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Liability for "Causing" Violations of the Federal Securities Laws: Defining the SEC's Next Counterattack in the Battle of Central Bank

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I. Introduction

Congress passed the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (Remedies Act)[1] to arm the U.S. Securities and Exchange Commission (SEC or Commission) with a broader arsenal of procedural and remedial weapons than it had previously possessed in order to facilitate the Commission's function of enforcing the federal securities laws.[2] In so doing, however, the legislators inadvertently created a new form of *substantive* liability for "causing" any other person or entity to violate any of these statutes and regulations.[3] The Remedies Act states in relevant part:

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1. Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931 (codified in scattered sections of 15 U.S.C.).

2. *See* Ralph C. Ferrara et al., *Hardball! The SEC's New Arsenal of Enforcement Weapons*, 47 BUS. LAW. 33, 33 (1991) (explaining purpose of Remedies Act); *infra* text accompanying note 13 (reciting new remedies such as cease-and-desist orders and civil monetary penalties). For a general description of the SEC and the statutes it administers, see 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 224–318 (3d ed., rev. vol. 1998). The SEC's Division of Enforcement files civil and administrative lawsuits against persons and companies that engage in fraudulent activities (such as insider trading, market manipulation, and drafting misleading financial and proxy statements) and nonfraudulent, but nonetheless illegal, conduct (such as corporate reporting and recordkeeping violations, broker-dealer misconduct, and improper registration of securities). *See infra* Part III.D (discussing types of securities law violations); *infra* note 7 and accompanying text (describing SEC enforcement mandate). *See generally* 2 MATTHEW BENDER & CO., FEDERAL SECURITIES EXCHANGE ACT OF 1934 § 9.02 (4th ed. 2002) (providing overview of SEC enforcement regime). Any person may be liable for "causing" any other person to engage in any of these violations. *See infra* Part III.D (discussing applicability of causing liability to various violations); *infra* note 19 and accompanying text (noting breadth of causing liability statutes).

3. *See* Steven W. Hansen, *The Securities and Exchange Commission's Use of Cease and Desist Authority: A Preliminary Appraisal*, 20 SEC. REG. L.J. 339, 343 (1993) (observing that "the [Remedies Act] cease-and-desist provisions may indirectly change the reach of the substantive securities laws" by means of "causing" liability); Bruce A. Hiler & Neil K. Gilman, *The SEC's Use of Its Cease-and-Desist Authority: A Survey*, 23 SEC. REG. L.J. 235, 239 (1995) ("Although the cease-and-desist authority is widely viewed as a remedies provision, it, in effect, creates a new category of secondary liability under the securities laws through the language of the provisions authorizing an action against any person who is a 'cause' of another's viola-

> If the Commission finds, after notice and opportunity for hearing, that any person is violating, has violated, or is about to violate any provision of this title, or any rule or regulation thereunder, the Commission may publish its findings and enter an order requiring such person, *and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation*, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation.[4]

Surprisingly, the scope of this "causing" liability has remained largely undefined for over ten years.[5] In fact, the Commission began to delineate its essential elements only two years ago.[6] Thus, the purposes of this Note are to explain the relatively slow development of causing liability, to analyze how and why the Commission began to define it, to propose reasonable solutions for the definitional controversies that remain, and to describe why causing liability is becoming an increasingly important weapon for the enforcement of securities laws.

The creation and initial growth of causing liability is attributable to the manner in which the Remedies Act altered the SEC enforcement program. The SEC exercises its duty to enforce the federal securities laws in two ways: by filing civil actions in federal district court and by instituting administrative enforcement proceedings before administrative law judges (ALJs).[7] However,

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tion."); Daniel J. Morrissey, *SEC Injunctions*, 68 TENN. L. REV. 427, 465 (2001) ("The Commission could conceivably use that wording ['causing' violations] to create new types of secondary liability . . . .").

4. Securities Enforcement Remedies and Penny Stock Reform Act of 1990 § 203, Pub. L. No. 101-429, 104 Stat. 931 (codified at Securities Act of 1933 § 8A(a), 15 U.S.C. § 77h-1(a) (2000); Securities Exchange Act of 1934 § 21C(a), 15 U.S.C. § 78u-3(a) (2000); Investment Company Act of 1940 § 9(f)(1), 15 U.S.C. § 80a-9(f)(1) (2000); Investment Advisers Act of 1940 § 203(k)(1), 15 U.S.C. § 80b-3(k)(1) (2000)) (emphasis added). The Remedies Act amended four major federal securities statutes to provide the cease-and-desist order as a remedy for violating or causing a violation of each. *See* William R. McLucas et al., *SEC Enforcement: A Look at the Current Program and Some Thoughts About the 1990s*, 46 BUS. LAW. 797, 832 (1991) (noting four provisions).

5. *See* Stephen J. Crimmins & Mitchell E. Herr, *SEC Resolves Long-Standing Questions About Its Cease-and-Desist Remedy*, 33 SEC. REG. & L. REP. (BNA) 1084, 1084 (July 23, 2001) (noting "long-standing questions" and "considerable uncertainty" surrounding causing liability and cease-and-desist orders from 1990 until 2001).

6. *See infra* Parts III.C.3 & III.E.1 (discussing *KPMG Peat Marwick LLP*, Exchange Act Release No. 43,862, 74 SEC Docket 384 (Jan. 19, 2001), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002)).

7. *See* 2 MATTHEW BENDER & CO., *supra* note 2, § 9.02[1]-[2] (distinguishing two types of SEC enforcement actions). The SEC Rules of Practice contain the procedural requirements for both Commission and ALJ hearings. SEC Rules of Practice 110-490, 17 C.F.R. § 201.110-490 (2002); *see also* 2 MATTHEW BENDER & CO., *supra* note 2, § 9.02[2][d]

the remedies available to the Commission have varied over time and continue to vary based on the type of enforcement proceeding. Before 1990, the SEC primarily relied on its civil enforcement power, which allowed it to seek injunctions[8] and ancillary equitable relief[9] from federal courts for any type of securities law violation. Later legislative enactments gave the SEC the right to ask federal courts to impose civil monetary penalties for insider trading.[10] In contrast, the Commission reserved the administrative forum for disciplinary actions against regulated securities professionals like broker-dealers, investment advisers, and their associates, as well as accountants and attorneys.[11] The remedies in these cases were limited to censure, registration suspension or

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(surveying rules). The SEC does not engage in criminal prosecution of securities law violations, but it does refer egregious cases to the Department of Justice for that purpose. *See* Margaret V. Sachs, *Harmonizing Civil and Criminal Enforcement of Federal Regulatory Statutes: The Case of the Securities Exchange Act of 1934*, 2001 U. ILL. L. REV. 1025, 1026–27, 1040–41 (stating that Exchange Act is "hybrid statute" providing for civil and criminal enforcement); *infra* note 8 (listing injunction provisions that also provide for criminal referrals). Securities litigation instituted by private plaintiffs also plays an important enforcement role, but Congress has not been receptive to it recently. *See* Bradley R. Aronstam, Note, *The Private Securities Litigation Reform Act of 1995's Paradigm of Ambiguity: A Circuit Split Ripe for Certiorari*, 28 HOFSTRA L. REV. 1061, 1061–62, 1068–70 (2000) (recounting problems with private securities suits that prompted major legislative response). This Note will not focus on private actions because only the SEC can utilize causing liability under its cease-and-desist authority. *See* Securities Exchange Act of 1934 § 21C(a), 15 U.S.C. § 78u-3(a) (2000) (stating only that Commission may enter causing liability orders).

8. *See* Morrissey, *supra* note 3, at 439 & n.78 (citing following injunction provisions of federal securities laws: Securities Act of 1933 § 20(b), 15 U.S.C. § 77t(b) (2000); Trust Indenture Act of 1939 § 321(a), 15 U.S.C. § 77uuu(a) (2000); Securities Exchange Act of 1934 § 21(d), 15 U.S.C. § 78u(d)(1) (2000); Public Utility Holding Company Act of 1935 § 18(e), 15 U.S.C. § 79r(e) (2000); Investment Company Act of 1940 § 42(d), 15 U.S.C. § 80a-41(d) (2000); Investment Advisers Act of 1940 § 209(d), 15 U.S.C. § 80b-9(d) (2000)). Injunctions were the SEC's first enforcement tool. *Id.* at 439–40.

9. *See* Gary Langan Goodenow, *Litigating the SEC's Ancillary Enforcement Remedies Following* Central Bank *and Its Progeny*, 21 AM. J. TRIAL ADVOC. 67, 67, 71 (1997) (observing that courts created remedies of disgorgement, asset freezes, and receiver appointments pursuant to equity jurisdiction because federal securities statutes did not expressly provide them for SEC civil enforcement actions). *But see infra* note 133 (citing recent codification of ancillary equitable remedies).

10. *See* Arthur B. Laby & W. Hardy Callcott, *Patterns of SEC Enforcement Under the 1990 Remedies Act: Civil Money Penalties*, 58 ALB. L. REV. 5, 8 & n.23, 9 & n.30 (1994) (citing Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (codified in scattered sections of 15 U.S.C.); Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (codified in scattered sections of 15 U.S.C.)).

11. *See* McLucas et al., *supra* note 4, at 830 (noting that traditional SEC administrative power was only over regulated persons); Morrissey, *supra* note 3, at 464 (same); *infra* note 48 (giving relevant statutes).

revocation, activity limitations, and denial of the ability to practice before the Commission.[12]

However, by amending various provisions of the federal securities laws, the Remedies Act expanded SEC enforcement authority along numerous fronts by allowing the Commission to:

> (1) [s]eek civil penalties for (a) violations of the securities statutes and rules and regulations thereunder, other than violations involving insider trading, and (b) violations of cease-and-desist orders in federal district court; (2) impose monetary penalties and enter orders requiring an accounting and disgorgement in administrative proceedings against regulated entities such as broker-dealers, investment advisers and their associated persons; (3) *issue cease-and-desist orders against any person, and order respondents in such proceedings to account for and disgorge ill-gotten gains*; (4) issue temporary cease-and-desist orders against regulated entities; and (5) seek orders from federal district courts prohibiting persons from serving as officers and directors of reporting companies if the person has violated certain antifraud provisions of the federal securities laws and if the person's conduct demonstrates a lack of fitness.[13]

Thus, the Remedies Act permitted the SEC for the first time to bring administrative enforcement actions seeking to order *any* person to refrain permanently (or "cease and desist") from violating *or causing* a violation of *any* statute or regulation and to return any illicit proceeds to the Commission for distribution to injured parties.[14] Most commentators correctly predicted that the SEC would quickly begin taking advantage of this new remedial flexibility to try less serious cases, including those involving causing liability, before ALJs.[15]

Nevertheless, the early adjudication of causing liability cases occurred without a corresponding development of the law governing causing liability. Moreover, although commentators have thoroughly analyzed most aspects of

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12. *See* Ann Maxey, *SEC Enforcement Actions Against Securities Lawyers: New Remedies vs. Old Policies*, 22 DEL. J. CORP. L. 537, 548 (1997) (reviewing remedies against attorneys); McLucas et al., *supra* note 4, at 830 (reviewing remedies against broker-dealers and investment advisers).

13. Ferrara et al., *supra* note 2, at 33–34 (emphasis added). Congress passed the Remedies Act out of frustration with the inflexibility of traditional equitable remedies for combating securities fraud. *Id.* at 35–36. Such remedies were simultaneously ineffective deterrents in some cases and drastically harsh penalties in others. *Id.* For a comparison of cease-and-desist orders with injunctions, see *infra* Part III.C.2.

14. *See* Hansen, *supra* note 3, at 348–49 (reviewing new remedies under Remedies Act).

15. *See* Crimmins & Herr, *supra* note 5, at 1084 ("Over the last decade, cease-and-desist proceedings have become an important enforcement tool for the Commission and are now a substantial portion of its enforcement docket."); *infra* notes 16, 19, 23 (reviewing commentators' concerns about breadth and increased use of both cease-and-desist orders and causing liability).

the Commission's cease-and-desist authority under the Remedies Act,[16] causing liability has remained relatively untouched. Initial scholarly critique of the Remedies Act simply overlooked causing liability[17] as the newest form of "secondary" liability for securities law violations;[18] that is, liability for somehow assisting another person or entity's violation, as opposed to "primary" liability for violating the text of a statute oneself. Later studies noted the uncertain and possibly large breadth of causing liability but, given the paucity of judicial and administrative materials addressing the subject, gave it rather cursory treatment.[19] The Commission itself precipitated this dearth of

16. *See* Ferrara et al., *supra* note 2, at 58–59 (expressing concern over breadth of power to order compliance, despite fact that cease-and-desist authority would reduce litigation over collateral consequences of injunctions); Hansen, *supra* note 3, at 347–53 (surveying SEC's use of cease-and-desist authority and debating propriety of not requiring showing of likely future violations in cease-and-desist proceedings); Hiler & Gilman, *supra* note 3, at 237–40 (addressing concerns that SEC would use lax procedural and evidentiary rules of administrative proceedings to bring marginal cases and create new law by enforcement rather than rulemaking); John F.X. Peloso & Elizabeth A. Corley, *The SEC's Cease-and-Desist Powers*, 26 REV. SEC. & COMMODITIES REG. 11, 15–16 (1993) (finding that SEC is using cease-and-desist orders as additional, not alternative, remedies); John Marshall Cook, Comment, *The Securities Enforcement and Penny Stock Reform Act of 1990: The Cost of Flexibility*, 6 ADMIN. L.J. AM. U. 359, 385–86 (1992) (downplaying claims that broader cease-and-desist orders will replace injunctions and that ALJs are not sufficiently impartial); David Franklin Levy, Comment, *The Impact of the Remedies Act on the SEC's Ability to Obtain Injunctive Relief*, 44 AM. U. L. REV. 645, 678–84 (1994) (claiming that courts are less likely to grant SEC injunction requests after Remedies Act because speedier administrative forum obviates pressing need for equity powers and because cease-and-desist orders lack collateral consequences of injunctions).

17. *See* Cook, *supra* note 16, at 381–83 (failing to discuss causing liability); Matthew Scott Morris, Comment, *The Securities Enforcement Remedies and Penny Stock Reform Act of 1990: By Keeping Up with the Joneses, the SEC's Enforcement Arsenal Is Modernized*, 7 ADMIN. L.J. AM. U. 151, 163–64, 190–99 (1993) (same).

18. *See* Carrie E. Goodwin, Note, Central Bank v. First Interstate Bank: *Not Just the End of Aiding and Abetting Under Section 10(b)*, 52 WASH. & LEE L. REV. 1387, 1392–93 (1995) (distinguishing primary from secondary liability).

19. *See* Ferrara et al., *supra* note 2, at 59–60 (noting that causing liability "raises concerns" because legislative history is silent regarding its mental state requirement, but that SEC is likely to use negligence standard); Hansen, *supra* note 3, at 343–47, 354–55 (reviewing scant legislative history regarding causing liability and Commission's initial reluctance to extend doctrine beyond aiding and abetting); Hiler & Gilman, *supra* note 3, at 239, 266–68 (calling causing doctrine "unclear and potentially extremely broad" and assessing dangers of SEC's apparent preference for negligence standard); Simon M. Lorne & W. Hardy Callcott, *Administrative Actions Against Lawyers Before the SEC*, 50 BUS. LAW. 1293, 1307–09 (1995) (stating that SEC has not resolved various issues regarding causing liability and that causing could be broader and easier to prove than aiding and abetting); S. Scott Luton, *The Ebb and Flow of Section 10(b) Jurisprudence: An Analysis of* Central Bank, 17 U. ARK. LITTLE ROCK L.J. 45, 67 (1994) (stating, without citing any authority, that causing liability encompasses negligent conduct that would not constitute aiding and abetting); Maxey, *supra* note 12, at 570–78

commentary by continually refusing to distinguish causing liability from the other forms of secondary liability at its disposal.[20] Eventually, however, the judicial assault on these other theories during the late 1990s[21] seemed to force the Commission into its first examination of causing liability in January 2001, when it defined the mental state requirement for causing liability in the case of *KPMG Peat Marwick LLP*.[22]

Given that the SEC will likely use causing liability more frequently to compensate for its loss of other secondary liability theories,[23] the time has

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(showing that Commission is allowing its administrative law judges to impose causing liability on attorneys without announcing definitive standards); McLucas et al., *supra* note 4, at 835 (noting that causing liability may apply to broader class of defendants than aiding and abetting, but not discussing why); Morrissey, *supra* note 3, at 464–67 (noting "expansive language" of causing liability, unfairness of its apparent negligence standard, and debate over recidivism requirement); Peloso & Corley, *supra* note 16, at 17 (noting that while meaning of causing "remains cloudy," SEC appears to be equating it with aiding and abetting); Bettina M. Lawton & Catherine Botticelli, *New Weapon in the SEC's Arsenal: Secondary Liability After* Central Bank, BUS. L. TODAY, July/August 1995, at 34 (suggesting that, despite lack of direct authority interpreting causing liability, SEC will adopt negligence standard).

20. *See infra* Part III.C.1 (discussing Commission's prevention of development of causing liability law).

21. *See infra* Part II (discussing decline of secondary liability for securities law violations).

22. *See infra* Parts III.C.3 & III.E.1 (discussing *KPMG*). *KPMG* may ultimately spark greater academic interest in causing liability as well. *See* 3 THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 16.5 (4th ed. 2002) (mentioning holding in *KPMG Peat Marwick LLP*, Exchange Act Release No. 43,862, 74 SEC Docket 384 (Jan. 19, 2001)); 1 MARC L. STEINBERG & RALPH C. FERRARA, SECURITIES PRACTICE: FEDERAL AND STATE ENFORCEMENT § 6:15 (2d ed. 2002) (mentioning holding in *KPMG, LLP v. SEC*, 289 F.3d 109 (D.C. Cir. 2002), which affirmed Commission's holding regarding negligence standard); *Annual Review of Federal Securities Regulation*, 58 BUS. LAW. 747, 895–99 (2003) (discussing D.C. Circuit's holding in *KPMG*); Crimmins & Herr, *supra* note 5, at 1084–87 (discussing Commission's holding in *KPMG*); Christian J. Mixter, *Individual Civil Liability Under the Federal Securities Laws for Misstatements in Corporate SEC Filings*, 56 BUS. LAW. 967, 984 (2001) (noting, but not discussing, Commission's holding in *KPMG*). *See generally* Dhaivat H. Shah, *The Care and Feeding of an SEC Cease-and-Desist Order: The Commission Defines Its Authority Through* In the Matter of KPMG Peat Marwick, LLP, 25 HAMLINE L. REV. 271 (2002) (examining Commission's holding in *KPMG*).

23. *See* Ferrara et al., *supra* note 2, at 59–60 (predicting that SEC will pursue more cases administratively if causing liability requires only negligence, because aiding and abetting claims in federal court require scienter); Hiler & Gilman, *supra* note 3, at 238–39 (stating that causing liability is "a valuable enforcement tool for the SEC" after *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994)); Lorne & Callcott, *supra* note 19, at 1309 (concluding that broad causing liability coupled with *Central Bank* holding will lead Commission to pursue more attorneys by administrative action for assisting securities law violations); Lawton & Botticelli, *supra* note 19, at 34, 39 (arguing that informal SEC statements suggest causing liability is broader than aiding and abetting and will thus become increasingly important

come for the Commission and the courts to define *all* of the basic elements governing causing liability in order to provide a fair, effective, and predictable basis for imposing permanent cease-and-desist orders on secondarily liable persons. Towards this end, this Note will review the slow development of causing liability and propose reasonable solutions for the controversies still surrounding it. Part II briefly recounts the recent decline of other forms of secondary liability for securities violations to illustrate the increasing importance of causing liability and thus the need for a clearer definition of its elements.[24] In the wake of *KPMG*, Part III discusses and attempts to resolve current interpretive issues regarding causing liability by comparing it to the similar but distinct concept of aiding and abetting.[25] These interpretive issues include the required mental state for causing a primary violation that requires scienter,[26] the degree of action required to trigger causing liability by contributing to another person's violation,[27] and the necessary causal nexus between the contributing act and the ensuing primary violation.[28] Finally, Part IV concludes that causing liability is appropriately different from and easier to establish than aiding and abetting liability.[29] The Commission and the courts should hold (1) that causing liability attaches to acts or omissions that are both a factual and a legal cause of the secondary actor's contribution to the underlying violation and (2) that, in most cases, the causing party need only act negligently, regardless of whether the primary violation requires a higher mental state.

II. The Decline of Secondary Liability

A. Aiding and Abetting

In the early 1990s, the SEC may not have felt the need to define causing liability simply because it had so many other theories of secondary liability

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after *Central Bank*); Richard M. Phillips, *Soft Dollar Decision Raises Concerns Over SEC Administrative Proceedings*, INSIGHTS, Vol. 8, No. 7, at 2, 2 (noting that defense bar celebration over *Central Bank* might wane if Commission uses causing liability to reach aider-abettors by administrative action); *infra* Part II (discussing *Central Bank* and decline of secondary liability generally). *But see* Morrissey, *supra* note 3, at 470–72 (claiming that congressional revival of aiding and abetting for SEC actions after *Central Bank* will preserve use of injunctions against rise of cease-and-desist orders).

24. *See infra* Part II (discussing decline of secondary liability generally).

25. *See infra* Part III (comparing causing liability with aiding and abetting).

26. *See infra* Part III.E.1 (examining degree of knowledge requirement for causing liability).

27. *See infra* Part III.E.2 (examining degree of action for causing liability).

28. *See infra* Part III.E.3 (analyzing causal nexus for causing liability).

29. *See infra* Part IV (concluding that aiding and abetting liability differs from causing liability in material respects).

upon which it could rely.[30] However, during the mid-1990s, the demise and partial revival of aiding and abetting as a tenable theory of secondary liability in securities litigation started a domino effect that continues to threaten the SEC's ability to use other forms of secondary liability.[31] Thus, the overall decline of secondary liability removed a major impediment to defining causing liability and paved the way for it to become the preferred form of secondary liability for SEC enforcement actions.

