December 2, 2010

Re: Questions Regarding Mandated GAO Study of Securities Litigation

Patrick Dynes
Financial Markets and Community Investment
Room 2410
U.S. Government Accountability Office
441 G Street NW
Washington, D.C. 20548

Dear Mr. Dynes,

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to submit these responses to the six questions posed to it by the Government Accountability Office ("GAO") on September 28, 2010, in connection with the GAO's study, pursuant to Section 929Z of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1871 (July 21, 2010) ("Dodd-Frank"), on the impact of authorizing a private right of action against any person who aids or abets another person in violation of the securities laws.

EXECUTIVE SUMMARY

In 1994, the U.S. Supreme Court decided Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994), and wisely eliminated the private cause of action for aiding and abetting violations of the federal securities laws. As the Supreme Court recognized at the time, the private aiding and abetting action had given rise to a potentially massive, but disturbingly standardless, form of liability for a wide range of secondary actors. Defendants who had engaged in no deceptive or unlawful conduct of their own faced vast damages awards based on the possibility that their otherwise perfectly legal conduct—whether or not it was known to investors—had substantially assisted someone else in violating the securities laws.

In the sixteen years since Central Bank, Congress has not disturbed the Supreme Court's conclusion. While Congress did clarify the authority of the U.S.

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

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Securities and Exchange Commission ("SEC") to pursue aiders and abettors, and has since expanded the SEC's powers to recover amounts from such defendants on behalf of investors, Congress has repeatedly declined to legislatively undo Central Bank by recreating a private right of action against aiders and abettors. Likewise, the Supreme Court in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008), rejected longstanding efforts by the plaintiffs' bar to reintroduce into the federal securities laws a theory of private liability akin to aiding and abetting by expanding the definition of what it means to commit a "primary violation" of those laws. As the Court recognized in Stoneridge, this theory—whatever its name—still threatened to subject secondary actors to expansive liability, with no uniform—or even discernable—way to identify the conduct that was being proscribed.

As set forth below, SIFMA believes that it is unnecessary and inadvisable for Congress to reverse its course over the last decade and a half to now legislatively undo Central Bank and Stoneridge by creating a private right of action for aiding and abetting securities fraud. This is principally so for six reasons.

First, creating a new cause of action for aiding and abetting is unnecessary to deter deceptive conduct or compensate investors. A variety of privately enforced statutory rights of action already exist under the federal securities laws that allow investors to sue those who "participate," "cause" or otherwise contribute to securities violations. For example, the securities laws already have a well-established private liability scheme in place for many secondary actors, including underwriters and accountants, in connection with the issuance of registered securities. Further, the SEC, the U.S. Department of Justice ("DOJ"), non-governmental self-regulatory organizations ("SROs") and state securities regulators already can, and do, punish those who assist in violating federal and state securities laws. Indeed, under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Congress specifically authorized the SEC to pursue aiders and abettors for violations of the securities laws. The recently enacted Dodd-Frank Act has expanded the SEC's power in this regard even further. Similarly, the DOJ can criminally prosecute those who aid and abet violations of, or conspire to violate, the securities laws. In addition to stiff criminal penalties (including imprisonment for individual actors), the reputational risk attendant to such prosecutions serves as a powerful deterrent. Financial companies and other secondary actors, which depend heavily on their customers' trust and goodwill, recognize that an indictment would in most cases be the equivalent of a death sentence.

Second, a private aiding and abetting cause of action would exacerbate the problem of abusive "strike suits"—a problem that both Congress and the courts have sought to address over the years. Despite the heightened pleading requirements applicable to securities fraud claims, motions to dismiss even the most meritless complaints are costly and distracting. Moreover, the highly specialized facts surrounding complex financial transactions can often raise enough uncertainty for even meritless complaints to survive motions to dismiss, exposing all participants in such transactions to the threat of liability. Cases surviving a motion to dismiss almost always settle due to the high cost of discovery and the risk of massive damages

awards—a risk that many rational defendants are unwilling to bear even when a lawsuit is frivolous. This problem is compounded by the fact that traditional secondary actors—i.e., financial institutions, auditing firms, lenders, financial advisors—are quintessential "deep pockets" often included as defendants in an attempt merely to drive up the settlement value of a case.

Third, a private right of action for aiding and abetting would lead to the imposition of disproportionate liability on secondary actors. Secondary actors typically earn comparatively modest fees for their supporting, yet essential, roles in financial transactions. Such fees, however, pale in comparison to the potential liability facing a secondary actor held to be jointly and severally liable for a multi-billion dollar damages award. Given that an aider and abettor can be found liable even where investors did not rely on its conduct so long as it provided substantial assistance, this is truly an unfair result, which would likely lead secondary actors to charge higher fees or refuse to provide their vital services at all, at least in the United States.

Fourth, in an area that the Supreme Court has said "demands certainty and predictability," aiding and abetting liability has been and remains anything but clear. Giving the plaintiffs' bar—a group with a large financial stake in the recoveries obtained in class action suits—the ability to bring aiding and abetting cases, therefore, is dangerous and runs directly counter to Congress's intent in prior legislation in this area. Such a cause of action is better left in the hands of the SEC and the DOJ—expert regulators that are duty-bound to exercise their authority in the most meritorious cases.

Fifth, the increased risk of liability for secondary actors will manifest itself in higher fees passed on to their customers and, ultimately, investors—the intended beneficiaries of any statute creating a private cause of action for aiding and abetting. Recent studies show that the high cost of doing business in the United States—due in large part to the risk of securities fraud class action litigation—is already an impediment to foreign companies listing on U.S. stock exchanges as well as doing business with domestic companies in general. There can be little doubt that an expanded private cause of action for aiding and abetting would only increase these costs and therefore severely hamper the global competitiveness of U.S. capital markets. In today's economic climate, it would be truly misguided—as well as counterintuitive—to enact legislation that would further raise the cost of transacting business in the United States. This is particularly true given that effective enforcement mechanisms already exist, as noted above.

And sixth, there are few circumstances, if any, in which a private right of action for aiding and abetting would add to the compensation that injured investors can already obtain through an action against the primary violator. Because aiding and abetting liability is traditionally derivative of the primary violator's liability, allowing aiders and abettors to be sued would not "expand the pie" of available compensation. Indeed, including secondary actor defendants would only be meaningful for the purpose of compensation where the primary violator is insolvent or judgment-proof. In such cases, the secondary actor would essentially act as an insurer of its counterparty's

compliance with the securities laws—another cost that will necessarily be passed on to and ultimately borne by the shareholders of public companies.

A new cause of action for aiding and abetting will, in the end, do little more than give plaintiffs' attorneys another tool to extract settlements from an expanded pool of defendants, regardless of the merit of the case, with little additional benefit to investors and at substantial cost to the U.S. economy. For these reasons and those set forth below, Congress should not alter the balance that it and the courts have struck over the last sixteen years by reimposing private aiding and abetting liability.

RESPONSES TO THE GAO'S QUESTIONS REGARDING SECURITIES LITIGATION

Question 1: Who are the primary and secondary actors in the company issuance of securities? What roles do secondary actors play and how do these roles vary?

Response to Question 1:

A company's issuance of new securities generally involves at least one "primary actor"—the issuer of the securities—as well as a number of supporting, or "secondary," actors who assist the issuer in a variety of ways with the registration, offering and distribution of the securities. In a typical offering, the secondary actors will include underwriters, auditors and lawyers. The roles and obligations of both the primary and secondary actors are dictated in large part by the comprehensive statutory and regulatory scheme governing the new issue of securities. This legal framework is primarily imposed by the Securities Act of 1933 (the "Securities Act"), see 15 U.S.C. § 77a et seq., SEC regulations promulgated thereunder, see, e.g., Regulation C, 17 C.F.R. §§ 230.400-230.494, and applicable rules of self-regulatory organizations ("SROs"), see, e.g., FINRA R. 5110. The roles of these various actors are discussed in turn below.

Issuers. Generally speaking, an issuer is any "person who issues or proposes to issue any security." 15 U.S.C. § 77b(a)(4); see also FINRA R. 5110(a)(1). Companies issue securities for a variety of reasons, but primarily to raise capital for further expansion and investment. See Carl W. Schneider et al., GOING PUBLIC: PRACTICE, PROCEDURE AND CONSEQUENCES 2 (Aspen Publishers 2006) (1970) [hereinafter GOING PUBLIC]; THE NEW YORK STOCK EXCHANGE IPO GUIDE 10 (Carolyn Boyle ed. 2010), available at http://www.nyse.com/exccelerate/content/NYSE_IPO_Guide.pdf [hereinafter NYSE IPO GUIDE]. Unless a specific exemption applies, issuers of new securities are usually required to register them with the SEC by filing a registration statement, which must include, among other things, a prospectus describing the securities being offered, as well as certain information relating to the issuer's business and financial condition. 15 U.S.C. §§ 77f(a), 77g(a), 77j, 77aa, sched. a; see also id. § 77e; Regulation S-K, 17 C.F.R. § 229.202. Registration serves the purpose of enabling investors to "make informed judgments about whether to purchase a company's securities." See The Laws that Govern the Securities Industry, SEC Website, http://www.sec.gov/about/laws.shtml (last visited Nov. 30, 2010). Materially

false or misleading representations in a registration statement can subject the issuer, as well as certain secondary actors, to private civil liability. See, e.g., 15 U.S.C. §§ 77k, 77l(a)(2).

Underwriters. An underwriter is "any person who has purchased from an issuer with a view to . . . the distribution of any security," or offers or sells any security in connection with a public distribution of securities, or participates in such a distribution. 15 U.S.C. § 77b(a)(11). Typically, the issuer will retain one or more investment banks as underwriters to manage its securities offering. In this role, the investment bank or a syndicate of investment banks will either buy the entire new issue from the issuer at a discount (a "firm commitment underwriting") or commit to do its best to sell the new issue (a "best efforts agreement"). See GOING PUBLIC at 4-8, 36-37. Most publicly traded securities in the United States are offered on a firm commitment basis.

The details of the arrangement between the issuer and the underwriter are memorialized in an underwriting agreement. Underwriters in a firm commitment underwriting take the risk that they will not be able to sell the entire offering and will be forced to hold the excess securities themselves. Id. at 36. The underwriter's fee is the difference between the price they pay the issuer and the money they collect from selling the offering to investors (sometimes referred to as the "underwriting discount" or "spread"). The underwriter or underwriting syndicate is responsible, among other things, for performing due diligence on the issuer, reviewing the prospectus prepared by the issuer, setting the offering price in consultation with the issuer, organizing and managing the syndicate that will help to sell the new securities, marketing the securities by preparing certain ancillary sales materials and organizing road shows to maximize the success of the sale, and—subject to certain limitations—supporting the price of the newly issued securities in the aftermarket. See GOING PUBLIC at 8; NYSE IPO GUIDE at 14.

Like issuers, underwriters who offer or sell securities pursuant to a registration statement containing materially false or misleading statements currently face potential private civil liability under the Securities Act to purchasers of that security. See 15 U.S.C. §§ 77k(a)(5), 77l(a).

Auditors. When a company issues new securities, it generally must include audited financial statements in its registration statement. See, e.g., 15 U.S.C. §§ 77g(a), 77aa, sched. a(25)-(26); Regulation S-X, 17 C.F.R. §§ 210.1-01(a)(1), 210.3-01(a), 210.3-02(a). Accordingly, an issuer will hire independent auditors to perform an audit of the annual financial statements prepared by the issuer for registration, and to review such unaudited interim financial statements as the issuer is required to include in the registration statement.[2] The auditor may also provide comfort to the issuer on any difficult accounting issues in connection with the

[2] In addition, issuers who are registered pursuant to Section 13 of the Exchange Act must also file annual reports that include financial statements that are certified by independent auditors. See 15 U.S.C. § 78m(a)(2); Regulation S-X, 17 C.F.R. §§ 210.1-01(a)(2), 210.3-01(a), 210.3-02(a).

registration statement and historical audited financial statements. See NYSE IPO GUIDE at 14. The auditor's relationship with the issuer is reviewed by the issuer's board of directors and the issuer's counsel to ensure independence in compliance with the securities laws and relevant rules of the securities exchange on which the issuer's securities are listed. Id.

An independent auditor that certifies the issuer's audited financial statements that are included in a registration statement is considered an "expert" under the securities laws and, as a result, currently faces private civil liability under the Securities Act if such audited financial statements are false or misleading. See 15 U.S.C. § 77k(a)(4).

Lawyers. Both the issuer and the underwriters in an offering of securities are typically represented by separate counsel. Company counsel works with the company's in-house lawyers to represent the interests of the issuer. Specifically, company counsel is closely involved in drafting the registration statement, conducting due diligence, and negotiating the underwriting agreements. See GOING PUBLIC at 19-22; NYSE IPO GUIDE at 14. Underwriters' counsel will represent the underwriters in the registration statement process as well as through due diligence, review of the prospectus, and the preparation of the underwriting agreement. See GOING PUBLIC at 19-22, 35-37; NYSE IPO GUIDE at 34. In addition, they also typically coordinate required filings with the applicable SROs and state securities regulators. See Constance E. Bagley & Craig E. Dauchy, THE ENTREPRENEUR'S GUIDE TO BUSINESS LAW, 3RD EDITION 688 (Jack W. Calhoun ed., Thomson West 2008) (2003). An issuer is required to include in the registration statement the opinion of counsel that the securities will be validly issued or, in the case of debt securities, will be binding obligations of the issuer. 15 U.S.C. §§ 77g(a), 77aa, sched. a(29).

