
WAKE FOREST JOURNAL OF BUSINESS
AND INTELLECTUAL PROPERTY LAW

VOLUME 16

FALL 2015

NUMBER 1

SPEAK NO EVIL

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I. INTRODUCTION

A group of people may tacitly agree to outwardly ignore something they all know to be wrong. Child abuse by fellow clergy is one example.¹ This Essay asks whether such silent witnessing is legally wrong in a business context. More specifically, may a corporate officer be prosecuted for failing to blow the whistle on a colleague's securities fraud, when the officer had no direct involvement with the fraud committed by his colleague, and is merely a silent, knowing witness?

The answer turns on the distinction between primary and secondary liability. Someone who helps another person commit a crime is an accomplice and is secondarily liable for the crime.² A common example is a getaway driver for a bank robber. The robber would face primary liability. Secondary liability does not arise unless the other person actually committed a crime.³ If, for example, the robber lacked the necessary *mens rea*, neither he nor his accomplice would face liability.⁴ In our hypothetical, the speaker of the falsehood may have violated SEC Rule 10b-5⁵ if he knew he was uttering a falsehood. He may have also committed a crime, since it is unlawful to willfully violate Rule 10b-5.⁶ On the other hand, if the speaker lacked the *scienter* necessary to violate Rule 10b-5, then he would not be liable as a primary wrongdoer, and there could be no accomplice either.⁷

There is good reason to believe that our hypothetical silent executive will not face primary liability. “[T]here is no general duty in tort law, a variant of a ‘good Samaritan’ duty, to report someone else’s fraud or other misconduct to the victim of it.”⁸ The concept of mandatory whistleblowing has been, as well, “almost universally opposed,” and compared to the tactics of a police state.⁹ The absence of primary liability is in accord with basic common law: silence is not fraudulent, absent a duty to speak.¹⁰ The Third Circuit held in *United States v.*

¹ Cf. EVIATAR ZERUBAVEL, *THE ELEPHANT IN THE ROOM: SILENCE AND DENIAL IN EVERYDAY LIFE* 2–3 (2006) (giving other examples).

² 1 CHARLES E. TORCIA, *WHARTON’S CRIMINAL LAW* § 18 (15th ed. 2015).

³ 2 WAYNE R. LAFAYE, *SUBSTANTIVE CRIMINAL LAW* § 13.3 (2d ed. 2014).

⁴ *See id.*

⁵ 17 C.F.R. § 240.10b-5 (2015).

⁶ 15 U.S.C. § 78ff(a) (2012).

⁷ *See id.*

⁸ *E. Trading Co. v. Refco, Inc.*, 229 F.3d 617, 624 (7th Cir. 2000).

⁹ Elizabeth C. Tippet, *The Promise of Compelled Whistleblowing: What the Corporate Governance Provisions of Sarbanes Oxley Mean for Employment Law*, 11 *EMP. RTS. & EMP. POL’Y J.* 1, 2–3 (2007).

¹⁰ 14 WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS* § 6861 (perm. ed., rev. vol. 2015).

*Schiff*¹¹ that the failure of a Chief Financial Officer (“CFO”) to speak up about his colleague’s fraud was not a primary violation of Securities and Exchange Commission Rule 10b-5.¹² One year later, the Supreme Court in *Janus Capital Group v. First Derivative Traders*¹³ held that only the maker of a false statement can be held liable in a private action under Rule 10b-5(b).¹⁴

Yet, there are circumstances in which a silent witness who owes no duty to speak might nonetheless be liable as an accomplice. The U.S. Securities and Exchange Commission (“SEC”) may bring an enforcement action against the silent officer for aiding and abetting his colleague’s fraud if the colleague’s misstatement violated Rule 10b-5, and if the silent officer chose to remain silent in expectation of benefit.¹⁵ It is possible that the Department of Justice may bring a criminal action against a silent accomplice.¹⁶

The law, then, seems to be this: The officer’s silence is not primarily unlawful because he was under no duty to speak, but he can be secondarily liable as an accomplice because he failed to speak. The silent executive will face punishment as an accomplice only if his colleague is a primary violator of Rule 10b-5,¹⁷ i.e., lied intentionally.

This is not a desirable result. Even if the silent officer intentionally chose to remain silent in the expectation of some personal benefit (such as compensation tied to the firm’s stock price), he will face no liability as an accomplice unless the speaker also intended to deceive. The silent officer may not know enough to form a judgment about his colleague’s state of mind, but if he knows that the statement was incorrect, material and made to the public, he should not escape responsibility for the harm foreseeably caused by his intentional indifference should it fortuitously happen that the speaker did not mean to deceive. Emerging corporation law supports this view.¹⁸ There is a growing recognition that a corporate officer owes the corporation a duty to notify the proper authorities within the corporation of a probable violation of law committed by a colleague.¹⁹ The duty is triggered by a “probable

¹¹ *United States v. Schiff*, 602 F.3d 152 (3d Cir. 2010).

¹² *See id.* at 177.

¹³ *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011).

¹⁴ *Id.* at 2301–02.

¹⁵ *Woodward v. Metro Bank of Dall.*, 522 F.2d 84, 97 (5th Cir. 1975).

¹⁶ David A. Dodds, Kit Addleman & Christopher Quinlan, *Haynes & Boone Discusses Criminal Enforcement of Rule 10b-5 Violations*, THE CLS BLUE SKY BLOG (May 28, 2014), <http://clsbluesky.law.columbia.edu/2014/05/28/haynes-boone-discusses-criminal-enforcement-of-rule-10b-5-violations/>.

¹⁷ *SEC v. Apuzzo*, 689 F.3d 204, 206 (2d Cir. 2012).

¹⁸ *See* MODEL BUS. CORP. ACT § 8.42(b) (2008).

¹⁹ *See id.*

violation,” not a violation in fact, because it would be unreasonable to expect the witnessing officer to be able to make any finer judgment.²⁰

The thesis of this Essay is that the distinction between primary and secondary liability seems inconsistent and bad policy, and is worth a closer look. Part II briefly discusses the primary liability of the silent officer. Part III discusses silence and inaction as a basis for criminal accomplice liability, and part IV discusses silence and inaction in the context of civil accomplice liability under the Exchange Act. Part V concludes by suggesting that the simplest way of resolving the tension in the law is to recognize that the silent officer owes a duty to speak in the circumstances posited.

A complete accounting of the topic should note that there are other bases for liability. One might argue that there is a conspiracy of silence between the primary offender and the silent witness.²¹ A control person theory of liability might also be applicable in an SEC enforcement action, but will not be explored in this Essay for reasons developed below.²² The focus of this Essay is accomplice liability because the theory is well developed by the courts of appeal.²³ Violations of Rule 10b-5 can be prosecuted criminally,²⁴ or civilly by the SEC and private parties.²⁵ Private party litigation is not within the scope of this article, however, because private parties cannot sue aiders and abettors of violations of Rule 10b-5.²⁶

²⁰ *See id.* cmt.

²¹ “Where the goal of a conspiracy can be reached only through deception and concealment, silence which is designed to conceal may indicate an intention to conspire . . . to be an act in furtherance of a conspiracy, silence must be a planned act and . . . if intended to facilitate the conspiracy, it can be an overt act in pursuance thereof.” *United States v. Eucker*, 532 F.2d 249, 254 (2d Cir. 1976) (internal citations and quotations omitted). *See also* *SEC v. Papa*, 555 F.3d 31, 38 (1st Cir. 2009) (considering aiding and abetting may be inferred from silence, where the silent party intended to further a violation).

²² *See infra* Part IV.E.

²³ In a seminal 1972 law review article, David Ruder noted that because conspiracy theory may be difficult to apply, “the securities law cases that have contained substantial analysis have tended to use aider and abettor language.” David S. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. PA. L. REV. 597, 641 (1972).

²⁴ *See, e.g.*, *United States v. O’Hagan*, 521 U.S. 642, 649 (1999).

²⁵ *See Ruder, supra* note 23, at 598 n.1.

²⁶ *See* *Ruder, Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 191 (1994).

II. NO PRIMARY LIABILITY

During a quarterly conference call with stock analysts, a corporation's CFO remained silent although he knew that another senior officer on the call had just made a material misrepresentation concerning the corporation's financial statements. When asked by an analyst whether there were any "inventory issues," the senior officer responded "no." However, both the senior officer and the CFO knew that the corporation has engaged in a "channel stuffing" scheme.²⁷ The government alleged that the silence constituted a primary criminal violation of Rule 10b-5. The Third Circuit in *Schiff* held that precedent did not allow a duty to correct another's misstatement and, as a matter of policy, such a duty was vague, open-ended, and therefore unsuitable for criminal enforcement.²⁸

The Sixth Circuit likewise held in *SEC v. Coffey*²⁹ that a corporation's chairman was not responsible for misstatements made by a subordinate.³⁰ In *Janus Capital Group*,³¹ the Supreme Court held that only the maker of the statement can be held liable in a private action under Rule 10b-5(b) for material misstatements.³² A failure to correct the misstatement of another "would be in tension" with this decision.³³ The law seems clear that a corporate officer does not become a primary violator of Rule 10b-5 by failing to correct a known misstatement made by a colleague.