Although the principal antifraud provision of the federal securities laws, Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act),[32] does not expressly provide a right of action for private plaintiffs, courts had long inferred that this right existed against both primary[33] and secondary defendants.[34] Most federal courts also agreed on three basic elements for an aiding and abetting claim: (1) someone other than the aider-abettor violated the text of a federal securities law, (2) the aider-abettor had general awareness or knowledge of the primary violation or his own improper conduct, and (3) the aider-abettor provided substantial assistance to the primary violator.[35]

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30. *See infra* Part II.A–C (discussing various forms of secondary liability).

31. *See* Goodwin, *supra* note 18, at 1389 (doubting future of conspiracy and vicarious liability claims).

32. *See* Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j (2000) (prohibiting deceptive or manipulative acts in connection with purchase or sale of any security). Section 10(b) is executed by Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (2002). *See* Goodwin, *supra* note 18, at 1390 n.14 (noting role of Rule 10b-5).

33. *See* Goodwin, *supra* note 18, at 1391–92 & nn.16–21 (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196–97 (1976) (recognizing implied primary private right of action under Section 10(b)); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975) (same); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) (same); Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512, 513 (E.D. Pa. 1946) (same)). The Supreme Court has consistently refused to reconsider whether an implied private right of action exists for primary violations of Section 10(b). *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 380 & n.10 (1983) ("The existence of this implied remedy is simply beyond peradventure.").

34. *See* Goodwin, *supra* note 18, at 1392–94 & nn.26–29 (reviewing cases from twelve federal courts of appeals after 1966 acknowledging private action against aider-abettors). However, the Supreme Court twice reserved the question of whether private aiding and abetting actions existed under Section 10(b). *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 379 n.5 (1983) (reserving issue); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 191 n.7 (1976) (same).

35. *See* David S. Ruder, *The Future of Aiding and Abetting and Rule 10b-5 After* Central Bank of Denver, 49 BUS. LAW. 1479, 1479–80 & n.4 (1994) (giving elements of aiding and abetting and citing cases); Goodwin, *supra* note 18, at 1395 & n.32 (same). Despite the common-law roots of aiding and abetting in tort and criminal law, courts differed on (1) whether knowing inaction with an intent to assist could constitute substantial assistance absent a fiduciary duty to disclose and (2) whether recklessness could satisfy both the Rule 10b-5 mental state requirement for the primary violator and the awareness requirement for aiding and abetting. *See* 1 HAZEN, *supra* note 22, § 7.13[1] (noting courts' slightly different approaches

Despite this general agreement, in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*,[36] the Supreme Court held that aiding and abetting claims are untenable under Section 10(b) because Congress did not explicitly provide for them in that text.[37] Although *Central Bank* arose in the context of private securities litigation and the majority opinion's language seemed to confine this surprising holding to that realm,[38] the dissenting Justices and commentators observed that the Court's textualist reasoning was equally applicable to SEC enforcement actions based on aiding and abetting.[39] Subsequently, many courts began dismissing SEC complaints based on aiding and abetting liability, and even the Commission appeared to acquiesce to this interpretation of *Central Bank*.[40]

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to aiding and abetting); Ruder, *supra*, at 1484–85 & nn.25–27 (same); Goodwin, *supra* note 18, at 1395–98 & nn.22, 36–42 (reviewing common-law roots and circuit differences).

36. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994). In *Central Bank*, the Court considered whether private civil liability under Section 10(b) extends to aider-abettors. *Id.* at 166–67. The case involved a claim by bondholders that the issuer, its underwriters, and a real estate developer had intentionally misrepresented the value of the real estate that secured the bonds. *Id.* at 167–68. The bondholders also claimed that Central Bank of Denver, as the indenture trustee, had aided and abetted the fraud by agreeing with the developer to delay an independent review of the appraisal until after the bond issue. *Id.* at 168. Despite a Tenth Circuit finding that the plaintiffs had shown sufficient recklessness and substantial assistance on the part of Central Bank to survive summary judgment, the Supreme Court reversed. *Id.* at 168–69, 192. Writing for the majority, Justice Kennedy reasoned that "[i]t is inconsistent with settled methodology in § 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text," regardless of whether such an extension furthers the broad policy objectives of the federal securities laws. *Id.* at 177, 188. Rejecting other arguments based on legislative intent and subsequent reenactment or acquiescence, the Court held that private plaintiffs may not maintain aiding and abetting claims under Section 10(b). *Id.* at 179, 183–86, 191.

37. *Id.* at 191.

38. *See id.* at 167, 171, 191 (discussing issue and holding in terms of private plaintiffs); Joel Seligman, *The Implications of* Central Bank, 49 BUS. LAW. 1429, 1430–32 (1994) (calling holding "unexpected" because Court had endorsed implied right of action for contribution under Section 10(b) in 1993 and eleven courts of appeals had endorsed implied action for aiding and abetting).

39. *See Cent. Bank*, 511 U.S. at 200 (Stevens, J., dissenting) ("The majority leaves little doubt that the Exchange Act does not even permit the SEC to pursue aiders and abettors in civil enforcement actions under § 10(b) and Rule 10b-5."); Seligman, *supra* note 38, at 1434–35 (citing language in *Aaron v. SEC*, 446 U.S. 680, 691 (1980), for proposition that same construction of Section 10(b) applies regardless of whether plaintiff is SEC or private party). For a discussion of the Supreme Court's escalating assault on implied private actions in general under the federal securities laws, see 9 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4312–39 (3d ed. 1992).

40. *See* Goodwin, *supra* note 18, at 1410 & n.125 (citing dismissed cases and remarks of then SEC Chairman Arthur Levitt that Commission would not litigate extension of *Central Bank* to SEC actions given availability of other enforcement options); Christi Harlan, *SEC Is*

That submissive attitude was short-lived, however. The SEC and its political allies soon persuaded Congress to overrule part of the holding in *Central Bank* by including a provision in the Private Securities Litigation Reform Act of 1995 (PSLRA) restoring the Commission's ability to pursue secondary defendants for aiding and abetting violations of the Exchange Act.[41] Section 20(e) of the Exchange Act reads:

> For purposes of any action brought by the Commission under paragraph (1) or (3) of section 21(d) [of the Exchange Act] *any person that knowingly provides substantial assistance to another person in violation of a provision of [the Exchange Act]*, or of any rule or regulation issued under [the Exchange Act], shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.[42]

However, this aiding and abetting restoration provision contains two ambiguities that courts very well may resolve against the SEC. First, by not defining the term "substantial assistance" in the statute's text, Congress failed to intervene in a longstanding judicial dispute as to whether inaction can satisfy this element.[43] Second, the insertion of the word "knowingly" into the statutory definition may have resolved the issue of the level of scienter[44] required to aid

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Voluntarily Dropping Charges in Certain Cases Due to High Court Ruling, WALL ST. J., May 6, 1994, at C15 (reporting securities defense bar reaction to SEC acquiescence).

41. Lewis D. Lowenfels & Alan R. Bromberg, *A New Standard for Aiders and Abettors Under the Private Securities Litigation Reform Act of 1995*, 52 BUS. LAW. 1, 3–4 (1996). The legislation was a compromise, however, in that it did not restore the aiding and abetting action for private plaintiffs. *Id.* at 7–8.

42. Private Securities Litigation Reform Act of 1995 § 104, 15 U.S.C. § 78t(e) (2000) (emphasis added).

43. *See* Ruder, *supra* note 35, at 1484–85 & nn.25–26 (noting dispute and recommending that, if Congress acts, it should not recognize inaction as substantial assistance without existence of duty to disclose); Goodwin, *supra* note 18, at 1396–97 & nn.36–40, 1430–31 (noting dispute and recommending legislative definition); *infra* note 222 (citing divided case law on this issue).

44. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12, 194 (1976) (defining scienter as "a mental state embracing intent to deceive, manipulate, or defraud" and holding that private plaintiffs must show it to prove primary violations of Rule 10b-5); *see also* Aaron v. SEC, 446 U.S. 680, 691 (1980) (holding that SEC must also prove primary violator's scienter in Rule 10b-5 civil enforcement actions). The Supreme Court twice reserved the question of whether a showing of recklessness satisfies the scienter requirement for securities fraud under Rule 10b-5 and has yet to decide the issue. *See Aaron*, 446 U.S. at 686 n.5 (reserving issue); *Hochfelder*, 425 U.S. at 194 n.12 (same). Until 1995, most circuits held that recklessness sufficed, but language in the PSLRA created circuit splits (and a deluge of commentary) regarding the substantive scienter requirement and, more controversially, what facts plaintiffs must plead to meet this requirement. *See* Christopher J. Hardy, Comment, *The PSLRA's Heightened Pleading Standard: Does Severe Recklessness Constitute Scienter?*, 35 U.S.F. L. REV. 565, 568–69 & nn.34–37 (2001) (outlining splits and citing cases and commentary).

and abet a violation by trumping previous holdings by some courts that recklessness sufficed in lieu of a knowing violation.[45] To date, the U.S. Court of Appeals for the Ninth Circuit is the only court that has endorsed this view.[46] The Commission has maintained, both before and after the passage of the PSLRA, that recklessness satisfies the scienter requirement for aiding and abetting.[47] Thus, continuing litigation over the contours of aiding and abetting liability after the PSLRA could make causing liability a more attractive enforcement option for the SEC, especially if courts eventually require the SEC to prove the higher scienter standard of knowledge rather than recklessness.[48]

Scienter requirements for primary violators and aider-abettors present two distinct issues, however. *Compare* Lowenfels & Bromberg, *supra* note 41 (analyzing latter) *with* Hardy, *supra* (analyzing former).

45. *See* Lowenfels & Bromberg, *supra* note 41, at 5–8 & nn.27–31 (citing conflicting cases on whether recklessness satisfies scienter for aiding and abetting and supporting view that new statute mandates scienter requirement of actual knowledge with reasoning from text, legislative history, and statutory purpose). Courts generally have defined recklessness in the securities fraud context as "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." Allan Horwich, *The Neglected Relationship of Materiality and Recklessness in Actions Under Rule 10b-5*, 55 BUS. LAW. 1023, 1024 & n.10 (2000) (citations omitted).

46. *See* SEC v. Fehn, 97 F.3d 1276, 1288 n.11 (9th Cir. 1996) ("Section 104, by its plain terms, requires 'know[ledge]' as an element of aiding and abetting."); Maxey, *supra* note 12, at 567 (stating that Ninth Circuit dicta stands alone).

47. *See* Mixter, *supra* note 22, at 983 (discussing SEC's position). The SEC has voiced this position primarily through administrative proceedings based on willful aiding and abetting by securities professionals. *See* Graham v. SEC, 222 F.3d 994, 1004 (D.C. Cir. 2000) (reiterating, in case involving willful aiding and abetting, that recklessness constitutes scienter); *infra* note 48 (reviewing willful aiding and abetting statutes).

48. *See supra* note 23 (reviewing commentators' assessments of same possibility after *Central Bank*). However, even after *Central Bank*, Section 20(e) is not the sole basis for aiding and abetting charges. Other sections of the federal securities laws also expressly provide for aiding and abetting liability, but only against securities professionals subject to extensive SEC regulation. *See* Securities Exchange Act of 1934 §§ 15(b)(4), (6), 21B, 15 U.S.C. §§ 78o(b)(4), (6), 78u-2 (2000) (providing that Commission may penalize broker-dealers and their associates in numerous ways (including fines, disgorgement, and registration revocation) for willfully aiding or abetting violations of federal securities laws); Investment Advisers Act of 1940 § 203(e)(6), (f), (i), (j), 15 U.S.C. § 80b-3(e)(6), (f), (i), (j) (2000) (providing likewise for investment advisers); Investment Company Act of 1940 § 9(b)(3), (d), (e), 15 U.S.C. § 80a-9(b)(3), (d), (e) (2000) (providing that Commission may prohibit persons from holding certain positions within investment companies if they have willfully aided and abetted violations); SEC Rule of Practice 102(e), 17 C.F.R. § 201.102(e)(1) (2002) (stating that Commission may censure or deny privilege of practicing before it to all persons (usually attorneys and accountants) who willfully aid and abet federal securities law violations, as well as accountants who engage in negligent improper professional conduct); Seligman, *supra* note 38, at 1436–37

B. Conspiracy

Federal judges have used the textualist reasoning of *Central Bank* to restrict other forms of secondary liability in addition to aiding and abetting, and this trend could lead to a greater role for causing liability in the SEC enforcement program. For instance, courts had long recognized that a person could be civilly liable for conspiring to commit securities fraud by agreeing to provide substantial assistance to the primary violator in furtherance of the violation.[49] Because Section 10(b) does not expressly provide a right of action based on conspiracy, however, most courts and commentators now believe that securities fraud conspiracy claims are no longer valid, at least for private plaintiffs.[50] The SEC has argued that the 1995 aiding and abetting provision in the PSLRA re-establishes its right to use conspiracy liability in civil en-

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(noting that, even after *Central Bank,* SEC retains statutory authority to pursue securities professionals for aiding and abetting); *see also* Securities Exchange Act of 1934 § 4C, 15 U.S.C.S. § 78d-3 (Law. Co-op. Supp. 2002) (codifying Rule 102(e) via Sarbanes-Oxley Act of 2002). *But see* Investment Advisers Act of 1940 § 209(d), 15 U.S.C. § 80b-9(d) (2000) (providing that SEC can seek to enjoin any person for aiding, abetting, counseling, commanding, inducing, or procuring any violation of Investment Advisers Act). Furthermore, criminal liability for aiding and abetting securities fraud continues to exist after *Central Bank* under a statute that forbids aiding and abetting any federal crime. *See* James D. Cox, *Just Deserts for Accountants and Attorneys After* Bank of Denver, 38 ARIZ. L. REV. 519, 539 (1996) (citing 18 U.S.C. § 2(a) (2000)).

In contrast, the Securities Act has never expressly provided for aiding and abetting liability. 1 HAZEN, *supra* note 22, § 7.13[1]. Before *Central Bank,* the SEC may have been able to bring implied claims for aiding and abetting violations of Sections 5 and 17 of the Securities Act, which prohibit unregistered offerings and fraudulent sales, respectively. *Id.* § 7.13[4]. However, even before *Central Bank,* neither the SEC nor private plaintiffs could use aiding and abetting under Sections 11 and 12 of the Securities Act because those sections expressly state who may be liable under them. *Id.* § 7.13[2]. The textualist reasoning of *Central Bank* seems to preclude the SEC from alleging aiding and abetting under Sections 5 and 17 now as well because they are implied claims. *See* LARRY D. SODERQUIST & THERESA A. GABALDON, SECURITIES REGULATION 245 (4th ed. 1999) (suggesting SEC's loss of claims). *But see* 1 HAZEN, *supra* note 22, § 7.13[4] (claiming that SEC can still allege aiding and abetting of Section 5 and 17 violations). Therefore, after *Central Bank,* secondary liability under the Securities Act is restricted to controlling person liability for private plaintiffs, willful aiding and abetting by professionals for the SEC, and causing liability for the SEC.

49. *See* Goodwin, *supra* note 18, at 1411–13 & n.129 (citing cases). Aiding and abetting does not require an agreement, however. *See* Lisa Klein Wager & John E. Failla, Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.—*The Beginning of an End, or Will Less Lead to More?*, 49 BUS. LAW. 1451, 1463 (1994) (noting this distinction between conspiracy and aiding and abetting). For a general discussion of conspiracy charges involving the federal securities laws, see Cox, *supra* note 48, at 528–32.

50. *See* Dinsmore v. Squadron, Ellenoff, Plesent, Sheinfeld & Sorkin, 135 F.3d 837, 841 (2d Cir. 1998) (citing numerous cases); Goodwin, *supra* note 18, at 1413–17 (giving reasons for decline of conspiracy claims).

forcement actions, but whether a significant number of jurisdictions will agree remains unclear.[51]

C. *Respondeat Superior and Controlling Person Liability*

Citing language in the *Central Bank* dissent,[52] commentators predicted that the decision would also eliminate the ability of the SEC and private plaintiffs to bring claims under the common-law doctrine of respondeat superior, which held employers strictly liable for acts of securities fraud committed by employees in the course of their employment.[53] However, many also believed that one of the few types of secondary liability to survive *Central Bank* would be a more limited form of respondeat superior known as "controlling person" liability because the Securities Act of 1933 (Securities Act) and the Exchange Act expressly provide for it.[54] Section 20(a) of the Exchange Act states:

> Every person who, directly or indirectly, controls any person liable under any provision of [the Exchange Act] or of any rule or regulation thereunder

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51. *Compare* SEC v. Norton, 21 F. Supp. 2d 361, 364–65 (S.D.N.Y. 1998) (finding that retroactive application of new aiding and abetting provision preserves SEC's right to charge conspiracy) *with* SEC v. U.S. Envtl., Inc., 897 F. Supp. 117, 119–21 (S.D.N.Y. 1995) (dismissing conspiracy claim based on *Central Bank*'s reasoning). *But see* Seligman, *supra* note 38, at 1435 (asserting that loss of conspiracy action means little because SEC seldom used it).

52. *See* Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 200 & n.12 (1994) (Stevens, J., dissenting) (predicting that decisions recognizing respondeat superior actions for SEC and private plaintiffs "appear unlikely to survive the Court's decision").

53. *See* Wager & Failla, *supra* note 49, at 1462–63 (stating that viability of respondeat superior is questionable after *Central Bank* because text of Section 10(b) never mentions it); Goodwin, *supra* note 18, at 1417–19, 1422 (defining respondeat superior and calling for restrictions). *But see* Robert A. Prentice, *Conceiving the Inconceivable and Judicially Implementing the Preposterous: The Premature Demise of Respondeat Superior Liability Under Section 10(b)*, 58 OHIO ST. L.J. 1325, 1325 (1997) (arguing that courts should continue to recognize respondeat superior liability for securities fraud based on nontextual considerations); Seligman, *supra* note 38, at 1436 (arguing that importance of respondeat superior was minimal given existence of controlling person liability and duty of broker-dealers to reasonably supervise employees).

54. *See* Lewis D. Lowenfels & Alan R. Bromberg, *Controlling Person Liability Under Section 20(a) of the Securities Exchange Act and Section 15 of the Securities Act*, 53 BUS. LAW. 1, 1–2 (1997) (reiterating statement of *Central Bank* majority that existence of controlling person liability shows that 1934 Congress knew how to provide for secondary liability in statutory text when it so desired). Controlling person liability is narrower than respondeat superior because the former has a good faith defense. *See* Goodwin, *supra* note 18, at 1421 (discussing good faith defense). Even before *Central Bank*, circuits were split as to whether the controlling person statutes precluded respondeat superior actions, with a majority concluding they did not. *See id.* at 1419–20 & nn.168–70 (citing cases).

> shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.[55]

Despite the firm textual basis of controlling person liability, however, judicial interpretation of the provisions has been sparse and muddled.[56] In fact, one of the unresolved issues surrounding the doctrine involves a circuit split over whether the SEC can even allege controlling person liability in its civil enforcement actions, as plaintiffs have always done in private cases.[57] However, even if the Commission can use this theory, controlling person liability is a poor substitute for aiding and abetting because some assisting parties outside of control relationships with the primary violator (for example, outside directors and lenders) could escape liability.[58]

D. Ramifications for Causing Liability

As it did with controlling person liability, Congress expressly created causing liability by statute, so that particular form of secondary liability is safe from the Supreme Court's holding in *Central Bank*.[59] However, the similari-

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55. Securities Exchange Act of 1934 § 20(a), 15 U.S.C. § 78t(a) (2000). The controlling person provision in Section 15 of the Securities Act contains slightly different language, but is immaterial to this discussion because it only applies to violations of Sections 11 and 12 of that Act, which create private rights of action unavailable to the SEC. *See* Lowenfels & Bromberg, *supra* note 54, at 4–5 (explaining narrowness of Section 15).

56. *See* Loftus C. Carson II, *The Liability of Controlling Persons Under the Federal Securities Acts*, 72 NOTRE DAME L. REV. 263, 266–67 (1997) (faulting broad language, minimal legislative history, and unwilling judges for poor state of controlling person law); Lowenfels & Bromberg, *supra* note 54, at 32–33 (noting irony of *Central Bank* eliminating aiding and abetting as "unpredictable" nontextual doctrine while text-based theory of controlling person liability is equally "complex and confusing"). Contested issues include what constitutes "control," what standard of care the controlling person must use to escape liability, and whether controlling person liability requires an element of "culpable participation." *See generally* Carson, *supra* (discussing these issues at length); Lowenfels & Bromberg, *supra* note 54 (same).

57. *Compare* SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1472 (2d Cir. 1996) (upholding Commission's right to use Section 20(a) because Exchange Act definition of "person" in 15 U.S.C. § 78c(a)(9) (2000) includes government agencies) *with* SEC v. Coffey, 493 F.2d 1304, 1318 (6th Cir. 1974) (holding that SEC cannot rely on Section 20(a) in injunctive enforcement actions because provision "was meant to specify the liability of controlling persons to private persons suing to vindicate their interests").

58. *See* Wager & Failla, *supra* note 49, at 1465 (explaining why controlling person liability is poor substitute for aiding and abetting); *see also* Cox, *supra* note 48, at 532–36 (explaining why controlling person liability is poor substitute for conspiracy).

59. *See* Lowenfels & Bromberg, *supra* note 41, at 4 n.19 (noting secure statutory basis of causing liability).

ties between causing and controlling person liability do not end there. Confusion, complexity, and conflicting adjudications stemming from broad statutory language and scant legislative histories have hindered the development of coherent bodies of law for both types of liability.[60] This state of affairs need not continue. For example, courts had long overlooked the distinction between primary and secondary liability because the difference was immaterial if both types of defendants were jointly and severally liable.[61] However, after *Central Bank*, efforts by private plaintiffs to recharacterize peripheral parties involved in securities fraud as primary violators in order to avoid dismissal compelled a judicial and scholarly re-examination of the difference between the two types of liability, with commentators seemingly reaching a consensus earlier than the courts.[62]

Central Bank may provide the catalyst to clarify the law of causing liability as well. As commentators have suggested, courts will likely rule against the SEC on at least some of the various disputes that arose after *Central Bank* concerning the assorted forms of secondary liability.[63] If the Commis-

60. *See* Jeffrey M. Steinberg, Administrative Proceedings Rulings Release No. 568, 68 SEC Docket 120, 121 (Sept. 11, 1998) ("Construing the 'knew or should have known' language has been complicated by the omission of any statutory definition, the absence of any guidance regarding the language in the legislative discussion, and the paucity of administrative decisions from the Commission and the administrative law judges."); *supra* note 56 and accompanying text (discussing tangled state of law for controlling persons). Some clear differences exist between the two, however. For example, the SEC is the only party able to base claims on causing liability, which is restricted to administrative proceedings, has identical foundations in four federal securities laws, and lacks a good faith defense and a control element. *See supra* notes 4, 7, 54, and text accompanying note 58 (establishing these facts).