Ratings Agencies. "Credit rating agencies are organizations that rate the creditworthiness of a company or a financial product, such as a debt security or money market instrument. These credit ratings are often considered by investors evaluating whether to purchase or sell securities." Fact Sheet: Strengthening Oversight of Credit Rating Agencies, SEC Website, http://www.sec.gov/news/press/2009/2009-200-factsheet.htm (last visited Nov. 30, 2010). Issuers therefore sometimes included credit ratings in the registration statement for certain types of securities. See Regulation S-K, 17 C.F.R. § 229.10(a), (c). Until the enactment of Dodd-Frank, "nationally recognized" ratings agencies were exempt from liability under certain provisions of the Securities Act for materially false or misleading ratings included in a registration statement. See 17 C.F.R. § 230.436(g)(1). Dodd-Frank, however, nullified this exemption. Dodd-Frank § 939G, 124 Stat. 1890. Dodd-Frank also reduced the standard of proof for establishing a claim against a ratings agency under the general antifraud provisions of the securities laws. See Dodd-Frank § 933(a)-(b), 124 Stat. 1883-84. As a result, as explained below, many rating agencies will no longer consent to the inclusion of the rating in the registration statement. See infra at 23.

Unregistered Offerings. Many of the specific requirements of the Securities Act apply only to offerings of registered securities. Unregistered offerings, however,

involve many of the same primary and secondary actors and are also subject to various regulations that limit how and to whom they can be marketed or sold. See, e.g., 17 C.F.R. §§ 230.144A(d)(1), 230.501(e), 230.502(c) (pursuant to Rule 144A exemption, unregistered securities may only be sold to large, sophisticated institutional buyers); 17 C.F.R. § 230.506 (pursuant to Regulation D exemption, unregistered securities may not be sold to more than thirty-five purchasers who are not accredited investors, and may not be offered using a general solicitation). Participants in an offering of unregistered securities that are issued pursuant to a valid exemption from registration still remain subject to general antifraud liability under the securities laws.

"Primary" Liability for "Secondary" Actors. As noted above and as discussed more fully in response to Questions 2 and 4 below, underwriters, auditors and attorneys—all typically described as "secondary" actors—already face private civil liability to purchasers in registered securities offerings under the Securities Act. In addition, they may, in certain circumstances, be held directly liable to investors for "primary" violations of the securities laws, including the antifraud provisions of the Securities Exchange Act of 1934, insofar as an alleged false statement may be attributed to them.[3]

Furthermore, while the GAO has posed its first question in reference to a company's issuance of securities, it is important to note that many of the same actors who play "secondary" roles in securities offerings interact with issuers in myriad other ways that are unconnected to the offering of securities. Investment banks that underwrite an offering of a company's securities, for example, might also act as a trading counterparty to another company as a market maker, or—through a commercial banking affiliate—provide financing as a commercial lender. Similarly, law firms may serve as counsel on any number of corporate transactions or in litigated matters. In such contexts, these "secondary" actors—together with all of the issuer's other business counterparties and vendors, who typically are not involved in securities offerings—remain subject to provisions of the securities laws described below that prohibit the making of false statements or the use of a deceptive or manipulative device or contrivance. See, e.g., 15 U.S.C. § 78j(b).

[3] Additionally, some "secondary" actors, such as certain investment banks that act as underwriters, are themselves publicly held companies (or are the subsidiaries or affiliates of such companies). Thus, these companies may, at times, issue their own securities. In this capacity, such firms would be "primary" actors subject to the same primary liability provisions of the federal securities laws as any other issuer.

Question 2: Do you have any information on the different issues in the courts' interpretation of the scope of liability for secondary actors and the types of lawsuits decided under the Private Securities Litigation Act of 1995?

Response to Question 2:

Since the Supreme Court's decision in Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994), there has been no private right of action for aiding and abetting violations of the federal securities laws. Despite amending these laws in significant ways on four occasions since 1994, Congress has declined to create a private aiding and abetting cause of action. Accordingly, federal securities litigation involving secondary actors has, since Central Bank, focused on the courts' efforts to delineate the circumstances under which secondary actors may be held liable as primary violators.

1. Statutory and Regulatory Background to Enforcement of the Securities Laws

Before discussing judicial interpretations regarding the scope of secondary actor liability, it is helpful to first review the statutory provisions that provide for private and public enforcement of the federal securities laws.

Sections 11 and 12 of the Securities Act. As explained above, the Securities Act of 1933 comprehensively regulates offerings of securities. Sections 11 and 12 of the Securities Act create a form of strict liability with respect to materially false or misleading registration statements for certain enumerated participants in the offering and distribution of registered securities. Section 11 provides a private right of action against anyone who signed the registration statement, the issuer's directors, the underwriters, and any experts—including auditors and lawyers—who are named with their consent as having certified a portion of the registration statement. 15 U.S.C. § 77k(a).

Section 12(a) provides a private right of action against anyone who offers or sells an unregistered security (which is not exempt from registration), id. § 77l(a)(1), as well as anyone—such as an issuer or underwriter—who offers or sells a security pursuant to a materially false or misleading registration statement, id. § 77l(a)(2). Private actions under Sections 11 and 12 do not require proof that the defendants had any deceptive intent. See, e.g., Rombach v. Chang, 355 F.3d 164, 171 (2d Cir. 2004) ("Fraud is not an element or a requisite to a claim under Section 11 or Section 12(a)(2).").[4] Given the breadth of liability under these provisions, Section 11 and 12 claims are subject to certain limitations: they must be brought within one year of discovering the false statement, 15 U.S.C. § 77m, Section 11 damages are capped at

[4] Defendants other than an issuer can, however, defeat liability if they prove that they did not know of the alleged misstatement and could not have discovered it through reasonable diligence. See 15 U.S.C. §§ 77k(b)(3), 77l(a)(2). And all defendants can also defeat or reduce liability by proving that the plaintiff's loss was due to something other than the alleged false statements. Id. §§ 77k(e), 77l(b).

the public offering price, id § 77k(g), and Section 12 claims are subject to a privity requirement, see id § 77l(a) (limiting defendant's liability "to the person purchasing such security from him [i.e., the defendant]") (emphasis added).

Section 10(b) of the Exchange Act. While the Securities Act regulates offerings, the Securities Exchange Act of 1934 (the "Exchange Act") regulates trading in the aftermarket—i.e., post-offering trading of registered securities by investors. The principal Exchange Act provision giving rise to private civil liability is Section 10(b), which makes it unlawful to "use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of [SEC Rule 10b-5]." 15 U.S.C. § 78j(b). Rule 10b-5, in turn, makes it unlawful to make any materially false or misleading statement in connection with the purchase or sale of a security. 17 C.F.R. § 240.10b-5(b). Although Section 10(b) and Rule 10b-5 do not expressly provide a private right of action, the federal courts implied the existence of such an action in the 1940s, see Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512, 513 (E.D. Pa. 1946) (first recognizing an implied cause of action under Section 10(b) of the Exchange Act); accord Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) (noting that "[i]t is now established that a private right of action is implied under § 10(b)"), and Congress subsequently ratified it in the PSLRA, see 15 U.S.C. § 78u-4(b) (setting forth requirements for securities fraud actions); S. Rep. No. 104-98, at 4-5, 26 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 683 (recognizing the § 10(b) implied cause of action). The private action under Section 10(b) is the principal basis for most private federal securities class actions. See 7 WILLIAM B. RUBENSTEIN, ALBA CONTE & HERBERT B. NEWBERG, NEWBERG ON CLASS ACTIONS § 22:1 (4th ed. 2010).

To state a claim under Section 10(b), a plaintiff must allege that the defendant knowingly or recklessly made a materially false statement or omission, and that the plaintiff relied on the alleged misrepresentation to its detriment. See Dura Pharm. Inc. v. Broudo, 544 U.S. 336, 341-42 (2005). So long as the securities at issue trade in an open and efficient market (such as the New York Stock Exchange or the NASDAQ national market system), however, courts generally employ a rebuttable presumption—pursuant to the "fraud on the market" doctrine—that any public, material misstatement will affect the securities' price, and that the plaintiff therefore relied on the misstatement, even if the plaintiff was not aware of it. Basic Inc. v. Levinson, 485 U.S. 224, 246-47 (1988).

Sections 9 and 18 of the Exchange Act. The Exchange Act expressly provides two other private rights of action against those who make, cause, or participate in certain types of misstatements and omissions. First, Section 9(e) permits private damages actions against anyone "who willfully participates" in certain enumerated acts or transactions for the purpose of manipulating securities prices. See 15 U.S.C. § 78i(a)-(c), (e). These prohibited acts include false or misleading statements by a broker-dealer for purposes of inducing a securities transaction at the manipulated price. Id. § 78i(a)(4). Second, Section 18 of the Exchange Act creates private civil liability for "[a]ny person who shall make or cause to be made any statement" in a report or document required to be filed pursuant to the Exchange Act that is materially false or

misleading. Id. § 78r(a). But while Section 18 covers a broader class of defendants than does Section 10(b), it recognizes a more narrow class of plaintiffs. Only those who actually read and rely upon the alleged misrepresentation can sue; the fraud on the market presumption of reliance is not available. See id. (limiting plaintiffs to those "who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement"); see also Howard v. Everex Sys., Inc., 228 F.3d 1057, 1063 (9th Cir. 2000); In re Adelphia Commc'ns Corp. Sec. & Derivative Litig., No. 03 MDL 1529(LMM), 2010 WL 3528872, at *4 (S.D.N.Y. Aug. 30, 2010).

Section 15 of the Securities Act and 20(a) of the Exchange Act. Under certain circumstances, both the Securities Act and the Exchange Act also allow private damages actions against "control persons"—individuals and entities who can be held derivatively liable because they control the actions of a primary violator of the federal securities laws. See 15 U.S.C. §§ 77o, 78t(a).

Government Enforcement of the Securities Act and Exchange Act. In addition to the private civil damages provisions described above, the United States government can seek civil and criminal penalties, as well as equitable relief, for violations of the federal securities laws. The SEC can enforce any provision of the Securities Act or the Exchange Act through administrative proceedings and through civil actions in the federal courts seeking injunctions and monetary penalties. See id. §§ 77h-1, 77t(b), 78u(a), (d). Moreover, Congress has given the SEC express authority to pursue aiders and abettors who knowingly or recklessly provide substantial assistance to a primary violator of the securities laws. Id. § 78t(e); Dodd-Frank §§ 929M, 929O, 124 Stat. 1861-62. Likewise, the United States can bring criminal prosecutions for any "willful[]" violations of the securities laws. See 15 U.S.C. §§ 77t(b), 77x, 78ff(a). The United States also has general authority to prosecute aiders and abettors and co-conspirators. 18 U.S.C. §§ 2, 371.

2. Judicial Approaches to Secondary Actor Liability

Central Bank. The first major judicial change to secondary actor liability under the federal securities laws came in 1994. Prior to that time, most federal courts had recognized a private action under Section 10(b) of the Exchange Act against aiders and abettors. In 1994, the Supreme Court decided Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., holding that there was no implied private action for aiding and abetting a violation of Section 10(b) and Rule 10b-5. 511 U.S. at 191.

The Supreme Court concluded in Central Bank that Section 10(b) did not reach aiding and abetting for three reasons. First, the text of Section 10(b) does not expressly prohibit aiding and abetting, while Congress clearly provided for such liability in other statutes. Id. at 177-78. Second, the absence of private aiding and abetting liability under any other provision of the securities laws supported the conclusion that Congress would not have intended private Section 10(b) actions to reach aiders and abettors, either. Id. at 179-80. Third, policy considerations favored rejection of implied liability for aiding and abetting. Such liability would inject uncertainty into the securities

markets, promote a further increase in "vexatious" securities litigation and allow plaintiffs to circumvent the reliance requirement of private Section 10(b) actions by bringing aiding and abetting claims against those who had made no statements at all. Id. at 180, 188-89.

Nevertheless, the Court made clear that "[a]ny person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming that all of the requirements for primary liability under Rule 10b-5 are met." Id. at 191.

Following Central Bank, plaintiffs attempted to circumvent the limitations imposed by Congress and the Supreme Court on the private right of action under Section 10(b) and Rule 10b-5. In particular, plaintiffs continued to assert claims against secondary actors who had not made any misstatements and did not owe any duty of disclosure based on two main theories: (1) that such defendants could be subject to "scheme" liability, and (2) that they could be liable for "substantial participation" in the crafting of false statements made by others. Both of these theories ultimately led to circuit splits, the first of which was resolved in Stoneridge and the second of which will be before the Supreme Court this term in Janus Capital Group Inc. v. First Derivative Traders, cert. granted, 78 U.S.L.W. 3762 (U.S. June 28, 2010).

"Scheme" Liability. In addition to liability for false statements, Rule 10b-5 prohibits, in connection with the purchase or sale of a security, the use of "any device, scheme, or artifice to defraud," or "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5(a), (c). In the wake of Central Bank, plaintiffs' counsel drew upon this language to argue that secondary actors could be held liable under Section 10(b) for participating in a fraudulent "scheme." Under this theory, plaintiffs could recover against a host of potential secondary actors so long as they could establish that the secondary actors had engaged in "deceptive" conduct that enabled a primary violator to make a false statement (or omit something required to be stated); reliance upon, and loss resulting from, the primary violator's statement, it was contended, was then sufficient.

