Secondary Liability For Securities Fraud: Gatekeepers In State Court

Jennifer J Johnson
SECONDARY LIABILITY FOR SECURITIES FRAUD:

GATEKEEPERS IN STATE COURT

Jennifer J. Johnson**

** Jeffrey Bain Scholar & Professor of Law, Lewis and Clark Law School. I would like to thank the members of the Law and Society Association for their helpful comments on this paper after my presentation at the 2010 meeting and Robert Scott for his invaluable research assistance.
# Table of Contents

I. INTRODUCTION .......................................................................................................................... 3

II. SECONDARY LIABILITY UNDER THE FEDERAL SECURITIES STATUTES .................. 7
   A. 1934 ACT — THE JURISPRUDENCE OF RULE 10b-5.................................................................... 7
   B. 1933 ACT —SECTIONS 11 AND 12(A)(2)................................................................................ 13
   C. CONTROL PERSON LIABILITY ................................................................................................. 14

III. SECONDARY LIABILITY UNDER STATE BLUE SKY LAWS ........................................... 17
   A. THE STATE ANTIFRAUD APPROACH .................................................................................. 17
   B. SECONDARY LIABILITY UNDER STATE ANTIFRAUD STATUTES...................................... 23
      1. Control Person Liability ....................................................................................................... 24
      2. Brokers/Dealers and Issuer Employees ............................................................................... 25
      3. “Others” Who Materially Aid or Participate in the Securities Transaction ......................... 26

IV. FEDERAL LIMITS ON BLUE SKY LAWS ............................................................................. 31
   A. PREEMPTION .......................................................................................................................... 31
      1. NSMIA ................................................................................................................................. 31
      2. SLUSA and CAFA ................................................................................................................. 33
   B. THE DORMANT COMMERCE CLAUSE ................................................................................ 40

V. SECONDARY LIABILITY UNDER BLUE SKY LAWS:A WISE POLICY CHOICE? .......... 45

VI. CONCLUSION ............................................................................................................................ 57
SECONDARY LIABILITY FOR SECURITIES FRAUD: GATEKEEPERS IN STATE COURT

I. INTRODUCTION

The recent economic meltdown stemming from the housing crisis exposed numerous Ponzi schemes from Madoff to Palm Beach Capital that were no longer able to masquerade as profitable enterprises under the strain of catastrophic market realities. As a result, victims in ever increasing numbers have filed lawsuits alleging misrepresentations in connection with a variety of securities transactions. When promoters of fraudulent ventures are unable to provide restitution, plaintiffs seek out other sources of repayment including those who aided or facilitated the original transactions. Imposition of this secondary liability largely impacts professionals including attorneys, accountants and investment bankers. Although most scholars agree that professionals can perform an important role in deterring securities fraud, scholarly opinions vary widely on the appropriate liability regime,


2 There is voluminous literature on the efficacy of gatekeepers in business transactions. See, e.g., JOHN C. COFFEE, GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE (2006)(suggesting reforms to improve gatekeeping roles of various
if any, that these gatekeepers should face.³ Civil liability for secondary participants in securities fraud was once well accepted in the federal courts, but in 1994 the Supreme Court invalidated such claims as beyond the purview of Section 10(b) of the 1934 Act and Rule 10b-5, the most widely utilized antifraud provisions in the federal securities laws.⁴ Fifteen years later, in conjunction with recent financial reform legislation, Congress again considered the wisdom of reinstating private civil aiding and abetting liability for Rule 10b-5 securities fraud.⁵

It is interesting to note, however, that absent from this recent debate was any discussion of the appropriate role of state law. In contrast to the current federal regime, there is a robust tradition of aiding and abetting liability in most state blue sky statutes. Secondary liability is perhaps alleged most often in state court


litigation over failed private offerings where the promoter is insolvent, such as the recent two billion dollar Medical Capital promissory note Ponzi scheme. 6 Many of these state actions target professionals who fail to detect the fraudulent activity of their clients. Unlike the federal implied Rule 10b-5 cause of action, state blue sky laws contain express secondary liability statutes that do not have strict scienter standards or rigorous pleading requirements.7 Indeed, some state statutes are negligence based and contain burden-shifting provisions that require non-seller defendants to establish that they were not negligent in failing to discover the seller’s fraud.8

This Article argues that the increasing number of state court civil suits against secondary defendants is a logical consequence of federal preemption of state authority over securities offerings. In 1996, as part of National Securities Market Improvement Act (NSMIA),9 Congress preempted state regulatory authority over Rule 506 private placements, which represent the bulk of private offerings. The result is that many allegedly fraudulent securities offerings now take place as preempted private placements that are virtually unregulated by any federal or state

6 See, e.g., McCoy v. Cullum & Burks Sec., Inc., Case No. SACV09-01084-DOC(RNBx)(C.D. Cal.) (class action against brokers who sold medical capital notes); Benson et al. v. JP Morgan Chase Bank, Case No. CV 09-5272 (N.D. Cal. 2009) (class action against bank as aider and abettor of private placement securities ); D. Kurtz’s Canyon Crest, LLC v Davis Wright Tremaine LLP, Case no. 0902-02841 (Multnomah County Circuit Court (Feb 26, 2009) (class action complaint against attorneys that drafted disclosure document in failed Sunwest venture).

7 See infra notes 113–16 and accompanying text.
8 See infra Part III(A).
governmental agencies.\textsuperscript{10} As a consequence, private state civil suits including those naming secondary defendants are necessary to fill this enforcement vacuum.\textsuperscript{11}

This Article explores the appropriate relationship between these state blue sky laws and federal 10b-5 jurisprudence. The Article ultimately concludes that Congress should reverse its propensity of the last decade to preempt state securities actions and should recognize the valuable contribution of such actions in addressing fraud, particularly fraud committed upon retail investors.

In Part II, the Article briefly reviews the current federal regime imposing civil liability for securities fraud and congressional and judicial limitations restricting this cause of action. Part II explains that under judicial interpretations of the federal antifraud securities statutes, secondary liability is largely confined to designated statutory “control persons.”

Part III contrasts the federal scheme with the more plaintiff friendly state blue sky laws. Part III demonstrates that there is a robust tradition under the state securities laws of imposing secondary liability for securities fraud and that professionals can be liable under state law for failing to serve as effective gatekeepers.

In Part IV, the Article discusses congressional preemption of state securities class actions and limitations imposed upon these state liability schemes under the Dormant Commerce Clause. Part IV explains the rational divide between national


markets and private placements and suggests that, perhaps quite by accident, state civil suits are now largely immune from problems that continue to plague federal class actions.

Part V then explores the policy implications of state laws that fundamentally differ from the federal system and sometimes from each other. Part V examines the costs and benefits of the most aggressive blue sky statutes and argues that state experimentation should continue without congressional interference. The Article concludes with the observation that state securities antifraud laws operate on an important and appropriate stage and suggests that Congress return more authority to state regulators to prevent securities fraud and resist efforts to further preempt state civil liability laws when those regulatory efforts fail.

II. SECONDARY LIABILITY UNDER THE FEDERAL SECURITIES STATUTES

A. 1934 Act — the Jurisprudence of Rule 10b-5

The vast majority of private securities litigation in the federal courts has involved section 10(b) of the 1934 Securities Exchange Act (the 1934 Act)\textsuperscript{12} and Rule 10b-5,\textsuperscript{13} both of which prohibit fraud in connection with the purchase or sale of securities.\textsuperscript{14} Courts have consistently implied a private cause of action under Rule

\textsuperscript{13} 17 C.F.R. § 240.10b-5 (2010).
\textsuperscript{14} Rule 10b-5 was drawn from section 17(a) of the 1933 Act, and by now its provisions are quite familiar: “It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of
10b-5, and over time, along with occasional tinkering by Congress, have established the elements of the private cause of action. As set forth by the Supreme court in *Dura Pharmaceuticals, Inc. v. Broudo,* to establish a prima facie case under Rule 10b-5, a private plaintiff must generally plead and prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." *Id.* Perhaps surprisingly, while there is a rich judicial precedent interpreting Rule 10b-5(b) prohibiting material omissions and misstatements of fact, there are very few cases directly addressing clauses (a) and (c), sometimes cumulatively deemed "fraud by conduct." Ronald J. Colombo, *Cooperation with Securities Fraud, 61 ALA. L. REV. 61* (2009); cf. Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc. 552 U.S. 148, 158–60 (2008) (discussing fraud by conduct in the context of secondary actors).


17 Under applicable Supreme Court precedent, "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." *TSC Industries, Inc. v. Northway, Inc.,* 426 U.S. 438, 449 (1976).

18 *Ernst & Ernst,* 425 U.S. at 193. To establish scienter, the plaintiff must prove the defendant intended to “deceive, manipulate, or defraud” the plaintiff. *Id.* Among the federal circuit courts, this intent requirement is satisfied by knowledge and varying degrees of recklessness. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 319 n.3 (2007). The Supreme Court in *Tellabs* also clarified the pleading standard for scienter: “the inference of scienter must be more than merely ‘reasonable’ or ‘permissible’—it must be cogent and compelling, thus strong in light of other explanations. A complaint will survive . . . only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.” *Id.* at 324.
between the misrepresentation or omission and the purchase or sale of a security;\(^9\) (4) reliance upon the misrepresentation or omission;\(^{20}\) (5) economic loss;\(^{21}\) and (6) loss causation.\(^{22}\) In 1995, Congress, in an effort to curb what it deemed vexatious litigation, enacted the Private Securities Litigation Reform Act (PSLRA),\(^{23}\) which imposed severe procedural hurdles for Rule 10b-5 plaintiffs. For example, under the PSLRA, in order to defeat a motion to dismiss, plaintiffs must, before discovery, state with particularity facts detailing the fraud and “giving rise to a strong inference that the defendant acted with the required state of mind (scienter).”\(^{24}\)

Until 1994, secondary participants in securities fraud transactions, such as attorneys, accountants, underwriters, and banks, faced civil aiding and abetting

\(^{19}\) Blue Chip Stamps, 421 U.S. at 730 (acknowledging a private cause of action under Rule 10b-5 and establishing standing requirements as limited to “purchasers” or “sellers” of securities).

\(^{20}\) Basic Inc. v Levinson, 485 U.S. 224, 241–50 (reiterating the importance of the reliance element and establishing the rebuttable presumption of “fraud-on-the-market”). In Stoneridge, the Supreme Court held that the reliance element of section 10b and Rule 10b-5 requires that investors be aware of the defendant’s role in the challenged transaction. Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc. 552 U.S. 148 (2008).

\(^{21}\) In Dura, the Court cites 15 U.S.C. § 78u-4(b)(4) as authority for the necessity of proving economic loss, although the cited provision actually refers to loss causation. Dura Pharm., 544 U.S. 336 (2005).

\(^{22}\) Id.


\(^{24}\) Id. (codified at 15 U.S.C. § 78-u4(b)(2)(A) (2006)). Among its many other provisions, the PSLRA provides for a stay of discovery pending a motion to dismiss, § 78-u4(b)(3)(B); contains a statutory safe harbor (unavailable under most state blue sky laws) for forward-looking statements, § 78-u5(c); establishes lead plaintiff criteria, § 78-u4(a)(3); establishes a safe harbor for forward looking statements, § 77z-2; and creates a system of proportionate liability, § 78u-4(f).
liability as well as potential primary liability under Rule 10b-5. However, the parameters of liability for aiding and abetting Rule 10b-5 violations, and how they differed from the elements of a primary violation, were never clear. Given the universal judicial recognition of aiding and abetting Rule 10b-5 liability before 1994, litigants and courts had little need to parse out the distinctions between secondary and primary liability. While somewhat murky, the elements of Rule 10b-5 secondary liability were generally premised on a secondary participant knowingly providing substantial assistance to the primary violator.

In 1994, in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, a closely divided Supreme Court held that the statutory text of Section 10(b) of the 1934 Act did not encompass aiding and abetting liability in private civil actions under Rule 10b-5, thereby reversing the prior law in every circuit. The *Central Bank* opinion was perhaps presaged in *Ernst & Ernst v. Hochfelder*, where the Court noted that “[i]n view of our holding that an intent to deceive, manipulate, or defraud is required for civil liability under § 10(b) and Rule 10b-5, the elements of aiding and abetting liability are not fairly comprehended within the reach of § 10(b) and Rule 10b-5.”

---


26 Anixter v. Home-Stake Prod. Co., 77 F.3d 1215, 1224 n.8 (10th Cir. 1996) (“Commentators have long recognized vagaries in the borders between primary and secondary liability.”).

