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## SECOND CIRCUIT NOTE 1975 TERM

### FOREWARD: A LAWYER'S OBSERVATIONS ON HOCHFELDER

ELLSWORTH A. VAN GRAAFEILAND\*

In recent years, increased exposure to liability under the federal securities acts<sup>1</sup> has caused insurance rates to climb dramatically and the availability of coverage to dwindle alarmingly for both the accounting and legal professions. It has been estimated that between 500 and 1000 suits against accountants were pending in 1974.<sup>2</sup> Although many plaintiffs eventually either recover nothing or settle for relatively small amounts, defendants nonetheless are faced with a substantial financial burden in defending their claims.<sup>3</sup> As Justice Rehnquist observed in *Blue Chip Stamps v. Manor Drug Stores*,<sup>4</sup> litigation under rule 10b-5 "presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general."<sup>5</sup> Litigation of this type, he said, often has a settlement value disproportionate to its prospect of success because of the po-

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\* Circuit Judge, United States Court of Appeals for the Second Circuit. The author of this Article was a practicing attorney until 1975, and the comments made herein are largely reflective of his 35 years of practice as a private attorney.

<sup>1</sup> Securities Act of 1933, 15 U.S.C. §§ 77a to 77aa (1970 & Supp. V 1975); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a to 78hh (1970 & Supp. V 1975).

<sup>2</sup> Fiflis, *Current Problems of Accountants' Responsibilities to Third Parties*, 28 VAND. L. REV. 31, 33 n.7 (1975).

<sup>3</sup> Carleton H. Griffin, in a recent article, describes two cases in which the plaintiffs sought damages of \$3,000,000 and \$600,000, but respectively settled for \$10,000 and \$7,000. Notwithstanding the relatively small amount of the settlements, the cost in legal fees to the defending accounting firms was \$196,000. Griffin, *Beleaguered Accountants: A Defendant's Viewpoint*, 62 A.B.A.J. 759, 761 (1976).

<sup>4</sup> 421 U.S. 723 (1975).

<sup>5</sup> *Id.* at 739.

tential for abuse of the liberal discovery provisions of the Federal Rules of Civil Procedure and the difficulty of disposition through summary judgment proceedings.<sup>6</sup> As a result of litigious overkill, even the most frivolous of claims may impose a strain upon the financial resources of a defendant.

From the viewpoint of a lawyer or accountant faced with a 10b-5 claim, this unhappy situation has not been remedied by the Supreme Court's recent decision in *Ernst & Ernst v. Hochfelder*.<sup>7</sup> In holding that a private cause of action for damages under section 10(b)<sup>8</sup> and rule 10b-5<sup>9</sup> cannot be predicated upon negligence alone but requires scienter, the Court in *Hochfelder* merely adopted the rule which was already being followed in a majority of the circuits;<sup>10</sup> and, because the *Hochfelder* complaint alleged only negligence, the Court went no further than it had to in holding it to be insufficient. Moreover, in defining scienter as a mental state embracing intent to deceive, manipulate or defraud, the Court recognized that in some areas of the law recklessness is considered to be a form of intentional conduct and specifically refrained from considering whether reckless behavior would be sufficient for civil liability

<sup>6</sup> *Id.* at 741-43.

<sup>7</sup> 425 U.S. 185 (1976).

<sup>8</sup> Section 10(b) of the Exchange Act states in pertinent part:

It shall be unlawful for any person . . .

(b) To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1970).

<sup>9</sup> In 1942, in accordance with the power granted to it in section 10(b), the Securities and Exchange Commission promulgated rule 10b-5, which provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1976).

<sup>10</sup> *Clegg v. Conk*, 507 F.2d 1351, 1361 (10th Cir. 1974), *cert. denied*, 422 U.S. 1007 (1975); *Vohs v. Dickson*, 495 F.2d 607, 622 (5th Cir. 1974); *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1306 (2d Cir. 1973) (en banc); *Kohn v. American Metal Climax, Inc.*, 458 F.2d 255, 280 (3d Cir.), *cert. denied*, 409 U.S. 874 (1972); *cf. SEC v. Coffey*, 493 F.2d 1304, 1314 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975). *But see White v. Abrams*, 495 F.2d 724 (9th Cir. 1974); *Myzel v. Fields*, 386 F.2d 718, 734-35 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968).

under section 10(b) and rule 10b-5.<sup>11</sup> Not only does this question remain open for the lower courts, but assuming that recklessness is actionable, these courts have complete freedom to determine where negligence ends and recklessness begins.

