E. Securities Exchange Act of 1934

Scope of Secondary Actor Liability. — After the Supreme Court held in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*[1] that private plaintiffs could not bring claims under § 10(b) of the Securities Exchange Act of 1934[2] against entities that only aided and abetted an alleged fraud, one major remaining question on the scope of private liability for secondary actors was when their conduct could be a primary violation of the securities laws.[3] In response to *Central Bank*'s rejection of aiding and abetting liability, private plaintiffs began arguing that participation in a scheme to violate the securities laws could be treated as a primary violation, a theory known as "scheme liability."[4] Last Term, in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*,[5] the Supreme Court rejected this theory in holding that liability under the implied private right of action recognized under § 10(b) and Securities and Exchange Commission (SEC) Rule 10b-5[6] requires that a private plaintiff must show reliance on the deceptive conduct or statements of the secondary actor specifically. In doing so, the Court avoided a dramatic expansion of securities liability for secondary actors. But, by focusing the liability question on the factual issue of whether the plaintiff relied on the actor's conduct, rather than on the contours of the non-actionable category of aiding and abetting under § 10(b), the Court departed from *Central Bank*'s categorical methodology and holding. In retreating from the clearer rule, the Court may have increased rather than limited the amount of private securities litigation that can proceed past the pleading stage.

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[1] 511 U.S. 164 (1994).

[2] 15 U.S.C. § 78j(b) (2006) ("It shall be unlawful for any person, directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.").

[3] *See* Jill E. Fisch, *The Scope of Private Securities Litigation: In Search of Liability Standards for Secondary Defendants*, 99 COLUM. L. REV. 1293, 1294 (1999). Although definitions vary and the phrase is somewhat misleading, the literature uses the term "secondary actor" to refer to all entities or individuals who are not direct issuers of securities. *See* Taavi Annus, Note, *Scheme Liability Under Section 10(b) of the Securities Exchange Act of 1934*, 72 MO. L. REV. 855, 858 & n.25 (2007). The category of "secondary actors" therefore can include investment banks, accountants and auditors, lawyers, and underwriters. *See id.* For further discussion of the questions left open by *Central Bank*, see Joseph A. Grundfest, *Scheme Liability: A Question for Congress, Not for the Courts* 8 (Stanford Law Sch. John M. Olin Program in Law & Econ., Working Paper No. 344, 2007), *available at* http://ssrn.com/abstract=1005524.

[4] *See* Annus, *supra* note 3, at 861–63.

[5] 128 S. Ct. 761 (2008).

[6] 17 C.F.R. § 240.10b-5 (2007).

Charter Communications is one of the nation's largest providers of cable television.[7] According to the plaintiffs' allegations, Charter executives realized in 2000 that they would not be able to meet the company's cash flow projections for the coming years, and so entered into a series of sham transactions in order to mislead Charter's analysts. Charter began paying its outside vendors of set-top cable boxes, including Scientific-Atlanta and Motorola (the "vendors"), twenty dollars extra per box; the vendors then returned this money to Charter as payment for advertising.[8] Charter treated these "advertising fees" as revenue in its accounting, inflating its operating cash flow by over $17 million by the end of 2000.[9]

A class of plaintiffs, led by Stoneridge Investment Partners, filed a securities class action against Charter, its outside auditor, and the vendors, alleging violations of § 10(b) and Rule 10b-5. The plaintiffs sought to recover on the scheme liability theory:[10] although the vendors did not themselves play any role in producing Charter's false financial statements, they knowingly or recklessly participated in a scheme to defraud Charter's investors. The sham transactions were thus "scheme[s] . . . to defraud" and a "course of business which operate[d] . . . as a fraud" under 10b-5(a) and (c).[11] The district court dismissed the claims against the vendors, holding that they were in substance no different from the claims for aiding and abetting that the Court rejected in *Central Bank*.[12]

The Eighth Circuit affirmed the dismissal.[13] The court began by noting that *Central Bank* had limited actionable conduct under § 10(b)

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[7] *In re* Charter Commc'ns, Inc., Sec. Litig., 443 F.3d 987, 989 (8th Cir. 2006).

[8] *Stoneridge*, 128 S. Ct. at 766.

[9] *Id.* at 766–67.

