This uncertainty and excessive litigation can have ripple effects. For example, newer and smaller companies may find it difficult to obtain advice from professionals. A professional may fear that a newer or smaller company may not survive and that business failure would generate securities litigation against the professional, among others. In addition, the increased costs incurred by professionals because of the litigation and settlement costs under 10b-5 may be passed on to their client companies, and in turn incurred by the company's investors, the intended beneficiaries of the statute.248

What did Central Bank mean for errant gatekeepers? It was a license issued under the seal of the Supreme Court to commit fraud up to the point of its final execution. Lawyers, accountants, and investment bankers could conceive the fraud. Like architects, they could take the concept to the drafting table to design the details.249 Again like architects, they could guide their clients step-by-step through execution of the fraud.250 If the fraud were successful, they could market their creation to others.251 The license came, however, with one key limitation: they could not directly execute the fraud on the investor. If they took this last step, they might be treated as a "primary violator."252

The Supreme Court warned gatekeepers what might happen if they stepped outside the zone:

The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any

248Id. at 189.
249Senator Levin concluded the evidence before his subcommittee established that J.P. Morgan Chase had designed one of the deceptive devices, known as slapshot, used by Enron: "Finally, the Slapshot transaction, another highly disturbing example of a major U.S. financial institution's helping Enron engage in a deception transaction. It is particularly disturbing because Chase, the financial institution involved here, itself designed the deceptive transaction. That was even more than aiding and abetting." Hearings on the Lessons of Enron, supra note 9.
250Substantial evidence showed that the financial institutions involved in the deals knew exactly what was going on. They structured the transactions, signed the paperwork, and supplied the funds, knowing that Enron was using the deal to report earnings better than its financial condition that it really was." See id.
251In the case of Citigroup and Chase, the banks not only assisted Enron, they developed the deceptive package as a financial product and sold it to other companies as so-called 'balance sheet friendly financing,' earning millions of fees for themselves in the process." See id. (emphasis added).
252Cent. Bank, 511 U.S. at 191.
person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met.\(^{253}\)

For the gatekeepers, the warning temporarily created a troubling ambiguity: how is a secondary actor to be distinguished from a primary violator?\(^{254}\) The Second Circuit resolved this ambiguity in *Wright v. Ernst & Young LLP*, making the zone a far safer place to work.\(^{255}\) It delineated the zone's boundary with a bright line.\(^{256}\) Under *Wright*, an actor does not become a primary violator merely by making a misstatement upon which an investor relies.\(^{257}\) The actor must be identified as the author of the lie in the communication to the investor.\(^{258}\) Hence, after *Wright*, gatekeepers could go one step further in perpetrating fraud in the Second Circuit, the location of the nation's financial capital. They could tell the lie so long as they refrained from identifying themselves as its author.

Two other risks exist for gatekeepers operating from the fraud-free zone: Section 11 of the 1933 Act and the SEC. The Section 11 risk is easily contained if one simple rule is followed during a public offering: do not serve as a corporate director, underwriter, certifying expert, or signer of the registration statement.\(^{259}\) A few gatekeepers got sloppy with Enron registration statements and may pay dearly for it.\(^{260}\)

The last risk was the SEC. Congress reinstated the SEC's power to prosecute civil actions against those who aid and abet violations of the 1934 Act, which *Central Bank* had taken away.\(^{261}\) Hence, the SEC may enter the fraud-free zone to check whether attorneys, accountants, and broker-dealers are behaving themselves and issue citations if they are not. Gatekeepers had reason to discount this risk. Only one proceeding, a class

\(^{253}\)See *id.*

\(^{254}\)HAZEN, *supra* note 60, at 691.

\(^{255}\)See *Wright v. Ernst & Young LLP*, 152 F.3d 169 (2d Cir. 1998).

\(^{256}\)Id. at 175.

\(^{257}\)Id.

\(^{258}\)Id.


\(^{260}\)Section 11 claims were expressly upheld against only four relatively minor players in the Enron fraud. *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 707-08 (S.D. Tex. 2002). Whether the Section 11 claim was upheld against Andersen is unclear: Andersen is not listed among the defendants against whom Section 11 claims were upheld. *Id.* On the other hand, its Rule 12(b)(6) motion was denied in its entirety. *Id.* at 708.

action, had ever been brought against any entity for using an SPE to cook the books before Chewco; the claims against the only gatekeeper—an auditing firm—were dismissed during the pleadings stage.\textsuperscript{262} The SEC never brought an injunctive or administrative proceeding on this theory before the Enron collapse.\textsuperscript{263}

One group, however, knew the SEC was not a risk—banks. Their conception, planning, and execution of the Enron fraud were beyond the reach of the SEC and banking regulators. Senator Levin explained this gap and his solution:

There is a regulatory gap now. The Securities and Exchange Commission does not generally regulate banks, and bank regulators don't regulate accounting practices or ensure accurate financial statements. Two steps need to be taken which, together, could close this gap.

First, the SEC should issue a policy which states clearly that the SEC will take enforcement action against financial institutions which aid or abet a client's dishonest accounting by selling deceptive structured finance or tax products or by knowingly or recklessly participating in deceptive structured transactions.

Second, the bank regulators, including the Federal Reserve that oversees our financial holding companies, need to state that violation of that SEC policy that I just described would constitute an unsafe and unsound banking practice, thereby enabling bank examiners to take regulatory action during bank examinations.\textsuperscript{264}

To summarize, the antifraud provisions created little risk for Barclays on the eve of its alleged misadventure with Chewco. More than

\textsuperscript{262}In re Wellcare Mgmt. Group, Inc. Sec. Litig., 964 F. Supp. 632 (N.D.N.Y.1997).

\textsuperscript{263}The first case where the SEC may have contended SPEs were used to cook the books was HSBC Holdings, plc, Notice of Application, 76 SEC DOCKET 11, Investment Co. Act of 1940, Release Nos. IC-25318 & 812-12726 (Dec. 17, 2001), but the facts were not stated in sufficient detail to be sure. The SEC did contend the use of SPEs violated Sections 10(b) of the 1934 Act and 17(a) of the 1933 Act in In re PNC Financial Services Group, Inc., 78 SEC DOCKET 1, Securities Act of 1933, Release No. 8112 (July 18, 2002), Securities Exchange Act of 1934, Release No. 46225 (July 18, 2002) and In re Dynegy, Inc., 78 SEC DOCKET 11, Securities Act of 1933 Release No. 8134 (Sept. 24, 2002), Securities Exchange Act of 1934 Release No. 46537 (Sept. 24, 2002).

\textsuperscript{264}Hearings on the Lessons of Enron, supra note 9.
twenty years of Supreme Court decisions had undone the work of the 73rd Congress. *Central Bank* created a fraud-free zone, safe from private civil suits. A regulatory gap prevented the SEC from entering the zone. So long as Barclays did not identify itself as the author of any lie, it could, with apparent immunity, conceive, plan, and help execute a fraud on Enron investors.

H. *Has the Supreme Court Pulled Back from Blue Chip Stamps?*

In 1995, Congress enacted the Private Securities Litigation Reform Act (PSLRA) to curb what it saw as abusive practices in private securities litigation, particularly in class actions. The legislation tightened pleading requirements for stating securities fraud claims and included an automatic stay of discovery until pleadings issues were resolved. Accordingly, the PSLRA should have obviated the need, from the Court's perspective, for any further steps to implement its war on strike suits.

Indeed, three decisions since the adoption of the PSLRA may signal the Court's pullback from Blue Chip Stamps. In the first, *United States v. O'Hagan*, the Court recognized the "misappropriation theory" as a "complement" to the classic theory of insider trading. The decision creates a new source for a duty under Section 10(b). However, investors have yet been unable to state a claim under the new theory in any reported decision.