The lower courts, however, could not agree on the standards applicable to "scheme" liability. Some courts, for example, allowed claims to proceed where the defendants were alleged to have engaged in "sham" transactions that "were by nature deceptive." See, e.g., In re Parmalat Sec. Litig., 376 F. Supp. 2d 472, 504-05 (S.D.N.Y. 2005) (distinguishing actionable claims based on the factoring and securitization of "worthless invoices" from claims based on legitimate financing transactions that were deceptive only in how the issuer reported them in its financial statements). Other courts, most notably the Ninth Circuit, allowed "scheme" claims to proceed where secondary actors allegedly engaged in conduct that had "the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme." Simpson v. AOL Time Warner Inc., 452 F.3d 1040, 1048 (9th Cir. 2006). Still other courts rejected scheme liability altogether, holding that the only "deceptive" conduct reached by Section 10(b) were misstatements, omissions and trading market

manipulation, or that reliance on the misstatement of another was insufficient to state a primary liability claim, even when the misstatement concerned a "deceptive" transaction in which the defendant had participated. See, e.g., Regents of the Univ. of Cal. v. Credit Suisse First Bos., 482 F.3d 372, 383, 392 (5th Cir. 2007).[5] As discussed below the Supreme Court finally resolved the issue in Stoneridge. See infra at 14-15.

Substantial Participation. A second approach advanced by plaintiffs' counsel following Central Bank was to argue that secondary actors could be held primarily liable for violating Section 10(b) if they "substantially participated" in crafting a false statement, even if the statement was uttered by another. A circuit split has developed over this theory as well.

The Ninth Circuit, for example, allows secondary actors to be held liable for their "substantial participation or intricate involvement in the preparation of fraudulent statements," regardless of whether the statement was attributable to the defendant or whether the defendant was even aware that the statement would be disseminated to the public. See Howard v. Everex Sys., Inc., 228 F.3d 1057, 1061 n.5 (9th Cir. 2000); see also In re Software Toolworks Inc. Sec. Litig., 50 F.3d 615, 625 (9th Cir. 1994) (reversing a finding of summary judgment for underwriters "[g]iven the Underwriters participation in drafting" documents alleged to be misleading). The Tenth and Eleventh Circuits, meanwhile, hold that a secondary actor's misstatement or omission can only be actionable as a primary violation if it was communicated to investors, and if the actor "knew or should have known that his representation would be communicated." Anixter v. Home-Stake Prod. Co., 77 F.3d 1215, 1226 (10th Cir. 1996); accord Ziemba v. Cascade Int'l, Inc., 256 F.3d 1194, 1205 (11th Cir. 2001). The Second Circuit and—very recently—the Fifth Circuit, more fully embracing Central Bank, do not permit misstatement claims against secondary actors unless the representation in question was "attributed to [the defendant] at the time of its dissemination." Wright v. Ernst & Young LLP, 152 F.3d 169, 175 (2d. Cir. 1998); accord AFFCO Inves. 2001 LLC v. Proskauer Rose LLP, No. 09-20734, WL 4226685, at *7 (5th Cir. Oct. 27, 2010) ("[E]xplicit attribution is required to show reliance under section 10(b)."); Pac. Inv. Mgmt. Co. v. Mayer Brown LLP, 603 F.3d 144, 155 (2d Cir. 2010).

The SEC has added its own theory—dubbed the "creator test"—to this mix, which would impose liability where a secondary actor fairly could be characterized as the author or co-author of a misrepresentation made by another, and the secondary actor knew or should have known that the statement was materially misleading and that investors would rely on it. See Brief for the Securities Exchange Commission as

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[5] The court presiding over the Enron case repeatedly revised the standard it applied to "scheme" claims, leading it to dismiss and reinstate the same claims against the same defendant multiple times. See In re Enron Corp. Sec., Deriv. & "ERISA" Litig., No. MDL-1446, Civil Action No. H-01-3624, 2006 U.S. Dist. LEXIS 88121, at *11 (S.D. Tex. Dec. 4, 2006); In re Enron Corp. Sec., Deriv. & "ERISA" Litig., No. MDL-1446, 2005 WL 1798423, at *1-3 (S.D. Tex. July 26, 2005); See In re Enron Corp. Sec., Deriv. & "ERISA" Litig., No. MDL-1446, Civil Action No. H-01-3624, 2005 U.S. Dist. LEXIS 34021, at *21 (S.D. Tex. June 21, 2005).

Amicus Curiae at 14-16, Klein v. Boyd, 1998 WL 55245 (3d. Cir. Feb. 12, 1998) (Nos. 97-1143, 97-1261), available at http://www.sec.gov/litigation/briefs/klein.txt. As noted above, the issue of substantial participation will be before the Supreme Court this term in Janus Capital Group Inc. See supra at 11.

3. Legislative Treatment of Secondary Actor Liability

On four occasions since the Supreme Court decided Central Bank, Congress has made substantial changes to the federal securities laws; yet each time, it chose not to create a private right of action for aiding and abetting violations of Section 10(b).

The Private Securities Litigation Reform Act of 1995. Within a year of Central Bank, Congress enacted the PSLRA, Pub. L. No. 104-67, 109 Stat. 737, in response to the pattern of "strike suits" and other concerns over the abuse of class-action securities litigation. See H.R. Rep. No. 104-369, at 41 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730. The PSLRA reformed the framework for securities class actions by, among other things: (1) requiring the district court to select the most adequate plaintiff to manage a securities class action and to oversee plaintiffs' counsel; (2) imposing heightened requirements for pleading misstatements and fraudulent intent; and (3) staying discovery in securities cases until after the court has ruled on the motion to dismiss. See 15 U.S.C. § 78u-4(a)(3)(B), (b)(1), (b)(2), (b)(3)(B).

Although Congress considered including a private right of action for aiding and abetting in the PSLRA, it declined to do so. See S. Rep. No. 104-98, at 19 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 698 ("The Committee considered testimony endorsing the result in Central Bank and testimony seeking to overturn this decision. The Committee believes that amending the 1934 Act to provide explicitly for private aiding and abetting liability actions under Section 10(b) would be contrary to [the PSLRA's] goal of reducing meritless securities litigation."). At the same time, Congress deliberately chose to restore the SEC's enforcement authority over aiding and abetting, which had been called into question by Central Bank. See id. ("The Committee does, however, grant the SEC express authority to bring actions seeking injunctive relief or money damages against persons who knowingly aid and abet primary violators of the securities laws.").

The Securities Litigation Uniform Standards Act of 1998. Congress was again prompted to enact additional reform legislation in 1998—the Securities Litigation Uniform Standards Act ("SLUSA")—this time to prevent private plaintiffs from circumventing the PSLRA by filing the same problematic suits in state court. See SLUSA §§ 2(2), (5), 105 Pub. L. No. 353, 112 Stat. 3227 (enacted to prevent the "shift from Federal to State courts" and "prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of" the PSLRA); 15 U.S.C. § 78bb(f)(1) (preempting certain class actions that allege fraud under state law). Through SLUSA, Congress again chose to limit, rather than expand, liability under the securities laws.

Sarbanes-Oxley Act of 2002. The large public scandals of 2001 and 2002—most notably the bankruptcy of the Enron Corporation—spurred further legislation, namely, the Sarbanes-Oxley Act of 2002. See H.R. Rep. No. 107-414, at 18 (2002). Sarbanes-Oxley tightened corporate governance requirements and bolstered SEC enforcement power, but notably rejected the expansion of private liability for aiders and abettors. See 148 Cong. Rec. S6575-02, S6584 (daily ed. July 10, 2002) (describing Senator Shelby's proposed amendment to include a "private litigation" provision stating that "persons that aid or abet violations . . . shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided"). In addition, Sarbanes-Oxley directed the SEC to establish a fund to distribute disgorgements and penalties to defrauded investors—the Fair Funds program. See 15 U.S.C. § 7246.

The Dodd-Frank Act of 2010. Most recently, Congress passed the Dodd-Frank Act in response to the credit crisis and general market fallout in 2007 and 2008. Expanding the private right of action to include aiders and abettors was again on the table, but was ultimately not included in the legislation. Instead, the SEC's enforcement power was once again strengthened. Dodd-Frank makes it easier for the SEC to bring aiding and abetting claims by lowering the scienter standard in Section 20(e) of the Exchange Act to include "reckless" conduct. See Dodd-Frank § 929O, 124 Stat. 1862. Prior to Dodd-Frank, the SEC needed to show actual knowledge of the wrongdoing on the part of the defendant. See, e.g., SEC v. KPMG LLP, 412 F. Supp. 2d 349, 382-83 (S.D.N.Y. 2006) (rejecting the contention that aiding and abetting liability could be shown by "reckless" conduct and applying an actual knowledge standard).

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The history of liability for secondary actors thus clearly reflects two distinct trends: (1) that different Congresses and courts, in response to a variety of major market events, have repeatedly considered and rejected expanding the private right of action under the federal securities laws to cover aiding and abetting liability; and (2) that Congress has identified the SEC as the entity best situated to pursue aiders and abettors, and has accordingly granted—and, when necessary, augmented—the SEC's authority to do so.

Question 3: What are your views on the Stoneridge Supreme Court decision? Please explain.

Response to Question 3:

SIFMA believes that Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008), was properly decided.[6] As described above, Stoneridge further settled an area of the securities laws that had previously been the subject of divergent views—the standard for determining when a secondary actors has committed a primary violation of Section 10(b). In reaching its decision, the Supreme Court essentially reaffirmed the unremarkable proposition it had set out fourteen years earlier in Central Bank: that, as with any other cause of action, a plaintiff cannot state a claim for a primary violation of Section 10(b) without alleging all of the elements of the claim with respect to each defendant.

In Stoneridge, the Supreme Court concluded that the secondary actors at issue—two vendors who sold equipment to the corporate issuer—could not be held liable under Section 10(b) based on a "scheme" liability theory. The Court began by stating that Section 10(b) reached all manner of deceptive conduct, and potentially could reach the vendors' allegedly deceptive transactions or alleged misstatements by the vendors to the issuer's auditor. Id. at 158. But drawing upon Central Bank, the Stoneridge Court reiterated that "[t]he conduct of a secondary actor must satisfy each of the elements or preconditions for [10(b)] liability." Id. at 158. The plaintiffs could not satisfy the reliance element as to the vendors' alleged deception, which had never been disclosed to investors. Id. at 161. Reliance on the issuer's misstated financial reports was "too remote to satisfy the requirement of reliance." Id. at 158, 161.

Among other things, the Supreme Court drew support for its decision from many of the "practical consequences" that had been raised in Central Bank, such as exposing a new class of defendants to the potential for "uncertainty and disruption," increasing the cost of doing business generally, deterring foreign companies from doing business in the United States and even encouraging U.S. firms to turn to foreign markets. See id. at 163-64. Finally, Stoneridge cited the robust federal and state enforcement mechanisms which are used to punish secondary actors for wrongdoing and to compensate injured investors. Id. at 166. Therefore, the Court found that the absence of a private right of action against aiders and abettors does not leave secondary actors unpunished.

Given the statutory scheme developed over time, discussed above, and the Supreme Court's decision in Central Bank, the Stoneridge decision was a sensible reading of the statute and a correct application of the law.

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[6] Indeed, SIFMA—in conjunction with the Futures Industry Association—filed an amicus brief in support of the respondents in Stoneridge urging the Court to reject the theory of "scheme liability." See Brief of the Securities Industry and Financial Markets Association and Futures Industry Association as Amici Curiae in Support of Respondents at 3, Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008).

<u>Question 4:</u> What are the advantages and disadvantages of Congress passing legislation authorizing a private right of action against any person who assists another person in violation of the securities laws?

<u>Response to Question 4</u>:

Imposing secondary liability in private actions under Section 10(b) and Rule 10b-5 would disturb the existing balance struck by Congress and the courts over years of legislation and court decisions. It would impose significant costs on the economy, would unfairly burden secondary actors with meritless litigation, and would serve no useful deterrent or compensatory purpose that is not already well-served by the current statutory scheme.

As discussed in detail below, there would be numerous, detrimental effects on the securities markets and the economy if Congress were to create a private action for aiding and abetting violations of Section 10(b). These include the promotion of "strike suits," the injection of uncertainty into the marketplace, and the imposition of what is essentially a tax on companies that access the U.S. capital markets—a tax that ultimately would be borne by investors and consumers, and which would make our markets less competitive at a time when companies can more easily than ever turn to cheaper, foreign sources of capital. Any benefits that a private aiding and abetting cause of action might have in deterring bad conduct and increasing investor compensation are largely illusory, and certainly do not outweigh the costs imposed. The only certain result of the creation of a private right of action for aiding and abetting would be an increase in litigation brought and attorneys' fees paid in connection with meritless cases.