For some years the Second Circuit has been firmly committed to the proposition that negligence alone will not support a private cause of action for damages under 10b-5. A brief historical review of Second Circuit decisions shows how this doctrine evolved. This review, of necessity, must start with the blanket statement in *Fischman v. Raytheon Manufacturing Co.*<sup>12</sup> that proof of fraud is a requisite for an action under 10b-5. This restrictive interpretation was subsequently followed by a number of district court judges.<sup>13</sup> However, as then District Judge Mansfield observed in his 1968 decision in *Globus v. Law Research Service, Inc.*,<sup>14</sup> considerable debate was taking place among the district court judges concerning the definition of scienter required by rule 10b-5.<sup>15</sup> Illustrative of these different approaches are Judge Mansfield's own opinion in *Richland v. Crandall*,<sup>16</sup> where he held that "guilty knowledge" is sufficient, and Judge Wyatt's determination in *Weber v. C.M.P. Corp.*<sup>17</sup> that deceit in the form of "cheating" or "hoodwinking" is essential. After considering the wide range of opinions on the question, Judge Mansfield concluded in *Globus* that 10(b) requires "at least 'manipulative' or 'deceptive' conduct or a 'contrivance,'"<sup>18</sup> and that a negligent misstatement does not meet these require-

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<sup>11</sup> 425 U.S. at 193 n.12.

<sup>12</sup> 188 F.2d 783, 786 (2d Cir. 1951).

<sup>13</sup> See, e.g., *Ruszkowski v. Hugh Johnson & Co.*, 302 F. Supp. 1371, 1375 (W.D.N.Y. 1969); *Gould v. Tricon, Inc.*, 272 F. Supp. 385, 393 (S.D.N.Y. 1967); *Weber v. C.M.P. Corp.*, 242 F. Supp. 321, 325 (S.D.N.Y. 1965); *Hoover v. Allen*, 241 F. Supp. 213, 227 (S.D.N.Y. 1965); *O'Neill v. Maytag*, 230 F. Supp. 235, 239 (S.D.N.Y.), *aff'd*, 339 F.2d 764 (2d Cir. 1964).

<sup>14</sup> 287 F. Supp. 188, 197 (S.D.N.Y. 1968), *aff'd in part and rev'd in part*, 418 F.2d 1276 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970).

<sup>15</sup> See, e.g., text accompanying notes 16-17 *infra*; *Gerstle v. Gamble-Skogmo, Inc.*, 298 F. Supp. 66, 97 (E.D.N.Y. 1969), *modified on other grounds*, 478 F.2d 1281 (2d Cir. 1973) (to sustain a 10b-5 suit plaintiff must show scienter, not mere negligence); *Gould v. Tricon, Inc.*, 272 F. Supp. 385 (S.D.N.Y. 1967) (plaintiff must prove defendant's fraudulent conduct to maintain § 10(b) action); *Dack v. Shanman*, 227 F. Supp. 26, 29 (S.D.N.Y. 1964) (allegation of material misrepresentation, regardless of defendant's intent, is sufficient to defeat motion to dismiss). See generally *Campbell, Elements of Recovery Under Rule 10b-5: Scienter, Reliance, and Plaintiff's Reasonable Conduct Requirement*, 26 S.C.L. REV. 653, 657-64 (1975); Note, *The Development of a Flexible Duty Standard of Liability Under SEC Rule 10b-5*, 32 WASH. & LEE L. REV. 99, 103-09 (1975).

<sup>16</sup> 262 F. Supp. 538, 553 n.12 (S.D.N.Y. 1967).

<sup>17</sup> 242 F. Supp. 321, 325 (S.D.N.Y. 1965).

<sup>18</sup> 287 F. Supp. at 197.

ments. However, he rejected the contention that intent to defraud is a necessary requisite to a private cause of action under 10b-5.<sup>19</sup>

The debate concerning scienter was not limited to the district courts. Later in 1968, the Second Circuit, sitting en banc in *SEC v. Texas Gulf Sulphur Co.*,<sup>20</sup> held that proof of negligence alone is sufficient to sustain an action for injunctive relief under rule 10b-5.<sup>21</sup> Judge Friendly, however, indicated in a concurring opinion that scienter would still be required in a private action for damages.<sup>22</sup> He included within the definition of scienter "the kind of recklessness that is equivalent to wilful fraud."<sup>23</sup> Judges Kaufman and Anderson concurred with this portion of Judge Friendly's opinion,<sup>24</sup> and it must be assumed that Judges Moore and Lumbard, who dissented,<sup>25</sup> would have given plaintiffs no greater rights in a private cause of action for damages.