The second decision, *Wharf (Holdings) Ltd. v. United International Holdings, Inc.*, is more important for its reasoning than its holding. The Court decided "security" included an oral option. The Court rejected defendant Wharf's argument that enforcement of oral options would violate

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266 See 1933 Act § 27 (15 U.S.C.A. § 77z-1(a)); 1934 Act § 21D (15 U.S.C.A. § 78u-4). The PLSRA, of course, made it more difficult for Enron investors to recover under the antifraud provisions because of its pleading requirements and discovery stay. It does not appear, however, to have been a major obstacle in the *Class Action* against the gatekeepers, since the plaintiffs overcame the Rule 12 (b)(6) motions brought by most gatekeeper-defendants. *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 708 (S.D. Tex. 2002).


268 Id. at 652.

269 See id.

270 No private claim based on the misappropriation theory has advanced beyond the pleadings stage. See, e.g., TFM Investment Group v. Bauer, No. 99-840, 1999 U.S. Dist. Lexis 15821, at *7-8 (E.D. Pa. Sept. 29, 1999) ("Thus, on its face, this case does not seem to fall within this theory because defendant does not owe a duty to plaintiff since plaintiff was not the source of this non-public, material information. In other words, defendant did not 'misappropriate' any non-public information from the plaintiff.").

the policy of Blue Chip Stamps "to protect defendants against law suits that "turn largely on what oral version of a series of occurrences the jury may decide to credit." Defendant Wharf's reliance on Blue Chip Stamps appears well-founded, since a lawsuit based on a "security" arising out of the spoken word was just the flimsy type of suit that Blue Chip Stamps was supposed to stamp out. Hence, the Court's rejection of this argument implies a pullback from Blue Chip Stamps.

SEC v. Zandford is the clearest signal of a pullback. The Court found a violation of Section 10(b) where an errant broker failed to disclose he was selling his client's securities to pocket the proceeds. The Court liberally construed the phrase "in connection with" to bring the broker's conduct within the scope of Section 10(b). As discussed next, however, In re Enron mistakenly reads Zandford to hold Section 10(b) prohibits deceptive conduct without deceptive words.

IV. In re Enron: A Bold But Flawed Effort
To Close the Fraud-Free Zone

The gatekeepers sued in the Enron class action fall into three groups. One group never left the safety of the fraud-free zone; these gatekeepers made no statements to investors. Barclays is the only gatekeeper from this group still in the suit. Central Bank's holding, rejecting liability for aiding and abetting a Section 10(b) violation, appears to protect this group.

A second group of gatekeepers identified themselves as co-authors of the lie in misleading statements distributed to investors. For example, by placing its audit stamp on Enron's financial statements filed with the SEC and distributed to investors, Andersen joined this group. It voluntarily stepped outside the fraud-free zone. Not even the Second

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272See id. at 594 (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 742 (1975)).
273The enforcement of an "oral option" violates at least the spirit if not the letter of Virginia Bankshares, 501 U.S. at 1092.
278See supra text accompanying notes 57-58.
Circuit's "bright line" interpretation of Central Bank can rescue Andersen.\textsuperscript{279}

The third group of gatekeepers made misleading statements passed along to investors; however, these gatekeepers were not so foolish to identify themselves in the documents as the authors of the lie. This group operates within the fraud-free zone under the Second Circuit interpretation of Central Bank, but not so under the SEC's interpretation.\textsuperscript{280}

In denying the gatekeepers' motions to dismiss, In re Enron articulated two legal theories to overcome Central Bank.\textsuperscript{281} The first addressed an issue that Central Bank left open. Central Bank observed secondary actors might become liable as "primary violators" under Section 10(b), but failed to articulate a rule under what circumstances that liability would arise.\textsuperscript{282} In re Enron, adopting the SEC position, held a secondary actor becomes a primary violator when the actor authors the misstatement statement communicated to the investor, even though the statement does not identify the actor as such.\textsuperscript{283} This holding closes the fraud-free zone for all those whose misstatements were passed along to investors, i.e., two of the three groups described above. However, this prong of In re Enron did not reach Barclays's use of Chewco, since those allegations were not based on misrepresentations to investors.\textsuperscript{284} Barclays was still safely within the fraud-free zone.

The second prong of the decision was aimed at the gatekeepers whose deceptive conduct allegedly violated Section 10(b), such as Barclays.\textsuperscript{285} Although a novel theory, it is elegantly simple and rests on legal granite. Central Bank held the defendant bank in that case was not liable for aiding and abetting the preparation of a misleading appraisal.\textsuperscript{286} Hence, the fraud at the core of Central Bank consisted of misleading words. Deceiving with misleading words, however, is not the only way to literally violate Section 10(b) and Rule 10b-5. The text of both the statute and the rule expressly include fraud committed by means other than deceptive words.\textsuperscript{287} On this point, In re Enron reads:

\textsuperscript{279}See Wright v. Ernst & Young LLP, 152 F.3d 169, 175 (2d Cir. 1998) (applying the "bright line" test).  
\textsuperscript{280}See id. The SEC's position on Central Bank was discussed at some length in In re Enron, 235 F. Supp. 2d at 588-90.  
\textsuperscript{281}In re Enron, 235 F. Supp. 2d at 583-90.  
\textsuperscript{282}Central Bank, 511 U.S. at 191.  
\textsuperscript{283}In re Enron, 235 F. Supp. 2d at 587-90. The Second Circuit held the defendant must be identified as the author of any misstatement to be a primary violator. Wright, 152 F.3d at 175.  
\textsuperscript{284}See supra notes 72-73.  
\textsuperscript{285}See In re Enron, 235 F. Supp. 2d at 577.  
\textsuperscript{286}Central Bank, 511 U.S. at 191.  
\textsuperscript{287}In re Enron, 235 F. Supp. 2d at 577.
Securities fraud actions under § 10(b) and Rule 10b-5 are not merely limited to the making of an untrue statement of material fact or omission to state a material fact. Section 10(b) prohibits "any manipulative or deceptive contrivance," which, as indicated above, the Supreme Court, relying on Webster's International Dictionary, includes "a scheme to deceive" or "scheme, plan or artifice."288

Hence, even if the wrongdoer made no misstatement to investors, as Barclays had not, it could still be liable if its conduct was deceptive. Under this theory, for example, Barclays's alleged use of Chewco would amount to the use of a "deceptive device or contrivance" in violation of Section 10(b).289 Central Bank would not protect Barclays because liability was not based on the theory that it aided and abetted Enron. Rather, Barclays acted as primary violator, but its violation was in the form of alleged acts rather than words. To this point, In re Enron's reasoning is sound; it did not stay that way.

Unfortunately for investors, the decision uniformly misstates the holdings of the cases it cites as authority for its textual interpretation of Section 10(b). In re Enron misreads Zandford to hold Section 10(b) may be violated by deceptive conduct without the classic misrepresentation or omission. On this point, the court reasoned:

In Zandford, a unanimous Supreme Court opinion, leaving aside the misrepresentation and omission language since it was not relevant to the case, the high court focused on § 10(b)'s alternative basis for liability, "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . ., any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe" and Rule 10b-5's ban on the use, "in connection with the purchase or sale of any security," of "any device scheme, or artifice to defraud" or any

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288 See id.
289 The Enron court summarized the pertinent allegations of this conduct:

Lead Plaintiff has alleged a scheme or course of business in which the various participant Defendants concealed a pattern of creating unlawful SPEs and utilizing fraudulent transactions with these entities as contrivances or deceptive devices to defraud investors into continuing to pour investment money into Enron securities to keep afloat the Ponzi scheme and thereby enrich themselves in a variety of ways.

