

## THE ROLE OF SECTION 20(B) IN SECURITIES LITIGATION

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### I. Introduction

In May 2014, Securities Exchange Commission (SEC) Chair, Mary Jo White, announced that the SEC would pursue actions under Section 20(b) of the Securities Exchange Act of 1934, which broadly prohibits violating federal securities law through the means of another person.<sup>1</sup> White cited the Supreme Court's ruling in *Janus Capital Group, Inc. v. First Derivative Traders*<sup>2</sup> as the impetus for this endeavor.<sup>3</sup> In *Janus*, the Court held that, to be liable for a material misstatement or omission (MMO) under Section 10(b) of the 1934 Act, the main securities anti-fraud provision, the maker of the statement must have "ultimate authority" over the statement's content and formulation, as well as whether to issue the statement.<sup>4</sup> This ruling effectively prevents using Section 10(b) to charge a defendant who directs or advises another person to make an MMO, but lacks "ultimate authority" over the statement. Therefore, the SEC seeks to use Section 20(b) as the cause of action in such cases where Section 10(b) is no longer available.

Part II of this Article explains in detail the gap that the *Janus* ruling creates in securities anti-fraud cases, specifically those involving "innocent instrumentalities." The Article explains the doctrinal limitations of using other, potentially related 1934 Act provisions, such as control person liability (Section 20(a)) and aiding and abetting (Section

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<sup>1</sup> Mary Jo White, Chairwoman, Sec. and Exch. Comm'n, Three Key Pressure Points in the Current Enforcement Environment, Address Before the NYC Bar Association's Third Annual White Collar Crime Institute (May 19, 2014) (transcript available at [http://www.sec.gov/News/Speech/Detail/Speech/1370541858285#.U6xknqHD\\_vI](http://www.sec.gov/News/Speech/Detail/Speech/1370541858285#.U6xknqHD_vI)).

<sup>2</sup> 131 S. Ct. 2296 (2011).

<sup>3</sup> White, *supra* note 1.

<sup>4</sup> *Janus*, 131 S. Ct. at 2302.

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20(e)). Recognizing these limitations is important for understanding how Section 20(b) would need to be interpreted by courts in order to be an effective tool that can fill this gap.

Part III of this Article explores Section 20(b)'s overall function and purpose. These issues are specifically analyzed in terms of Section 20(b)'s relationship to Section 20(a), which is the provision governing control person liability. Identifying Section 20(b)'s overall function and purpose can shed light on the underlying doctrinal issues outlined in Part IV, most specifically on whether Section 20(b) requires a control relationship.

Because Section 20(b) has rarely been used in securities litigation, its scope and practical application remain unclear. Whether Section 20(b) can be an effective tool for the SEC and private plaintiffs by filling the gap described in Part II of this Article depends on the resolution of several doctrinal questions: whether Section 20(b) (A) imposes primary or secondary liability, (B) has a scienter requirement, (C) requires the defendant to “control” the active party, and (D) creates an implied private cause of action. In reviewing each of these doctrinal questions, Part IV of this Article presents the relevant cases that discuss these questions, recognizing that none fully resolves the doctrinal issues because of the courts' brief, and often tangential, treatment of them. In addition to presenting the relevant case law, this Article offers the strongest arguments, largely based on textual analysis of the 1934 Act, for each position on each of the doctrinal questions.

Part V presents different contexts—including two securities fraud cases brought by the SEC currently pending before federal district courts—that exemplify how Section 20(b) can be used when other causes of actions are not applicable. Identifying viable circumstances in which Section 20(b) can be applied can help clarify whether Section 20(b) can be an effective anti-fraud tool.

Considering the lack of clarity in the case law and the paucity of extant opinions, the path that the courts take on these matters ultimately will dictate how effective of an anti-fraud tool Section 20(b) can be for the SEC. While the provision's statutory construction and legislative history suggest that it imposes primary liability and does not require a control relationship, courts inexplicably have ruled (and likely will continue to rule) against this view. Since these qualities are necessary if Section 20(b) is to fill the gap created by *Janus*, the SEC's intended use ultimately may be judicially constrained.

