Washington University Law Review

Volume 92 | Issue 5

2015

Slouching Towards Monell: The Disappearance of Vicarious Liability Under Section 10(B)

Ann M. Lipton
Tulane University Law School

Follow this and additional works at: https://openscholarship.wustl.edu/law_lawreview

Part of the Business Organizations Law Commons, and the Securities Law Commons

Recommended Citation
Ann M. Lipton, *Slouching Towards Monell: The Disappearance of Vicarious Liability Under Section 10(B)*, 92 WASH. U. L. REV. 1261 (2015).
Available at: https://openscholarship.wustl.edu/law_lawreview/vol92/iss5/7

This Article is brought to you for free and open access by the Law School at Washington University Open Scholarship. It has been accepted for inclusion in Washington University Law Review by an authorized administrator of Washington University Open Scholarship. For more information, please contact digital@wumail.wustl.edu.

SLOUCHING TOWARDS *MONELL*: THE DISAPPEARANCE OF VICARIOUS LIABILITY UNDER SECTION 10(B)

ANN M. LIPTON*

ABSTRACT

Liability under section 10(b) of the Securities Exchange Act is one of the primary mechanisms for enforcing the federal securities laws. Section 10(b), however, prohibits only intentional or reckless deception, and there has never been consensus as to how to determine whether an organization, rather than a natural person, harbors the relevant mens rea. Traditionally, organizational liability under federal law is determined according to agency principles, and most courts pay lip service to the notion that agency principles govern under section 10(b). As this Article demonstrates, they do not.

Many section 10(b) actions involve "open-market" frauds, whereby the allegedly fraudulent statements are issued publicly under the corporate imprimatur. These statements depend on agents operating at all levels of the company, who may intentionally or recklessly pass along inaccurate information through corporate reporting channels. In such circumstances, the actus reus that forms the basis of the section 10(b) violation—the false public statement—has been disaggregated from the actor who harbors mens rea. As this Article shows, courts have used this disaggregation to eschew the agency principles applied in other areas of law. Courts instead seek to impose a form of "direct" organizational liability tied to the actions and omissions of the organization's highest-level authorities. This regime is, in practical effect, strikingly similar to the regime used to determine the liability of local governments under § 1983, where vicarious liability has been formally rejected by the Supreme Court.

Though these two statutes would seem to have little in common, this Article argues that vicarious liability has been rejected under both regimes for similar policy reasons. Among other things, as federal corporate disclosure requirements—backed by the threat of section 10(b) liability—expand into a mechanism for substantively regulating the quality

* Associate Professor, Tulane University Law School. Many thanks to Jim Cox, Joseph Blocher, Rachel Brewster, Sam Buell, Toby Heytens, Deborah DeMott, Darrell Miller, Hillary Sale, Rebecca Tushnet, and all of the participants in the Duke Faculty Workshop.

Washington University Open Scholarship

of corporate governance (a matter traditionally left to state law), courts have pushed back by limiting vicarious liability in order to distinguish "true" fraud claims from garden-variety mismanagement. Similarly, in the § 1983 context, the elimination of vicarious municipal liability functions, as a practical matter, to distinguish matters of federal constitutional concern from ordinary state law torts.

This Article ultimately concludes that, despite the criticisms that have been leveled at the current approaches to organizational liability under § 1983, § 1983 doctrine may in fact improve jurisprudence under section 10(b). Courts considering section 10(b) claims may borrow from jurisprudence developed under § 1983 to formulate objective standards of fault, in order to prevent high-level corporate authorities from insulating themselves from knowledge of wrongdoing at lower levels of the corporate hierarchy.

TABLE OF CONTENTS

INTRODUCTION

Securities fraud liability—and in particular, liability under section 10(b) of the Securities Exchange Act of 1934[1]—is one of the primary mechanisms for enforcing the disclosure obligations imposed upon publicly traded corporations under the federal securities laws. Nonetheless, despite the long history of securities fraud litigation under section 10(b), courts have yet to announce a uniform standard for determining liability when the defendant is an organization. The sticking point is organizational mens rea: Professor Donald Langevoort recently described corporate scienter as "one of the greatly under-theorized subjects in all of securities litigation"[2]

Yet despite courts' failure to formally endorse a coherent standard for attributing mens rea to an organization, this Article demonstrates that the situation is less indeterminate than has been previously acknowledged. It turns out that when evaluating section 10(b) claims, courts increasingly seek to identify organizational "fault" in a manner that is strikingly similar to the regime that is used to determine the liability of local governments under the Civil Rights Act of 1871, 42 U.S.C. § 1983. Though these two statutes would seem to have little in common, and the case law under each has developed independently of the other, this Article shows that similar policy considerations have driven courts to eschew vicarious liability in both contexts, in favor of developing a form of "direct" organizational liability tied to the actions and omissions of the organization's highest-level authorities.

The story begins with the changing nature of the section 10(b) cause of action. The statute prohibits any person from engaging in manipulative or deceptive conduct in connection with securities transactions,[3] and requires proof that the defendant acted with "scienter"—either an "intent to deceive, manipulate, or defraud,"[4] or reckless indifference to the "'danger of misleading buyers or sellers'"[5] Because the Exchange Act explicitly provides that organizations, as well as natural persons, can violate

---

1. 15 U.S.C. § 78j(b) (2012).

2. Donald C. Langevoort, *Lies Without Liars?* Janus Capital *and Conservative Securities Jurisprudence*, 90 WASH. U. L. REV. 933, 959 (2013).

3. *See* 15 U.S.C. § 78j(b); *see also* 17 C.F.R. § 240.10b-5 (2014).

4. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976).

5. Southland Sec. Corp. v. INSpire Ins. Solutions Inc., 365 F.3d 353, 366 (5th Cir. 2004) (quoting Broad v. Rockwell Int'l Corp., 642 F.2d 929, 962 (5th cir. 1981)).

Washington University Open Scholarship

section 10(b),[6] courts must create rules for determining the "scienter" of an organizational defendant.

Traditionally, under federal law, mens rea is imputed to organizations via agency principles, such as respondeat superior. Because the earliest claims against organizational defendants under section 10(b) involved face-to-face frauds—corrupt brokers, for example, were common—they presented easy cases.[7] The fraudster, acting in his capacity as an employee, personally violated section 10(b), justifying strict liability for his employer. Over time, however, brokerage claims moved out of public view and into arbitration.[8] Simultaneously, courts began to entertain cases involving "open-market" frauds, whereby a publicly traded corporation is alleged to have issued false statements about the quality of its business. In such circumstances, courts would presume that the false statements affected the market price of the corporation's securities, thereby damaging investors who had traded at that price.[9] This legal theory, known as the fraud-on-the-market doctrine, left the corporation potentially liable to the entire marketplace of traders. It also radically altered the nature of the section 10(b) action with two significant consequences.

First, it allowed for disaggregation between the employee who committed the actus reus—the corporate official who issued the false statement—and the employee harboring the mens rea. This necessarily presented the question of which actors' mental states could be imputed to the corporation. Statements issued under the corporate imprimatur often have multiple anonymous authors, and include information supplied by employees scattered throughout the company. Any of these employees, or combinations of them, or business segments, may intentionally filter false information up through corporate reporting channels without the knowledge of the top officers.

Second, the extension of liability to open-market frauds exponentially expanded the number of potential plaintiffs damaged by a single fraudulent act, and the fraud-on-the-market doctrine facilitated the

6. As originally drafted, the statute defined a "person" to mean "an individual, a corporation, a partnership, an association, a joint-stock company, a business trust, or an unincorporated organization." Brown v. Covington, 805 F.2d 1266, 1268 (6th Cir. 1986). In 1975, it was amended to define a "person" to mean "a natural person, company, government, or political subdivision, agency, or instrumentality of a government." 15 U.S.C. § 78c(a)(9) (2012).

7. *See, e.g.*, Commerford v. Olson, 794 F.2d 1319 (8th Cir. 1986); Paul F. Newton & Co. v. Tex. Commerce Bank, 630 F.2d 1111 (5th Cir. 1980); Marbury Mgmt., Inc. v. Kohn, 629 F.2d 705 (2d Cir. 1980); Carras v. Burns, 516 F.2d 251 (4th Cir. 1975).

8. *See* Barbara Black & Jill I. Gross, *Making It up as They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 991–92 (2002).

9. *See* Basic Inc. v. Levinson, 485 U.S. 224 (1988).

https://openscholarship.wustl.edu/law_lawreview/vol92/iss5/7

certification of classes of those plaintiffs, thus dramatically increasing corporations' damages exposure. With this change, the *purpose* of the section 10(b) was transformed. No longer is "compensation" for defrauded investors a realistic or achievable goal;[10] instead, section 10(b) actions—at least those based on open-market purchases—are now justified as a deterrent mechanism to protect the integrity of corporate communications.[11] But this justification extends section 10(b) far beyond the mere confines of fraud prevention, because corporate communications today serve broader purposes. Disclosure enhances internal corporate governance by, among other things, enforcing a duty of care on corporate managers and facilitating shareholders' ability to monitor managers' conduct.[12] Disclosure also has macroeconomic effects: Regulators make policy based on their understanding of how businesses operate; lenders extend credit based on their perception of the stability of the borrower; competitors change business strategies based on reports of their rivals; symbiotic industries make business plans based on their expectations of future dealings with customers and suppliers; employees choose where to invest their skills based on perceived demand.[13] All of these areas of economic activity depend on the accuracy and reliability of public corporate communications, yet the persons and institutions affected have few, if any, avenues for relief when those communications prove false. Thus, the securities laws—and in particular, the private section 10(b) cause of action—bear the practical responsibility of protecting these varied interests, despite the rather distant relationship between section 10(b) plaintiffs and the wide variety of persons injured by false public statements.

As a result, section 10(b) has shifted from a mechanism for making defrauded investors whole to a mechanism for representing the varied

10. *See, e.g.*, William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 99–100 (2011); Merritt B. Fox, *Why Civil Liability for Disclosure Violations When Issuers Do Not Trade?*, 2009 WIS. L. REV. 297, 302–09; John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 COLUM. L. REV. 1534, 1545–47 (2006); Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1309 (2008). *But see* Elliott J. Weiss, *The Lead Plaintiff Provisions of the PSLRA After a Decade, or "Look What's Happened to My Baby*," 61 VAND. L. REV. 543, 558 (2008) (arguing that compensation is achieved more often than previously thought).

11. James D. Cox, *The Social Meaning of Shareholder Suits*, 65 BROOK. L. REV. 3, 4 (1999); Fox, *supra* note 10, at 318–32.

12. Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 872–78 (2003); Fox, *supra* note 10, at 310–13.

13. Urska Velikonja, *The Cost of Securities Fraud*, 54 WM. & MARY L. REV. 1887, 1926–38 (2013).

Washington University Open Scholarship

concerns that animate securities regulation more generally. In other words, the action itself is now less akin to a "private" law tort action, and more akin to "public" law, serving purposes associated with criminal, or at least regulatory, enforcement. Shareholder lawsuits do more than protect investors or even markets; they also act as a quasi-public mechanism for enforcement of societal norms.[14]

Commentators have previously argued that vicarious liability principles should not be used to determine organizational liability for section 10(b) open-market frauds. The usual claim is that for open-market frauds—where a corporation issues false statements about its business, but does not trade in its own securities—the corporation itself gains no benefit. It does not earn any profits from the fraud, nor is it spared any expenses. The only persons affected are secondary market traders who transact at the distorted market price, some of whom will gain by the fraud, and others of whom will lose. As a result, the usual instrumental justifications for vicarious liability do not apply.[15]

What has been largely overlooked, however, is that courts—sensitive to the transformation in the nature of the section 10(b) action—have *already* limited the application of vicarious liability. Aware that the justifications for vicarious liability no longer fit the modern section 10(b) cause of action, courts have used the disaggregation of actus reus from mens rea commonly exhibited in fraud-on-the-market cases as a lever to decouple corporate liability from misconduct that originates from lower level employees. Instead, courts are increasingly moving toward a doctrine of organizational fault that resembles, both in application and policy justification, the organizational liability doctrine that governs suits for civil rights violations under 42 U.S.C. § 1983. This form of liability, which the Supreme Court has deemed "direct," rather than "vicarious," only allows organizations to be held responsible for torts committed pursuant to official policies, actually or constructively adopted by the highest-level officials. This narrowed form of liability has been a feature of the section 10(b) case law ever since open-market frauds began to dominate the landscape, and has only accelerated with two recent Supreme Court decisions that dramatically narrowed the scope of the private section 10(b) action.

14. Cox, *supra* note 11, at 5–12; James D. Cox, Response, *Securities Class Actions as Public Law*, 160 U. PA. L. REV. PENNUMBRA 73, 76 (2011).

15. *See, e.g.*, Donald C. Langevoort, *On Leaving Corporate Executives "Naked, Homeless and Without Wheels": Corporate Fraud, Equitable Remedies, and the Debate over Entity Versus Individual Liability*, 42 WAKE FOREST L. REV. 627, 627–29 (2007); Fox, *supra* note 10, at 321.

This interpretation of section 10(b) jurisprudence carries with it several important implications. First, courts should explicitly acknowledge that they are no longer applying vicarious liability principles to section 10(b) open-market frauds. This will free courts to reconcile conflicting strands in the case law and set clearer guidelines for organizational liability.

Second, courts considering section 10(b) claims may be informed by jurisprudence developed under § 1983, which (though subject to its own extensive criticism) at least includes standards for determining organizational fault in the absence of subjective mens rea of higher level authorities. Courts have failed to set such standards under section 10(b), focusing their attention on the mental states at the top of the corporate hierarchy, while simultaneously failing to clarify which mental states are sufficient to trigger organizational liability. Unless courts identify a form of organizational fault that does not depend on the subjective, provable mens rea of a corporation's top officers, corporate managers will be incentivized to tacitly encourage fraudulent behavior by their subordinates while maintaining plausible deniability of that behavior. And because the Supreme Court's recent jurisprudence essentially immunizes those subordinates from personal section 10(b) liability, they will have little reason to resist supervisory encouragement. This would represent a "worst of all worlds" scenario, resulting in increased levels of fraud and corporate misconduct. But by taking lessons from § 1983, courts entertaining section 10(b) claims may be able to formulate "gap-fillers" to prevent high-level authorities from insulating themselves from knowledge of lower level wrongdoing.

Third, because courts' changing approach to organizational liability is tied to the development of the fraud-on-the-market doctrine, this Article recommends that if that doctrine is pared back or eliminated—as scholars continuously advise[16]—courts should restore the ordinary agency rules for determining organizational liability. In the absence of fraud on the market, the section 10(b) action would more closely resemble the common law tort of deceit, and the traditional justifications for vicarious liability would once again counsel in favor of the application of agency principles.

Finally, and perhaps most importantly, Congress and the Securities Exchange Commission ("SEC") must make a determination as to the

16. *See, e.g.*, Jill E. Fisch, *Confronting the Circularity Problem in Private Securities Litigation*, 2009 WIS. L. REV. 333, 348–49; Merritt B. Fox, *Civil Liability and Mandatory Disclosure*, 109 COLUM. L. REV. 237, 279 (2009); Bratton & Wachter, *supra* note 10, at 75–76; Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 U. ILL. L. REV. 691, 734.

Washington University Open Scholarship

purposes that section 10(b) is designed to serve. As this Article argues, part of the reason for courts' discomfort with vicarious liability under section 10(b) is likely the expansion of the federal mandatory disclosure regime—and thus, section 10(b)'s role in the enforcement of that regime—well past protection against traditional fraud. That problem is one that only Congress and the SEC can solve by making their goals clearer, so that courts no longer feel the need to develop ad hoc doctrines to cabin the shifting contours of section 10(b) liability.

I. ORGANIZATIONAL LIABILITY UNDER FEDERAL LAW

Under federal law, organizational liability is typically vicarious, based on agency principles.[17] A principal is liable for the torts of its agents that are either accomplished within the scope of the agent's authority and for the principal's benefit,[18] or that are within the scope of the agent's apparent authority.[19] When a tort requires a particular mental state, the mental state of the agent who commits the tort is imputed to the organization: when the agent acts negligently, recklessly, or intentionally, liability follows accordingly.[20]

One of the more notable features of vicarious liability is that it does not matter whether the agent was a low-level employee, nor does it matter whether the agent was acting contrary to corporate policy or express instructions[21] (although such facts may be relevant to determine whether the agent was acting within the scope of her authority and to benefit the corporation).[22] Instead, liability is imposed "although the principal did not authorize, or justify, or participate in, or, indeed, know of such misconduct; or even if he forbade or disapproved of them."[23] For this reason, vicarious liability is commonly described as a form of "strict" liability—"[i]t neither requires the plaintiff to prove fault on the part of the

17. *See* United States v. A & P Trucking Co., 358 U.S. 121, 125–26 (1958); N.Y. Cent. & Hudson River R.R. v. United States, 212 U.S. 481, 493–96 (1909); Standard Oil Co. v. United States, 307 F.2d 120, 127–28 (5th Cir. 1962).

18. *N.Y. Cent.*, 212 U.S. at 493.

19. Am. Soc'y of Mech. Eng'rs v. Hydrolevel Corp., 456 U.S. 556, 565–66 (1982).

20. *See, e.g.*, *A & P Trucking Co.*, 358 U.S. at 125; *N.Y. Cent.*, 212 U.S. at 494–96; *Standard Oil Co.*, 307 F.2d at 127–28; United States v. Nearing, 252 F. 223, 231 (S.D.N.Y. 1918).

21. *N.Y. Cent.*, 212 U.S. at 493; United States v. Hilton Hotels Corp., 467 F.2d 1000, 1007 (9th Cir. 1972); *Standard Oil Co.*, 307 F.2d at 127; Egan v. United States, 137 F.2d 369, 379 (8th Cir. 1943).

22. *Standard Oil Co.*, 307 F.2d at 128–29.

23. McDougald v. Bellamy, 18 Ga. 411, 432 (1855).

employer nor allows the employer to exonerate himself by proving his freedom from fault."[24]

The purposes served by vicarious liability and agency principles are well-established. Courts have cited the master's duty to exercise control over his servants so as to avoid causing harm, and the simple justice of requiring that one who profits by use of servants also be forced to bear the costs associated with them.[25] As the Supreme Court put it,

> [t]he treasury of the business may not with impunity obtain the fruits of violations which are committed knowingly by agents of the entity in the scope of their employment. Thus pressure is brought on those who own the entity to see to it that their agents abide by the law.[26]

Absent vicarious liability, businesses may be tempted to encourage illegal but profitable behavior by their judgment-proof employees, thereby externalizing the costs of their torts on to the public.

Vicarious liability becomes a complicated question in the context of large corporations. Many organizational torts are not accomplished via a single actor, but instead require the cooperation or involvement of multiple employees, such that no single employee has personally committed all elements of the violation. In the case of torts that have a mens rea element, courts have developed the rough principle that organizational liability may be imposed so long as three conditions are met: (1) a harmful action

---

24. Konradi v. United States, 919 F.2d 1207, 1210 (7th Cir. 1990); *see* Alan O. Sykes, *The Boundaries of Vicarious Liability: An Economic Analysis of the Scope of Employment Rule and Related Legal Doctrines*, 101 HARV. L. REV. 563, 577 (1988).

25. *See McDougald*, 18 Ga. at 433 ("For it is well established, that where one of two innocent persons are to suffer from the tortious act of a third, he who gave the aggressor the means of doing the wrong, must alone bear the consequences of the act."); David Jacks Achtenberg, *Taking History Seriously: Municipal Liability Under 42 U.S.C. § 1983 and the Debate over Respondeat Superior*, 73 FORDHAM L. REV. 2183, 2197–203 (2005) (describing the typical justifications for respondeat superior liability offered by nineteenth century courts); Theresa A. Gabaldon, *Milberg Weiss: Of Studied Indifference and Dying of Shame*, 2 J. BUS. & TECH. L. 207, 229 (2007).

26. United States v. A & P Trucking Co., 358 U.S. 121, 126 (1958) (footnote omitted). As Prosser and Keeton describe it,

> [t]he losses caused by the torts of employees, which as a practical matter are sure to occur in the conduct of the employer's enterprise, are placed upon that enterprise itself, as a required cost of doing business. They are placed upon the employer because, having engaged in an enterprise, which will on the basis of all past experience involve harm to others through the torts of employees, and sought to profit by it, it is just that he, rather than the innocent injured plaintiff, should bear them . . . .

W. PAGE KEETON, DAN. B. DOBBS, ROBERT E. KEETON & DAVID G. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS § 69, at 500 (5th ed. 1984).

Washington University Open Scholarship

committed by one agent; (2) an agent who harbors the specific mens rea required by the offense; and (3) a causal connection between the actions of the agent harboring mens rea and the ultimate harmful action.

