Volume 19
Issue 3 *Symposium: Current Issues in Securities Regulation*

Article 6

4-15-1992

# Collateral Participant Liability Under State Securities Laws

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As I lecture continuing legal education groups, or consult in the securities litigation field, the questions practitioners frequently ask do not involve internationalization of securities markets, or insider trading, or failure of the national market system to evolve. By a ratio of four, five, or more to one, practitioners ask about collateral participants' involvement in securities transactions and the potential liability resulting from that involvement.[1]

"Collateral participant," of course, is a generic name frequently applied to attorneys, accountants, appraisers, investment bankers, consulting engineers, commercial bankers, business consultants, celebrity spokespersons, corporate directors, and other similarly situated individuals. These individuals have become defendants in lawsuits because someone with whom they have had a relationship, usually the issuer of securities, has violated the securities laws.[2] When deals go bad, disappointed investors invoke the securities laws to name as defendants great numbers of collateral participants.[3]

Due to developments at the federal level, including United States

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1. The next most frequently discussed topic seems to be exemptions from registration, particularly those contained in Securities and Exchange Commission (SEC) Regulation D, 17 C.F.R. 240.501-509. *See generally* D., *Selecting and Complying With Exemptions from Registration*, Chapter C, in UNIV. OF WASHINGTON CONTINUING LEGAL EDUCATION, SECURITIES REGULATION FOR THE GENERAL PRACTITIONER (1991).

2. *See, e.g.*, Douglas M. Branson, *Collateral Participant Liability Under the Securities Laws—Charting the Proper Course*, 65 OR. L. REV. 327, 329-330 (1986).

3. The record number of collateral participants named as defendants may have been in *In re* Washington Public Power Supply System Litigation, No. MDL 551 (W.D. Wash. filed July 15, 1983) (over 700 defendants named). Other examples include Armstrong v. McAlpin, 669 F. 2d 79, 84 (2d Cir. 1983) (57 Page complaint alleging 20 causes of action against 30 individual defendants); McFarland v. Memorex Corp., 493 F. Supp. 631 (N.D. Calif. 1983) (42 defendants); *In re* ZZZZ Best Securities Litigation, BLUE SKY L. REP. (CCH) ¶ 73,277 (C.D. Cal. 1990) (37 defendants named); Roberts v. Heim, BLUE SKY L. REP. (CCH) ¶ 72,616 (N.D. Cal. 1987) (over 100 defendants named).

Supreme Court opinions in 1975 in *Ernst & Ernst v. Hochfelder*[4] and in 1988 in *Pinter v. Dahl*,[5] federal courts have modified and narrowed the bases for collateral participant liability. Narrowing of liability under federal law has shifted plaintiffs' focus to state securities, or blue sky, laws.

Unlike federal law, most state securities acts allow successful plaintiffs also to recover attorneys' fees.[6] Availability of attorneys' fees has sharpened this focus on state law. State law then has become the area in which practitioners' questions, and *angst*, proliferate.

This *angst* increases because few, if any, answers exist. Until recently, the number of state court published appellate opinions has been small. The number of recent decisions has increased but outcomes vary greatly, bouncing from one extreme to the other, like an inebriate navigating a wide thoroughfare.

For example, the Washington State Supreme Court has affirmed liability imposed upon seemingly industrious and diligent outside directors of a failed high tech venture.[7] Oregon's Supreme Court has also interpreted Oregon's statute expansively, holding an Idaho attorney liable for preparing offering documents in securities transactions touching Oregon.[8] Oregon practitioners have predicted a "parade of horribles" as an aftermath of the decision[9] and, without success, have sought legislative change.[10] By contrast, California courts have steadfastly adhered to a narrow, strict privity test for collateral participant liability, at least under one key provision of the California Corporations Code.[11]

For my contribution to this securities law symposium, then, I have

4. 425 U.S. 185 (1976) (mere negligence would not suffice for recovery of money damages under SEC Rule 10b-5). *See also* Aaron v. SEC, 446 U.S. 680 (1980) (Hochfelder principle applied to SEC actions for prophylactic relief).

5. 486 U.S. 622 (1988) (eliminating broader substantial factor test and confining broadened seller status and liability under Securities Act § 12(1) to those defendants who solicited the plaintiff).

6. *See, e.g.*, ALASKA STAT. § 5.55.220(a) ("reasonable attorneys' fees"); ARIZ. REV. STAT. § 44-2001 ("taxable court costs and reasonable attorneys' fees"); HAW. REV. STAT. § 59.115(2) ("costs and reasonable attorneys' fees at trial and on appeal"); WASH. REV. CODE § 21.20.430(1)&(2) (provision for a "reasonable attorneys' fee").

7. *See* Hines v. Data Line Systems, Inc. 787 P.2d 8 (Wash. 1990).

8. *See* Prince v. Brydon, 764 P.2d 1370 (1988).

9. *See generally* Gary M. Berne & Neil Bregenzer, *Participants Liability Under the Oregon Securities Law after* Prince v. Brydon, 68 OR. L. REV. 885 (1989) (predicting that a parade of horribles is unlikely to ensue).

10. *See Professionals' Liability Bill Dies in Oregon House After Senate Passage*, 23 FED. SEC. REG. & L. REP. 1085 (BNA) (July 12, 1991).

11. *See infra* notes 115-125 and accompanying text, discussing CAL. CORP. CODE § 25501, the general antifraud civil liability provision of the California Corporate Securities Code of 1968. Furthermore, in Lubin v. Sybedon Corporation, 688 F. Supp. 1425, 1453 (S.D. Cal. 1988), Judge Enright held that privity with the issuer is necessary under all, or nearly all, civil liability provisions of the California statute.

chosen a mundane and pedestrian topic — collateral participant liability under state securities acts. With respect to that topic, my goals are likewise mundane and modest. I will elaborate on some possible alternative interpretations of statutes and point to the policy considerations favoring one choice over any other. Downsizing my contribution still further, I will confine my discussion to the Pacific Rim states: Alaska, Washington, Oregon, California, and Hawaii. An occasional decision from farther afield is tossed into the mix if, but only if, by way of contrast or elaboration the decision can aid in construction of a similar statute in one of the Pacific Rim jurisdictions, or act as a beacon on the uncharted, unruly sea that state securities law seems to have become.

## II. SETTING THE STAGE

### A. *Developments on the Federal Level: SEC Rule 10b-5 and Aiding and Abetting*

By the early 1970s, after a collage of Supreme Court and Court of Appeals precedents, a securities plaintiff needed merely to demonstrate that she had purchased or sold securities at or about the same time the defendant had misrepresented or omitted to state material facts. Gone were most analogies to elements of a common law fraud action, including a reliance requirement,[12] a loss causation requirement,[13] and any requirement of fault beyond mere negligence.[14] Courts even judged materiality of the omitted or misrepresented fact under a relaxed standard that a reasonable investor just "might" have considered the fact important in making his or her decision.[15] The standing requirement, that the plaintiff bought or sold securities in order to journey past the federal courtroom door, also gave way in at least two federal circuits.[16] Prodded by hard cases, those circuit

12. *See, e.g.*, Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153-54 (1972) (reliance is presumed in cases involving nondisclosure in face-to-face transactions); Shapiro v. Merrill Lynch, Pierce, Penner & Smith, Inc., 495 F.2d 228, 239-40 (2d Cir. 1974) (reliance presumed in case of misrepresentation rather than omission).

13. *See, e.g.*, Fridrich v. Bradford, 542 F.2d 307, 318 (6th Cir. 1976) (attempting to reinstate at least some causal connection between plaintiff's loss and defendant's loss and defendant's alleged wrongdoing).

14. *See, e.g.*, City Nat'l. Bank v. Vanderbloom, 442 F.2d 221, 229-30 (8th Cir. 1970); Stevens v. Vowell, 343 F.2d 374, 379-80 (10th Cir. 1965) (mere negligence would suffice).

15. *See* Affiliated Ute Citizens 406 U.S. at 154; Mills v. Electric Auto-Lite Co., 396 U.S. 375, 384 (1970).

16. *See* Blue Chip Stamps v. Manor Drug Stores, 492 F.2d 136, 141-42 (9th Cir. 1974) (establishing a new exception to standing rule), *rev'd* 421 U.S. 723 (1975); Eason

courts of appeals moved to a more existentialist and looser test of standing. In these efforts, the Ninth Circuit lead the way on many issues.[17]

Beginning in the mid 1970s, the Supreme Court began a program of tightening up the securities laws' coverage that later became one of most pronounced, but little-noticed, jurisprudential swings anywhere and certainly the most pronounced change wrought by the Burger Court.[18] In this dramatic swing of the pendulum, at least two cases directly affected collateral participant liability and figure prominently in the resurgence of state law.

First, of course, was *Ernst & Ernst v. Hochfelder*,[19] a case in which plaintiffs sought to pinion aiding and abetting securities fraud, or rule 10b-5, liability on an outside accounting firm. Justice Powell began by discussing, under rule 10b-5, "whether an action for civil damages may lie . . . in the absence of an allegation of intent to deceive, manipulate or defraud."[20] The entire discussion focused on whether a mere lack of reasonable care, or negligence, will suffice. The Court held that it would not. Securities Exchange Act section 10(b),[21] pursuant to which the SEC promulgated rule 10b-5, speaks in terms of manipulation and "deceptive device or contrivance." These are near terms of art connotating a state of mind or fault requirement higher than mere lack of reasonable care.[22] To the extent that on its face the SEC rule prohibits making "any untrue statement of a material fact" or omitting "to state a material fact necessary in order to make the statements made . . . not misleading," language devoid of any state of mind requirement whatsoever, the scope of the rule cannot exceed the scope of the statute pursuant to which it has been adopted.[23]

*Hochfelder* left open whether more severe forms of negligence, such as gross negligence or recklessness, would suffice to ground rule 10b-5 liability.[24] The manner in which Justice Powell crafted his opinion, in particular leaving unresolved the interstice between

v. GMAC, 490 F.2d 654, 657-61 (7th Cir. 1973) (abolishing rule altogether), *cert. denied*, 416 U.S. 960 (1974).

17. *See, e.g.*, Blackie v. Barrack, 524 F.2d 891, 906 (9th Cir. 1975) (dispensing with proof of reliance in case of affirmative misrepresentation); Blue Chip Stamps, 492 F.2d at 141-42 (modifying standing requirement); Royal Air Properties v. Smith, 312 F.2d 210, 212 (9th Cir. 1962) (mere negligence sufficient); Ellis v. Carter, 291 F.2d 270, 274 (9th Cir. 1961) (same).

18. *See, e.g.*, Thomas Hazen, *Symposium Introduction - The Supreme Court and the Securities Laws: Has the Pendulum Slowed?*, 30 EMORY L. J. 5 (1981).

19. 425 U.S. 185 (1976).

20. *Id.* at 187-88.

21. 15 U.S.C. § 78b.

22. 425 U.S. at 197-99.

23. *Id.* at 212-14.

24. *Id.* at 193-94, n.12.

knowing and intentional conduct on one hand, and mere negligence on the other, has led to much posturing. Keying on Justice Powell's opening sentence, defense lawyers have boldly asserted that allegation and proof of *scienter* is necessary. Reading the entire opinion, plaintiffs allow only that negligence no longer will suffice but that recklessness or other more severe forms of misfeasance are sufficient.

After *Hochfelder*, almost all federal circuits have answered this question, largely, but not wholly, in plaintiffs' favor.[25] They have held that recklessness, but only of a more severe sort, would suffice. That severe sort of recklessness had to amount to lack of even the slightest care, giving rise to an inference that the defendant had acted in conscious disregard of the effect his conduct could have on others.[26] But proof of intentional, purposeful wrongdoing was not necessary.

Under rule 10b-5, the secondary liability concept plaintiffs most frequently utilize is aiding and abetting. Other means of capturing collateral participants exist, such as conspiracy or respondeat superior on the common law side,[27] or the securities laws' controlling persons provisions on the statutory side.[28] But overwhelmingly plaintiffs attempt to cast a wider rule 10b-5 net with aiding and abetting allegations.[29]

25. *See, e.g.*, Kevin R. Johnson, *Liability for Reckless Misrepresentation and Omissions Under Section 10(b) of the Securities Exchange Act of 1934*, 59 U. CIN. L. REV. 667, 674 n.22 (1991) (noting that every circuit that has addressed the issue has found that recklessness satisfies the *Hochfelder* state of mind requirement); Note, *Liability for Aiding and Abetting Violators of Rule 10b-5: The Recklessness Standard in Civil Damage Actions*, 62 TEX. L. REV. 1087, 1090 n.19 (1984).

26. *See, e.g.*, Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977) (the Rule 10b-5 recklessness requirement "comes closer to being a lesser form of intent than merely a greater degree of ordinary negligence"); Sunstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1045 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977) ("recklessness required is of a high sort, but an extreme departure from the standards of ordinary care"). *See also* Hollinger V. Titan Capital Corp., 914 F.2d 1564, 1569 (9th Cir. 1990) (en banc) (adopting *Sunstrand* as unified standard in the circuit).

27. *See, e.g.*, Hollinger V. Titan Capital Corp., 914 F.2d 1564, 1576 (9th Cir. 1990) (en banc) (statutes controlling person's liability supplements, but does not supplant, common law principles of respondeat superior); *In re* Atlantic Fin. Management, Inc., 784 F.2d 29, 32-34 (1st Cir. 1986).

28. Securities Act of 1933 § 15 U.S.C. § 77(o) (1988); Securities Exchange Act of 1934 § 20(a), 15 U.S.C. § 78t(a) (1988).

29. *See, e.g.*, Alan A. Bromberg & Lewis D. Lowenfels, *Aiding and Abetting Securities Fraud; A Critical Examination*, 52 ALA. L. REV. 637, 643 (1988). Traditionally the leading work has been 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 (1972).

