The SEC on a Forum Shopping Spree: SEC Enforcement Power and Control Person Liability After Dodd–Frank

*Brianna L. Gates**

ABSTRACT: In 2010, Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd–Frank") in response to the collapse of the United States economy. Prior to Dodd–Frank, two separate circuit splits existed. One circuit split affected the Securities and Exchange Commission's ("SEC") ability to bring control person liability actions against executives whose subordinates violated securities laws. The other circuit split concerned the proof requirements in control person actions. This lack of uniformity made it difficult for the SEC to hold executives accountable for securities violations that occurred under its watch, as the SEC was both unsure as to whether it could bring control person liability claims altogether in some jurisdictions, and in others it seriously questioned the likelihood that it could succeed. Partially attributing the recession to financial regulation failures, Congress and President Obama, via Dodd–Frank, responded by expanding the SEC's subpoena powers, by granting it nationwide subpoena power for civil actions, and resolving one of the circuit splits, ensuring the SEC's ability to at least bring control person liability claims in all jurisdictions. However, there remains a circuit split over the proof requirements attendant to such actions. While some circuits impose relatively lenient requirements, under the Second and Third Circuits' rigorous standard, one who controls a person who was liable for a securities violation can be held liable to the same extent as the controlled person (i.e., the primary violator) only upon a showing that he or she culpably participated in the violation. In light of the SEC's newfound subpoena power and its solidified ability to institute enforcement actions in all jurisdictions, it may now seek to avoid the Second and Third Circuits' rigorous "culpable participation" standard, and thus engage in undesirable forum shopping. Forum shopping can create unnecessary expenses and lead

* J.D. Candidate, The University of Iowa College of Law, 2014; B.B.A. The University of Iowa, 2011. Thank you to my parents, grandparents, friends, and Nick Long for their encouragement and support throughout law school. Also, thank you to the *Iowa Law Review* Volume 98 and 99 editors and writers for their hard work on this Note.

to injustice. Accordingly, this Note argues that the Supreme Court should finish what Dodd–Frank started, resolve the remaining circuit split by rejecting "culpable participation" and thereby strengthen the SEC's enforcement power while avoiding SEC forum shopping.

I. INTRODUCTION

In 2010, Congress responded to the economic recession and collapse of the U.S. economy that began in 2008 by passing the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd–Frank").[1] The legislation sought to increase accountability and transparency in the financial sector through vigilant market regulation.[2] In the wake of numerous large-scale financial scandals orchestrated by executives,[3] control person liability became an area ripe for reform.[4] Accordingly, Congress enacted several provisions to "enhance" the U.S. Securities and Exchange Commission's ("SEC") enforcement power.[5]

Prior to 2010, the interaction of two separate circuit splits led the SEC to become uncertain as to both its ability to bring control person claims altogether under section 20(a) of the Securities Exchange Act ("SEA"), and the likelihood that it would be able to successfully make out a prima facie control person liability case in a given jurisdiction.[6] The overlap of these two circuit splits effectively chilled the SEC's ability to bring enforcement actions. In the circuits with easier liability standards, the SEC was unsure of its ability to bring action altogether. In circuits where the SEC was confident it could bring enforcement actions, courts imposed a more rigorous liability standard. Further, the SEC's ability to bring enforcement actions was inhibited due to its lack of a nationwide subpoena power.

1. SANJAY ANAND, ESSENTIALS OF THE DODD-FRANK ACT 8 (2011); *see also* DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD–FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES 1–2 (2011).

2. *See* ANAND, *supra* note 1, at 8–9. Dodd–Frank begins by stating that the purpose of the Act is "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes." Dodd–Frank Wall Street Reform and Consumer Protection (Dodd–Frank) Act, Pub. L. No. 111-203, 124 Stat. 1376, 1376 (2010) (codified in scattered sections of the U.S. Code).

3. *See, e.g.*, James O'Toole, *SEC Shuts Down Alleged $600 Million Ponzi Scheme*, CNNMONEY (Aug. 17, 2012, 6:53 PM), http://www.money.cnn.com/2012/08/17/technology/zeek-rewards-ponzi-scheme/index.html; E. Scott Reckard, *Barry Minkow Seeks Leniency in His Latest Securities Fraud Case*, L.A. TIMES (July 21, 2011), http://www.articles.latimes.com/2011/jul/21/business/la-fi-minkow-sentencing-20110721; Aaron Smith & Hussein Saddique, *Galleon Manager Rajaratnam Sentenced*, CNNMONEY (Oct. 14, 2011, 3:27 PM), http://money.cnn.com/2011/10/13/news/companies/insider_trading_raj_rajaratnam/index.htm ("Rajaratnam was found guilty . . . of conspiracy and fraud, after netting $64 million on a long-running insider trading scam."); *see also* Brian A. Melhus, Note, *Control Person Liability: A Repudiation of Culpable Participation*, 37 J. CORP. L. 929, 931–32 (2012) (describing the Bernie Madoff $50 billion Ponzi scheme scandal among other market fraud incidents).

4. A control person is one who oversees the person who causes a primary violation of the securities laws; usually a manager, director, executive, or supervisor. *See infra* Part II.A.1.

5. *See* H.R. REP. NO. 111-517, at 870 (2010) (Conf. Rep.); 111 CONG. REC. H13404–05 (daily ed. Dec. 2, 2009).

6. *See infra* Part IV.

Dodd–Frank section 929P(c) resolved the circuit split regarding the SEC's authority to bring control person liability claims altogether.[7] Prior to Dodd–Frank, three circuits were in disagreement over whether the SEC constituted a "person" under the SEA, rendering it able to bring control person liability claims against executives whose subordinates had violated the SEA under their watch.[8] Section 929P(c) amended the control person liability statute to include the SEC within the definition of a "person," which allowed it to bring control person liability actions under the SEA.[9]

However, the circuits continue to disagree about the elements needed to make out a prima facie case for control person liability actions.[10] The majority of circuits require a showing of two elements: (1) that a primary securities law violation, and (2) that the executive charged with control person liability had control over the primary violator.[11] A minority of circuits, namely the Second and Third Circuits, require an additional showing of "culpable participation" by the control person.[12]

Additionally, Dodd–Frank section 929E further enhances the SEC's enforcement power by allowing it to serve subpoenas nationwide in civil actions.[13] As this Note will discuss, this newfound subpoena power could ultimately facilitate the SEC's ability to engage in rampant forum shopping[14] in order to avoid the Second and Third Circuits' rigorous "culpable participation" requirement.[15] Forum shopping can create inefficiencies and unfairly affect the outcome of a dispute.[16]

In light of this continued circuit split and the SEC's increased subpoena power, this Note analyzes the overlapping circuit splits, Dodd–Frank's effect on control person liability, and the SEC's resulting enforcement power in the United States. Part II outlines the origins of control person liability, discusses Dodd–Frank provisions that impact control person liability (including the resolved circuit split over the SEC's enforcement authority under section 20(a)), and examines the SEC's newfound subpoena power

7. *See infra* Part II.B.I.

8. *See infra* Part II.B.I.