1. The Securities Laws Already Provide for Secondary Actor Liability in Appropriate Cases

As an initial matter, it is simply unnecessary for Congress to create a new, private cause of action for aiding and abetting Section 10(b) violations because the federal securities laws already contain a variety of provisions to address conduct by secondary actors. For example, as discussed in response to Question 2 above, where securities are offered pursuant to a materially false or misleading registration statement, Sections 11 and 12(a)(2) of the Securities Act permit investors to sue the issuer's directors and the underwriters and sellers of the securities—regardless of whether they made false statements of their own in connection with the offering. 15 U.S.C. §§ 77k(a)(2)(5), 77l(a)(2). Section 9 of the Exchange Act permits claims for market manipulation not only against those who execute the manipulative securities trades, but against anyone who "willfully participates in" them. <u>Id.</u> § 78i(e). Similarly, Section 18 of the Exchange Act creates private civil liability for those who make misstatements in reports required to be filed under the Exchange Act, as well as those "who . . . cause [such statements] to be made." <u>Id.</u> § 78r(a). And Sections 15 of the Securities Act and 20(a) of the Exchange Act create joint and several liability for "[e]very person who, directly or indirectly, controls" any primary violator. <u>Id.</u> §§ 77o, 78t(a).

In many instances, these provisions reach the exact same conduct by secondary actors as that which would be covered by a private aiding and abetting cause of action under Section 10(b). These provisions, however, contain appropriate limitations—such as the damages cap under Section 11(e) of the Securities Act or the strict reliance requirement of Section 18(a) of the Exchange Act—which help to reduce the risk of vastly disproportionate liability that would attend any general aiding and abetting claim under Section 10(b). See infra at 20-21.

Furthermore, private damages actions under the federal securities laws are not the only way to deter secondary actors from engaging in deceptive conduct or to compensate investors who are injured by that conduct. As discussed below in response to Questions 5 and 6, the SEC and the Department of Justice can and do actively pursue those who aid and abet securities law violations. Self-regulatory organizations such as the Financial Industry Regulatory Authority ("FINRA") add an additional layer of protection for investors. FINRA can bring disciplinary actions against securities firms and their employees who aid and abet Section 10(b) violations. See, e.g., Dep't of Enforcement v. J. Alexander Sec., Inc., CA F010021, 2004 NASD Discip. LEXIS 16, at *45-46, 65-69 (Aug. 16, 2004) (holding that aiding and abetting another's securities fraud violates NASD Conduct Rule 2110, and barring aider and abettor from associating with any NASD firm). And regulators and prosecutors at the state level are also active enforcers of their respective securities laws.[7]

Actions brought by federal, state and non-governmental authorities often carry significant penalties beyond mere monetary fines or injunctive relief. For example, the SEC and FINRA are the principal regulators for many of the financial institutions that compose SIFMA's membership, and actions they bring can have substantial reputational consequences on those institutions. Regardless of outcome, criminal prosecutions, too, can be a veritable "death sentence" for financial institutions, auditors

[7] See, e.g., In re Gary King Financial Stewardship LLC, 2010 WL 2776572, Sec. Bureau, Ins. Division, Iowa Dep't of Commerce (July 7, 2010) (charging defendant with aiding and abetting the offer or sale of unregistered stock or investment contracts as defined by Iowa law); In re K.W. Brown and Co., 2008 WL 4530705, Office of Fin. Inst. & Sec. Regulations, Florida Dep't of Fin. Servs. (Sept. 19, 2008) (sanctioning defendant under state law for aiding and abetting violations of Section 10(b) and Rule 10b-5); SEC v. Christian, SEC Litig. Release No. 19,294 (Jul. 7, 2005) (acknowledging New York Attorney General's assistance in bringing civil enforcement action relating to market timing of mutual-fund trades, including for aiding and abetting Section 10(b) violations), available at http://www.sec.gov/litigation/litreleases/lr19294.htm; Press Release, N.Y. State Att'y Gen., Former Trust Company Officials Arrested in Late Trading Fraud (Nov. 25, 2003) (announcing that the combined efforts of the New York Attorney General, SEC, and Office of the Comptroller of Currency had resulted in felony charges against three of Security Trust Co.'s executives for assisting in mutual-fund late trading and had led to the firm's dissolution), available at http://www.oag.state.ny.us/press/2003/nov/nov25a_03.html; SEC v. J.P. Morgan Chase & Co., SEC Litig. Release No. 18,252 (July 28, 2003) (announcing civil complaint and $135 million settlement achieved "in coordination with the New York County District Attorney's Office" arising from bank's aiding and abetting accounting fraud), available at http://www.sec.gov/litigation/litreleases/lr18252.htm; Press Release, Conn. Attorney General, Blumenthal, CRRA Take Action Against Enron, CRRA's Legal Advisors for $220 Million Deal (Aug. 7, 2002), available at http://www.ct.gov/ag/cwp/view.asp?A=1777&Q=283774 (announcing lawsuit by Connecticut Attorney General against Enron counsel in connection with same transaction).

and law firms. For example, in 2002, Arthur Andersen LLP was convicted of a single count of obstruction of justice for its involvement in Enron's collapse—a conviction that was later overturned. See Arthur Andersen LLP v. United States, 544 U.S. 696 (2005). Nevertheless, the firm was never able to recover as a viable business due to the irreversible damage to its reputation. See Elizabeth K. Ainslie, Indicting Corporations Revisited: Lessons of the Arthur Andersen Prosecution, 43 AM. CRIM. L. REV. 107, 107-08 (2006).

In light of all the mechanisms that presently exist for holding secondary actors accountable for their conduct in connection with the securities markets, there are few—if any—meritorious cases in which secondary actors would not already face some liability from private litigants or the government. Creating a broad new form of liability and placing it into the hands of plaintiffs' attorneys would be both unwarranted and unwise.

2. Creating a Private Right of Action for Aiding and Abetting Would Promote "Strike Suits"

The problem of abusive "strike suits" would likely be exacerbated if Congress created a private right of action against aiders and abettors under Section 10(b). An aiding and abetting cause of action would cause a flood of meritless litigation against secondary actors that would, in many cases, be difficult and expensive for secondary actors to dispose of.

The elements of an aiding and abetting cause of action will often be inherently fact-intensive. In addition to a primary violation of the law, plaintiffs would have to prove the defendant's knowledge of the violation and its substantial assistance to the primary violator. See infra at 21-22. Financial institutions routinely engage in highly complex transactions subject to intricate accounting, taxation, and reporting rules, all of which may be difficult for even the ablest judges to understand fully at the pleading stage of a case. Because courts considering the adequacy of aiding and abetting claims will already have upheld the pleading of a primary violation, these courts may be reluctant, prior to discovery, to parse the degree of assistance provided by the secondary actor or the extent and implications of its alleged knowledge, thereby reducing the prospects for dismissal of even the most meritless aiding and abetting claims at the pleadings stage.[8]

Even where a complaint can be dismissed on motion at the outset of the case, it is not costless to do so. To the contrary, litigating such a motion requires expending

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[8] In re Parmalat Securities Litigation, decided pursuant to the "scheme liability" theory rejected in Stoneridge, is illustrative. In denying the secondary actor's motion to dismiss, the district court admitted that the transactions alleged in the complaint might well have been legitimate, but—due in part to their prolixity—held that the court had no choice but to sustain the allegations at the pleading stage. 376 F. Supp. 2d at 504 n.160.

substantial sums of money on legal fees in the trial court,[9] and a costly appeal generally follows. Where a lawsuit is utterly meritless, it may still often make sense for the defendant to pay a settlement and thereby avoid the expense and uncertainty of litigation.

Once a securities class action survives a motion to dismiss, it almost always settles because of the high costs of discovery and the potential for astronomical class-wide damages awards. Electronic discovery costs for litigants exceeded $2.8 billion in 2009, and the costs are expected to increase by 10% to 15% in each of 2010 and 2011. See George Socha & Tom Gelbmann, Climbing Back: Consultants George Socha and Tom Gelbmann Highlight Key Trends They Identified in Their Annual E-Discovery Survey, L. TECH. NEWS, Aug. 1, 2010, http://www.law.com/jsp/lawtechnologynews/PubArticleLTN.jsp?id=1202463900292 (last visited Nov. 30, 2010). Furthermore, by some metrics, estimated damages related to recently settled securities class actions are also on the rise, increasing to an average of $2.6 billion in 2009 from $1.9 billion in 2008. See Ellen M. Ryan and Laura E. Simmons, Securities Class Action Settlements: 2009 Review and Analysis 4 (Cornerstone Research 2010) [hereinafter 2009 Cornerstone Review].

With potential joint and several liability, see 15 U.S.C. § 78u-4(f)(2)(A), going to trial becomes an impossible risk, no matter how frivolous the case.[10] It is rarely sensible to "stake [one's] compan[y] on the outcome of a single jury trial." In re Rhone-Poulenc Rorer, Inc., 51 F.3d 1293, 1299 (7th Cir. 1995). As Congress has recognized, the "basic economics" of "judicial blackmail" can "force a corporation to settle [a class action] suit, even if it is meritless." S. Rep. No. 109-14, at 21 (2005), reprinted in 2005 U.S.C.C.A.N. 3, 21. Consequently, it is no surprise that of the "over 3,400 cases [that] have been filed since the passage of the PSLRA, . . . only 27 have gone to trial[, and e]ven fewer end in a verdict at trial, as some cases settle while a trial is underway." Dr. Jordan Milev et al., Trends 2010 Mid-Year Study: Filings Decline as the Wave of Credit Crisis Cases Subsides, Median Settlement at Record High 19 (NERA Economic Consulting 2010).

Secondary actors, such as underwriters, securities brokers, financial advisors, lenders, and other financial institutions, are quintessential "deep pockets," whose inclusion in a lawsuit can be expected to drive up the settlement value regardless of the merit of any claims alleged against them. See 2009 Cornerstone Review at 9 (noting that although "underwriters were named [as defendants] in less than 15 percent of all [post-Reform Act] cases [through 2009]," "median settlements as a percentage of estimated . . . damages [were] higher for . . . cases involving an underwriter as a named defendant"); see also Stephanie Plancich et al., 2008 Trends: Subprime and Auction-Rate Cases Continue to Drive Filings, and Large Settlements Keep Averages High 21

[9] See, e.g., 138 Cong. Rec. S12605 (Aug. 12, 1992) (remarks of Sen. Sanford) (asserting that in 83% of 10b-5 cases, major accounting firms pay $8 in legal fees for every $1 paid in claims).

[10] For instance, if a company faces even a 10% chance of a $2.6 billion verdict, it will rationally settle for anything less than $260 million.

(NERA Econ. Consulting 2008) ("Settlements increase with the potential depth of defendants' pockets."); S. Rep. 104-98 at 9 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 688 ("The deeper the pocket, the greater the likelihood that a marginal party will be named as a defendant in a securities class action."). In addition, financial institutions play a variety of roles in the daily operations of virtually all public companies. Thus, anytime a decline in an issuer's stock price can be traced to a transaction or event which allegedly was not properly disclosed, it would be no great difficulty to find a deep-pocket financial institution that was involved in the transaction to sue for aiding and abetting. At a minimum, any bank that loaned money to the issuer could expect to be sued for "substantially assisting" in the fraud by "funding" it.

Congress has long recognized—and repeatedly legislated against—the special problems posed by meritless securities "strike suits." See S. Rep. No. 104-98, at 6 (1995) ("Many such actions are brought on the basis of their settlement value. The settlement value to defendants turns more on the expected costs of defense than the merits of the underlying claim."), reprinted in 1995 U.S.C.C.A.N. 679, 685; see also Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739 (1975) (noting that "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general."). Congress should not now create a private cause of action against aiding and abetting Section 10(b) violations, which would have the immediate and direct effect of promoting these same kinds of meritless suits that the PSLRA and SLUSA were intended to curb.

3. A Private Aiding and Abetting Cause of Action Would Impose Liability on Secondary Actors Out of Proportion to Their Roles in Securities and Other Transactions

A private right of action for aiding and abetting would also lead to the imposition of disproportionate liability on secondary actors. As described above in response to Question 1, secondary actors, such as underwriters, banks, auditors, lawyers and ratings agencies, perform important services in connection with securities offerings and companies' ongoing business operations. In compensation for their services, secondary actors receive relatively modest fees. See, e.g., FIN. EXECS. RESEARCH FOUND., 2010 AUDIT FEE SURVEY 3 (June 21, 2010) (average audit fees in 2009 of $4.8 million based on survey of 150 public companies); Michael Tsang & Lee Spears, Stock Sales Fall to Five-Year Low, Cutting Fees as Debt Booms, Bloomberg (Oct. 1, 2010) (average equity underwriting fees in first three quarters of 2010 were 4.21% of offering size, more than double average bond offering fees), available at http://www.businessweek.com/news/2010-10-01/stock-sales-fall-to-five-year-low-cutting-fees-as-debt-booms.html; see also FINRA R. 5510(c)(2)(A), (E) (underwriters may not receive unfair or unreasonable compensation in connection with securities offering).

Under traditional aiding and abetting principles, however, secondary actors could be held liable "to the same extent" as a primary violator, resulting in damages awards that are potentially many multiples of the fees received by the secondary actors in the first place. See, e.g., Brief of Merrill Lynch & Co., Inc. as Amicus Curiae in

Support of Respondents at 8-9, Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008) (No. 06-43) (explaining that Merrill Lynch settled the enforcement action brought by the SEC for $80 million, nearly six times more than the $14 million in fees it earned from transactions with Enron; yet in the private class action, Merrill faced approximately $40 billion in damages on a "scheme" liability theory—nearly 3,000 times more than its allegedly ill-gotten gain). Indeed, in securities class actions, the damages faced by a primary violator are often computed by multiplying the "artificial inflation" in the stock price due to the alleged fraud by the number of shares affected. See Janet Cooper Alexander, Rethinking Damages in Securities Class Actions, 48 STAN. L. REV. 1487, 1490-91 (1996) [hereinafter Rethinking Damages]. Even if the amount of the inflation affecting each share is small, the damages estimates for any company with a large market capitalization can quickly reach billions of dollars. Moreover, because reliance on the secondary actor is not a traditional element of aiding and abetting liability, a secondary actor could potentially be held jointly and severally liable for multi-billion dollar damages even if the plaintiffs never even knew about the role of the secondary actor or the assistance it provided, and, indeed, regardless of how substantial the assistance truly was.

