Client Alert

Aiding and Abetting SEC Violations Limited by the First Circuit

February 17, 2009

The Securities and Exchange Commission must show that a defendant provided substantial assistance to an ongoing fraud scheme to prove aiding and abetting liability, according to a recent decision by the First Circuit Court of Appeals. *SEC v. Papa*, Case No 08-1172, 2009 WL 280358 (Feb. 6, 2009). The court rejected the SEC's claim that aiding and abetting liability could be predicated on conduct that happened after the fraud was completed.

In *Papa*, the SEC alleged that six executives of Putman Fiduciary Trust Company ("Putnam") schemed to defraud a client by covering up their failure to timely invest the client's assets in a defined benefit plan in early 2001. The one day delay caused the client to be deprived of $4 million in market gains. To conceal the error, the defendants backdated accounting entries and used various other accounting mechanisms. The district court dismissed the claims against three of the defendants who the SEC alleged were either the primary violators or aided and abetted the fraud because the three did no more than attend a meeting where the cover up was discussed. On appeal, the SEC abandoned the primary violator theory and argued that the three defendants aided and abetted uncharged violations by Putnam by signing letters to Putnam's external auditor in 2002 and 2003 that stated they were "unaware of any uncorrected errors, frauds or illegal acts . . . "*Id.* at *2. The SEC contended that Putnam had an ongoing continuing fiduciary duty to disclose the late transactions and that the three defendants aided and abetted PFTC's breach of this duty and the resulting, albeit uncharged, securities fraud.

The Court of Appeals rejected the Government's arguments. First, the court concluded that the execution of audit letters one and two years after the alleged fraud was completed did not render substantial assistance to the fraud. The First Circuit reasoned that to find differently would mean that the scheme was never ending. Second, the court rejected the SEC's argument that the defendants aided and abetted a breach of fiduciary duty by Putman through the general denials in the audit letters. The court noted the SEC's approach would create aiding and abetting liability for individuals not liable for the original, allegedly fraudulent transactions "based solely on general denials of wrongdoing" and it was unwilling to extend the law that far. *Id.* at *6.

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