, but it was not assistance because reliance by plaintiff on defendant’s acts or on the result of defendant’s acts seems logically necessary to a claim of assistance. The case may fit better within the conspiracy category. Judge Pierce in December of 1975 was faced with a claim of aiding and abetting under Rules 10b-5 and 14a-9 and stated that for certain defendants, brokers and banks, for example, liability is not dependent upon an affirmative duty to disclose, but can be based upon defendant’s assistance or participation in the wrongdoing.¹²⁹ The court is unclear on the issue of liability for inaction. It noted that defendant had no independent duty to disclose, but did not think that this was a situation involving “inaction” alone because of defendant’s unique relationship to the transactions.¹³⁰ The court recognized an interrelationship between the assistance element of the cause of action and defendant’s knowledge, concluding that knowledge may be inferred the further one’s conduct departs from normal business transactions. More recently, in January of 1976, Judge Lasker in *Fischer v. New York Stock Exchange*¹³¹ addressed the issue whether secondary liability can attach and whether a duty to disclose might exist even in the absence of affirmative action in aid of the primary wrongdoer. Plaintiffs had loaned money to the primary wrongdoer, a brokerage

127. *Odette v. Shearson, Hammill Co.*, 394 F. Supp. 946 (S.D.N.Y. 1975).

128. *Seligson v. New York Produce Exch.*, 394 F. Supp. 125 (S.D.N.Y. 1975).

129. *H.L. Federman & Co. v. Greenberg*, 405 F. Supp. 1332 (S.D.N.Y. 1975).

130. *Id.* at 1337 n.1.

131. 408 F. Supp. 745 (S.D.N.Y. 1976). Interestingly, the vice president of the exchange was charged with personally encouraging plaintiffs to renew their loans; thus dismissal of the action would be inappropriate for that claim alone.

firm that was a member of defendant exchange, and had subordinated their rights to the other creditors of the firm. In accordance with its policy the exchange did not disclose that the firm had a history of noncompliance with SEC and exchange rules and had been disciplined three times by the exchange. Plaintiff claimed that the exchange aided and abetted the firm's fraud by failing to disclose the firm's prior sanctioning. In denying a motion to dismiss, the court concluded that a duty to disclose could arise solely on the basis of a failure to act, but added that scienter at least greater than negligence was a requirement for a finding of liability based on inaction alone.

In a suit against a corporate vice president as an aider and abettor and a control person with respect to the president's Rule 10b-5 violations, the Third Circuit stated that defendant must have known of the violation and by his conduct substantially assisted the primary wrongdoer.¹³² Recognizing that the courts have been unwilling to extend vicarious liability when a secondary defendant's conduct consisted of mere inaction, the court nevertheless held that inaction could constitute the requisite substantial assistance when defendant's silence was consciously intended to aid the securities law violation.

The Fifth Circuit recently has attempted a synthesis of the law in *Woodward v. Metro Bank*.¹³³ Defendants, the alleged aiders and abettors, were a bank official and the bank in which the primary wrongdoer, Starnes, had some funds and from which Starnes and his controlled corporation had borrowed money. Through false representations Starnes sold plaintiff shares in the corporation and induced plaintiff to become an accommodation maker on the corporation's note, which was given to secure a loan from defendant bank. At no time did defendants inform plaintiff of the precarious financial position of Starnes or his corporation or the actual intended use of the loan proceeds. Assuming that the note was a security and that a Rule 10b-5 violation had occurred, the court recognized that the aiding and abetting cause of action had not yet crystallized into a set pattern and examined the *Coffey*, *Strong*, and *Landy* opinions among others. Stating that a defendant could know of the existence of a wrong without being aware of his role in a fraudulent scheme, the court emphasized that assistance must be both substantial and knowing. "A remote party must not only be aware of his role, but

132. *Rochez Bros v. Rhoades*, 527 F.2d 880 (3d Cir. 1975).

133. 522 F.2d 84 (5th Cir. 1975).

he should also know when and to what degree he is furthering the fraud.”¹³⁴ On the specific issue of liability for silence and inaction the court recognized four separate approaches¹³⁵ and adopted a fifth—a combination of the *Coffey* and *Strong* cases. In the absence of a duty to disclose, the Fifth Circuit would find an aider and abettor liable if scienter of the “conscious intent” variety is proved. A lesser degree of scienter is required when there exists a special duty of disclosure, which the securities acts impose on certain defendants such as an insider, control person, accountant, or broker. The court noted that when the existence of a “security” is in doubt, assistance must be directed clearly and intentionally toward aiding the fraud; otherwise, commercial relationships would be destroyed. In addition, when the defendant is engaged in normal business activities, generally more evidence of complicity is required. In *Woodward* neither the bank nor its officer owed any special duties to plaintiff, and in fact certain information in the bank’s possession about Starnes was “confidential” under Texas statute. In light of this conflicting duty owed to its customer and because defendants were merely engaging in normal business practice, no cause of action was stated by plaintiff against these defendants. The court recognized, however, that “[u]nder different facts, demonstrating awareness of complicity and substantial assistance, we would not hesitate to hold a bank to account.”¹³⁶

In the Sixth Circuit a district court in Ohio held that an accounting firm could be found liable under section 12(2) of the 1933 Act as a seller if it aided and abetted the offeror’s misstatements or omissions.¹³⁷ The court did not indicate the components of the aiding and abetting claim, but stated that it was “semantic hairsplitting” to attempt to differentiate between violators of section 12(2), aiders and abettors thereof, and conspirators.