Such disjunction between what secondary actors earn for their roles in securities offerings (or business transactions) and the liability they would face under a private aiding and abetting cause of action would multiply the settlement pressures already faced by such entities. See supra at 18-20. Further, as discussed below, this sort of disproportionate liability would likely cause secondary actors to charge more for their services, or to refuse to provide them at all in the United States. See infra at 23-24.

4. It is Inappropriate to Empower Private Parties to Bring Aiding and Abetting Actions Because Such Actions Are Subject to an Inherently Vague Standard of Liability

Aiding and abetting is—and always has been—an inherently imprecise cause of action that permits the imposition of liability based on vague standards of conduct. It can be a useful tool for expert regulators such as the SEC and the DOJ, who are duty-bound to exercise their authority to pursue aiders and abettors only when the facts and the interests of justice truly warrant it. But a right of action for aiding and abetting is something else entirely in the hands of private plaintiffs' counsel, who are not similarly bound and who instead typically have a personal financial stake in the recoveries they can obtain out of the cases they file.

In rejecting private aiding and abetting liability in Central Bank, the Supreme Court observed that "the rules for determining aiding and abetting liability are unclear, in an area that demands certainty and predictability." 511 U.S. at 188 (internal quotation marks omitted). Vague legal standards, the Court said, "lead[] to the undesirable result of decisions made on an ad hoc basis, offering little predictive value to those who provide services to participants in the securities business. Such a shifting and highly fact-oriented disposition of the issue of who may be liable for a damages claim for violation of Rule 10b-5 is not a satisfactory basis for a rule of liability

imposed on the conduct of business transactions." Id. (internal citations, alteration, and quotation marks omitted).

At the time Central Bank was decided, just as today, there was no uniform or clear standard for imposing aiding and abetting liability. For example, while most circuits held that the alleged aider and abettor had to "substantially assist" in achieving the primary violation, one circuit held that the secondary actor actually had to commit one of the "manipulative or deceptive" acts prohibited by Section 10(b) and Rule 10b-5. Compare IIT v. Cornfeld, 619 F.2d 909, 922 (2d Cir. 1980), with Robin v. Arthur Young & Co., 915 F.2d 1120, 1123 (7th Cir. 1990).

More significantly, the circuit courts divided over the scienter necessary to establishing aiding and abetting. Some circuits held that recklessness always was sufficient. See, e.g., Herm v. Stafford, 663 F.2d 669, 684 (6th Cir. 1981). Other circuits held that, in the absence of a duty to disclose, a secondary actor could not be held liable for aiding and abetting without a showing of "conscious intent to defraud." See, e.g., Schatz v. Rosenberg, 943 F.2d 485, 496-97 (4th Cir. 1991). Still other circuits applied a "sliding scale" approach, whereby the degree of scienter required for aiding and abetting liability varied depending on the nature of the defendant's conduct and the presence or absence of a duty to disclose. See, e.g., Woodward v. Metro Bank, 522 F.2d 84, 95-97 (5th Cir. 1975). These courts examined whether the transactions at issue occurred in the "ordinary course . . . of business," or were "atypical" or lacking in "business justification." Woods v. Barnett Bank, 765 F.2d 1004, 1010 (11th Cir. 1985). Of course, courts and juries were ill-equipped to decide whether complex financial transactions were "ordinary" or "atypical," and the confusion produced by various conflicting decisions prompted the Supreme Court to step in.[11]

As discussed above in response to Question 2, the confusion inherent in aiding and abetting and similar forms of liability did not end with Central Bank. The Stoneridge decision brought an end to the lower courts' incoherent experiment with "scheme" liability, while the pending Janus case will, hopefully, resolve the confusion over the "substantial participation" approach to primary liability.

This history belies any argument that Congress could craft a private aiding and abetting statute containing a clear and objective standard of liability. Not that the fault lies with Congress. Rather, the problem is that aiding and abetting is inherently a vague and amorphous concept. "Substantial assistance" generally consists of transactions that, in and of themselves, are entirely lawful. Thus, the distinction between legitimate conduct and fraudulent conduct turns on post-hoc allegations of scienter, which, of necessity, are analyzed with the benefit of hindsight.[12] This is not

[11] As discussed above, see supra at 14, Dodd-Frank clarifies that the scienter standard in SEC actions against aiders and abettors now covers "reckless" as well as "knowing" conduct. See Dodd-Frank § 929O, 124 Stat. 1862.

[12] See also Credit Suisse Sec. (USA) LLC v. Billing, 551 U.S. 264, 279, 281 (2007) (noting that "only a fine, complex, detailed line separates activity that the SEC permits or encourages . . . from activity that the SEC must (and inevitably will) forbid" and that "the nuanced nature of the evidentiary

to suggest that secondary actors never aid and abet securities fraud; nor that they should escape liability when they do so. But because liability for aiding and abetting turns on fact-intensive determinations of highly subjective legal concepts, and because this means that even meritless complaints alleging aiding and abetting will in many cases be difficult or impossible to defeat before trial, the power to bring such claims should rest solely in the hands of the government.

5. Creating Private Aiding and Abetting Liability Would Impose Substantial Detrimental Costs on the U.S. Economy

Long before Stoneridge, the Supreme Court noted that the "uncertainty and excessive litigation" caused by private aiding and abetting liability "can have ripple effects." Central Bank of Denver, 511 U.S. at 189. "For example, newer and smaller companies may find it difficult to obtain advice from professionals. A professional may fear that a newer or smaller company may not survive and that business failure would generate securities litigation against the professional, among others. In addition, the increased costs incurred by professionals because of the litigation and settlement costs under 10b-5 may be passed on to their client companies, and in turn incurred by the company's investors, the intended beneficiaries of the statute." Id. These are real and serious risks. Basing 10b-5 liability on a vague and subjective aiding and abetting standard would transform every routine transaction with a public company into a minefield of potential exposure to crippling class-action litigation.

First, secondary actors faced with a vastly increased risk of liability might decline to participate in securities transactions at all. This risk is not speculative. Indeed, there have already been reports that in the wake of Congress's decision to expose the credit ratings agencies to liability under Section 11 of the Securities Act, the credit agencies have determined that they will no longer consent to the inclusion of their credit ratings in registration statements. See Anusha Shrivastava, Ford Scuttles Debt Deal as Overhaul Chills Market, WALL ST. J., July 22, 2010, at C1 ("The nation's dominant ratings firms have in recent days refused to allow their ratings to be used in bond registration statements. The firms, including Moody's Investors Service, Standard & Poor's and Fitch Ratings, fear they will be exposed to new liability created by the Dodd-Frank law."). Similarly, in the years leading up to 1994—prior to Central Bank and the PSLRA—major auditing firms responded to the intolerable litigation environment by significantly curtailing their willingness to perform audits for risky companies. See Frederick L. Jones & K. Raghunandan, Client Risk and Recent Changes in the Market for Audit Services, 17 J. ACCT. & PUB. POL'Y 169, 179 (1998). Shareholders hardly benefit from rules that make it more difficult for the smallest public companies to find a firm willing to audit their financial statements.

Second, even if they continue to participate in securities offerings, secondary actors might charge substantially more for their services, or they might demand

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evaluations necessary to separate the permissible from the impermissible" makes it "difficult for . . . many different courts to reach consistent results").

onerous disclosures from issuers and/or an issuer's auditors in an effort to ensure that they are not substantially assisting in a fraud. As the Supreme Court recognized, these higher costs would likely be borne by "the company's investors, the intended beneficiaries of the statute." Central Bank of Denver, 511 U.S. at 189.

Already, the "substantial uncertainties and costs" imposed by securities litigation "are the most significant impediments to the competitiveness of U.S. businesses." Richard M. Kovacevich et al., The Blueprint for U.S. Financial Competitiveness 63 (Fin. Servs. Roundtable 2007). In particular, these costs "present[] a major competitive challenge to U.S. financial services firms in comparison to foreign firms that are not subject to a similar risk." Id. Over the past decade, S&P 500 companies in the financial sector have been subjected to a higher proportion of securities class action lawsuits than companies in any other sector. See Cornerstone Research, Securities Class Action Filings: 2010 Mid-Year Assessment 9 (2010). Enabling plaintiffs to easily add secondary actors as defendants in securities class actions would only cause further damage to the global competitiveness of the U.S. financial services industry. Of necessity, U.S. financial firms would need to price the anticipated cost of this expanded litigation into their fees ex ante. And U.S. financial institutions would become reluctant to engage in innovative transactions, for fear that new types of deals would be particularly vulnerable to being described as frauds by creative lawyers.[13]

Business counterparties might also be dissuaded from doing business with U.S. companies. This would be especially likely in the case of companies that already are based outside the United States. Many foreign companies have no knowledge of U.S. Generally Accepted Accounting Principles ("GAAP") and lack any ability to discern what information would be considered "material" to an American company's shareholders. It would be almost impossible for them to police their customers' public disclosures. Moreover, these foreign businesses could rationally conclude that by dealing exclusively with other foreign companies, they would minimize the risk of getting pulled into lengthy and expensive litigation under the U.S. securities laws. There can be little doubt that adding a new source of private 10b-5 liability would hasten the departure of foreign companies from American capital markets, causing further corrosion to our already weakened economy.[14]

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[13] Of course, this is not to suggest that unbridled financial innovation ought to be blindly encouraged. But the decision to ban risky financial transactions is a prerogative best left to the SEC and other expert regulators. The blanket deterrence of financial innovation that would result from private aiding and abetting liability is a blunt and costly weapon.

[14] Indeed, this is precisely why foreign companies were so concerned about the possibility of "scheme liability" being upheld by the Supreme Court. As The Economist noted, "An unfavourable ruling [in Stoneridge] would send a chill through boardrooms, and not only in America. If suppliers and advisers can be dragged into class actions, it would no longer even be necessary to issue shares in the United States to incur securities liability . . . . Any firm, anywhere, doing business with American companies would have to live with the risk that the transaction could later be portrayed as fraudulent or deceptive. And painting such pictures is what trial lawyers do best." The Stoneridge Showdown, THE ECONOMIST, Jun. 14, 2007, at 84; see also Timothy Shipman, Stoneridge Court Case Threatens Trade

In all, the cost of being listed on an American stock exchange would escalate, driving more and more foreign companies to list themselves in markets outside the United States. This would severely hamper the global competitiveness of our capital markets—fueling a disturbing trend that already has been underway for several years. Whereas the 1990s saw a dramatic increase in the number of foreign issuers listed on the NYSE and NASDAQ, since 2000, the situation has reversed. Global IPOs—i.e., those in which the issuer sells shares outside of its domestic market—are widely viewed as an indicator of the relative competitiveness of capital markets. In 2000, 48% of global IPOs occurred in the United States; six years later, the United States' share had plummeted to 8%. See Stephen M. Bainbridge, Corporate Governance and U.S. Capital Market Competitiveness 4 (UCLA Sch. of Law, Law-Econ Research Paper No. 10-13, 2010), available at http://ssrn.com/abstract=1696303 [hereinafter U.S. Capital Market Competitiveness]; Luigi Zingales, Is the U.S. Capital Market Losing its Competitive Edge? 2 (ECGI Fin. Working Paper No. 192, 2007) (forthcoming in J. ECON. PERSP.), available at http://ssrn.com/abstract=1028701.

Moreover, this trend appears to be growing worse. The Committee on Capital Markets Regulation reports that the first half of 2010 "evidence[d] a continued, overall decline in U.S. competitiveness." Press Release, Comm. on Capital Mkts. Reg., Latest CCMR Study Confirms Resumed Deterioration in Competitiveness of U.S. Public Equity Markets 2 (Sept. 22, 2010), available at http://www.capmktsreg.org/pdfs/10-Sept-22_Q2_press_release.pdf. For instance, "[t]he U.S. captured a very disappointing 2.7% of global IPO activity by value in the first half of 2010. Historically, the U.S.'s share was 16.9% in all of 2009, 1.9% in 2008, 6.9% in 2007, and averaged 28.7% for the period 1996-2006." Id. at 1. The U.S. captured none of the top 20 IPOs in the first half of 2010; captured two of the top 20 in 2009; and captured none in both 2008 and 2007; compared with capturing, on average, five of the top 20 from 1996-2006. Id. And while a mere 0.3% of U.S. issuers chose to list exclusively abroad from 1996-2006, that number rose to 8.6% in 2007, 20% in 2008, 3% in 2009, and 4.6% for the first half of 2010. Id. Clearly, "foreign firms [are] no longer treat[ing] the American stock markets as their first choice for raising capital." U.S. Capital Market Competitiveness at 2.

