

The Banking Law Journal

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Control Person Liability—Is Pleading and Proof of “Culpable Participation” Required and What Does That Requirement Mean

*Frank Kaplan**

This article discusses a requirement for control person liability under the Securities and Exchange Act of 1934 that has been primarily advanced by courts in the U.S. Court of Appeals for the Second Circuit, adopted by courts in two other circuits, and rejected in all the other circuits. That requirement is called “culpable participation.”

Virtually every complaint alleging a violation of the federal securities laws includes, near the end of the pleading, one or more counts alleging “control person” liability. Those counts are typically directed against the usual suspects—corporate officers and directors and parent companies—although plaintiffs have sought to expand such defendants to include lenders, accountants, and investment bankers. Motion to dismiss decisions routinely address the “control person” counts generally at the end, often with a perfunctory paragraph or two.

This article discusses a requirement for control person liability under the Securities and Exchange Act of 1934 (the “34 Act”) that has been primarily advanced by courts in the U.S. Court of Appeals for the Second Circuit, adopted by courts in two other circuits, and rejected in all the other circuits. That requirement is called “culpable participation.”

“Culpable participation” as a potential element of control person liability raises a number of questions which have been addressed by the courts with differing outcomes:

- (1) is that requirement consistent with the language of the control person section of the 34 Act;
- (2) does the requirement comport with the scienter element of Section 10(b) of the 34 Act and Rule 10b-5 promulgated thereunder;
- (3) what does the requirement mean if it does apply;
- (4) what pleading standards govern if the requirement applies; and
- (5) even if the requirement exists to control person liability under the 34 Act, does it also apply to control person liability under the Securities Act of 1933 (the “33 Act”)?

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Each of these issues will be explored in this article.

THE CONTROL PERSON STATUTES

Section 20(a) of the 34 Act¹ provides in relevant part of follows:

Every person who, directly or indirectly, controls any person liable under any provision of this title 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.

Section 15 of the 33 Act² provides in relevant part as follows:

Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 11 or 12, 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 had no knowledge or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.³

Despite the difference in language, the two sections are considered “parallel provisions” and generally “their terms are interpreted in the same manner.”⁴ As discussed below, however, when it comes to “culpable participation,” all courts appear to understand that the two sections part company.

CONTROL PERSON LIABILITY ARISING FROM 10b-5 CLAIMS

Control person counts appear most frequently in complaints alleging a violation of Section 10(b) of the 34 Act and Rule 10b-5 promulgated thereunder.

¹ 15 U.S.C. § 78t(a).

² 15 U.S.C. § 77o.

³ Section 11 of the 33 Act, 15 U.S.C. § 77k, deals with civil liability on account of false registration statements. Section 12 of the 33 Act, 15 U.S.C. § 77l, deals with civil liability on account of false prospectuses or oral communications.

⁴ See e.g. *In re Refco Sec. Litig.*, 503 F. Supp.2d 611, 660 (S.D.N.Y. 2007).

Section 10(b), the 34 Act's antifraud statute, states in relevant part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . (b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 provides that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or any facility of any national securities exchange, (a) to employ any device, scheme or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Scienter is a critical element of a civil 10b-5 claim for damages brought by securities investors.⁵ Section 10(b) "is intended to proscribe knowing or intentional misconduct."⁶ Accordingly, scienter means an intent to deceive, manipulate or defraud; negligence is not enough.⁷

Is "Culpable Participation" a Requirement for Control Person Liability Under the 34 Act's Control Person Statute, and If So, What Does It Mean

Whether a plaintiff must plead and prove "culpable participation" and, if so, what that requirement means, will depend on which circuit the case is pending and, indeed, may also depend on which judge within that circuit is handling the case.

⁵ *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). Scienter is required even where the SEC is seeking injunctive relief based on a violation of Section 10(b) and Rule 10b-5. *Aaron v. SEC*, 446 U.S. 680, 689-695 (1980).

⁶ *Hochfelder*, 425 U.S. at 197.

⁷ *Id.* at 193, n.12 and 215.

