Is There Any Viability to Scheme Liability for Secondary Actors After Stoneridge Investment Partners, LLC v. Scientific-Atlanta?

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IS THERE ANY VIABILITY TO SCHEME LIABILITY FOR SECONDARY ACTORS
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I. INTRODUCTION

Imagine a company is having trouble meeting the earnings projections of Wall Street analysts. If the company does not meet the projections by the time it reports its earnings, its stock price will slump. Should it take the hit and watch the fall-out? Or should it somehow manipulate its earnings so they are more in line with the analysts’ projections? Then, it could report inflated revenues, thereby keeping the stock afloat, encouraging investors to purchase its stock. If a troubled company’s management chooses this path, the company probably will not be able to go it alone. It would need the assistance of other entities – lawyers, investment bankers, accountants, or possibly contractual third parties – that would play an integral role in accomplishing this fraudulent objective. Maybe this other entity would agree to falsify transaction documents with the company. Maybe it would enter into transactions with the company that look like sales of the company’s money-losing assets so the company could report earnings. Or perhaps it could simply “round-trip” money between it and the company and use a trumped-up transaction as a front. All of this would be done in an attempt to generate phantom revenue for the company so it could meet its earnings projections, which it would then report to investors in its financial statements. The company would most assuredly be liable under § 10(b) of the Securities Exchange Act of 1934\(^1\) and Rule 10b-5\(^2\) for misrepresenting its financial status to investors. But if another entity helped the company to create revenue that did not truly exist,

\(^2\) 17 C.F.R. § 240.10b-5 (2008). Per the Supreme Court in SEC v. Zandford, the scope and coverage of § 10(b) and Rule 10b-5 is coextensive; thus, they are used interchangeably in this article. SEC v. Zandford, 535 U.S. 813, 816 (2002).
should that entity be liable for securities fraud as well to the investors who bought stock of the company?

A preliminary question may be why should the entity which helped effectuate the troubled company’s fraud be liable to the investors who bought stock of that company. Presumably one goal is to punish as many wrongdoers as possible who participated in the scheme. A more fundamental reason for rounding up all culpable actors, however, is that the troubled company is likely bankrupt.\(^3\) As a result, investors of that company will see no recovery from a Rule 10b-5 action against it. Therefore, an investor’s only means of recovery may be pursuing liability against the other entities for securities fraud. This is especially important if, for example, an investor has lost all of his retirement savings because his 401(k) portfolio was made up mostly, if not entirely, of stock in the troubled company.\(^4\) As that company may be in bankruptcy, the stock is worth nothing, and the investor has lost everything.

But whether a so-called “secondary actor” can actually be held liable under Rule 10b-5 has been debated in the courts,\(^5\) but is still unclear. The Supreme Court recently had an opportunity to decisively determine this question when it decided *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.* on January 15, 2008.\(^6\) Unfortunately, its opinion was not as decisive as it could have, or arguably, should have been. Its opinion has been read to

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\(^{5}\) See infra, note 18; Section II.E. and accompanying notes.

reject liability for secondary actors, yet this article suggests that it left open the possibility for such liability, not to mention additional protracted litigation as to the meaning of its language.

The Stoneridge decision was highly anticipated because of the impact it would have on private securities litigation, specifically, the standards of acceptable conduct for corporate directors and officers, as well as outside third parties. The case followed in the wake of the Court’s pivotal 1994 decision in Central Bank of Denver v. First Interstate Bank of Denver, a case which answered to a certain extent the scope of liability for secondary actors, yet spawned confusion in the lower courts. The Court in Central Bank held that § 10(b) does not prohibit “aiding and abetting” another’s securities fraud. As a result, secondary actors, such as lawyers, accountants, banks, and contractual third-parties, cannot be liable under § 10(b) for “secondary violations” of the securities laws. Liability under § 10(b) and Rule 10b-5 requires the use of a “manipulative or deceptive device,” to perpetrate fraud on the investing public. The Court reasoned in Central Bank that an entity’s mere aiding and abetting of another’s fraud does not present the requisite scintener necessary to be manipulative or deceptive. Moreover, the Court concluded, without explanation, that the plaintiffs had not established the requisite reliance to recover. It did note, however, that any person or entity, in the capacity of secondary actor, may be primarily liable under § 10(b) and Rule 10b-5 assuming all the elements of the

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10 See infra note 18; pp. 18-29 and accompanying notes.
12 Id.
14 See Cent. Bank, 511 U.S. at 176.
15 Id. at 180.
claim for primary liability are met,16 but it did not explore this statement in the opinion. Thus, two critical elements a plaintiff asserting a 10b-5 claim against a secondary actor must establish are (1) that the secondary actor engaged in manipulative or deceptive conduct, and (2) that he relied on that manipulative or deceptive conduct.17

The holding from Central Bank has been difficult for the lower courts to apply.18 The difficulty arises from the varying interpretations of what § 10(b) and Rule 10b-5 actually prohibit;19 in other words, what is a “manipulative or deceptive device” and thus, at what point does a secondary actor’s involvement in another company’s scheme to defraud its investors rise to the level of a primary violation of § 10(b). Moreover, whether a plaintiff can establish reliance on that conduct has been subject to debate.20 These two concepts have collectively come to be known as “scheme liability.”21 Lower courts have struggled to determine whether scheme liability meets the requirements for a Rule 10b-5 claim. Two recent circuit court decisions, Simpson v. AOL Time Warner Inc.22 and Regents of University of California v. Credit Suisse First Boston (USA), Inc.,23 both discussed in greater detail in this article, addressed this issue with differing results.24 These two cases, notable for their contrary interpretations of

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16 Id. at 191.
17 For a more complete discussion of the elements of a Rule 10b-5 claim, see supra, pp. 7-9 and accompanying notes.
20 Simpson, 452 F.3d at 1051; Regents, 482 F.3d at 382-84.
21 See Stoneridge, 128 S.Ct. at 770; Regents, 482 F.3d at 378. This article discusses the viability of scheme liability for secondary actors who participate in another entity’s scheme to defraud, as opposed to scheme liability generally where there is simply one actor who has engaged in a scheme to defraud See, e.g., SEC v. Zandford, 535 U.S. 813 (2002) (holding that a securities broker’s scheme to defraud an elderly man and his mentally retarded daughter by misappropriating their securities without their knowledge and consent violated § 10(b) and Rule 10b-5).
22 Simpson, 452 F.3d 1040.
23 Regents, 482 F.3d 372.
24 Simpson, 452 F.3d at 1055; Regents, 482 F.3d at 394.
scheme liability in the context of Rule 10b-5’s requirements, arguably set the stage for the Supreme Court’s *Stoneridge* decision.

The Supreme Court in *Stoneridge* determined that the plaintiffs there could not recover against certain secondary actors for securities fraud. While the Court arguably determined that participation in a scheme to defraud is deceptive conduct, it held that the plaintiffs could not establish reliance on that conduct. In effect, the Court reasoned that the defendants’ conduct – falsification and backdating of commercial documents by customers of and suppliers to Charter Communications, Inc. – was too remote to the injury suffered by Charter’s investors to establish reliance thereon. The *Stoneridge* decision signals, at the very least, another move by the Supreme Court away from liability for secondary actors, and at most, a rejection of scheme liability for secondary actors as a potential theory of liability. Yet a broad reading of the opinion suggests there may be some availability for plaintiffs and courts to maneuver within its confines.

The Court had the opportunity to illuminate for the lower courts whether a secondary actor’s participation in a company’s scheme to defraud its investors is prohibited conduct under § 10(b), yet the opinion neither accepted nor rejected this contention and provided little guidance for answering the question one way or the other. Moreover, its reliance analysis is less than definitive as well. While arguably the Court eliminated the possibility that a plaintiff can establish reliance on a scheme to defraud, given the relatively open-ended nature of its language, the potential to craft a plausible reliance argument still exists. A secondary actor’s conduct must simply fall within the parameters the Court set as a means of denying that reliance existed in *Stoneridge* itself. The Court could have expressly rejected scheme liability, much as it expressly

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25 *Stoneridge*, 128 S.Ct. at 769.
26 *Id.* at 774.
27 *Id.* at 770.
rejected aiding and abetting liability in *Central Bank*. However, it did not, and thus opportunities may exist for varying interpretations by lower courts of the Court’s language, thereby negating any exactitude with regard to this issue.

This article suggests that the Supreme Court left the door open for scheme liability as a possible theory of recovery against secondary actors. This assertion necessarily depends on a plaintiff’s ability to distance the conduct being complained of from aiding and abetting, as the Court clearly rejected that theory of liability in *Central Bank*. Section II of this article thus examines the development in the courts of liability for secondary actors and discusses in greater detail the Supreme Court’s decision in *Central Bank*. Section II also addresses the Supreme Court’s determination of how a plaintiff establishes reliance on conduct prohibited by § 10(b). This determination took on extreme importance in *Stoneridge*, as the Court used its reliance analysis to seemingly shut down any opportunity for a plaintiff to assert scheme liability. Yet this article posits that a secondary actor’s conduct could potentially fit within the confines the Court used to refute the existence of reliance in *Stoneridge*.

