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## YALE LAW & POLICY REVIEW

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### From the Regulatory Abyss: The Weakened Gatekeeping Incentives Under the Uniform Securities Act

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## INTRODUCTION

Under the Uniform Securities Act (Act or USA),<sup>1</sup> in-house accountants, analysts, attorneys, and other inside gatekeepers may be held responsible for running afoul of the secondary liability provisions of the USA, while their outside counterparts will escape liability. As a result, an inherent inequity in treatment exists between inside and outside actors in private state securities litigation.

Gatekeepers are actors, often attorneys and accountants in a securities context, who are well-situated to detect fraud or other improper conduct and are able to withhold their essential services in an effort to prevent such fraud or improper conduct from occurring or continuing.<sup>2</sup> These actors have been an essential part of the U.S. financial system for well over a century. As early as 1900, the New York Stock Exchange (NYSE) instituted public reporting requirements mandating that listed companies publish financial statements certified by an independent auditor.<sup>3</sup> In 1964, the eminent Judge Friendly eloquently analogized the role of attorneys and accountants in corporate governance. He explained: “In our complex society the accountant’s certificate and the lawyer’s opinion can be instruments for inflicting pecuniary loss more potent than the chisel or

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1. UNIF. SEC. ACT (UNIF. LAW COMM’N 2005).
  2. See, e.g., *Lawson v. FMR LLC*, 134 S. Ct. 1158, 1170–71 (2014) (quoting S. REP. NO. 107-146, at 2 (2002)) (“Emphasizing the importance of outside professionals as ‘gatekeepers who detect and deter fraud,’ the Senate Report concludes: ‘Congress must reconsider the incentive system that has been set up that encourages accountants and lawyers who come across fraud in their work to remain silent.’”). Attorneys and auditors provide their reputational status in the securities setting, which in turn provides validity to a transaction and comfort to investors and shareholders. See *Pac. Inv. Mgmt. Co. LLC v. Mayer Brown LLP*, 603 F.3d 144, 156 (2d Cir. 2010) (“Where statements are publicly attributed to a well-known national law or accounting firm, buyers and sellers of securities (and the market generally) are more likely to credit the accuracy of those statements.”); see also Stephen Choi, *Market Lessons for Gatekeepers*, 92 NW. U. L. REV. 916, 916–18 (1998) (discussing traditional gatekeeper intervention); John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1296 (2003) (explaining the role gatekeepers play in the arena of securities regulation and giving examples); Howell E. Jackson, *Reflections on Kaye, Scholer: Enlisting Lawyers To Improve the Regulation of Financial Institutions*, 66 S. CAL. L. REV. 1019 (1993) (discussing the role of attorneys as gatekeepers and effective gatekeeping regimes); Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 888–98 (1984) (discussing the role of gatekeepers generally and the logic behind gatekeeper liability).
  3. John C. Coffee, Jr., *Gatekeeper: Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 302 n.1 (2004); John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 37 (2001); David F. Hawkins, *The Development of Modern Financial Reporting Practices Among American Manufacturing Corporations*, 37 BUS. HIST. REV. 135, 149–50 (1963).

the crowbar.”<sup>4</sup> Indeed, effective gatekeepers are imperative to enhancing market integrity and protecting the investing public.

The Uniform Securities Act is an important legislative component in incentivizing proper gatekeeper behavior and regulating the securities markets. As a uniform law, one of its fundamental purposes is to standardize securities law across the states.<sup>5</sup> It is ironic, then, that the USA lacks uniformity in its treatment of gatekeepers in securities transactions. That is, two attorneys, one employed as in-house counsel and the other retained as outside counsel, who prepare identical documents and play identical roles in a securities offering that violates the law, cannot necessarily expect the same legal consequences. Under the USA, the outside lawyer avoids civil liability while the in-house attorney is subject to liability for the securities violations of his or her client. This follows from the language of the USA as adopted by the majority of states coupled with the interpretation of that language by the courts.<sup>6</sup>

In this way, the USA provisions governing civil liability have led to a regulatory abyss, which allows many of those who are as well situated as inside actors (including inside counsel) to uncover and prevent securities violations—namely, outside accountants, lawyers, and other outside gatekeepers—to materially aid primary violators without incurring liability in private actions under the securities laws.<sup>7</sup> As a result, professionals in similar positions suffer dispar-

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4. United States v. Benjamin, 328 F.2d 854, 863 (2d Cir. 1964).
  5. *Uniform Securities Act (Last Revised or Amended in 2005)*, NAT’L CONF. COMMISSIONERS ON UNIFORM ST. LAWS (Nov. 4, 2008), [http://www.uniformlaws.org/shared/docs/securities/securities\\_final\\_05.pdf](http://www.uniformlaws.org/shared/docs/securities/securities_final_05.pdf) [<http://perma.cc/8JRR-MTLF>] (stating that the National Conference of Commissioners on Uniform State Laws (NCCUSL) “provides states with non-partisan, well-conceived and well-drafted legislation that brings clarity and stability to critical areas of state statutory law. . . . NCCUSL strengthens the federal system by providing rules and procedures that are consistent from state to state but that also reflect the diverse experiences of the states” and noting “the technical challenge of drafting a new Act that could achieve the basic goal of uniformity among states and with applicable federal law”).
  6. See *infra* notes 61–62 and accompanying text. Note that this Article uses the terms “inside” counsel and “in-house” counsel interchangeably—meaning an attorney who is an employee of the subject enterprise. The same holds true for other “inside” or “in-house” professionals—signifying that they are employees of the subject enterprise.
  7. It is important to note that federal securities laws do not fill this regulatory abyss, as there is no aiding and abetting liability in private actions under the federal securities laws, i.e., Section 10(b) of the Securities Exchange Act. See *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994); Marc I. Steinberg, *The Ramifications of Recent U.S. Supreme Court Decisions on Federal and State Securities Regulation*, 70 NOTRE DAME L. REV. 489 (1995); see also, e.g., *In re Refco, Inc. Sec. Litig.*, 609 F. Supp. 2d 304, 305–06 (S.D.N.Y. 2009), *aff’d*, *Pac. Inv. Mgmt. Co.*, 603 F.3d at 148 (“The core issue before the Court is whether the plaintiff-investors can hold Refco’s outside counsel liable for their injury pursuant to §§ 10(b) and 20(a) of the Securities Exchange Act of 1934. Although the Complaint al-

ate treatment, and a glaring gap subsequently emerges in the incentivization of outside actors to properly perform their gatekeeping role. Thus, the USA, as it is widely adopted, creates a dangerous liability gap that inhibits the gatekeeping function in securities transactions that demands rectification.

This Article focuses on this critical incongruity. Part I closely examines the gatekeeping role, addresses the Uniform Securities Act in the realm of civil liability, and explores its construction of primary and secondary liability. More specifically, Part I examines how changes in federal law have created a regulatory abyss for certain secondary (or collateral) actors. Part II addresses variations in the adoption of the USA among certain states as it relates to secondary liability and discusses non-USA approaches adopted by other states. Part III assesses the different ways in which courts have dealt with collateral participants under the USA, including classification as employees, agents, or control persons. Finally, Part IV focuses on the risk to investors in securities transactions, ethical concerns, and inadequate encouragement of outside gatekeepers as a result of the USA. The Article concludes by proposing meaningful solutions to address the current liability abyss.

## I. THE GATEKEEPING FUNCTION

Gatekeepers are reputational intermediaries that, in the securities context, enhance market integrity by staking their reputation on the credibility of an investment through their certification, assessment, or verification of facts sur-

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leges facts that, if true, would make the Mayer Brown Defendants guilty of aiding and abetting the securities fraud that harmed the plaintiffs, the Supreme Court and Congress have declined to provide a private right of action for victims of securities fraud against those who merely—if otherwise substantially and culpably—aid a fraud that is executed by others. Accordingly, the motions to dismiss must be granted.”). In a footnote of the case quoted above, Judge Lynch of the Southern District of New York commented:

It is perhaps dismaying that participants in a fraudulent scheme who may even have committed criminal acts are not answerable in damages to the victims of the fraud. However . . . the fact that the plaintiff-investors have no claim is the result of a policy choice by Congress. In 1995, in reaction to the Supreme Court’s decision in *Central Bank*, Congress authorized the SEC—but not private parties—to bring enforcement actions against those who “knowingly provide [ ] substantial assistance to another person” in violation of the federal securities laws. This choice may be ripe for legislative re-examination. While the impulse to protect professionals and other marginal actors who may too easily be drawn into securities litigation may well be sound, a bright line between principals and accomplices may not be appropriate.

*Refco*, 609 F. Supp. 2d at 318 n.15 (internal citations omitted) (quoting Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, § 104, 109 Stat. 737, 757 (codified as 15 U.S.C. § 78t(f) (2012))).

rounding it.<sup>8</sup> Depending on the circumstances, gatekeepers have the ability to detect and deter fraud.<sup>9</sup> Gatekeeper reliability is thus an integral component of the integrity of securities markets.

The need to properly motivate effective gatekeeper functioning cannot be overemphasized. Consistent with their client engagements, gatekeepers assess the integrity and transparency of a corporation's offering of securities.<sup>10</sup> For example, gatekeepers may function to reduce the risk of harm to investors by refusing to provide services.<sup>11</sup> The gatekeeper's position as the red or green light to the consummation of securities transactions is often superior to the after-the-fact remedies provided by investor lawsuits and government enforcement proceedings.<sup>12</sup> Gatekeeping thus has the realistic potential to prevent systemic frauds such as those perpetrated by Enron, Tyco, WorldCom, Adelphia, Baptist Foundation of Arizona, and Radical Bunny.<sup>13</sup>

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8. Coffee, *supra* note 2, at 1296. *See generally* sources cited *supra* note 2.
  9. Lawson v. FMR LLC, 134 S. Ct. 1158, 1170–71 (2014) (“Emphasizing the importance of outside professionals as ‘gatekeepers who detect and deter fraud,’ the Senate Report concludes: ‘Congress must reconsider the incentive system that has been set up that encourages accountants and lawyers who come across fraud in their work to remain silent.’” (quoting S. REP. NO. 107-146, at 2 (2002))).
  10. Kirschner v. KPMG LLP, 938 N.E.2d 941, 962 (N.Y. 2010) (“There can be little doubt that the role played by auditors and other gatekeepers serves the public as well as the corporations that contract for such services. Investors rely heavily on information prepared by or approved by auditors, accountants, and other gatekeeper professionals. Corporate financial statements, examined by ostensibly independent auditors, ‘are one of the primary sources of information available to guide the decisions of the investing public.’” (quoting United States v. Arthur Young & Co., 465 U.S. 805, 810–11 (1984))).
  11. *See generally* Lawson, 134 S. Ct. at 1170–71 (noting the role of gatekeepers in detecting and deterring fraud); *see also* Kraakman, *supra* note 2, at 888–98 (explaining the incentives and duties of gatekeepers).
  12. *See* SEC v. Coven, 581 F.2d 1020, 1028 (2d Cir. 1978); United States v. Benjamin, 328 F.2d 854, 863 (2d Cir. 1964); SEC v. Nat’l Student Mktg. Corp., 457 F. Supp. 682, 689 (D.D.C. 1978); In the Matter of Carter & Johnson, Exchange Act Release No. 17,597, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847 (Feb. 28, 1981); *see also* Assaf Hamdani, *Gatekeeper Liability*, 77 S. CAL. L. REV. 53, 83 (2003) (“Gatekeepers can often take a variety of steps to prevent their clients from acting unlawfully. Gatekeepers can screen prospective clients prior to selling them a product or offering them a service. They may also be positioned to observe client conduct and prevent wrongdoing from taking place.”); Fred Zacharias, *Lawyers as Gatekeepers*, 41 SAN DIEGO L. REV. 1387, 1389 (2004) (“Lawyers are gatekeepers and always have been.”); *Developments in the Law: Corporations and Society*, 117 HARV. L. REV. 2169, 2245 (2004) (“By withholding his or her support (such as a lawyer’s opinion letter or an accountant’s certification), the professional gatekeeper may be able to prevent the fraud.”).
  13. In each of these cases of large-scale fraud, attorneys and accountants allegedly failed to effectively perform their gatekeeping functions; they failed to minimize,

Most often, corporate scandals involve multitudes of potential gatekeepers who do not adequately respond, leading to enormous investor financial losses and hardship.<sup>14</sup> As Judge Stanley Sporkin, former Director of the Division of Enforcement of the Securities and Exchange Commission (SEC), and former General Counsel of the Central Intelligence Agency, asserted:

Where were these professionals, a number of whom are now asserting their rights under the Fifth Amendment, when these clearly improper transactions were being consummated? Why didn't any of them speak up or disassociate themselves from the transactions? Where also were the outside accountants and attorneys when these transactions were effectuated? What is difficult to understand is that with all the professional talent involved (both accounting and legal) why at least one professional would not have blown the whistle to stop the overreaching that took place in this case.<sup>15</sup>

These types of scandals are harmful to the reputation of outside professionals as well as monetarily damaging in jurisdictions where outside professionals are vulnerable to liability under applicable state securities and common law. For

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let alone prevent, the violations by alerting the investing public or regulators. *See, e.g., In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 681–82 (S.D.N.Y. 2004) (“The Underwriter Defendants contend that . . . they were entitled to rely on Andersen’s comfort letters for WorldCom’s unaudited interim financial statements . . . .”); *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 567 (S.D. Tex. 2002) (law firm, Vinson and Elkins, and accounting firm, Arthur Andersen, sued for misrepresentations that allowed the scandal to continue); *accord, In re Lehman Bros. Sec. & ERISA Litig.*, 903 F. Supp. 2d 152 (S.D.N.Y. 2012); *Facciola v. Greenberg Traurig LLP*, No. CV-10-1025-PHX-FJM, 2011 WL 2268950 (D. Ariz. June 9, 2011); *In re Adelpia Comm’ns. Corp. Sec. & Derivative Litig.*, No. 04 Civ. 3961, 2010 U.S. Dist. LEXIS 91584 (S.D.N.Y. Aug. 30, 2010).

14. In the Baptist Foundation of Arizona (BFA) scandal, for example, the amount due to investors, many of whom were elderly, at the time of the organization’s bankruptcy was approximately \$590 million. One of the authors of this Article (Marc I. Steinberg) served as an expert witness in this litigation. From at least the mid-1980s through July 1999, BFA offered and sold securities to investors located in Arizona and throughout the United States and several foreign countries. According to the Arizona Corporations Commission, a fraud of that size and length of time could not have occurred without the outside auditor, Arthur Andersen, “knowingly or recklessly ignoring the repeated warnings, or ‘red flags’ uncovered during its audits.” In the Matter of Arthur Andersen LLP, No. S-03386A-00-0000, 2000 WL 35730980, at \*4–7 (Ariz. Corp. Comm’n Sept. 27, 2000); *see also* Christine E. Earley et al., *Some Thoughts on the Audit Failure at Enron, the Demise of Andersen, and the Ethical Climate of Public Accounting Firms*, 35 CONN. L. REV. 1013, 1020–21 (2003) (noting the BPA fraud “was uncovered by a folksy CPA in Phoenix . . . [who] discovered the foundation’s insolvency in basically one afternoon worth of work—humbly attributing her skills as ‘Accounting 101, Auditing 101’”).
15. *Lincoln Sav. & Loan Ass’n v. Wall*, 743 F. Supp. 901, 920 (D.D.C. 1990).

example, the law firm that served as counsel to the Baptist Foundation was sued, settling the lawsuit for over \$20 million.<sup>16</sup> Even more astounding, the accounting firm for the Baptist Foundation, Arthur Andersen, agreed to a settlement of over \$200 million.<sup>17</sup> More recently, the outside law firms for Radical Bunny and Mortgages Limited settled litigation for \$88 million.<sup>18</sup> These scandals, which occurred in states such as Arizona and Texas that have not adopted the USA and thus allow for secondary liability for outside professionals, underscore the need to incentivize proper gatekeeping behavior by collateral actors. While these massive corporate scandals led to the passage of the Sarbanes-Oxley Act of 2002,<sup>19</sup> the legislation fails to adequately address a recurring scenario: the gatekeeping functions of collateral actors. In the securities offering context, gatekeeper functioning likely would improve by placing a burden on *all* collateral actors who materially aid a violation to show that they had exercised reasonable care.<sup>20</sup>

The role that gatekeepers play in the securities markets has been widely recognized by the courts.<sup>21</sup> It is, therefore, even more troubling that the gatekeep-