The Ninth Circuit affirmed a district court holding that a bank maintaining collection accounts for an investor who defrauded plaintiff broker-dealer was not an aider and abettor of the fraud.¹³⁸ The court required proof of defendant’s knowledge of the fraudulent

134. *Id.* at 95.

135. The court recognized the following approaches:

- (1) silence and inaction alone are actionable.
- (2) inaction alone is insufficient to create liability.
- (3) *Coffey*: conscious intent to aid must exist.
- (4) *Strong*: liability only when a duty to disclose exists.

136. *Id.* at 100.

137. *Sandusky Land Ltd. v. Uniplan Groups, Inc.*, 400 F. Supp. 440 (N.D. Ohio 1975).

138. *Grimes, Hooper & Messer, Inc. v. Pierce*, 519 F.2d 1089 (9th Cir. 1975).

act, even if merely constructive. Unwittingly permitting the investor to use defendant's accounts and to associate with defendant's officers in order to create a false financial aura essential to the fraudulent scheme was not sufficient to impose liability on defendant bank for aiding and abetting.

IV. THE AIDING AND ABETTING CAUSE OF ACTION

A. *Elements of the Cause of Action and Defenses*

Although courts in the different circuits have taken a variety of approaches to the issue of liability based on passive conduct, the recent cases do represent a developing trend in the law. In part because of the very frequency of lawsuits containing an allegation of aiding and abetting by means of silence and inaction, plaintiffs, in their attempts to reach the deep pocket wherever it might be located, have succeeded in carving into Rule 10b-5 a niche for aiding and abetting liability based on passive conduct. All of the elements of the cause of action have not become firmly fixed in each circuit, but the basic requirements are clear, and meaningful predictions are possible.

At the minimum plaintiff must allege and prove three interrelated¹³⁹ elements: fraud by another (the primary violation), scienter (some degree of knowledge and possibly intent), and a third element (action or a non-act).¹⁴⁰ This last element has been termed "substantial assistance or encouragement," and according to a substantial majority of the recent decisions, it can be satisfied by passive conduct. Proof that the aider and abettor did nothing is easily established. Judicial attention thus focuses upon the context and circumstances surrounding defendant's non-act. At this point the courts have split, and subdivisions within the element have arisen. Different courts have emphasized intent, benefit to the defendant, a connection with the fraudulent scheme, defendant's status, and duties owed by defendant. This recent trend is not a new form of strict liability. Knowledge alone or assistance alone is an insufficient basis for a judgment in favor of plaintiff.¹⁴¹ In fact the courts

139. For judicial acknowledgements of the interrelationship between the knowledge and assistance elements see *Woodward v. Metro Bank*, 522 F.2d 84 (5th Cir. 1975); *H.L. Federman & Co. v. Greenberg*, 405 F. Supp. 1332 (S.D.N.Y. 1975).

140. These basic categories are derived from the RESTATEMENT OF TORTS § 876, (1939) which many courts have adopted to represent a statement of the law of aiding and abetting. See cases cited in Part III.B.(4) *supra*.

141. See, e.g., *Hochfelder v. Midwest Stock Exch.*, 503 F.2d 364 (7th Cir.), *cert. denied*, 419 U.S. 875 (1974) (unwitting facilitation of another's fraud not actionable; knowledge in

have suggested three separate defenses, apart from failure by plaintiff to prove one of the elements: good faith, no connection with a transaction involving the purchase or sale of a security, and normal business practice. The balance of this section will discuss and analyze the elements and defenses.

(1) Primary Violation

Aiding and abetting is a relative offense, a form of liability secondary to some other independently wrongful act. Within the context of a suit based on Rule 10b-5, the primary wrong is a securities fraud violation by another in connection with a purchase or sale of securities. The aider and abettor's conduct must be different in some way from the conduct of the primary wrongdoer; otherwise, the distinction between aiding and abetting and the primary fraud would blur, and a separate offense for aiding and abetting would be unnecessary. The difference is the substantial assistance requirement: the aider and abettor's conduct per se would not constitute an independent violation of the antifraud provisions. Plaintiff thus must allege an independent violation by another.¹⁴² The specificity with which the independent violation must be established, however, is unclear since most of the recent cases were not decided on the merits. They generally involved motions to dismiss and considered only the allegations in the complaint. Of course, a prior judgment against the primary violator is useful, but frequently he is another defendant in the lawsuit. Most courts do not consider all of the elements¹⁴³ of the Rule 10b-5 claim when dealing with the primary violation, but place emphasis on fraudulent conduct and scienter.