9. *See* Dodd–Frank Act, Pub. L. No. 111-203, § 929P(c), 124 Stat. 1376, 1865 (2010) (codified at 15 U.S.C. § 78t(a) (2006 & Supp. V 2011)); *infra* Part II.B.1.

10. *See infra* Part III.

11. *See, e.g.*, Aldridge v. A.T. Cross Corp., 284 F.3d 72, 84–85 (1st Cir. 2002) (requiring the two-part test); Harrison v. Dean Witter Reynolds, Inc., 974 F.2d 873, 881 (7th Cir. 1992); Metge v. Baehler, 762 F.2d 621, 631 (8th Cir. 1985).

12. *See* Boguslavsky v. Kaplan, 159 F.3d 715, 720 (2d Cir. 1998) (requiring culpable participation in addition to the two-part test).

13. *See infra* Part II.B.2.

14. Forum shopping is defined as "[t]he practice of choosing the most favorable jurisdiction or court in which a claim might be heard." BLACK'S LAW DICTIONARY 726 (9th ed. 2009).

15. *See infra* Part IV.

16. *See infra* Part IV.

under section 929E. Part III discusses the circuit split regarding whether "culpable participation" is a required element of control person liability, including the majority and minority views. Part IV elaborates on the way in which the SEC's newfound subpoena power will likely lead to forum shopping and discusses the undesirable aspects of forum shopping. Finally, Part V argues that the Supreme Court should reject the "culpable participation" standard and apply the majority view, as this approach best adheres to the plain meaning of section 20(a), comports with the underlying purpose of the Securities Act of 1933 and the Securities Exchange Act of 1934 (collectively, the "Securities Acts") and increased enforcement trends, and creates uniformity. Additionally, the majority approach allows the SEC to further its enforcement objectives and thereby increases both executive accountability and transparency.

II. BACKGROUND

Control person liability originated after the Great Depression. The Securities Acts each contained provisions purporting to hold control persons liable for their employees' violations of the Securities Acts. After the 2008 recession began, it became apparent that increased control person liability was necessary to increase market regulation. Accordingly, Congress and President Obama, via Dodd–Frank, enhanced the SEC's enforcement powers over control persons in an effort to better regulate the market.

A. THE ORIGINS OF CONTROL PERSON LIABILITY, THE SECURITIES ACTS, AND DODD–FRANK

During the Great Depression the American economy suffered tremendously, as its financial markets collapsed and unemployment permeated the nation.[17] In 1933 and 1934, Congress responded to the stock market crash of 1929 by enacting the Securities Acts.[18] The Securities Acts were intended to "combat fraudulent practices" and securities market abuse that resulted from "ineffective self-regulation."[19]

1. Section 20(a) of the Securities Exchange Act

Believing the current system to be "dangerous[,] unreliable[,]" and "depend[ant] upon dummy directors [who] lacked any accountability or responsibility," Congress passed section 20(a) of the Securities Exchange

17. *See* Matthew W. Goulding, Note, *Making It Easier to Milk the Cow: The Southern District of New York Collapses the Culpable Participation Doctrine and Sidesteps the Private Securities Litigation Reform Act*, 49 VILL. L. REV. 551, 556 (2004) ("From 1929 until 1933, the U.S. securities markets lost half their total value and twenty percent of the U.S. workforce was unemployed.").

18. *See id.* at 556–57 (explaining the events that led to the enactment of the Securities Act and the Securities Exchange Act).

19. *Id.*

Act.[20] Specifically targeting business directors and executives committing fraud and abusing the securities markets through their subordinates, section 20(a) created a cause of action to hold those in "control" of primary violators (e.g., managers, executives, and bosses) liable in addition to the persons actually committing violations of the Securities Exchange Act.[21] Through this provision, Congress intended to "prevent people and entities from using straw parties, subsidiaries, or other agents acting on their behalf to accomplish ends that would be forbidden directly by the securities laws."[22] Thus, today superiors may be held liable for the actions of their subordinates in a fashion similar to other vicarious liability theories, such as respondeat superior.[23]

Congress intentionally declined to define the meaning of control,[24] leaving this task to the courts.[25] In the absence of a statutory definition, the SEC and the courts have generally defined control as the ability to exert power over or direct a person's actions.[26] However, courts to some extent diverged from one another in regard to the elements required to establish a prima facie case of control person liability.[27]

Additionally, section 20(a) creates an affirmative defense of good faith. If a plaintiff establishes a prima facie case of control person liability, the

20. Laperriere v. Vesta Ins. Grp., Inc., 526 F.3d 715, 721–22 (11th Cir. 2008) (quoting S. REP. NO. 73-47, at 5–6 (1933)) (internal quotation marks omitted).

21. 15 U.S.C. § 78t(a) (2006 & Supp. V 2011) ("Every person who, directly or indirectly, controls any person liable under any provision of this chapter . . . shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable . . . 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."); *see also* Goulding, *supra* note 17, at 556–58.

22. *Laperriere*, 526 F.3d at 721; *see also* Melhus, *supra* note 3, at 931.

23. *See Laperriere*, 526 F.3d at 721–22; *see also* Melhus, *supra* note 3, at 932–33 (describing the similarities between control person liability and respondeat superior, and identifying where the causes of action differ).

24. *See* H.R. REP. NO. 73-1383, at 26 (1934) ("It was thought undesirable to attempt to define the term. It would be difficult if not impossible to enumerate or to anticipate the many ways in which actual control may be exerted.").

25. *See* Lustgraaf v. Behrens, 619 F.3d 867, 873 (8th Cir. 2010).

26. *See, e.g.*, 17 C.F.R. § 230.405 (2013) ("The term *control* . . . means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."); *see also Lustgraaf*, 619 F.3d at 873 (finding that control "requir[es] only some indirect means of discipline or influence short of actual direction"); *In re* Nat'l Century Fin. Enters., Inc., 504 F. Supp. 2d 287, 300 (S.D. Ohio 2007) ("Control is 'the practical ability to direct the actions of the people' who committed the violation." (quoting Stavroff v. Meyo, No. 95-4118, 1997 WL 720475, at *7 n.5 (6th Cir. Nov. 12, 1997)) (internal quotation marks omitted)).

27. *See infra* Part III.

defendant then has the opportunity to prove that he or she acted in good faith or did not induce the primary violation.[28]

2. The Dodd–Frank Act

In 2008, the U.S. economy collapsed and a financial crisis ensued.[29] Some economists, reports, and even President Obama refer to the 2008 financial crisis as "the Great Recession."[30] During the Great Recession, the stock market collapsed, the cost of borrowing increased, and unemployment drastically escalated.[31] Amidst this financial crisis, regulators uncovered widespread fraud and market abuse that the Securities Acts were intended to and theoretically should have prevented.[32] The federal government attributed the financial crisis to the "failure of capitalism" and "inefficiency of previously passed regulations."[33] In response, Congress enacted the Dodd–Frank Wall Street Reform and Consumer Protection Act in order to remedy the problems that caused the market failure.[34]

Senator Chris Dodd, chairman of the Senate Banking Committee, and Representative Barney Frank, House Financial Services Committee chairman, proposed Dodd–Frank on December 2, 2009.[35] Dodd–Frank's provisions aimed to stabilize the economy through vigilant regulation of the financial sector.[36] In June of 2009, President Obama called for a "sweeping overhaul of the United States financial regulatory system, a transformation

28. 15 U.S.C. § 78t(a) (2006 & Supp. V 2011) (imposing liability "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"); *see also* Metge v. Baehler, 762 F.2d 621, 631 (8th Cir. 1985); G.A. Thompson & Co. v. Partridge, 636 F.2d 945, 957–59 (5th Cir. 1981); *In re* WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d 392, 414 (S.D.N.Y. 2003).