[10] "Scheme liability" is liability under Rules 10b-5(a) and (c). Scheme liability allows a defendant to be held liable for participating in a course of business or scheme to defraud investors, even though the defendant may not have made any actual material misstatements or omissions as required in a 10b-5(b) case. *See generally In re* Enron Corp. Sec., Derivative & ERISA Litig., 235 F. Supp. 2d 549, 577–78 (S.D. Tex. 2002).

[11] 17 C.F.R. § 240.10b-5(a), (c) (2007).

[12] *In re* Charter Commc'ns, Inc. Sec. Litig., No. MDL 1506 4:02-CV-1186-CAS, 2004 WL 3826761, at *5 (E.D. Mo. Oct. 12, 2004). *Central Bank* involved a claim by investors in a land development against the Central Bank of Denver, which had served as the indenture trustee for the bond issues that financed the development. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 167 (1994). The bank received information suggesting that the developer's assessment of the land's value was fraudulently inflated, but delayed before seeking its own outside appraisal; before an appraisal could be completed, the developer defaulted on the bonds. *Id.* at 167–68. The investors sued Central Bank for aiding and abetting the developer's fraud. *Id.* at 168. The Supreme Court held that summary judgment for Central Bank was proper because "the text of § 10(b) does not prohibit aiding and abetting"; therefore, "a private plaintiff may not maintain an aiding and abetting suit under § 10(b)." *Id.* at 191.

[13] *In re* Charter Commc'ns, Inc., Sec. Litig., 443 F.3d 987 (8th Cir. 2006). Chief Judge Loken wrote for a unanimous panel, joined by Judges Wollman and Riley.

to "'manipulative or deceptive' devices or contrivances," defined as market manipulation, material misstatements, or failures to disclose material facts that one had a duty to disclose.[14] *Central Bank* had, however, left unclear the limits of liability of secondary actors — market participants who did not themselves issue securities but whose conduct allowed or facilitated the issuer's primary violation of § 10(b).[15] The court held that the vendors' conduct had not been "deceptive" under *Central Bank*'s definition: the vendors neither made a misstatement on which a reasonable investor would be expected to rely in making investment decisions, nor did they violate any duty of disclosure that they might have had to Charter's shareholders. Thus, a "defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under § 10(b)."[16]

The Supreme Court affirmed, but on different grounds from those relied on by the Eighth Circuit. Writing for the majority, Justice Kennedy[17] framed the question as whether an entity that does not make a public misstatement or violate a duty to disclose, but that does participate in a scheme to violate § 10(b), can be held liable in a private suit by an injured investor.[18] The Court reaffirmed the principle of *Central Bank* — that the text of § 10(b) does not allow liability for aiding

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[14] *Id.* at 990 (citing Santa Fe Indus. v. Green, 430 U.S. 462 (1977); Affiliated Ute Citizens of the State of Utah v. United States, 406 U.S. 128 (1972)).

[15] *See Central Bank*, 511 U.S. at 191.

[16] *Charter Commc'ns*, 443 F.3d at 992. The Solicitor General later filed an amicus brief in *Stoneridge* which, though urging affirmance, directly challenged this limitation on the content of what conduct could be "deceptive" under the statute. *See* Brief for the United States as Amicus Curiae Supporting Affirmance at 11–17, *Stoneridge*, 128 S. Ct. 761 (No. 06-43), 2007 WL 2329639. The court of appeals also noted the breadth of liability that a ruling for the plaintiffs would produce. *Charter Commc'ns*, 443 F.3d at 992–93 ("[W]e are aware of no case imposing § 10(b) or Rule 10b-5 liability on a business that entered into an arm's length non-securities transaction with an entity that then used the transaction to publish false and misleading statements . . . . To impose liability for securities fraud on one party to an arm's length business transaction in goods or services other than securities . . . would introduce potentially far-reaching duties and uncertainties for those engaged in day-to-day business dealings."). The court also rejected Stoneridge's argument that it should have been granted leave to amend its pleadings. *Id.* at 993.

[17] Justice Kennedy was joined by Chief Justice Roberts and by Justices Scalia, Thomas, and Alito. Justice Breyer did not participate in the case.