(2) Scienter

The second element of the cause of action, scienter, could easily have been termed "knowledge." The two concepts are distinguish-

absence of improper motive or breach of duty to disclose not actionable). When defendant's assistance consists of inaction, liability may appear to be premised upon knowledge alone. This is not true. The third element, substantial assistance, must also be established. For example, defendant must have had an intent to aid and abet the fraud or benefit from it or must have been under a duty to disclose the fraudulent conduct. When one of these additional factors exists, defendant also satisfies the substantial assistance element of the cause of action, not just the knowledge element.

142. Most courts do not deal in depth with this requirement. Ruder calls it "the largely unarticulated premise." Ruder, *supra* note 40, at 630.

143. These elements include a misrepresentation/omission, causal connection, materiality, reliance, and scienter, as well as the *Birnbaum* rule. See BROMBERG, *supra* note 30, at §§ 8.1-8.9; 3 Loss, *supra* note 25, at 1763-71; 6 Loss, *supra* note 25, at 3869-97.

able, but interrelated—with each other and with “intent.” In the aiding and abetting context scienter includes *knowledge* of the fraud of another, that is, an awareness of the other’s conduct and acts and an awareness that such acts are illegal.¹⁴⁴ The concept, however, is broader. Scienter also includes a *lack of belief* in the truth of a representation (or the legality of conduct) and *recklessness* with respect to truth or legality.¹⁴⁵ Scienter additionally refers to an intent to deceive, mislead, or convey a false impression.¹⁴⁶ But scienter does not include negligence. Thus an honest though unreasonable belief in the truth of a representation or legality of an act is not scienter.

The Supreme Court in the *Hochfelder* opinion has clarified some of the confusion in this area, but has left open several questions and created a few new problems. The Court held that a civil damages action will not lie under section 10(b) and Rule 10b-5 in the absence of an allegation of an intent to deceive, manipulate, or defraud, and defined “scienter” to embrace such intent. Although plaintiff based her claim on a theory of aiding and abetting by means of negligent nonfeasance, the Court did not reach the question whether a civil action for aiding and abetting is appropriate under Rule 10b-5, nor did it decide whether scienter includes reckless conduct.¹⁴⁷ It stated that the language of section 10(b) suggests “knowing or intentional misconduct,” something greater than negligence. By stating the scienter element in terms of intent and not also of knowledge, the Court has perhaps opened the door for the lower courts to seize the term and inject it into the cause of action as a new element lacking a knowledge requirement. In so doing the Court has separated two interrelated terms and has defined scienter imprecisely.¹⁴⁸ Clearly the Court did not have before it an allegation of reckless conduct and thus refrained from deciding that issue. There was also, however, no allegation of an intent to defraud the plaintiff, and therefore the holding was broader than necessary. Facilitating the perpetration of a fraud upon another by means of reckless conduct is certainly as reprehensible as knowing assistance

144. Ruder, *supra* note 40, at 630-38.

145. Derry v. Peek, [1889] 14 App. Cas. 337; W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 107 (4th ed. 1971); Keeton, *Fraud: The Necessity of an Intent to Deceive*, 5 U.C.L.A.L. REV. 583 (1958).

146. W. PROSSER, *supra* note 145, § 107, at 700. Bromberg discusses seven versions of scienter: actual knowledge, constructive knowledge, intent, purpose, bad faith, recklessness, and negligence. BROMBERG, *supra* note 30, at § 8.4(501-92).

147. Ernst & Ernst v. Hochfelder, 96 S. Ct. 1375, 1380 n.7, 1381 n.12 (1976).

148. See text accompanying notes 144-46 *supra*.

and should be barred under Rule 10b-5.¹⁴⁹

Pre-*Hochfelder* opinions in the lower federal courts generally included perfunctory remarks on the subject of knowledge. Most courts required a finding of knowledge and then found it. A few courts discussed intent in the context of passive aiding and abetting. The Third and Sixth Circuits have stated that inaction would lead to liability only when the aider and abettor's silence was "consciously intended" to aid the securities law violation.¹⁵⁰ The Seventh Circuit requires that plaintiff show knowledge plus an "improper motive" or breach of a duty of disclosure to prove a claim based upon inaction.¹⁵¹ The Second Circuit, in a section 14(e) action, stated that liability could be premised on "reckless" conduct.¹⁵²