29. ANAND, *supra* note 1, at 7–8.

30. *See* David Wessel, *Did 'Great Recession' Live Up to the Name?*, WALL ST. J. (Apr. 8, 2010), http://online.wsj.com/article/SB10001424052702303591204575169693166352882.html (analyzing whether the Great Recession was actually the worst economic downturn since the Great Depression).

31. ANAND, *supra* note 1, at 8 ("There was an overall failure of capitalism in the U.S. stock markets and economy.").

32. *See supra* note 3.

33. ANAND, *supra* note 1, at 8. *But see* Bill Thomas et al., *What Caused the Financial Crisis?*, WALL ST. J. (Jan. 27, 2011), http://online.wsj.com/article/SB10001424052748704698004576104500524998280.html (attributing the Financial Crisis to "both global economic forces and failures in U.S. policy and supervision").

34. *See* ANAND, *supra* note 1, at 8; SKEEL, *supra* note 1, at 2 ("Dodd-Frank . . . is the response to Americans' call for help, for a new regulatory framework for the twenty-first century.").

35. ANAND, *supra* note 1, at 7.

36. *See id.* at 8–9. Because of the interconnected nature of today's global economy, Dodd–Frank's scope extends internationally. *See id.*

on a scale not seen since the reforms that followed the Great Depression": Congress responded with Dodd–Frank.[37]

Dodd–Frank's purpose was "to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the U.S. taxpayer by ending bailouts, [and] to protect consumers from abusive financial services."[38] Key components of Dodd–Frank include: "[c]onsolidation of financial regulatory entities," updated and stronger consumer protections, crisis rescue tools, and increased credit-rating agency regulations.[39] President Obama signed Dodd–Frank into law on July 21, 2010.[40]

Many of Dodd–Frank's provisions were not effective immediately, and some provisions required follow-up rulemaking by regulators or agencies—including the SEC—to become effective.[41] Although the legislation itself is expansive, this Note focuses on two relatively small provisions that have already had a substantial impact on control person liability.[42] These important provisions are section 929P(c), which resolved the aforementioned "person" circuit split, and section 929E, which expands the SEC's subpoena power.

B. Dodd–Frank Provisions That Impact Control Person Liability

Dodd–Frank included two provisions that expanded the SEC's enforcement power against control persons: section 929P(c) and section 929E. Section 929P(c) resolved the "person" circuit split, solidifying the SEC's authority to bring actions under section 20(a). Section 929E expanded the SEC's subpoena power, which consequently allows the SEC to utilize its enforcement power anywhere it can establish jurisdiction.

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37. ROSS P. BUCKLEY & DOUGLAS W. ARNER, FROM CRISIS TO CRISIS: THE GLOBAL FINANCIAL SYSTEM AND REGULATORY FAILURE 185 (2011) (citing President Barack Obama, Remarks by the President on 21st Century Financial Regulatory Reform (Jun. 17, 2009)).

38. Dodd–Frank Act, Pub. L. No. 111-203, 124 Stat. 1376, 1376 (2010). Put differently, Dodd–Frank's two main objectives are to "limit the risk of contemporary finance" and to "limit the damage caused by the failure of a large financial institution." SKEEL, *supra* note 1, at 4.

39. *See* ANAND, *supra* note 1, at 11.

40. SKEEL, *supra* note 1, at 1.

41. BUCKLEY & ARNER, *supra* note 37, at 185; *see Implementing the Dodd–Frank Wall Street Reform and Consumer Protection Act*, U.S. SEC, http://www.sec.gov/spotlight/dodd-frank.shtml (last modified Aug. 20, 2013) (describing the ongoing rulemaking required by Dodd–Frank provisions). As of October 2012, it seems the SEC is substantially finished with the rulemaking Dodd–Frank tasked to it. *See* Robert Feinberg, *Robert Feinberg: SEC's Schapiro Speaks at Dodd-Frank Conference*, MONEYNEWS (Oct. 26, 2012, 10:49 AM), http://www.moneynews.com/Finance News/Feinberg-Schapiro-Dodd–Frank-transparency/2012/10/26/id/461666 ("With the release of [security-based swap] proposed rules, the SEC has completed essentially its entire regulatory agenda under Dodd–Frank . . . .").

42. *See infra* Part II.B.

1. Dodd–Frank Section 929P(c) Resolved the "Person" Circuit Split: The SEC Is a Person Under Section 20(a)

Section 20(a) of the SEA states that "[e]very person who . . . controls any person liable under any provision of this chapter . . . shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable."[43] In 1974, the Sixth Circuit held, in *SEC v. Coffey*, that the SEC was not a "person" under the Securities Acts.[44] Thus, the SEC could not bring claims under section 20(a) against alleged control persons in the Sixth Circuit.[45] However, in 1975, the Second Circuit declined to follow the Sixth Circuit and upheld the SEC's enforcement power under section 20(a).[46] Although Congress attempted to clarify the statutory definition of "person" in 1975, the circuits remained split on the issue for over three decades.[47]

The Second Circuit's interpretation became the majority view when the Third Circuit followed suit over thirty years later.[48] Yet, prior to Dodd–Frank, only these three circuits (Second, Third, and Sixth) had addressed whether the SEC had enforcement power under section 20(a).[49] As a result, outside these circuits, district courts were unsure whether the SEC had the

43. 15 U.S.C. § 78t(a) (2006 & Supp. V 2011).

44. *See* SEC v. Coffey, 493 F.2d 1304, 1318 (6th Cir. 1974) ("As a matter of legislative interpretation, we hold that the SEC is not a person under section 20(a), since section 20(a) was meant to specify the liability of controlling persons to private persons suing to vindicate their interests."). Thus, because the SEC was not a private person, the SEC was unable to initiate a control person liability suit. *Id.*

45. *See id.*

46. *See* SEC v. Mgmt. Dynamics, Inc., 515 F.2d 801, 812–13 (2d Cir. 1975).

47. *See* Securities Acts Amendments of 1975, Pub. L. No. 94-29, §3(2), 89 Stat. 97, 97 (codified at 15 U.S.C. § 78c(a)(9) (2006)). It is unclear whether Congress's amendment resulted from the *Coffey* decision or other considerations entirely. *See* SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1472 (2d Cir. 1996) (noting that government agencies are included in the definition of person without discussing the reasoning behind Congress's 1975 amendment); SEC v. Daifotis, No. C11-00137 WHA, 2011 WL 4714250, at *5 (N.D. Cal. Oct. 7, 2011) (agreeing with the SEC that the 1975 amendment to the definition of person "*clarified* a power that already existed under the Exchange Act"); U.S. SEC v. Smith, No. C2-CV-04-739, 2005 WL 2373849, at *10 (S.D. Ohio Sept. 27, 2005) (discussing the fact that the amendment to the definition of person came after the *Coffey* decision and citing the current definition and the weight of authority as support for finding the SEC has enforcement power under section 20(a)); S. REP. NO. 94-75, at 90 (1975) (giving the amended definition of person without explanation).