See id. at 578 n.15.
other "act, practice, or course of business" that "operates . . . as a fraud or deceit."\textsuperscript{290}

Again later, \textit{In re Enron} states \textit{Zandford} "made crystal clear that a misrepresentation need not be involved and that a suit could be based on Rule 10b-5(a) or (c)."\textsuperscript{291}

\textit{In re Enron}'s reliance on \textit{Zandford} is misplaced. \textit{Zandford} involved the fiduciary duty of a broker-dealer to his customer in a discretionary account.\textsuperscript{292} \textit{Zandford} was pocketing the proceeds from the sales of securities in his customer's account, but not disclosing the thefts to his customer.\textsuperscript{293} Significantly, the taking of the funds was not the violation. Rather, the Supreme Court explained each sale was "deceptive because it was neither authorized by, nor disclosed to, the Woods."\textsuperscript{294}

Similarly, \textit{In re Enron}'s reliance on \textit{Affiliated Ute, Superintendent of Insurance, Santa Fe, Central Bank, and O'Hagan} was misplaced for the same reason.\textsuperscript{295} From these cases, \textit{In re Enron} distills the following principle:

While subsection (b) of Rule 10b-5 provides a cause of action based on the "making of an untrue statement of a material fact and the omission to state a material fact," subsections (a) and (c) "are not so restricted" and allow suit against defendants who, with scienter, participated in "a 'course of business' or a 'device, scheme or artifice' that operated as a fraud" on sellers or purchasers of stock even if these defendants did not make a materially false or misleading statement or omission.\textsuperscript{296}

None of the holdings go that far. To the contrary, in each case, the Court predicated liability on a misrepresentation or a nondisclosure. \textit{Affiliated Ute} ("they possessed the affirmative duty . . . to disclose " the existence of a second market for the securities),\textsuperscript{297} \textit{Superintendent of Insurance} ("Manhattan's Board . . . was allegedly deceived into authorizing

\textsuperscript{290}Id. at 578 (emphasis added) (alterations in original).
\textsuperscript{291}See \textit{In re Enron}, 235 F. Supp. 2d at 585.
\textsuperscript{293}Id.
\textsuperscript{294}Id. at 821 (emphasis added).
\textsuperscript{296}In \textit{re Enron}, 235 F. Supp. 2d at 577 (emphasis added).
\textsuperscript{297}Affiliated Ute, 406 U.S. at 153.
this sale by the misrepresentation that the proceeds would be exchanged for
a certificate of deposit of equal value");298 Santa Fe (no liability because
"there was no 'omission' or 'misstatement' in the information statement");299
O'Hagan ("failure to disclose his personal trading . . . made his conduct
'deceptive'");300 and Central Bank (misleading appraisal).301 Hence, the
reasoning of In re Enron is flawed.

V. CAN THE FRAUD-FREE ZONE BE CLOSED?
YES, IF SECTION 10(B) APPLIES TO CONDUCT

A. One Possibility for Closing the Fraud-Free Zone:
Conduct as Fraud

At least for now, In re Enron closed the fraud-free zone. The case
became the first reported decision to interpret Section 10(b) to impose
liability on an actor who had no contact with the injured investor, solely on
the basis of deceptive conduct.302 This means Barclays, despite its
disciplined silence, may be liable to investors though it never uttered a
word to them. The decision, however, is based on the faulty premise that
the Supreme Court had already decided deceptive conduct—in the absence
of a misrepresentation or omission—may violate Section 10(b). The Court
has never decided the issue, at least not in a way that supports In re Enron.

Indeed, many commentators interpret Santa Fe303 and Schreiber304 to
have reached the opposite holding: a violation of Section 10(b) cannot be
established without a misrepresentation or nondisclosure.305 But their

298Superintendent of Ins., 404 U.S. at 8 n.1.
299Santa Fe, 430 U.S. at 474.
300O'Hagan, 521 U.S. at 660.
301Cent. Bank, 511 U.S. at 166.
2002). The courts, however, have held certain schemes to manipulate prices on the open market
to be in violation of Section 10(b). See HAZEN, supra note 60, at 561-62. Nevertheless, this
limited theory cannot be extended by Enron's investors to impose liability on Barclays for its
alleged use of Chewco. See infra text accompanying note 313.
305See HAZEN, supra note 60, at 564 ("The impact of the Supreme Court's decision in
Schreiber v. Burlington Northern, Inc. could likely be carried over to Section 10(b). The court in
Schreiber held that 'without misrepresentation or non-disclosure, § 14(e) has not been
violated.'") (quoting Schreiber, 471 U.S. at 12); James D. Redwood, Toward a More Enlightened
Securities Jurisprudence in the Supreme Court? Don't Bank on it Anytime Soon, 32 Hous. L.
Rev. 3, 19 (1995) ("The Court [in Santa Fe, 30 U.S. at 476] has informed the securities bar that
'deceptive' in section 10(b) means a misrepresentation or omission to state a material fact . . . .").
Margaret V. Sachs, The Relevance of Tort Law Doctrine to Rule 10b-5: Should Careless
views are part of a larger issue: Is there any legal theory under Section 10(b) for holding Barclays liable which is not barred by a holding of the Supreme Court?

One theory might be based on Barclays's nondisclosure of its secret transactions with Enron and JEDI that rendered Chewco a sham. Since nondisclosure may violate Section 10(b), would not Barclays's failure to disclose these facts constitute such a violation? The omitted facts were "material"; for 1997 alone, the disclosure of these facts would have cut Enron's earnings by forty percent, increased its debt by $711 million, and trimmed shareholders' equity by $313 million. There is, however, a fly in the ointment—duty. Chiarella requires one, but Barclays has none.

No recognized theory obligated Barclays to disclose the secret transactions. First, a duty may arise where the actor is a fiduciary. However, Barclays did nothing to become a fiduciary of Enron's investors. Additionally, even if no duty to speak exists, an actor must speak the full truth if he or she breaks silence—half truths violate Section 10(b).

Barclays kept silent. Finally, a duty to speak may arise under SEC regulations, such as Regulation S-K. No SEC regulation required Barclays to speak. Accordingly, Barclays cannot be held liable under Section 10(b) for its failure to disclose a material fact.

What about the theory that Barclays's alleged role in forming, funding, and controlling Chewco violated Section 10(b)'s prohibition against using a manipulative device or contrivance? This theory collides with the express bar in Hochfelder and Santa Fe where the Court held "manipulate" is a "term of art" limited to specific schemes that artificially

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306 See supra Section II.
307 Affiliated Ute held an omission may serve as the basis for liability under Section 10(b): Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153-54 (1972).
308 Enron Class Action Complaint, supra note 10, ¶ 61.
309 "When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak." Chiarella v. United States, 445 U.S. 222, 235 (1980).
310 See id. at 229.
311 "This statement, then, could be construed to be a half-truth which could be shown to be a § 10(b) violation. Therefore, the court will not dismiss this portion of the claim." Endo v. Albertine, 812 F. Supp. 1479, 1486 (N.D. Ill. 1993).
312 See supra text accompanying note 263.
affect securities prices on the open market, e.g., "wash sales," or "matched orders."\textsuperscript{313} If Section 10(b) cannot get the job done, why not call upon Rule 10b-5 to pick up the slack? Perhaps Barclays's conduct violated one or more of the three prongs of Rule 10b-5, although outside the scope of Section 10(b). This theory risks a rebuke from the Supreme Court based on Hochfelder, which held Rule 10b-5 cannot be interpreted broader than the language of Section 10(b).\textsuperscript{314}

Consequently, this process of elimination leaves only one contender for holding Barclays accountable: Did Barclays use Chewco as a deceptive device or contrivance in violation of Section 10(b)? This issue turns on the Court's holding in Santa Fe and possibly Schreiber. Do these cases mean, as commentators suggest,\textsuperscript{315} that Section 10(b) can only be violated by deception in the form of misrepresentation or nondisclosure? If so, Section 10(b) does not apply to deceptive conduct, such as Barclays's alleged use of Chewco.\textsuperscript{316} For Barclays, this means the denial of its motion to dismiss was error.\textsuperscript{317} For investors, it means the fraud-free zone is permanent unless the Supreme Court reverses Santa Fe\textsuperscript{318} and Schreiber\textsuperscript{319} or unless Congress acts. Neither appears likely.