[18] *Stoneridge*, 128 S. Ct. at 767. The courts of appeals had split on the question of whether "scheme liability" was actionable under 10b-5. The Ninth Circuit had allowed liability against defendants who had "committed a manipulative or deceptive act in furtherance of the scheme" to defraud investors, Simpson v. AOL Time Warner, Inc., 452 F.3d 1040, 1048 (9th Cir. 2006) (quoting Cooper v. Pickett, 137 F.3d 616, 624 (9th Cir. 1997)) (internal quotation mark omitted), while, along with the Eighth Circuit in *Charter Communications*, the Fifth Circuit had rejected scheme liability in an appeal of class certification in the litigation against the Enron Corporation's outside banks that followed the collapse of the company, *see* Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc., 482 F.3d 372 (5th Cir. 2007).

and abetting. Permitting such claims against secondary actors would allow plaintiffs to avoid having to satisfy the reliance requirement of 10b-5 actions — the requirement that plaintiffs rely on the manipulative conduct or material misstatement or omission in engaging in a securities transaction.[19] The Court rejected one interpretation of the Eighth Circuit's holding — that *only* false verbal statements and specifically defined fraudulent trading practices were "deceptive" conduct prohibited by § 10(b). Some "[c]onduct itself," as well as statements or omissions, "can be deceptive," the Court held.[20] Such deceptive conduct gave rise to liability when it had the "requisite proximate relation to the investors' harm."[21] The Court concluded that the vendors' conduct lacked this proximate relation, finding that the Charter investors could not demonstrate any reliance on the actions of the vendors, "except in an indirect chain that [is] too remote for liability."[22]

The Court then considered scheme liability and rejected the investors' argument that they were entitled to the fraud-on-the-market presumption of reliance recognized by the Court in *Basic Inc. v. Levinson*.[23] The investors argued that because the vendors engaged in conduct that was necessary for Charter's "scheme" to inflate revenue on its financial statements, which were then released to the market, reliance could be presumed because the vendors' deceptive acts were reflected in Charter's stock price. The Court disagreed, reiterating that the vendors' acts were simply too remote from the deceptive conduct to satisfy the reliance requirement of 10b-5. The Court also noted that the investors' theory would drastically expand federal securities liability into areas that Congress did not intend — fraudulent business transactions already governed by state law[24] — which in turn could deter foreign companies from doing business with American companies and from listing themselves on American stock exchanges.[25]

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[19] *Stoneridge*, 128 S. Ct. at 768 (citing *Central Bank*, 511 U.S. at 180); *see also id.* at 769 ("The conduct of a secondary actor must satisfy each of the elements or preconditions for liability" under 10b-5 to be actionable.).

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] 485 U.S. 224 (1988). The fraud-on-the-market theory holds that in an efficient market, the price of a company's stock reflects all material public information available about that company. Therefore, by purchasing or selling the stock at the known price, an investor can be presumed to have relied on the information that informed that price, including any material misstatements or fraudulent conduct creating false information. *Id.* at 241–42 (citing Peil v. Speiser, 806 F.2d 1154, 1160–61 (3d Cir. 1986)).

[24] *See Stoneridge*, 128 S. Ct. at 770–71.

[25] *Id.* at 772 (citing Brief for the Nasdaq Stock Market, Inc. and NYSE Euronext as *Amici Curiae* in Support of Respondents at 12–14, *Stoneridge*, 128 S. Ct. 761 (No. 06-43) [hereinafter Nasdaq Brief]), 2007 WL 2958946. The Court pointed to the "extensive discovery and the potential for uncertainty and disruption" that would allow plaintiffs "with weak claims to extort settlements from innocent companies." *Id.* The threat of such settlements, in turn, "rais[es] the cost of

This refusal to expand the implied private right of action under 10b-5 was also appropriate, the Court concluded, in light of the history of the Court's securities jurisprudence. Although the Court had been more liberal in implying private rights of action in the mid-twentieth century, the majority noted, such private rights were no longer recognized without evidence of congressional intent.[26] The Court inferred from Congress's passage of the Private Securities Litigation Reform Act of 1995[27] (PSLRA) that Congress had "accepted the § 10(b) private cause of action as then defined but chose to extend it no further."[28]