48. SEC v. J.W. Barclay & Co., 442 F.3d 834, 842 (3d Cir. 2006) ("We . . . hold that the SEC is a 'person' within the meaning of 20(a).").

49. *See id.*; *Mgmt. Dynamics, Inc.*, 515 F.2d at 812–13; *Coffey*, 493 F.2d at 1318. The Third Circuit pointed out that the Sixth Circuit's reason for disallowing the SEC to bring actions under section 20(a) might have been supported by the definition of "person" before the 1975 amendments. *J.W. Barclay & Co.*, 442 F.3d at 842.

ability to bring a suit under section 20(a).[50] Congress resolved this uncertainty with Dodd–Frank section 929P(c).[51]

Dodd–Frank section 929P(c) inserted "(including to the Commission in any action brought under paragraph (1) or (3) of section 21(d))" into section 20(a).[52] Accordingly, section 20(a) of the Securities Act now reads:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable (*including to the Commission* in any action brought under paragraph (1) or (3) of section 78u(d) of this title), 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.[53]

While Dodd–Frank's legislative history does not reveal Congress's explicit intent behind section 929P(c) specifically,[54] both the plain meaning of the text and legislative history of Dodd–Frank section IX, which contains 929P(c), are highly indicative of Congress's intent.

First, the text of section 929P(c) unambiguously gives the SEC power to bring enforcement actions against controlling persons,[55] as it explicitly references the SEC—"*including to the Commission.*"[56]

Second, a Joint Explanatory Statement of the Committee of Conference that stated section IX (which contains section 929P(c)) "strengthens the SEC's authority to conduct investigations, impose liability on control persons, and assess penalties for violations of the securities laws."[57] Moreover, New York SEC Regional Director George Canellos explained at an SEC conference that the SEC would interpret the law to mean that "the Dodd–Frank Act explicitly makes control persons at regulated entities

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50. *See* ZACHARY S. BREZ ET AL., ROPES & GRAY LLP, CONTROL PERSON LIABILITY 2 & n.6 (2011), *available at* http://www.ropesgray.com/files/Publication/1bd285b7-8035-47c2-a2b1-1a9a9d859bbf/Presentation/PublicationAttachment/c7249062-9bc5-4b5f-ac4a1ba5343a6177/ropes_gray_brez_oconnor_article.pdf. (comparing district court cases in circuits other than the Second, Third, and Sixth).

51. *See* Dodd–Frank Act, Pub. L. No. 111-203, § 929P(c), 124 Stat. 1376, 1865 (codified at 15 U.S.C. § 78t(a) (2006 & Supp. V 2011)).

52. *Id.* (internal quotation marks omitted). The subsection is titled "Control Person Liability Under the Securities Exchange Act of 1934." *Id.*

53. 15 U.S.C. § 78t(a) (emphasis added).

54. *See* BREZ ET AL., *supra* note 50.

55. *Cf.* Dodd–Frank Act, § 929P(c). In *SEC v. Daifotis,* the SEC argued that Dodd–Frank "merely *clarified* a power that already existed under the Exchange Act." SEC v. Daifotis, No. C11-00137 WHA, 2011 WL 4714250, at *5 (N.D. Cal. Oct. 7, 2011). Both the SEC and the alleged control person stipulated that under section 929P(c) the SEC is a "person." *Id.*

56. Dodd–Frank Act, § 929P(c).

57. H.R. REP. NO. 111-517, at 870 (2010) (Conf. Rep.); *see also* BREZ ET AL., *supra* note 50.

vicariously liable for the type of penalties the agency may impose against the controlled person."[58] Thus, given section 929P(c)'s plain meaning, the Committee Conference's Joint Explanatory Statement, and the SEC's own interpretation, section 929P(c) effectively empowers the SEC to bring suit under section 20(a) against control persons, and thereby resolves the "person" circuit split.

2. Dodd–Frank Section 929E: The Subpoena Power

Prior to the enactment of Dodd–Frank in 2010, the SEC had the ability to service subpoenas nationwide in administrative proceedings.[59] However, in civil enforcement actions before Dodd–Frank, the SEC could "issue a subpoena only within the Federal jurisdictional district where a trial takes place or within 100 miles of the courthouse."[60] The SEC's witnesses in civil trials were often outside of the jurisdictional district, and thus, outside of the reach of the SEC's subpoena power.[61] Congress believed this "hampered the Commission's ability to efficiently and effectively mount its cases."[62] Where witnesses would not voluntarily appear at trial, the SEC had to spend extra time and money to depose witnesses in order to use their testimony at trial.[63]

Congress created the nationwide subpoena power in response to the "recent Wall Street scandals."[64] Believing the SEC's limited subpoena powers to have inhibited the SEC from aggressively combatting fraud and market abuse in the past, Congress sought to give the SEC "some additional enforcement tools . . . to fight [such evils in the future]."[65] As such, Dodd–Frank section 929E(b) provides:

> Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa) is amended by inserting after the third sentence the following: "In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, a subpoena issued to compel the attendance of a witness or the production of documents or tangible things (or both) at a hearing

58. Randall J. Fons & Tiffany A. Rowe, *The SEC Speaks: Aggressive Enforcement to Intensify in 2011*, MORRISON & FOERSTER LLP (Feb. 9, 2011), http://www.mofo.com/files/Uploads/Images/110209-The-SEC-Will-Aggressively-Pursue-Enforcement-Matters-in-2011.pdf.

59. 111 CONG. REC. H13404–05 (daily ed. Dec. 2, 2009) (statement of Rep. Kanjorski).

60. *Id.* at H13405.

61. *See id.*

62. *Id.*

63. *Id.* ("[D]epositions are generally more expensive than having a witness attend a trial.").

64. *Id.* (statement of Rep. Campbell).

65. *Id.*; *see also* Bruce Carton, *Changes in Securities Enforcement Thanks to Dodd-Frank*, SEC. DOCKET (Aug. 4, 2010, 7:40 AM), http://www.securitiesdocket.com/2010/08/04/changes-in-securities-enforcement-thanks-to-dodd-frank/ (stating that the SEC had a nationwide subpoena power on its "Wish List" and had "long sought to expand . . . to nationwide 'service of process'" (internal quotation marks omitted)).