Section II addresses as well cases such as *Simpson* and *Regents*, wherein the Ninth and Fifth Circuits, respectively, each examined the viability of scheme liability, but with conflicting results. The courts in those cases disagreed as to whether a secondary actor’s participation in a scheme to defraud is conduct prohibited by § 10(b) and Rule 10b-5. Moreover, they disagreed as to whether a plaintiff could establish reliance on such conduct. These cases arguably set the stage for the Supreme Court’s decision in *Stoneridge*, as there was clearly conflict at the circuit court level. Section III addresses in more depth the Court’s opinion in *Stoneridge*. The factual context of scheme liability has become a fairly common theme in § 10(b) cases.29 It involves a

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design or plan, whereby secondary actors – who otherwise have no duty to the investors of a particular company – assist a company in a scheme to defraud the investors of that other company.\(^\text{30}\) Thus, the need to establish to whether such conduct can form the basis of a § 10(b) claim is of extreme importance. Section III also analyzes the Court’s decision in Stoneridge, particularly in light of the Simpson and Regents decisions, and suggests scheme liability may remain a feasible weapon in a plaintiff’s arsenal of claims against the secondary actors who helped perpetrate the fraud. While the Court may have implicitly rejected scheme liability, this article argues that the language in its opinion leaves the door open for varying interpretations of that language, which may maintain scheme liability’s viability. Thus, this article concludes with a discussion of what, if anything, is to be done to illuminate this issue anew and provide guidance for what is arguably a very important question given the seemingly widespread use of schemes to defraud investors.\(^\text{31}\)

II. THE DEVELOPMENT OF LIABILITY FOR SECONDARY ACTORS

If a secondary actor is ever to be liable under § 10(b), it is necessary to understand how the statute has been interpreted to apply to a primary violator.\(^\text{32}\) The Supreme Court cases interpreting when § 10(b) liability is appropriate have focused on two issues: the scope of prohibited conduct, as well as what the elements of the claim should be.\(^\text{33}\) The reliance element of the § 10(b) claim is the element that has created considerable confusion with regard to secondary actors and scheme liability.\(^\text{34}\)

\(^{30}\) See Simpson, 452 F.3d 1040; Regents, 482 F.3d 372.
\(^{31}\) See supra note 30.
\(^{32}\) See generally Cent. Bank, 511 U.S. at 169 (noting that the statutory text is important in defining the scope of the conduct prohibited by § 10(b)); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 472 (1977) (stating that in deciding what is fraud under Rule 10b-5 “we turn first to the language of § 10(b), for [t]he starting point in every case involving construction of a statute is the language itself”), quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976).
\(^{33}\) Cent. Bank, 511 U.S. at 172.
\(^{34}\) See Regents, 482 F.3d 372; Simpson, 452 F.3d 1040; In re Charter Commc’ns, Inc., Sec. Litig., 443 F.3d 987.
A. The Scope of Conduct Prohibited by Section 10(b) and Rule 10b-5

In pertinent part, § 10(b) of the Securities Exchange Act prohibits any person from using or employing, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance.\textsuperscript{35} The Securities and Exchange Commission (the “SEC”), pursuant to the authority granted to it under § 10(b), promulgated Rule 10b-5, which states that it is

\ldots unlawful (a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o 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) [t]o 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.\textsuperscript{36}

While the statute prohibits conduct that is “manipulative or deceptive,” the Rule attempts to delineate what that conduct might be. Subsection (b) of the Rule prohibits the making of material misstatements of fact or any omissions thereof. This prohibition has become the cornerstone of the securities fraud action and is the subsection most relied upon by plaintiffs in such an action.\textsuperscript{37} Thus, in a typical action brought under 10b-5(b), the plaintiff must prove the following: “(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4)

\textsuperscript{35} 15 U.S.C.A. § 78j (2000). The full text of the statute is as follows: “It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentalities of interstate commerce, or of 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.” \textit{Id.}

\textsuperscript{36} 17 C.F.R. § 240.10b-5 (2008).

\textsuperscript{37} See Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 152-53 (1972). \textit{See also} Markel & Ballard, \textit{supra} note 9, at 883 (discussing what a typical plaintiff’s § 10(b) claim looks like); Berry, \textit{supra} note 8, at 358 (2007) (stating that the majority of § 10(b) cases deal with deception in the form of misstatements or omissions).
reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.”

Importantly, however, the Supreme Court has made clear that conduct – in addition to a misrepresentation or omission -- may also violate § 10(b). This concept implicates subsections (a) and (c) of the Rule. Rule 10b-5(a) and (c) are more general and prohibit any “scheme” to defraud, in addition to any “act, practice or course of business” which operates as a fraud. Various courts have asserted that to state a claim under subsections (a) or (c), a “plaintiff must assert that the defendant (1) committed a manipulative act, (2) with scienter, that (3) the act affected the market for securities or was otherwise in connection with their purchase or sale, and (4) that the defendant’s actions caused the plaintiff’s injuries.”

In order to violate § 10(b), participation in a scheme to defraud must fall within the proscriptions of the statute itself. In addressing the scope of conduct prohibited by the statute, the Supreme Court in Ernst & Ernst v. Hochfelder held that the language of § 10(b) regarding a “manipulative or deceptive device or contrivance” does not proscribe negligent conduct, but rather imposes a requirement that acts done in violation of § 10(b) must be done with scienter – generally an intent to deceive, manipulate or defraud. Ernst was a case involving a claim against a secondary actor – an accounting firm -- for its failure to discover major fraud in its audits of a securities firm. The president of the securities firm, Nay, induced the plaintiffs to invest in funds in escrow accounts that he represented would yield a high rate of return. In fact, there were no such accounts, and Nay immediately converted the funds for his own use. The

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38 Markel & Ballard, supra note 9, at 883.
39 See Stoneridge, 128 S.Ct. at 769 (stating that conduct can also be deceptive and thus violate § 10(b)); Cent. Bank, 511 U.S. at 177 (stating that § 10(b) prohibits not only the making of a misstatement or omission, but also the commission of a manipulative act).
40 In re Enron Corp., 529 F.Supp.2d at 678 (citing In re Parmalat, 376 F. Supp.2d at 491-92).
41 Ernst, 425 U.S. at 193, 197-98.
42 Id. at 189-90.
43 Id. at 189.
44 Id.
plaintiffs contend that if the accountants had conducted a proper audit, they would have discovered certain irregular internal practices, thereby illuminating the fraud. Although Ernst was a case involving a secondary actor, there was no necessity for the Court to answer whether secondary actors could be held liable under § 10(b), as the plaintiffs could not establish the requisite scienter necessary to state a claim.

Similarly, in Santa Fe Industries, Inc. v. Green, the Supreme Court construed § 10(b) and Rule 10b-5 to mean that claims brought thereunder must involve either a misrepresentation or omission on the one hand, or manipulative or deceptive conduct on the other. The Court defined “manipulative” to denote manipulation of the securities market, and thus refer “generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.” Absent an allegation of manipulation, a plaintiff must allege deception, which the Court said involves a misrepresentation or omission. In other words, to deceive an investor, one must make a misrepresentation of a material fact, or fail to disclose a material fact to the investor in violation of a duty to that investor to disclose the same. Ernst and Santa Fe make clear that § 10(b) liability should be based on some sort of manipulative or deceptive conduct.

The question thus becomes, and the question the Supreme Court addressed, albeit only implicitly in Stoneridge, whether a secondary actor’s participation in a scheme to defraud falls

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45 Id. at 190. The practice relied on was Nay’s rule that only he could open mail either addressed to him, or addressed to his firm, but to his attention, even if he was not in the office. Id. The plaintiffs alleged that if the accounting firm had conducted a non-negligent audit, it would have discovered this rule and would have disclosed in the firm’s periodic reports that the rule prevented a proper audit. Id. This disclosure would have lead to an investigation which would have uncovered the fraud. Id.
46 Id.
47 Santa Fe, 430 U.S. 462.
48 Id. at 474-76.
49 Id. at 475.
50 Id. at 475-76; See also Markel & Ballard, supra note 9, at 885 (Because the Santa Fe definition of manipulative was not tested often, a plaintiff’s claim seemed to focus on showing a misstatement or omission.).
within these confines. Arguably, the Court has accepted that assertion, as it merely stated that conduct is also deceptive. It was fairly easy for the Court to acknowledge that, however, as its analysis hinged on whether a plaintiff could ever establish reliance on that conduct, thereby causing injury. Yet if a plaintiff can ever establish such reliance exists, the Court ought to have determined the boundaries of such conduct.

B. The Reliance Element of the 10b-5 Claim

Not only is the scope of prohibited conduct relevant to the inquiry of whether secondary actors can be primarily liable for a scheme to defraud, but also whether a plaintiff can establish reliance on that conduct sufficient to state a claim. Reliance by an investor establishes the causal link between a defendant’s deceptive act and a plaintiff’s resulting injury.\(^{51}\) The Supreme Court has acknowledged in prior opinions, however, that reliance in the classic sense may be difficult for a plaintiff to establish and would place an unnecessarily unrealistic evidentiary burden on a 10b-5 plaintiff who has traded in an impersonal securities market.\(^{52}\) For example, it would be very difficult for a plaintiff to establish whether he would have bought or sold securities of a company if omitted material information regarding the company had been disclosed, or if a misrepresentation about the company had not been made. As such, the Court has adopted presumptions of reliance in certain instances, thereby relaxing the proof requirement thereof.\(^{53}\)

As discussed above, most 10b-5 claims relate to 10b-5(b), which prohibits the making of a misrepresentation, or misstatement, of a material fact or an omission thereof. In the context of omissions of information, where one with a duty to disclose information fails to do so, the Supreme Court held in *Affiliated Ute Citizens of Utah v. United States*\(^{54}\) that the necessary nexus


\(^{52}\) *See id.* at 243.

\(^{53}\) *Id.*

\(^{54}\) *Affiliated Ute*, 406 U.S. 128.
between a defendant’s wrongful conduct and a plaintiff’s injury is presumed, assuming the omitted information was “material.” Thus, plaintiffs whose claims are based on nondisclosure of material information can satisfy the reliance element of a 10b-5 claim by asserting this presumption. On the other hand, where there have been false or misleading misrepresentations about a company in the market, the Supreme Court in Basic Inc. v. Levinson adopted a rebuttable presumption of reliance based on a “fraud-on-the-market” theory of reliance. The fraud-on-the-market theory is grounded in the hypothesis that the price of a company’s stock reflects all available material information in the market regarding a company and its business. Misleading statements therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements because the misleading statements affect the market price of the company’s stock. The fraud-on-the-market theory posits that investors buy or sell stock based on the integrity of the market and the price of the stock; if the misleading information has in some way affected the market price of the stock, courts presume that there has been reliance on the misinformation by the plaintiff. Thus, although reliance is still a required element in the plaintiff’s case, the proof requirement thereof has been significantly relaxed in these contexts.

