

Second Circuit Lowers the Bar for Aiding and Abetting Liability in SEC Securities Fraud Actions

On August 8, 2012, in [SEC v. Apuzzo](#), the United States Court of Appeals for the Second Circuit ruled that the US Securities and Exchange Commission ("SEC") is not required to establish that a defendant proximately or directly caused injury in a securities fraud action to be liable for aiding and abetting a primary actor.¹ This ruling settles a longstanding question regarding what conduct satisfies the "substantial assistance" prong of the *DiBella* test for determining aiding and abetting liability in securities fraud enforcement actions.

Defendant Joseph P. Apuzzo, the chief financial officer of a large equipment manufacturer, Terex Corp., allegedly aided a leasing company, United Rentals Inc., ("URI") in fraudulently inflating its profits through a shrouded accounting scheme. The SEC alleged that Apuzzo entered into various interlocking agreements with URI and a third party that allowed URI to recognize income prematurely under GAAP. The SEC alleged that Apuzzo aided and abetted URI's violation of the securities laws (i) prohibiting the use of manipulative devices in the purchase or sale of a security, (ii) requiring accurate books and records and (iii) requiring compliance with Rule 10b-5.

Section 20(e) of the 1934 Act allows the SEC, but not private litigants, to bring civil enforcement actions against aiders and abettors of securities fraud. 15 U.S.C. § 78t(e). The traditional elements of an aiding and abetting claim require the SEC to prove: (i) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party; (ii) knowledge of the violation on the part of the aider and abettor; and (iii) substantial assistance by the aider and abettor in the achievement of the primary violation.²

Prior to *Apuzzo*, the Second Circuit did not draw a clear distinction between private civil tort actions and governmental claims when determining what constituted "substantial assistance." Therefore, relying on a private tort action standard, the district court in *Apuzzo* dismissed the SEC action finding that the SEC had failed to establish the requisite "substantial assistance" since the defendant did not *proximately* – or directly – cause the securities violation.

On the SEC's appeal, the Second Circuit rejected the notion that "substantial assistance" required a showing of proximate causation. Rather, the court looked to criminal aiding and abetting cases for guidance, citing the standard first espoused by

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Judge Learned Hand in US v. Peoni, that accessorial liability exists when a defendant "in some sort associate[d] himself with the venture, that he participate[d] in it as in something that he wishe[d] to bring about, [and] that he [sought] by his action to make it succeed."³

The court based its ruling on a finding that enforcement actions are different from private civil actions. That is, in enforcement actions, there is no requirement that the government prove injury, because "the purpose of such actions is *deterrence*, not compensation." Furthermore, imposing a proximate cause requirement on enforcement activity could permit aiders and abettors to escape liability because their activities are rarely the direct cause of the injury brought about by the primary fraud.

In applying Judge Hand's standard in Apuzzo, the Second Circuit held that the SEC sufficiently alleged that Apuzzo provided "substantial assistance" to the primary actor in the fraud. The Complaint alleged that Apuzzo participated in a series of interlocking transactions, which he knew were designed to conceal URI's financial risks and permitted URI to artificially inflate its revenues, including approving documents containing false information.

The Apuzzo decision should embolden the SEC to test the scope of the expanded authority to pursue aiding and abetting liability that it was bestowed under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Prior to Dodd-Frank, Section 20(e) of the Securities Exchange Act only permitted prosecution of persons who *knowingly* aided and abetted securities fraud violations. Now, under Dodd-Frank, the SEC may bring actions against persons that knowingly or recklessly provide substantial assistance to another person in violation of the Securities Exchange Act. Thus, empowered by Dodd-Frank, and secure in its position that the Second Circuit will apply the less onerous standard for substantial assistance, the SEC is likely to pursue aggressive enforcement actions for aiding and abetting securities fraud violations against entities and individuals.

¹ The case is available at <http://caselaw.findlaw.com/us-2nd-circuit/1608342.html>.

² *SEC v. DiBella*, 587 F.3d 553, 566 (2d Cir. 2009) (quoting *Bloor v. Carro*, 25 Spanbock, Londin, Rodman & Fass, 754 F.2d 57, 62 (2d Cir. 1985)).

³ *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938).