> or trial may be served at any place within the United States. Rule 45(c)(3)(A)(ii) of the Federal Rules of Civil Procedure shall not apply to a subpoena issued under the preceding sentence."[66]

Congress's grant of a nationwide subpoena power can be characterized as giving the SEC an "additional enforcement tool."[67] Section 929E appears in the Dodd–Frank section entitled "Enhanced S.E.C. Enforcement Authority Act."[68] This placement is indicative of Congress's expansion or enhancement of the SEC's enforcement power.[69] The power to subpoena witnesses in any jurisdiction gives the SEC far greater flexibility in choosing where to bring an enforcement action.[70] Further, a nationwide subpoena allows the SEC to operate more efficiently.[71] This "ensure[s] that the Commission maximizes its limited resources to investigate and resolve wrongdoing in our securities markets."[72]

Viewed in isolation, section 929E gives the SEC just another "tool" to aid in the regulation of market fraud. However, viewed in conjunction with the current "culpable participation" circuit split, discussed below, section 929E could have much larger implications. Prior to Dodd–Frank's section 929E, it was inefficient for the SEC to bring actions outside the jurisdiction with the greatest number of significant witnesses.[73] After Congress granted the SEC nationwide subpoena power in 2010, the SEC could subpoena witnesses to appear in the jurisdiction of its choice. Thus, "[t]his change will free the SEC to select the most favorable jurisdictions, subject to the typical jurisdictional limits."[74] Therefore, presuming it can establish jurisdiction and venue, the SEC can avoid the Second and Third Circuits' "culpable participation" standard by bringing claims in friendlier jurisdictions.[75]

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66. Dodd–Frank Act, Pub. L. No. 111-203, § 929E(b), 124 Stat. 1367, 1853 (2010) (internal quotation marks omitted) (codified at 15 U.S.C. § 78aa(a) (2006 & Supp. V 2011)). Sections 929E(a) and (c)–(d) use almost identical language to amend the Securities Act of 1933, the Investment Company Act of 1940, and the Investment Advisers Act of 1940 and give the SEC nationwide subpoena power in civil actions related to these Acts. *Id.* § 929E(a), (c), (d).

67. *See* 111 CONG. REC. H13405 (daily ed. Dec. 2, 2009) (statement of Rep. Campbell).

68. *See id.* at H13404 (statement of Rep. Kanjorski).

69. *See id.* at H13405 (statement of Rep. Campbell).

70. *See* Joseph D. Edmondson et al., *SEC Enforcement Actions and Investigations in Private and Public Offerings*, *in* 24A WILLIAM M. PRIFTI, SECURITIES: PUBLIC AND PRIVATE OFFERINGS ch. 14, § 14:21 (2d ed. 2011).

71. 111 CONG. REC. H13404–05 (daily ed. Dec. 2, 2009) (statement of Rep. Kanjorski).

72. *Id.* at H13405.

73. *See id.*

74. Edmondson et al., *supra* note 70, at § 14:21; *see also* BREZ ET AL., *supra* note 50, at 3 ("The SEC, presuming it can show proper venue, need not file its cases in the Second or Third Circuit, because it has nationwide service of process and can apparently compel witnesses to attend trials in jurisdictions with friendlier pleading standards.").

75. BREZ ET AL., *supra* note 50, at 3.

III. CIRCUIT SPLIT CONCERNING WHETHER "CULPABLE PARTICIPATION" IS A REQUIRED ELEMENT OF A CONTROL PERSON LIABILITY CLAIM

"The requirements for demonstrating controlling person liability vary widely, depending on the court."[76] The circuit courts are currently divided over the elements necessary to bring a successful control person liability claim. Although most circuits have developed their own variation of the test,[77] the circuits are split into two main camps: those that require "culpable participation" by the controlling person and those that do not.[78]

A. *THE MAJORITY VIEW: NO REQUIREMENT OF CULPABLE PARTICIPATION*

The First, Fifth, Sixth, Seventh, Eighth, Ninth, and Tenth Circuits do not require culpable participation to make out a prima facie case of control person liability.[79] Even though these circuits decline to require the tougher culpable participation element, they each apply different versions of this less rigorous test.[80]

The Eighth Circuit has "rejected the culpable participation test as contrary to 'the plain meaning' of the statute and to its remedial purpose" and has adopted a two-prong test.[81] A defendant must have both "actually participated in" the general corporate operations and had the power to control the activity that is the source of the primary violation.[82] Further, the Eighth Circuit does not require the plaintiff to prove the control person exercised power over the primary violation activity.[83]

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76. *In re* Nat'l Century Fin. Enters., Inc., 504 F. Supp. 2d 287, 301 (S.D. Ohio 2007) (quoting Newby v. Enron Corp., Nos. MDL-1446, Civ.A.H-01-3624, 2003 WL 230688, at *9 (S.D. Tex. Jan. 28, 2003) (internal quotation marks omitted)). Other courts have acknowledged the "lack of clarity in the law concerning Section 20(a)." *Id.* (quoting *In re* WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d 392, 414 (S.D.N.Y. 2003)).

77. In *In re National Century Financial Enterprises., Inc.*, the court summarized the various tests each circuit used to address control person liability. *In re Nat'l Century*, 504 F. Supp. 2d at 300–05. The Second Circuit requires that the controlling person be "in some meaningful sense a culpable participant in the primary violation." Boguslavsky v. Kaplan, 159 F.3d 715, 720 (2d Cir. 1998) (internal quotation marks omitted). In contrast, the Eighth Circuit applies a two-part test and rejects a culpable participant element. Metge v. Baehler, 762 F.2d 621, 630–31 (8th Cir. 1985). Similarly, the First Circuit applies a two-part control person liability test where the control person must actually exercise their control. Aldridge v. A.T. Cross Corp., 284 F.3d 72, 85 (1st Cir. 2002). The Seventh Circuit looks to whether the control person has power over the primary violator and the activity constituting the primary violation. Harrison v. Dean Witter Reynolds, Inc., 974 F.2d 873, 881 (7th Cir. 1992). However, the Ninth Circuit requires only the ability to control, and not actual exercise of that control. Howard v. Everex Sys., Inc., 228 F.3d 1057, 1065 (9th Cir. 2000).

78. *See* BREZ ET AL., *supra* note 50, at 2.

79. *See id.*

80. *See In re Nat'l Century*, 504 F. Supp. 2d at 300–05 (surveying the various tests employed across circuits).

81. *Id.* at 302 (citing *Metge*, 762 F.2d at 631).

82. *Id.* (citing *Metge*, 762 F.2d at 631).

83. *Id.* (citing *Metge*, 762 F.2d at 631).

Similarly, the Tenth Circuit requires the plaintiff to show a primary violation and "'control' over the primary violator by the alleged controlling person," and does *not* require "actual direction" over the primary violator in order to establish a prima facie case.[84]

The First and Seventh Circuits apply the most rigorous tests of the circuits who subscribe to the majority view.[85] The First Circuit requires the controlling person to possess the power to control the primary violator and a showing of an actual exercise of such power in order to establish the control element.[86] Similarly, the Seventh Circuit first evaluates whether the controlling person exercised control over the primary violator in general.[87] It then reviews whether the control person "possessed the power or ability to control the *specific transaction or activity* upon which the primary violation was predicated, whether or not that power was exercised."[88] Put differently, under the Seventh Circuit's test, the control person must exercise actual control over the primary violator's general actions. However, the control person only needs to possess the ability to control the specific activity that constituted the primary violation, regardless of whether he or she exercised that control when the primary violator committed the violation.[89] This contrasts with the First Circuit's test where actual control at the time of the violation must be exercised in order to meet the control element.