The Ninth Circuit's rationale in *United States v. Shortt Accountancy Corp.*[27] provides a useful example. In that case, Shortt Accountacy, a CPA firm, was criminally convicted for making and subscribing false tax returns for a client in violation of 26 U.S.C. § 7206(1). Shortt's chief operating officer ("COO") designed an illegal tax shelter for the client. Pursuant to the scheme, a false return was prepared by a different Shortt employee based on information provided by the COO; the preparing employee had no knowledge of the impropriety and innocently subscribed to the return's correctness.[28] Under such circumstances, the Ninth Circuit had no trouble combining the mens rea of the COO and the actus reus of the innocent employee, holding that "[a] corporation will be held liable . . . when its agent deliberately causes it to make and subscribe to a false income tax return."[29] Strikingly, the court did not resort to a simple respondeat superior analysis to impose organizational liability based solely on the COO's guilt, though it might have been able to do so.[30] Instead, the court aggregated the actions and states of mind among the different agents to reach its conclusion about the liability of the organization.

This type of liability should not be confused with an alternate scenario that most courts reject—namely, where no single employee harbors the mens rea required by the offense, but where several employees each separately, but innocently, have knowledge that, if aggregated, would suggest wrongdoing. For example, one employee might innocently make a false statement, while another employee—unaware of the first employee's actions—has information that demonstrates the statement's falsity.[31] Undoubtedly, if a natural person made a misstatement with knowledge of facts rendering it false, courts would have no trouble inferring that the person intentionally or recklessly misled her audience.[32] But with a corporate defendant, where knowledge and action reside in different agents and neither individually harbors mens rea—where, in short, the right hand does not know what the left hand is doing—courts generally

27. 785 F.2d 1448 (9th Cir. 1986).

28. *Id.* at 1450–51.

29. *Id.* at 1454.

30. The COO may have personally committed violations of the relevant statutes; he was charged alongside the corporation, though he did not appeal. *Id.* at 1451–52.

31. *See, e.g.*, Woodmont, Inc. v. Daniels, 274 F.2d 132, 137 (10th Cir. 1959); United States v. United Techs., Corp., 51 F. Supp. 2d 167, 196–99 (D. Conn. 1999).

32. *See, e.g.*, Novak v. Kasaks, 216 F.3d 300, 311–12 (2d Cir. 2000).

agree that there is no organizational mens rea,[33] at least not unless communication failures between the right hand and left hand were so egregious, and evidenced such disregard for legal requirements, that they amount to organizational "willful blindness."[34]

But when there is at least one agent who personally harbors mens rea and causes the corporation to commit a harmful act, it is widely accepted in many areas of law that the corporation may be held responsible.[35] In the employment discrimination context, the concept is called "cat's paw" liability, a reference to a fable in which a monkey persuades a cat to grab chestnuts out of a fire, and then makes off with the chestnuts while the cat suffers burned paws.[36]

---

33. *See* U.S. *ex rel.* Harrison v. Westinghouse Savannah River Co., 352 F.3d 908, 918 n.9 (4th Cir. 2003); Saba v. Compagnie Nationale Air Fr., 78 F.3d 664, 670 n.6 (D.C. Cir. 1996) ("[C]orporate knowledge of certain facts [can be] accumulated from the knowledge of various individuals, but the proscribed intent (willfulness) depend[s] on the wrongful intent of specific employees."); Browning v. Fidelity Trust Co., 250 F. 321, 326–27 (3d Cir. 1918);United States v. LBS Bank-N.Y., Inc., 757 F. Supp. 496, 501 n.7 (E.D. Pa. 1990) (citations omitted) ("Although knowledge possessed by employees is aggregated so that a corporate defendant is considered to have acquired the collective knowledge of its employees, specific intent cannot be aggregated similarly."); First Equity Corp. v. Standard & Poor's Corp., 690 F. Supp. 256, 260 (S.D.N.Y. 1988) ("While . . . a corporation may be charged with the collective knowledge of its employees, it does not follow that the corporation may be deemed to have a culpable state of mind when that state of mind is possessed by no single employee.").

34. *See, e.g.*, United States v. Bank of New England, N.A., 821 F.2d 844, 855 (1st Cir. 1987) (A bank "willfully" violates certain Treasury regulations if the bank as a whole is "flagrantly indifferent to its obligations"); *id.* at 855–56 (Willful blindness exists where "the bank as an organization consciously avoided learning about and observing [regulatory] requirements."); United States v. Sci. Applications Int'l Corp., 626 F.3d 1257, 1276 (D.C. Cir. 2010) (Corporation's recklessness or deliberate ignorance may be established where "a plaintiff can prove that [the company's] structure prevented it from learning [the relevant] facts"); *id.* at 1276 (A jury may consider company's "systems and structure" and the adequacy of the company's compliance system to determine if the company acted with scienter); *see also* Thomas A. Hagemann and Joseph Grinstein, *The Mythology of Aggregate Corporate Knowledge: A Deconstruction*, 65 GEO. WASH. L. REV. 210, 237–38 (1997). The Restatement (Third) of Agency § 5.03 (Tentative Draft No. 3, 2002), provided that the principal's intent may be "based on inferences to be drawn from the fact that agents could act with ignorance of the acts and omissions of other agents with adverse consequences for third parties," but this section was dropped from the final version of the Third Restatement, without commentary.

35. *See, e.g.*, Am. Soc'y of Mech. Eng'rs v. Hydrolevel Corp., 456 U.S. 556 (1982) (holding an industry standard-setting organization liable under the Sherman Act when two members of the organization used their positions to manipulate a committee secretary into distributing a letter in ASME's name disparaging a competitor's product); ING Bank v. PNC Fin. Servs. Group, 629 F. Supp. 2d 351, 354–56 (D. Del. 2009) (corporation properly charged with fraud on the patent office when certain unnamed employees had knowingly caused the corporate secretary to submit a false declaration); Sci. Applications Int'l Corp., 626 F.3d at 1276 (False Claims Act); Grand Union Co. v. United States, 696 F.2d 888, 890–91 (11th Cir. 1983) (same); U.S. ex rel. Harrison v. Westinghouse Savannah River Co., 352 F.3d 908, 919 (4th Cir. 2003) (same).

36. Staub v. Proctor Hosp., 131 S. Ct. 1186, 1190 n.1 (2011). To spin out the analogy, the monkey is aware of the danger of grabbing the chestnuts, and the cat is not; the monkey therefore uses the innocent cat to obtain his goal without personally taking the dangerous action.

Washington University Open Scholarship

That said, the Supreme Court recently addressed the issue of cat's paw liability in *Staub v. Proctor Hospital*[37] and put its own spin on the case law. The plaintiff, army reservist Vincent Staub, claimed that his immediate supervisors at his employer, Proctor Hospital, resented his military obligations. The supervisors filed unjustified disciplinary actions against him, which ultimately caused the vice president of human resources to fire him. Staub sued Proctor under the Uniformed Services Employment and Reemployment Rights Act (USERRA), which prohibits employers from denying "retention in employment"[38] to a servicemember, where service membership is "a motivating factor in the employer's action."[39] The Supreme Court was thus forced to determine whether the mens rea of the supervisors could be combined with the actus reus of the vice president for the purposes of determining the hospital's USERRA liability.

Justice Scalia, writing for the majority, first held that the statutory language did not support such an aggregation:

> When a decision to fire is made with no unlawful animus on the part of the firing agent, but partly on the basis of a report prompted (unbeknownst to that agent) by discrimination, discrimination might perhaps be called a "factor" or a "causal factor" in the decision; but it seems to us a considerable stretch to call it "a motivating factor."[40]

The Court supported this reasoning by citing to the *Restatement (Second) of Agency*, which, it held, advised that the "malicious mental state of one agent cannot generally be combined with the harmful action of another agent to hold the principal liable for a tort that requires both."[41] The Court concluded, however, this problem could be solved with a close reading of the statutory text. As the Court put it:

> Animus and responsibility for the adverse action can both be attributed to the earlier agent (here, Staub's supervisors) if the adverse action is the intended consequence of that agent's discriminatory conduct. So long as the agent intends, for discriminatory reasons, that the adverse action occur, he has the scienter required to be liable under USERRA. And it is axiomatic

37. *Id.* at 1186.
38. 38 U.S.C. § 4311(a) (2012).
39. *Id.* § 4311(c)(1).
40. *Staub*, 131 S. Ct. at 1192.
41. *Id.* at 1191.

> under tort law that the exercise of judgment by the decisionmaker [in this case, the vice president] does not prevent the earlier agent's action (and hence the earlier agent's discriminatory animus) from being the proximate cause of the harm.[42]

Thus, the Court elided the question whether the harmful conduct of one agent can be combined with the harmful intent of another by redefining the concept of harmful conduct in the first place, interpreting *the statute itself* to mean *both* that decisionmakers may not discharge persons with a discriminatory motive, *and* that intermediate actors may not intentionally take steps that *cause* a discharge. As the Court put it, its new interpretation of the scope of the statute's prohibitions permitted it to "avoid[] the aggregation of animus and adverse action"[43] that it believed to be of questionable legitimacy.

Concurring in the judgment, Justice Alito, joined by Justice Thomas, rejected the Court's reliance on principles of agency and tort common law. Instead, they interpreted the statute to require that the same decisionmaker who took the adverse action must also harbor the discriminatory animus.[44] They believed that on this record, however, there was evidence that responsibility for the final decision to fire Staub had been partly delegated from the person with "formal decisionmaking authority" to one of Staub's supervisors.[45] Since that supervisor was motivated by animus, the requirements of the statute were met.[46]

One intriguing aspect of the majority opinion was its invocation of the *Restatement (Second) of Agency*. Contrary to the majority's view, the *Second Restatement* does not prohibit the combination of malicious mental state and action; instead, it draws the same distinction that the earlier case law does between a court cobbling together "innocent" pieces of knowledge, and an agent who intentionally manipulates the principal, allowing liability to be imposed in the latter circumstance. The *Restatement* accomplishes this by distinguishing between imputation of "notice" of a fact to a principal and imputation of "actual knowledge,"

42. *Id.* at 1192.
43. *Id.*
44. *Id.* at 1195 (Alito, J., concurring in the judgment).
45. *Id.*
46. *Id.* at 1195–96.

Washington University Open Scholarship

which is akin to a subjective state of mind. Notice of a fact is not sufficient to impose liability for torts that require scienter,[47] but

> [i]f the agent consciously and purposely fails to reveal the information [in connection with a given transaction], the principal may be liable because, under the circumstances, the conduct of the agent has the same effect as if the agent had personally acted and were himself guilty of the fraudulent or other tortious conduct.[48]

Similarly, the *Restatement* provides that ordinarily, if an agent discovers information that he fails to communicate to the principal, and the principal makes a misrepresentation as a result, the principal is not liable for fraud—*unless* the agent "had intended [the principal] to make the misrepresentation."[49] Thus, the *Restatement* fully permits liability to be imposed on principals based on the manipulative behind-the-scenes actions of their agents, despite the Supreme Court's suggestion to the contrary.[50]

In any event, the implications of this line of case law is clear: In the ordinary course, an organization has the scienter of employees who either personally commit a prohibited act or who, acting with the relevant scienter, *proximately cause* the organization to commit the act.

---

47. *See, e.g.*, RESTATEMENT (SECOND) OF AGENCY § 275 (1958) (*"Except . . . where knowledge as distinguished from reason to know is important*, the principal is affected by the knowledge which an agent has a duty to disclose to the principal or to another agent of the principal to the same extent as if the principal had the information." (emphasis added)); *id.* § 275 cmt. b; *id.* § 268 cmt. d ("If the agent fails to transmit the information [to the principal] . . . the principal is not responsible in an action *in which a consciousness of the fact not revealed is a necessary element*." (emphasis added)).

48. *Id.* § 268 cmt. d.

49. *Id.* § 275 cmt. b, illus. 4. These sections do not address the many variations on the scenarios described—such as where an agent affirmatively misleads the principal by communicating false information (which presumably is subsumed under the general rubric of withholding information), or withholds information from a fellow agent rather than the principal himself (particularly relevant where the principal is an organization and thus only acts through other agents), or withholds information recklessly rather than intentionally. Nonetheless, the theme appears to be similar to that in the case law—i.e., a principal's mens rea cannot be constructed out of "innocent" knowledge held by its agents, but guilty knowledge and intentions may be imputed to the principal, even if the relevant actus reus was committed by a different agent.

50. *Staub*, 131 S. Ct. at 1191. The situation becomes murkier when one considers the *Restatement (Third) of Agency*, which was adopted in 2005 but was not cited in *Staub*. That Restatement *eliminates* the references to agents who intentionally manipulate their principals into acting tortiously, and instead, merely repeats the basic rule that an agent's knowledge is imputed to the principal, but that knowledge alone will not result in liability for torts that require intentional conduct *See, e.g.*, RESTATEMENT (THIRD) OF AGENCY § 5.03 (2006); *id.* § 5.03 illus. 15 ("[A] principal may not be subject to liability for fraud if one agent makes a statement, believing it to be true, while another agent knows facts that falsify the other agent's statement. Although notice is imputed to the principal of the facts known by the knowledgeable agent, the agent who made the false statement did not do so intending to defraud the person to whom the statement was made.").

II. THE DIFFERENT RULES APPLICABLE TO § 10(B)

Vicarious liability has long been viewed with suspicion in the context of section 10(b). Historically, the objection has been textual[51]: because vicarious liability is a form of "strict" liability, many have argued that it conflicts with section 20(a) of the Exchange Act, which imposes liability on those who "control" others who violate section 10(b).[52] "Controlling persons" are permitted a good faith defense; thus, it has often been argued, vicarious liability principles, which do not permit a good faith defense, undermine the "controlling person" provisions.

After an initial flurry of court activity that roughly settled in favor of the application of ordinary agency principles to section 10(b),[53] the debate was rekindled in 1994, when the Supreme Court decided *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*[54] The Supreme Court held that under a strict textual analysis, section 10(b) "prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act," and does *not* extend to "aiding and abetting" another's fraud.[55] This decision sparked new arguments that vicarious liability represented a form of "extratextual" liability, akin to aiding and abetting, and equally void.[56] Tellingly, the *Central Bank* majority repeatedly cited to Professor Daniel Fischel's 1981 article, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, which argued that aiding and abetting, conspiracy, *and respondeat superior* all represented forms of

---

51. *See, e.g.*, Christoffel v. E. F. Hutton & Co., 588 F.2d 665, 667 (9th Cir. 1978), *overruled by* Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1577 (9th Cir. 1990) (en banc); Jackson v. Bache & Co., 381 F. Supp. 71, 95 (N.D. Cal. 1974); Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 CALIF. L. REV. 80, 87 (1981); William J. Fitzpatrick & Ronald T. Carman, *Respondeat Superior and the Federal Securities Laws: A Round Peg in a Square Hole*, 12 HOFSTRA L. REV. 1, 17–19 (1983); Ediberto Román, *Statutory Interpretation in Securities Jurisprudence: A Failure of Textualism*, 75 NEB. L. REV. 377, 395 (1996).

52. *See* 15 U.S.C. § 78t(a) (2012) ("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 . . . 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. *See In re* Villa, 261 F.3d 1148, 1152 n.5 (11th Cir. 2001) (citing cases).

54. 511 U.S. 164 (1994).

55. *Id.* at 177.

56. *See, e.g.*, *In re* Fidelity/Micron Sec. Litig., 964 F. Supp. 539, 544 (D. Mass. 1997); Converse, Inc. v. Norwood Venture Corp., No. 96 CIV . 3745 (HB), 1997 WL 742534, at *3 (S.D.N.Y. Dec. 1, 1997); *In re* Prudential Ins. Co. of Am. Sales Practices Litig., 975 F. Supp. 584, 612–13 (D.N.J. 1996); *see also* Robert A. Prentice, *Conceiving the Inconceivable and Judicially Implementing the Preposterous: The Premature Demise of* Respondeat Superior *Liability Under Section 10(b)*, 58 OHIO ST. L.J. 1325, 1330–31 (1997).

Washington University Open Scholarship

liability that were not supported by section 10(b)'s text,[57] suggesting that vicarious liability would be the next to fall. Even Justice Stevens's *Central Bank* dissent argued that the majority's decision cast doubt on the continuing vitality of respondeat superior and related agency doctrines.[58]

Most courts, however, eventually concluded that vicarious liability survived *Central Bank*. For one thing, the Exchange Act explicitly makes corporations liable for section 10(b) violations, which most courts interpreted as being impossible without resort to agency principles.[59] Additionally, as the Third Circuit observed, unlike aiding and abetting, "courts imposing liability on agency theories are not expanding the category of affirmative conduct proscribed by the relevant statute; rather, they are deciding on whose shoulders to place responsibility for conduct *indisputably proscribed* by the relevant statute."[60]

A. Courts Resist Application of Agency Principles in Open-Market Section 10(b) Cases

Despite courts' ostensible acceptance of vicarious liability principles in the section 10(b) context, the reality is more complex, at least when it comes to open-market frauds committed by publicly traded corporations. This is because when it comes to open-market frauds, disaggregation is particularly salient. These frauds are, by definition, based on public announcements in the form of officially-sanctioned statements issued under the corporate imprimatur, such as SEC filings, press releases, or publicly broadcast conference calls between CEOs and market analysts. Official corporate statements may be attributed to top corporate officers, but they frequently depend on information provided by a myriad of anonymous agents operating at all levels of the company who may intentionally or recklessly pass along inaccurate or misleading information. In such circumstances, the actus reus that forms the basis of the alleged section 10(b) violation—the false public statement—has been disaggregated from the actor who harbors the relevant mental state. This disaggregation has become a pressure point that courts have used to narrow and eschew the agency principles applied in other areas of law.

57. Fischel, *supra* note 51, at 106–07.

58. 511 U.S. at 200 n.12 (Stevens, J., dissenting).

59. *See, e.g.*, Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 101 (2d Cir. 2001); Paul F. Newton & Co. v. Tex. Commerce Bank, 630 F.2d 1111, 1118 (5th Cir. 1980) (citing SEC v. Mgmt. Dynamics, Inc., 515 F.2d 801, 812 (2d Cir. 1975)); *In re* Centennial Techs. Litig., 52 F. Supp. 2d 178, 185 (D. Mass. 1999).

60. AT&T Co. v. Winback & Conserve Program, Inc., 42 F.3d 1421, 1430–31 (3d Cir. 1994).

With few exceptions, courts have been willing to aggregate mens rea and actus reus only where mens rea is harbored by another high level actor, who may be presumed to have caused, if only from behind the scenes, the false statement by approving or drafting it. Forms of causation most likely to emanate from lower level employees are disregarded, frequently without explanation.

For example, in *Southland Securities Corp. v. INSpire Insurance Solutions, Inc.*,[61] the Fifth Circuit formally endorsed an approach similar to that used by courts outside the 10(b) context, namely, that the scienter of the "individual corporate official or officials who make or issue the statement (or order or approve it or its making or issuance, or who furnish information or language for inclusion therein, or the like)" is imputed to the corporation.[62] Just as courts had done previously, the Fifth Circuit refused to aggregate the innocently held knowledge of multiple agents to create a guilty state of mind, but it was willing to allow for a "cat's paw" style of liability, whereby corporate liability would exist if a behind-the-scenes agent intentionally funneled false information to the public via internal corporate reporting channels.[63] In making this decision, the Fifth Circuit cited the *Second Restatement* for the proposition that a principal is liable when an agent consciously and purposefully withholds information.[64]

Other appellate courts, however, have expressed varying degrees of discomfort with the Fifth Circuit's rule. The Seventh Circuit, while acknowledging that *Southland* stated the common law rule, refused to endorse it to the extent it would impute to the corporation the scienter of mid-level agents, apparently concerned that ordinary agency principles might stretch too far.[65] Three circuits have formally endorsed either

61. 365 F.3d 353 (5th Cir. 2004).

62. *Id.* at 366. Though the court began by discussing corporate "officers," subsequent references to "agents" and "employees" suggest that the court was unconcerned with the rank of the relevant agent. *See id.* at 367.

63. *See id.* at 366–67. Additionally, in the earlier case of *Sharp v. Coopers & Lybrand*, 649 F.2d 175 (3d Cir. 1981), the Third Circuit imposed section 10(b) liability on an accounting firm when one of its associates, acting with scienter, contributed to a false opinion letter that was distributed on the firm's behalf. In that case, the Third Circuit refused to declare a general rule for aggregating the conduct of multiple agents, or even to endorse agency liability in section 10(b) cases across the board. Instead, it decided it is the firm's obligation, under these circumstances, to "exercise a high degree of care in preparation of the letter, and this care included close supervision of its employee." *Id.* at 183. *But see* Prentice, *supra* note 56, at 1327 n.8 (arguing that *Sharp*'s rule would functionally permit agency liability in all cases).

64. *Southland Sec. Corp.*, 365 F.3d at 366 (citing RESTATEMENT (SECOND) OF AGENCY § 275 cmt. b, § 268 cmt. d (1958)).