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## II. The Gap Created by *Janus*

In *Janus*, the Court held that to be liable for an MMO under Section 10(b), the maker of the statement must have “ultimate authority” over the statement’s content and formulation, as well as whether to issue the statement.<sup>5</sup> The Court’s ruling effectively prevents Section 10(b) from supporting actions against a defendant who commits fraud through the means of another innocent person or entity to shield himself from the scheme. As long as the ultimate decision regarding whether, what, and how to issue the statement lies in someone else’s hands, the defendant has not “made” the MMO, despite his involvement and influence.<sup>6</sup>

This newly created gap in Section 10(b) litigation leaves securities fraud schemes involving an “innocent instrumentality” unaccountable. Typically, this consists of schemes that are knowingly orchestrated by one person, but are actually executed, unknowingly, by another. While the 1934 Act imposes forms of secondary liability, such as control person liability under Section 20(a) and aiding and abetting under Section 20(e), together they do not stop the gaps. Control person liability holds liable only one who “effectively controls” the primary perpetrator of the fraud. However, absent such control, as well as a primary violation, such liability cannot be established. Aiding and abetting also requires a separate primary violation that a secondary party substantially assists. In cases

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<sup>5</sup> *Id.* at 2302. There, Janus Investment Fund, a mutual fund owned entirely by its investors, hired Janus Capital Management (JCM), an entirely separate legal entity, as its fund manager and administrator. *Id.* at 2299–302. The fund issued legally mandated prospectuses that allegedly contained misleading information. *Id.* However, the Court held that JCM could not be held liable under Section 10(b) for the misleading statements in these prospectuses because it did not have ultimate control over the fund’s issuance of those statements. *Id.* at 2304–05. Although JCM was the fund’s investment advisor and administrator, the ultimate decision as to whether to issue the prospectuses and what to include therein rested with the fund. *Id.* The Court rooted its decision in Section 10(b)’s language, which prohibits a person “to *make* any untrue statement of a material fact.” *Id.* at 2302. The Court reasoned that to “make” a statement, a person must have ultimate control over it. *Id.* Otherwise, one merely suggests or drafts a statement, but does not “make” it. *Id.*

<sup>6</sup> It should be noted that the Fourth Circuit held that the *Janus* holding is limited to implied private causes of action and does not apply to criminal actions for securities violations. *Prousalis v. Moore*, 751 F.3d 272, 276 (4th Cir. 2014). Even though the statutory language “make” in Section 10(b) serves as the basis of criminal actions just as in private actions, the Fourth Circuit believes that the Supreme Court’s limitation of liability under Section 10(b) was due to its recent general trend of limiting implied private causes of action. *Id.* at 276–77; *see generally supra* p. 10–11. However, other courts have held that *Janus* applies to SEC enforcement proceedings as well. The Fourth Circuit’s analysis notwithstanding, the SEC has conceded that *Janus* governs its enforcement proceedings as well. *See, e.g., SEC v. Kelly*, 817 F. Supp. 2d 340 (S.D.N.Y. 2011); *SEC v. Sentinel Mgmt. Grp.*, 2012 WL 1079961 (N.D. Ill. Mar. 30, 2012). Indeed, the plain reading of *Janus* is that the basis for the holding is a linguistic argument that the term “make” requires ultimate authority.

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involving an innocent instrumentality, however, no primary Section 10(b) violation exists because the party acted unknowingly, thereby not meeting the scienter requirement. And sometimes the orchestrating party does not have ultimate control over the innocent actor, such as in *Janus*, where the two parties were separate legal entities, with the former merely advising, albeit intimately, the latter.

To fill this hole, the SEC seeks to use Section 20(b). Section 20(b)'s broad, general language avoids *Janus*' linguistic restrictions. Section 20(b) states, "It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this chapter or any rule or regulation thereunder through or by means of any other person."<sup>7</sup> This provision does not contain the term "make," thereby obviating the need for the defendant to have ultimate control over the issuance of a statement. Further, at first glance, the provision does not require a separate primary violation by the "other person" to impose liability. Indeed, White reads this provision as imposing primary liability, not secondary liability.<sup>8</sup> Therefore, the SEC views Section 20(b) as a potentially effective tool for cases that Section 10(b) no longer covers.