27 See Pettit v. Am. Stock Exch. 217 F.Supp. 21, 28–29 (D.C.N.Y. 1963) (first articulating aiding and abetting liability and formulating the elements of knowledge and substantial assistance); *Brennan*, 259 F.Supp. 673, 680 (following *Pettit* and codifying the elements); Cleary v. Perfecture, Inc. 700 F.2d 774, 777 (1st Cir. 1983) (listing “knowing and substantial assistance of the primary violation” as an element of aiding and abetting liability); IIT, an Intern. Inv. Trust v. Cornfield 619 F.2d 909, 922 (2d Cir. 1980) (also listing “knowledge of the violation” as an element of liability (citing cases)).

28 511 U.S. at 170–78. This opinion was perhaps presaged in *Ernst & Ernst v. Hochfelder*, where the Court noted that “[i]n view of our holding that an intent to deceive, manipulate, or defraud is required for civil liability under § 10(b) and Rule 10b-5, the elements of aiding and abetting liability are not fairly comprehended within the reach of § 10(b) and Rule 10b-5.”
Bank decision also rendered uncertain the continuing ability of the SEC to bring actions based upon aiding and abetting liability.\textsuperscript{30} In 1995, as part of the political compromise surrounding the passage of the PSLRA,\textsuperscript{31} Congress expressly restored to the SEC (but not to private plaintiffs) the ability to bring aiding and abetting civil actions against secondary actors who knowingly provide substantial assistance to persons who violate 1934 Act rules, including Rule 10b-5.\textsuperscript{32}

In Stoneridge Investment Partners, LLC v. Scientific-Atlanta, the Supreme Court confirmed its Central Bank holding that section 10(b) of the 1934 Act and Rule 10b-5 do not support aiding and abetting liability.\textsuperscript{33} However, the Court explained that while not liable as “aiders and abettors,” secondary actors may still face primary liability exposure under Rule 10b-5 but only if their conduct satisfies “each

\textsuperscript{29} Central Bank of Denver, N.A., 511 U.S. at 192 (Stevens, J., dissenting) (“In hundreds of judicial and administrative proceedings in every Circuit in the federal system, the courts and the SEC have concluded that aiders and abettors are subject to liability under § 10(b) and Rule 10b-5.”).
\textsuperscript{30} The Court's reasoning, however, strongly suggested that, as is the case in a suit brought by a private plaintiff, the SEC may have been without the generalized authority to pursue aiders and abettors in the absence of a specific statutory grant. \textit{Id.} at 176–85.
\textsuperscript{32} Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.). Sections 929-N and 929-O of the Dodd-Frank Act impose aiding and abetting liability on persons who “recklessly” provide substantial assistance to someone who violates the Exchange Act. Previously, the SEC was generally required to show that such assistance was provided “knowingly.” In addition, the Act provides, for the first time, for aiding and abetting liability under the Securities Act, the Investment Company Act, and the Investment Advisers Act. §§ 929-M & 929-N.
\textsuperscript{33} 552 U.S. 148 (2008).
of the elements or preconditions for liability.” In finding against plaintiffs who alleged that business partners of the primary violator should be liable as participants in a scheme to defraud, the Court stated that the critical Rule 10b-5 element of reliance was missing. Plaintiffs could point to no evidence that investors in any way relied upon the conduct of the defendants. Furthermore, the Court refused to presume reliance based upon the “fraud-on-the-market” theory, finding it inapplicable when the non-sellers role in the fraud was not communicated to the public. Therefore, under the current jurisprudence of Rule 10b-5, investors can only state a claim against those who can be deemed “primary violators” upon whom investors relied.

34 Id. at 158. See also Central Bank of Denver, N.A., 511 U.S. at 191 (attorneys, accountants and banks could be liable as primary violators of Rule 10b-5); Rubin v. Schottenstein, Zox & Dunn, 143 F.3d 263 (6th Cir. 1998) (holding an attorney liable, under a primary liability analysis, for a materially misleading omission made in connection with the sale of securities); Trust Co. of La. v. N.N.P. Inc., 104 F.3d 1478 (5th Cir. 1997) (same); Kline v. First W. Gov’t Sec., Inc., 24 F.3d 480 (3d Cir. 1994) (law firm can face primary liability for material misstatements or omissions despite the fact that the opinion letters in question disclaimed liability for the validity of the information).

35 Stoneridge, 552 U.S. at 158–61.

36 Id. at 159.

37 In the compromises surrounding the enactment of the Dodd-Frank Act, Congressional efforts to reinstate aiding and abetting liability were confined to a mandated GAO study of the issue. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z. See Stoneridge, 552 U.S. at 159. However, the Supreme Court has not provided, in Stoneridge or Central Bank, any guidance as to what type of conduct would make a secondary actor a primary violator under the securities statutes. In re Enron Corp. Sec., Derivative & “ERISA” Litig. 235 F.Supp.2d 549, 583 (S.D. Tex. 2002). Allowing the district courts to define “primary violator” resulted in a circuit split with the Second, Tenth, and Eleventh Circuits applying the more rigid “bright line test,” and the Third and Ninth Circuits applying the more lenient “substantial participation test.” Id. at 583–86 (citing cases). The bright line test requires that the secondary actor made a publicly disseminated material omission or misrepresentation prior to the investment decision, id. at 583, whereas the substantial participation test
Section 11 of the 1933 Act, while not necessarily an antifraud statute, provides for civil liability for misrepresentations in a registered offering against the issuer and named secondary defendants such as officers, directors, and underwriters. Defendants other than the issuer have a due diligence defense that differs slightly according to the secondary actor's role in preparing the registration statement. Section 12(a)(2) of the 1933 Act provides an alternative express private cause of action against sellers for misrepresentations to purchasers with whom they are in privity, but the Supreme Court has confined this remedy to requires only that the secondary actor played a significant role in the drafting or creation of a false or misleading statement, id. at 585. The Tenth Circuit has specifically criticized the liberal substantial participation test, alleging that it undermines Central Bank's termination of aiding and abetting liability. Anixter v. Home-State Prod. Co. 77 F.3d 1215, 1226 n.10 (10th Cir. 1996); see also Pacific Inv. Mgmt. LLC v. Mayer Brown LLP 603 F.3d 144 (2d Cir. 2010) (rejecting the "creator standard" and holding that a secondary actor can be held liable in a private damages action brought pursuant to Rule 10b-5(b) only for false statements attributed to the secondary-actor defendant at the time of dissemination); Affco Investments 2001 LLC v. Proskauer Rose L.L.P., No. 09-20734, 2010 WL 4226685 (5th Cir. Oct. 27, 2010)(same).

40 Id. § 11(a). Section 11 therefore imposes a species of aiding and abetting liability for registered public offerings.
41 Id. § 11(b)(3) & (c); Rule 176, 17 C.F.R. § 230.176 (2006). For a comprehensive analysis of the section 11 due diligence defense, see In re WorldCom, Inc. Securities Litigation, No. 02 Civ. 3288DLC, 2005 WL 638268 (S.D.N.Y. Mar. 21, 2005).
42 Securities Act of 1933 § 12(a)(2), 15 U.S.C. § 77l(a)(2) (2006). To the extent defendants solicit purchasers, they are treated as sellers and thus can face primary liability. See Pinter v. Dahl, 486 U.S. 622 (1998). While Pinter involved the definition of "seller" under section 12(a)(1) of the 1933 Act, it has come to represent a unified definition of "seller" under section 12(a)(2) as well. Ryder Intern. Corp. v. First Am. Nat. Bank, 943 F.2d 1521, 1528 n.11 (11th Cir. 1991) ("Since Pinter, all the courts that we are aware of which have again considered the scope of section 12(2), have used or adopted the definition of seller as enunciated in Pinter."); Craftmatic Sec.
misrepresentations in the context of public offerings. Section 12(a)(2) does not expressly provide for aiding and abetting liability, and even before the Central Bank decision, most courts refused to imply aiding and abetting liability under this provision. Most commentators believe that while Central Bank involved Rule 10b-5 of the 1934 Act, its reasoning equally applies to section 12(a)(2) of the 1933 Act, and post-Central Bank virtually every court has agreed.

C. Control Person Liability

Under the current federal securities law regime, secondary liability outside of section 11 is largely confined to express, control-person civil liability provisions set

---

43 Gustafson v. Alloyd Co. 513 U.S. 561 (1995). The courts are still wrestling with the issue of whether a particular offering is public or private for purposes of Gustafson. See, e.g., Yung v. Lee 432 F.3d 142 (2d Cir. 2005) (holding the defendant not liable under section 12(a)(2) even though the misleading prospectus prepared in connection with a private transaction was identical to that disseminated for a parallel public offering); cf. In re Enron Corp. Sec., Derivative & “ERISA” Litig. 310 F.Supp.2d 819 (S.D. Tex. 2004) (applying a broad reading of section 12(a)(2), denying a motion to dismiss, and basing analysis heavily on the fact that a private offering memorandum nearly mirrored a public offering prospectus); see also In re Refco, Inc. Sec. Litig. 503 F.Supp.2d 611 (acknowledging the split, rejecting Enron, and following Yung). A last minute amendment to the Dodd-Frank Act that attempted to overturn Gustafson was ultimately not included in the final legislation.

44 See, e.g., Craftmatic Sec. Litig., 890 F.2d at 637 (3d Cir. 1989); Royal American Managers, Inc. v. IRC Holding Corp., 885 F.2d 1011, 1017 (2d Cir. 1989); Schlifke v. Seafirst Corp., 866 F.2d 935, 942 (7th Cir. 1989).

45 See, e.g., 12A JOSEPH C. LONG, BLUE SKY LAW §§ 9:7–9:8 (2009); see also THOMAS LEE HAZEN, LAW OF SEC. REG. § 7.6(1) (2010)

forth in section 15 of the 1933 Act and section 20(a) of the 1934 Act. There is
disagreement among the circuits on the elements necessary to establish “control,”
which is not defined in either statute. The disagreement stems from the
appropriate participation standard to be applied to make out a prima facie case.
Some circuits find liability based upon control status alone and do not require
allegations that the defendant exercised control over the particular transaction that
gave rise to the violation. Other courts utilizing the “culpable participation test"
reason that control persons are not liable unless they actively participated in the
fraudulent transaction. Still other courts take an intermediate position finding
control person liability if the control person actually exercised general control over

vicarious liability for persons controlling those who violate sections 11 and 12 of the
1933 Act and provides an inverse negligence defense. Section 20(a) of the 1934 Act
imposes liability upon those who control persons who violate any title of the 1934
Act. Section 20(a) provides an affirmative defense of good faith and that the control
persons did not induce the violation.

48 The absence of a definition of control in sections 15 and 20(a) was apparently a
purposeful Congressional omission. H.R. Rep. No. 73-1383 at 26 (1934) (stating that
it would be impossible to anticipate the possible ways in which control may be
exerted). Securities Exchange Commission Rule 405 defines “control” as “the
possession, direct or indirect, of the power to direct or cause the direction of the
management and policies of a person, whether through the ownership of voting
securities, by contract, or otherwise.” 17 C.F.R. § 230.405(f) (2006). Most courts
adopt (or at least refer to) this S.E.C. definition. See, e.g., Laperriere v. Vesta Ins.
Group, Inc. 526 F.3d 715, 723 (11th Cir. 2008); Maher v. Durango Metals, Inc. 144
F.3d 1302, 1305 (9th Cir. 1998).

49 See Erin L. Massey, Control Person Liability under Section 12(A): Striking a Balance
Of Interests for Plaintiffs and Defendants, 6 Hous. Bus. & Tax J. 109 (2005) (describing
disparate tests among the circuits); Loftus C. Carson II, The Liability of Controlling

50 See, e.g., Hollinger v. Titan Capital Corp. 914 F.2d 1564, 1573 (9th Cir. 1990).

51 Boguslavsky v. Kaplan, 159 F.3d 715, 720 (2d Cir. 1998); Rochez Bros., Inc. v.
Rhoades, 527 F.2d 880, 885 (3d Cir. 1975). Courts adopting this standard are forced
to confront the enhanced pleading standards of the PSLRA. See In re Refco, Inc. Sec.
the controlled person’s operations and had the power or ability to control the transaction or act giving rise to the primary violation, even if the power was not exercised.\(^{52}\) Both section 15 and section 20(a) provide affirmative defenses. Section 15 provides a “due diligence” defense—control persons will be liable unless they “had no knowledge of or reasonable ground to believe in the existence of facts by reason of which the liability of the controlled person is alleged to exist.”\(^{53}\) Courts that have considered this defense generally have found that it contains a negligence standard.\(^{54}\) Under section 20(a), there is no control-person liability if the control persons establish that they “acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.”\(^{55}\) Courts have interpreted this defense to require controlling persons to show affirmatively that they were not reckless.\(^{56}\)

---

\(^{52}\) See e.g., City of Monroe Employees Ret. Sys. v. Bridgestone Corp., 387 F.3d 468, 484–85 (6th Cir. 2004); Harrison v. Dean Witter Reynolds, Inc., 974 F.2d 873, 876–82 (7th Cir. 1992) (rejecting culpable participation test); Metge v. Baehler, 762 F.2d 621, 630–31 (8th Cir. 1985) (relying on negligence under section 15 of the 1933 Act but not under section 20(a) of the 1934 Act).