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16. Floyd Norris, *\$217 Million New Settlement by Andersen in Baptist Case*, N.Y. TIMES (May 7, 2002), <http://www.nytimes.com/2002/05/07/business/217-million-new-settlement-by-andersen-in-baptist-case.html> [<http://perma.cc/2DMM-NATG>] (reporting an estimated \$350 million lost by investors, excluding interest, and that inside counsel for the foundation was indicted on fraud charges); Art Toalston, *Law Firm Settlement Recovers \$21M for Foundation Investors*, BAPTIST PRESS (May 16, 2002), <http://www.bpnews.net/13390/law-firm-settlement-recovers-21m-for-foundation-investors> [<http://perma.cc/9SAA-8Z7C>].
  17. Norris, *supra* note 16. In addition to the large monetary component, the Andersen partner in charge of the audit as well as the manager of the audit agreed to give up their licenses to practice accounting in Arizona.
  18. Nate Raymond, *Law Firms To Pay \$88 Mln in Case Related to Mortgage Crisis*, REUTERS (June 21, 2012, 2:31 PM), <http://www.reuters.com/article/greenberg-quarles-classaction-idUSL1E8HLB6520120621> [<http://perma.cc/JC6B-D5WJ>]; Debra Cassens Weiss, *Greenberg Traurig, Quarles To Pay \$88M To Settle Suit by Mortgage Investors*, A.B.A. J. (June 22, 2012, 11:34 AM), [http://www.abajournal.com/news/article/greenberg\\_traurig\\_quarles\\_to\\_pay\\_88m\\_to\\_settle\\_suit\\_by\\_mortgage\\_investors](http://www.abajournal.com/news/article/greenberg_traurig_quarles_to_pay_88m_to_settle_suit_by_mortgage_investors) [<http://perma.cc/SKL4-7FHD>]. One of the authors of this Article (Marc I. Steinberg) served as an expert witness in this litigation.
  19. 107 Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.); *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-113, 124 Stat. 1376 (codified in scattered sections of 7, 12, 15, 18, 22, 31, and 42 U.S.C.).
  20. *See* UNIF. SEC. ACT § 410(b) (UNIF. LAW COMM'N 2005); *see also* Sung Hui Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 411, 415 (2008); Kraakman, *supra* note 2, at 888–98.
  21. *See, e.g.*, SEC v. Spectrum, Ltd., 489 F.2d 535, 536 (2d Cir. 1973) (noting the importance of attorneys in serving the public as gatekeepers in securities transactions); *In re Parmalat Sec. Litig.*, 375 F. Supp. 2d 278, 289 (S.D.N.Y. 2005) (“Inde-

ing role of outside advisers is slighted under the USA's secondary liability provisions. As the Second Circuit has observed: while "[t]he securities laws provide a myriad of safeguards designed to protect the interests of the investing public[,] [e]ffective implementation of these safeguards . . . depends in large measure on the members of the bar who serve in an advisory capacity to those engaged in securities transactions."<sup>22</sup> In the same decision, issued over four decades ago, the court voiced its disagreement with the premise that aider and abettor liability should not attach if an actor was simply "engaging in customary business practices," such as providing legal advice.<sup>23</sup> Instead, the Second Circuit embraced the gatekeeping function, asserting that "[t]he public trust demands more of its legal advisers than 'customary' activities which prove to be careless."<sup>24</sup> Without the specter of private securities liability exposure, these higher

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pendent auditors serve a crucial role in the functioning of world capital markets because they are reputational intermediaries. In certifying a company's financial statements, their reputations for independence and probity signal the accuracy of the information disclosed by the company, the managers of which typically are unknown to most of the investing public."); *Lincoln Sav. & Loan Ass'n v. Wall*, 743 F. Supp. 901, 920 (D.D.C. 1990) (discussing the failure of gatekeepers to adequately perform their role in the case at issue); sources cited *supra* note 11.

22. *Spectrum, Ltd.*, 489 F.2d at 536. The court further stated that "[t]he legal profession plays a unique and pivotal role in the effective implementation of the securities laws. Questions of compliance with the intricate provisions of these statutes are ever present and the smooth functioning of the securities markets will be seriously disturbed if the public cannot rely on the expertise proffered by an attorney when he renders an opinion on such matters." *Id.* at 541-42.
23. *Id.* at 542 ("We do not find persuasive the argument by one recent commentator that since 'the alleged aider and abettor will merely be engaging in customary business activities, such as loaning money, managing a corporation, preparing financial statements, distributing press releases, completing brokerage transactions, or giving legal advice, [a requirement that he] investigate the ultimate activities of the party whom he is assisting [may impose] a burden . . . upon business activities that is too great.' In the distribution of unregistered securities, the preparation of an opinion letter is too essential and the reliance of the public too high to permit due diligence to be cast aside in the name of convenience." (quoting David S. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution*, 120 U. PA. L. REV. 597, 632-33 (1972))).
24. *Id.*; see also *Kirschner v. KPMG LLP*, 938 N.E.2d 941, 963 (N.Y. 2010) (Ciparick, J., dissenting) (noting the important policy concerns regarding gatekeeper incentives and warning that immunizing gatekeeper professionals "merely invite[s] gatekeeper professionals 'to neglect their duty to ferret out fraud by corporate insiders because even if they are negligent, there will be no damages assessed against them for their malfeasance'" (quoting Adam Pritchard, *O'Melveny Meyers v. FDIC: Imputation of Fraud and Optimal Monitoring*, 4 SUP. CT. ECON. REV. 179, 192 (1995))); *In re Fields*, Exchange Act Release No. 5404, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,407, at 83,175 n.20 (June 18, 1973), *aff'd*, 495 F.2d 1075 (D.C. Cir. 1974).

expectations for those in the position to prevent or minimize harm are significantly undermined.

Because a gatekeeper's leverage lies in his or her ability to help prevent widespread wrongdoing by withholding cooperation, cost-effective motivation to withhold services is essential. A successful gatekeeping regime must include sufficient deterrence through meaningful enforcement mechanisms.<sup>25</sup> Although enforcement mechanisms do currently exist by way of government enforcement and private causes of action,<sup>26</sup> the effectiveness of these mechanisms is insufficient when outside advisers behave negligently.

Moreover, an ethical dilemma results for accountants and lawyers who are positioned to undertake a gatekeeping role. For example, with respect to lawyers, under the rules of professional conduct, "a lawyer is not privileged to unthinkingly permit himself to be co-opted into an ongoing fraud and cast as a dupe or a shield for a wrong-doing client."<sup>27</sup> Similarly, SEC Rule 102(e) provides for the suspension of an accountant from practicing or appearing before the Commission for violating professional standards through specific acts of negligent conduct.<sup>28</sup> And yet despite professional standards, outside professionals—beyond the reach of the USA—find themselves insulated from private securities liability for just such unthinkingly negligent behavior.<sup>29</sup>

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25. See Kim, *supra* note 20, at 415 (describing the key components of a successful gatekeeping regime as: "(1) a gatekeeper—someone 'who can and will prevent misconduct reliably,' (2) a gate—some service which the wrongdoer needs to accomplish his goal, and (3) a law enforcement mechanism—an enforceable duty—that obligates private parties to take some action aimed at averting misconduct when detected").
  26. For instance, increased obligations for attorneys exist under the Sarbanes-Oxley regime. See also *infra* notes 32–50 and accompanying text (discussing the other causes of actions available in regard to gatekeepers and other collateral actors).
  27. In the Matter of Carter & Johnson, Exchange Act Release No. 17,597, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847 (Feb. 28, 1981).
  28. SEC Rules, 17 C.F.R. § 201.102(e) (2016). Rule 102(e) is now codified as Section 4C of the Securities Exchange Act, 15 U.S.C. § 78d-3 (2012). See *Dearlove v. SEC*, 573 F.3d 801, 804 (2009) (upholding the disbarment of an accountant from practicing before the Commission because he violated the Generally Accepted Auditing Standards (GAAS)); Securities Act Release No. 7593, 68 SEC Docket 489 (Oct. 19, 1998); MARC I. STEINBERG & RALPH C. FERRARA, *SECURITIES PRACTICE: FEDERAL & STATE ENFORCEMENT* § 4:3 (2d ed. 2001, 2016–2017 supp.). Attorneys also are subject to discipline under Rule 102(e). See, e.g., *SEC v. Altman*, 666 F.3d 1322 (D.C. Cir. 2011) (attorney disciplined for engaging in unethical conduct).
  29. See, e.g., *Bennett v. Durham*, 683 F.3d 734 (6th Cir. 2012) (holding attorney not liable under Kentucky securities law despite allegations that he knowingly drafted misleading documents).

## II. THE REGULATORY GAP OUTSIDE THE USA

Absent liability under the state securities acts (also called “blue sky laws”),<sup>30</sup> holding attorneys and other gatekeepers accountable for negligently assisting unlawful securities transactions quickly becomes extremely onerous. Under the USA, an individual who falls within the secondary liability provisions will be held civilly liable in private actions unless that individual can sustain the burden of proof “that he did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.”<sup>31</sup> In theory, then, a collateral actor likewise may be subject to private liability under the federal securities laws and common-law causes of action. But, as explored in further detail below, changes in the law have largely eliminated federal liability, and common-law causes of action entail increased

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30. “Blue sky” laws refer to state statutes that regulate securities transactions. While the origin of the term is not entirely clear, some have proffered that certain securities operators were so blatant in their schemes that they would “sell building lots in the blue sky in fee simple.” See Jonathan Macey & Geoffrey Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 359 n.59 (1991). See generally Symposium, *Blue Sky Anniversary Edition*, 50 WASHBURN L.J. 3 (2011) (commemorating the one hundredth anniversary of the Kansas blue sky law, the first state law regulating the sale of securities).
31. UNIF. SEC. ACT § 410(b) (UNIF. LAW COMM’N 1956). Liability is, of course, subject to defenses such as a statute of limitations defense or an *in pari delicto* defense. For example, in *Kirschner v. KPMG LLP*, the court stated: “The doctrine of *in pari delicto* mandates that the courts will not intercede to resolve a dispute between two wrongdoers. This principle has been wrought in the inmost texture of our common law for at least two centuries.” 938 N.E.2d 941, 950 (N.Y. 2010) (citing *Woodworth v. Janes*, 2 Johns. Cas. 417, 423 (N.Y. 1800)). The court held that a litigation trustee, appointed to pursue causes of action possessed by the defrauding company, which was now bankrupt, could not bring a claim against secondary actors such as outside counsel and the outside accounting firm for fraud, breach of fiduciary duty, and malpractice because it was barred by the doctrine of *in pari delicto*. In so holding, the court rejected the plaintiff’s claim that the “adverse interest exception” applied. This exception holds that “where an officer acts entirely in his own interests and adverse to the interests of the corporation, that misconduct cannot be imputed to the corporation.” *Id.*; see also *Pinter v. Dahl*, 486 U.S. 622, 633 (1988) (examining the *in pari delicto* defense and explaining the defense is only available under Section 12 of the Securities Act where “(1) as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public”); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 301 (1985) (discussing the *in pari delicto* defense under Section 10(b) of the Securities Exchange Act but deciding not to allow the defense in the case of tipsters who fraudulently induced investors to purchase securities by misrepresenting that they were conveying material non-public information about the issuer). See generally MARC I. STEINBERG & WILLIAM K.S. WANG, *INSIDER TRADING* § 4.1 (3d ed. 2010).

## FROM THE REGULATORY ABYSS: THE WEAKENED GATEKEEPING INCENTIVES UNDER THE USA

requirements that limit their application. Thus, absent private collateral liability under state securities law, a regulatory gap emerges.

A. *Common Law Causes of Action*

A collateral participant who does not fall under the secondary liability provisions of the USA nonetheless may be monetarily liable for such claims as fraud, negligent misrepresentation, malpractice, breach of fiduciary duty, and aiding and abetting fraud.<sup>32</sup> That said, each potential claim has significant limitations.

Negligent misrepresentation, depending on the state, may have strict requirements, such as demanding a relationship that is “near-privy”<sup>33</sup> and a showing of justifiable reliance<sup>34</sup> by the complaining party. There have traditionally been three approaches to negligent misrepresentation claims when applied to outside auditors or professionals.<sup>35</sup> The most stringent approach requires privity between the tortfeasor (the accountant or outside professional) and the third party who was allegedly injured by the misrepresentation.<sup>36</sup> On the other

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32. See, e.g., *NCP Litig. Tr. v. KPMG LLP*, 901 A.2d 871 (N.J. 2006); *Cowburn v. Leventis*, 619 S.E.2d 437, 447–48 (S.C. Ct. App. 2005); *In re Jack Greenberg, Inc.*, 240 B.R. 486, 523 (Bankr. E.D. Pa. 1999). See generally MARC I. STEINBERG, ATTORNEY LIABILITY AFTER SARBANES-OXLEY (2016).
33. See, e.g., *Ultramares Corp. v. Touche*, 174 N.E. 441 (N.Y. 1931) (holding that privity or something close to it is required for negligent misrepresentation); *Haddon View Inv. Co. v. Coopers & Lybrand*, 436 N.E.2d 212, 214 (Ohio 1982) (same); RESTATEMENT (SECOND) OF TORTS § 552 (AM. LAW INST. 1997); William L. Prosser, *Misrepresentation and Third Persons*, 19 VAND. L. REV. 231 (1966); Robert K. Wise & Heather E. Poole, *Negligent Misrepresentation in Texas: The Misunderstood Tort*, 40 TEX. TECH L. REV. 845, 914–15 (2008).
34. See, e.g., *Bonhiver v. Graff*, 248 N.W.2d 291, 298 (Minn. 1976) (noting the requirement of justifiable reliance); *Lucky 7, LLC v. THT Realty, LLC*, 775 N.W.2d 671, 675 (Neb. 2009) (same); *Silva v. Stevens*, 589 A.2d 852, 860 (Vt. 1991) (same).
35. See *Bily v. Arthur Young & Co.*, 834 P.2d 745, 752 (Cal. 1992) (discussing the three approaches and observing that “[t]he complex nature of the audit function and its economic implications has resulted in different approaches to the question whether CPA auditors should be subjected to liability to third parties who read and rely on audit reports. Although three schools of thought are commonly recognized, there are some variations within each school and recent case law suggests a possible trend toward merger of two of the three approaches”).
36. This approach was put forward famously in *Ultramares Corp.*, 174 N.E. at 444. The court explained its reasoning for such a high barrier as follows: “If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.” *Id.*

end of the spectrum, some courts have provided that liability should be based only on the foreseeability of injury to third persons.<sup>37</sup> The last approach tracks something of a middle course; that is, actors are exposed to liability when the recipient of the representation has justifiably relied on the representation, but this approach limits this liability exposure to loss suffered by a limited group of persons for whom the information was intended to benefit or for whom guidance was provided by the allegedly negligent party.<sup>38</sup> This middle approach, espoused in the Second Restatement of Torts, is the most widely adopted, and it significantly limits allegedly aggrieved parties from mounting a successful claim.<sup>39</sup>

Legal malpractice claims are similarly restrictive. Typically, only the client of the subject attorney can bring a claim.<sup>40</sup> Legal malpractice and negligent misrepresentation are nonetheless distinguishable, as the federal district court in the *Enron* litigation explained:

[L]iability for legal malpractice . . . is based on ‘the breach of a duty that a professional owes his clients or others in privity,’ [while] liability for negligent misrepresentation . . . is “based on an independent duty to a nonclient based on the professional’s manifest awareness of the

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37. See *Bily*, 834 P.2d at 764; Howard Wiener, *Common Law Liability of the Certified Public Accountant for Negligent Misrepresentation*, 20 SAN DIEGO L. REV. 233, 260 (1983) (“Accountant liability based on foreseeable injury would serve the dual functions of compensation for injury and deterrence of negligent conduct.”).
38. RESTATEMENT (SECOND) OF TORTS § 552.
39. See *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*, 991 S.W.2d 787, 792–94 (Tex. 1999) (noting “Section 552 is the most widely adopted standard of negligent misrepresentation in attorney liability cases and economic negligence cases generally” and explaining the limited applicability of section 552); see also, e.g., *Vogel v. Foth & Van Dyke Assocs., Inc.*, 266 F.3d 838, 841 (8th Cir. 2001) (applying Iowa law).
40. *Hustler Cincinnati, Inc. v. Cambria*, 625 F. App’x 712 (6th Cir. 2015) (applying Ohio law); *Mason Tenders Dist. Council Pension Fund v. Messera*, 4 F. Supp. 2d 293, 298 (S.D.N.Y. 1998) (applying New York law); *Jennings v. Badgett*, 230 P.3d 861, 866 (Okla. 2010). In some jurisdictions, third parties may also institute malpractice actions when an attorney allegedly breaches a duty owed to them. See *Essex Ins. Co. v. Tyler*, 309 F. Supp. 2d 1270, 1274 (D. Colo. 2004) (applying Colorado law and discussing the policy reasons for generally limiting legal malpractice claims to claims “grounded on the existence of an attorney-client relationship”); *McCamish*, 991 S.W.2d at 794. *But see* *Century 21 Deep S. Props., Ltd. v. Corson*, 612 So. 2d 359, 374 (Miss. 1992) (holding that legal malpractice actions involving title work done by an attorney do not require an attorney-client relationship, and “extend[ing] liability to foreseeable third parties who detrimentally rely”).