The commentators have seized on dicta, ambiguous dicta at that, in Santa Fe and Schreiber to buttress their theory that Section 10(b) requires the deception to be in the form of a misrepresentation or nondisclosure.\textsuperscript{320} In both Santa Fe and Schreiber, minority shareholders claimed the buyout of their holdings by the majority violated the 1934 Act. The Santa Fe plaintiffs alleged the majority conducted a Delaware short-form merger in violation of Section 10(b), while the Schreiber plaintiff alleged the majority's tender offers violated Section 14(e).\textsuperscript{321} No claim was made in

\textsuperscript{313}Santa Fe Indus., Inc., v. Green, 430 U.S. 462, 476 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 205 (1976); \textit{In re Enron Corp. Sec., Derivative & ERISA Litig.}, 235 F. Supp. 2d 549, 569 n.10 (S.D. Tex. 2002).
\textsuperscript{314}Thus, despite the broad view of the Rule [10b-5] advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b). Hochfelder, 425 U.S. at 214.
\textsuperscript{315}HAZEN, \textit{supra} note 60, at 564, 678; Redwood, \textit{supra} note 305, at 19 n.52; Sachs, \textit{supra} note 305, at 142.
\textsuperscript{316}\textit{In re Enron}, 235 F. Supp. 2d at 703.
\textsuperscript{317}\textit{id.} at 708.
\textsuperscript{318}Santa Fe Indus., Inc., v. Green, 430 U.S. 462 (1977).
\textsuperscript{320}See \textit{supra} note 315.
\textsuperscript{321}\textit{Schreiber}'s holding, as opposed to its dicta, comes into sharper focus in the context of the conflict it resolved among the circuit courts over the meaning of "manipulation" in Section 14(e). The Court described the conflict: "The Court of Appeals for the Sixth Circuit has held that manipulation does not always require an element of misrepresentation or nondisclosure. The
either case that the majority had used any form of deception.\textsuperscript{322} Accordingly, the issue before the Court in both cases may be stated: Does a violation of Section 10(b) (\textit{Santa Fe}) or Section 14(e) (\textit{Schreiber}) require deception? To the extent the Court decided that issue, its decision was a holding. To the extent it sought to distinguish which species of deception violates Section 10(b) or 14(e), an issue the litigants had not raised, it was parsing an issue that was not before it. The Court's conclusions, therefore, on this issue would be dicta and have no precedential value.\textsuperscript{323}

\textit{Santa Fe}, however, does not even offer dicta to support the theory that Section 10(b) prohibits only verbal deception. A "deceptive device or contrivance," according to \textit{Santa Fe}, not only includes misrepresentations and nondisclosures, but also includes other forms of deception which the Court left undefined. The following statement comes closest to being the holding of \textit{Santa Fe}: "[T]he cases do not support the proposition, adopted by the Court of Appeals below and urged by respondents here, that a breach of fiduciary duty by majority stockholders, without any deception, misrepresentation, or nondisclosure, violates the statute and the Rule."\textsuperscript{324} The use of "deception" in the above phrase must mean something more than misrepresentation or nondisclosure unless the Court's choice of words was

\begin{quote}
Court of Appeals for the Second and Eighth Circuits have applied an analysis consistent with the one we apply today." \textit{Schreiber}, 472 U.S. at 5 n.3 (citations omitted).

In \textit{Mobil Corp. v. Marathon Oil Co.}, 669 F.2d 366, 377 (6th Cir 1981), the district court denied Mobil's application for injunctive relief to prevent a rival from closing its tender offer. In reversing, the Sixth Circuit found the acceptance of the rival tender offer to be manipulation in violation of Section 14(e), even if all facts were disclosed to shareholders. The Court reasoned:

The artificial ceiling on the price of their shares at $125 is manipulation to which they must submit whether it is disclosed to them or not. . . . In short, to find compliance with section 14(e) solely by the full disclosure of a manipulative device as a fait accompli would be to read the "manipulative acts and practices" language completely out of the Williams Act.

\textit{Id.}

Hazan describes the holding in \textit{Marathon Oil}: "[T]he Sixth Circuit held that 'manipulative' conduct under Section 14(e) could extend beyond deception to include interference with the tender offer market." HAZEN, supra note 60, at 536.

\textsuperscript{322}In \textit{Santa Fe}, the Court accepted the district court's conclusion "that the 'complaint fail[ed] to allege an omission, misstatement or fraudulent course of conduct that would have impeded a shareholder's judgment of the value of the offer.'" \textit{Santa Fe}, 430 U.S. at 469. In \textit{Schreiber}, the Court stated: "The amended complaint fails to allege that the cancellation of the first tender offer [the basis of the 14(e) claim] was accompanied by any misrepresentation, nondisclosure, or deception." \textit{Schreiber}, 472 U.S. at 12-13.

\textsuperscript{323}Local 144 Nursing Home Pension Fund v. Demisay, 508 US. 581, 592 n.5 (1993) ("It was, if anything, those dicta themselves—uninvited, unargued, and unnecessary to the Court's holdings—which insulted that virtue; and we would add injury to insult by according them precedential effect."); Colgrove v. Battin, 413 U.S. 149, 158 (1973) ("We cannot, therefore, accord the unsupported dicta of these earlier decisions the authority of decided precedents.").

\textsuperscript{324}\textit{Santa Fe}, 430 U.S. at 476 (emphasis added).
redundant. That flaw should not be presumed. Since deception includes more than the use of deceptive words, it must also include the use of deceptive conduct. In any case, at a minimum, Santa Fe does not bar the application of Section 10(b) to deceptive conduct.

At first glance, Schreiber\textsuperscript{324} does not even seem relevant to the issue whether Section 10(b) reaches deceptive conduct. How could Schreiber's interpretation of "manipulative" in Section 14(e) have any baring on the meaning of a different term ("deceptive") in the context of a different provision (Section 10(b))? The connective theory has four steps. Step 1: Schreiber held "manipulative" conduct does not violate Section 14(e) unless it is also deceptive. Step 2: Schreiber also required the deception to be in the form of a misrepresentation or nondisclosure. Step 3: Section 10(b) should apply to the same type of deception as Section 14(e).\textsuperscript{325} Step 4: Hence, Section 10(b) only prohibits deception in the form of a misrepresentation or nondisclosure.

The flaw in the above theory is at Step 2. As discussed above, any discussion in Schreiber that Section 14(e) only prohibits certain types of deception would have been a dictum, since that issue was not before the Court. But the flaw in Step 2 has a second facet. Schreiber does not merely offer one dictum on this issue; it offers four. The Court makes four conflicting statements in Schreiber—all dicta—of the type of deception required to establish "manipulative" acts or practices. Two suggest the deception may include conduct: the other two suggest the opposite. The Court stated twice that "manipulation" requires a misrepresentation to violate Section 10(b)\textsuperscript{327} and three times that "manipulation" requires either a misrepresentation or nondisclosure to violate Section 14(e).\textsuperscript{328} In yet a


For example, section 14(e) requires that there actually be a tender offer before anything can be considered manipulative, so "shark repellant" techniques like "poison pills" might fall outside its grasp. Moreover, given the general level of complexity, one can understand a judicial desire to adopt a hands-off approach until Congress or the SEC has provided more precise standards.