Although formulae vary slightly from decision to decision, aiding and abetting has three elements: (1) the existence of a securities law violation by the primary violator, usually the issuer of the securities; (2) the rendering of substantial assistance by the collateral participant to the primary violator; and (3) rendering this assistance while generally aware of or with knowledge that the primary violator was violating the law.[30] Alternatively, in the exercise of even the slightest care, the collateral participant should have known that the primary violator was violating the law.[31]

As any experienced business litigator knows, the last element, state of mind, or fault, is the key to any fraud case. Alleging and proving that an attorney, or an appraiser or some other collateral participant, has failed to exercise even the slightest care, when courts have interpreted that as recklessness of the high conscious disregard variety, is difficult.[32] Complicating the scene further is many federal courts' flat statement that the alleged aider and abettor must have known that the primary violator was violating the law.[33] Those courts' statements not only reflect the trend toward a knowledge standard but also are instructive in showing where courts' sympathies might lie.

### *B. Developments on the Federal Level: Securities Act Section 12 and Broadened Seller Status*

The fallout of these developments on the rule 10b-5 and aiding and abetting fronts was to shift plaintiffs' attention elsewhere. Attention shifted to the Securities Act of 1933 section 12(2). That section imposed primary liability on those who have sold a security by means of a false or misleading written or oral prospectus. The *raison d'être* of

30. *See, e.g.*, Bromberg & Lowenfels, *supra* note 29, at 662; Ruder, *supra* note 29, at 632-33. The general awareness standard, perhaps a shade below knowledge, comes from SEC v. Coffey, 493 F.2d 1304, 1316 nn.29-30 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975) (aider and abettor must have had at least "general awareness that [her] role was part of an overall activity that was improper").

31. *See, e.g.*, Bromberg & Lowenfels, *supra* note 29, at 663-64, 676-683 ("reckless disregard" standard).

32. *See, e.g.*, Koehler v. Pulvers, 614 F. Supp. 829, 845 (S.D. Cal. 1985) (refusing to find attorney possessed the requisite state of mind, despite four years' extensive legal work and knowledge of fraudulent financial planner scam perpetrated by client real estate developers).

33. *See, e.g.*, Harmsen v. Smith, 693 F.2d 932, 943 (9th Cir. 1982), *cert. denied*, 464 U.S. 822 (1983); *In re* U.S. Grant Hotel Associates, Ltd., 740 F. Supp. 1460, 1464 (S.D. Cal. 1990) ("In order to establish aider and abettor liability, a plaintiff must show. . . actual knowledge by the alleged aider and abettor of the wrong.") More stringent are cases such as Wright v. Schock, 571 F.Supp. 642, 662-63, *aff'd*, 742 F.2d 541 (9th Cir. 1984) ("actual knowledge by the alleged aider and abettor of the wrong and of his or her role in furthering it"); B.K. Medical Sys. v. Clesh, FED. SEC. L. REP. (CCH) § 92,301 (W.D. Pa. 1984) ("[t]hat the aider-abettor knowingly and substantially participated in the wrongdoing").

the shift to section 12 is the state of mind requirement. Under section 12(2), the fault requirement is mere lack of reasonable care. Moreover, it is the defendant who must sustain the burden of proof that she did not know, and in the exercise of reasonable care could not have known, of the untruth or omission. And under section 12(1), which imposes liability for failures to register, the liability is strict liability.

The hitch in applying section 12 is that liability is limited to sellers. Plaintiffs, though, achieved a fair but somewhat limited measure of success in shoehorning a variety of collateral participants into broadened definitions of who sellers are under the securities laws. Various circuits adopted various tests ranging from narrow to quite broad. During the 1980s, though, plaintiffs and commentators shifted their attention to Securities Act section 12(2) and broadened seller status.[34]

In summary, under rule 10b-5 collateral participants generally will be held liable, if at all, under common law aiding and abetting secondary liability concepts. The net a plaintiff can cast is wide but significantly limited by the high degree of fault a plaintiff must prove. Under section 12(2) for section 12(2), the net a plaintiff can cast is not nearly so wide. The tradeoff, however, is that mere negligence will suffice. In cases of registration violations, no fault at all need be proven.

Other theories of collateral participant liability may exist but aiding and abetting and broadened seller status have become the primary two. Some plaintiffs attempt to cross over, mixing and matching these two weapons, as in alleging that defendants aided and abetted a section 12 violation. These plaintiff assertions give conservative commentators fits but have made little, if any, headway with courts.[35]

By the mid 1980s, the basic law of the land was rule 10b-5, with aid-

34. *See, e.g.*, Branson, *supra* note 2, at 335 n.41 (almost all commentary from 1981-86 focused on section 12 rather than on aiding and abetting and Rule 10b-5).

35. *See, e.g.*, SEC v. Seaboard Corp., 677 F.2d 1301, 1311 n.12 (9th Cir. 1982); Pharo v. Smith, 621 F.2d 656, 669 (5th Cir. 1980); Ahern v. Gaussoin, 611 F. Supp. 1465, 1486 (D. Or. 1985) (the "better reasoning" is no aider and abettor liability); *In re* Diasonics, 599 F. Supp. 447, 458 (N.D. Cal. 1984) (aiding and abetting would "eviscerate" other tests courts have developed for use with section 12); Hokama v. E.F. Hutton, 566 F. Supp. 636, 642 (C.D. Cal. 1983). As to commentators, see Patricia A. O'Hara, *Erosion of the Privacy Requirement in Section 12(2) of the Securities Act of 1933, The Expanded Meaning of Seller*, 31 UCLA L. REV. 921, 982 & 985 (1984) (calling use of aiding and abetting under section 12(2) a "machination" and the "ultimate bootstrap").

ing and abetting allegations as to collateral participants, and section 12(2), with broadened seller status, each with its own advantages and limitations. Finally, the balance gradually was beginning to tip toward section 12 and its lower state of mind requirements.

In 1988, *Pinter v. Dahl*[36] changed all of that. In a Securities Act section 12(1) (failure to register) rather than 12(2) (false or misleading prospectus) case, the Supreme Court returned to the text of the statute. The Court limited seller status to those who sold or solicited the sale of the security, or actually participated in those efforts. Although the Securities Act broadly defines "sell" and "offer to sell," the Supreme Court discarded broader tests such as "substantial factor in the transaction," or "substantial factor in the sale," as without foundation in the statute's text.[37]

Moreover, the Court held that only those collateral participants who have some direct financial or economic stake in the sale can be held liable. The uncompensated volunteer who, out of excess enthusiasm or a desire to have other investors in the same boat, solicits or sells, cannot be held liable. Probably, too, a temporal requirement exists. The defendant must have solicited or sold at or about the point of sale, to use a test the Eighth Circuit grafted onto section 12.[38]

*Pinter v. Dahl* thus introduced a bright line and somewhat restrictive test of broadened seller status. In subsequent cases, lower federal courts have been quick to embrace and apply it.[39] The result has been a shift to state law to fill whatever void, real or imagined, that exists in the wake of these federal court decisions.[40]

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36. 486 U.S. 622 (1988).

37. *See, e.g., id.* at 648-51 ("The deficiency of the substantial factor test is that it divorces the analysis . . . from any reference to the applicable statutory language.").

38. *See* Wasson v. SEC, 558 F.2d 879, 888 (8th Cir. 1977) ("The point of sale is a crucial step in the Act's disclosure system . . . . [T]he sale point assumes this importance because it is the occasion where . . . relevant information can be obtained from the seller and disclosed to the buyer.").

39. At the court of appeals level alone, the decisions are becoming numerous and uniform, invariably finding no liability. *See, e.g.*, Wade v. Skipper's, Inc., 915 F.2d 1324, 1328-29 (9th Cir. 1990) (collateral participant corporation not a seller); Insurance Co. of N. A. v. Dealy, 911 F.2d 1096, 1100-01 (5th Cir.1990) (issuer of surety bond not a seller of oil and gas partnership units); Moore v. Kayport Package Exp., Inc., 885 F.2d 531, 538-40 (9th Cir. 1989) (attorneys, accountants, and stockbrokers not sellers); Royal Am. Managers, Inc. v. IRC Holding Corp., 885 F.2d 1011, 1017 (2d Cir. 1989) (attorney who attended portions of all sales meetings who was also director and executive committee member of issuer held not a seller); Crawford v. Glenn's, Inc., 876 F.2d 507, 512 (5th Cir. 1989) (corporate officer of non-issuer who had not dealt with plaintiff not a seller); Wilson v. Saintine Exploration & Drilling Corp., 872 F.2d 1124, 1126 (2d Cir. 1989) (law firm's "ministerial act" of mailing private placement memorandum to investor "cannot under any view be considered the kind of solicitation required under *Pinter*"); Abell v. Potomac Ins. Co., 858 F.2d 1104, 1115 (5th Cir. 1988) (law firm that had prepared misleading offering circular not a seller).

40. An even more radical contraction of federal law's reach is presaged by deci-

### C. *Collateral Participant Liability: Tactics, Strategy and Policy*

Obviously, plaintiffs name collateral participants as defendants to reach deep pockets, or to reach any pocket at all. In the usual case, the primary violator, the issuer, is insolvent or defunct.

Plaintiffs' lawyers, though, usually are more sophisticated than that. They name as defendants anyone with any possible culpability and begin discovery. Typically, defendants, or their lawyers, do not cooperate in defense. They reserve the right to point fingers, blaming each other. More often, actual finger-pointing begins soon after discovery has commenced. Escalating further, defendants formalize finger-pointing by filing third party complaints, bringing into the case still additional defendants, or by filing cross-claims against those co-defendants already in the case.

This typical lack of cooperation, and the predictability of it, whatever its source may be, is fertile ground that permits plaintiffs to proceed to step two. Step one, of course, is naming a number of defendants. Step two is utilizing the tactical device game theorists call the prisoners' dilemma.[41] Once through the discovery process, if probable culpability has been established, plaintiffs will isolate one or two of the peripheral but culpable defendants, reaching a settlement with them that the defendant cannot refuse, given the cost of a probable trial, or a trial plus adverse publicity. By payment into its coffers of the settlement amount, the plaintiff fattens its war chest and proceeds. The path down which the plaintiff proceeds may have way stations working the prisoners' dilemma still further with additional party defendants, or may lead straight to the courthouse and trial.

The key for defendants, of course, is cooperation. If culpability exists, they should undertake coordinated, rather than individual, settlement efforts early. If the consensus is that no one has done anything wrong, and plaintiffs' loss is due to changed business conditions or good faith errors in judgement, defendants should present a

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sions such as Ballay v. Legg Mason Wood Walker, Inc., 925 F.2d 682 (3rd Cir. 1991) (holding that Securities Act section 12(2) is limited to the initial offering stage and has no application to other securities trades). *See also* T. Rowe Price New Horizons Fund, Inc. v. Preletz, 749 F. Supp. 705 (D. Md. 1990). *But see* Therese H. Maynard, *Liability Under Section 12(2) of the Securities Act of 1933 for Fraudulent Trading in Postdistribution Markets*, 32 WM. & MARY L. REV. 847, 848 (1991) (decisions represents a "strained and rather distorted reading of the statute").

41. *See generally* ROBERT AXELROD, THE EVOLUTION OF COOPERATION (1984). *See also* Robert Axelrod, *Effective Choice in the Prisoners' Dilemma*, 24 J. CONFLICT RES. 379 (1980); Robert Harris, *Note on Optimal Policies for the Prisoners' Dilemma*, 76 PSYCH. REV. 375 (1969).

unified or at least coordinated defense effort, reserving the finger-pointing until later. In the typical case, however, they never do.

Defendants' biggest aid then has not been common sense but federal courts. *Hochfelder*, *Pinter v. Dahl*, and their progeny have had the effect of limiting the ability of plaintiffs to work the prisoners' dilemma. Plaintiffs cannot name as many defendants, or present colorable claims against them, as before. One method of viewing the resurgence of state law is an attempt by plaintiffs to regain at least some of the strategic ground that has been lost on the federal level.[42]

More from a policy than a strategy standpoint, the turn toward state law may have its genesis in erroneous policy assumptions by federal courts. Especially with the *Dahl* solicitation test, but also with the aiding and abetting substantial assistance and knowledge requirements, the judicial assumption seems to be that collateral participants should be found at fault when they have become over-involved in the primary violator's activity. Actual selling efforts, whether born of an excess of greed or enthusiasm, are the paradigm of over-involvement. And, indeed, liability, or the specter of it in such cases, seems proper.

There is, however, another side. Many collateral participants are culpable and should be held liable, not because they over-perform but because they knowingly or recklessly under-perform.[43] The attorney who because of ignorance of securities law, or perhaps more likely a desire to get or retain the client's other legal business, turns a blind eye to a registration or a disclosure violation, is as culpable as one who over-performs. An appraiser who gives a high appraisal based upon incomplete analysis and labels it "for client's eyes only," knowing full well that the document will be a keystone in selling a deal, under-performs but seems culpable.[44] The accountant who

42. Yet another tactical difficulty with federal legal requirements is that, as against professional defendants such as attorneys or accountants, by alleging higher states of mind, plaintiffs may plead themselves into professional malpractice policies' exclusions for intentional misconduct. Plaintiffs may enhance their legal case but simultaneously plead and prove themselves out of any chance for a generous settlement or recovery. These ubiquitous exclusions furnish yet another reason to turn to state laws, among which lower state of mind requirements have come to predominate. *See infra* notes 99-106 and accompanying text.

43. Some older decisions recognize and codify this but the recent trend has been the other way. As to the former, see, e.g., SEC v. Frank, 388 F.2d 486, 489 (2nd Cir. 1968) ("A lawyer, no more than others can escape liability for fraud by closing his eyes to what he saw and could readily understand."); Adams v. American Western Sec., Inc., 510 P.2d 838, 843-44 (Or. 1973) (an attorney who performs only routine legal work nonetheless will be held liable if he has actual knowledge that the client has or is violating the securities laws).

