Aiding and Abetting Liability – Gatekeepers Beware

With over $3 billion in settlements to date, financial gatekeepers (including accountants, lawyers, lenders and investment bankers) should beware – the tide may be starting to turn against them and their liability carriers. The gatekeepers of the world have faced a road filled with ups and downs, good times and bad and their fate remains tied to the views of the courts and Congress.

The bad times came first. Between the passage of the Securities Exchange Act of 1934 and the United States Supreme Court’s 1994 ruling in Central Bank of Denver, NA v. First Interstate Bank of Denver, NA, courts recognized a private cause of action against gatekeepers under Section 10(b) and Rule 10(b)-5 of the federal securities law. The three elements to proving the aiding and abetting were:

- Someone other than the aider-abettor violated federal securities laws.
- The aider-abettor had general awareness of the primary violation or his or her own improper conduct.
- The aider-abettor provided substantial assistance to the primary violator.

The good times followed. In Central Bank, the US Supreme Court held that a private plaintiff may not maintain an aiding and abetting suit against gatekeepers under Section 10(b). Therefore, according to the Court in Central Bank, gatekeepers could only be liable if plaintiffs could prove the higher standard of primary liability under the federal securities laws. The good times continued when the Private Securities Litigation Reform Act of 1995 (SRA), despite lobbying efforts to the contrary, did not include a private right of action for aiding and abetting. However, the gatekeepers were not quite free and clear because the SRA did give the Securities and Exchange Commission the authority to bring actions for aiding and abetting under the Securities and Exchange Act of 1934.

To "abet" is to encourage, incite, or set another on to commit a crime. In relation to a charge of aiding and abetting, the term supposes knowledge of the perpetrator’s wrongful purpose, and encouragement, promotion or counsel of another in the commission of the criminal offense.

To "aid and abet" is to help, assist, or facilitate the commission of a crime, promote the accomplishment thereof, help in advancing or bringing it about, or encourage, counsel or incite as to its commission.

Black’s Law Dictionary

Unfortunately for the gatekeepers, Central Bank left open the question of just what activities of the secondary actors would result in liability. Not surprisingly, the circuits interpreting Central Bank have diverging views on the type of activity that is required to impose primary liability. The Ninth Circuit created the “substantial participation” approach, whereby a secondary actor could be held liable for substantially participating or being intricately involved in a violation of Section 10(b). A bright line approach is followed by the Second, Tenth and Eleventh circuits whereby the secondary actor must have been identified to investors as the author of the misstatement in order to be liable as a primary actor. Clearly the Ninth Circuit approach is more flexible than the bright line approach followed in other circuits.
More recently, although Congress had an opportunity to legislatively create an aiding and abetting cause of action against gatekeepers through Sarbanes-Oxley (SOX), it did not do so. SOX creates accountability and certain duties of professional conduct, but clearly does not create a private right of action.

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But it can’t all be good – there may still be bad times ahead for the gatekeepers. Because Congress has not seized on the opportunity to bring back aiding and abetting liability, the ball is now in the courts’ court and the good times may be over. Judge Melinda Harmon’s decision in In Re Enron Corp. Sec., Derivative & ERISA Litig., denying many of the gatekeepers’ motions to dismiss, appears to be inching away from Central Bank and inching toward aiding and abetting liability. Judge Harmon expanded the scope of liability even further than the Ninth Circuit’s “substantial assistance” approach by finding that even if gatekeepers make no misstatement to investors either directly or indirectly, they can still be liable if their conduct is found to be deceptive. Some commentators have opined that Judge Harmon’s opinion is flawed and that it will be overturned on appeal, but only time will tell.

One thing is for certain, gatekeepers will always be targets of the plaintiffs’ bar. The uncertainty is whether the gatekeepers will have the ammunition, either through case law precedent or federal law, to fight for and win quick dismissals. Stay tuned . . .

The New Reality: Terrorism and Kidnap and Ransom Coverage

Significant resources worldwide have been allocated to reducing the vulnerability of traditional high-profile terrorist targets such as embassies, transportation networks, critical utilities and other key infrastructure. As we grow more effective in preventing such attacks, terrorist groups will expand their target list to assure their cause continues to garner the media attention they seek.

Asymmetric warfare occurs when a party employs unexpected or unusual tactics to neutralize the superiority of its opponents. Militants have employed asymmetric warfare in recent years through bombings, assassinations, hijackings and kidnappings.

Images of foreign hostages in the hands of Islamic militants in Iraq have recently focused attention on the threat that kidnapping poses to private contractors in that environment. The taking of civilian hostages allows them to meet their dual objectives of bringing attention to their cause as well as spreading fear without engaging a superior enemy.

The purpose of these of these acts, at least in part, is to frustrate US efforts to employ the private sector in the rebuilding of Iraqi infrastructure and development of social and political institutions. It can be argued that the spate of foreign hostage taking has, to some extent, had its desired effect, with a number of participating countries ordering the evacuation of their citizens. Even the British foreign office - which has avoided warning civilians against "essential" trips to Iraq despite the dangers - has revised its travel advice, saying "even the most essential travel to Iraq should be delayed, if possible."

