AIDING AND ABETTING, A MADOFF FAMILY AFFAIR: WHY SECONDARY ACTORS SHOULD BE HELD ACCOUNTABLE FOR SECURITIES FRAUD THROUGH THE RESTORATION OF THE PRIVATE RIGHT OF ACTION FOR AIDING AND ABETTING LIABILITY UNDER THE FEDERAL SECURITIES LAWS

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In the first few weeks of December 2008, Bernard L. Madoff confessed to running what he described as, “basically, a giant Ponzi scheme.”1 In reality, what Madoff described in such modest terms was a scheme of massive proportions, what has been referred to as “America’s largest financial fraud ever.”2 The exact scope of the Madoff scheme is still unraveling; however, it is estimated that thousands of investors lost somewhere between twenty and sixty-five billion dollars.3 Madoff purported to invest the savings of some four thousand clients, and these investors spanned across forty-eight of the fifty states,4 as well as throughout Europe, Latin

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1 Complaint at 6, U.S. Sec. & Exch. Comm’n v. Madoff, No. 08 Civ. 10791(LLS), 2009 WL 980288 (S.D.N.Y. Dec. 11, 2009) [hereinafter Civil Complaint]; Complaint at 4, United States v. Madoff, 586 F. Supp. 2d 240 (S.D.N.Y. 2009) (No. 08 Mag. 2735), 2009 WL 3347945 [hereinafter Criminal Complaint]; see also ERIN ARVEDLUND, TOO GOOD TO BE TRUE: THE RISE AND FALL OF BERNIE MADOFF 13 (2009) (noting that, while the civil complaint identified the persons to whom Madoff initially confessed as senior employees, they were actually his sons, Mark and Andrew Madoff).

2 ARVEDLUND, supra note 1, at 2.

3 See e.g., Diana B. Henriques, A Year Under Fire, N.Y. TIMES, Dec. 9, 2009, at B1 (indicating that as of the date of the article, victims’ claims thus far had totaled more than twenty billion dollars); Civil Complaint, supra note 1, at 6 (noting that Madoff confessed his Ponzi scheme to be worth approximately fifty billion dollars); ARVEDLUND, supra note 1, at 266–67 (speculating that while some suspected the total losses of the scheme to be sixty-five billion dollars, it was probably closer to thirty billion dollars).

America, and Asia. But it all was a sham, perhaps from the very beginning.

In part, what makes the Madoff affair so notable is that Bernie Madoff and his family members were well-known and respected in the securities industry. Many members of the Madoff family held securities licenses, were considered experts in the field, and worked alongside Bernie in his brokerage business. Despite their involvement and expertise in the business, to date none of the family members other than Bernie Madoff have been held liable for participating in the scam. Indeed, the current regulatory framework insulates them from private civil liability. On July 30, 2009, however, Senator Arlen Specter, on behalf of himself and co-sponsors Edward Kaufman, John Reed and Sheldon Whitehouse, introduced S. 1551, the Liability for Aiding and Abetting Securities Violations Act of 2009, which would reinstate a private cause of action against those alleged to have aided and abetted securities fraud violations under section 20 of the Securities Exchange Act of 1934. This Comment discusses how the Madoff family represents a class of potential defendants who remain shielded from private civil liability because investors are unable to bring causes of action against those who aid and abet securities fraud, and proposes that Senator Specter’s bill is the appropriate mechanism to restore the right of private litigants to sue aiders and abettors. Part I of this Comment discusses the Madoff Affair, including Madoff’s massive Ponzi scheme and how the scam went undetected by regulators for nearly half a century. Also discussed in Part I is how the brokerage firm that Bernie Madoff began in 1960 was a family business, the role that the Madoff family played in its operation, and the inability of investors to seek retribution from alleged secondary actors like the Madoff family. Part II outlines the history of the private cause of action under section 10(b) of the Securities Act and SEC Rule 10b–5. Specifically, Part II examines the implication of the private cause of action for aiding and abetting securities fraud, and the significant case law and legislation that have impacted the right of private litigants to pursue secondary actors. Finally, Part III discusses the ability of Senator Specter’s bill to reinstate the private

See generally ARVEDLUND, supra note 1.

right of action for aiding and abetting liability. This Comment concludes that there is a need to restore the private right because the current enforcement mechanisms by the Securities and Exchange Commission are insufficient.

I. THE MADOFF FAMILY AFFAIR: A PARADIGM FOR THE NEED TO REINSTATE THE PRIVATE RIGHT OF ACTION FOR AIDING AND ABETTING SECURITIES FRAUD

A. The Madoff Ponzi Scheme: “America’s Largest Financial Fraud”

Madoff got his start in the securities industry after graduating from Hofstra University in Long Island, in 1960. He began his brokerage business, Bernard L. Madoff Investment Securities (BMIS), on Wall Street in Downtown Manhattan, and later moved his entire operation to Midtown, where he occupied the seventeenth, eighteenth, and nineteenth floors of the Lipstick Building. Many of Madoff’s early customers were referrals from an accounting firm, Alpern & Heller, owned and operated by Sol Alpern, Bernie Madoff’s father-in-law. The accounting firm would later be taken over by Frank Avellino and Michael Bienes, who would go on to raise over half a billion dollars in referrals for Madoff.

Madoff first became well-known on Wall Street through his successful brokerage business. Madoff was an accomplished

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7 ARVEDLUND, supra note 1, at 20. While Madoff alluded to being a lawyer, indicating on his website that he began his brokerage business “soon after leaving law school,” Madoff was not an attorney. In fact, he left law school after taking only a few classes. See id. at 20–21; see also Civil Complaint, supra note 1, at 4.
8 ARVEDLUND, supra note 1, at 53, 169–71. Ironically Madoff chose to operate his business out of the oval-shaped building despite his obsession for right-angles. See id. at 61.
9 See id. at 25–26.
10 Id. at 26–27.
11 Madoff was a licensed broker-dealer, and the operations of the broker-dealer firm seemed to be legitimate, at least for the most part. ARVEDLUND, supra note 1, at 12, 20. At most, in 2006 the SEC determined that due to the size of his purported client base, Madoff was required to register as an Investment Advisor. This was the extent of the SEC findings over the course of 9 examinations from 1990–2008. See OFFICE OF INVESTIGATIONS, U.S. SEC. & EXCH. COM’N, REPORT OF INVESTIGATIONS: INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF’S PONZI SCHEME 301–03 (2009), available at http://www.sec.gov/news/studies/2009/oig-509.pdf [hereinafter SEC REPORT] (comprising of an entire report devoted to the failures of the SEC adequately to investigate Bernie Madoff and BMIS). As a broker-dealer Madoff was subject to examinations every two years. ARVEDLUND, supra note 1, at 171.
market maker, and as such he alone handled over five percent of the stocks sold on the New York Stock Exchange by 1989. Additionally, BMIS was one of the first five broker-dealers to incorporate the NASDAQ (National Association of Securities Dealers Automated Quotation system) into its trading business and take advantage of its potential for efficient trading. Madoff also assisted in the creation of the Intermarket Trading System (“ITS”), which later “exploded onto Wall Street.” Additionally incorporated into the firm was software designed by Bernie’s brother, Peter Madoff, allowing BMIS to execute trades at the best price possible in a matter of seconds. BMIS was one of the first firms to utilize computerized trading techniques, and from it, Madoff was able to make a fortune in the market by helping to “revolutionize[] trading.”

It now seems apparent that while all of these innovations furthered Bernie Madoff’s success as a trader and market maker, his knowledge of the markets and compliance rules also enabled him to create and operate his Ponzi scheme. At some point after 1960, Madoff began a highly exclusive investment advisory business, and selected customers from his brokerage firm to invest into his advisory business in order to fuel his scheme. Although

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12. As defined by the Financial Industry Regulatory Authority (FINRA), a market maker is: A firm that maintains a firm bid and offer price in a given security by standing ready to buy or sell at publicly-quoted prices. The Nasdaq Stock Market is a decentralized network of competitive Market Makers. Market Makers process orders for their own customers, and for other broker-dealers; all Nasdaq securities are traded through Market Maker firms. Market Makers also will buy securities from issuers for resale to customers or other broker-dealers. FINRA, Glossary, http://www.finra.org/Glossary/P011116 (last visited Feb. 20, 2010).

13. ARVEDLUND, supra note 1, at 45.

14. Id. at 33–34. Madoff would later go on to become chairman of the NASDAQ in 1990. Id. at 44.

15. Id. at 34.

16. Id. at 36.

17. See id. at 40–46, 47.

18. The exact timing that the fraudulent investment advisory business began is unknown. The civil complaint filed against Bernie Madoff and Bernard L. Madoff Investment Securities on December 11, 2008 alleged that it had gone on from “an indeterminate time to the present.” Civil Complaint, supra note 1, at 4. The civil complaint filed against Madoff’s auditor and accounting firm, David Friehling and Friehling & Horowitz, CPA’s, P.C., respectively, indicated that the scheme was launched “at least [by] the 1980s.” Complaint at 7, U.S. Sec. & Exch. Comm’n v. Friehling, No. 09 Civ. 2467 (S.D.N.Y. Mar. 18, 2009) [hereinafter Friehling Complaint], available at http://www.sec.gov/litigation/complaints/2009/comp20959.pdf. Others speculate that it began much sooner. See ARVELUND supra note 1, at 47.

19. Id. at 47–48; see also Civil Complaint, supra note 1, at 4. The term “Ponzi scheme,” initially coined in reference to a 1920’s investment con artist named Charles Ponzi, is an
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many were under the impression that Madoff ran his own hedge fund, \(^{20}\) Madoff denied being a manager of—or even an advisor to—a hedge fund; rather he claimed that he only executed a particular trading strategy for his hedge fund clients, known as the “split-strike conversion.”\(^{21}\) Madoff’s strategy did not purport to be a get-rich-quick scheme (at least not for his investors). Rather, the goal of the investment strategy was to yield steady and average returns with minimal risk, which is what made it so appealing to so many investors.\(^{22}\) In reality, Madoff kept his existing clients happy by paying them consistent returns using money that came in from new clients or existing clients who were looking to increase their investments.