Although “culpable participation” as an element of control person liability appears to have been borne in the Second Circuit, there appears to be a disagreement now within that circuit as to whether the plaintiff must plead and/or prove culpable participation in order to establish control person liability. The U.S. Courts of Appeals for the Third and D.C. Circuits, however, do insist on that requirement. The U.S. Courts of Appeals for the Fifth and Sixth Circuits appear split on the issue. None of the other circuits appear to impose this requirement on the plaintiff, although the U.S. Court of Appeals for the First Circuit has not decided the issue and has expressly left it open.

Second Circuit

In *SEC v. First Jersey Sec., Inc.*,⁸ the court, quoting from *Lanza v. Drexel & Co.*,⁹ concluded that a plaintiff must show that the controlling person was “in some meaningful sense [a] culpable participant] in the fraud perpetrated by [the] controlled person.” Once the plaintiff establishes a prima facie case for control person liability, then the burden shifts to the defendant to show that he acted in good faith and did not induce the acts constituting the violation.¹⁰ To establish good faith, according to the court, the controlling person “must prove that he exercised due care in his supervision of the violator’s activities in that he ‘maintained and enforced a reasonable and proper system of supervision and internal controls.’”¹¹ This suggests merely a negligence standard in order to impose culpable participation.

Since *First Jersey*, district courts in the Second Circuit have expressed wildly diverging views as to whether culpable participation is part of the plaintiff’s prima facie case and, if so, what that requirement means and how it must be pled.¹²

Several district courts in the Second Circuit have forcefully rejected any notion that culpable participation is a required element of the plaintiff’s case or that *First Jersey* actually imposed such a requirement. In *In re Parmalat Sec. Litig.*,¹³ the court squarely rejected the requirement. The court first noted that

⁸ 101 F.3d 1450, 1472–1473 (2d Cir. 1996).

⁹ 479 F.2d 1277, 1299 (2d Cir. 1973).

¹⁰ *Id.* at 1473.

¹¹ *Id.*

¹² Later Second Circuit cases have recited, without discussion, that the plaintiff must show that the defendant was, in some meaningful sense, a culpable participant in the controlled person’s fraud. See e.g. *Carpenters Pension Trust Fund of St. Louis v. Barclays PLC*, 750 F. 3d 227, 236 (2d Cir. 2014); *ATSI Commc’ns, Inc. v. Shaar Fund, Ltd.*, 493 F. 3d 87, 108 (2d Cir. 2007).

¹³ 375 F. Supp. 2d 278 (S.D.N.Y. 2005).

the absence of such a requirement was consistent with the purpose of Section 20(a), which was enacted “to expand, rather than restrict, the scope of liability”¹⁴

The court also concluded that the Second Circuit had in fact *not* addressed whether a plaintiff is required to plead culpable participation.¹⁵ Nor did the court think that *First Jersey* actually imposed such a requirement, noting that the language in that case was *dictum* and that by shifting the burden to the defendant to show good faith, the Second Circuit had in essence rendered the culpable participation requirement “meaningless.”¹⁶

Finally, the court asserted that no later Second Circuit case had “applied *First Jersey* to conclude that culpable participation must be pleaded to state a legally sufficient Section 20(a) claim.”¹⁷ Instead, according to the court, a plaintiff is only required to plead a primary violation by the controlled person, and control of the primary violator by the Section 20(a) defendant.¹⁸

In *In re World Com Sec. Litig.*,¹⁹ the court held that pleading culpable participation was satisfied by alleging a primary violation and control over the primary violator, since culpable participation referred to the level of control required and not the controlling person’s state of mind. Culpable participation was not required to be separately alleged, and control need only be alleged pursuant to Rule 8, and was not governed by the Private Securities Litigation Reform Act’s (“PSLRA”) heightened pleading standard.

In *In re Bioscrip*,²⁰ the court acknowledged “the ongoing debate in [the Second Circuit] whether culpable participation must be pled with particularity or whether it is an affirmative defense, with the burden on the defendant in establishing the absence of such participation.”²¹ The court found it unnecessary to resolve the issue, concluding that the individual defendants’ culpable participation had been adequately alleged, since each was alleged to have been responsible for reviewing the corporation’s SEC filings, and therefore “knew or

¹⁴ *Id.* at 308.