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nonclient's reliance on the misrepresentation and the professional's intention that the nonclient so rely."<sup>41</sup>

Accordingly, unless an allegedly aggrieved party can show that the attorney or other professional owed a duty to her, a malpractice claim does not normally lie. And this duty ordinarily cannot be shown when aggrieved investors seek to sue outside professionals retained by the subject enterprise.<sup>42</sup>

Likewise, to bring a breach of fiduciary duty claim, plaintiffs must prove that the subject professional owed this duty to them.<sup>43</sup> While corporate directors and officers generally owe a fiduciary duty to the corporation and collectively to the shareholders,<sup>44</sup> recognition of this duty to investors and other equity holders ordinarily is not imposed upon collateral participants such as attorneys and accountants.<sup>45</sup> Thus, proving that a fiduciary duty existed between investor-plaintiffs and these professionals is unlikely.<sup>46</sup>

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41. *In re Enron Corp. Sec. Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 608 (S.D. Tex. 2002) (quoting *McCamish*, 991 S.W.2d at 792) (applying Texas law), *rev'd on other grounds*, 482 F.3d 372 (5th Cir. 2007).
  42. *See, e.g.*, *SMWNP Holdings, Inc. v. Devore*, 165 F.3d 360, 367 (5th Cir. 1999) (applying Texas law and finding no attorney-client relationship, and thus no legal malpractice claim, in an investment transaction in which the other party to the transaction was represented by an attorney, but the attorney performed services for both parties to the transaction when preparing the closing document); *Bancroft v. Kneipper*, No. CA3-90-2754-D, 1992 U.S. Dist. LEXIS 18790 (N.D. Tex. Apr. 30, 1992) (dismissing legal malpractice claims because attorney does not owe duty directly to individual investors). Note that, because the subject attorney's client is the affected company, a shareholder derivative action may be brought against the attorney for alleged malpractice. Of course, derivative claims are subject to challenging procedural hurdles and any monetary recovery, after the award of attorneys' fees and expenses, is paid to the company. *See, e.g.*, MODEL BUS. CORP. ACT §§ 7.40-7.47 (2002) (AM. BAR ASS'N); *infra* note 50 and accompanying text.
  43. *See, e.g.*, *Airgas, Inc. v. Cravath, Swaine & Moore LLP*, No. 10-612, 2010 U.S. Dist. LEXIS 78162, at \*10 (E.D. Pa. Aug. 3, 2010) (applying Pennsylvania law).
  44. *See, e.g.*, *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 99 (Del. 2007) (citing *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998); *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939)).
  45. *In re Banks*, 584 P.2d 284, 289 (Or. 1978) (en banc) ("The corporation usually is considered an entity and the attorney's duty of loyalty is to the corporation and not to its officers, directors or any particular group of stockholders." (citing *Meehan v. Hopps*, 301 P.2d 10, 15 (Cal. Dist. Ct. App. 1956); *U.S. Indus., Inc. v. Goldman*, 421 F. Supp. 7 (S.D.N.Y. 1976); and *Jacuzzi v. Jacuzzi Bros., Inc.*, 32 Cal. Rptr. 188 (Dist. Ct. App. 1963))); *Lively v. Henderson*, No. 14-05-01229-CV, 2007 Tex. App. LEXIS 8951, at \*13 (Tex. App. 2007) (holding attorney owed no fiduciary duty to shareholder because corporations were distinct from shareholders, even when there is only one shareholder) (citing *Grain Dealers Mut. Ins. Co. v. McKee*, 943 S.W.2d 455, 458 (Tex. 1997)); *cf.* *Eternal Pres. Assocs., LLC v. Accidental Mummies Touring Co., LLC*, 759 F. Supp. 2d 887, 894 (E.D. Mich. 2011) (applying

Claims based on fraud or aiding and abetting fraud also place significant burdens upon an allegedly injured party, contributing to an overall regulatory gap.<sup>47</sup> Because of the current USA language, outside professionals are insulated from monetary liability in cases where this higher burden cannot be met. A fraud claim requires proof of the requisite intent, reliance, loss causation, and damages.<sup>48</sup> An aider and abettor claim, moreover, has been interpreted to re-

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Michigan law) (“An attorney who represents a closely held corporation and a controlling shareholder may also have a fiduciary to the other shareholder[s].”).

46. *Belmont v. MB Inv. Partners, Inc.*, 708 F.3d 470, 500 (3d Cir. 2013) (applying Pennsylvania law) (“[A] plaintiff alleging a fiduciary breach must first demonstrate that a fiduciary or confidential relationship existed, which requires that one person has reposed a special confidence in another to the extent that the parties do not deal with each other on equal terms. Although no precise formula has been devised to ascertain the existence of a confidential relationship, it has been said that such a relationship exists whenever one occupies toward another such a position of advisor or counselor as reasonably to inspire confidence that he will act in good faith for the other’s interest.” (citations omitted)).
47. See *infra* notes 48–50.
48. See FED. R. CIV. P. 9(b) (“In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person’s mind may be alleged generally.”). The Utah Supreme Court has stated:

In order to properly assert a claim for fraud, the plaintiff must show the following nine elements: (1) a representation; (2) concerning a presently existing material fact; (3) which was false; (4) which the representor either (a) knew to be false, or (b) made recklessly, knowing that he had insufficient knowledge upon which to base such representation; (5) for the purpose of inducing the other party to act upon it; (6) that the other party, acting reasonably and in ignorance of its falsity; (7) did in fact rely upon it; (8) and was thereby induced to act; (9) to his injury and damage. Additionally, rule 9(b) of the Utah Rules of Civil Procedure requires that “[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.” This means that “a complaint cannot survive dismissal by pleading mere conclusory allegations unsupported . . . by a recitation of relevant surrounding facts.” In other words, “the mere recitation by a plaintiff of the elements of fraud in a complaint does not satisfy the particularity requirement”—only “a sufficiently clear and specific description of the facts underlying the [plaintiff’s] claim of [fraud] will satisfy the requirements of rule 9(b).”

*Carlton v. Brown*, 323 P.3d 571, 581–82 (Utah 2014) (citations omitted); see also *Lazar v. Superior Court*, 909 P.2d 981, 982 (Cal. 1996) (discussing the specificity needed in pleading fraud claims); *Cont’l Basketball Ass’n v. Ellenstein Enters. Inc.*, 669 N.E.2d 134, 138 (Ind. 1996) (same); *Pocahontas Mining Co. Ltd. P’ship v. Oxy USA, Inc.*, 503 S.E.2d 258, 263 (W. Va. 1998) (same). But see *Rocker v. KPMG LLP*, 148 P.3d 703, 704 (Nev. 2006) (adopting a more relaxed pleading requirement under the state’s Rule 9(b), where the “facts necessary for the plaintiff to plead a cause of action for fraud with particularity . . . are peculiarly within the defendant’s

quire proof of actual intent.<sup>49</sup> If a derivative suit were to be brought in this context (where any monetary recovery goes to the subject corporation, after the award of attorneys' fees and expenses), it likely would be dismissed because of the onerous procedural hurdles, including the demand requirement and the use of special litigation committees.<sup>50</sup>

The limitations of each of these common-law causes of action demonstrate why they normally are less attractive than the state securities laws and explains why these common-law causes of action fail to fill the regulatory gap for outside professionals in securities transactions.

### B. Collateral Liability, or Lack Thereof, Under Federal Law

The private enforcement gap for secondary actors also prevails under the federal securities laws. The U.S. Supreme Court has held that liability for aiders and abettors is not available in private actions under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5.<sup>51</sup> Additionally, more recent Supreme Court decisions have significantly confined the reach of Section 10(b) and Rule 10b-5 primary liability, thereby effectively insulating collateral actors from liability under these provisions in private actions.<sup>52</sup> Moreover, the Private Securi-

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knowledge or possession” and finding that “if the plaintiff pleads specific facts giving rise to an inference of fraud, the plaintiff should have an opportunity to conduct discovery and amend his complaint to include the particular facts”).

49. See, e.g., *Eurycleia Partners, LP v. Seward & Kissel, LLP*, 910 N.E.2d 976, 979 (N.Y. 2009).
50. See *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 782 (Del. 1981); Marc I. Steinberg, *The Use of Special Litigation Committees To Terminate Shareholder Derivative Suits*, 35 U. MIAMI L. REV. 1 (1980). Moreover, the PSLRA requires that plaintiffs state with particularity both the facts constituting an alleged securities violation and the facts showing scienter—which is the intention to deceive, manipulate, or defraud. See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007); see also *infra* note 53 and accompanying text (discussing the PSLRA).
51. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994) (holding that § 10(b) does not provide for aider and abettor liability in private actions). Prior to the Supreme Court's ruling, secondary liability in federal cases was well accepted by the federal appellate courts. See *id.* at 192 (Stevens, J., dissenting) (“In hundreds of judicial and administrative proceedings in every Circuit in the federal system, the courts and the SEC have concluded that aiders and abettors are subject to liability under § 10(b) and Rule 10b-5.”); *Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982, 986 (10th Cir. 1992); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 496 (7th Cir. 1986). See generally Marc I. Steinberg, *The Propriety and Scope of Cumulative Remedies Under the Federal Securities Laws*, 67 CORNELL L. REV. 557 (1982).
52. See *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011); *Stoneridge Inv. Partners, LLC v. Sci.-Atlanta, Inc.*, 552 U.S. 148 (2008). In *Janus*, the court held that primary liability for a misleading statement under Rule 10b-

ties Litigation Reform Act of 1995 (PSLRA) requires that plaintiffs adequately plead both the facts constituting an alleged securities violation and the facts showing scienter, that is, the intention to deceive, manipulate, or defraud.<sup>53</sup> Control person liability under Section 15 of the Securities Act and Section 20(a) of the Securities Exchange Act also has limited applicability due to the fact that these provisions so rarely reach collateral actors.<sup>54</sup> Moreover, the Supreme

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5(b) can only attach to the maker of the statement, defined as the one who has ultimate authority over the statement. The court stated:

For purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it. Without control, a person or entity can merely suggest what to say, not “make” a statement in its own right. One who prepares or publishes a statement on behalf of another is not its maker. And in the ordinary case, attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by—and only by—the party to whom it is attributed.

*Janus*, 564 U.S. at 142–43. In *Stoneridge*, the Court held that secondary actors in securities transactions could not be found primarily liable under the “scheme liability” theory as espoused in that case. 552 U.S. at 149. Respondents, suppliers to the subject corporation, were held not primarily liable for entering into arrangements with the corporation for the alleged known purpose of allowing the corporation to mislead its auditors and thereby issue misleading financial statements to inflate its stock price. No primary Section 10(b) liability existed, according to the Court, because the respondent’s conduct was not relied upon by the plaintiffs in making stock purchase decisions. *Id.* at 166–67.

53. 15 U.S.C. § 78u-4(b) (2012) (“[T]he complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed. . . . [T]he complaint shall . . . state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.”); *see also Tellabs*, 551 U.S. at 314. In *Tellabs*, interpreting the “strong inference” language of the PSLRA, the Court stated that “to determine whether a complaint’s scienter allegations can survive threshold inspection for sufficiency, a court governed by [the PSLRA] must engage in a comparative evaluation; it must consider, not only inferences urged by the plaintiff . . . but also competing inferences rationally drawn from the facts alleged.” *Id.* The Court held that “an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.” *Id.*
54. *See, e.g., Sheinkopf v. Stone*, 927 F.2d 1259, 1270 (1st Cir. 1991) (holding attorney not liable as “controlling person” unless “significantly probative evidence” exists showing “direct or indirect” control amounting to “meaningful hegemony” over the enterprise by attorney or law firm); *see also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 209 n.28 (1976) (holding that the control person provision in Section 20(a) “contains a state-of-mind condition requiring something more than negligence”). Section 15 of the Securities Act imposes liability on a person that controls a person liable under Section 11 or 12. No liability attaches if “the controlling per-

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Court in *Pinter v. Dahl*,<sup>55</sup> while not imposing a strict vendor-purchaser privity requirement, defined the term “seller” under Section 12(1) (today Section 12(a)(1)) of the Securities Act so as to preclude liability for collateral actors. As the Court reasoned, “§ 12’s failure to impose express liability for mere participation in unlawful sales transactions suggests that Congress did not intend that the section impose liability on participants collateral to the offer or sale.”<sup>56</sup>

Due to these Supreme Court holdings, avenues for recovery for investors from those who substantially participated in the violations, but were only collateral actors, have been effectively eliminated at the federal level.<sup>57</sup> Today, aggrieved plaintiffs are usually forced to resort to state law remedies when pursuing secondary actors.<sup>58</sup> Most states have adopted the Uniform Securities Act,

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son acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.” 15 U.S.C. § 78t (2012).

55. 486 U.S. 622 (1988).
56. *Id.* at 650–51 (deciding not to adopt the broader substantial factor test adhered to by some jurisdictions, and noting that “although the substantial-factor test undoubtedly embraces persons who pass title and who solicit the purchase of unregistered securities as statutory sellers, the test also would extend § 12(1) liability to participants only remotely related to the relevant aspects of the sales transaction. Indeed, it might expose securities professionals, such as accountants and lawyers, whose involvement is only the performance of their professional services, to § 12(1) strict liability for rescission. The buyer does not, in any meaningful sense, ‘purchas[e] the security’ from ‘such a person.’”); *see also* *Wilson v. Saintine Expl. & Drilling Corp.*, 872 F.2d 1124 (2d Cir. 1989) (holding law firm not a seller under § 12(2)). *See generally* Mark Klock, *Promoter Liability and In Pari Delicto Under Section 12(1)*: *Pinter v. Dahl*, 17 SEC. REG. L.J. 53 (1989).
57. Liability still exists in a limited fashion, as discussed in the preceding paragraph, for “control persons” under Section 20(a) of the Exchange Act and Section 15 of the Securities Act, but such persons are rarely collateral actors.
58. Recovery under state law has also been eliminated in many situations due to the passage of the Securities Litigation Uniform Standards Act of 1998 (SLUSA) that, with certain exceptions, preempts private class actions involving nationally traded securities. These state class actions are preempted by federal law. SLUSA was passed in response to plaintiffs attempting to bypass the disadvantages, including stricter pleading requirements and a stay on discovery pending a motion to dismiss, imposed on federal securities class action suits by the PSLRA. *See Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058, 1066 (2014) (interpreting the scope of SLUSA); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 86 (2006) (discussing the purpose behind SLUSA, specifically to prevent plaintiffs from frustrating the objectives of the PSLRA); *In re Worldcom, Inc. Sec. Litig.*, 308 F. Supp. 2d 236, 242 (S.D.N.Y. 2004) (“Faced with the hurdles presented by the PSLRA, claimants simply abandoned federal court and filed suit in state court, alleging state securities law claims.” (citing *Lander v. Hartford Life & Annuity Ins. Co.*, 251 F.3d 101, 107–08 & n.4 (2d Cir. 2001))). *See generally* MARC I. STEINBERG, *SECURITIES REGULATION: LIABILITIES AND REMEDIES* § 9.06 (2015).

which, as outlined above, allows for secondary liability in certain situations but contains glaring holes.

### III. INEQUALITY IN LANGUAGE: THE REGULATORY GAP WITHIN THE USA

Section 410 of the USA, which sets forth private civil liability regarding the offer or sale of securities, results in unequal exposure to liability between in-house and outside actors. Section 410 provides for primary liability for the seller and secondary liability for certain parties, and has become increasingly important for plaintiffs in private securities litigation as decisions by the Supreme Court have eliminated aider and abettor liability under Section 10(b) of the Securities Exchange Act and drastically confined the reach of primary liability for collateral actors.<sup>59</sup> Section 410(b) enumerates the categories of persons other than a seller who can be held liable:

(b) Every person who directly or indirectly controls a seller liable under subsection (a), every partner, officer, or director of such a seller, every person occupying a similar status or performing similar functions, every employee of such a seller who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with and to the same extent as the seller, unless the non-seller who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.<sup>60</sup>

An outside accountant, attorney, or consultant performing traditional functions does not, absent additional actions or relationships to the seller, fall within the scope of Section 410(b).<sup>61</sup>

59. See *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135 (2011) (restricting further the application of § 10(b) by holding that only the person or entity with ultimate authority over a statement is a maker of the statement under Rule 10b-5(b)); *Stoneridge Inv. Partners, LLC v. Sci.-Atlanta, Inc.*, 552 U.S. 148 (2008) (holding that collateral actors could not be held liable as § 10(b) primary violators under the “scheme” theory of liability presented at bar because of a lack of reliance); *Cent. Bank of Denver, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994) (eliminating aiding and abetting liability for private litigants under § 10(b) of the Securities Exchange Act).