III. SILENCE AND INACTION LEADING TO CRIMINAL ACCOMPLICE LIABILITY

"The federal aiding and abetting statute, 18 U.S.C. § 2, . . . reflects a centuries-old view of culpability: that a person may be responsible for a crime he has not personally carried out if he helps another to complete its commission."³⁴ "As at common law, a person is liable under § 2 for

²⁷ Craig Ehrlich, *When Minding Your Own Business Means Speaking Up: Criminally Punishing a Corporate Executive for Failing to Blow the Whistle on the Illegal Misconduct of a Colleague*, 32 J.L. & COM. 255, 255 (2014).

²⁸ *United States v. Schiff*, 602 F.3d 152, 165 (3d Cir. 2010).

²⁹ *SEC v. Coffey*, 493 F.2d 1304 (6th Cir. 1974).

³⁰ *Id.* at 1315.

³¹ *Janus Capital Grp. v. First Derivative Traders*, 131 S. Ct. 2296 (2011).

³² *Id.* at 2298.

³³ *Ho v. Duoyuan Global Water*, 887 F. Supp. 2d 547, 572 n.13 (S.D.N.Y. 2012). *But see Prousalis v. Moore*, 751 F.3d 272 (4th Cir. 2014) (holding *Janus* does not apply to criminal prosecutions).

³⁴ *Rosemond v. United States*, 134 S. Ct. 1240, 1245 (2014). The statute reads:

(a) Whoever commits an offense against the United States or aids, abets,
continued . . .

aiding and abetting a crime if (and only if) he (1) takes an affirmative act in furtherance of that offense, (2) with the intent of facilitating the offense's commission."³⁵ "In proscribing aiding and abetting, Congress used language that comprehends all assistance rendered by words, acts, encouragement, support, or presence."³⁶ While the exact elements of aiding and abetting have been variously described,³⁷ the criminal aider and abettor must "in some sort associate himself with the venture, . . . participate in it as in something that he wishes to bring about, . . . [and]

counsels, commands, induces or procures its commission, is punishable as a principal.

(b) Whoever willfully causes an act to be done which if directly performed by him or another would be an offense against the United States, is punishable as a principal.

18 U.S.C. § 2 (2012).

³⁵ *Rosemond*, 134 S. Ct. at 1245.

³⁶ *Id.* at 1246 (internal quotations omitted).

³⁷ Two elements: "[A] person is liable under § 2 for aiding and abetting a crime if (and only if) he (1) takes an affirmative act in furtherance of that offense, (2) with the intent of facilitating the offense's commission." *Id.* at 1245.

Three elements: "Aiding and abetting requires proof that: (1) the substantive offense was actually committed; (2) the defendant assisted in the commission of that crime or caused it to be committed; and (3) the defendant intended to assist in the commission of that crime or to caused it be committed." *United States v. Davis*, 717 F.3d 28, 33 (1st Cir. 2013).

A different three elements: "The government must prove that the defendant associated with the criminal venture, purposefully participated in the criminal activity, and sought by his actions to make the venture successful." U.S. DEP'T OF JUSTICE, U.S. ATT'Y MANUAL: CRIMINAL RESOURCE MANUAL § 2474 (1998), available at <http://www.justice.gov/usam/criminal-resource-manual-2474-elements-aiding-and-abetting> (last visited Oct. 6, 2015).

Four elements: (1) Someone committed the underlying offense; (2) the aider/abettor knew that the underlying offense was going to be committed or was being committed by the alleged principal; (3) the aider/abettor knowingly did some act for the purpose of aiding, assisting, soliciting, facilitating or encouraging the alleged principal in committing the specific offense charged and with the intent that the alleged principal commit that specific offense; and (4) the aider/abettor performed an act in furtherance of the offense charged. *United States v. Nolan*, 718 F.2d 589, 592 (3d Cir. 1983).

A different four elements: "[T]he elements necessary for an aiding and abetting conviction are: (1) that the accused had the specific intent to facilitate the commission of a crime by another, (2) that the accused had the requisite intent of the underlying substantive offense, (3) that the accused assisted or participated in the commission of the underlying substantive offense, and (4) that someone committed the underlying substantive offense." *United States v. Shorty*, 741 F.3d 961, 969–70 (9th Cir. 2013).

seek by his action to make it succeed.”³⁸ The language is that of Judge Learned Hand; it has been called the “classic formula” and the “clearest definition possible.”³⁹

What is the *least* one might do to be guilty of aiding and abetting another’s crime? The necessary *actus reus* is minimal, as long as the accomplice intends by his action to facilitate the crime—a mere word of encouragement might suffice.⁴⁰ “Liability as an aider and abettor is based on the act of intentionally counseling, aiding, or assisting another in the commission of a crime.”⁴¹ “One need not participate in an important aspect of a crime to be liable as an aider and abettor; participation of relatively slight moment is sufficient . . . [e]ven mere words or gestures of encouragement constitute affirmative acts capable of rendering one liable under this theory.”⁴²

Of course, persons have been convicted of aiding and abetting securities fraud.⁴³ Some courts of appeal have written that the *actus reus* must be an overt act designed to aid in the success of the venture.⁴⁴ Under this view, mere silence or inactivity would not be sufficient. For example, in *United States v. Aarons*,⁴⁵ a company borrowed money from a local bank.⁴⁶ The loan proceeds were not paid to the borrower; however, but instead to the two individuals who controlled the borrower, and to other firms that they controlled.⁴⁷ The loan was guaranteed by the Small Business Administration (“SBA”) and the loan settlement sheet, representing how the proceeds were disbursed, was sent to the SBA.⁴⁸ The settlement sheet falsely stated that the proceeds had been disbursed to the borrower.⁴⁹

The false settlement sheet was written by two officers of the local

³⁸ *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938).

³⁹ *See United States v. Irwin*, 149 F.3d 565, 569 (7th Cir. 1998); *IIT, an Int’l Inv. Trust v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980), *abrogated by Morrison v. Nat’l Austl. Bank, Ltd.*, 561 U.S. 247 (2010).

⁴⁰ Baruch Weiss, *What Were They Thinking?: The Mental States of the Aider and Abettor and the Causer Under Federal Law*, 70 *FORDHAM L. REV.* 1341, 1347–48 (2002).

⁴¹ *United States v. Bowen*, 527 F.3d 1065, 1078 n.10 (10th Cir. 2008).

⁴² *United States v. Rufai*, 732 F.3d 1175, 1190 (10th Cir. 2013) (internal citations and quotation marks omitted) (quoting *Bowen*, 527 F.3d at 1077–78).

⁴³ *E.g.*, *United States v. Sneed*, 34 F.3d 1570, 1574 (10th Cir. 1994).

⁴⁴ *E.g.*, *United States v. Beck*, 615 F.2d 441, 449 (7th Cir. 1980) (quoting *United States v. Longoria*, 569 F.2d 422, 425 (5th Cir. 1978)).

⁴⁵ *United States v. Aarons*, 718 F.2d 188 (6th Cir. 1983).

⁴⁶ *Id.* at 189.

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

bank and by one of the individuals who controlled the borrower.⁵⁰ There was another person, Aarons, who also controlled the borrower.⁵¹ “The government contends that Aarons’ repeated failure to disclose to the SBA his knowledge that the Bank had distributed a substantial portion of the proceeds of the loan in a manner contrary to that specified in the loan application documents renders him culpable.”⁵² The court of appeals disagreed.⁵³ “In the absence of overt acts by Aarons relating to the making of the false representations by [the others] to the SBA, his mere failure to ‘speak up’ to the SBA is insufficient to punish him” as an aider and abettor of the false statement.⁵⁴ Because Aarons received a portion of the misdirected proceeds, “[a] different result would come dangerously close to trenching upon a person’s right against self-incrimination under the Fifth Amendment.”⁵⁵

The court’s observation is correct. A participant in the scheme cannot be punished for remaining silent about his own crime.⁵⁶ In *United States v Jennings*,⁵⁷ Chicago police officers were accused of taking bribes from narcotics dealers.⁵⁸ One count of the indictment charged misprision of a felony in violation of 18 U.S.C. § 4, for which they were convicted.⁵⁹ The appeals court reversed.⁶⁰ Disclosing information as to their knowledge of the underlying felony would place them in the position of furnishing the government with evidence that could lead to their prosecution or conviction in violation of the Fifth Amendment.⁶¹ The silent witness hypothesized in the opening paragraph of this Essay was not a participant in the scheme, however, and this objection is not applicable.