61. *See* Goodwin, *supra* note 18, at 1437 ("During the thirty years that the cause of action for aiding and abetting existed, courts gave little attention to the distinction between primary and secondary liability because both classes of actors were jointly and severally liable for the Section 10(b) violation.").

62. *See* Gareth T. Evans & Daniel S. Floyd, *Secondary Liability Under Rule 10b-5: Still Alive and Well After* Central Bank?, 52 BUS. LAW. 13, 26, 33–34 (1996) (proposing bright line test based on making representations); Amanda J. Aymond, Comment, *You'd Better Watch What They Say: An Examination of Primary Liability for Secondary Actors Under Section 10(b)*, 68 U. CIN. L. REV. 835, 860–61 (2000) (endorsing test based on creating misrepresentations); Rodney D. Chrisman, Note, *"Bright Line," "Substantial Participation," or Something Else: Who Is a Primary Violator Under Rule 10b-5?*, 89 KY. L.J. 201, 224–25 (2001) (proposing modified bright line test); Mary M. Wynne, Comment, *Primary Liability Amongst Secondary Actors: Why the Second Circuit's "Bright Line" Standard Should Prevail*, 44 ST. LOUIS U. L.J. 1607, 1608 (2000) (endorsing bright line approach). *But see* 9 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 698–702 (Supp. 2000) (discussing myriad judicial attempts at sharpening distinction between primary and secondary liability).

63. *See* Lowenfels & Bromberg, *supra* note 41, at 11–12 (predicting that Section 20(e) of Exchange Act will require scienter and substantial assistance elements of aiding and abetting to scale upward to knowing violation and proximate causation, respectively); *supra* note 50 and

sion no longer can bring civil enforcement actions in federal district court based on conspiracy, respondeat superior, and controlling person liability and must prove that alleged aider-abettors assisted primary violators with actual knowledge of wrongdoing, then pursuing secondary defendants in administrative proceedings for causing primary violations will become an even more favored weapon for enforcing the federal securities laws.[64] Thus, a more precise definition of what conduct triggers causing liability, and how the elements of causing liability differ from their closest analogues under aiding and abetting, is just as necessary as a brighter line between primary and secondary liability for securities fraud (and could, in turn, further clarify that distinction). Part III seeks such a clarification of causing liability.

III. Defining Causing Liability

A. Method of Analysis

The best approach to defining causing liability is to distinguish it from the form of secondary liability that it most resembles: aiding and abetting. Commentators have analyzed causing liability in this fashion in the past by asking whether a person who causes a violation is necessarily also an aider-abettor—that is, are the two doctrines coterminous, or is one broader than the other?[65] Among the various forms of secondary liability, causing liability most resembles aiding and abetting liability because both require only a primary violation, an assisting act or omission, and an accompanying mental state; additional requirements, such as an agreement or control relationship, are unnecessary.[66] However, differences may exist between the two theories regarding these elements, and if causing liability is easier to establish than

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accompanying text (suggesting loss of conspiracy claim); *supra* note 53 and accompanying text (suggesting loss of respondeat superior claim).

64. *See supra* Part II.A-C (suggesting these possibilities). *But see supra* note 48, *infra* note 124, and accompanying text (discussing other statutory forms of secondary liability still available after *Central Bank*).

65. *See* Hansen, *supra* note 3, at 343, 346, 354–56 (noting that whether one can cause violation without aiding and abetting it is unclear, but that Commission apparently thinks so); Lorne & Callcott, *supra* note 19, at 1308–09 (suggesting that causing liability may be broader than aiding and abetting in multiple respects); Lawton & Botticelli, *supra* note 19, at 34, 36–37 (comparing causing liability with aiding and abetting liability). *But see* Peloso & Corley, *supra* note 16, at 17 & n.31 (doubting that negligent conduct, insufficient for aiding and abetting, could nonetheless cause violations).

66. *See* Lawton & Botticelli, *supra* note 19, at 34, 36–37 (giving elements of causing liability and aiding and abetting liability); *supra* note 49 (noting that, unlike conspiracy, aiding and abetting does not require agreement); *supra* text accompanying note 58 (noting that aiding and abetting does not require control relationship like controlling person liability and respondeat superior).

aiding and abetting, one would expect the Commission to shift prosecution of secondary offenders to the administrative forum.[67]

Indeed, a comparison of the statutory text creating causing liability with that creating (or, rather, restoring) aiding and abetting liability initially suggests that the elements of causing liability are less demanding. Specifically, the mental state and act requirements for aiding and abetting ("knowingly" and "substantial assistance") appear to be more rigorous than those for causing liability ("know or should have known" and "contribute").[68] To evaluate this textual argument, this Note now proceeds to examine: (1) the history of causing liability, (2) procedural and remedial differences between causing liability and aiding and abetting liability stemming from the purpose of the Remedies Act, (3) differences between the two theories based on their applicability to different primary violations, and (4) recent cases interpreting the scope of causing liability.

B. Historical Sources

1. Section 15(c)(4) of the Exchange Act

Unfortunately, the history of causing liability provides little guidance to anyone seeking to interpret the doctrine today. Apparently, Congress imported the concept of causing liability into the Remedies Act from an existing statutory source.[69] Section 15(c)(4) of the Exchange Act provides that:

> If the Commission finds, after notice and opportunity for a hearing, that any person subject to the provisions of section 12, 13, 14, or subsection (d) of section 15 of [the Exchange Act] or any rule or regulation thereunder has failed to comply with any such provision, rule, or regulation in any material respect, the Commission may publish its findings and issue an order requiring such person, *and any person who was a cause of the failure to comply due to an act or omission the person knew or should have known would contribute to the failure to comply*, to comply, or to take steps to effect

67. *See* Lorne & Callcott, *supra* note 19, at 1309 ("[T]he practical effect of a distinction between 'causing' and aiding and abetting theories of liability inevitably would be to encourage the SEC to file more administrative proceedings against secondary participants in securities violations because the standard for obtaining relief on a 'causing' theory appears easier to meet.").

68. *Compare* Securities Exchange Act of 1934 § 20(e), 15 U.S.C. § 78t(e) (2000) (giving elements of aiding and abetting) *with* Securities Exchange Act of 1934 § 21C(a), 15 U.S.C. § 78u-3(a) (2000) (giving elements of causing liability).

69. *See* Ferrara et al., *supra* note 2, at 59 (observing that Congress apparently derived Section 21C(a) causing liability from Section 15(c)(4)); Hansen, *supra* note 3, at 343 (same); Maxey, *supra* note 12, at 571 (same). *But see* Jeffrey M. Steinberg, Administrative Proceedings Rulings Release No. 568, 68 SEC Docket 120, 122 (Sept. 11, 1998) (noting that no legislative report explicitly refers to borrowing from Section 15(c)(4)).

> compliance, with such provision or such rule or regulation thereunder upon such terms and conditions and within such time as the Commission may specify in such order.[70]

The Commission secured passage of Section 15(c)(4) in 1964 to force companies to correct inaccurate Exchange Act filings without having to pursue an injunction.[71] Again at the behest of the Commission, Congress added the language on causing liability in 1984 to resolve uncertainty as to whether the SEC could bring proceedings under that section against individual directors, officers, or employees of a corporation who, as the corporeal agents of an ethereal entity, had caused that entity's noncompliance by drafting or signing the documents.[72] Congress gave little attention to either the original statute or the amendment, however, and none of the 1984 committee reports mention anything about causing liability.[73] Furthermore, the SEC settled all but four of the 113 proceedings that it brought under Section 15(c)(4) between 1964 and 1990,[74] so that "at the time of the enactment of the Remedies Act, there existed only a limited gloss on the meaning of causing a violation."[75]

That "limited gloss" came primarily from the SEC's controversial case against George C. Kern, Jr.,[76] in which an ALJ found that outside counsel for

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70. Securities Exchange Act of 1934 § 15(c)(4), 15 U.S.C. § 78o(c)(4) (2000) (emphasis added).

71. *See Report of the ABA's Section of Business Law Task Force on SEC Section 15(c)(4) Proceedings*, 46 BUS. LAW. 253, 256–58 (1990) [hereinafter *ABA Report*] (stating purpose for Section 15(c)(4)).

72. *See id.* at 260–62, 266 (stating purpose for 1984 amendments); *see also* Hansen, *supra* note 3, at 343–44 (noting that individual respondents also needed to hold positions from which they could make corrective filings).

73. *ABA Report*, *supra* note 71, at 258, 263. The insider trading amendments that Congress passed along with the Section 15(c)(4) revision received most of the publicity, and the SEC's characterization of the change as a mere "technical" alteration of its existing authority preempted opposition to the amendment. *Id.* at 263.

74. *Id.* at 260.

75. Hansen, *supra* note 3, at 344.

76. George C. Kern, Jr., Exchange Act Release No. 24,648, [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342 (Nov. 14, 1988), *aff'd*, Exchange Act Release No. 29,356, 50 S.E.C. 596 (1991). In *Kern*, an ALJ considered whether Kern, an attorney for and director of the Allied Store Corporation (Allied), had "caused" the company to violate Exchange Act Rule 14d-9(c) (within the meaning of Section 15(c)(4)) by failing to amend promptly its Schedule 14d-9, a required filing when a board of directors recommends to shareholders that they should accept or reject a tender offer. *Id.* at 89,580–81 & nn. 2–3. Allied's CEO had given Kern complete discretion over the necessity of amending the filing, and Kern chose not to disclose that, in response to a hostile tender offer, Allied had (1) entered into negotiations for an asset sale that would allow it to recapitalize and avoid a takeover, (2) subsequently agreed in principle to a "white knight" merger to avoid the hostile takeover, and (3) then adopted a board resolution directing management to execute the merger. *Id.* at 89,580–82, 89,584–87.

the target company of a hostile tender offer had caused the target to violate Exchange Act Rule 14d-9(c)[77] by failing to amend a Schedule 14D-9 filing promptly.[78] This failure amounted to negligence, which the ALJ held (as a matter of first impression) satisfied the mental state requirement of Section 15(c)(4).[79] The ALJ rejected Kern's argument for a recklessness standard on two grounds: (1) a lower threshold was consistent with the section's legislative purpose of providing rapid corrective disclosure to investors rather than enforcing specific Exchange Act provisions,[80] and (2) the phrase "knew or should have known" need not require the same level of scienter in every context.[81]

However, the ALJ discontinued the proceedings because Kern no longer served the company after it became a wholly owned subsidiary, and thus he did not have the power to correct the omission, which is the only remedy that Section 15(c)(4) provides.[82] The Commission affirmed the lack of a remedy against Kern but expressed no opinion on the negligence standard, thus

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Kern argued that Section 15(c)(4) required proof of at least recklessness, but the ALJ concluded that the language "knew or should have known" connoted a negligence standard. *Id.* at 89,591–92. Finding the issue to be one of first impression, the ALJ reasoned that a higher standard would frustrate the section's primary purpose of quickly providing accurate disclosures to investors (rather than enforcing the federal securities laws). *Id.* at 89,591. Furthermore, the liability standard of Section 15(c)(4) did not need to match those of other securities laws (such as aiding and abetting Section 10(b) violations); Congress knew how to create differing standards by using different language when it so desired, as evinced by other provisions. *Id.* at 89,591–92. Although finding that Kern had breached his duty of care, the ALJ discontinued the proceedings against him after deciding that ordering compliance was the only remedy available under Section 15(c)(4) and that Kern was no longer in a position to make a corrective filing or control Allied's future compliance. *Id.* at 89,592, 89,595. The Commission affirmed the dismissal on the remedy issue and expressed no opinion on the negligence standard. George C. Kern, Jr., Exchange Act Release No. 29,356, 50 S.E.C. 596, 601–02 (1991).

77. 17 C.F.R. § 240.14d-9(c) (2002).

78. *Kern*, [1988–89 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 89,580.

79. *Id.* at 89,591 ("[I]t is concluded that a showing of negligence by a person contributing to a failure to comply is sufficient to satisfy the phrase 'should have known' in Section 15(c)(4).").

80. *Id.*

81. *Id.* Kern argued that aiding and abetting a violation of Section 10(b) required at least recklessness and that causing liability under Section 15(c)(4) was more demanding than aiding and abetting. *Id.* However, the ALJ maintained that the meaning of the phrase "knew or should have known" is "flexible, varying with the context in which the question arises," and that Congress knew how to impose higher standards by not using this language. *See id.* at 89,591–92 (citing language of "willful aiding and abetting" in Exchange Act Section 15(b)(4)(E) as more indicative of recklessness standard).

82. *Id.* at 89,581, 89,595.

leaving the state of causing liability law ill-defined.[83] Nevertheless, one commentator has suggested that the Commission may have intended to imply a negligence standard by not withdrawing the ALJ's findings, while simultaneously preventing an appellate reversal by not imposing a sanction.[84]

In the time between the two *Kern* decisions, the American Bar Association Task Force on Section 15(c)(4) Proceedings (Task Force) also attempted to clarify the meaning of causing liability under that provision in two ways.[85] First, the Task Force examined what degree of participation or involvement the Commission should require to establish a causal nexus between a person's act or omission and the failure of the entity to comply with the applicable securities laws.[86] Congress had overlooked this issue as well, but a colloquy between then Commissioner James Treadway and Enforcement Division Director John Fedders at a 1984 SEC open meeting illustrates an early interpretation of the phrase "a cause of the failure to comply."[87] In response to Treadway's inquiries, Fedders explained that he believed causing liability entailed a higher causation standard than aiding and abetting because, in addition to being a "but for" cause of the failure to comply, an individual would have to be the "person directly responsible" for causing the entity's misstatement or omission.[88] The Task Force agreed with this view and stated that merely providing "substantial assistance" to an entity, as required for aiding and abetting, should be insufficient to establish Section 15(c)(4) causing liability; such liability should, as a matter of policy, require not just factual but also legal causation, which Fedders's definition would ensure.[89] The Task Force recommended that the Commission not view ministerial tasks as significant acts or omissions; so, to use the Task Force's example, a messenger could not cause an issuer to file a false form with the SEC (even though his participation would be a "but for" cause of the improper filing), but could cause the issuer to fail to file the form at all.[90]

Second, the Task Force re-examined one of the issues addressed by the ALJ in *Kern*: the mental state requirement of the phrase "knew or should

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83. *See* George C. Kern, Jr., Exchange Act Release No. 29,356, 50 S.E.C. 596, 601–02 (1991) ("[W]e affirm solely the law judge's determination to discontinue these proceedings and reach none of the other matters addressed therein.").

84. *See* Maxey, *supra* note 12, at 554–55 (noting this possibility).

85. *See ABA Report*, *supra* note 71, at 255–56 (describing Task Force's mission).

86. *See id.* at 277 (examining issue of causal nexus).

87. *See id.* at 276–77 (discussing exchange between Treadway and Fedders).

88. *See id.* at 277 (explaining Fedders's view of causation standard).

89. *See id.* at 278–79 ("The conduct that 'caused' the failure to comply ordinarily must constitute a violation of a legal duty as well.").

90. *See id.* at 279 (stating why ministerial acts should not suffice to establish causing liability).

have known" in Section 15(c)(4).[91] Citing the lack of a statutory definition, legislative discussion, or administrative case law other than *Kern*, the Task Force members felt compelled to follow the ALJ's conclusion that Congress intended to use a negligence standard based on the ordinary meaning of the phrase "should have known."[92] The Task Force reasoned that both Supreme Court decisions in other contexts[93] and leading authorities on tort law[94] buttressed this interpretation as the plain meaning.[95] However, statutory construction aside, the Task Force still maintained that, as a matter of policy, the Commission should not use the full power that Congress had given it in this case and should only institute Section 15(c)(4) proceedings against persons who cause violations intentionally or recklessly.[96] The Task Force's reasons for this policy included protecting individuals from career-damaging public stigma (from which entity violators are immune) and preventing circumvention of the recklessness standard in SEC Rule of Practice 102(e) disciplinary proceedings against securities attorneys and accountants.[97]

2. *Legislative History of the Remedies Act*

Prior to the enactment of the Remedies Act, the "any person" language of Section 15(c)(4) provided virtually the only way for the Commission to

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91. *See id.* at 280–85 (examining mental state requirement or standard of culpability).

92. *See id.* at 280–81 (approving *Kern*'s negligence standard as consistent with congressional intent).

93. *See* Scindia Steam Navigation Co. v. De Los Santos, 451 U.S. 156, 169 & n.16 (1981) (characterizing phrase "knew or should have known" in context of longshoremen's compensation statute as "cast in terms of negligence rather than unseaworthiness"); Gallick v. Baltimore & Ohio R.R. Co., 372 U.S. 108, 118 (1963) (reciting jury instructions in Federal Employers' Liability Act case as defining negligence in terms of reasonable foreseeability or what "in the light of the facts then known, should or could reasonably have been anticipated").

94. *See* RESTATEMENT (SECOND) OF TORTS § 284(a) (1965) ("Negligent conduct may be . . . an act which the actor as a reasonable man *should* recognize as involving an unreasonable risk of causing an invasion of an interest of another . . . .") (emphasis added); W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 32, at 175 (5th ed. 1984) ("[N]egligence is a failure to do what the reasonable person *would* do 'under the same or similar circumstances.'") (emphasis added).

95. *See ABA Report*, *supra* note 71, at 281 & nn.132–34 (citing these sources).

96. *See id.* at 282 (stating Task Force's policy recommendations on use of causing liability).

97. *See id.* at 282–85 (explaining Task Force's reasoning); *supra* note 48 (explaining Rule 102(e)). However, the SEC has since amended Rule 102(e) to encompass negligent improper professional conduct by accountants. *See* SEC Rule of Practice 102(e), 17 C.F.R. § 201.102(e)(1)(iv) (2002) (punishing single instances of highly unreasonable conduct and repeated instances of unreasonable conduct by accountants). Moreover, while entities do not have "careers" as such, they certainly are not immune from bad publicity.

bring administrative proceedings against individuals not regularly involved in the securities industry.[98] But Congress and the SEC had limited this power in three important ways. First, only violations of Sections 12-15 of the Exchange Act (and the rules thereunder) could give rise to Section 15(c)(4) causing liability, so individuals could not be liable for causing Section 10(b) securities frauds.[99] Second, Congress never intended the section to be an enforcement tool because, as indicated by the Commission's opinion in *Kern*, the only remedy that Section 15(c)(4) provides is an order to correct filings—the SEC could not order prospective relief.[100] Finally, because of the foregoing limitations, the SEC used Section 15(c)(4) to pursue only individuals who caused an *entity* to violate a securities law; a person could not cause another *person's* violation under that provision.[101]

Because of these limitations, the Commission petitioned Congress in 1989 to amend Section 15(c)(4) and enhance its potential as an enforcement weapon by permitting, among other things, the imposition of civil monetary penalties under that section.[102] Congress did not act on the proposal, but one year later newly appointed SEC Chairman Richard Breeden proposed that Congress give the SEC the power to issue administrative cease-and-desist orders instead of amending Section 15(c)(4).[103] This proposal was the progenitor of the Remedies Act,[104] but because the SEC did not submit the statutory language to Congress until after all the committee hearings on the subject,

98. *See* Hiler & Gilman, *supra* note 3, at 237–38 (stating role of Section 15(c)(4) prior to Remedies Act); Morrissey, *supra* note 3, at 464 (same); *see also* McLucas et al., *supra* note 4, at 830–31 (noting Securities Act Section 8(d) stop orders and Section 12(j) registration revocation as only other options).

99. *See* 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 20:23 (2d ed. 2002) (noting limitation to Sections 12–15); William R. McLucas & Laurie Romanowich, *SEC Enforcement Proceedings Under Section 15(c)(4) of the Securities Exchange Act of 1934*, 41 BUS. LAW. 145, 149 (1985) (noting Section 10(b) exclusion).

100. *See* 3D BLOOMENTHAL & WOLFF, *supra* note 99, § 20:23 (noting lack of penalty under Section 15(c)(4)); Hiler & Gilman, *supra* note 3, at 237 (discussing Section 15(c)(4) remedies under *Kern*).

101. *See ABA Report*, *supra* note 71, at 266 (noting that SEC used Section 15(c)(4) against individuals only fifteen times, all of which were against directors, officers, or employees of entities whose compliance failures they had allegedly caused).

102. *See* Ferrara et al., *supra* note 2, at 38 (giving details of 1989 proposal).

103. *See id.* at 38–39 (discussing 1990 proposal); Peloso & Corley, *supra* note 16, at 13–14 (discussing 1989 and 1990 proposals); *see also* Hansen, *supra* note 3, at 340 (noting that SEC told Congress in 1989 that it "neither needed nor wanted" cease-and-desist authority because Section 15(c)(4) was sufficient).

