The *Sell* Decision

Aiding, Abetting Liability Not Added

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In *Sell v. Gama*, the Arizona Supreme Court held that the Arizona Securities Act (the "ASA") does not authorize a secondary liability claim for aiding and abetting another's primary securities fraud.[1] In so holding, the Supreme Court followed the federal courts' interpretation of the federal securities laws, and rejected the plaintiff's and *amici curiae's* argument that aiding and abetting liability was authorized under Section 2003(A) of the ASA.[2] Section 2003(A) provides that a securities fraud action "may be brought against any person, including any dealer, salesman or agent, who made, participated in or induced the unlawful sale or purchase."

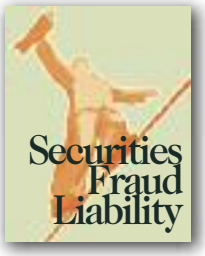
This article discusses the *Sell* Court's holding, explains why it is consistent with both the text of the ASA and prior constructions of Section 2003, and how *Sell* affects claims under the ASA.

The *Sell* Decision

In *Sell*, the Supreme Court addressed whether attorneys and accountants could be secondarily liable for allegedly aiding and abetting their client's primary violation of Section 1991 of the ASA. Section 1991 makes it a "fraudulent practice and unlawful" for a person to—directly or indirectly—in connection with a sale or purchase of securities or an offer to sell or buy securities:

(1) Employ any device, scheme or artifice to defraud.

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



(3) Engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit.[3]

Sections 2001 and 2002 establish the civil remedies available for violations of Section 1991, and Section 2003 authorizes a securities fraud action to "be brought against any person, including any dealer, salesman or agent, who made, participated in or induced the unlawful sale or purchase."[4]

The *Sell* plaintiff had support for his aiding and abetting theory. In *State v. Superior Court (Davis)*, the Arizona Supreme Court followed the lead of the lower federal courts in recognizing aiding and abetting liability for securities fraud.[5] In that 1979 decision, the Court explained that Section 1991 "is almost identical" to its federal counterpart in the Securities Act of 1933, and that there was no reason why a person who aids and abets a violation of Section 1991 "should not also be held liable as a principal."

In 1994, however, the federal courts changed course. In *Central Bank of Denver v. First Interstate Bank of Denver*,[6] the U.S. Supreme Court held that a private plaintiff could not maintain an action for aiding and abetting a violation of § 10(b) of the Securities Exchange Act of 1934.

Sell was the Arizona Supreme Court's first opportunity to address the issue after *Central Bank*. Although not bound in interpreting the ASA to follow federal courts in their interpretations of the federal securities laws, the Supreme Court has found it "helpful, for consistency in the application of the law, to be harmonious with the United States Supreme Court." Unless there are good reasons not to follow the U.S. Supreme Court, the Arizona Supreme Court "will follow the reasoning of that court in interpreting sections of our statutes which are identical or similar to federal securities statutes."[7]

The Court, the *Sell* plaintiff argued, had two good reasons not to follow *Central Bank*: It was inconsistent with the Court's prior holding in *Davis*, and the *Sell* plaintiff based its aiding and abetting theory on Section 2003, to which there is no federal counterpart.

Despite its prior precedent and the distinctions between the ASA and federal securities law, however, the *Sell* Court followed *Central Bank* because it found that, "Much of the Supreme Court's reasoning in *Central Bank* regarding the federal statute and congressional intent applies with equal force to the ASA and the Arizona Legislature's intent."[8] In particular, the Court noted that the Arizona Legislature amended the ASA in 1996—after both *Davis* and *Central Bank*—but "expressly declined to specify whether aiding and abetting liability exists under the ASA," even though "the legislature has expressly recognized aiding and abetting liability in other statutes."[9] The Court also noted that its earlier opinion in "*Davis* neither analyzed the federal cases it cited nor evaluated whether § 44-1991 or any other section of the ASA independently authorized aiding and abetting liability."

