

COMMENT

After *Howard* and *Monetta*: Is Ignorance of the Law a Defense to Administrative Liability for Aiding and Abetting Violations of the Federal Securities Laws?

Alexander P. Robbins[†]

INTRODUCTION

Throughout the past few decades, federal courts have carved out some limited exceptions to the traditional maxim *ignorantia legis non excusat*¹ in the context of criminal prosecutions.² Until recently, the courts have generally refused to apply such exceptions to administrative actions for violations of the securities laws.³ Two recent decisions from the D.C. and Seventh Circuit Courts of Appeals, however, suggest that ignorance of the law may be emerging as a defense to certain types of administrative violations of the federal securities laws as well.⁴

*Howard v SEC*⁵ and *Monetta Financial Services v SEC*⁶ both vacated administrative penalties⁷ that the Securities and Exchange Commission (SEC) had imposed against high-ranking employees for aiding and abetting their respective employers' violations of the secu-

[†] B.A. 2004, Stanford University; J.D. Candidate 2007, University of Chicago.

¹ Literally: "ignorance of the law does not excuse." Sharon L. Davies, *The Jurisprudence of Willfulness: An Evolving Theory of Excusable Ignorance*, 48 Duke L J 341, 342 (1998).

² See generally *id.* (urging judicial enforcement of the maxim absent clear contrary signals in text or legislative intent).

³ See, for example, *Wonsover v SEC*, 205 F3d 408, 414 (DC Cir 2000) ("[Willfulness] means no more than that the person . . . knows what he is doing. It does not mean that . . . he must suppose that he is breaking the law."), quoting *Hughes v SEC*, 174 F2d 969, 977 (DC Cir 1949). See also *Tager v SEC*, 344 F2d 5, 8 (2d Cir 1965) ("There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.").

⁴ Although there are both federal and state securities laws (the latter are commonly referred to as "blue sky laws," see Jonathan R. Macey and Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 Tex L Rev 347, 359 n 59 (1991)), this Comment is concerned exclusively with the former and generally refers to the federal securities laws as simply the "securities laws."

⁵ 376 F3d 1136 (DC Cir 2004).

⁶ 390 F3d 952 (7th Cir 2004).

⁷ The Securities Exchange Act of 1934 (Exchange Act), 15 USC § 78o(b)(4) (2000 & Supp 2002), provides that the SEC can censure, limit, suspend, or deregister any broker-dealer who has "willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of" the securities laws.

rities laws.⁸ Both *Howard* and *Monetta* appear to hold that a respondent⁹ cannot be liable for aiding and abetting unless he was aware of the *illegality* of his actions.¹⁰ Subsequent commentary regarding these decisions has tended to focus on the issue of whether recklessness can satisfy the scienter element of securities fraud,¹¹ which is defined by the Supreme Court as “a mental state embracing intent to deceive, manipulate, or defraud.”¹² Few have noted that both holdings appear to have created a mistake of law defense by requiring knowledge of an act’s illegality¹³—a departure from the traditional rule that ignorance of the law is no excuse.

Nor does there appear to be any published commentary noting that *Howard* and *Monetta* are at odds with a wide body of precedent regarding intentional violations of the securities laws. The Second Circuit has expressly rejected a mistake of law defense under the same enforcement provision at issue in *Howard* and *Monetta*.¹⁴ There is also significant intracircuit tension: the D.C. Circuit has rejected a mistake of law defense for primary violators of the securities laws, based on almost identical language in a subsection neighboring the one dealing with aiders and abettors (or “secondary violators”). But the D.C. Circuit in *Howard* and the Seventh Circuit in *Monetta* fail to discuss any of this conflicting authority.

This Comment will attempt to resolve both the intercircuit split and intracircuit tension regarding whether ignorance of the law is a

⁸ *Howard*, 376 F3d at 1150; *Monetta*, 390 F3d at 958.

⁹ The person accused of the violation is referred to as a “defendant” in civil enforcement actions and as a “respondent” in administrative actions. The distinction between the two types of actions is discussed in Part II.A.

¹⁰ See *Howard*, 376 F3d at 1143 (“In short, the evidence showed that Howard was not aware, generally or otherwise, of any wrongdoing.”); *Monetta*, 390 F3d at 956 (“The SEC has not provided any evidence suggesting that [the respondent] was, in fact, aware that disclosure of the IPO allocations was required.”).