Dealing with the threat of terrorism is a worldwide effort and it is inevitable that civilians from Western countries will be targeted. Kidnap & Ransom insurance, which has no exclusion for terrorism and which includes an array of prevention and response services, is at the center of this storm.

Twenty-three terrorist organizations on the State Department’s current list of Foreign Terrorist Organizations have acted against US citizens and interests. Most of these groups are comprised of radical Islamic militants but others include the Japanese Red Army, Colombian and Philippine leftist guerrillas, and Greek militant nationalists. The areas of these groups’ activities include the Middle East, East Asia, South Asia, Central Europe, the former Soviet Union and South America. Post-9/11, the US must of course be included on this list as well.
Companies operating internationally should be well aware of the threats of kidnapping for ransom and political detention – both of which have been seen recently in Iraq. Reliable statistics are difficult to obtain for several reasons: many kidnappings are not reported out of fear of retaliation by kidnappers; there are laws that prohibit payment of ransom; and there is often pressure by foreign governments concerned about losing foreign investment and tourism revenues. But a conservative estimate of the annual number of kidnappings for ransom worldwide is 12,000. Over half of these kidnappings, about 7,000, occur in Latin America, mainly in Colombia, which had 2,200 cases reported last year with many other likely occurring without the knowledge of government or media. Kidnappings are also on the rise in Mexico, Guatemala, Honduras, El Salvador, Venezuela, Ecuador and Brazil. Outside of Latin America, countries of concern include Nigeria, Russia, India, Pakistan, Yemen and the Philippines.

Virtually all kidnappings before 9/11 were crimes with economic motives, including those carried out by guerrilla groups, but the war on terrorism opens up a new dimension where hostage taking is driven by a strictly political objective.

Today’s more aggressive and broad-based threats suggest that organizations should take a similarly aggressive approach to security and contingency planning in order to protect their human and financial assets and to reassure their employees and stockholders. A kidnapping of a company employee, whether for economic or political motives, impacts employee well being, corporate liability and business continuity. It is essential for organizations with such exposures to assess these risks and take steps to mitigate them. If an incident does occur, a company should be ready to respond effectively to a crisis. While some companies have extensive security and risk management resources in-house, few security departments have handled sensitive and time-consuming kidnapping, extortion or political detention incidents. The financial and management implications of such incidents and possible subsequent litigation have made clear the need for expert preventative and incident management advice.

A Kidnap, Extortion and Wrongful Detention policy is a useful way to effectively address the exposures of international travel and operational disruption when it comes to the threat of political or economic kidnap.

**Key Types of Coverage**
- Kidnap and threat to kidnap
- Extortion, defined as threat to:
  - Kill or injure
  - Damage property
  - Contaminate a product
  - Introduce a computer virus
  - Reveal a trade secret
- Political threat or detention by a foreign government or politically motivated group
- Hijacking by holding, under duress, people traveling in any aircraft, motor vehicle or waterborne vessel

**Key Covered Losses**
- Ransom monies
- Loss in transit of ransom monies
- Fees and expenses of professional negotiators
- Legal liability
- Death or dismemberment
- Business interruption
- Additional expenses including:
  - Travel and accommodation costs
  - Psychiatric and medical care
  - Reward monies

The value of ransoms paid worldwide probably exceeds $500 million every year. In Colombia alone, the government estimates that guerillas who are responsible for the majority of kidnappings there took in over $80 million in ransoms last year. Also, kidnappers everywhere no longer limit their attention to wealthy families or business executives. Victims now include small businessmen, middle-level managers, and middle-class families. Likewise, in an attempt to emulate the perceived success of hostage taking in Iraq, other terrorist groups can be expected to employ these tactics to cause fear among Western business travelers and disrupt operations through the targeting of expatriate personnel and local managers.

![Kidnaps for Ransom Worldwide 1998-2002](image1)

- Business Personnel - 27%
- Dependant - 27%
- Government officials and security - 5%
- Non-professional employees - 10%
- Professionals including journalists - 9%
- Ranchers - 7%
- Project workers - 5%
- Others - 10%

![Kidnaps of Foreign Nationals 1998-2002](image2)

- Over 100 days - 56%
- 51-100 days - 22%
- 11-50 days - 7%
- 0-10 days - 15%

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Response Consultants
Carriers partner with incident response consultants, often on an exclusive basis. The choice of response consultant is a critical factor in determining whether a policy addresses a company's specific exposure. There are material differences in the philosophy, expertise and geographic reach of security firms offering response services. The choice can have a direct impact on whether or not an incident is successfully resolved and can also influence subsequent litigation. The costs to carriers in making these firms available to their insureds can vary from one response firm to another, but these costs are typically passed on to the insured through premiums.

Plague of Fair Labor Standard Act Claims Defeated – Or Not?