In following *Central Bank*, the *Sell* Court rejected the plaintiff's arguments that secondary liability was consistent with both the remedial purpose of the ASA and the arguably "broad language" in Section 2003, finding instead that Section 2003 "supports a claim for primary liability under § 44-1991; it does not create a separate cause of action for, or secondary liability based on, aiding and abetting."

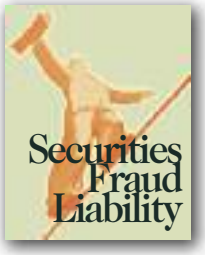
Is there any reason to adopt a new theory of liability? There do not appear to be any examples of wrongdoing in the securities area that are not subject to the scope of the ASA.

Sell: Consistent With ASA and Prior Interpretations of Section 2003

The goal in interpreting statutes is "to give effect to the intent of the legislature."[10] Arizona courts thus start by reviewing the statutory language "to determine if it has a plain meaning and clearly reflects the legislature's intent." Courts must also consider statutory terms "in context."

Section 2001 authorizes a civil action by a purchaser of securities that were purchased in violation of the registration or anti-fraud provisions of the ASA,[11] and Section 2003 specifies the persons against whom such an action may be brought: "any person, including any dealer, salesman or agent, who made, participated in or induced the unlawful sale or purchase."

Both Divisions of the Court of Appeals already have concluded that this language limits rather than expands liability. In *Grand v. Nacchio*, Division 2 concluded that Section 2003 "is a limitation on the private civil remedy, not a stand-alone basis for liability,"[12] whereas Section 1991 describes the types of acts that are considered unlawful and fraudulent. In *Standard Chartered*, Division 1 held that Sections 2001 and 2003 "do not provide a private civil remedy against anyone who makes a material misstatement in connection with a securities transaction"[13] because "the legislature provided a private civil remedy only against the narrower range of persons 'who made, participated in or induced the unlawful sale.'" In other words, Section 2003 does not expand liability beyond what is described in Section 1991; it only specifies the class of persons who are subject to suit for violating Section 1991. The *Sell* Court's refusal to



infer a claim for secondary liability is thus consistent with both the text of the ASA and the Court of Appeals' narrow construction of Section 2003.

Sell Eliminates Civil Liability for Secondary Actors

Given the procedural posture of the case, the *Sell* Court expressly did not address whether the accountant and attorney defendants there could be primarily liable under Section 2003. Some commentators have therefore construed *Sell* as leaving the door open to impose liability against "aiders and abettors" as long as the claims against them are pled under a "participant" or "inducement" theory. This argument, however, overlooks recent Arizona decisions addressing the scope of "participant" and "inducement" liability and the traditional criteria for aiding and abetting liability.

The Court of Appeals analyzed the meaning of these words in its 1996 decision in *Standard Chartered*. Looking to the dictionary definition of "participate," the Court interpreted the word to mean "take part in" or "partake."[14] A person "takes part" in a purchase or sale when he or she has a direct stake in the transaction. Applying this definition to Section 2003, participant liability extends only to those who take part in the purchase or sale.[15]

The Court also looked to the dictionary and the Restatement of Torts to define "induce" as "persuade" or "prevail." As the Court explained, giving this word an expansive definition would "sweep within the statute any outsider to a securities transaction" who provided information that indirectly influences a buyer or seller's decision to enter into a transaction.[16] Accordingly, inducement liability requires a showing that the defendant intentionally persuaded or encouraged the buyer or seller to make the purchase or sale.[17]

The established elements of aiding and abetting liability, by contrast, are: (1) tortious conduct by a third party or co-defendant; (2) the defendant's knowledge that the other person's conduct was tortious; and (3) conduct by the defendant that substantially assisted or encouraged the tortious conduct.[18]