¹⁵ *Id.* at 307.

¹⁶ *Id.* at 309.

¹⁷ *Id.*

¹⁸ *Id.* at 310. In a later opinion in the same case, Judge Kaplan reiterated his views and stated that he respectfully declined to follow the *dicta* in *First Jersey* and a later Second Circuit case, *ATSI Commc’ns, Inc. v. Shaar Fund, Ltd.*, 493 F. 3d 87,108 (2d Cir. 2007).

¹⁹ 294 F. Supp. 2d 392, 414–419 (S.D.N.Y. 2003).

²⁰ 2015 U.S. Dist. LEXIS 46763 (S.D.N.Y. Mar. 31, 2015).

²¹ *Id.* at *65–66.

should have known that the primary violator, over whom [they] had control, was engaging in fraudulent conduct.”²² Although this standard (“should have known”) might be thought to be one of negligence, other cases make clear that culpable participation requires a showing of recklessness and that this language, when coupled with particularized facts, apparently satisfies that standard.²³

The majority of district court decisions in the Second Circuit do require the plaintiff to plead culpable participation, require that the culpable conduct be pled as conscious misbehavior or at least reckless, and mandate that the pleadings meet the PSLRA’s heightened standards.²⁴

While these cases require that culpable participation be adequately pled by the plaintiff, it appears that the burden is on the defendant to disprove it at trial.²⁵

In finding that recklessness must be pled, some of these decisions note that the U.S. Supreme Court in *Hochfelder* appears to have considered Section 20(a) a “state of mind” provision.²⁶ Other courts note that imposing only a negligence standard for control person liability could have a chilling effect on the willingness of persons such as outside directors to serve, where those persons are typically not involved in the day to day affairs of the company.²⁷ Instead,

²² Other cases find that culpable participation is either not a required element of the plaintiff’s case or do not decide the issue, but then show that the defendant’s conduct would have satisfied that requirement anyway. See e.g. *Meyer v. Concordia *Int’l Corp.*, 2017 U.S. Dist. LEXIS 119436 at *28–29 (S.D.N.Y. July 28, 2017) (individual Section 20(a) defendant participated in calls with analysts and knew that other defendants were making false statements); *CSX Corp. v. Children’s Inv. Fund*, 562 F. Supp. 2d 511, 558 (S.D.N.Y. 2008).

²³ See e.g. *In re Livent, Inc. Noteholders Sec. Litig.*, 151 F. Supp. 2d 371, 421 (S.D.N.Y. 2001) (discussing that while phrases such as “failed to check information” or “should have known” often connote mere negligence, allegations that a defendant failed to check information that he had a duty to monitor or had access to information suggesting that public statements were not accurate could constitute recklessness).

²⁴ See e.g. *SEC v. Yorkville Advisors, LLC*, 2018 U.S. Dist. LEXIS 57587 at *39 (S.D.N.Y. Mar. 29, 2018) (the “weight of well-reasoned authority [in the Second Circuit] requires the plaintiff to prove ‘some level of culpable participation at least approximating recklessness in the section 10(b) context’”); *Special Situations Fund III QP, L.P. v. Deloitte Touche Tohmatsu CPA, Ltd.*, 33 F. Supp. 3d 401, 437–439 (S.D.N.Y. 2014); *Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Arbitron, Inc.*, 741 F. Supp. 2d 474, 491–492 (S.D.N.Y. 2010); *In re Alstrom SA Secs. Litig.*, 406 F. Supp. 2d 433, 489–491 (S.D.N.Y. 2005); *In re Livent, Inc. Noteholders Sec. Litig.*, 151 F. Supp. 2d at 414–417.

²⁵ *In re Livent, Inc. Noteholders Sec. Litig.*, 151 F. Supp. 2d at 415–416.

²⁶ See *In re Livent, Inc. Noteholders Sec. Litig.*, 151 F. Supp. 2d at 417, citing *Ernst & Ernst v. Hochfelder*, 425 U.S. at 209, n.28.