44. *See, e.g.*, Buffo v. Graddick, 742 F.2d 592, 594 (11th Cir. 1984) (appraisal of $720,000 on land arguably worth only $18,000); Schmidt v. Cornerstone Investments, Inc., 795 P.2d 1143, 1145 (Wash. 1990) (appraisal of $460,000 on commercial property months early appraised at $120,000-155,000).

prepares track record data for a repeat syndicator or an investment advisor, knowing it to be puffed considerably, but labels it a "compilation," under-performs and thus escapes liability but may be as culpable as the primary defendant. Raising the long glass to the blind eye, as Horatio Nelson did at the Battle of the Nile when signaled to retreat, has always been common among many classes of collateral participants in business deals.

Arguably, under federal securities law, blind eye practices now are encouraged by the legal test applicable to those collateral participants. Over and over these cases arise: the lawyer, the accountant, the appraiser, the corporate director, or the banker turns a blind eye toward suspected wrongdoing. With the solicitation test under Securities Act section 12, and substantial assistance and knowledge requirements for rule 10b-5 aiding and abetting, plaintiffs have great obstacles to surmount in many cases in which collateral participants should be held responsible, in whole or in part, for the financial losses that have occurred. From a policy standpoint, two questions should arise. Should that void be filled? Does state securities law already go all or part of the way in filling any void that may exist with regard to collateral participants in securities transactions?[45]

## II. LIABILITY UNDER STATE LAW

### A. *Statutory Patterns*

The dominant state statute is the Uniform Securities Act of 1956.

45. The other antipode is deputizing accountants, lawyers, and others as "traffic cops of fraud," assigning to them a duty of plenary inquiry into clients' ventures and activities. That extreme reached its apotheosis with the White and Case whistleblowing case, in which the SEC contended that upon discovering material omissions in merger documents, a lawyer should have withdrawn and notified the SEC if the client attempted to go forward. *See* SEC v. National Student Mktg. Corp., 457 F. Supp. 682 (D.D.C. 1978). At about the same time, a respected SEC Commissioner, Al Sommer, made a famous speech in which he gave currency to the traffic cops of fraud idea. *See* Sommer, *The Emerging Responsibilities of the Securities Lawyer*, [1973-74 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,631 (Jan. ; 1974). The SEC soon backed off from its extreme position. *See In re* Carter & Johnson, SEC RELEASE No. 34-17397 (Feb. 28, 1981) (only whistleblowing duty alleged is to higher-ups within the organization represented). Today no one contends that lawyers, accountants, or other collateral participants are duty bound to root out, let alone blow the whistle on, client frauds. Be that as it may, closing one's eyes to a fraud one knows or has firm suspicions is occurring, and continuing to be involved, is a far different matter than action as a traffic cop of fraud, *See, e.g.*, Adams v. Am. West Securities, Inc., 510 P.2d 838 (Or. 1973). *See also* Martin B. Robbins, *Policeman, Conscience or Confidant: Thoughts on the Appropriate Response of a Securities Attorney Who Suspects Violations of the Federal Securities Laws*, 15 J. MARSHALL L. REV. 373 (1982).

That statute has been the law of thirty-seven jurisdictions.[46] The Uniform Act, however, is not uniform, as states have adopted a "model" rather than uniform act approach to it, enacting substantial local variations, both at the time of original enactment and subsequently.

In 1985, the Commissioners on Uniform State Laws updated the Uniform Securities Act, in part motivated by a desire to reintroduce uniformity.[47] Six states have adopted the 1985 version, three being states that had the uniform statute previously and upgraded to the 1985 model.[48] The other three states represent new adoptions, bringing the number of Uniform Securities Act jurisdictions to approximately forty.[49]

Of the Pacific Rim states, Alaska, Washington, Oregon, and Hawaii have adopted versions of the 1956 Uniform Securities Act. By contrast, California has a home-grown state securities act.[50]

### *B. Civil Liability Provisions*

Essentially, the beginning point in analyzing federal law is common law. Applicable federal statutes and rules apply only to "any person"[51] or to "any person who offers or sells."[52] They are cryptic enactments. The need to resort to case law and commentary to give meaning to those terms is immediate.[53]

In contrast, state securities laws have civil liability provisions more detailed than their cryptic federal counterparts. These civil liability provisions thus require more attention before resort is had to the case law.

The civil liability provision of the 1956 Uniform Securities Act provides that "[a]ny person who . . . offers or sells a security in violation of [registration requirements] . . . is liable to the person buying the

46. *See* 7B UNIFORM LAWS ANN. at 509 (1985) (table of 36 states and Puerto Rico).

47. *See generally* HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS OF THE ANNUAL CONFERENCE MEETING IN ITS NINETY FOUR YEAR at 349 (1985) (hereinafter COMMISSIONERS ON UNIFORM STATE LAWS—PROCEEDINGS OF ANNUAL MEETING (1985)).

48. Those states all are Rocky Mountain or Western States: Colorado, Nevada and New Mexico. *See, e.g.*, COLO. REV. STAT., Article 51 (prefatory table of adopting states) (1990 & Supp. 1991).

49. *Id.* (Maine & Vermont). Apparently, South Dakota also has adopted the 1985 version.

50. CALIF. CORP. CODE §§ 25000-25804 (1968). California's neighbor to the east, Arizona, also has a home grown securities act. *See* ARIZ. REV. STAT. ANN. § 44-2003 (1951).

51. SEC Rule 10b-5, 17 C.F.R. 240.10b-5.

52. Securities Act of 1933 § 12, 15 U.S.C. § 77l.

53. *Cf.* Securities Act of 1933 § 11, 15 U.S.C. § 77k (long, complex statutory provision naming several classes of collateral participants who become primarily liable for material misrepresentations or omissions in registered offerings).

security from him . . . ."[54] The seller or offeror also is liable if he "offers or sells a security by means of an untrue statement of a material fact or omits to state a material fact . . . ."[55] The question that arises is the same as that under Securities Act of 1933 section 12. That question is how expansive are the terms "seller," and "any person who offers or sells."

Arguably, seller is not elastic at all, for the very next subsection of the civil liability provision deals with individuals other than sellers, naming some but by no means all categories of frequently seen collateral participants:

> Every person who directly or indirectly controls a seller liable [for registration violations], every partner, officer, or director of such a seller [who has violated registration rules], every person occupying a similar status or performing similar functions, every employee of such a seller who materially aids in the sale . . . is liable unless the non-seller who is so liable sustains the burden of proof that he did not know, and in [the] exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.[56]

Oregon has made its collateral participant provision much more expansive, although the basic framework is still Uniform Securities Act section 410. In addition to "every partner, officer or director," Oregon's statute holds liable "every [other] person who participates or materially aids in the sale."[57] That phrase is an expansive substitution for the original narrow language, which merely adds to the list "every employee of the seller who materially aids in the sale."[58]

Washington's version of the Uniform Act reflects only fine tuning done by the Legislature. Washington makes the civil liability provision applicable to buyers as well as to sellers.[59] Washington retains

54. UNIFORM SECURITIES ACT § 410(a)(1), 7b UNIFORM LAWS ANN. 643 (1985).

55. *Id.* at (a)(2).

56. *Id.*

57. OR. REV. STAT. § 59.115 (Supp. 1991).

58. Arizona has a statute with similar language and express reach. *See* ARIZ. REV. STAT. ANN. § 44-2003 (1987) ("An action . . . may be brought against any [person] . . . who made, participated in or induced the unlawful sale or purchase . . . ."). *See also* Strom v. Black, 523 P.2d 1339 (Ariz. App. 1974) (statute applied to business broker who omitted material information); Trump v. Badet, 327 P.2d 1001, 1004 (Ariz. 1958) (applied to defendant attorney who acted as go-between in stock sale). Texas has a similar "any person " provision, but adds a state of mind requirement of at least recklessness to hold other persons. *See* TEX. REV. STAT. § 581-33 (Vernon Supp. 1991) ("[a] person who directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or the law materially aids a seller, buyer, or issuer of a security is liable . . . jointly and severally with the seller, buyer, or issuer.").

59. *See* WASH. REV. CODE § 21.20.430(2) & (3) (1990). By contrast, Oregon enacted a duplicate civil liability provision under which buyers can be sued for registration or antifraud violations. *See* OR. REV. STAT. § 59.127 (1989).

the original "employee . . . who materially aids in the transaction," but adds to the list "every broker-dealer, salesperson, or person exempt under the provisions of RCW 21.21.040 who materially aids in the transaction."[60]

Alaska follows the latter change, also adding to employees, "every broker-dealer or agent who materially aids in the sale."[61] Hawaii has taken Uniform Act section 410 and collapsed it all into a single sentence of a single statutory subsection. That sentence reads "Every sale made in violation of this chapter shall be voidable . . . and the person making the sale and every director, officer, or agent of or for the seller, if the director, officer or agent has personally participated or aided in any way in making the sale, shall be jointly and severally liable . . . ."[62]

Unlike Oregon's significant expansion of the category of persons who can be held liable, Hawaii's modification represents a contraction from the Uniform Act. The contraction is not in terms of categories of persons but in the standard of liability. Under Uniform Act section 410, unless they can sustain their defense that in the exercise of reasonable care they could not have known of the violation, partners, officers, and directors are liable. That is true whether or not they have aided or participated in the transaction. Only employees benefit from the modifier "who materially aids in the transaction."[63]

Partners, directors or officers are not insurers or guarantors, because they do have an "in the exercise of reasonable care could not have known" defense. Nonetheless, they are their sibling's keeper because they can be found liable for transactions in which they have had no personal involvement. The effect is that to escape liability, partners, officers and directors must make inquiry and otherwise become personally involved in an issuer's securities transaction. Several courts have read the statute in that manner.[64] None have required

60. WASH. REV. CODE § 21.20.430(3) (1990). The 1985 Uniform Act also makes the "broker dealer" addition to the list of persons liable. Otherwise, the 1985 Act makes only stylistic changes in the civil liability provision. *See* UNIFORM SECURITIES ACT of 1985 § 605 & Comment 1, COMMISSIONERS ON UNIFORM STATE LAWS—PROCEEDINGS OF ANNUAL MEETING at 461-63 (1985) (with the exception of the addition of an anti-manipulation subsection, rewriting of the section "is not intended to alter significantly existing law.").

61. ALASKA STAT. § 45.55.220(c) (1991).

62. HAW. REV. STAT. § 485-20(a) (Supp. 1991).

63. UNIFORM SECURITIES ACT 410(a)(1), 76 UNIFORM LAWS ANN. 643 (1985). It would be otherwise if a comma had been placed after "every employee of such a seller," as in "every partner, officer, [or] director . . . every employee of such a seller[,] who materially aids in the transaction." *See supra* note 55 and accompanying text.

64. *See* Hines v. Data Line Sys., Inc., 787 P.2d 8, 16-17 (Wash. 1990). *Accord* Mitchell v. Beard, 513 S.W.2d 905, 907 (Ark. 1974); Arnold v. Dirrim, 398 N.E.2d 426, 433 (Ind. App. 1979); Taylor v. Perdition Minerals Group, Ltd., 766 P.2d 805, 810 (Kan. 1988); Rzepka v. Farm Estates, Inc., 269 N.W.2d 270, 273 (Mich. App. 1978); Foelker v. Kwake, 568 P.2d 1369, 1373 (Or. 1977).

that a partner, officer or director "personally participate or aid" in the transaction. The Hawaii Legislature, though, has imposed such an additional requirement on partner, officer or director liability.[65]

### C. *California's Approach*

California devotes an entire chapter of its code to civil liability.[66] To understand that chapter's approach, however, one must back away for an even wider view. In its substantive provisions, California devotes separate statutory sections to each garden variety form of securities law violation. For example, separate sections make unlawful manipulation of securities prices or trading volumes,[67] material untruths or omissions,[68] and trading while in possession of inside information.[69]

In the civil liability chapter, then, California devotes a separate statutory section to civil liability for each distinct practice previous substantive sections have made unlawful. Thus, "any person who willfully participates" in manipulative acts or transactions is liable.[70] Under another section, any person who violates the antifraud rule "shall be liable to the person who purchases a security from him or sells a security to him . . . ."[71] Separate civil liability provisions exist for insider trading[72] and for selling securities without a permit.[73] A newer section spells out liability of accountants, engineers, appraisers and other experts who use their expertise or permit their name to be used in a prospectus or offering circular.[74]

Several catchall provisions exist. One section of the California civil liability chapter is essentially a modification of Uniform Securities

65. Nevertheless, the Supreme Court of Hawaii has taken back some of the protection offered partners, officers and directors by holding that the term " 'aided' not only includes assisting in the inducement but rather covers any contribution to the disposition of securities." Young v. Kwock, 474 P.2d 285, 287 (Haw. 1970).

In similar fashion, Oregon's predecessor statute, repealed in 1967, required that a director, officer or agent, as well as any other collateral participant, actually participate in a sale which violated the securities law. *See, e.g.*, Gonia v. E. I. Hagen, 443 P.2d 634, 634 (Or. 1968) (construing then effective OR. REV. STAT. § 59.250(1)); Adamson v. Lang, 389 P.2d 39, 41 (Or. 1964).

66. CAL. CORP. CODE §§ 25500-25510 (West 1991).

67. *See id.* at § 25400.

68. *Id.* at § 25401.

69. *Id.* at § 25402.

70. *Id.* at § 25500.

71. *Id.* at § 25501.

72. *Id.* at § 25502.

73. *Id.* at § 25503.

74. *Id.* at § 25504.2 (West Supp. 1991).

Act section 410.[75] Indirectly, the statute picks up purchasers as well as sellers.[76] The section also adds the modifier "principal executive" to "officer," and, as many other states do,[77] adds "every broker-dealer or agent who materially aids" after the Uniform Act language pertaining to "every employee . . . who materially aids."[78] The affirmative defense given these named persons is also different. The Uniform Act language is "in the exercise of reasonable care could not have known of the existence of the facts by reason of which the liability is alleged to exist."[79] The California defense is that the defendant had no knowledge of or "reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist."[80]

By a newer provision, California's statute broadens the list of persons who can be named to "any person who materially assists in any violation of [registration or antifraud sections]."[81] But while the statute broadens the list of potential defendants, it also increases a plaintiff's burden of proof as to these additional collateral participants. Plaintiff must allege and prove that the other person who materially assisted the primary violation did so "with intent to deceive or defraud."