At the peak of his scheme, Madoff reported that his firm BMIS had “more than $700 million in firm capital [and] . . . rank[ed] among the top 1% of US Securities firms.”\(^{23}\) He also represented that his advisory business operated with over seventeen billion dollars in assets under management.\(^{24}\) Nonetheless, even Bernie Madoff could not avoid the impact of the market losses of the financial crisis in 2008. By definition, a Ponzi scheme requires a steady flow of income in order to stay afloat;\(^{25}\) however, during the latter half of 2008, rather than contributing money to Madoff, his investors were looking to pull out. As was typical in the past, when Madoff received requests from his advisory clients to withdraw portions of their assets, he could cover the costs of the withdrawals.
using investments from other clients. However, in 2008 Madoff faced redemption requests from clients totaling about seven billion dollars, and Madoff was unable to keep up with his clients’ demands for cash. On December 10, 2008, unable to sustain the façade any longer, Madoff admitted to his sons that his advisory business was all “one big lie,” and that all the money was gone and the business was insolvent.

B. Regulatory Loopholes and Enforcement Mishandling Allow Madoff to Avoid Detection

While Madoff was eventually arrested and charged with fraud, he managed to fool investors and regulators for almost half a century. So how did he pull it off? While many agencies, including the Federal Bureau of Investigation (“FBI”), the Department of Labor-Employee Benefit Security Administration (“DOL-EBSA”), the Internal Revenue Service (“IRS”) and the Securities and Exchange Commission (“SEC”), have all been involved in the investigation of the scheme since its unraveling (and some before that), it seems that Madoff was able to locate and exploit regulatory loopholes and inefficiencies in order to keep his “advisory business” highly secretive and successful. As one author wrote, “[t]here are no heroes in the Madoff story; only villains and suckers.” While this explanation is overly simplistic and unsympathetic (especially to victims who unknowingly invested their savings through feeder funds which utilized, but did not identify Madoff as their hedge fund manager), the general theme is appropriate in terms of regulation and regulators. Although Madoff publicly claimed that

26 Civil Complaint, supra note 1, at 5.
27 Id. at 6. See also ARVEDLUND, supra note 1, at 12–13.
he managed over seventeen billion dollars in assets,\textsuperscript{30} he did not register with the SEC as an investment advisor until 2006.\textsuperscript{31} Up to that point, Madoff insisted that he was not required to register as an advisor because he claimed to have less than fifteen discretionary accounts, thus qualifying for a broker-dealer exemption.\textsuperscript{32} This allowed Madoff to be subject to less regulatory oversight by the SEC and FINRA, which only conducted examinations related to Madoff’s broker-dealer firm on the eighteenth and nineteenth floors of the Lipstick Building.\textsuperscript{33} In fact, these two regulators were totally clueless as to the fact that Madoff ran any operation at all on the seventeenth floor.\textsuperscript{34} Additionally, regulators were under the impression that Madoff was running a hedge fund.\textsuperscript{35} Madoff flew under the regulatory radar because hedge funds are neither required to register with the SEC nor subject to the same reporting requirements as other types of investments.\textsuperscript{36}

In addition to loopholes and problems associated with the American “patchwork” system of regulation of the financial industry,\textsuperscript{37} Madoff also avoided detection in part because regulators missed and/or ignored significant red flags. The SEC’s Office of the Inspector General (“OIG”) wrote a 477-page report examining in detail the SEC’s failure to uncover the scam.\textsuperscript{38} The report indicated that the SEC missed numerous opportunities to discover that Madoff was perpetuating a fraud, and ignored complaints about Madoff from many within the industry, including several reports by a certified fraud examiner, Harry Markopolos.\textsuperscript{39} For instance, the SEC ignored a detailed report by Markopolos entitled “The World’s

\textsuperscript{30} See Civil Complaint, \textit{supra} note 1, at 4.
\textsuperscript{31} SEC REPORT, \textit{supra} note 11, at 256.
\textsuperscript{32} ARVEDLUND, \textit{supra} note 1, at 77 (noting that Madoff, in calculating the amount of discretionary accounts he managed, apparently only counted feeder-fund clients and not individual investors).
\textsuperscript{33} ARVEDLUND, \textit{supra} note 1, at 171–72.
\textsuperscript{34} Id. at 171.
\textsuperscript{35} Id. at 47; see also SEC REPORT, \textit{supra} note 11, at 266.
\textsuperscript{38} See generally SEC REPORT, \textit{supra} note 11.
\textsuperscript{39} ARVEDLUND, \textit{supra} note 1, at 195; see generally SEC REPORT, \textit{supra} note 11, at 21, 27, 35.
Largest Hedge Fund is a Fraud” which enumerated thirty reasons detailing why Markopolos suspected that Madoff was running a Ponzi scheme.40 The Marokopolos report was one of many that was not adequately pursued or investigated by the SEC. In addition to criticizing the SEC, commentators have also accused some institutional investors—including so-called Madoff “feeder funds”—for ignoring red flags.41

The SEC’s report indicates that much of its failure to uncover the fraud stemmed from the inefficiencies of its examinations of Madoff.42 For example, the report indicates that throughout various examinations, the examiners were too focused on the possibility that Madoff could be front-running through his broker-dealer business, and in turn failed to focus on the red flags reported to the SEC by Markopolos and others.43 Furthermore, there was little to no communication between the Washington D.C. headquarters and the Northeast Regional Office in New York City, which simultaneously conducted independent examinations of Madoff.44 Moreover, many of the examiners were inexperienced and failed to

40 See SEC REPORT, supra note 11, at 21, 35. Among the red flags identified by Markopolos were: Madoff’s demands for secrecy relating to the advisory business; unusually consistent high rates of returns; and the fact that—unlike other hedge fund managers—Madoff charged only brokerage commissions, no management or performance fees. SEC REPORT, supra note 11, at 28, 75. In addition, although Madoff represented that he traded in options, the options market did not reflect Madoff’s purported trading volume. Id. Also of serious concern was that Madoff cleared his own trades, and his auditor was a related party. Id.


42 The SEC conducted a total of nine examinations of Madoff’s broker-dealer operation from 1990 to 2008. ARVEDLUND, supra note 1, at 104–05, 126–28, 232. According to the report, the SEC missed several opportunities to expose Madoff during its examinations. See generally SEC REPORT, supra note 11 (finding that the SEC should have discovered Madoff’s scheme as early as 1992).

43 SEC REPORT, supra note 11, at 23. The report indicated that the SEC’s BD/SRO (Broker-Dealer/Self-Regulatory Organization) division that conducted examinations on Madoff did not have expertise in options trading. Id. at 91. It further indicated that the Investment Management division did have such expertise, but that at that time Madoff was not required to register as an investment advisor, and therefore this division would not have been involved in the examinations. See id. at 40, 72, 83 n.50. To make matters worse, the SEC rarely did joint examinations, meaning the different departments within the commission rarely collaborated efforts in its investigations. Id. at 92.

44 Id. at 132.
investigate or further question Madoff’s inconsistent responses to their inquiries. Additionally, Madoff’s stature and reputation within the securities and financial industries also played a role, as did his stark and abrasive demeanor during the examinations.

As a result of its investigation, the OIG report concluded that the SEC had adequate information to expose Madoff’s fraud as early as 1992—sixteen years prior to his confession. Nonetheless, it was not until late 2008 to early 2009 that Bernie Madoff and Bernard L. Madoff Investment Securities were charged by the SEC and U.S. Attorney’s Office for various civil and criminal violations. Bernie Madoff pled guilty and on June 29, 2009, he was sentenced by Judge Denny Chin to one-hundred fifty years in prison.

C. Members of the Madoff Family Were Entrenched in the Business Operations of BMIS

Schemes like Madoff’s require the assistance of others—typically many others—in order to be successful. Yet, since his arrest and confession, Madoff has insisted that he acted alone, and that “he had personally traded and lost money” for his clients and that it “was all his fault.” Still, authorities and critics have refused to believe that Madoff acted independently; in fact, a few of Madoff’s employees and feeder-funds have already been indicted for their participation in the scheme. Nonetheless, many of those who

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45 Id. at 143.
46 Id. at 180–82, 383. For example, many of the junior examiners within the SEC knew that Madoff was “a pioneer in the industry;” they were also familiar with Madoff’s connection to the commission, and even used an NASD manual with Madoff’s name on it. Id. at 383 (citation omitted).
47 Id. at 26.
48 See Civil Complaint, supra note 1, at 7–10; Criminal Complaint, supra note 1, at 1–5; see also Madoff Pleads Guilty, supra note 28 (listing the charges brought against Bernie Madoff and BMIS, including securities fraud, investment adviser fraud, mail fraud, wire fraud, money laundering, and making false statements, among others).
50 See Criminal Complaint, supra note 1, at 4.
likely played major roles in perpetuating (or at least enabling) Madoff’s scam have not been held accountable for their participation.52

In Madoff’s case, it is probable that there were numerous individuals and entities outside the walls of the seventeenth, eighteenth, and nineteenth floors of the Lipstick building that furthered this scheme. One does not need to go outside that building to find alleged enablers or co-conspirators, however. BMIS was a family business. Madoff family members filled the upper echelon of the organization:53 they were compliance officers, directors of trading, in-house counsel, and officers of the company.54

In hindsight, one of the most interesting things about BMIS is that Peter Madoff, Bernie’s younger brother, was essentially Bernie’s right hand man.55 He joined the firm in 1970 and was well-educated.56 He is a lawyer and obtained his J.D. from Fordham Law School.57 Peter was the senior managing director, head of trading, and chief compliance officer for both the broker-dealer side and the investment advisory side—when it was finally forced to register in 2006.58 He maintained an office on the nineteenth floor, and had a significant presence at BMIS.59 Peter signed all of the SEC filings on a quarterly basis.60 Additionally, only Peter was allowed to audit the company; neither Bernie nor Peter allowed outside performance audits.61 Peter also was responsible for depositing investors’ checks into the advisory side of the business.62

By keeping his brother in the number two position within the company, Bernie Madoff was able to ensure that non-family employees were not involved in the running of the business. Peter’s efforts did not go unrewarded: he allegedly milked the company for fictitious trading records. Complaint at 25–29, U.S. Sec. & Exch. Comm’n v. O’Hara, No. 09 CV 9425 (S.D.N.Y. Nov. 19, 2009), available at http://www.sec.gov/litigation/complaints/2009/ohara-perez-111309.pdf.