65. Makor Issues & Rights, Ltd. v. Tellabs Inc., 513 F.3d 702, 708 (7th Cir. 2008).

Washington University Open Scholarship

Southland or a similar formulation, but have then gone on to *apply* the rule in a more truncated fashion, considering only the scienter of high-level employees when determining organizational liability—even in the face of explicit allegations that the misstatements were the result of lower level employees intentionally filtering false information up through corporate reporting channels.[66] At least three other circuits, without declaring a general rule on the subject, have ignored company *admissions* that fraudulent information supplied by low-level officers and employees had been incorporated into public financial statements. In those cases, again, the courts focused their attention solely on whether the plaintiffs had demonstrated that the highest officers had intentionally or recklessly issued false public statements, and concluded they had not.[67] In all of these cases, the actions of the lower level employees were only relevant to the extent they created an evidentiary inference that the misinformation was known at the top of the corporate hierarchy; because the courts concluded the inference was not strong enough, the complaints were dismissed.[68]

Even the Fifth Circuit later seemed to dodge its own rule. In an unpublished opinion in *Pipefitters Local No. 636 Defined Benefit Plan v.*

---

66. *See* Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1241, 1254–55 (11th Cir. 2008); Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc., 531 F.3d 190, 193, 195 (2d Cir. 2008); *In re* Dynex Capital, Inc. Sec. Litig., No. 05 Civ. 1897(HB), 2006 WL 314524, at *7 (S.D.N.Y. Feb. 10, 2006); *see also In re* Omnicare, Inc. Sec. Litig., 769 F.3d 455, 476 (6th Cir. 2014). In *Omnicare*, the Sixth Circuit took a particularly bizarre approach: it formally adopted the *Southland* standard, which depends on finding mens rea within a single actor, but then abandoned the standard in the very same case, seeking to identify corporate scienter by conducting a holistic analysis of the corporation's intentions, apparently divorced from the intention of any single employee (including one who, the court admitted, had been aware of the misconduct the corporation had concealed). *See Omnicare*, 769 F.3d at 476, 483–84.

67. *See* Kushner v. Beverly Enters., Inc., 317 F.3d 820, 828 (8th Cir. 2003); Matrix Capital Mgmt. Fund, L.P. v. BearingPoint, Inc., 576 F.3d 172, 177, 188–90 (4th Cir. 2009); *In re* Alpharma Inc. Sec. Litig., 372 F.3d 137, 150 (3d Cir. 2004).

68. In *Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424 (9th Cir. 1995), the Ninth Circuit suggested that if non-officer-level employees—in that case, the personnel director and public relations director—intentionally or recklessly contributed to false corporate statements, they would have committed a section 10(b) violation, and the corporation would be vicariously liable. *Id.* at 1433–34. Though the *Nordstrom* court expressly distinguished this possibility from the distinct concept cobbling together innocently held knowledge, which it called "collective scienter," *id.* at 1435 (internal quotation marks omitted), for many years, the case was interpreted to mean that a corporation's scienter may only be derived from corporate officers who personally "make" false statements. *See, e.g.*, *In re* Apple Computer, Inc., Sec. Litig., 243 F. Supp. 2d 1012 (N.D. Cal. 2002), *aff'd sub nom. In re* Apple Computer, Inc., 127 Fed. App'x 296 (9th Cir. 2005). Yet the scope of this rule was never clear because at the time, the Ninth Circuit also had an unusually lenient standard for determining whether an official has "made" a statement. *See In re* Software Toolworks Inc. Sec. Litig., 50 F.3d 615, 628 n.3 (9th Cir. 1994). More recently, in *Glazer Capital Mgmt., LP v. Magistri*, 549 F.3d 736 (9th Cir. 2008), the Ninth Circuit held that corporate scienter would be determined only by looking to the state of mind of the persons to whom the statements were expressly attributed, while leaving open the possibility that it would use a different approach in other cases. *Id.* at 744–45.

Zale Corp.,[69] the Fifth Circuit dismissed a complaint where the company conceded that a mid-level vice president had falsified accounting entries in her department, causing the company to issue false public statements.[70] Rather than explicitly reject *Southland* and hold that the vice president's scienter would not be imputed to the organization, the Fifth Circuit instead held that she had "acted with the intent to maintain the good appearance of her department rather than to defraud investors,"[71] and thus did not harbor the relevant mens rea. In reaching this conclusion, the Fifth Circuit actually quoted *Southland* but *omitted Southland*'s reference to employees who furnish false information.[72]

To be sure, in many—though not all—of these cases, the wrongdoing occurred at a subsidiary, potentially raising issues of corporate separateness, and the propriety of attributing the mens rea of the subsidiary's agents to the parent. But it seems unlikely that respect for the corporate form was what motivated these decisions. Not only is it exceedingly rare for courts to voice such concerns,[73] but also many cases

69. 499 Fed. App'x 345 (5th Cir. 2012) (unpublished).

70. *See id.* at 347–48.

71. *Id.* at 351.

72. *See id*. at 349. Many district courts have explicitly stated what appellate courts seem to be unwilling to admit—that the mens rea of lower level employees may not be attributed to the corporation. *See, e.g.*, *In re* Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493, 515–16 (S.D.N.Y. 2009) (courts should look only to the "scienter [of] management-level employees" when determining corporate mens rea); *In re* Faro Techs. Sec. Litig., 534 F. Supp. 2d 1248, 1262 (M.D. Fla. 2007) ("[I]n order to state an actionable claim of institutional fraud, this Court holds that scienter must be found as to either the employee making the alleged false statement to the market or as to any other high level employee. . . ."); Hill v. Tribune Co., Nos. 05 C 2602, 05 C 2927 & 06 C 0741, 2006 WL 2861016, at *12 (N.D. Ill. Sept. 29, 2006), *aff'd sub nom.* Pugh v. Tribune Co., 521 F.3d 686 (7th Cir. 2008) ("[T]he corporation's scienter is generally limited to being based on knowledge or scienter of a senior officer or director of the corporation, or an employee involved in issuing the alleged misrepresentation."); *In re* VeriFone Holdings, Inc. Sec. Litig., No. C 07-6140 MHP, 2011 WL 1045120, at *9 (N.D. Cal. Mar. 22, 2011), *rev'd on other grounds*, 704 F.3d 694 (9th Cir. 2012) ("It is undisputed that Periolat [the supply chain controller] was not a VeriFone officer, and he made none of the challenged statements. Periolat's misconduct is therefore not attributable to VeriFone.").

73. For example, *In re Alpharma Inc. Securities Litigation*, 372 F.3d 137 (3d Cir. 2004); *City of Roseville Employees' Retirement System v. Horizon Lines, Inc.*, 442 Fed. App'x 672 (3d Cir. 2011); *Matrix Capital Management Fund, L.P. v. BearingPoint, Inc.*, 576 F.3d 172 (4th Cir. 2009); *Teamsters Local 445 Freight Division Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190 (2d Cir. 2008); and *In re Sunpower Securities Litigation*, No. C 09-5473 RS, 2011 WL 7404238 (N.D. Cal. Dec. 19, 2011) all involved parent companies that issued false statements concerning misconduct that filtered up from their wholly-owned subsidiaries, but the issue of separate incorporation is not mentioned in any of the opinions. A prominent exception is *Pugh v. Tribune Co.*, 521 F.3d 686 (7th Cir. 2008). In *Pugh*, the parent corporation issued false statements based on information supplied by a wholly-owned subsidiary. Invoking agency principles and corporate separateness, the Seventh Circuit refused to impute the mens rea of one of the subsidiary's officers to the parent. *See id.* at 698. But this is an outlier, rather than the norm. Even in that case, the subsidiary was publicly presented as a standalone business, with its own trade name, rather than being merely an arm of the parent's operations.

Washington University Open Scholarship

involve fact patterns that, at least at the pleading stage, seem appropriate for veil-piercing.[74]

The cases are very different, however, when the behind-the-scenes actor is of a *high* level, such as a top officer or a member of the board of directors. In these circumstances, the high-level actor's approval of the false statement—even if only presumed at the pleading stage—triggers liability not only against the actor personally, but also against the organization.[75]

Notably, courts rarely, if ever, are forced to confront these issues in the context of SEC enforcement actions rather than individual, fraud-on-the-market claims, likely because the SEC, apparently as a matter of policy, does not typically bring actions against organizations for open-market disclosure violations originating at lower levels of the company. As a result, the question of organizational liability under these circumstances almost always arises in private actions, brought using the fraud-on-the-market theory.

74. For example, *In re Dynex* involved a parent and wholly-owned subsidiary that not only shared officers, but also a single business address and telephone number. *See* Amended Class Action Complaint at ¶¶ 26–27, *In re* Dynex Capital, Inc. Sec. Litig., No. 05 Civ. 1897(HB), 2006 WL 314524, at *7 (S.D.N.Y. Feb. 10, 2006). Moreover, it is not clear that corporate separateness should be a relevant consideration in the context of financial reporting. Professor Langevoort points out that SEC reporting requirements cross corporate lines and require that the organization be treated as one unit. *See* Langevoort, *supra* note 2, at 961.

75. This is the foundation of what is known as the "group pleading" doctrine. While there have been conflicting definitions of "group pleading," the most common one is that it is a pleading presumption that statements in "group published" documents, such as corporate press releases and SEC filings, "are the collective work of those individuals with direct involvement in the everyday business of the company." *In re* Pfizer Inc. Sec. Litig., 584 F. Supp. 2d 621, 637 (S.D.N.Y. 2008). The doctrine is used to help plaintiffs satisfy the pleading requirements of Federal Rule of Civil Procedure 9(b) and the Private Securities Litigation Reform Act ("PSLRA") by establishing, for pleading purposes, that a company's top officers are responsible for drafting or approving the contents of allegedly false official corporate statements, even if their names are not explicitly attached. If the plaintiff is then able to plead facts demonstrating that any of those officers acted with scienter, the court will conclude that the plaintiff's complaint sufficiently establishes that those officers (and, via vicarious principles, their corporate employer) violated section 10(b). Thus, although the doctrine is technically a pleading tool to help plaintiffs connect specific company officers to unattributed false statements, the legal premise that underlies the doctrine is that if an officer does, in fact, anonymously draft, disseminate, review, or approve false public statements, that officer has "made" a statement for Rule 10b-5 purposes. Though some courts have rejected, as a pleading matter, the presumption that high-level corporate officers are involved in approving corporate statements—these courts require plaintiffs to allege specific facts demonstrating such involvement, *see* Southland Sec. Corp. v. INSpire Ins. Solutions Inc., 365 F.3d 353, 365 (5th Cir. 2004)—there has been wide agreement that anonymous drafting, review, or approval of false public statements by a high-level officer is enough to impose liability both on the officer and the corporate entity. That agreement largely persists even after the Supreme Court's decision in *Janus*, which is discussed further below.

B. The Supreme Court Affirms that Section 10(b) Is Different

Two recent Supreme Court decisions have only lent further support to lower courts' refusal to impute the scienter of lower level actors to the corporation.

First, in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*,[76] the Supreme Court narrowed the test for "causation" in private section 10(b) cases. Shareholders of Charter Communications alleged that two of Charter's vendors helped Charter report phantom revenue by jointly engaging in "wash" transactions.[77] The Supreme Court held that the vendors' conduct only constituted aiding and abetting, and thus could not trigger private liability under section 10(b) under *Central Bank*, because the chain of causation between the vendors' actions and Charter's false statements was "too remote."[78] In the Court's view, Charter chose to fraudulently account for the transactions; nothing the vendors did "made it necessary or inevitable for Charter to record the transactions as it did."[79] The Court acknowledged that its new "necessity" test was stricter than the common law, but justified its holding on the ground that Congress had not intended to provide broad liability against "the entire marketplace in which the issuing company operates."[80]

Stoneridge did not involve a cat's paw scenario: two different companies were involved, and Charter itself was not an innocent dupe. Nonetheless, courts have interpreted *Stoneridge* to apply even within a single corporation (or corporate group); thus, where "behind-the-scenes" agents were alleged to have funneled false information to the public, courts refused to impose liability on the agent, deeming the connection between the agent's act and the final misstatement too attenuated.[81] Where no higher level agents were alleged to have known of the fraud, claims against the organization were dismissed.[82]

---

76. 552 U.S. 148 (2008).

77. *Id.* at 153–55.

78. *Id.* at 159.

79. *Id.* at 161.

80. *Id.* at 162.

81. *See, e.g.*, Katz v. Image Innovations Holdings, Inc., 542 F. Supp. 2d 269 (S.D.N.Y. 2008) (internal bookkeepers alleged to have participated in accounting fraud); *In re* Brocade Commc'ns Sys., Inc. Derivative Litig., 615 F. Supp. 2d 1018 (N.D. Cal. 2009) (CFO who allegedly participated in options backdating scheme); *In re* Dura Pharms., Inc. Sec. Litig., 548 F. Supp. 2d 1126 (S.D. Cal. 2008) (senior vice president alleged to have participated in channel-stuffing); SEC v. Lucent Techs., Inc., 610 F. Supp. 2d 342 (D.N.J. 2009) (sales executives who intentionally withheld information from corporate accounting department).

82. *See In re* Int'l Rectifier Corp. Sec. Litig., No. CV 07-02544-JFW, 2008 WL 4555794, at *10-12, *21 (C.D. Cal. May 23, 2008) (vice president alleged to have orchestrated accounting fraud); Pugh

Washington University Open Scholarship

Three years later, in *Janus Capital Group, Inc. v. First Derivative Traders*,[83] the Supreme Court was faced with another case involving a behind-the-scenes actor. This time, however, unlike in *Stoneridge*, the entity that issued the statement publicly had no knowledge of the misinformation. Nonetheless, the Court refused to hold the behind-the-scenes actor liable.

In *Janus*, a mutual fund, issued a prospectus that falsely claimed that the fund placed limits on trading that would protect the fund from damage caused by sophisticated arbitrage techniques. Though the prospectus was issued in the fund's name, the fund itself was a shell entity, owned by its investors, but entirely controlled by its investment adviser. All of the fund's officers were also officers of the investment adviser, and the adviser both drafted the false prospectus and set the policies that had been misdescribed.[84] The plaintiffs sued the adviser, alleging that as the drafter of the prospectuses, it was liable for the false statements contained therein.[85]

The Supreme Court, per Justice Thomas, rejected the argument that the adviser was responsible for the false statements in the prospectus it had drafted. The Court reasoned that under *Central Bank* and *Stoneridge*, the only person who "makes" a statement is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."[86] Under this rule, one who merely provides false information for inclusion in a statement is not its maker and thus has not committed a primary violation under *Central Bank*.[87] The Court counseled that, though not dispositive of the question, "attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by—and only by—the party to whom it is attributed."[88] In one particularly telling sentence, the Court held that to impose liability on the adviser for the prospectus's contents would be to

---

v. Tribune Co., 521 F.3d 686, 698 (7th Cir. 2008) (officer of wholly-owned subsidiary of defendant corporation).

83. 131 S. Ct. 2296 (2011).

84. *Id.* at 2299–300. The prospectus represented that the fund did not permit "market timing," when in fact it was permitted. Market timing is a trading strategy that allows some investors to rapidly buy and sell mutual fund shares so as to take advantage of brief delays before the mutual fund updates its asset valuations. It is legal but it can harm the other investors in the mutual fund. *See id.* at 2300 n.1.

85. The plaintiffs were not investors in the fund, but instead were shareholders in the parent company of the adviser. They claimed that the false statements in the fund prospectus inflated the parent company's stock price. *Id.* at 2300.

86. *Id.* at 2302.

87. *See id.* at 2303.

88. *Id.* at 2302.

create a form of liability that is "similar to—but broader in application than—what Congress has already created expressly elsewhere" in section 20(a), i.e., the controlling person provision that sparked the original debates over the application of vicarious liability principles to section 10(b) claims.[89] The Court reconciled its holding with *Stoneridge* by reasoning that absent "ultimate authority," the *Stoneridge* causation test—requiring that the actor's conduct make the false statement "necessary or inevitable"—could not be met.[90]

Writing in dissent, Justice Breyer expressed concern that the majority's rule would leave plaintiffs without remedies, even for intentional frauds:

> The possibility of guilty management and innocent board is the 13th stroke of the new rule's clock. What is to happen when guilty management writes a prospectus (for the board) containing materially false statements and fools both board and public into believing they are true? Apparently under the majority's rule, in such circumstances *no one* could be found to have "ma[d]e" a materially false statement . . . .[91]

As it turns out, despite Justice Breyer's fears, most district courts have rejected the suggestion that an organization's board of directors—and not the corporate officers—are the ultimate authority for corporate actions. Instead, it is generally agreed that officers who approve statements for public distribution, or who personally speak to the public, are the "ultimate authority" and thus "maker" of corporate statements. When these officers act with scienter, they may be held liable, and so may the corporate entity.[92] Nonetheless, Justice Breyer's concern is well-taken: when *Janus*, *Stoneridge*, and the employment case of *Staub* are considered together, it becomes clear that the traditional rules courts have used to aggregate actus reus and mens rea no longer hold.

As discussed above, in *Staub*, the Court addressed a situation in which one agent fired the plaintiff, while another harbored a discriminatory animus. The defendant advocated, essentially, an "ultimate authority"

89. *Id.* at 2304.
90. *Id.* at 2302–03.
91. *Id.* at 2310 (Breyer, J., dissenting) (alteration in original).
92. *See, e.g.*, City of Roseville Emps. Ret. Sys. v. EnergySolutions, Inc., 814 F. Supp. 2d 395, 417 (S.D.N.Y. 2011); *In re* Merck & Co., Sec., Derivative & "ERISA" Litig., No. 1658 (SRC), 2011 WL 3444199, at *25 (D.N.J. Aug. 8, 2011); *In re* Stillwater Capital Partners Inc. Litig., 853 F. Supp. 2d 441, 460 (S.D.N.Y. 2012); *In re* Pfizer Inc. Sec. Litig., 936 F. Supp. 2d 252, 268–69 (S.D.N.Y. 2013). As a result, in jurisdictions where the group pleading doctrine had been accepted prior to *Janus* as an appropriate way of satisfying particularity requirements for securities fraud complaints, courts have continued to apply it.

Washington University Open Scholarship

rule—namely, that the only relevant action was that taken by the final decisionmaker, and only that decisionmaker's scienter could be considered.[93] The majority rejected this argument because it believed that the statute imposed organizational liability not only when a single employee took an adverse employment action with discriminatory animus, but also when an employee, acting with animus, took an *intermediate* action that was intended to, and proximately caused, the adverse action.[94]

In *Janus*, by contrast, the Court held that intermediate steps toward issuing a false statement do *not* violate the statute, while in *Stoneridge*, the Court *rejected* the use of traditional proximate cause to determine whether the actions of one person cause a false statement to be issued by another. In both cases, the majority reasoned that so long as another decisionmaker interpositions itself between the earlier action and the final one, it is that decisionmaker—and not the actor who took earlier steps—who is responsible for the false statement, *even if the final decisionmaker is unaware of the earlier actor's misconduct*. In other words, the precise reasoning that *Staub* used to justify imposing liability on an organizational employer is reasoning that *Janus* and *Stoneridge* have held is *inapplicable* in the context of section 10(b). In fact, the reasoning of *Janus* and *Stoneridge* is more similar to the rule endorsed by the *Staub* concurrence, which sought to focus attention on the employee with "formal decisionmaking authority," rather than the employees who had acted behind-the-scenes.[95]

Thus, the fact that *Staub* permitted the scienter of lower level, intermediate actors to be imputed to the corporation only by employing reasoning that is of at least questionable relevance when applied to section 10(b) necessarily raises the question whether the same "ultimate authority" rule that applies when determining who "made" a statement after *Janus* also applies when determining whose scienter should be imputed to the company. This is particularly so given the *Staub* majority's apparent distrust of imposing liability on a corporation based on aggregation of the actus reus of one agent and the scienter of another.[96]

In fact, it is striking just how far the Supreme Court's reasoning under section 10(b) diverges from the reasoning that previous courts have employed to impute scienter to a corporation. For example, in *Shortt Accountancy*, the Ninth Circuit attributed to an accounting firm the mens

93. Staub v. Proctor Hosp., 131 S. Ct. 1186, 1192 (2011).
94. *Id.*
95. *Staub*, 131 S. Ct. at 1195 (Alito, J., concurring in the judgment).
96. *Id.* at 1191 (majority opinion).

rea of a COO who caused the firm to prepare a false tax return, even though the COO had not personally signed the return.[97] In so doing, the Ninth Circuit rejected the argument that the COO had not "made" a false return, and had at most assisted in the preparation of a false return,[98] precisely because it saw no significant difference between aiding a violation and actually "making" a tax return, nor did it believe that to "make" a return was coextensive with the legal obligation to file one.[99] In *Janus*, however, not only did the Court distinguish between "making" a false statement and aiding the creation of one, but in so doing, the Court relied in part on the fact that only the fund—and not the investment adviser—had a statutory duty to file a prospectus.[100]

Here, more than the scenario of a guilty management and an innocent board of directors, is where the true thirteenth stroke of the clock lies. Open-market section 10(b) claims involve official corporate statements, which means that under *Janus*'s rule, they are, at best, "made" only by high-level corporate officers and the corporation itself. If the Supreme Court has, or is on the verge of, formalizing the approach taken by lower courts—that only the scienter of these officers is relevant— then, as a practical matter, corporate liability in most section 10(b) cases must be derived exclusively from a corporation's highest management. This naturally begs the question whether organizational liability under section 10(b) is, in fact, based on agency principles at all, or is more properly described as "direct," on the theory that high-level actors represent the organization's "alter ego."[101]

Indeed, even though *Janus* commands that attributed statements are presumed to be "made by—and only by—the party to whom it is attributed,"[102] lower courts interpreting *Janus* have freely allowed that

97. 785 F.2d 1448, 1451 (9th Cir. 1986).

98. *Id.* at 1454.

99. *Id.*

100. Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2304 (2011).