Several recent studies have concluded that a key factor explaining the declining competitiveness of U.S. capital markets is the impact of securities fraud class action litigation.[15] "[T]he litigious nature of U.S. society and capital markets has a negative

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With US, SUNDAY TELEGRAPH (London), Jul. 8, 2007, at 30 ("British companies that conduct business in the United States or do deals with American companies could find themselves sued for billions of dollars as the result of [the Stoneridge] case before the Supreme Court . . . . [T]he case . . . could severely damage transatlantic trade . . . . [T]he increased risk of legal action could also prove a huge boost to the London Stock Exchange, by pushing companies to list there rather than in New York.").

[15] By contrast, there appears to be "little evidence that poor corporate governance practices contributed to . . . the declining competitiveness of U.S. capital markets." U.S. Capital Market Competitiveness at 5 (citing Bengt Holmstrom & Steven N. Kaplan, The State of U.S. Corporate Governance: What's Right and What's Wrong? 1 (ECGI Fin. Working Paper No. 23, 2003); Brian R. Cheffins, Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Case of the

impact on the competitiveness of those markets. The key problem appears to be the prevalence of private party securities fraud class actions, which do not exist in most other major capital market jurisdictions." Id. at 7-8 (footnote omitted). According to a widely cited survey of foreign companies:

> When asked which aspect of the legal system most significantly affected the business environment, senior executives surveyed indicated that propensity toward legal action was the predominant problem . . . . [Sixty-three] percent of respondents thought the UK . . . had a less litigious culture than the United States, while only 17 percent felt the US . . . was a less litigious place than the United Kingdom. . . . This . . . dramatic result . . . is echoed even more strongly by the CEOs surveyed: 85 percent indicated that London was preferable, and not a single one chose New York. . . .
>
> Over the past several years, the number of US companies that have been forced into bankruptcy or liquidated because of the threat of securities-related litigation . . . has reinforced the perception that the US legal system is particularly punitive in this regard. . . .
>
> Only about 15 percent [of senior executives] felt that the US system was better than the UK's in terms of predictability and fairness, while over 40 percent favored the UK in both these regards. The CEOs interviewed also shared this sentiment, although they felt that London's advantage was particularly strong in terms of the predictability. Legal experts indicated that this is a major reason why many corporations now choose English law to govern their international commercial contracts.

Michael R. Bloomberg & Charles E. Schumer, Sustaining New York's and the US's Global Financial Services Leadership 75-77 (Dec. 2006).[16] Another recent survey of senior executives found that "nine out of 10 companies who de-listed from a U.S. exchange [from 2003-2007] said the litigation environment played some role in that decision." The Fin. Servs. Forum, 2007 Global Capital Markets Survey 8 (2007).[17]

S&P 500, 65 BUS. LAW. 1, 2 (2009); Report of the New York Stock Exchange Commission on Corporate Governance 2 (Sept. 23, 2010)).

[16] This perception of the U.S. legal system is not confined to foreigners; it is also widely held by the American public. A nationwide poll of voters on election day of 2010 revealed that 88% of voters believe the number of frivolous, lawyer-driven lawsuits is a "serious problem," with a majority (53%) viewing it as a "very serious problem." See Bill McInturff & Lori Weigel, 2010 Voters' Views on Lawsuits (Pub. Op. Strategies 2010), available at http://www.instituteforlegalreform.com/images/stories/documents/pdf/research/2010electionsurveykeyfindings.pdf.

[17] See also Vanessa Fuhrmans & Laura Stevens, Symbolic Shift: Why Daimler Is Delisting: Why Daimler, European firms want to delist from U.S. exchanges, WALL ST. J., May 18, 2010, at C2 ("A U.S. listing was supposed to be a win-win for European companies: more international exposure and an entrée to serious American expansion. But . . . many have come to view it as a liability . . . . Simply put, the costs have come to outweigh the benefits . . . . The cachet of trading on a U.S. exchange has

An even more recent interview-based study confirmed these same findings:

> Many [experts on international securities regulation] cite U.S. anti-fraud laws—specifically Rule 10b-5—as a "top concern" because they are the "most intrusive" and have the "biggest" impact on extra-territorial transactions. What drives foreign firms away from the U.S. capital markets is not U.S. regulatory compliance but rather the "fear that listing on a U.S. exchange exposes the foreign issuer to potentially bankrupting securities litigation if its stock price were to decline sharply." . . . As a result, "the only way foreign companies can protect themselves from being exposed to costly class action litigation, is to move out of the United States altogether—and that is what a lot of companies are doing."

Howell E. Jackson, Summary of Research Findings on Extra-Territorial Application of Federal Securities Law 1243, 1253-54, in GLOBAL CAPITAL MARKETS AND THE U.S. SECURITIES LAWS 2009: STRATEGIES FOR THE CHANGING REGULATORY ENVIRONMENT (Practising Law Inst. 2009) (citations omitted); see also Ian Swanson, Foreign Executives Press for Reform of Litigation in United States, THE HILL, May 17, 2007, at 11 (reporting that foreign executives view "litigation as the No. 1 problem with U.S. investments" and find "that litigation is a greater disincentive to doing business in the U.S. than fears that a protectionist Congress might impose new barriers to foreign trade and investment").

In sum, it was with very good reason that the Supreme Court in Stoneridge noted the dire "practical consequences of an expansion" of private 10b-5 liability to secondary actors: that it would "expose a new class of defendants to the[] risks" of "extensive discovery" and "extort[ionate] settlements"; would "rais[e] the cost of doing business" by compelling counterparties to take precautions "necessary to protect against these threats"; and would deter "[o]verseas firms . . . from doing business here," thus "rais[ing] the cost of being a publicly traded company under our law and shift[ing] securities offerings away from domestic capital markets." 552 U.S. at 163-64. Particularly in today's strained economic climate, it would be seriously misguided to enact legislation that would raise the cost of transacting business in the United States. To truly benefit shareholders, Congress should focus on spurring foreign interest in American investors and strengthening the global competitiveness of American companies.

6. Enabling Plaintiffs to Add "Aiders and Abettors" as Defendants Would not Increase the Funds Available for Investor Compensation

The promise of "compensation" offered by private aiding and abetting liability is, in large measure, illusory, because there are few, if any situations, where such

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faded to some degree, with markets becoming more global, and governance and listing standards rising on many overseas markets. Meanwhile, the cost and complexity of adhering to U.S. regulations, such as the Sarbanes-Oxley Act, have risen.").

liability would actually increase the amount of money available to reimburse injured investors. Under traditional aiding and abetting principles, the liability of the aider and abettor is completely derivative of the primary violator's liability. See, e.g., 15 U.S.C. § 78t(e) (providing that defendants who provide substantial assistance "shall be deemed to be in violation . . . to the same extent as the person to whom such assistance is provided") (emphasis added). But under the Exchange Act, except where a defendant is found to have knowingly committed a violation, liability is strictly proportionate. See 15 U.S.C. § 78u-4(f)(2)(B)(i) (providing that a defendant "shall be liable solely for the portion of the judgment that corresponds to the percentage of responsibility of that [defendant]").

Consequently, allowing private plaintiffs to add aiders and abettors as defendants would not "expand the pie" of compensation available to investors. In general, the primary actor would be liable for its proportionate share of damages, and the secondary aider and abettor would be liable to the same extent. Investors would be able to recover the sum of their losses from either the primary actor or the secondary actor, but not both. Thus, providing a right of action against aiders and abettors would not entitle shareholders to additional damages; it would merely multiply the number of defendants available to satisfy the same judgment. This would only be meaningful in those rare cases where the primary violator becomes insolvent or otherwise unable to pay a judgment. But if the goal is to provide investors with insurance against the risk of a judgment-proof primary violator, creating private aiding and abetting liability is an incredibly inefficient means of achieving it. Transforming underwriters, lenders, auditors, manufacturers, lawyers and other secondary actors into insurers of their counterparties' compliance with federal securities laws would cause such actors to undertake costly measures to offset their increased exposure to securities litigation. These costs, in turn, would be passed on to public companies and eventually would be borne by shareholders. Insurance is not free, and the securities laws are poorly designed to provide it.[18] See Dura Pharm, Inc., 544 U.S. at 345 (warning that, while

[18] To be sure, there have been some notable examples of massive corporate frauds—Enron, most prominently—in which the primary violator became insolvent and recoveries from secondary actors were the only substantial source of compensation available to investors. Had Stoneridge been decided prior to the litigation, it is arguable that some of these secondary actors either would have won motions to dismiss or, at least, would have settled for less money.

But it does not follow that private aiding and abetting liability is necessary to ensure investor compensation in these types of cases. As a practical matter, in any case involving a corporate fraud as massive and sweeping as Enron's, the SEC will avidly pursue all potential defendants. Indeed, the SEC's Enron-related enforcement actions resulted in substantial settlements that were paid into an SEC Fair Fund, which was distributed in full to shareholders—unlike the class action settlements, from which $688 million was skimmed off the top for the lawyers. See In re Enron Corp. Sec., Derivative & ERISA Litig., 586 F. Supp. 2d 732, 741 (S.D. Tex. 2008). Moreover, the absence of private "scheme liability" or aiding and abetting liability under Rule 10b-5 would have had no effect whatsoever on the ability of Enron shareholders to recover against several financial institutions—such as Credit Suisse First Boston, the Canadian Imperial Bank of Commerce, Lehman Brothers, and Bank of America—for violating Section 11 of the Securities Act. See In re Enron Corp. Sec., Derivative & ERISA Litig., 235 F. Supp. 2d 549, 707 (S.D. Tex. 2002).

securities laws are meant to deter fraud, they do not exist "to provide investors with broad insurance against market losses").

Questions 5 and 6: How would you assess the SEC's and DOJ's performance in pursuing secondary actors in securities fraud cases?

Response to Questions 5 and 6:

Empowering plaintiffs as "private attorneys general" to pursue aiders and abettors of securities fraud is unnecessary because the SEC and the DOJ already can and regularly do investigate and file actions against secondary actors. The SEC and the DOJ have aggressively pursued both individual and corporate secondary actors when appropriate and have obtained substantial settlements for investors, as well as civil penalties and—in some cases—imprisonment for serious wrongdoers. Indeed, the Independent Committee on Capital Markets Regulation has remarked that "[t]he United States has the toughest administrative enforcement of securities laws in the world." Committee on Capital Markets Regulation, Interim Report 71 (Nov. 2006), available at http://www.capsmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf.

1. SEC Performance

The PSLRA specifically tasked the SEC with enforcing the securities laws against aiders and abettors, see 15 U.S.C. § 78t(e), and the SEC has embraced this authority. For instance, before any class action was filed in the Stoneridge case, the SEC had recovered $45 million in disgorgement and civil penalties from the secondary actors—Scientific-Atlanta and Motorola—that aided and abetted the fraud perpetrated by Charter Communications. See SEC v. Scientific-Atlanta, Inc., SEC Litig. Release No. 19,735 (June 22, 2006), available at http://www.sec.gov/litigation/litreleases/2006/lr19735.htm; In re Motorola, Inc., SEC Exch. Act Release No. 55,725 (May 8, 2007), available at http://www.sec.gov/litigation/admin/2007/34-55725.pdf.

In all of the most notorious corporate scandals, the SEC has vigorously pursued secondary actors. In the wake of Enron's collapse, the SEC's enforcement actions netted approximately $450 million for distribution to investors. See Enron Victim Trust, http://www.enronvictimtrust.com/Faq.aspx#1 (last visited Nov. 30, 2010). Much of this recovery resulted from actions against corporate and individual aiders and abettors:

- Merrill Lynch settled with the SEC for $80 million, and two of its senior executives agreed to pay $300,001 each in disgorgement and civil penalties. The SEC claimed that Merrill aided and abetted Enron's fraud by engaging in artificial year-end transactions designed to overstate Enron's financial results. See SEC v. Bayly, SEC Litig. Release No. 21,361 (Jan. 6, 2010), available at http://www.sec.gov/litigation/litreleases/2010/lr21361.htm; SEC v. Furst, SEC Litig. Release No. 21,523 (May 11, 2010), available at http://www.sec.gov/litigation/litreleases/2010/lr21523.htm; SEC v. Merrill

Lynch & Co., SEC Litig. Release No. 18,038 (Mar. 17, 2003), available at http://www.sec.gov/litigation/litreleases/lr18038.htm.

- The Canadian Imperial Bank of Commerce ("CIBC") settled with the SEC for $80 million and two of its executives agreed to pay a combined $623,000 in disgorgement and civil penalties.[19] The SEC claimed that CIBC aided and abetted Enron's manipulation of reported financial results through a series of structured finance transactions designed to hide Enron's borrowings from investors and rating agencies. See SEC Litig. Release No. 18,517 (Dec. 22, 2003), available at http://www.sec.gov/litigation/litreleases/lr18517.htm.

- JPMorgan agreed to pay $135 million in disgorgement and civil penalties, and Citigroup agreed to pay $120 million, for their respective roles in transactions allegedly designed to allow Enron to manipulate its financial results. See Press Release, SEC, J.P. Morgan Chase Agrees to Pay $135 Million to Settle SEC Allegations that It Helped Enron Commit Fraud; Citigroup Agrees to Pay $120 Million to Settle SEC Allegations that It Helped Enron and Dynegy Commit Fraud (July 28, 2003), available at http://www.sec.gov/news/press/2003-87.htm.