Justice Stevens dissented.[29] He agreed with the majority in rejecting the Eighth Circuit's view that only misstatements, material omissions, and market manipulation were "deceptive conduct" under § 10(b), and agreed that the statute "covers nonverbal as well as verbal deceptive conduct."[30] The claims of the Charter investors were to him, however, fundamentally different from claims for aiding and abetting because the vendors had actually committed deceptive conduct themselves.[31] Justice Stevens criticized the majority's view of the reliance and causation elements of 10b-5 as unduly narrow. He noted that to prove reliance, plaintiffs needed only to show traditional but-for causation: but for the deception, the plaintiff would not have engaged in the securities transaction.[32] Stoneridge had demonstrated both but-for and proximate causation, Justice Stevens argued; but for the sham transactions, Charter could not have accomplished its fraud, and the vendors knew that the sham transactions would eventually be reflected in Charter's financial statements.[33] Responding to the majority's policy arguments, Justice Stevens noted that far from being a deterrent, the transparency of U.S. markets provided by the securities laws was an attraction for foreign capital.[34] He concluded by defending private rights of action generally, arguing that they enjoyed a far longer pedigree in American jurisprudence than the majority suggested.[35]

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doing business," such that "[o]verseas firms with no other exposure to our securities laws could be deterred from doing business here." *Id.*

[26] *Id.* at 773.

[27] Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.).

[28] *Stoneridge*, 128 S. Ct. at 773.

[29] His dissent was joined by Justices Souter and Ginsburg.

[30] *Stoneridge*, 128 S. Ct. at 775 (Stevens, J., dissenting).

[31] *Id.* By contrast, the defendant in *Central Bank* had engaged in innocent activity — Central Bank's delay in conducting the outside land appraisal — that resulted in aid to a primary violator.

[32] *See id.* at 776 (citing Lentell v. Merrill Lynch & Co., 396 F.3d 161, 172 (2d Cir. 2005)).

[33] *Id.* at 776–77.

[34] *Id.* at 779 (citing Brief *Amici Curiae* of Former SEC Commissioners in Support of Petitioner at 9, *Stoneridge*, 128 S. Ct. 761 (No. 06-43), 2007 WL 2065260).

[35] *Id.* at 779–81 & n.12.

The Court's decision was hailed as "quite a victory" for American shareholders because it rejected scheme liability,[36] which could have extended the reach of American securities laws to all entities engaged in transactions with companies subject to American laws, even entities conducting deals overseas, thereby hindering business and discouraging international transactions.[37] The majority seemed sensitive to this economic reality, invoking the consequences of scheme liability in rejecting it.[38] The Court's means of limiting 10b-5 suits, however — its holding that certain deceptive conduct is simply "too remote" for plaintiffs to have relied on it — is a vague test that produces uncertainty about liability in future cases.[39] This focus on the case-by-case reliance of plaintiffs, as opposed to the category of non-actionable "aiding and abetting" conduct, is problematic for two reasons. First, it is inconsistent with the categorical approach of *Central Bank* and other 10b-5 cases. Second, the holding that all conduct can be "deceptive" under § 10b, and the necessary implication that plaintiffs need only satisfy a fact-based pleading standard to allege that such deception occurred, could allow more litigation to proceed past the pleading stage than would be allowed under the Eighth Circuit's and *Central Bank*'s narrower definition of "deceptive" conduct. The Court's emphasis on reliance could therefore defeat its evident goal of interpreting § 10(b) to limit meritless litigation and the coercion of settlements.

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[36] Paul S. Atkins, Comm'r of the Sec. & Exch. Comm'n, Speech to the Federalist Society Lawyers' Chapter of Dallas, Texas (Jan. 18, 2008), *available at* http://www.sec.gov/news/speech/2008/spch011808psa.htm.

[37] *See The* Stoneridge *Showdown*, ECONOMIST, Jun. 16, 2007, at 84.

[38] *See generally* Peter Page, *This Case Turned on Law, but Also on Policy*, NAT'L L.J., Apr. 7, 2008, at S5 (noting that the Court's decision may have turned as much on the practical economic consequences that scheme liability would have for the competitiveness of U.S. capital markets as on the law, and comparing the amicus briefs making such arguments to the famous "Brandeis brief" filed in *Muller v. Oregon*, 208 U.S. 412 (1908)). The majority referred particularly to an amicus brief filed by NASDAQ and the New York Stock Exchange. *See Stoneridge*, 128 S. Ct. at 772. The brief in turn drew on several recent reports detailing American capital markets' increasingly tenuous hold on international competitiveness. *See* Nasdaq Brief, *supra* note 25, at 6–15; MICHAEL R. BLOOMBERG & CHARLES E. SCHUMER, SUSTAINING NEW YORK'S AND THE US' GLOBAL FINANCIAL SERVICES LEADERSHIP (2006), *available at* http://www.senate.gov/~schumer/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf; COMM. ON CAPITAL MKTS. REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION (2006), *available at* http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf. The reports note that the decline in American competitiveness was due at least in part to the liberal availability of private recovery under America's financial regulations. *See, e.g.*, BLOOMBERG & SCHUMER, *supra*, at 73–78.