60. UNIF. SEC. ACT § 410(b) (UNIF. LAW COMM’N 1956) (emphasis added).

61. See, e.g., *Bennett v. Durham*, 683 F.3d 734 (6th Cir. 2012) (interpreting Kentucky securities law); *Ackerman v. Schwartz*, 733 F. Supp. 1231 (N.D. Ind. 1989), *aff’d in part and rev’d in part on other grounds*, 947 F.2d 841 (7th Cir. 1991); *Baker, Watts & Co. v. Miles & Stockbridge*, 620 A.2d 356, 368 (Md. Ct. Spec. App. 1993). When performing traditional legal functions, an outside lawyer will not fall into any of the enumerated categories listed in USA § 410(b).

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On the other hand, inside counsel and other in-house professionals fall within the liability net as employees of a seller if they materially aid in a sale.<sup>62</sup> This uneven application set forth in the Uniform Securities Act's language, which allows for liability for inside professionals as employees while not reaching outside professionals, raises serious ethical and liability concerns because outside professionals (including outside legal counsel) are able to escape private civil liability under the Act and, thus, may be less incentivized to engage actively in their gatekeeping functions. This disparate treatment is illogical both from corporate governance and law compliance perspectives.<sup>63</sup>

Clearly, the impact of this disparity extends beyond outside attorneys. The same problems exist with any outside actor, including accountants, financial analysts, and consultants. Indeed, the gap arises wherever individuals are retained to perform services in connection with a securities transaction, but not hired as employees. In fact, the gap is likely to become even more problematic in the wake of increasing corporate contracting with outside vendors to procure temporary personnel.<sup>64</sup> This lack of private securities liability for these "outside actors," who often are well-positioned to recognize and prevent fraudulent action, raises substantial ethical and public policy concerns.

A relatively recent Sixth Circuit case illustrates this civil liability disparity under the USA. In *Bennett v. Durham*,<sup>65</sup> outside counsel was found, as a matter

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62. An enterprise's chief legal officer or general counsel also would be subject to liability under Section 410(b) as an "officer" if conferred that status. Note that the terms "inside" and "in-house" are used interchangeably in this Article, signifying that the individual is an employee of the subject enterprise. *See supra* note 6.
63. No justifiable reason exists for distinguishing outside attorneys or auditors from inside attorneys or auditors. Both groups perform the same functions and have access to similar information to enable them to serve as gatekeepers. *See* MARC I. STEINBERG & STEPHEN B. YEAGER, *INSIDE COUNSEL: PRACTICES, STRATEGIES, AND INSIGHTS* (2015).
64. *See* Christopher S. Rugaber, *Temporary Jobs Becoming a Permanent Fixture*, USA TODAY (July 7, 2013), <http://www.usatoday.com/story/money/business/2013/07/07/temporary-jobs-becoming-permanent-fixture/2496585/> [<http://perma.cc/MBZ5-LQ8G>] (discussing the trend towards increased use of temporary and contract labor and noting that "[t]he use of temps has extended into sectors that seldom used them in the past—professional services, for example, which include lawyers, doctors and information technology specialists"). Certain companies specialize in providing temporary, contract, or interim executives. For example, The Brenner Group specializes in providing outsourced finance and accounting help through temporary and interim CFOs and Controllers. *See Interim Management Overview*, BRENNER GROUP, <http://www.thebrennergroupp.com/interim-management> [<http://perma.cc/8A9C-MHLS>]. As another example, Cerius Executives provides all types of high-level executives on a contract basis. *See About Us*, CERIUS EXECUTIVES, <http://ceriusexecutives.com/> [<http://perma.cc/S5SH-PRRM>].
65. 683 F.3d 734 (6th Cir. 2012).

of law, not liable under Kentucky's blue sky law.<sup>66</sup> The court, citing U.S. Supreme Court authority<sup>67</sup> and applying common understanding,<sup>68</sup> held that the outside attorney Durham was not a "seller" under the state statute because, even though he drafted the offering memorandum and made himself available to speak with clients, he had not solicited the purchases.<sup>69</sup> Moreover, the *Bennett* court held that Durham was not secondarily liable because he was not a partner, director, or officer of the enterprise; neither was he an "agent" as that term is used in the USA.<sup>70</sup> Since Durham fell under no other category that sub-

66. *Id.* at 735 (interpreting Kentucky Revised Statutes sections 92.480(1) and (4)). Kentucky's blue sky law provides:

(1) Any person, who offers or sells a security in violation of this chapter . . . or offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact . . . , and who does not sustain the burden of proof that he did not know and in the exercise of reasonable care could not have known of the untruth or omission[,] is liable to the person buying the security from him. . . .

(4) Every person who directly or indirectly controls a seller or purchaser liable under subsection (1) or (2) of this section, every partner, officer, or director (or other person occupying a similar status or performing similar functions) or employee of a seller or purchaser who materially aids in the sale or purchase, and every broker-dealer or agent who materially aids in the sale or purchase is also liable jointly and severally with and to the same extent as the seller or purchaser, unless [he] sustains the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

KY. REV. STAT. § 92.480(1), (4) (2016).

67. *Bennett*, 683 F.3d at 737 (citing *Pinter v. Dahl*, 486 U.S. 622 (1988)). *Pinter* held that the definition of "seller" under Section 12(1) (now § 12(a)(1) of the Securities Act of 1933) "extends only to a broker or other person who successfully solicits a purchase of securities, so long as he is motivated at least in part by a desire to serve his own financial interests or those of the securities owner." 486 U.S. at 647. In reaching this conclusion, the *Pinter* Court rejected the broader "substantial factor" test adopted previously by some courts that defined the term seller as one whose participation in the transaction is a substantial factor in causing the transaction to take place. *Id.* at 655.
68. Customary understanding of the term "seller" generally entails an actor who actually sells or offers to sell, as opposed to the broader definition of seller laid out in *Pinter*, discussed in *supra* note 67 and accompanying text.
69. *Bennett*, 683 F.3d at 736 ("The client and its broker-dealers sell the securities. Durham no more 'offered' or 'sold' these securities than the lawyer representing Magic Johnson's investment group recently 'bought' the Los Angeles Dodgers.").
70. See *infra* notes 130–36 and accompanying text discussing interpretation of attorneys as agents by states that have adopted the USA; see also *Bennett*, 683 F.3d at 740 ("An attorney who performs ordinary legal work, such as drafting documents, giv-

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jected him to liability exposure under the statute, the Sixth Circuit affirmed the dismissal of the action.<sup>71</sup>

While this case, discussed further below,<sup>72</sup> represents the prevailing view adopted by courts across the country, the Sixth Circuit recognized the internal contradiction in the USA—that is, that it fails to reach the knowing misconduct of outside counsel. Nonetheless, the court swept the disparity aside, observing that in some situations outside counsel would be subject to liability exposure under other causes of action:

The . . . factual allegations [include] that Durham served as an attorney to Heartland and Mammoth on many different occasions, that he knew the securities sales were illegal, and that Heartland’s executives “relied completely” on his advice. . . . A lawyer does not become something other than a lawyer by serving the same client multiple times. Still less is that the case because the client follows his advice unquestioningly or because he knowingly drafts false or misleading documents. Of course, an attorney who knowingly drafted false or misleading documents would face other problems. He might be liable for fraud . . . [o]r he might be liable for malpractice or face disciplinary proceedings.<sup>73</sup>

However, as discussed *supra*, the other civil liability ramifications that may ensue do not fill the gap left open by the current statutory framework.<sup>74</sup>

The plain language of the USA provides that only specified enumerated parties may be held liable, including the issuer, its officers and directors, and certain collateral parties, such as agents or employees of the seller who materially aid in the sale. Many states have looked to federal law when defining who qualifies as a seller.<sup>75</sup> Accordingly, outside professionals will not fall under the umbrella of “seller” for purposes of the Act, unless they solicit the purchaser to buy the subject security for financial gain.<sup>76</sup> In states that have enacted the USA,

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ing advice and answering client questions, is not an ‘agent’ under Ky. Rev. Stat. § 292.480(4). Even if we accept all of the facts alleged in the complaint, that is all Durham did.”).

71. *Bennett*, 683 F.3d at 740.

72. *See supra* notes 32–50 and *infra* note 131 and accompanying text.

73. *Bennett*, 683 F.3d at 737–38.

74. *See supra* notes 32–50 and accompanying text.

75. *See, e.g., Bennett*, 683 F.3d at 737 (applying Kentucky law and noting that “[s]ince *Pinter*, . . . other state courts have construed their own blue-sky laws the same way” as the Supreme Court); *Highland Capital Mgmt., LP v. Ryder Scott Co.*, 402 S.W.3d 719, 741 (Tex. Ct. App. 2012) (interpreting “seller” consistent with federal law and stating “Texas courts generally cite decisions of the federal courts to interpret the [Texas Securities Act]”).

76. *See Pinter v. Dahl*, 486 U.S. 622, 644–47 (1988) (limiting “seller” to one who is the vendor, the vendor’s agent, or who solicits the transaction for financial gain to himself or the vendor).

therefore, the only way to hold actors accountable in private litigation under that Act based on their assistance in perpetrating a securities violation alone—i.e., without engaging in solicitation—is secondarily under Section 410(b).<sup>77</sup>

State “blue sky” laws tend to adopt some form of the USA. There are three versions of the Act—the 1956 original version and two revisions that followed in 1985 and 2002.<sup>78</sup> The 1985 revision, which is commonly referred to as the Revised Uniform Securities Act (RUSA), is not widely enacted.<sup>79</sup> The original version is the most commonly adopted, with a number of states enacting all or most of it, although a number of these states have subsequently adopted the 2002 version at least in part.<sup>80</sup> That all said, the case law predominately construes the 1956 Act<sup>81</sup> and the language of this version is, accordingly, the focus of this Article.<sup>82</sup>

Notably, the 2002 Act expanded secondary liability to include “an individual who is an employee of *or associated with* a person liable under subsections (b) through (f)<sup>83</sup> and who materially aids the conduct giving rise to the liability . . . .”<sup>84</sup> Unfortunately, nothing in the official comments expands on or clarifies this change and no case law exists, thus far, interpreting the added term.<sup>85</sup> It

77. UNIF. SEC. ACT § 410(b) (UNIF. LAW COMM’N 1956).

78. See *Uniform Securities Act*, *supra* note 5, at 1.

79. According to the National Conference of Commissioners on Uniform State Laws, only six states enacted RUSA. *Securities Act Summary*, UNIFORM L. COMMISSION, <http://www.uniformlaws.org/ActSummary.aspx?title=Securities%20Act> [<http://perma.cc/T4YN-EVAS>].

80. *U.S. Survey: State Adoption of Uniform Securities Act as of June 15, 2012*, NAT’L ASS’N FIXED ANNUITIES (Oct. 12, 2012), [http://www.nafa.com/wp/wp-content/uploads/2012/07/20120920-NAFA-Uniform-Security-Act-Adoption\\_At-A-Glance.pdf](http://www.nafa.com/wp/wp-content/uploads/2012/07/20120920-NAFA-Uniform-Security-Act-Adoption_At-A-Glance.pdf) [<http://perma.cc/832H-JNL9>].

81. *State v. Casper*, 297 S.W.3d 676, 685 (Tenn. 2009) (noting that the majority of states adopted the 1956 Act).

82. UNIF. SEC. ACT § 509(e). Interestingly, the 2002 Act made certain revisions including adding persons who are investment advisers or representatives to those potentially liable as well as anyone who was paid to give investment advice. See *id.*

83. Persons liable in sections (b) through (f) include: a person that buys or sells a security in violation of the Act, a person acting as a broker-dealer or agent that buys or sells a security in violation of the Act, a person acting as an investment adviser or investment adviser representative that provides advice regarding securities for compensation in violation of the Act, or a person that receives directly or indirectly any consideration for providing investment advice regarding securities and employs a scheme or attempts to defraud regarding the securities. *Id.* § 509(b)–(f).

84. *Id.* § 509(g)(3) (emphasis added).

85. See generally UNIF. SEC. ACT; Jennifer J. Johnson, *Secondary Liability for Securities Fraud: Gatekeepers in State Court*, 36 DEL. J. CORP. L. 463, 483 (2011) (“The 2002 USA extends secondary liability beyond agents and employees to persons ‘associated with’ the issuer who materially aid in the sale. Nothing in the official com-

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could be argued that this additional language covers outside professionals in addition to employees, but this view has not been adopted by any court thus far. Furthermore, the broad nature of the language is arguably ambiguous and might lead to overbroad and disparate application. Significantly, each of the revised Acts allows for an affirmative defense if the “non-seller who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.”<sup>86</sup> The USA also requires a showing of a primary violation by the issuer or other primary actor before aider liability can be imposed.<sup>87</sup> Such requirements minimize the imposition of undue liability on subject defendants and deter abuse of the securities laws by potential plaintiffs.

## IV. VARIANT APPROACHES TO THE USA

Blue sky laws do not universally adopt the original 1956 version of the USA; but rather, there remains significant variation among the states as to exactly how secondary liability is addressed. Understanding these diverse approaches to collateral liability is key to reaching a solution concerning the current outside gatekeeper regulatory gap. This solution seeks to effectively promote investor

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ments, however, explains this addition and at present, there is no precedent explaining the term ‘associated with.’”). Interestingly, South Carolina altered its adoption of the Act by removing the “associated with” language and adding language so that the statute reads: “an individual who is an employee, or occupying a similar status or *performing a similar purpose*.” This language arguably would encompass outside actors, such as accountants, bankers, and lawyers. According to the South Carolina Reporter Comments, this “change was made to eliminate an interpretation of the ‘associated with’ language as creating an unintended ‘aider and abettor’ liability.” See South Carolina Reporter Comments, S.C. CODE ANN. § 35-1-509(g)(3) (1976) (emphasis added).

86. UNIF. SEC. ACT § 509(g)(3) (amended 2002); REVISED UNIF. SEC. ACT § 605(d) (1985); UNIF. SEC. ACT § 410(b). The only difference of note in the 2002 Act is that the word “facts” is changed to “conduct,” an interesting alteration but beyond the scope of this Article.
87. *In re Inv’rs Funding Corp. Sec. Litig.*, 523 F. Supp. 533, 542 (S.D.N.Y. 1980) (“The imposition of aider and abettor liability requires the establishment of three elements: (1) the existence of a primary violation, (2) the defendant’s knowledge of the primary violation, and (3) the defendant’s knowing rendition of substantial assistance to the violator.”); *Kirchoff v. Selby*, 703 N.E.2d 644, 652 n.7 (Ind. 1998) (comparing state and federal aider and abettor requirements); see also Marc I. Steinberg & Chris Claassen, *Attorney Liability Under the State Securities Laws: Landscapes and Minefields*, 3 BERKELEY BUS. L.J. 1, 15–16 (2005) (“Secondary liability under the state securities acts is derivative: if the seller cannot be held liable, then the non-seller is not liable. Consequently, secondary actors can be liable to the same extent as the primary violator. States are divided on whether this limitation requires a primary violator to be held liable and whether it requires a plaintiff to bring an action against the primary violator.”).

protection, prevent disparate treatment of in-house and outside personnel, and protect the integrity of the securities markets, while also maintaining practicality in today's legislative environment. Any proposed changes to the current language of the USA must be assessed in the context of these variations in Blue sky laws across the country.

California, Florida, and Texas are three major states that have not adopted the Uniform Securities Act. The Texas Securities Act allows for an indeterminate class of actors to be held secondarily liable by including any person who, acting with reckless disregard, "materially aids a seller."<sup>88</sup> That said, the liability net under the Texas statute is narrowed by requiring an "intent to deceive or defraud or with reckless disregard for the truth or the law."<sup>89</sup> In contrast, courts have interpreted Florida's statute to restrict the liability of secondary actors to those persons that are specified insiders and agents who personally participate or aid in effecting the transaction.<sup>90</sup> In practice, this requirement often limits collateral actor liability to those who come within the *Pinter* "seller" test.<sup>91</sup>

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88. TEX. REV. CIV. STAT. art. 581-33 (2010); see *Highland Capital Mgmt., LP v. Ryder Scott Co.*, 402 S.W.3d 719, 733 (Tex. Ct. App. 2012); see also Steinberg & Claassen, *supra* note 87, at 31.
89. TEX. REV. CIV. STAT. art. 581-33 § F(2). In contrast, the USA enumerates the class of persons but does not require a showing of intent or recklessness; rather, the USA provides a defense to the non-seller who carries the burden of proof of showing reasonable care was taken and that the non-seller did not in fact know of the existence of facts by reason of which the liability is alleged to exist. See *Sterling Tr. Co. v. Adderley*, 168 S.W.3d 835, 837 (Tex. 2005) ("[The Texas Securities Act's] requirement of 'reckless disregard for the truth or the law' means that an alleged aider is subject to liability only if it rendered assistance to the seller in the face of a perceived risk that its assistance would facilitate untruthful or illegal activity by the primary violator. This standard does not mean that the aider must know of the exact misrepresentations or omissions made by the seller, but it does mean that the aider must be subjectively aware of the primary violator's improper activity.").
90. See FLA. STAT. § 517.211(2) (2013) (subjecting to liability exposure a subject purchaser and seller "and every director, officer, partner, or agent of or for the purchaser or seller, if [such person] has personally participated or aided in making the sale or purchase"); *Bailey v. Trenam Simmons, Kemker, Scharf, Barkin, Frye & O'Neill*, PA, 938 F. Supp. 825, 828 (S.D. Fla. 1996) (applying Florida law and holding that general counsel to a company could not be held liable because he did not fall under any of the categories of persons, [seller of a security or a director, officer, partner, or agent of or for the seller of securities] allowed for under the Florida Securities laws, FLA. STAT. § 517.211(1), (2); further pointing out that "[t]he only basis of liability would be a finding that [the defendant] was an agent of [the company] with respect to the sale of securities to Plaintiffs. In addition to being an agent, [the defendant] must also have 'personally participated or aided in making the sale.'"); see, e.g., *Anwar v. Fairfield Greenwich Ltd.*, 826 F. Supp. 2d 578, 588 (S.D.N.Y. 2011) (applying Florida law) ("A plaintiff may recover under § 517.211 if he shows that defendant is either the seller of the securities or the 'agent of such a seller who has solicited the sale of the securities on his own behalf or on behalf of the seller.'" (quoting *In re Sahlen & Assocs., Inc. Sec. Litig.*, 773 F. Supp.