Last month, after much anticipation and public comment, new rules were rolled out redefining the white collar workers who will be exempt from the minimum wage and overtime requirements of the Fair Labor Standard Act (FLSA). Many employers, as well as the Wage and Hour Administration itself, are welcoming these changes, the first significant modifications in over 50 years, as long overdue. For some, however, the changes do not go far enough. This could be especially true for the many major employers who have been sued under the FLSA for damages in the $100 million+ range.

The New Rules
The new rules attempt to add clarity to the murky exemption for "any employee employed in a bona fide executive, administrative, or professional capacity or in a capacity of outside salesman." They do so by replacing the complex maze of regulations that have proliferated since the enactment of the FLSA with new definitions of executive, administrative and professional; and a new category, unimaginable 50 years ago: computer employees.

The new federal regulations also increase the minimum annual threshold from $8,060 – a significant amount in 1954 – to $23,660 or $455 per week. Employees earning less than this amount become automatically eligible for overtime pay. This salary-based test had been, as one expert expressed it, "a minefield for employers and a breeding ground for litigation."

While serious liability issues still exist, including the fact that the rules will not be applied retroactively, the updating of the seriously antiquated and potentially costly FLSA regulations appears to be a victory for employers, as it is expected to reduce the likelihood of expensive litigation.

Markets Respond?
When the recent spate of litigation concerning the FLSA's minimum wage and overtime rules first arose, an examination of the major Employment Practices Liability Insurance (EPLI) policies of the day revealed an FLSA exclusion. The only general exception, the Equal Pay Act claims, provided no relief. Despite Willis’ regular, repeated requests to the insurance marketplace, no carrier showed interesting providing a transfer mechanism for this potential exposure.

Today, while companies are re-examining their current payroll practices and job descriptions, in light of the new regulations, one Bermuda market is seriously considering offering some coverage for FLSA claims.
**Overheard at RIMS 2004**

- A carrier shared a risk manager’s comment on the still hardening Fiduciary Liability marketplace, "I used to think of my Fiduciary coverage as sleep insurance. Now it’s more like nightmare insurance."

- One major carrier predicted, "The subcertification process that most public companies are utilizing in response to SOX has created, in effect, a continuous warranty environment. Combined with the document retention provisions of the statute, this can be extremely problematic for Ds and Os -- and potential grist for the plaintiffs’ bar."

- When asked how to best differentiate a D&O risk with the fast-approaching deadline for public companies’ §404 testing of their loss control methodology, one carrier commented, the insureds should “Do anything other than seem dismissive. Say anything other than that things are going ‘fine.’ Everyone says compliance is going fine — so who are we to believe? Instead, give some specifics, especially about the amounts of money and/or time expended and expected completion dates, etc. Talking about any particularly challenging aspects of the compliance issue is also good.”

- A risk manager observed, “Technology is critically important in every business today and it’s scary to think about the risks that the use of these technologies bring. At one point I had thought the markets were going to begin broadening traditional E&O policies to pick up these risks, but it’s looking more and more like specialty coverages in this area are here to stay.”

- Sharing his opinion in the leadership conference, Joe Plumeri, the Chairman of Willis, said, "The insurance industry has got to get into the 21st century in terms of using technology. Those that don’t get this will probably not be around in the long run."

**Contacts:**

For further information, please contact any of the following:

<table>
<thead>
<tr>
<th>Name</th>
<th>Address</th>
<th>Phone</th>
<th>Fax</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Glenn Dockery</td>
<td>One Glenlake</td>
<td>404 224 5123</td>
<td>404 224 5001</td>
<td><a href="mailto:dockery_jg@willis.com">dockery_jg@willis.com</a></td>
</tr>
<tr>
<td>Brian Gauen</td>
<td>10 South LaSalle Street</td>
<td>312 621 4855</td>
<td>312 621 6870</td>
<td><a href="mailto:brian.gauen@willis.com">brian.gauen@willis.com</a></td>
</tr>
<tr>
<td>Jim Iacino</td>
<td>1400 16th Street</td>
<td>720 932 8203</td>
<td>720 932 8138</td>
<td><a href="mailto:jim.iacino@willis.com">jim.iacino@willis.com</a></td>
</tr>
<tr>
<td>Roger Wood</td>
<td>7 Hanover Square</td>
<td>212 820 7276</td>
<td>212 509 4912</td>
<td><a href="mailto:roger.wood@willis.com">roger.wood@willis.com</a></td>
</tr>
<tr>
<td>Todd J. Jones</td>
<td>5 Corporate Center</td>
<td>610 254 7284</td>
<td>610 254 5600</td>
<td><a href="mailto:todd.jones@willis.com">todd.jones@willis.com</a></td>
</tr>
<tr>
<td>Brenda Shelly</td>
<td>One Bush Street</td>
<td>415 291 1520</td>
<td>415 398 4986</td>
<td><a href="mailto:brenda.shelly@willis.com">brenda.shelly@willis.com</a></td>
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