Subsequently, in *Heit v. Weitzen*,<sup>26</sup> the court agreed that scienter is required in a private damage action, but expressed no opinion as to whether the test would be "strict or liberal." In *Green v. Wolf Corp.*,<sup>27</sup> however, the court of appeals made clear that it had "gone far beyond the limits of the common law in imposing liability" and would not require proof of all the essential elements of common law

<sup>19</sup> *Id.* at 198.

<sup>20</sup> 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969).

<sup>21</sup> 401 F.2d at 863. Prior to *Hochfelder*, a majority of courts adhered to a less stringent standard of culpability in an SEC enforcement action. Essentially, the standard applied was that of negligence or lack of due diligence. *See, e.g.*, *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 808-09 (2d Cir. 1975); *SEC v. Dolnick*, 501 F.2d 1279 (7th Cir. 1974); *SEC v. Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969). *But see* *SEC v. Coffey*, 493 F.2d 1304, 1316 n.30 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975). Although the *Hochfelder* Court held that scienter must be shown to establish liability in a 10b-5 damages action, the Court explicitly refused to decide whether scienter is also an essential element in a suit for injunctive relief. 425 U.S. at 193 n.12. In light of the Court's silence on this issue, it appears that this question remains open for the lower courts.

In the cases that have been decided since *Hochfelder*, it appears that the previous standard of negligence in SEC enforcement actions is being retained. *See, e.g.*, *SEC v. Universal Major Indus.*, [1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,804, at 90,916 (2d Cir. Dec. 16, 1976); *SEC v. World Radio Mission, Inc.*, 544 F.2d 535 (1st Cir. 1976); *SEC v. Geotek*, [1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,756, at 90,724 (N.D. Cal. Nov. 11, 1976).

<sup>22</sup> 401 F.2d at 868 (Friendly, J., concurring).

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

<sup>24</sup> *Id.* at 869 (Kaufman & Anderson, JJ., concurring separately).

<sup>25</sup> *Id.* at 884-86 (Moore, J. & Lumbard, C.J., dissenting).

<sup>26</sup> 402 F.2d 909, 914 (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969).

<sup>27</sup> 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969).

fraud in an action under rule 10b-5.<sup>28</sup> The following year, the Second Circuit affirmed *Globus*,<sup>29</sup> sustaining Judge Mansfield's holding that intent to defraud is not a requirement of scienter, and approving of his instruction to the jury that defendants could be held liable if they knew that an offering statement was "misleading or knew of the existence of facts which, if disclosed, would have shown it to be misleading."<sup>30</sup>

Following *Globus*, serious ambiguities surrounding the meaning of scienter continued to cause problems in the district courts.<sup>31</sup> In 1972, however, Judge Timbers provided some interpretive assistance in *Leasco Corp. v. Taussig*.<sup>32</sup> He declared that "mere negligence is insufficient; there must be a showing of knowledge of falsity or reckless disregard for the truth."<sup>33</sup> More significantly, a flurry of activity by the Second Circuit in 1973 indicated that a solution to the definitional problem was in sight. In *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*,<sup>34</sup> Judge Timbers reiterated the court's position that fraudulent intent is not a necessary element under rule 10b-5, stating that "knowledge of falsity or reckless disregard for the truth may be sufficient."<sup>35</sup> He annexed to this concept the possibility of an affirmative duty of disclosure, dependent upon access to information or a specific relationship to the investor, a knowing disregard of which might subject the individual involved to private 10b-5 liability.<sup>36</sup> Judge Gurfein, in concurring, discounted the possibility of formulating a "litmus paper" test of scienter, declaring simply that "'recklessness that is equivalent to wilful fraud' is required."<sup>37</sup> Judge Mansfield, concurring in part and dissenting in part, went one step further than he had as a trial judge in *Globus*, stating that

the *scienter* requirement would be met if a corporate officer (1)

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<sup>28</sup> 406 F.2d at 303. See, e.g., *SEC v. Great Am. Indus., Inc.*, 407 F.2d 453, 462-63 (2d Cir. 1968) (en banc) (Kaufman, J., concurring), cert. denied, 395 U.S. 920 (1969).