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California courts, on the other hand, explicitly reject the definition of “seller” adopted in *Pinter* and instead require that privity exist between the plaintiff and the defendant “seller.”<sup>92</sup> While liability under California law is extended to collateral actors in a manner almost identical to Section 410(b) of the USA,<sup>93</sup> liability is also imposed on any person who materially assists certain securities violations with the intent to deceive or defraud.<sup>94</sup> Another section of California’s blue sky law directly addresses professionals, providing for liability if a subject professional certifies certain documents distributed in connection with the sale or offer of securities,<sup>95</sup> but allows that professional to avoid liability by

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342, 372 (S.D. Fla. 1991)); *Rushing v. Wells Fargo Bank, N.A.*, 752 F. Supp. 2d 1254, 1260 (M.D. Fla. 2010) (stating that “there is authority for the premise that the seller’s agent can be liable if the agent solicits the sale of securities” (citing *Hilliard v. Black*, 125 F. Supp. 2d 1071, 1083 (N.D. Fla. 2000))).

91. See *Rushing*, 752 F. Supp. 2d at 1260 (applying Florida law, and citing *Pinter* as support for its premise that a seller’s agent can be liable if the agent engages in solicitation); *Bailey*, 938 F. Supp. at 828 (“[C]onduct sufficient to constitute solicitation for purposes [of] § 517.211 liability is similar to that deemed sufficient by the Supreme Court in *Pinter v. Dahl* . . .”).
92. *SEC v. Seaboard Corp.*, 677 F.2d 1289, 1296 (9th Cir. 1982) (“[L]iability was limited to actual sellers” and the seller’s attorney “was not the literal seller, as required by [California’s provision imposing liability on sellers of securities].”); *Apollo Capital Fund, LLC v. Roth Capital Partners, LLC*, 158 Cal. App. 4th 226, 253 (2007) (rejecting the argument that California’s definition of “seller” is analogous to that in *Pinter* and holding that liability as a seller of securities in California requires that privity be shown between the plaintiff and the defendant).
93. See CAL. CORP. CODE § 25504 (2016) (“Every person who directly or indirectly controls a person liable under Section 25501 or 25503, every partner in a firm so liable, every principal executive officer or director of a corporation so liable, every person occupying a similar status or performing similar functions, every employee of a person so liable who materially aids in the act or transaction constituting the violation, and every broker-dealer or agent who materially aids in the act or transaction constituting the violation, are also liable jointly and severally with and to the same extent as such person, unless the other person who is so liable had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist.”).
94. *Id.* § 25504.1. Arguably, for liability to attach the actor apparently must have actual knowledge of the fraud—with recklessness being insufficient. See *Orloff v. Allman*, 819 F.2d 904, 907 (9th Cir. 1987) (implying that allegations of recklessness are not sufficient and stating “CAL. CORP. CODE § 25504.1 restricts liability for aiding and abetting a state securities violation to cases where it is shown that the defendant had an ‘intent to deceive or defraud’”).
95. Specifically, CAL. CORP. CODE § 25504.2(a) clarifies what documents are included within the provision by stating that “[a]ny accountant, engineer, appraiser, or other person whose profession gives authority to a statement made by such person, who pursuant to rule of the commissioner has given written consent to be and has been named in any prospectus or offering circular distributed in connection with

showing she had reasonable grounds to believe, and did believe, that no material misstatement was made.<sup>96</sup>

In addition, other states have created special statutory carve-outs for attorneys and other outside professionals that exempt them from liability when they render incidental professional services.<sup>97</sup> For example, Ohio extends aider liability to anyone who, with the requisite culpability, aids the seller in any way in making the sale;<sup>98</sup> but the Ohio Securities Act, in a separate provision, clarifies that attorneys, accountants, and engineers are excluded if that person's performance was "incidental" to the practice of her profession.<sup>99</sup> The attorney, accountant, or engineer, therefore, will not be considered to have "aided in the

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the offer or sale of securities as having prepared or certified in such capacity either any part of such document or any written report or valuation which is distributed with or referred to in any such document."

96. CAL. CORP. CODE § 25504.2; *see also In re Lehman Bros. Sec. & ERISA Litig.*, 903 F. Supp. 2d 152, 197 (S.D.N.Y. 2012) (applying California law); *In re Adelpia Commc'ns Corp. Sec. & Derivative Litig.*, No. 03 Civ 5751, 2011 U.S. Dist. LEXIS 128908 (S.D.N.Y. Nov. 4, 2011) (quoting *Lubin v. Sybedon Corp.*, 688 F. Supp. 1425, 1453 (S.D. Cal. 1988)) (applying California law) ("The Ninth Circuit has held that liability under section 25401 is limited to actual sellers, so that strict privity is required. Because the causes of action provided for in sections 25501, 25504, 25504.1 and 25504.2 are by their terms derived from section 25401, a failure to show strict privity will defeat these derivative claims.").
97. *See* ARIZ. REV. STAT. § 44-2003(A) (2016) ("No person shall be deemed to have participated in any sale or purchase solely by reason of having acted in the ordinary course of that person's professional capacity in connection with that sale or purchase."); OHIO REV. CODE § 1707.431 (2016). This legislative carve-out is different from the majority approach of most states because most blue sky laws do not expressly contain an exemption for attorneys, but rather court interpretation has held that none of the enumerated categories encompass outside attorneys performing traditional legal services. *See also* Steinberg & Claassen, *supra* note 87, at 31 (describing the carve-outs enacted by certain states regarding attorneys).
98. OHIO REV. CODE § 1707.43 (2016) ("The person making such sale or contract for sale, and every person that has participated in or aided the seller in any way in making such sale or contract for sale, are jointly and severally liable to the purchaser . . . unless the court determines that the violation did not materially affect the protection contemplated by the violated provision." (emphasis added)). The statute has been broadly interpreted. *See In re Nat'l Century Fin. Enters., Inc.*, 755 F. Supp. 2d 857, 884 (S.D. Ohio 2010) ("The statute does not require knowledge, intent, or any other mental state on the part of secondary actor, nor does it require reliance, inducement, or proximate cause as between the secondary actor and purchaser.").
99. OHIO REV. CODE § 1707.431 ("For purposes of this section, the following persons shall not be deemed to have effected, participated in, or aided the seller in any way in making, a sale or contract of sale in violation of sections 1707.01 to 1707.45 of the Revised Code: (A) Any attorney, accountant, or engineer whose performance is incidental to the practice of the person's profession.").

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sale” if she was simply performing services traditionally performed in her respective occupation.<sup>100</sup>

Arizona law creates a similar carve-out scheme, which allows an action to be brought against any person “who made, participated in or induced the unlawful sale or purchase,”<sup>101</sup> but then expressly states that “[n]o person shall be deemed to have participated in any sale or purchase solely by reason of having acted in the ordinary course of that person’s professional capacity in connection with that sale or purchase.”<sup>102</sup> In construing this language, however, the Arizona Supreme Court has clarified that the state securities act contains “sweeping language of inclusion” and is to be liberally interpreted, thereby providing for its applicability in many situations despite the carve-out.<sup>103</sup> Indeed, Arizona courts have, in practice, construed the statutory safe harbor for outside professionals narrowly, allowing for primary liability in many instances where an attorney has rendered professional services.<sup>104</sup> While the scope of primary violators is inter-

100. *Compare In re Nat’l Century Fin. Enters., Inc. Inv. Litig.*, No. 2:03-MD-1565, 2008 WL 1995216, at \*9 (S.D. Ohio May 5, 2008) (holding attorney immune under § 1707.431 despite drafting a legal opinion letter), *with* *Perkowski v. Megas Corp.*, 563 N.E.2d 378, 380 (Ohio Ct. App. 1990) (denying attorney statutory protection who received a commission for advertising an investment opportunity on a radio talk show); *and* *Gerlach v. Wergowski*, 584 N.E.2d 1220, 1222–23 (Ohio Ct. App. 1989) (denying accountant protection who was a corporate director and treasurer and who actively solicited plaintiffs to invest); *see also* *McCartney v. Universal Elec. Power Corp.*, No. 22417, 2005 WL 2020559, at \*2 (Ohio Ct. App. Aug. 24, 2005) (stating that section 1707.431 “immunizes attorneys acting as legal counsel, and not as salesmen, from R.C. 1707 securities fraud liability”).

101. ARIZ. REV. STAT. § 44-2003(a).

102. *Id.*

103. *Grand v. Nacchio*, 236 P.3d 398, 401 (Ariz. 2010) (en banc); *Grubaugh v. DeCosta*, Nos. 1 CA-CV 97-0477, 1 CA-CV 98-0060, 1999 Ariz. App. LEXIS 35, at \*37 (Ariz. Ct. App. Mar. 16, 1999) (“Arizona courts have consistently construed the Arizona Securities Act in an expansive fashion resulting in greater liability than exists under federal securities law.”). Indeed, this is consistent with the legislature’s apparent intent, i.e., that the Act “not be given a narrow or restrictive interpretation or construction, but [] be liberally construed as a remedial measure in order not to defeat the purpose thereof.” 1951 Ariz. Sess. Laws, ch. 18, § 20.

104. *See Facciola v. Greenberg Traurig LLC*, No. CV-10-1025-PHX-FJM, 2011 U.S. Dist. LEXIS 61785, at \*14 (D. Ariz. June 9, 2011) (holding that a law firm did not fall under the safe harbor of the statute and reasoning: “This case is distinguishable from . . . an accounting firm preparing a negligent audit when it prepared the audit in the normal course of its professional duties, and would have prepared the audit without regard to securities transactions. In contrast, Greenberg was retained in large part to prepare documents that were primarily designed to solicit investors. This work is not merely ‘tangentially’ related to the sale of the securities, but instead is a key component to the investor solicitation. We reject Greenberg’s argument that § 44-2003(A) immunizes any lawyer when acting as a lawyer, even if he participates in his client’s fraudulent scheme. Allegations that Greenberg know-

preted broadly, the Arizona Supreme Court recently held that there is no cause of action for aiding and abetting securities violations under the state's blue sky laws.<sup>105</sup> Thus, although secondary liability has been effectively eliminated, collateral actors under Arizona law may still be held liable as primary violators.<sup>106</sup>

The Oregon Securities Act is likewise expansive.<sup>107</sup> While Oregon has substantially adopted the USA, it has expanded secondary liability to include "every person who participates or materially aids in the sale."<sup>108</sup> The Oregon Supreme Court, in turn, has interpreted its blue sky law to include the preparation of legal materials for an offering within the meaning of "participat[ing] or materially aid[ing] a violation," thereby exposing inside as well as outside counsel to liability.<sup>109</sup> The court has also made clear that the secondary actor's knowledge of

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ingly assisted in ML's fraud are obviously acts beyond the ordinary course of Greenberg's professional duties. A lawyer may not continue to provide services to a client when the lawyer knows that the client is engaged in a course of conduct designed to deceive others, and where it is obvious that the lawyer's compliant legal services may be a substantial factor in permitting the deceit to continue."); *Allstate Life Ins. Co. v. Robert W. Baird & Co.*, 756 F. Supp. 2d 1113, 1157–58 (D. Ariz. 2010) (distinguishing *Standard Chartered PLC v. Price Waterhouse*, 945 P.2d 317 (Ariz. Ct. App. 1996)) (holding that the plaintiff bondholders had adequately pled facts indicating law firms had "participated in" the sale of bonds at issue and noting: "[T]hese law firms were retained to prepare relevant documents that were necessary to procure financing . . . . Thus, unlike the auditor in *Standard Chartered*, who would have conducted an audit irrespective of the securities transaction, the law firms were hired for work that was not merely 'tangentially' related to the sale of a security or that otherwise would have been performed if no sale had been in progress. [The law firms] were retained for the sole purpose of preparing, drafting, and reviewing documents that were primarily designed to solicit purchasers for the Bonds."); *see also In re Allstate Life Ins. Co. Litig.*, 971 F. Supp. 2d 930, 942 (D. Ariz. 2013) (holding that the fact that fifteen secondary market purchasers had bought bonds through the defendant underwriters was "sufficient evidence to create a triable issue of fact that those Defendants 'made' the sales under the [Arizona Securities Act]"); *Strom v. Black*, 523 P.2d 1339, 1341 (Ariz. Ct. App. 1974) (holding an outside business broker liable for both participating in and inducing a sale).

105. *Sell v. Gama*, 295 P.3d 421, 425–26 (Ariz. 2013) ("[T]he legislature did not expressly authorize secondary liability for aiding and abetting in either the sections setting forth the types of actionable fraudulent practices under the [Arizona Securities statutes]. . . . No ASA provision mentions the terms 'aiding' or 'abetting.' . . . [Section 44-2003(a)] . . . supports a claim for primary liability under § 44-1991; it does not create a separate cause of action for, or secondary liability based on, aiding and abetting.").

106. *See Facciola*, 2011 U.S. Dist. LEXIS 61785; cases cited *supra* note 104.

107. OR. REV. STAT. § 59.115 (2016).

108. *Id.* § 59.115(3).

109. *Adams v. Am. W. Sec., Inc.*, 510 P.2d 838, 844 (Or. 1973) (en banc) (holding that an individual need not have actual knowledge of an illegal securities transaction to

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the underlying facts and circumstances is not determinative of whether secondary liability will attach:

Whether one's assistance in the sale is "material" does not depend on one's knowledge of the facts that make it unlawful; it depends on the importance of one's personal contribution to the transaction. Typing, reproducing, and delivering sales documents may all be essential to a sale, but they could be performed by anyone; it is a drafter's knowledge, judgment, and assertions reflected in the contents of the documents that are "material" to the sale.<sup>110</sup>

Another Oregon statute applies to any person who "materially aids in a violation" of that state's antifraud statute.<sup>111</sup> This statute has been interpreted to require reliance on the misstatements by the purchaser, but allows for reliance to be established based on the "fraud-on-the-market" presumption.<sup>112</sup> Moreover, although the Oregon statute expands the USA's scope to every person who participates or materially aids in the sale, it retains the USA's affirmative defense.<sup>113</sup>

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become a participant nor have even communicated with the purchaser and stating that an attorney could not avoid liability by ignoring what he saw and could readily have understood).

110. Prince v. Brydon, 764 P.2d 1370, 1371 (Or. 1988) (en banc).
111. OR. REV. STAT. §§ 59.135 (fraud and deceit with respect to securities or securities business), 59.137(1) (liability in connection with violation of OR. REV. STAT. § 59.135). Note that the language of section 59.135 is patterned after Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (2012), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (2016).
112. State v. Marsh & McLennan Cos., 292 P.3d 525, 526 (Or. 2012). The U.S. Supreme Court has given its approbation to the applicability of the "fraud-on-the-market" theory of reliance in securities class actions brought for alleged violations of section 10(b). See *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014); *Basic Inc. v. Levinson*, 485 U.S. 224 (1988); see also Ann M. Lipton, *Halliburton and the Dog that Didn't Bark*, 10 DUKE J. CONST. L. & PUB. POL'Y 1 (2015).
113. OR. REV. STAT. § 59.115(3). The Oregon Supreme Court clarified that "[k]nowledge becomes an element of liability only in the form of an affirmative defense, to be proved by a nonseller, that he 'did not know, and, in the exercise of reasonable care, could not have known, of the existence of the facts on which the liability is based.'" *Prince*, 764 P.2d at 1372. In so ruling, the court made clear that the Oregon statute places upon persons who materially aid an unlawful sale of securities a "substantial burden to exonerate themselves from liability for a resulting loss." *Id.* Applied to outside collateral actors, the Oregon approach is not widely shared. Under the court's implicit rationale, without this substantial burden to exonerate themselves, outside gatekeepers are more likely to shirk their responsibility to the investing public.