The Fifth and the Ninth Circuits apply the most lenient standards.[90] The Ninth Circuit originally applied the culpable participation element, but later rejected it and joined the majority camp.[91] Today, the Ninth Circuit requires the plaintiff show only that the control person has the ability to control the primary violator to satisfy the control element.[92] Similarly, "under Fifth Circuit case law, a plaintiff may assert control[] person liability by alleging that the controlling person had the power to control the

84. Maher v. Durango Metals, Inc., 144 F.3d 1302, 1305 (10th Cir. 1998).

85. *See In re Nat'l Century*, 504 F. Supp. 2d at 302.

86. *Id.* (citing Aldridge v. A.T. Cross Corp., 284 F.3d 72, 85 (1st Cir. 2002)).

87. *Id.* (citing Harrison v. Dean Witter Reynolds, Inc., 974 F.2d 873, 881 (7th Cir. 1992)).

88. *Id.* (emphasis added) (quoting *Harrison*, 974 F.2d at 881).

89. *Id.* (citing *Harrison*, 974 F.2d at 881).

90. *See id.* at 302–03.

91. *See, e.g.*, Buhler v. Audio Leasing Corp., 807 F.2d 833, 835 (9th Cir. 1987) (requiring culpable participation); Seymour v. Summa Vista Cinema, Inc., 817 F.2d 609, 609 (9th Cir. 1987) (same). The Ninth Circuit rejected the "culpable participation" standard in 1990. *See* Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1575 (9th Cir. 1990) ("Today, however, we hold that a plaintiff is *not* required to show 'culpable participation' . . . ."). The court in *Hollinger* rejected the culpable participation requirement as not required by section 20(a). *Id.* ("[T]he statute premises liability solely on the control relationship . . . .").

92. *See In re Nat'l Century*, 504 F. Supp. 2d at 302 (quoting Howard v. Everex Sys., Inc., 228 F.3d 1057, 1065 (9th Cir. 2000)) ("[I]t is not necessary to show actual participation or the exercise of actual power.").

controlled person or to influence corporate policy."[93] Neither the Fifth nor the Ninth Circuits require actual control.[94]

Finally, the Fourth Circuit addressed the elements required to establish a prima facie case for control person liability in *In re Mutual Funds Investment Litigation*.[95] The court applied a two-part test requiring: (1) a primary violation, and (2) an exercise of control over the controlling person.[96] The Supreme Court reversed *In re Mutual Fund Investment Litigation* on different grounds and it is unclear whether the test is still good law.[97] However, district courts within the Fourth Circuit's jurisdiction continue to apply the two-prong test even after the reversal.[98]

B. *The Minority View: Culpable Participation Required*

The Second and Third Circuits apply the most rigorous standard—"culpable participation."[99] This test makes it more difficult for plaintiffs to establish prima facie cases because the circuits require them to prove an additional, difficult element concerning the defendant's state of mind. The "culpable participation" element puts a greater burden on plaintiffs to show the defendant "was in some meaningful sense a culpable participant in the primary violation."[100]

The Second and Third Circuits have interpreted section 20(a)'s legislative history to require a showing of "culpable participation."[101] Congress adopted the House of Representatives' version of the statute, which imposed a "fiduciary standard" on controlling persons.[102] The Senate version was described as an "insurer's liability" standard.[103] The Third

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93. Newby v. Enron Corp., 258 F. Supp. 2d 576, 642 (S.D. Tex. 2003) (citing Abbott v. Equity Grp., Inc., 2 F.3d 613, 619–20 (5th Cir. 1993); G.A. Thompson & Co. v. Partridge, 636 F.2d 945, 957–58 (5th Cir. 1981)).

94. *Id.* ("[A]ctual exercise of that control need not be alleged.").

95. *See In re* Mut. Funds Inv. Litig., 566 F.3d 111, 129–30 (4th Cir. 2009), *rev'd on other grounds sub nom.* Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296 (2011).

96. *See id.*

97. *See* Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2305 (2011).

98. *See In re* Massey Energy Co. Sec. Litig., 883 F. Supp. 2d 597, 627 (S.D. W. Va. 2012).

99. *See* Rochez Bros. v. Rhoades, 527 F.2d 880, 885 (3d Cir. 1975); *In re* Nat'l Century Fin. Enters., Inc., 504 F. Supp. 2d 287, 301 (S.D. Ohio 2007); BREZ ET AL., *supra* note 50, at 2.

100. Boguslavsky v. Kaplan, 159 F.3d 715, 720 (2d Cir. 1998) (quoting SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1472 (2d Cir. 1996)) (internal quotation marks omitted).

101. *See Rochez Bros.*, 527 F.2d at 884–85 ("Congress intended liability to be based on something besides control. That something is culpable participation.").

102. *Id.* at 885. A fiduciary is defined as "[a] person who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, trust, confidence, and candor." BLACK'S LAW DICTIONARY, *supra* note 14, at 702.

103. *Rochez Bros.*, 527 F.2d at 885 (citing S. REP. NO. 73-47, at 5 (1933)). Liability insurance is defined as "[a]n agreement to cover a loss resulting from the insured's liability to a third party." BLACK'S LAW DICTIONARY, *supra* note 14, at 873.

Circuit claims Congress's choice of the House version of section 20(a)—which imposes a fiduciary "duty of due care" on the control person instead of a stricter "insurer's liability"—is evidence that Congress did not want to make control persons "an insurer against the fraudulent activities of another" (i.e., control persons must be culpable participants).[104]

By this strict standard, in the Second and Third Circuit a plaintiff must prove three elements in order to make out a prima facie case of control person liability.[105] The first two elements are the same as those required by the majority of circuits: (1) a "primary violation," and (2) "control of the primary violator by the targeted defendant."[106] The third element is where the minority interpretation differs from the majority, adding that the plaintiff must also show "the controlling person 'was in some meaningful sense a culpable participant in the primary violation.'"[107] This added element makes it very difficult for a plaintiff to establish a prima facie case due to the difficulty of proving an additional element and the hardships inherent in proving someone's state of mind.

IV. AFTER DODD–FRANK ENHANCED THE SEC'S ENFORCEMENT AND SUBPOENA POWERS, THE SEC WILL LIKELY ENGAGE IN FORUM SHOPPING TO AVOID THE "CULPABLE PARTICIPATION" ELEMENT

As previously demonstrated, the past overlapping circuit splits affected the SEC's enforcement power under section 20(a). The "person" and "culpable participation" circuit splits together impacted the SEC's ability to bring a control person suit. Prior to Dodd–Frank, the SEC could be most certain about its authority to bring an action under section 20(a) in the Second and Third Circuits.[108] However, these same two circuits also made establishing liability substantially more difficult by applying the rigorous "culpable participation" standard. Alternatively, outside of the Second and Third Circuits the SEC could more easily establish liability under the two-element test, but its authority to bring claims under section 20(a) was uncertain. Historically, this led to noteworthy SEC enforcement patterns.

A review of the SEC litigation releases from 1999 to 2011 "show[s] that the SEC has filed few Section 20(a) control person claims."[109] While such

104. *See Rochez Bros.*, 527 F.2d at 885. A duty of care is a "legal relationship arising from a standard of care, the violation of which subjects the actor to liability." BLACK'S LAW DICTIONARY, *supra* note 14, at 581.