In the context of secondary actors and scheme liability, the relevant inquiry is whether the plaintiff can establish either of these two presumptions of reliance in the absence of actual reliance on the scheme to defraud. It has been unclear in the lower courts whether a secondary

55 See id. at 153-54 (defining information as “material” if there is a substantial likelihood that reasonable investor would consider the information important in making an investment decision.); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).
56 Basic, 485 U.S. 224.
57 See id. at 229-30.
58 Id. at 241.
59 Id. at 242.
60 Id. at 246-47.
61 See id. at 248. A defendant may rebut this presumption of reliance by introducing evidence that the misrepresentation did not distort the price or that the plaintiff traded or would have traded the stock knowing the statement was false. Id.
actor’s participation in a scheme to defraud should be construed as a misrepresentation or omission under subsection (b) of the Rule, or as some other conduct under subsections (a) or (c). This inquiry is acutely relevant because its answer dictates which presumption, if any, applies for a plaintiff to establish reliance in the context of scheme liability. Moreover, once a court determines which presumption applies, the Stoneridge decision makes clear that the plaintiff may not always be entitled to rely on the presumption because of the factual context of the case. But the factual context of a particular case is precisely where the Court’s opinion leaves room for an assertion of reliance on a scheme to defraud. Assuming the facts can fit within the restrictions delineated by the Court, a plaintiff might successfully mount a reliance argument.

C. Secondary Actor Liability Prior to the Supreme Court’s Decision in Central Bank

Notwithstanding these emerging requirements for § 10(b) liability of establishing a manipulative or device and reliance thereon, lower courts continually held that secondary actors could be liable for aiding and abetting another’s fraud. These courts often presumed that a plaintiff could successfully state a claim against secondary actors under § 10(b) and Rule 10b-5 without necessarily establishing the elements of the claim as set forth above. Notably, liability was premised on Rule 10b-5(b); “plaintiffs rarely invoked subsections (a) and (c), because, as District Judge Kaplan has surmised, during the pre-Central Bank era of aiding and abetting..."
liability, the ‘path of least resistance’ for a plaintiff alleging a fraud involving multiple actors was to plead that one defendant misrepresented or omitted a material fact and that the other defendants aided and abetted the making of that misrepresentation or omission.66 The courts adopted variations of a rule to establish “secondary liability” under § 10(b), which required fraud in the sale of securities by the primary violator, knowledge of that fraud or recklessness by a secondary actor, and substantial assistance given to the primary violator by the secondary actor.67 Thus, these lower courts effectively side-stepped the requirements that a secondary actor engage in manipulation or deception.68 Moreover, there was no need for a plaintiff to assert reliance on the secondary actor’s conduct, as that element was not part of the secondary liability claim.

Thus, aiding and abetting another’s primary violation of the securities laws remained a viable theory upon which to base liability. Yet courts and commentators began to question whether aiding and abetting was an appropriate theory upon which to base liability, given these more restrictive decisions.69 As Professor Fischel posited in his 1981 article, cases such as Ernst and Santa Fe made it apparent that the determination of liability for any wrongdoer – whether a primary violator or a secondary actor – must be established by looking at the “language, structure, and legislative history of the relevant [securities] statutes.”70 Against this backdrop, the Supreme Court decided Central Bank.

D. The Central Bank Decision

The Central Bank decision marked the end of aiding and abetting liability as a theory upon which secondary actors could be held liable for securities fraud.71 The plaintiffs in Central

66 Mustokoff, supra note 8, at 239 (citing In re Parmalat Sec. Litig., 376 F. Supp. 2d at 497).
67 See supra notes 64, 65.
68 See supra notes 64, 65.
70 Fishel, supra note 69, at 82.
71 Cent. Bank, 511 U.S. 164.
Bank were purchasers of bonds upon which the issuer ultimately defaulted. The plaintiffs filed suit against the issuing building authority, the underwriters of the bonds, the developer of the property the bonds were issued to finance, as well as the indenture trustee, Central Bank. The plaintiffs alleged that the first three defendants violated § 10(b) in connection with the issuance of the bonds and that Central Bank “secondarily” violated § 10(b) for aiding and abetting the other defendants’ fraud. The Court of Appeals for the Tenth Circuit delineated what it considered to be the elements of a § 10(b) aiding and abetting claim: “(1) a primary violation of § 10(b); (2) recklessness by the aider and abettor as to the existence of the primary violation; and (3) substantial assistance given to the primary violator by the aider and abettor.”

Applying that standard, the Tenth Circuit found that Central Bank could be liable for aiding and abetting under § 10(b): it was aware of alleged inadequacies regarding an appraisal for real property which was to serve as collateral for the bonds; it knew that the issuance of the bonds was imminent; and it further knew that the purchasers of the bonds would use the appraisal to evaluate the collateral used to secure payment on the bonds in deciding whether to purchase the bonds. Thus, the Tenth Circuit determined that the plaintiffs had established a genuine issue of material fact as to whether Central Bank acted recklessly under that court’s test for § 10(b) aiding and abetting liability, and could thus survive a motion for summary judgment.

On appeal, the Supreme Court first noted that while § 10(b) does not expressly create a private right of action, the Court has previously implied that such a private right does exist.

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72 Id. at 168.
73 Id.
74 Id.
75 Id.
76 Id. at 168-69.
77 Cent. Bank, 511 U.S. at 169.
78 Id. at 171.
Nevertheless, the Court ultimately concluded that the implied right of action does not extend to aiding and abetting\(^80\) and thus, liability was not appropriate for Central Bank under an aiding and abetting theory.\(^81\) The Court reasoned that the scope of prohibited conduct must be dictated by the statutory language;\(^82\) thus, a plaintiff cannot successfully bring a § 10(b) claim against a defendant for acts not prohibited by the language of the statute itself.\(^83\) In its adherence to the text of § 10(b), the Court first posited that § 10(b) does not prohibit aiding and abetting because the plain language of the statute does not mention it.\(^84\) Further, the Court rejected the plaintiffs’ argument that the words “directly or indirectly” in the text of the statute suggest congressional intent to prohibit indirect violations of § 10(b), such as aiding and abetting a primary violation thereof.\(^85\) The Court reasoned that to extend the scope of the statute that far would reach “persons who do not engage in the proscribed activities at all, but who give a degree of aid to those who do.”\(^86\) The Court concluded that if Congress had intended § 10(b) to reach aiders and abettors, it would have used the words “aid” and “abet” in the statute itself.\(^87\) Rather, as the statute clearly prohibits manipulation and deception, the Court was unwilling to extend the reach thereof to one who simply gives aid to another who commits a manipulative or deceptive act.\(^88\)

Pursuant to this stricture, the Court determined that § 10(b) prohibits the making of a material misrepresentation or omission, or the commission of a manipulative act, but not the

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\(^80\) Cent. Bank, 511 U.S. at 191.

\(^81\) Id.

\(^82\) Id. at 173.

\(^83\) Id.

\(^84\) Id. at 175.

\(^85\) Id. at 175-76.

\(^86\) Id. at 176.

\(^87\) Id. at 177.

\(^88\) Id. The plaintiffs in Central Bank conceded that Central Bank did not commit a manipulative or deceptive act within the meaning of § 10(b); rather, it should be held secondarily liable for aiding and abetting the fraud. Id. at 191.
giving of aid to a person who commits a manipulative or deceptive act. According to the Court, the mere “giving of aid” would not involve the commission of a manipulative or deceptive act. However, the Court did not appear to limit the word “manipulative” to include only conduct that technically manipulated the securities markets, such as rigged prices and the like; rather, it appeared that any activity that somehow affected the market price of a security would qualify, so long as it was “manipulative.” Yet the Court ultimately concluded that Central Bank had not engaged in any manipulative or deceptive act, nor had it made a misstatement or omission. This was a situation, according to the Court, wherein Central Bank had merely aided and abetted another’s fraud.

In closing, however, the Court did state that “the absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met.” While this statement firmly rejected the notion of aiding and abetting liability, at the same time it opened the door for a broadening of the scope of conduct relevant for a § 10(b) claim against a secondary actor.

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89 Id.
90 Id. at 177-78.
91 Id. at 191.
92 Id.
93 Id.
94 Id. Although the Court stated that the language of the statute was dispositive, it further reasoned that even if the statutory language did not resolve the case, there would nonetheless be no private right of action. Id. at 178. One of the critical elements necessary for recovery under § 10(b) was missing from the plaintiffs’ case; the Court concluded, without explanation, that the plaintiffs had not established the requisite reliance necessary to recover under § 10(b). Id. at 180.
The holding from Central Bank has proven difficult for the lower federal courts to apply. The difficulty arises from the lack of parameters given by the Court as to what conduct suffices for liability to attach, particularly given the fact that Rule 10b-5(a) and (c) prohibit schemes or acts, practices or courses of business which operate as a fraud. In fact, at least one court has suggested that Central Bank’s holding should be limited only to claims brought under subsection (b) of Rule 10b-5. Although repudiating aiding and abetting liability, the Central Bank decision provided scant guidance for determining when a secondary actor had merely aided or abetted another’s fraud, as opposed to having engaged in fraud itself. As a result, after Central Bank, courts began expanding the meaning of “manipulative device” to include more than market manipulation or have asserted that deception means something other than a misstatement or omission. And scheme liability premised upon subsections (a) and (c) of Rule 10b-5 emerged as a viable theory upon which to base liability. Yet the theory had no definitive test for determining primary liability for secondary actors, and contrasting opinions among circuits surfaced.