The line between an overt act and inaction is not clear, however. It

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.* at 190.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.* See also *United States v. Rank*, Nos. 84-1257/1870, 85-1249, 1986 WL 18059, at *4 (6th Cir. Oct. 14, 1986) (“This evidence establishes at most, however, that Brown knowingly acquiesced in the fraudulent scheme being perpetrated at the Clinic, not that he participated in the fraud or caused the fraudulent mailings, and is insufficient to sustain Brown’s convictions We decline to adopt the government’s theory, akin to a *respondeat superior* basis for criminal liability, that if Brown knew of the criminal activity, was in a position to stop it, and failed to do so, he was thereby guilty of aiding and abetting, or causing, the fraudulent conduct.”).

⁵⁶ See, e.g., *Aarons*, 718 F.2d 188; *United States v. Jennings*, 603 F.2d 650 (7th Cir. 1979).

⁵⁷ *Jennings*, 603 F.2d 650.

⁵⁸ *Id.* at 650.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.* at 652.

vanishes in a simple example. Imagine two cases involving identical acts but different mental states. In both cases, a person is present at the scene of a crime committed by others. In one case, the person is a thug standing near an extortion that is happening. He is liable as an aider and abettor. In the other case, the person happens to be in the wrong place at the wrong time, has not associated himself with the crime, and has no wish to see it succeed.⁶² Thus, while it is not a crime for a witness to an assault not to call the police,⁶³ the “250 lb. bruiser” who says and does nothing but is present at the scene to provide moral support to the attacker has aided and abetted.⁶⁴ Sometimes, the difference between doing something and doing nothing appears to be nothing more than a matter of phrasing. A decision to abstain from acting was held to constitute “affirmative action” by the Tenth Circuit in a civil case.⁶⁵

There are other examples of silence and inaction that rise to the level of criminal aiding and abetting. In one, a blackjack player who sat in knowing silence, and did not protest when the dealer cheated, aided and abetted the dealer’s fraud.⁶⁶

In a second case, a mob entered a jail, taking and lynching a prisoner.⁶⁷ The only person in charge when the mob arrived was the Deputy Sheriff, Gibson.⁶⁸ While the mob was in possession of the jail, the sheriff arrived, but neither one made any effort to prevent the mob from taking the prisoner from jail.⁶⁹ A criminal contempt action was brought against the sheriff and his deputy, among others.⁷⁰ The Attorney General’s petition to the Supreme Court for a rule to show cause alleged that the defendants “did aid and abet said mob.”⁷¹ The rule to show cause was made absolute as to the sheriff and his deputy.⁷²

In a third case, corrupt labor union officers who, by affirmative

⁶² U.S. DEP’T OF JUSTICE, U.S. ATTY’S MANUAL: CRIMINAL RESOURCE MANUAL § 2478 (rev. ed. 1998), available at <http://www.justice.gov/usam/criminal-resource-manual-2478-what-not-aiding-and-abetting>.

⁶³ See *Jennings*, 603 F.2d at 652.

⁶⁴ *United States v. Ortiz*, 966 F.2d 707, 712 (1st Cir. 1992) (quoting *United States v. Martinez*, 479 F.2d 824, 829 (1st Cir. 1973)). See also *Sanford v. Yukins*, 288 F.3d 855, 862 (6th Cir. 2002).

⁶⁵ See *First Interstate Bank of Denver v. Pring*, 969 F.2d 891, 902 (10th Cir. 1992), *rev’d on other grounds sub nom. Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994) (no private cause of action for aiding and abetting a Rule 10b-5 violation).

⁶⁶ See *Dumas v. State*, 806 So. 2d 1009, 1013 (Miss. 2000).

⁶⁷ See *United States v. Shipp*, 214 U.S. 386, 413 (1909).

⁶⁸ *Id.*

⁶⁹ *Id.* at 420–21.

⁷⁰ *Id.* at 403–05.

⁷¹ *Id.* at 405.

⁷² *Id.* at 425.

misconduct and by their “deliberate refusal to exercise their supervisory powers,”⁷³ allowed organized crime to infiltrate the union, were held to have aided and abetted racketeering acts by failing to redress those acts at the time they were being committed in breach of their fiduciary duty to the union.⁷⁴ The second and third cases have in common a defendant who abdicated a duty to act. This is the key point, as explained by the Second Circuit in a 2010 case.⁷⁵ A woman kept her domestic servants in peonage and required them to perform forced labor.⁷⁶ The husband was also convicted; his contention on appeal was that the district court’s instructions on aiding and abetting permitted the jury to convict him for failing to act.⁷⁷ The court of appeals did not decide whether the husband could be convicted based upon an omission to act, because the instructions did not in fact convey that impression to the jury.⁷⁸ In discussing the husband’s contention, the court analyzed both the *mens rea* and *actus reus* requirements of aiding and abetting.⁷⁹ The district court instructed the jury that the husband must have acted willfully.⁸⁰ “Participation in a crime is willful if action is taken voluntarily and intentionally or in the case of a failure to act with the specific intent to fail to do something the law requires to be done.”⁸¹

The jury was also instructed that to aid and abet, it is necessary that the defendant act, participate and associate himself with the crime, and that mere presence at a crime scene, or mere acquiescence in the criminal conduct of others is not sufficient.⁸² The trial judge’s repeated emphasis of the necessity of acting was enough to clarify any confusion that might have arisen from the willfulness instruction.⁸³ The court of appeals observed that the challenged portion of the instruction—which explained that participation in a crime is “willful” not only when “action is taken voluntarily and intentionally” but also “in the case of a failure to act, with specific intent to fail to do something the law requires”—“was not inaccurate,” but only “extraneous to this case.”⁸⁴

The court then offered the following observations about aiding and

⁷³ United States v. Dist. Council of N.Y.C., 778 F. Supp. 738, 744 (S.D.N.Y. 1991).

⁷⁴ *Id.* at 744–49.

⁷⁵ See United States v. Sabhnani, 599 F.3d 215, 237 (2d Cir. 2010).

⁷⁶ *Id.* at 225.

⁷⁷ *Id.* at 224.

⁷⁸ *Id.* at 238–39.

⁷⁹ *Id.* at 239–40.

⁸⁰ *Id.* at 236.

⁸¹ *Id.* at 236 n.11. This is a standard instruction. See, e.g., United States v. Barber, 495 F.2d 327, 329 (9th Cir. 1974).

⁸² *Sabhnani*, 599 F.3d at 240.

⁸³ *Id.* at 239.

⁸⁴ *Id.* at 238.

abetting by inaction. “This general principle, that omissions may serve as the basis of criminal liability only if there is an affirmative duty to act, is equally applicable when the crime charged is aiding and abetting.”⁸⁵ Such a duty can arise from a statute, the common law or contract.⁸⁶

The possibility of aiding and abetting by silence or inaction is also recognized in the Third Circuit’s Model Jury Instructions.⁸⁷ “A defendant may also be responsible as an accomplice (aider and abetter) based on his or her failure to act despite having a legal duty to act.”⁸⁸ The Instructions also discuss the circumstances in which there might be a legal duty to act.

Ordinarily, criminal liability is based on an omission when the statute defining the crime explicitly makes an omission or failure to act criminal. However, a legal duty to act may also be imposed by contract or tort law, and also because of a relationship between the defendant and another person that makes the defendant responsible for the safety and well-being of another person, or where a defendant voluntarily undertakes to provide assistance to another person, or when a defendant’s actions put another person in danger.⁸⁹

In sum, even if we set aside the 250-pound bruiser type of case, there is still authority for the proposition that silence and inaction can make one a criminal accomplice.⁹⁰ Only one of the cases involved a defendant who resembles a corporate officer, but the union officials in *United States v. District Council* had also committed positive acts of misconduct.⁹¹ Though examples are few, the general principle that

⁸⁵ *Id.* at 237.

⁸⁶ *Id.* at 237 n.12.

⁸⁷ COMM. ON MODEL CRIMINAL JURY INSTRUCTIONS, THIRD CIRCUIT, MODEL CRIMINAL JURY INSTRUCTIONS § 7.02 (2015), available at <http://www.ca3.uscourts.gov/sites/ca3/files/Chap%207%20July%202014%20Rev.pdf> (last visited Oct. 6, 2015).

⁸⁸ *Id.*

⁸⁹ COMM. ON MODEL CRIMINAL JURY INSTRUCTIONS, THIRD CIRCUIT, MODEL CRIMINAL JURY INSTRUCTIONS § 5.10 (2015), available at <http://www.ca3.uscourts.gov/sites/ca3/files/Chapter%205%20Rev%20April%202015.pdf> (last visited Oct. 6, 2015).