101. *See* Burlington Indus., Inc. v. Ellerth, 524 U.S. 742, 758 (1998) (citing RESTATEMENT (SECOND) OF AGENCY § 219(2) (1957) (describing liability based on high-level managers as "direct" rather than "vicarious" because top officers are the organization's alter ego); *see also* Sharp v. Coopers & Lybrand, 649 F.2d 175, 182 n.8 (3d Cir. 1981) (distinguishing "direct" liability, based on the highest level agents, from indirect liability based on lower level actors); Nordstrom, Inc. v. Chubb & Son, Inc., 54 F.3d 1424, 1435 (9th Cir. 1995) (same). In general, corporate directors—the highest source of corporate authority—are not considered to be corporate "agents" of either the corporation or its shareholders, because of their unique role in overseeing corporate activities and their lack of direct accountability to shareholders. *See* Arnold v. Soc'y for Sav. Bancorp, Inc., 678 A.2d 533, 539–40 (Del. 1996); RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. (f)(2) (2006); Deborah A. DeMott, *Forum-Selection Bylaws Refracted Through an Agency Lens*, 57 ARIZ. L. REV. 269, 277–78 (2015).

102. *Janus*, 131 S. Ct. at 2302.

Washington University Open Scholarship

multiple high-level actors may be liable for a single false statement, regardless of attribution, so long as they had a hand in reviewing or approving them,[103] with corporate liability to follow.[104] In other words, courts are less concerned with the formal rule of *Janus*—locating a single, final authority to whom a statement is attributed—and more concerned with seeking a general high level-endorsement of the fraud, demonstrating that it is not *disaggregation* per se that concerns them, but rather the notion of permitting section 10(b) liability to be imposed based on the actions of lower level actors.[105]

C. Why the Difference?

The dramatic difference between the way courts examine section 10(b) claims and the way they examine other kinds of federal claims begs an

103. *See, e.g.*, *In re* Nevsun Res. Ltd., No. 12 Civ. 1845(PGG), 2013 WL 6017402, at *11 n.5 (S.D.N.Y. Sept. 27, 2013) (approval of press releases triggers section 10(b) liability; approval of high-level officers may be presumed at pleading stage pursuant to the group pleading doctrine); *In re* Satyam Computer Servs. Sec. Litig., 915 F. Supp. 2d 450, 477 (S.D.N.Y. 2013) (members of the board audit committee, along with corporate officers, made statements for *Janus* purposes); Touchtone Grp., LLC v. Rink, 913 F. Supp. 2d 1063, 1079 (D. Colo. 2012) (CFO and Chief Legal Officer jointly had ultimate authority); City of Pontiac Gen. Emp.'s Ret. Sys. v. Lockheed Martin Corp., 875 F. Supp. 2d 359, 375 (S.D.N.Y. 2012) (high-level nonsignatory is presumed, for pleading purposes, to have shared authority over corporate statement with other officers); *In re* Pfizer Inc. Sec. Litig., 936 F. Supp. 2d 252, 269 (S.D.N.Y. 2013) (evidence that top officers reviewed all press releases is sufficient to render them all ultimate authorities). In one case (not involving a fraud-on-the-market claim), where a financial advisor innocently repeated information he had been supplied as part of company training, the court held the company liable on the theory that corporate executives had overseen the training and thus were responsible for the broker's statements. *See* Richardson v. Oppenheimer & Co., No. 2:11-cv-02078-GMN0-PAL, 2014 WL 1304343, at *8 (D. Nev. Mar. 31, 2014).

104. In some post-*Janus* cases, courts have held that when a corporate agent acts with scienter to cause a false statement, the corporation may be liable even if the actor is not a "speaker" for *Janus* purposes. Yet, unlike the aggregation cases described in Part II.A, or even the situation in *Staub*, in two of the cases, the actors were quite high-level, thus providing further evidence that as a practical matter, courts are imposing organizational liability based on authority. *See* Curry v. Hansen Medical, Inc., No. C 09-5094 CW, 2012 WL 3242447, at *2 (N.D. Cal. Aug. 10, 2012) (one of only six corporate executives); Kerr v. Exobox Techs. Corp, No. H-10-4221, 2012 WL 201872, at *14 (S.D. Tex. Jan. 23, 2012) (sole shareholder and, later, 88% controlling shareholder). In *Lee v. Active Power, Inc.*, No. A-13-CA-797-SS, 2014 WL 3010679 (W.D. Tex. July 2, 2014), as well as *Hansen*, higher level corporate officers—including the CEO—were also implicated in the fraud, so the scienter of the behind-the-scenes employee ultimately was immaterial to corporate liability.

105. Though *Janus* has been applied equally to actions brought by the SEC as to private actions, it has more significance to private plaintiffs than to the SEC, for a variety of reasons. First, *Stoneridge* does not apply to SEC actions. SEC v. Richetelli, No. 3:09-cv-361 (CFD), 2010 U.S. Dist. LEXIS 68923 (D. Conn. July 12, 2010). Second, the SEC has explicit statutory authority to bring aiding and abetting claims. *See* 15 U.S.C. § 78t(e) (2012). Third, the SEC has a variety of other statutory options available to it when lower level employees manipulate corporate statements. *See* SEC v. Monterosso, 756 F.3d 1326, 1334 (11th Cir. 2014). Interestingly, however, despite *Janus*'s application to SEC actions, the Fourth Circuit declined to apply *Janus* to criminal actions. *See* Prousalis v. Moore, 751 F.3d 272, 279 (4th Cir. 2014).

inquiry into what it is about the section 10(b) cause of action—and, in particular, the context of open-market frauds—that causes courts to resist the application of agency principles.

One answer might simply be that courts doubt the merits of securities claims and the usefulness of securities class actions, and thus seek to narrow section 10(b) claims. There is a long history of courts deriding securities actions as "vexatious,"[106] and fraud-on-the-market class actions in particular may simply strain courts' ability to empathize with absent plaintiffs. In such cases, most members of the class have not lost enough money to justify an individual lawsuit, and the plaintiffs do not even claim the dignitary harm that might be associated with traditional fraud claims.[107]

Yet even if this is so, there are three interrelated features of the fraud-on-the-market action that likely drive these impulses: (1) the fact that open-market frauds differ from traditional frauds in ways that challenge the usual justifications for vicarious liability; (2) the fact that section 10(b) actions have come to resemble criminal actions in terms of their social meaning; and (3) the need to distinguish fraud claims from claims that appear to be more targeted at the general quality of corporate governance.

1. Many Instrumental Justifications for Vicarious Liability Do Not Apply to Section 10(b) Open-Market Claims

The first reason why courts are unwilling to look to lower level actors when identifying organizational fault is likely that they share the concern that commentators have discussed for over a decade: namely, that there is a poor fit between the traditional justifications for vicarious liability and the unique nature of open-market frauds under section 10(b).

As explained above, the typical justification for vicarious liability is that if the employer reaps the benefits of the agent's misconduct, that employer should also be forced to bear the costs.[108] But when it comes to open-market frauds, the corporation does not obtain the "fruits of violations" while externalizing the costs onto the public. The corporation's false statements may influence traders in the secondary market and cause them to misvalue the corporation's securities. But unless the corporation itself trades, the corporation does not earn any direct benefit from the

106. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739 (1975).

107. John C.P. Goldberg & Benjamin C. Zipursky, *The Fraud-on-the-Market Tort*, 66 VAND. L. REV. 1755, 1763–64 (2013).

108. *See supra* notes 25–26 and accompanying text.

Washington University Open Scholarship

fraud. Instead, the fraud most directly "benefits" secondary market traders, who are presumed to be uninvolved in, and unaware of, the misconduct.[109] Indeed, in situations where the corporation most directly benefits—i.e., when it issues new securities—the corporation may be subject to liability under section 11 of the Securities Act, which imposes strict liability on issuers.[110] At the same time, the persons who are recognized as "injured" under section 10(b) are not a separate population, but are the corporation's owners, who suffer when the truth is revealed and the value of their investment is diminished.[111]

The point may stretch even further. Because fraud-on-the-market actions are unlikely to compensate investors for their losses, such actions today are justified largely in terms of deterrence, as a means of enforcing the mandatory disclosure regime of the federal securities laws.[112] But the purposes served by the extensive federal disclosure system go beyond merely protecting against fraud, or even ensuring that investors make informed choices when buying and selling securities. Instead, mandatory

---

109. *See* Donald C. Langevoort, *Reading* Stoneridge *Carefully: A Duty-Based Approach to Reliance and Third-Party Liability Under Rule 10b-5*, 158 U. PA. L. REV. 2125, 2141–42 (2010). Thus, when commentators recommend eliminating entity liability in the section 10(b) context, they often make exceptions for situations where the company trades in its own shares. *See, e.g.*, Bratton & Wachter, *supra* note 10, at 75–76; Coffee, *supra* note 10, at 1556–57. Of course, the story is not quite so simple. The lack of *direct* benefit should not be taken to mean there are no benefits to the corporation of any kind; fraud firms may benefit from extensions of credit, both from lenders and suppliers, or may have an easier time retaining employees. *See* Velikonja, *supra* note 13, at 1925, 1936. They may also reap intangible benefits from increased prestige, such as greater influence over regulators. *Cf.* Adam Sorensen, *JPMorgan's Other Loss: A Voice for Regulatory Restraint*, TIME (May 14, 2012), http://swampland.time.com/2012/05/14/the-fall-of-jamie-dimon-washingtons-deregulation-squad-loses-credibility/#ixzz2mYNtVVDH, *archived at* http://perma.cc/R6GB-HV4U; Danielle Douglas & Steven Mufson, *JPMorgan Chase CEO Jamie Dimon's Complicated Relationship with Washington*, WASH. POST (Nov. 1, 2013), http://www.washingtonpost.com/business/economy/jpmorgan-chase-ceo-jamie-dimons-complicated-relationship-with-washington/2013/11/01/6806f9d4-3c3d-11e3-b6a9-da62c264f40e_story.html, *archived at* http://perma.cc/XBE7-D34A. Moreover, many corporations compensate employees with stock and stock options, and thus benefit from fraud in a way that may not be immediately obvious just by looking at the corporation's formal public distributions. That said, courts generally *perceive* fraud-on-the-market scenarios as offering few benefits to the corporation itself; they treat situations where there *are* specific benefits (such as the corporation's plan to affirmatively raise new capital) as departures from the norm warranting a different analysis. *See, e.g.*, *In re* Time Warner Inc. Sec. Litig., 9 F.3d 259, 270 (2d Cir. 1993).

110. *See* 15 U.S.C. § 77k(a) (2012). Similarly, section 14 of the Exchange Act, 15 U.S.C. § 78n (2012), which may come into play when an issuer uses its own artificially-inflated securities to affect corporate transactions, has been interpreted by many courts not to require scienter. *See, e.g.*, Beck v. Dobrowski, 559 F.3d 680 (7th Cir. 2009); Herskowitz v. Nutri/System, Inc., 857 F.2d 179 (3d Cir. 1988).

111. *See* Coffee, *supra* note 10, at 1556–61. As described below, the harms caused by securities fraud actually extend far beyond the corporation's immediate shareholders; however, section 10(b) itself does not provide any direct remedy for those injuries.

112. *See supra* notes 10–11 and accompanying text.

disclosure improves the allocation of resources across companies, with benefits felt across the economy.[113] Disclosure also facilitates the development of a deep and liquid trading market,[114] which in turn may spur growth and innovation.[115] Corporate disclosures also have an impact beyond the investment sphere, providing an important source of financial information for employees, competing firms, creditors, suppliers, customers, and even government actors making regulatory choices.[116]

As a result, when issuers disclose information pursuant to federal mandate, they are not merely engaged in an activity that generates private benefits or even one that prevents harm. They are also contributing to a public benefit that operates to improve society as a whole.[117] Though certainly each issuer reaps gains as a result of its access to the developed economy generated by such disclosures, on an individual basis, each issuer might very well have preferred to remain silent, at least as to some of the topics on which disclosure is required.[118] The more disclosures that corporations are obligated to make, the more avenues for private securities actions to enforce those obligations,[119] creating a symbiotic relationship between substantive regulation of corporate disclosures and private open-market section 10(b) actions. The size and scope of these actions, facilitated by the fraud-on-the-market doctrine makes them an effective regulatory tool. But with damages divorced from compensatory goals, and serving mainly a deterrent purpose—and with reporting obligations imposed on corporations that go well beyond fraud prevention and instead compel them to contribute to an affirmative public good—section 10(b) lawsuits stray far afield from the traditional instrumental justifications for vicarious liability.

In other areas of law, when the justifications for vicarious liability seem less appropriate, courts and commentators seek forms of "direct" liability that locate fault in the organization itself. The most prominent example is found within criminal law. It is often argued that civil regulatory liability is sufficient to deter corporate misbehavior and to force

113. Fox, *supra* note 10, at 312; John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984).

114. Fox, *supra* note 16, at 264.

115. JOHN C. COFFEE, JR. & HILLARY A. SALE, SECURITIES REGULATION: CASES AND MATERIALS 8 (12th ed. 2012).

116. *See* Velikonja, *supra* note 13, at 1933–38, 1945–47.

117. *See* Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1362–63 (1999).

118. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1548 (2007).

119. Thompson & Sale, *supra* note 12, at 904.

Washington University Open Scholarship

corporations to internalize the costs of their conduct; thus, an additional justification is needed to prosecute a corporation criminally. Typically, that justification is described in moral terms—a criminal conviction signals a *moral* judgment by society regarding the egregiousness of the corporation's behavior. In that context, however, agency principles do not capture the moral *fault* associated with criminal liability.[120] Thus, in the criminal context, there have been several proposals to determine liability based on fault within the corporation itself, via some fundamental flaw in the corporation's functioning, such as the existence of corporate policies and practices that cause the corporation to violate the law.[121] In practice, however, because it is rare for corporations to officially sanction lawbreaking, these "direct" forms of liability are often operationalized as actions taken by higher level corporate actors. For example, the Model Penal Code, variations of which have been adopted by twenty-four states,[122] requires that a corporation's board of directors or a "high managerial agent" have "authorized, requested, commanded, performed or recklessly tolerated" the offense before corporate liability may be imposed.[123] High managerial agents appear to be good proxies for organizational misconduct because they implement corporate policy; their actions may influence those of their subordinates, and they may be responsible for a corporate "tone" that encourages fraud.[124] Because "tone" may be a real phenomenon but is difficult to define in precise terms, high managerial fault works as a next-best solution.

When it comes to section 10(b), courts may well have the same impulse as scholars who have criticized vicarious liability in the open-market fraud context, detecting a mismatch between vicarious liability and

120. Samuel W. Buell, *The Blaming Function of Entity Criminal Liability*, 81 IND. L.J. 473, 526 (2006); William S. Laufer, *Corporate Liability, Risk Shifting, and the Paradox of Compliance*, 52 VAND. L. REV. 1343, 1366 (1999). Similarly, there is a tradition of limiting vicarious liability when an organization confers a public benefit. For example, at common law, charities had only limited liability for the acts of their agents; though that immunity has been abrogated by statutes in most states, it still persists in certain limited forms. *See generally* NONPROFIT RISK MGMT. CTR., STATE LIABILITY LAWS FOR CHARITABLE ORGANIZATIONS AND VOLUNTEERS (4th ed. 2001), *available at* https://www.nonprofitrisk.org/downloads/state-liability.pdf.

121. *See, e.g.*, WILLIAM S. LAUFER, CORPORATE BODIES AND GUILTY MINDS: THE FAILURE OF CORPORATE CRIMINAL LIABILITY (2006); Pamela H. Bucy, *Corporate Ethos: A Standard for Imposing Corporate Criminal Liability*, 75 MINN. L. REV. 1095 (1991).

122. *See* Christopher R. Green, *Punishing Corporations: The Food-Chain Schizophrenia in Punitive Damages and Criminal Law*, 87 NEB. L. REV. 197, 205 (2008).

123. Model Penal Code § 2.07(1)(c) (2001). Similarly, twenty-four states have adopted rules that in civil lawsuits, punitive damages may only be imposed when a managerial agent authorized the tort, or a principal ratified it. *See* Green, *supra* note 122, at 208.

124. Yair Berson et al., *CEO Values, Organizational Culture and Firm Outcomes*, 29 J. ORG. BEHAV. 615 (2008).

the policies that justify it. As a result they have, in practical effect, adopted a high-level authority rule that mimics the kinds of rules categorized as "direct" liability in other contexts.

The problem with this approach, however, as has often been observed in the criminal context, is that corporate misconduct is often the result of incentives and signals obliquely communicated to lower level employees, allowing top management to maintain plausible deniability;[125] a rule that focuses only on the actions of higher authorities "is apt to be, in practice, a rule of no liability at all."[126] And even when top management is uninvolved, lower level employees may still develop corrupt cultures that cause significant harm.[127] For these reasons, states that have adopted the Model Penal Code use a definition of "high management" that is very forgiving, often allowing anyone deemed an "officer," or who holds a supervisory role, to be equated with the corporation.[128]

Perhaps sensitive to these concerns, the Model Penal Code has not been adopted under federal law, where vicarious liability remains the official order of the day. Nonetheless, in the federal system, the search for organizational fault has shifted to other phases of the criminal prosecution. The U.S. Attorneys' Manual lists factors that federal prosecutors should consider when determining whether to prosecute a corporation, including "the pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management."[129] Similarly, the federal sentencing guidelines direct judges to consider markers of corporate culpability when setting penalties, such as the participation of high management and "pervasive" tolerance of the offense by "substantial authority personnel."[130] Though these are not

---

125. *See, e.g.*, Commonwealth v. Benefit Fin. Co., 275 N.E.2d 33, 82 (Mass. 1971); Bucy, *supra* note 121, at 1105; Buell, *supra* note 120, at 528–29 (criticizing models of institutional liability that focus solely on top management); Laufer, *supra* note 120, at 1413; John C. Coffee, Jr., *"No Soul to Damn, No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386, 398–400 (1981) (recognizing that top management may insulate itself from the tactics that lower level employees use to meet corporate expectations).

126. Kathleen F. Brickey, *Rethinking Corporate Liability Under the Model Penal Code*, 19 RUTGERS L.J. 593, 626 (1988).

127. Buell, *supra* note 120, at 528–29.

128. *See, e.g.*, People v. Lanzo Construction Co., 726 N.W.2d 746, 753–54 (Mich. Ct. App. 2006) (construction foreman supervising safety on job site); State v. Cmty. Alternatives Mo., Inc., 267 S.W.3d 735, 745–46 (Mo. Ct. App. 2008) ("lead staff person" for two group homes for mentally disabled, employed with a corporation that owned thirty homes); *see also* Sean Bajkowski & Kimberly R. Thompson, *Corporate Criminal Liability*, 34 AM. CRIM. L. REV. 445, 451 (1997) (the lower standard for "high managerial agent" "likely reflects a fear that a strict high managerial agent rule would make convictions so difficult that corporate criminal liability would be all but abolished").

129. UNITED STATES ATTORNEYS' MANUAL § 9-28.300(A)(2) (1997).

130. U.S. SENTENCING GUIDELINES MANUAL § 8C2.5 (2014).

Washington University Open Scholarship

liability rules, they do represent an attempt under federal law to impose a form of "direct" liability, tied specifically to higher level managers, because of the intuition that vicarious liability does not represent a good "fit" with criminal law.

Section 10(b), however, has no such equivalent. Either a company is liable for damages attributed to the fraud, or it is not; there is no sliding scale of fault. Moreover, private plaintiffs do not exercise the type of discretion that would be expected of a public prosecutor; they are not likely to determine whether a "policy" has been implemented, but instead will naturally try to expand the boundaries of corporate fault so long as damages are likely to exceed the costs of litigation. Thus, flexible standards are likely to be no standards at all, leaving courts dissatisfied with vicarious liability with only the extremely high-level authority rule they have, in practice, adopted.

2. Section 10(b) Has Taken on a More Expressive Role

Additionally, the mandatory disclosure regime, backed by the threat of liability under section 10(b), serves purposes that extend beyond economic regulation. The federal securities laws impose disclosure obligations that often seem geared toward what scholars have described as corporations' "publicness," namely, the responsibilities that they owe to the public as a result of their power and prominence in American life.[131] New demands have been placed on corporations to conduct themselves as accountable not just to their own investors, but to other stakeholders and the public generally.[132] For good or for ill, the federal securities laws have become the chief mechanism for accomplishing this, with an increasing number of regulations devoted to both ensuring the accuracy and completeness of public disclosures, and to forcing disclosure of internal arrangements and corporate conduct so as to enable greater public regulation and oversight.[133] Disclosure itself is a mechanism for improving a corporation's conduct as public citizens, by opening up the workings of the corporation to public scrutiny.

As the purposes of disclosure obligations change, so too does the meaning of the section 10(b) action. Just as criminal law serves an

131. *See, e.g.*, Hillary A. Sale, *Public Governance*, 81 GEO. WASH. L. REV. 1012, 1013–14 (2013); Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817, 1828 (2007); Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 378 (2013).

132. *See* Sale, *supra* note 131, at 1032–33.