### III. Section 20(b)'s Purpose and Function

Whether Section 20(b) can be an effective anti-fraud tool depends on the resolution of various doctrinal issues. However, determining the purpose and function of Section 20(b) is helpful for understanding the doctrinal questions outlined in Part IV. Indeed, the varying rigidity and flexibility that courts have demonstrated in interpreting this provision stems from their respective understandings of Section 20(b)'s purpose.

A central question in the discussion regarding Section 20(b)'s purpose and function is how it relates to Section 20(a). The circuit courts are split on whether Section 20(a), which governs control person liability, is available for SEC enforcement proceedings. The Sixth Circuit held that the SEC cannot use Section 20(a),<sup>9</sup> but instead must use Section 20(b) for control person liability.<sup>10</sup> The Sixth Circuit seemingly reads these two provisions as imposing the same kind of liability, each to be used in a different type of action: Section 20(a) is to be used in private actions and Section 20(b) in enforcement actions. Under this approach, Section 20(b) is read as somewhat of a catchall for control

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<sup>7</sup> 15 U.S.C. § 78t(b) (2011).

<sup>8</sup> White, *supra* note 1. *But see infra* p. 7–9.

<sup>9</sup> SEC v. Coffey, 493 F.2d 1304, 1318 (6th Cir. 1974).

<sup>10</sup> See SEC v. Savoy, 587 F.2d 1149, 1170 (D.C. Cir. 1978) (interpreting the Sixth Circuit's ruling in *Coffey*).

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person liability, or at least read in tandem with Section 20(a). Because Section 20(b) is interpreted as being the version of Section 20(a) for the SEC to use, liability under Section 20(b) would require a control relationship and may even allow for a good faith defense.<sup>11</sup> The Sixth Circuit understands these two provisions as two sides of the same coin because, otherwise, Section 20(b) could be used to hold corporate directors liable for the actions of inferior agents. The Sixth Circuit seems unwilling to recognize such expansive liability, claiming that Congress never intended for such broad liability.<sup>12</sup>

Conversely, the Second and Third Circuits held that Section 20(a) is available for SEC enforcement proceedings.<sup>13</sup> This has been recognized as the view of the majority of courts.<sup>14</sup> Under this approach, Section 20(b) is not read as the SEC's provision for Section 20(a) liability, nor as a mere catchall. Rather, the two provisions have their own goals. Indeed, the Third Circuit read Sections 20(a) and 20(b) as targeting "different forms of wrongdoing."<sup>15</sup> It noted that Section 20(a) covers cases that Section 20(b) does not, such as where the control person induces a transfer to himself, but does not participate in the underlying violations.<sup>16</sup> The court implied that Section 20(b) requires that the defendant participate in the fraud in some way, even though his violation is primarily through the means of another.<sup>17</sup>

The Eighth Circuit presents a third approach to the relationship between Sections 20(a) and 20(b). Section 20(a) states,

Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable . . . *unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.*<sup>18</sup>

The court held that controlling persons, who are the "intended beneficiaries" of a transaction executed by a controlled person through making MMOs, are liable under the

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<sup>11</sup> See *infra* p. 10–11.

<sup>12</sup> See *Coffey*, 493 F.2d at 1318.

<sup>13</sup> SEC v. J.W. Barclay & Co., 442 F.3d 834, 842 (3d Cir. 2006); SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1472 (2d Cir. 1996).

<sup>14</sup> See *e.g.*, SEC v. Hawk, No. 03:05-CV-00172-LRH-VPC, 2007 U.S. Dist. LEXIS 57414, at \*6–7 (D. Nev. Aug. 3, 2007).

<sup>15</sup> *J.W. Barclay*, 442 F.3d at 845.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> 15 U.S.C. § 78t(a) (2011) (emphasis added).

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“directly or indirectly inducing the act” clause of Section 20(a).<sup>19</sup> Consequently, the controlling persons need not know of the specific violations committed by the controlled persons and are not entitled to the good faith defense. The court reasoned that “[t]o hold otherwise would vitiate the plain meaning of Section 20(b).”<sup>20</sup> The court seemingly believes that, where the defendant “induces” another to commit an action consisting of a securities violation, it is viewed as the defendant committing the fraud through the means of another. Therefore, even if in such a case a control relationship exists between the parties, it is not governed under typical control person liability principles—the defendant is not entitled to a good faith defense. Rather, it is viewed as a Section 20(b) violation. This approach views Section 20(b) as broader than Section 20(a) and not solely a form of control person liability.