⁹⁰ COMM. ON MODEL CRIMINAL JURY INSTRUCTIONS, THIRD CIRCUIT, MODEL CRIMINAL JURY INSTRUCTIONS § 7.02 (2015), available at <http://www.ca3.uscourts.gov/sites/ca3/files/Chap%207%20July%202014%20Rev.pdf> (last visited Oct. 6, 2015).

⁹¹ See *United States v. Dist. Council of N.Y.C.*, 778 F. Supp. 738, 749 (S.D.N.Y. 1991).

mere silence and inaction can give rise to accomplice liability under 18 U.S.C. § 2 is recognized by the Second and Third Circuits, if the defendant's failure to act was in breach of a duty to act.⁹² The civil aiding and abetting cases examined next suggest when a witness to fraud may have a legal duty to speak.

IV. SILENCE AND INACTION LEADING TO CIVIL ACCOMPLICE LIABILITY UNDER THE EXCHANGE ACT

In contrast to the paucity of criminal accomplice cases based upon silence and inaction, there is a rich body of case law holding that such passivity can constitute civil aiding and abetting under the Securities Exchange Act of 1934 ("Exchange Act").⁹³ Section 20(e) of the Exchange Act is the governing statute.⁹⁴ It states:

For purposes of any action brought by the Commission . . . any person that knowingly or recklessly 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.⁹⁵

Congress enacted §20(e) in 1995 in response to the Supreme Court's decision in *Central Bank of Denver*,⁹⁶ which held that there is no aiding and abetting liability in private actions under § 10(b) of the Exchange Act.⁹⁷ Congress codified the test for aiding and abetting liability that had been uniformly adopted in the courts of appeals.⁹⁸ In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")⁹⁹ revised § 20(e) to permit the Securities and Exchange Commission to bring an aiding and abetting claim against "any person

⁹² See *IIT, an Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 927 (2d Cir. 1980), *abrogated by Morrison v. Nat'l Austl. Bank, Ltd.*, 561 U.S. 247, 259 (2010). See also *Landy v. FDIC*, 486 F.2d 139, 161 (3d Cir. 1973).

⁹³ Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78pp (2012)).

⁹⁴ 15 U.S.C. § 78t(e).

⁹⁵ *Id.*

⁹⁶ *SEC v. Fehn*, 97 F.3d 1276, 1287 (9th Cir. 1996).

⁹⁷ *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 191 (1994).

⁹⁸ *Fehn*, 97 F.3d at 1287–88.

⁹⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended at 15 U.S.C. §§ 78a–78pp (2012)).

that knowingly or recklessly” provides substantial assistance.¹⁰⁰ This amendment changed the requisite state of mind for an aiding and abetting violation from “knowingly” to “knowingly or recklessly.”¹⁰¹ As will be seen, the amendment conformed the language of the statute to the mental state required by existing case law.¹⁰²

A. The Principal Court of Appeals Decisions

The first case to have addressed silence as a basis for aiding and abetting securities fraud is *Brennan v. Midwestern United Life Insurance Co.*¹⁰³ Plaintiffs purchased shares of Midwestern United Life Insurance Co. from Dobich Securities, but they “failed to receive delivery of their stock.”¹⁰⁴ Dobich was misusing his customers’ money, selling them Midwestern stock, which he neither owned nor had funds to purchase.¹⁰⁵ The market for Midwestern stock was thin, so the effect of Dobich’s activity “was to drive up the price of the stock.”¹⁰⁶ That benefitted Midwestern in pending merger negotiations.¹⁰⁷ Midwestern’s president and general counsel knew that Dobich was dealing in a fraudulent manner with his customers’ money, but did not report Dobich to the SEC or state authorities.¹⁰⁸ The Seventh Circuit expressly declined to decide “whether the failure to report Dobich’s activities to the Indiana Securities Commission would in itself give rise to liability under Rule 10b-5.”¹⁰⁹

Midwestern had also sent a letter.¹¹⁰ In answer to complaints from some of Dobich’s customers about the delay in receiving their shares, Midwestern’s letter advised them to first contact Dobich, rather than to contact law enforcement immediately, thereby allowing Dobich to continue to operate.¹¹¹ This was the basis of the court’s holding that “under all the facts and circumstances . . . Midwestern’s actions

¹⁰⁰ 15 U.S.C. § 78t(e).

¹⁰¹ See Dodd-Frank Wall Street Reform and Consumer Protection Act, ch. 404, Pub. L. No. 111-203, 124 Stat. 1376, 1862 (2010) (codified as amended at 15 U.S.C. § 78t(e) (2012)) (noting that “[s]ection 20(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78t(e)) is amended by inserting “or recklessly” after “knowingly”).

¹⁰² See *infra* Part IV.A.

¹⁰³ See *Brennan v. Midwestern United Life Ins. Co.*, 417 F.2d 147, 154 (7th Cir. 1969).

¹⁰⁴ *Id.* at 148.

¹⁰⁵ *Id.* at 151.

¹⁰⁶ *Id.*

¹⁰⁷ See *id.* at 153.

¹⁰⁸ *Id.* at 154.

¹⁰⁹ *Id.* at 155.

¹¹⁰ *Id.*

¹¹¹ *Id.* at 152–53.

amounted to a tacit agreement with Dobich to prevent complaints from reaching the Commission, thus facilitating the fraud”¹¹² and aiding and abetting Dobich’s violations “by both affirmative conduct and silence and inaction.”¹¹³ *Landy v. FDIC*¹¹⁴ did not deal with silence, but was the first appeals court opinion to discuss at length the elements of aiding-and-abetting liability.¹¹⁵ Under *Landy*’s test, which the court drew from the Restatement of Torts, liability for aiding and abetting required a showing of:

- (1) the existence of a securities law violation by the primary party;
- (2) knowledge of this violation on the part of the aider and abettor; and
- (3) substantial assistance by the aider and abettor in the achievement of the primary violation.¹¹⁶

As the Third Circuit in *Landy* explained, the Restatement indicates that the “substantial assistance” prong of aiding and abetting requires that the defendant’s assistance have been a cause of the tort, and that the assistance have been more than minor or incidental.¹¹⁷ The Third Circuit also found the concept of aiding and abetting in criminal law to be “instructive.”¹¹⁸ Judge Learned Hand’s test has the same basic thrust as the Restatement’s “substantial factor in causing the resulting tort” test for aiding and abetting,¹¹⁹ under which a court determines whether the assistance was substantial based on considerations such as the amount of assistance, the defendant’s relation to the primary tortfeasor, and his state of mind.¹²⁰

In *Landy*, a bank president misused bank funds by engaging in

¹¹² *Id.* at 155.

¹¹³ *Id.* at 148.

¹¹⁴ *Landy v. FDIC*, 486 F.2d 139 (3d Cir. 1973).

¹¹⁵ *See id.* at 162–63.

¹¹⁶ *Id.*

¹¹⁷ *Id.* at 163 (quoting Restatement’s considerations relevant to determining whether assistance is “substantial,” including the amount of assistance, the defendant’s presence or absence at the time of the tort, his relation to the primary tortfeasor, and his state of mind).

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *See Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 181 (1994) (“The Restatement of Torts [§ 876(b)], under a concert of action principle, accepts a doctrine with rough similarity to criminal aiding and abetting.”). *See also Metge v. Baehler*, 762 F.2d 621, 625 (8th Cir. 1985) (discussing that where the evidence of substantial assistance is slim, the requirement of knowledge or *scienter* is enhanced).

market speculation, which culminated in the collapse of the bank.¹²¹ Purchasers of the bank's stock, among others, sued the brokers who handled the president's trades.¹²² The brokers, however, owed no duty to the plaintiffs to disclose the scheme.¹²³ Nor, held the court, had the plaintiffs sufficiently alleged a claim for aiding and abetting liability.¹²⁴ The brokers' assistance consisted only of handling ordinary business transactions such as the president's stock purchases and sales.¹²⁵ Further, there was no allegation that the brokers wished to "bring about" the publication of the bank's false financial statements and the consequent fraud upon the stock purchasers.¹²⁶

In *Woodward v. Metro Bank of Dallas*,¹²⁷ the Fifth Circuit modified the elements necessary for establishing liability for damages as an aider and abettor of a violation of § 10(b) or Rule 10b-5:

[A] person may be held as an aider and abettor only if some other party has committed a securities law violation, if the accused party had general awareness that his role was part of an overall activity that is improper, and if the accused aider-abettor knowingly and substantially assisted the violation.¹²⁸

In discussing the "general awareness" element, the court noted that the surrounding circumstances and expectations of the parties were critical.¹²⁹ For instance, stronger evidence of complicity would be required for the alleged aider and abettor that conducts what appears to be a transaction in the ordinary course of his business.¹³⁰

In discussing the "knowing and substantial assistance" requirement, the court focused on the kinds of assistance an aider and abettor might offer to the primary violator.¹³¹ For a defendant whose only role is to remain silent in the face of securities violations, liability might depend upon a duty owed to the other parties to the transaction.¹³² A defendant who is not under any duty to disclose can be found liable as an aider and abettor only if he acts with a high degree of *scienter*, that is, with a

¹²¹ *Landy*, 486 F.2d at 143.