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95 See supra note 18.
96 The circuits developed their own tests for determining primary liability after Central Bank. The two that emerged were the “bright line” and “substantial participation” tests. Gorman, supra note 9, at 202. The bright line test required the violator actually make a misrepresentation or omission. Id. at 204 (citing Anixter v. Home-Stake Prod. Co., 77 F.3d 1215, 1226-27 (10th Cir. 1996)). However, the violator need not make the statement directly to investors; rather, it was sufficient that they knew or should have known the statement (or omission) would reach investors. Id. The Eleventh Circuit also adopted the bright line test, requiring that the statement be attributed to the actor at the time of its dissemination. Id. at 207 (citing Ziemba v. Cascade Int’l, Inc., 256 F.3d 1194 (11th Cir. 2001)). The substantial participation test, on the other hand, allowed liability for anyone who substantially participated in the preparation of a fraudulent document. Id. at 202 (citing In re Software Toolworks, Inc. Sec. Litig., 50 F.3d 615 (9th Cir. 1994)). These tests focus on liability premised upon Rule 10b-5(b), whereas, scheme liability emerged later and was premised upon Rule 10b-5(a) and (c). See Travis S. Souza, Freedom to Defraud: Stoneridge, Primary Liability, and the Need to Properly Define Section 10(B), 57 DUKE L.J. 1179, 1187-88 (2008).
97 In re Parmalat, 376 F.Supp.2d at 499.
98 Markel & Ballard, supra note 9 at 885-86; E.g., Simpson, 452 F.3d 1040; In re Enron Corp., 529 F.Supp.644.
99 See Souza, supra note 96, at 1180.
100 Id. at 1189-93.
E. Cases after Central Bank

Following Central Bank, courts labored to define the parameters of scheme liability under Rule 10b-5. As one commentator has noted:

Courts that have rejected scheme liability arguments have generally held that conduct is actionable under § 10(b) or any subpart of Rule 10b-5 only if it (a) involved a material misstatement or omission or (b) it involved manipulative securities trading practices that artificially affect market activity and are therefore “manipulative” within the meaning of the Santa Fe definition. . . . On the other hand, [other] courts have embraced the idea of scheme liability. Some courts . . . have held that active participation in a fraudulent scheme, through actions other than material misstatement or omission or manipulation, can be actionable because “deceptive” within the meaning of Section 10(b). Other courts have held that active participation in a fraudulent scheme can be actionable because it is “manipulative” within the meaning of Section 10(b). Finally, there are courts that have not differentiated between the two concepts and have merely held that such conduct is actionable because it is “manipulative or deceptive.” All of these decisions, however, have difficulty distinguishing between aiding and abetting, which is not actionable under Central Bank, and being a primary violator in a fraudulent scheme.101

The Ninth Circuit’s and the Fifth Circuit’s decisions in the Simpson and Regents cases, respectively, are alluded to in the paragraph above; those circuits are two such courts that have addressed the scheme liability theory with differing results. As the courts’ conclusions conflict regarding whether scheme liability is a viable theory upon which to base securities fraud liability, so do their analyses regarding whether subsequent reliance on those schemes has been established.

1. Simpson v. AOL Time Warner, Inc.102

In Simpson v. AOL Time Warner, Inc., Homestore.com (“Homestore”), an online real estate company, engaged in a series of triangular transactions in which Homestore participated in sham “round-trip” or “barter” transactions whereby it would purchase either shares, products, or

101 Markel & Ballard, supra note 9, at 885-86. (referring to the Eighth Circuit in Charter, the Fifth Circuit in Regents, the Ninth Circuit in Simpson, the district court in Enron and the SEC).

102 Simpson, 452 F.3d 1040.
services from a third-party company which, in turn, would buy advertising from AOL Time Warner (“AOL”) using all or most of the money Homestore paid to that third-party company.\footnote{Id. at 1043.} AOL, after taking a commission, would pass the money from this sale back to Homestore in accordance with an advertising reseller agreement between Homestore and AOL.\footnote{Id. at 1044.} Additional transactions involving a company called L90, Inc. (“L90”) mirrored those involving AOL.\footnote{Id. at 1045.} It was also alleged that Homestore grossly overpaid Cendant Corporation (“Cendant”) for a real estate internet website,\footnote{Id. at 1044-45.} which purchase was contingent upon a promise by Cendant to “recycle” some of the money it received from the sale of the website back to Homestore for transactions to be entered into over the next two years.\footnote{Simpson, 452 F.3d at 1044-45.} In violation of an SEC accounting standard requiring companies to report only the net revenue from these barter transactions, Homestore recorded the money it received as gross revenue in order to meet its revenue expectations, thereby deceiving its auditor, PriceWaterhouseCoopers.\footnote{Id. at 1043.}

The California State Teachers’ Retirement System (“CalSTRS”), the lead plaintiff in the class action litigation, brought a securities fraud claim against AOL and two of its officers, Cendant and one of its officers, and L90 (collectively, “Defendants”).\footnote{Id. at 1042.} Relying on the Supreme Court’s decision in \textit{Central Bank}, the United States Court of Appeals for the Ninth Circuit affirmed the district court’s dismissal of the claims, ruling that CalSTRS failed to allege a valid claim for primary liability under § 10(b).\footnote{Id. at 1055.} The court held that, although the scope of § 10(b) includes deceptive conduct in furtherance of a scheme to defraud, to be liable as a primary violator under § 10(b), a defendant’s conduct must have had the “principal purpose and effect of
creating a false appearance of fact in furtherance of a scheme to defraud." The court reasoned that it is not enough that a defendant is involved in a transaction with a deceptive purpose; rather, a defendant must have contributed his own deceptive conduct to the overall scheme to impose liability. Conduct consistent with the normal course of a defendant’s business cannot typically be considered to have a deceptive purpose.

The court determined that CalSTRS had not alleged that any of the Defendants acted with the purpose and effect of creating a false appearance in furtherance of a scheme to defraud. There was no indication that the advertisements AOL sold and for which it received a commission contained a false appearance or other deceptive qualities, as they complied with the legal advertising reseller agreement between Homestore and AOL. Further, there were no allegations that showed how the funding set aside by Cendant for the future transactions with Homestore in conjunction with Homestore’s acquisition of Cendant’s website had any potential for misrepresentation or false appearance when the future transactions were acknowledged and made public in a press release by Cendant. And finally, there was no assertion that L90 helped to create the scheme or acted to misrepresent its transactions with Homestore in any way. Rather, L90 simply entered into a legal transaction that Homestore manipulated as a part of its scheme. According to the court, each of these transactions merely gave Homestore the opportunity to record its revenue in violation of SEC accounting standards. The court refused

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111 Id. at 1048.
112 Id.
113 Simpson, 452 F.3d at 1049.
114 Id. at 1055.
115 Id. at 1053.
116 Id. at 1053-54.
117 Id. at 1054.
118 Simpson, 452 F.3d at 1054
119 Id. at 1053.
to hold the Defendants liable for participating in legitimate transactions that were distorted by Homestore’s fraud.\textsuperscript{120}

Consequently, although the court held that a secondary actor’s participation in a scheme to defraud is prohibited conduct, it ultimately concluded there had been no true scheme to “defraud” here, as the Defendants lacked the requisite culpability, or scienter. Nonetheless, the court set forth what it considered to be the requisites for determining reliance, assuming a true scheme to defraud had existed. The court thus determined that reliance is satisfied if “the introduction of misleading statements into the securities market was the intended end result of a scheme to misrepresent revenue.”\textsuperscript{121} Therefore, although the Defendants in \textit{Simpson} had not themselves made any misrepresentations directly to Homestore’s investors, their conduct in engaging in transactions to inflate Homestore’s revenues brought about the misrepresentations upon which the plaintiffs relied.\textsuperscript{122} Regardless of the fact that Homestore was the one that subsequently misrepresented the revenues to its investors, the Defendants’ conduct made those misrepresentations possible.\textsuperscript{123} The roadmap used by that court operates as follows: (1) conduct by a defendant that has the principal purpose and effect of creating a false appearance as part of a scheme to defraud is deceptive conduct for purposes of § 10(b) liability; and (2) a plaintiff may be presumed to have relied on the scheme to defraud if a misrepresentation, which resulted from the scheme, was disseminated into the market and was reflected in the market price for a security.\textsuperscript{124} The court would thereby allow a fraud-on-the-market presumption of reliance to be established on the basis of a misrepresentation that was one step removed from the Defendants’

\textsuperscript{120} Id. at 1053.
\textsuperscript{121} Id. at 1051.
\textsuperscript{122} Id.
\textsuperscript{123} \textit{Simpson}, 452 F.3d at 1051.
\textsuperscript{124} Id. at 1052 (stating that conduct is in connection with the purchase or sale of a security, as required by § 10(b), if “it is part of a scheme to misrepresent public financial information where the scheme is not complete until the misleading information is disseminated into the securities market.”).
participation in the scheme. However, having determined that the Defendants had not engaged in any prohibited conduct, the court had no occasion to establish whether reliance thereon existed.\textsuperscript{125}

2. \textit{Regents of the University of California v. Credit Suisse First Boston}\textsuperscript{126}

The Fifth Circuit Court of Appeals’ decision in \textit{Regents of the University of California v. Credit Suisse First Boston} is in sharp contrast with the decision in \textit{Simpson}. The court in \textit{Regents} determined that a secondary actor’s participation in a scheme to defraud is not prohibited conduct, nor could reliance be established thereon. The \textit{Regents} case involved over thirty actions filed against Enron Corporation (“Enron”) and later consolidated, with the Regents of the University of California (“Regents”) designated as the lead plaintiff.\textsuperscript{127} The lawsuit arose due to the spectacular, and now all too familiar, rise and fall of Enron. Prior to its 2001 collapse, Enron entered into a series of partnerships and transactions that allowed it to remove liabilities from its books and record revenue from certain transactions, thereby inflating its financial condition.\textsuperscript{128} The plaintiffs alleged that Merrill Lynch & Company, Inc. (“Merrill Lynch”), Credit Suisse First Boston (“Credit Suisse”) and Barclays Bank PLC (“Barclays,” together with Merrill Lynch and Credit Suisse, the “Banks”) each entered into these transactions, thereby allowing Enron to misstate its financial condition.\textsuperscript{129} An example of one such transaction occurred when Merrill Lynch agreed to purchase from Enron an interest in electricity-generating barges off the coast of Nigeria.\textsuperscript{130} Enron, in turn, guaranteed that it would buy back the barges from Merrill Lynch at a premium within six months.\textsuperscript{131} Although in effect a loan to Enron,

\begin{flushright}
\textsuperscript{125} \textit{Id.} at 1053. \\
\textsuperscript{126} \textit{Regents}, 482 F.3d 372. \\
\textsuperscript{127} \textit{Id.} at 377-78. \\
\textsuperscript{128} \textit{Id.} at 377. \\
\textsuperscript{129} \textit{Id.} at 378. \\
\textsuperscript{130} \textit{Id.} at 377. \\
\textsuperscript{131} \textit{Id.} \\
\end{flushright}
Enron recorded this transaction as a sale, and recorded the revenue from the transaction in its 1999 year-end financial statements.\footnote{Regents, 483 F.3d at 377.}