#### **IV. Section 20(b)’s Doctrinal Issues**

The Court’s decision in *Janus* created a need for an additional anti-fraud tool for the SEC and private plaintiffs to use. Whether Section 20(b) can be that tool depends on the resolution of several doctrinal questions that remain unresolved due to a dearth of case law regarding Section 20(b). The doctrinal issues include whether Section 20(b) (A) imposes primary or secondary liability, (B) has a scienter requirement, (C) requires the defendant to “control” the active party, and (D) creates an implied private cause of action.

##### **A. Does Section 20(b) Impose Primary or Secondary Liability?**

If SEC Chair White’s assertion that Section 20(b) imposes primary liability on a defendant<sup>21</sup> is correct, Section 20(b) can be a potent tool for the SEC because there would be no need to first establish a primary Section 10(b) or similar violation. In a case like *Janus*, where a Section 10(b) violation could not be levied against the investment adviser, using Section 20(b) as an alternative, independent source of liability would potentially be the only avenue through which to pursue litigation.

Despite White’s confidence, the issue is not clear. The Majority in *Janus* declined to address whether Section 20(b) creates liability for those who act through innocent intermediaries.<sup>22</sup> However, the Dissent stated that if Section 20(b) is available for the plaintiffs, the Court should remand the case to allow for an amended complaint,<sup>23</sup> thereby sug-

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<sup>19</sup> *Myzel v. Field*, 386 F.2d 718, 738–39 (8th Cir. 1967).

<sup>20</sup> *Id.* at 739.

<sup>21</sup> White, *supra* note 1.

<sup>22</sup> *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2304 n.10 (2011).

<sup>23</sup> *Id.* at 2311.

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gesting Section 20(b)'s applicability to the case.

The statute does not explicitly address the matter. The phrase “any act or thing which it would be unlawful for such person to do under the provisions of this chapter or any rule or regulation thereunder”<sup>24</sup> is ambiguous. It could mean an act, which would *otherwise* be unlawful for such a person to commit on his own, is prohibited when executed through the means of another. Or it could mean an act, which *is committed unlawfully* by another person under a different provision or rule, is prohibited secondarily to the one who orchestrates it. Although she did not offer her reading of the statute, given White's position that Section 20(b) imposes primary liability, White likely reads the statute the first way.

The ambiguity in the statute's language notwithstanding, the context of this provision may be instructive. Section 20(b) is between two of the main secondary liability provisions in the 1934 Act. Section 20(a) establishes secondary liability for controlling persons, and Section 20(e) establishes secondary liability for aiding and abetting securities law violations. On the one hand, placement of Section 20(b) between these two provisions suggests that it too establishes secondary liability. However, a comparison of the language of these three provisions indicates that Section 20(b) is to be understood differently from the other two. Section 20(a) and Section 20(e) explicitly require a pre-existing violation by another person to attach a second level of liability.<sup>25</sup> Section 20(b)'s lack of such explicit language and its placement between two provisions in which Congress used unequivocal formulations suggest that Congress intended for Section 20(b) to establish primary liability.

Few courts address this issue outright. Two federal district courts each ruled that a complaint alleging a Section 20(b) violation cannot be sustained without a sufficiently plead primary violation, such as a Section 10(b) violation.<sup>26</sup> These courts understand Sec-

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<sup>24</sup> 15 U.S.C. § 78t(b) (2011).

<sup>25</sup> Section 20(a) states, “Every person who, directly or indirectly, *controls any person liable under any provision of this chapter or of any rule or regulation thereunder* shall also be liable jointly and severally with and to the same extent as such controlled person.” 15 U.S.C. § 78t(a) (2011) (emphasis added). Section 20(e) states, “[A]ny person that knowingly or recklessly provides substantial assistance *to another person in violation of a provision of this chapter, or of any rule or regulation issued under this chapter*, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.” 15 U.S.C. § 78t(e) (2011) (emphasis added).