Professor Ruder, who has not favored the substitution of a duty of inquiry or "reason to know" standard for the scienter requirement, has made two helpful distinctions in this area.¹⁵³ Ruder first distinguished the knowledge of the aider and abettor from the then unsettled question whether scienter on the part of the primary wrongdoer was required under Rule 10b-5—two separate issues. Then he bisected the knowledge requirement itself and said that the aider and abettor must have not only knowledge of the acts, conduct, or omissions of the primary wrongdoer, but also knowledge of the illegal nature of those acts.¹⁵⁴ This distinction is reasonable from a policy standpoint. An individual who possesses knowledge of the occurrence of certain acts but who lacks knowledge that such acts are illegal under the securities laws will not be deterred from violating the securities laws if a court finds liability on the basis of such limited knowledge. Just as unwitting facilitation is not actionable, incomplete knowledge should not be a basis for liability. "Reason to know" that another's conduct is illegal might have been a basis for liability, but it is not actionable today in light of *Hochfelder*.¹⁵⁵

149. Cf. *Ernst & Ernst v. Hochfelder*, 96 S. Ct. 1375, 1392 (1976) (Blackmun, J., dissenting).

150. *Rochez Bros. v. Rhoades*, 527 F.2d 880 (3d Cir. 1975); *SEC v. Coffey*, 493 F.2d 1304 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975).

151. *Hochfelder v. Midwest Stock Exch.*, 503 F.2d 364, 374 (7th Cir.), cert. denied, 419 U.S. 875 (1974).

152. *Lowenschuss v. Kane*, 520 F.2d 255, 268 n.10 (2d Cir. 1975).

153. Ruder, *supra* note 40, at 632-33.

154. *Id.* at 630-38.

155. The "reason to know" version of scienter is what Bromberg calls constructive knowledge. BROMBERG, *supra* note 30, at § 8.4(531). It is linked with the duty of inquiry element mentioned in several cases and relied on by the Seventh Circuit in *Hochfelder v. Ernst & Ernst*, which the Supreme Court indicated was an insufficient basis for liability in private damage actions. It may still be viable in injunctive suits and disciplinary proceedings.

As the majority opinion pointed out, the language of section 10(b) speaks of "manipulative or deceptive" "devices" or "contrivances," concepts definitely implying more than negligence. A defendant who merely has reason to know of another's fraud, and who is not reckless, is literally not within the scope of the section. As an additional policy consideration, plaintiff is not left without a remedy. Other potential remedies include a suit against the primary wrongdoer, a common law fraud or negligence action (if privity can be shown), and possibly an injunctive action for which negligence may still be the standard.

The scienter element of the cause of action is interrelated with the substantial assistance element in what some courts have indicated is an inversely proportional relationship: "the scienter requirement scales upward when activity is more remote."¹⁵⁶ The Supreme Court, however, has set a minimum level upon the scienter element beyond which plaintiff cannot pass. Defendant's conduct must be greater than mere negligence. Above this minimum, the degree of scienter necessary to establish that element of the cause of action may vary depending upon defendant's status.¹⁵⁷ Defendants with higher duties may be subject to liability on the basis of scienter closer to recklessness than actual knowledge.

Before the substantial assistance element is considered in greater detail, two additional topics should be discussed: the method of proof of scienter and the good faith defense. Scienter is generally established in one of three ways: (1) from direct evidence of intent in the form of written or oral statements; (2) from circumstantial evidence; or (3) from reckless conduct.¹⁵⁸ One case has also indicated that the circumstances surrounding defendant's conduct may deviate so radically from normal business practice that he will be deemed to know the consequences of his acts (or inaction).¹⁵⁹

Good faith on the part of defendant indicates a lack of intent

See *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1096 (2d Cir. 1972) (negligence is sufficient basis for equitable or prophylactic relief).

156. *Woodward v. Metro Bank*, 522 F.2d 84, 95 (5th Cir. 1975).

157. See Part IV.A.(3) *infra*. For example, in *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973), Coleman's status as an outside director was crucial to the court's holding that a director owes no duty to insure that all material, adverse information is conveyed to prospective purchasers of stock of the corporation.

158. See *SEC v. Coffey*, 493 F.2d 1304, 1317 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975); *BROMBERG*, *supra* note 30, at § 8.4(529, 539, 549, 559, 569, 579); *Keeton*, *supra* note 145, at 592-98; *Ruder*, *supra* note 40, at 634-36. To the extent that the first method involves inference, (1) and (2) are the same.

159. See *Woodward v. Metro Bank*, 522 F.2d 84, 97 (5th Cir. 1975).

to assist or aid and abet a fraud, and some courts have so held.¹⁶⁰ Good faith, being a subjective standard, must be proved circumstantially. Either defendant's conduct (action or inaction) in light of the circumstances falls within the good faith category, or it is actionable. As a matter of policy, liability should be barred upon a showing of good faith—when there is no intent to deceive, there should be no violation of the securities laws in the absence of a strict liability provision. Good faith in connection with section 20(a) is discussed in subpart (4) *infra*.