The plaintiffs filed a § 10(b) claim against the Banks for their part in effectuating Enron’s financial statement fraud.\footnote{Id. at 378.} The Banks filed motions to dismiss the claims, but those were denied by the district court.\footnote{Id.} However, the district court later reconsidered some of the issues raised by the motions to dismiss when it considered whether to grant the plaintiffs’ motion for class certification.\footnote{Id.} The district court had determined that participation in a “transaction whose principal purpose and effect is to create a false appearance of revenues” is a deceptive act as required by Rule 10b-5(c).\footnote{In re Enron Corp., 529 F.Supp.2d at 705.} As the court determined the plaintiffs’ claims involved an “overarching, concealed scheme to defraud, which involve[d] a large number of alleged material misrepresentations or omissions, but primarily aim[ed] at wrongful conduct by key participants that allegedly employed a device, scheme or artifice to defraud or engaged in an act, practice or course of business that operated as a fraud, under Rule 10b-5(a) and (c)[,]”\footnote{Id. at 739.} the plaintiffs had successfully alleged a deceptive act. The district court further reasoned that a defendant who commits such a deceptive act can be jointly and severally liable based on Rule 10b-5(a)’s prohibition against any scheme to defraud.\footnote{Id. at 724.} Moreover, since the Banks had engaged in deceptive acts, the plaintiffs could also establish reliance on those acts; the district court concluded that the plaintiffs were entitled to rely on the class-wide presumptions of reliance for

\begin{footnotes}
\footnote{Regents, 483 F.3d at 377.}
\footnote{Id. at 378.}
\footnote{Id.}
\footnote{Id.}
\footnote{In re Enron Corp., 529 F.Supp.2d at 705. The district court noted that “determining when secondary actors are liable as primary violators of § 10(b) is especially difficult where the allegations are of scheme liability based on concealed conduct under Rule 10b-5(a) and (c). [The Banks] have argued that pleading scheme liability under Rule 10b-5(a) and (c), when a scheme participant that has engaged in a sham transaction or fraudulent conduct that allows a securities issuer to submit false and misleading financial statements but makes no statement itself, is no longer viable in the wake of Central Bank, but is merely an attempt to circumvent its holding that aiding and abetting is not actionable under the statute.” Id. at 701. The district court did not agree. Id. at 706.}
\footnote{Id. at 739.}
\footnote{Id. at 724.}
\end{footnotes}
both omissions and fraud-on-the-market.\textsuperscript{139} With respect to the Affiliated Ute presumption of reliance regarding omissions, the court concluded that the Banks did have a duty to the plaintiffs; the duty was not a duty to disclose, but rather, a duty not to engage in a fraudulent scheme.\textsuperscript{140} Moreover, the district court found that Basic’s fraud-on-the-market presumption of reliance was also available to the plaintiffs.\textsuperscript{141} According to the district court, where a scheme to deceive investors exists, a fraud on the market exists as well and thus reliance is established because the scheme disseminates false or misleading statements into the securities markets.\textsuperscript{142} As a result, the district court held that the plaintiffs had stated a claim against the Banks for a primary violation of § 10(b), even though they were secondary actors.\textsuperscript{143}

The Banks appealed to the United States Court Appeals for the Fifth Circuit.\textsuperscript{144} The issue on appeal centered on whether the district court’s determination of a “deceptive act” could

\textsuperscript{139} Id. at 683, 739. The district court discussed that reliance may be presumed using the Affiliated Ute presumption in cases based on material omissions. Id. at 679. On the other hand, reliance may be presumed using Basic’s fraud-on-the-market theory when the plaintiff alleges there has been a material misrepresentation. Id. at 680. The court explained that to determine whether a case involves primarily an omission or primarily a misrepresentation for the applicability of the relevant presumption, the Fifth Circuit focuses on under which subsection of Rule 10b-5 the misconduct alleged by the plaintiff falls. Id. at 681-82. Thus, although Rule 10b-5(b) focuses on misrepresentations and omissions (a failure to state a fact necessary to make the statements made not misleading), the Fifth Circuit has determined that omissions also exist in the context of “any device, scheme, or artifice to defraud” under Rule 10b-5(a) or an “act, practice or course of business which operates or would operate as a fraud or deceit” in the context of Rule 10b-5(c). Id. at 682. (citing Finkel v. Docutel/Olivetti Corp, 817 F.2d 356, 360 (5th Cir. 1987), cert. denied, 485 U.S. 959 (1988) (“Cases involving primarily a failure to disclose implicate the first and third subsections of Rule 10b-5; cases involving primarily a misstatement or a failure to state a fact necessary to make the statements made not misleading implicate the second subsection. . . .”). As such, the Fifth Circuit has limited the Affiliated Ute presumption to cases with claims based primarily on alleged omissions under subsections (a) and (c) of the Rule, and the fraud-on-the-market presumption to cases with claims based primarily on alleged misstatements or failure to state a fact necessary to make statements made therein not misleading under subsection (b) of the Rule. Id. However, the Fifth Circuit, according to the district court, has at times intermingled the two presumptions of class-wide reliance under Affiliated Ute and Basic where allegations of schemes to defraud exist. Id. at 684, 689. According to the court, schemes to defraud can implicate not only the withholding of material information from the market, but also the dissemination of false or misleading information. Id. at 686.

\textsuperscript{140} Id. at 683, 739.

\textsuperscript{141} Id. at 689, 739.

\textsuperscript{142} Id. at 686.

\textsuperscript{143} Id. at 744.

\textsuperscript{144} Regents, 482 F.3d at 379.
support its application of the class-wide presumption of reliance.\textsuperscript{145} In other words, for a class to be certified, the court must find that questions of law or fact common to all class members predominate over questions affecting individual members.\textsuperscript{146} As such, each plaintiff must be able to prove all of the elements of a § 10(b) claim, including that fraud occurred and that the fraud proximately caused plaintiff’s loss.\textsuperscript{147} Yet without the district court’s broad construction of a “deceptive act” to include a scheme to defraud, it could not have found the entire class of plaintiffs could establish a presumption of reliance.\textsuperscript{148}

The circuit court noted that a collective interpretation of the relevant Supreme Court securities fraud decisions would lead to the conclusion that § 10(b) prohibits acts involving manipulation or deception.\textsuperscript{149} Yet, that court held that an act is not deceptive under § 10(b) unless the actor had a duty to disclose to the investors.\textsuperscript{150} Nor is an act manipulative unless the act occurred directly in the market for the relevant security.\textsuperscript{151} Having determined that the Banks owed the plaintiffs no duty to disclose, the Banks’ acts could not be considered deceptive as defined under § 10(b).\textsuperscript{152} Moreover, since the Banks did not act directly in the market for the Enron securities, but rather engaged in a transaction with Enron, the Banks’ acts also could not

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\item \textsuperscript{145} Id. at 381-82. A related issue was whether the district court’s acceptance of scheme liability as a valid theory would allow it to certify a single class of plaintiffs whose losses were commonly caused by a scheme consisting of many actors and many different, unconnected schemes, rather than to certify subclasses whose losses were caused by the actions of particular defendants. \textit{Id.} at 382. The circuit court, however, addressed only the definition of deceptive act, as it was the dispositive issue on appeal. \textit{Id.}
\item \textsuperscript{146} \textit{Id.} at 382.
\item \textsuperscript{147} \textit{Id.} (citing Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 346 (2005) (stating that a private securities fraud action can only be permitted where the plaintiff can prove the traditional elements of proximate causation and loss)).
\item \textsuperscript{148} \textit{Id.}
\item \textsuperscript{149} \textit{Id.} at 388. The court discussed the Supreme Court decisions in \textit{Central Bank, Ernst, Santa Fe}, as well as \textit{Chiarella v. U.S.}, wherein the Court stated, “‘When an allegation of fraud is based upon non-disclosure, there can be no fraud absent a duty to speak.’” \textit{Id.} at 387 (quoting \textit{Chiarella v. U.S.}, 445 U.S. 222, 234 (1980)). The court interpreted \textit{Chiarella} to stand for the proposition that conduct relating to omissions, or a nondisclosure of information, is only fraudulent when there is a duty to disclose the information. Thus, the court rejected the district court’s determination that engaging in a scheme replete with withholding of information from the market violates a duty not to engage in the scheme, as opposed to a duty to disclose. \textit{Id.} at 388.
\item \textsuperscript{150} \textit{Regents}, 482 F.3d at 387-88.
\item \textsuperscript{151} \textit{Id.} at 391.
\item \textsuperscript{152} \textit{Id.} at 390.
\end{itemize}
be considered to be manipulative.\textsuperscript{153} Using a narrow construction of the scope of conduct prohibited by § 10(b), the court concluded that the Banks’ acts were neither deceptive nor manipulative, and thus did not violate the statute.\textsuperscript{154}