<sup>26</sup> See *Espinoza v. Whiting*, 8 F. Supp. 1142, 1157 (E.D. Mo. 2014); *Shemian v. Research in Motion, Ltd.*, No. 11 Civ. 4068 (RJS), 2013 U.S. Dist. LEXIS 49699, \*72 (S.D.N.Y. Mar. 29, 2013), *aff'd*, 570 F. App'x. 32 (2d Cir. 2014); *Union Cent. Life Ins. Co. v. Credit Suisse Securities (USA), LLC*, No. 11 Civ. 2327 (GBD), 2013 U.S. Dist. LEXIS 48984, \*29–30 (S.D.N.Y. Mar. 29, 2013).

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tion 20(b) as establishing secondary liability, like its counterpart, Section 20(a). The Sixth Circuit, in *SEC v. Coffey*, also read all of Section 20 as establishing secondary liability.<sup>27</sup> Therefore, considering the direction of the case law, to have Section 20(b) impose primary liability, the SEC will need to support any linguistic argument by addressing the provision's purpose or speculating Congress's intent in enacting it.<sup>28</sup>

### **B. Does Section 20(b) Have a Scienter Requirement?**

Even if primary liability can be pursued under Section 20(b), such liability may require the showing of scienter.<sup>29</sup> Although Section 20(b) does not explicate whether the defendant must be of a certain state of mind when committing or directing the unlawful acts, the Second, Sixth, and District of Columbia Circuits require that a defendant *knowingly* use another person to violate the law.<sup>30</sup>

In most cases, such a requirement can easily be met.<sup>31</sup> Although a scienter requirement prevents using Section 20(b) against a corporation's top executives that are unaware of any fraud, the SEC's current goal is to use it against those who knowingly use innocent intermediaries to violate securities law. Therefore, the scienter requirement does not impede the SEC's planned use of Section 20(b).

### **C. Does Section 20(b) Mandate that the Defendant Control the Third Party?**

The plain language of Section 20(b) does not require a control relationship between the defendant and innocent intermediary. This is in contrast to Section 20(a), which imposes liability on "[e]very person who, directly or indirectly, *controls* any person liable under any provision of this chapter."<sup>32</sup> Furthermore, the legislative history indicates that Congress intentionally left out a control requirement. The original bill introduced in the Senate that was the basis for the 1934 Act limited liability under Section 20(b) to controlled persons.<sup>33</sup> However, Congress ultimately expanded the statute to cover parties that

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<sup>27</sup> 493 F.2d 1304, 1316 (6th Cir. 1974).

<sup>28</sup> See generally *infra* p. 5–7.

<sup>29</sup> The control requirement will be discussed in the following section.

<sup>30</sup> *Coffey* at 1318; *Moss v. Morgan Stanley, Inc.*, 553 F. Supp. 1347, 1362 (S.D.N.Y. 1983), *aff'd*, 719 F.2d 5 (2d Cir. 1983); *Cohen v. Citibank*, 954 F. Supp. 621, 630 (S.D.N.Y. 1996); see also *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1170 (D.C. Cir. 1978).

<sup>31</sup> In *Janus*, the investment adviser allegedly directed the fund to issue prospectuses containing MMOs. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2300 (2011). This allegation suggests that the investment adviser acted intentionally with regards to disseminating the fraudulent statements.

<sup>32</sup> 15 U.S.C. § 78t(a) (2011) (emphasis added).

<sup>33</sup> It stated,

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lack control over the one executing the fraud. Nevertheless, the Second, Sixth, and District of Columbia Circuits held that liability under Section 20(b) requires the “knowing use of a controlled person by a controlling person.”<sup>34</sup> Otherwise, “every link in a chain of command would be personally[,] criminally[,] and civilly liable for the violations of inferior corporate agents.”<sup>35</sup> And the *Coffey* court believed that Congress did not intend Section 20(b) to impose such expansive liability.<sup>36</sup>

A control requirement would significantly constrain the SEC’s intended use of Section 20(b). First, it could not be used in cases like *Janus*, where the investment adviser and its mutual fund client did not have a control relationship, but were separate legal entities.<sup>37</sup> Additionally, by requiring control under Section 20(b), the courts read Section 20(b) in conjunction with Section 20(a), which requires a control relationship between the defendant and corporate agent. However, such a reading raises the question whether the good faith defense under Section 20(a) applies to Section 20(b). Although, to date, no courts have recognized this defense, if Section 20(b) is indeed an application of control person liability, such a defense could be raised and would present an additional hurdle for the SEC.