²⁷ *In re Alstrom SA Secs. Litig.*, 406 F. Supp. 2d at 490.

some indicia of wrongdoing “other than just being there” is required.²⁸ This policy is reflected in the PSLRA’s treatment of outside directors.²⁹

To adequately plead recklessness, the complaint must allege “highly unreasonable or extreme misconduct, and not simply a deviation from the standard of ordinary care.”³⁰ So, for example, a complaint sufficiently pled at least recklessness where it alleged that the Section 20(a) defendant had signed SEC filings, had a duty to familiarize himself with the company’s core operations, the misrepresentations related to those operations, and the defendant was involved in the company’s day to day operations.³¹

On the other hand, a failure to monitor others, by itself, does not constitute recklessness.³² Even where the alleged controlling person is alleged to have had a duty to monitor and report suspicious activity, the failure to have uncovered a massive Ponzi scheme has been held to constitute only negligent and not reckless conduct, insufficient to support a pleading of culpable participation.³³

Third Circuit

The Third Circuit requires the plaintiff to plead and prove culpable participation, and mandates that such participation be specifically pled in accordance with the PSLRA standards.³⁴ According to the courts in this circuit, Congress did not intend for controlling persons to be insurers against the fraudulent activities of others, and instead intended to impose liability on those who were controlling persons and “who were in some meaningful sense culpable participants in the fraud.”³⁵

Culpable participation “refers to either knowing or substantial participation in the wrongdoing or inaction with the intent to further the fraud or prevent

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.* at 491.

³¹ *Id.* at 496.

³² *Id.* at 491.

³³ *Friedman v. JP Morgan Chase & Co.*, 2016 U.S. Dist. LEXIS 65558 at *36–39 (S.D.N.Y. May 18, 2016).

³⁴ See e.g. *In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 284 n.16 (3d Cir. 2006); *Rochez v. Rhodes*, 527 F.2d 880, 890 (3d Cir. 1975); *Universal Am. Corp. v. Partners Healthcare Solutions Holdings, LP*, 176 F. Supp.3d 387, 397 (D. Del. 2016); *Semon v. Maps Indeed, Inc.*, 2016 U.S. Dist. LEXIS 31851 at *35 (M.D. Pa. Mar. 11, 2016); *In re Merck & Co.*, 2015 U.S. Dist. LEXIS 62983 at *110–111 (D.N.J. May 13, 2015); *AJZN, Inc. v. Yu*, 2015 U.S. Dist. LEXIS 8407 at *11 (D. Del. Jan. 26, 2015).

³⁵ *Belmont v. MB Inv. Partners, Inc.*, 708 F.3d 470, 485 (3d Cir. 2013).

its discovery.”³⁶ Culpable participation may be based on inaction by the defendant if the plaintiff proves both knowledge of the underlying fraud and deliberate inaction done intentionally or recklessly to aid the controlled person and further the fraud.³⁷

D.C. Circuit

The D.C. Circuit requires particularized pleading (but not necessarily proof) of culpable participation in order to establish control person liability.³⁸ Courts in this circuit have concluded that culpable participation (1) is consistent with the purpose of the 34 Act and the PSLRA, (2) by the PSLRA, Congress intended to make it harder to prosecute securities fraud cases, (3) without “some evidence of malfeasance,” any director of a public company could be held liable as a control person because of some degree of control over the corporation, its policies and its employees, (4) culpable participation is consistent with the Supreme Court’s analysis in *Ernst & Ernst v. Hochfelder*,³⁹ which required more than negligence to establish liability under Section 10(b) of the 34 Act and Rule 10b-5 and cited Section 20(a) as an example of a “state of mind” provision, and (5) some conduct greater than negligence is required to establish liability (but unclear whether recklessness or conscious misconduct is required).⁴⁰

Sixth Circuit

The law in the Sixth Circuit is unclear as to whether there is a culpable participation requirement. *PR Diamonds, Inc. v. Chandler*⁴¹ required only an underlying violation and control of the primary violator. Other cases have held

³⁶ *In re Merck & Co.*, 2015 U.S. Dist. LEXIS at *111, citing *Rochez*, 527 F.2d at 890; *Belmont*, 708 F.3d at 485.