To determine whether reliance existed, the court in \textit{Regents} again looked to whether the Banks had engaged in conduct prohibited by § 10(b) by looking at the relevant presumptions of reliance. In other words, presumptions of reliance exist only where there has been either a misrepresentation of a material fact or an omission thereof in violation of a duty to disclose. On the one hand, the court determined that the district court’s application of the \textit{Affiliated Ute} presumption of reliance with respect to omissions to be incorrect.\textsuperscript{155} Although the Banks’ acts of entering into fraudulent documentation was deemed to be nondisclosure by the court, the plaintiffs in \textit{Regents} nevertheless could not establish reliance because the Banks had not failed to disclose information to the market in breach of a duty to disclose.\textsuperscript{156} As a result, there had been no deceptive act. Nor could the plaintiffs establish reliance on the basis of the fraud-on-the-market theory without an overly broad conception of liability for deceptive acts.\textsuperscript{157} To accept the fraud-on-the-market presumption of reliance would require a deceptive act to include misrepresentations, which the court deemed it did not; rather, a deceptive act only includes omissions in violation of a duty to disclose.\textsuperscript{158}

While the courts in both \textit{Simpson} and \textit{Regents} concurred that an act prohibited by § 10(b) must be one that is “manipulative” or “deceptive,” they interpreted differently what that act might be. The court in \textit{Simpson} held that a scheme to defraud investors is conduct prohibited by

\textsuperscript{153} \textit{Id.} at 392.
\textsuperscript{154} \textit{Id.}
\textsuperscript{155} \textit{Id.} at 383.
\textsuperscript{156} \textit{Regents}, 482 F.3d at 384.
\textsuperscript{157} \textit{Id.} at 382.
\textsuperscript{158} \textit{Id.} at 385-86.
§ 10(b), however, it required some level of culpability on the part of the secondary actor in order for the conduct to be manipulative or deceptive. As such, the secondary actor’s conduct must be for the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme. The court in Regents, however, rejected a scheme to defraud as manipulative or deceptive conduct. It held that manipulative conduct under § 10(b) is only an act done directly in the market for a particular security, while a secondary actor’s conduct is deceptive only if it owed to investors a duty to disclose. Consequently, the courts in Simpson and Regents each accepted a different premise upon which reliance either could or could not be based. The court in Simpson determined that the element of reliance could be established upon a showing of a scheme to defraud (including the entering into of documentation to create the fraud) and a subsequent misrepresentation of material fact by the primary violator to the market which resulted from the scheme. As an affirmative misrepresentation would exist, albeit one step removed from the secondary actor’s participation in the scheme, the fraud-on-the-market presumption of reliance would be appropriate. The court in Regents, on the other hand, determined that the entering into of documentation is an omission of material fact, rather than a misrepresentation thereof. Thus, without a duty to disclose the information, there has been no deceptive act, and thus, no presumption of reliance is appropriate.

Given the conflict at the circuit court level, the time was ripe for the Supreme Court decisively to resolve these issues among the courts. Against this backdrop, the Supreme Court in Stoneridge affirmed the dismissal of Stoneridge’ claim; it concluded that Stoneridge did not state a claim for liability under § 10(b) and Rule 10b-5 because Stoneridge could not establish reliance on the Charter Secondary Actors’ participation in a scheme to defraud.159 Yet while the Court

159 Stoneridge, 128 S.Ct. at 766.
rejected scheme liability for this particular case, the language it used arguably allows for scheme liability in certain other factual settings.

III. THE STONERIDGE DECISION

A. Factual Background

The Stoneridge case involved a securities fraud claim against Charter Communications, Inc. (“Charter”), Scientific-Atlanta, Inc. (“Scientific-Atlanta”) and Motorola, Inc. (“Motorola,” together with Scientific-Atlanta, “Charter Secondary Actors”). The plaintiffs in this lawsuit were investors who had purchased Charter stock during the relevant period. Stoneridge Investment Partners, LLC (“Stoneridge”), as the lead plaintiff in the class action, claimed that Scientific-Atlanta and Motorola, respectively, each assisted Charter in misrepresenting certain transactions between the entities in order to inflate Charter’s revenues in its publicly-filed financial statements. Stoneridge filed a securities fraud class action on behalf of purchasers of Charter stock and sought to hold Charter, Scientific-Atlanta and Motorola liable under § 10(b) and Rule 10b-5. Charter ultimately entered into a settlement with Stoneridge for $146,250,000 in connection with its violation of § 10(b) for filing fraudulent and misleading financial statements. But Stoneridge sought damages from the Charter Secondary Actors as well for their part in enabling Charter’s financial statement fraud on the theory that without the Charter Secondary Actors’ help in falsifying transaction documents, Charter could not have fraudulently misrepresented its financial status to the public. The Supreme Court ultimately

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160 Id. at 766.
161 Id.
162 Id.
163 Id.
164 In re Charter Commc’ns, Inc., Sec. Litig., No. MDL 1506, 4:02-CV-1186 CAS, 2005 WL 4045741, at *1 (E.D.Mo. June 30, 2005). The district court noted that according to a study by Bloomberg News, the settlement falls within the top twenty-five securities fraud class action settlements of all time. Id.
165 Id. at *5.
166 Stoneridge, 128 S.Ct. at 767.
determined that Stoneridge could not recover. Without explicitly rejecting scheme liability as a viable theory of liability, the Court concluded that Stoneridge could not state a claim under §10(b) or Rule 10b-5 against either Scientific-Atlanta or Motorola, as it could not establish reliance on either Motorola’s or Scientific-Atlanta’s conduct.\textsuperscript{167}

Charter, a cable operator, was concerned with the impact lower-than-expected quarterly earnings would have on Wall Street expectations as to its performance.\textsuperscript{168} In late 2000, Charter executives realized that the fraudulent activity they had already engaged in would be insufficient to meet projected earnings by a margin of $15 to $20 million.\textsuperscript{169} The executives’ prior fraud had included “misclassification of its customer base; delayed reporting of terminated customers; improper capitalization of costs that should have been shown as expenses; and manipulation of the company’s billing cutoff dates to inflate reported revenues.”\textsuperscript{170} To right this shortfall, Charter approached the Charter Secondary Actors with a plan to alter some of their respective transactions, with the Charter Secondary Actors’ full complicity.\textsuperscript{171} The scheme worked as follows: both Scientific-Atlanta and Motorola supplied Charter with cable converter boxes that Charter, in turn, furnished to its customers.\textsuperscript{172} Charter agreed to overpay for each cable box by $20 until the end of the year, at which time the Charter Secondary Actors would use such overpayment to purchase advertising from Charter.\textsuperscript{173} Although in reality a net wash, Charter recorded the advertising purchases as revenue and capitalized its purchase of the cable boxes, with the end result that its financial statements reflected Charter having met its projected revenue

\textsuperscript{167} Id. at 774.
\textsuperscript{168} Id. at 766.
\textsuperscript{169} Id.
\textsuperscript{170} Id.
\textsuperscript{171} Id.
\textsuperscript{172} Stoneridge, 128 S.Ct. at 766.
\textsuperscript{173} Id.
and operating cash flows.\textsuperscript{174} Although this scheme violated generally accepted accounting principles, Charter’s auditors\textsuperscript{175} approved Charter’s financial statements because Charter and the Charter Secondary Actors “de-linked” the two transactions: at Charter’s request, Scientific-Atlanta sent documents to Charter which falsely stated that Scientific-Atlanta was increasing its prices for cable boxes by $20 per box.\textsuperscript{176} Charter and Motorola, on the other hand, agreed to language in Charter’s purchase contract for cable boxes which specified a certain amount of cable boxes Charter was to purchase, yet provided for liquidated damages of $20 per cable box in the event Charter failed to purchase the specified amount.\textsuperscript{177} It was fully expected when the contract was entered into that Charter would fail to purchase all the units and pay the $20 per box to Motorola.\textsuperscript{178} These agreements were backdated to make it appear as though they were entered into a month before the agreements to purchase advertising.\textsuperscript{179} The accounting effect allowed Charter to record revenue and operating cash flow from the advertising purchases of approximately $17 million, enough to close the gap on the shortfall it anticipated.\textsuperscript{180}

Stoneridge, the lead plaintiff on behalf of investors who allege losses after they bought Charter stock, filed a securities fraud class action lawsuit against Charter, Scientific-Atlanta, Motorola and others under § 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.\textsuperscript{181} Stoneridge alleged that, not only did Charter violate the securities laws, but that the Charter Secondary Actors did as well by participating in the scheme, resulting

\textsuperscript{174} \textit{Id.}
\textsuperscript{175} Charter’s independent auditor was Arthur Andersen LLP (“Andersen”). \textit{Id.} Andersen was also named as a defendant in this litigation; the Court, however, notes that it is unclear whether Andersen was misled by Charter and the Charter Secondary Actors or whether Andersen was complicit in the fraud. \textit{Id.} Ultimately, however, the Court concluded that Andersen’s involvement, or lack thereof, is neither controlling nor significant for purposes of the case. \textit{Id.}
\textsuperscript{176} \textit{Id.} at 766-67.
\textsuperscript{177} \textit{Id.} at 767.
\textsuperscript{178} Stoneridge, 128 S.Ct. at 767.
\textsuperscript{179} \textit{Id.}
\textsuperscript{180} \textit{Id.}
\textsuperscript{181} \textit{Id.} at 766-67.
in fraudulent financial statements upon which Stoneridge relied in making investment
decisions.\textsuperscript{182} The district court granted the Charter Secondary Actors’ motion to dismiss, and the
Court of Appeals for the Eighth Circuit affirmed.\textsuperscript{183} The Court of Appeals noted that, at most,
the Charter Secondary Actors aided and abetted Charter’s financial statement fraud, and
according to the holding in \textit{Central Bank}, there is no private right of action for aiding and
abetting under § 10(b).\textsuperscript{184} Rather, to recover for a § 10(b) violation, Stoneridge would have to
show more than that the Charter Secondary Actors merely aided and abetted Charter’s primary
violation of § 10(b); Stoneridge would have to show a primary violation by the Charter
Secondary Actors.\textsuperscript{185} The Court of Appeals’ view was that the allegations failed to show a
primary violation of § 10(b) by the Charter Secondary Actors because Stoneridge made no
showing of either misstatements made to the investing public by the Charter Secondary Actors
upon which the investing public relied or that the Charter Secondary Actors failed to disclose
material information in violation of a duty to disclose.\textsuperscript{186} The United States Supreme Court
granted certiorari to resolve the conflict among the Courts of Appeal as to when an investor may
recover from a secondary party under § 10(b).\textsuperscript{187}