(3) "Substantial Assistance"

The third element in the aiding and abetting cause of action is called by the courts "substantial assistance or encouragement." The exact scope of this element is not yet clear, however, because courts have taken different approaches in attempting to fix its boundaries. Passive conduct falls within this element. The theory is that silence and inaction coupled with an additional factor constitute the requisite substantial assistance when scienter exists. The additional factor may be one of several possible choices, depending upon the court involved, including a duty arising out of defendant's status or special relationship vis-a-vis plaintiff and the primary wrongdoer, and possibly a departure from normal business practice.¹⁶¹ Most courts rely on a duty approach and recognize that certain defendants, because of who they are, what they know, and how closely they are connected with the subject matter, owe to plaintiff a duty of disclosure. Breach of this duty constitutes passive conduct sufficient to invoke aiding and abetting liability when the duty is coupled with the requisite scienter on the part of the aider and abettor.

The source of the term "substantial assistance or encouragement" is the Restatement of Torts section 876(b).¹⁶² Under tort law the important considerations are the nature of the act encouraged, the amount of assistance, the location of defendant at the time of the tort, the relation of defendant to the other parties, and the state of mind of defendant.¹⁶³ Generally the courts have used the term as a unit, but "assistance" and "encouragement" are different, and

160. See Hawes & Sherrard, *Reliance on Advice of Counsel as a Defense in Corporate and Securities Cases*, 62 VA. L. REV. 1, 147-48 (1976). But see SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1096 (2d Cir. 1972).

161. Some courts have mentioned intent and benefit to the defendant as the additional factor. Intent of course overlaps with the scienter element, and benefit seems better analyzed as evidence of primary liability. See text accompanying notes 172-74 *infra*.

162. See notes 47-50 *supra* and accompanying text.

163. See note 49 *supra*.

some courts speak only of substantial assistance.

Both terms imply the rendering of some sort of aid to another, with "assistance" raising an inference of conduct that is active. Passive assistance is possible, though. For example, failure to inform the SEC of a fraud violation by one's brokerage firm is passive aid that may be actionable.¹⁶⁴ If plaintiff alleges only assistance, however, and if defendant did record certain misstatements in its books, but plaintiff never saw the books or knew of the misstatements in them, then an aiding and abetting claim based on such conduct should fail on the basis of the lack of the section 10(b) reliance. At the least such conduct should not be deemed substantial.¹⁶⁵ In other words, although no court directly has developed the thought, in a case involving claims of passive aiding and abetting *and* affirmative acts unknown to plaintiff at the time of their occurrence, reliance should be a requirement of the claim based on affirmative acts. The policy would be that no one is harmed by defendant's active conduct in this situation when no one relies thereon. Reliance should not be a requirement of the passive conduct claim, however. Commentators have noted that proof of reliance would be illogical and unnecessary in an omission or nondisclosure case,¹⁶⁶ and by analogy, reliance should be unnecessary in a suit based upon passive aiding and abetting. The courts, however, continue to refer to the term.¹⁶⁷

Generally the courts have required assistance to be both substantial¹⁶⁸ and knowing¹⁶⁹ to be actionable, especially in the passive conduct area. In fact a suit based on inaction would be meaningless in the absence of proof of the aider and abettor's knowledge of the fraud, or recklessness with regard to it. Passive aiding and abetting is not a form of strict liability. Substantiality and knowledge along with the "in connection with" requirement apparently have been

164. See *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673 (N.D. Ind. 1966).

165. This fact situation is based upon *Odette v. Shearson, Hammill & Co.*, 394 F. Supp. 946 (S.D.N.Y. 1975). An extensive discussion of reliance is beyond the scope of this Note. In general the term is closely related to causation, privity, and materiality. In other than nondisclosure and omission cases, the concept is still viable. See 3 BROMBERG, *supra* note 30, § 8.6(1), at 420.7.

166. BROMBERG, *supra* note 30, at § 8.6(1); Comment, 29 VAND. L. REV. 287 (1976); see *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972).

167. *Landy v. Federal Deposit Ins. Corp.*, 486 F.2d 139 (3d Cir. 1973).

168. *Woodward v. Metro Bank*, 522 F.2d 84 (5th Cir. 1975); *SEC v. Coffey*, 493 F.2d 1304 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975); see RESTATEMENT OF TORTS § 876, comment on clause (b) (1939).

169. *Rochez Bros. v. Rhoades*, 527 F.2d 880, 886 (3d Cir. 1975); *Anderson v. Francis I. duPont & Co.*, 291 F. Supp. 705 (D. Minn. 1968).

used by the courts to limit liability to conduct that has some close relation to the primary wrong. As an example, the *Landy* court could find no basis in securities law policy to extend Rule 10b-5 in the aiding and abetting area in the absence of a "special relationship between the parties." The court mentioned the absence of reliance, and with regard to another aspect of the case, stated that defendants failed to meet the "in connection with" requirement.¹⁷⁰

Additional factors are necessary to convert nonaction on the part of the defendant into actionable "substantial assistance." "Intent" was discussed in relation to scienter in Part IV.A.(2) above. Some courts have indicated that silence is actionable only when defendant "consciously intended" to aid the primary wrong.¹⁷¹