\(^{54}\) In re Refco, Inc. Sec. Litig., 503 F.Supp.2d at 660–61 (allegation of negligence sufficient under section 15 of the 1933 Act but not under section 20(a) of the 1934 Act).


\(^{56}\) E.g., G.A. Thompson & Co. v. Partridge, 636 F.2d 945, 959–60. This view is supported in dicta by the U.S. Supreme Court in Ernst & Ernst v. Hochfelder: 425 U.S. 185, 209 n.28 (1976) (listing section 20(a) as one of the 1934 Act provisions that requires more than negligence).
III. SECONDARY LIABILITY UNDER STATE BLUE SKY LAWS

A. The State Antifraud Approach

Secondary liability under state law is derivative and requires proof of a valid claim against a primary violator, ordinarily the seller of securities. The state approach to primary liability for securities fraud is quite different from the federal scheme. Most state statutes are modeled generally on the 1956 Uniform Securities Act (USA), as amended in 1958, or the 2002 Uniform Securities Act. Both Acts contain securities fraud civil liability provisions that track section 12(a)(2) of the 1933 Act. Under these statutes, sellers of securities who make material misrepresentations or omissions are liable to their purchasers for rescissionary damages unless they can “sustain the burden of proof that [they] did not know, and in the exercise of reasonable care, could not have known of the untruth or omission.” The 2002 version of the USA gives defrauded sellers a similar cause of action.

action against purchasers who buy securities by means of a material
misrepresentation. Similarly, many states with non-uniform provisions have
liability statutes that mirror section 12(a)(2) of the 1933 Act and the Uniform
Acts.

Unlike the implied Rule 10b-5 federal cause of action, under these state
antifraud formulations, plaintiffs need not prove that the seller acted with
scienter. Rather, consistent with section 12(a)(2) of the 1933 Act, sellers are
liable to purchasers (and vice versa) unless they can meet the affirmative defense
that they were not negligent. Also, reliance and causation are not usually

2009) (USA places heavy burden on the seller to show that she did not know of the
misrepresentation.)

62 Unif. Sec. Act § 509(c) (2002). Some states that have not adopted the 2002 USA
have similarly extended liability to purchasers. See, e.g., Or. Rev. Stat. § 59.127
(2010).

04-17 (2009); Ohio, Ohio Rev. Code Ann. § 1707.41(A) (West 2010); Tennessee,
33(A) (Vernon 2009). New York does not recognize a civil private right of action for
rescission for securities fraud. See CPC Intern. Inc. v. McKesson Corp., 514 N.E.2d

64 Compare Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 & n.12 (1976) (Rule 10b-5
violation dependent upon a finding of scienter) with People v. Johnson, 213
Cal.App.3d 1369, 1371 (Cal. Ct. App. 1989) ("We hold that [California’s equivalent to
Rule 10b-5] does not require proof of defendant’s scienter.") and Foster v. Alex, 572
N.E.2d 1242, 1245 (Ill. App. 5 Dist.1991) (scienter not required under § 12(G) of the
Illinois Securities Act) and Busse v. Pacific Cattle Feeding Fund No. 1, Ltd., 896
S.W.2d 807, 815 (Tex. App. 1995) ("The Texas Securities Act does not require proof
of scienter.").


66 Professor Long refers to this as an “inverse negligence standard” because the
defendant must prove that she was not negligent—a high standard that is rarely

67 Unif. Sec. Act § 509(b), official cmt. 4 (2002) ("Unlike the current standards on
implied rights of action under Rule 10b-5, neither causation nor reliance has been
required elements for the state privity-based antifraud causes of action. Unlike section 12(a)(2), however, the state civil liability provisions cover any sales—not just sales by means of a prospectus.\(^69\)

Most state blue sky laws also contain a general antifraud provision that tracks section 17(a) of the 1933 Act\(^70\) and Rule 10b-5,\(^71\) but many statutes provide,

---

\(^68\) See, e.g., Hines 787 P.2d at 12–13 ( causation not a required element under Washington’s 10b-5 analogue, section 21.20.010); Dunn v. Borta, 369 F.3d 421 (4th Cir. 2004) (holding that because causation is not referenced in section 13.1-522(A)(ii) of Virginia’s Annotated Code, it is not a required element); Ritch v. Robinson-Humphrey Co., 748 So.2d 861, 862 (Ala. 1999) ( causation not an element under section 8-6-19(a)(1) of the Alabama Securities Act).

\(^69\) Under federal precedents, the term “prospectus” for purposes of section 12(a)(2) is narrowly defined as “a document that describes a public offering of securities by an issuer or controlling shareholder.” Gustafson v. Alloyd Co., 513 U.S. 561, 584 (1995). See generally supra note 43.

\(^70\) Rule 10b-5 was modeled on section 17(a) of the 1933 Act. See, e.g., Sprangers v. Interactive Tech., Inc., 394 N.W.2d 498, 503 n. 1 (Minn. Ct. App. 1986). Civil plaintiffs rarely invoke section 17(a) because it is extremely doubtful that courts will imply a private cause of action under this statute. See, e.g., CPC Intern. Inc. v. McKesson Corp., 514 N.E.2d 116, 120–24 (N.Y. 1987) (examining and discussing the circuit split on the issue and holding that there is no implied cause of action under section 17(a)); In re Washington Pub. Power Supply Sys. Sec. Litig., 823 F.2d 1349 (9th Cir. 1987).
in accordance with the Uniform Acts, that there is no private civil liability—express or implied—for violations of these general antifraud provisions.\textsuperscript{72} Some state statutes, however, including some that otherwise track the USA, have modified their civil liability sections and provide an express, private cause of action for violations of the state version of Rule 10b-5.\textsuperscript{73} Still other states have civil liability statutes that reference violations of the general antifraud statute rather than including a misrepresentation clause in the civil liability provision itself as do the Uniform Acts.\textsuperscript{74} While these latter statutes still require privity, and may contain an inverse negligence culpability standard, other elements of the cause of action such as reliance and causation are less certain as courts may tend to apply Rule 10b-5 precedent.\textsuperscript{75}

\textsuperscript{71} \textsc{Unif. Sec. Act} § 101 (1956) (amended 1958); \textsc{Unif. Sec. Act} § 501 (2002).
\textsuperscript{72} Section 410(h) of the 1956 USA expressly provides that the act “does not create any cause of action not specified in this section or section 202(e)” (dealing with broker/dealer surety bond). \textsc{Unif. Sec. Act} § 410(h) (1956) (amended 1958). Similarly, the Official Comments to section 501 of the 2002 USA state that there is no civil liability, express or implied, for a violation of section 501. \textsc{Unif. Sec. Act} § 501, official cmt. 7 (2002). Not all uniform act states, however, adopted these limiting provisions, see Douglas M. Branson, \textit{Collateral Participant Liability Under State Securities Laws}, 19 \textsc{Pepp. L. Rev.} 1027, 1063 (1992) (“Only half of the forty or so Uniform Securities Act jurisdictions adopted [§ 410(h)]”) and some state courts have implied a private cause of action. See, \textit{e.g.}, Carothers v. Rice, 633 F.2d 7, 9–12 (6th Cir. 1980).
\textsuperscript{73} See, \textit{e.g.}, \textsc{Or. Rev. Stat} § 59.137 (2009); \textsc{Ariz. Rev. Stat. Ann.} 44-1991(B) (2010).
\textsuperscript{74} See, \textit{e.g.}, \textsc{Tenn. Code Ann.} § 48-2-122(c) (incorporating general antifraud statute into privity-based civil liability provision); \textsc{Wash. Rev. Code} § 21.20.430(2010) (same).
\textsuperscript{75} See, \textit{e.g.}, Keogler v. Krasnoff, 601 S.E.2d 788 (Ga. Ct. App. 2004), cert. denied, (Jan. 24, 2005) (reliance required under former version of Georgia Act incorporating general antifraud statute into civil liability section); Hines v. Data Line Sys., Inc., 787
Express causes of action for securities fraud contained in the majority of blue
sky laws are privity based and unlike Rule 10b-5, do not provide civil liability for
secondary market transactions. Some exceptions exist, however. For example, the
California blue sky statute has an express cause of action that extends to market
manipulation in the secondary market,\textsuperscript{76} and Oregon has adopted an express cause
of action for violations of its Rule 10b-5 clone that extends to secondary market
transactions.\textsuperscript{77} Uncertainties remain as to the elements of these causes of action.
For example, the culpability standard for sellers is not specified in the Oregon
statute. While state courts often follow federal precedent in interpreting state
statutes that parallel federal legislation, it is unclear under the Oregon statute
whether the culpability standard is scienter consistent with Rule 10b-5\textsuperscript{78} and
section 17(a)(1) of the 1933 Act,\textsuperscript{79} negligence consistent with sections 17(a)(2) &
(3) of the 1933 Act,\textsuperscript{80} or strict liability with an affirmative defense of non-negligence

\textsuperscript{76} \textsc{Cal.Corp.Code} §§ 25400, 25500 (2010). The California statute does not require
privity, but unlike Rule 10b-5 and the Oregon provision, it does require the
defendant to be a purchaser or seller (or offeror) of the securities. \textit{See} Murphy v.
(statutory language limits liability to actual sellers or buyers of, or someone who
offers to buy or sell, a security).

\textsuperscript{77} \textsc{Or.Rev.Stat.} § 59.137 (2010).

\textsuperscript{78} \textit{Ernst & Ernst} v. Hochfelder, 425 U.S. 185, 193 (1976).

\textsuperscript{79} \textit{Aaron} v. SEC, 446 U.S. 680, 701–02 (1980) (section 17(a)(1) of 1933 Act requires
scienter).

\textsuperscript{80} \textit{See id.} (culpability standard for sections 17(a)(2) & (3) of the 1933 Act is
negligence); Orthologic Corp. v. Columbia/HCA Healthcare Corp., No. CIV 01-0006-
approach of \textit{Aaron} for state antifraud statutes). \textit{See also} Kurt M. Saunders, Comment,
PITT. L. REV. 1083 (1985) (arguing that the Pennsylvania’s Securities Act does not
consistent with section 12(a)(2) of the 1933 Act, or strict liability.\textsuperscript{81} Moreover, the Oregon legislature did not specify whether the express private causes of action for secondary market transactions requires reliance and causation by analogy to the implied Rule 10b-5 cause of action,\textsuperscript{82} whether certain presumptions to establish reliance under federal precedent are available,\textsuperscript{83} or whether other federal courts have reached near consensus regarding the unavailability of the fraud-on-the-market doctrine under state blue sky laws. See, e.g., Oregon v. AIG, No. 0802-03061U (Multnomah County Cir Ct. 2009), No. 0802-03061U (order denying defendant’s motion to dismiss); Marsh & McLennan, Co., No. 0508-08454, slip op. at 14–15 (refusing to import the fraud-on-the-market presumption of reliance into Oregon state law). See also Lee v. Carter-Reed Co., L.L.C., 2009 WL 2475314, at *6 (N.J. Super. Ct. App. Div. Aug. 14, 2009) (“[A]pplication of [the fraud-on-the-market] theory is confined to federal securities fraud litigation.”); Garcia v. Medved Chevrolet, Inc., No. 09CA1465, 2009 WL 3765481, at *10 (Colo. App. Nov. 12, 2009) (“We are also persuaded by a variety of state cases that have similarly rejected the invitation to apply a fraud on the market theory to presume reliance and causation in common law fraud or statutory deceit lawsuits.”); Malone v. Brincat, 722 A.2d 5, 13 (Del. Super. Ct. 1998) (Delaware does not recognize a state cause of action for fraud-on-the-market).


\textsuperscript{82} Compare State v. AIG, No. 0802-03061U (Multnomah County Cir Ct. 2009) (Kanter, J.) (order denying defendant’s motion to dismiss) (no showing of reliance necessary under Oregon Revised Statute 59.137) with Marsh & McLennan, Co., No. 0508-08454 (holding that reliance is an element of Oregon’s section 59.137). See also State v. Merck & Co., No. 0508-8455, slip op. at 2 (Multnomah County Ct. July 19, 2006) (reliance a necessary element of Oregon Revised Statute 59.137).