\textbf{B. \textit{The Supreme Court’s Analysis of a Scheme to Defraud and a Plaintiff’s Reliance Thereon}}

The Court first noted that § 10(b) liability does not extend to aiding and abetting
liability.\textsuperscript{188} Rather, a plaintiff must establish a primary violation of § 10(b) against a secondary
actor.\textsuperscript{189} Against this backdrop, the Court of Appeals in \textit{Stoneridge} affirmed the dismissal of
Stoneridge’s case against the Charter Secondary Actors, concluding that Stoneridge had not

\textsuperscript{182} Id. at 767.
\textsuperscript{183} \textit{In re Charter Commc’ns, Inc.}, 443 F.3d 987.
\textsuperscript{184} Id. at 992.
\textsuperscript{185} Id.
\textsuperscript{186} Id.
\textsuperscript{187} \textit{Stoneridge}, 128 S.Ct. at 767-68.
\textsuperscript{188} Id. at 769.
\textsuperscript{189} Id.
alleged any deceptive act prohibited by § 10(b), “noting that only misstatements, omissions by one who has a duty to disclose, and manipulative trading practices . . . are deceptive within the meaning of the rule.”¹⁹⁰ The Supreme Court noted that if the Court of Appeals’ decision is to be read as suggesting that only statements, oral or written, can form the basis for § 10(b) liability, that would be an erroneous interpretation of the law.¹⁹¹ Rather, conduct can also be deceptive and provide such a basis.¹⁹² As such, the Court interpreted the Court of Appeals’ holding as suggesting that although the Charter Secondary Actors may have engaged in deceptive acts prohibited under § 10(b) by virtue of their assistance in altering certain documents, there was no reliance on those acts by Stoneridge.¹⁹³ As reliance is one of the required elements of a § 10(b) claim, Stoneridge had failed to state a claim.¹⁹⁴

In light of the presumptions of reliance discussed above, the Court determined that neither presumption applied to the facts of the case.¹⁹⁵ First, the Charter Secondary Actors had no duty to disclose the fraudulent transactions to Stoneridge.¹⁹⁶ As such, their failure to disclose the falsified documentation could not form the basis of any presumption of reliance on the part of Stoneridge, as there had been no omission in breach of a duty owed to them.¹⁹⁷ Second, the Charter Secondary Actors’ conduct was not communicated to the public. The Court reasoned that “[n]o member of the investing public had knowledge, either actual or presumed, of respondents’ deceptive acts during the relevant times.”¹⁹⁸ As a result, reliance could not be established upon a fraud-on-the-market theory. In other words, the Charter Secondary Actors’

¹⁹⁰ Id.
¹⁹¹ Id.
¹⁹² Id.
¹⁹³ Stoneridge, 128 S.Ct. at 769.
¹⁹⁴ Id.
¹⁹⁵ Id.
¹⁹⁶ Id.
¹⁹⁷ Id.
¹⁹⁸ Id.
acts were not communicated to the public; rather, Charter made misrepresentations regarding its financial status in its own publicly-filed financial statements. The Charter Secondary Actors did not make any such statements, even though their actions in falsifying documents formed the basis upon which the misrepresentations were made. Thus, the Court concluded that Stoneridge could not establish the requisite element of reliance.\(^\text{199}\)

Stoneridge asserted reliance as follows: had the Charter Secondary Actors not engaged in a scheme with Charter to help Charter create false financial statements, Charter’s auditors would not have been fooled, and Charter’s publicly-filed financial statements would have more accurately reflected its true financial condition.\(^\text{200}\) By virtue of the Charter Secondary Actors’ scheme with Charter, they indirectly made a misrepresentation to the public upon which Stoneridge relied when making their investment decision to purchase Charter’s stock.\(^\text{201}\) The Court rejected this argument, asserting that adopting this concept of reliance would cast the net of potential liability to the marketplace at large, and the Court was unwilling to so broaden the scope of § 10(b).\(^\text{202}\) The Court’s argument rested on the principle of reliance being closely linked to causation; a defendant’s deceptive acts and a plaintiff’s reliance thereon must be linked “immediate[ly]”, rather than remotely, insofar as the deceptive acts must be “in connection with the purchase or sale of a security.”\(^\text{203}\) Although the requirements of establishing both reliance and “in connection with the purchase or sale of any security” are distinct from one another, the Court concluded that they are related enough such that the Charter Secondary Actors’ deceptive acts and Stoneridge’s reliance thereon in connection with the purchase of Charter’s securities

\(^{199}\) Stoneridge, 128 S.Ct. at 769.
\(^{200}\) Id. at 770.
\(^{201}\) Id.
\(^{202}\) Id. at 770-71.
\(^{203}\) Id. at 770.
were too remote for Stoneridge’s reliance argument to be accepted.\textsuperscript{204} The Court reasoned that although § 10(b) is “‘not limited to preserving the integrity of the securities markets,’”\textsuperscript{205} it does not reach all commercial transactions that are fraudulent and affect the price of a security in some attenuated way.\textsuperscript{206} The Court also raised the concern that extending the scope of liability to include generic “contracting parties” might necessarily increase the cost of doing business out of fear of § 10(b) liability.\textsuperscript{207} Similarly, overseas firms may shy away from doing business in this country which could raise the cost of being a publicly-traded company and shift securities offerings away from domestic capital markets.\textsuperscript{208} The Court concluded its opinion by signaling the SEC’s role in enforcement of § 10(b) claims against secondary actors.\textsuperscript{209}

C. Analysis of the Supreme Court’s Stoneridge Decision: Has the Court Made Clear Whether Scheme Liability for Secondary Actors Remains a Viable Theory for Recovery?

Various commentators have suggested that the Supreme Court rejected scheme liability in Stoneridge.\textsuperscript{210} However, the Court never expressly rejected scheme liability in the opinion, unlike its explicit rejection of aiding and abetting in Central Bank. Moreover, its rather indistinct language in the opinion suggests plaintiffs may be able to assert scheme liability for some secondary actors who participate in a scheme to defraud. The first example of its somewhat open-ended language is the Court’s assertion that “conduct,” in addition to misrepresentations and omissions, can also be a “deceptive act” prohibited under § 10(b).\textsuperscript{211} The Court thus appears to have casually accepted that participating in a scheme to defraud is, at least,

\textsuperscript{204} Id.
\textsuperscript{206} Id.
\textsuperscript{207} Id. at 772.
\textsuperscript{208} Id.
\textsuperscript{209} Id. at 773. The Court noted that allowing Stoneridge’s theory of liability to extend to these secondary actors would undermine Congress’ determination that the SEC is solely responsible for pursuing aiders and abettors. Id.
\textsuperscript{210} See supra, note 8.
\textsuperscript{211} Id. at 769.
deceptive, and can therefore be violative of § 10(b), which offered some credence to the separation of subsections (a) and (c) from subsection (b) of Rule 10b-5. Yet the Court gave very little guidance as to what types of acts are relevant in this context. Importantly, however, the Court described the Charter Secondary Actors’ conduct as “ordinary business operations” and an “arrangement . . . in the marketplace for goods,” as opposed to conduct in the “investment sphere.”212 In other words, Motorola’s and Scientific-Atlanta’s conduct was simply that of a customer or supplier entering into a business transaction. In the context of their deceptive acts, neither was engaged in any conduct directly involving the securities markets. This posture provides a potential opening for secondary actor scheme liability: to the extent a secondary actor has engaged in fraud that a court could find is within the investment sphere – notwithstanding the fact that it has participated in a scheme to defraud – that court could determine the secondary actor has engaged in manipulative or deceptive conduct violative of § 10(b).

Yet there is no discussion in the opinion, as there was in the Simpson decision, regarding to what extent such conduct would rise to the level of being manipulative or deceptive. Rather, the Court clung to the concept that any assistance given by a secondary actor to a primary violator is merely aiding and abetting, regardless of the deceptive nature of such conduct.213 Importantly, however, the Court’s rejection of aiding and abetting liability in Central Bank was not based simply on an actor’s participation in a scheme, but rather on the culpability, or scienter, attributable to the actor. Thus, the Court’s implicit recognition of conduct as potentially deceptive in Stoneridge creates an opportunity for a secondary actor’s conduct to be deemed manipulative or deceptive, despite the role such conduct may have played in effectuating another company’s securities fraud. Notwithstanding the Court’s connection in Stoneridge between

212 Stoneridge, 128 S.Ct. at 770, 774.  
213 Id. at 771.
participation in a scheme and aiding and abetting, this association is seemingly linked in the opinion to the notion of secondary actors as commercial actors, as opposed to actors acting in the securities markets.\textsuperscript{214} Thus, if a court could find a secondary actor has engaged in manipulative or deceptive conduct in the investment sphere, the Court has potentially left an opening between where aiding and abetting ends and primary liability for a secondary actor begins.

Yet this opportunity may be much ado about nothing, as arguably a plaintiff could never establish reliance on a scheme to defraud using either presumption of reliance. The Court reasoned that to establish reliance on the basis of conduct, the existing presumptions are the only means to establish reliance, absent actual reliance. According to the Court, the secondary actor must therefore have a duty to disclose to meet the \textit{Affiliated Ute} presumption in the context of a failure to disclose information. Alternatively, the fraud-on-the-market presumption would require that the secondary actor’s deceptive acts be communicated to the public. The Court also imposed a more immediate connection between the secondary actor’s conduct and the plaintiff’s injury to survive a remoteness claim. In other words, the deceptive conduct must not be too remote from the injury in order to be “in connection with the purchase or sale” of a security. Otherwise, reliance on a scheme to defraud would only be available on the basis of actual reliance.