¹²² *Id.*

¹²³ *Id.* at 161.

¹²⁴ *Id.* at 164.

¹²⁵ *Id.* at 163.

¹²⁶ *Id.* at 164.

¹²⁷ *Woodward v. Metro Bank of Dall.*, 522 F.2d 84 (5th Cir. 1975).

¹²⁸ *Id.* at 94–95 (quoting *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974)).

¹²⁹ *Woodward*, 522 F.2d at 95.

¹³⁰ *Id.*

¹³¹ *See id.* at 97–100.

¹³² *Id.* at 97.

“conscious intent” to aid the fraud.¹³³ On the other hand, liability could be imposed upon an aider and abettor who is under a duty to disclose if he acts “with a lesser degree of *scienter*.”¹³⁴ For an aider and abettor who combines silence with affirmative assistance, the degree of knowledge required should depend upon how ordinary the assisting activity is in the involved businesses.¹³⁵ “If the evidence shows no more than [a] transaction[] constituting the daily grist of the mill,” a court would be reluctant “to find 10b-5 liability without clear proof of intent to violate the securities laws.”¹³⁶ “Conversely, if the method or transaction is atypical or lacks business justification, it may be possible to infer the knowledge necessary for aiding and abetting liability.”¹³⁷

In the case before the court, a swindler named Starnes had induced a divorced housewife to co-sign a note to provide his business, called CIC, with working capital.¹³⁸ The money was borrowed from the Metro Bank.¹³⁹ Ms. Woodward alleged that the bankers knew Starnes and CIC to be financially thin, but failed to tell her, thus aiding and abetting Starnes’ fraud.¹⁴⁰ The court found that the bankers lacked the requisite *mens rea*.¹⁴¹ Since the transaction was an ordinary commercial loan, the court required evidence of the bank’s “consciously helping” to entice Ms. Woodward into the transaction to impose liability.¹⁴²

The fourth case is Judge Friendly’s oft-cited opinion in *IIT, an International Investment Trust v. Cornfeld*.¹⁴³ An investment trust claimed that it was fraudulently induced to buy securities related to a group of companies controlled by John M. King, an American oil and gas entrepreneur.¹⁴⁴ The prospectus was alleged to be false.¹⁴⁵ Among those sued as alleged aiders and abettors of the fraud was King’s

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Id.* at 87–88.

¹³⁹ *Id.* at 87.

¹⁴⁰ *Id.* at 89.

¹⁴¹ *Id.* at 98.

¹⁴² *Id.* In *Stokes v. Lokken*, 644 F.2d 779 (8th Cir. 1981), an attorney who wrote an allegedly incorrect legal opinion letter on behalf of his client was not liable as an accomplice. *Id.* at 781. The client was engaged in violations of the securities laws. *Id.* at 781–82. The lawyer’s involvement with the misleading promotional brochure was minimal though, and his work was the usual work of a corporate lawyer. *Id.* at 782. He lacked “the quality of intent required” as there was no indication that he knew his opinion letter was incorrect. *Id.* at 783.

¹⁴³ *IIT, an Int’l Inv. Trust v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980).

¹⁴⁴ *Id.* at 914.

¹⁴⁵ *Id.* at 915.

auditor.¹⁴⁶ Judge Friendly listed what had by then become the usual three elements of adding and abetting liability—the existence of a primary violation, knowledge of this violation by the aider and abettor, and the substantial assistance of the aider and abettor in the achievement of the primary violation—and wondered whether the line of cases decided since *Brennan* had added anything to Learned Hand's formulation.¹⁴⁷ In this case, the allegedly false prospectus furnished the primary violation.¹⁴⁸

Judge Friendly explained that the second element, the mental state of the accomplice, might be recklessness if the accomplice owed the defrauded party a fiduciary duty, but should be scaled upward when there is no such duty.¹⁴⁹ Since the alleged omissions did not concern the financial statements, but more general wrongs not connected to the auditor's work, King's auditor owed the plaintiffs no duty of disclosure, and the complaint did not allege a conscious intent to aid in the fraud.¹⁵⁰

Judge Friendly next considered whether the auditor had given substantial assistance.¹⁵¹ Its work on the prospectus could not be substantial assistance because there was no allegation that the auditor knew the financial statements to be false or misleading.¹⁵²

The alleged substantial assistance also included the auditor's failure to inform the plaintiff or the authorities of "what was afoot."¹⁵³ Judge Friendly considered how far mere inaction could fulfill the requirement of substantial assistance.¹⁵⁴ He noted a Ninth Circuit case that refused to impose aiding and abetting liability for inaction, except where there is an independent duty to disclose.¹⁵⁵ There was no duty in *IIT* for the auditors to speak because the omissions did not relate to the financial statements.¹⁵⁶

Judge Friendly also noted that inaction can be substantial assistance, even absent a duty to disclose, if there is a conscious intention to further

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 922. See also *Edwards & Hanly v. Wells Fargo Sec. Clearance Corp.*, 602 F.2d 478, 484–85 (2d Cir. 1979); *Rochez Bros. v. Rhoades*, 527 F.2d 880, 889 (3d Cir. 1975); *Woodward v. Metro Bank of Dall.*, 522 F.2d 84, 97 (5th Cir. 1975); *Kerbs v. Fall River Indus.*, 502 F.2d 731, 740 (10th Cir. 1974); *SEC v. Coffey*, 493 F.2d 1304, 1317 (6th Cir. 1974); *Strong v. France*, 474 F.2d 747, 752 (9th Cir. 1973).

¹⁴⁸ *IIT*, 619 F.2d at 922.

¹⁴⁹ *Id.* at 923.

¹⁵⁰ *Id.* at 925.

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* (citing *Wessel v. Buhler*, 437 F.2d 279 (9th Cir. 1971)).

¹⁵⁶ *Id.* at 927.

the violation of Rule 10b-5.¹⁵⁷ He considered *Brennan* to be “close to mere inaction,” since the affirmative action—Midwestern advised complaining purchasers to contact Dobich—“was slight indeed.”¹⁵⁸ Unlike *Brennan*, there was no allegation in *IIT* that the auditor “intended by its silence to forward completion of the fraudulent transactions, in the expectation of benefitting from the fraud.”¹⁵⁹

Two opinions specifically addressed the liability of a silent officer for a fraud perpetrated on behalf of the corporation. In *Coffey*,¹⁶⁰ King Resources had sold \$8 million in two-year promissory notes to the State of Ohio using the services of a “money-finder” called Crofters.¹⁶¹ King Resources collapsed and the notes became worthless.¹⁶² The SEC alleged that King Resources had failed to disclose that it was not meeting its obligations and that it planned to re-loan some of the borrowed funds to others.¹⁶³

King was chairman of King Resources.¹⁶⁴ Coffey was its financial vice-president.¹⁶⁵ There was no evidence that King or Coffey was involved in discussions with the State.¹⁶⁶ Since there was no direct contact, there could be no primary liability for the omissions.¹⁶⁷ On the other hand, Coffey did send financial information to a credit rating agency.¹⁶⁸ If he omitted material facts necessary to make the statements made to the ratings agency not misleading (a half-truth), he could be liable as a primary violator of Rule 10b-5.¹⁶⁹ The court then considered aiding and abetting, sketching out the usual three elements of liability: a primary violation, a general awareness by the aider that he is part of something improper, and his knowing and substantial assistance of the violation.¹⁷⁰ Inaction may be a form of assistance if the silence was “consciously intended” to aid the securities law violation.¹⁷¹ There was no evidence that King knew of the deception.¹⁷² Coffey, however, may have known that Crofters’ personnel were misleading the State of Ohio;

¹⁵⁷ *Id.* at 926.

¹⁵⁸ *Id.* at 926–27.

¹⁵⁹ *Id.*

¹⁶⁰ SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974).

¹⁶¹ *Id.* at 1308.

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* at 1314.

¹⁶⁷ *Id.* at 1315.

¹⁶⁸ *Id.* at 1314.

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* at 1316.

¹⁷¹ *Id.* at 1317.