\textsuperscript{83} Both state and federal courts have reached near consensus regarding the unavailability of the fraud-on-the-market doctrine under state blue sky laws. See, e.g., Oregon v. AIG, No. 0802-03061U (Multnomah County Cir Ct. 2009), No. 0802-03061U (order denying defendant’s motion to dismiss); Marsh & McLennan, Co., No. 0508-08454, slip op. at 14–15 (refusing to import the fraud-on-the-market presumption of reliance into Oregon state law). See also Lee v. Carter-Reed Co., L.L.C., 2009 WL 2475314, at *6 (N.J. Super. Ct. App. Div. Aug. 14, 2009) (“[A]pplication of [the fraud-on-the-market] theory is confined to federal securities fraud litigation.”); Garcia v. Medved Chevrolet, Inc., No. 09CA1465, 2009 WL 3765481, at *10 (Colo. App. Nov. 12, 2009) (“We are also persuaded by a variety of state cases that have similarly rejected the invitation to apply a fraud on the market theory to presume reliance and causation in common law fraud or statutory deceit lawsuits.”); Malone v. Brincat, 722 A.2d 5, 13 (Del. Super. Ct. 1998) (Delaware does not recognize a state cause of action for fraud-on-the-market).
ameliorative doctrines such as the “bespeaks caution” doctrine apply under Oregon law.\textsuperscript{84}

\textit{B. Secondary Liability Under State Anti-fraud Statutes}

Perhaps the biggest difference between state blue sky antifraud statutes and the federal scheme lies in the liability of secondary actors, generically known as aiders and abettors.\textsuperscript{85} The imposition of express liability for secondary actors under state blue sky laws is much more expansive than under the federal scheme.\textsuperscript{86} Under


\textsuperscript{85} Commentators sometimes use the generic term “aiding and abetting” liability to refer to express secondary liability under state blue sky laws. Traditional aiding and abetting liability, however, is premised on knowing substantial assistance. LONG, supra note 45, § 9:94; Lowenfels & Bromberg, supra note 31, at 2 (describing elements of aiding and abetting liability). As noted above, this is not the typical culpability standard for secondary liability under state blue sky laws. Nonetheless, in addition to express provisions for secondary liability in state blue sky statutes, some state courts, even post-\textit{Central Bank}, have implied civil aiding and abetting liability using traditional aiding and abetting norms. See, e.g., Wojtunik v. Kealy, 394 F.Supp.2d 1149, 1170 (D. Ariz. 2005) (noting the U.S. Supreme Court’s holding in \textit{Central Bank} but confirming the continued availability of a private right of action for aiding and abetting under Arizona Revised Statute section 44-1991(A).

\textsuperscript{86} According to the SEC, 49 of 50 states authorize private rights of action against persons who aid and abet violations of state securities laws. \textit{See Securities Litigation
many state statutes, secondary liability extends not only to defined control persons but also to others who participate or materially aid in the securities transaction.\(^{87}\)

1. Control Person Liability

Most blue sky laws contain a provision imposing liability upon persons who “control” a seller who is liable under the acts.\(^{88}\) Like the confusion surrounding control-person liability under section 15 of the 1933 Act and section 20(a) of the 1934 Act, states have differing interpretations of the requirements for control-person liability.\(^{89}\) This uncertainty, however, is less significant under state blue sky laws because most statutes specifically name partners, officers, and directors of the seller as parties with secondary liability due to their respective status alone.\(^{90}\) There

---

\(^{87}\) UNIF. SEC. ACT § 410(b) (1956) (amended 1958); UNIF. SEC. ACT § 509(b) (2002).

\(^{88}\) UNIF. SEC. ACT § 410(b) (1956) (amended 1958); UNIF. SEC. ACT § 509(b) (2002).

\(^{89}\) See, e.g., Hines v. Data Line Sys., Inc., 787 P.2d 8, 14 (Wash. 1990) (“[I]nvestors need show only that the defendant ‘directly or indirectly control[led] [the] seller.’ The statute does not require the plaintiff to prove that the defendant ‘culpably participated’ in the alleged violation.” (citing REV. CODE OF WASH. § 21.20.430(3)); Schuster v. Anderson, 413 F.Supp.2d 983, 1012 (N.D. Iowa. 2005) (“[T]he Eighth Circuit has held that in order to be secondarily liable under the statute, a controlling person need not actually participate in the alleged violation.”); cf. Grand v. Nacchio, 217 P.3d 1203, 1208–10 (Ariz. Ct. App. 2009) (participation is a required element under Arizona’s control-person liability statute).

\(^{90}\) See, e.g., UNIF. SEC. ACT § (410)(b) (1956) (amended 1958); UNIF. SEC. ACT § 509(g)(2) (2002). Some states have modified the uniform acts to include additional categories of control persons, such as LLC managers. See, e.g., OR. REV. STAT. § 59.115(3) (2009).
is usually no requirement that these named control parties participate in the
challenged securities transaction.\textsuperscript{91}

2. Brokers/Dealers and Issuer Employees

Virtually all state statutes extend liability beyond control persons to other
enumerated persons who may be associated with and materially aid or participate
in the securities transaction. Statutes based upon the Uniform Acts extend liability
to non-sellers who are broker-dealers or issuer-employees who materially aid in the
sale.\textsuperscript{92} Of course, to the extent broker-dealers or issuer-employees solicit purchases
or sales, they too would be deemed “sellers” under the definition set forth in \textit{Pinter}\textsuperscript{93}
and most state interpretations of the term “seller.”\textsuperscript{94}

\textsuperscript{91} Under a few statutes, however, the named control persons must materially aid in
the sale. \textit{See, e.g.,} \textsc{Fla. Stat.} § 517.211(1) (2010) (requires personal participation or
aid by control person).

\textsuperscript{92} \textsc{Unif. Sec. Act} §§ 509(g)(3) (joint and several liability of employees) & (4) (joint
and several liability of broker-dealers) (2002); \textsc{Unif. Sec. Act} § 410(b) (1956)
amended 1958) (“[E]very employee of such a seller who materially aids in the sale,
and every broker-dealer or agent who materially aids in the sale are also liable
jointly and severally with and to the same extent as the seller . . . ”). Broker-dealer
customer disputes usually proceed through arbitration. Jennifer J. Johnson & Ed
Brunet, \textit{Substantive Fairness in Securities Arbitration}, 76 U. Cin. L. Rev. 459 (2007);
Jennifer J. Johnson, \textit{Wall Street Meets the Wild West: Bringing Law and Order to

\textsuperscript{93} \textit{Pinter} v. Dahl, 486 U.S. 622, 642, 647 (1988) (For the purposes of securities law,
the definition of “seller” includes both the “owner who passed title, or other interest
in the security, to the buyer for value” and “the person who successfully solicits the
purchase, motivated at least in part by a desire to serve his own financial interests
or those of the securities owner.”).

\textsuperscript{94} \textit{See, e.g.,} \textsc{Or. Rev. Stat.} §§ 59.115, 59.137 (2009) (imposing liability upon sellers
and those who successfully solicit the sale); \textit{In re Trade Partners}, Inc. Inv. Litig., No.
courts apply the \textit{Pinter} definition of seller under the MUSA); Meyers v. Lott, 993 P.2d
609, 612–13 (Idaho 2000) (finding the \textit{Pinter} definition of seller—the “substantial
benefit” test—applicable under Idaho securities law); Gordon v. Drews, 595 S.E.2d
864, 870 (S.C. Ct. App. 2004) (“financial benefits test” applicable under South
3. “Others” Who Materially Aid or Participate in the Securities Transaction

Beyond these enumerated persons, many state statutes extend secondary liability to some other persons who materially aid or participate in the securities transaction, but the statutes differ on which additional classes of people are impacted and on the definition of “materially aid” or “participate.”

Statutes based upon the USA 1956 and 2002 extend secondary liability to sellers’ “agents” who materially participate in the sale. Under common law, the definition of “agent” can be quite broad and may include employee agents as well as others such as professional advisors who work on behalf of a principal.95 In other sections of the Uniform Acts, the term “agent” is a defined term limited to individuals who act on behalf of issuers or broker-dealers to effect or attempt to effect securities transactions and who, absent an exemption, must register under the Act.96 Under this definition, the term “agent” means only individuals who help to

---

95 Restatement (Third) of Agency § 1.01 & cmt. c (2010).
sell securities, a position buttressed by the placement of the term “agent” next to the term “brokers” in the secondary liability provisions of the uniform statutes. Many potential secondary defendants, particularly professionals such as attorneys and accountants would not qualify as agents under this definition unless they became involved in sales efforts. On the other hand, some courts have taken a more expansive view and define agent, for secondary liability purposes, according to its broader common law definition, a definition that could include outside professionals working for the issuer.

---


99 See, e.g., Bristow v. Mourot, 260 S.W.3d 733 (Ark. Ct. App. 2007) (buyer’s former employer not an agent under statutory definition as he did not participate in selling efforts on behalf of issuer); In re Infocure Sec. Litig., 210 F. Supp. 2d 1331, 1366 (N.D. Ga. 2002) (attorney for the seller, who perform duties within the normal ambit of transactional professionals, may not be held liable as “employees” or “agents” of the seller under Michigan Securities Act); In re Sahlen & Assocs, Inc. Sec. Litig., 773 F. Supp. 342, 372 (S.D. Fla. 1991) (attorney not liable as agent unless she provides more than standard legal services to the primary violator). Baker, Watts & Co. v. Miles & Stockbridge, 620 A.2d 356, 368 (Md. Ct. App. 1993) (attorney is not an agent merely by virtue of performing professional services).

100 Arkansas, Quick v. Woody, 747 S.W.2d 108 (Ark. 1988) (finding that mother of seller participated in the sale and holding her liable as an agent); Maryland, Baker, Watts & Co. v. Miles & Stockbridge, 876 F.2d 1101, (4th Cir. 1989) (reversing district court for applying statutory definition of agent when state law was unsettled on the
The 2002 version of the USA extends secondary liability beyond agents and employees to “persons associated with” the issuer who materially aid in the sale. Nothing in the official comments explains this addition and, at present, there is no precedent explaining the term “associated with.” A few statutes, such as those in California, Ohio, Oklahoma, Oregon, and Texas, further extend secondary liability to “any person” who participates or materially aids in the sale.102

Under most blue sky provisions, secondary liability does not attach unless the defendants “participate” or “materially aid” in the securities transaction.103 While ultimately a factual inquiry,104 state courts apply differing legal definitions of these terms of art. Many courts take a broad view and define “participate” or “materially aid” to require something less than the pre-\textit{Pinter} substantial factor test used to issue); Minnesota, Jenson v. Touche Ross & Co., 335 N.W.2d 720, 729 (Minn. 1983) (requiring, in accordance with the common-law definition of agency, that the principal exercise control over the agent).


103 Only liability for a named control person is status based. See \textsc{Unif. Sec. Act} § (410)(b) (1956) (amended 1958); \textsc{Unif. Sec. Act} § 509(g) (2002).

104 Bristow v. Mourot, 260 S.W.3d 733, 735 (Ark. Ct. App. 2007) (“The question of whether a representative materially aids in the sale of a security is one of fact, the resolution of which depends, to some extent, on inferences drawn from the testimony”). \textit{See also} Hogg v. Jerry, 773 S.W.2d 84, 87–88 (Ark. 1989) (proximate location, personal relationship, and degree of trust between the parties all contribute to a finding of material aid); Foster v. Jesup and Lamont Sec. Co., 482 So.2d 1201, 1207 (Ala. 1986); Klein v. Oppenheimer & Co., 130 P.3d 569 (Kan. 2006) (clearing firm materially participated in the violation).
define seller\textsuperscript{105} or the substantial assistance requirement stemming from traditional aiding and abetting liability.\textsuperscript{106} Judicial opinions in a few states make clear that professional service that goes beyond ministerial tasks can qualify as material aid.\textsuperscript{107} In other jurisdictions that impose general material aid or participant liability, however, there are stated statutory exceptions for some professionals, such as attorneys and accountants, who perform only routine professional services.\textsuperscript{108} Under these latter statutes, professionals can still be liable but only if they otherwise participate in the transaction.\textsuperscript{109} In some states, such as Texas, that impose liability

\textsuperscript{105} See Foster v. Jesup & Lamont Sec. Co., 482 So.2d 1201, 1207 (Ala. 1986) (materially aids standard is broader than substantial factor test under then interpretation of section 12 of the 1933 Act).