104. *See* Ferrara et al., *supra* note 2, at 34–42 (summarizing legislative history of Remedies Act); Peloso & Corley, *supra* note 16, at 13–14 (same).

meaningful debate on the Act was practically nonexistent.[105] Specifically, neither the House nor the Senate report on the Remedies Act even mentions the concept of causing liability or its possible negligence standard.[106] Thus, "despite the uncertainty surrounding the concept of liability for causing a violation under Section 15(c)(4), Congress employed virtually identical language in the Remedies Act without discussion."[107]

The Commission has not initiated a Section 15(c)(4) proceeding since 1990 because, unlike that section, the Remedies Act clearly provides for prospective relief via cease-and-desist orders.[108] Thus, the Commission now uses the Remedies Act in lieu of Section 15(c)(4). Nevertheless, several commentators have suggested that, unless courts can somehow assign different meanings to the identical causing liability language in Section 15(c)(4) and the Remedies Act, they should view *Kern*'s negligence standard as governing the new form of causing liability as well.[109] However, several considerations counsel against this method of interpreting causing liability under the Remedies Act exclusively by textual comparison to Section 15(c)(4). First, the ALJ's decision in *Kern* does not bind the Commission or even other ALJs regarding the proper interpretation of Section 15(c)(4) or the Remedies Act.[110] Second, *Kern* only addressed the mental state requirement of causing liability under Section 15(c)(4) and thus provides only limited guidance on other causing liability issues.[111] Finally, a purely textual comparison ignores the ALJ's observation in *Kern* that the phrase "knew or should

105. *See* Peloso & Corley, *supra* note 16, at 14 (stating that debate suffered because of late draft submission).

106. *See* H.R. REP. NO. 101-616 (1990) (omitting discussion of causing liability), *reprinted in* 1990 U.S.C.C.A.N. 1379; S. REP. NO. 101-337 (1990) (same); Ferrara et al., *supra* note 2, at 59 (noting omission of causing liability from reports); Hansen, *supra* note 3, at 345 & n.25 (same).

107. Hansen, *supra* note 3, at 345.

108. *See* Hiler & Gilman, *supra* note 3, at 238, 240 n.15 (noting that, unlike Section 15(c)(4), Remedies Act expressly permits SEC to issue orders directing future compliance, which explains decline of Section 15(c)(4)).

109. *See* Ferrara et al., *supra* note 2, at 59–60 (observing that SEC is likely to take position that negligence suffices for causing liability based on similar statutory language in Section 15(c)(4) and Remedies Act); Lawton & Botticelli, *supra* note 19, at 34, 38–39 (same); *see also* Hansen, *supra* note 3, at 346 (stating that SEC can allege causing liability based on negligence unless courts interpret two statutes differently).

110. *See supra* note 83 and accompanying text (noting that Commission expressed no opinion in *Kern* regarding negligence standard); *infra* notes 149, 187, and accompanying text (discussing cases in which ALJs disagreed with conclusions of law expressed in prior initial decisions of other ALJs).

111. *See infra* Part III.C.3 (examining issue of further showing for prospective relief); *infra* Part III.E.2 (examining issue of degree of action required for causing liability); *infra* Part III.E.3 (examining issue of causal nexus).

have known" need not have the same meaning under every enforcement provision of the Exchange Act; rather, its meaning should be "flexible, varying with the context in which the question arises."[112]

The Remedies Act provides a much different context for causing liability than does Section 15(c)(4). First, it applies the concept to four different statutes rather than four sections of one statute,[113] thus encompassing a much wider variety of violations. Second, Congress passed the Remedies Act for enforcement and deterrence reasons in addition to the disclosure rationale of Section 15(c)(4).[114] Therefore, an inquiry into the proper standards governing causing liability under the Remedies Act should not be tied to the text of or the policies supporting the forgotten Section 15(c)(4).[115] Rather, as this Note contends, the most productive approach for analyzing causing liability is to compare it to aiding and abetting liability.[116] Therefore, given the scant legislative history surrounding causing liability, the remainder of this Note will examine the possible differences between causing liability and aiding and abetting liability primarily by analyzing legislative purpose and administrative and judicial case law.[117]

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112. George C. Kern, Jr., Exchange Act Release No. 24,648, [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342, at 89,591 (Nov. 14, 1988), *aff'd*, Exchange Act Release No. 29,356, 50 S.E.C. 596 (1991); *see* Lawton & Botticellli, *supra* note 19, at 34, 38 (stating that ALJ's comment "mudd[ies] the waters" of analogy between causing liability under Section 15(c)(4) and Remedies Act).

113. *See supra* note 4 (giving applicability of Remedies Act causing liability); *supra* notes 99–101 and accompanying text (giving Section 15(c)(4) applicability).

114. *See* Ferrara et al., *supra* note 2, at 33 (stating that Remedies Act meant to increase deterrence); Hansen, *supra* note 3, at 346 n.26 (explaining that disclosure philosophy of Section 15(c)(4) arguably applies to any ongoing violation depriving investors of material information); Cook, *supra* note 16, at 360 (stating that Remedies Act has punitive, not remedial, focus).

115. *See* Hiler & Gilman, *supra* note 3, at 267 (maintaining that ALJ's reliance on legislative purpose rather than statutory text limits value of *Kern* for interpreting causing liability under Remedies Act). The Commission did in fact rely on *Kern* and a textual comparison with Section 15(c)(4) to support its eventual finding of a negligence standard for causing liability under the Remedies Act. *See infra* text accompanying note 194 (noting Commission's argument that Congress incorporated negligence standard into Remedies Act by adopting "causing" language from Section 15(c)(4)). However, the Commission did not rely *solely* on this factor in making its decision. *See infra* text accompanying notes 188–93 (discussing Commission's four other justifications for negligence standard).

116. *See supra* Part III.A (describing method of analysis).

117. Commentators have criticized the Commission for using its settlement orders, which contain both factual and legal conclusions, to put the securities industry on notice of certain standards of conduct despite the fact that, unlike ALJ decisions or rulemaking, settlement creates no positive law. *See generally* Anne C. Flannery, *Time for Change: A Re-Examination of the Settlement Policies of the Securities and Exchange Commission*, 51 WASH. & LEE L. REV. 1015 (1994); *Report of the Task Force on SEC Settlements*, 47 BUS. LAW. 1083, 1140–48 (1992). However, this Note will cite and discuss settled cases as needed given the paucity of

C. Procedural Issues

1. Forum

Procedural and remedial differences between causing liability and aiding and abetting liability may suggest proper distinctions between their respective substantive elements. Therefore, before analyzing the elements of causing liability, this Note will examine the proper forums for alleging aiding and abetting claims and causing claims, the remedies available under each theory, and the additional requirements for obtaining prospective relief.

Two observations regarding the forum for alleging causing liability merit discussion here. First, even after *Central Bank* and until quite recently, the SEC forestalled the development of causing liability law by routinely combining willful aiding and abetting claims and causing claims in the administrative forum.[118] Throughout the 1990s, the Commission and its ALJs couched both the allegations and legal findings in their orders in terms of a respondent "aiding and abetting and causing" securities law violations.[119] However, they analyzed the facts of these cases solely by reference to the elements of aiding

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litigated administrative actions, especially those interpreting causing liability. *See* Flannery, *supra*, at 1015 (noting that SEC settles vast majority of its cases). Furthermore, this Note will cite aiding and abetting cases brought by private plaintiffs in addition to SEC actions because, at least in the past, most courts agreed that the language of the substantive federal securities laws applies to both types of litigants unless stated otherwise. *See* Sachs, *supra* note 7, at 1040–43, 1046–47, 1055–58 (criticizing recent shift toward interpreting Exchange Act differently in public and private actions).

118. *See infra* notes 119–23 and accompanying text (discussing why SEC used aiding and abetting before ALJs). In fact, the Commission refused to define the elements of causing liability officially during the same period that the SEC was unofficially suggesting a mental state requirement of negligence. *See* KPMG Peat Marwick LLP, Exchange Act Release No. 43,862, 74 SEC Docket 384, 422 n.104 (Jan. 19, 2001) (listing prior unofficial announcements), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002); Lawton & Botticelli, *supra* note 19, at 35, 39 (discussing prior unofficial announcements).

119. *See, e.g.*, Russell Ponce, Exchange Act Release No. 43,235, 73 SEC Docket 442, 443–44, 470 (Aug. 31, 2000) (barring accountant from practicing before Commission and imposing cease-and-desist order for aiding and abetting and causing reporting and recordkeeping violations of audit client), *appeal docketed*, No. 00-71398 (9th Cir. Nov. 1, 2000); John J. Kenny, Initial Decision Release No. 147, 70 SEC Docket 1011, 1011, 1032 (Aug. 6, 1999) (finding that broker aided and abetted and caused superior's fraud); Jeffry L. Feldman, Securities Act Release No. 7,014, 55 SEC Docket 8, 11–13 (Sept. 20, 1993) (finding that attorney aided and abetted and caused entity clients' violations of Section 5 of Securities Act); Hansen, *supra* note 3, at 354 & n.55 (citing cease-and-desist proceedings involving allegations of aiding and abetting and causing); Peloso & Corley, *supra* note 16, at 17 & n.29 (same); *see also* James R. Doty, *SEC Enforcement Actions Against Lawyers: The Next Phase*, 35 S. TEX. L. REV. 585, 599 n.63 (1994) (noting that phrasing of orders is important because it reveals factual conduct that will create liability).

and abetting.[120] The Commission's only justification for this approach was that a factual finding that an individual had aided and abetted a violation "necessarily" implied that his or her conduct was also a cause of that violation under Section 21C(a) of the Exchange Act and its parallel Remedies Act provisions.[121] By analyzing cases exclusively in terms of aiding and abetting liability, the Commission avoided any litigation over what conduct, if any, could trigger causing liability but *not* liability for aiding and abetting.[122] If no such conduct existed, then causing and aiding and abetting would be substantively identical by reaching exactly the same conduct (despite the different language in their respective statutes) because the Commission had already confirmed the converse proposition that all acts of aiding and abetting include causing.[123]

The Commission had statutory authority to use aiding and abetting liability in this way in administrative actions against regulated entities and associated securities professionals for "willfully" aiding and abetting any securities law violation.[124] Whether it should have done so is another matter.

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120. *See, e.g.*, John J. Kenny, Initial Decision Release No. 147, 70 SEC Docket 1011, 1011, 1032 (Aug. 6, 1999) (finding that broker aided and abetted and caused superior's fraud, but only analyzing aiding and abetting claim); Jeffry L. Feldman, Securities Act Release No. 7,014, 55 SEC Docket 8, 11–13 (Sept. 20, 1993) (finding that attorney aided and abetted and caused entity clients' violations of Section 5 of Securities Act, but only discussing law of aiding and abetting); Lawton & Botticelli, *supra* note 19, at 34, 36–37 (noting this practice).

121. *See* Dominick & Dominick, Inc., Exchange Act Release No. 29,243, 50 S.E.C. 571, 578 n.11 (1991) ("Because the Commission finds that [respondent] aided and abetted the violation, his conduct was necessarily a 'cause' under Section 21C of the Exchange Act of a violation of the securities laws."); Hiler & Gilman, *supra* note 3, at 266 n.116 (noting use of this rationale in other cases). The Commission did not explain why it had rejected the view of the ABA Section 15(c)(4) Task Force that causing liability involves a higher causation standard than aiding and abetting. *See supra* notes 88–90 and accompanying text (explaining Task Force's conclusion).

122. *See* 3B BLOOMENTHAL & WOLFF, *supra* note 99, § 14.34 (suggesting that causing liability is broader than willful aiding and abetting); Peloso & Corley, *supra* note 16, at 17 ("It remains to be seen whether something less than aiding and abetting can nevertheless be deemed a cause."); Lawton & Botticelli, *supra* note 19, at 34, 36 (stating that no standard test has developed for causing liability partly because SEC has refused to distinguish its elements from those of aiding and abetting).

123. *See supra* text accompanying note 121 (establishing this converse proposition). Put another way, if "all *A*s are *C*s" and "all *C*s are *A*s," then sets *A* and *C* are identical.

124. *See supra* note 48 (discussing liability under Sections 15(b)(4) and 15(b)(6) of Exchange Act and Rule 102(e)); *see also* 2 MATTHEW BENDER & CO., *supra* note 2, § 9.02[2][c][i] (discussing definition of "willfully"); 6 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 3034-39 & n.152 (3d ed. 1990) (same). *But see* Jeffry L. Feldman, Securities Act Release No. 7,014, 55 SEC Docket 8, 11–13 (Sept. 20, 1993) (finding, in settled administrative proceeding *not* involving Rule 102(e), that attorney "aided and abetted and caused" entity clients' violations of Section 5 of Securities Act, but only discussing law of

This practice could have delayed the development of causing liability indefinitely by essentially hiding it under the rubric of aiding and abetting. However, prompted by its ALJs,[125] the Commission eventually abandoned its "tacit policy not to explore the boundaries" of causing liability[126] and, beginning with the *KPMG* case decided in January 2001, began deciding administrative proceedings based solely on that theory.[127] To be sure, even today the SEC continues to use combined administrative proceedings alleging both aiding and abetting and causing liability against regulated persons, ostensibly to pile a cease-and-desist order on top of the other available remedies.[128] Nevertheless, one hopes that the SEC will continue to bring cases charging only causing liability in order to engender more litigation over the precise conduct that causing liability encompasses and thereby generate a greater respect for causing liability as an independent form of secondary liability.

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aiding and abetting). The substantive elements of these types of aiding and abetting are the same as under Section 20(e). *See* H.J. Meyers & Co., Initial Decision Release No. 211, 2002 SEC LEXIS 2075, at *90–91 (Aug. 9, 2002) (reciting traditional test for aiding and abetting in broker-dealer disciplinary case). However, "willful" in the Section 15(b) context means only that a person knows what he is doing, while in the Rule 102(e) context it means knowledge that one took part in an activity that is illegal. *See* Ferrara et al., *supra* note 2, at 80, 92–93 (discussing various definitions of willfulness).

125. *See infra* notes 186–87 (citing cases in which ALJs analyzed aiding and abetting liability separately from causing liability even though Enforcement Division brought combined charges); *cf.* Byron G. Borgardt, Initial Decision Release No. 167, 72 SEC Docket 1675, 1709–10 (June 1, 2000) (finding, in first case decided by ALJ charging only causing liability, that respondent negligently caused investment company to issue false registration statements by signing them).

126. Hansen, *supra* note 3, at 355.

127. *See, e.g.*, Michael A. Kolberg, Exchange Act Release No. 45,853, 77 SEC Docket 1625, 1628–29 (May 1, 2002) (finding that plant accountant caused company to violate reporting and recordkeeping provisions); Erik W. Chan, Exchange Act Release No. 45,693, 77 SEC Docket 851, 859–60 (Apr. 4, 2002) (determining that officer caused corporation's violation of antifraud provisions); Joan L. Fleener, Securities Act Release No. 8,000, 75 SEC Docket 1739, 1740–41 (Aug. 14, 2001) (concluding that executives at two corporations caused bond promoters to violate Section 17 with fraudulent bond offering); *see also infra* Parts III.C.3 & III.E.1 (discussing *KPMG Peat Marwick LLP*, Exchange Act Release No. 43,862, 74 SEC Docket 384 (Jan. 19, 2001), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002)).

128. *See, e.g.*, ND Money Mgmt., Exchange Act Release No. 45,743, 77 SEC Docket 1331, 1334–35 (Apr. 12, 2002) (finding that registered representatives both aided and abetted and caused investment adviser and investment company violations); IMS/CPAs & Assocs., Exchange Act Release No. 45,019, 76 SEC Docket 669, 686 & n.40, 693 (Nov. 5, 2001) (imposing investment adviser registration suspension for willfully aiding and abetting fraud and cease-and-desist order for causing it); *see also* Hansen, *supra* note 3, at 350–51, 353 (noting how SEC is piling administrative remedies on regulated entities and their agents); Hiler & Gilman, *supra* note 3, at 241–43 (same); Morrissey, *supra* note 3, at 466–67 (same); Peloso & Corley, *supra* note 16, at 16 (same).

The second important issue regarding the forum for causing liability claims is the proper conclusion to draw from the fact that Congress allows the SEC to allege causing liability only in an administrative setting, whereas it may use the aiding and abetting theory in court. Administrative cases proceed more quickly than federal court proceedings because of relatively lax evidentiary and procedural rules as well as restricted discovery.[129] The limited but flexible administrative forum, the expansion of which was a major purpose of the Remedies Act, seems to dovetail best with the prosecution of less culpable actors who are more likely to have extenuating circumstances that judges might be unwilling or unable to consider in court.[130] This congruence between procedure and culpability is initial evidence supporting the textual argument that the substantive elements of causing liability claims should be less demanding than those of aiding and abetting liability. However, this evidence is quite weak because the SEC can also allege aiding and abetting in the administrative forum against securities professionals.[131]

2. *Remedies*

The different remedies that the SEC can impose on those who cause violations versus those who aid and abet them is stronger evidence that causing liability has a lower substantive culpability standard than that of aiding and abetting liability. Regarding the remedies for aiding and abetting, a federal district judge may impose a civil monetary penalty or an injunction on anyone who aids and abets an Exchange Act violation.[132] Furthermore, courts have retained the right to combine injunctions with traditional forms of ancillary equitable relief (including disgorgement of ill-gotten gains, asset freezes, and appointment of receivers) in the securities law context despite the fact that, until very recently, no statute gave the SEC the authority to seek these remedies in court.[133] The SEC responds to an injunction violation by

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129. *See* 2 MATTHEW BENDER & CO., *supra* note 2, § 9.02[2] (stating that SEC Rules of Practice govern ALJ proceedings in lieu of Federal Rules of Evidence and Civil Procedure); Lorne & Callcott, *supra* note 19, at 1310–11 (noting relative speed of ALJ actions); Morrissey, *supra* note 3, at 464 (noting evidentiary and procedural differences).

130. *See* Hiler & Gilman, *supra* note 3, at 269 (stating that SEC has used administrative cease-and-desist authority to distinguish violators based on conduct, involvement, and status).

131. *See supra* note 124 and accompanying text (describing willful aiding and abetting).

132. *See* Securities Exchange Act of 1934 § 20(e), 15 U.S.C. § 78t(e) (2000) (authorizing SEC aiding and abetting claims in actions under Sections 21(d)(1) and (3) of Exchange Act); Securities Exchange Act of 1934 § 21(d)(1), (3), 15 U.S.C. § 78u(d)(1), (3) (2000) (authorizing SEC injunctive and monetary penalty actions in district court).

133. *See* Goodenow, *supra* note 9, at 67, 69, 71 (noting that *Central Bank* could end practice of judicially implied ancillary equitable relief). *But see* Securities Exchange Act of 1934 § 21(d)(5), 15 U.S.C.S. § 78u(d)(5) (Law. Co-op. Supp. 2002) (allowing courts to grant

seeking a contempt charge from the issuing judge that results in fines or imprisonment.[134] Finally, under the federal securities laws, an injunction for practices in connection with the purchase or sale of securities has certain "collateral consequences" that have caused some courts to view such an injunction as punitive rather than remedial.[135] These consequences include: (1) a duty to disclose the existence of any injunctions against an issuer in all its SEC filings, (2) automatic loss of most Securities Act registration exemptions, (3) automatic application of administrative penalties (censure, activity limitations, and registration suspension or revocation) against enjoined broker-dealers and investment advisers, (4) automatic temporary suspension of the privilege of practicing before the Commission against enjoined attorneys and accountants, (5) disqualification of enjoined individuals from serving as directors or officers of investment companies, and (6) possible disqualification from stock exchanges and other self-regulatory organizations.[136]

In contrast, a person who causes a securities law violation is only subject to an order requiring that person to "cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation" and to take steps to effect present and future compliance with the law if the Commission so orders.[137] Cease-and-desist orders are similar to injunctions,[138] but differ in a few key respects. First, disgorgement in cease-and-desist proceedings has always been an express remedy under the Remedies Act.[139] Second, if the SEC seeks to enforce a cease-and-desist order, it

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all forms of equitable relief in SEC actions for violations of any securities law under Sarbanes-Oxley Act of 2002).

134. *See* Morrissey, *supra* note 3, at 432 (discussing enforcement of injunctions).

135. *See* Levy, *supra* note 16, at 651 (explaining effect of collateral consequences on role of injunctions).

136. *See* Andrew M. Smith, *SEC Cease-and-Desist Orders*, 51 ADMIN. L. REV. 1197, 1219–25 (1999) (discussing collateral consequences of securities law injunctions); Levy, *supra* note 16, at 673–75 (same).

137. Securities Act of 1933 § 8A(a), 15 U.S.C. § 77h-1(a) (2000); Securities Exchange Act of 1934 § 21C(a), 15 U.S.C. § 78u-3(a) (2000); Investment Company Act of 1940 § 9(f)(1), 15 U.S.C. § 80a-9(f)(1) (2000); Investment Advisers Act of 1940 § 203(k)(1), 15 U.S.C. § 80b-3(k)(1) (2000). A party may appeal an ALJ's imposition of a permanent cease-and-desist order first to the Commission itself and then to a federal court of appeals. *See* Securities Exchange Act of 1934 § 25(a)(1), 15 U.S.C. § 78y(a)(1) (2000) (providing judicial review); SEC Rule of Practice 410(a), 17 C.F.R. § 201.410(a) (2002) (providing Commission review).

138. Ferrara et al., *supra* note 2, at 58.

139. Securities Act of 1933 § 8A(e), 15 U.S.C. § 77h-1(e) (2000); Securities Exchange Act of 1934 § 21C(e), 15 U.S.C. § 78u-3(e) (2000); Investment Company Act of 1940 § 9(f)(5), 15 U.S.C. § 80a-9(f)(5) (2000); Investment Advisers Act of 1940 § 203(k)(5), 15 U.S.C. § 80b-3(k)(5) (2000). *But see supra* note 133 (noting recent codification of ancillary equitable relief

must leave the administrative forum and ask a federal judge either to impose a civil monetary penalty on the person who violated the order[140] or to issue an injunction directing compliance with the order, the violation of which could lead to contempt charges.[141] Finally, the cease-and-desist order carries no collateral consequences beyond disclosure.[142]

Clearly, the remedies for causing a violation are weaker (or at least more flexible) than those for aiding and abetting a violation because (1) the SEC must go through more steps to secure punitive monetary penalties or contempt sanctions against those who cause violations and (2) cease-and-desist orders lack the collateral consequences of injunctions.[143] By passing the Remedies Act, Congress intended for the SEC to use the remedial flexibility of the cease-and-desist order to address isolated and less egregious—but nevertheless illegal—conduct.[144] Thus, one could reasonably infer that Congress also

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for securities law cases in federal court).