¹⁷² *Id.*

if so, his failure to take remedial action *would* be a form of aiding and abetting.¹⁷³

The Tenth Circuit discussed an officer's aiding and abetting a corporate fraud in *Kerbs v. Fall River Industries, Inc.*¹⁷⁴ Kerbs lost money that he had invested with defendants.¹⁷⁵ He loaned Fall River \$6,200, secured by a stock certificate for 25,000 shares of Fall River.¹⁷⁶ The certificate was bogus.¹⁷⁷ The discussions with Kerbs had been handled by a Fall River officer named Dial, but the president of Fall River, Thompson, was present during some of the conversations in which the fraudulent transaction was discussed.¹⁷⁸ The court noted that "one who aids and abets a fraudulent scheme may be held accountable even though his assistance consists of mere silence or inaction."¹⁷⁹ Thompson's presence lent an appearance of legitimacy to the transaction, and he was "obliged to speak out."¹⁸⁰ There was also evidence that Thompson had participated in the scheme by affirmative acts.¹⁸¹

The Ninth Circuit takes a stricter approach, and allows aiding and abetting liability only if the silent defendant owed a duty to speak.¹⁸²

In sum, the general rule seems to be as follows: When the alleged accomplice to fraud has not rendered affirmative acts of assistance, has merely remained silent, and is engaged in the ordinary course of business—as would be the case with our silent officer—he may be liable as an accomplice if he decided to remain silent in order to further the fraud in the expectation of benefit.¹⁸³ If the accomplice owed the victim a duty of disclosure, the lesser *mens rea* of recklessness will suffice.¹⁸⁴

¹⁷³ *Id.* at 1316.

¹⁷⁴ *Kerbs v. Fall River Indus.*, 502 F.2d 731 (10th Cir. 1974), *abrogated by* Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994).

¹⁷⁵ *Kerbs*, 502 F.2d at 733.

¹⁷⁶ *Id.* at 734.

¹⁷⁷ *Id.* at 735.

¹⁷⁸ *Id.* at 734.

¹⁷⁹ *Id.* at 740.

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *See* DCD Programs, Ltd. v. Leighton, 833 F.2d 183, 190 (9th Cir. 1987); Strong v. France, 474 F.2d 747, 752 (9th Cir. 1973).

¹⁸³ The expectation of benefit was noted in Brennan v. Midwestern United Life Ins. Co., 417 F.2d 147, 155 (7th Cir. 1969); IIT, an Int'l Inv. Trust v. Cornfeld, 619 F.2d 909, 927 (2d Cir. 1980), *abrogated by* Morrison v. Nat'l Austl. Bank, Ltd., 561 U.S. 247 (2010); SEC v. Coffey, 493 F.2d 1304, 1317 (6th Cir. 1974).

¹⁸⁴ *IIT*, 619 F.2d at 927.

B. Duty to Disclose

The Second,¹⁸⁵ Eighth,¹⁸⁶ and Ninth¹⁸⁷ Circuits have expressly stated in Rule 10b-5 aiding and abetting cases that a fiduciary relationship entails a duty to disclose. If the silent officer owed a fiduciary duty to speak, then it is arguable that he should be criminally responsible as an accomplice.¹⁸⁸ Civil liability will be imposed with the lesser *mens rea* of recklessness.¹⁸⁹ It is also arguable that the same silence should also entail primary liability: A failure to disclose information can be fraudulent for § 10(b) purposes when there is a duty to speak arising out of a fiduciary or similar relationship of trust and confidence.¹⁹⁰ A duty to disclose arises “when one party has information ‘that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.’”¹⁹¹

A corporate officer generally does not owe a fiduciary duty directly to the corporation’s securities holders, who are the victims of fraud, but does owe a duty of candor to the corporation itself.¹⁹² An officer who knows that a colleague has disseminated false information about the corporation should report that fact to the appropriate authorities within the corporation.¹⁹³ Delaware case law, for example, provides a foundation for finding that an officer is duty bound to report to the board or to the audit committee violations of law or other wrongs known to the officer but not to the board, if material to the board’s ability to perform its functions.¹⁹⁴ “Like directors, officers also have other contextual obligations as fiduciaries. These include the responsibility

¹⁸⁵ *Id.*

¹⁸⁶ *Camp v. Dema*, 948 F.2d 455, 460 (8th Cir. 1991).

¹⁸⁷ *DCD Programs, Ltd.*, 833 F.2d at 190.

¹⁸⁸ See Kenneth N. Klee & Matthew C. Heyn, *Developments in Lender Liability: Four Causes of Action, a Theory of Damages, and a Defense* (ALI-ABA Course of Study, Mar. 29–31, 2007), WL SM014 ALI-ABA 231, 277 (2007).

¹⁸⁹ See generally *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 198 (1st Cir. 1999) (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)).

¹⁹⁰ *United States v. O’Hagan*, 521 U.S. 642, 662 (1997).

¹⁹¹ *Chiarella v. United States*, 445 U.S. 222, 228 (1980) (quoting RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (1976)).

¹⁹² See *Gantler v. Stephens*, 965 A.2d 695, 708–09 (Del. 2009) (explaining that corporate officers’ duties are generally that of duty of loyalty and care to the corporation). See also *In re Brae Corp. S’holders Litig.*, Civ. A. No. 11348, 1991 WL 80213, at *2 (Del. Ch. May 15, 1991) (holding that a full disclosure of fraud precludes violation of the duty of candor).

¹⁹³ See *Metro Commc’n Corp. BVI v. Advanced MobileComm Techs. Inc.*, 854 A.2d 121, 131–32 (Del. Ch. 2004).

¹⁹⁴ *Hamshire Grp., Ltd. v. Kuttner*, C.A. No. 3607-VCS, 2010 WL 2739995, at *34 (Del. Ch. July 12, 2010).

to disclose to their superior officer or principal ‘material information relevant to the affairs of the agency entrusted to them.’”¹⁹⁵

The Model Business Corporation Act (“MBCA”) was amended in 2005 to address the duties of a corporate officer to inform superiors within the corporation of probable violations of law.¹⁹⁶ Section 8.42(b)(2) of the MBCA specifically requires an officer to report “up the chain” violations of law and breaches of duty.¹⁹⁷ “[T]he 2005 amendments codify, for the first time in a state corporate statute, a duty of directors and officers to be candid in their dealings with one another.”¹⁹⁸

8.42 Standards of Conduct for Officers

(b) The duty of an officer includes the obligation:

(1) to inform the superior officer to whom, or the board of directors or the committee thereof to which, the officer reports of information about the affairs of the corporation known to the officer, within the scope of the officer's functions, and known to the officer to be material to such superior officer, board or committee; and

(2) to inform his or her superior officer, or another appropriate person within the corporation, or the board of directors, or a committee thereof, of any actual or probable material violation of law involving the corporation or material breach of duty to the corporation by an officer, employee, or agent of the corporation, that the officer believes has occurred or is likely to occur.¹⁹⁹

The Official Comment to Section 8.42 explains that “the common law, including the law of agency, has recognized a duty on the part of officers and key employees to disclose to their superiors material information relevant to the affairs of the agency entrusted to them.”²⁰⁰ Subsection (b)(2) states this disclosure obligation by confirming that the

¹⁹⁵ *Id.* at *12.

¹⁹⁶ See R. Franklin Balotti & Megan W. Shaner, *Safe Harbor for Officer Reliance: Comparing the Approaches of the Model Business Corporation Act and Delaware’s General Corporation Law*, 74 LAW & CONTEMP. PROBS. 161, 163 (2011).

¹⁹⁷ *Id.*

¹⁹⁸ John F. Olson & Aaron K. Briggs, *The Model Business Corporation Act and Corporate Governance: An Enabling Statute Moves Toward Normative Standards*, 74 LAW & CONTEMP. PROBS. 31, 38 (2011).

¹⁹⁹ MODEL BUS. CORP. ACT § 8.42(b) (2005).

²⁰⁰ *Id.* § 8.42 cmt.

officer must:

- inform the relevant superior authority, or other appropriate person within the corporation
- of violations of law or breaches of duty
- that the officer believes
- have occurred or are about to occur (i.e., more likely than not to occur) and
- are or would be material to the corporation.²⁰¹

Subsection (b)(1) requires the officer to report information that is “within the scope of the officer’s functions, but subsection (b)(2) does not include this scope limitation.²⁰² As with Delaware law, the officer is supposed to inform the board, or, since many codes of conduct establish a system for reporting violations of law, officers may make report to the ethics officer, internal auditor, general counsel or the like.²⁰³ “Any disclosure of information must be truthful, accurate, and complete. The duty of disclosure appears to be an obligation of complete candor.”²⁰⁴

The duty of candor is of recent vintage and is still undeveloped. In 2003, one writer called the officer’s duty of candor “an empty space” in the law.²⁰⁵ No state has yet adopted the 2005 amendment to the MBCA. Therefore, many questions remain unanswered. Must an officer report probable violations of law that are beyond the scope of his responsibility? Does it matter whether the violator is a subordinate, an equal or a superior? Does this duty apply to junior officers? How long does an officer have to make this report? How sure must the officer be that a violation of law has happened or will happen? If no report is made, and the wrong remains undetected, at what point does the failure to report become too remote in time to matter? If this duty becomes more widely recognized by state courts or enacted by state legislatures, then an officer’s silence can give rise to criminal accomplice liability, and civil accomplice liability can be based on the lesser *mens rea* of recklessness. Primary liability would also be a possibility.