\textsuperscript{106} Klein, 130 P.3d at 585 ("State courts, a federal court anticipating state law, and arbitration panels interpreting the language of § 410 and statutes based on it have taken a rather broad view of activities that may constitute 'material aid.'"); Conn. Nat'l Bank v. Giacomi, 699 A.2d 101, 121–22 (Conn. 1997) ("[A]id is material if it has a natural tendency to influence, or was capable of influencing, the decision of the purchaser.") (quoting Kungys v. United States, 485 U.S. 759, 770 (1988))). Pre-Central Bank cases, however, support the proposition even under the stricter substantial assistance federal standard. See, e.g., Powell v. H.E.F. P'ship, 835 F. Supp. 762, 768 (D. Vt. 1993) (denying law firm’s motion to dismiss because firm provided substantial assistance in drafting materially misleading documents for purposes of aiding and abetting liability under § 10(b) of the Exchange Act).

\textsuperscript{107} See, e.g., Prince v. Brydon, 764 P.2d 1370 (Or. 1988) (attorney document preparation constitutes material aid); Towery v. Lucas, 876 P.2d 814, 819 (Or. Ct. App. 1994) (noting that "every person" includes attorneys and that the courts have recognized no privilege for attorneys who participate or materially aid in an unlawful sale of securities).

\textsuperscript{108} See, e.g., ARIZ. REV. STAT. ANN. § 44-2003(A) (West 2010) ("No person shall be deemed to have participated in any sale or purchase solely by reason of having acted in the ordinary course of that person’s professional capacity in connection with that sale or purchase."); OHIO REV. CODE ANN. § 1707.431(A) (West 2005) (exempting from liability “[a]ny attorney, accountant, or engineer whose performance is incidental to the practice of the person's profession”).

upon “any person,” the definition of “materially aids” is unclear due to inconsistent appellate opinions. Some Texas courts have imposed a narrow definition and require that the secondary defendant provide substantial assistance to the primary violator, and professional gatekeeper liability is less likely under this standard. Other Texas appellate panels, however, disagree and find no support in the Texas statute for a “substantial assistance” requirement.

3. Defenses

Under all versions of the USA, secondary participants have the affirmative defense that they did not know, and in the exercise of reasonable care could not have known, of the fact underlying the violation. Some states that have extended the category of secondary defendants to include “any person” have retained this general inverse negligence defense, while others require the plaintiff to prove that such other persons acted intentionally or with scienter.


110 Navarro v. Grant Thornton, LLP, 316 S.W.3d 715 (Tex. Ct. App. 2010) (material aids standard requires substantial assistance, a standard that does not include failure to disclose material information in absence of an independent duty to investors).

111 Id. (summary judgment for accounting firm that provided professional services upheld as there was no evidence that firm substantially assisted primary violator).


114 See, e.g., Or. Rev. Stat. §§ 59.115, 59.137. Secondary liability premised on an affirmative defense of no negligence is a more lenient burden for plaintiffs than traditional aiding and abetting standards, which require knowledge.

115 See, e.g., Cal. Corp. Code § 25401 (West 2005) (secondary defendants are liable if
IV. FEDERAL LIMITS ON BLUE SKY LAWS

A. Preemption

While many states maintain a robust forum providing injured investors with a means to redress securities fraud against both sellers and those who materially assist them, Congress has imposed some limits on state actions. In addition, states are ultimately constrained by the provision of the Dormant Commerce Clause of the U.S. Constitution.

1. NSMIA

In 1996 Congress enacted NSMIA\textsuperscript{117} to preempt state regulatory authority over defined “covered securities” including nationally listed securities and Rule 506 private placements.\textsuperscript{118} NSMIA, however, expressly reserves to state regulators the ex post power to investigate and prosecute fraud, and nothing in they act with intent to deceive). Courts have consistently held that under the California statute, an allegation of recklessness does not suffice. See Orloff v. Allman, 819 F.2d 904, 907–08 (9th Cir. 1987) (allegations of recklessness not sufficient under section 25504.1); Bitter v. Borton, 2002 Cal. App. Unpub. LEXIS 8, at *4, *22 (Cal. Ct. App. Apr. 15, 2002) (dismissing claim under section 25504.1 against law firm for issuing a materially misleading opinion letter in an alleged Ponzi scheme for failure to allege the opinion letter was issued “with the intent to deceive or defraud plaintiffs”).


\textsuperscript{118} Johnson, supra note 10 (examining legislative history of NSMIA).
NSMIA preempts private civil actions for securities fraud. Indeed the legislative history of NSMIA expressly notes that the statute was not intended to impact any state statutory or common law claim for fraud.\footnote{The Commerce Committee stated that in passing NSMIA, it did not intend to "alter, limit, expand, or otherwise affect in any way any State statutory or common law with respect to fraud or deceit . . . in connection with securities or securities transactions." H.R. REP. No. 104-622, at 34 (1996) (Comm. Rep.), reprinted in 1996 U.S.C.C.A.N. at 3897.}

It is so patently clear that NSMIA does not preempt state civil antifraud liability that the issue is seldom raised in litigation. One exception was the case of \textit{Houston v Seward & Kissel, LLP.}\footnote{Houston v. Seward & Kissel, LLP, No. 07cv6305(HB), 2008 WL 818745 (S.D.N.Y. Mar. 27, 2008).} In \textit{Houston}, the federal District Court for the Southern District of New York rejected an argument by a New York law firm that NSMIA preempted a cause of action for secondary liability under Oregon blue sky law. The federal court noted the express NSMIA provision reserving antifraud authority to the states and held that it applied equally to civil liability under state antifraud statutes.\footnote{Id. at *4 ("A plain reading of the statute shows that NSMIA’s preemption of state securities law is limited to precluding states from imposing disclosure requirements in prospectuses, traditional offering documents and sales literature relating to covered securities.” (citing Zuri-Invest A.G. v. Natwest Finance, Inc., 177 F.Supp.2d 189, 192 (S.D.N.Y. 2001))).} The defendant also asserted that the Oregon statute was invalid due to implied field and conflict preemption. In rejecting these claims, the court noted that while Congress could have preempted the entire field of securities regulation, in NSMIA it expressly preserved state antifraud authority even for covered securities.\footnote{Id. at *5.} Moreover, given that NSMIA only preempted state registration
and disclosure requirements for covered securities, there was no actual conflict between NSMIA and the Oregon antifraud statute.

2. SLUSA and CAFA

State securities litigation, however, while not impacted by NSMIA, can rarely proceed as a class action. Two different federal statutes now prohibit state court adjudication of the vast majority of securities class actions. In 1998, Congress confronted allegations that civil plaintiffs were attempting to avoid the pleading and other procedural hurdles imposed by the 1995 PSLRA by filing claims in state court.123 Though the empirical evidence of a shift to state court was inconclusive,124 Congress enacted the Securities Litigation Uniform Standards Act (SLUSA)125 in order to restrict most securities fraud class actions to federal court, where they would be subject to the jurisprudence of Rule 10b-5 and the procedural requirements of the PSLRA.126 SLUSA precludes both state and federal courts from

126 Dabit, 547 U.S. at 82
adjudicating certain class actions that are based upon state statutory or common law and that allege a misrepresentation in connection with the purchase or sale of nationally traded securities.\textsuperscript{127}

SLUSA applies to class actions or groups of lawsuits pending in the same courts that raise common issues of law and fact, and when combined seek damages on behalf of 50 or more persons.\textsuperscript{128} Individual securities claims suits are not impacted by SLUSA\textsuperscript{130} unless they are part of a series of lawsuits that “proceed as a

\begin{flushright}
\textsuperscript{127} Initially, SLUSA would have prohibited all private actions in state court involving nationally traded securities. H.R. 1653, 105th Cong. (1997). See also Michael Perino \textit{Fraud and Federalism: Preempting Private State Securities Causes of Action}, 50 STAN L. REV. 273, 334 (arguing that adoption of a bill that only precludes class actions would allow plaintiffs to avoid the discovery stay of the PSLRA by filing an individual action in state court).

\textsuperscript{128} 15 U.S.C. § 78bb(f)(1)(A) (2006). SLUSA applies to “covered securities” which are defined in the statute as any security that is either listed on a national exchange or is “a security of the same issuer that is equal in seniority or that is a senior security to a security” that is listed on a national exchange. §§ 77r(b)(1)(B)–(C). A senior security has “priority over any other class as to the distribution of assets or payment of dividends.” § 77r(d)(4). Privately placed debt securities, however are not “covered securities” under SLUSA. § 78(bb)(5)(E).

\textsuperscript{129} § 78bb(f)(5)(B)(ii). SLUSA contains exceptions such as the "Delaware carve-out," which preserves any otherwise "covered class action . . . that is based upon the statutory or common law of the State in which the issuer is incorporated."

\textsuperscript{130} See S. REP. NO. 105-182, at 7 (1998) (The Senate Banking Committee stated that it “does not intend for the bill to prevent plaintiffs from bringing bona fide individual actions simply because more than fifty persons commence the actions in the same state court against a single defendant.”). The All Writs Act, however, could broaden the impact of SLUSA to include even individual actions if concurrent federal litigation is underway and the individual state suit unduly interferes with the jurisdiction of the district trial court. 28 U.S.C. §1651(a). See, e.g., \textit{Newby v. Enron Corp.} 302 F.3d 295, 299–303 (5th Cir. 2002) (affirming district trial court’s order}
single action.” Courts can combine individual suits, even over the objection of the plaintiffs, if the plaintiffs have consolidated the actions for any purpose. If the lawsuits, once combined, involve more than 50 plaintiffs, SLUSA preclusion applies. SLUSA creates federal removal jurisdiction over covered class actions, so SLUSA interpretations have been the sole province of the federal courts as they consider remand petitions.

SLUSA preclusion applies to state class action claims involving misrepresentations in securities transactions even if the state cause of action does not mirror Rule 10b-5. For example, lower courts have held that SLUSA precludes state court class actions premised on state statutory or common law provisions that
dissolving ex parte state court restraining order under the All Writs Act ). But see Ret. Sys. of Ala. v. J.P. Morgan Chase & Co., 386 F.3d 419 (2d Cir. 2004) (reversing trial court order to stay state court discovery, issued pursuant to the All Writs Act, on grounds of federalism).

131 15 U.S.C. § 78bb(f)(5)(B)(ii)(II) (2006). See, e.g., In re Enron Corp. Sec., 535 F.3d 325, 339–42 (5th Cir. 2008) (cases filed by a single law firm involving 196 plaintiffs were held to be “proceed[ing] as a single action” under SLUSA, even though each case involved fewer than 50 plaintiffs).

132 § 78bb(f)(5)(B)(ii). See, e.g., Instituto De Prevision Militar v. Merrill Lynch, 546 F.3d 1340 (11th Cir. 2008) (actions can be involuntarily combined if plaintiffs have agreed to consolidation for discovery or any other purpose); In re WorldCom, Inc. Sec. Litig., 308 F.Supp.2d 236, 246 (S.D.N.Y. 2004) (cases consolidated for pretrial purposes qualified as a “group of lawsuits” under § 78bb(f)(5)(B)(ii)); Gordon Partners v. Blumenthal, No. 02-Civ-7377, 2007 WL 431864, at 18 (S.D.N.Y. Feb. 9, 2007) (same); In re Fed. Nat’l Mortgage Ass’n Sec., Derivative, and “ERISA” Litig., 503 F.Supp.2d 25, 30–33 (D.D.C., 2007) (concluding that two lawsuits brought by plaintiffs who opted out of a class action were “covered class actions” after they had been consolidated with the original class action).

133 § 78bb(f)(2). Proctor v. Vishay Intertechnology Inc, 584 F.3d 1208 (9th Cir. 2009) (citing §§ 78bb(f)(1)–(2)) (SLUSA creates a federal preclusion defense and alone creates federal removal jurisdiction if a claim is covered under the statute).
do not require scienter or reliance. In *Merrill Lynch v. Dabit*, the U.S. Supreme Court held that a class action based upon state law providing for liability for misrepresentations that cause investors to “hold” securities was “in connection with the purchase or sale of securities” and thereby was subject to SLUSA, even though such claims could not have proceeded under Rule 10b-5 due to the purchaser-or-seller standing requirement of *Blue Chip Stamps*. The Court noted that SLUSA should be interpreted broadly in order to effectuate the Congressional intent to limit abusive class actions. In the wake of *Dabit*, courts have liberally construed the “in connection with” element of SLUSA and have looked at the substance of state complaints to prevent claimants from trying to elude preemption by “artful pleading.”