Similarly, in connection with the massive financial fraud at Adelphia Communications Corporation, the SEC brought charges against Scientific-Atlanta Inc. and two of its senior executives, claiming they aided and abetted Adelphia's scheme to artificially inflate earnings by entering into sham marketing support agreements. Scientific-Atlanta agreed to pay $20 million in disgorgement to settle the action. See SEC Litig. Release No. 19,735 (June 22, 2006), available at http://www.sec.gov/litigation/litreleases/2006/lr19735.htm. In addition, the 2005 settlement of the SEC's aiding and abetting charges against Time Warner Inc. (formerly AOL Time Warner) was one of its largest settlements in history. America Online, Inc. ("AOL") was alleged to have entered into sham transactions that its counterparty, PurchasePro, used to report inflated revenue. Time Warner settled the claims with the SEC by agreeing to pay $300 million in civil penalties. See SEC Litig. Release No. 19,147 (Mar. 21, 2005), available at http://www.sec.gov/litigation/litreleases/lr19147.htm.

The SEC successfully pursues aiders and abettors in large and small cases alike. For example, in January of this year, the SEC brought aiding and abetting charges against General Re Corporation for enabling a fraud by American International Group ("AIG") and Prudential Financial, Inc. by entering into sham reinsurance transactions. Gen Re paid a penalty greatly exceeding the fees it received for the underlying transactions. See SEC Litig. Release No. 21,384 (Jan. 20, 2010), available at http://www.sec.gov/litigation/litreleases/2010/lr21384.htm. Likewise, the SEC

[19] As discussed further below, the DOJ pursued Merrill Lynch and CIBC, as well as several of their senior executives, for potential criminal liability for aiding and abetting Enron's fraud.

brought aiding and abetting charges against Zurich Financial Services Group for assisting Converium Holding AG in a fraudulent transaction to inflate Converium's financial performance. Zurich agreed to pay a $25 million penalty and was subjected to a cease-and-desist order in a related administrative proceeding.[20] See SEC Litig. Release No. 20,825 (Dec. 11, 2008), available at http://www.sec.gov/litigation/litreleases/2008/lr20825.htm.

The SEC's vigorous enforcement of the securities laws provides a powerful deterrent against would-be aiders and abettors. As many commentators have noted, private securities class actions perform terribly at deterring fraud because "the individuals responsible for the violation hardly ever have to contribute to any payment made to the class." Rethinking Damages at 1498; see John C. Coffee, Jr., Reforming the Securities Class Action: An Essay on Deterrence and its Implementation, 106 COLUM. L. REV. 1534, 1550 (2006) (citing study showing that in securities class actions in which officers and directors were named as defendants, insurers paid on average 68.2% of settlements and the corporations paid 31.4%, leaving at most 0.4% to be paid by individual offenders); Bernard Black et al., Outside Director Liability, 58 STAN. L. REV. 1055, 1060, 1070 (2006) (finding, based on an empirical study of out-of-pocket risk for outside directors of public companies in securities fraud cases, that from 1980 to 2005, outside directors have only once made personal payments after a trial and only twelve times made out-of-pocket settlement payments or payments for their own legal expenses).[21]

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[20] The SEC has pursued numerous other aiders and abettors of securities fraud since the PSLRA was enacted. In August 2009, the SEC charged Terex Corporation with aiding and abetting a fraudulent accounting scheme at United Rentals, Inc. Terex agreed to pay an $8 million penalty. See SEC Litig. Release No. 21,177 (Aug. 12, 2009), available at http://www.sec.gov/litigation/litreleases/2009/lr21177.htm.

In a recently filed enforcement action against Samuel E. Wyly and Charles J. Wyly, Jr. for securities fraud, the SEC also brought charges against their lawyer and stockbroker for aiding and abetting. See SEC Litig. Release No. 21,607 (July 29, 2010), available at http://www.sec.gov/litigation/litreleases/2010/lr21607.htm.

The SEC brought an enforcement action against First BanCorp, alleging it aided and abetted a securities fraud committed by Doral Financial Corporation by concealing the true nature of more than $4 billion worth of transactions involving subprime mortgages from 2000 to 2005. First BanCorp settled for $8.5 million and Doral Financial paid a $25 million civil penalty. See SEC Litig. Release No. 20,227 (Aug. 7, 2007), available at http://www.sec.gov/litigation/litreleases/2007/lr20227.htm.

In connection with a securities fraud at Brightpoint, Inc., the SEC charged AIG and one of its executives with aiding and abetting the fraud by constructing so-called "round-tripping" transactions. The SEC accused AIG of fashioning artificial insurance products that Brightpoint used to hide $11.9 million in losses and to overstate earnings by 61 %. AIG paid a $10 million civil penalty to settle the SEC's charges. See Press Release, SEC Charges American International Group and Others in Brightpoint Securities Fraud; AIG Agrees to Pay $10 Million Civil Penalty (Sept. 11, 2003), available at http://www.sec.gov/news/press/2003-111.htm.

[21] See also A.C. Pritchard, Stoneridge Investment Partners v. Scientific-Atlanta: The Political Economy of Securities Class Action Reform, 2007-08 CATO SUP. CT. REV. 217, 239 ("Traditionally,

By contrast, the SEC regularly pursues individual wrongdoers. From 2003 to 2010, 73% of all SEC settlements have been with individual defendants. See Jan Larsen et al., SEC Settlements Trends: 1H10 Update 3 (NERA Econ. Consulting 2010) [hereinafter SEC Settlements Trends: 1H10 Update]; see also Press Release, SEC, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006) (noting that the SEC "view[s] penalties against individual offenders as a critical component in punishing and deterring violative conduct" and that, "[w]here shareholders have been victimized by the violative conduct," the SEC will "seek penalties from culpable individual offenders acting for a corporation"), available at http://www.sec.gov./news/press/2006-4.htm. Moreover, the SEC's policy is to require that penalties imposed on individual defendants be paid by those individuals personally, rather than by their companies or insurers. See, e.g., 17 C.F.R. §§ 229.510, 229.512(i); see also SEC Chairman William H. Donaldson, Remarks Before the New York Financial Writers Association (June 5, 2003), available at http://www.sec.gov/news/speech/spch060503whd.htm. Accordingly, the SEC often requires, as a condition to settlement, that defendants agree not to seek or accept indemnification. See, e.g., Press Release, SEC, The Securities and Exchange Commission, NASD and the New York Stock Exchange Permanently Bar Henry Blodget From the Securities Industry and Require $4 Million Payment (Apr. 28, 2003), available at http://www.sec.gov/news/press/2003-56.htm.

The SEC also has power to impose a variety of non-monetary penalties that affect individual defendants personally. For example, the SEC regularly enters into settlements barring individuals from serving as directors or officers of public companies, barring defendants from serving as investment advisers, barring individuals from associating with broker-dealers, and barring accountants and attorneys from appearing or practicing before the SEC.[22] Moreover, being subjected to an SEC enforcement proceeding—unlike being named in a private class action—carries a significant stigma that can cause lasting reputational damage. For all these reasons, SEC actions are far more effective at deterring fraud than private lawsuits.

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class action settlements have not included a contribution from corporate officers individually. Plaintiffs' lawyers forgo that source of recovery because they can reach a settlement much more quickly if they do not insist on a contribution from the individual defendants. The only reason that officers and directors are named is to improve the plaintiffs' lawyers' bargaining position. The big money for plaintiffs' attorneys is in pursuing the corporation and its insurers, and the officers and directors are happy to buy peace for themselves with the corporation's money. The dirty secret of securities class actions is that companies and their insurers pay the costs of settlement, which effectively means that shareholders are paying the costs of settlements to shareholders.").

[22] See, e.g., SEC Litig. Release No. 21,474 (Apr. 2, 2010), available at http://www.sec.gov/litigation/litreleases/2010/lr21474.htm; SEC Litig. Release No. 20,970 (Mar. 24, 2009), available at http://www.sec.gov/litigation/litreleases/2009/lr20970.htm; SEC Litig. Release No. 21,359 (Jan. 5, 2010), available at http://www.sec.gov/litigation/litreleases/2010/lr21359.htm; SEC Litig. Release No. 19,996 (Feb. 9, 2007), available at http://www.sec.gov/litigation/litreleases/2007/lr19996.htm.

Furthermore, the SEC has recently taken steps to increase the effectiveness of its enforcement arm. In August 2009, Robert Khuzami, Director of the SEC Enforcement Division, outlined his plan to overhaul the Division to bolster its efficiency and success in pursuing violators of the securities laws. See Robert Khuzami, Director of Enforcement, SEC, Remarks Before the New York City Bar: My First 100 Days as Director of Enforcement (Aug. 5, 2009), available at http://sec.gov/news/speech/2009/spch080509rk.htm. In his speech, Mr. Khuzami described four initiatives he had implemented to accomplish these goals: (1) introducing five specialized units, led by Unit Chiefs and staffed with Division employees with expertise in these topics to maximize the knowledge base in each of these areas; (2) streamlining the agency's management structure by reducing the number of managers and "redeploying" many of the branch chiefs back into investigative roles; (3) creating an Office of Market Intelligence to collect and triage the thousands of tips, complaints, and referrals that the SEC receives; and (4) increasing incentives for individuals to cooperate in SEC investigations. See id. Most importantly, as part of the streamlining initiative, Mr. Khuzami announced that he would relieve SEC staff of the obligation to obtain Commission approval to issue subpoenas—requiring only that staff members get approval from a senior supervisor. Furthermore, routine case decisions would now be made at the local level rather than the national level, increasing the autonomy of those closest to the facts of a particular case. See id. Notably, Mr. Khuzami expressed his hope that Congress would increase the agency's resources for fighting financial fraud. Id.

In Dodd-Frank, Congress answered the SEC's call and went even further to augment the SEC's already robust enforcement authority. Not only does Dodd-Frank give the SEC authority to pursue secondary actors that aid and abet recklessly as well as knowingly, see supra at 14, the legislation also includes several changes that will likely lead to increased enforcement against aiders and abettors.[23] For example, it grants the SEC authority to impose penalties for aiding and abetting violations of the Securities Act and the Investment Advisors Act of 1940, see Dodd-Frank §§ 929M, 929N, 124 Stat. 1861-62; expands the SEC's subpoena power, see id. § 929E, 124 Stat. 1853 (granting the SEC nationwide service of process for witnesses and production of documents); provides substantially more funding and personnel resources to the SEC, see id. § 991, 124 Stat. 1950 (increasing the SEC's budget from $1.3 billion in 2011 to $2.25 billion in 2015); and expands the SEC's ability to bring administrative proceedings, see id. § 929P, 124 Stat. 1862.[24] The SEC's budget

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[23] See Robert Khuzami, Director of Enforcement, SEC, Testimony Concerning Investigating and Prosecuting Fraud after the Fraud Enforcement and Recovery Act (Sept. 22, 2010) (noting that Congress—through Dodd-Frank—granted to the SEC many of the "legislative initiatives" that the agency had previously sought), available at http://www.sec.gov/news/testimony/2010/ts092210rk.htm.

[24] One of the more dramatic reforms enacted by Dodd-Frank is its whistleblower provision. See Dodd-Frank, § 922, 124 Stat. 1841-49. This section provides that anyone who alerts the SEC to a securities infraction by providing "original information" that leads to SEC penalties of more than $1 million can collect 10% to 30% of the total penalties imposed by the agency. Id. The provision allows for whistleblowers to make a claim anonymously—as long as they are represented by counsel—and reap massive benefits from doing so. See id. With SEC settlements often reaching hundreds of millions of

authority has in fact increased substantially every year since the PSLRA was enacted and has doubled since 2002. See Frequently Requested FOIA Document: Budget History, SEC Website, http://www.sec.gov/foia/docs/budgetact.htm.

2. DOJ Performance

Like the SEC, the DOJ has successfully pursued both primary and secondary violators of the securities laws. For example, the DOJ obtained fines against four of Charter's individual officers who were accused of conspiracy and aiding and abetting the same alleged accounting fraud that was at issue in Stoneridge.[25] Under a similar set of facts, the DOJ charged three senior executives of General Re and one senior executive of AIG with conspiring to commit securities fraud by entering into sham reinsurance transactions in order to manipulate AIG's financial statements. See Press Release, U.S. Dep't of Justice, Three Former Gen Re and One Former AIG Senior Executives Charged in Connection with Fraud Scheme (Feb. 2, 2006), available at http://www.justice.gov/opa/pr/2006/February/06_crm_057.html. All four were convicted at trial. See U.S. Jury Convicts Former Gen Re, AIG Executives, REUTERS, Feb. 26, 2008, available at http://www.reuters.com/article/idUSN2525608120080226.

In many instances—particularly in cases of massive corporate fraud—the Justice Department has conducted extensive investigations and brought criminal prosecutions in the same cases pursued by the SEC. For example, the DOJ vigorously pursued secondary actors that aided and abetted Enron's fraud. The DOJ brought criminal charges against four Merrill Lynch executives, including the Global Head of Investment Banking, for orchestrating the so-called "Nigerian barge" transaction, in which Enron fraudulently sold a power-generating barge to Merrill but secretly agreed to repurchase the asset at an agreed-upon premium six months later. All four were convicted at trial.[26] In addition, Merrill Lynch entered into a non-prosecution agreement with the government, requiring it to institute significant internal reforms. See Press Release, U.S. Dep't of Justice, Three Top Former Merrill Lynch Executives Charged With Conspiracy, Obstruction Of Justice, Perjury in Enron Investigation; Merrill Lynch Agrees to Cooperate with Enron Investigation, Implement Reforms, with Oversight by Monitor (Sept. 17, 2003), available at http://www.fbi.gov/news/pressrel/press-releases/three-top-former-merrill-lynch-executives-charged-with-conspiracy-obstruction-of-justice-perjury-in-enron-

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dollars, the whistleblower bounty provides a strong incentive for individuals to report fraudulent activity.