<sup>29</sup> 418 F.2d 1276 (2d Cir. 1969), cert. denied, 397 U.S. 913 (1970).

<sup>30</sup> 418 F.2d at 1290.

<sup>31</sup> See, e.g., *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 584 (E.D.N.Y. 1971); *Astor v. Texas Gulf Sulphur Co.*, 306 F. Supp. 1333, 1343-44 (S.D.N.Y. 1969).

<sup>32</sup> 473 F.2d 777 (2d Cir. 1972).

<sup>33</sup> *Id.* at 785.

<sup>34</sup> 480 F.2d 341 (2d Cir.), cert. denied, 414 U.S. 910 (1973).

<sup>35</sup> 480 F.2d at 363.

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

<sup>37</sup> *Id.* at 393 (Gurfein, J., concurring) (citation omitted), quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 868 (2d Cir. 1968) (en banc) (Friendly, C.J., concurring), cert. denied, 394 U.S. 976 (1969).

knew the essential facts and failed to disclose them, or (2) failed or refused, after being put on notice of a possible material failure in disclosure, to apprise himself of the facts . . . where he could reasonably have ascertained and disclosed them without any extraordinary effort.<sup>38</sup>

One month later, in *Cohen v. Franchard Corp.*,<sup>39</sup> the Second Circuit refused to adopt a standard that would have imposed 10b-5 liability for failure to discover material facts which could have been ascertained without inordinate effort.<sup>40</sup> The proper measure of fault, according to the *Cohen* decision, is whether the defendant either knew the misstated or omitted material facts and should have realized their significance, or failed to ascertain the facts although he had ready access to them and reason to think they existed.<sup>41</sup> The court equated such a state of mind with "knowledge of falsity or reckless disregard for the truth."<sup>42</sup>

The *Cohen* decision was followed almost immediately by the en banc decision in *Lanza v. Drexel & Co.*,<sup>43</sup> a case involving the duty of disclosure of an individual corporate director. The Second Circuit again concluded that a plaintiff could not recover under rule 10b-5 without "proof of a wilful or reckless disregard for the truth."<sup>44</sup> The court stated that the determinant normally would be whether the defendant knew the misstated or omitted material facts, "or failed or refused, after being put on notice of a possible material failure of disclosure, to apprise [himself] of the facts where [he] could have done so without any extraordinary effort."<sup>45</sup>

Two months later, Judge Mulligan, concurring in *Republic Technology Fund, Inc. v. Lionel Corp.*,<sup>46</sup> took the majority somewhat to task for "inadequately articulating" the test of culpability as "something short of specific intent to defraud . . . and something more than 'mere' negligence,"<sup>47</sup> recommending stricter adherence to the test laid down in *Lanza*.<sup>48</sup> Judge Mulligan's comments notwithstanding, the *Republic Technology* majority's statement that

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<sup>38</sup> 480 F.2d at 398 (Mansfield, J., concurring in part and dissenting in part).

<sup>39</sup> 478 F.2d 115 (2d Cir.), cert. denied, 414 U.S. 857 (1973).

<sup>40</sup> 478 F.2d at 123.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* at 123-24.

<sup>43</sup> 479 F.2d 1277 (2d Cir. 1973) (en banc).

<sup>44</sup> *Id.* at 1306.

<sup>45</sup> *Id.* at 1306 n.98.

<sup>46</sup> 483 F.2d 540 (2d Cir. 1973), cert. denied, 415 U.S. 918 (1974).

<sup>47</sup> 483 F.2d at 551.

<sup>48</sup> *Id.* at 553 (Mulligan, J., concurring).

“something more than ‘mere’ negligence” is required clearly articulates the rule in the Second Circuit. Indeed, this is the rule everywhere after *Hochfelder*.

Unfortunately, the boundary line between “mere negligence” and “something more” is a hazy one, and the *Hochfelder* rule could well be emasculated by defining too narrowly the nature of the conduct which may properly be described as negligent. Where there have been knowing, material misstatements of fact, application of rule 10b-5 is simple.<sup>49</sup> Where, however, liability is asserted because of a failure to discover and disclose what should have been known or because of a deviation from generally accepted accounting principles, difficulty may be encountered in distinguishing conduct which is actionable from that which is simply negligent.