54 See ARVEDLUND, supra note 1, at 20.
55 Id. at 67, 176, 220.
56 Id. at 20.
57 Id.
58 Id. at 67; see supra note 30 and accompanying text.
59 ARVEDLUND, supra note 1, at 169.
60 Id. at 176, 220.
61 SEC REPORT, supra note 11, at 63.
62 ARVEDLUND, supra note 1, at 218.
sixty-one million dollars, and made extravagant purchases including a $275,000 Aston Martin.63

Bernie Madoff’s sons also were heavily involved in the business, though they claim to be unaware of the Ponzi scheme that their father ran for decades.64 Andrew Madoff held a degree from University of Pennsylvania’s Wharton Business School.65 He joined the firm in 1988 and became director of NASDAQ trading.66 Bernie’s elder son Mark joined the firm two years before Andrew in 1986 after graduating from the University of Michigan, and became director of listed trading.67 Andrew and Mark collectively ran the trading floor at BMIS.68 For their contributions to the business, the Madoff sons received over fifty million dollars in compensation over the years, not counting the millions of dollars in withdraws from company accounts, and millions more to cover company expenses.69 Bernie’s sister Sandra also had a son, Charles, who joined the firm in 1978, and served as director of administration.70

Also high on the ranks of BMIS, with an office on the eighteenth floor,71 was Shana Madoff, Peter’s daughter and Bernie’s niece. Shana, like Peter, had graduated from Fordham Law School and joined BMIS to become its in-house compliance attorney.72 Shana was well known for her role as compliance counsel for BMIS, and was well-known in the securities industry, often coordinating conferences for the Securities Industry Association (“SIA”).73 From 2003 to 2006, Shana was in frequent contact with SEC staff regarding BMIS participation in these conferences, and in 2006 she began a romantic relationship with an SEC Assistant Director, Eric Swanson.74 Notably, Swanson was routinely involved in the examinations of Madoff, which were commenced as a result of the

63 See Arvedlund, Faces of Greed, supra note 52.
64 The idea that both Madoff sons were ignorant to the scam that their father ran is unlikely. In an article written in July 2000 about BMIS, Mark Madoff was quoted as stating “[w]hen it is a family operated business you don’t go home at night and shut everything off, so you take things home with you, which is how all of us grew up.” Guerra, supra note 53.
65 Id.
66 ARVEDLUND, supra note 1, at 67.
67 Id.; Guerra, supra note 53.
68 ARVEDLUND, supra note 1, at 67.
69 Arvedlund, Faces of Greed, supra note 52.
70 Guerra, supra note 53.
71 ARVEDLUND, supra note 1, at 169.
72 Guerra, supra note 53.
73 SEC REPORT, supra note 11, at 389–396. Shana was referred to as the “emcee” of certain SIA conferences. Id. at 400.
74 Id. at 389–400, 407.
tips the SEC had received that alleged that Madoff was operating a Ponzi scheme.\textsuperscript{75} Swanson left the SEC in 2006, and in 2007 the couple was married.\textsuperscript{76}

Finally, among Bernie Madoff’s “minions”\textsuperscript{77} was his wife Ruth. Bernie and Ruth were high school sweethearts, and she was with him when BMIS opened its doors in 1960.\textsuperscript{78} Bernie and Ruth had a reputation for being inseparable, “a team in every sense of the word.”\textsuperscript{79} Like the rest of the family, Ruth had her own office at BMIS.\textsuperscript{80} It was there that she kept track of the company’s invoices and was responsible for the bookkeeping of the business.\textsuperscript{81} Additionally, not only was Ruth involved in her husband’s enterprise, she—as well as Peter, Mark, and Andrew—all held shares in the Madoff’s London office, Madoff Securities International.\textsuperscript{82} The international business has been described as the family’s “personal ‘piggy bank,”’ and was also used by Madoff to launder money internationally.\textsuperscript{83}

Despite her close relationship with her husband and her involvement in daily business operations, Bernie has insisted that Ruth knew nothing of the scheme. Following her husband’s sentencing she stated “[t]he man who committed this horrible fraud is not the man whom I have known for all these years.”\textsuperscript{84} Evidence suggests that this is unlikely, and as one former Madoff employee stated, “[Madoff] conferred with her on everything. The idea that she didn’t know anything is laughable.”\textsuperscript{85} Like other family members, Ruth appears to have benefitted from her husband’s Ponzi scheme. Ruth reportedly received two million dollars in payments from Madoff Securities International just before Madoff’s confession to the Ponzi scheme,\textsuperscript{86} in addition to the millions of
dollars that were transferred into Ruth’s name beginning in the
1990s, and millions of dollars in withdrawals made in the weeks
prior to Madoff’s confession. As a result of the Madoff family’s “success,” all of the Madoffs enjoyed lavish lifestyles. The Madoff’s assets included an Oceanside beach house in Montauk, Long Island, a Manhattan penthouse, a mansion in Palm Beach, Florida and a French villa in Cap d’Antibes. Madoff also owned a $2.3 million yacht and rented a private company seaplane which he and some of his associates chartered to deliver them from Long Island to downtown Manhattan as part of their daily commute. The family spent close to a million dollars in country club dues over a period of twelve years, went on expensive vacations, and charged millions in expenses to the company credit cards. From the family’s spending habits, it is clear that the Madoff family lived the high life off of investors’ money.

D. Madoff’s Family Members, and Others Who Allegedly Enable or Participate in Securities Fraud, Are Shielded from Private Aiding and Abetting Liability

There is no doubt that Bernie Madoff will spend the rest of his life in prison; however, to date no other member of his family has been charged. While aggrieved investors have the right under federal securities laws to bring private civil suits against Madoff, they will find little comfort or relief in doing so, considering that he is imprisoned and that most of his ill-gotten gains have been disgorged. So what form of recourse do the thousands of injured Madoff investors—and other investors like them who are victims of securities fraud—have against those entrenched in schemes like Madoff’s? Typically, American civil litigation provides a means by which those who are economically injured by fraud may collect damages against fraudulent actors. In the context of federal

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87 ARVEDLUND, supra note 1, at 266.
88 Id. at 265.
89 Id.
90 Arvedlund, Faces of Greed, supra note 52.
91 ARVEDLUND, supra note 1, at 51; 60 Minutes: The Liquidator (CBS television broadcast Sept. 27, 2009), available at 2009 WLNR 19099731 (interviewing Irving Picard).
92 ARVEDLUND, supra note 1, at 223.
93 60 Minutes: The Liquidator, supra note 91.
94 Arvedlund, Faces of Greed, supra note 52.
95 See Alan R. Bromberg & Lewis D. Lowenfels, Aiding and Abetting Securities Fraud: A
securities laws, however, private litigants generally do not have this option, at least not against the class of defendants that Madoff’s family represents—i.e., defendants, both individuals and corporations, who may not have made actionable misstatements and/or omissions to investors, but who are suspected of enabling the fraud. Such a class of participants is sometimes referred to as “secondary actors,” because they are not alleged to have committed primary violations of the federal securities laws; rather, secondary actors aid and abet primary violators, and have at least some knowledge or awareness that what they are doing is wrong.

Prior to 1994, courts (and thus plaintiffs) did not see the need to draw the distinction between primary and secondary actors. That was because those whose role was limited to aiding and abetting anti-fraud securities laws typically were sued as primary violators, and were recognized by courts to have violated section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 promulgated thereunder. During this era, the Madoff family, and other outsiders who participated in securities fraud, could have been found liable as primary violators under the statute (as Madoff himself was) as long as a plaintiff could establish the required elements of a primary violation. In 1994, however, in Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., the Supreme Court made a significant distinction between primary and secondary liability. The Court held that private litigants could only bring actions against primary violators and not those whose role was limited to aiding and abetting. This decision was affirmed in 1995 with Congress’s passage of the Private Securities Litigation Reform Act (“PSLRA”), and reaffirmed by the Supreme Court in Stoneridge Investment Partners, L.L.C. v. Scientific-Atlanta, Inc. in 2008. As a result of Central Bank and Stoneridge, and under the current regulatory framework, aiders and abettors of


96 See Robert A. Prentice, Locating That “Indistinct” and “Virtually Nonexistent” Line Between Primary and Secondary Liability Under Section 10(b), 75 N.C. L. REV. 691 (1997).


99 See infra note 119 and accompanying text.

100 511 U.S. 164 (1994).