To establish fraud-on-the-market reliance, the conduct must be communicated to the public, yet the Court never explicitly made clear by whom the deceptive acts must be communicated to the public, as the Court truly engaged the passive voice with each reference to this requirement. Although the Court did state that the “implied right of action does not reach the [Charter Secondary Actors] because the investors did not rely upon \textit{their} statements or

\textsuperscript{214} See id. at 772.
representations,\textsuperscript{215} that statement is rendered ambiguous by the Court’s continual reference to conduct as a statement.\textsuperscript{216} At least one court has interpreted Stoneridge’s holding as requiring the secondary actor to communicate its conduct to the investing public.\textsuperscript{217} If this is so, there might be more opportunity for courts to require less in the way of immediacy between the conduct and the injury. As the secondary actor would have effectuated a fraud on the market by disclosing its conduct itself to the market, that actor is now presumably in the “investment sphere” for having made the statement. Unfortunately, however, if a plaintiff is able to establish fraud by the secondary actor on the basis of a public statement, then the plaintiff has not avowed itself of scheme liability for secondary actors at all; rather it has merely established fraud on the basis of a statement under Rule 10b-5(b), and has arguably established reliance on the basis of actual reliance.

The question then becomes whether a possibility exists to establish fraud-on-the-market reliance on the basis of a communication made by the primary violator to its shareholders regarding the secondary actor’s conduct. Assuming Charter had included in its publicly-filed financial statements a description of the transactions entered into with Motorola and Scientific-Atlanta, instead of including merely the effect these transactions had on Charter’s revenues, would that have changed the landscape? Arguably not in Stoneridge, as the Court deemed their conduct too remote from the plaintiff’s injury. Since their actions were ordinary course

\textsuperscript{215} Id. at 766 (emphasis added). The Court later stated that the Charter Secondary Actors’ “acts or statements were not relied upon by the investors. . . .” Id. at 769 (emphasis added).

\textsuperscript{216} Id. at 766, 769.

\textsuperscript{217} See Burnett v. Rowzee, Nos. 07-0393 & 07-0641, 2008 WL 638503 (C.D.Cal. Feb. 11, 2008). In Burnett, defendant Halstead was the “pitch man” with regard to a PIPES financing. Id. at 1. Plaintiff agreed to invest funds in short term loans to companies in the process of obtaining the PIPES financing. Id. No financing was ever arranged; rather, the principals of the scheme simply solicited additional investments from subsequent investors and used those investments to pay returns to earlier investors. Id. The court held that the plaintiff had established reliance on this scheme because plaintiff had direct contact with the principals of the scheme and directly relied on the interest to be paid in making their investment. Id. at 6. See also Pugh v. Tribune Co., 521 F.3d 686 (7th Cir. 2008) (holding that where the defendant was the “mastermind” of a scheme to defraud, yet did not prepare press releases, the causal chain was too indirect to establish reliance on the scheme).
transactions, as opposed to securities transactions, there was insufficient immediacy between them and Stoneridge’s injury. But how “direct” must this connection be? This is where the secondary actor’s conduct could become relevant in determining how remote its conduct is to the plaintiff’s injury. The Court did provide that actions in the “realm of ordinary business operations” are generally too remote to be considered “in connection with” a securities transaction.218 Again, arguably, there is an opportunity for varying interpretations as to what actions take place in the “investment sphere,” versus the “marketplace for goods.”

Similarly, the prospect exists to attack the remoteness of one’s conduct. For example, had Charter and Motorola engaged in a fraudulent securities transaction, as opposed to an ordinary course marketplace transaction, and the transaction, as well as its effect, was reported in Charter’s financial statements, would a plaintiff have established an immediate enough connection in order to assert fraud-on-the-market reliance? Presumably, the fraudulent securities transaction between the secondary actor and the primary violator need not be the transaction in which a plaintiff participates in order to satisfy the “in connection with” requirement.219 Thus, that requirement may have a better chance of being established if there is some communication of the deceptive act. Moreover, the Court suggested that the Charter Secondary Actors’ acts were too remote from Stoneridge’s injury to satisfy reliance because “nothing [they] did made it necessary or inevitable for Charter to record the transactions as it did.”220 Arguably, a court could thus allow reliance to exist if the secondary actor somehow made it “necessary or inevitable” for the transaction to become public. Again, this language, while limiting

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218 Stoneridge, 128 S.Ct. at 770.
219 See U.S. v. O’Hagan, 521 U.S. 642, 655-56 (1997). The Supreme Court in O’Hagan determined in the context of the misappropriation theory of insider trading that the “in connection with” requirement is satisfied “even though the person or entity defrauded is not the other party to the trade, but is, instead, the source of the nonpublic information.” Id. at 656. The Court went on to note that “[t]he misappropriation theory comports with § 10(b)’s language, which requires deception “in connection with the purchase or sale of any security,” not deception of an identifiable purchaser or seller.” Id. at 658.
220 Stoneridge, 128 S.Ct. at 770.
Stoneridge’s ability to assert scheme liability, could be relevant in another context given its ambiguity. Presumably it was used by the Court in Stoneridge to suggest that the Charter Secondary Actors could have backdated or falsified numerous transaction documents at Charter’s request, but ultimately, Charter could have decided to report its income correctly. However, the words “necessary or inevitable” could give rise to another interpretation by a court in a different context.

Thus, the vagueness of some of the Court’s language creates the possibility that an entrepreneurial plaintiff and a willing court may interpret the holding from Stoneridge as allowing a secondary actor to be liable on the basis of scheme liability. The true stumbling block for a plaintiff would be whether he could establish fraud-on-the-market reliance in the absence of actual reliance on the scheme.

IV. CONCLUSION

The Supreme Court in its Stoneridge decision may have thought it closed the door on scheme liability for secondary actors as a viable theory of liability in the absence of actual reliance. However, what the Court may have intended and what the Court wrote are two different things. Within the confines of its opinion, a broad reading thereof suggests there may still be room for plaintiffs to construct a plausible argument, particularly in light of the fact that the Court did not expressly reject the theory. It is doubtful the Court will revisit the issue of § 10(b) liability for secondary actors any time soon, as it denied certiorari in the Regents case a week after deciding Stoneridge.221 The Court’s declining an opportunity to further hone this difficult – but important – issue of the precise scope of secondary actor liability may well have injurious effects. On the one hand, courts may read the opinion as rejecting scheme liability entirely, thereby eradicating any possible recovery for wronged plaintiffs in this context. On the

other hand, the absence of any definitive rejection of scheme liability may allow courts to impose liability on secondary actors. Or at the very least, such absence may allow a court not to dismiss the case in the early stages of a proceeding.

Yet, the Court’s refusal to extend Rule 10b-5’s implied private right of action to allow scheme liability in all cases is due in large part, if not entirely, to a lack of congressional intent to so extend it.222 Thus, Congress could act to clarify whether scheme liability for secondary actors is in the purview of § 10(b), but its doing so would likely depend on a variety of factors, particularly the outcome of the Presidential election.223 But as the Supreme Court’s decision in Stoneridge is certainly one extolling the public policy concern of increased litigation beyond the realm of the securities laws, Congress may wish to advance a competing policy concern of deterring culpable conduct.

SEC rulemaking is another means by which the securities laws may be changed. Certainly, the SEC could not disregard clear Supreme Court precedent interpreting a Rule 10b-5.224 Thus, the SEC could not, for example, adopt a rule that states a new method by which a plaintiff could establish reliance on a scheme to defraud. Yet as the Court did not expressly reject scheme liability as a viable theory upon which to base liability, the SEC could adopt rules which supplement Rule 10b-5 to elucidate the contours of scheme liability for secondary

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222 Stoneridge, 128 S.Ct. at 771-73; see also Joseph A. Grundfest, Disimplying Private Rights of Action under the Federal Securities Laws: The Commission’s Authority, 107 HARV. L. REV. 961, 998 (1994) (citing Musick, Peeler & Garrett v. Employers Ins., 508 U.S 286, 299-300 (Thomas, J., joined by Blackmun and O’Connor, JJ., dissenting)) (stating that the certain members of the Supreme Court have expressed concern over the Court’s continued acceptance of Rule 10b-5’s implied private right and that it should not be extended absent any congressional support).

223 See Black, supra note 8, at 7-8. Professor Black suggests that Congress could be persuaded to amend the securities laws due to the purported lack of effectiveness of the Private Securities Litigation Reform Act, which was enacted after Central Bank to curb the abuses of securities fraud class actions, as well as the reduced liability after Central Bank which may have led to participation by accounting firms and investment banks in the Enron and WorldCom financial scandals. Id. at 8.

224 See Grundfest, supra note 222, at 984 (stating that while the SEC has the authority to define the conduct that violates § 10(b), the doctrine of stare decisis would preclude it from disregarding the Supreme Court’s prior interpretation of a statute).
Specifically, it could explicate more clearly what it means for conduct to be “immediate” as opposed to remote. Similarly, it could clarify when conduct is in the investment sphere or not, or when it is sufficiently in connection with a purchase or sale of a security for the causal connection between the deceptive conduct and the injury to bolster reliance. Having rules in place to determine the boundaries of scheme liability would arguably be beneficial, both to the regulated as well as to the investor, even if that benefit was simply certainty of the law. If any such adopted SEC rule withstood judicial scrutiny, scheme liability for secondary actors could potentially be more readily established.

However, the likely result of this case will be that the lower courts must make determinations as to when – if ever – a plaintiff has established fraud-on-the-market reliance on a secondary actor’s deceptive act in the context of a scheme to defraud. And thus, expensive and protracted litigation will continue – not necessarily over whether a secondary actor has wronged investors in cases of corporate crisis, but rather over whether the laws in place even cover the conduct asserted by plaintiffs.

225 See id. at 1011-1012. The main premise of Professor Grundfest’s article is that, notwithstanding judicial acceptance of a plaintiff’s private right of action for securities fraud, the SEC’s rulemaking authority would allow it to disimply such a right. Id. at 976-978. Absent complete disimplication, however, the SEC also has the authority to tighten the elements a plaintiff must establish in a 10b-5 claim. Id. at 1011.