Although it is well established neither accountants nor lawyers may close their eyes to that which is plainly visible,<sup>50</sup> the extent of their duty to inquire and disclose is not so clear.<sup>51</sup> Illustrative of this difficulty is the post-*Hochfelder* case of *Herzfeld v. Laventhol, Krekstein, Horwath & Horwath*.<sup>52</sup> There, the defendants were accountants for a corporation which was attempting to raise capital through private placement. The plaintiff entered into a stock purchase agreement with the corporation which called for the delivery of audited financial statements prior to closing. The corporation had entered into two contracts for the purchase and sale of property which, if they had not aborted, would have given it a profit of approximately \$2 million. The original audit prepared by the defendants showed most of the \$2 million as unrealized gross profit. In a subsequent financial statement, the defendants included only the down payment by the purchaser as income, stating that the remainder would be considered realized when the balance called for by the contract was received. This report was accompanied by a letter of qualification making the opinion subject to the collectability of this balance.

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<sup>49</sup> See, e.g., *Gordon v. Burr*, 366 F. Supp. 156, 167 (S.D.N.Y. 1973), *aff'd in part and rev'd in part on other grounds*, 506 F.2d 1080 (2d Cir. 1974); *Reeder v. Mastercraft Elec. Corp.*, 363 F. Supp. 574, 580 (S.D.N.Y. 1973).

<sup>50</sup> See, e.g., *Hanly v. SEC*, 415 F.2d 589, 595-96 (2d Cir. 1969); *SEC v. Frank*, 388 F.2d 486, 489 (2d Cir. 1968).

<sup>51</sup> *SEC v. Frank*, 388 F.2d 486, 489 (2d Cir. 1968). *But cf.* *United States v. Natelli*, 527 F.2d 311, 318-20 (2d Cir. 1975), *cert. denied*, 425 U.S. 934 (1976) (discussion of accountant's duty).

<sup>52</sup> 540 F.2d 27 (2d Cir. 1976), *aff'g in part and rev'g in part* 378 F. Supp. 112 (S.D.N.Y. 1974).



The district court held that the duty which the defendants owed could not be satisfied simply by following generally accepted accounting principles and that if application of such principles alone did not give adequate information to investors, defendants were required to "lay bare all the facts needed by investors to interpret the financial statements accurately."<sup>53</sup> The district court concluded that this duty of full disclosure required the defendants to include in their financial report at least ten factual items, including the net worth of the purchaser, the ambiguity of the contractual language, the absence of title searches and the fact that the legal opinions covering the contracts had been obtained by the defendants over the telephone from an attorney who had never seen the contracts.<sup>54</sup>

Although the court of appeals rejected the district court's holding that inclusion of the ten factual items was required, it nonetheless upheld the award against the defendants. In substance, the court found that the financial report was materially misleading because it was prepared without recognition of the "elemental and universal" accounting principle that revenue should not be recognized until the earning process is complete or virtually complete.<sup>55</sup> The defendants' petition for rehearing and en banc consideration contended that liability was imposed solely on the basis of an error in their accounting judgment and that there was no proof of an intent to deceive, manipulate, or defraud.<sup>56</sup> The petition was denied.<sup>57</sup>

While the court of appeals had no difficulty distinguishing *Herzfeld* from *Hochfelder*, this distinction may not be so readily apparent to others. It would be even less apparent were the accountants' course of action to be measured against more sophisticated standards of conduct. Much of an accountant's work product results from exercises in judgment which are not easily comprehended by laymen. As the guidelines for accounting procedures continue to become more comprehensive and exacting, it will be interesting to observe whether variations therefrom will be routinely treated as the equivalent of the scienter required by *Hochfelder*.

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<sup>53</sup> 378 F. Supp. at 122.

<sup>54</sup> *Id.* at 125-26.

<sup>55</sup> 540 F.2d at 34.

<sup>56</sup> Defendant-Appellant's Brief for Rehearing En Banc at 9-10.

<sup>57</sup> *Herzfeld v. Laventhol, Kreckstein, Horwath & Horwath*, No. 74-2405 (2d Cir. Oct. 6, 1976).