[39] *Cf.* Brief for Richard I. Beattie et al. as Amici Curiae Supporting Respondents at 28–30, *Stoneridge*, 128 S. Ct. 761 (No. 06-43), [hereinafter Beattie Brief], 2007 WL 2363253 (arguing that failure to draw a clear line creates considerable difficulty for attorneys representing clients who support issuers of securities).

The Court was of course correct in the abstract to hold that "[c]onduct itself can be deceptive" under § 10(b) and 10b-5.[40] But the Eighth Circuit was equally correct to limit actionable "deceptive" conduct, as *Central Bank* did, to deceptive conduct that is communicative enough to reach the market.[41] This is consistent with *Central Bank*'s holding that § 10(b) only prohibits "the making of a material misstatement (or omission) or the commission of a manipulative act,"[42] and with the traditional understanding of what § 10(b) prohibited.[43] This categorical approach to liability was also how the Supreme Court had dealt with secondary liability claims in other 10b-5 cases,[44] and how lower courts had dealt with claims against secondary actors post-*Central Bank*. They employed various tests to distinguish between the *categories* of primary violations and aiding and abetting.[45]

For defendants, one advantage of this categorical approach was that the question of whether the plaintiff had alleged a primary violation or mere aiding and abetting was treated as a question of law, and therefore courts could resolve litigation at the motion to dismiss stage.[46] Whether a plaintiff relied on a particular actor's conduct and whether such reliance was reasonable, however, are factual questions; if disputed, the case proceeds.[47] It is therefore possible that *Ston-*

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[40] *Stoneridge*, 128 S. Ct. at 769.

[41] *See In re* Charter Commc'ns, Inc., Sec. Litig., 443 F.3d 987, 992 (8th Cir. 2006).

[42] Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 177 (1994).

[43] *See, e.g.*, Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 CAL. L. REV. 80, 102–03 (1981) ("[D]efendants can be held liable, if at all, only if they . . . make a material misrepresentation or wrongfully fail to disclose despite a fiduciary duty to do so . . . or engage in a manipulative practice designed to mislead investors by artificially affecting market activity.").

[44] *See generally* Beattie Brief, *supra* note 39, at 3–10.

[45] For instance, the Second Circuit employed a "bright line" test for determining the boundary between primary and aiding and abetting prior to *Stoneridge* that looked to whether the secondary actor made the statements and the statements were attributed to them. *See, e.g.*, Wright v. Ernst & Young LLP, 152 F.3d 169, 175 (2d Cir. 1998). For a description of the positions taken by the lower courts on the definition of the line between aiding and abetting and primary violations, see Celia R. Taylor, *Breaking the Bank: Reconsidering* Central Bank of Denver *after Enron and Sarbanes-Oxley*, 71 MO. L. REV. 367, 373–78 (2006).

[46] *See, e.g.*, *Wright*, 152 F.3d at 177–78. Such cases could still be vulnerable to summary judgment motions, at which the plaintiff must provide sufficient actual evidence of reliance. *See* Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986). Summary judgment motions would only take place, however, after extensive discovery, the costs of which will have caused most defendants to settle after the case passes the dismissal stage. *See* Marilyn F. Johnson, et. al, In re Silicon Graphics Inc.*: Shareholder Wealth Effects Resulting from the Interpretation of the Private Securities Litigation Reform Acts Pleading Statement*, 73 S. CAL. L. REV. 773, 782–84 (2000).