#### **D. Does Section 20(b) Create an Implied Private Cause of Action?**

Whether Section 20(b) creates an implied private cause of action is an important question in considering the potential scope of Section 20(b) actions. Although the SEC seeks to use Section 20(b) in enforcement actions, if a private cause of action can be implied from the statute, Section 20(b) can be available for private parties as well.

The Supreme Court historically authorized implying private causes of action from

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It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this Act or any rule or regulation thereunder through or by means of any other person *who is controlled by such person by or through stock ownership, agency, or otherwise or through or by means of any other person who is controlled by such person and one or more other persons by or through stock ownership, agency or otherwise for the purpose of avoiding any provisions of this Act or any rule or regulation made thereunder.*

S. 2693, 73rd Cong. § 19(b) (1934) (emphasis added) (In this bill, the current Section 20(b) is contained in Section 19(b).). The final version of the 1934 Act did not contain the italicized language.

<sup>34</sup> *Coffey*, 493 F.2d at 1318; *Cohen*, 954 F. Supp. at 630; *Savoy Industries, Inc.*, 587 F.2d at 1170; *see Moss*, 553 F. Supp. at 1362.

<sup>35</sup> *Coffey*, 493 F.2d at 1318.

<sup>36</sup> *Id.*

<sup>37</sup> *See Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2299 (2011).

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the 1934 Act,<sup>38</sup> but the Court most recently has been reluctant to do so.<sup>39</sup> Consequently, it will be difficult for private parties to pursue litigation under Section 20(b). The statute contains no language that indicates congressional intent to create such an action. Furthermore, courts have been reluctant to establish private causes of action for neighboring provisions of Section 20.<sup>40</sup> And, in 1976, the United States District Court for the District of Massachusetts in *McLaughlin v. Campbell* ruled that no private cause of action exists under Section 20(b).<sup>41</sup> In reaching its decision, the court highlighted both the lack of legislative history and statutory language supporting a private action.<sup>42</sup>

Nevertheless, an argument exists for implying a private cause of action. Although the Fourth Circuit refused to create a private cause of action under Section 20(a), other circuits seem to disagree. Class certifications have been granted, or would have been granted if other class requirements were met, to private actions that pursued violations of

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<sup>38</sup> In a 1964 landmark decision, the Supreme Court in *J. I. Case Co. v. Borak* ruled that Section 27 of the 1934 Act authorizes private parties to bring a direct or derivative suit against a company for issuing a false or misleading proxy statement in violation of Section 14(a). 377 U.S. 426, 431–32 (1964). Although Congress did not explicitly reference a private cause of action in Section 14(a), the Court ruled that Section 27, which grants the federal courts jurisdiction over “all suits in equity and actions at law brought to enforce any liability or duty created,” under the Act supports a private cause of action because it furthers the purpose of Section 14(a), namely, to protect investors. *Id.* This ruling opened the door for implied private causes of action under the Act. In 1971, the Court confirmed the consensus of the lower federal courts that an implied private cause of action existed for Section 10(b). *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971).

<sup>39</sup> The Court’s expansion of the Act to include private causes of action even where Congress did not indicate that one existed eventually regressed. In 2001, the Court emphasized that private rights of action to enforce federal law must be created by Congress. Therefore, it ruled that a private action can be implied only when it determined that Congress intended for one to exist. *Alexander v. Sandoval*, 532 U.S. 275, 286 (2001). The Court believed that, absent congressional intent, a court’s attempt to imply a cause of action constitutes judicial overreaching into the realm of Congress, and undermines the constitutional directive that Congress establish the content of federal jurisdiction, not the Judiciary. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 164–65 (2008). Therefore, while an implied private cause of action for a Section 10(b) violation still exists, *see Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2407 (2014), the Court’s reluctance to imply private causes of action where Congress has not intended to do so informs their interpretation and application of Section 10(b). Indeed, the Supreme Court’s narrow interpretation of Section 10(b) in *Janus* was partially due to its reluctance to expand it when Congress did not. 131 S. Ct. 2296, 2302 (2011).

