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Second Circuit Clarifies the SEC's Pleading Threshold in Bringing Claims Against Aiders and Abettors

Earlier this month, the Second Circuit clarified the US Securities and Exchange Commission's pleading threshold for claims of aiding and abetting securities laws violations against vendors and other secondary actors. In *SEC v. Apuzzo*, No. 11-696-cv, 2012 WL 3194303 (2d Cir. Aug. 8, 2012), the Second Circuit (in an opinion authored by District Judge Jed S. Rakoff, sitting on the Second Circuit by designation) clarified that the SEC need *not* show that a defendant's conduct was the "proximate cause" of a primary violation of the securities laws or injury to prevail on an aiding and abetting claim. By clarifying the law in a way that makes it easier for the SEC to prevail, the Court widened the already substantial gulf between what is required of the SEC, on the one hand, and private litigants, on the other, in pursuing alleged securities law violations.

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In *Apuzzo*, the SEC alleged that the chief financial officer of an equipment manufacturing company, Terex, was liable for aiding and abetting a scheme by an equipment rental company, United Rentals, Incorporated (URI), to inflate and recognize prematurely revenue from sale-lease back transactions. The alleged scheme involved URI selling equipment and leasing it back for a limited period of time, after which Terex had agreed to arrange for the sale of the equipment. In provisions allegedly buried within other agreements that ostensibly related to URI's purchase of equipment from Terex, URI agreed to indemnify Terex against any losses it incurred in connection with arranging for the sale of the equipment (and also allegedly improperly compensated Terex for such losses through inflated payments for equipment purchases). URI allegedly hid these arrangements from its auditors because their existence compromised its ability to recognize revenue in accordance with GAAP. Pursuant to Section 20(e) of the Securities Exchange Act of 1934 (Exchange Act), the SEC filed charges against Apuzzo for aiding and abetting fraud under Section 10(b) of the Exchange Act, and for aiding and abettting violations of the

books and records and internal controls provisions of Section 13 of the Securities Act of 1933 (Securities Act). In particular, the SEC alleged that Apuzzo, as CFO, knew of the fraud, permitted the transactions to be documented in a manner designed to conceal their true nature and signed contracts that facilitated the alleged scheme. See ***SEC v. Apuzzo***, 758 F. Supp.2d 136, 138-45 (D. Conn. 2010).

Apuzzo moved to dismiss, arguing that his misconduct did not constitute the "substantial assistance" required for aiding and abetting because it did not proximately cause URI's securities law violations. The US District Court in the District of Connecticut agreed and dismissed the case. ***Id.*** at 153. Although the district court found a "but for" causal relationship between Apuzzo's conduct and the fraud, it did not find that he was a "proximate" cause. The court reasoned that Apuzzo did not structure the sale-leaseback transactions, bring the parties to the agreement together, modify transaction documents so as to conceal their fraudulent nature, or make URI's allegedly fraudulent accounting decisions. ***Id.*** at 152. The district court concluded that "mere awareness and approval of the primary violation" were insufficient to show proximate causation. ***Id.*** at 153.

The Second Circuit reversed, finding that the SEC need not show that the aider and abettor's conduct was the proximate cause of the violation or injury in question. ***Apuzzo***, No. 11-696-cv, 2012 WL 3194303, at *7. The Court acknowledged that in its ***Bloor*** decision it had held that to allege a viable aiding and abetting claim, the plaintiff "must allege that the acts of the aider and abbettor proximately caused the harm to the corporation on which primary liability is predicated." ***Id.*** (quoting ***Bloor v. Carro, Spanbock, Londin, Rodman & Fass***, 754 F.2d 57, 62 (2d Cir. 1985)). The ***Apuzzo*** decision noted, however, that Bloor was filed by a private plaintiff, not the SEC, and that the Supreme Court had subsequently eliminated private aiding and abetting claims under Section 10(b) altogether in ***Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.***, 511 US 164 (1994). ***Apuzzo***, 2012 WL 3194303, at *7. Then, after considering other distinctions in the law making it harder for private plaintiffs to pursue claims than it is for the SEC to do so, the Court squarely held that "there is no reason to carry this requirement [of proximate causation] over to the context of SEC enforcement action." ***Id.***

The Second Circuit explained that the proximate cause requirement is appropriate in private cases where plaintiffs, unlike the SEC, are required to prove reliance, causation, and damages. ***Id.*** The Court also emphasized that, in the wake of the ***Central Bank*** decision, Congress granted the SEC express statutory authority to bring aiding and abetting cases notwithstanding the Supreme Court's holding in ***Central Bank***. ***Id.*** Quoting a standard set forth many years ago by District Court Judge Learned Hand in the context of criminal cases, the Second Circuit stated that in aiding and abetting cases, the SEC could plead substantial assistance by showing that the aider and abettor "in some sort associated himself with the venture, that he participated in it as in something that he wished to bring about, and that he sought by his action to make it succeed." ***Id.*** at *6. The Second Circuit held that Apuzzo easily met that standard by his negotiation and signing of the agreements. ***Id.*** at *8.

Apart from its direct impact on SEC claims against alleged aiders and abettors, the ***Apuzzo*** decision underscores the substantial difference – in the eyes of the Second Circuit and the Supreme Court – between the allegations and evidence required of private plaintiffs, on the one hand, and the SEC, on the other, in federal securities fraud actions. For example, the Supreme Court in ***Stoneridge Investment Partners, LLC v. Scientific-Atlanta*** clarified that secondary actors that are alleged securities fraud "scheme" participants cannot be pursued by private plaintiffs under Section 10(b) because investors do not rely upon their conduct. 552 US 148, 159 (2008). In ***Dura Pharmaceuticals, Inc. v. Broudo***, 544 US 336 (2005), the Supreme Court clarified that private plaintiffs pursuing 10(b) claims must plead and prove proximate causation of loss (typically through a corrective disclosure) rather than simply that they purchased a security at an artificially inflated price. ***Id.*** at 338. Moreover, last year, in ***Janus Capital Group, Inc. v. First Derivative Traders***, the US Supreme Court held that a

secondary actor cannot be responsible for "making" a fraudulent statement unless he or she is ultimately responsible for the statement and controls its dissemination. 131 S. Ct. 2296, 2303-04 (2011). Finally, as mandated by the Dodd-Frank Act, in 2011, the GAO released a study about the advisability of providing a statutory basis for private aiding and abetting claims, but the study did not recommend any legislative action. US GOV'T ACCOUNTABILITY OFFICE, GAO-11-664, SECURITIES FRAUD LIABILITY OF SECONDARY ACTORS (2011). In sum, none of these rigorous requirements for private plaintiffs – who may not pursue aiding and abetting claims – apply to the SEC.

The Second Circuit's recent *Apuzzo* decision, therefore, reflects a further expansion of the difference between the challenges that face the SEC as opposed to private plaintiffs in pursuing federal securities fraud violations.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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