101 Id. at 191.


securities fraud are virtually untouchable by private litigants.¹⁰⁴

II. HISTORY AND DEVELOPMENT OF PRIVATE RIGHT OF ACTION FOR AIDING AND ABETTING UNDER SECTION 10(B) OF THE ’34 ACT

A. History and Purpose of the Federal Securities Laws

Following the Great Depression, Congress implemented the federal securities laws in order to mandate the disclosure of information regarding securities offerings to investors, and to protect investors by outlawing fraudulent behavior too common within the industry.¹⁰⁵ In particular the 1933 Securities Act requires, among other things, an issuer of securities to file a registration statement with the SEC¹⁰⁶ before the issuer offers to sell or an investor offers to buy a security.¹⁰⁷ The ’33 Act also requires that issuers file with the SEC and make available to the public certain disclosure documents.¹⁰⁸

In addition to the disclosure requirements, the Securities Act of 1933 and the Securities Exchange Act of 1934 also prohibit false and misleading statements or omissions in registration statements, prospectuses, and other documents which must be filed with the SEC and made available to the public.¹⁰⁹ The general idea behind these anti-fraud provisions is the protection of investors.¹¹⁰ Those who engage in fraudulent practices can be found liable under various sections of the Acts.

¹⁰⁴ Notably, the PSLRA codified the SEC’s authority to bring aiding and abetting claims. See infra notes 171–73 and accompanying text.
¹⁰⁶ The SEC was created by section 4 of the Securities Exchange Act of 1934. 15 U.S.C. § 78d.
¹⁰⁷ 15 U.S.C. § 77e(c) (“It shall be unlawful for any person, directly or indirectly . . . to offer to sell or offer to buy . . . any security, unless a registration statement has been filed . . . .”).
¹⁰⁸ See, e.g., 15 U.S.C. § 78e (requiring that a security, not exempted from the registration requirements, meet the requirements of § 10 of the ’33 Act).
¹⁰⁹ See 15 U.S.C. § 77k (entitled “Civil liabilities on account of false registration statement;” making it illegal for an issuer and certain other parties to make a material misrepresentation or omission in a registration statement); 15 U.S.C. § 77l (entitled “Civil liabilities arising in connection with prospectuses and communications;” prohibiting material misrepresentations or omissions in a prospectus); 15 U.S.C. § 77q(a) (entitled “Use of interstate commerce for purpose of fraud or deceit;” making it unlawful to use interstate commerce to “employ any device, scheme or artifice to defraud”).
¹¹⁰ See supra note 105 and accompanying text.
A particularly important anti-fraud provision of the federal securities laws is section 10(b) of the Securities Exchange Act of 1934, which makes it unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange—

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.111

Pursuant to its authority under the Securities Exchange Act of 1934, the SEC created Rule 10b–5:112

It shall be unlawful for any person, directly or indirectly . . .

(a) To employ any device, scheme, or artifice to defraud,
(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.113

B. The Supreme Court Recognizes an Implied Private Right of Action Under Section 10(b) and Rule 10b–5 of the ‘34 Act

The Securities Exchange Act of 1934 also grants the SEC the authority to pursue those who violate section 10(b) and Rule 10b–5.114 In addition to the SEC’s prosecutorial power, a private right of action for 10b–5 violations was developed in case law following the creation of the federal securities laws. In 1941, the right was officially recognized by a federal district court in Pennsylvania.115

112 See id. (recognizing the SEC’s rulemaking authority under this section).
Though the statute is silent concerning a private right of action for those who violate section 10(b) and Rule 10b–5, the Supreme Court officially recognized the right in *Blue Chip Stamps v. Manor Drug Stores* in 1975.\(^{116}\) In that case, Justice Rehnquist described the development of the judicial implication of private actions from the rule by stating “[w]hen we deal with private actions under Rule 10b–5, we deal with a judicial oak which has grown from little more than a legislative acorn.”\(^{117}\) The right of private litigants to pursue claims against those who allegedly violate section 10(b) and Rule 10b–5 is now generally accepted in American federal securities law jurisprudence.\(^{118}\)

A private plaintiff who alleges a 10b–5 violation must prove the following elements: (1) a material misrepresentation (or omission); (2) made in connection with the purchase or sale of a security; (3) scienter, or the intent to deceive; (4) reliance; (5) economic loss; and (6) loss causation.\(^{119}\)

The scope of Rule 10b–5 had been significantly expanded in the decades following its initial drafting in 1942. Milton Freeman, also known as the “father” of Rule 10b–5,\(^{120}\) has argued that the rule has been extended beyond the purpose that the SEC drafters had in mind.\(^{121}\) For instance, he noted in the foreword of the Fordham Law Review’s Annual Survey Issue in 1993 entitled “Happy Birthday 10b–5: 50 Years of Antifraud Regulation,” “plaintiffs [have] urged that the words of the Rule ‘in connection with the purchase or sale of a security’ meant ‘not in connection with the purchase or sale of a security.’ They urged that ‘fraud’ meant ‘negligence’ and that ‘immaterial’ meant ‘material.’”\(^{122}\)

\(^{116}\) 421 U.S. 723 (1975).

\(^{117}\) Id. at 737.

\(^{118}\) See, e.g., Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) (“It is now established that a private right of action is implied under § 10(b).”), *Blue Chip Stamps*, 421 U.S. at 729–30 (1975) (recognizing the Supreme Court’s prior confirmation of a private right of action); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976) (“Although § 10(b) does not by itself create an express civil remedy for its violation, and there is no indication that Congress, or the Commission when adopting Rule 10b–5, contemplated such a remedy, the existence of a private cause of action for violations of the statute and the Rule is now well established.”) (citations omitted).  See also *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta Inc.*, 552 U.S. 148 (2008); Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994).

\(^{119}\) In re *PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 6–7 (2005).

\(^{120}\) Milton V. Freeman, *Foreword*, 61 FORDHAM L. REV., at S3 (1993). Milton Freeman is credited as one of the initial drafters of Rule 10b–5.  Id. at S1.

\(^{121}\) See id. at S2–S4.

\(^{122}\) Id. at S3.
C. Prior to Central Bank, Some Courts Recognized Private Rights of Action for Aiding and Abetting Violations Under Section 10(b) and Rule 10b–5

Prior to the Central Bank decision, a number of courts held that section 10(b) and Rule 10b–5 permitted private rights of action not only against primary violators (meaning those who allegedly made actionable misstatements and omissions to plaintiffs), but also against those alleged to have aided and abetted such violators. In particular, in Brennan v. Midwestern United Life Insurance Co.,123 the United States District Court for the Northern District of Indiana found that those who did not commit a primary violation of section 10(b) and Rule 10b–5 themselves could be liable as aiders and abettors if they “knowingly and purposefully encouraged” the fraud of another.124

In Brennan, the plaintiff was allowed to pursue an aiding and abetting claim for violation of section 10(b) and Rule 10b–5 against a corporation which failed to report that a brokerage firm selling the corporation’s securities would not be able to deliver the securities before it went bankrupt.125 The brokerage company, Dobich Securities Corporation, misrepresented to the shareholders of Midwestern United Life Insurance Company the reasons for the delay in the delivery of the securities. The plaintiff alleged that Midwestern knew of the fraudulent activity by Dobich, but permitted the fraud to continue because Midwestern stood to gain from potential mergers which would have collapsed if the misrepresentations were disclosed to investors.126 Accordingly, Midwestern did not disclose the fraudulent activity on behalf of Dobich to either the state security commission or to the SEC, and its directors and officers profited substantially when they sold their shares of stock.127 The outside investors, however, suffered considerable losses as a result of Dobich’s insolvency.128

Because the private right had not yet been recognized, defendants moved to dismiss for failure to state a claim upon which relief can be granted.129 The court dismissed the motion, acknowledging that

124 Id. at 675.
125 Id.
126 Id.
127 Id.
128 Id.
129 Id.
in light of the purpose of the securities acts (i.e., the protection of investors), it is just as important to prevent a secondary actor from engaging in fraudulent conduct that would affect the value of a shareholder’s stock as preventing misrepresentations by primary actors. The court noted that a secondary actor’s fraudulent conduct “may be just as dangerous and equally as damaging as a failure by the issuer to disclose information of its own improper activities affecting the value of its stock. The loss to the investor may well be the same.”  

130 The court recognized that “the provisions of Section 10(b) and Rule 10b–5 were applied to aiders and abettors even before the first case recognizing civil liability under that statute and rule.” 131 The Brennan court pointed out that the first aiding and abetting case applicable under the federal securities laws was brought by the SEC in Securities and Exchange Commission v. Timetrust, Inc. 132 In that case, the SEC was seeking an injunction against defendant Timetrust for primarily engaging in fraud, and against several other defendants as aiders and abettors. The court decided that injunctive proceedings could be extended to aiders and abettors who assisted a principal in committing a fraud. Ruling in favor of the SEC, the court stated that “whoever aids or abets in the commission of an offense is a principal. Persons charged with aiding and abetting a criminal offense . . . may be joined as defendants, and no good reason appears why this same rule should not apply in an injunctive proceeding to restrain a violation of the same statute.” 133 The court in Brennan built on the theory from Timetrust, and concluded that “it cannot be said that civil liability for damages . . . may never under any circumstances be imposed upon persons who do no more than aid and abet a violation of Section 10(b) and Rule 10b–5.” 134

Following Brennan, federal courts across the country overwhelmingly recognized the right of private plaintiffs to pursue causes of action against defendants for aiding and abetting securities frauds under section 10(b) and Rule 10b–5. 135 A private

130 Id. at 680.
131 Id. at 676.
133 Timetrust, 28 F. Supp. at 43 (citations omitted).
135 Abandonment of the Private Right of Action for Aiding and Abetting Securities Fraud/Staff Report on Private Securities Litigation: Hearing on Central Bank of Denver vs. First Interstate Bank of Denver Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, and Urban Affairs, 103rd Cong. 8 (1994) [hereinafter Central Bank Hearings]
plaintiff who alleged that a defendant aided and abetted a securities violation had to prove the three elements in order to be successful. First, the plaintiff had to prove the existence of a primary violation of section 10(b). The second element required the defendant to know or be in reckless disregard of that violation. Third, plaintiffs were required to prove that the aiding and abetting defendant had provided substantial assistance to the primary violator. The implied private right to sue those who aid and abet primary violators of section 10(b) and Rule 10b–5 survived until 1994.