<sup>40</sup> The Supreme Court refused to create a private cause of action for aiding and abetting under Section 20(e). *See Stoneridge Inv. Partners*, 552 U.S. at 164–66. The Fourth Circuit refused to create one for control person liability under Section 20(a). *See Data Controls N., Inc. v. Fin. Corp. of America, Inc.*, 688 F. Supp. 1047, 1050 (D. Md. 1988), *aff’d*, 875 F.2d 314 (4th Cir. 1989).

<sup>41</sup> *See* 410 F. Supp. 1321, 1325 (D. Mass. 1976).

<sup>42</sup> *See id.*

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Section 20(a).<sup>43</sup> However, because these cases predate the Supreme Court's narrowing of implied private causes of action, which began in 2001, further case law is needed to clarify the current landscape of Section 20(a) class actions.

Furthermore, in *McLaughlin*, part of the court's reasoning for refusing to create a private Section 20(b) cause of action was that, because Section 18 explicitly creates a private cause of action, implying one under Section 20(b) is unnecessary.<sup>44</sup> Section 18 allows for private litigation against a person who makes a false or misleading statement in a statutorily mandated document.<sup>45</sup> However, it does not support a cause of action in a case where the MMO was made in a document or statement that a company or fund has no legal obligation to issue. In such cases, a plaintiff could argue that a private cause of action under Section 20(b) is needed. Nevertheless, given the *McLaughlin* court's holding, as well as the Supreme Court's recent reluctance to imply private causes of action, it is unlikely that private parties will be able to bring actions under Section 20(b).

## V. Contexts in Which Section 20(b) Could Apply

Assessing whether Section 20(b) can be a useful anti-fraud tool in securities litigation requires not only the resolution of the doctrinal questions presented above, but also identification of specific contexts in which Section 20(b) can be applied.

### A. Tippee Liability in Insider Trading

The Supreme Court has already understood Section 20(b) as governing tippee liability in insider trading cases. In *Dirks v. SEC*, the Supreme Court ruled that a tippee, who receives information from an insider, has a duty to disclose or abstain from acting on that information, much like the insider himself.<sup>46</sup> The Court grounded the basis for this duty in Section 20(b), which it read as prohibiting an insider from disclosing inside information to an outsider, or tippee, to exploit the information for his personal gain.<sup>47</sup> The Court seems to understand the tippee's duty to disclose or abstain as a function of the prohibition against the insider committing fraud through the means of another.<sup>48</sup> Furthermore, the Court established tippee liability under Section 20(b) without requiring the

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<sup>43</sup> See e.g., *In re W. Union Sec. Litig.*, 120 F.R.D. 629, 634–35 (D.N.J. 1988); *Snider v. Upjohn Co.*, 115 F.R.D. 536, 542 (E.D. Pa. 1987); *Koenig v. Benson*, 117 F.R.D. 330, 340 (E.D.N.Y. 1987); *Katz v. Comdisco, Inc.*, 117 F.R.D. 403, 413 (N.D. Ill. 1987).

<sup>44</sup> See 410 F. Supp. at 1325.

<sup>45</sup> 15 U.S.C. § 78r(a) (2011).

<sup>46</sup> *Dirks v. SEC*, 463 U.S. 646, 659 (1983).

<sup>47</sup> *Id.*

<sup>48</sup> See *id.*

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showing of a control relationship or a primary violation.<sup>49</sup> Instead, the Court seemingly understands Section 20(b) as imposing primary liability on the insider.<sup>50</sup> Therefore, the Court's formulation in *Dirks* serves as strong support for the SEC's plan for using Section 20(b).