³⁷ *Universal Am. Corp.*, 176 F. Supp.3d at 397–398; *Semon*, 2016 U.S. Dist. LEXIS 31851 at *35 (allegation that defendant knew or was reckless in not knowing that other defendants were involved in fraudulent conduct sufficient).

³⁸ See e.g. *Freeland v. Iridium World Communs., Ltd.*, 545 F. Supp.2d 59, 81–84 (D.D.C. 2008) (holding that a plaintiff must plead culpable participation, but imposing on the defendant the burden of disproving such participation, or proving good faith); *Evergreen Equity Trust v. Fannie Mae (In re Fannie Mae Sec.)*, 503 F. Supp.2d 25, 44–45 (D.D.C. 2007).

³⁹ 425 U.S. 185, 209 n.28 (1976).

⁴⁰ *Evergreen Equity*, 503 F. Supp.2d at 44–45.

⁴¹ 364 F.3d 671, 696 (6th Cir. 2004).

that the culpable participation requirement does not apply.⁴² However, other cases in the circuit do require culpable participation to be alleged.⁴³

Ninth Circuit

Cases in the Ninth Circuit hold that culpable participation is not a requirement for control person liability.⁴⁴ Accordingly, neither the heightened pleading standards of the PSLRA or Rule 9(b) of the Federal Rules of Civil Procedure dealing with the pleading of fraud apply when pleading control person liability under the 34 Act.⁴⁵

According to the Ninth Circuit, Section 20(a) “premises liability solely on the control relationship, subject to the good faith defense.”⁴⁶ Ninth Circuit requires the defendant to prove lack of scienter and culpable participation in order to establish a “good faith” defense.⁴⁷

Tenth Circuit

The Tenth Circuit also does not require pleading and proof of culpable participation by a defendant sued for control person liability under the 34 Act. Instead, the plaintiff need only establish primary liability by a defendant and control over that person by the defendant sued for control person liability. Once that is shown, the burden shifts to the control person defendant to show a lack of culpable participation or knowledge.⁴⁸

Nor does the PSLRA dictate that the plaintiff must prove culpable participation, since that statute deals with proof that the defendant acted with

⁴² See e.g. *In re Nat'l Century Fin. Enters.*, 2006 U.S. Dist. LEXIS at *77–78 (E.D. Ohio Feb. 27, 2006).

⁴³ See e.g. *D.E. & J.L.P. v. Conaway*, 284 F. Supp.2d 719, 750 (E.D. Mich. 2003); *Yadlosky v. Thornton*, 120 F. Supp.2d 622, 631 (E.D. Mich. 2000), quoting from *Bomarko, Inc. v. Hemodynamics*, 848 F. Supp. 1335, 1339 (W.D. Mich. 1993) (culpable participation standard met by evidence that controlling persons encouraged and permitted issuance of statements they knew were false).

⁴⁴ See e.g. *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1575 (9th Cir. 1990); *Paracor Fin., Inc. v. GE Capital Corp.*, 96 F.3d 1151, 1161 (9th Cir. 1996) (plaintiff only required to show a primary violation and direct or indirect control of the person or entity committing the primary violation; need not prove scienter or culpable participation); *Teamsters Local 617 Pension & Welfare Funds v. Apollo Group, Inc.*, 690 F. Supp.2d 959, 966–967 (D. Ariz. 2010) (fraud/scienter is not an element of control person liability).

⁴⁵ *Teamsters Local 617*, 690 F. Supp.2d at 966–967.

⁴⁶ *Hollinger*, 914 F.2d at 1575.

⁴⁷ *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1065 (9th Cir. 2000).