The state of Washington takes yet another approach.<sup>114</sup> The Washington Securities Act<sup>115</sup> tracks the language of the USA with regard to civil liability, but Washington courts have found, in certain contexts, attorneys and other professionals subject to liability exposure by broadly interpreting the term “seller.”<sup>116</sup> Washington courts define a seller as any person whose acts were a “substantial contributive factor” to the improper sale.<sup>117</sup> Under this rather expansive definition of the term, professionals may be deemed sellers, and thus subject to liability as primary violators.<sup>118</sup> In defining “substantial contributive factor,” Washington courts consider:

- (1) the number of other factors which contribute to the sale and the extent of the effect which they have in producing it; (2) whether the defendant’s conduct has created a force or series of forces which are in continuous and active operation up to the time of the sale, or has created a situation harmless unless acted upon by other forces for which the actor is not responsible; and (3) lapse of time.<sup>119</sup>

Interestingly, the Washington Supreme Court has reasoned that its interpretation of the statutory definition of “seller” is consistent with an official comment to the 1985 USA that sets forth the scope of seller status.<sup>120</sup>

In *Hines v. Data Line System*, the Washington Supreme Court refined its view by holding that outside professionals, specifically attorneys, were excluded

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114. H.B. 2916, 2006 Leg., 59th sess. (Wash. 2006) (adopting the Uniform Securities Act under Chapter 21.20 of the Revised Washington Code).
115. WASH. REV. CODE § 21.20.430 (2016).
116. See, e.g., *Haberman v. Wash. Pub. Power Supply Sys.*, 744 P.2d 1032 (Wash. 1987) (en banc).
117. *Silver Valley Partners, LLC v. De Motte*, No. 06-429-N-ELJ, 2007 WL 2802315, at \*9 (D. Idaho Sept. 24, 2007) (applying Washington law); *FutureSelect Portfolio Mgmt., Inc. v. Tremont Grp. Holdings, Inc.*, 331 P.3d 29, 38 (Wash. 2014) (en banc); *Haberman*, 744 P.2d 1032; *Herrington v. David D. Hawthorne, CPA, PS*, 47 P.3d 567, 570–71 (Wash. Ct. App. 2002).
118. See *In re Metro. Sec. Litig.*, 532 F. Supp. 2d 1260, 1300–01 (E.D. Wash. 2007) (refusing to dismiss state securities fraud claims against an independent auditing and accounting firm and an investment banking firm); *Haberman*, 744 P.2d at 1050 (reversing dismissal and adopting a substantial contributive factor test for determining who is a “seller”); cf. *Hines v. Data Line Sys.*, 787 P.2d 8, 20 (Wash. 1990) (affirming summary judgment in favor of attorneys because there was insufficient evidence indicating their status as a seller).
119. *Haberman*, 744 P.2d at 1052.
120. *Id.* at 1051 (citing UNIF. SEC. ACT, § 605 cmt., which explains that “liability may be imposed on a person in addition to the immediate seller if the person’s participation was a substantial contributive factor in the violation”).

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from the statutory definition of “seller.”<sup>121</sup> In that case, the plaintiffs contended that Perkins Coie, counsel for the seller in a stock offering, was liable as a “seller, control person, director, or employee,” but the court rejected their argument that outside counsel qualified as a control person, director, or employee in one sentence, stating that the investors had not provided “sufficient evidence” to create a fact issue on these points.<sup>122</sup> Similarly, to be held liable as a seller under the Washington statute, the court held that the firm must have done “something more” than perform typical or customary drafting and filing services.<sup>123</sup> In addition, Washington courts have noted that a showing of reliance by the plaintiff-purchaser is required and, moreover, that such reliance must be reasonable.<sup>124</sup>

In *Hines*, the plaintiffs alleged that the law firm’s advice that the company president’s multiple brain aneurysms need not be disclosed to investors constituted the requisite “something more.”<sup>125</sup> In ultimately denying seller status, the court emphasized that the Perkins Coie attorneys neither had personal contact with nor solicited investors. Furthermore, the court classified the firm’s advice as “the rendering of routine professional legal services in connection with an offer” that did not rise to the level of acting as a “catalyst in the sales transaction.”<sup>126</sup> Thus, once again, an outside actor avoided liability where an insider in the same situation would likely have been held accountable. If the attorneys had been inside counsel, the court may well have found that a genuine issue of material fact existed, and the action would have proceeded.

## V. EXPLORING AND TAMING THE ABYSS

With attorneys and other collateral actors largely beyond the reach of private liability under the federal securities regime, state blue sky laws exist as an alternative avenue for meaningful redress.<sup>127</sup> Unfortunately, the USA, as enacted by the states and applied by the courts, leaves a glaring absence of private liabil-

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121. *Hines*, 787 P.2d at 20 (holding that outside counsel did not meet the definition of a “seller” because counsel had no personal contact with investors and was not “in any way involved in the solicitation process”).

122. *Id.* at 19–21.

123. *Id.* at 20.

124. *Stewart v. Estate of Steiner*, 93 P.3d 919, 923 n.9 (Wash. 2004) (citing *Clausing v. DeHart*, 515 P.2d 982, 985 (Wash. 1973)).

125. *Hines*, 787 P.2d at 20 (defendants argued that this was the rendition of professional services and did not substantially contribute to the violating sales).

126. *Id.*

127. SLUSA places significant limitations on this avenue by preempting state law, with certain exceptions, in regard to class actions involving nationally traded securities, thereby preventing these state claims from being brought in state or federal court. Pub. L. 105-353, 112 Stat. 3227 (1998). For further discussion, see *supra* note 58.

ity exposure for many central outside actors well situated to serve as gatekeepers. Unable to proceed under the USA, private litigants are left to bring other claims—such as common law fraud, aiding and abetting fraud, breach of fiduciary duty, negligent misrepresentation, and legal malpractice—that typically require more onerous levels of mental culpability or entail other burdensome procedural requirements.<sup>128</sup> This Part discusses how the statutorily enumerated categories of persons under the USA have been interpreted and applied, thereby impacting the troublingly disparate liability exposure of in-house versus outside company personnel.

#### A. Attorneys as Agents

Any “agent” who materially aids in the sale or purchase of a security is potentially liable. In the USA, “agent” is defined as “any individual other than a broker-dealer who represents a broker-dealer or issuer in *effecting* or attempting to *effect* purchases or sales of securities.”<sup>129</sup> While classifying attorneys and accountants as “agents” of the seller may seem like a fairly reasonable interpretation, courts have generally not favored such a construction. Instead, the overwhelming majority of courts have found just the opposite: attorneys are not “agents” under the USA. In *Bennett*, for example, the plaintiff investors alleged that the attorney Durham was a seller under the USA or, alternatively, an agent of the seller. In holding that Durham was *not* an agent of the seller, the Sixth Circuit focused on the word “effect” in the USA definition:

An attorney does not “effect,” as opposed to “affect,” purchases or sales of securities. . . . An attorney performing ordinary legal work . . . is not hired to “carry out” or “bring about” the sale of securities; the attorney’s job is to ensure that any such sale, should the client choose to pursue it, complies with the law. The attorney’s work, it is true, may be a but-for cause of a later sale of securities, but the statute requires more.<sup>130</sup>

Consistent with *Bennett*, other courts have held that an attorney is not an agent of the seller if she has performed only traditional legal functions.<sup>131</sup>

128. For further discussion on this point, see *supra* notes 32–49 and accompanying text.

129. UNIF. SEC. ACT § 401(b) (UNIF. LAW COMM’N 1956) (emphasis added); *Bennett v. Durham*, 683 F.3d 734, 738 (6th Cir. 2012).

130. *Bennett*, 683 F.3d at 738.

131. See *Ward v. Bullis*, 748 N.W.2d 397, 403–06 (N.D. 2008) (quoting *Baker, Watts & Co. v. Miles & Stockbridge*, 620 A.2d 356, 368 (Md. Ct. Spec. App. 1993)) (summarizing relevant case law and stating “[t]his Court has not addressed whether an attorney may be liable for violations of securities laws, but other courts, applying similar statutory definitions of an agent, have considered similar arguments and held an attorney is not liable as an agent unless the attorney . . . act[s] in a manner that goes beyond legal representation. The definition of ‘agent’ . . . does not include attorneys who merely provide legal services, draft documents for use in the

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Another argument militating against classifying attorneys, bankers, or auditors as agents is based on the statutory definition of “agent” contained in the USA. Because the USA mandates that “agents” register, rather than attorneys, bankers, or auditors specifically, these individuals—engaged solely in their professional functions—are not “agents” under the USA.<sup>132</sup> It follows, however, that if an attorney, auditor, or banker acts outside the realm of ordinary professional services, then that conduct may be interpreted as representing a seller in effecting a sale.<sup>133</sup> For example, an attorney who meets with and answers questions from prospective purchasers regarding the substance of a prospective investment may potentially be characterized as an agent.<sup>134</sup>

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purchase or sale of securities, or engage in their profession’s traditional advisory functions. To rise to the level of ‘effecting’ the purchase or sale of securities, the attorney must actively assist in offering securities for sale, solicit offers to buy, or actually perform the sale.”); *accord In re Infocure Sec. Litig. v. Infocure Corp.*, 210 F. Supp. 2d 1331, 1364 (N.D. Ga. 2002) (holding attorney performing traditional legal functions did not meet the definition of “employee” or “agent” under South Carolina, North Carolina, or Michigan blue sky laws); *CFT Seaside Inv. Ltd. P’ship v. Hammet*, 868 F. Supp. 836, 844 (D.S.C. 1994) (“The definition of ‘agent’ in [South Carolina’s securities statute] is not intended to cover professionals such as attorneys engaging in their traditional advisory functions.”); *Rendler v. Markos*, 453 N.W.2d 202, 206 (Wis. Ct. App. 1990) (“The definition of ‘agent’ [in Wisconsin securities laws] does not include attorneys who merely render legal advice or draft documents for use in securities transactions.”).

132. UNIF. SEC. ACT § 101(14); *see Baker, Watts & Co. v. Miles & Stockbridge*, 620 A.2d 356, 368 (Md. Ct. Spec. App. 1993) (relying on the definition of agent in the Act); *Steinberg & Claassen*, *supra* note 87, at 6.
133. A Vermont court has found a law firm to be an agent of the seller for drafting an offering memorandum, but this results from a definition of “agent” in Vermont’s statute different from that in the commonly adopted USA. Thus, this finding is not widely applicable. The definition of “agent” in the Vermont statute was modified from that in the USA to also include “its ordinary meaning.” Since attorneys would fall under the typical understanding of “agent” in regard to a client, the law firm could be held liable as an agent. The law firm in this case had prepared the Offering Memorandum and the Amended Offering. In other states, “agent” is statutorily defined and does not include its ordinary meaning. Hence, “agent” is defined as an individual who represents an issuer or broker-dealer “in effecting or attempting to effect purchases or sales of securities.” *See Powell v. H.E.F. P’ship*, 835 F. Supp. 762, 765 (D. Vt. 1993).
134. *Excalibur Oil, Inc. v. Sullivan*, 616 F. Supp. 458, 467 (N.D. Ill. 1985) (applying West Virginia law and holding attorney potentially liable as agent for making face-to-face and direct telephonic representations to the buyer that materially aided in effecting the sale); *Johnson v. Colip*, 658 N.E.2d 575, 579 (Ind. 1995) (holding that it was a material issue of fact about whether an attorney’s conduct at the meetings with prospective investors constituted an attempt to effect the sale of securities by making it more likely than not that investors would purchase the securities); *Oster v. Kirschner*, 77 A.D.3d 51, 59 (N.Y. App. Div. 2010) (applying New Jersey law and holding that, at the pleading stage, there were adequate allegations that the attor-

In sum, absent classification as an agent of the seller who materially aids a violation (or status liability based on being a control person, officer, partner, or director), outside counsel ordinarily would escape private securities liability despite materially assisting a securities violation. For inside lawyers, as well as other in-house personnel, who are employed by the defendant seller corporation, a different result will often follow.<sup>135</sup>

### B. Attorneys as Employees

Attorneys, just like other laborers, are subject to categorization as employees or independent contractors by courts.<sup>136</sup> Moreover, attorneys from outside firms, including temporary personnel agencies,<sup>137</sup> act as service providers to corporations.<sup>138</sup> While little case law directly addresses the viability of defining inside counsel as employees under the USA, there are decisions in other contexts that do just that.<sup>139</sup>

Thus, while judicial analysis of inside counsel as employees under the USA is scant, the definition of “employee” has been discussed in the context of the

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neys were liable as agents “who materially aided in the ‘sale or conduct’ constituting the violation”).

135. UNIF. SEC. ACT § 410(b). Note that a company’s chief legal officer or general counsel also may incur liability exposure under the USA as an “officer.” *Id.*
136. See, e.g., *Cave v. Comm’r*, 476 F. App’x 424, 425 (5th Cir. 2012) (quoting *Breaux & Daigle, Inc. v. United States*, 900 F.2d 49, 51 (5th Cir. 1990)) (discussing factors for determining whether an attorney is an independent contractor or an employee “including the ‘degree of control, opportunities for profit or loss, investment in facilities, permanency of relation, and skill required in the claimed independent operation’”).
137. Several agencies provide placement of attorneys in temporary and contract positions to law firms and corporate legal departments. See, e.g., *About Us*, ROBERT HALF, <http://www.roberthalf.com/about-us> [<http://perma.cc/C7X3-UGKB>]; *Our Firm*, HIRE COUNSEL, <http://www.hirecounsel.com/who-we-are/our-firm/> [<http://perma.cc/4WR7-R3KC>].
138. Peter S. Trotter, *Working with Inside Counsel*, 101 ILL. B.J. 642, 642 (2013) (discussing the role of outside counsel being hired as a service provider and noting the hiring and supervising of a variety of outside counsel by inside counsel on both a limited-engagement and long-term basis).
139. See, e.g., *Nordling v. N. States Power Co.*, 478 N.W.2d 498, 502 (Minn. 1991) (“The fact remains, however, that the in-house attorney is also a company employee, and we see no reason to deny the job security aspects of the employer-employee relationship if this can be done without violence to the integrity of the attorney-client relationship.”); see also *Gen. Dynamics Corp. v. Superior Court*, 876 P.2d 487, 496 (Cal. 1994) (citing *Nordling*, 478 N.W.2d at 502) (“For matters of compensation, promotion, and tenure, inside counsel are ordinarily subject to the same administrative personnel supervision as other company employees.”).

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USA.<sup>140</sup> While “employee” is not defined in the Act, case law has recognized that common law principles apply.<sup>141</sup> In other words, courts have most often given “employee” its plain and ordinary meaning.<sup>142</sup> According to a South Carolina court, in *Allen v. Columbia Financial Management, Ltd.*,<sup>143</sup> “employer” and “employee” are rooted in the terms “master” and “servant.”<sup>144</sup> Hence, the principal factor for determining who qualifies as an employee is the same as was used to determine who was a servant: the right of the employer-master “to control and direct the particular work or undertaking as to the means or manner of its accomplishment.”<sup>145</sup> Outside secondary actors in a securities transaction typically will not fall under this definition of “employee,” as they themselves are usually responsible for the “means or manner” of achieving the work assigned. In *Allen*, the plaintiffs sued outside corporate counsel under the theory that outside counsel were “employees of the seller, because they were retained by the seller for certain services.” Not surprisingly, the court rejected this contention, citing a lack of evidence indicating that outside counsel was subject to the degree of control necessary to be deemed an employee.<sup>146</sup> This pronouncement that outside counsel are not employees is consistent with the view held by courts and commentators.<sup>147</sup>

Another court, in *Jablonski v. Victor D.*,<sup>148</sup> by contrast, defined outside actors as employees. In *Jablonski*, Arthur Andersen, the outside auditor accused of aid-

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140. See, e.g., *CFT Seaside Inv. LP v. Hammet*, 868 F. Supp. 836, 843 (D.S.C. 1994) (applying South Carolina Law); *Allen v. Columbia Fin. Mgmt., Ltd.*, 377 S.E.2d 352, 356–57 (S.C. Ct. App. 1988).
141. See, e.g., *Allen*, 377 S.E.2d at 356–57; see also JOSEPH C. LONG, 12-12A BLUE SKY LAW § 9:88 (2010).
142. See *In re Infocure Sec. Litig. v. Infocure Corp.*, 210 F. Supp. 2d 1331, 1364 (N.D. Ga. 2002) (applying Georgia law); *CFT Seaside*, 868 F. Supp. at 843 (applying South Carolina law); *Allen*, 377 S.E.2d at 356–57.
143. 377 S.E.2d 352 (S.C. Ct. App. 1988).
144. *Id.* at 356. See generally *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322–23 (1992); *Hutson v. Herndon*, 133 S.E.2d 753 (S.C. 1963); *Bates v. Legette*, 121 S.E.2d 289, 293 (S.C. 1961).
145. *In re Infocure*, 210 F. Supp. 2d at 1364; *CFT Seaside*, 868 F. Supp. at 843 (citing *Hutson*, 133 S.E.2d at 756); *Bates*, 121 S.E.2d at 293.
146. *Allen*, 377 S.E.2d at 356–57; see *In re Infocure*, 210 F. Supp. 2d at 1364 (holding that an outside law firm was not an employee of a seller, citing *Allen*); *CFT Seaside*, 868 F. Supp. at 842 (same).
147. See Long, *supra* note 141, § 9:88 (“[I]ndependent auditors and outside counsel are not employees.” (citations omitted)); see, e.g., *Hines v. Data Line Sys.*, 787 P.2d 8, 21 (Wash. 1990); cases cited *supra* notes 139, 146.
148. No. C85-2274V 1986, U.S. Dist. LEXIS 26697, at \*11 (W.D. Wash. Apr. 16, 1986) (applying Washington law); see *supra* notes 144–47.

ing and abetting violations of the Washington Securities Act,<sup>149</sup> moved to dismiss, asserting that outside auditors did not fall within any of the enumerated categories of parties subject to participant liability under the Act. The court denied the motion, holding instead that “Andersen could be considered an employee of the sellers of the securities who materially aided the sales transaction.”<sup>150</sup> This broad interpretation of “employee of the seller” contradicts the plain meaning of “employee” as it is understood under common-law principles.<sup>151</sup> Defining “employee” expansively in this area of the law could have unintended adverse ramifications if such a construction were expanded to the myriad areas of law where “employee” status comes into play.<sup>152</sup> Such a broad definition of “employee” has, unremarkably, not received widespread approbation by other courts.<sup>153</sup>

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149. WASH. REV. CODE § 21.20.430(3) (2016).