133. *Id.* at 1017–32; Langevoort & Thompson, *supra* note 131, at 374.

expressive purpose—particularly when it comes to organizational defendants—section 10(b) actions have taken on an expressive role, both to enforce and develop public norms regarding corporate behavior.[134] Securities lawsuits can go beyond enforcing existing obligations by educating other firms, setting new standards of behavior that can ripple through an industry.[135] Yet, as described above, it is in the realm of criminal law that the imposition of vicarious liability is most challenged. Accordingly, courts appear to have a corresponding instinct to identify an organizational "fault," which is again interpreted to mean actions taken by the policymaking organs of the corporation: its highest managers.

3. Distinguishing Poor Corporate Governance from Fraud

Finally, the expansion of section 10(b) has posed a challenge for courts regarding the tension between section 10(b)'s doctrinal and practical roles. Traditionally, section 10(b) lawsuits and federal securities regulation generally have been reserved for regulation of corporate disclosures. Internal governance matters have been considered to be matters of state concern, and various specific laws, both state and federal, govern substantive corporate behavior.[136] But, as mandatory disclosure requirements have increased, the federal securities laws have come to resemble a type of "backdoor federalization of state corporation law."[137] By requiring extensive disclosures regarding a corporation's financial position, its plans, and its trends, the federal securities laws have become a mechanism for policing the quality of corporate governance by ensuring that managers exercise a certain duty of care,[138] facilitating informed voting by shareholders,[139] and enhancing the ability of outside directors to monitor managerial performance.[140] The consequence of this regime is that

134. Cox, *supra* note 11, at 7; Jonathan D. Glater, *Hurdles of Different Heights for Securities Fraud Litigants of Different Types*, 2014 COLUM. BUS. L. REV. 47, 61–62 (2014).

135. Jared Jennings et al., *The Deterrent Effects of SEC Enforcement and Class Action Litigation* (December 2011), *available at* http://ssrn.com/abstract=1868578; *see also* Elizabeth Chamblee Burch, *Securities Class Actions as Pragmatic Ex Post Regulation*, 43 GA. L. REV. 63, 114 (2008); Cox, *supra* note 11, at 7.

136. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 473–79 (1977).

137. Fisch, *supra* note 16, at 339 (describing the views of Professors Merritt Fox and Laurence Mitchell).

138. Thompson & Sale, *supra* note 12, at 903–05.

139. Fox, *supra* note 10, at 311.

140. *See* Thompson & Sale, *supra* note 12, at 873; *see also* Gordon, *supra* note 118, at 1541–61; Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047 (1995) (arguing that the disclosure regime of the federal securities laws was initially designed to combat agency costs).

Washington University Open Scholarship

every corporation is at risk of a securities fraud lawsuit if it conceals that the business was at least partially reliant on unethical or illegal activity. Courts may be limiting the use of vicarious liability principles as a way of distinguishing core "fraud" from other forms of corporate misconduct.

Section 10(b) claims are frequently premised on the allegation that the organization secretly engaged in some form of illegal or unethical activity unrelated to corporate disclosures, such as anticompetitive conduct;[141] or bribery of foreign officials;[142] or "kickbacks" to steer business to particular companies;[143] or the misuse of analyst reports to attract IPO business;[144] or off-label drug marketing;[145] or fraudulent sales of consumer financial products.[146] For these kinds of cases, the false statement that ostensibly triggers the section 10(b) violation—typically, a generic attribution of the company's profits to a legitimate business strategy—can seem like a fig leaf for a claim that, in truth, is based on corporate managers' failure to properly supervise and direct corporate activities.[147] By truncating the use of vicarious liability, courts set an outer limit on the degree to which antisocial corporate behavior can be reformulated into a section 10(b) violation.

Courts accomplish this by drawing sometimes rather strained distinctions between the mens rea likely to be harbored by lower level actors and the mens rea required for a section 10(b) violation. For example, in *Nordstrom*, the Ninth Circuit expressed doubt that lower level agents, such as the personnel director and public relations director, would be "aware of the requirements of SEC regulations and state law and of the 'danger of misleading buyers and sellers.'"[148] Similarly, the Fifth Circuit in *Zale* held that a mid-level executive who falsified internal financial results had "acted with the intent to maintain the good appearance of her department rather than to defraud investors," and thus did not harbor the kind of scienter required for section 10(b) liability to be imposed on the

141. *See, e.g.*, Chamberlain v. Reddy Ice Holdings, Inc., 757 F. Supp. 2d 683 (E.D. Mich. 2010).

142. *See, e.g.*, Glazer Capital Mgmt., LP v. Magistri, 549 F.3d 736 (9th Cir. 2008).

143. *See, e.g.*, *In re* Marsh & Mclennan Cos. Sec. Litig., 501 F. Supp. 2d 452 (S.D.N.Y. 2006).

144. *See, e.g.*, Lapin v. Goldman Sachs Grp., Inc., 506 F. Supp. 2d 221 (S.D.N.Y. 2006).

145. *See, e.g.*, *In re* Gilead Scis. Sec. Litig., 536 F.3d 1049 (9th Cir. 2008).

146. *See, e.g.*, *In re* Providian Fin. Corp. Sec. Litig., 152 F. Supp. 2d 814 (E.D. Pa. 2001).

147. For example, the false statement may be as simple as a representation of "compliance in all material respects with all laws," *Glazer*, 549 F.3d at 741 (internal quotation marks omitted), which seems less likely to truly influence investors than investors' own background assumptions about the regularity of business operations. *See generally* Alison B. Miller, Note, *Navigating the Disclosure Dilemma: Corporate Illegality and the Federal Securities Laws*, 102 GEO. L.J. 1647 (2014) (describing how obligatory disclosures may be rendered false by a failure to disclose uncharged criminal activity).

148. Nordstrom, Inc. v. Chubb & Son., Inc., 54 F.3d 1424, 1436 (9th Cir. 1995).

corporation.[149] In *Plichta v. SunPower Corp.*,[150] the court dismissed a complaint alleging that mid-level executives had falsified accounting entries, because, in the court's view, "[t]he question . . . is *not* whether one or more SunPower accounting department employees intended to mislead someone when preparing journal entries, but whether the corporation and management intended to mislead potential investors when they relied on that information and incorporated it in the various SEC filings . . . ."[151]

If these decisions are questionable—someone who knowingly manipulates internal accounting entries is likely aware that his actions will mislead investors, or at least is recklessly indifferent to the possibility—in other cases, it may be difficult to distinguish scienter with respect to section 10(b) specifically from scienter with respect to other forms of corporate misconduct. When lower level actors are responsible for antitrust violations or illegal marketing schemes or improper charges to vendors, they no doubt hoped to increase the corporation's bottom line, and almost certainly had at least some perception that "the numbers" would be publicly reported. In such circumstances, by ignoring lower level mens rea, courts avoid the necessity of having to parse the precise nature of the lower level actors' awareness and risk expanding section 10(b) into an all-purpose good-corporate-citizen statute.[152]

149. Pipefitters Local No. 636 Defined Benefit Plan v. Zale Corp., 499 Fed. App'x 345, 351 (5th Cir. 2012) (unpublished).

150. 790 F. Supp. 2d 1012 (N.D. Cal. 2011).

151. *Id.* at 1017; *see also* Hill v. Tribune Co., Nos. 05 C 2602, 05 C 2927 & 06 C 0741, 2006 WL 2861016, at *8 (N.D. Ill. Sept. 29, 2006), *aff'd sub nom.* Pugh v. Tribune Co., 521 F.3d 686 (7th Cir. 2008) (no organizational liability because mid-level officer only harbored scienter to "inflat[e] circulation numbers in order to charge higher advertising rates" and not to "deceiv[e] the investing public").

152. *ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187 (2d Cir. 2009) serves as another example of how courts use scienter on an ad hoc basis to distinguish mismanagement cases from fraud cases. The plaintiffs alleged that JP Morgan Chase had defrauded its own shareholders by concealing its risky role in the Enron fraud—a role that, when revealed publicly, caused a significant drop in JP Morgan's share price. These allegations are exactly the sort that could easily strike a court as being an attack less on JP Morgan's deceit than on its substantively unethical business practices. Nonetheless, the plaintiffs did identify specific false statements: among other things, the plaintiffs claimed that JP Morgan helped Enron conceal its outstanding debt by disguising loans to Enron as trades, which forced both Enron and JP Morgan to improperly account for the transactions. *See id.* at 194. In rejecting the plaintiffs' claims, the Second Circuit held that the plaintiffs "fail[ed] to show an intent to defraud JPMC's shareholders rather than Enron's shareholders." *Id.* at 203. The Second Circuit's narrow approach to scienter—defining it as an intent to harm a specific group of shareholders—stands in sharp contrast to the usual definition, which includes an intent to *mislead*, regardless of whether any harm is intended. *See, e.g.*, *In re* Level 3 Commc'ns, Inc. Sec. Litig., 667 F.3d 1331, 1344 (10th Cir. 2012) (defining scienter as '"an intent to deceive or a reckless indifference to whether the statements were misleading'" (quoting Makor Issues & Rights, Ltd. v. Tellabs, Inc., 513 F.3d 702, 709 (7th Cir. 2008))).

Causation has a role to play here, as well. It is precisely because there is a relatively distant causal nexus between the lower-level actors' behavior and the ultimate false statement that lower-level actors' precise intentions seem impossible to discern. Thus, it is not surprising that when imposing its "supercausation" rule in *Stoneridge*, the Supreme Court cited, among other things, a fear of employing "the federal power . . . to invite litigation beyond the immediate sphere of securities litigation and in areas already governed by functioning and effective state-law guarantees."[153] Courts' curtailment of vicarious liability—that is, their refusal to allow lower-level actors' actions and intentions to be imputed to the corporation—served the same purpose even before *Stoneridge* was decided.

Relatedly, vicarious liability is only supposed to be imposed when the agent acts for the principal's benefit. But employees who filter false information up the reporting chain may seem to be doing so to preserve their own salaries or jobs, or to obtain bonus payments and other undeserved rewards from the corporation. Though these motives are not sufficient to defeat the agency relationship as a formal matter,[154] they may still strike courts as suggesting less the intent to mislead investors on the corporation's behalf than the intent to defraud the corporation itself.[155] Once again, the fear that section 10(b) intent cannot be distinguished from other kinds of malicious intent when it comes to lower level actors seems to be driving courts to adopt the rather blunt approach of simply disregarding these actors' intent entirely.[156]

---

153. Stoneridge Inv. Partners, LLC v. Scientific-Atl., Inc., 552 U.S. 148, 161 (2008).

154. *See* FDIC v. Shrader & York, 991 F.2d 216, 223–26 (5th Cir. 1993); Kirschner v. KPMG LLP, 938 N.E.2d 941, 951–63 (N.Y. 2010).

155. *See, e.g.*, *In re* Cendant Corp. Sec. Litig., 109 F. Supp. 2d 225, 233–34 (D.N.J. 2000) (denying motion for summary judgment against corporate defendant: '"[A] reasonable trier of fact could conclude that the true motive of the wrongdoers was the preservation of their employment, salaries, emoluments, and reputations, as well as their liberty, at the expense of [the corporation's] well-being'" (quoting *In re* Phar-Mor, Inc. Sec. Litig., 900 F. Supp. 784, 787 (W.D. Pa. 1995))); *see also* Buell, *supra* note 120, at 533:

> The difficult problem of fraud-on-the-market cases suggests a need to develop proper baselines for measuring an agent's intent to benefit her firm. One might view an agent's parity of self-interest with the short-term interests of the firm, but not with the long-term interests of the firm, as a case of self-interest, not firm interest.

cf. Pugh v. Tribune Co., 521 F.3d 686, 698 (7th Cir. 2008) (actions of officer of subsidiary corporation could not be imputed to parent because the officer acted to increase wholly-owned subsidiary's income, which the court distinguished from an intent to benefit the parent).

156. Notably, in the context of sexual harassment claims under Title VII, the Supreme Court has departed from a pure regime of respondeat superior in part because of its distrust that harassers act to benefit their employers, rather than out of personal animus or for personal gratification. *See* Burlington Indus., Inc. v. Ellerth, 524 U.S. 742, 756–57 (1998)

The problem of identifying whether an agent held the precise mens rea required for the offense is not unique to section 10(b), but may be an issue in any form of "cat's paw" liability.[157] But because section 10(b) is (theoretically) confined to fraud in connection with securities laws, and set off from other areas of corporate governance, the problem apparently looms large in courts' concerns.

4. The Puzzle of Secondary Actors

Viewing courts' approach to organizational scienter through this lens also helps explain another phenomenon—the fact that a different set of rules applies when courts examine the section 10(b) liability of secondary actors, such as underwriters and auditing firms.

After the *Central Bank* line of cases, secondary actors may only be liable when they personally issue false statements or engage in deceptive conduct communicated directly to the market, such as when an auditor falsely issues a clean audit opinion. Curiously, however, when *organizational* secondary actors are defendants, courts almost never search for a single agent whose knowledge may be imputed to the firm, let alone a high-level agent; instead, they are willing to gauge the firm's conduct as a whole (or at least the conduct of the particular team assigned to the issuer's account) to determine whether it evidences scienter. As the Second Circuit put it in the context of an audit firm defendant, "the requisite [organizational] intent exists '[w]hen it is clear that a scheme, viewed broadly, is necessarily going to injure,'" a standard that would be met "where a large entity, firm, institution, or corporation is acting in a manner that easily can be foreseen to result in harm."[158] One court even

157. For example, in *U.S. ex rel. Harrison v. Westinghouse Savannah River Co.*, 352 F.3d 908 (4th Cir. 2003), the Fourth Circuit held that an organization could be held liable under the False Claims Act (FCA) if one employee was aware of a conflict of interest on a government contract, while another employee submitted a false certification declaring that no such conflict existed. In the court's view, even though the employee with knowledge of the conflict was unaware of the false certification, awareness of the conflict itself constituted sufficiently guilty knowledge to trigger FCA liability, and thus was not comparable to aggregating "innocent" knowledge. Harrison v. Westinghouse Savannah River Co., 176 F.3d 776, 793 (4th Cir. 1999). In so holding, the court elided the core problem: under the FCA, the statutory wrongful conduct was not the conflict, but the false certification. *Id.* at 919. A similar situation arose in *Grand Union Co. v. United States*, 696 F.2d 888 (11th Cir. 1983). The Eleventh Circuit held that the mens rea of grocery store cashiers who accepted foodstamps as payment for ineligible items could be combined with the false certification submitted by a different employee when determining FCA liability. *Id.* at 890–91. Although there was evidence that the cashiers were aware that they had accepted ineligible items, there was no apparent evidence that the cashiers were specifically aware of the false certifications.

158. AUSA Life Ins. Co. v. Ernst & Young, 206 F.3d 202, 220, 221 (2d Cir. 2000) (second brackets in original) (quoting United States v. Chacko, 169 F.3d 140, 148 (2d Cir. 1999)).

Washington University Open Scholarship

went so far as to explicitly hold that the scienter of an audit firm can be shown "through a cumulative pattern of decisions and inaction," even if no individual auditor behaves with scienter.[159]

With this approach, courts are not concerned with the relative rank of any particular employee involved in the fraud. To the contrary, courts locate scienter *not* in the mind of any single actor, high-or low-level, but in the firm's overall functioning—exactly the type of "direct" organizational liability that theorists have long sought in the criminal context.[160] Critically, however, these standards are almost never applied to primary actors. They appear to be uniquely associated with secondary actors, even in situations where the primary actor also has been "acting in a manner that easily can be foreseen to result in harm."[161]

There are two related reasons for this disparate treatment. First, when a secondary actor assists with an issuer's fraud—for example, falsely certifying an issuer's financial statements—there is a direct benefit to that actor, in the form of the fees from the issuer and the maintenance of the business relationship. Moreover, the harm caused by a secondary actor is not to its own shareholders or owners, but to the owners of the issuer, so that the secondary actor, much more than the issuer, is externalizing the cost of its business onto innocent parties. Thus, the traditional justifications for vicarious liability have more of a role to play, which, at the very least, likely makes courts less wary of looking to lower level actors when identifying organizational fault. Ironically, courts' disregard of employee rank in this context ultimately results in a more holistic view of the firm, if only because low-level employees rarely act alone; thus, courts' willingness to consider lower ranking employees when

159. *In re* WorldCom, Inc. Sec. Litig., 352 F. Supp. 2d 472, 499 (S.D.N.Y. 2005); *see also* Gould v. Winstar Commc'ns, Inc., 692 F.3d 148, 159 (2d Cir. 2012); *In re* Suprema Specialties, Inc. Sec. Litig., 438 F.3d 256, 280–81 (3d Cir. 2006) (scienter alleged against auditing firm; no allegations regarding specific auditors); *In re* MicroStrategy, Inc. Sec. Litig., 115 F. Supp. 2d 620, 656 (E.D. Va. 2000) (same); *In re* Initial Pub. Offering Sec. Litig., 241 F. Supp. 2d 281, 360–62 (S.D.N.Y. 2003) (scienter alleged against investment banks; no allegations regarding specific personnel). Indeed, in *New Mexico State Investment Council v. Ernst & Young LLP*, 641 F.3d 1089 (9th Cir. 2011), the Ninth Circuit explicitly rejected what it called a "right hand, left hand" defense and allowed a section 10(b) case to proceed against an auditing firm, regardless of whether the particular personnel who worked on the audit were aware of "red flags" that had been communicated to different personnel. *Id.* at 1099.

160. *See supra* Part II.C.1.

161. *AUSA Life Ins.*, 206 F.3d at 221. For example, in *Teamsters Local 445 Freight Division Pension Fund v. Dynex Capital Inc.*, the plaintiffs alleged wholesale corruption in the firm's approach to purchasing and securitizing mortgages, yet the Second Circuit held that scienter must exist in the mind of a specific culpable agent in order for the firm to be liable under section 10(b). 531 F.3d 190, 193–95 (2d Cir. 2008).

determining the scienter of a secondary-actor organizational defendant translates into an evaluation of the firm on a broad scale.

But this holistic view of the firm highlights an important distinction between secondary actors and primary actors: When an auditor or an underwriter behaves in a manner that indicates wide-scale corruption, its conduct is necessarily aimed directly at investors. Underwriters exist to bring securities to the market and auditors exist to communicate with investors and provide assurances regarding the quality of issuer earnings. Thus, in most cases involving secondary actors, there is no risk of further blurring the line between fraud and generalized corporate misconduct. When it comes to issuers, however, it is a far more complex task to distinguish widespread corruption throughout the organization that is specifically aimed at investors from generalized corporate misconduct aimed at improving profits.

III. SECTION 10(B) AND DIRECT ORGANIZATIONAL LIABILITY

As the above discussion demonstrates, recent Supreme Court developments, as well as precedent from the lower courts, strongly suggest that the liability of an organizational defendant in an open-market section 10(b) action depends solely on the conduct of its highest level authorities. Thus, the debate about organizational vicarious liability under section 10(b) must be reopened. In the wake of *Central Bank*, defenders of agency liability argued that unlike aiding and abetting liability, which imposes liability for conduct the Supreme Court deemed outside the scope of the statute, agency liability merely shifts the costs of prohibited conduct from the employee to the employer.[162] But this is not true. To the extent there was any doubt, *Stoneridge* and *Janus* have made clear that where one agent has final authority over a corporate statement, and another harbors the relevant mens rea, vicarious liability does not merely cost-shift, but creates liability against the corporation that would not exist against either employee alone.

Courts have also justified the continued use of vicarious liability as necessary to give effect to statutory provisions that explicitly subject organizations to section 10(b).[163] But this is not true, either: as Professor

162. *See* AT&T Co. v. Winback & Conserve Program, Inc., 42 F.3d 1421, 1430–31 (3d Cir. 1994); Prentice, *supra* note 56, at 1350–51.

163. *See, e.g.*, Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 101 (2d Cir. 2001); Paul F. Newton & Co. v. Tex. Commerce Bank, 630 F.2d 1111, 1118 (5th Cir. 1980) (citing SEC v. Mgmt. Dynamics, Inc., 515 F.2d 801, 812 (2d Cir. 1975)); *In re* Centennial Techs. Litig., 52 F. Supp. 2d 178, 185 (D. Mass. 1999); *see also* Prentice, *supra* note 56, at 1354–55. Courts have also

Washington University Open Scholarship

Fischel argued, organizational liability under section 10(b) can be imposed directly, via something like an "ultimate authority" rule, in the form of authorization by the board of directors.[164] Significantly, Professor Fischel's argument was rooted in the notion that vicarious liability expanded liability beyond what was permitted in section 20(a)—the very section that the Supreme Court cited when making a similar argument to reject the plaintiffs' claims in *Janus*. And in fact, there is precedent for imposing direct liability by tying organizational fault to the actions of individuals with—as *Janus* put it—"ultimate authority" to take action. That precedent is civil rights litigation against municipal defendants under 42 U.S.C. § 1983, originally from the Civil Rights Act of 1871.[165]

A. Organizational Liability Under § 1983

Section 1983 provides a cause of action to any person who has been subjected to a "deprivation of any rights, privileges, or immunities secured by the Constitution and laws" that occurs "under color of" state law.[166] In essence, the statute provides a cause of action to victims of civil rights violations. In *Monell v. Department of Social Services*,[167] the Supreme Court held that while municipalities, as well as natural persons, could be liable under § 1983, vicarious liability principles would not apply to municipalities. Instead, municipalities would be liable only where the municipality itself could be said to be responsible for the plaintiff's injury. This would occur, according to the Court, when the injury was inflicted as a result of "a government's policy or custom" as created by "lawmakers or by those whose edicts or acts may fairly be said to represent official policy"[168] This "policy or custom" test is meant to distinguish acts of employees from the acts of the municipality.[169]

In subsequent cases, the Court elaborated that a government "policy or custom" is an official or unofficial action that is traceable to persons who

imposed respondeat superior liability on the theory that Congress intended, at the very least, to incorporate rights at common law. *See, e.g.*, Commerford v. Olson, 794 F.2d 1319, 1323 (8th Cir. 1986); Paul F. Newton, 630 F.2d at 1118. In *Stoneridge*, however, the Supreme Court rejected the use of common law to interpret section 10(b)'s scope. Stoneridge Inv. Partners, LLC v. Scientific-Atl., Inc., 552 U.S. 148, 162 (2008).