The Supreme Court in *Hochfelder* left unexplored the situation wherein a plaintiff seeks damages resulting from the alleged breach of a fiduciary obligation. In its recent decision in *Green v. Santa Fe Industries, Inc.*,<sup>58</sup> the Second Circuit climaxed a series of corporate insider cases by holding that a majority shareholder could be guilty of a section 10(b) violation by effecting a Delaware short-form merger without any justifiable business purpose.<sup>59</sup> Notwithstanding its holding with respect to majority shareholders, the court dismissed the complaint against an investment company which had evaluated the stock, finding that the investment company was not involved in planning or effectuating the merger and had participated in none of the alleged profiteering and faithless conduct.<sup>60</sup> It is unlikely, however, that attorneys and accountants will be overlooked in future litigation in this area.

Although the Court in *Hochfelder* intentionally avoided the legal morass of civil liability for aiding and abetting,<sup>61</sup> the lower courts have not been so reluctant.<sup>62</sup> The *Lanza* court held that wilful or reckless disregard for the truth is required for aiding and abetting liability in civil actions for damages;<sup>63</sup> *quaere* whether these elements would be required where the claim against the wrongdoer is based on the breach of a fiduciary duty. In *Schein v. Chasen*,<sup>64</sup> the Second Circuit stated the general rule to be that "one who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary."<sup>65</sup> *Hochfelder* does not tell us whether coun-

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<sup>58</sup> 533 F.2d 1283 (2d Cir. 1976), *cert. granted*, 97 S. Ct. 54 (1976) (No. 75-1753).

<sup>59</sup> 533 F.2d at 1291.

<sup>60</sup> *Id.* at 1293-94.

<sup>61</sup> 425 U.S. at 191 n.7.

<sup>62</sup> *See, e.g.,* *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 888-89 (3d Cir. 1975) (liability as aider and abettor founded upon knowing participation in the fraudulent plan); *Woodward v. Metro Bank*, 522 F.2d 84, 97 (5th Cir. 1975) (aider-abettor must knowingly give substantial aid); *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1289 (2d Cir. 1973) (en banc) (standard of knowing involvement for aider-abettor liability); *Brennan v. Midwestern United Life Ins. Co.*, 417 F.2d 147, 154-55 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970) (silence together with affirmative action sufficient to sustain liability for aiding and abetting); *Crofoot v. Sperry Rand Corp.*, 408 F. Supp. 1154, 1157 (E.D. Cal. 1976) (standard of knowing participation in fraudulent plan). Recently, the Second Circuit in *SEC v. Universal Major Indus. Corp.*, [1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,804, at 90,915-16 (2d Cir. Dec. 16, 1976), stated in dictum that injunctive action may be taken against anyone who aids or abets in violating § 5 of the Securities Act of 1933, 15 U.S.C. § 77(e) (1970), on a showing of mere negligence.

<sup>63</sup> 479 F.2d at 1289, 1306.

<sup>64</sup> 478 F.2d 817 (2d Cir. 1973), *vacated and remanded on other grounds sub nom. Lehman Bros. v. Schein*, 416 U.S. 386 (1974).

<sup>65</sup> 478 F.2d at 822, *quoting* *Oil & Gas Ventures v. Kung*, 250 F. Supp. 744, 749 (S.D.N.Y.

sel and assistance given to corporate insiders by their attorneys and accountants expose the latter to 10b-5 liability despite lack of scienter. Indeed, *Hochfelder* does not eliminate the possibility that someday liability might be asserted against attorneys and accountants in stockholder derivative actions for breach of the fiduciary duty which they owe directly to their corporate employer.<sup>66</sup>

Legislation by judicial decree, such as that which has occurred in the field of 10b-5 liability, is not only undemocratic, it is also unpredictable. Much ground remains to be plowed, therefore, before attorneys and accountants doing securities work can rest assured that the scope of their potential civil liability has been fully delineated. The reader will have to draw his own conclusions as to what the existing decisions portend. This is no easy task, and one who would undertake it must bear in mind the Supreme Court's admonition that, in this much litigated area, "glib generalizations and unthinking abstractions are major occupational hazards."<sup>67</sup>

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1966). See also *Pettit v. American Stock Exch.*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963) (one who knowingly aids or participates in fraudulent plan as culpable as principal actor).

<sup>66</sup> Cf. *Perlman v. Feldmann*, 219 F.2d 173, 175 (2d Cir.), cert. denied, 349 U.S. 952 (1955) (defendant, as both director and principal shareholder, liable to minority shareholders for breach of fiduciary duty).

<sup>67</sup> *SEC v. National Sec., Inc.*, 393 U.S. 453, 465 (1969).