150. *Jablonski*, 1986 U.S. Dist. LEXIS 26697, at \*4.

151. *See supra* notes 141–47 and accompanying text.

152. Employee status is critically important in many areas of tort law, for example. The doctrine of respondeat superior subjects an employer to vicarious liability for the negligent conduct of an employee performed within the scope of employment. *See, e.g., Mary M. v. City of L.A.*, 814 P.2d 1341, 1343 (Cal. 1991); *Chesterman v. Barmon*, 753 P.2d 404, 406 (Or. 1988) (en banc); *St. Joseph Hosp. v. Wolff*, 94 S.W.3d 513, 541–42 (Tex. 2002). Employee status can also be important in limiting an injured party’s available remedies to solely statutory prescriptions. *See, e.g., Lomeli v. Sw. Shipyard, LP*, 363 S.W.3d 681, 689–90 (Tex. App. 2011) (affirming dismissal of a negligence claim because plaintiff held the status of “employee;” thus, the exclusive remedy provision of the federal Longshoremen and Harbor Worker’s Compensation Act applied, defeating any common law negligence claim). The designation of outside contractors as employees could expose employers to significantly increased liability exposure for independent contractors and their employees. *See, e.g., SeaBright Ins. Co. v. US Airways, Inc.*, 258 P.3d 737, 741 (Cal. 2011) (concluding that “an independent contractor’s hirer implicitly delegates to that contractor its tort law duty, if any, to provide the employees of that contractor a safe workplace”). Moreover, outside contractors being deemed employees leads to increased regulation over treatment, pay, and other benefits reserved for employees. *See, e.g., Herman v. Express Sixty-Minutes Delivery Serv.*, 161 F.3d 299, 305 (5th Cir. 1998) (holding workers were independent contractors under the Fair Labor Standards Act meaning minimum wage, overtime compensation, and record keeping provisions of the Act did not apply). Another example is the National Labor Relations Act, which only applies to “employees” and specifically excludes “independent contractors.” *See National Labor Relations Act of 1935*, 29 U.S.C. § 152(3) (2012); *NLRB v. United Ins. Co.*, 390 U.S. 254, 255 (1968); *see also Katherine V.W. Stone, Legal Protections for Atypical Employees: Employment Law for Workers Without Workplaces and Employees Without Employers*, 27 BERKELEY J. EMP. & LAB. L. 251, 253 (2006) (discussing the lack of legal protections for independent contractors and temporary workers).

153. *See, e.g., In re Infocure Sec. Litig. v. Infocure Corp.*, 210 F. Supp. 2d 1331, 1364 (N.D. Ga. 2002) (applying a narrower definition of “employee” for USA purposes); CFT

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Nonetheless, in a similarly expansive reading, an Alaska court, denying a motion for summary judgment, indicated that it would accept a broader definition of “employee,”—and, moreover, one that might very well include both outside counsel and attorneys hired from temporary service agencies.<sup>154</sup> *Pottle v. Coffey* involved alleged violations by the outside counsel, Coffey, who rendered legal services to a closely held corporation.<sup>155</sup> The *Pottle* court abandoned the requirement of control over the means and manner of the work and instead defined “employee” as “one who renders services to another for pay.”<sup>156</sup> However, the court recognized that other courts had not held outside legal counsel liable as employees when “their involvement was ‘only tangential’ or ‘minimal at most.’”<sup>157</sup> Still, after citing case law from other jurisdictions, the court decided that a genuine issue of material fact remained as to whether the attorney could be classified as an employee.<sup>158</sup>

This decision minimizes the difference between independent contractors and employees. While such a broad definition of “employee” in this context would encompass outside professionals, it is an unacceptable solution—first,

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Seaside Inv. LP v. Hammet, 868 F. Supp. 836, 842 (D.S.C. 1994) (same); Allen v. Columbia Fin. Mgmt., Ltd., 377 S.E.2d 352, 356–57 (S.C. Ct. App. 1988) (same).

154. See *Pottle v. Coffey*, Blue Sky L. Rep. (CCH) ¶ 73,226, No. 3AN 86-9414, 1989 WL 1724589 (Alaska Super. Ct. Sept. 8, 1989); see also Joe Borstein, *Alt.legal: The \$21BN Contract Lawyer Marketplace Is up for Grabs, ‘Hire an Esquire’ Plans To Catch It*, ABOVE L. (Feb. 10, 2016, 5:44 PM), <http://abovethelaw.com/2016/02/alt-legal-the-21bn-contract-lawyer-marketplace-is-up-for-grabs-hire-an-esquire-plans-to-catch-it/> [<http://perma.cc/TMU4-3Z3E>] (discussing the demand for temporary or contract lawyers, citing an annual spend on legal contract labor in the United States of twenty-one billion dollars); Vanessa O’Connell, *Lawyers Settle . . . for Temp Jobs*, WALL ST. J. (June 15, 2011), <http://www.wsj.com/articles/SB10001424052702303714704576383641752966666> [<http://perma.cc/UR54-375D>] (noting the significant increase in the use of temporary attorneys with the percentage of temporary private law practice jobs rising from 5.4% of all private practice jobs in 2007 to 10% in 2011).
155. *Pottle*, 1989 WL 1724589.
156. *Id.* Such a definition, applied broadly in the law, would result in temporary or contract workers and outside contractors falling under the definition of “employee.”
157. *Id.* (citing *Stokes v. Lokken*, 644 F.2d 779, 784 (8th Cir. 1981)).
158. *Id.* (“Conversely, a corporate attorney who was a ‘key participant’ or played ‘an active role’ in a securities sale has been held liable as a seller for the sale of unregistered securities. . . . Although the plaintiff has established that Mr. Coffey played some role in the sale of CPRS stock, the extent and nature of Mr. Coffey’s participation is not clear.” (citing *Junker v. Crory*, 650 F.2d 1349, 1360 (5th Cir. 1981); *Ahern v. Gaussoin*, 611 F. Supp. 1465 (D. Or. 1985))). Note that the Fifth Circuit’s definition of “seller” in *Junker* was subsequently rejected by the Supreme Court in *Pinter v. Dahl*, 486 U.S. 622 (1988), in favor of a narrower construction. See *supra* notes 55–56, 67–68 and accompanying text.

due to the distinct prospect of adverse ramifications in other areas of the law (as discussed above) and, second, because the vast majority of courts already define the term “employee” in terms of control.<sup>159</sup> To expand this definition would necessitate a sea change in the current predominant approach and would, accordingly, challenge significant precedent. Moreover, this definition would include temporary attorneys and other personnel hired from temporary service providers, wreaking havoc in job markets by blurring previously distinct categories of workers.<sup>160</sup>

To recap, absent classification as an agent or employee, outside attorneys and other outside professionals integral to the securities offering process escape private liability under the USA.<sup>161</sup> Outside professionals not subject to the USA still might be held liable under a claim for fraud, negligent misrepresentation, common law aiding and abetting fraud, breach of fiduciary duty, or legal malpractice.<sup>162</sup> However, these avenues are problematic as they entail their own unique challenges, such as significantly increased procedural burdens or elevated mens rea requirements as compared to the USA.<sup>163</sup>

Hence, in practice, the only way outside attorneys and other professionals will be held accountable under the USA is if they take on a dual role as a partner, officer, director, or control person of the seller. Outside legal counsel and other collateral actors could incur “status liability” (meaning liability can attach without a showing that the “status” person materially aided the violation) if any of the aforementioned roles are taken on. The language is clear, confirmed by case law, that status as a control person or any of the other listed designations (such as serving as an officer or director) does not require that the actor materi-

159. See *supra* notes 141–47 and accompanying text; see also *Cobb v. Sun Papers, Inc.*, 673 F.2d 337, 340 (11th Cir. 1982) (adopting the common, ordinary understanding of employee in the context of Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e *et seq.* (2012)); *Newspapers, Inc. v. Love*, 380 S.W.2d 582, 586 (Tex. 1964) (“We believe, however, that the solution of the question presented in this case is correctly reached by the application of the test of right of control, which, according to our decisions and most of the modern cases, is used as the supreme test.”).

160. See *supra* notes 152–53 and accompanying text (discussing the expansive ramifications of such a broad definition of employee).

161. Subject to the exception for those secondary actors deemed control persons as outlined in the federal securities laws imposing control person liability. See Securities Act of 1933, 15 U.S.C. § 77(a) *et seq.* (2012); Securities Exchange Act of 1934, *id.* § 78(a) *et seq.*; UNIF. SEC. ACT. § 410(b) (UNIF. LAW COMM’N 1956).

162. See *Bennett v. Durham*, 683 F.3d 734, 738 (6th Cir. 2012) (“[A]n attorney who knowingly drafted materially false or misleading documents would face other problems. He might be liable for fraud . . . [o]r he might be liable for malpractice or face disciplinary proceedings.”).

163. For example, derivative litigation often involves making a demand on the board of directors, while fraud claims typically require a showing of intent. See *supra* notes 32–50 (discussing the shortfalls of other types of liability in this context).

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ally aid the violation.<sup>164</sup> Absent the undertaking of such a dual role, then, outside gatekeepers, integral in detecting and preventing securities law violations, are insulated from private securities liability under the USA for their misconduct. In the same manner, temporary professional workers, an ever-expanding segment of business workers,<sup>165</sup> avoid such private securities liability because of their lack of “employee” status. The next Section of this Article discusses the problems that arise due to this regulatory abyss and offers meaningful solutions for revitalizing the gatekeeping function traditionally served by attorneys, accountants, and other pertinent actors.

C. *What Is Lost to the Abyss*

A system that allows complicit attorneys, accountants, and other collateral participants to escape private securities liability is fraught with problems that, over time, will degrade investor confidence and market integrity as well as the public image of these professions. Moreover, the obvious inequity that participant liability will often hinge on employment status presents ethical quandaries for professionals as well as significant concerns regarding investor protection and corporate governance. As discussed in Part I, these gatekeepers are integral to the regulatory regime in the United States.

While human conduct is difficult to predict, certain behaviors are likely to ensue when adverse consequences, such as the specter of potential liability, are present.<sup>166</sup> Conversely, when such incentives are lacking, the cost of complicity in wrongdoing is lessened, potentially resulting in enfeebled gatekeeper functioning. Moreover, incentivizing the gatekeeping function through the specter of secondary liability is effective and consistent with public policy objectives.

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164. See *Moerman v. Zipco, Inc.*, 302 F. Supp. 439, 450 (E.D.N.Y. 1969), *aff'd*, 422 F.2d 871 (2d Cir. 1970), *adhered to on reh'g*, 430 F.2d 362 (2d Cir. 1970) (“In defining liability, the statute imposes liability on an employee of a seller only if he ‘materially aids in the sale,’ but it puts no similar restrictions on the liability of a partner, officer, or director.”); *Mitchell v. Beard*, 513 S.W.2d 905, 907 (Ark. 1974) (recognizing strict liability for a “partner” as distinguished from an “employee, broker, or agent”); *Taylor v. Perdition Minerals Grp., Ltd.*, 766 P.2d 805, 809 (Kan. 1988) (“The states that have passed § 410(b) of the Uniform Securities Act have consistently interpreted the statute to impose strict liability on partners, officers, and directors unless the statutory defense of lack of knowledge is proven.”); see also *Steinberg & Claassen*, *supra* note 87, at 14 & n.80 (stating that “for liability to attach to the first three groups, there is no condition that they provide material aid or otherwise participate in the transaction” and providing various example cases in the accompanying footnote).

165. See Borstein, *supra* note 154.

166. See generally Naci H. Mocan & R. Kai Gittings, *The Impact of Incentives on Human Behavior: Can We Make It Disappear? The Case of the Death Penalty* (Nat’l Bureau of Econ. Research, Working Paper No. 12631, 2006), <http://www.nber.org/papers/w12631.pdf> [<http://perma.cc/MC68-VA9V>].

While no definitive research has been conducted, there is evidence that the implementation of a robust secondary liability framework provides tangible benefits that outweigh potential costs.<sup>167</sup> Existing research, along with the occurrence of massive scandals that all too frequently result when gatekeepers fail to act appropriately, support the inference that the gatekeeping function, as traditionally envisioned, is an effective means of investor protection.<sup>168</sup> Adherence to sound gatekeeping practices thus may be encouraged through the threat of potential private securities liability, which is obviated by meeting an affirmative defense of reasonable care by those gatekeepers who materially aid violative conduct.

Gatekeepers facilitate issuer access to the securities markets by their participation and can provide a necessary check on contemplated perpetration of improper corporate action.<sup>169</sup> In practice, gatekeepers should function as a control system, green lighting transactions that are law-compliant and seeking to halt transactions that are based on faulty information or are otherwise illegal.<sup>170</sup> As the corporate securities landscape changes, becoming increasingly complex,

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167. Jennifer J. Johnson, *Secondary Liability for Securities Fraud: Gatekeepers in State Court*, 36 DEL. J. CORP. L. 463, 502–03 (2011). Professor Johnson analyzed Oregon case law as well as claims from a mandatory malpractice insurance program maintained by the Oregon Bar Association, which provided data on the number of securities actions against attorneys. Specifically, Professor Johnson looked at the period of time following the Oregon Supreme Court decision, *Prince v. Brydon*, 764 P.2d 1370 (Or. 1988), which held that attorneys performing traditional legal services could be held secondarily liable for materially aiding a securities violation. She found “there was not a marked increase in Professional Liability Fund claims processed in the *Prince* aftermath” and notes “the trend remains fairly constant throughout the [Professional Liability Fund] reporting years, without the expected rise following the *Prince* decision.” Johnson, *supra* note 167, at 504. Additionally, Professor Johnson notes that “Oregon attorneys do not report any noticeable increase in securities offerings without professional involvement; to the contrary, one noted positive trend is that attorneys not conversant in securities law are advised to refer potential issuers to those with experience.” *Id.* at 505. This research on secondary liability “suggests that the potential benefits for investor protection outweigh costs associated with increased secondary liability.” *Id.* at 506.

168. See *supra* notes 11–19 and accompanying text.

169. SEC v. Spectrum, Ltd., 489 F.2d 535, 536 (2d Cir. 1973) (noting the pivotal role that gatekeepers play); *In re Parmalat Sec. Litig.*, 375 F. Supp. 2d 278, 289 (S.D.N.Y. 2005) (discussing the need for gatekeepers or “reputational intermediaries”).

170. See *In re Fields*, Exchange Act Release No. 5404, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,407, at 83,175 n.20 (June 18, 1973), *aff'd*, 495 F.2d 1075 (D.C. Cir. 1974) (SEC noting that attorneys occupy an important position in the investment process and that the SEC is especially dependent on the diligence of the professionals that practice before it because of its limited resources); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-664, SECURITIES FRAUD LIABILITY OF SECONDARY ACTORS (2011) (“Attorneys play important roles in securities transactions. . . . Counsel generally reviews the veracity and completeness of registration materials and attempts to ensure that a thorough investigation of the issuer is made.”).

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gatekeepers must, to properly fulfill their obligations, maintain a heightened sense of vigilance when providing services that are vitally necessary for the successful consummation of a securities transaction.<sup>171</sup>

The USA, as currently implemented, places this vigilance requirement on inside actors, but fails to demand this same vigilance from outside actors performing the same vital functions. By failing to incentivize “outside” gatekeepers, the USA fails to create an effective system for protecting the securities markets. The USA’s failure to properly incentivize inside actors is problematic for two reasons: first, because it results in an overall loss in gatekeeping protection, and second, because it results in disturbing inequities with respect to secondary liability. Employees, including inside counsel and internal auditors, are civilly liable under the state securities laws while outside counsel, auditors, and other outside collateral actors who engage in identical conduct are beyond the reach of private liability under the USA.

