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SEC v. Apuzzo: The Second Circuit Clarifies the Standard for Aider and Abettor Liability in SEC Civil Enforcement Actions

On August 8, 2012, the Second Circuit issued an important decision in *Securities and Exchange Commission v. Apuzzo*, 2012 WL 3194303, clarifying the test the SEC must meet to establish aiding and abetting liability for a securities law violation. There previously had been uncertainty in the Second Circuit whether the SEC must prove that the aider and abettor proximately caused the harm on which the primary violation was based. In *Apuzzo*, the Second Circuit made clear that "proximate cause" was not an element of the aiding and abetting violation and that, to charge someone with aiding and abetting, the SEC need allege and prove only that the aider and abettor associated himself with the venture in some way, participated in the venture as in something he wished to bring about, and sought by his action to make the venture succeed. The Court of Appeals also stated that proof of a high degree of knowledge of a primary violation may lessen the SEC's burden in proving substantial assistance.

SEC v. Apuzzo arose from allegations that an equipment rental company, United Rentals, Inc. ("URI"), engaged in fraudulent sale-leaseback transactions, whereby it purported to sell equipment to a second company ("Company 2") when, in fact, it had secretly arranged through a third company ("Company 3") to guarantee the second company against any risk of loss. The SEC alleged that URI committed a primary violation of the securities laws by reporting revenue from the sale-leaseback transactions immediately as if the transactions reflected sales (when, in fact, the risks and rewards of ownership were not transferred) and charged the CFO (Apuzzo) of Company 3 with aiding and abetting the primary violation by agreeing effectively to guarantee Company 2 against any loss in exchange for URI's agreement to indemnify Company 3 against any loss it suffered. The SEC alleged that Apuzzo knew that the result of the 3-way transactions was that URI would misreport its revenue. It also alleged that Apuzzo knew that if the indemnification payments were disclosed, URI's auditors would object to URI's recognition of revenue and agreed to delete references to Company 2 from the indemnification agreements in order to facilitate URI's fraud.

In order to prove aiding and abetting liability in an SEC enforcement action, the SEC must establish: (1) the existence of a primary violation; (2) knowledge of the violation on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor in the achievement of the primary violation. Apuzzo moved in the District Court to dismiss the complaint on the ground that the complaint did not allege that his acts proximately caused the harm on which primary liability was predicated. The District Court – relying on the Second Circuit's prior determinations that such allegations are required in a private suit -- agreed.[1]

On appeal, the Second Circuit reversed, concluding that the trial court had applied the wrong standard to the "substantial assistance" element.[2] Relying on the principle stated by Learned Hand nearly 75 years ago in *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938), and on the fact that the SEC need not prove reliance in an enforcement action, the Court held that in order to satisfy the substantial assistance element, the SEC need allege only that the defendant "in some sort associate[d] himself with the venture, that [the defendant] participate[d] in it as in something that he wishe[d] to bring about, [and] that he [sought] by his action to make it succeed." The Court of Appeals also noted in the decision the important relationship between the "knowledge" and "substantial assistance" elements, confirming that, where the SEC alleges a high degree of actual knowledge of the primary violation, the burden it must meet in alleging substantial assistance is decreased. Likewise, the decision points out the inverse: where a high degree of substantial assistance is alleged, the SEC's burden in proving scienter may be lowered.

Apuzzo relaxes the standards for the SEC to allege and prove aiding and abetting liability. As the Court stated, the SEC's "statutory mandate would be undercut if proximate causation were required for aider and abettor liability in SEC enforcement actions." In holding that the complaint stated a claim, the Court also rejected Apuzzo's claim that aiding and abetting liability applies only to employees or officers of the company engaged in the fraudulent transaction. The Court stated that "[e]ven if it were true that aiders and abettors are typically employees of the

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1 *SEC v. Apuzzo*, 758 F. Supp. 2d 136 (D. Conn. 2010). The Distrct Court relied on *Bloor v. Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 57 (2d Cir. 1985), in which the Court stated the complaint must allege that the acts of the aider and abettor proximately caused the harm to the corporation on which primary liability is based. *Bloor* was later superseded by *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), rejecting aiding and abetting liability in private actions under Section 10(b).

2 The SEC is authorized by Section 20(e) of the Securities Exchange Act of 1934 to bring civil actions alleging aiding and abetting of securities fraud against "any person that knowingly provides substantial assistance" to a primary violator of the securities laws. 15 U.S.C. 78t(e).

same company or government entity as the primary violator, that is certainly not a requirement of our case law." At the same time, however, the Court reiterated its standards that inaction on the part of the alleged aider and abettor ordinarily does not constitute substantial assistance except when it is designed intentionally to aid the primary fraud or was in conscious or reckless violation of a duty to act and noted that if Apuzzo had no duty to act and took no affirmative acts, he would not be liable. Finally, the decision is explicitly based on the SEC's statutory enforcement mandate and a comparison of that mandate to the standards for criminal liability: nothing on the face of the opinion purports to address, or change, the standards for aiding and abetting liability in private actions.

Please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under "White-Collar Defense, Securities Enforcement and Internal Investigations" in the "Practices" section of our website (http://www.clearygottlieb.com) if you have any questions.

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