\textit{Id.}

\textsuperscript{326}Schreiber, 472 U.S. at 4 ("The District Court relied on the fact that in cases involving alleged violations of § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), this Court has required misrepresentation for there to be a 'manipulative' violation of the section."). "But Congress used the phrase 'manipulative or deceptive' in § 10(b) as well, and we have interpreted 'manipulative' in that context to require misrepresentation." Schreiber, 472 U.S. at 7-8.

\textsuperscript{327}Schreiber, 472 U.S. at 8. "Our conclusion that 'manipulative' acts under § 14(e) require misrepresentation or nondisclosure is buttressed by the purpose and legislative history of the provision." \textit{Id.} "We hold that the term 'manipulative' as used in § 14(e) requires misrepresentation or nondisclosure. It connotes 'conduct designed to deceive or defraud investors
third version, which implies deception includes nonverbal acts, the Court stated its holding: "[W]e hold that the actions of respondents were not manipulative. The amended complaint fails to allege . . . any misrepresentation, nondisclosure, or deception." The Court also blessed a fourth meaning of "manipulative" which also includes deceptive acts. The Court decided the meaning it had given "manipulative" was "consistent with the use of the term at common law." The Court then explained how "manipulation" at common law could be satisfied by deception in the form of words or acts:

[T]he seminal English case of Scott v. Brown, Doering, McNab & Co., which broke new ground in recognizing that manipulation could occur without the dissemination of false statements, nonetheless placed emphasis on the presence of deception. As Lord Lopes stated in that case, "I can see no substantial distinction between false rumours and false and fictitious acts." [The court in] United States v. Brown [stated:] "[Even] a speculator is entitled not to have any present fact involving the subject matter of his speculative purchase or the price thereof misrepresented by word or act."

Under this fourth version, as well as the third, Section 10(b) would apply to deceptive conduct and thus reach Barclays's alleged use of Chewco. Two other dicta in Schreiber, however, support the opposite view. The only conclusion that can be drawn from Schreiber is the folly of citing the Court's dicta as law.

In sum, it is a leap, unsupported by the law or logic, to take the holdings in Santa Fe and Schreiber—that a violation of Section 10(b) requires deception—to the conclusion that the deception must be in the form of an omission or a misrepresentation. Further, the Court's language indicates it has not taken that leap. Accordingly, Schreiber and Santa Fe have left the door ajar for the theory that deceptive conduct, without a misrepresentation or omission, violates Section 10(b).

by controlling or artificially affecting the price of securities. Without misrepresentation or nondisclosure, § 14(e) has not been violated." Id. at 12 (citation omitted).

329Id. at 12-13 (emphasis added).

330Id. at 7.

331Id. at 7 n.4 (citations omitted; emphasis added) (quoting Scott v. Brown, Doering, McNab & Co., [1892] 2 Q.B. 724, 730 (C.A.); United States v. Brown, 5 F. Supp. 81, 85 (S.D.N.Y. 1933)).

332See Schreiber, 472 U.S. at 7, 12-13; Santa Fe, 430 U.S. at 476.
That opening may widen if recent Supreme Court decisions truly signal a pullback from the "policy considerations" announced in Blue Chip Stamps. As discussed above, in order to deter strike suits, the Court restricted the reach of the antifraud provisions in a series of decisions that began in 1974. The enforcement of those "policy considerations" was obviated, if ever needed, by Congress's adoption in 1995 of PSLRA, which also had the goal of eliminating specious suits for securities fraud. Indeed, the Court's later decisions in Wharf, O'Hagan, and Zandford suggest it may be pulling back from its disciplined application of Blue Chip Stamps.

This implies a more benign environment for the Court to consider closing the fraud-free zone. Further, the magnitude and scope of the Enron fraud demonstrate the Court has gone too far in weakening the antifraud provisions to protect Wall Street and corporate America from strike suits. But a benign environment is not enough. A viable legal theory must require the Court to close the zone. That theory must accept as given the Court's decisions that created the zone, Blue Chip Stamps and its progeny, which now, as precedents, obstruct its closing. The legal theory presented next endeavors to satisfy those criteria. It has four complementary but independent strands. The theory begins where In re Enron did, but takes a different path at the fork where that case went wrong.

B. Textual Interpretation: Section 10(b) Applies to Conduct

The Supreme Court claims to use the most basic rule of statutory construction for deciding whether a wrongdoer's conduct falls within the scope of Section 10(b). In the Court's words, "[T]he statutory text controls the definition of conduct covered by § 10(b)." So, accepting the Court's mandate, what is the literal meaning of the key language in Section 10(b)? The Court has already adopted definitions for two of the three key words in the operative phrase: "deceptive device or contrivance." Using Webster's International Dictionary, Hochfelder defined "device" to mean

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334See supra Sections III.F.-G.
337Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 175 (1994); see also SUTHERLAND, supra note 243, § 47.01 (stating that "[t]he starting point in statutory construction is to read and examine the text of the act and draw inferences concerning the meaning from its composition and structure").
"[t]hat which is devised, or formed by design; a contrivance; an invention; project; scheme; often, a scheme to deceive; a stratagem; an artifice."\textsuperscript{338} Again using the same dictionary, the Court defined "contrivance" to mean "in pertinent part . . . [a] thing contrived or used in contriving; a scheme, plan, or artifice.' [and] [i]n turn, 'contrive' in pertinent part [to mean] '[t]o devise; to plan; to plot . . . [t]o fabricate . . . design; invent . . . to scheme.'\textsuperscript{339} To complete the definitions, the same dictionary defines "deceptive" to mean "tending or having power to deceive."\textsuperscript{340} Hence, using the Court's definitions and its choice of dictionaries, a deceptive device or contrivance covers a broad spectrum of conduct, including: an invention, stratagem, or thing fabricated tending to deceive. Thus, a "deceptive device or contrivance" literally includes both the scam artist's use of the cassock and collection box, as well as Barclays's alleged use of Chewco to doctor Enron's books.

C. Contextual Interpretation: Section 10(b) Applies to Conduct

Another key principle of statutory construction requires each section of a legislative scheme, such as the 1933 and 1934 Acts,\textsuperscript{341} to be construed with the other sections to produce a "harmonious whole."\textsuperscript{342} The Supreme Court applied a variant of this principle in \textit{Touche Ross}, when it refused to imply a private remedy under Section 17(a) of the 1934 Act.\textsuperscript{343} Preliminarily, the Court observed Congress had created express remedies in Sections 18(a) and 9(e).\textsuperscript{344} From that threshold, in refusing to imply a remedy, the Court reasoned: "Obviously, then, when Congress wished to provide a private damages remedy, it knew how to do so and did so expressly."\textsuperscript{345}

This principle equally applies in ascertaining the meaning of "deceptive device or contrivance." If Congress intended this phrase to include only fraud committed by misleading statements or omissions, two nagging questions seek an answer: (1) Why did it depart from the two
formulas it used in five other antifraud provisions, and (2) why did it employ such obtuse language in Section 10(b) to say the same thing? Sections 11, 12(a)(2), and 17(a)(2) of the 1933 Act explicitly define fraud as the use of a misrepresentation or omission.\footnote{See Securities Act of 1933, § 11, 15 U.S.C.A. § 77k (West 1997); § 12(a)(2), 15 U.S.C.A. § 77l(a)(2) (West 2003); § 17(a)(2), 15 U.S.C.A. § 77q(a)(2) (West 2003).} Sections 9(a)(4) and 18(a) of the 1934 Act define fraud as the use of false or misleading statements.\footnote{See Securities Exchange Act of 1934, § 9(a)(4), 15 U.S.C.A. § 78i(a)(4) (West 2003); § 18(a), 15 U.S.C.A. § 78(a) (West 1997).} Hence, using the language "deceptive device or contrivance" to mean the same makes no sense. The principles of statutory construction require a more harmonious interpretation of this statutory scheme.\footnote{See SUTHERLAND, supra note 243, § 46.05.} The rule of construction from \textit{Touche Ross} is easily adapted to the issue here: when Congress intended to define fraud committed by a misstatement or omission, "it knew how to do so and did so expressly."\footnote{Touche Ross, 442 U.S. at 572.} Therefore, in using the language "deceptive device or contrivance," Congress must have intended to define a different type of fraud, one that went beyond misleading or omitted words. That leaves deceptive conduct.