140. Securities Act of 1933 § 20(d), 15 U.S.C. § 77t(d) (2000); Securities Exchange Act of 1934 § 21(d)(3), 15 U.S.C. § 78u(d)(3) (2000); Investment Company Act of 1940 § 42(e), 15 U.S.C. § 80a-41(e) (2000); Investment Advisers Act of 1940 § 209(e), 15 U.S.C. § 80b-9(e) (2000). The fine for disobeying a cease-and-desist order is rather severe, ranging from $5,000 to $500,000 or the amount of the defendant's pecuniary gain resulting from the violation, if higher. 2 MATTHEW BENDER & CO., FEDERAL SECURITIES ACT OF 1933 § 10.10[10][c] (4th ed. 2002). A court may fine a defendant separately for each discrete violation of an order or for each day of failed compliance in cases of continuing violations. *Id.*

141. *See* Peloso & Corley, *supra* note 16, at 13 (stating that remedies include injunction directing compliance).

142. *See* Smith, *supra* note 136, at 1221–23 (noting lack of collateral consequences for cease-and-desist orders). However, cease-and-desist orders may trigger Nasdaq delisting or state disciplinary action. *Id.* at 1224–25.

143. *See id.* at 1217–18 (noting that cease-and-desist orders lack harsh collateral consequences of injunctions); Cook, *supra* note 16, at 380 (noting that cease-and-desist orders create "new lowest boundary of punishment" and allow SEC to stop violations "flexibly" by avoiding federal district court litigation); Levy, *supra* note 16, at 679 n.214 (outlining many steps to secure contempt sanctions for enforcing cease-and-desist orders). *But see* Hansen, *supra* note 3, at 360 n.75 (warning that subsequent private plaintiffs could use factual findings in settled cease-and-desist orders for collateral estoppel or as public report evidence under FED. R. EVID. 803(8)(c)). The cease-and-desist order is arguably less harsh than most of the remedies for willful aiding and abetting by a securities professional as well. *See supra* note 48 (discussing willful aiding and abetting provisions). Although censure is perhaps the mildest of all remedies, suspension or revocation of a broker-dealer registration or of an attorney's or accountant's privilege of practicing before the Commission strips the affected individuals of their livelihoods. *See supra* note 48 (outlining remedies for willful aiding and abetting under various securities law provisions). Thus, those remedies have an immediate pecuniary impact that a cease-and-desist order does not. *But see* Lawton & Botticelli, *supra* note 19, at 34, 39 (noting that cease-and-desist orders can also affect defendants' livelihoods).

144. *See* Morrissey, *supra* note 3, at 465 (noting that Congress adopted into its reports statements by former Chairman Breeden that cease-and-desist authority recognized "different

intended for the procedural flexibility of cease-and-desist orders relative to injunctions to track the substantive flexibility of causing liability relative to aiding and abetting liability.[145] That is, given the Remedies Act's purpose of remedial flexibility, causing liability should be easier to establish than aiding and abetting liability because the remedy for the former is less severe.

3. *Further Showing for Prospective Relief*

Although courts have long required the SEC to show a "reasonable" likelihood of future violation in order to secure an injunction (for both aiding and abetting and primary violations),[146] until recently considerable controversy existed as to whether the Enforcement Division must make a similar showing to an ALJ in order to secure a cease-and-desist order for committing or causing a violation.[147] The first of the ALJs to consider the issue decided that this showing was not necessary because no such requirement exists in the text of the Remedies Act and because Congress intended the cease-and-desist order to be a rapid and flexible remedy.[148] However, later decisions by other ALJs were divided on the issue.[149]

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degrees of securities violations") (citation omitted).

145. *See* Jeffrey M. Steinberg, Administrative Proceedings Rulings Release No. 568, 68 SEC Docket 120, 123 (Sept. 11, 1998) (arguing that imposing scienter requirement on causing liability would "subvert the whole purpose" of providing SEC with remedies to respond to less egregious conduct); Cox, *supra* note 48, at 538 ("The [Remedies Act's] Congressional history is replete with the philosophy that balancing fault with the sanction not only serves the public interest but also avoids too draconian a sanction being imposed on the defendant.").

146. *See* Levy, *supra* note 16, at 649 & n.25 (citing cases requiring showing beyond underlying violation in order to justify prospective relief). The securities statutes providing for SEC injunctive actions require a "proper showing" from the Commission for judges to grant such requests, but courts have held that while that showing does include a reasonable likelihood of future violation, it does not include irreparable harm or inadequacy of legal remedies given the statutory rather than equitable basis for the action. *Id.* at 649; *see supra* note 8 (citing injunction statutes). Courts determine the reasonable likelihood of a future violation by balancing the following factors, which vary somewhat based on the jurisdiction: egregiousness of offense, repeated offenses, degree of scienter, sincere assurances against future violations, recognition of wrongful conduct, and likelihood that the defendant's occupation will present opportunities for future violations. Ferrara et al., *supra* note 2, at 69.

147. *See* 2 MATTHEW BENDER & CO., *supra* note 2, § 9.02[2][c][ii] (noting lingering question of required showing for cease-and-desist orders); Hansen, *supra* note 3, at 347–48 (same); Morrissey, *supra* note 3, at 467 (same); Shah, *supra* note 22, at 276–77 (same).

148. *See* Joel Zbar, Administrative Proceedings Rulings Release No. 425, 56 SEC Docket 1784, 1787–89 (Apr. 28, 1994) (explaining why further showing is unnecessary); *see also* Smith, *supra* note 136, at 1207–08 (noting that injunction provisions require showing that defendant is "about to engage" in future violations, whereas ALJ may issue cease-and-desist order against anyone who "has violated" securities laws).

149. *Compare* Fu-Sung Peter Wu, Initial Decision Release No. 144, 70 SEC Docket 513,

In January 2001, the Commission held in *KPMG Peat Marwick LLP*[150]

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537 (July 22, 1999) ("By the explicit language of the statutes, an order may issue absent a finding that a respondent is apt to commit violations in the future."), *rev'd on other grounds*, Exchange Act Release No. 45,694, 77 SEC Docket 922 (Apr. 4, 2002), *and* Hudson Investors Fund, Inc., Initial Decision Release No. 139, 69 SEC Docket 1365, 1401 (Mar. 30, 1999) ("These statutes, by their terms, permit the entry of a cease-and-desist order upon concluding that a violation of the securities laws has occurred."), *with* Warren G. Trepp, Initial Decision Release No. 115, 65 SEC Docket 614, 642 (Aug. 18, 1997) ("Similar to an injunction, there must be a likelihood of future violation to issue a cease-and-desist order . . . ."), *aff'd on other grounds*, Exchange Act Release No. 41,913, 70 SEC Docket 2037 (Sept. 24, 1999), *and* Valicenti Advisory Servs., Inc., Initial Decision Release No. 111, 64 SEC Docket 2363, 2387–88 (July 2, 1997) (requiring reasonable likelihood by analogy to injunctions and cease-and-desist orders of other agencies), *rev'd on other grounds*, Investment Advisers Act Release No. 1,774, 53 S.E.C. 1033, 1040–41 (1998) (finding reasonable likelihood on facts as presented, but not stating if it is required in all cases), *aff'd*, 198 F.3d 62 (2d Cir. 1999). In reviewing the *Trepp* decision, the Commission cited the age of the case as its reason for affirming the ALJ's dismissal of the matter, but refused to address "whether the standard employed by the law judge in denying the Division's request for a cease-and-desist order was the proper one." Warren G. Trepp, Exchange Act Release No. 41,913, 70 SEC Docket 2037, 2037–38 (Sept. 24, 1999). For further discussion of *Trepp*, *Wu*, and *Zbar*, see Byron G. Borgardt, Initial Decision Release No. 167, 72 SEC Docket 1675, 1711–12 (June 1, 2000), Shah, *supra* note 22, at 281–83, and Smith, *supra* note 136, at 1198–1200.

150. KPMG Peat Marwick LLP, Exchange Act Release No. 43,862, 74 SEC Docket 384 (Jan. 19, 2001), *reconsideration denied*, Exchange Act Release No. 44,050, 74 SEC Docket 1351 (Mar. 8, 2001), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002). Among the issues the Commission considered in *KPMG* were whether the SEC can allege causing liability based on negligence and whether it must show a reasonable likelihood of future violation to secure a cease-and-desist order. *Id.* at 421, 428–29. The auditing firm of KPMG Peat Marwick LLP (KPMG) had forged a strategic alliance with KPMG BayMark Strategies LLC (Baymark) in order to provide restructuring consulting services to KPMG audit clients. *Id.* at 386–89. KPMG formed Baymark by loaning secured funds to Baymark's principals for use as equity contributions to Baymark. *Id.* at 388. One of Baymark's principals, Edward Olson, accepted the post of chief operating officer at Porta Systems Corp. (Porta), an audit client of KPMG, in an effort to save Porta from insolvency and in return for a fee based on Porta's earnings. *Id.* at 392. The Commission found that KPMG violated the auditor independence rules of Regulation S-X both by engaging in a loan transaction with an officer of an audit client and by receiving a fee contingent on a client's success. *Id.* at 412–19. The Commission also found that KPMG caused Porta to violate Section 13(a) of the Exchange Act by preparing financial statements submitted as part of Porta's Form 10-K that independent accountants had not audited. *Id.* at 420–21. Based on the plain meaning of Exchange Act Section 21C(a) and its legislative history, the Commission held that, at least in cases involving a primary violation of a statute that does not require scienter (such as Section 13(a)), the Enforcement Division can establish causing liability based on negligence rather than recklessness. *Id.* at 421–23. In this case, after receiving notice of a possible independence problem with Porta, two KPMG partners had unreasonably failed to inquire further and thus subjected KPMG to liability, although their conduct was not reckless given that they previously discussed the general contours of the Baymark arrangement with the SEC's Chief Accountant. *Id.* at 423–28. The Commission also held that the issuance of a cease-and-desist order requires a showing of some likelihood of

that an order requiring a person to cease and desist from committing or causing a securities law violation requires a showing by the Division of Enforcement that "some" likelihood of a future violation by that person would exist but for the order.[151] The Commission justified imposing a likelihood requirement by saying that, like an injunction, a cease-and-desist order is prospective by definition, so that "[i]f there is no possible risk of future violation, it is difficult to see the remedial purpose" of the order.[152] However, the Commission appeared to take a middle position in the debate over the likelihood requirement by further reasoning that both the statutory text of Exchange Act Sections 21C(a) and 21(d) and the legislative history of the former suggest that Congress intended the required showing for a cease-and-desist order to be "significantly less" than that for an injunction.[153] Specifically, the Commission stated: "Though 'some' risk is necessary, it need not be very great . . . . Absent evidence to the contrary, a finding of violation raises a sufficient risk of future violation."[154]

Thus, the Commission created a likelihood requirement for cease-and-desist orders, but then subjected it to a rebuttable presumption in the SEC's favor by basing it on the violation that the Division of Enforcement has presumably just proved.[155] Precisely what rebuttal evidence a respondent could offer is unclear. In a motion for reconsideration, KPMG argued that the

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future violations because that remedy is forward-looking by definition. *Id.* at 428–29. However, based on the text and legislative purpose of Section 21C(a), the Commission also found that the required showing is less than that required for an injunction and that, in most cases, the Enforcement Division can satisfy it simply by pointing to the current violations at issue. *Id.* at 430–32, 435–36. Finding that the loan and fee arrangements each independently warranted a sanction, the Commission ordered KPMG to cease-and-desist from violating Regulation S-X or causing a violation of Section 13(a). *Id.* at 436–38.

151. *Id.* at 428–30.

152. *Id.* at 429–30.

153. *See id.* at 430–32, 435–36 (comparing "has violated" standard for cease-and-desist orders with "about to engage" standard for injunctions and noting that Congress intended for SEC to use orders as alternative remedies against isolated and less threatening conduct). The Commission also found that the cease-and-desist order practices of other federal agencies did not provide clear guidance on the likelihood requirement issue. *Id.* at 433–35.

154. *Id.* at 430.

155. *See* G. Bradley Taylor, Initial Decision Release No. 215, 2002 SEC LEXIS 2429, at *37 (Sept. 24, 2002) (finding strong likelihood of future violation and imposing cease-and-desist order based solely on respondent's "disregard for the securities laws" in case at hand), *final*, Exchange Act Release No. 46,711, 2002 SEC LEXIS 2713, at *1 (Oct. 23, 2002); Crimmins & Herr, *supra* note 5, at 1086–87 (discussing post-*KPMG* cases applying new standard, all of which resulted in cease-and-desist orders); Mixter, *supra* note 22, at 989 n.101 (calling *KPMG* requirement mere "perfunctory showing"); *cf.* Shah, *supra* note 22, at 289 ("In practical effect, the Commission's decision means that no showing of likelihood of future violations is required for cease-and-desist orders.").

presumption "nullified" the requirement because the "'question of whether or not to issue a cease-and-desist order only arises after there has been a finding of a past violation, and issuance of a cease-and-desist order would become automatic if nothing more were required to show future likelihood.'"[156] In denying this claim and KPMG's motion, the Commission reiterated its statement from the original opinion that "[a]long with the risk of future violations, we will continue to consider our traditional factors" for determining whether the Commission should exercise its discretion to impose sanctions for securities law violations.[157] These so-called "*Steadman* factors" include:

> The egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that his occupation will present opportunities for future violations.[158]

Because these factors are substantially the same ones that courts consider to determine whether a reasonable likelihood of future violations exists to warrant an injunction,[159] one would think that an administrative respondent could also use them to rebut the "some likelihood" presumption for cease-and-desist orders. However, the Commission specifically stated that it will use the *Steadman* factor inquiry "not to determine whether there is a 'reasonable likelihood' of future violations but to guide our discretion."[160]

Despite this ambiguity, in May 2002 the U.S. Court of Appeals for the District of Columbia Circuit affirmed the Commission's standard on a petition for review by KPMG.[161] The court found that the language and history of Exchange Act Section 21C supported the use of a lower risk of future violation

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156. KPMG Peat Marwick LLP, Exchange Act Release No. 44,050, 74 SEC Docket 1351, 1360 (Mar. 8, 2001).

157. *Id.* (quoting KPMG Peat Marwick LLP, Exchange Act Release No. 43,862, 74 SEC Docket 384, 436 (Jan. 19, 2001), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002)); *see* 2 MATTHEW BENDER & CO., *supra* note 2, § 9.02[2][c][iii] (discussing *Steadman* factors).

158. KPMG Peat Marwick LLP, Exchange Act Release No. 43,862, 74 SEC Docket 384, 428 (Jan. 19, 2001) (quoting Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981)), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002). In its *KPMG* ruling, the Commission added to these traditional factors by stating that, in issuing cease-and-desist orders, it would also consider the recency of the violation, the resulting degree of harm to investors or the marketplace, the remedial function of a cease-and-desist order in light of other sanctions being sought in the same proceedings, and possibly the use of the order as a means of alerting the public about the violation. *Id.* at 436 & n.148.

159. *See id.* at 436 (calling cease-and-desist factors "akin" to injunction factors); *cf. supra* note 146 (discussing injunction factors).

160. *KPMG*, 74 SEC Docket at 436.

161. KPMG, LLP v. SEC, 289 F.3d 109, 112 (D.C. Cir. 2002).

for cease-and-desist orders.[162] Although the ruling applies to all cease-and-desist orders, it is particularly important for causing liability. The contrast between the rigorous showing of the likelihood of future violations that judges require for an injunction[163] and the negligible additional proof of recidivism that ALJs must consider for a cease-and-desist order further suggests that aiding and abetting liability should require a greater degree of culpability than causing liability. The substantive and remedial standards governing these two doctrines should be symmetric.

D. Applicability: Types of Violators and Violations

As just described, the procedural differences between causing liability and aiding and abetting liability suggest that the substantive elements of the former should be easier to establish than those of the latter. However, before analyzing whether the law does or should recognize such a substantive distinction, this Note addresses a preliminary question. Because both forms of liability require a primary violation, the two could differ based on whether the securities statutes or SEC enforcement practices have limited either of these doctrines to particular classes of securities law violators or primary violations. If causing liability applies to a broader range of primary offenses—and hence to less serious offenses—than does aiding and abetting liability, then one might further expect the substantive requirements of causing liability to be less demanding.

Unlike Exchange Act Section 15(c)(4), the causing liability sections created by the Remedies Act do not contain any explicit coverage limitations; rather, they apply to "any person" causing a violation of "any provision" of any federal securities statute.[164] The SEC has taken advantage of this breadth by bringing causing liability claims for a variety of violations against both regulated and nonregulated parties, including: violations by registered representatives of broker-dealer regulations under Section 15 of the Exchange Act,[165]

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162. *Id.* at 124.

163. *See* Morrissey, *supra* note 3, at 453–58 (discussing courts' requiring stronger showings by SEC to justify injunctions after 1970); Levy, *supra* note 16, at 651–54 (same).

164. Securities Exchange Act of 1934 § 21C(a), 15 U.S.C. § 78u-3(a) (2000); *see* Securities Exchange Act of 1934 § 15(c)(4), 15 U.S.C. § 78o(c)(4) (2000) (limiting application to violations of Sections 12–15 of Exchange Act). The other securities acts have provisions identical to Section 21C(a) of the Exchange Act; thus, virtually all securities law violations are covered by causing liability. *See supra* note 4 (listing parallel provisions).

165. *See, e.g.*, Larry W. Tyler, Exchange Act Release No. 44,314, 74 SEC Docket 2854, 2855–56 (May 17, 2001) (claiming that representative sold unregistered securities that he was unlicensed to sell by private placement, thereby willfully aiding and abetting and causing broker-dealer to violate Securities Act Section 17 and Exchange Act Section 15); *see also supra* note 128 and accompanying text (noting that SEC often combines Section 21C causing claims

issuer reporting and recordkeeping violations under Section 13 of the Exchange Act,[166] securities registration violations under Section 5 of the Securities Act,[167] and a variety of fraudulent practices under Sections 10(b) and 14 of the Exchange Act and Section 17 of the Securities Act.[168] The SEC has even begun bringing causing liability actions for violations of the controversial Regulation FD.[169] Furthermore, given the broad definition of "person" in the securities laws,[170] the SEC has been quite willing to allege and find that natural persons have caused business entities to violate the law[171] and, in a few instances, even that one entity caused another entity's violations.[172] In fact, the

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and Section 15 willful aiding and abetting claims against regulated parties).

166. *See, e.g.*, Carl Albano, Exchange Act Release No. 44,765, 75 SEC Docket 2185, 2186, 2189 (Sept. 5, 2001) (alleging that general manager caused his company to violate reporting and recordkeeping provisions by filing misleading Form 10-Qs and failing to maintain adequate books and records).

167. *See, e.g.*, *Tyler*, 74 SEC Docket at 2855-56 (claiming that representative sold unregistered securities that he was unlicensed to sell by private placement, thereby violating and causing his broker-dealer to violate Securities Act Sections 5 and 17 and Exchange Act Section 10(b)).

168. *See, e.g.*, Douglas E. Costa, Exchange Act Release No. 45,636, 77 SEC Docket 666, 668–69 (Mar. 25, 2002) (finding that CEO and corporate counsel caused corporation to violate Sections 10(b) and 17 by overstating value of assets at shareholders' meeting and on website); Joseph H. Kiser, Exchange Act Release No. 44,859, 75 SEC Docket 2631, 2633–34 (Sept. 27, 2001) (concluding that executive caused company to violate Section 14 by signing proxy statement without ensuring that it disclosed all compensation he had received that year, which it did not); Sharon M. Graham, Exchange Act Release No. 40,727, 53 S.E.C. 1072, 1075–76, 1080–82, 1084–85 & n.35, 1090 (1998) (finding that broker-dealer representative willfully aided and abetted, and thus also caused, client's fraud violations by executing his wash trades and matched orders), *aff'd*, 222 F.3d 994 (D.C. Cir. 2000).

169. *See* Raytheon Co., Exchange Act Release No. 46,897, 2002 SEC LEXIS 3020, at *2, 18 (Nov. 25, 2002) (finding that CFO caused corporation's Regulation FD violations by selectively disclosing earnings guidance to analysts). The Commission seems to be operating under the premise that, because Regulation FD directs *issuers* to disclose to the public earlier selective disclosures made by the issuer or its agents to analysts, only the issuer itself can be a primary violator of Regulation FD by failing to disclose publicly. *See* Regulation FD, 17 C.F.R. § 243.100(a) (2002) (requiring public disclosure by issuers); *Raytheon*, 2002 SEC LEXIS 3020, at *2 ("This matter involves violations of Regulation FD by Raytheon through its Chief Financial Officer, Caine."). Therefore, officers can be liable only for causing their corporations' violations.

170. *See, e.g.*, Securities Exchange Act of 1934 § 3(a)(9), 15 U.S.C. § 78c(a)(9) (2000) (defining "person" as used in Exchange Act to include, *inter alia*, both natural persons and business entities).

171. *See, e.g.*, Erik W. Chan, Exchange Act Release No. 45,693, 77 SEC Docket 851, 859–60 (Apr. 4, 2002) (determining that officer caused corporation's violation of antifraud provisions).

172. *See* PricewaterhouseCoopers LLP, Exchange Act Release No. 46,216, 2002 SEC LEXIS 1824, at *38 (July 17, 2002) (concluding that accounting firm caused audit client's

SEC seems to claim that a person caused an entity to violate the law much more often than it claims that a person caused another person to do so, perhaps because the antiquated Section 15(c)(4) causing liability applied only in the former situation.[173]

In contrast to the causing liability provisions, the 1995 aiding and abetting statute applies to all persons but only for Exchange Act violations,[174] whereas provisions in various statutes prohibit willfully aiding and abetting violations of any securities law, but only by certain regulated persons.[175] Thus, the statutory reach of causing liability is broader than that of aiding and abetting liability. Nevertheless, the SEC has brought civil actions alleging aiding and abetting of most of the same Exchange Act violations for which it has alleged causing liability.[176] The Commission also seems more willing to allege that a person aided and abetted another person rather than an entity.[177]

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violations); Ashford.com, Inc., Exchange Act Release No. 46,052, 2002 SEC LEXIS 1484, at *30 (June 10, 2002) (finding that corporation caused contractual partner corporation's violations); Korea Data Sys. USA, Inc., Exchange Act Release No. 46,047, 2002 SEC LEXIS 1510, at *11 (June 7, 2002) (finding that one corporation, along with its officers, caused violations by second corporation); KPMG Peat Marwick LLP, Exchange Act Release No. 43,862, 74 SEC Docket 384, 420, 428 (Jan. 19, 2001) (concluding that accounting firm caused audit client's violations), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002). The author worked on the *Ashford.com* case as a legal intern at the SEC.