The California Assembly's extensive enactments in the area of defining offenses of its securities law and their labyrinth of civil liability provisions is without parallel in any other state or even the federal scheme.[82] For purposes of this article, however, the examination of this impressive body of law must be somewhat limited.

75. *Id.* at § 25504.

76. By beginning with the cross-reference: "[e]very person who directly or indirectly controls a person liable under Section 25501 [antifraud section] or 25503 [sales without a permit]," the statute incorporates the inclusion in those sections' of purchasers as well as sellers. *Id.*

77. *See, e.g., supra* notes 59-61 and accompanying text (Alaska's and Washington's additions to the Uniform Securities Act civil liability provision).

78. CAL. CORP. CODE § 25504 (West 1991).

79. UNIFORM SECURITIES ACT § 410(a)(1), 7b UNIFORM LAWS ANN. 643 (1985).

80. CAL. CORP. CODE § 25504 (West 1991).

81. CAL. CORP. CODE § 25504.1 (West Supp. 1991).

82. Even among substantive provisions of the corporate law portion of the California Corporations Code exist additional liability provisions that from time to time plaintiffs utilize in securities cases. For example, Section 1507(a) of the California Corporations Code makes officers, directors, agents or employees of a corporation liable if they "[m]ake, issue, deliver or publish any prospectus, report, circular, certificate, financial statement, balance sheet . . . or participate in the making, issuance, delivery or publication thereof . . . ." CAL. CORP. CODE § 1507(a) (West 1991). Further subsections render those individuals liable for false entries in books or records or erasures or alterations of book entries. *See* CAL. CORP. CODE § 1507 (b) & (c) (West 1991). But the entire "cooked books" section is modified by a true *scienter* requirement. To establish liability a plaintiff must prove that the officer, director or employee made or published the false statement "with knowledge that the same is false in a material respect." *Id.* at § 1507(a). Liability arises only for alterations or erasures "with intent to deceive."

Three catchall liability provisions then are the focus. They are: (1) the civil liability provisions for general antifraud rule violations,[83] which is a combination of Federal Securities Act section 12(2) and clause (b) of rule 10b-5; (2) the collateral participant provision ("every partner, every principal executive officer or directors");[84] and (3) the expanded collateral participant provision ("any person who materially assists . . . with intent to deceive or defraud").[85]

### D. *State Securities Laws General Antifraud Rules*

Before a full discussion of collateral participant liability can begin, one other item must be put on the table. Each state securities act has a general antifraud section that tracks the SEC general antifraud rule, rule 10b-5.[86] The source of these state enactments is Uniform Securities Act section 101.[87]

From North to South along the Pacific Rim, Alaska and Washington merely replicate the Uniform Securities Act provision.[88] Oregon substitutes a lengthy series of phrases for "in connection with the offer, sale or purchase of a security," that, among other items, deletes the word "offer."[89] California, as usual, requires more explanation. The California substantive provision uses language arguably narrower than Uniform Securities Act section 101. The section invalidates offers, sales or purchases "by means of any written or oral communication" which contains an untruth or omission relating to a

83. *Id.* at § 25501.

84. *Id.* at § 25504.

85. *Id.* at § 25504.1 (1977 West & Supp. 1991).

86. 17 C.F.R. § 240.10b-5.

87. *See, e.g.*, 7B UNIFORM LAWS ANN. at 516 (1986):

> It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly
> (1) to employ any device, scheme, or artifice to defraud,
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

*Id.*

88. *See* ALASKA STAT. § 45.55.010 (1959) (substituting "a person" for "any person"); WASH. REV. CODE § 21.20.010 (1990).

89. *See* OR. REV. STAT. § 59.135 (1988) ("It shall be unlawful for any person, directly or indirectly, in connection with the purchase or sale of any security or the conduct of a securities business or for any person who receives any consideration from another person primarily for advising the other person as to the value of securities, or their purchase or sale, whether through the issuance of analyses or reports or otherwise.")

material fact,[90] rather than outlawing certain acts or omissions "in connection with" offers, sales or purchases.[91] The California antifraud rule, like Hawaii's,[92] also adds a geographic qualifier, "in this state," as in "offer or sell a security in this state . . . by means of any [untrue] written or oral communication."[93]

The companion California civil liability provision, however, goes off in a different direction. The provision resembles Federal Securities Act section 12 rather than grafting an express provision for civil liability onto rule 10b-5-language:

> Any person who violates Section 25401 [the general antifraud section] shall be liable to the person who purchases a security from him or sells a security to him, who may sue either for rescission or for damages . . . unless the defendant proves that the plaintiff knew the facts concerning the untruth or omission or that defendant had exercised reasonable care and did not know (or if he had exercised reasonable care would not have known) of the untruth or omission.[94]

Finally, with the exception previously noted, Hawaii returns to rule 10b-5 language, but inserts two clarifying cross-references.[95] Then, after replicating the three clauses of rule 10b-5, Hawaii adds its own clauses 4 through 7. These clauses add *per se* violations of the general antifraud rule. Those violations relate to untrue or misleading written prospectuses, circulars or other advertising material, failures to file the same with the commissioner, issuing such material anonymously, and the like.[96]

### *E. Standing, State of Mind and Other Antifraud Rule Issues*

Federal SEC rule 10b-5 contains the tagline "in connection with the purchase or sale of a security."[97] Soon after its enactment, the courts interpreted that language as a standing requirement.[98] The Burger Court later upheld the purchaser-seller requirement after lower federal courts had begun to erode it.[99] To get past the federal courthouse door, no matter how outrageous a defendant's untruths or omissions have been, the plaintiff must have purchased or sold securities.

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90. CAL. CORP. CODE § 25401 (West 1991).

91. *See generally* C. Edward Fletcher, *The "In Connection With" Requirement of Rule 10b-5*, 16 PEP. L. REV. 913 (1989).

92. *Compare* HAW. REV. STAT. § 485-25 (a) (1984) ("in the State") *with* CAL. CORP. CODE § 25401 (West 1969) ("in this state").

93. CAL. CORP. CODE § 25401 (West 1991).

94. *Id.* at § 25501 (1984).

95. *See* HAW. REV. STAT. § 485-25(a) (1984).

96. HAW. REV. STAT. § 485-25(a)(4)-(7) (1984). Subsection (b) contains a similar litany of *per se* violations for investment advisors.

97. ITC. F.R. § 240.106-5.

98. The earliest case is Birnbaum v. Newport Steel Co., 193 F.2nd 461 (2d Cir. 1952).

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

Assuming the existence of a substantive violation of state securities act antifraud provisions,[100] an issue frequently raised of late, those state antifraud provisions would grant broader standing. Most declare unlawful certain practices "in connection with the offer, sale or purchase of any security."[101] An offeree would have standing, although imagining what damages a mere offeree would have seems difficult at first blush.

One such instance would be that in which the offeror's negative misdisclosure had caused the offeree to forego a favorable investment opportunity that other investors had then seized.[102] Another might be the case of a takeover bid. One who had not tendered shares would have standing to raise untruths or omissions that caused the stampeding of fellow shareholders into the offeror's outstretched arms.[103]

One hypothetical illustration of the SEC rule 10b-5 purchaser-seller requirement involves the broker who fails to disclose negative news to her client. The motive might be so that the broker and her more favored clients might be the first to sell, that is, the first to abandon a listing ship. Even though "every hold is a buy," and the broker's conduct is the very type securities laws should police, the plaintiff would have no standing because, on the federal level, she has neither bought nor sold, and under state statutes, she is neither offeree nor seller nor purchaser.[104]

Oregon, however, remedies this problem. The Oregon antifraud provision grants standing to those harmed by prohibited conduct ("device, scheme, artifice to defraud," or material untruths or omissions) when that conduct has occurred "in connection with . . . the conduct of a securities business,"[105] regardless of whether the plain-

100. *See infra* notes 182-201 and accompanying text.

101. UNIFORM SECURITIES ACT § 101, 7B UNIFORM LAWS ANN. 516 (1985) (emphasis added).

102. *Blue Chip Stamps*, 421 U.S. 723, is such a case. Another is Iroquois Industries, Inc. v. Syracuse China Corp., 417 F.2d 963 (2d Cir. 1969), *cert. denied*, 399 U.S. 990 (1970).

103. *See, e.g.*, Douglas M. Branson, *Some Suggestions from a Comparison of British and American Tender Offer Regulation*, 56 CORNELL L. REV. 685, 702-03 (1971) (explaining reason for "in connection with any tender offer" standing rule incorporated in statutory antifraud rule applicable to takeover bids).

104. *See, e.g.*, Molasky v. Garfinkle, 380 F. Supp. 549, 551-52 (S.D.N.Y. 1974) (complaint that accountants and issuer had conspired fraudulently to induce plaintiff to retain her shares dismissed for failure to state a claim upon which relief could be granted).

105. OR. REV. STAT. § 59.135 (1988).

tiff has bought or sold securities. The prohibition extends also to the rendering of investment advice for consideration and for "advising the other person as to the value of securities."[106] The latter provision could be used by a plaintiff to vindicate harms done by business brokers and similar valuation experts in a given case. Most jurisdictions, though, have enacted only the standard Uniform Act language "in connection with the offer, sale, or purchase."[107]

A generally acknowledged open question under state general antifraud statutes is the required level of fault. The issue became acute after *Ernst & Ernst v. Hochfelder* held that any state of mind higher than a mere lack of reasonable care was required under SEC rule 10b-5.[108] State laws generally follow the language of rule 10b-5 but they do so as statutory enactments rather than administrative rule. On its face the rule 10b-5 language is that of strict liability. The rule, and state general antifraud statutes, flatly make it unlawful "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading."[109]

In *Kittilson v. Ford*,[110] the Washington Supreme Court noted the similarity of the language but difference in source: "[I]n contrast to the federal scheme, the language of rule 10b-5 is not derivative but is the statute in Washington."[111] The court therefore declined to follow *Hochfelder*. Under Washington's state securities law, proof of negligence is sufficient grounds for liability.

So many states, particularly those in the West, have followed this reasoning that the state law state of mind question may no longer be an open one.[112] Washington courts have reiterated the Washington Supreme Court's initial observation.[113] A smattering of decisions from other parts of the United States have reached the same conclu-

106. *Id.*

107. 7B UNIFORM LAWS ANN. 516 (1985).

108. *See supra* notes 19-25 and accompanying text.

109. *See, e.g.*, ALASKA STAT. § 45.55.010 (1959); OR. REV. STAT. § 59.135 (1988); WASH REV. CODE. § 21.20.010 (1990).

110. 608 P.2d 264 (Wash. 1980).

111. *Id.* at 265.

112. *See, e.g.*, State v. Gunnison, 618 P.2d 604, 607 (Ariz, 1980), *overruling* State v. Superior Court of Maricopa County, 599 P.2d 777 (Ariz. 1979) and Greenfield v. Cheek, 593 P.2d 280; Rose v. Dobras, 624 P.2d 887, 892 (Ariz. App. 1981); Pottern v. Bache Halsey Stuart, Inc., 589 P.2d 1378, 1379 (Colo. App. 1978); State *ex rel.* Mays v. Ridenhour, 811 P.2d 1220, 1232-33 (Kan. 1991); Fakhrdai v. Mason, 696 P.2d 1164, 1166-67 (Or. App. 1985). *See also* Bowden v. Robinson, 67 Cal. App. 3d 136 Cal. Rptr. 871, 878, 705 (1977) (California general antifraud civil liability provision is not a strict liability provision—burden is on defendant to prove freedom from negligence).

113. *See, e.g.*, Golberg v. Sanglier, 616 P.2d 1239, 1248 (Wash. App. 1980), *rev'd on other grounds*, 639 P.2d 1347 (Wash. 1981), *modified*, 647 P.2d 489 (Wash. 1982); Aspeland v. Olerich, 784 P.2d 179, 182 (Wash. App. 1990).

sion.[114] Under state securities laws' general antifraud statutes, allegation and proof of mere negligence is the general state of mind requirement. That lower requirement seems a big advantage for plaintiffs, because the federal standard is higher and because state of mind, or fault, quickly becomes the focal point in securities law cases, particularly those in which plaintiff seeks recovery from collateral participants in the transaction.[115]

## III. THE OPEN QUESTIONS FOR COLLATERAL PARTICIPANTS AND COURTS UNDER STATE SECURITIES LAWS

### A. *Preview*

The thorny questions that practitioners ask begin with the state securities acts' civil liability provisions. The first is, can plaintiffs expand the term seller, as in Uniform Securities Act section 410(a), to include within its ambit collateral participants other than those named by Uniform Securities Act section 410(b) and its progeny? If plaintiffs can do so, what is the test of expanded seller status? Beyond strict privity, in the sense of passing title, is the proper state law test of expanded seller status a broader, but still limited, transactional privity? Or is it a solicitation, point of sale analysis similar to that the Supreme Court adopted in *Pinter v. Dahl*? Or is a broader still substantial factor, substantial contributive factor, or proximate cause test that various of the federal circuits, and a few state courts, attempted to articulate before *Pinter v. Dahl* a more appropriate test of expanded seller status under state law?

What is the standard for liability of collateral participants in states such as Oregon or Arizona which impose liability upon "every person who participates or materially aids" in the sale?[116] What prevents routine rendition of professional services from resulting in liability? Do the lines courts draw under those statutes offer any guidance for courts called upon to expand seller status under the Uniform Securities Act civil liability provision?

Moving to state law general antifraud statutes, the first question is whether an implied private right of action exists for their violation,

114. *See, e.g.*, Crook v. Shearson Loeb Rhodes, Inc., 591 F. Supp. 40, 49 (N.D. Ind. 1983); State v. Temby, 322 N.W.2d 522, 526 (Wis. App. 1982).