D. \textit{Intent of the 73rd Congress: Section 10(b) Applies to Conduct}

By way of background, two identical bills that became the 1934 Act were introduced in the House and Senate during February 1934.\footnote{S. 2693, 73d Cong. (1934); H.R. 7852, 73d Cong. (1934).} Section 9(c) of these bills, which became Section 10(b), did not contain the language "manipulative or deceptive device or contrivance."\footnote{S. 2693, 73d Cong. § 9(c) (1934); H.R. 7852, 73d Cong. § 9(c) (1934).} The original language of Section 9(c) broadly prohibited the use of "any device or contrivance in a way or manner which the Commission may by its rules and regulations find detrimental to the public interest or to the proper protection of investors."\footnote{S. 2693, 73d Cong. § 9(c) (1934); H.R. 7852, 73d Cong. § 9(c) (1934).} Section 9(c) would pass through three iterations on its way to becoming Section 10(b). As discussed below, Congress added the limiting language "manipulative and deceptive" to Section 9(c) so its grant of power to the SEC would not exceed constitutional constraints.

The concern over Section 9(c) was part of the larger concern about the constitutionality of the entire 1934 Act. The 73rd Congress foresaw the risk that the courts might strike down the 1934 Act as an unlawful delegation of legislative authority. This concern was apparent in the report
of the House Interstate and Foreign Commerce Committee (House Committee), which offered a lengthy justification for the broad delegation of legislative power, at that time to the Federal Reserve Board and the Federal Trade Commission. The Report stated the grant of legislative power to regulatory agencies went to the limit the Committee thought the Constitution would permit. The Committee wrote, "The constitutional significance of the wide delegation of powers . . . has been considered with particular care . . . The bill legislates specifically, just as far as the Committee feels it can."

These concerns were well-founded. At the time the 73rd Congress was holding hearings on the 1934 Act, the National Industrial Recovery Act—enacted a year earlier—was under constitutional attack as an unlawful delegation of legislative authority. The following year, the Supreme Court would strike down two separate provisions of the National Industrial Recovery Act on this exact constitutional ground.

In regard to Section 9(c), the criticism of the bill from the securities industry was unanimous, uniform, and high-pitched. For example, the president of the Associated Stock Exchanges testified before the Senate Banking and Currency Committee:

This subsection [9(c)] is so vague and inadequate for the purpose evidently intended to be accomplished that it should be stricken out in its entirety. To allow it to remain leaves in the hands of the commission a weapon with which that body


The constitutional significance of the wide delegation of powers to the Federal Reserve Board and to the Federal Trade Commission, which would administer the act, has been considered with particular care—and the delegation made only with the indication of such maximum standards for discretion as, in the considered judgment of the Committee, the technical character of the problems to be dealt with would permit. The bill legislates specifically, just as far as the Committee feels it can. . . In a field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers in the administrative agency have been found practically essential, despite the desire of the Committee to limit the discretion of the administrative agencies so far as compatible with workable legislation.

Id. at 799-800.

[334] Id. (emphasis added).


might determine upon anything as being detrimental to the public interest or to the proper protection of investors.\textsuperscript{357}

In a similar vein, the president of the New York Exchange testified before the Senate Committee:

The final subsection [9(c)] giving the Federal Trade Commission [later changed to the SEC] unlimited power to make unlawful any device or contrivance which it may determine is detrimental to the public interest, is a surprising delegation of power, particularly as any violation of the rules or regulations of the Commission would be a criminal act which might result in heavy fines and imprisonment.\textsuperscript{358}

Given the tone of this criticism, both the Senate and the House bills were amended to add the qualifying term "manipulative."\textsuperscript{359} The criticism did not abate. After the amendment, the attorney for the New York Stock Exchange testified before the Senate Committee:

We suggest that section 9 be omitted entirely... As to subsection (c), which seemed to be a general grant of power to the Commission to define as a crime any practice which they thought was manipulative, it seemed to us to be an altogether too broad grant of power to any administrative body. It is a criminal provision there, which the Federal Trade Commission might, by rule or regulation, interpret in common practice, and suddenly announce that it was a violation of that, subjecting the violator to 10 years in jail. It seemed to us to be going a little far, and we suggest its omission \textit{in toto}.\textsuperscript{360}


\textsuperscript{358}Id. at 6634 (statement of Richard Whitney, President, New York Stock Exchange); see also id. at 6910 (statement of Frank R. Hope, President, Association of Stock Exchange Firms, New York City): "The last subdivision of this section [9] giving them [FTC] control over devices and contrivances might be construed to mean almost anything."

\textsuperscript{359}See H.R. 8720, 73d Cong. § 9 (c) (1934); see S. 3420, 73d Cong. § 10(b) (1934).

\textsuperscript{360}Stock Exchange Practices: Hearings on S. Res. 84 (72nd Cong.) and S. Res. 56 and S. Res 97 (73d Cong.) Before the Senate Banking and Currency Committee, 73d Cong. 7561-7562 (1934) (statement of Roland L. Redmond, Attorney for New York Stock Exchange) (emphasis added)
Apparentlly out of constitutional concerns, the House Committee withdrew Section 9(c) in its entirety from the bill, and the full House passed the bill without 9(c).

The Senate Committee continued to work on the language of 9(c). A proposed amendment was submitted by a spokesperson for the Roosevelt Administration, Assistant Secretary of Commerce, John C. Dickinson (Dickinson). He suggested "deceptive" be substituted for "manipulative" in the phrase "manipulative device or contrivance," the language in the bill then under consideration by the Senate Committee. Dickinson believed the change was necessary because, in his judgment, "manipulative" was so vague a standard that Section 9(c) was unconstitutional. His suggestion to revise Section 9(c) read:

Section 9c gives to the Commission power to forbid the use of any "manipulative" device or contrivance which the Commission may find detrimental to the public interest. The word "manipulative" is extremely vague and in my opinion supplies no adequate standard for the Commission to act upon. Some word or words should be used which more specifically indicates [sic] the nature of the evil designed to be rectified. I suggest that the word "deceptive" be substituted for "manipulative" in line 3 on Page 27 and also in the heading of Section 9 in line 10 of Page 26. It would not be in my opinion for Constitutional purposes a sufficiently clear standard to outlaw any device which the Commission may find "detrimental to the public interest."

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361 See Thel, supra note 361, at 417. This article establishes Dickinson was the source of the amendment to H.R. 8720 that added the term "deceptive." See id.

The Senate Committee,366 and later Congress itself, did half what Dickinson asked. It added "deceptive" but did not delete "manipulative," which resulted in the phrase "manipulative or deceptive device or contrivance" in the final text of Section 10(b).367

Accordingly, the legislative history of Section 10(b) warrants the most liberal interpretation of the term "deceptive" in the phrase "manipulative or deceptive device or contrivance." Congress's intent may be stated: "deceptive" was added to the text of Section 10(b) so that section would not be an unlawful delegation of Congressional power. Therefore, in applying congress's will, the court should not define "deception" so broadly that it renders Section 10(b) unconstitutional. Short of that, the term should be interpreted consistently with Congress's intent to delegate the broadest authority to the SEC to promulgate rules, such as Rule 10b-5, to deter and punish securities fraud.