D. The Supreme Court Rejects Private Rights of Action for Aiding and Abetting

With its 1994 decision in Central Bank, however, the Supreme Court held that the language of section 10(b) and Rule 10b–5 did not permit private rights of action against those who aid and abet securities law violations, and that Congress did not intend to extend the scope of the statute to include such a right. The Court decided the issue of aiding and abetting liability on appeal—even though the particular issue had not been contested by the petitioners—because it had assumed that such a cause of action existed. The facts in Central Bank revolved around two bond offerings in 1986 and 1988. In those two years, the Colorado Springs Stetson Hills Public Building Authority (“Authority”) issued twenty-six million dollars in bonds in order to fund a housing project in Colorado Springs. The Authority used Central Bank as the indenture bond trustee; and as a trustee Central Bank was required to ensure that, in both 1986 and 1988, the land that was subject to the liens for the bonds was worth 160% of the bonds’...
outstanding principal and interest.\textsuperscript{141} During the process, however, and just before the issuance of the 1988 bonds, Central Bank became aware that the value of the land subject to the liens had decreased and would not meet the required 160%.\textsuperscript{142} Instead of acting on this information in accordance with its duties as trustee, Central Bank made an agreement with the developer not to act immediately and allowed the 1988 bond offering to go through.\textsuperscript{143} The Authority defaulted on the 1988 bonds shortly thereafter.\textsuperscript{144} The complaint alleged that the Authority, among others involved, had violated section 10(b) and that Central Bank was “secondarily liable under section 10(b) for its conduct in aiding and abetting the fraud.”\textsuperscript{145} Following a judgment for the plaintiffs, and on appeal, the Court decided that although there was an implied private cause of action for violations of section 10(b), a “private plaintiff may not bring a 10b–5 suit against a defendant for acts not prohibited by the text of section 10(b).”\textsuperscript{146} The Court found that the text of section 10(b) did not proscribe aiding and abetting of securities violations, and refused to accept the SEC’s and respondent’s argument that the terms “directly or indirectly” in the statute referred to such a prohibition.\textsuperscript{147} The Court added that it believed that aiding and abetting a fraud ought to be prohibited; however, “[t]he issue . . . is not whether imposing private civil liability on aiders and abettors is good policy but whether aiding and abetting is covered by the statute.”\textsuperscript{148} In so holding, the Supreme Court cut off the ability of private litigants to bring such actions.\textsuperscript{149}

In arriving at its holding in \textit{Central Bank}, the Supreme Court was clearly concerned with the extension of section 10(b) and Rule 10b–5. For one thing, the Court seems to have shared Milton Freeman’s fear that Rule 10b–5 had been stretched beyond its scope and purpose, and was leading to an excess of securities class action suits.\textsuperscript{150} It also expressed concerns that the antifraud provisions of

\begin{footnotesize}
\begin{footnote}{141 Id.}
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\begin{footnote}{142 Id.}
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\begin{footnote}{143 Id. at 168.}
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\begin{footnote}{144 Id.}
\end{footnote}
\begin{footnote}{145 Id. (citation omitted).}
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\begin{footnote}{146 Id. at 173.}
\end{footnote}
\begin{footnote}{147 Id. at 175–76.}
\end{footnote}
\begin{footnote}{148 Id. at 177.}
\end{footnote}
\begin{footnote}{149 Id. at 191 (“Because the text of § 10(b) does not prohibit aiding and abetting, we hold that a private plaintiff may not maintain an aiding and abetting suit under § 10(b).”).}
\end{footnote}
\begin{footnote}{150 See Freeman, \textit{supra} note 120, at S3 (“I was afraid that the Rule was being subject by plaintiffs, governmental and private, to arguments for expansion to an extent that I believed}
\end{footnotesize}
the securities laws were extending into the realm of ordinary business transactions, despite the lack of statutory authority for such an expansion.\textsuperscript{151}

Furthermore, according to the Supreme Court, its decision in \textit{Central Bank} did not altogether eliminate the possibility that those who aid and abet securities violations could be subject to litigation. It noted that:

The absence of section 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b–5, assuming all of the requirements for primary liability under Rule 10b–5 are met.\textsuperscript{152}

It is worth noting that under this rule, secondary actors like \textit{Central Bank} could not be held liable for violations of section 10(b) and Rule 10b–5 because they did not make a material misstatement or omission upon which an investor relied. That is, the reliance element required for a 10b–5 violation was missing.\textsuperscript{153} In the wake of the \textit{Central Bank} decision, it has become exceedingly difficult for private litigants to pursue claims against aiders and abettors.

\textbf{E. The PSLRA Codifies Central Bank for Private Litigants}

In 1995, citing some of the same concerns described by the Supreme Court in \textit{Central Bank}, Congress passed the PSLRA.\textsuperscript{154}
The major initiatives of the PSLRA, as articulated by one of the proposal’s sponsors, Senator Christopher J. Dodd, were to empower investors in their own securities class actions, rather than their attorneys; to reform the ability of investors to recover damages and further deter fraud; to limit frivolous securities litigation; and, finally, to implement stronger regulation with respect to professional liability for accountants. Senator Dodd urged that reform was necessary due to abusive securities class-action litigation that was driven by the plaintiffs’ bar and which frequently resulted in negligible recovery for investors. Senator Phil Gramm also spoke in favor of the proposals, citing the need for reform because “current practices [were] limiting the ability of the financial markets to work because companies [were] making decisions based on potential litigation costs instead of decisions that [were] driven by the marketplace to create jobs, growth, and opportunity for our people.” Senator Peter Domenici, the other sponsor of the proposed bill which became the PSLRA, stated that he expected the effect of the legislation to “return some fairness and common sense to our broken securities class action litigation system, while continuing to provide the highest level of protection to investors in our capital markets.” It would do so by “lower[ing] the cost of raising capital by combatting [sic] . . . abuses, while maintaining the incentive for bringing meritorious actions.”

While the PSLRA enacted safeguards to prevent abusive litigation, the fears associated with private plaintiff class-action litigation prevented the enactment of proposed sections of the PSLRA which would have reinstated the private right of action for aiding and abetting liability. Those who were seeking reform to

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156 Id. at 3–4.
157 Id. at 8 (statement of Sen. Phil Gramm made during opening statement of Sen. Peter V. Domenici).
159 Id.
160 Id. at 19, reprinted in 1995 U.S.C.C.A.N. 679, 698 (“The Committee considered testimony endorsing the result in Central Bank and testimony seeking to overturn this decision. The Committee believes that amending the 1934 Act to provide explicitly for private aiding and abetting liability actions under Section 10(b) would be contrary to S. 240’s goal of reducing meritless securities litigation. The Committee does, however, grant the SEC
deter frivolous litigation in the securities industry were concerned with limiting the scope of liability rather than creating another cause of action that private plaintiffs could pursue. For instance, corporations were sued so frequently, and the costs of discovery and trial were so enormous, that it was often more advantageous for a corporation to settle than to defend the case on the merits. Thus lawsuits were settled for their nuisance value even if the claim had no merit. Furthermore, it was argued that these suits were only settled for “pennies on the dollar” and the individual investor barely stood to break even. Those in favor of reform argued that plaintiffs’ attorneys were the only parties benefiting from these abusive practices, and not investors. Additionally, public companies, fearful of litigious shareholders, had become increasingly wary of making projections regarding the future of their businesses. As one CEO of a major communications corporation noted, many companies refused to talk about their future business plans for fear of being sued if the projections failed to materialize.

In response to these concerns, the PSLRA reformed private securities litigation, including, but not limited to, reformation of the appointments of lead plaintiffs in class action suits, limitations on multiple actions, recovery limits on plaintiffs, restrictions on the awarding of attorney fees and expenses, stays of discovery during pendency of motions to dismiss, imposition of sanctions for abusive litigation, and a safe harbor for forward-looking statements. Importantly, the PSLRA also imposed heightened pleading standards for section 10(b) claims. Inclusive in the standard is a

express authority to bring actions seeking injunctive relief or money damages against persons who knowingly aid and abet primary violators of the securities laws.

161 Id.
163 See, e.g., Hearings on Reform Proposals, supra note 155, at 4 (statement of Sen. Christopher J. Dodd) (“[S]ecurities class actions have grown vulnerable to abuses by entrepreneurial lawyers who put their own interests ahead of their clients. Many critics charge that plaintiffs’ attorneys appear to control the settlement of the case with little or no influence from either the named plaintiffs or the larger class of investors.”).
164 Id. at 111 (statement of George Sollman, President & CEO, Centigram Communications Corporation).
166 The relevant section of the PSLRA states that:
In any private action arising under this chapter in which the plaintiff alleges that the defendant—
requirement that the pleading allege with particularity that the defendant acted with the scienter with respect to each violation of section 10(b).\textsuperscript{168}

In addition to these reforms, the PSLRA also amended section 20 of the Securities Exchange Act of 1934, and granted the SEC the sole authority to prosecute those who aid and abet securities violations.\textsuperscript{169} The amendment added a subsection that states that, for the purpose of an action brought by the SEC,

\textit{any person that knowingly provides substantial assistance to another person in violation of a provision of this chapter, or of any rule or regulation issued under this chapter, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.}\textsuperscript{170}

This addition alleviated serious concerns that the Supreme Court’s decision in \textit{Central Bank} withdrew the SEC’s authority to pursue secondary violators.\textsuperscript{171}

Although the PSLRA affirmed the SEC’s authority to prosecute secondary actors for aiding and abetting violations under the umbrella of section 10(b) and Rule 10b–5, the Act did not recognize a private right of action, despite much support for the inclusion of such a remedy.\textsuperscript{172} Since that time, legislative attempts to reinstate

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\textsuperscript{168} § 78u–4(b)(2) (“In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.”).

\textsuperscript{169} § 78t.