105. *See First Jersey Sec., Inc.*, 101 F.3d at 1472–73.

106. *Id.*

107. *In re* Nat'l Century Fin. Enters., Inc., 504 F. Supp. 2d 287, 301 (S.D. Ohio 2007) (quoting Boguslavsky v. Kaplan, 159 F.3d 715, 720 (2d Cir. 1998)).

108. *See supra* Part II.B.1.

109. BREZ ET AL., *supra* note 50, at 2 (surveying all litigation releases in order to ascertain SEC enforcement patterns relating to control person liability claims under section 20(a)). However, it is important to note that a survey of the litigation releases does "not provide an exhaustive catalog of enforcement actions." *Id.*

actions have been sparse, the SEC's jurisdictional choices intuitively follow from the state of the above-described pre-Dodd–Frank control person liability law. In the thirty-seven total control person liability claims brought by the SEC between 2002 and 2011, seventeen of those were brought in the Second and Third Circuits.[110] The remaining circuits heard a total of twenty claims *combined*.[111] This pattern can likely be attributed to the Second and Third Circuits' express affirmance of the SEC's power to bring control person actions.[112]

Further, in the Second and Third Circuits, half of the controlling persons against whom the SEC instituted control person liability claims were also criminally prosecuted on charges relating to *primary securities violations*.[113] In contrast, only two criminal prosecutions were instituted against allegedly liable control persons in all of the other circuits.[114] Arguably, the difference between the SEC's decision to prosecute control persons on primary violation charges in the Second and Third Circuits, and not to do so in the others, can be attributed to the more rigorous "culpable participation" standard applied by the Second and Third Circuits.[115] Put differently, the relatively high volume of criminal actions instituted against executives alleging primary securities violations, in addition to control person liability civil actions, in the circuits imposing the "culpable participation" standard evidences the SEC's need to regulate control persons in cases where under that more rigorous standard, section 20(a) would likely prove an ineffective tool.

Given its increased enforcement power after Dodd–Frank, the SEC could turn to forum shopping to avoid "culpable participation" unless the Supreme Court resolves the circuit split. Forum shopping is largely viewed as an evil in the judicial system and treated as "unethical and inefficient."[116] Forum shopping can create inefficiencies by overburdening courts and creating expenses when litigants seek the most favorable jurisdiction.[117]

110. *Id.*

111. *Id.*

112. *See supra* Part II.B.1. However, it is possible there are other explanations for the saturation of section 20(a), e.g., the Second and Third Circuits include New York and thus, Wall Street.

113. BREZ ET AL., *supra* note 50, at 2. Indeed, "the typical enforcement approach has been to assert claims premised on primary liability before tacking on claims under the control person statute." *Id.*

114. *Id.*

115. *See id.*

116. Note, *Forum Shopping Reconsidered*, 103 HARV. L. REV. 1677, 1677 (1990).

117. *Id.* at 1684; *See also* Richard Maloy, *Forum Shopping? What's Wrong with That?*, 24 QUINNIPIAC L. REV. 25, 26 (2005) (stating that some federal courts view forum shopping as creating "inconvenience and expense"). "The losers from [forum shopping] are the American public who end up paying excessive legal fees that are silently encapsulated in the price of products." 135 CONG. REC. E2243 (daily ed. June 21, 1989) (statement of Rep. Luken).

Because forum shopping can affect the outcome of a dispute, it is also viewed as unjust.[118] Moreover, SEC forum shopping will thwart Congress's intent that Dodd–Frank lead to more efficient enforcement. The SEC will avoid the Second and Third Circuits which will not only create unnecessary expenses for both parties by litigating in an inconvenient forum, but will also unfairly increase its likelihood of success in control person actions. The Supreme Court can only avoid the inefficiencies and injustice that will result from SEC forum shopping if it resolves the circuit split by rejecting the "culpable participation" element.

V. THE SUPREME COURT SHOULD RESOLVE THE REMAINING CIRCUIT SPLIT BY REJECTING THE "CULPABLE PARTICIPATION" STANDARD

The Supreme Court should continue the work Dodd–Frank started and further enhance the SEC's ability to regulate control persons by resolving the "culpable participation" circuit split. The certainty of the SEC's ability to bring an action under section 20(a) and the nationwide subpoena power will likely lead to the SEC avoiding the Second and Third Circuits because of their more demanding "culpable participation" standard.[119] There are four main reasons why the Supreme Court should resolve this circuit split by rejecting the "culpable participation" element. First, section 20(a)'s text does not require "culpable participation." Second, following the less rigorous standard will adhere to the trend of increasing the SEC's enforcement power over control persons. Third, resolution of this circuit split will create uniformity and certainty in federal law. Finally, applying the majority test will allow the SEC to utilize its enforcement power to better prevent future financial crises.

A. *THE PLAIN MEANING OF SECTION 20(A) DOES NOT REQUIRE "CULPABLE PARTICIPATION"*

Neither the language of section 20(a) nor the text of the SEC's corresponding regulation references a "culpable participation" requirement.[120] Courts rejecting the culpable participation test often criticize the requirement and note that a plain reading of section 20(a) does not require such a showing.[121] These courts also emphasize that the SEC's

118. Antony L. Ryan, *Principles of Forum Selection*, 103 W. VA. L. REV. 167, 167–68, 200 (2000) ("The choice of favorable substantive law is the most dramatic prize for the successful forum-shopper . . . .").

119. *See supra* Part IV.

120. *See* 15 U.S.C. § 78t(a) (2006 & Supp. V 2011). *See generally* SEC, 17 C.F.R. pt. 230 (2013).

121. *See, e.g.*, Adams v. Kinder-Morgan, Inc., 340 F.3d 1083, 1109 (10th Cir. 2003) ("Section 20 . . . contains no requirement that plaintiffs must prove a control person's state of mind."); Metge v. Baehler, 762 F.2d 621, 631 (8th Cir. 1985) ("[T]he plain meaning of [the statute] does not require participation in the wrongful transaction."); G.A. Thompson & Co. v. Partridge, 636 F.2d 945, 957–58 (5th Cir. 1981) (stating Section 20(a) does not "appear[] to require participation in the wrongful transaction.").

regulation interpreting section 20(a) and the meaning of "control" under that section does not require culpable participation.[122] The SEC regulations define control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person."[123] Thus, the regulation's text speaks to the possession of the power to control and the text does not require "culpable participation," let alone actual exercise of that control.