The congressional testimony of Thomas G. Corcoran (Corcoran), "a spokesman for the drafters,"368 also supports the application of Section 10(b) to deceptive conduct. The Supreme Court has recognized Corcoran's testimony as the "most relevant exposition of the provision that was to become § 10(b)."369 In February 1934, Corcoran testified before the House Committee to the scope and purpose of Section 9(c) of the original bill that would later become Section 10(b): "Thou shalt not devise any other cunning devices."370 He continued, "Of course subsection (c) is a catch-all clause to prevent manipulative devices... The Commission should have the authority to deal with new manipulative devices."371 Since Corcoran testified before the word "deceptive" was added to the text of Section 9(c), the final version would be more aptly characterized as "a catch-all clause" designed to deal "with new manipulative or deceptive devices."372

Corcoran's use of the terms "other cunning devices" and "catch-all" clarifies Section 10(b)’s place in the statutory arsenal. Section 10(b) was intended to reach future variants of the fraudulent and manipulative practices specifically prohibited by the 1934 Act. Accordingly, the reach of Section 10(b) is tied to the reach of the other provisions in the Act that prohibit manipulative or deceptive practices. If the latter apply to manipulative and deceptive conduct as well as misleading words, Section

366See Thel, supra note 361, at 453 nn.312-16.
367See H.R. 9323, 73d Cong. § 10(b) (1934).
369See id.
370Stock Exchange Regulation Hearings on H.R. 7852 and H.R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong. 115 (1934) (emphasis added).
371Id. (emphasis added).
372See id.
10(b) must do the same or fail in its role as a "catch-all." In this light, Section 18 of the 1934 Act applies to deceptive conduct as well as misleading words, reaching acts that cause misleading statements to be included in SEC filings. Likewise, Section 9 applies to both conduct and misleading words. Therefore, for Section 10(b) to fulfill its role as a "catch-all," it must also apply to deceptive conduct as well as deceptive words.

E. Replacing the Failed "Policy Considerations" of Blue Chip Stamps

The fraud-free zone exists because the Rehnquist majority overlooked one inherent quality of fraud: its ever-changing form. As fraud changes form, it moves beyond the reach of statutes and regulations too tightly drafted or too strictly interpreted. In the context of Enron, as classic accounting fraud morphs into Chewco, it steps beyond the reach of the antifraud provisions too tightly drawn by the Rehnquist majority.

Four decades ago, before the Rehnquist majority, the Supreme Court had a better grasp of this inherent quality of securities fraud: the ability to change its form. In SEC v. Capital Gains, the Court recognized, "'general and flexible' antifraud provisions . . . have long been considered necessary to control 'the versatile inventions of fraud-doers.'" It quoted from an eighteenth century English judge who could be describing Barclays's alleged use of Chewco:

Fraud is infinite, and were a Court of Equity once to lay down rules, how far they would go, and no farther, in extending their relief against it, or to define strictly the species or evidence of it, the jurisdiction would be cramped, and perpetually eluded by new schemes which the fertility of man's invention would contrive.

Capital Gains relied on a chain of authority that linked this principle back to the jurisprudence of ancient Rome. Capital Gains borrowed the

372Of the nine types of practices prohibited by subsection 9(a) and (b), only subsection 9(a)(4) is limited to misleading words. The other eight categories prohibit different types of conduct. See Securities Exchange Act of 1934, 15 U.S.C.A. § 78l (West 1997).
374Capital Gains, 375 U.S. at 193 n.41 (quoting Letter from Lord Hardwicke to Lord Kames (June 30, 1759), printed in J. PARKES, HISTORY OF THE COURT OF CHANCERY 508 (1828), quoted in E. SNELL, PRINCIPLES OF EQUITY 496 (25th ed. 1960)).
phrase "versatile inventions of fraud-doers" from the Missouri Supreme Court, which explained in Stonemets v. Head why fraud must be defined flexibly: "Fraud being infinite and taking on protean form at will, were courts to cramp themselves by defining it with a hard and fast definition, their jurisdiction would be cunningly circumvented at once by new schemes beyond the definition."376 Stonemets cited an earlier decision of the same court, Howard v. Scott,377 which suggested, in colorful prose, why fraud must be undefined.378 Howard borrowed this notion from an early nineteenth century treatise.379 That treatise traced the principle—a flexible law to adapt to the changing form of fraud—back to its origin in ancient Rome.380 Over time Roman jurists, from Cicero to Labeo, had a hand in refining the definition of fraud.381 Its last and "true" iteration, from more than 2,000 years ago, seems to blend Rule 10b-5 and Section 10(b). Under

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376 Stonemets, 154 S.W. at 114. The court noted the far-reaching potential of fraud when it stated:

Fraud is kaleidoscopic, infinite. Fraud being infinite and taking on protean form at will, were courts to cramp themselves by defining it with a hard and fast definition, their jurisdiction would be cunningly circumvented at once by new schemes beyond the definition. Messieurs, the fraud-feasors, would like nothing half so well as for courts to say they would go thus far, and no further in its pursuit. Accordingly definitions of fraud are of set purpose left general and flexible, and thereto courts match their astuteness against the versatile inventions of fraud-doers.

Id. (citations omitted)

377 Id.

378 The Howard court explained "fraud" was left undefined by wisest of jurists: What is fraud? No statute and no judge has been so daring and unwise as to define it by hard and fast rules. That pre-eminent jurist who "perfected English equity into a symmetrical science," who is deemed by no less an authority than Lord Campbell "the most consummate judge who ever sat in the court of chancery," Lord Chancellor Hardwicke, he who as the lad, Phillip Yorke, was designed by his pious Presbyterian mother for some "honester trade" than the profession of an attorney (she longing to "see his head wag in the pulpit") who gave his "days and nights to the volumes of Addison" in acquiring a luminous and chaste style, and at the bar with unremitting toil and pains, superadded to a happy temperament and facile and receptive mind, informed and grounded himself in all essentials to wisdom, learning and virtue on the woolsack, so that his administration on that judgment seat is "fondly looked back upon as the golden age of equity," laid down the precept, never since departed from, that fraud should be left undefined.

Howard v. Scott, 125 S.W. 1158, 1165 (Mo. 1910) (emphasis added).

379 See id.; see 1 Joseph Story, LL.D, Commentaries on Equity Jurisprudence as Administered in England and America 185 (12th ed. 1877). The case cites the 13th edition, which was unavailable.

380 Story, supra note 379, at 185.

381 See id.
Roman law, fraud was defined "to be any cunning deception, or artifice, used to circumvent, cheat, or deceive another."\(^{382}\)

The economic and financial collapse that began in 1929 taught the 73rd Congress why the Romans defined fraud so liberally. In explaining the need for the delegation of broad rule-making authority to the SEC, the House Report on the 1934 Act explained:

In a field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers in the administrative agency have been found practically essential, despite the desire of the Committee to limit the discretion of the administrative agencies so far as compatible with workable legislation.\(^{383}\)

In a similar vein, the Senate report also spoke to the need for flexibility in the antifraud provisions:

The [C]ommittee has repeatedly heard testimony illustrating the evasions, suppressions, distortions, exaggerations, and outright misrepresentations practiced by corporations with intent to cloak their operations and to present to the investing public a false or misleading appearance as to financial condition . . . . Many other instances of "window-dressing" were observed, where inexcusable methods were employed to inflate assets, obscure liabilities, and conceal deficits.\(^{384}\)

What Congress, Corcoran, the Missouri Supreme Court, Lord Chancellor Hardwicke, and Cicero all grasped, and the Rehnquist majority forgot, is the ingenuity of those who commit fraud. Congress saw a spectrum of wrongdoing, ever-changing, comprised of deception at one end, manipulation at the other, and the two overlapping somewhere in the middle. To the extent the Constitution would permit, it delegated the authority to the SEC to adapt the law to these dynamics.