173. *See, e.g.*, *Chan*, 77 SEC Docket at 867 (determining that officer caused corporation's violation of antifraud provisions); *see also supra* text accompanying notes 71–72 (discussing purpose of Section 15(c)(4)). *But see, e.g.*, Rodona Garst, Exchange Act Release No. 46,987, 2002 SEC LEXIS 3167, at *2–4 (Dec. 11, 2002) (finding that individual intentionally caused other individual's Rule 10b-5 violations).

174. *See* Securities Exchange Act of 1934 § 20(e), 15 U.S.C. § 78t(e) (2000) (applying aiding and abetting liability to "any person" who knowingly provides substantial assistance to another in violation of Exchange Act).

175. *See supra* note 48 (listing aiding and abetting provisions for regulated entities and persons).

176. *See, e.g.*, SEC v. Rind, 991 F.2d 1486, 1488 (9th Cir. 1993) (alleging that defendant aided and abetted Section 13 reporting and recordkeeping violations by concocting transaction that overstated assets on company's securities registration statement); SEC v. Milan Capital Group, Inc., No. 00 Civ. 0108 (DLC), 2001 U.S. Dist. LEXIS 11804, at *1–4 (S.D.N.Y. Aug. 14, 2001) (alleging that president of registered broker-dealer aided and abetted firm's violation of Exchange Act's broker-dealer registration requirements); SEC v. Lybrand, No. 00 Civ. 1387 (SHS), 2000 U.S. Dist. LEXIS 9388, at *1–4, 7–9 (S.D.N.Y. July 6, 2000) (alleging that various persons aided and abetted stock promoter's market manipulation scheme in violation of Section 10(b)); SEC v. Ernst & Young, 775 F. Supp. 411, 412 (D.D.C. 1991) (alleging that auditing firm aided and abetted company's Section 14 proxy violations by incorrectly certifying that it was independent of company); *see also* Cox, *supra* note 48, at 537 (noting that SEC enforcement actions have "successfully equated cause with conduct that could equally be regarded as aiding and abetting").

177. *See, e.g.*, SEC v. Fehn, 97 F.3d 1276, 1280–82, 1296 (9th Cir. 1996) (concluding that

In sum, although the statutory breadth of causing liability is greater than that of aiding and abetting liability, the SEC has routinely applied both doctrines to the same types of primary violations. Moreover, causing liability and aiding and abetting liability apply to primary violations of roughly the same severity. Therefore, the applicability of causing liability relative to aiding and abetting liability does not provide much guidance for determining the proper substantive elements of the former. An examination of those substantive elements follows.

E. Substantive Elements

1. Degree of Knowledge

As noted above, throughout the 1990s the SEC consistently used its prosecutions of securities professionals for willful aiding and abetting to maintain, in a conclusory fashion, that one who aids and abets another's violation of the federal securities laws is necessarily also a cause of such violation under Section 21C(a).[178] In other words, at least one of the three general elements of both aiding and abetting liability and causing liability (an act or omission, performed with some mental state, that furthers a primary violation) is more difficult to establish for aiding and abetting liability, or all three operate under the same standard for both types of liability.[179] If and only if the latter situation is true does a finding of causing liability necessarily imply aiding and abetting,[180] in which case the only differences between the two doctrines are remedial.[181]

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attorney aided and abetted fraud violations of company and its promoter by preparing Form 10-Qs that failed to disclose degree of promoter's control over company and previous securities fraud violations); *Lybrand*, 2000 U.S. Dist. LEXIS 9388, at *1–4, 7–9 (alleging that various persons aided and abetted stock promoter's market manipulation scheme in violation of Section 10(b)); SEC v. Moskowitz, No. 97 Civ. 7174 (HB), 1998 U.S. Dist. LEXIS 12994, at *1–5 (S.D.N.Y. Aug. 20, 1998) (alleging that defendant aided and abetted CEO and trust's Section 10(b) violations by helping CEO conceal fraud).

178. *See, e.g.*, Nicholas P. Howard, Initial Decision Release No. 138, 69 SEC Docket 1226, 1243 (Mar. 24, 1999) (stating that aiding and abetting necessarily implies causing), *aff'd*, Exchange Act Release No. 47,357, 2003 SEC LEXIS 377, at *21 n.24 (Feb. 12, 2003); Sharon M. Graham, Exchange Act Release No. 40,727, 53 S.E.C. 1072, 1085 n.35 (1998) (same), *aff'd*, 222 F.3d 994 (D.C. Cir. 2000); Dominick & Dominick, Inc., Exchange Act Release No. 29,243, 50 S.E.C. 571, 578 n.11 (1991) (same); *supra* notes 118, 121, and accompanying text (noting this trend of "implied" causing liability).

179. *See supra* note 66 and accompanying text (giving elements for aiding and abetting liability and causing liability).

180. *See supra* note 65 and accompanying text (establishing corollary to SEC position as proper inquiry).

181. *See supra* Part III.C (examining procedural differences between causing liability and

The Commission's January 2001 decision in *KPMG* is easily the most important case interpreting causing liability to date because, by holding that a person may negligently cause another person's violation, it rejected the idea that causing is equivalent to aiding and abetting and thereby recognized causing liability as a distinct theory of secondary liability.[182] Before *KPMG*, courts had long held that aiding and abetting required "scienter," a mental state embracing knowing or reckless but not negligent assistance of a primary violation.[183] The 1995 aiding and abetting restoration statute complicated matters by using the word "knowingly," prompting one court to speculate that even recklessness no longer sufficed.[184]

This mental state debate spilled over from aiding and abetting liability into causing liability as commentators pondered whether the language "knew or should have known" in the Remedies Act's causing liability provisions implied a recklessness or negligence standard.[185] For nearly ten years the

aiding and abetting liability).

182. *See* KPMG Peat Marwick LLP, Exchange Act Release No. 43,862, 74 SEC Docket 384, 421 (Jan. 19, 2001) (holding that negligent conduct meets culpability standard for causing liability in most cases), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002); *supra* note 150 (discussing facts of *KPMG*); *see also* Shah, *supra* note 22, at 273 (noting "groundbreaking illumination" provided by *KPMG*).

183. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193, 194 n.12 (1976) (defining scienter as "mental state embracing intent to deceive, manipulate, or defraud," which might include reckless, but not negligent, behavior); *Graham*, 53 S.E.C. at 1084 n.33 ("Knowledge means awareness of the underlying facts, not the labels that the law places on those facts. Except in very rare instances, no area of the law not even the criminal law demands that a defendant have thought his actions were illegal." (quoting SEC v. Falstaff Brewing Corp., 629 F.2d 62, 77 (D.C. Cir. 1980))); *supra* note 44 and accompanying text (defining recklessness and describing case law on whether recklessness satisfies scienter requirement for aiding and abetting).

184. *See supra* notes 45–46 and accompanying text (discussing *Fehn*).

185. *See* Doty, *supra* note 119, at 604–05 (arguing that SEC will be on sound footing as long as it continues to require scienter for causing liability against attorneys because it should not set professional standards); Hiler & Gilman, *supra* note 3, at 266–68 (assessing dangers of SEC's apparent preference for negligence standard; namely, that accountants and attorneys could be liable for negligent advice); Lorne & Callcott, *supra* note 19, at 1308–09, 1317–25 (noting that unresolved mental state issue could broaden causing liability and listing administrative actions that SEC should not take against attorneys); Maxey, *supra* note 12, at 570–78 (showing that Commission is using negligence standard without saying so as end run around Rule 102(e) process for pursuing attorneys); Morrissey, *supra* note 3, at 464–67 (noting unfairness of using negligence standard with broad net of liability against attorneys, accountants, and broker-dealers who are already subject to more specific regulations); Peloso & Corley, *supra* note 16, at 17 & n.31 (doubting that negligence will trigger causing liability given Commission's references to aiding and abetting in cease-and-desist orders); Lawton & Botticelli, *supra* note 19, at 34, 39 (assessing dangers of SEC's apparent preference for negligence standard).

Commission clung to its mantra that aiding and abetting liability necessarily implied causing liability and avoided the opportunity to clarify the law of causing liability.[186] Perhaps the rise of conflicting ALJ opinions on the issue finally prompted the Commission to act.[187]

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186. *See* Russell Ponce, Exchange Act Release No. 43,235, 73 SEC Docket 442, 452–59 & n.25 (Aug. 31, 2000) (listing elements of both aiding and abetting and causing liability, but analyzing facts only in terms of former), *appeal docketed*, No. 00–71398 (9th Cir. Nov. 1, 2000); Valicenti Advisory Servs., Inc., Initial Decision Release No. 111, 64 SEC Docket 2363, 2382–83 (July 2, 1997) (finding that investment adviser caused firm's violations but did not willfully aid and abet them because he acted negligently but not knowingly or recklessly), *rev'd*, Investment Advisers Act Release No. 1,774, 53 S.E.C. 1033, 1040 & n.11 (1998) (reversing ALJ, finding aiding and abetting, and noting that it requires scienter whereas causing liability is based on "knew or should have known" language, but stopping short of calling that language indicative of negligence), *aff'd*, 198 F.3d 62 (2d Cir. 1999); Sharon M. Graham, Initial Decision Release No. 82, 60 SEC Docket 3162, 3163, 3201–07, 3212 (Dec. 28, 1995) (finding that broker-dealer representative knowingly or recklessly aided and abetted fraud by executing wash trades of customer, but that even if she had not, she still would have caused violation under negligence standard), *aff'd*, Exchange Act Release No. 40,727, 53 S.E.C. 1072, 1085 n.35 (1998) (noting that aiding and abetting implies causing but not analyzing causing liability claim as ALJ did in dictum), *aff'd*, 222 F.3d 994 (D.C. Cir. 2000) (ignoring causing liability claim altogether); *supra* notes 118, 126, and accompanying text (noting tacit Commission policy not to explore bounds of causing liability). The ALJ who decided *Graham* had used the same reasoning in prior related proceedings, and the Commission dodged the issue when hearing those appeals as well. *See* Carole L. Haynes, Initial Decision Release No. 78, 60 SEC Docket 2294, 2341 (Nov. 24, 1995) (using same reasoning as *Graham*), *final*, Exchange Act Release No. 36,692, 61 SEC Docket 66 (Jan. 5, 1996); Richard M. Kulak, Initial Decision Release No. 75, 60 SEC Docket 1010, 1053–54 (Sept. 26, 1995) (same), *appeal dismissed*, Exchange Act Release No. 38,657, 64 SEC Docket 1615 (May 20, 1997); Adrian C. Havill, Initial Decision Release No. 74, 60 SEC Docket 371, 402 (Aug. 31, 1995) (same), *aff'd*, Exchange Act Release No. 40,726, 53 S.E.C. 1060 (1998); Richard D. Chema, Initial Decision Release No. 71, 60 SEC Docket 124, 167 (Aug. 22, 1995) (same), *rev'd on other grounds*, Exchange Act Release No. 40,719, 53 S.E.C. 1049 (1998).

187. *Compare* Byron G. Borgardt, Initial Decision Release No. 167, 72 SEC Docket 1675, 1710 (June 1, 2000) (noting that Commission had not yet decided mental state requirement for causing liability, choosing negligence standard based on *Jones*, *infra*, and applying it to respondents who did not knowingly cause investment company to issue false registration statements by signing them, but nonetheless did so negligently), Jeffrey M. Steinberg, Administrative Proceedings Rulings Release No. 568, 68 SEC Docket 120, 121–23 (Sept. 11, 1998) (noting dearth of causing liability law, but concluding that negligence standard applies based on Section 21C(a) text, Section 15(c)(4), and legislative intent), *and* Edward D. Jones & Co., Initial Decision Release No. 125, 66 SEC Docket 3086, 3093–95 (Apr. 15, 1998) (noting that Commission had not yet decided mental state requirement for causing liability and choosing negligence standard, but finding that respondents did not knowingly, recklessly, or negligently cause broker-dealer to violate Rule 22c-1 under Investment Company Act of 1940), *final*, 67 SEC Docket 726 (May 28, 1998), *with* Nicholas P. Howard, Initial Decision Release No. 138, 69 SEC Docket 1226, 1243 (Mar. 24, 1999) (noting that Commission had not yet decided mental state requirement for causing violations involving fraud, so applying same standard as for aiding and abetting, despite Commission's hinting at lesser standard by contrasting scienter

The Commission justified its holding in *KPMG* in several ways. First, the Commission stated that the phrase "knew or should have known" is "classic negligence language" and should operate under its "ordinary meaning," at least in the context of cases in which the primary violation does not require scienter.[188] That this argument was the Commission's first is unsurprising given that the same textualist reasoning had nearly eliminated its ability to allege aiding and abetting seven years earlier in *Central Bank*.[189] Second, the Commission responded to the policy concerns that many commentators had expressed regarding the ability of the SEC to prosecute remote secondary actors too easily under a mere negligence standard[190] by saying that Congress easily could have used different language (such as the knowingly aiding and abetting standard in Section 20(e) of the Exchange Act) if it had wanted to apply a scienter-based standard.[191] Third, the Commission argued that the legislative history of the Remedies Act, with its emphasis on remedial flexibility, demonstrated that Congress intended causing liability to reach the less egregious conduct that a negligence standard encompasses.[192] Fourth, the Commission cited its prior pronouncements and consent orders, congressional testimony, scholarly commentary, and ALJ opinions as being consistent with

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and "knew or should have known" requirements in previous opinions), *aff'd*, Exchange Act Release No. 47,357, 2003 SEC LEXIS 377, at *21–23 (Feb. 12, 2003) (upholding ALJ's finding of reckless aiding and abetting and causing violations, but not commenting on her assertion that one cannot negligently cause scienter-based primary violations). Both *Jones* and *Howard* noted the silence of the Remedies Act's legislative history on this issue. *Howard*, 69 SEC Docket at 1243; *Jones*, 66 SEC Docket at 3094. However, the ALJ in *Jones* treated the issue much more extensively, citing *Kern*, proceedings related to *Graham*, and cases interpreting the phrase "should have known" in other contexts. *Jones*, 66 SEC Docket at 3093–95.

188. *See* KPMG Peat Marwick LLP, Exchange Act Release No. 43,862, 74 SEC Docket 384, 421 & n.101 (Jan. 19, 2001) (citing nonsecurities law cases for proposition that "knew or should have known" is language of negligence), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002); *see also supra* notes 91–97 and accompanying text (noting that ABA Section 15(c)(4) Task Force made similar arguments in construing that statute and citing leading tort authorities for same proposition).

189. *See supra* notes 36–37 and accompanying text (describing textualist reasoning of *Central Bank*).

190. *See supra* note 185 (reviewing commentators' concerns).

191. *KPMG*, 74 SEC Docket at 422 n.103.

192. *Id.* at 422, 431–32. This reasoning parallels the discussion in Part III.C of this Note, but it is less convincing if aiding and abetting requires knowing assistance because even reckless causing liability would still be below that standard. *See supra* Part III.C (suggesting that procedural flexibility calls for lesser standard for causing liability than for aiding and abetting liability); *supra* notes 45–46 and accompanying text (noting possibility of knowing aiding and abetting standard). However, even if aiding and abetting requires knowing assistance, negligent causing liability would still provide the most remedial flexibility by allowing the SEC, in its discretion, to punish the widest range of violators.

its position.[193] Finally, the Commission cited *Kern* for the proposition that Section 15(c)(4) causing liability also operated under a negligence standard and that Congress incorporated this standard by adopting the language of that section nearly verbatim in the 1990 causing liability provisions.[194]

Several additional rationales that the Commission did not enunciate also support the negligence standard of *KPMG*. First, given that negligence is generally a better defined concept in the law than recklessness,[195] the *KPMG* standard should ensure more predictable results in causing liability adjudications, which will help individuals pattern their behavior to avoid liability. Second, allowing causing liability to attach to negligent conduct recognizes the social harm that negligence causes, leads to more optimal exercise of due care, and avoids the proof problems inherent in subjective, scienter-based mental states.[196] Finally, causing liability may be the only practical way for the SEC to pursue secondary violators of the Securities Act, which lacks a general

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193. *See KPMG*, 74 SEC Docket at 422 n.104 (citing Rita L. Schwartz, Exchange Act Release No. 42,684, 72 SEC Docket 514, 518 (Apr. 13, 2000); Amendment to Rule 102(e) of the Commission's Rules of Practice, Exchange Act Release No. 40,567, 68 SEC Docket 707, 710 & n.38 (Oct. 26, 1998) (identifying causing liability as example of securities laws imposing liability for unintentional conduct); Incomnet, Inc., Exchange Act Release No. 40,281, 67 SEC Docket 2062, 2070 (July 30, 1998); Edward D. Jones & Co., Initial Decision Release No. 125, 66 SEC Docket 3086, 3093–95 (Apr. 15, 1998); Carole L. Haynes, Initial Decision Release No. 78, 60 SEC Docket 2294, 2341 (Nov. 24, 1995), *final*, Exchange Act Release No. 36,692, 61 SEC Docket 66 (Jan. 5, 1996); *Staff Report on Private Securities Litigation: Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 103d Cong. 49 & n.27 (1994) (statement of then SEC Chairman Arthur Levitt) (stating that causing liability "would appear to be as broad, if not broader, than aiding and abetting liability" and noting that "knew or should have known" equates with negligence in other contexts); 5D ARNOLD S. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10B-5 § 261.05[e][vii] (2000) (opining that causing liability uses negligence standard except in cases in which primary violation requires scienter); Luton, *supra* note 19, at 67 (noting that causing liability appears to require only negligence); McLucas et al., *supra* note 4, at 835 (claiming that causing liability is broader than aiding and abetting)).

194. *Id.* at 423. *But see supra* notes 110–15 and accompanying text (suggesting weaknesses in this argument).

195. *See* MODEL PENAL CODE AND COMMENTARIES § 2.02(2)(c) (1962) (defining recklessness as conscious disregard of substantial and unjustifiable risk); KEETON ET AL., *supra* note 94, § 34, at 210–14 (noting that courts have condemned concept of degrees of negligence as unworkable); Jeanne Calderon & Rachel Kowal, *Auditors Whistle an Unhappy Tune*, 75 DENV. U. L. REV. 419, 443 (1998) (noting various ways that courts have defined recklessness regarding conduct of accountants); Lorne & Callcott, *supra* note 19, at 1320 (noting danger of confusing recklessness with negligence if courts define former as gross negligence); *supra* note 45 (giving yet another definition of recklessness common to securities law).

196. *See* Maxey, *supra* note 12, at 560 (noting, in context of SEC Rule of Practice 102(e), that scienter standard would forego deterring harmful negligent conduct and entail proof problems).

aiding and abetting provision comparable to the one that Congress added to the Exchange Act in 1995.[197]

Nevertheless, when the U.S. Court of Appeals for the District of Columbia Circuit affirmed the Commission's negligence standard in May 2002,[198] its primary reasoning was clear and, like the Commission's opinion, unsurprising in light of *Central Bank*. The court stated that the Commission was "virtually compelled" to adopt a negligence standard by Congress's choice of the phrase "knew or should have known."[199] The SEC's textualist revenge on the defense bar for *Central Bank* was complete.

By announcing a basic mental state requirement in *KPMG*, the Commission took its long-awaited first step toward defining causing liability. However, the other basic elements of causing liability remain undefined, and the rest of this Note will attempt to flesh out these requirements. Moreover, despite the major impact of its holding, the Commission did not even completely define the mental state requirement for causing liability in *KPMG*. Instead, it expressly confined its holding to cases in which the primary violation does not require scienter and left open the question of whether a secondary actor can negligently cause a primary actor to violate a federal securities statute knowingly or recklessly.[200]

Several ALJs and commentators have subsequently answered this question by postulating that only scienter-based conduct can cause scienter-based primary violations; that is, the causing party must act with the same mental state that the law requires of the primary violator (or a greater one) in order to

197. *See supra* note 48 (stating that Securities Act lacks its own aiding and abetting provision). Nevertheless, the Exchange Act prohibitions on willful aiding and abetting by securities professionals still apply to primary violations of the Securities Act, such as unregistered stock sales under Section 5 or fraudulent sales under Section 17. *See supra* note 165 (discussing *Tyler*, which fits this mold).

198. KPMG, LLP v. SEC, 289 F.3d 109, 112 (D.C. Cir. 2002).

199. *Id.* at 120. The court also rebutted KPMG's claim that the SEC could not use causing liability to regulate accountants in light of the existing Rule 102(e). *Id.* at 119.

200. *See* KPMG Peat Marwick LLP, Exchange Act Release No. 43,862, 74 SEC Docket 384, 421–22 & n.103 (Jan. 19, 2001) (confining holding), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002). The Commission stated:

> Where, as here, the primary violations do not require culpability beyond negligence, we see no reason not to give the phrase ["knew or should have known"] its ordinary meaning . . . . It can be argued that a standard higher than negligence should be applied to limit the reach of the statute and so avoid the spectre of cease-and-desist orders against persons who have little contact with the primary actor. At least in cases such as this one involving non-scienter-based primary violations, however, this concern does not warrant our imposing a standard higher than negligence.