[25] See Judgment, United States v. Barford, No. 4:03CR00434 (E.D. Mo. Apr. 22, 2005); Judgment, United States v. Kalkwarf, No. 4:03CR434 (E.D. Mo. Apr. 22, 2005); Judgment, United States v. McCall, No. 4:03CR434 (E.D. Mo. Apr. 22, 2005); Judgment, United States v. Smith, No. 4:03CR434 (E.D. Mo. Apr. 22, 2005).

[26] However, the U.S. Court of Appeals for the Fifth Circuit reversed these convictions holding that the government's "honest services" theory of fraud was flawed. See United States v. Brown, 459 F.3d 509, 517 (5th Cir. 2006). Ultimately, the government did not retry the defendants. See John R. Emshwiller, U.S. Won't Retry Key Enron Figure, WALL ST. J., Sept. 16, 2010, at C4.

investigation. As discussed further below, the DOJ also entered into a deferred prosecution agreement with CIBC. See infra at 35.

Also in connection with the Enron scandal, the Justice Department obtained convictions of three bankers employed by National Westminster Bank Plc ("Nat West") for secretly investing with Enron's Chief Financial Officer in an entity designed to purchase an asset they were selling on behalf of Nat West. They were sentenced to 37 months' imprisonment and ordered to repay approximately $7.3 million.[27] See Press Release, U.S. Dep't of Justice, Three Former British Bankers Plead Guilty to Wire Fraud in Enron Case (Nov. 28, 2007), available at http://www.justice.gov/opa/pr/2007/November/07_crm_949.html.

Even in cases where defendants are able to avoid conviction by cooperating with the government, deferred prosecution agreements usually involve massive financial penalties and onerous obligations. For example, CIBC entered into a deferred prosecution agreement with the DOJ for its role in enabling Enron's fraudulent financial practices. See Press Release, U.S. Dep't of Justice, Canadian Imperial Bank

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[27] Similarly, the SEC and DOJ brought aiding and abetting charges against Joseph Collins, the outside lawyer to Refco Inc., for assisting Refco executives in defrauding investors of $2.4 billion by concealing hundreds of millions of dollars in related-party indebtedness. Following a jury trial, Collins was found guilty and sentenced to seven years' imprisonment. See Press Release, U.S. Attorney for the Southern District of New York, Refco's Principal Outside Attorney Sentenced in Manhattan Federal Court to Seven Years in Prison for $2.4 Billion Fraud (Jan. 14, 2010), available at http://www.justice.gov/usao/nys/pressreleases/January10/collinsjosephrefcosentencingpr.pdf.

The DOJ also brought aiding and abetting charges against BAWAG P.S.K., a major Austrian bank, for assisting Refco in concealing hundreds of millions of dollars in related party indebtedness and related party transactions. BAWAG entered into a non-prosecution agreement with the DOJ, requiring it to pay $675 million, including $337.5 million in restitution to Refco investors. See Press Release, U.S. Attorney for the Southern District of New York, Austrian Bank "BAWAG" to Pay $337.5 Million for Restitution to Victims of Refco Fraud (June 5, 2006), available at http://www.justice.gov/usao/nys/pressreleases/June06/bagwagnon-prosecutionagreementpr.pdf.

In connection with a scheme by Peregrine Systems Inc. to fraudulently inflate its revenue by $509 million from 1999 to 2001, the SEC and DOJ brought actions against Larry Rodda, a principal at KPMG Consulting LLC, for aiding and abetting the fraud by signing sham software license agreements. Rodda pled guilty and was sentenced to six months' imprisonment and six months' house detention. He also paid an $80,000 penalty to settle the SEC's charges. See Press Release, SEC, Former KPMG Consulting Principal Settles SEC Charges for Role in Peregrine Accounting Fraud (Feb. 6, 2008), available at http://www.sec.gov/news/press/2008/2008-14.htm.

Likewise, the DOJ brought criminal charges against AIG alleging it aided and abetted the PNC Financial Services Group, Inc. ("PNC") in executing fraudulent transactions designed to enhance PNC's balance sheet. AIG entered into a deferred prosecution agreement, pursuant to which it paid $80 million in penalties, implemented a series of reforms, established a transaction review committee, and agreed to be monitored by an independent consultant. AIG also consented to the entry of judgment in a related SEC enforcement proceeding requiring it to disgorge $46.3 million in fees and interest. See Press Release, U.S. Dep't of Justice, American International Group, Inc. Enters Into Agreements With the United States (Nov. 30, 2004), available at http://www.justice.gov/opa/pr/2004/November/04_crm_764.htm.

of Commerce Agrees to Cooperate with Enron Investigation (Dec. 22, 2003), available at http://www.usdoj.gov/opa/pr/2003/December/03_crm_718.htm. CIBC had engaged in certain "accounting-driven transactions" with Enron through which Enron assets were sold to "special purpose entities" with off-balance-sheet financing. Id. Under the agreement, CIBC agreed to cooperate fully with the ongoing investigation, cease engaging in structured finance transactions with U.S. companies for three years, adopt a series of significant internal reforms, accept an appointed monitor to oversee compliance, and pay $80 million to the SEC. Id. Similarly, the DOJ brought a criminal complaint against AOL for aiding and abetting PurchasePro's fraud. AOL entered into a deferred prosecution agreement, obligating it to adopt internal compliance measures, pay $150 million into a compensation and settlement fund, pay a $60 million criminal penalty, and cooperate with an independent monitor who would report to the DOJ on at least a semi-annual basis. In addition, four PurchasePro executives pled guilty to criminal charges. See Press Release, U.S. Dep't of Justice, America Online Charged with Aiding and Abetting Securities Fraud; Prosecution Deferred for Two Years (Dec. 15, 2004), available at http://www.justice.gov/opa/pr/2004/December/04_crm_790.htm.

The last two U.S. presidents have each created task forces involving the DOJ and other government agencies, to specifically target financial fraud and use interagency resources to do so. In 2002, President Bush created the Corporate Fraud Task Force "to strengthen the efforts of the Department of Justice and Federal, State, and local agencies to investigate and prosecute significant financial crimes, recover the proceeds of such crimes, and ensure just and effective punishment of those who perpetuate financial crimes." Corporate Fraud Task Force 2008, Report to the President (Apr. 2, 2008), available at http://www.justice.gov/archive/dag/cftf/corporate-fraud2008.pdf. Through April 2008, the Corporate Fraud Task Force had secured nearly 1,300 corporate fraud convictions. Id. at iii. In November 2009, President Obama established the Financial Fraud Enforcement Task Force "to hold accountable those who helped bring about the last financial crisis, and to prevent another crisis from happening." About the Task Force, http://www.stopfraud.gov/about.html. The task force is comprised of over twenty federal agencies including the DOJ, 94 U.S. Attorneys Offices, and state and local partners in an effort to better protect investors from economic fraud. Id.

3. Scope of Enforcement

As demonstrated above, the SEC and the DOJ have put their full resources into prosecuting aiding and abetting cases. In fact, these organizations have brought enforcement actions in difficult scenarios, sometimes resulting in unsuccessful outcomes for the government. For example, in the case of PurchasePro's fraud, discussed above, the SEC and DOJ brought actions against AOL as well as a wide array of both PurchasePro and AOL executives with varying roles in the alleged fraud. See Indictment, U.S. v. Benyo et al., No. 1:05CR12 (E.D. Va. Jan. 10, 2005) (charging defendants with primary and secondary violations of the securities laws); Complaint, SEC v. Johnson et al., No. 05-CV-0036-GK (D.D.C. Jan. 10, 2005) (alleging primary and secondary liability for certain defendants). While the SEC and the DOJ were

either successful in or settled their actions against AOL itself and against certain PurchasePro executives, see supra at 30, 36, both entities lost their cases against certain other executives alleged to have aided and abetted the fraud, see SEC Litig. Release No. 21,213 (Sept. 18, 2009) (noting that the jury found defendants Michael Kennedy and Kent Wakeford not liable on the charges against them and that the SEC voluntarily dismissed the allegations against defendant John Tuli), available at http://www.sec.gov/litigation/litreleases/2009/lr21213.htm; Carrie Johnson, 3 Acquitted in Lengthy AOL Trial, WASH. POST, Feb. 7, 2007, at D1 (describing the acquittal of defendants Wakeford, Tuli and Christopher Benyo from the DOJ's charges).

The SEC and the DOJ also have vigorously pursued claims against large and prominent companies. For instance, between August 2002 and March 2010, the SEC's top ten largest settlements have included actions against AIG, WorldCom, Inc., Citigroup Global Markets Inc., Siemens, State Street Bank and Trust Company, Time Warner Inc., and Bear, Stearns & Co.[28] See SEC Settlements Trends: 1H10 Update at 2.

4. The Current Enforcement Regime is Focused on Providing Compensation to Injured Investors

The DOJ regularly utilizes its criminal restitution and forfeiture powers to compensate injured investors. For example, through mid-2007, the DOJ's Asset Forfeiture and Money Laundering Section obtained more than $1 billion in fraud-related forfeitures, all of which it distributed to victims of corporate fraud. See Press Release, U.S. Dep't of Justice, Fact Sheet: President's Corporate Fraud Task Force Marks Five Years of Ensuring Corporate Integrity (July 17, 2007), available at http://www.justice.gov/opa/pr/2007/July/07_odag_507.html.

The SEC has also prioritized the compensation of injured investors. Under Sarbanes-Oxley, Congress empowered the SEC to create the Fair Funds provision to collect and return to injured investors funds that the SEC recovers through disgorgement and civil penalties. See 15 U.S.C. § 7246. This was meant to be, and has proven to be, a more efficient method of compensating injured parties than private lawsuits since legal fees can account for a substantial portion of any private recovery. Since the Fair Funds provision was enacted in 2002, the SEC has returned more than $6.6 billion to injured investors, with $2.1 billion returned in 2009 alone. See SEC, 2009 Performance and Accountability Report 11, 29 (2009), available at http://www.sec.gov/about/secpar/secpar2009.pdf. Combined with the Dodd-Frank Act's lower burden for establishing aiding and abetting liability and its increase in

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[28] In another recent example, the SEC brought suit against Goldman, Sachs & Co. in April 2010 for omitting facts in the course of arranging and marketing a collateralized debt obligation, Abacus 2007-AC1. The action was resolved through the largest settlement against a financial services firm in SEC history—a $550 million penalty, $250 million of which would be redistributed to investors through the Fair Funds program, as well as significant mandatory internal reforms. See SEC Litig. Release No. 21,592 (July 15, 2010), available at http://www.sec.gov/litigation/litreleases/2010/lr21592.htm.

funds dedicated to the enforcement efforts of the SEC, these numbers will only increase and allow the SEC to be even more effective at policing violations than they have already been in the past.

Moreover, Section 929P(a) of Dodd-Frank now allows the SEC to impose civil penalties in cease-and-desist proceedings under the Securities Act, the Exchange Act, the Investment Company Act of 1940, and the Investment Advisers Act of 1940, even against individuals not regulated by the SEC. See Dodd-Frank § 929P(a), 124 Stat. 1862. Given the SEC's advantages in administrative proceedings as compared to a federal court action—such as limited discovery, lack of a jury trial, and a de novo standard of review on appeal—the SEC may now elect to bring more actions as administrative proceedings under this new provision. See Robert Khuzami, Director of Enforcement, SEC, Testimony Concerning Investigating and Prosecuting Fraud after the Fraud Enforcement and Recovery Act (Sept. 22, 2010) (detailing SEC's plans to utilize new tools provided by Dodd-Frank Act to pursue secondary actors), available at http://www.sec.gov/news/testimony/2010/ts092210rk.htm.

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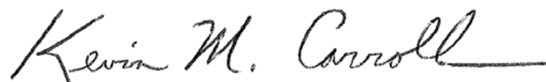
Leaving the power to pursue aiders and abettors exclusively in the hands of the SEC and the DOJ is consistent with the judicial and legislative balance struck over the last sixteen years. As discussed, through its decisions in Central Bank and Stoneridge, the Supreme Court has limited the private right of action under the securities laws to primary actors—i.e., those for which all elements of a primary violation can be shown. The courts have consistently chosen not to expand this right to aiding and abetting liability and have cited the SEC's enforcement authority in this area as an effective mechanism for pursuing these actors. See Stoneridge, 552 U.S. at 166 (noting that federal enforcement power against secondary actors is not "toothless"); Zoelsch v Arthur Andersen & Co., 824 F.2d 27, 33 n.3 (D.C. Cir. 1987) (recognizing that a securities suit brought by the SEC has greater legitimacy than a suit brought by a private party because the SEC is "a responsible government agency").

CONCLUSION

For all of the above reasons, a new private right of action against aiders and abettors of securities law violations would have a dramatic negative impact with little, if any, corresponding benefit. We would be happy to answer further questions or provide further information and look forward to discussing these matters with you.

Respectfully yours,



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