[47] *See, e.g.*, Brown v. Earthboard Sports USA, Inc., 481 F.3d 901, 921 (6th Cir. 2007); *cf. In re* Enron Corp. Sec., Derivative & "ERISA Litig.", 258 F. Supp. 2d 576, 639 (S.D. Tex. 2003) (noting that the question of whether Enron's outside directors reasonably relied on Enron's auditor's determination that the company's financial statements were valid was a fact-intensive inquiry not appropriately resolved on a motion to dismiss).

eridge's reliance holding will expand the number of cases that clear the motion to dismiss procedural hurdle, particularly because the Court did not resolve the reliance question along clear lines. The Court held that the Charter-vendor transactions were simply too remote to be relied upon by shareholders,[48] without providing guidance for lower courts on how close information must be to the market before investors can plausibly claim to rely on it. Because *Stoneridge* failed to explain what facts suffice, 10b-5 complaints post-*Stoneridge* will likely survive motions to dismiss simply by alleging reliance on the secondary actor's conduct, with lower courts unable to reject such facts as insufficient as a matter of law.[49] While such allegations regarding third party transactions not communicated to the market might be difficult to make, plaintiffs can make plausible reliance allegations against certain types of secondary actors, including auditors, accountants, and lawyers, who participate in the framing or approval of a company's statements to the market.[50]

So far, these possibilities are only theoretical. Instead of adding reliance allegations to 10b-5 complaints in response to *Stoneridge*, plaintiffs appear to be arguing, mostly without success, that their claims satisfy one of the two situations in which the Court has recognized a presumption of reliance, obviating the need to prove it specifically. The first is the fraud-on-the-market situation;[51] the second is the Court's presumption that plaintiffs rely on statements made by actors with duties to disclose, such that when those actors make a material omission a plaintiff is presumed to have relied on the actor's silence.[52]

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[48] *See Stoneridge*, 128 S. Ct. at 769.

[49] The PSLRA requires "particularity" in pleading of 10b-5 claims based on misleading statements or omissions. *See* 15 U.S.C. § 78u-4(b)(1) (2006). However, this heightened pleading standard appears to apply only to cases involving defendants alleged to have actually made a misstatement or omission. *See id.* Moreover, in order to survive a motion to dismiss, only the facts supporting the scienter element of a 10b-5 claim, not reliance, need be pleaded to satisfy a "strong inference" standard. *See id.* § 78u-4(b)(2); Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2504 (2007). Theoretically, therefore, a plaintiff could avoid § 78u-4(b)(1)'s pleading requirement by alleging that he relied on the defendant's deceptive conduct, but *not* his statements, thus taking the claim out of the "misstatement or omission" category covered by the statute. Applying this logic to the *Stoneridge* facts, a plaintiff could have alleged that he relied on the existence of the transaction between Charter and the vendors, rather than Charter's statements, in making his investment decision; the claim then would be based not on any misstatement or omission by the vendors but on their conduct, and therefore would not seem to be covered by § 78u-4(b)(1)'s pleading standard.

[50] *Cf.* Transcript of Oral Argument at 36–38, *Stoneridge*, 128 S. Ct. 761 (No. 06-43), *available at* http://www.supremecourtus.gov/oral_arguments/argument_transcripts/06-43.pdf (questioning from Justices Kennedy and Souter during which vendors' counsel agreed that Arthur Andersen, Charter's outside auditor, could be held liable under 10b-5 while the vendors were innocent, because Andersen communicated directly to investors who could have relied on its statements).

[51] *See supra* note 23.

[52] *See* Affiliated Ute Citizens of the State of Utah v. United States, 406 U.S. 128, 153–54 (1972).

Plaintiffs have begun repackaging their scheme liability claims into arguments that they are entitled to these presumptions of reliance, based on the alleged duties of secondary actors to disclose negative information about companies to the entire market instead of to individual investors.[53] These claims so far have met with little success, with courts generally reading *Stoneridge* broadly to prohibit a presumption of reliance when the secondary actor's conduct was not directly communicated to the market and when the secondary actor lacked a duty to disclose to particular shareholders.[54]

The possibility of more litigation proceeding past the pleading stage remains, however, and is made at least theoretically more likely due to *Stoneridge*'s focus on the fact-specific reliance requirement. This threatens to undo the Court's effort to limit abusive securities class actions and coerced settlements. As the Court recognized as far back as the *Blue Chip Stamps*[55] case in 1975, the costs of discovery in private securities litigation result in greater "possible abuse." The Court noted:

> [T]o the extent that [discovery] permits a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the process will reveal relevant evidence, it is a social cost rather than a benefit.[56]