²⁰¹ *Id.* § 8.42(b)(2).

²⁰² *Id.* § 8.42(b)(1).

²⁰³ *See id.*

²⁰⁴ Norman D. Bishara & Cindy A. Schipani, *A Corporate Governance Perspective on the Franchisor-Franchisee Relationship*, 19 STAN. J.L. BUS. & FIN. 303, 318 (2014).

²⁰⁵ Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. CIN. L. REV. 1187, 1189 (2003).

C. Third Parties vs. Insiders

Dean Ruder wrote in 1972 that mere inaction should not give rise to secondary liability under Rule 10b-5 in the absence of an “independent duty to make disclosure of the primary wrong.”²⁰⁶ The reason was to exclude from liability individuals who may have known of the fraud but whose “degree of fault is relatively minor,” such as lenders, suppliers and minor employees.²⁰⁷

The courts are in general agreement that third party professionals such as accountants and lawyers will face no liability for failing to disclose their client’s wrongs to third parties, unless they owed a duty to speak.²⁰⁸ That duty arises when the professional acts as promoter, owes a fiduciary duty to the third party, or previously made statements that must be corrected.²⁰⁹

The courts have shown lesser solicitude to bankers and clearing agents.²¹⁰ A fraudster’s bank might face liability even in the absence of a duty to speak, but only if the bank consciously intended “to entice the pigeon into its precincts.”²¹¹ A securities clearing agent likewise might be liable for failing to blow the whistle on its client in the absence of a duty to speak, if it had “something closer to an actual intent to aid in the fraud.”²¹²

²⁰⁶ Ruder, *supra* note 23, at 644.

²⁰⁷ *Id.* at 646.

²⁰⁸ *See, e.g.*, Wessel v. Buhler, 437 F.2d 279 (9th Cir. 1971) (finding that nothing in Rule 10b-5 purports to impose liability on accountants whose conduct consists solely of inaction).

²⁰⁹ *See, e.g.*, Ziemba v. Cascade Int’l, 256 F.3d 1194, 1206–07 (11th Cir. 2001); Farlow v. Peat, Marwick, Mitchell & Co., 956 F.2d 982 (10th Cir. 1992); Schatz v. Rosenberg, 943 F.2d 485, 490–91 (4th Cir. 1991) (quoting Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 497 (7th Cir. 1986)) (“Neither lawyers nor accountants are required to tattle on their clients in the absence of some duty to disclose.”); IIT, an Int’l Inv. Trust v. Cornfeld, 619 F.2d 909, 925–27 (2d Cir. 1980), *abrogated by* Morrison v. Nat’l Austl. Bank, Ltd., 561 U.S. 247 (2010) (finding that the accounting firm had no duty to correct a portion of the client’s prospectus that did not relate to the financial statements, over which the accounting firm had responsibility). *Accord* Shapiro v. Cantor, 123 F.3d 717, 721–22 (2d Cir. 1997). *But see* Roberts v. Peat, Marwick, Mitchell & Co., 857 F.2d 646, 652–53 (9th Cir. 1988) (per curiam); Rudolph v. Arthur Andersen & Co., 800 F.2d 1040, 1044 (11th Cir. 1986).

²¹⁰ *See, e.g.*, *In re Rural Metro Corp.*, 88 A.3d 54 (Del. Ch. 2014) (finding a banker liable for breaching a fiduciary owed to the stockholders), *decision clarified on denial of reargument* No. 6350-VCL, 2014 WL 1094173 (Del. Ch. Mar. 19, 2014).

²¹¹ Woodward v. Metro Bank of Dall., 522 F.2d 84, 98 (5th Cir. 1975).

²¹² Edwards & Hanly v. Wells Fargo Sec. Clearance Corp., 602 F.2d 478, 485 (2d Cir. 1979).

It may be argued that the policy of protecting providers of ordinary commercial and professional services and minor employees should not apply to a member of the guilty firm's C-suite, who has a more direct connection to the fraudster.

D. The Effect of Dodd Frank

The Dodd-Frank amendment to section 20(e) of the Exchange Act did not change the case law discussed above.²¹³ The amendment might be read to empower the SEC to act against reckless accomplices in all cases, including accomplices who render affirmative acts of assistance and those who remain passive. If recklessness were enough to render liable all silent accomplices, however, then third parties who had been shielded in most cases would be liable even absent a duty to disclose, based not on a high conscious intent to further the fraud, but on the lesser *mens rea* of recklessness. Congress nowhere stated an intention to overrule case law.²¹⁴

The legislative history is sparse. The amendment appeared in Rep. Frank's original bill, introduced December 2, 2009.²¹⁵ It would have amended section 20(e) of the Exchange Act by inserting "or recklessly" after "knowingly."²¹⁶ The language was carried over verbatim into the Dodd-Frank Act.²¹⁷ There is sparse explanation for the amendment in the Joint Explanatory Statement of the Committee of Conference, which provides:

Increasing Regulatory Enforcement and Remedies strengthens the SEC's authority to conduct investigations, impose liability on control persons, and assess penalties for violations of the securities laws. It also makes clear that the intent standard in SEC enforcement actions for aiding and abetting is recklessness, and it requires a study regarding the issue of aiding and abetting liability in private actions.²¹⁸

There is no indication in this passage that Congress meant to overrule the established law concerning the *mens rea* of an accomplice. It is more likely that in making it "clear," Congress meant to conform the mental state required by the Exchange Act to the mental state

²¹³ See 12 U.S.C. § 5536 (2012).

²¹⁴ H.R. REP. NO. 111-517, at 870 (2010) (Conf. Rep.).

²¹⁵ H.R. 4173, 111th Cong. § 7215 (1st Sess. 2009).

²¹⁶ *Id.*

²¹⁷ See *supra* note 101.

²¹⁸ H.R. REP. NO. 111-517.

required by existing case law. Recklessness is a sufficient state of mind in some, but not all cases.²¹⁹

E. Control Person Liability

Control person liability is a duplicative theory of liability. A control person who knows of a subordinate's fraud but fails to act can be vicariously liable under § 20(a) of the Exchange Act.²²⁰ "To impose secondary liability on a controlling person for his inaction, the plaintiff must prove that the inaction was deliberate and done intentionally to further the fraud."²²¹ The required *mens rea* is the same as that for aiding and abetting under the Hand formulation.²²² The control person statute includes an addition element not required of an accomplice, that of control,²²³ and so its scope is potentially narrower than accomplice theory. On closer look, though, the two theories will often be coextensive in scope. Recall the Restatement's "substantial factor in causing the tort" test for aiding and abetting,²²⁴ under which a court determines whether the assistance was substantial based on considerations including the defendant's relation to the primary tortfeasor.²²⁵ This suggests that the liability of a silent officer as an accomplice will depend on the officer's relation to the fraudster, including whether the fraudster is a subordinate of the officer and whether the subject matter of the fraud comes within the purview of the officer's corporate responsibilities. Since control person liability is not inconsistent with accomplice liability in this context, this Essay bypasses further consideration of the topic.

²¹⁹ See, e.g., *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 181 (1994).

²²⁰ "Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable (including to the Commission . . .) unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a).

²²¹ *Belmont v. MB Inv. Partners*, 708 F.3d 470, 485 (3d Cir. 2013).

²²² *Id.* at 486.

²²³ 15 U.S.C. § 78t.

²²⁴ See *Cent. Bank of Denver*, 511 U.S. at 181 ("The Restatement of Torts [§ 876(b)], under a concert of action principle, accepts a doctrine with rough similarity to criminal aiding and abetting.").

²²⁵ See *Landy v. FDIC*, 486 F.2d 139, 163 (3d Cir. 1973) (quoting Restatement's considerations relevant to determining whether assistance is "substantial," including: the amount of assistance, the defendant's presence or absence at the time of the tort, his relation to the primary tortfeasor, and his state of mind).

V. CONCLUSION

A. The Rules

Under present case law our hypothetical silent officer faces no primary liability for violating Rule 10b-5. However, the emergence of a corporate duty of candor will require reconsideration, as the officer's silence is in derogation of a duty to speak.²²⁶

Under present case law, our hypothetical silent officer will face secondary accomplice liability.²²⁷ If the law imposes upon him a duty to inform those charged with governance of his colleague's probable fraud, then he will face criminal accomplice liability if he fails to do so. His civil accomplice liability in an SEC enforcement action will require proof only of his reckless state of mind.²²⁸ Even if he owes no duty to speak, our silent officer can still be held liable as an accomplice in an SEC enforcement action, if he remained silent with the conscious intention of furthering the fraud in the expectation of benefit, such as incentive compensation linked to the firm's stock price.²²⁹

²²⁶ Bishara & Schipani, *supra* note 204, at 318.