Moreover, section 20(a) explicitly creates a "good faith escape hatch."[124] Some courts that have rejected the culpable participation standard argue that because, pursuant to section 20(a), defendants can raise an affirmative defense of good faith, imposing a requirement to show culpable participation is unduly repetitious and renders the good faith provision superfluous.[125] Further, the culpable participation standard places the burden of proof on the plaintiff to prove the defendant's state of mind, which is often an exceedingly difficult task. While a good faith affirmative defense requires the *defendant* to show the control person's own state of mind, the culpable participation test requires the *plaintiff* to prove the control person's state of mind. In the case of the good faith affirmative defense, the burden is on the party who is more apt to be able to show state of mind—the defendant. As one court succinctly summarizes, "good faith and lack of participation are affirmative defenses in a controlling person action, and requiring them as part of the plaintiff's prima facie case . . . confuses the parties' responsibilities and unnecessarily burdens plaintiffs contrary to the plain meaning of the statute."[126]

The words "culpable participation," or some variation thereof, do not appear in the text, and the structure of the statute explicitly creates a state-of-mind affirmative defense of good faith thereby precluding the imposition of a nearly identical requirement on the plaintiff. Thus, the proper construction of section 20(a) is one that does not impose a "culpable participation" element. Moreover, this construction has the added benefit of placing the burden on defendants to prove their own state of mind, or a *lack* of culpable participation (i.e., good faith participation) or no participation at all. Otherwise, the burden would be unnecessarily placed on the plaintiffs by requiring them to prove the state of mind of another. Further, this

122. *See Metge*, 762 F.2d at 630–31; *G.A. Thompson & Co.*, 636 F.2d at 957–58; *see also* 17 C.F.R. § 230.405.

123. 17 C.F.R. § 230.405.

124. *See* Goulding, *supra* note 17, at 569; *see also* 15 U.S.C. § 78t(a) (stating that a controlling person may be held 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").

125. *See Adams*, 340 F.3d at 1109; Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1575 (9th Cir. 1990).

126. *Metge*, 762 F.2d at 631.

construction is not unfair to defendants, as they still have the "good faith escape hatch." Therefore, the Supreme Court should adhere to the plain meaning of section 20(a), which is in keeping with the SEC's interpretation of that statute, and reject the "culpable participation" standard.

B. *REJECTING THE MORE RIGOROUS "CULPABLE PARTICIPATION" STANDARD FOLLOWS THE TREND TOWARD INCREASED ENFORCEMENT*

In the wake of the Great Recession, Congress sought to increase the SEC's enforcement power through Dodd–Frank.[127] Section 929E was but one provision included in a section of Dodd–Frank titled "Enhanced SEC Enforcement Authority."[128] Additionally, Congress stated that section 929P(c) and the surrounding provisions in Dodd–Frank were meant to "strengthen[] the SEC's authority to conduct investigations, impose liability on control persons, and assess penalties for violations of the securities laws."[129] Thus, Dodd–Frank and its provisions show a congressional trend toward increasing the SEC's enforcement power.

The Supreme Court should continue this trend toward increased SEC enforcement authority, as this would ensure that controlling persons are better held accountable for violations of securities laws. Application of the majority test requires plaintiffs to show only two elements to establish a prima facie case of control person liability.[130] The minority view requires the difficult third "culpable participation" element.[131] Thus, it is generally easier to make out a prima facie case under the majority standard. Therefore, by rejecting the "culpable participation" standard, the Supreme Court would increase the ability of plaintiffs, including the SEC, to establish prima facie cases of control person liability. Accordingly, this will follow Congress's trend of increased enhancement of the SEC's authority to enforce securities regulations.

C. *RESOLVING THE CIRCUIT SPLIT WILL CREATE UNIFORMITY AND CERTAINTY ACROSS ALL CIRCUITS*

The Second and Third Circuits are the only circuits that require the tough "culpable participation" element.[132] Whenever a circuit split exists, the law is not applied uniformly. Uniform application of federal law is of

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127. *See* ANAND, *supra* note 1, at 8–9.

128. *See supra* Part II.B.2.

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

130. *See In re* Nat'l Century Fin. Enters., Inc., 504 F. Supp. 2d 287, 300–05 (S.D. Ohio 2007) (surveying the various tests employed across circuits).

131. *See* SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1472–73 (2d Cir. 1996).

132. *See supra* Part III.B.

such great importance that debate over the subject is minimal.[133] Uniformity creates certainty and predictability in the law, both of which are desirable. As such, "[t]he Supreme Court's docket is largely fueled by circuit splits and disagreements among the lower courts."[134]

With market abuse widespread, holding control persons accountable for their actions is more important now than ever.[135] "Given the extraordinary variations in determining § 20(a) liability, the [country] would benefit from a uniform standard" and the resolution of this debate.[136] By resolving the "culpable participation" circuit split, the Supreme Court will unify the application of federal law, section 20(a), and the elements necessary for a control person liability claim.

D. Adoption of the Majority Test Will Help the SEC Prevent Future Financial Crises

President Obama attributed the 2008 recession to "old and poorly enforced laws [that] had facilitated a few to take risks that endangered the entire U.S. economy."[137] Congress responded by amending and enacting regulations in Dodd–Frank.[138] Dodd–Frank section 929P(c), in conjunction with section 929E, enhances the SEC's ability to regulate the securities markets.[139]

Application of the majority test excluding the culpable participation requirement will make it easier for the SEC to establish prima facie cases against control persons.[140] Enhancing the SEC's enforcement power fulfills Dodd–Frank's purpose by increasing accountability among directors and executives, and increasing enforcement of securities regulations.[141] A lack of accountability and enforcement at least partially caused the financial crisis.[142] Therefore, the Supreme Court should reject the "culpable participation" standard in order to enhance the SEC's enforcement power, which would further help to prevent the reoccurrence of similar financial crises.

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133. *See* Erwin Chemerinsky, *Parity Reconsidered: Defining a Role for the Federal Judiciary*, 36 UCLA L. REV. 233, 237 (1988) ("[T]he Supreme Court's role in assuring the uniformity and supremacy of federal law has not been the subject of substantial debate.").

134. David O. Stewart, *Judicial Restraints: Court to Decide Reach of the Federal Arm of the Law*, A.B.A. J., Dec. 1997, at 38, 38 (quoting Yale Law Professor Akhil Reed Amar) (internal quotation marks omitted).

135. *See supra* note 3 and accompanying text.

136. Erin L. Massey, *Control Person Liability Under Section 20(a): Striking a Balance of Interests for Plaintiffs and Defendants*, 6 HOUS. BUS. & TAX L.J. 109, 142 (2005).

137. ANAND, *supra* note 1, at 6–7.

138. *See supra* note 34 and accompanying text.

139. *See supra* Part IV.

140. *See supra* note 100 and accompanying text.

141. *See supra* note 38 and accompanying text.

142. *See supra* notes 32–33 and accompanying text.

VI. CONCLUSION

Congress and President Obama partially attributed the 2008 recession to a failure of financial regulation under the Securities Acts. At least some of this failure can be attributed to the lack of regulation of control persons under SEA section 20(a). Dodd–Frank resolved one circuit split regarding control person liability, solidifying the SEC's ability to bring control person actions under section 20(a). A circuit split over the elements required to make out a prima facie case remains. Further, because Dodd–Frank gives the SEC a nationwide subpoena power, the SEC has an incentive to forum shop to avoid the Second and Third Circuits' "culpable participation" requirement.

In light of this, the Supreme Court should finish what Dodd–Frank started and resolve the remaining control person liability circuit split by rejecting the "culpable participation" requirement. By resolving the circuit split the Supreme Court can decrease the likelihood of inefficient, unjust SEC forum shopping. Endorsing the majority view will adhere to the plain meaning of section 20(a), follow the trend toward increased SEC enforcement power, create uniformity in the law, and help the SEC prevent future financial crises.