Such disparity in treatment of outside professionals and inside professionals unfairly burdens companies employing inside counsel with more liability risk. As the 2008 recession rocked the country,<sup>172</sup> the corporate legal services market found itself in the midst of transformation.<sup>173</sup> Faced with tightening budgets, corporations have increasingly relied on inside legal counsel to handle legal matters that traditionally were assigned to an outside law firm.<sup>174</sup> This trend could result in unforeseen costs if plaintiffs’ attorneys begin targeting in-

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171. As former U.S. Attorney General Richard Thornburgh explained, in the context of general counsel, “[T]he role of attorneys as gatekeepers needs to be strengthened. The role of corporate counsel has changed dramatically in recent times. Historically, a general counsel’s primary client was senior management and, to a lesser extent, the board. While general counsel must continue to serve these constituencies, they also now are viewed by regulators and potential litigants as gatekeepers to the interests of the company’s shareholders.” Richard Thornburgh, Remarks at the SMU 16th Annual Corporate Counsel Symposium: The Importance of Gatekeepers in Protecting Investors from Corporate Fraud and Corruption 8 (Oct. 3, 2008).
172. See generally Justin Baer & Chelsey Dulaney, *Goldman Reaches \$5 Billion Settlement over Mortgage-Backed Securities*, WALL ST. J. (Jan. 14, 2016), <http://www.wsj.com/articles/goldman-reaches-5-billion-settlement-over-mortgage-backed-securities-1452808185> [<http://perma.cc/44NP-KRSG>] (discussing the largest regulatory penalty of Goldman Sachs’ history over toxic mortgages it bundled and sold to unsuspecting investors); World Econ. & Fin. Surveys, *World Economic Outlook: Crisis and Recovery*, INT’L MONETARY FUND (Apr. 2009), <http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/text.pdf> [<http://perma.cc/2SUJ-V3KZ>].
173. Juliana Kenny, *Impacts of the Recession on the Legal Industry: Expert Ed Winslow Provides Insight into How the Legal Industry Is Moving Towards Segmentation in a Post-Recession World*, INSIDE COUNS. MAG. (July 28, 2014, 7:00 PM), <http://www.insidecounsel.com/2014/07/28/impacts-of-the-recession-on-the-legal-industry> [<http://perma.cc/KCN2-LNJ8>].
174. Jennifer Smith, *Companies Curb Use of Outside Law Firms*, WALL ST. J. (Sept. 14, 2014), <http://www.wsj.com/articles/companies-curb-use-of-outside-law-firms-1410735625> [<http://perma.cc/U6JZ-QTMG>].

side counsel for securities violation liability under the USA. As is normally the case when circumstances change, the plaintiffs' bar adapts and pursues remedies for aggrieved investors wherever practicable.<sup>175</sup> In the face of heightened difficulty proving private claims against outside actors, inside counsel may become a primary target. Not only may such selective treatment be viewed as unfair, but it is also detrimental to companies that employ inside professionals. With litigation resources disproportionately focused on inside actors, subject companies will quite likely face enhanced and disparate financial burdens, in the form of increased insurance costs and indemnification expenses.<sup>176</sup> Smaller companies unable to shoulder the added expense of utilizing outside professionals will find themselves at a competitive disadvantage in the marketplace. In view of their shared gatekeeping obligations, companies employing inside counsel as well as outside counsel themselves should bear the burden of these costs in an equitable manner.

Meanwhile, because proving the requisite mental intent or overcoming challenging procedural hurdles typically is necessary to hold outside professionals accountable in private actions,<sup>177</sup> lack of diligence and vigilance among outside professionals who are insulated from private securities liability remains a concern. In fact, an outside secondary actor that falls outside of the USA's provisions could knowingly assist fraudulent conduct without incurring private liability under either the federal securities laws or the USA.<sup>178</sup> These loopholes raise the prospect that even law-abiding companies might be inclined, for loss-reduction purposes, to enhance their number of retained independent contractors and temporary professional workers with a corresponding reduction for in-house personnel. Corporations already commonly utilize contract attorneys,<sup>179</sup>

175. See, e.g., *In re Worldcom, Inc. Sec. Litig.*, 308 F. Supp. 2d 236, 242 (S.D.N.Y. 2004) (citing *Lander v. Hartford Life & Annuity Ins. Co.*, 251 F.3d 101, 107–08, 108 n.4 (2d Cir. 2001)) (noting that plaintiffs, when restricted by the PSLRA, sidestepped the restrictions by proceeding under state “blue sky” laws before the passage of SLUSA); see also discussion *supra* note 58 and accompanying text.

176. An analogous situation was the passing of PSLRA which made it harder for plaintiffs to bring class actions involving nationally traded securities based on the federal securities laws. Plaintiff attorneys responded by flooding state courts with class actions based on state securities laws, prompting the passage of SLUSA that, with certain exceptions, preempts state law and thereby prevents these suits. See MARC I. STEINBERG, *SECURITIES REGULATION* 674–82 (6th ed. 2013); *supra* note 53 and accompanying text.

177. See *supra* notes 32–50 and accompanying text.

178. See UNIF. SEC. ACT § 410(b) (UNIF. LAW COMM'N 1956); see, e.g., *Bennett v. Durham*, 683 F.3d 734 (6th Cir. 2012) (applying Kentucky law) (discussing that outside attorney could escape private civil liability under the USA despite knowingly drafting fraudulent documents).

179. Robert Reich, *Why We're All Becoming Independent Contractors*, HUFFINGTON POST (Feb. 22, 2015, 5:45 PM), <http://www.huffingtonpost.com/robert-reich/why-were->

arguably due in part to the liability laws.<sup>180</sup> And this migration from an employee workforce to a contractor workforce frequently carries with it reduction in pay and benefits for workers.<sup>181</sup> Finally, the far too frequent episodic avoidance of gatekeeping functions by attorneys in the absence of proper incentives to interdict will only exacerbate the crisis in public perception of attorneys as uneth-

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all-becoming-independent-contractors\_b\_6731760.html [http://perma.cc/3FR9-5PE2]; see also *supra* note 64 and accompanying text (discussing the trend toward the use of contract workers in the legal field and noting businesses that specialize in providing temporary executive workers).

180. Corporate focus on risk management would imply that this is a consideration when determining whether to utilize independent contractors or retain permanent employees. See Robert F. Weber, *An Alternative Story of the Law and Regulation of Risk Management*, 15 U. PA. J. BUS. L. 1005 (2013).
181. Nancy Cremins, *The Rise of the On-demand Economy: The Tension Between Current Employment Laws and Modern Workforce Realities*, BOS. B. J., (Jan. 13, 2016), <http://bostonbarjournal.com/2016/01/13/the-rise-of-the-on-demand-economy-the-tension-between-current-employment-laws-and-modern-workforce-realities/> [http://perma.cc/PN]7-3W88] (“Workers classified as independent contractors do not have access to company-provided benefits and protections such as paid time off. They are not given the payment protections of minimum wage, and overtime pay. Nor do they have the safeguards of worker’s compensation and unemployment insurance. These workers also shoulder the cost of the business expenses incurred in performing their jobs, such as their tools, supplies, or the cost of vehicle operation (though those are deductible business expenses). In addition, workers are responsible for paying all taxes on pay, which means the company is not contributing to employment taxes, Social Security, or Medicare.”); see also Reich, *supra* note 179 (“The rise of ‘independent contractors’ is the most significant legal trend in the American workforce—contributing directly to low pay, irregular hours, and job insecurity. What makes them ‘independent contractors’ is . . . that the companies they work for say they are. So those companies don’t have to pick up the costs of having full-time employees. But are they really ‘independent’? Companies can manipulate their hours and expenses to make them seem so. It’s become a race to the bottom. Once one business cuts costs by making its workers ‘independent contractors,’ every other business in that industry has to do the same—or face shrinking profits and a dwindling share of the market.”).

ical.<sup>182</sup> Accountants and outside auditors, in the face of Enron and more recent debacles, face similar problems in public perception.<sup>183</sup>

With respect to attorneys, the problem is obvious: when attorneys are held to different ethical—and liability—standards based arbitrarily on whether an attorney is an employee versus outside counsel or an independent contractor, disparate treatment, perverse corporate governance incentives, damage to the reputation of the profession, and significant degradation of investor protection result.

*D. Rescue from the Abyss: Meaningful Solutions for Filling the Gap in Liability*

There are numerous ways the regulatory abyss might be addressed, but many possible avenues for reform would be impractical in light of legislative and judicial hurdles. For example, the definition of “agent” might be interpreted to include attorneys and other professionals involved in the securities transaction process. In the same respect, the definition of “employee” in this context could be construed more broadly to include outside actors such as outside counsel, outside auditors, and other outside collateral actors. However, this brand of reform would be unlikely and undesirable, as it would certainly impact other areas of law and call for judges to overrule both common law principles and long-established precedent.<sup>184</sup>

Oregon’s approach—which prescribes civil liability for every person who materially aids a violation, allowing a defense of reasonable care—is another possible solution. But, many jurisdictions would likely decline to take such an overtly plaintiff-friendly approach. This type of reform could be perceived as implicating too many tangential actors in private damages actions, chilling the securities markets and wasting resources through vexatious litigation.

182. See Gary A. Hengstler, *Vox Populi—The Public Perception of Lawyers: ABA Poll*, 79 A.B.A. J. 60 (1993) (discussing the perception of attorneys by the public as unethical and the various ethical improprieties by attorneys which have come to light); *Public Esteem for Military Still High*, PEW RES. CTR. (July 11, 2013), <http://www.pewforum.org/2013/07/11/public-esteem-for-military-still-high/> [<http://perma.cc/7NB4-KN45>] (finding lawyers ranked last by occupation in public esteem when compared with ten other occupations). See generally Jennifer K. Robbennolt & Jean R. Sternlight, *Behavioral Legal Ethics*, 45 ARIZ. ST. L.J. 1107 (2013) (describing the high instance of unethical behavior by attorneys and exploring possible psychological causes).

183. See Gary J. Aguirre, *The Enron Decision: Closing the Fraud-free Zone on Errant Gatekeepers*, 28 DEL. J. CORP. L. 447 (2003); Roger C. Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 BUS. LAW. 143, 144 (2002) (“Andersen’s indictment and conviction for obstruction of justice highlighted the role of accountants in structuring and auditing corporate transactions that turned out to be fraudulent or illegal.”); *supra* notes 8–29.

184. See *supra* notes 132–37, 153–62, and accompanying text.

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Thus, this Article posits that the regulatory abyss would best be remedied by making changes to the structure of the USA. Since the USA has been amended in the past, it is amenable to adaptation in the future.<sup>185</sup> While the 2002 revision added the language “associate of the seller” in addition to “employee of the seller,”<sup>186</sup> this language has not been widely adopted<sup>187</sup> and fails to provide sufficient clarity. In addition, many state legislatures may legitimately be concerned that the language “associated with” is too expansive, thereby encompassing unintended parties within the liability net. Thus, a solution to the current gap in liability must reach those parties best positioned to fulfill the gatekeeping role, but avoid any ambiguity that might result in over-inclusion via judicial misconstruction. This Article proposes such a solution.

The USA should be amended to include *every person who, directly or indirectly, has or maintains a contractual relationship with the seller or whose employer or contractor, directly or indirectly,<sup>188</sup> has or maintains a contractual relationship with the seller who materially aids in the sale.* The amended USA would provide as follows:

(b) Every person who directly or indirectly controls a seller liable under subsection (a), every partner, officer, or director of such a seller, every person occupying a similar status or performing similar functions, every employee of such a seller who materially aids in the sale, ***every person who, directly or indirectly, has or maintains a contractual relationship with the seller or whose employer or contractor, directly or indirectly, has or maintains a contractual relationship with the seller who materially aids in the sale,*** and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with and to the same extent as the seller, unless the non-seller who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.<sup>189</sup>

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185. For example, the categories of investment advisers, representatives, and those giving investment advice for financial benefit have been added to the USA. See UNIF. SEC. ACT § 410(b) (UNIF. LAW COMM’N 2002) (adding as a category of persons those giving advice for financial benefit).

186. See *id.* § 509(g)(3).

187. See *supra* note 81 (noting that the majority of states have adopted the Uniform Securities Act of 1956); *supra* note 85 (explaining the lack of precedent or comment on this “associated” language).

188. The addition of the “directly or indirectly” language is intended as a safeguard against potentially subject entities using corporate intermediaries or other types of business enterprises to avoid liability under the Act.

189. Proposed addition bold and italicized.

By employing this language, the unwarranted distinction between employees and “contract vendors” would be eliminated. Moreover, this language is not over-encompassing and does not have the ambiguity present in the term “associated with the seller” found in the 2002 amendment to the USA. It would also ensure that outside counsel and other outside professionals are held to the same standard as their counterparts working within the subject corporation. Further, aggrieved investors would not be arbitrarily deprived of a private remedy under the Act.

The application of the USA to all such collateral actors, whether employees or outside advisers, would provide stability in application and should not produce an undue chilling effect on professional services incidental to securities transactions. Rather, in practice, this approach should incentivize outside gatekeepers to aptly perform their obligations. In addition, it provides a fair and predictable application of the law that aids aggrieved investors, protects the reputation of collateral securities professionals, and enhances the integrity of the securities markets as a whole.

Finally, this recommended approach would not detrimentally affect those secondary actors integral to the securities offering process. This is because, first, secondary liability was prevalent in the federal arena for several decades and, in fact, the law in every circuit supported it.<sup>190</sup> Second, collateral actors have been and are still subject to government enforcement actions.<sup>191</sup> Moreover, the USA provides an affirmative defense, entitling the defendant to show that she did not and should not have reasonably known of the violation.<sup>192</sup> Thus, this framework encourages a consistent adherence to the gatekeeping function while enabling diligent actors to avoid liability.

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190. See, e.g., *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 192 (1994) (Stevens, J., dissenting) (“In *hundreds* of judicial and administrative proceedings in every Circuit in the federal system, the courts and the SEC have concluded that aiders and abettors are subject to liability under § 10(b) and Rule 10b-5.”); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104 (5th Cir. 1988); see also Steinberg, *supra* note 7, at 489–90 (discussing the Supreme Court’s narrowing of the scope of the federal securities laws).

191. See Baer & Dulaney, *supra* note 172 (discussing the massive \$5.1 billion regulatory penalty assessed against Goldman Sachs).

192. See Kim, *supra* note 20, at 417–18 (“[S]olutions intended to incentivize the gatekeeper to interdict (e.g., harsh sanctions imposed on the gatekeeper who has ‘knowledge’ of client wrongdoing but nonetheless fails to interdict) may perversely disincentivize monitoring. A gatekeeper who potentially faces the hard decision of either losing one’s job (being fired for resisting the wrongdoer) or losing one’s professional license (for failing to resist the wrongdoer) will prefer to cloister herself within her office and hear no evil.” (citation omitted)).

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CONCLUSION

To achieve an equitable framework that encourages gatekeepers to better protect the investing public, enhance the integrity of the securities markets, and safeguard the reputation of professionals, all collateral actors—whether inside or outside—should be held liable under the USA to the same extent. With the massive investor losses incurred due to violations of the securities laws in the past two decades because of scandals such as Baptist Foundation of Arizona, Enron, Tyco, Worldcom, and the more recent Madoff and Stanford Ponzi Schemes,<sup>193</sup> the accountants' and lawyers' work product has been used to inflict more pecuniary loss than anyone a few decades ago ever could have imagined. Considering the staggering potential consequences of a failure in gatekeeper vigilance, meaningful precautions should be taken to protect the vitality of the gatekeeping system in order to help prevent similar financial debacles in the future. The recommendations set forth in this Article aim to achieve this objective—to successfully catalyze the outside adviser's gatekeeping role without imposing undue liability.

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193. See, e.g., Scott Cohn, *Five Years After Stanford Scandal, Many Victims Penniless*, CNBC (Feb. 15, 2014, 2:23 PM), <http://www.cnbc.com/2014/02/14/-many-victims-penniless.html> [<http://perma.cc/E7FY-ZYEW>] (noting that Ponzi scheme defrauded investors of over \$7 billion); Jan Lee, *Madoff Ponzi Scheme Judgments Slam 'Gatekeepers' Ernst & Young*, TRIPLEPUNDIT (Nov. 17, 2015), <http://www.triplepundit.com/2015/11/madoff-ponzi-scheme-judgments-slam-gate-keepers-ernst-young/> [[http://perma.cc/8\]NK-G8Y7](http://perma.cc/8]NK-G8Y7)] (stating that an estimated \$17 billion was taken from aggrieved investors); Norris, *supra* note 16 (estimating that investors lost \$350 million not including interest).