"Benefit" is another factor, and in fact it may be the principal distinction between primary liability and secondary aiding and abetting liability, despite a Seventh Circuit opinion indicating that benefit may be necessary to the substantial assistance element.¹⁷² In that opinion the court observed that the defendant had benefitted from a course of conduct that operated as a fraud on others. Two other courts, however, have not relied on benefit—one¹⁷³ placed no weight on the lack of an allegation of gain and the other¹⁷⁴ found defendant liable despite the fact that he did not profit from his aiding and abetting. Benefit therefore is a weak factor that should not be relied on independently to establish substantial assistance. In fact the presence of benefit should be an indication either of a primary wrong or an inadvertent profiting from unknowing conduct. When one acts with an intent to obtain benefit, a strong inference exists that defendant's conduct is based upon fraud, and as a matter of policy defendant's conduct should be discouraged by a finding of liability.

Another fact that has received some attention is "departure from normal business practices." In the first of two recent opinions the Fifth Circuit stated:

In a case combining silence/inaction with affirmative assistance, the degree of knowledge required should depend on how ordinary the assisting activity is in the business involved. If the evidence shows no more than transactions constituting the daily grist of the mill, we would be loathe to find 10b-5 liability without clear proof of intent to violate the securities laws. Conversely, *if the*

170. 486 F.2d at 161-62, 169.

171. See text accompanying note 150 *supra*.

172. *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969).

173. *Fischer v. Kletz*, 266 F. Supp. 180, 190 (S.D.N.Y. 1967).

174. *Blakely v. Lisac*, 357 F. Supp. 255, 264 (D. Ore. 1972).

method or transaction is atypical or lacks business justification, it may be possible to infer the knowledge necessary for aiding and abetting liability.¹⁷⁵ (emphasis added)

The second opinion quoted the former and added that the nature of the assistance required for liability relates back to the knowledge element.¹⁷⁶ Together these two opinions indicate that courts may be willing to find the requisite substantial assistance by implication from conduct that radically departs from normal business activities. Conversely, when plaintiff seeks to establish scienter by means of a weak inference, evidence that defendant's conduct (active or passive) was merely normal business routine may be a defense.

The most important of the factors indicating substantial assistance is based ultimately upon defendant's status with respect to plaintiff and the primary wrongdoer. Courts use the terms "duty" and "special relationship" to indicate that extra ingredient necessary to change inaction into substantial assistance. Although Professor Ruder has concluded that in such instances liability should be based upon a direct breach of a duty to disclose and not upon the aiding and abetting theory,¹⁷⁷ courts consistently have phrased liability in terms of aiding and abetting.

In *Fischer v. Kletz*¹⁷⁸ the court spoke directly of duty in connection with an aiding and abetting claim against an accounting firm; the court found no duty since no special relationship was created between defendant and plaintiffs when defendant furnished figures to the ultimate primary wrongdoer. The source of the court's "special relationship" language was *Brennan*. Another court indicated that a duty arises when defendant possesses inside information, knowingly assists or participates in a fraudulent scheme, or in the capacity of a director consents to and approves of fraudulent practices.¹⁷⁹

Presently the law seems to be that an alleged aider and abettor will be liable if he possesses scienter and breaches a duty owed to the plaintiff. The duty is to disclose the fraudulent conduct of which he knows. The duty arises when a special relationship between plaintiff and defendant exists. Implicit in this conclusory statement is the principle that no duty is owed when a relationship becomes

175. *Woodward v. Metro Bank*, 522 F.2d 84, 97 (5th Cir. 1975).

176. *H.L. Federman & Co. v. Greenberg*, 405 F. Supp. 1332, 1338 (S.D.N.Y. 1975).

177. Ruder, *supra* note 40, at 644. Ruder believes that positive assistance is necessary when defendant possesses no independent duty to act. *Id.* at n.211.

178. 266 F. Supp. 180 (S.D.N.Y. 1967); *see Ross v. Licht*, 263 F. Supp. 395 (S.D.N.Y. 1967).

179. *Strong v. France*, 474 F.2d 747, 752 (9th Cir. 1973).

too remote.¹⁸⁰ Some courts have indicated that the special relationship *must* exist for the court to find liability when defendant's conduct consists of "mere inaction."¹⁸¹ The special relationship may also exist in the form of a fiduciary relationship between the parties, such as the corporate director-shareholder situation.¹⁸²

Certain defendants owe duties to the public because of their connection with the securities industry—exchanges, broker-dealers, attorneys, and accountants. The policy behind the securities laws is that disclosure and the prohibition of fraud can best be effected by allowing a great amount of self-regulation. A concomitant of such self-regulation is a duty to disclose known facts constituting fraudulent conduct.¹⁸³ As a result of their status with respect to the securities laws, these parties' relationship to the investing public is special, and passive conduct should amount to substantial assistance sufficient to invoke liability when scienter is shown.