SLUSA does not apply to state securities fraud class actions resulting from privately placed securities by nonpublic companies or privately placed debt.

---

134 See, e.g., Anderson v. Merrill Lynch, Pierce, Fenner & Smith, Inc. 521 F.3d 1278 (10th Cir. 2008) ("Plaintiffs did not have to allege scienter or reliance for SLUSA to apply."); Siepel v. Bank of America, N.A., 526 F.3d 1122 (8th Cir. 2008).
137 *Dabit*, 547 U.S. at 85 ("[I]t is enough that the fraud alleged ‘coincide’ with a securities transaction—whether by the plaintiff or by someone else.").
138 *Id.* at 82.
139 See, e.g., Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 310–11 (6th Cir. 2009); City of Chattanooga v. Hartford Life Ins. Co., No. 3:09CV516(WWE), 2009 WL 5184706 (D. Conn. Dec. 22, 2009) (complaint for breach of fiduciary duty and unjust enrichment resulting from a misrepresentation held to be in connection with the purchase or sale of a security); Levinson v PSCC Services, Inc., No. 3:09-CV-00269(PCD), 2009 WL 5184363, at 12 (D. Conn. Dec. 23, 2009) ("Plaintiffs’ claims of common law fraud, negligent misrepresentation, and aiding and abetting conversion and statutory theft are preempted by SLUSA because a misrepresentation or other fraudulent conduct is a necessary element of these causes of action.").
However, defendants may still remove these class actions to federal court under the 2005 Class Action Fairness Act (CAFA), which confers original federal jurisdiction over any class action with at least 100 claimants, minimal diversity and an aggregate amount in controversy of at least $5 million. CAFA contains exceptions for class actions that fall under SLUSA, for actions that concern corporate governance, and for claims relating to the terms or ownership of the security itself. Otherwise, state antifraud claims involving privately placed securities, such as mortgage backed securities or limited partnership offerings, such as mortgage backed securities or limited partnership offerings.

---

142 Under CAFA, the term “class action” includes mass actions, which are claims on behalf of more than 100 persons, even if not styled as class actions. 28 U.S.C. § (d)(11)(A)–(B) (2006) (defining mass actions). Cf. Anwar v. Fairfield Greenwich Ltd., 676 F.Supp.2d 285 (S.D.N.Y. 2009) (derivative suit on behalf of fund with 700 shareholders not a mass action subject to removal under CAFA); Greenwich Fin. Serv. Distressed Mortgage Fund 3 LLC v. Countrywide Fin. Corp., 603 F.3d 23 (2d Cir. 2010) (appeal dismissed on grounds that CAFA does not permit appellate review of remand orders).
143 CAFA provides that the “district courts shall have original jurisdiction of any civil action in which the matter in controversy exceeds the sum or value of $5,000,000, exclusive of interest and costs, and is a class action in which . . . any member of a class of plaintiffs is a citizen of a State different from any defendant.” 28 U.S.C. § 1332(d)(2). Under CAFA, a corporation is a citizen of the state of incorporation and the state where it maintains its principal place of business. 28 U.S.C. § 1332(c)(1). A corporation’s principal place of business is its “nerve center” where “a corporation’s officers direct, control, and coordinate the corporation’s activities.” Hertz Corp. v. Friend, 130 S.Ct. 1181, 1192 (2010).
144 § 1332(d)(9)(A).
145 § 1332(d)(9)(B).
146 § 1332(d)(9)(C). In Estate of Pew v Cardarelli, 527 F.3d 25, 31 (2d Cir. 2008), the Second Circuit held that this third CAFA exception was limited to disputes over the meaning of the terms of the security itself, such as the interest rate. See also Greenwich Fin. Serv. Distressed Mortgage Fund 3 LLC, 603 F.3d (remand to state court after finding class action fell within CAFA exception on meaning of terms of securities).
appear to fall squarely within CAFA and cannot generally proceed as a class action in state court if more than 100 plaintiffs are involved.\textsuperscript{147} CAFA preemption is not absolute—the statute requires the federal courts to decline jurisdiction when more than two-thirds of the class members as well as the defendant are from a single state\textsuperscript{148} and gives discretion to the courts to decline jurisdiction when more than one-third but less than two-thirds of the plaintiffs reside in the same state as the defendant.\textsuperscript{149} Also, CAFA provides exclusive federal jurisdiction over designated class actions, including those based upon state law claims. Unlike SLUSA, it does not eliminate the class action as a means to adjudicate the state law claims.

The overall impact of Congressional preemption is that blue sky claims against secondary participants in securities fraud cases involving public companies are only viable as individual actions (or very small class actions) in state court.

\textsuperscript{147} There is a split among the circuits on the relationship between CAFA and section 22 of the 1933 Act, which provides concurrent jurisdiction in federal and state court for 1933 Act claims. \textit{Compare} Luther v. Countrywide Home Loan Servicing LP, 533 F.3d 1031 (9th Cir. 2008) (action was not removable because section 22 of the 1933 Act is the more specific statute and trumps CAFA) \textit{with} Katz v. Gerardi 552 F.3d 558 562–63 (7th Cir. 2009) (expressly disagreeing with Luther and holding that securities class actions alleging 1933 Act claims are removable under CAFA unless they fall within a statutory exception). \textit{See also} N.J. Carpenters Vacation Fund v. HarborView Mortgage Loan Trust 2006-4, 581 F.Supp.2d 581 (S.D.N.Y. 2008) (removal power under CAFA supersedes section 22(a)).

\textsuperscript{148} \textit{See} Lao v. Wickes Furniture Co., 455 F.Supp.2d 1045, 1050 (C.D. Cal. 2006) ("Under the 'home state controversy,' district courts must decline jurisdiction where two-thirds or more of the class members and the 'primary' defendants are citizens of the state where the action was originally filed." (citing 28 U.S.C. § 1332(d)(4)(B))). To meet the "local controversy" exception, district courts must also find that "the principal injuries suffered by the class were incurred in the state where the action was originally filed; and no other class action asserting the same or similar factual allegations has been filed against any of the defendants within the past three years." \textit{Id.} at 1051 (citing 28 U.S.C. § 1332(d)(4)(A) (2006)).

Generally, securities fraud claims involving private, non-public entities may be pursued either as individual or small class actions in state court, or for diversity cases, in federal court. Given the privity requirement of most state antifraud civil liability statutes, these Congressional preemptive statutes should not unduly impede the ability of plaintiffs to proceed in state court, as large class actions would not be feasible in any event. Perhaps accidentally, this procedural lineup insulates blue sky secondary liability claims from the common criticisms of federal securities class actions. Many scholars have argued that even meritorious federal securities class actions do not provide sufficient deterrence or compensatory benefits to justify their costs.\textsuperscript{150} Indeed many federal securities class actions involving secondary market transactions simply impose a wealth transfer upon public shareholders and result in a net loss to investors after transaction costs are considered.\textsuperscript{151} Diversified investors are usually net losers under the current federal class action regime. Most state statutes, however, provide for liability only in privity situations, and state law suits against secondary defendants largely avoid the wealth transfer problem.

\textsuperscript{150} Jennifer J. Johnson & Edward Brunet, \textit{Critiquing Arbitration of Shareholder Claims}, 36 SEC. REG. L. J. 181, 183–85 (summarizing critiques of class action securities litigation).

B. The Dormant Commerce Clause

Defendants, particularly out-of-state defendants, have occasionally challenged state antifraud statutes that are more stringent than their federal counterparts under the dormant commerce clause of the United States Constitution. While the Commerce Clause expressly provides that "Congress shall have power To ... regulate Commerce ... among the several States,"\(^{152}\) the United States Supreme Court has stated that there is also an "implicit" or "dormant" part of the clause that restricts state regulations that impact interstate commerce.\(^{153}\) To assess state regulations under the dormant Commerce Clause, the Supreme Court employs a two-tiered test. Under the first tier, a state statute is per se invalid when it "directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests."\(^{154}\) If the state regulation is nondiscriminatory, "[t]he critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State."\(^{155}\) If however the state regulation only indirectly affects interstate commerce and regulates evenhandedly, courts will apply the second tier balancing test.\(^{156}\) Under the balancing test, a court must determine whether the burden on interstate commerce imposed by the state regulation "clearly exceeds" the state’s legitimate

---

\(^{152}\) U.S. CONST., art. I, § 8, cl. 3.
\(^{155}\) Healy, 491 U.S. at 336.
local interests.\textsuperscript{157}

The few dormant Commerce Clause challenges to state blue sky laws have focused on the extraterritorial effect of the statutes and the increased burden on interstate commerce. On the whole, these constitutional challenges to state blue sky laws have been unsuccessful. The Supreme Court, in a trilogy of cases collectively known as the “Blue Sky Cases,” upheld against commerce clause challenges the rights of the states to regulate securities.\textsuperscript{158} Key to the Court’s reasoning that the state laws were constitutional was the fact that “[t]he provisions of the law[s] . . . apply to dispositions of securities \textit{within} the state.”\textsuperscript{159} The Court held that the state blue sky laws were merely “police regulation[s],” that “affect[ed] interstate commerce . . . only incidentally.”\textsuperscript{160}

These Supreme Court precedents make it quite difficult for defendants to challenge state liability provisions on the basis that they regulate conduct wholly

\begin{flushleft}
\begin{itemize}
\item \textsuperscript{157} \textit{Brown-Forman Distillers Corp.}, 476 U.S. 573, 579 (1986). \textit{See also} \textit{Pike}, 397 U.S. at 142 (“Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”).
\item \textsuperscript{158} \textit{See} \textit{Merrick v. N.W. Halsey & Co.}, 242 U.S. 568 (1917) (upholding Michigan blue sky laws); \textit{Caldwell v. Sioux Falls Stock Yards Co.}, 242 U.S. 559 (1917) (upholding North Dakota blue sky laws); \textit{Hall v. Geiger-Jones Co.}, 242 U.S. 539 (1917) (upholding Ohio blue sky laws).
\item \textsuperscript{159} \textit{Hall v. Geiger-Jones Co.}, 242 U.S. 539, 557 (1917).
\item \textsuperscript{160} \textit{Id.} at 558; \textit{see also} \textit{CTS Corp. v. Dynamics Corp. of Am.}, 481 U.S. 69, 93 (1987) (rejecting challenge by out-of-state company to Indiana law conditioning acquisition of corporate control of Indiana corporation on approval of a majority of the pre-existing disinterested shareholders, reasoning that the law regulated in-state corporations).
\end{itemize}
\end{flushleft}
outside of the state.\textsuperscript{161} For example, in \textit{Houston v. Seward & Kissel, LLP},\textsuperscript{162} a New York law firm challenged the imposition of secondary liability under the Oregon blue sky laws on the grounds that the statute violated the dormant Commerce Clause. The defendant first argued that the Oregon antifraud statute was unconstitutional because it regulated activity that occurred wholly beyond Oregon’s borders—that is, the conduct of a New York law firm advising an Idaho client. In rejecting the argument, the federal court for the Southern District of New York noted, “the Oregon Blue Sky laws are aimed at protecting Oregon residents from securities fraud and limited to the sale of securities in the state. The Plaintiff received the offering materials from Whittier at his home in Oregon, and made the purchase from there. It is this transaction that the Blue Sky laws address . . . .”\textsuperscript{163} Therefore, the Court found that the Oregon statute regulated conduct within Oregon and did not violate the Commerce Clause on the basis of extraterritorial impact.

In addition to a territorial requirement, to withstand a Commerce Clause challenge, the state statute must further a legitimate state interest that does not unduly burden interstate commerce.\textsuperscript{164} Every court to consider the issue has held that both the protection of state-resident investors\textsuperscript{165} and the regulation of in-state

\textsuperscript{161} See A.S. Goldmen & Co. v. N.J. Bureau of Sec., 163 F.3d 780 (3d Cir. 1999) ("[T]he overwhelming majority of courts that have considered dormant commerce clause challenges to blue sky laws" have upheld the statutes.).

\textsuperscript{162} No. 07cv6305(HB), 2008 WL 818745 (S.D.N.Y. Mar. 27, 2008).

\textsuperscript{163} \textit{Id.} at *5. See also \textit{A.S. Goldmen & Co.}, 163 F.3d (New Jersey blue sky law only regulated in-state half of an interstate transaction).

\textsuperscript{164} See \textit{A.S. Goldmen & Co.}, 163 F.3d at 787 (citing Edgar v. MITE Corp., 457 U.S. 624, 644 (1982); \textit{CTS Corp.}, 481 U.S. at 93).