115. *But see infra* note 211 and preceding text (explaining the conclusion that an across-the-board negligence floor may turn out to be disadvantageous for plaintiffs).

116. *See, e.g.*, ARIZ. REV. STAT. ANN. § 44-2003 (1987); OR. REV. STAT. § 59.115(3) (1988).

independent of the civil liability provision? Expressed another way, is the civil liability provision of the state securities act exclusive? If a private right of action exists, does that right include within its reach implied secondary liability for those who assist or otherwise become involved in the primary violator's wrongdoing? Is the test of such secondary liability aiding and abetting? If aiding and abetting is a legitimate allegation under state antifraud statutes, is the state of mind requirement the same as, or is it higher, than that required to be proven against a primary violator? These and other intractable subjects are the topics to which this more analytical section of the article addresses itself.

### B. *Expanded Seller Status*

In 1987, in *Haberman v. WPSS*,[117] when the Supreme Court of Washington first addressed itself to the question, Justice Brachtenbach could find only two other state law decisions that had addressed the issue. One had refused to adopt broadened seller status under the Uniform Securities Act civil liability provision.[118] The other had followed federal decisions, adhering to a substantial factor test of expanded seller status under a Uniform Securities Act 410 based provision.[119] The Supreme Court of Washington adopted the latter course, holding that a collateral participant could be held as a seller "if his acts were a substantial contributive factor in the sales transaction,"[120] and raising the number of state court decisions on the issue to three.

Since that time, and reflecting the rapid emergence of state law, there have been a number of decisions,[121] including at least four by the Washington Supreme Court alone.[122] The vast majority of these decisions adopt and apply tests of expanded seller status. The principal debate is the contour of the test of expanded seller status. At least the latter is true if one analyzes the issue state by state rather than by sheer number of opinions. The statement made must be qualified in this way because the number of California decisions rivals reported cases in all other jurisdictions combined. And the California decisions require strict privity.[123]

117. 744 P.2d 1032, 1050 (Wash. 1987) *modified in part*, 750 P.2d 254 (Wash. 1988).
118. Nikkel v. Stifel, 542 P.2d 1305, 1307 (Okla. 1975).
119. Anders v. Dakota Land & Develop. Co., 380 N.W.2d 862, 868 (Minn. App. 1986).
120. *Haberman*, 744 P.2d at 1051.
121. *See infra* note 133 for decisions from other states.
122. Hoffer v. State, 755 P.2d 781 (Wash. 1988) (Hoffer I); Hoffer v. State, 113 N.W.2d 148 (Wash. 1989) (Hoffer II); Hines v. Data Line Systems, 787 P.2d 8 (Wash. 1990); Schmidt v. Cornerstone Investments, 795 P.2d 1143 (Wash. 1990).
123. *See, e.g.*, Victor v. White, BLUE SKY L. REP. ¶ 73,015, at 74,046 (N.D. Cal. 1989) ("strict privity" is required; cannot "honestly be contended" that indenture trustee was a seller of municipal bonds under s. 25501); *In re* ZZZZ Best Securities Litigation,

Alternatively, California cases hold that to be held under the state's antifraud rule a defendant must actually have been a "literal seller."[124] The latter phrasing arguably would expand the defendant class beyond those who pass title in the legal sense, but not by much.[125] Last of all, in order to survive a motion to dismiss, a California antifraud rule plaintiff must be a direct purchaser. Even if they are able to prove both reliance and loss causation, aftermarket and other purchasers from third parties cannot hold a defendant for misrepresentations because they did not purchase from him.[126]

The California position is anomalous but understandable. On its face, the California general antifraud provision seems to be a generous no fault scheme. The general antifraud provision combines the language of Federal Securities Act section 12(2), making unlawful offers or sales "by means of any written or oral communication which includes an untrue statement of a material fact," with clause (b) of Federal rule 10b-5.[127] Neither component mentions fault or state of mind. Only the companion civil liability provision prevents a strict

BLUE SKY L. REP. ¶ 73,015 at 73,833, 838-39 & 847-48 (C.D. Cal. 1989) ("Only actual sellers, i.e., the transferers of title, can be liable under § 25501"; the court therefore dismissed claims against market maker, certain underwriters and accounting firm.); Lubin v. Sybedon Corporation, 688 F. Supp. 1425, 1453 (S.D. Cal. 1988) (privity required; Section 25501 and 25504 claims against law firm and others were dismissed); *In re* National Mortg. Equity Corp. Mortg. Pool, 636 F. Supp. 1138, 1170 (C.D. Cal. 1986) ("Liability is limited to actual sellers"; the claims against a lawyer and his large Chicago law firm were dismissed); *In re* Diasonics Securities Litigation, 599 F. Supp. 447, 458-59 (N.D. Cal. 1984) (Section 25501 claims against officers, directors and co-lead underwriters were dismissed). *But see* Commins v. Johnson & Higgins, Inc., BLUE SKY L. REP. (CCH) ¶ 72,921, at 73,544 (N.D. Cal. 1988) (liability under 25501 'extends no further than liability under section 12(2) of the 1933 Act," nonetheless it dismissed claims against oil drilling venture's insurer); *In re* Activision Securities Litigation, 621 F. Supp. 415, 427 (C.D. Cal. 1985) (holding sections 25401 and 25501 "together are similar to § 12(2) and require that Plaintiffs allege seller or 'substantial factor' status.").

124. The phrasing comes from the leading case of Admiralty Fund v. Jones, 677 F.2d 1289, 1296 (9th Cir. 1982) (attorney who had assisted sale of unregistered stock could be a seller for section 12(2) purposes but could not be held under California antifraud rule which would require that he be a "literal seller").

125. Some California decisions make clear that transactional privity is what they require. *See, e.g.*, Commins v. Johnson & Higgins, BLUE SKY L. REP. (CCH) § 72,921, at 73,537 (N.D. Cal. 1988) (attorney who drafted a telephone sales compliance manual and spoke with potential investors held liable). Many others speak in terms of "strict privity" and intimate that nothing less than passing title will suffice. *See, e.g.*, *supra* note 114.

126. *See, e.g.*, Griffin v. Rontek Corp., BLUE SKY L. REP. ¶ 72,960 (N.D. Cal. 1988) (Section 25501 claims were dismissed as to aftermarket purchasers of debentures).

127. CAL. CORP. CODE § 25401 (1991) ("or omits to state a material fact necessary in order to made the statements made, in light of the circumstances under which they were made, not misleading.").

liability scheme from emerging, providing that a defendant can prove that the plaintiff knew of the untruth or "that the defendant exercised reasonable care and did not know . . . of the untruth or omission."[128]

Yet access to this generous scheme for plaintiffs is extremely narrow, confined to first tier purchasers who were in strict privity with those named as defendants. Courts guard this route because, in more deliberate fashion than does any other jurisdiction, California describes other routes to be followed for reaching other defendant classes. As has been seen,[129] one provision names categories of collateral participants (partners, officers, directors, brokers, employees who materially assist).[130] Beyond named categories, another provision provides that still other defendants can be reached but the state of mind requirement scales upward to "intent to deceive or defraud."[131] Still another liability provision governs expert collateral participants who have consented to be named in offering documents.[132]

California's scheme is thus a legislative version of sliding scale analysis that at least two federal circuits have evolved as a matter of

128. *Id.* at § 25501.

129. *See supra* notes 74-76 and accompanying text.

130. But the California federal courts have held that strict privity limitation applies to section 25504 as well. Thus, a plaintiff must have been a direct purchaser from the issuer with whom the defendant is affiliated as control person, partner, officer, director, employee or broker-dealer. *See, e.g., In re* ZZZZ Best, BLUE SKY L. REP. (CCH) ¶ 72,890, at 73838 (C.D. Cal. 1989) (ZZZZ Best I) ("Under section 25504, strict privity is still required."); Lubin v. Sybedon, 688 F.Supp. 1425, 1453 (S.D. Cal. 1987) ("Because the causes of action provided for in sections 25501, 25504, 25504.1 and 25504.2 are by their terms derived from section 25401, a failure to show direct privity will defeat those derivative claims."); *In re* Diasonics 599 F. Supp. 447, 459, (N.D. Cal. 1984) ("Section 25504, by its terms, applies to violations of section 25501). Hence strict privity is still proper under the wording of section 25540 but not as to sections 25504.1 and 25504.2. For example, section 25504.1 holds '[a]ny person who materially assists in any violation" of registration or antifraud provisions "jointly and severally liable with any other person liable . . . for such violation." *Accord In re* ZZZZ Best BLUE SKY L. REP. (CCH) ¶ 73,277, at 7,4,720 (C.D. Cal. 1990) (ZZZZ Best II) ("Greenberg's argument that 'strict privity' between the defendant and plaintiff is required under section 25504.1 is without merit. From a plain reading of the statute, liability is placed upon 'any person who materially assists in any violation of Section . . . 24401.' Liability under this section is not dependent upon the alleged relationship with the vendor or purchaser.").

131. CAL. CORP. CODE § 25504.1 (West Supp. 1992). This state of mind requirement has been interpreted to impose a requirement much stricter than a federal securities law aiding and abetting construct. Orloff v. Allman, 819 F.2d 904, 907-08 (9th Cir. 1987) (requirements for pleading aiding and abetting under California law are "much stricter" than under federal law). *See also* ZZZZ Best II, BLUE SKY L. REP. (CCH) ¶ 73,277, at 74,717 (dismissing aiding and abetting allegations against New York law firm of Hughes, Hubbard & Reed that allege only recklessness and, for purposes of California law, refusing to equate, for some purposes, reckless with intentional conduct, as federal courts have done in federal securities law cases).

132. CAL. CORP. CODE § 25504.2 (West Supp. 1991).

common law.[133] That is, as a defendant, or the class of which he is a part, is or is likely to be further removed from the core of a transaction, the state of mind and perhaps other elements of a cause of action scale upward.[134] But, contrary to first impressions, rather than being a generous no fault scheme, from plaintiffs' perspective, California's extensive enactments are among the least generous. The requirement of strict privity and the high state of mind required to reach many typical collateral participants make plaintiffs' chances for recovery slim to none.

Returning to other jurisdictions and the Uniform Securities Act, the arguments for or against expansion of the term seller are several. First, along with its state-by-state counterparts, Uniform Securities Act section 410 contains a list of collateral participants who the legislature believes should be held responsible ("every partner, officer, director," etc.). Applying the maxim *expressio unius est exclusio alterius*,[135] the naming of some excludes the others not named.

In *Haberman v. Washington Public Power Supply System*,[136] the Washington Supreme Court rejected such analysis, reasoning that

> [R]espondents' argument that a substantial contributive factor approach to seller in [Uniform Securities Act section 410(a)] would render [section 410(b)'s listing of categories of defendants] meaningless is without merit. Although some secondarily liable parties under [subsection (b)] may also be liable as sellers under [subsection (a)], clearly not all secondarily liable parties are sellers under the substantial contributive factor test. Thus, as contemplated by the statutory scheme, participants who are involved in a securities sale, but who are not substantial contributive factors [such as partners, officers or directors], may be subject to secondary liability under [subsection (b)].[137]

Many state statutes also provide that they are to be construed consistently with federal law.[138] In *Dahl*, the Supreme Court either

133. *See, e.g.*, Branson, *supra* note 2, at 350-55 (description of sliding scale analysis in Second and Ninth Circuits). *See generally* Douglas Branson, *Statutory Securities Fraud in the Post-Hochfelder Era: The Continued Viability of Modes of Flexible Analysis*, 52 TULANE L. REV. 50 (1977).

134. Of course, from a plaintiff's viewpoint, a principle difficulty with the California scheme is that the state of mind requirement is too high. To state a case against other collateral participants, a plaintiff will plead and prove herself into malpractice policies' intentional misconduct exclusions, increasing chances for winning the legal case but lessening chances for actual recovery. *See supra* note 42.

135. Expression of one thing is the exclusion of the other.

136. 744 P.2d 1032, 1052 (Wash. 1987).

137. *Id.*

138. Uniform Securities Act § 415 7B UNIFORM LAWS ANN. 678 (Amended 1985) provides: "This act shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this act with the related federal regulation." *See also* ARIZ. REV. STAT. ANN. § 44-2001 (1987) (same); WASH. REV. CODE ANN. § 21.20.900 (1989) (same).

eliminated broadened seller status altogether or retained it only in narrow fashion.[139] The Supreme Court of Washington has read *Dahl* as having done the former, adopting "a strict privity analysis of the term 'seller.' "[140]

That is a misreading of *Dahl.* By reading the Securities Act's broad definitions of "sell" and "offer to sell" into the liability section, the Supreme Court adopted a broad transactional privity rather than a strict "passing title" test that may be seen as a broadened seller construct, albeit one on the narrower part of the broadened seller spectrum.[141]

Moreover, when asked to reconsider an earlier ruling in light of *Dahl,* the Supreme Court of Washington noted that "the Supreme Court's construction of a similarly worded federal statute, although often persuasive, 'is not controlling in our interpretation of a state statute.' "[142] For a number of reasons,[143] the court decided to retain broadened seller liability and the substantial factor test of that status which the Supreme Court had rejected in *Dahl.* Other state courts have split on the issue, with intermediate appellate courts applying *Dahl* and at least two state supreme courts opting for retention of a broader test of seller status.[144]

While state courts have split on the issue of what test to apply,

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*But see* Kittilson v. Ford, 608 P.2d 264, 265 (Wash. 1980) (provision does not require "imitation" of the federal scheme's administration). Alaska, Hawaii and Oregon did not adopt Uniform Securities Act section 415.

139. Pinter v. Dahl, 486 U.S. 622, 642-43 (1988).

140. *See, e.g.*, Hoffer v. State, 776 P.2d 963, 964 (Wash. 1989). *See also* Hines v. Data Line Systems, Inc., 787 P.2d 8, 20 & n. 8 (Wash. 1990) (reaffirming holding in Hoffer).