164. *See* Fischel, *supra* note 51, at 107 n.145.

165. *Cf.* Prentice, *supra* note 56, at 1348 (highlighting the similarities between *Monell* and Fischel's proposal).

166. 42 U.S.C. § 1983 (2012).

167. 436 U.S. 658 (1978).

168. *Id.* at 694.

169. Pembaur v. City of Cincinnati, 475 U.S. 469, 481–82 (1986).

possess "final authority" to create policy with respect to the designated area.[170] The Court has identified three types of policies or customs on which municipal liability may be predicated: officially promulgated "on the books" policies (which necessarily will implicate the persons with final authority to create policy); individual actions authorized by persons who "possess[] final authority to establish municipal policy with respect to the action ordered;"[171] and unofficial custom, defined to mean "practices so persistent and widespread as to practically have the force of law"[172] of which "[a]ctual or constructive knowledge" may be attributed to persons who possess policymaking authority.[173] As the Supreme Court put it in *Jett v. Dallas Independent School District*,[174] municipal liability under § 1983 may be imposed only when final policymaking authorities either "caused the deprivation of rights at issue by policies which affirmatively command that it occur, or by acquiescence in a longstanding practice or custom which constitutes the standard operating procedure of the local governmental entity."[175] In other words, municipal liability under § 1983 bears a striking resemblance to the *Janus* test, which designates the "maker" of a statement as the person with "ultimate authority" over it.

Though *Monell* has been described as just another form of respondeat superior—"respondeat superior 'plus,'" in the words of Larry Kramer and Alan Sykes[176]—it represents a systematic attempt under federal law to identify a form of organizational liability distinct from vicarious principles. And, similar to *Janus*, it distinguishes official action from unofficial action based on an "ultimate authority" rule.[177] Notably, there is even a body of case law that applies *Monell*-style liability standards to private corporations: although the issue has come under scholarly fire,

---

170. *Id.* at 480–81.

171. *Id.*

172. Connick v. Thompson, 131 S. Ct. 1350, 1354 (2011) (citing *Monell*, 436 U.S. at 691).

173. Nobby Lobby, Inc. v. City of Dallas, 970 F.2d 82, 92 (5th Cir. 1992) (citing Bennett v. City of Slidell, 735 F.2d 861, 862 (5th Cir. 1984)).

174. 491 U.S. 701 (1989).

175. *Id.* at 737 (internal quotation marks omitted).

176. *See* Larry Kramer & Alan O. Sykes, *Municipal Liability Under § 1983: A Legal and Economic Analysis*, 1987 SUP. CT. REV. 249, 254; *see also* Prentice, *supra* note 56, at 1417.

177. In theory, *Monell* liability is not terribly dissimilar from the types of liability imposed under the Model Penal Code or proposed by various scholars, as described above. That is, the test locates "corporate" actions either in the acts of high-level officials or in widespread corporate conduct. Nonetheless, the specifics of how *Monell* is applied in practice differ quite significantly from these tests. Most notably, *Monell* is quite strict about who counts as a "policymaker," whereas jurisdictions that follow the Model Penal Code have defined "high management" very loosely. As Professor Achtenberg observed, the test for organizational liability under *Monell* is unheard-of in any other area of law. *See* Achtenberg, *supra* note 25, at 2191.

Washington University Open Scholarship

most courts agree that when private contractors agree to perform state functions (such as run prisons), they may be sued only under standards applicable to municipalities, and will only be liable if *Monell*'s tests are satisfied.[178] Or, to put it another way, contrary to the arguments put forth by defenders of vicarious liability in the context of section 10(b), it is *not* true that organizational liability can only be premised on agency principles, at least not as those are traditionally understood.

B. Section 10(b) and § 1983: Similar Means to Similar Ends

If courts are eliminating vicarious liability in section 10(b) cases specifically due to the changing nature and purposes of the section 10(b) cause of action, similar motivations have provided the impetus for the elimination of vicarious liability under § 1983.

First, the instrumental justifications for vicarious liability are less applicable in the context of actions against municipalities. Local governments, unlike private companies, do not receive the "benefits"of their activity in the form of profits; thus, the argument that one who obtains the economic benefits should also pay the economic costs has less, or no, application.[179] Additionally, the "harms" of misconduct by local governments fall on the entity itself (i.e. its own citizens), so that local government misconduct is not akin to a business that externalizes the cost of operations onto others.[180] As Professor Frankel explains,

> [T]he fairness rationale for respondeat superior, that the entity that enjoys the profits of its employees' labor also should bear the risk of their misconduct, carries less force in the public sector than in the private sector. Although in both cases the fairness rationale supports providing full compensation for an injured victim, public entities are not motivated by profit, and it is the general populace that

178. *See, e.g.*, Johnson v. Karnes, 398 F.3d 868, 877 (6th Cir. 2005); Austin v. Paramount Parks, Inc., 195 F.3d 715, 729 (4th Cir. 1999); *see also* Richard Frankel, *The Failure of Analogy in Conceptualizing Private Entity Liability Under Section 1983*, 78 UMKC L. REV. 967 (2010); Barbara Kritchevsky, *Civil Rights Liability of Private Entities*, 26 CARDOZO L. REV. 35 (2004).

179. Myriam E. Gilles, *In Defense of Making Government Pay: The Deterrent Effect of Constitutional Tort Remedies*, 35 GA. L. REV. 845, 863–67 (2001) (arguing that, given the different incentives faced by government actors, the restrictions on vicarious liability imposed by *Monell* are well-calculated to ensure that constitutional tort lawsuits have a deterrent effect); Richard Frankel, *Regulating Privatized Government Through § 1983*, 76 U. CHI. L. REV. 1449, 1484–92 (2009) (describing the ways that governments may not respond to ordinary tort incentives the same way that private, wealth-maximizing firms do).

180. Kramer & Sykes, *supra* note 176, at 278–79.

> ultimately benefits from the labor of government employees rather than a group of private investors or shareholders.[181]

Similarly, for open-market section 10(b) frauds, no direct benefits accrue to the corporation (unless it simultaneously trades in its own securities), and the harms (at least, those compensable by the section 10(b) action) fall upon the corporation's own shareholders, i.e., members of the corporate "polity."

To be sure, neither statute is quite so simple. For example, in the § 1983 context, some types of civil rights violations may fall unequally on certain members of the polity (the poor, racial minorities, etc), or even on persons who are not members of the polity at all (immigrants), which may incentivize some voters to externalize costs at the expense of others.[182] Similarly, in the section 10(b) context, shareholders who trade during the fraud period may actually benefit from the fraud, while shareholders who maintain their holdings ultimately bear its costs.[183] Nonetheless, both causes of action challenge the traditional justifications for vicarious liability in ways that make it easy to infer that courts are driven by similar policy impulses in the two contexts.

Second, the obligations imposed on municipalities are intended to benefit the general public; they are governmental responsibilities with benefits felt throughout the polity. Similarly, the disclosure obligations now imposed on corporations have also taken on a quasi-governmental character that is intended to both benefit the general public and expose the corporation's operations to public scrutiny.[184] As described above, disclosure duties are imposed not simply to protect the corporation's security holders, but to improve the functioning of the "real economy,"[185] and to force corporations to adhere to norms of "social legitimacy" due to their power and role in society.[186] In other words, in exchange for gaining access to public financing, corporations are required to shoulder certain responsibilities—the responsibilities of disclosure, paired with section 10(b) liability—that have public purposes: to improve market

181. Frankel, *supra* note 179, at 1490.

182. Kramer & Sykes, *supra* note 176, at 279.

183. Such "holding" shareholders not only suffer as a result of the fraud itself, but also bear the costs of liability for a suit to which they do not have standing to bring a claim. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

184. Langevoort & Thompson, *supra* note 131, at 374; Sale, *supra* note 131, at 1032–34.

185. Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1415 (1999); *see also* John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 722 (1984).

186. Langevoort & Thompson, *supra* note 131, at 378.

Washington University Open Scholarship

functioning, to improve allocations of resources across the economy, and to allow for public scrutiny and control.[187] Corporations are thus increasingly treated—like municipalities—as public, rather than private actors.[188]

Finally, and most strikingly, in the § 1983 context, limitations on vicarious liability are used as a pressure point to effect a more substantive limitation, namely, to distinguish constitutional violations (a matter of federal concern) from ordinary torts (which are reserved for state law), just as limitations on vicarious liability in the section 10(b) context are used to distinguish governance claims (a matter of state concern) from federal fraud. This is not facially evident from § 1983 doctrine itself—that doctrine requires that there be a constitutional violation before any inquiry can be made into a municipality's liability for it[189]—but as a practical matter, the motivation for limiting municipalities' vicarious liability appears to have been borne of a desire to distinguish matters of constitutional concern from garden-variety state tort matters.

To see why, it is necessary to trace the history of municipal liability under § 1983. In *Monroe v. Pape*,[190] the Supreme Court held that local governments were not "persons" for the purposes of the statute, and thus were immune from liability.[191] At the same time, the Court held that even unauthorized actions by government actors are taken "under color of law" for statutory purposes, and thus may form the basis of a claim against the actor individually.[192] The Court reasoned that any other interpretation would allow states to disclaim responsibility for widespread, but informal, policies of violating federal rights.[193]

Justice Frankfurter dissented. He believed that unauthorized torts committed by state actors could be dealt with satisfactorily within the confines of state tort law.[194] Rather than adopt a prophylactic policy of allowing even unauthorized torts committed by state actors to form the basis of a claim, he believed that § 1983—and thus federal law—should only be invoked where it could be shown that a formal or informal state policy permitting or immunizing the offending conduct blocked the

---

187. Fox, *supra* note 10, at 310–13 (market functioning); Gordon, *supra* note 118, at 1508 (resource allocation); Sale, *supra* note 131, at 1032–34 (public scrutiny and control).

188. Sale, *supra* note 131, at 1032; Langevoort, *supra* note 131, at 1829.

189. *See* Collins v. City of Harker Heights, 503 U.S. 115, 120 (1992).

190. 365 U.S. 167 (1961).

191. *Id.* at 187.

192. *Id*.

193. *Id.* at 173–74.

194. *Id.* at 239 (1961) (Frankfurter, J. dissenting).

plaintiff from obtaining redress under local law.[195] In Justice Frankfurter's view, the extension of § 1983 to torts for which states could and did fashion local remedies "makes the extreme limits of federal constitutional power a law to regulate the quotidian business of every traffic policeman, every registrar of elections, every city inspector or investigator, every clerk in every municipal licensing bureau in this country."[196]

In *Monell*, the Supreme Court reversed *Monroe v. Pape*'s holding that local governments were immune from liability under § 1983.[197] At the same time, however, it held that local governments would not be vicariously liable for the unauthorized torts of their agents, and instead, would only be liable for actions taken pursuant to an official policy or custom.[198] In so doing, the Court, in practical effect, "adopt[ed] the very limitation on municipal liability for section 1983 actions that Justice Frankfurter, in his *Monroe* dissent, had advocated to be applied to all government-level liability."[199] In other words, the Court used the doctrines of vicarious and direct organizational liability to accomplish what Justice Frankfurter had earlier urged: to draw a distinction between matters fit for local regulation and matters of federal constitutional concern. Professor David Achtenberg points out that this was no accident: Justice Powell, the swing Justice in *Monell*, sought the restrictions on vicarious liability precisely because he believed that Justice Frankfurter had the better of the argument in *Monroe*.[200]

195. *Id.* at 235.

196. *Id.* at 242.

197. Monell v. Dep't of Soc. Servs., 436 U.S. 658 (1978).

198. *Id.* at 690–91.

199. Paul F. Wingenfeld, Note, *Section 1983 and the* Parratt *Doctrine After* Zinermon v. Burch: *Ensuring Due Process or Turning the Fourteenth Amendment into a 'Font of Tort Law,'* 39 CLEV. ST. L. REV. 445, 452 (1991).

200. David Jacks Achtenberg, *Frankfurter's Champion: Justice Powell,* Monell*, and the Meaning of "Color of Law*," 80 FORDHAM L. REV. 681, 682 (2011); *see also* Jones v. Preuit & Mauldin, 851 F.2d 1321, 1336–38 (11th Cir. 1988) (Vance, J., dissenting) (citing rejection of vicarious liability for municipalities as one of several methods that the Supreme Court has used to attempt to distinguish constitutional torts from ordinary torts); Christina B. Whitman, *Government Responsibility for Constitutional Torts*, 85 MICH. L. REV. 225, 247–48 (1986) ("The effort to distinguish constitutional torts from ordinary torts has led, in suits against individuals, to an insistence that the wrong be somehow more egregious than that ordinarily remedied through tort. That requirement has been carried over to suits against institutions, where an additional effort to distinguish constitutional torts has led to the rejection of vicarious liability."); Susan Bandes, Monell*,* Parratt*,* Daniels*, and* Davidson*: Distinguishing a Custom or Policy from a Random, Unauthorized Act*, 72 IOWA L. REV. 101, 104 (1986) (explaining that, properly interpreted, *Monell*'s rejection of vicarious liability, coupled with the definition of due process set forth in other cases, work together to "provide an accurate way of relegating common-law tort claims to state court, while preserving the federal forum for constitutional violations by the state"). The Supreme Court has tacitly admitted that its conception of "direct" municipal liability under *Monell* is intended to distinguish matters of constitutional concern from

Washington University Open Scholarship

This is, of course, precisely what appears to motivate courts in the section 10(b) context. Just as with § 1983, courts focus on the conduct of higher level actors as a mechanism for distinguishing garden-variety mismanagement (a matter of state law concern) from federal securities fraud.[201]

To be sure, federalism concerns have a different tenor in the § 1983 context as compared to the section 10(b) context. In the § 1983 context, there is a special solicitude for the states' autonomous decisions regarding the hiring and regulation of their own agents that is not present under section 10(b). Under both statutes, however, federalism has a dimension tied to efficiency—the sense that local regulators can make more informed choices, with greater room for tailoring and experimentation, than can the more distant federal government.[202] That concern is reflected in the interpretations of both statutes.

In fairness, there are several reasons why one might argue that *Monell*-style liability is inappropriate for section 10(b) litigation. *Central Bank* encouraged courts to interpret the statute by reference to how Congress would have decided the question when the Act was passed,[203] and respondeat superior liability was a "well-understood workhorse[] of business law" in 1934.[204] Similarly, when the 1975 Congress reworded the definition of "person" in the Exchange Act and reaffirmed its application to organizations,[205] it could not have expected that organizational liability

---

matters better left to state regulation. As the Court explained in *Board of County Commissioners of Bryan County v. Brown*, 520 U.S. 397 (1997), "[a] failure to apply stringent culpability and causation requirements [to distinguish direct from vicarious municipal liability] raises serious federalism concerns, in that it risks constitutionalizing particular hiring requirements that States have themselves elected not to impose." *Id.* at 415.

201. *See supra* Part II.C.3; *cf.* Nat Stern, *The Constitutionalization of Rule 10b-5*, 27 RUTGERS L.J. 1 (1995) (recognizing that under both section 10(b) and in a variety of areas of constitutional law, the Supreme Court defines substantive rights in part by reference to whether state law provides an alternative remedy).

202. Experimentation and decentralization have often been touted as one of the virtues of federalism. *See, e.g.*, Gregory v. Ashcroft, 501 U.S. 452, 458 (1991) (federalism "assures a decentralized government that will be more sensitive to the diverse needs of a heterogenous society; it increases opportunity for citizen involvement in democratic processes; it allows for more innovation and experimentation in government; and it makes government more responsive by putting the States in competition for a mobile citizenry."). In the corporate context, the ability of states to "compete" for charters and to innovate in the development of the law is often touted as one of the law's greatest strengths. *See, e.g.*, Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 290 (1977).

203. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 173 (1994).

204. Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. CIN. L. REV. 1187, 1228 (2003).

205. *See supra* note 6.

would depend on a doctrine that would not exist for another three years. In 1995, when Congress passed the PSLRA and dealt directly with the conduct of private suits, vicarious liability had been accepted in a majority of the circuits.[206] If anything, the 1995 Congress believed that the mens rea of a nonspeaking actor would be combined with the mens rea of the speaker, because it passed a special rule preventing such aggregation only in a specific circumstance: when the statement qualifies as "forward-looking," and thus is subject to special protections.[207] Finally, though the Supreme Court has held that the private section 10(b) action ought to be given a "narrow" construction due to its origin as an implied right of action,[208] the Court has also acknowledged that the PSLRA "ratified the implied right of action,"[209] which counsels in favor of at least looking to 1995 jurisprudence when interpreting the statute. In 1995, Congress could barely have understood how *Central Bank* would be interpreted,[210] let alone have predicted the adoption of a "final authority" rule for assessing corporate liability.[211]

That said, it is difficult to avoid noticing the similarities between *Monell* and *Janus* jurisprudence, as well as the contextual similarities outlined above. Though *Monell* on first blush appears to be rooted in the language of § 1983 and its particular legislative history,[212] in fact, § 1983 has been interpreted more as a source of authorization for federal common

206. *See* Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1576 n.27 (9th Cir. 1990) (en banc) (citing cases).

207. *See* 15 U.S.C. § 78u-5 (2012).

208. Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2302 (2011) (citing Stoneridge Inv. Partners, LLC v. Scientific-Atl., Inc., 552 U.S. 148, 167 (2008)).

209. *Stoneridge*, 552 U.S. at 165. The PSLRA provides that the statute shall not be "deemed to create or ratify any implied private right of action," Pub. L. No. 104-67 § 203 (1995), but this statement is of dubious validity given the design of the statute. *See* Robert A. Prentice, *Stoneridge, Securities Fraud Litigation, and the Supreme Court*, 45 AM. BUS. L.J. 611, 671–73 (2008) (concluding that the PSLRA's no-ratification provision is nonsensical). Moreover, even after the PSLRA, in 2002, Congress "ratified" the private right of action when it expanded the statute of limitations in the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 804, 116 Stat. 745, 801, an action that would be meaningless if there existed no private right of action to limit. At no time could Congress have anticipated that the Supreme Court would eliminate vicarious liability principles for determining corporate liability. Indeed, even in 1993, two years before the enactment of the PSLRA, the Supreme Court recognized that Congress had acknowledged and acquiesced in the section 10(b) private right of action. *See* Musick, Peeler & Garrett v. Emp'rs Ins., 508 U.S. 286, 293–94 (1993).

210. *See* Prentice, *supra* note 209, at 648–49, 674.

211. Notably, however, by redefining the word "make" in *Janus*, the Court adopted an interpretation that was completely different—and far narrower—than any that had existed before, suggesting that the Court is not overly concerned with maintaining the 1995 boundaries of the private right of action.

212. Monell v. Dep't of Soc. Servs., 436 U.S. 658, 691–94 (1978); *see also* Prentice, *supra* note 56, at 1348.

Washington University Open Scholarship

law rulemaking,[213] precisely as jurisprudence under section 10(b) has developed.[214] After *Stoneridge* and *Janus*, it is plain that the Supreme Court has come a long way from interpreting section 10(b) in light of Congress's intent; instead, in private actions, the Court seems committed to adopting narrowing constructions whenever possible.[215]

It is also significant that under the *Monell* "final policymaking authority" rule, liability under § 1983 may be triggered when the policymaker delegates his or her authority to another official, who then creates a policy in violation of federal law.[216] That was also the approach taken by Justice Alito in his *Staub* concurrence. Although he believed that only the actions of the person with "formal decisionmaking authority" could be considered when determining organizational liability, he agreed that where that person delegates that authority by "rubberstamp[ing]" the decisions of another, the delegatee becomes the new decisionmaker.[217] Because it is difficult to quarrel with the notion that boards of directors delegate authority to operate the corporation to its highest officers,[218] a *Monell*-style form of corporate liability does not, as Justice Breyer feared, depend solely on the conduct of the board of directors. Instead, it additionally permits the imposition of corporate liability based on the conduct of its highest level officers. Which is, as described above, precisely how district courts have interpreted *Janus*.[219]

Finally, it is worth noting that both § 1983 and section 10(b) offer significant protections to *individual* defendants, as well as organizations. Section 10(b), of course, has been so narrowly defined under *Central Bank* and its progeny that most lower level employees who cause a corporation

213. Michael J. Gerhardt, *The* Monell *Legacy: Balancing Federalism Concerns and Municipal Accountability Under Section 1983*, 62 S. CAL. L. REV. 539, 541 (1989).