\textsuperscript{165} See, \textit{e.g.}, Hall v. Geiger-Jones Co., 242 U.S. 539 (1917) (upholding statute that required out-of-state issuers to register sales to in-state residents). In \textit{Houston v. Seward & Kissel, LLP.}, the court addressed the Pike balancing test by focusing on the
issuers and dealers are legitimate state interests that do not unduly burden interstate commerce. To date, no case has invalidated a remedial state securities statute providing civil liability for an antifraud violation. In fact, noted securities commentators suggest that there no longer need be any substantial constitutional doubts about blue sky provisions.

A State’s imposition of civil liability in secondary market transactions, however, could press the constitutional limits of even remedial blue sky laws. For example, in 2009, the trustees of the Oregon Public Employee Retirement System

nondiscriminatory impact of the statute. 2008 WL 818745, at *6. Finding no undue burden on interstate commerce, the court stated: “where the effect of the regulation is the same in and outside of the enacting state’s territory, a Commerce Clause challenge will fail.” Id. (citing Baseball v. City of New York, 509 F.Supp.2d 285 (S.D.N.Y. 2007)).

See, e.g., Enntex Oil & Gas Co. (of Nev.) v. State, 560 S.W.2d 494 (Tex. Ct. App. 1977) (upholding Texas statute regulating sales by Texas issuer to out-of-state purchasers), appeal dismissed for lack of substantial federal question by 439 U.S. 961 (1978); Upton v. Trinidad Petroleum Corp., 468 F.Supp. 330, 336 (N.D. Ala. 1979) (finding no constitutional issues in state exemption from registration for sales of up to ten in- or out-of-state purchasers), aff’d on other grounds, 652 F.2d 424 (5th Cir. 1981); Oil Resources, Inc. v. Fla. Dept. of Banking & Fin. Div. of Sec., 583 F.Supp. 1027 (S.D. Fla. 1984) (Florida statute regulating issuers and dealers in Florida does not violate Commerce Clause), aff’d. without op., 746 F.2d 814 (11th Cir. 1984); Haberman v. Washington Pub. Power Supply Sys., 744 P.2d 1032 (Wash. 1987) (rejecting Commerce Clause challenge to application of Washington blue sky laws to bond sale where issuer, its members and directors, one respondent bond counsel, as well as the majority of the respondent participants were Washington residents); cf. Arizona Corp. Com’n v. Media Prod., Inc., 763 P.2d 527, 531–34 (Ariz. Ct. App. 1988) (holding that an Arizona statute requiring local registration of securities even where the issuer was incorporated out-of-state and all purchasers were out-of-state residents violated the Commerce Clause because it created an excessive burden on interstate commerce).

Chrysler Capital Corp. v. Century Power Corp., 800 F.Supp. 1189, 1194 (S.D.N.Y. 1992) (holding that an Arizona antifraud statute does not violate the Commerce Clause and noting that defendant “fails to cite any case in which a remedial antifraud statute was found to burden interstate commerce”).

(PERS) filed suit in state court, under the Oregon securities laws, against AIG and Marsh McLennan, two publically traded insurance companies. Money managers hired by PERS had purchased shares in each company on the secondary market and sought to recover losses on those investments alleging that the companies had made misrepresentations and omissions in violation of Oregon antifraud statutes. Among other defenses, AIG and Marsh McLennan argued that the Oregon antifraud statute violated the Commerce Clause because it imposed an undue burden upon interstate commerce. The cases were heard before two different judges in Multnomah County, Oregon, and each judge reached different conclusions on the Commerce Clause issue. The Oregon statute was upheld in the AIG case but found to violate the Commerce Clause in Marsh McLennan. The AIG litigation soon settled while the Marsh McLennan ruling was appealed to the Oregon Court of Appeals.

The primary argument set forth in both cases was the increased burden the Oregon statute imposes upon out-of-state, public-company issuers. While in name a remedial antifraud statute, the defendants argued that, if held valid, the more lenient state culpability standard would force public issuers to review disclosure documents with a level of precision not required under the federal system. While

---

169 In addition to facing liability in Oregon courts under Oregon blue sky laws, AIG and Marsh McLennan both have been subjected to class action lawsuits in federal courts. See In re Marsh & McLennan Cos., Inc. Sec. Litig., No. 04 Civ. 8144, 2006 WL 2057194 (S.D.N.Y. July 19, 2006) (consolidate class action); In re Am. Int'l Group, Inc. 2008 Sec. Litig. (S.D.N.Y. 2008). The Marsh McLennan claim was settled for four hundred million dollars with an additional sixty million awarded in attorney fees, In re Marsh & McLennan Cos., Inc. Sec. Litig., No. 04 Civ. 8144(CM), 2009 WL 5178546, at *1, *25 (S.D.N.Y. Dec. 23, 2009) (decision and order approving settlement), whereas the AIG class action continues.

this argument has failed in the context of preemption challenges,\textsuperscript{171} a Commerce Clause challenge could prove interesting. The Marsh case itself is a case of first impression given the rather unique Oregon statute that combines civil liability for secondary market transactions with a culpability standard of negligence or perhaps even strict liability.

\textbf{V. SECONDARY LIABILITY UNDER BLUE SKY LAWS: A WISE POLICY CHOICE?}

States often justify their stringent secondary liability standards on the grounds that secondary participants in securities transactions, such as lawyers and accountants, should perform a gatekeeper role, a view that most academics support. Legislative and judicial pronouncements make clear that federal law has not expressly or impliedly preempted state antifraud remedies against secondary defendants. Moreover, there has never been a successful commerce clause challenge to a securities antifraud civil liability statute. Nonetheless, we must ask whether state imposition of secondary liability for securities fraud under state law is a wise policy choice given that this cause of action is currently unavailable under federal

\footnotesize{\textsuperscript{171} See Wyeth v. Levine, 129 S.Ct. 1187 (2009) (holding that federal law does not preempt tort claim under state law alleging that an FDA-approved label for a drug did not contain an adequate warning); Altria Group, Inc. v. Good, 129 S.Ct. 538 (2008) (holding that the Federal Cigarette Labeling and Advertising Act does not preempt a state law action on deceptive advertising).}
law, and would, even if reinstated into the federal system, be subject to much
different substantive and procedural standards.

The continuing state role in the regulation and enforcement of securities
regulations is often defended on the grounds of federalism, which at one level
defines much of our political system. There is no shortage of scholarly work on
the benefits as well as the costs of federalism. Perhaps the most prevalent view of
the benefits of our dual federal/state regime is that it provides flexibility to allow
state experimentation and innovation. This is a view espoused by the U.S. Supreme
Court in several federalism decisions as well as by numerous commentators.

---

172 See supra Part II.
173 For example, the Dodd-Frank Act directs the GAO to study the impact of
reinstating civil aiding and abetting liability under Rule 10b-5, but even this study
was premised on a “knowledge” standard rather than the inverse negligence rule
174 John C. Coffee, Jr. & Hillary A. Sale, Redesigning the SEC: Does the Treasury Have a Better Idea? 95 VA. L. REV. 707, 710 n.6 (2009) (“Federalism is, of course, the opium of the law professors, which they can rarely avoid, even if there is nothing new to be said.”).
175 Federalism is championed as a system protecting individual rights by limiting
reduces the risk of tyranny); Robert P. Inman & Daniel L. Rubinfeld, Rethinking Federalism, 11 J. ECON. PERSPECTIVES 43 (Fall 1997); Michael W. McConnell,
decentralized decision-making allows for diversified citizen input into the political
system); McConnell, supra, at 1500 (local and state governments are better
defenders of liberty); A.C. Pritchard, Constitutional Federalism, Individual Liberty,
(2000) (“States are respected in our constitutional system because of the counter-
balance that they provide to federal power.”).
176 See Gregory v. Ashcroft, 501 U.S. 452, 458 (1990) (lauding one of the benefits of
federalism—it “allows for more innovation and experimentation in government”).
177 Thomas R. Dye, American Federalism: Competition Among Governments 20–21
(1990) (advocating that competitive federalism fosters innovation); David Osborne,
Laboratories of Democracy 1–17 (1990) (explaining that state governments,
formerly the enemies of change, have evolved into experimental laboratories
promoting novel agendas in an effort to solve social and economic problems); see
Critics, however, contend that costs of dual regulation, such as inconsistent or duplicative laws may outweigh the perceived benefits of state innovation.\textsuperscript{178}

So how do state securities civil liability schemes, particularly those imposing secondary liability, fit into the complicated debate about the appropriate role of federal versus state securities regulation and enforcement. Do the state blue sky laws that impose secondary liability upon professionals inform the debate on appropriate gatekeeper liability and thus foster the goal of experimentation and innovation? Or do such statutes impose unwarranted costs due to inconsistent regulations and interference with interstate commerce?

Outside of class action preemption,\textsuperscript{179} most of the debate and analysis involving federalism and securities regulation has revolved around the dual roles of the federal and state securities regulators rather than the different state securities civil liability schemes.\textsuperscript{180} NSMIA preemption resulted from the Congressional

\begin{flushright}
\textsuperscript{179} One exception, of course, is the federalization of class actions involving nationally traded securities under SLUSA, \textit{supra} notes 124–40 and accompanying text, and the federalization of larger class actions involving non-SLUSA covered securities under CAFA, \textit{supra} notes 141–51 and accompanying text.
decision that inconsistent state regulations unduly impeded the U.S. capital markets.\textsuperscript{181} Perhaps lost in the rush for regulatory preemption, however, was the concept that non-uniformity in liability schemes can have equally great import.\textsuperscript{182} Issuers and their advisors who could face liability under state blue sky laws must adapt their ex ante behavior to conform to the state’s liability schemes as well as its regulatory regime. \textsuperscript{183} Therefore, we must ask whether the federalism rationale at all justifies the state secondary liability rules that differ greatly from each other as well as from the federal system. If so, we should champion and protect state innovation.\textsuperscript{184} If a state “gets its right,” all can benefit from the better idea. If a state “gets it wrong,” the adverse impact is largely limited to one state, and upon realizing its error, the state can change its regulations.\textsuperscript{185}

If the “experimental lab” metaphor is to go beyond rhetoric, however, someone needs to check the lab results and evaluate the impact of the varying state

\textsuperscript{181} See Johnson, supra note 10 (analyzing rationale underlying NSMIA preemption).
\textsuperscript{182} Indeed, Congress specifically preserved the states’ antifraud role as a matter of regulation, enforcement, and civil liability.
\textsuperscript{183} See Pritchard, supra note 175, at 437 n.11 (2000) (“It should be obvious to even the casual observer that the threat of potential state litigation is likely to have an effect on the ex ante expectations of participants in the interstate securities markets.”)
\textsuperscript{184} In celebrating the potential role of the states, Justice Brandeis once stated, “[i]t is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory and try novel social and economic experiments without risk to the rest of the country.” New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J. dissenting).
\textsuperscript{185} In SLUSA, Congress pre-empted class actions based upon state blue sky laws that involve nationally traded securities, thus significantly lessening the impact of the laws of any one state upon national markets. The stated rationale of SLUSA, however, had more to do with federal procedural protections for defendants than differing state liability schemes. See generally supra notes 124–40 and accompanying text.
civil liability regimes upon secondary defendants. Variations in state regimes can involve statutes and administrative regulations, appellate opinions, and trial court decisions and rulings. These in turn can impact state court filings, party disputes, and ultimately on the ground, the ex ante behavior of both primary and secondary participants in securities transactions.

We can examine and compare state statutes and published administrative regulations, both with each other and with the federal statutes and regulations, and we can draw some preliminary conclusions from the variations. Interestingly, while there are works describing the uniform securities acts and state variations, very few scholarly articles attempt to examine the various state securities liability regimes to evaluate and compare their impact. Rather, the few scholars who address state securities law at all tend to argue abstractly about the wisdom of overlapping regulatory systems. Perhaps due to the complexities of 50 state

186 But see Rose, supra note 178 (questioning whether it is possible to measure the impact of differing state enforcement regimes).


systems, others are content to leave the macro-description to the treatise writers and concentrate solely on a description of the laws of one state.\textsuperscript{190}

State court judicial opinions could provide one glimpse of the impact of the varying state statutory schemes, but outside of Delaware our ordinary view of the state courts is limited to published appellate opinions.\textsuperscript{191} While useful interpreters of the state statutes, these appellate rulings do not present a cogent street view of the effect of a particular civil liability regime. Rulings or opinions from state trial courts would come closer to the mark, but unfortunately they are sporadic and exceedingly difficult to research with any assurance of obtaining reliable data.\textsuperscript{192} At present, most states do not maintain a database of trial court decisions, and few, if any, state trial courts routinely render opinions or track summary judgments or other interim procedural rulings.