⁴⁸ See e.g. *Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1109 (10th Cir. 2003); *Maher v. Durango Metals, Inc.*, 144 F.3d 1302, 1305 (10th Cir. 1998) (burden on defendant to show lack of culpable participation or knowledge); 2015 U.S. Dist. LEXIS 83234 at *___ (D. Colo. ___).

a particular state of mind, and Section 20 of the 34 Act does not require proof of the control person's state of mind.⁴⁹

Eleventh Circuit

The Eleventh Circuit rejects culpable participation as a requirement for control person liability, holding that the imposition of such liability did not require the controlling person to knowingly participate in or independently commit a primary violation of the 34 Act.⁵⁰ Instead, once a prima facie case is made, the defendant has the burden of establishing “good faith” by proving that he did not act “recklessly in failing to do what he could have done to prevent the violation.”⁵¹

First Circuit

The district courts in the First Circuit does not require the plaintiff to plead and prove culpable participation as part of plaintiff's prima facie case, finding no support in the statutory language for that requirement. Instead, the burden is on the defendant to prove good faith as an affirmative defense.⁵² According to one court, there would be little reason for a control person liability statute unless it differed in some meaningful way from non-control person liability.⁵³ The First Circuit Court of Appeals has reserved judgment on the issue.⁵⁴

Fifth Circuit

The Fifth Circuit and some district courts have said that culpable participation is not a required element of control person liability, but other district courts in the circuit appear to say otherwise.⁵⁵ Some cases state that the plaintiff

⁴⁹ *Adams*, 340 F.3d at 1109.

⁵⁰ *Laperriere v. Vesta Ins. Group*, 526 F.3d 715, 723–725 (11th Cir. 2008); *City Pension Fund for Firefighters & Police Officers in the City of Miami Beach v. Aracruz*, 41 F. Supp.3d 1369, 1408–1409 (S.D. Fla. 2011).

⁵¹ *Laperriere*, 526 F.3d at 725.

⁵² See e.g. *In re Credit Suisse-AOL Sec. Litig.*, 2011 U.S. Dist. LEXIS 95889 at *25–27 (D. Mass. Aug. 26, 2011); *In re Brooks Automation Inc. Secs. Litig.*, 2007 U.S. Dist. LEXIS 88045 at *44–45 (D. Mass. Nov. 6, 2007).

⁵³ *In re Brooks Automation*, 2007 U.S. Dist. LEXIS 88045 at *45.

⁵⁴ *In re Stone & Webster Sec. Litig.*, 424 F.3d 24, 26 & n.2 (1st Cir. 2005) (provisionally holding that the PSLRA's “strong inference of scienter” pleading requirement does not apply to a Section 20(a) claim, but noting that because the parties had not briefed the issue, the court was not deciding whether a plaintiff needed to prove culpable participation and whether that requirement would trigger a pleading that met the PSLRA standard.

⁵⁵ See *G.A. Thompson & Co., Inc. v. Partridge*, 636 F.2d 945, 959–960 (5th Cir. 1981) (not a requirement; text of statute and regulations do not require participation in the wrongful

must prove that the controlling person induced or participated in the alleged violation by the controlled person, but then seemingly ignore that statement and instead focus on whether there were sufficient allegations of specific knowledge or facts demonstrating control.⁵⁶

Fourth, Seventh, and Eighth Circuits

Culpable participation is not a required element of control person liability in the U.S. Court of Appeals for the Fourth Circuit. The controlling person need not have acted with scienter or be directly liable in order to have control person liability; instead, the defendant must show a lack of culpable participation or knowledge.⁵⁷ Requiring culpable participation would “conflate” the requirements for secondary liability under Section 20(a) with primary liability under Section 10(b) of the 34 Act and Rule 10b-5 promulgated thereunder.⁵⁸

The U.S. Courts of Appeals for the Seventh and Eighth Circuits each reject culpable participation as a requirement for control person liability.⁵⁹ The Eighth Circuit has specifically noted that the PSLRA does not require revisiting the culpable participation issue, since the PSLA was designed to create heightened pleading standards in fraud cases, and “federal control-person liability is dependent on control, not fraud.”⁶⁰

transaction, and lack of participation and good faith constitute an affirmative defense for the controlling person); *Carlton v. Cannon*, 2016 U.S. Dist. LEXIS 96305 at *11 (S.D. Tex. July 22, 2016) (alleging and proving control person liability does not require pleading facts that would show the control person’s “participation in the wrongful transaction”). *But see In re BP P.LC Secs. Litig.*, 2016 U.S. Dist. LEXIS 73721 at *70 (S.D. Tex. May 31, 2016) (plaintiff must show that defendant was, “in some meaningful sense,” a culpable participant in the controlled person’s fraud).