214. Edward A. Fallone, *Section 10(b) and the Vagaries of Federal Common Law: The Merits of Codifying the Private Cause of Action Under a Structuralist Approach*, 1997 U. ILL. L. REV. 71, 95; *cf.* Stern, *supra* note 201, at 3 (arguing that the Supreme Court interprets section 10(b) in a manner resembling its interpretation of constitutional provisions).

215. See Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2302 (2011) ("We must give 'narrow dimensions . . . to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law.'" (quoting Stoneridge Inv. Partners, LLC v. Scientific-Atl., Inc., 552 U.S. 148, 167 (2008))).

216. *See* City of St. Louis v. Praprotnik, 485 U.S. 112, 126–27 (1988).

217. *See* Staub v. Proctor Hosp., 131 S. Ct. 1186, 1195 (2011) (Alito, J., concurring in the judgment).

218. *See* Thompson & Sale, *supra* note 12, at 877–78; Lawrence E. Mitchell & Theresa A. Gabaldon, *If I Only Had a Heart: Or, How Can We Identify a Corporate Morality*, 76 TUL. L. REV. 1645, 1657–58 (2002). As Thompson and Sale point out, federal law increasingly imposes corporate governance duties directly on management, not the board of directors. *See* Thompson & Sale, *supra* note 12, at 878.

219. *See supra* note 92 and accompanying text.

https://openscholarship.wustl.edu/law_lawreview/vol92/iss5/7

to issue misstatements are immune from private liability. Meanwhile, under § 1983, various immunity rules significantly limit the liability of individual tortfeasors.[220]

IV. *MONELL* AS APPLIED TO SECTION 10(B)—IMPLICATIONS AND PROBLEMS

If courts examining section 10(b) claims are slouching towards a *Monell*-like form of organizational liability, and are doing so for similar policy reasons, it is worth examining how this form of liability can—or should—be applied to section 10(b) claims. As it turns out, despite the criticisms that the *Monell* doctrine has received from various scholars,[221] there are some ways that a *Monell*-style analysis seems to be a better "fit" with section 10(b) claims than it does with § 1983 claims. Moreover, there are areas of *Monell* doctrine where application of *Monell*-style rules may help clarify the law with respect to section 10(b).

A. The Scope of the Final Authority Rule

It is too soon to tell whether courts examining section 10(b) claims will find themselves embroiled in the same kinds of disputes over the identity of the "final policymaker" that have engulfed § 1983 claims. In § 1983 litigation, the "final authority" rule is quite strict, focusing on formal rather than practical authority. As a result, as Justice Breyer pointed out, attempting to distinguish decisions that emanate from final policymaking authority from other sorts of decisions is a hopeless task, requiring courts to "spin ever finer distinctions . . . between liability that rests upon policy and liability that is vicarious."[222] In the context of section 10(b), however, courts appear to be more forgiving than the *Monell* rule would formally allow. They generally recognize that many high-level officers and corporate directors may be ultimate authorities, with shared responsibility

220. *See* Owen v. City of Independence, 445 U.S. 622, 637–38 (1980).

221. *See, e.g.*, Barbara E. Armacost, *Organizational Culture and Police Misconduct*, 72 GEO. WASH. L. REV. 453 (2004); George D. Brown, *Municipal Liability Under Section 1983 and the Ambiguities of Burger Court Federalism: A Comment on* City of Oklahoma City v. Tuttle *and* Pembaur v. City of Cincinnati*—The "Official Policy" Cases*, 27 B.C. L. REV. 883, 884 (1986); Kramer & Sykes, *supra* note 176, at 294; Prentice, *supra* note 56, at 1418; Harold S. Lewis, Jr. & Theodore Y. Blumoff, *Reshaping Section 1983's Asymmetry*, 140 U. PA. L. REV. 755, 797 (1992); Peter H. Schuck, *Municipal Liability Under Section 1983: Some Lessons from Tort Law and Organization Theory*, 77 GEO. L.J. 1753 (1989).

222. Bd. of Cnty. Comm'rs of Bryan Cnty. v. Brown, 520 U.S. 397, 430 (1997) (Breyer, J., dissenting).

Washington University Open Scholarship

for corporate documents (thus avoiding delicate questions about whether one high-level actor's authority "trumps" another's), and that individuals are ultimate authorities for their own statements.[223] This approach is arguably at odds with *Janus's* rather strict, *Monell*-like admonition that a statement is usually "made by—and only by—the party to whom it is attributed,"[224] but is certainly more practical than *Monell*'s "there can be only one" approach.[225]

Issues may arise when one considers that *Janus*'s attribution rule is, according to the Supreme Court, only evidence of "ultimate authority," not proof.[226] Thus, even attributed statements may not have been "made" by the persons to whom they are attributed. For example, in *SEC v. Daifotis*,[227] evidence showed that it was common practice at Charles Schwab for the client management division to invent the quotes contained in corporate advertisements.[228] In *Tyson Foods*, the press release that formed the basis of the plaintiffs' claims included a quote attributed to the CEO "which was never made or expressly approved by him."[229] Under such circumstances, courts will have to determine whether authority has

223. *See supra* note 103 and accompanying text; *see also* Local 703, I.B. of T. Grocery & Food Emp.'s Welfare Fund v. Regions Fin. Corp., No. CV: 10-2847-IPJ, 2011 U.S. Dist. LEXIS 93873, at *3 (N.D. Ala. Aug. 23, 2011) (CEOs and CFOs are ultimate authorities over documents they certify); *In re* Merck & Co., Sec., Derivative & "ERISA" Litig., No. 1658 (SRC), 2011 WL 3444199, at *25 (D.N.J. Aug. 8, 2011) (corporate officer is ultimate authority over his own statements to the market, and documents he signed).

224. *Janus*, 131 S.Ct. at 2302.

225. Courts have not, however, become so lenient as to mimic the "high management" tests employed by states for corporate criminal liability under variations of the Model Penal Code. As described above, under state law, even relatively low-level managers may trigger corporate-wide liability. Thus far, section 10(b) courts appear to hold a slightly larger group of officers liable than *Monell* would permit for "making" statements, but they still limit liability to a fairly circumscribed group of top management/directorial level agents. For mid-level actors—typically those who clearly report to more senior personnel—courts have had no trouble holding that they are not "final" authorities for *Janus* purposes. *See, e.g.*, *In re* Miller Energy Res. Sec. Litig., No. 3:11-CV-386-TAV-CCS, 2014 U.S. Dist. LEXIS 15810 (E.D. Tenn. Feb. 4, 2014) (President and Vice-Chair); SEC v. Mercury Interactive, LLC, No. 5:07-cv-02822-WHA, 2011 WL 5871020, at *3 (N.D. Cal. Nov. 22, 2011) (corporate general counsel); SEC v. Kelly, 817 F. Supp. 2d 340, 343 (S.D.N.Y. 2011) (Vice President of Accounting Policy); Touchtone Grp., LLC v. Rink, 913 F. Supp. 2d 1063 (D. Colo. 2012) (controller). And where a particular officer takes direction from a higher level one, the lower level officer is not deemed "maker" of a statement. *See, e.g.*, *Rink*, 913 F. Supp. 2d at 1078–79; Haw. Ironworkers Annuity Trust Fund v. Cole, No. 3:10 CV 371, 2011 WL 3862206, at *5 (N.D. Ohio Sept. 7, 2011).

226. Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2302 (2011) (attribution that is explicit or "implicit from surrounding circumstances is strong evidence" of who made the statement).

227. 874 F. Supp. 2d 870 (N.D. Cal. 2012).

228. *See id.* at 877.

229. *In re* Tyson Foods, Inc. Sec. Litig., No. Civ. A. 01-425-SLR, 2004 WL 1396269, at *6 (D. Del. June 17, 2004).

https://openscholarship.wustl.edu/law_lawreview/vol92/iss5/7

been "delegated" from the named actor to another, as both *Monell* and Justice Alito's *Staub* concurrence envision. The standards to establish delegation under *Monell* are extraordinarily stringent; even an agent granted discretion to act, and whose actions are not reviewed by any other person, may still not be deemed a "policymaker" if her discretion is (nominally) constrained by policies promulgated by a higher authority.[230] However, Justice Alito's *Staub* concurrence suggested a more forgiving notion of delegated authority; it remains to be seen how courts will examine the issue in the section 10(b) context.

That said, for most corporate communications, identifying the "ultimate authority" may present a less complex problem under section 10(b) than it does for § 1983. Section 10(b) claims are almost always premised on corporate communications, presenting courts with a fairly uniform set of determinations, unlike the many different fact patterns that courts are forced to confront under § 1983. Moreover, unlike local governments, publicly traded corporations are subject to a uniform set of disclosure rules set by the SEC, which include requirements that certain public filings be signed or certified by particular corporate officers and directors.[231] Additionally, the Sarbanes-Oxley Act and implementing regulations impose stringent duties on registered companies regarding their internal control and compliance systems, which may also provide a source of information for determining the "ultimate authority" for any given statement.[232]

---

230. *See* City of St. Louis v. Praprotnik, 485 U.S. 112, 130 (1988) (the mere fact that higher level officials failed to review personnel decisions of lower level officials does not establish delegation); Darchak v. City of Chi. Bd. of Educ., 580 F.3d 622, 629–30 (7th Cir. 2009) (same).

231. *See, e.g.*, 17 C.F.R. §§ 240.13a-14 (2014); SEC Form 10-K, General Instructions, Part D. Complications are more likely to arise when the defendant is not a publicly traded corporation (although in such circumstances, the defendant could almost certainly not be a primary actor in a fraud-on-the-market claim). For instance, in *SEC v. KPMG LLP*, 412 F. Supp. 2d 349 (S.D.N.Y. 2006), the court anticipated *Janus* by holding that audit opinions are only "made" by the audit partner with "ultimate authority" to issue them. Under KPMG internal rules, as well as guidelines issued by the American Institute of Certified Public Accountants, audit opinions were the responsibility of the engagement partner, but required an additional review by a "concurring review partner." *Id.* at 376. Performing a balancing test, the court concluded that due to the more limited scope of the concurring partner's responsibilities, he could not be said to have "made" the statements in the audit opinion—an obviously discretionary decision that makes it difficult to predict how future cases will be determined. *Id.* at 377.

232. *See* 17 C.F.R. §§ 229.307, 229.308, 229.601 (2013); 17 C.F.R. § 240.13a-15 (2014).

Washington University Open Scholarship

B. The Role of "Deliberate Indifference"

Where § 1983 can provide the most guidance to section 10(b) is in situations where the wrongdoing was not directly authorized by the "final" policymaker, but instead the policymaker is deemed "deliberately indifferent" to the risk of harm.

As described above, § 1983 allows municipal liability to be imposed based on the direct actions of final policymakers—the promulgation of official policies, acts taken directly under their orders, and so forth. But it also allows liability to be imposed when a lower level actor commits a constitutional tort, and the policymaker acts with "deliberate indifference" toward the risk. For example, if the lower level actor behaves in accordance with a widespread "custom"—defined to mean a convention that, although "not formally approved by an appropriate decisionmaker is so widespread as to have the force of law"[233]—municipal liability will be imposed if the policymaker had "actual or constructive" knowledge of the custom[234] and displayed "deliberate indifference" to the risk the custom posed.[235] Critically, both the "constructive knowledge" inquiry, and the "deliberate indifference" inquiry, represent objective evaluations regarding the proper standard of behavior; they do not depend on the policymaker's subjective mens rea. Knowledge of the custom may be imputed when the custom is "so widespread or flagrant that in the proper exercise of its official responsibilities the governing body should have known of them."[236] "Deliberate indifference" requires the court to assess whether the municipality "knew or should have known" of the risk.[237]

Similar standards apply when the plaintiff alleges that a constitutional injury was the result of the municipality's "failure to train" its actors, or its

233. B.S. v. Somerset Cnty., 704 F.3d 250, 274 (3d Cir. 2013) (internal quotation marks omitted).

234. Miller v. Kennebec Cnty., 219 F.3d 8, 12 (1st Cir. 2000); Pineda v. City of Houston, 291 F.3d 325, 328 (5th Cir. 2002).

235. Baker v. District of Columbia, 326 F.3d 1302, 1306-07 (D.C. Cir. 2003).

236. Spell v. McDaniel, 824 F.2d 1380, 1387 (4th Cir. 1987); *see id.* at 1391 ("Constructive knowledge may be inferred from the widespread extent of the practices, general knowledge of their existence, manifest opportunities and official duty of responsible policymakers to be informed, or combinations of these."); Myriam E. Gilles, *Breaking the Code of Silence: Rediscovering "Custom" in Section 1983 Municipal Liability*, 80 B.U. L. REV. 17, 82 (2000) ("[A]s a practical matter, a showing that a pervasive pattern of conduct exists, is generally sufficient to satisfy the requirement that high-ranking officials 'knew of, or should have known' of the complained-of practice").

237. *Baker*, 326 F.3d at 1306–07; *see also* Farmer v. Brennan, 511 U.S. 825, 840–41 (1994). These standards are comparable to common law standards for holding an employee liable for ultra vires acts that are ratified or endorsed by his employer. *See* RESTATEMENT (SECOND) OF AGENCY § 219(2)(b) (1958) (the master is liable for acts of an agent that exceed the scope of employment where "the master was negligent or reckless").

https://openscholarship.wustl.edu/law_lawreview/vol92/iss5/7

negligence in hiring. In each case, the plaintiff must show a policymaker's objective deliberate indifference to the risk of harm.[238] These standards hold even when the constitutional tort (like section 10(b)) is one that requires mens rea.[239] In such circumstances, if the lower level actor harbors the relevant mens rea, the policymaker need only be objectively deliberately indifferent to the risk before municipal liability may be imposed.

As the Supreme Court has acknowledged, this type of liability serves to fill the gap that might otherwise be created by the "final authority" rule, to prevent attempts to "insulate the government from liability simply by delegating their policymaking authority to others."[240] As discussed above, when organizational liability is premised only on the actions of higher authorities, those authorities may formally order compliance with the law while tacitly rewarding employees who break it.[241] Thus, by holding municipalities responsible for injuries caused by their objective deliberate indifference to the conduct of lower level employees, the Supreme Court has recognized that any theory of organizational liability distinct from respondeat superior is incomplete if it is limited solely to the subjective knowledge and mens rea of the organization's highest authorities.

It is here that section 10(b) courts could be most usefully guided by *Monell* jurisprudence. Just as in the § 1983 context, if organizational liability for section 10(b) violations must ultimately be traceable to "ultimate authorities," there should be a "gap-filler" that prevents those authorities from simply blinding themselves to the behavior of their subordinates. Cases brought under section 10(b) have alleged, for example, widespread intentional accounting fraud at corporate subsidiaries,[242] various forms of mortgage fraud by individual brokers and underwriters,[243] extensive off-label drug marketing,[244] and bribery of

---

238. *Farmer*, 511 U.S. at 840–41, 847; Bd. of Cnty. Comm'rs of Bryan Cnty. v. Brown, 520 U.S. 397, 407 (1997).

239. Such as "subjective" deliberate indifference to a prisoner's safety in violation of the Eighth Amendment (defined to mean that the prison official is actually aware of, and disregards, a substantial risk of serious harm to the inmate), *Farmer*, 511 U.S. at 842, or an intent to discriminate under the Equal Protection Cause, Washington v. Davis, 426 U.S. 229, 239–40 (1976).

240. City of St. Louis v. Praprotnik, 485 U.S. 112, 126 (1988).

241. *See* text accompanying *supra* notes 125–46. Even the *Staub* majority recognized this possibility and used it to support its textualist interpretation of USERRA. Staub v. Proctor Hosp., 131 S. Ct. 1186, 1193 (2011).

242. *See* Matrix Capital Mgmt. Fund, L.P. v. BearingPoint, Inc., 576 F.3d 172, 185 (4th Cir. 2009); *In re* Alpharma Inc. Sec. Litig., 372 F.3d 137, 141 (3d Cir. 2004).

243. Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc., 531 F.3d 190, 193, 195 (2d Cir. 2008); *In re* Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326, 342, 352 (S.D.N.Y. 2011).

244. *In re* Gilead Scis. Sec. Litig., 536 F.3d 1049, 1050–51 (9th Cir. 2008).

Washington University Open Scholarship

foreign officials[245]—all of which could be recharacterized as "customs" of lower level employees who, acting with at least subjective reckless disregard of the risk their actions posed, "caused" a false statement by filtering false information up through corporate reporting channels (or by withholding information the employees had a duty to report). Though courts do not necessarily deem such conduct a "custom" in the § 1983 sense,[246] they do attempt to determine organizational liability by inquiring whether the conduct was so commonplace that the knowledge of senior level officers can be inferred, with individual and organizational liability to follow.[247] At the pleading stage, courts have adopted certain rules of thumb that allow them to impute knowledge of a custom to senior officers, such as drawing the inference that when the problems affect a "core" aspect of the business, knowledge of senior officers may be assumed.[248] Similarly, where plaintiffs can identify red flags of illicit activity,[249] or can allege that wrongdoing was so widespread as to be common knowledge,[250] knowledge of corporate officers may be imputed. Indeed, the similarities between the *Monell* analysis and the section 10(b) analysis can be quite striking. For instance, in both *Pineda v. City of Houston*,[251] (a custom § 1983 case) and *Teamsters Local 445 Freight Division Pension Fund v. Dynex Capital Inc.*,[252] (a section 10(b) case), the courts held that organizational liability had not been pled because plaintiffs had not shown that raw data regarding lower level agent misconduct had ever been compiled into easily accessible reports that could be digested by higher level authorities.

But the critical difference is that for section 10(b) claims, courts locate mens rea solely in the higher level actors, with the conduct of lower level

245. *See* Glazer Capital Mgmt., LP v. Magistri, 549 F.3d 736, 741–42 (9th Cir. 2008); *In re* Faro Techs. Sec. Litig., 534 F. Supp. 2d 1248, 1255, 1263 (M.D. Fla. 2007).

246. Though they might deem it "pervasive," *In re* Providian Fin. Corp. Sec. Litig., 152 F. Supp. 2d 814, 818 (E.D. Pa. 2001), "routine[]," *In re* Dynex Capital, Inc. Sec. Litig., No. 05 Civ. 1897(HB), 2009 WL 3380621, *7 (S.D.N.Y. Oct. 19, 2009), or "an ongoing method of doing business." *Faro Techs.*, 534 F. Supp. 2d at 1263.

247. *See Providian*, 152 F. Supp. 2d at 825 (concluding that "illegal or fraudulent practices permeated core aspects of Providian's business and were so pervasive that [the top officers] must have known or were reckless in not knowing"); *cf. Alpharma*, 372 F.3d at 151 (refusing to infer knowledge by top officers because misconduct occurred at a division that contributed one half of one percent of company's revenues).

248. *See* Michael J. Kaufman & John M. Wunderlich, *Messy Mental Markers: Inferring Scienter from Core Operations in Securities Fraud Litigation*, 73 OHIO ST. L.J. 507, 517 (2012).

249. *See In re* ArthroCare Corp. Sec. Litig., 726 F. Supp. 2d 696, 711–18 (W.D. Tex. 2010).

250. *See, e.g.*, *In re* Flag Telecom Holdings, Ltd. Sec. Litig., 352 F. Supp. 2d 429, 467 (S.D.N.Y. 2005).

251. 291 F.3d 325, 331 (5th Cir. 2002).

252. 531 F.3d 190, 196 (2d Cir. 2008).

actors only serving as *evidence* of the higher level actors' true state of mind.[253] By contrast, under § 1983, when the constitutional tort requires mens rea, courts permit mens rea to be located in the lower level actor, with organizational liability imposed when higher level actors behave with *objective* disregard for the lower level behavior. Section 10(b) does not draw the distinction that § 1983 does between organizational liability based on objective deliberate indifference to the conduct of lower level actors, and organizational liability based on actions of higher level actors; in the section 10(b) context, only higher level actors have the courts' attention.

Perhaps because of this narrowed set of options, there is great uncertainty as to the precise mens rea that these higher level officials must harbor before they (and their companies) may be deemed liable under section 10(b). Though there is universal agreement that recklessness, as well as intent, is sufficient for liability, there has never been clarity about whether recklessness is a subjective or an objective standard.[254] Courts vacillate between describing recklessness as an objective standard of conduct, or a subjective disregard of risk by the actor, sometimes employing conflicting definitions within a single opinion.[255] Professor Langevoort describes section 10(b) recklessness as a standard of care that

253. *See, e.g.*, Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1251–54 (11th Cir. 2008) (inquiring whether the widespread fraudulent conduct of lower level employees was sufficiently obvious that it would have been known to higher level actors).

254. *See* Geoffrey Rapp, *Rewiring the DNA of Securities Fraud Litigation:* Amgen*'s Missed Opportunity*, 44 LOY. U. CHI. L.J. 1475, 1486 (2013); William H. Kuehnle, *On Scienter, Knowledge, and Recklessness Under the Federal Securities Laws*, 34 HOUS. L. REV. 121, 187–88 (1997). Several scholars have argued that the Supreme Court's decision in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) requires that recklessness be defined subjectively. *See* Paul S. Milich, *Securities Fraud Under Section 10(b) and Rule 10b-5: Scienter, Recklessness and the Good Faith Defense*, 11 J. CORP. L. 179, 180–81 (1986); Kuehnle, *supra*, at 177–88.