141. *See, e.g.*, 486 U.S. at 642-43:

> In common parlance, a person may offer or sell property without necessarily being the person who transfers title to, or other interest in, that property. We need not rely entirely on ordinary understanding of the statutory language, however . . . Section 2(3) defines "sale" or "sell" [broadly] . . . Under these definitions, the range of persons potentially liable under § 12(1) is not limited to persons who pass title.

*Id.*

142. Hoffer v. State, 776 P.2d 963, 964 (1989).

143. *Hoffer's* reasoning included a conclusion that the Washington statute is to be more broadly construed than the federal statute and differences in structure of the two statutes. *Id.* at 965.

144. *See, e.g.*, Zendell v. Newport Oil Corp., 544 A.2d 878, 882 (N.J. App. 1988) (adopting the Dahl sale-solicitation as test of expanded seller status under New Jersey Securities Act); State v. Williams, 390 S.E.2d 746, 749 (N.C. App. 1990) (applies *Dahl* to reverse attorney's criminal conviction); Allen v. Columbia Financial Mgmt. Ltd., 377 S.E.2d 352, 356 (S.C. App. 1988) (applies Dahl v. Pinter as test of seller status under South Carolina law). *Accord* Abell v. Potomac Insurance, 858 F.2d 1104, 1115 (5th Cir. 1988) (applying *Dahl* as test of broadened seller status under Louisiana law); Capri v. Murphy, BLUE SKY L. REP. (CCH) ¶ 72,901 (2nd Cir. 1988) (Connecticut law). *But see* State *ex rel.* Mays v. Ridenhour, 811 P.2d 1220, 1230 (Kan. 1991) ("the basic framework in which the [state and federal] statues are formulated shows a different approach should be employed"); State v. Hoffer, 776 P.2d 963, 964, *applying* Haberman v. WPSS, 744 P.2d 1032, 1051-52 (1987).

they have not differed on the underlying principle. That is, they argue that the term "seller" encompasses more than just the actual seller. Although often unarticulated, their reasons are several. One reason is that they view state securities acts both as remedial legislation, to be broadly construed, and as a gap filling device, to fill the interstices left blank by federal securities laws and decisions.

In adopting a broader test of seller status, the Supreme Court of Washington found it "important to note that the [Washington State Securities Act] has a different purpose than the federal statute, in that it endeavors to protect investors, not just the integrity of the marketplace. Accordingly, our statute is more broadly construed."[145] Stating that the federal securities acts do not have protection of investors at their core, when federal statutes are replete with the language "necessary or appropriate in the public interest or for the protection of investors,"[146] seems incongruous at the least. What is noteworthy is the judicial feeling itself that state securities acts have a broader and somewhat different purpose than does the federal scheme.

Another reason for states' continuing broad interpretation of seller may be the legislative reenactment doctrine, or some version of it. On at least two occasions, in connection with securities law issues, the United States Supreme Court has applied the doctrine to uphold implied causes of action.[147] If Congress has enacted substantial amendments to a statutory framework under which substantial numbers of judicial decisions have been implying a private cause of action, and the legislative package leaves undisturbed the provision under which the cause of action has been implied, the court will read the latter bit of nonaction as tantamount to legislative reenactment of the well-recognized implied cause of action.

Arguably, under the Uniform Securities Act legislative renactment

145. Hoffer v. State, 776 P.2d 963, 965 (1989) (Hoffer II), relying on *Haberman*, 744 P.2d at 1049.

146. *See, e.g.*, Securities Act of 1933 § 3b, 15 U.S.C. § 77c(b) (Commission can add class of securities to those exempted if "enforcement of this title . . . is not necessary in the public interest or for the protection of investors"); Securities Act of 1933 § 2c, 15 U.S.C. § 77c(c) (can exempt small business investment company securities if not necessary "in the public interest and for the protection of investors"). At any time Congress delegated authority to the commission to exempt transactions or to implement a provision, and at many other points, the unvarying statutory standard is "in the public interest and for the protection of investors." *Id.* (citations omitted).

147. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 386-87 (1983) (Securities Exchange Act of 1934 and Rule 10b-5); Merrill Lynch v. Curran, 456 U.S. 353, 381-82 (1982) (Commodity Exchange Act).

has taken place on two levels. First, periodically, state legislatures have substantially amended state securities acts while leaving undisturbed the provision under which courts have been reading seller broadly.[148] Secondly, the Commissioners on Uniform State Laws have revised and restated the Uniform Securities Act while leaving undisturbed the portion of it under which courts have expanded seller.[149] Stronger still, in commentary the Commissioners seemingly endorse the practice of courts:

> [The section] follows closely Section 12(2) of the Securities Act of 1933 which imposes liability for material misstatements or omissions in the disclosures given to buyers. As is the case with the latter, liability may be imposed on a person in addition to the immediate seller if the person's participation was a substantial contributive factor in the violation.[150]

The Justices of the Washington Supreme Court felt that a legislative renactment had taken place. That court cited the Commissioners on Uniform State Laws' 1985 commentary in support of their decision not to follow *Dahl* and to retain broadened seller status under Washington's version of the Uniform Securities Act.[151]

Uniform Securities Act section 410(b) would also hold liable "any employee of such seller who materially aids in the sale."[152] Some states have broadened the list by adding "agent" to employee.[153] Plaintiffs have had some success in pursuing collateral participants under section 410(b) or their state's equivalent and broadened readings of employee rather than under section 410(a) and broadened seller status. In limited fashion, too, plaintiffs might attempt expansion of the categories of officers and directors that Uniform Securities Act section 410 names to include *de facto* officers[154] or those who function as "shadow directors."[155]

In *Ackerman, Jablonski, Porterfield & De Ture v. Alhadeff*,[156] federal district Judge Voorhees denied the national accounting firm Arthur Andersen's motion to dismiss. As to a failed oil and gas exploration program, the judge held that "[u]nder these allegations

148. *Cf.* Hawaii's amendment of the civil liability provision itself requiring that partners, officers and directors are liable only if they "materially aid" the transaction, *supra* notes 62-64 and accompanying text.

149. *See* COMMISSIONERS ON UNIFORM STATE LAWS—PROCEEDINGS OF ANNUAL MEETING at § 605 & Comment 1, at 463 (1985) ("The section has been rewritten . . . but is not intended to alter significantly existing law.").

150. *Id.*, Comment 2, at 464.

151. Haberman v. WPSS, 744 P.2d 1032, 1051 (1987).

152. *See* 7B UNIFORM LAWS ANN. 643 (1985).

153. *See, e.g.*, HAW. REV. STAT. § 485-20 (West Supp. 1991) (every director, officer or agent of or for the seller, if the director, officer or agent has personally participated or aided in any way in making the sale).

154. Possibly in anticipation of such an attempt, the California statute adds the qualifier "principal executive" to officers. *See* CAL. CORP. CODE § 25504.

155. The term is British, legislatively introduced to company law, which includes securities law, by Companies Act 1980, § 63(1).

156. FED. SEC. L. REP. ¶ 92,756 at 93,685 (W.D. Wash. 1986).

Andersen could be considered an employee of the seller of the securities who materially aided the sales transaction."[157] An Alaska court has refused to permit an attorney out from under allegations that he could be held liable as an employee under Alaska's version of Uniform Securities Act section 410(b).[158] An older Hawaiian decision adopts a broad view of agents' liability under the Hawaii Securities Act.[159]

By contrast, several courts have applied the Uniform Securities Act definition of agent as limited to one who "represents a broker/dealer or issuer in effecting or attempting to effect purchases or sales of securities," declining to hold liable attorneys or accountants as agents of the seller.[160]

### C. *Tests of Expanded Seller Status*

Certain jurisdictions such as Arizona and Oregon do not need tests of expanded seller. Those jurisdictions have statutes that hold liable "every person who participates or materially aids in the sale" that violated their state's securities laws.[161] In a direct manner, they hold liable those who might be reached in other jurisdictions through ex-

157. *Id.* (citing Washington's version of Uniform Securities Act § 410(b)).

158. *See* Pottle v. Coffey, BLUE SKY L. REP. (CCH) ¶ 73,226, at 74,449-50 (Alaska Sup. Ct. 1990) (denying plaintiff's motion for summary judgment as to attorney's liability). *Cf.* Allen v. Columbia Financial Mgmt., 377 S.E.2d 352, 356-57 (S.C. App. 1988) (attorneys could not be deemed employees).

159. *See* Young v. Kwock, 474 P.2d 285, 287 (Haw. 1970):

> [A] corporation, bereft of both body and mind, can only perate trough agents, and it is the agents who knowingly aid the illegal transaction that are jointly and severally liable.
>
> . . . [Defendant corporate agent] argues that "aids" means *inducing* the purchaser to buy and that the facts indicate that she took no part in the "selling" effort. Though some jurisdictions have followed such reasoning, . . . Therefore, not merely the salesman who induced the purchase but all officers, directors and agents who *in any way* contributed to the disposition of the securities are liable.

*Id.* (footnotes omitted) (emphasis in original).

160. Uniform Securities Act § 401(b). The definition of agent has been used to limit categories of persons liable in, *inter alia*, Ackerman v. Schwartz, 733 F. Supp. 1231 (N.D. Ind. 1989), *rev'd on other grounds*, 947 F.2d 841 (7th Cir. 1991) (attorney who wrote opinion letter is not an agent for purposes of Indiana securities law); Jensen v. Touche Ross & Co., 335 N.W.2d 720, 729 (Minn. 1983) (accounting firm did not represent issuer in any transaction "nor did it effect or attempt to effect any sales"); Rendler v. Markos, 453 N.W.2d 202 (Wisc. App. 1990) ("The definition of agent does not include attorneys who merely render legal advice or draft documents for use in securities transactions.").

161. *See, e.g.*, ARIZ. REV. STAT. ANN. § 44-2003 (1987); OR. REV. STAT. § 59.115(3) (1988).

panded seller status.[162] At the opposite end of the spectrum is California. Holding to strict privity under its general antifraud rule, and admitting liability for other participants only under a statutory "intent to deceive or defraud" standard,[163] California also has no motivation to expand or otherwise modify the term "seller" as used in the California Securities Law of 1968.

The remaining Pacific Rim jurisdictions are between those poles but only one, Washington, has any significant case law.[164] Washington has borrowed from the federal circuit courts of appeal to fashion its test of who expanded sellers might be. Although commentators purport to discern no less than four different federal court tests of expanded seller status,[165] Washington has seized upon the federal test with by far the most, and some would say the only,[166] currency. That test is the proximate cause/substantial factor test appellate panels in the Fifth Circuit developed,[167] to be followed by several other circuits, including the Ninth.[168]

A principal criticism of the test as applied by federal circuits is that, although those courts mouth proximate cause as the test of expanded seller, they utilize the tort law substantial factor analysis of cause in fact. True proximate cause analysis is a further winnowing, based upon factors such as forseeability, a cost-benefit analysis of the harm to be avoided versus the costs of precautionary measures, and other policy factors.

Unlike federal courts of appeal, the Washington Court at least has consulted the Restatement (Second) of Torts on the subject of proximate cause:

> [W]e hold that a defendant is liable as a seller under RCW 21.20.430(1) [Uniform Securities Act section 410(a)] if his acts were a substantial contributive factor in the sales transaction. Considerations important in determining whether a defendant's conduct is a substantial contributive factor in the sales

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162. *See also In re* Gas Reclamation, Inc., 733 F. Supp. 713 (S.D.N.Y. 1990) (applying similar but somewhat modified Texas statute to hold potentially liable surety); Perkowski v. Megas Corp., 563 N.E.2d 378 (Ohio App. 1990) (radio talk show host held liable under similar statute despite exclusion for gratuitous investment advice).

163. CAL. CORP. CODE § 25504.1 (West Supp. 1991).

164. *But see* the discussion of Young v. Kwock, 474 P.2d 285, 287 (Haw. 1970), *supra* note 147 ("*all* officers, directors and agents who *in any way* contributed to the disposition of the securities are liable") (emphasis in original).

165. *See, e.g.*, Joseph E. Reece, *Would Someone Please Tell Me the Definition of the Term "Seller": The Confusion Surrounding Section 12(2) of the Securities Act of 1933*, 14 DEL. J. CORP. L. 35, 42 (1989) (proximate cause/substantial factor, unique position, solicitation, and participation tests discerned in various circuits).

166. *See, e.g.*, Branson, *supra* note 2, at 337 ("nonexistent" participation test of expanded seller status has been "more of a topic for commentary than anything else").

167. *See, e.g.*, Junker v. Crory, 650 F.2d 1349 (5th Cir. 1981); Croy v. Campbell, 624 F.2d 709 (5th Cir. 1980); Lewis v. Walston & Co., 487 F.2d 617 (5th Cir. 1973); Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680 (5th Cir. 1971).

168. SEC v. Murphy, 626 F.2d 633, 650 (9th Cir. 1980), and Anderson v. Aurotek, 774 F.2d 927, 930 (9th Cir. 1985), are the leading cases.

transaction include: (1) the number of other factors which contribute to the sale and the extent of the effect which they have in producing it; (2) whether the defendant's conduct has created a force or series of forces which are in continuous and active operation up to the time of the sale, or has created a situation harmless unless acted upon by other forces for which the actor is not responsible; and (3) lapse of time. Whether a defendant's conduct was a substantial contributive factor is necessarily a question of fact.[169]

Defense attorneys argue that this test is nothing more than a version of the *Pinter v. Dahl* point of sale solicitation test.

The Washington courts do regard participation in the sales effort as a clincher. Or, more accurately, the lack of any personal involvement by defendant with plaintiff or others of her class is regarded as highly persuasive.[170] Nonetheless, the lack of personal involvement is not dispositive.