Id.

be liable for causing the violation.[201] However, the reasons advanced for this rule are largely conclusory and simply take the Commission's reserving the question in *KPMG* and its subsequent silence on the matter as conclusive evidence that it would not sanction an action alleging negligent causation of another's fraud.[202] The rule is dubious on its face simply because the text of

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201. *See* H.J. Meyers & Co., Initial Decision Release No. 211, 2002 SEC LEXIS 2075, at *92–94 & n.35 (Aug. 9, 2002) (following *Yesner* and *Howard*, *infra*, because Commission had not yet found in any contested proceeding that person negligently caused primary violations requiring scienter); Albert Glenn Yesner, Initial Decision Release No. 184, 75 SEC Docket 220, 254–66 (May 22, 2001) (finding that controller caused company's non-scienter-based reporting violations by his negligence but could not have caused its antifraud violations because he did not act with scienter), *final*, Exchange Act Release No. 44,452, 75 SEC Docket 648 (June 19, 2001); 5E ARNOLD S. JACOBS, DISCLOSURE AND REMEDIES UNDER THE SECURITIES LAWS § 20:132 (2002) (arguing that person cannot negligently contribute to Rule 10b-5 violation because courts should interpret term "contribute" as equivalent to aiding and abetting despite its literal breadth); Crimmins & Herr, *supra* note 5, at 1087 ("The Commission [in *KPMG*] has appropriately limited the negligence standard for the 'causing' liability of secondary violators to instances where the underlying or primary violation is not scienter-based."); Hansen, *supra* note 3, at 346 n.26 ("It, however, would be anomalous to require proof of scienter to establish a primary violation, for example, a violation of Rule 10b-5, but only require negligence to be found a 'cause' of such a violation."); Shah, *supra* note 22, at 292 ("The Commission limited its decision to cases in which the primary violation was not scienter-based; there is no evidence that Congress, in devising the SEC's cease-and-desist order, intended to lower the state of mind requirement for secondary violations."); *see also* Nicholas P. Howard, Initial Decision Release No. 138, 69 SEC Docket 1226, 1243 (Mar. 24, 1999) (concluding, pre-*KPMG*, that because Commission had not decided any cases involving negligent causing of primary violations requiring scienter, causing party must also act with scienter, at least in these instances), *aff'd*, Exchange Act Release No. 47,357, 2003 SEC LEXIS 377, at *21–23 (Feb. 12, 2003) (upholding ALJ's finding of reckless aiding and abetting and causing violations, but not commenting on her assertion that one cannot negligently cause scienter-based primary violations). This is the approach that courts and the Commission have taken for aiding and abetting. *See* F.X.C. Investors Corp., Initial Decision Release No. 218, 2002 SEC LEXIS 3168, at *25–26 (Dec. 9, 2002) ("Irrespective of the level of proof required to establish the primary violation, the Commission has made clear that the accused aider and abetter must have acted with scienter.") (citations omitted), *final*, Investment Advisers Act Release No. 2,097, 2003 SEC LEXIS 35, at *1 (Jan. 9, 2003); Lawton & Botticelli, *supra* note 19, at 34, 36 ("[T]he level of knowledge required of an aider and abettor was generally that required of a primary violator—knowing or reckless conduct.").

202. *See supra* note 201 (giving reasons for rule). Jacobs and Shah argue that the prevailing rule for causing liability must be correct in the absence of any legislative history indicating congressional intent to depart from the rule for aiding and abetting liability. 5E JACOBS, *supra* note 201, § 20:132; Shah, *supra* note 22, at 292 n.130; *see supra* note 201 and accompanying text (describing both rules). This argument misses the mark. The text of a statute is the primary (if not sole) indicator of congressional intent, and Section 21C on its face applies the "knew or should have known" standard for causing liability to *any* Exchange Act violation, even those requiring scienter. *Infra* note 203. The legislative history of causing liability is virtually irrelevant in the face of this unambiguous language and the fact that Congress probably never

Section 21C(a) does not mention any requirements regarding the primary violator's mental state. Instead, the statute applies the "knew or should have known" standard to any secondary offender causing *any* Exchange Act violation, even those requiring scienter.[203] In contrast to the currently prevailing rule, then, this Note contends that a person in many cases *can* negligently cause another person to violate a securities statute requiring scienter. The reasoning supporting this approach follows.

In restricting the *KPMG* holding to primary violations not involving scienter, the Commissioners probably had a specific fact pattern in mind: a "classic" form of causing liability, reminiscent of Section 15(c)(4),[204] in which one or more natural persons cause their business entity to violate a securities law.[205] The SEC has recognized causing liability in this situation both when all the natural persons negligently cause the entity to violate a statute not requiring scienter[206] and when at least one person knowingly or recklessly causes the entity to violate a statute that does require scienter.[207] However, the Commission has never found that a person or group of people, all acting only negli-

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actually intended to create causing liability in the first place. *See supra* note 3 and accompanying text (describing possibly inadvertent creation of causing liability).

Furthermore, after *KPMG*, the fact that one cannot negligently aid and abet a scienter-based violation is immaterial to deciding whether one can negligently cause a scienter-based violation. In *KPMG*, the Commission interpreted Section 21C to allow negligent causation of non-scienter-based violations *even though* courts had long held that a person could not negligently aid and abet a non-scienter-based violation. The phrase "any provision" has just as plain a meaning and is just as indicative of legislative intent as is the phrase "knew or should have known," *especially* in the absence of any legislative history to the contrary.

203. *See* Securities Exchange Act of 1934 § 21C(a), 15 U.S.C. § 78u-3(a) (2000) (applying "knew or should have known" standard for causing liability to violations of "any provision of this title, or any rule or regulation thereunder").

204. *See supra* notes 70, 99, 173 and accompanying text (noting restriction on Section 15(c)(4) causing liability to persons causing corporations to violate Exchange Act reporting requirements).

205. *See supra* notes 170–73 and accompanying text (noting prevalence of "person causing entity" cases).

206. *See, e.g.*, Byron G. Borgardt, Initial Decision Release No. 167, 72 SEC Docket 1675, 1698, 1710–12 (June 1, 2000) (concluding that two officers caused investment company to violate Securities Act Sections 17(a)(2) and 17(a)(3), which do not require scienter, by negligently omitting material facts from registration statement). Apparently, a person can even cause a violation by a corporation to which he or she does not belong. *See* Korea Data Sys. USA, Inc., Exchange Act Release No. 46,047, 2002 SEC LEXIS 1510, at *11 (June 7, 2002) (finding that one corporation, along with its officers, caused violations of second corporation).

207. *See, e.g.*, Erik W. Chan, Exchange Act Release No. 45,693, 77 SEC Docket 851, 859–60 (Apr. 4, 2002) (finding that corporate secretary caused corporation to violate Securities Act Section 17(a)(1) and Exchange Act Section 10(b), both of which require scienter, by knowingly participating in promulgation of fraudulent private placement memorandum).

gently, caused an entity to violate a scienter-based statute, and for good reason. Business entities depend on agents to supply them with mental states.[208] So, if the agent or agents in question act negligently, the corporation or other entity cannot act knowingly or recklessly to commit the primary violation. One or more of the agents must act with scienter to cause the entity to act with scienter.[209] Thus, an officer of a corporation, acting alone, simply cannot negligently cause his or her corporation to commit securities fraud.

However, unlike Section 15(c)(4), the language of the Remedies Act extends causing liability to the situation in which one natural person causes another natural person to violate a securities statute.[210] The SEC has used causing liability in this way in only a few cases to date,[211] and only in situations in which Person *A* knowingly or recklessly caused Person *B* to violate a statute requiring scienter,[212] or *A* knowingly or recklessly caused *B* to violate

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208. *See* 3B BLOOMENTHAL & WOLFF, *supra* note 99, § 14.12 ("Congress . . . had to recognize that a company can act only through its agents and the knowledge of a company can exist only to the extent the knowledge of its agents is imputed to the company.").

209. For example, suppose that the CEO, CFO, and comptroller of a corporation each somehow contributed to a scheme designed by the CEO that resulted in the corporation violating Rule 10b-5. The CEO acted knowingly and the CFO acted recklessly, so each may be both primarily liable and secondarily liable for causing the corporation's violation. However, even if the comptroller did not know that he was contributing to the fraud but only should have known, he may still be liable for causing the corporation's violation (which requires scienter) because any violation may have multiple causes and the corporation already has the requisite scienter for the primary violation by imputation from the CEO and CFO. *See Chan*, 77 SEC Docket at 867 ("Thus, the mere fact that others also may have caused [the corporation] to violate the securities laws does not insulate [the respondent] from [causing] liability for his own acts and omissions.").

210. *See* Securities Exchange Act of 1934 § 3(a)(9), 15 U.S.C. § 78c(a)(9) (2000) ("The term 'person' means a natural person, company, government, or political subdivision, agency, or instrumentality of a government."); *supra* note 164 and accompanying text (noting that Section 21C(a) applies to any person causing violations of any other person).

211. *See supra* notes 172–73 and accompanying text (noting SEC reluctance to extend causing liability past bounds of Section 15(c)(4)).

212. *See* Rodona Garst, Exchange Act Release No. 46,987, 2002 SEC LEXIS 3167, at *2–4 (Dec. 11, 2002) (finding that individual intentionally caused other individual's Rule 10b-5 violations by sending fraudulent e-mail messages written by primary violator); Keith J. Mauney, Exchange Act Release No. 46,448, 2002 SEC LEXIS 2254, at *7 (Sept. 3, 2002) (finding that broker-dealer supervisor recklessly caused registered representative to violate antifraud provisions by executing adjusted trades at representative's behest); Joan L. Fleener, Securities Act Release No. 8,000, 75 SEC Docket 1739, 1740–41 (Aug. 14, 2001) (concluding that executives at two corporations knowingly caused bond promoters to violate Securities Act Section 17(a)(1) by providing promoters with false information concerning value of bonds and companies that those promoters then disseminated to investors); Sharon M. Graham, Exchange Act Release No. 40,727, 53 S.E.C. 1072, 1075–76, 1080–82 (1998) (finding that broker-dealer representative willfully aided and abetted, and thus also caused, client's Section 10(b) violations

a statute that does not require scienter for a primary violation.[213] Nonetheless, in a case involving the same facts except that the secondary defendant acted only negligently and the primary defendant acted with scienter, no reason explains why one natural person could not negligently "cause" another natural person's fraud within the meaning of the Remedies Act, as at least one study has implicitly recognized.[214]

If the only impediment is that this situation somehow sounds anomalous, perhaps the term "causing" liability itself is to blame. Speaking in terms of one person "causing" another person's violation seems to imply an element of *sole* causation. Yet, the text of Section 21C(a) speaks only in terms of any person being "*a* cause" of another person's violation, and the Commission itself has recognized that "the mere fact that others also may have caused" the primary violation does not insulate one from causing liability.[215] For example, suppose Person *B* knowingly concocts a fraudulent securities scheme and persuades Person *A* to execute a part of it that would not constitute fraudulent conduct on its own but that is essential to the success of *B*'s plan. *B* is then in some sense a cause of her own violation by deliberate choice. However, even if *A* does not know that he is contributing to *B*'s violation *but should know*, then the SEC could hold *A* liable for negligently being a (second) cause of *B*'s fraud.

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by executing his wash trades and matched orders), *aff'd*, 222 F.3d 994 (D.C. Cir. 2000).

213. *See* John K. Bradley, Exchange Act Release No. 46,035, 2002 SEC LEXIS 1448, at *10–11 (June 5, 2002) (finding that credit manager caused CFO to lie to auditors in violation of Exchange Act Rule 13b2-2 by preparing two falsified deferred revenue reports upon CFO's request); *Fleener*, 75 SEC Docket at 1740–41 (concluding that executives at two corporations knowingly caused bond promoters to violate Securities Act Section 17(a)(3) by providing promoters with false information concerning value of bonds and companies that those promoters then disseminated to investors).

214. *See* Hiler & Gilman, *supra* note 3, at 268 ("A mere negligence standard [for causing liability] would put persons in management positions at risk of liability for even egregious, scienter-based violations by others with whom they may have little contact."). As a matter of policy, the Commission and the ALJs might wish to restrict the applicability of causing liability in this "negligent causation of fraud" situation, on a case-by-case basis or as a matter of law, via a proximate causation requirement. *See infra* Part III.E.3 (recommending proximate causation element for causing liability). In this way, the SEC could avoid the "spectre" of sanctioning remote parties that negligently contribute to scienter-based violations while remaining faithful to the text of Section 21C by not changing the "ordinary meaning" of the phrases "knew or should have known" and "any provision" depending on the nature of the primary violation. *See supra* note 200 (noting Commission's concerns). However, Congress certainly did not mandate this restriction in the Remedies Act, and a more expansive view of causing liability in this regard would not be as ridiculous as some commentators have suggested. *See supra* note 201 (reviewing commentators' statements).

215. Erik W. Chan, Exchange Act Release No. 45,693, 77 SEC Docket 851, 867 (Apr. 4, 2002).

In conclusion, the Commission should hold that both natural persons and business entities can negligently cause other natural persons and business entities[216] to violate securities statutes that require scienter, except in cases in which no natural person exists who can supply the entity with the requisite scienter to commit the primary violation. This approach gives maximum effect to the statutory text of the Remedies Act and its stated purpose of covering a wide range of less culpable behavior, but does so only within the bounds of recognized agency principles[217] and common sense.

2. Degree of Action

The Commission has yet to address the second element of causing liability: the act requirement. The diction of Sections 21C(a) and 20(e) of the Exchange Act certainly suggests that the act requirement for aiding and abetting liability is more demanding than for causing liability; specifically, providing "substantial assistance"[218] seems to require more participation than performing an act that merely "contributes" to a violation.[219] Unfortunately, case law has added very little gloss to these concepts directly, perhaps be-

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216. The Commission has recognized that one entity can cause another entity's violation as long as the causing entity has the requisite mental state (supplied by its agents) for the primary violation. *See* PricewaterhouseCoopers LLP, Exchange Act Release No. 46,216, 2002 SEC LEXIS 1824, at *38 (July 17, 2002) (concluding that accounting firm caused audit client's reporting violations); Ashford.com, Inc., Exchange Act Release No. 46,052, 2002 SEC LEXIS 1484, at *30 (June 10, 2002) (finding that corporation caused contractual partner corporation's reporting violations by negligent acquiescence of its employees); Korea Data Sys. USA, Inc., Exchange Act Release No. 46,047, 2002 SEC LEXIS 1510, at *11 (June 7, 2002) (finding that one corporation, along with its officers, caused fraud violations of second corporation with requisite scienter); KPMG Peat Marwick LLP, Exchange Act Release No. 43,862, 74 SEC Docket 384, 420, 428 (Jan. 19, 2001) (concluding that accounting firm caused audit client's reporting violations through negligence of two partners), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002). Again, however, this Note argues that Corporation *A* could be liable for causing Corporation *B*'s violation if Agent *X* of Corporation *A* negligently contributes to the knowing or reckless violation of a scienter-based statute by Agent *Y* of Corporation *B*.

217. *See* 3B BLOOMENTHAL & WOLFF, *supra* note 99, § 14.12 ("[T]he law often imputes the knowledge of an agent to a principal." (citing RESTATEMENT (SECOND) OF AGENCY § 272 (1958))).

218. Securities Exchange Act of 1934 § 20(e), 15 U.S.C. § 78t(e) (2000). The term comes from the RESTATEMENT (SECOND) OF TORTS § 876(b) (1965), which summarizes the common law of aiding and abetting. *See* Patrick J. McNulty & Daniel J. Hanson, *Liability for Aiding and Abetting by Silence or Inaction: An Unfounded Doctrine*, 29 TORT & INS. L.J. 14, 18–22 (1993) (discussing aiding and abetting in torts).

219. Securities Exchange Act of 1934 § 21C(a), 15 U.S.C. § 78u-3(a) (2000); *see* 5E JACOBS, *supra* note 201, § 20:132 ("The amorphous term 'contribute' also is not defined. Read literally, it is broader than the secondary liability concepts recognized for Rule 10b-5 infractions, such as aiding and abetting.").

cause of the wide variety of factual situations in which secondary liability for securities law violations arises.[220] Moreover, one could hardly expect the Commission to issue a release detailing every possible act that could result in aiding and abetting or causing a violation.

Even so, a few generalizations are possible. Regarding aiding and abetting, courts will not characterize "ministerial" assisting acts or those involving the provision of ordinary business services as substantial assistance because the aider-abettor derives no unusual economic benefit in those situations.[221] Furthermore, courts have long been divided over whether a person may aid and abet a violation by silence or inaction, with those courts recognizing this claim often requiring both a duty to disclose or prevent the violation and a conscious intent to assist on the part of the secondary defendant.[222]

Given that the subject matter of causing liability cases has proven to be at least as diverse as in aiding and abetting cases,[223] a direct analysis of what

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220. *See* Marc N. Geman, Exchange Act Release No. 43,963, 74 SEC Docket 999, 1031 (Feb. 14, 2001) ("In determining whether there has been 'substantial assistance,' we consider all of the facts and circumstances."); Lowenfels & Bromberg, *supra* note 41, at 8 ("What is substantial is highly fact-specific, dependent on the nature of the primary violation and on the nature of the assistance.").

221. *See* Woodward v. Metro Bank of Dallas, 522 F.2d 84, 97–98 (5th Cir. 1975) (finding that bank did not aid and abet fraud by not disclosing customer corporation's insolvency to other party in transaction because bank lacked high degree of scienter needed to transform actions that were merely in ordinary course of bank's business into substantial assistance); Seligman, *supra* note 38, at 1437–38 (discussing courts' reluctance to recognize ministerial acts and transactions in ordinary course of business as aiding and abetting); Lawrence A. Steckman & Robert E. Conner, *Loss Causation Under Rule 10b-5, A Circuit-by-Circuit Analysis: When Should Representational Misconduct Be Deemed the Cause of Legal Injury Under the Federal Securities Laws?*, *in* 1 SECURITIES ARBITRATION 1998, at 375, 404–05 (1998) (noting that courts will not find substantial assistance when banks, attorneys, accountants, or brokers provide "basic support services to help consummate transactions" and derive no unusual economic benefit from them). *But see* Graham v. SEC, 222 F.3d 994, 1004 (D.C. Cir. 2000) (concluding that broker-dealer representative aided and abetted customer's matched orders by executing them, conduct that involved discretion and thus was not ministerial).

222. *See* McNulty & Hanson, *supra* note 218, at 27 & nn.97–99 (citing cases divided on this issue); *supra* notes 35, 43, and accompanying text (discussing judicial division). Unlike the heightened mental state required for inaction, active aiding and abetting may require a lesser degree of scienter if proof of the assisting act is strong. *See* Albert Glenn Yesner, Initial Decision Release No. 184, 75 SEC Docket 220, 261 (May 22, 2001) ("The second and third elements of aiding and abetting vary inversely with one another and must be viewed together. Accordingly, if there is scant evidence of substantial assistance, then there must be more evidence of scienter."), *final*, Exchange Act Release No. 44,452, 75 SEC Docket 648 (June 19, 2001).

223. *See supra* notes 164–73 and accompanying text (describing range of causing liability cases).

acts can constitute contributing to violations is as ineffective as a factual examination of substantial assistance. But again, two trends are discernible. First, in a few cases, the SEC has found natural persons liable for causing an entity's violation simply because they signed a document required to be filed with the Commission.[224] A second recognized trend is that the SEC regularly institutes causing liability cases based on silence or inaction,[225] probably because Section 21C(a) expressly includes "omissions" while Section 20(e) does not.[226]

Because the act of signing a document can have drastic consequences,[227] that act is hardly "ministerial" even if it is rather easy to execute. Therefore, this distinction is insufficient support for the argument that causing liability has a relatively low act standard. The "act versus omission" dichotomy is a better way to distinguish the degree of action required for aiding and abetting versus causing liability at a conceptual rather than factual level, perhaps in conjunction with the idea of causal nexus as a proxy for degree of action as discussed below. Given the textual support for causing liability based on omissions, the lack of such support in the aiding and abetting statutes, and the longstanding debate over aiding and abetting based on inaction while it was still an implied right of action, courts should hold either (1) that aiding and

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224. *See* Robert M. Fuller, Initial Decision Release No. 210, 2002 SEC LEXIS 1996, at *43 (Aug. 2, 2002) (finding that board chairman caused corporation's fraud violation by signing Form 10-K that he knew contained material misrepresentations and omissions); Deprince, Race & Zollo, Inc., Investment Advisers Act Release No. 2,035, 2002 SEC LEXIS 1517, at *4 (June 12, 2002) (finding that company's principal was "a cause" of company's violation by signing forms); *cf.* Rodona Garst, Exchange Act Release No. 46,987, 2002 SEC LEXIS 3167, at *2–4 (Dec. 11, 2002) (finding that individual intentionally caused other individual's Rule 10b-5 violations by sending fraudulent e-mail messages written by primary violator).

225. *See, e.g.*, Erik W. Chan, Exchange Act Release No. 45,693, 77 SEC Docket 851, 860 (Apr. 4, 2002) (determining that officer caused corporation's violation of antifraud provisions by failing to correct private placement memorandum); Byron G. Borgardt, Initial Decision Release No. 167, 72 SEC Docket 1675, 1675–76, 1680–81 (June 1, 2000) (claiming that officers of investment company omitted material facts from registration statements, thereby causing company to violate Section 17 antifraud provisions); Incomnet, Inc., Exchange Act Release No. 40,281, 67 SEC Docket 2062, 2070–71 (July 30, 1998) (finding that inside directors knowingly failed to ensure accuracy of company's public statements); Cox, *supra* note 48, at 538 ("Overall, cause, as interpreted by the SEC, appears to include within any organization those who, though not the source of the false representation to the defrauded investors, have failed to take action that could have prevented the fraud.").

226. *See* Securities Exchange Act of 1934 § 20(e), 15 U.S.C. § 78t(e) (2000) (failing to include omissions expressly); Securities Exchange Act of 1934 § 21C(a), 15 U.S.C. § 78u-3(a) (2000) (including omissions).

227. *See, e.g.*, 18 U.S.C.S. § 1350(c) (Law. Co-op. Supp. 2002) (providing, as part of Sarbanes-Oxley Act of 2002, criminal penalties for signing Exchange Act reports while knowing they are materially inaccurate).

abetting liability simply does not cover inaction anymore while causing liability does or (2) that aiding and abetting by omission retains an intent requirement that causing liability lacks.[228] Either way, the standard governing the degree of action for aiding and abetting would be more demanding than that for causing liability. Thus, this Note argues that, consistent with the treatment of the mental state requirement in *KPMG*, the act requirement for causing liability should be easier to establish than that for aiding and abetting because only the former expressly includes omissions.