²²⁷ See Belmont v. MB Inv. Partners, 708 F.3d 470, 486 (3d Cir. 2013).

²²⁸ Camp v. Dema, 948 F.2d 455, 459–61 (8th Cir. 1991); DCD Programs, Ltd., 833 F.2d at 188–89; IIT, an Int'l Inv. Trust v. Cornfeld, 619 F.2d 909, 923 (2d Cir. 1980), *abrogated by* Morrison v. Nat'l Austl. Bank, Ltd., 561 U.S. 247 (2010).

²²⁹ Woodward v. Metro Bank of Dall., 522 F.2d 84, 97 (5th Cir. 1975).

B. Why the Rules are Unsatisfactory

The elements of proof in primary and secondary liability cases against our hypothetical silent officer would be nearly the same. Compare:

A primary case against silent officer²³⁰

- material misstatement by colleague in connection with purchase/sale of a securities
- silent officer's silence
- **a duty to speak**
- silent officer's *mens rea/scienter*

A secondary case against silent officer

- **primary violation**
material misstatement by colleague in connection with purchase/sale of a securities
colleague's *mens rea/scienter*
- silent officer's silence
- silent officer's *mens rea/scienter*²³¹

The unbolded elements are the same in both cases. Only the **bolded** elements differ. The practical upshot of the law's refusal to recognize primary liability is that in an accomplice case, the government must prove the guilty state of mind of the colleague who uttered the misstatement—a significant burden.²³² The silent officer should not be

²³⁰ In an SEC enforcement action “under section 10(b) and Rule 10b-5, the [SEC] must ‘prove that in connection with the purchase or sale of a security the defendant, acting with *scienter*, made a material misrepresentation (or a material omission if the defendant had a duty to speak) or used a fraudulent device’ In order to impose criminal liability, the government must also prove that the defendant willfully violated the law.” *United States v. Vilar*, 729 F.3d 62, 88 (2d Cir. 2013) (citation omitted). Neither the SEC nor the prosecutor need prove reliance. *See id.* “[T]he government, as opposed to a private plaintiff, need prove only materiality, meaning that ‘there is a substantial likelihood that a reasonable investor would find (the omission or misrepresentation) important in making an investment decision’ . . . and not that a victim did, in fact, rely on it.” *Id.* at 89 (quoting *United States v. Contorinis*, 692 F.3d 136, 143 (2d Cir. 2012)).

²³¹ *Rochez Bros. v. Rhoades*, 527 F.2d 880, 886–88 (3d Cir. 1975); *SEC v. Coffey*, 493 F.2d 1304, 1315–16 (6th Cir. 1974).

²³² *See* U.S. DEP'T OF JUSTICE, U.S. ATTORNEY MANUAL: CRIMINAL RESOURCE MANUAL § 2476 (rev. ed. 1998), available at <http://www.justice.gov/usam/criminal-resource-manual-2476-18-usc-2-not-independent-offense> (explaining there is no need to try or convict the colleague); U.S. DEP'T OF JUSTICE, U.S. ATTORNEY

protected by the double *mens rea* requirement because it should not matter whether his colleague, the speaker of the falsehood, actually meant to lie, as long as the silent officer intended by his inaction to perpetuate the dissemination of false information. The double *mens rea* requirement impedes the fundamental purpose of the securities laws—to encourage the flow of truthful information, including the swift public correction of public misstatements.²³³

C. A Suggested Remedy

The *mens rea* of the silent officer alone should determine his culpability. His intentional or reckless breach of his duty of candor should subject him to liability for a primary violation of Rule 10b-5.

Consider again *Coffey*.²³⁴ Might the chairman of King Resources be primarily liable for misstatements made by King Resource's financial vice-president to a credit rating agency? No, held the court; a superior officer has no "duty to monitor" a subordinate's dealings with a third party.²³⁵ Imposing such a duty "would disrupt corporate systems of authority and accountability."²³⁶ The imposition of primary liability need not disrupt the governance of the corporation, however. Such liability would not entail that the chairman monitor his staff,²³⁷ because Rule 10b-5 liability would have to be based on the chairman's actual knowledge or reckless disregard of the fraud, and not his negligent failure to learn of it.²³⁸

MANUAL: CRIMINAL RESOURCE MANUAL § 2479 (rev. ed. 1998), available at <http://www.justice.gov/usam/criminal-resource-manual-2479-what-not-required-prove-aiding-and-abetting> (explaining proof of the guilty state of mind of the colleague could be introduced in the case against the silent officer).

²³³ See 15 U.S.C. § 77b(b) (2012); Richard E. Mendales, *We Can Work It Out: The Interaction of Bankruptcy and Securities Regulation in the Workout Context*, 46 RUTGERS L. REV. 1211, 1247 (1994).

²³⁴ *Coffey*, 493 F.2d at 1304.

²³⁵ *Id.* at 1315.

²³⁶ *Id.*

²³⁷ A director or officer may be liable for failures in the supervision and control affairs if he fails to act with due diligence in his supervision. There is also authority for the contra proposition, that a failure to supervise will not result in the personal liability of the senior authority. See Martin Petrin, *The Curious Case of Directors' and Officers' Liability for Supervision and Management: Exploring the Intersection of Corporate and Tort Law*, 59 AM. U. L. REV. 1661, 1675–79 (2010).

²³⁸ The *mens rea* and *scienter* requirements are similar in all forms of Rule 10b-5 cases. The primary criminal liability of the silent officer is governed by § 32 of the Exchange Act. See *United States v. Tarallo*, 380 F.3d 1174, 1188 (9th Cir. 2004), amended by 413 F.3d 928 (9th Cir. 2005) (explaining "willfully" as it is used in § 32(a) means intentionally undertaking an act that one knows to be wrongful). See

continued . . .

The *Coffey* court also emphasized that the chairman was under no legal duty to contact the deceived parties and disclose the truth, and therefore his silence could not make him a primary violator.²³⁹ The court recognized that the chairman might be an accomplice, had he known of the misstatements made by his subordinate and remained silent in order to benefit from the fraud.²⁴⁰ Since the *Coffey* court was willing to recognize secondary liability in the absence of a duty to speak, based on a conscious intention to further the fraud, then was not the court really saying that the chairman should have done *something* to thwart the fraud? It is a legal fiction to deny primary liability based on the absence of a duty to speak.

Another concern of the *Coffey* court was that holding the chairman liable would effectively override the protections contained in the controlling person provision of the Exchange Act.²⁴¹ Primary liability would not be inconsistent with the liability scheme established by the Exchange Act, however, since the scope of primary liability would not exceed the scope of accomplice liability.²⁴²

The emerging duty of candor provides a doctrinal basis to impose

also id. at 1189 n.5 (noting “[this] does not preclude a conviction arising out of recklessness”) (internal citations omitted); *United States v. Weiner*, 578 F.2d 757 (9th Cir. 1978) (applying a recklessness standard in a criminal securities fraud prosecution).

A criminal aiding and abetting prosecution requires that the defendant seek by his action or inaction to make the primary crime succeed. Is there a meaningful difference between intentionally undertaking an act that one knows to be wrongful, and behaving with the intention of bringing about that act?

The SEC must show the defendant’s *scienter* in a civil suit alleging primary liability under Rule 10b-5. This means an intention to deceive or recklessness. *See In re Nvidia Corp. Sec. Litig.*, 768 F.3d 1046, 1053 (9th Cir. 2014) (“In *Ernst & Ernst v. Hochfelder*, the Supreme Court explained in a footnote that the term *scienter* refers to a mental state embracing intent to deceive, manipulate, or defraud. The Court recognized that some Courts of Appeals include within their definition of *scienter* a form of recklessness, but it did not address whether those courts are correct in doing so. As recently as in its decision in *Matrixx Initiatives*, the Court stated that it ‘ha[s] not [yet] decided whether recklessness suffices to fulfill the *scienter* requirement.’”) (internal citations and quotations omitted). *See also Corporate Scienter Under Section 10(b) and Rule 10b-5*, 46 Sec. Reg. & L. Rep. (BNA) No. 18, at 875 (May 5, 2014) (“[E]very Circuit to consider the question has held that *scienter* can be shown by reckless conduct.”).

Under section 20(e) of the Exchange Act, the defendant must have remained silent in order to further the fraud. If the defendant owed the victim a duty of disclosure, it is enough that the defendant was recklessly indifferent to the truth of statements made.

²³⁹ *Coffey*, 493 F.2d at 1315, 1317.

²⁴⁰ *Id.* at 1316.

²⁴¹ *Id.* at 1315.

²⁴² *Id.* at 1316.

primary liability upon the silent officer.²⁴³ Doing so will put the focus where it should be: on the guilty mind of the silent officer.

²⁴³ See *supra* Part IV.B.