⁵⁶ *Alameda Cty. Emp. Ret. Assoc. v. BP p.l.c. Avalon Holdings Inc.*, 2018 U.S. Dist. LEXIS 9185 at *27–28 (S.D. Tex. Jan. 19, 2018) (also holding that the plaintiff was subject only to the pleading requirements of Rule * and not the heightened requirements of Rule 9(b) of the Federal Rules of Civil Procedure).

⁵⁷ *See e.g. In re Mut. Funds Inv. Litig.*, 566 F.3d 111, 130 (4th Cir. 2009) rev’d on other grounds, *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011); *In re MicroStrategy, Inc. Sec. Litig.*, 115 F. Supp.2d 620, 659–661 (E.D. Va. 2000).

⁵⁸ *In re MicroStrategy, Inc. Sec. Litig.*, 115 F. Supp.2d at 659–660.

⁵⁹ *See e.g. Harrison v. Dean Witter Reynolds, Inc.*, 79 F.3d 609, 614 (7th Cir. 1996) (Seventh Circuit has “never had any test similar to the culpable participation test”); *Metge v. Baehler*, 762 F.2d 621, 631 (8th Cir. 1985) (relying on Fifth Circuit’s reasoning in *G.A. Thompson*, 636 F.2d at 958 that the statute and regulations do not require culpable participation, and lack of participation and good faith are affirmative defenses).

⁶⁰ *Lustgraaf v. Behrens*, 619 F.3d 867, 877 (8th Cir. 2010).

NO CULPABLE PARTICIPATION REQUIREMENT UNDER 33 ACT'S CONTROL PERSON STATUTE

Even though the control sections of the 33 Act and the 34 Act are considered “parallel provisions” and generally “their terms are interpreted in the same manner,”⁶¹ that interpretative model ends when it comes to “culpable participation.” The vast majority of courts hold that culpable participation is not required in order to establish control person liability under Section 15 of the 33 Act.⁶²

In so holding, some courts appear focused on the fact that the language of Section 15 of the 33 Act uses language that imparts negligence, unlike the “good faith” requirement in Section 20 of the 34 Act.⁶³ Other courts emphasize that culpable participation is not a required element, since primary claims brought under Sections 11 and 12, unlike 10b-5 claims under the 34 Act, can be established under strict liability or negligence standards.⁶⁴

CONCLUSION

Given the heightened pleading requirements imposed on alleged primary violators under Rule 10b-5, plaintiffs may rely more heavily on Section 20(a)'s secondary control person liability in order to sweep in other, deep pocket defendants. Depending on the jurisdiction and the particular court within that jurisdiction, asserting control person liability may be equally as difficult as pleading primary liability. Or maybe it won't be.

⁶¹ See e.g. *In re Refco Sec. Litig.*, 503 F. Supp.2d 611, 660 (S.D.N.Y. 2007).

⁶² See e.g. *In re Bear Stearns Mortgage Pass-Through Certificates Litig.*, 851 F. Supp.2d 746,773 (S.D.N.Y. 2012); *In re Refco Sec. Litig.*, 503 F. Supp.2d at 637 n.24; *In re Vivendi Universal, S.A. Sec. Litig.*, 381 F. Supp.2d 158, 188 (S.D.N.Y. 2003) (noting contra cases as well); *Freeland v. Iridium World Communs., Ltd.*, 545 F. Supp.2d at 82.

⁶³ See e.g. *In re Refco Sec. Litig.*, 503 F. Supp.2d at 660 n.43.

⁶⁴ *In re Vivendi Universal, S.A. Sec. Litig.*, 381 F. Supp.2d at 188; *In re CINAR Corp. Sec. Litig.*, 186 F. Supp.2d 279, 309–310 (E.D.N.Y. 2002) (noting contra cases); *In re Indep. Energy Holdings*, 154 F. Supp.2d 741, 770 (S.D.N.Y. 2001); *In re Twinlab Corp. Sec. Litig.*, 103 F. Supp.2d 193, 208 (E.D.N.Y. 2000).