3. *Causal Nexus*

Lacking textual guidance on the meaning of substantial assistance in the context of Section 10(b) and perhaps finding the development of the concept on an ad hoc basis to be unworkable, courts soon adopted the tort approach of equating substantial assistance with proximate causation for purposes of analyzing aiding and abetting.[229] This conception of proximate cause differs from the one usually associated with securities fraud because it seeks to link the aider-abettor's actions not with the victim's monetary loss but with the primary violator's actions, which in turn directly cause the damages.[230] Presumably, however, this type of proximate cause still imports the entire tort causation framework whereby "but for" or factual causation is a necessary but insufficient condition for liability, with proximate or legal causation being the additional requirement that connotes a rough policy judgment as to how "remote" a factual cause the law should recognize.[231] Nevertheless, the SEC

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228. *See* Albert Glenn Yesner, Initial Decision Release No. 184, 75 SEC Docket 220, 261–66 (May 22, 2001) (taking second approach and thus finding that controller caused company's recordkeeping violations by inaction but did not aid and abet them because he did not act with requisite level of intent), *final*, Exchange Act Release No. 44,452, 75 SEC Docket 648 (June 19, 2001); *supra* Part III.E.1 (concluding that causing liability is based on negligence and thus lacks any intent requirement).

229. *See* Lowenfels & Bromberg, *supra* note 41, at 8 ("To illuminate the meaning of 'substantial,' the cases have often treated substantial assistance as a causation concept, parallel to the causation requirement for a primary violation."); McNulty & Hanson, *supra* note 218, at 25 ("As at common law, the substantial assistance requirement is the equivalent of proximate cause."); Goodwin, *supra* note 18, at 1396–97 (noting that courts, lacking textual guidance, seized on concepts of causation and duty as alternate tests for substantial assistance).

230. *See* McNulty & Hanson, *supra* note 218, at 25 ("The plaintiff must prove that the assistance provided by the alleged aider and abettor was a substantial factor in bringing about the primary violation. Stated otherwise, the primary violation must be a 'direct or reasonably foreseeable consequence' of the aider and abettor's conduct."); Steckman & Conner, *supra* note 221, at 403 (noting that issue of proximate causation differs in context of primary versus secondary liability for securities fraud).

231. *See* KEETON ET AL., *supra* note 94, § 41, at 264 (discussing meaning of proximate

has recognized that neither "but for" nor proximate causation requires that the secondary defendant's actions be the *sole* cause of the primary violation; they need only be *a* cause of it.[232]

As commentators have noted, the key question is whether Congress, by the text of Section 21C(a), meant for the SEC to apply only a "but for" causation test in causing liability cases or whether ALJs must undertake a proximate cause analysis as well.[233] Even after *KPMG*, this issue is still unresolved and has serious policy implications. On the one hand, a factual causation standard would be more predictable given the notoriously vague and confusing array of tests for proximate cause, most of which ultimately boil down to a policy judgment.[234] On the other hand, only requiring "but for" causation would cast a wide net of liability around remote secondary actors,[235] and some would say that Congress never intended such a departure from the substantial assistance requirement of aiding and abetting. Indeed, a proximate cause element might imbue cease-and-desist proceedings based on causing liability with a certain amount of flexibility from the respondent's point of view (which would complement the procedural flexibility that the Remedies Act gave the Commission) by permitting policy arguments as to why the SEC should deem that person too far removed from the violation to be culpable.[236]

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cause as policy restraint); Lowenfels & Bromberg, *supra* note 41, at 8 (noting that courts have held "but for" causation to be insufficient in private aiding and abetting securities law cases). For a general discussion of factual and legal causation in tort law, see KEETON ET AL., *supra* note 94, §§ 41–42, at 263–79.

232. *See* Erik W. Chan, Exchange Act Release No. 45,693, 77 SEC Docket 851, 867 (Apr. 4, 2002) (stating that "mere fact that others also may have caused" violation is no defense to causing liability); Carole L. Haynes, Initial Decision Release No. 78, 60 SEC Docket 2294, 2339 (Nov. 24, 1995) (stating that aiding and abetting liability requires only that aider-abettor's substantial assistance is one cause of violation, not sole or even principal cause), *final*, Exchange Act Release No. 36,692, 61 SEC Docket 66 (Jan. 5, 1996).

233. *Compare* 5E JACOBS, *supra* note 201, § 20:132 ("[T]he test surely should be proximate cause rather than a cause-in-fact."), *and* Hansen, *supra* note 3, at 346 (arguing that causing liability should require proximate causation), *with* Lorne & Callcott, *supra* note 19, at 1308–09 (noting that causing liability may be broader than aiding and abetting if former only requires loose causal nexus), Maxey, *supra* note 12, at 570–71 (maintaining that "contribute" in Section 21C(a) gives SEC room to argue for requiring only "but for" causation), *and* Lawton & Botticelli, *supra* note 19, at 39 (predicting that SEC will find that causing liability does not require substantial assistance and that secondary actor need not immediately induce violation).

234. *See* KEETON ET AL., *supra* note 94, § 42, at 276–80 (rejecting "fruitless quest for a universal formula" for proximate cause because concept is fundamentally one of policy, not fact); Steckman & Conner, *supra* note 221, at 382–84 (noting disagreement over test for proximate cause and observing that choice of test is usually outcome determinative).

235. *See* Lorne & Callcott, *supra* note 19, at 1309 (noting breadth of causing liability without requirement of substantial assistance).

236. *See infra* notes 244–49 and accompanying text (discussing case in which respondent

Recent administrative decisions highlight this tradeoff in predictability versus flexibility, as well as the direct and indirect approaches to analyzing substantial assistance and how the causation standard might differ between aiding and abetting liability and causing liability. In *Sharon M. Graham*,[237] a case brought jointly under Sections 15(b) and 21C(a) of the Exchange Act, an ALJ found that Graham, a registered broker-dealer representative, had willfully aided and abetted her customer's market manipulation scheme by recklessly failing to inquire into the propriety of his matched orders before executing them.[238] The ALJ stated that the substantial assistance element required a finding that the broker's trades were "a causal factor but not necessarily the sole factor in bringing about the primary violation."[239] The ALJ then noted that the finding of aiding and abetting necessarily implied a finding of causing liability, but that even if Graham had not aided and abetted her customer's violations, she had still caused them under Section 21C(a) by negligence because she should have known that his actions were illegal.[240] The Commission and the U.S. Court of Appeals for the District of Columbia Circuit af-

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successfully argued that he was too remote in causal chain to be liable). Courts have long recognized the concept of legal duty in negligence law as a substitute analysis for proximate causation and remoteness that perhaps better suggests that the proper inquiry is one of policy, not physical directness. *See* KEETON ET AL., *supra* note 94, § 42, at 273–75 (noting that duty test may direct focus toward policy and away from "the mechanical sequence of events which goes to make up causation in fact"). The SEC decisions are split between the duty and cause formulations. *Compare* Albert Glenn Yesner, Initial Decision Release No. 184, 75 SEC Docket 220, 257–66 (May 22, 2001) (finding that controller caused company to violate reporting and recordkeeping provisions by failing in his duty to assess and report accounting practices to audit committee), *final*, Exchange Act Release No. 44,452, 75 SEC Docket 648 (June 19, 2001), *and* Marc N. Geman, Exchange Act Release No. 43,963, 74 SEC Docket 999, 1031–32 (Feb. 14, 2001) (analyzing willful aiding and abetting claims based on reckless inaction in terms of CEO's "responsibility" for firm's trading strategy), *with infra* notes 243–54 and accompanying text (discussing cases using proximate causation tests based on physical remoteness).

237. Sharon M. Graham, Initial Decision Release No. 82, 60 SEC Docket 3162 (Dec. 28, 1995), *aff'd*, Exchange Act Release No. 40,727, 53 S.E.C. 1072 (1998), *aff'd*, 222 F.3d 994 (D.C. Cir. 2000). The issue in *Graham* was whether Sharon Graham had entered orders for John Broumas to buy and sell the stock of his former company while knowing that another party had or would execute a "matched order" for the same stock (so that the trading volume of the stock would increase without a real change in ownership), thereby aiding and abetting Broumas's Section 10(b) fraud violation. *Id.* at 3163, 3176–78. An ALJ found that Graham had knowledge of her involvement in the scheme or at least recklessly failed to inquire about the propriety of the trades. *Id.* at 3201–05. The ALJ rejected Graham's defenses of insubstantial assistance and reliance on superiors and found that her aiding and abetting necessarily implied that she was also a cause of Broumas's violation, thus justifying a cease-and-desist order. *Id.* at 3206–07.

238. *Id.* at 3163, 3203–05, 3212.

239. *Id.* at 3206–07.

240. *Id.*

firmed without commenting on the ALJ's dictum regarding the negligence standard,[241] but the court analyzed the substantial assistance question directly in terms of action instead of indirectly in terms of causation by focusing on Graham's discretionary (rather than ministerial) powers over her customer's account.[242]

However, both the Commission and its ALJs appear to prefer using the causal method of analyzing aiding and abetting.[243] For example, in *Warren G. Trepp*,[244] an ALJ dismissed charges against a junk bond trader whom the SEC believed had aided and abetted and caused one of his entity clients to make material misstatements in its Form 10-Q and in a filing in anticipation of an initial public offering.[245] Trepp initialed tickets confirming that he had made trades for the company, but the tickets did not reveal that the trades were part of a secret "parking" program whereby the company sold bonds to create gains, but later repurchased them from the broker-dealer at the same price in return for a fee.[246] The company was liable for reporting and fraud violations because the gains from these trades improperly appeared on its financial statements and

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241. *See* Sharon M. Graham, Exchange Act Release No. 40,727, 53 S.E.C. 1072, 1085 n.35 (1998) (noting that aiding and abetting implies causing, but not analyzing causing liability claim); *see also* Graham v. SEC, 222 F.3d 994, 1004 (D.C. Cir. 2000) (ignoring causing liability claim altogether).

242. *See Graham*, 222 F.3d at 1004 (focusing on executing trades as discretionary, not ministerial, activity).

243. *See* Russo Sec., Inc., Exchange Act Release No. 39,181, 53 S.E.C. 271, 271–72, 278–82 (1997) (finding that broker-dealer and its principal did not willfully aid and abet or cause client company to violate Section 10(b) by providing it with sham interest rate reset opinions for company's bonds to hide noncompliance with indenture agreement because company never gave those false opinions to anyone, so respondents' acts were not proximate cause of primary violation in that they did not substantially assist or even contribute to it). *But see* Nicholas P. Howard, Initial Decision Release No. 138, 69 SEC Docket 1226, 1243 (Mar. 24, 1999) (analyzing substantial assistance in terms of specific acts without mentioning causation), *aff'd*, Exchange Act Release No. 47,357, 2003 SEC LEXIS 377, at *19–21 (Feb. 12, 2003) (same).

244. Warren G. Trepp, Initial Decision Release No. 115, 65 SEC Docket 614 (Aug. 18, 1997), *aff'd on other grounds*, Exchange Act Release No. 41,913, 70 SEC Docket 2037 (Sept. 24, 1999). Trepp was a junk bond trader whose firm had a secret agreement with Reliance Group Holdings, Inc. (Reliance) to "park" bonds that Reliance had sold by holding them for repurchase without market risk in return for a fee. *Id.* at 623, 626–27, 634–35. Reliance improperly recognized gains from the sales in violation of GAAP and reported them on its quarterly and IPO filings in violation of Section 13(a) of the Exchange Act and Section 17(a)(2) of the Securities Act. *Id.* at 638–40. However, the ALJ found that Trepp had not aided and abetted or caused these violations by executing the trades because of his "remoteness in the chain of causation" and lack of knowledge that the purpose of Reliance's trading program was to create gains. *Id.*

245. *Id.* at 638–40, 643.

246. *Id.* at 626–27, 630, 634–35.

filings.[247] As for Trepp, the ALJ found that he (1) had not aided and abetted the company's violations because the SEC had not proven substantial assistance given Trepp's "remoteness in the chain of causation," which necessitated a finding of knowledge that he lacked, and (2) had not caused the violations based solely on the remoteness rationale.[248] The chain of the company reporting Trepp's trades on its financial statements, which it then incorporated into its SEC filings, was apparently too indirect to support a finding of proximate causation because Trepp did not know that the program's purpose was to create gains to appear on SEC filings, despite his knowing that his trades would appear in the company's financial statements.[249]

To see how unpredictable the concept of proximate cause can be, compare *Trepp* with *Robert G. Weeks*,[250] a case in which the Division of Enforcement alleged that three men who controlled a virtual shell corporation had caused the company to violate the Section 13 reporting provisions of the Exchange Act by filing late annual and quarterly reports with the SEC and failing to file current reports.[251] After citing conflicting cases on the meaning of "cause" from other securities law contexts and the newly adopted negligence standard for causing liability from *KPMG*,[252] the ALJ found that the respondents had caused the violation by "creating the predicament" that resulted in the violation.[253] Specifically, they had diverted so much money from the company that it could not pay its auditors, who therefore would not prepare the financial statements, which the company thus could not file

247. *Id.* at 638–40.

248. *Id.*

249. *Id.*

250. Robert G. Weeks, Initial Decision Release No. 199, 76 SEC Docket 2609 (Feb. 4, 2002). In *Weeks*, an ALJ found that three men who controlled the nominal officers and directors of a shell corporation, Dynamic American Corp. (Dynamic), had violated the securities laws by selling unregistered Dynamic stock based on materially misleading statements that inflated the company's mining assets. *Id.* at 2609–10. The ALJ further found that the respondents had negligently caused Dynamic to file late Forms 10-K and 10-Q, to fail to file Form 8-K, and to fail to maintain expense records by "creating the predicament that resulted in Dynamic American's violations." *Id.* at 2659–61. Specifically, the respondents had diverted the funds from Dynamic's illegal stock sales so that the company could not pay its auditors and therefore could not create or file financial statements. *Id.* at 2660. They also refused to provide the nominal officers with sufficient information to establish an adequate records system. *Id.*

251. *Id.* at 2610, 2659–61.

252. *See id.* at 2659 (citing Berko v. SEC, 316 F.2d 137, 140–41 (2d Cir. 1963) (holding that conduct that is "cause" of violation must consist of more than merely conduct that has "to some degree been a factor"); R.H. Johnson & Co. v. SEC, 198 F.2d 690, 696 (2d Cir. 1952) (rejecting contention that courts must always interpret "cause" to mean "an immediate or inducing cause")); *supra* Part III.E.1 (discussing *KPMG*).

253. *Weeks*, 76 SEC Docket at 2660.

promptly with the SEC.[254] This causation chain is no less attenuated than the one in *Trepp*, yet the results are opposite.

Given the unpredictability of proximate causation, should causing liability require only factual causation? At least one ALJ appears to concur with this view.[255] Furthermore, this treatment of causing liability would be consistent with its mental state and act requirements, which are also lower than those for aiding and abetting liability.[256]

Nevertheless, one can imagine the SEC trying to establish even more tenuous causation chains than those in *Trepp* and *Weeks* if causing liability only required factual causation. And while *Trepp* and *Weeks* are arguably inconsistent and neither explicitly referred to proximate causation per se, the ALJs in both cases seemed to rely on proximate causation arguments to support their conclusions.[257] Moreover, policy arguments aside, Congress imported the "cause" language in Section 21C(a) from Section 15(c)(4),[258] and presumably before that from tort and criminal law,[259] which provide the foundation for most securities law secondary liability theories, including aiding and abetting.[260] Because those sources of law require proximate

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254. *Id.*

255. *See* Jeffrey M. Steinberg, Initial Decision Release No. 196, 76 SEC Docket 1538, 1583 (Dec. 20, 2001) (applying *KPMG* negligence standard and accepting Enforcement Division's argument that causing liability did not require proximate causation). However, the ALJ in *Steinberg* hedged slightly by saying that "it is incorrect to assert that any act which contributes to the violation is a 'cause' of that violation." *Id.* at 1583–84. Furthermore, the ALJ had just quoted a passage discussing the importance of determining the meaning of "cause" on a case-by-case basis by means of discretion and policy, which seems to belie his assertion that causing liability requires only "but for" causation. *Id.* at 1583.

256. *See supra* Part III.E.1–2 (defining mental state and act requirements).

257. *Compare* Robert G. Weeks, Initial Decision Release No. 199, 76 SEC Docket 2609, 2659–61 (Feb. 4, 2002) (finding sufficient causation where secondary offender "created the predicament" resulting in primary violation) *with* Warren G. Trepp, Initial Decision Release No. 115, 65 SEC Docket 614, 638–40 (Aug. 18, 1997) (finding insufficient causation based on respondent's lack of knowledge and his remoteness in chain of causation), *aff'd on other grounds*, Exchange Act Release No. 41,913, 70 SEC Docket 2037 (Sept. 24, 1999).

258. *See supra* notes 69–70, 88–89, and accompanying text (noting that Congress imported causing liability language from Section 15(c)(4) and that SEC informally agreed that causation in that statute meant proximate causation).

259. *See* Doty, *supra* note 119, at 604 (recognizing "tort-based concepts which inhabit the causation cabinets of the common law"); Hansen, *supra* note 3, at 346 (arguing that causing liability should require proximate causation because "the concept of being a 'cause' of a violation presumably imports at least the notion of 'proximate' cause from negligence law").

260. *See* Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 181 (1994) (noting tort and criminal law foundations of aiding and abetting); Goodwin, *supra* note 18, at 1411, 1417 (noting tort basis for conspiracy and respondeat superior).

causation in most circumstances,[261] the textualist rationale of *Central Bank* militates in favor of a proximate causation requirement for causing liability.[262] Courts should so hold, thereby giving effect to presumed congressional intent, but still permitting ALJs to approach causing liability cases with flexibility by raising or lowering the amount of indirectness that they will accept as establishing proximate cause on a case-by-case basis and as policy concerns dictate.

IV. Conclusion

Although the Securities and Exchange Commission took more than a decade to define one of the most basic elements of causing liability, at least it eventually did so correctly. The Commission's interpretation of causing liability as requiring only negligence is firmly grounded in the statutory text and remedial structure of the Remedies Act and is consistent with the history of causing liability under Section 15(c)(4) and a lesser "likelihood" showing for cease-and-desist orders. The textualist reasoning of *Central Bank* worked in the SEC's favor this time, and the D.C. Circuit rightly deferred to the Commission's judgment and affirmed *KPMG*.

Nevertheless, some basic issues regarding causing liability remain unresolved, and this Note suggests several solutions. First, the Commission should clarify its holding in *KPMG* by overruling the prevailing view among the ALJs regarding causing liability in cases of primary violations requiring scienter. The Commission should hold that both natural persons and business entities can negligently cause other natural persons and business entities to violate securities statutes that require scienter, except in cases in which no natural person exists who can supply the entity with the requisite scienter to commit the primary violation. By prohibiting negligent causing liability in all cases involving scienter-based primary violations, the current rule is overbroad and contravenes the statutory text that created causing liability.

Second, the Commission and courts should formally recognize that the act requirement for causing liability is easier to establish than that for aiding and abetting because the former expressly includes omissions. This pronounce-

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261. *See* MODEL PENAL CODE AND COMMENTARIES, *supra* note 195, § 2.03(1)(a) (requiring "but for" causation and any additional causation requirements imposed by law); RESTATEMENT (SECOND) OF TORTS, *supra* note 94, §§ 430–33 (establishing legal causation requirement for negligence); KEETON ET AL., *supra* note 94, §§ 41–42, at 263–80 (explaining proximate causation requirement for negligence).

262. *See* Neder v. United States, 527 U.S. 1, 21 (1999) ("It is a well-established rule of construction that '[w]here Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms.'" (quoting Cmty. for Creative Non-Violence v. Reid, 490 U.S. 730, 739 (1989))).

ment might also help courts resolve the longstanding question of whether inaction can support aiding and abetting liability at all. Finally, the Commission should hold that causing liability, like aiding and abetting liability, requires proximate causation. A proximate causation requirement would parallel and reinforce the *Steadman* factors and the prosecutorial discretion of the SEC in the crucial function of saving peripheral defendants from the textually expansive reach of causing liability in appropriate cases. This requirement is not just good policy, either. Rather, the statutory text of Section 21C(a) nearly commands it because a requirement of proximate causation has traditionally accompanied the negligence standard in tort law.

Although this Note has attempted to define causing liability, the future of causing liability will largely depend not on how the SEC defines it, but on how the SEC uses it. Causing liability is expansive on its face and applies to all persons and to all securities law violations. This secondary liability theory is certainly broader than aiding and abetting liability because it has lower act and mental state thresholds.

Nevertheless, for various policy reasons and as a matter of prosecutorial discretion, the SEC very well may decline to exercise the full extent of its authority to reach secondary violators of the securities laws via causing liability. The SEC will likely continue to use cease-and-desist orders based on causing liability to supplement the other remedies available against securities professionals for willful aiding and abetting, and perhaps even use it as an end run around the high hurdles of the aiding and abetting standard in those cases. However, in light of the SEC's loss of most of its secondary liability arsenal after *Central Bank*, the Commission also could decide to extend causing liability into more generic securities fraud situations, especially when proof of scienter is unavailable or when the fraudulent scheme involves negligent peripheral actors. Indeed, the recent scandals in corporate America may provide added incentive to use causing liability as the vanguard to regain the ground lost in the battle of *Central Bank*. Although a cease-and-desist order based on causing liability is obviously much too light a penalty for massive corporate financial fraud, causing liability could become a useful preventive tool by announcing standards of conduct and stopping relatively small errors from escalating into a culture of corruption.

By beginning to define the elements of causing liability, the SEC solidified a long overlooked weapon in its enforcement arsenal. By continuing its nascent efforts at a basic definition, the SEC could complete the transformation of causing liability into a distinct and legitimate form of secondary liability with unparalleled expansiveness. Still, the securities world can only hope that the Commission will not wait another ten years to define the next element of causing liability.