Fact patterns from Arizona cases highlight the differences between aiding and abetting liability, on one hand, and liability based on participation or inducement, on the other hand. In *Standard Chartered*, for example, Price Waterhouse ("PW") audited the financial statements of United Bank of Arizona, which Union Bancorp of California allegedly relied on in acquiring United and which overstated United's income by $27 million.[19] A misrepresentation in financial statements used to induce a sale of securities is a classic violation of Section 1991, and PW's audit could certainly be considered to have substantially assisted that violation. If PW knew that United's income was overstated, therefore, PW's conduct would satisfy the requirements for aiding and abetting liability.[20] The Supreme Court, however, found that PW did not "participate" in the transaction because the assistance PW provided—the preparation of audits—would have been the same regardless of whether the sale occurred, and because "PW had no stake in the sale."[21] The Court also found that PW did not "induce" the sale because PW neither promoted nor solicited the transaction.[22]

Likewise, it is doubtful that Section 2003 would provide a basis to impose primary liability on the attorneys and accountants in *Sell* who were alleged to have concealed their clients' violations of Section 1991.[23] Although the alleged concealment could serve as the basis for aiding and abetting liability, Section 2003 expressly excludes ordinary professional services from participant liability,[24] and there was no alleged basis for inducement liability because there were no allegations that any of the professionals induced the plaintiffs to invest in the Mathon Fund scheme.

Conclusion

In light of the way that Arizona courts have interpreted "participate in" and "induce" in Section 2003, there is reason to be skeptical that Section 2003 would allow for new theories of liability that would permit a cause of action against aiders and abettors. But more generally, is there any reason to adopt a new theory of liability? There do not appear to be any examples of wrongdoing in the securities area that are not subject to the scope of the ASA, whether by private plaintiffs or otherwise. To the extent that any such examples exist, the Legislature is the proper entity to evaluate whether new law is needed in this area.

endnotes

1. 295 P.3d 421 (Ariz. 2012).
2. A.R.S. § 44-2003(A).
3. *Id.* § 44-1991(A).
4. *Id.* §§ 44-2001, 2002, 2003(A).
5. 599 P.2d 777, 784-85 (Ariz. 1979).
6. 511 U.S. 164, 177, 179-81 (1994).
7. *State v. Gunnison*, 618 P.2d 604, 606-07 (Ariz. 1980).
8. *Sell*, 295 P.3d at 425 ¶ 8.
9. *Id.* at 424-26 ¶¶ 15, 21.
10. *Estate of Braden v. State*, 266 P.3d 349, 351 (Ariz. 2011) (quoting *In re Estate of Winn*, 150 P.3d 236, 238 (Ariz. 2007)).
11. A.R.S. §§ 44-1841-1842; § 44-1991(A).
12. 217 P.3d 1203 ¶ 18 (Ariz. Ct. App. 2009), *aff'd*, 236 P.3d 398 (Ariz. 2010).
13. *Standard Chartered, PLC v. Price Waterhouse*, 945 P.2d 317, 333 (Ariz. Ct. App. 1996).
14. *Id.* at 332.
15. *See id.*
16. *Id.*
17. *Id.* at 332-33; *Grand v. Nacchio*, 236 P.3d 398, 403 (Ariz. 2010).
18. *See, e.g., Wells Fargo Bank v. Ariz. Laborers, Teamsters & Cement Masons Local No. 395 Pension Trust Fund*, 38 P.3d 12, 23 (Ariz. 2002) (en banc) (stating the elements for aiding and abetting liability).
19. 945 P.2d at 323.
20. If PW's conduct was merely negligent (*i.e.*, PW should have known), however, PW could not be deemed to have aided or abetted the violation.
21. *Standard Chartered*, 945 P.2d at 332.
22. *Id.* at 333.
23. *See*, Second Am. Compl., *Sell v. Sewell*, Maricopa County Superior Court Case No. CV2007-005734 (filed July 31, 2007) ¶¶ 209-15.
24. *See* A.R.S. § 44-2003(A) ("No person shall be deemed to have participated in any sale or purchase solely by reason of having acted in the ordinary course of that person's professional capacity in connection with that sale or purchase.").