\textsuperscript{170} Id. § 78t(e).

\textsuperscript{171} During the legislative hearings discussing \textit{Central Bank} in May of 1994, less than one month after \textit{Central Bank} was decided, there was debate as to whether the decision even applied to the SEC, and if it did, whether it would have any effect on the SEC’s enforcement program. See \textit{Central Bank Hearings, supra} note 135, at 13, 21, 44.

\textsuperscript{172} Id. at 14–15 (“[T]he Central Bank [decision] illustrates why it is important to address abuses in the system through legislation, rather than to rely exclusively on the courts. . . . [T]he ability of private plaintiffs to assert their rights in cases of fraud is [] fundamental to any scheme of investor protection . . . .” (statement of Arthur Levitt, Chairman, Securities and Exchange Commission)); id. at 9 (“[T]he Central Bank decision severely weakens the deterrence of securities fraud.” (opening statement of Sen. Howard M. Metzenbaum)); id. at
a private cause of action for aiding and abetting liability have been unsuccessful. As a result, \textit{Central Bank}'s holding still stands, with the result that private litigants still may not seek retribution from those who secondarily violate Rule 10b–5.

\textbf{F. The Supreme Court Further Limits the Extent of Private Rights of Action Under Section 10(b) and Rule 10–5}

In 2008, the Supreme Court decided another significant case relating to the private rights of action implied within section 10(b) of the Securities Exchange Act of 1934. In \textit{Stoneridge Investment Partners, L.L.C. v. Scientific-Atlanta, Inc.}, the court held that liability under section 10(b) and Rule 10b–5 did not extend to a defendant where the plaintiff could not prove reliance upon the defendant's statements or actions.\textsuperscript{174}

In \textit{Stoneridge}, respondents Scientific-Atlanta and Motorola were suppliers—and later customers—of Charter Communications, a cable service provider. The respondents sold cable converter boxes to Charter, which Charter in turn sold to its customers. At times, the respondents also purchased advertising time from Charter. In 2000, Charter attempted to meet anticipated increases in competition by engaging in a series of fraudulent practices on its own financial statements.\textsuperscript{175} Charter lied about the number of its customer base, delayed reporting about customers who had terminated their service, manipulated billing statements, and inflated revenues in violation of generally accepted accounting principles ("GAAP").\textsuperscript{176}

Despite altering its numbers, Charter still appeared to be short of Wall Street's projections.\textsuperscript{177} Charter therefore approached the
respondents and persuaded them to manipulate their contracts for the sales of converter boxes. Charter and the respondents entered into an agreement where Charter overpaid the respondents twenty dollars for each cable converter box. The respondents then separately signed written contracts agreeing to purchase advertising time from Charter at an artificially inflated price, effectively compensating for the overpayment for the cable converter boxes. The respondents agreed to backdate the contracts for advertising time to make it appear as though the converter boxes and the advertising contracts were independent of each other. The scam allowed Charter to overstate its revenue and operating cash flow by approximately seventeen million dollars. The fraudulent figures were reflected on Charter’s financial statements that it filed with the SEC, and which were reported to the public. The respondents reported the sham transactions on their own financial statements as a wash (in accordance with GAAP), and did not take part in the creation of Charter’s statements.

The petitioners were a class of shareholders (with Stoneridge Investment Partners as lead plaintiff) of Charter. They alleged primary violations of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the SEC against Charter—with whom they later settled—and against the respondents. The petitioners argued that the respondents knew of, or recklessly disregarded, Charter’s intention to create false financial statements resulting from the phony contracts for cable converter boxes and advertising time. The petitioners contended that the respondents were aware that the financial statements would become public and would be relied upon by investors seeking information on Charter’s financial performance. The district court, however, dismissed the

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178 Id. at 154.  
179 Id.  
180 Id. at 154–55.  
181 Id. at 155.  
182 Id.  
183 Id.  
184 Id.  
185 Id. at 153.  
187 Id. at 155.  
188 Id.  
189 Id.
petitioner’s claim for failure to state a claim on which relief could be granted.

The petitioners appealed the district court’s decision to dismiss the action against respondents.\textsuperscript{190} The Eighth Circuit affirmed the decision, agreeing with the district court that the respondents could not have been liable for primary violations of section 10(b) or Rule 10b–5 because neither respondent had made a public misstatement upon which investors could have relied.\textsuperscript{191} The district court did acknowledge that the respondents’ actions at most amounted to aiding and abetting securities fraud; however, the private cause of action for aiding and abetting no longer existed since \textit{Central Bank} and the promulgation of the PSLRA, and thus there could be no liability.\textsuperscript{192}

Supporters of the petitioners in \textit{Stoneridge} filed amicus briefs arguing that the holding in \textit{Central Bank}—and the language of the PSLRA—was limited to those who did not actively commit a manipulative or deceptive act.\textsuperscript{193} The amici argued that \textit{Central Bank} and the PSLRA only intended to limit aiding and abetting liability when the defendant’s role was limited to providing assistance to the primary violator, and not when the defendant actually engaged in deceptive or misleading conduct itself. The amici urged that the respondents in \textit{Stoneridge} were different from those in \textit{Central Bank}; unlike in \textit{Central Bank}, the respondents in \textit{Stoneridge} individually entered into contracts for phony transactions and backdated the contracts to make it appear as though the agreements were legitimate. The amici therefore argued that the respondents had engaged in deceptive acts themselves, and were not aiders and abettors, but rather primary violators.

In its decision, the Supreme Court did not specifically address the argument of secondary liability; however, it disagreed that the respondents met the elements of a primary violator. Rather, it noted that since \textit{Central Bank}, Congress had opportunities to create a private action for aiding and abetting, and chose not to do so.

\textsuperscript{190} \textit{In re Charter Commc’ns, Inc., Sec. Litig.}, 443 F.3d 987,989 (8th Cir. 2007).
\textsuperscript{191} \textit{Id.} at 992.
\textsuperscript{193} Brief for Professors James D. Cox, et al. as Amici Curiae Supporting Petitioners, Stoneridge Inv. Partners, L.L.C. v. Scientific-Atlanta, Inc., 552 U.S. 148 (June 11, 2007) (No. 06-43), 2007 WL 1701606. The brief quoted the relevant section of the decision in \textit{Central Bank}: “[T]he defendant must have committed a manipulative or deceptive act to be liable under § 10(b), a requirement that in effect forecloses liability on those who do no more than aid and abet a 10b–5 violation.” \textit{Id.} at *16.
Therefore, section 10(b) and Rule 10b–5 liability did not apply to secondary actors in private civil suits. Instead, in order for the petitioners to be successful, the Court required them to prove that the respondents were primary violators of section 10(b) and Rule 10b–5. Like the lower courts, the Supreme Court concentrated on the issue of reliance. The Court recognized in *Central Bank* fourteen years earlier that a lack of reliance would be problematic for a plaintiff who alleged a primary violation against an aider and abettor: “Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor’s statements or actions.”

The Court concluded that neither of the presumptions of reliance that may apply in securities class-action lawsuits applied to the defendants in *Stoneridge*. The respondents owed no duty to the shareholders of Charter to disclose Charter’s own fraud (because respondents were unaffiliated with Charter), nor did investors rely on any statements or actions of respondents because the transactions in question were not made public during the relevant times. Therefore, the Court held that petitioners had not met all of the requirements of a section 10(b) or Rule 10b–5 claim, and affirmed the dismissal for failure to state a claim. The Supreme Court’s dismissal of the actions protected Scientific-Atlanta and Motorola from liability and, thus, neither respondent participated in the settlement against Charter.

The inequitable result in *Stoneridge* illustrates the difficulty that private litigants have faced and will likely continue to face when...
attempting to hold secondary actors liable for violations of section 10(b) and Rule 10b–5. Under the rationale of the Supreme Court, the result in Stoneridge will not be uncommon in the future because secondary actors typically do not owe a duty to primary violators and/or do not make public statements on which the investors rely. The Court’s holding is unfortunate considering the majority’s concession that the conduct that respondents engaged in was deceptive: “Conduct itself can be deceptive, as respondents concede. In this case, moreover, respondents’ course of conduct included both oral and written statements, such as the backdated contracts agreed to by Charter and respondents.”

It seems from the decision in Stoneridge that the Supreme Court gave the green light for secondary actors to engage in fraudulent conduct without fear of primary liability, even though their participation in the scheme allowed the fraudulent conduct by the primary actor to take place.

In sum, although section 10(b) has been referred to as the “catch-all” provision for fraudulent conduct in the securities industry, its reach has been increasingly restricted since the early 1990s. As a result, there is an entire class of secondary actors who are virtually untouchable by private litigants. In the spectrum of antifraud liability, these defendants are situated in a gray area somewhere between primary violators and passive beneficiaries. The Madoff family members—Peter, Mark, Andrew, Shana and Ruth—are examples of the class of individuals who fall within this gray area, and are essentially immune from private civil liability, unless private litigants can satisfy the heavy burden of establishing liability for primary violations under the ’33 and/or the ’34 Acts.

200 Id. at 158.

201 As of the date of this article, there was a pending lawsuit against Peter Madoff. See Lautenberg Found. v. Madoff, No. 09-816, 2009 WL 2928913, at *1 (D.N.J. Sept. 9, 2009). Plaintiffs in this suit alleged primary violations of section 10(b) as well as violations of section 20(a) of the Exchange Act—Control Person Liability—as well as various state law claims. Id. at *2. The plaintiffs were unable to survive a motion to dismiss their claims that Peter Madoff made material misrepresentations to them, as the court determined that they did not adequately plead that Madoff had been the source of the misrepresentations. Id. at *5 (“[M]ere responsibility for published reports, without a specific allegation that the defendant was actually involved in the preparation of a public statement or report will not suffice to plead a claim under the PSLRA” (citing Winer Family Trust v. Queen, 503 F.3d 319, 334–35 (3d Cir. 2007))).