(4) Defenses

Three possible defenses to an aiding and abetting claim have been mentioned in the subsections immediately above: no connection with the purchase or sale of a security, normal business practice, and good faith. *Landy*¹⁸⁴ is the opinion best exemplifying the first defense. This defense appears merely to represent plaintiff's failure to prove one of the elements of the cause of action, and thus technically it may not be a defense. Section 10(b) mandates that actionable fraud must be "in connection with" a purchase or sale of securities. Although no opinions discuss aiding and abetting in the context of the elements necessary to prove a direct violation of section 10(b), some correspondence must exist. After all, the aider and abettor is jointly and severally liable with the primary wrongdoer, and thus proof of his liability should not be based upon lesser standards. In *Landy* plaintiffs charged defendant brokers with misstatements violating Rule 10b-5 and with aiding and abetting by means of inaction. The court discussed the "in connection" requirement in its discussion of the Rule 10b-5 claim, but seemed to indicate that the brokers' *conduct* was not "in connection with" plain-

180. See *H.L. Federman & Co. v. Greenberg*, 405 F. Supp. 1332 (S.D.N.Y. 1975).

181. See, e.g., *Landy v. Federal Deposit Ins. Corp.*, 486 F.2d 139, 161-62 (3d Cir. 1973).

182. See *Strong v. France*, 474 F.2d 747, 752 (9th Cir. 1973); *Sprayregen v. Livingston Oil Co.*, 295 F. Supp. 1376, 1378 (S.D.N.Y. 1968). Most courts do not mention fiduciary duties in this context.

183. See Part II.C. *supra*.

184. 486 F.2d 139 (3d Cir. 1973).

tiffs' purchases¹⁸⁵—a statement equally applicable to the aiding and abetting claim. Later in the opinion the court spoke in terms of the failure of plaintiffs to show reliance, a reference to causation. The "no connection" defense is based only upon inference from the *Landy* opinion; the courts may not accept it.

The second proposed defense, normal business conduct, was discussed above.¹⁸⁶ It also is a weak defense. A stronger argument can be made for its converse: that abnormal business conduct is a factor establishing the substantial assistance element.

The strongest of these defenses is good faith. It has received support from the judiciary and the commentators.¹⁸⁷ The circuits have split, however, on the issue whether section 20(a),¹⁸⁸ which contains a statutory good faith defense, is exclusive.¹⁸⁹ If the section is exclusive, then when defendant's status as a control person falls within the section, plaintiff must proceed under the section and be subject to the good faith defense. Even if the section is not exclusive, a good post-*Hochfelder* argument can be made that good faith should be a valid defense to a claim of aiding and abetting, just as it is a defense to crimes requiring intent.¹⁹⁰ In *Hochfelder* the Court required scienter, which connotes intent, in suits involving Rule 10b-5. Since intent is a required element, in some form, good faith should be allowed as a defense. Furthermore, in several recent opinions including *Hochfelder*, the courts have indicated that limitations on liability in certain sections of the securities acts should apply in suits brought under Rule 10b-5; otherwise, express provisions of the statutes would be rendered meaningless.¹⁹¹ If this view ultimately is accepted, good faith is a valid defense to an aiding and abetting claim.

185. Plaintiffs claimed that defendants should be liable because they failed to inform plaintiffs that they bought and sold for the primary wrongdoer. *Id.* at 161.

186. See text accompanying notes 175-76 *supra*.

187. See *Hawes & Sherrard*, *supra* note 160, at 1 (when courts construe knowledge or willfulness to require criminal intent, good faith is a defense); *Ruder*, *supra* note 40, at 601-08; Note, *The Burden of Control: Derivative Liability Under Section 20(a) of the Securities Exchange Act of 1934*, 48 N.Y.U.L. Rev. 1019 (1973); cf. *Johns Hopkins Univ. v. Hutton*, 297 F. Supp. 1165 (D. Md. 1968).

188. 15 U.S.C. § 78t (1970). This section provides for the liability of controlling persons.

189. *Gordon v. Burr*, 366 F. Supp. 156, 168 (S.D.N.Y. 1973); see *Zweig v. Hearst Corp.*, 521 F.2d 1129 (9th Cir. 1975); *SEC v. Lum's Inc.*, 365 F. Supp. 1046 (S.D.N.Y. 1973); *Kamen & Co. v. Paul H. Aschkar & Co.*, 382 F.2d 689 (9th Cir. 1967).

190. See note 187 *supra*.

191. See *Ernst & Ernst v. Hochfelder*, 96 S. Ct. 1375 (1976); *Gilbert v. Nixon*, 429 F.2d 348, 357 (10th Cir. 1970); Note, *supra* note 187, at 1034.