State court filings could provide a relevant indication of a statutory impact—if a state has a securities statute that is too plaintiff friendly, we should expect to see


\textsuperscript{191}The Delaware Chancery Court, which has jurisdiction over business disputes including state securities matters, maintains a searchable database. \textit{See} Delaware State Court, Court of Chancery Opinions and Orders, \url{http://courts.delaware.gov/opinions/List.aspx?ag=Court of Chancery}.

\textsuperscript{192}New York, for example, publishes selected trial court opinions from its Supreme Court.
much more litigation, even if it generally does not proceed through a trial or appeal. Unfortunately, however, this data is almost impossible to obtain because state courts are dispersed throughout a state and rarely centralize their statistics. In any event, few state courts track filings at all and rarely by subject matter. Even state filings that are sometimes traced, such as state class actions, do not always produce consistent and reliable results.\footnote{See Joseph A. Grundfest, et al., Securities Class Action Litigation in Q1 1998: A Report to NASDAQ from the Stanford Law School Securities Class Action Clearinghouse, http://securities.stanford.edu/research/reports/19980602q1.html (June 2, 1998) (“It is inordinately difficult to track state court filings and to provide precise figures for the volume of state court litigation.”).} For example, witness the conflicting studies on the volume of state securities class actions produced by parties supporting or opposing the 1998 SLUSA class action preemption bill.\footnote{See supra note 124.} Of course, there is even less information concerning disputes that arise over statutory liability and are settled without a judicial filing.

Finally, statutes also can influence ex ante behavior even if no visible disputes result. For example, some argue that imposing overly strict secondary civil liability will cause securities professionals to price their services beyond the reach of smaller, more risky issuers. These issuers therefore would forgo legal or accounting advice in selling securities, a situation that ultimately is harmful to investors. Others, however, stress the gatekeeping function of professionals and applaud stricter statutory liability.\footnote{See, e.g., Report of the New York City Bar Ass’n Task Force on the Lawyer’s Role in Corporate Governance [Excerpted for Publication in The Business Lawyer], 62 BUS. LAW. 427, 455–61 (2007) (predicting expanded regulation and observing that lawyers are obligated to advise clients responsibly in recognition of the clients’ duties to the investing public).} While both arguments have some intuitive
appeal, to evaluate a state system imposing civil liability upon secondary
defendants, we should at least attempt to assess the validity of each theory on the
ground.

If state imposition of secondary liability produces costs in excess of benefits,
one might expect to see this manifest itself in states that have the most aggressive
securities civil liability statutes. The State of Oregon provides a useful proxy for
these jurisdictions as it has perhaps the most plaintiff friendly blue sky laws in the
country. Under the Oregon securities statutes, sellers are liable for
misrepresentations to investors unless they can prove that they were not
negligent. The Oregon blue sky statutory scheme extends liability for securities
fraud to any person who participates in or materially aids a securities
transaction. Moreover, the Oregon courts have promulgated a liberal judicial
definition of “materially aids” to include professionals who assist in a securities
transaction via standard professional services. Under Oregon law, professionals
and other secondary participants have liability to the same extent as the seller
unless they maintain an affirmative defense of inverse negligence. Finally, the
Oregon statutes contain an express civil cause of action against issuers and
secondary defendants for securities fraud in secondary market transactions.

In Oregon, as in most states, trial court filings and opinions are not readily
available; leaving reported appellate opinions as the sole searchable judicial

197 Id.
database. There is, however, a unique resource available in Oregon that provides an unusual window into the impacts of the state securities statutes apart from reported judicial opinions. The Oregon State Bar Association maintains a mandatory malpractice-insurance program. All active members of the Oregon State Bar engaging in the private practice of law must purchase a minimum of $300,000 in insurance coverage from a sole provider, the Professional Liability Fund (PLF).\textsuperscript{201} Since 1983, all Oregon private attorneys have maintained minimum insurance coverage that includes protection against claims based upon securities transactions.\textsuperscript{202} Therefore, the PLF is the insurance carrier of first resort for Oregon lawyers, and any claim involving securities matters is processed first by the PLF. The PLF claims process may be initiated not only when an attorney is named in litigation, but also when a covered attorney has concerns about potential errors in securities transactions. Such concerns could stem from a number of sources including: contact with a client, the client’s lawyer, or a third party such as an investor. Securities related claims could include potential liability from errors resulting from compliance with both state and federal securities law and could include malpractice as well as secondary liability under the blue sky laws.

\textsuperscript{201} \textit{Or. Rev. Stat.} § 9.080(2)(a) (2010). Pursuant to O.R.S. section 9.080, and with membership approval, the Oregon State Bar Board of Governors established the Professional Liability Fund in 1977. Since July 1, 1978, all practicing Oregon lawyers have been required to carry primary malpractice coverage through the PLF.

\textsuperscript{202} Before 1983, securities coverage was optional and available from the PLF only by means of a separate endorsement.
Of particular interest is the PLF securities claims history since 1988 when the Oregon Supreme Court in *Prince v. Brydon* held that attorneys performing traditional professional roles could “materially aid” a securities sale for purposes of the secondary liability provisions of the Oregon blue sky laws. As the chart below shows, there was not a marked increase in PLF claims processed in the aftermath of *Prince*. The latest available PLF statistics show that from 2000 to 2009 (a time period spanning two economic downturns), 62 securities related claims were processed, equivalent to 1% of the total claims. The PLF paid on securities related claims a total of $2,978,104, representing approximately 2.5% of the value of all claims paid in the ten-year period. These statistics indicate that the imposition of secondary liability upon attorneys engaged in Oregon securities transactions did not result in a marked increase in liability claims. Indeed the trend remains fairly constant throughout the PLF reporting years, without an expected rise following the *Prince* decision.

---

203 764 P.2d 1370 (Or. 1988)
204 OR. REV. STAT. § 59.115(3) (2009).
205 Of more significance are the large number of claims from 1983–1986—stemming perhaps from the inclusion of all attorneys in securities coverage in 1983.
206 Of the $2,978,104, $1,139,203 represented the indemnity payment and $1,658,901 the expenses. The indemnity payments represent 2% of all PLF payments while the expenses represent 3% of PLF payments for expenses.
207 The PLF statistics do not reflect the total dollar value of claims given that the PLF only requires minimum insurance protection for Oregon attorneys. Attorneys may procure excess coverage through any number of insurance carriers. Therefore, in a particular case, the actual dollar amount of paid securities claims could be much higher, See e.g. Jeff Manning, Portland law firm agrees to $30M Sunwest settlement, THE OREGONIAN, October 22 2009 (describing settlement as one of the largest ever by an Oregon law firm).
208 The PLF statistics indicate a sharp peak in 1985, two years following mandatory securities coverage and a smaller unexplained peak in 1992.
To be sure, when used to assess claims for secondary liability under Oregon's blue sky laws, these PLF statistics are both over- and under-inclusive. First, the “claims” are over-inclusive in that they can represent mere inquiries or concerns rather than actual liability. Second, the claims could involve potential liability emanating from federal as opposed to state securities law compliance. Third, the PLF statistics may be over-inclusive in that they also include malpractice claims. Nonetheless, while the correlation between malpractice claims and secondary liability claims is not perfect, these claims significantly overlap. If a client issuer is solvent and must pay a securities claim, the client may file a malpractice claim against her attorney. Alternatively, if a client is insolvent, and cannot pay the investors, secondary liability claims are more likely.

On the other hand, the PLF statistics are under-inclusive in that they do not reflect secondary liability claims against out-of-state attorneys or non-attorney
defendants such as accountants. Accurate statistics on claims under Oregon blue sky laws against these defendants are not readily available. The plaintiffs’ bar in Oregon that brings such cases, however, is relatively small and well integrated. Asked to recall any securities claims brought in the past ten years against secondary defendants other than Oregon lawyers (and thus not included within the PLF statistics) the plaintiffs’ lawyers report only a handful of cases.

While the Oregon secondary liability securities statute has not engendered a slew of securities claims, there remains the question of whether the potential imposition of liability for professionals who materially aid securities transactions in Oregon has in fact caused issuers to forgo professional services due to increased costs. Again, Oregon attorneys do not report witnessing any noticeable increase in securities offerings without professional involvement. To the contrary, one noted positive trend is that attorneys not conversant in securities law are advised to refer potential issuers to those with experience. This development portends well for

\[^{\text{209}}\text{See e.g. See Brad Broberg, Securities fraud victims target perpetrators’ advisors, Portland Business Journal, June 4, 2010 (noting 2008 $30 million dollar Oregon jury verdict against Arthur Andersen); Agee’s Wyndmoor LLC et al v Thompson and Knight , LLP et al (Multnomah County Circuit Court (May 7 2009)( complaint against accounting firm involved in failed Sunwest venture)}\]

\[^{\text{210}}\text{Statistics from Oregon Trial Lawyers on file with author.}\]

\[^{\text{211}}\text{The following email exchange occurred on the Oregon State Bar Business Law Section list-serve in June of 2010: Email entitled “Newbie Advice?” “Listmates, Is anyone willing to chat on the phone with me for a few minutes regarding the best way to structure an investment group and how to avoid some common pitfalls? PC will be leasing and developing certain real properties using investors’ money. Thanks!” This request produced 8 responses strongly encouraging “newbie” to refer the matter to experienced securities counsel. The following are representative responses: “Usually I would advise new attorneys to try different areas of the law to gain experience but securities law is an area filled with pitfalls and malpractice traps for the inexperienced. Be careful. Associate experienced counsel or refer out.}\]
the gatekeeper role that attorneys can play to protect investors, a role made even more important given the anemic pre-sale authority now exercised by state and federal regulators. 212

The PLF statistics, together with substantial anecdotal evidence, suggest that Oregon’s strict secondary liability regime has not produced significant adverse impacts upon issuers or secondary defendants, including professionals. Neither the number nor dollar amount of claims has substantially increased since the Oregon Court held that the provision of professional services falls within the statutory definition of “materially aids.” While Oregon securities professionals would undoubtedly prefer that their services fall outside the statutory definitions,213 the system has not produced the dire consequences predicted for the federal securities law or feared in other states that have eliminated gatekeeper liability. Instead, the potential statutory liability seems to have the salutatory impact of channeling securities cases to attorneys with expertise who can act as effective gatekeepers. The Oregon experience suggests that the potential benefits for investor protection outweigh costs associated with increased secondary liability.

VI. CONCLUSION

Please do not walk, but run away from this one and refer the PC to an existing attorney who handles security issues. In this economic climate, which appears likely to continue for some time, you do not - I repeat, "do not" want to be a target under the blue sky laws.” [email on file with author]

212 Johnson, supra note 10.

213 See Broberg, supra note 209 (noting examples of professional discontent with the aiding and abetting provisions of the Oregon securities laws).
There has been a pointed tendency of late for Congress to preempt state blue sky laws that conflict with the federal system, especially when dealing with publicly traded companies. With the exception of the class action arena, however, state securities civil liability regimes have largely survived. This Article argues that the state civil liability statutes should continue to coexist with the federal regulatory system. Outside of section 11 of the 1933 Act, governing registered public offerings, federal law does not provide any private remedy against gatekeeper defendants in cases of securities fraud, and so it is entirely appropriate that state law operate in this arena. Even Oregon’s aggressive civil liability regime has not produced adverse consequences of great import even in the state and certainly not on the national stage. The integration of the generally privity-based blue sky laws with the federal class action preemption acts has perhaps achieved an ideal balance, even if by accident. Individual investors or small groups of investors remain free to bring claims under blue sky antifraud statutes against both sellers and secondary defendants, sometimes including professionals. There also remains a limited space for smaller state court class actions against secondary defendants. Larger class actions against public issuers appropriately remain the sole province of the federal securities law, where stricter procedural hurdles are in place to combat potential abuses on precisely those cases where the incentives for abuse are most compelling. Indeed, perceived class action abuses are the primary driver keeping civil aiding and abetting liability out of the federal system.

Civil liability for securities fraud is an important component of antifraud efforts given the limited resources of federal and state regulatory agencies. Nothing
underscores the limits of these governmental resources more clearly than the
anemic regulatory efforts that preceded the catastrophic events leading to the
recent economic crisis. Gatekeepers such as professionals involved in securities
offerings can play an important role in deterring the wrongs of their clients. In
private offerings in particular, the professional advisors provide the only line of
defense between promoters and investors, many of whom are vulnerable retail
investors. While it seems unlikely that Congress will, in the foreseeable future,
reinstate civil aiding and abetting liability into the federal system, Congress should
at least resist efforts to further restrict states’ attempts to deter securities fraud and
compensate victims.