The court did, however, deny the defendant’s motion to dismiss for failure to state a claim with regard to the plaintiff’s omission allegation. The plaintiffs alleged that Peter Madoff omitted material information within his knowledge from investors—namely, that BMIS was involved in a Ponzi scheme. Id. at 6. The court came to a preliminary conclusion that Peter Madoff, as one of the two control persons of BMIS (the other being Bernie Madoff), did owe a
III. THE SPECTER BILL: REINSTATING LIABILITY FOR AIDING AND
ABETTING

A. Introduction and Purpose of the Bill

On July 30, 2009, Senator Arlen Specter sought to eliminate the
inequity that remains after the Stoneridge decision by introducing a
bill entitled “Liability for Aiding and Abetting Securities Violations
Act of 2009.” The bill seeks to impose liability on secondary
actors (aiders and abettors) who purposefully engage in wrongful
and deceitful conduct, but who are not primary violators within the
court’s interpretation of the statute. The bill seeks to amend section
20(e) of the Securities Exchange Act of 1934 with respect to aiding
and abetting violations brought by both the SEC and in private civil
actions. It would amend section 20(e) to allow the SEC to
prosecute those who knowingly or recklessly provide substantial
assistance to a primary violator. Furthermore, the bill includes
an express right for private civil actions:

For purposes of any private civil action implied under this
title, any person that knowingly or recklessly provides
substantial assistance to another person in violation of this
title, or of any rule or regulation issued under this title, shall
be deemed to be in violation of this title to the same extent
as the person to whom such assistance is provided.

In support of his proposal, Senator Specter spoke of the need to
adopt the bill in order to “overturn two errant decisions of the
Supreme Court,” speaking of Central Bank and Stoneridge. He
indicated that it is time for Congress to reconsider these two
judgments as a result of “massive frauds involving Enron, Refco,
Tyco, Worldcom, and countless other[s] . . . [that] have taught us
that a stock issuer’s auditors, bankers, business affiliates, and
lawyers—sometimes called ‘secondary actors’—all too often actively
fiduciary duty to the shareholders, and therefore had a duty to disclose the omitted material
information. Id. at *2, *9.

This case against Peter Madoff is ongoing, and the plaintiffs still have significant burdens
to overcome. While the claim against Peter Madoff has not yet been resolved, it seems
unlikely that the rest of the Madoff family will be held liable for primary violations of section
10(b) or Rule 10b–5.

203 See supra notes 157–59 and accompanying text.
204 S. 1551.
205 Id.
participate in and enable the issuer's fraud.”

Surprisingly, the Madoff Ponzi scheme was not mentioned in Specter's list of “massive frauds,” despite the fact that Madoff had been sentenced to 150 years in prison just over a month earlier, and that the lawsuit against Madoff’s accounting firm, Friehling & Horowitz, was still pending at the time. Although Madoff's scheme was not mentioned in Specter's introduction of the bill, Specter’s bill has the potential to hold secondary actors accountable like those involved in the Madoff scheme. Had this type of reform occurred sooner, it is possible that the massive frauds described by Senator Specter could have been avoided.

B. The Current Enforcement Mechanisms for Aiding and Abetting Are Insufficient: The SEC Lacks Adequate Resources

Frauds like Madoff’s, Enron’s, and the “countless others” mentioned by Senator Specter demonstrate how the current regulatory scheme that gives the SEC the sole authority to bring civil actions against those who aid and abet securities fraud is insufficient. The Madoff scheme provides a model example for how investors cannot simply rely on the resources of the SEC to protect them against fraudulent activity. The SEC had adequate information to uncover Madoff’s fraud sixteen years before his confession, and yet it failed to stop the fraud from happening. In fact, there was ample evidence suggesting that Madoff investors relied on the fact that the SEC conducted regular examinations of him when making investment decisions. Because the SEC had been making periodic reviews and had kept watch over Madoff’s businesses for decades, investors assumed that his business operations had to be legitimate. Of further concern is the fact that

207 Id.


209 See infra Part III.D (discussing the potential deterrent effect of such a bill).

210 See supra note 207 and accompanying text.

211 See supra note 46 and accompanying text; see also Central Bank Hearings, supra note 135, at 57 (statement of Mark Griffin, Director, Division of Securities, Utah Department of Commerce) (“The strength and stability of our Nation’s securities markets depend in large measure on investor confidence in the fairness and efficiency of these markets. In order to maintain this confidence, it is critical that investors have effective remedies against persons who violate the antifraud provisions of the securities laws.”).

212 SEC REPORT, supra note 11, at 425.
investors relied on the SEC’s approval of Madoff, sometimes even despite the red flags that had surfaced during their own due diligence. Madoff capitalized on the opportunity to use the SEC’s approval of his operations when attempting to lure in investors.

It is likely that the SEC was unable to properly address the Madoff affair due to inadequate resources to accomplish its far-reaching regulatory responsibilities. The SEC’s Office of Compliance Inspections and Examinations (“OCIE”), the division that has been most scrutinized in connection with the SEC’s failure to uncover Madoff’s Ponzi scheme, is currently responsible for conducting examinations of broker-dealers, investment advisors, investment companies, transfer-agents, nationally-recognized statistical rating organizations, clearing agencies, and self-regulatory organizations (“SROs”). As part of its responsibilities, the OCIE must make regular examinations—ranging from every year to every four years—of every group of registrants it oversees. While the SEC only consists of about 3,800 staff members, it is responsible for overseeing about 11,300 investment advisors; 5,600 broker-dealers, including 174,000 branch offices; and 676,000 registered representatives. Also included in its oversight are “950 fund complexes with over 8,000 mutual fund portfolios” and countless other complex financial instruments. Due to its expansive regulatory authority, the SEC’s budget and resources are ill-equipped to adequately and fully address the needs of investors. As one supporter of Senator Specter’s bill stated, “[s]tate regulators and the Securities and Exchange Commission . . . filed numerous cases against corporations and secondary actors in the past decade. However, many more cases of fraud were not pursued by the regulators due to their limited resources.” Mary Shapiro, Chairman of the SEC, also acknowledged the SEC’s lack of

213 Id. at 427.
214 Id. at 429.
217 Id.
resources in a speech in April of 2009 to the Council of Institutional Investors: “Staying one step ahead of predators and the practices that they may employ is a never-ending struggle. Quite frankly, our enforcement and examination resources have been seriously constrained in recent years . . . .”219 It appears that scarce resources within the SEC have impacted—and are likely to continue to impact—the SEC’s ability to counteract fraudulent schemes,220 such as the one perpetrated by Madoff and his family. Thus, the Act would provide a vital complement to the regulatory enforcement actions already in place.

C. Investors Are More Adequately Compensated Through Private Litigation, as Opposed to Relying on SEC Enforcement

As a result of the monetary constraints of the SEC, investors have struggled to recover relief in the form of damages since the private right of action for aiding and abetting was abolished. Again, the Madoff scheme illustrates the fact that often-times those who primarily violate the federal securities laws are insolvent by the time their frauds are exposed. Madoff's confession came as a result of the financial crisis of 2008 which caused his Ponzi scheme to dry up. By the time authorities like the SEC intervened, the money was gone. This is typical of corporate fraud cases, and further demonstrates a need for investors to have the opportunity to recover from those secondary actors with deep pockets who knowingly participate and assist in, and—more importantly—who benefit from stealing their money.221

One of the major benefits of Senator Specter’s bill is that it would enhance the ability of victims to recover stolen investments. During the hearings following the Central Bank case, former Chairman of the SEC, Arthur Levitt, noticed this advantage: “[A]iding and abetting liability in private actions . . . [is] a necessary supplement to our overall enforcement program. [It] serve[s] to deter securities fraud and to compensate injured investors.”222 In fact, private civil

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220 See Aiding and Abetting Hearings, supra note 218 (statement of Tanya Solov, Director, Illinois Securities Department).


222 Central Bank Hearings, supra note 135, at 14 (statement of Arthur Levitt, Former
actions against aiding and abetting often serve to provide better compensation for investors than does SEC litigation.\textsuperscript{223} The North American Securities Administrators Association, a nonprofit organization of securities regulators in North America, noted in its amicus brief in support of the petitioners in \textit{Stoneridge} that “[p]rivate actions afford victims of fraud the best and often the only hope of recovering their losses—something government enforcement actions are ill-equipped to do on a large scale.”\textsuperscript{224} Statistics have shown that “private enforcement . . . dwarf[s] public enforcement,” and thus private litigants are much more successful in terms of recovery than the SEC.\textsuperscript{225} In fact, “even in major scandals where the SEC has brought its own action, the damages paid in securities class actions are usually (but not always) a multiple of those paid to the SEC.”\textsuperscript{226} The SEC has given further support in the past for the right of investors to privately sue aiding and abettors:

Private actions . . . serve the compensatory purposes of the securities laws. Although the Commission may seek certain monetary relief, its remedies are designed primarily to deter violations by making them unprofitable, rather than to make investors whole. . . . Accordingly, the primary means of compensating injured investors remains the private action, and all participants in a fraud should be liable in order to ensure full recovery.\textsuperscript{227}

This is especially true with respect to the Madoff fraud: although arguably the largest financial fraud in American history, thousands of the victims involved in Madoff’s scam stand to recover nothing.\textsuperscript{228}
For these investors and many others, the restoration of aiding and abetting liability could be their only hope for recovery.