The Court has recognized this social cost of discovery in business litigation in its recent business cases,[57] and raising the pleading requirements to cut "meritless" litigation off at an early stage was also the primary purpose of the passage of the PSLRA.[58] While the *Stoneridge* majority may have been correct that the adoption of scheme liability would have resulted in "rais[ing] the cost of being a publicly

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[53] *See, e.g.*, Lead Plaintiffs' Second Supplemental Opposition to Pending Motions for Summary Judgment at 10, *In re* Enron Corp. Sec. Litig., No. H-01-3624 (S.D. Tex. June 9, 2008) (arguing the "revised theory of reliance" in light of *Stoneridge* that the financial institutions with whom Enron Corp. had engaged in structured finance transactions had a duty to the market to disclose Enron's accounting irregularities).

[54] *See, e.g.*, *In re* Parmalat Sec. Litig., No. 04 MD 1653(LAK), 2008 WL 3275643, at *1–3 (S.D.N.Y. Aug. 7, 2008); *In re* DVI, Inc. Sec. Litig., 249 F.R.D. 196, 216–18 (E.D. Pa. 2008) (refusing to certify class against company's law firm, on the grounds that the market did not know of the firm's activity).

[55] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

[56] *Id.* at 741.

[57] *See, e.g.*, Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2510 (2007) (upholding heightened requirements for pleading of scienter in 10b-5 cases); *cf. also* Bell Atl. Corp. v. Twombly, 127 S. Ct. 1955, 1965 (2007) (requiring a heightened pleading standard of "plausible grounds to infer an [illegal] agreement" in cases brought under § 1 of the Sherman Antitrust Act).

[58] *See* Geraldine Szott Moohr, *An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime*, 55 FLA. L. REV. 937, 970–71 (2003).

traded company under our law,"[59] it failed to see how its solution could raise those same concerns.

The *Stoneridge* Court had an easy alternative to the reliance holding that would have avoided emphasizing a fact-bound standard in the § 10(b) liability question. The Court could simply have applied its holding in *Central Bank* (and the Eighth Circuit's in *Charter*) that conduct cannot be "deceptive" unless it involves market manipulation, a material misstatement, or omission by an actor with a duty to disclose; any other conduct, the Court could have held, is only aiding and abetting and cannot be actionable in a private suit. Not only would this solution have produced far less confusion by avoiding the evident conflict between *Stoneridge*'s definition of "deceptive" conduct and that of *Central Bank*, but also it would have been fairly straightforward for the Court to find that the transaction in *Stoneridge* was clearly of the type that courts had found in earlier cases to be only aiding and abetting. For example, the vendors in *Stoneridge* and the bond indenture trustee in *Central Bank* each participated in a business transaction with the primary violator — Charter in *Stoneridge*, the land developer in *Central Bank* — and each had knowledge that the counter-party to the transaction would use its actions — the sham transactions in *Stoneridge* and the failure to re-appraise the land value in *Central Bank* — to defraud its investors.[60] Moreover, neither made any statement to the market regarding the transactions, nor did either have a duty to disclose to the counter-party's shareholders. Thus, as it did in *Central Bank*, the Court could have held in *Stoneridge* that the secondary actor's conduct amounted to nothing more than "substantial assistance" to the primary violator, not a primary violation itself.[61]

While Congress hoped to curb abuses of private securities litigation by passing the PSLRA, *Stoneridge* confirms that the Court retains the greater power to limit or expand the amount of litigation under the securities laws. *Stoneridge* may have clarified certain questions, but it opened up significant possibilities for expanded liability for secondary actors. Ultimately, the Court's solution for limiting the contours of § 10(b) likely fails on its own terms to cut off potentially meritless litigation before it can impose significant costs on defendants.

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[59] *Stoneridge*, 128 S. Ct. at 772.

[60] In the *Central Bank* litigation, Central Bank of Denver was alleged to have been "aware of serious concerns about . . . the accuracy of the . . . appraisal," First Interstate Bank of Denver N.A. v. Pring, 969 F.2d 891, 894 (10th Cir. 1992), and to have deferred its own independent appraisal in response to meetings with the land developer, *id.* at 895 & n.7.

[61] *See* Grundfest, *supra* note 3, at 8–9 (comparing the facts of *Central Bank* and *Stoneridge* and arguing that, were the Court to approve of scheme liability in *Stoneridge*, it would be inconsistent with the result in *Central Bank*).