The other ammunition for defense attorneys is the Washington Court's enunciation of the test as "substantial contributive factor in the sales transaction." That language is fodder for argument that the state law test of expanded seller status is no broader than the federal test the Supreme Court devised in *Pinter v. Dahl.* That the Supreme Court of Washington pointedly refused to follow *Pinter v. Dahl* aside,[171] the Washington Court uses varying phraseology. Broader possibly than sales transaction, the Washington justices have referred to substantial factor "in causing the sale to take place."[172] They have also referred to "substantial contributive factor in the sales process"[173] and to "substantial factor in the violation"[174] or in the acts constituting the violation:

Proximate cause properly applied, or in the form of a substantial factor test, needs a qualifier. A court may ask if the collateral participant was a substan-

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169. Haberman v. Wash. Pub. Power Supply Sys., 744 P.2d 1032, 1052 (1987) (citing RESTATEMENT (SECOND) OF TORTS §§ 432, 433 (1977)).

170. *See* Schmidt v. Cornerstone Inv., 795 P.2d 1143, 1151 (Wash. 1990), involving loans brokers' use of an inflated appraisal of the "Bargain Boys" commercial property to obtain funds. Of the corporate alter ego, Brink, the court found "no evidence . . . which showed Brink had any contact with the appraisers, or that he was involved in marketing Bargain Boys or in soliciting plaintiffs to make the investment. In fact, the evidence showed Brink met plaintiffs for the first time many months after they made their initial investment." *Id.*

Of the attorney, the court noted that "[t]he record indicates no evidence was presented at trial which showed Austin had contact with plaintiffs regarding the investment, nor was there evidence that Austin had any involvement in negotiations . . . during the search for an investor." *Id.* at 1151-52.

171. *See* Hoffer v. State, 776 P.2d 963, 964-65 (Wash. 1989) (en banc) (Hoffer II).

172. *See* Hoffer v. State, 755 P.2d 781, 789-90 (Wash. 1988) (en banc) (Hoffer I).

173. Hines v. Data Line Sys. Inc., 787 P.2d 8, 20 (Wash. 1990) (en banc).

174. Haberman v. WPSS, 744 P.2d 1032, 1051 (Wash. 1987) *cert. denied*, 488 U.S. 805 (1988).

tial factor in the sale or selling effort, a substantial factor in producing the harm which has befallen the plaintiff, or a substantial factor in the transaction . . . . [C]ourts do seem to be asking merely if defendants were substantial factors in the transaction. It is, however, difficult to tell. Many [federal] courts which use substantial factor fail to add any qualifier at all.[175]

The Washington court's problem, of course, has not been lack of a qualifier but inconsistent use of several qualifiers. Be that as it may, defense attorneys' seizure of "substantial contributive factor in the sales transaction" is only part of the story. The Washington Supreme Court has chosen a test of expanded seller status broader than the *Dahl* solicitation test that, based upon language such as substantial factor in the sales process or in the violation, could be fully as broad as the pre-*Dahl* federal court decisions, or nearly so.

Other than such a statement, the only other guidance as to how far-reaching broadened seller status might be would involve a highly fact sensitive case-by-case analysis. At least the beginnings for such an analysis post-*Pinter v. Dahl* already exist in the Washington case law.

In *Hines v. Data Line Sys., Inc.*,[176] the Washington Supreme Court affirmed a summary judgement in favor of the state's largest law firm.[177] The court agreed that to hold attorneys liable, " 'something more' must be shown than performance of the usual drafting and filing services provided by counsel."[178] That something more could be involvement in the solicitation process. Alternatively, something more could be the rendering of legal advice if the advice had been "a catalyst in the sales transaction."[179] The law firm's advice that a principal corporate officer's illness had been rendered immaterial by superseding events did not rise to that level.[180]

By contrast, in *Hoffer v. State*,[181] the court found potentially liable another collateral participant who had no face-to-face dealings with investors.[182] The defendant state auditor had, however, provided a comfort letter for the public power agency to include in its annual reports that could have lead investors to believe that the auditor was an alert watchdog. Likewise, in *Haberman v. WPSS*,[183] the court faced claims against members of a public power consortium, participants in its nuclear power plant construction projects, and the professionals who rendered services to the consortium, including accountants, con-

175. Branson, *supra* note 2, at 357.
176. 787 P.2d 8, 20 (Wash. 1990).
177. *Id.* at 21.
178. *Id.* at 20.
179. *Id.*
180. *Id.*
181. 755 P.2d 781 (Wash. 1988) (en banc), *aff'd* upon reconsideration in light of Dahl v. Pinter, 776 P.2d 963 (Wash. 1989).
182. *Id.* at 785-87.
183. 744 P.2d 1032 (Wash. 1987).

sulting engineers and lawyers. After adopting a "substantial contributive factor" test of expanded seller status, the court remanded the case to the trial court for determination as to which of these parties defendants, most of whom had no face-to-face or other direct dealings with investors, might be sellers under the enunciated test.[184] On analysis of the facts of Washington cases, and the status of various defendants in them, it becomes clear that to be held liable a defendant need not have participated in the solicitation or sales process directly or have had face-to-face or other dealings with investors in order to be held to have been a "substantial contributive factor."

### D. *The Dividing Line Between Rendition of Routine Professional Service and Liability-Creating Activity*

Until recently at least, Oregon judges reiterated that, without more, rendition of routine professional services could not make liable collateral participants. Thus, the Oregon judges reached a conclusion identical to that reached by their brethren in states with broadened seller status and substantial factor tests.[185] In several cases, however, Oregon courts have found the "something more," resulting in liability.

At the top of one branch of cases is *Adams v. American Western Sec.*[186] There, an attorney confronted the not uncommon situation in which the client issuer has pre-offered or sold the securities about which the issuer belatedly seeks legal advice. The normal prescription is first to work a rescission of any illegal offers or sales that have

184. *Haberman*, of course, is pre-*Pinter v. Dahl*. But of similar ilk post-*Pinter v. Dahl* is the application of the *Haberman* test by a federal judge in *In re* Wash. Public Power Supply Sys. Securities Litigation, FED. SEC. REG. REP. (CCH) § 72,961, at 73,739-41 (W.D. Wash. 1988) (financial advisor, consulting engineer and member participants could be sellers and at least a jury question presented as to forecast data that was disclosed" in offering documents could be sellers).

185. *Compare* Gonia v. Estep, 446 P.2d 114 (Or. 1968) (dismissal of attorney upheld under predecessor statute) *with* Hines v. Data Line Systems, 787 P.2d 8 (Wash. 1990) ("something more' must be shown than performance of the usual drafting and filing services provided by counsel.") *Id.* at 20. *See also* Allison v. Southampton Music Co., [1986-87 Transfer Binder] BLUE SKY L. REP. (CCH) ¶ 72,440, at 72,069 (D. Or. 1986) (attorney in master recording tax shelter scheme did no more than "render legal services normally performed by lawyers for their clients" and could not be held under Oregon statute); Austin v. Bear, Marks & Upham, [1986-87 Transfer Binder] BLUE SKY L. REP. (CCH) ¶ 72,437 (D. Or. July 18, 1986) (summary judgement for lawyers who did nothing more than procure Oregon consent to process forms and review oil and gas limited partnership certificate for validity under local law).

186. 510 P.2d 838 (Or. 1973).

taken place.[187] Attorney Joachims, however, proceeded to take steps for registration or perfection of a limited offering exempt transaction under Oregon law. He was held liable as one who participates or materially aided the illegal sale. The Oregon Supreme Court held

> that when an attorney prepares, attends to the execution of, and personally delivers and files documents required for the registration of a security with the knowledge that solicitation and sales of such a security have already been made, such conduct goes beyond what plaintiff describes as the 'preparation of documents and other services normally performed by a lawyer for a client'. . . .[188]

The case seems a classic instance of the "blind eye" phenomenon in which the collateral participant renders only routine services but does so while knowing that a violation of law has occurred or is about to occur.[189]

The other principal branch of cases in which Oregon courts have held seemingly routine services to be something more are cases in which the collateral participant has helped the primary wrongdoer create or maintain a false appearance. In *Fakhrdai v. Mason*,[190] for example, the defendant attorney drafted documents for the purchase of a car dealership. The documents recited an inflated purchase price and downpayment, so that a third party who later purchased a one-half interest would unknowingly be funding the entire down payment.[191]

Another Oregon "false appearance" case is *Adamson v. Lang*.[192] The defendant collateral participant there lent funds to an issuer so that the issuer could break escrow under a common type arrangement imposed by state securities regulators. Lifting the sales restriction created the false appearance that the offering had been more successful than was the case. Defendant lender was held liable as one who had participated in or materially aided the illegal sale of securities.[193]

These two branches of material assistance cases, blind eye and false appearance cases, contain a strong inference, or more, of knowledge.

187. *See generally* Alan A. Bromberg, *Curing Securities Violations: Recession Offers and Other Techniques*, 1 J. CORP. L. 1 (1975).

188. *Adams*, 510 P. 2d at 844 (quoting Gonia v. Estep, 446 P.2d 114 (Or. 1968)).

189. *See also* Ahern v. Gaussoin, 611 F. Supp. 1465, 1491 (D. Or. 1985). In *Ahern*, which involved a large prominent Portland, Oregon client corporation, the Registration statement, as well as other documents, were alleged to have contained numerous misrepresentations. The law firm partner and law firm were held in the case on the basis of *American West*: "It [*American West*] stands for the proposition that certain routine professional services, coupled with *knowledge* of violations of the Oregon securities laws by the seller, may give rise to liability." Defendant attorneys' motions for summary judgement were denied. *Id.*

190. 696 P.2d 1164 (Or. Ct. App. 1985).

191. *Id.* at 1167.

192. 389 P.2d 39 (Or. 1964).

193. *Id.* at 92. The Oregon court relied on a Kansas case holding liable an individual who had allowed himself to be named a dummy director of an issuer. His presence

The collateral participant rendered only what seem to be routine services but the conclusion that they knew, or must have known, of the primary violator's wrongdoing is inescapable. Even though the Oregon courts do not always articulate their belief that knowledge was present, as they did do in *American Western*, a strong judicial belief in knowledge's presence is evident from the opinions, at least until Justice Hans Linde and *Prince v. Brydon*.[194]

In *Prince*, an Idaho attorney had prepared documents, including an offering circular, for a mining partnership. He knew that one partner intended to sell units in Oregon but the record did not establish whether he had advised on Oregon Securities Act requirements. Nonetheless, the record contained no evidence of the type of knowledge present in the blind eye and false appearance cases in which other collateral participants had been held liable in Oregon. Disagreeing with the court of appeals, Justice Linde held that there need not be.

Reading the statute literally, Justice Linde reasoned:

> Whether one's assistance in the sale is "material" does not depend upon one's knowledge of the facts that make it unlawful; it depends on the importance of one's personal contribution to the transaction. Typing, reproducing, and delivering sales documents may all be essential to a sale, but they could be performed by anyone; it is a drafter's knowledge, judgement, and assertions reflected in the contents of the documents that are "material" to the sale.[195]

Thus, the dividing line had become not knowledge or a strong inference of knowledge but ministerial or scrivener's acts versus more substantial functions.

The defendant can exonerate herself by proof that, in the exercise of reasonable care, she could not have know "of the existence of the facts on which the liability is based."[196] But even there Justice Linde offered scant consolation:

> The drafters took pains to make clear that the relevant knowledge is of "the existence of the facts," not of the unlawfulness of a sale. These provisions may place upon persons . . . who materially aid in an unlawful sale of securi-

on the issuer's board had created a false appearance that facilitated sale of shares. *See* Mosley v. Unruh, P.2d 537 (Kan. 1939).

More routine creations of false appearances are those in which broker-dealers or issuers promulgate inflated sales or profit figures. *See, e.g.*, Green v. Jonhop Inc., 358 F. Supp. 413 (D. Or. 1973) (issuer, corporate officer, and broker dealer firm found liable under the Oregon type statute, as a person who participates or materially assists). *See also* Gonia v. E.I. Hagen Co., 443 P.2d 634 (Or. 1968) (where the court held liable the defendant who had accompanied securities salesperson calling on prospective customers).

194. 764 P.2d 1370 (Or. 1988).

195. *Id.* at 1371.

196. OR. REV. STAT. § 59.115(3) (1987).

ties a substantial burden to exonerate themselves . . . but this legislative choice was deliberate . . . . The defense against strict liability, in short, was to be a showing of ignorance, not the professional role of the person who renders material aid in the unlawful sale.[197]

The standard defense tactic, to show that the defendant collateral participant is a professional who rendered only standard or routine services, will no longer work in Oregon.

Justice Linde's close reading of the statute is no doubt accurate. But it evinces none of the tempering gloss that wise judicial interpretation may dictate. Also, his decision, and the "hubbub" surrounding it, obscure earlier Oregon decisions.[198] Unlike *Prince*, which is of real significance only in Oregon and a few other states, the earlier Oregon decisions seem to contain raw material for differentiating between when collateral participants, who seemingly do no more than render routine professional services, should nonetheless be held as substantial factors, or "substantial contributive factors," and when they should not be. The "blind eye" and "creation of false appearances" cases, when a strong inference of knowledge is also present, are cases in which the professional or other collateral participant who underperforms, or routinely performs, rather than becoming over-involved in the issuer's solicitation, sales, or similar effort, ought to be held.

*E. Antifraud Rules and Implication of Private Rights of Action*

Another and last burning issue under state securities laws is whether a private right of action for damages lies under state statute's analog to the federal general antifraud rule, rule 10b-5. The alternative view is that the antifraud statutory provision is only a substantive prohibition. Any liability for a violation of that prohibition must be found in the general, all-purpose civil liability provision.[199]

Modeled on Uniform Securities Act section 410, the civil liability provision does incorporate by reference the antifraud statute and the registration commands as the substantive violations for which liability will lie under the section.[200] The more comprehensive the ex-

197. *Prince*, 764 P.2d at 1372 (emphasis added).

198. Berne & Bregenzer find no deviation from prior decisions: "*Prince* does no more than reaffirm the prophylactic rule that is at the heart of the securities laws: those who are responsible for the misrepresentations made in a securities transaction must take reasonable steps to determine that there has been compliance with the securities laws." Berne & Bregenzer, *supra* note 9, at 892.