D. A Private Cause of Action for Aiding and Abetting Would Deter Secondary Actors from Participating in Securities Fraud

While the Madoff affair is not necessarily indicative of the way the SEC does business, it does show that there are fundamental issues with relying on the SEC as the “sole cop on the beat.” 229 Instead, the idea that the public can play the role of an attorney general through private civil litigation provides the complement and assistance to deterring financial fraud that both the SEC and investors need. Indeed, there has been much support for the suggestion that private litigation is an effective means to further enforcing federal securities laws and deterring fraud. For example, the SEC acknowledged in its amicus brief supporting the respondents in Central Bank that the role of private civil actions is vital to SEC enforcement:

[T]he Commission has only limited resources to detect or investigate federal securities law violations, and private actions accordingly serve as “a necessary supplement to Commission action.” . . . The private right of action’s effectiveness as a supplement to Commission enforcement would be severely undercut if it did not also reach aiders and abettors. 230

The prospect of private civil suits against aiders and abettors, in conjunction with civil and criminal actions brought by the SEC and the Department of Justice, are more likely to deter fraudulent conduct and enforce current regulations. 231 The Supreme Court, as well as many lower courts, has recognized that the private right of

(providing that the thousands of investors who relied on Madoff’s false account statements may be unable to recover the profits that were reflected in their statements). David Sheehan, the lawyer for Irvin Picard (the trustee for the Madoff assets), asserted that, despite investors’ reliance on the phony account balances, “[t]he only fair way to distribute whatever assets the trustee can raise is to channel them to those who have not yet recovered even their original investment, not to share it with those who have.” Id.

229 Aiding and Abetting Hearings, supra note 218, at 3 (statement of Patrick Szymanski, General Counsel, Change to Win).

230 SEC Amicus Brief, supra note 227, at 16.

231 See, e.g., Central Bank Hearings, supra note 135, at 9 (statement of Sen. Howard M. Metzenbaum) (stating that the decision in Central Bank “severely weaken[ed] the deterrence of securities fraud,” and further noting that the “decision sen[it] a dangerous signal to the securities markets that a primary enforcement tool ha[d] been eliminated”).
action is a useful means for deterring fraud. In 1964, the Court noted that the threat of private civil liability can serve as a "most effective weapon in enforcement."232 In the past, as well as in the present, members of Congress have recognized the deterrent effect of private civil suits against secondary actors. Following the decision in Central Bank, Senator Dodd urged that "aiding and abetting liability has been critically important in deterring individuals from assisting possible fraudulent acts by others."233

The deterrent effect of private civil suits has also been recognized in academia. Professor John C. Coffee has argued that the deterrent effect of securities class actions has a lot to do with "who gets sued."234 From a practical perspective, when shareholders sue a corporation or its inside directors for fraud, it is typically the corporation’s insurance or the insider’s directors’ and officers’ (D & O) liability insurance carriers who pay the settlements.235 This in turn causes the insurance premiums to increase, and the shareholders of the corporation ultimately pay the price of their own lawsuits.236 Professor Coffee argues, however, that those with deep pockets—i.e. secondary actors or “gatekeepers,” like accountants, who often play a role in the fraud—are "virtually immun[e]" from liability.237 Arguably, if secondary actors or gatekeepers were not insulated from private civil liability and were accordingly more accountable to shareholders, they would be more diligent to avoid potentially fraudulent conduct for fear of personal liability.

Additionally, Professor Joel Seligman noted that with a significant private civil enforcement mechanism like aiding and abetting liability, there would be “a powerful incentive to discourage fraud before it occur[s].”238 Professor Seligman also commented in his article on private securities litigation in 2004 that the restoration of the private action for aiding and abetting liability would be “[t]he single most important substantive step Congress could take today to vitalize corporate accountability.”239 Congress has yet to do so, and until it does, secondary actors like the Madoff

232 Moohr, supra note 223, at 1470 (quoting J.I. Case v. Borak, 377 U.S. 426, 432 (1964)).
234 See Coffee, supra note 223, at 1549.
235 Id. at 1550.
236 Id. at 1536.
237 Id. at 1550.
239 Id.
family have little incentive to prevent fraud from occurring within their organizations, because they are subject to little or no accountability.

E. Criticism Regarding the Reinstatement of the Private Cause of Action for Aiding and Abetting

It is not surprising that Congress has not jumped at prior opportunities to reinstate private civil liability for aiding and abetting. Many of the concerns described by the Court in Central Bank are still prevalent today. For example, some fear that an increase in regulation in the securities industry will lead investors to flee domestic capital markets and flock to largely unregulated competing foreign markets. Similarly, others believe that the bill would bring an increase in strike suits brought by the plaintiffs’ bar, which would drive up the costs of D&O liability insurance premiums, which in turn would ultimately be paid by shareholders. Likewise, those who oppose Specter’s bill argue that the current regulatory enforcement procedures—i.e., SEC enforcement practices and enforcement by the Department of Justice—are sufficient.

Few of these claims have merit, and others are simply false. The recent decisions in Central Bank and Stoneridge, as is evidenced by the Madoff scheme, bring regulation further from the original purposes of federal securities laws—i.e., the protection of investors. Senator Specter’s bill would provide a mechanism for Congress to reaffirm its policy that investors should be protected from financial misconduct and fraud, as opposed to the “buyer beware” mentality that existed within the industry prior to the enactment of the federal securities laws. Such an affirmation would likely play a significant role in helping to restore investor confidence that is much needed in the capital markets. Also, a market that deters fraud rather than promotes it is likely to lead to an increase in investor participation, therefore attracting competition rather than

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240 See supra notes 172–73 and accompanying text (describing the opportunity Congress had when it passed PSLRA in 1995 and the Sarbanes-Oxley Act in 2002).
241 See supra notes 150–52, 154–65 and accompanying text (discussing concerns that led to the decision in Central Bank and the passage of the PSLRA).
242 See infra Part III.E. (expressing arguments made at the committee hearings opposing the bill).
243 See Aiding and Abetting Hearings, supra note 218 (statement of Patrick J. Szymanski, General Counsel, Change to Win).
deterring it.244 Should secondary liability be reinstated for aiders and abettors, it is important to address the standard for applying liability to this class of defendants. Senator Specter proposed that one who knowingly or recklessly provides substantial assistance should be as liable as a primary violator. The standard appears to simply revive the elements that were in place before Central Bank eliminated the cause of action.245 Critics of the bill have argued that recklessness is an inappropriate state of mind for imposing civil liability.246 Additionally, there is concern that the phrase “substantial assistance” is not defined within the bill, thereby leaving its interpretation up to the courts on an ad hoc basis.247 These concerns appear to be unfounded however, as there is considerable case law that gives the courts assistance on how to apply the standard of recklessness, and furthermore, what constitutes substantial assistance.248 Additionally, the SEC has had the ability to prosecute aiders and abettors for decades, and the application of the standard in these cases could easily be adopted in private litigation. It is also important to note that the state of mind requirement in Senator Specter’s bill is knowing or reckless, and not negligent.

In order for a secondary actor to avoid liability, Congress should require the secondary actor to diligently investigate red flags or storm warnings that arise during the course of business. A duty to investigate would approximate the duty set forth in the Worldcom, Inc. Securities Litigation in the context of false or misleading information contained in a registration statement.249 Secondary actors should be required to perform due diligence when faced with

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244 See id. ("As with any market system, the capital markets will function most efficiently and fairly if investors themselves have the legal tools necessary to hold accountable those who knowingly or recklessly put their investments at risk.").
246 Aiding and Abetting Hearings, supra note 218 (statement of Patrick J. Szymanski, General Counsel, Change to Win).
247 Id.
248 See generally Bromberg & Lowenfels, supra note 95 (analyzing the history of aiding and abetting liability and noting how courts have applied its elements, including knowingly or recklessly providing substantial assistance).
indications of fraudulent activity, and a failure to investigate red flags should result in a finding of the requisite state of mind.

Other concerns related to Senator Specter’s bill are fears that the recreation of this form of liability would frustrate the purpose of the prior legislation which sought to limit abusive civil practices and frivolous lawsuits. However, the current safeguards that have been put in place by the PSLRA, such as heightened pleading requirements, court approval of settlements, and certification of plaintiff classes, are likely to continue to prevent a surge of litigation as they have in the past. Rather, the bill would simply provide an opportunity for plaintiffs to adequately plead that defendants’ actions satisfied the elements of an aiding and abetting cause of action.

F. Further Hopes for Reinstating the Private Cause of Action for Aiding and Abetting

On September 17, 2009, hearings on Senator Specter’s bill were held before the Subcommittee on Crime and Drugs of the Senate Judiciary Committee. Despite the hearing, no further action has been taken on the bill. Senator Specter’s bill is not, however, the only hope for restoring aiding and abetting liability in the future. Senator Dodd has also proposed a section in a bill entitled “Restoring American Financial Stability Act of 2009” that is almost identical to the one introduced by Senator Specter. The proposal for reform to aiding and abetting liability, which is buried on page 795 of the 1,136-page bill, would amend section 21D of the Securities Exchange Act of 1934, and include the following:

(g) PRIVATE CIVIL ACTIONS.—For purposes of any private civil action implied under this title, any person that knowingly or recklessly provides substantial assistance to another person in violation of this title, or of any rule or regulation issued under this title, shall be deemed to be in

250 See Aiding and Abetting Hearings, supra note 218 (statement of Adam Pritchard, Director, University of Michigan Empirical Legal Studies Center).


violation of this title to the same extent as the person to whom such assistance is provided.\textsuperscript{253} Senator Dodd unveiled the draft of his bill in November, 2009 and no formal action has been taken thus far;\textsuperscript{254} however, if either bill were passed, it could pave the way for private investors to seek redress against secondary actors like the Madoff family.

IV. CONCLUSION

Based on the arguments set forth, Congress should restore the right of private litigants to bring aiding and abetting claims. Its failure to do so would encourage and perpetuate further fraudulent conduct in the market, thereby injuring investor confidence. In the wake of such massive frauds like Bernie Madoff’s Ponzi scheme, the industry is ripe for change. The Liability for Aiding and Abetting Securities Violations Act of 2009 is the necessary step to reaffirm the industry’s policy of protecting investors and preventing fraud at their expense.