B. Proposed Definition

Despite innumerable references to aiding and abetting in judicial opinions¹⁹² and by commentators,¹⁹³ no real definition exists, although some tests have been offered.¹⁹⁴ Analogies to tort and criminal law and to statutes that refer to the term without defining it are all that exist. Even the new Federal Securities Code refers to the term without precisely defining it.¹⁹⁵ This Note proposes the following definition of aiding and abetting for purposes of a private action for damages:

Aiding and abetting exists when one whose conduct does not independently violate the securities laws substantially assists, with scienter, a violation of the securities laws by another (the primary wrongdoer). Scienter includes knowledge of the acts, conduct, or omissions of the primary wrongdoer and knowledge that such conduct is illegal. Scienter also includes recklessness. Substantial assistance includes any positive action that assists the violation by the primary wrongdoer or encourages him in furtherance of the violation. Substantial assistance also includes passive conduct (silence and inaction), but only when the defendant aider and abettor has (1) actual knowledge of plaintiff's innocent involvement in the transaction and (2) a duty to disclose the violation to plaintiff. A duty to disclose arises (1) when plaintiff is acting in reliance upon defendant's silence and inaction because a fiduciary relationship between the two exists, or (2) when defendant owes a duty to the public to maintain the integrity and proper functioning of the securities markets and the policies behind the securities laws because of his close relationship to or position within the securities industry.

Although no court has yet indicated that it would agree with all of the provisions in the proposed definition, the author suggests that

192. *E.g.*, *Lowenschuss v. Kane*, 520 F.2d 255, 268 n.10 (2d Cir. 1975).

193. Professor Ruder does have a section entitled "Conspiracy and Aiding and Abetting Defined and Distinguished," but no technical definition is offered. Ruder, *supra* note 40, at 620.

194. *See SEC v. Coffey*, 493 F.2d 1304 (6th Cir.), *cert. denied*, 419 U.S. 875 (1974). The *Coffey* test could be called a definition, but terms are used that are not defined.

195. The Federal Securities Code in Tentative Drafts No. 2 and 3 includes liability provisions for aiding and abetting without ever using the term in the textual portions. The Code states:

§ 1419(b) [*Aiders and Abettors.*] (1) An agent or other person who *causes, commands, induces, procures,* or gives substantial assistance to conduct by another person (herein a "principal") giving rise to liability under this Code (as defined in section 217A and except for section 1413) with knowledge that that conduct is the kind specified in section 1419(a)(1) [conduct that is unlawful, actionable, or a breach of duty, or involving a deceptive act, misrepresentation or nondisclosure of a material fact by an insider] is liable to the same extent as the principal.

Federal Securities Code § 1419(b), *cited in* Federal Securities Code § 1704, Comment (4), at 199 (Tent. Draft No. 3, 1974) (emphasis added). The original version in Tentative Draft No. 2 was renumbered and substantially changed: a "knowledge or reasonable ground to believe" requirement was changed to "knowledge." *Id.* § 14.18(b) (Tent. Draft No. 2, 1973). Section 1419(a)(1) is not included in Tentative Draft No. 3. The bracketed material paraphrases § 1418(a)(1).

a fair reading of the recent cases and an examination of the policies behind the securities laws support this definition. The three elements of the cause of action are included. *Scienter* traditionally has been defined to include reckless conduct, and it is so defined here. The relationship between the *scienter* and assistance elements is recognized. It is believed that recklessness is a sufficient standard when active conduct exists, but that actual knowledge should, in part, be necessary in a claim based upon passive conduct. Furthermore, in keeping with traditional tort law, violation of a duty is a requisite to liability for inaction (nondisclosure). A duty to disclose should arise when defendant is a fiduciary and when defendant owes a duty to the public because of his special status within the securities industry.

V. CONCLUSION

Despite many divergent threads running through the recent opinions, a clear trend is discernible: the theory of aiding and abetting liability grounded on passive conduct is viable, and the elements of the cause of action are solidifying. The frequency of lawsuits containing counts alleging aiding and abetting by means of silence and inaction has belied the prediction made in 1972 that the aider and abettor doctrine would be of less importance in the future because defendant need no longer be a purchaser or seller.¹⁹⁶

The policies of the securities acts are served by sanctioning aiding and abetting—active and passive. Disclosure is encouraged and fraud discouraged. The scope of the statutes should extend to action or inaction that is not a direct violation of the statutes. After all, an aider and abettor is a person with knowledge of illegal conduct who assists that conduct. Aiding and abetting, however, is not a direct violation. Generally, the aider and abettor derives no benefit from his conduct, and his action or inaction, considered separately from the acts of the primary wrongdoer, is not a violation of the securities acts.

Plaintiffs have been seeking to reach the deep pocket, and now they have a means at their disposal. The accounting firm, law firm, stock exchange, and bank will provide fertile ground for future recoveries if the requisite assistance and *scienter* are proved.

CLYDE A. BILLINGS, JR.

196. R. JENNINGS & H. MARSH, *SECURITIES REGULATION: CASES AND MATERIALS* 1181 (3d ed. 1972). These authors did concede the possibility that the *Brennan* doctrine might be accepted by other courts.