199. *See, e.g.*, E.F. Hutton & Co., Inc. v. Rousseff, 537 So. 2d 978, 980 (Fla. 1989).

200. *See, e.g.*, WASH. REV. CODE § 21.20.3 40(1) (1989) ("Any person, who offers or sells a security in violation of any provisions of RCW 21.20.010 [antifraud] or 21.20.140 through 21.20.230 [registration] is liable . . . .") (§ 21.20.010 cross-reference added in 1975); *see also* UNIFORM SECURITIES ACT § 410(a) (1), 7B UNIFORM LAWS ANN. at 643 (1958) (similar incorporation by reference). *But see* OR. REV. STAT. § 59.115(5) (1987), mentioning in the civil liability section's statute of limitations provision "[a]n action under this section . . . or ORS 59.135 . . . ." The latter is the Oregon general antifraud

press right, the argument goes, the less justification exists for implied rights of action. But plaintiffs nonetheless argue for a free standing cause of action for antifraud rule violations. They do so, however, only as the means to an end.

The end is secondary liability for collateral participants who have assisted in the misrepresentations or misleading statements. Generally, the primary violator will be liable as a seller under the general civil liability provision. Under the aiding and abetting construct so familiar to the federal rule 10b-5 area,[201] plaintiffs seek to hold responsible lawyers, accountants and others who have lent substantial assistance to the primary wrongdoer, or at least they seek to hold liable those secondary defendants that cannot be held under seller, or broadened seller, status under the civil liability section.[202]

The Uniform Securities Act itself is inconclusive on the question. The original civil liability provision ended with a subsection, seemingly dispositive on the issue, that read: "The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or in equity, but this act does not create any cause of action not specified in this section . . . ."[203] The limitation, however, did not prove popular. Only half of the forty or so Uniform Securities Act jurisdictions adopted it.[204] On the Pacific Rim, neither Washington, Oregon nor Hawaii adopted it.[205]

Moreover, the commissioners on Uniform State Laws have indicated a belief that primary and secondary liability exists under the section, going even one better than legislative reenactment.[206] In commentary to the 1985 revision of the Uniform Securities Act, the Commissioners state that "Activity which constitutes 'aiding and

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statute. The statute of limitations provision thus contemplates a right of action for antifraud violations.

201. *See, e.g.*, Bromberg & Lowenfels, *supra* note 29, at 639-739.

202. The question is somewhat less crucial in jurisdictions that have chosen not to follow *Pinter v. Dahl* and have retained a "substantial factor" or similar test of broadened seller status. *See supra* notes 129-40, 149-67 and accompanying text.

203. UNIFORM SECURITIES ACT § 410(h), 7B U.L.A. at 644 (1958) (emphasis added) (cross-reference omitted).

204. *See, e.g.*, Naye v. Boyd, FED. SEC. L. REP. (CCH) ¶ 92,980, at 94,811 (W.D. Wash. 1986).

205. *Cf.* ALASKA STAT. § 45.55.220 (Supp. 1991) (verbatim adoption of Uniform Securities Act § 410(h)).

206. *See supra* notes 136-40 and accompanying text. The Supreme Court of Washington expressly found legislative reenactment of a private right of action under Washington's general antifraud statute. *See* Kittilson v. Ford, 608 P.2d 264, 266 (Wash. 1980) ("The interpretation of RCW 21.20.010 first announced in *Shermer* is the better rule. *The legislature has not seen fit to disturb it and neither do we.*") (emphasis added).

abetting' also is actionable under the federal rule 10b-5 . . . . Assuming comparable elements are established, this section should also support an aiding and abetting theory of liability."[207] They then add the somewhat cryptic sentence, "While civil liability to third persons would only infrequently result in light of the limitations of Section 605(a) [section 410], this theory would support administrative sanctions against an aider or abettor under this section."[208] The section seems to give and then take away. All the other evidence on the existence of an implied right of action is similarly "back and forth"—inconclusive at best.

One reasoned decision purported authoritatively to decide the question. In *Naye v. Boyd*,[209] federal district Judge Barbara Rothstein traced the various twists and turns the Washington antifraud statute had taken. She found it quite persuasive that only one other decision, *Shermer v. Baker*,[210] also from Washington, had found liability under the section. She seemed, however, too quick to dismiss the findings in other cases as dicta.[211] The relative paucity of prior decisions would thus not be surprising. Not until after the implications of *Ernst & Ernst v. Hochfelder*, and to a lesser extent the later *Pinter v. Dahl*, had been fully realized[212] did the halcyon days for plaintiffs in federal courts cease and serious emphasis on state securities laws begin.

The Supreme Court of Washington has itself reserved judgment on the issue.[213] Moreover, in retaining "substantial contributive factor" and broadened seller status, the court found highly persuasive the commentary of the commissioners on Uniform State Laws.[214] If the court finds highly persuasive the commissioners' opinion on that issue, equally likely is that the court would find persuasive the commissioners' belief that private rights of action exist under the antifraud statute. The latter would be true if the somewhat cryptic commentary is interpreted in that manner.

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207. NAT'L CONFERENCE OF COMM'RS ON UNIFORM STATE LAWS—PROCEEDINGS OF THE ANNUAL CONFERENCE, Comment 3 to Uniform Securities Law § 501, at 448 (1985).

208. *Id.*

209. FED. SEC. L. REP. (CCH) ¶ 92,980 (W.D. Wash. 1986).

210. 472 P.2d 589 (Wash. Ct. App. 1970).

211. In Washington alone, at least three other decisions assume the existence of a cause of action under the section. *See, e.g., In re* Washington Public Power Supply System Securities Litigation, BLUE SKY L. REP. (CCH) ¶ 72,371 (W.D. Wash. 1986) (finding that in an early case if "the Washington Supreme Court had wanted to reject the existence of an implied right of action, it could have done so . . . ."); Kittilson v. Ford, 608 P.2d 264, 266 (Wash. 1980) (making conscious decision not to disturb earlier *Shermer* ruling and finding legislative reenactment); Clausing v. DeHart, 515 P.2d 982, 983-84 (Wash. 1974) (recognizing right of action but finding alleged omission immaterial).

212. *See supra* notes 12-40 and accompanying text.

213. *See* Haberman v. Washington Public Power Supply System, 744 P.2d 1032, 1052-53 (Wash. 1987).

214. *See id.* at 1051.

One difficulty in the area of state securities laws is that many of the decisions involve federal courts making educated *Erie* guesses about the interpretation of state securities acts. The difficulty is that the guesses are not educated at all. Federal courts find no cause of action when the state supreme court has expressly reserved the issue for later consideration. Federal judges do not rely on state law. They consult merely their federal brethren's no more educated *Erie* guesses on the state law question before them.[215] In another way, their education is imperfect. They consult only opinions that suit their purposes, no matter how discredited those state law decisions may be.[216]

Failures of federal judges to truly educate themselves about state law when sitting as an *Erie* court or deciding pendant claims is documented.[217] But, in this context, that statement is misleading. The true or "right" answer is not necessarily the other way. The evidence as to whether or not a private right of action exists under the Uniform Securities Act antifraud section is conflicting. After a thorough review, the only answer may be to throw one's hands in the air.

Hands in the air may not be problematic for plaintiffs in jurisdictions such as Oregon and Arizona which have broad "every person who participates or materially aids" language in their express civil liability provisions.[218] In those jurisdictions little need for separate antifraud and aiding and abetting liability exists.[219]

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215. *See, e.g.*, Wade v. Skipper's, Inc., 915 F.2d 1324, 1330-32 (9th Cir. 1990) (finding no cause of action, relying almost exclusively on Naye v. Boyd); Russo v. Prudential Bache, No. C88-895, Order on Post Verdict Motions (W.D. Wash. Dec. 13, 1989) (finding that an implied cause of action "had since been abandoned in Washington").

216. In *Naye v. Boyd*, Judge Rothstein found Ludwig v. Mutual Real Estate Investors, 567 P.2d 658 (Wash. Rep. 1977) to be a highly relevant Washington Appellate decision. *See* FED. SEC. L. REP. (CCH) ¶ 92,980, 71,779-80. *Ludwig* is and was a discredited opinion. In a gross misreading of Ernst & Ernst v. Hochfelder, *Lugwig* had held that knowing or intentional conduct was required for liability under the Washington State antifraud statute. *See, e.g.*, Davis Strout, Comment, *Unlawful Securities Transactions and Scienter: An Emasculation Requirement*, 1 U. PUGET SOUND L. REV. 366, 380 (1978) (*Ludwig* "constitutes a complete abdication by a Washington court of any role in policing securities transactions . . ."). On its face, the opinion demonstrated that the court had probably not read *Hochfelder* and can be regarded as, at best, an aberration.

217. *See, e.g.*, David A. Thomas, *The Erosion of Erie in the Federal Courts: Is State Law Losing Ground?*, 1 B.Y.U. L. REV. (1977) (study of federal court decisions indicates that federal courts apply the court's own idea of what "the law" is, with little or no real attention to state law precedents).

218. *See supra* notes 56-57 and accompanying text.

219. The question also has a clear answer in California. California provides an express but grudging remedy for violation of its antifraud rule. California also has an express aiding and abetting provision but with a high "intent to deceive or defraud" state of mind requirement. *See supra* notes 79-81 and 116-25 and accompanying text.

Hands in the air may be more worrisome in jurisdictions such as Washington, Alaska or Hawaii in which plaintiffs desire an aiding and abetting cause of action to cover the territory not reached by an expanded seller construct. On the other hand, the defense bar has fewer worries. They applaud federal decisions finding no cause of action under antifraud statutes and, with increased vigor, turn their attention to circumscribing closely, if not hammering down, expanded seller status under the express liability provision of their respective state securities laws.

## IV. CONCLUSION

Merely putting upon the table the statutes and case law of five Pacific Rim states' securities laws relevant to collateral participants' liability turns out to have been an exhausting and daunting task. Some answers emerged but a plethora of questions, some seemingly intractable, remains. Predicting the future actually might be easier than surveying the past.

The low and across-the-board negligence state of mind standard in Uniform Securities Act jurisdictions may be a delusion rather than a benefit. Judges are loath to find liable, for a mere lack of reasonable care, collateral participants in securities transactions. So judges, especially federal judges reviewing *Erie* or pendant state securities act claims, tend to be receptive to defense bar claims that no right of action exists under the antifraud rule, or that any expanded seller status should not exceed the scope of *Pinter v. Dahl*, or that a civil liability provision requires transactional, or even strict, passing title privity. At least the latter may be true when the collateral participant is a professional not intimately involved in the securities transaction. As a result some very culpable collateral participants go free.

In fact, from the plaintiffs' standpoint, the best gift might be evolution of a more forgiving regime in which knowledge would be the state of mind required to find liability for collateral participants. That seems to be the result brought about by fifteen to twenty years' evolution of aiding and abetting under the federal rule 10b-5.[220] The pre-*Prince v. Brydon* decisions in Oregon seem to have arrived at a similar outcome.[221] The standard Uniform Securities Act framework, found in Washington, Hawaii, and Alaska, does not seem to have the flexibility to allow such an evolution. By statute California requires "intent to deceive or defraud."[222]

The future may then come full circle. Plaintiffs in states in which the courts take a restrictive attitude will rely increasingly upon

220. *See, e.g.*, *supra* notes 32-7 and accompanying text.
221. *See supra* notes 168-177 and accompanying text.
222. CAL. CORP. CODE § 25504.1 (West Supp. 1992).

claims of simple negligence against collateral participants in securities transactions. Those plaintiffs will attempt to slip the bounds of a common law privity requirement by analogy to the accountant cases.[223] In a good many jurisdictions, courts have held accountants liable to third parties with whom they have not dealt if the third party was forseeable, or at least a member of a forseeable class.[224] Post- *Pinter v. Dahl* at least one state law decision,[225] while applying *Dahl* to narrow statutory Uniform Securities Act liability, broadened greatly a securities lawyer's common law liability by analogy to the state's accountants' liability precedent.[226] A great deal of uncertainty, and some seemingly intractable questions, seem to persist in the area of state securities acts. The way out of the maze may be old, true and tried common law cases and methods.

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223. For decades, of course, the old chestnut has been then Judge Cardozo's holding in Ultramares Corp. v. Touche Niven & Co., 174 N.E. 441 (N.Y. 1931) (holding that negligent accountants' only liability for negligence was to the client for malpractice). The famous statement from that opinion is:

> If liability [to third parties] for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted in these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exist in the implication of a duty that exposes to these consequences.

*Id.* at 444.

224. *See, e.g.*, Branson, *supra* note 2, at 338-41; Edward Brodsky & Richard P. Swanson, *The Expanded Liability of Accountants for Negligence*, 12 SEC. REG. L. J. 252 (1985); Ronald A. Schy, *Privity and Accountants' Liability*, 16 SEC. REG. L. J. 54 (1988). California has such a case. *See* International Mortgage Co. v. John B. Butler Accountancy Corp., 223 Cal. Rptr. 218, 227, (1986) (liability "to reasonably foreseeable plaintiffs who rely on negligently prepared . . . financial statements").

225. Zendell v. Newport Oil Corp., 544 A.2d 878 (N.J. Ct. App. 1988).

226. "[I]n *Rosenblum v. Adler*, 93 N.J. 324, 461 A.2d 138 (1983), our Supreme Court repudiated this privity notion and held that an action for negligent misrepresentation may be maintained for economic loss against the provider of a service. *Rosenblum* held that an auditor owes a duty to all reasonably foreseeable recipients of information . . . ." Zendell 544 A.2d Ct., 881 (reversing summary judgement in favor of Pennsylvania law firm that had done oil and gas limited partnership offering). *See also* Ackerman v. Schwartz, 947 F.2d 841, 847 (7th Cir. 1991) (allowing investor plaintiffs to reach defendant tax lawyer on common law theory because "Indiana does not apply a privity rule in fraud cases.").