### **B. Hiring a Third Party to Draft Fraudulent Reports**

Section 20(b)'s utility is further highlighted by the SEC's allegations in a case currently pending before the United States District Court for the Northern District of Georgia, *SEC v. Strebinger*.<sup>51</sup> The SEC alleges that the defendants "coordinated a . . . campaign to promote the [s]tock" of a company in which each owned more than 5% of the outstanding stock.<sup>52</sup> According to the complaint, the defendant promoted the stock primarily by hiring third parties to draft stock promotion reports and mail them to potential investors. Specifically, it claims that the defendant arranged for various third parties to draft reports to be sent to potential investors, knowing, or at least recklessly not knowing, that they contained MMOs.<sup>53</sup> However, as argued in the motion to dismiss, it is not clear that the defendant had the "ultimate authority" over these reports as required by *Janus* to be deemed the "maker" of these statements under Section 10(b).<sup>54</sup> If the defendant lacked such authority, Section 20(b) would serve as the only form of primary liability that could be assigned to the defendant. By hiring third parties to draft and mail reports without retaining the authority to oversee their contents, the defendant committed fraud solely through the means of another person. While the motion to dismiss cites the case law discussed above that requires a control relationship under Section 20(b), which does not exist in this case,<sup>55</sup> if such a relationship is not necessary, Section 20(b) would directly apply to this case.

### **C. Inducing a Business Partner to Make MMOs**

A slight variation of the allegations made by the SEC in *SEC v. Plummer*, which is currently pending before the United States District Court for the Southern District of New

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<sup>49</sup> *Id.*

<sup>50</sup> *See id.*

<sup>51</sup> Complaint for Injunctive and Other Relief at 2, *SEC v. Strebinger*, No. cv-03533 (N.D. Ga. Nov. 3, 2014).

<sup>52</sup> *Id.*

<sup>53</sup> *Id.* at 9, 19, 25.

<sup>54</sup> Memorandum in Support of the Motion to Dismiss of Defendants Bruce D. Strebinger, et al. at 17–18, *SEC v. Strebinger*, No. cv-03533 (N.D. Ga. Feb. 17, 2015).

<sup>55</sup> *Id.* at 29–30.

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York, further demonstrates how Section 20(b) can be a useful tool for the SEC.<sup>56</sup> Essentially, CEO A of company A, formed a business relationship to engage in a joint venture with the CEO of two other companies, B and C. CEO A supplied CEOs B and C with fraudulent information regarding company A's business activities and financial statements, which CEOs B and C included in press releases of their respective companies. The goal was to drive up the stock prices of the respective companies, especially of Company A, which was failing. Although CEOs B and C could be liable under Section 10(b) for issuing the press releases containing the MMOs (assuming they had the requisite scienter regarding the fraudulent character of the information), under *Janus*, CEO A could not because he did not have the ultimate authority over issuing the releases. Although he could be held liable for aiding and abetting, that establishes only secondary liability and thus would be contingent on the success of the Section 10(b) claims against CEOs B and C. However, under Section 20(b), CEO A would be liable for committing fraud through CEOs B and C. Since he supplied them with fraudulent information, and he would be liable under Section 10(b) had he included this information in a press release issued by Company A, he would be liable under Section 20(b) for committing this fraud through CEOs B and C.

## VI. Conclusion

More case law needs to be written to determine how effective a tool Section 20(b) can be in pursuing actions against defendants who cannot be held liable under Section 10(b). Only a case that uses Section 20(b) as its sole or even primary cause of action will force the courts to properly delve into the doctrines outlined above.<sup>57</sup> As discussed, to fill the gap created by *Janus*, Section 20(b) needs to be interpreted as imposing primary liability and not requiring a control relationship. The statutory construction and legislative history both strongly support such a view. Courts, especially the Sixth Circuit, have nevertheless ruled against this view without much explanation, holding that Section 20(b) imposes secondary liability and requires a control relationship. Given courts' seemingly blind acceptance of this view, it appears unlikely that any court presented with these questions in the future will hold otherwise.

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<sup>56</sup> Cf. Complaint, SEC v. Plummer, No. 1:14-cv-05441 (S.D.N.Y. July 18, 2014).

<sup>57</sup> While the cases currently pending before various district courts contain counts that cite Section 20(b), none of the alleged violations are being pursued solely on the basis of Section 20(b). Consequently, the courts treatment of the issues relating to Section 20(b) may not provide the final word on Section 20(b)'s parameters.