The Rehnquist majority, on the other hand, saw manipulation and deception as two narrow and static bands on the conduct spectrum. For twenty-one years, it conformed the antifraud provisions to this vision.

\(^{382}\)In its original Latin: "Dolum malum esse omnem calliditatem, fallaciam, machinationem ad circumveniendum, fallendum, decipiendum alterum, adhibitam." See id.

\(^{383}\)H.R. No. 73-1383, at 6-7 (1934).

\(^{384}\)S. Rep. No. 73-792, at 11 (1934).
When the majority was done, the law wore shackles. Attorneys, accountants, and investment banks were licensed to help their clients commit fraud.

Corporate scandals, the recent market collapse, and the Sarbanes-Oxley Act certify the "policy considerations" of Blue Chip Stamps a failure. Enron may be the vehicle for the Court to substitute the policy that guided the 73rdCongress—to protect the investor—for the "policy considerations" of Blue Chip Stamps—to protect the S&P 500. It is time for the Court to reconsider Justice Blackmun's dissent in Blue Chip Stamps: "[T]he Court exhibits a preternatural solicitousness for corporate well-being and a seeming callousness toward the investing public quite out of keeping, it seems to me, with our own traditions and the intent of the securities laws."385

VI. CONCLUSION

The Supreme Court has created a haven for expertise and money ready to help others commit fraud. Attorneys and accountants, some of the best, are the expertise. Financial institutions, some of the largest, are the money. These two elements need only a generous risk taker, someone willing to commit fraud for profit. The candidate must be risk-tolerant because fraud is risky business and generous because the services of money and expertise do not come cheap. Such risk takers have never been scarce. Hence, so long as the fraud-free zone is open, fraud is inevitable. When the largest financial institutions and some of the most sophisticated lawyers and accountants help conceive and execute the fraud, as they allegedly did with Enron,386 its magnitude may be breathtaking.

The 73rd Congress never contemplated the SEC would alone enforce the antifraud provisions. It also armed a militia to help with the task. Both the 1933 and 1934 Acts contain express provisions allowing injured investors to bring civil actions to recover their losses. The courts implied other civil remedies. Those lawsuits curb the greed of money, expertise and risk takers in two ways. First, by bringing the business practices of the enterprise (money-expertise-risk taker) into the sunshine, investor lawsuits raise the risk of enforcement proceedings by the SEC or criminal charges by federal or state prosecutors. Second, and more directly, they make the enterprise less profitable to the extent that investors recover their losses.387

386See supra Section II.
387See Dooley, supra note 137, at 836.
Before Blue Chip Stamps and its progeny "fixed" the antifraud provisions, it was commonly accepted that private lawsuits deterred securities fraud. Ironically, this point is forcefully made by one of the authorities cited by the Supreme Court in Blue Chip Stamps in support of its new "policy considerations." Applying a "cost-benefit analysis," the author explains how private lawsuits under Section 10(b), before Blue Chip Stamps, caused issuers and underwriters to improve the accuracy of information disclosed to the public:

If the costs of inadequate information are imputed to issuers and underwriters, they will be induced to improve the quality of information they supply in prospectuses, up to the point at which the benefit to be derived from reducing the risk of liability by the inclusion or verification of one more item of information is equal to the cost of including or verifying that information. If the marginal cost of improving the information is less than the marginal benefit from avoiding the corresponding risk of liability, the issuers and underwriters will improve the information; and vice versa. A corollary to the author's reasoning may be stated: if the liability cost for inaccurate information is not imputed to issuers and underwriters, they will not incur the cost to make the prospectus factually accurate.

The 1933 and 1934 Acts seemed to be working well enough over their first forty years. The markets took their bumps, but they were caused by, not the cause of, economic events. The collapse of the financial markets in 2000 was its own doing, the burst of a bubble that began to form in 1995. One year before that bubble began to inflate, Central Bank declared the fraud-free zone open for business. Attorneys, accountants, and banks could help public companies cheat their investors and not worry about pesky lawsuits, so long as they stayed within the brightly lit boundaries of the fraud-free zone. The SEC, which had never investigated a Chewco-style fraud, posed little risk for Enron's accountants and attorneys, and no risk for its banks, thanks to a gap in the regulatory system.

No one knew better than Ferdinand Pecora (Pecora) what would happen if money and expertise broke free from the constraints of the 1933 and 1934 Acts. Pecora was chief counsel for the Senate Committee that

388Blue Chip Stamps, 421 U.S. at 740 (citing Dooley, supra note 137, at 836).
389See Dooley, supra note 137, at 836.
390See supra text accompanying note 264.
drafted the 1933 and 1934 Acts, including the key operative language of Section 10(b). His detailed cross-examination of powerful bankers, brokers, and industrialists before the Senate Committee revealed the very ills the 1933 and 1934 Acts were designed to cure. Those hearings eventually were named after him, the Pecora Hearings. Reflecting years later, Pecora warned in his opening words in *Wall Street under Oath*:

> Under the surface of the governmental regulation of the securities market, the same forces that produced the riotous speculative excesses of the "wild bull market" of 1929 still give evidences of their existence and influence. Though repressed for the present, it cannot be doubted that, given a suitable opportunity, they would spring back into pernicious activity.

> Frequently we are told that this regulation has been throttling the country's prosperity. Bitterly hostile was Wall Street to the enactment of the regulatory legislation. It now

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391 Pecora served as chief counsel to the Senate Committee on Banking and Currency from January 1933 to July 1934, the period during which the 1933 and 1934 Acts passed through the Committee and were enacted by the Congress. See FERDINAND PECORA, WALL STREET UNDER OATH: THE STORY OF OUR MODERN MONEY CHANGERS 3 (1939), reprinted by Augustus M. Kelly (1968).


[From January 24, 1933, through May 4, 1934, with full press coverage, Mr. Pecora conducted a painstakingly detailed cross-examination of the country's most respected bankers, brokers, and industrialists, producing evidence of a plethora of problems. In particular, the hearings found evidence of the following: unsound credit practices leading to excess speculation in the markets; manipulative devices used by pools, such as wash sales, matched orders, and short sales, all of which produced a false impression of market activity and/or manipulated or depressed the prices of the securities; unfair or manipulative market activities by insiders and directors; various deceptive and manipulative devices used during the underwriting of securities, including a lack of full disclosure of the underlying facts concerning the companies whose securities were being sold; monopolistic practices by investment banks; and unfair practices, such as the use of "preferred lists" for distributing securities.

Id.

393 Adam Clymer, *The Nation*: Hearing One Tree; Never Have So Many Missed the Forest, N.Y. TIMES, Feb. 10, 2002, § 4, at 6 ("The most striking past investigations of business were the "money trust" probe in 1912 and 1913... and the stock market investigation of 1932 to 1934 (unique among Congressional probes because it is not named after a chairman, but after its chief counsel, Ferdinand Pecora"); Williams, supra note 392, at 1123-24 ("These hearings, referred to as the Pecora hearings after Ferdinand Pecora, the chief counsel hired shortly after Roosevelt's election, produced extensive evidence of market manipulation by corporate officers and investment bankers.").
looks forward to the day when it shall, as it hopes, reassume the reigns of its former power. . . .

The public, however, is sometimes forgetful. As its memory of the unhappy market collapse of 1929 becomes blurred, it may lend at least one ear to the persuasive voices of The Street subtly pleading for a return to the "good old times." 394

Pecora got it right with one caveat: The Supreme Court, not the public, would warm to the message that the antifraud provisions were "throttling the country's prosperity." When the Court dismantled those laws, as Pecora predicted, the "same forces that produced the riotous speculative excesses of the 'wild bull market' of 1929 . . . [sprang] back into pernicious activity." 395

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394 PECORA, supra note 391, at ix-x.
395 Id. at ix.