255. For example, courts commonly define section 10(b) recklessness as "a form of intent" (implying subjective awareness of wrongdoing) but also describe it as "an extreme departure from the standards of ordinary care" (implying an objective standard). *See, e.g.*, *In re* VeriFone Holdings, Inc. Sec. Litig., 704 F.3d 694, 702 (9th Cir. 2012) (internal quotation marks omitted) (employing both definitions); SEC v. Shanahan, 646 F.3d 536, 543 (8th Cir. 2011) (same); Frank v. Dana Corp., 646 F.3d 954, 959 (6th Cir. 2011) (internal quotation marks omitted) (describing recklessness as "highly unreasonable conduct which is an extreme departure from the standards of ordinary care" but also as akin to "conscious disregard"). Most definitions of section 10(b) recklessness are traceable to the Seventh Circuit's decision in *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir. 1977), which claimed, alternately, that recklessness was the "functional equivalent of intent," "measures conduct against an external standard," and that "[t]his is a subjective test." *Id.* at 1045 & n.20; *see also* Milich, *supra* note 254, at 193–96 (discussing the contradictions in *Sundstand*); Kuehnle, *supra* note 254, at 180–86 (same). In *In re NVIDIA Corp. Sec. Litig*. 768 F.3d 1046 (9th Cir. 2014), the Ninth Circuit went so far as to suggest that recklessness is *subjective* for purposes of a motion to dismiss, but *objective* for purposes of summary judgment—without explaining how a substantive element of a section 10(b) violation can change definitions depending on the stage of litigation. *See id.* at 1053 n.7.

Washington University Open Scholarship

has "an extra element of subjective awareness" that "the speaker knows that he does not know the truth, but speaks as if he does."[256]

To be sure, these concepts are often difficult to distinguish; without direct access to another person's thoughts, even "subjective" mental states may only be proved by reference to external criteria, which resembles an objective inquiry.[257] Nonetheless, some courts have demonstrated a particular hostility to inferring recklessness based on what corporate officials "must have known" by virtue of their positions, at least in the absence of allegations of specific reports those officials actually received about internal conditions.[258] While some courts are relatively forgiving about declaring that certain facts were widespread enough that knowledge of top officers should be presumed, other courts direct their inquiries to what officials actually did know,[259] rather than what they should have known (let alone what "in the proper exercise of [their] official responsibilities," officers should have known).[260] As a result of this inconsistency in the doctrine, courts have spent little energy attempting to define a standard of ordinary care for corporate executives, which leaves them without any consistent tools for determining whether a particular misstatement represented a departure from those standards.[261]

Therefore, the *Monell* doctrine may have a particular lesson to teach courts entertaining section 10(b) claims. For torts that require scienter, organizational liability is appropriate if *either* the higher level officials harbor subjective mens rea when "making" false statements, *or* lower level employees harbor the subjective mental state and higher level officials act with some kind of fault, such as *objective* indifference to the risk that the lower level employees pose to the integrity of the corporation's statements. In the former case, both the organization and the individual

256. Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 COLUM. BUS. L. REV. 429, 437 (2013).

257. *See* Milich, *supra* note 254, at 184–86.

258. *See, e.g.*, Metzler Inv. GMBH v. Corinthian Colls., Inc., 540 F.3d 1049, 1068 (9th Cir. 2008) ("[C]orporate management's general awareness of the day-to-day workings of the company's business does not establish scienter—at least absent some additional allegation of specific information conveyed to management and related to the fraud."); Bd. of Trs. of Ft. Lauderdale Gen. Emps. Ret. Sys. v. Mechel OAO, 811 F. Supp. 2d 853, 873 (S.D.N.Y. 2011); Local No. 38 Int'l Bhd. of Elec. Workers Pension Fund v. Am. Express Co., 724 F. Supp. 2d 447, 462 (S.D.N.Y. 2010).

259. *See, e.g.*, Zucco Partners, LLC v. Digimarc Corp., 552 F.3d 981, 998–99 (9th Cir. 2009); *In re* Ceridian Corp. Sec. Litig., 542 F.3d 240, 248 (8th Cir. 2008); *Local No. 38*, 724 F. Supp. 2d at 461; *Mechel OAO*, 811 F. Supp. 2d at 873.

260. Spell v. McDaniel, 824 F.2d 1380, 1387 (4th Cir. 1987).

261. *See* Ann Morales Olazabal, *Defining Recklessness: A Doctrinal Approach to Deterrence of Secondary Market Securities Fraud*, 2010 WIS. L. REV. 1415, 1425 (explaining that courts have not gone much further than describing various fact patterns that may be indicative of recklessness).

https://openscholarship.wustl.edu/law_lawreview/vol92/iss5/7

official would be liable under section 10(b), but in the latter case, after *Janus*, only the organization itself would be liable.

There are sporadic examples of section 10(b) courts employing this sort of analysis—relying on the conduct of a behind-the-scenes agent to impose organizational liability, but bolstering their reasoning by highlighting the widespread nature of the conduct, or the dysfunctional nature of the organization as a whole.[262] Though *Monell* is widely criticized for imposing too high a burden on plaintiffs, comparisons to *Monell* would allow section 10(b) courts to deal in a systematic way with at least one common fact pattern. If anything, because section 10(b) cases—unlike most § 1983 suits—involve an actus reus that comes from top management, rather than lower level actors, it is arguably more appropriate in the context of section 10(b) to factor higher level actors in the organizational fault analysis.

A complete analysis of how *Monell* doctrine might usefully inform section 10(b) jurisprudence is beyond the scope of this Article;[263] however, at least some of the virtues are plain. Borrowing from *Monell* would allow courts to formulate objective standards of fault—"deliberate indifference" or something similar—to play a similar role in section 10(b) litigation that they do in the context of § 1983, i.e., that of a "gap-filler." Such standards would prevent high-level authorities from insulating themselves from knowledge of wrongdoing, while still ensuring that section 10(b)'s scienter requirement is satisfied by locating it in lower level actors. Even if this approach only makes a practical difference on the margin, it focuses courts' attention on institutional wrongdoing without depending entirely on the subjective understandings of top officers, which allows for a more

262. *See, e.g.*, *In re* Sonus Networks, Inc. Sec. Litig., No. Civ. A.04-10294-DPW, 2006 WL 1308165, at *23 (D. Mass. May 10, 2006) (holding corporation liable for the behind-the-scenes actions of a controller because "[a]t a minimum, more senior management than [the controller] recklessly failed to have a structure that would insure the dissemination of correct information in an environment where [the controller] allegedly encouraged accounting fraud"); *In re* Faro Techs. Sec. Litig., 534 F. Supp. 2d 1248, 1263 (M.D. Fla. 2007) (corporation may be liable partly because of the illegal conduct of mid-level officers, but also because the conduct represented "an ongoing method of doing business by FARO").

263. Among other things, questions may be raised as to whether section 10(b) liability is appropriate in circumstances where *no* individual actor—whether high- or low-level—harbored the relevant scienter. In the § 1983 context, even for constitutional torts that require mens rea, some courts permit such liability when institutional policies display objective deliberate indifference to the risk of a constitutional violation, and simultaneously prevent individual actors from forming the relevant mens rea (by, for example, preventing relevant information from circulating throughout the organization). *See, e.g.*, Thomas v. Cook Cnty. Sheriff's Dep't, 604 F.3d 293, 305 (7th Cir. 2009); *cf.* Epps v. Lauderdale Cnty., 45 Fed. App'x 332, 335 (6th Cir. 2002) (Cole, J., concurring). There may also be questions regarding the mechanisms used to prove the existence of scienter among, potentially, many lower level employees whose combined actions cause the corporation to issue false statements.

Washington University Open Scholarship

nuanced, and more accurate, notion of corporate "fault." Otherwise, especially given the increasingly narrow set of persons who may be held personally liable for section 10(b) violations, corporations will have every incentive to encourage misconduct by lower level actors, and lower level actors will have little reason to resist that encouragement.

Moreover, though there have been several challenges to the concept of entity liability in section 10(b) cases at all,[264] where lower level actors harbored subjective scienter, the value of entity-level liability is plain: lower level actors are likely to be judgment-proof and, in many cases, will have acted en masse; lawsuits against them individually would present an impossible task. Entity-level liability would certainly have at least some deterrent effect, by, among other things, encouraging corporate actors to develop the types of internal systems required to identify lower level wrongdoing.[265] And to the extent that courts are seeking a mechanism for identifying organizational "fault" to match the seriousness of a section 10(b) lawsuit, the case for entity liability is *strongest* under precisely these conditions, namely, when no individual actor can be held liable, or when the only individuals responsible are too low-level to bear the moral weight of the offense.[266] If federal disclosure requirements have taken on a moral dimension—policing corporations as public actors—that section 10(b) enforces, it is particularly appropriate for liability to be imposed based on such widespread misconduct.[267]

Another advantage to this approach is that it allows courts to make use of the Sarbanes-Oxley Act ("SOX") to determine what sorts of knowledge to impute to management. Under SOX and its implementing regulations, the CEO and CFO have a nondelegable duty to design, periodically evaluate, and publicly report on the effectiveness of corporate internal controls.[268] These systems must (1) ensure that all "material information

---

264. Many scholars have argued that whatever deterrent effect section 10(b) liability has, it would be improved if there were a greater focus on the wrongdoing of individual executives. *See, e.g.*, Arlen & Carney, *supra* note 16, at 734; Cox, *supra* note 11, at 40; Langevoort, *supra* 15, at 655–56.

265. *See, e.g.*, Steven P. Croley, *Vicarious Liability in Tort: On the Sources and Limits of Employee Reasonableness*, 69 S. CAL. L. REV. 1705, 1733–37 (1996); *see also* Jennings et al., *supra* note 135; Brian C. McTier & John K. Wald, *The Causes and Consequences of Securities Class Action Litigation*, 17 J. CORP. FIN. 649, 663 (2011). The Sarbanes-Oxley Act, in fact, requires just such systems, as discussed below; a "custom" based liability as described here would therefore appropriately help to both enforce, and develop, the law regarding these requirements.

266. Gerard E. Lynch, *The Role of Criminal Law in Policing Corporate Misconduct*, L. & CONTEMP. PROBS., Summer 1997, at 23, 51 (1997); *see also* Gabaldon, *supra*, note 25, at 238–40 (recognizing that entity liability—civil or criminal—is particularly appropriate in situations where there is no single individual who can be held accountable).

267. *See supra* Part II.C.3.

268. *See* 17 C.F.R. §§ 229.307, 229.308, 229.601, 240.13a-15 (2014).

relating to" the company and its consolidated subsidiaries, including all information that the company is required to disclose to investors, "is accumulated and communicated to the issuer's management," including the CEO and CFO; and (2) "provide reasonable assurance regarding the reliability of financial reporting."[269] Through these rules, SOX "imposed an obligation of oversight and monitoring on top corporate officers."[270]

Courts have generally refused to rely on internal control certifications to impute mens rea to corporate management,[271] presumably because all public corporations are subject to the certification requirements, and therefore certification alone provides no basis for distinguishing fraud from negligence. Nonetheless, SOX certification can serve as guidance for courts to help them define the appropriate standard of care for corporate executives—what, in other words, "in the proper exercise of their official responsibilities," officers should have known. This will will then allow courts to gauge whether those officers' failure to know of lower level misconduct represents the kind of extreme departure from those standards that constitutes "objective" recklessness/deliberate indifference.[272] Courts could also take into account the responsibilities of independent directors to monitor the accuracy of corporate communications—another obligation imposed by the securities laws, but rarely subject to judicial enforcement.[273] Thus, the use of a *Monell*-like standard could not only bring clarity to section 10(b) in general, but also could provide an opportunity for courts to give much-needed content to the broad monitoring mandates imposed by the securities laws. Or, to put it another way, in situations where lower level actors behaved with *subjective*

---

269. 17 C.F.R. §§ 229.601, 240.13a-15 (2014).

270. Olazabal, *supra* note 261, at 1454.

271. *See, e.g.*, Garfield v. NDC Health Corp., 466 F.3d 1255, 1266 (11th Cir. 2006).

272. Professor Morales Olazabal similarly proposes, in line with the spirit of the SOX certification requirements, that courts adopt a presumption that management was aware of problems or misconduct within the firm that reach a certain threshold of size, importance, and unusualness. She does not, however, recommend that this presumption extend beyond the pleading stage of a securities case, out of fear that the results would be too "draconian." *See* Olazabal, *supra* note 261, at 1455; *see also* Kaufman & Wunderlich, *supra* note 248, at 534 (arguing that, at the pleading stage, courts should infer that management acted with scienter when they speak falsely about the company's "core operations"). The custom standards proposed here are different: they extend beyond the pleading stage, but are limited to organizational (rather than personal) liability. Moreover, as described in this Part, they are only relevant in the specific context where lower level agents acted with the relevant scienter for a section 10(b) violation, namely, a subjective intent, or reckless indifference, to the potential for misleading investors.

273. Hillary A. Sale, *Independent Directors as Securities Monitors*, 61 BUS. LAW. 1375, 1382–88 (2006). Some case law has been generated under section 11, which imposes liability for false statements in a registration statement subject to a due diligence defense, but it is extremely underdeveloped. *See id.* at 1394.

Washington University Open Scholarship

recklessness, courts need not determine what the highest management *did* know in order to impose liability on the organization. Instead, courts might ask whether, given management's assurances that they have met federal obligations to ensure that they are notified of material matters, they *should* have known, had they acted with basic regard for their responsibilities.

Finally, and perhaps most importantly, liability under these conditions would appropriately set minimal standards for corporate behavior that are in keeping with the modern role that securities lawsuits play in setting corporate governance standards. It is entirely consonant with the modern statutory scheme to define organizational fraud broadly enough to encompass materially false statements that are caused by the objectively unreasonable indifference of high level corporate officials to the widespread reckless conduct of lower level employees. Even though corporate officials may only be mismanaging the company by permitting such conduct, this behavior—a blind eye turned by corporate managers to reckless conduct within the company that has a direct effect on public reporting—is precisely what SOX and Dodd-Frank were intended to curb.[274] Officials' failure to control their employees falls so far outside of the basic duties that federal law requires of corporate managers that accountability via section 10(b) is appropriate.

To be sure, this approach does not completely resolve the problem of defining scienter that emanates from lower level misconduct that is not directed specifically toward corporate bookkeeping. Nonetheless, courts will at least have a framework for analysis—did the lower level agents act with reckless disregard as to whether their conduct would cause the corporation to issue false statements?—with the "cushion" of higher level wrongdoing to assuage any fears of casting too wide a net of liability.

CONCLUSION

This Article has demonstrated that rules that courts have used to hold organizations liable for section 10(b) violations in open-market cases differ from agency principles as they are applied in other areas of law. In fact, when it comes to open-market section 10(b) claims, courts appear uncomfortable with the "strict" aspects of vicarious liability, and prefer to identify organizational "fault," typically defined to mean endorsement of the fraud at the corporation's highest levels. Courts' reasons for eschewing vicarious liability principles in this context are likely based on a series of

274. Hillary A. Sale, *The New "Public" Corporation*, LAW & CONTEMP. PROBS., Winter 2011, at 137 (2011); Langevoort, *supra* note 131, at 1829.

https://openscholarship.wustl.edu/law_lawreview/vol92/iss5/7

policy concerns rooted in the changing nature of the section 10(b) action. Of these, the most important is likely the fear that the deterrence function of section 10(b) is no longer aimed exclusively at policing securities fraud, but also now captures matters more traditionally addressed under state corporate governance standards and even other federal statutes designed to substantively control corporate misconduct. Courts limit the use of vicarious liability in order to prevent section 10(b) from becoming a "super" statute that is used to punish corporations for any kind of antisocial behavior.

Similar concerns have animated the approach courts have taken in determining organizational liability under § 1983. Perhaps most strikingly, in the § 1983 context, just as in the section 10(b) context, courts appear to be limiting vicarious liability as a mechanism for distinguishing matters of federal concern—constitutional torts—from ordinary torts that are more appropriately dealt with under state law.

For this reason, the doctrines that have been developed under § 1983 can help guide courts in the section 10(b) context. This is particularly so with respect to the concept of organizational "deliberate indifference" to lower level misconduct, a notion that prevents higher level municipal authorities from avoiding liability by insulating themselves from knowledge of the conduct of lower level actors. Because section 10(b) organizational liability is currently skewed toward the knowledge and conduct of high-level officers, some sort of gap-filler is necessary to prevent a similar evasion; § 1983 may therefore point the way forward.

Perhaps the most important implication of this analysis, however, is that if the nature of the section 10(b) action changes again, courts should revisit their approach to determining organizational mens rea. Section 10(b)'s deterrence function, and its role in enforcing the federal disclosure-based corporate governance standards, is directly traceable to the adoption of the fraud-on-the-market doctrine. But that doctrine has been controversial from its inception, and there are perpetual proposals to either pare it back or eliminate it entirely. The Supreme Court's recent decision in *Halliburton Co. v. Erica P. John Fund, Inc.*,[275] for example, left the doctrine intact but may make it more difficult for plaintiffs to win class certification. Because only a small number of investors are likely to have personally relied on any particular false statement, if fraud-on-the-market theory is narrowed, the number of potential plaintiffs in any given case will be dramatically reduced. Many of those potential plaintiffs will

275. 134 S. Ct. 2398, 2417 (2014).

Washington University Open Scholarship

not have losses large enough to justify the risk and expense of a securities lawsuit; thus, section 10(b) claims based on open-market frauds will become much rarer, and seek smaller damages.

If this occurs, it is unlikely that section 10(b) will continue to serve a significant deterrent function, while at the same time, those lawsuits that are brought are much more likely to result in significant compensation to the few investors who bring them (at minimum, they are likely to do a better job at compensating investors than their class action predecessors). The persons who bring such suits—who can demonstrate that they personally relied on the corporate misstatements—may also have a greater claim to compensation than other traders, because they are less likely to be diversified, and more likely to contribute to market efficiency with their trading behavior.[276] Under such circumstances, section 10(b) may once again become a garden-variety tort statute, and many of the concerns that have apparently motivated courts to limit the application of vicarious liability will no longer be relevant. Thus, if fraud-on-the-market liability is eliminated, courts should become more willing to allow lower level actors' scienter to be imputed to the organization, in accord with ordinary agency principles.

More radically, the best solution may simply be to develop different standards for organizational liability within and without the fraud-on-the-market context. Scholars have argued that fraud on the market is so distinct from its predecessor tort of deceit that it should be considered its own separate type of tort;[277] as this Article demonstrates, class action suits brought via the fraud-on-the-market doctrine serve a fundamentally different purpose than individual suits brought based on an individual investor's reliance on a particular false statement. Therefore, it may be appropriate only to impose *Monell*-style corporate liability when investors claim market reliance, while restoring vicarious liability principles for lawsuits based on actual reliance.[278] Indeed, we may see precisely this situation in the after math of the Jumpstart Our Business Startups Act (JOBS Act),[279] which, among other things, makes it easier for smaller companies to raise capital in small offerings, but these smaller offerings are unlikely to qualify for application of the fraud-on-the-market doctrine.

276. *See* Fisch, *supra* note 16, at 348; Bratton & Wachter, *supra* note 10, at 102.

277. Goldberg & Zipursky, *supra* note 107, at 1799.

278. It has previously been proposed that fraud-on-the-market damages should differ from damages incurred by actual reliance on false statements. *See* A. C. Pritchard, Stoneridge Investment Partners v. Scientific-Atlanta*: The Political Economy of Securities Class Action Reform*, 2007–08 CATO SUP. CT. REV. 217, 237–38.

279. Pub. L. No. 112-106, 126 Stat. 306 (2012).

Any section 10(b) claims brought against companies taking advantage of the JOBS Act will thus likely be based on actual reliance, where the case for ordinary vicarious liability is stronger.

Ultimately, however, the courts' dilemma in this regard can be traced back to the fact that both Congress and the SEC increasingly use federal disclosure requirements as a mechanism for substantive regulation of corporate behavior, to be enforced by the threat of section 10(b) liability. These new requirements often appear to be more of a compromise to avoid mandating particular standards of conduct than they do a judgment about the propriety of disclosure as a governance mechanism per se.[280] It is precisely because Congress and the SEC are insufficiently committed to fully regulating corporate behavior that courts are forced into the awkward position of attempting to use agency law to delineate the proper contours of section 10(b) claims. The solution is for Congress and the SEC to decide what role the federal government has, or should have, with respect to imposing substantive standards of behavior on corporations, and to further decide what role section 10(b) should play in policing those standards. Until then, courts will increasingly feel the need to develop their own ad hoc rules on the subject, which may or may not accord with federal policy, either by imposing liability too broadly or—as seems more likely—increasingly focusing on a narrow set of high-level actors, even when corporate behavior strays very far from the standards that federal law has imposed.

---

280. *See, e.g.*, 15 U.S.C. § 78n-1 (2012) ("say on pay" statute requiring disclosure of CEO compensation and nonbinding shareholder approval); 17 C.F.R. § 229.407(c)(2)(vi) (2014) (requiring disclosure of diversity considerations when board members are selected).

Washington University Open Scholarship