¹¹ See, for example, Jay K. Musoff and Adam S. Zimmerman, *D.C. Circuit Wrestles with Intent in Securities Fraud*, Natl L J S4, S4 (Dec 13, 2004) (noting only that “the circuits have split over whether reckless behavior still satisfies the substantive scienter requirement for securities fraud”).

¹² *Aaron v SEC*, 446 US 680, 686 n 5 (1980) (reserving the question “whether, under some circumstances, scienter may also include reckless behavior”).

¹³ Although a number of commentators have argued for a distinction between “ignorance of the law” and “mistake of law,” any such distinction would bear on the precise question of *how* knowledge of the law is relevant to liability, not the general question of *whether* it is relevant at all. Accordingly, this Comment will follow the common practice of using the two terms interchangeably. Consider Davies, 48 Duke L J at 344 n 9 (cited in note 1) (acknowledging that “ignorance” and “mistake” are distinct concepts but “adopt[ing] the practice of those who use the terms interchangeably”); Edwin R. Keedy, *Ignorance and Mistake in the Criminal Law*, 22 Harv L Rev 75, 76 (1908) (noting that the “terms have generally been used interchangeably,” though they “convey different ideas”).

¹⁴ See *Arthur Lipper Corp v SEC*, 547 F2d 171, 180 (2d Cir 1976) (“There is no requirement that the actor [] be aware that he is violating one of the Rules or Acts.”).

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defense to administrative aiding and abetting liability. Part I describes the historical rule that ignorance of the law is not an excuse and the traditional exceptions to the rule. Part II describes various forms of SEC enforcement actions, discusses how the rule has been applied in SEC administrative enforcement proceedings, and explains the circuit split. Part III evaluates and rejects the arguments in favor of creating a general mistake of law defense specifically for administrative aiding and abetting liability. Part IV offers a coherent and tenable alternative rule, under which ignorance of the law is a limited defense that is relevant only to the extent that it negates the scienter required for both primary and secondary violations of the securities laws. Part V concludes that this rule is generally consistent with judicial practice, but needs to be expressly articulated in order to avoid erroneously creating different standards of intent for aiding and abetting liability and primary liability.

I. IGNORANCE OF THE LAW GENERALLY

This Part will describe the history of the rule that ignorance of the law is not a defense, noting the two traditional exceptions: when provided for by statute or when ignorance of the law negates an intent element of the crime. This Part will also discuss how the rule has retained its validity over time, subject occasionally to a modern exception based on the word “willfully.”

A. Origins of the Rule

The maxim *ignorantia legis non excusat*¹⁵ has a venerable pedigree and a long history of academic attention.¹⁶ The rule can be found in English decisions as far back as 1231,¹⁷ and was apparently adapted from Roman law.¹⁸ Blackstone described the rule as follows:

[I]gnorance or mistake is another defect of will; when a man, intending to do a lawful act, does that which is unlawful. For here

¹⁵ The maxim has a number of Latin variants. See, for example, Keedy, 22 Harv L Rev at 76 & n 1 (cited in note 13) (rendering the maxim as “[i]gnorantia juris non excusat, ignorantia facti excusat” and listing other versions).

¹⁶ See generally, for example, id. See also Jerome Hall, *Ignorance and Mistake in Criminal Law*, 33 Ind L J 1 (1957) (analyzing ignorance and mistake of both fact and law in light of the principle of legality, mens rea, and an imperfect criminal justice system); Livingston Hall and Selig J. Seligman, *Mistake of Law and Mens Rea*, 8 U Chi L Rev 641 (1941) (tracing the maxim’s history and justifications and describing traditional exceptions); Rollin M. Perkins, *Ignorance and Mistake in Criminal Law*, 88 U Pa L Rev 35 (1939).

¹⁷ See Keedy, 22 Harv L Rev at 78–81 (cited in note 13).

¹⁸ See id at 80–81 (noting that under Roman law, ignorance of the law as a defense applied only to certain classes, such as “peasants and other persons of small intelligence”).

the deed and the will acting separately, there is not that conjunction between them, which is necessary to form a criminal act. But this must be an ignorance or mistake of fact, and not an error in point of law. . . . For a mistake in point of law, which every person of discretion not only may, but is bound and presumed to know, is in criminal cases no sort of defence.¹⁹

The rule's primary historical justification was that the law is certain and knowable, and therefore anyone of sound mind can rightly be expected to obey its precepts.²⁰ The modern justification, set out by Justice Holmes, is pragmatic: "[T]o admit the excuse at all would be to encourage ignorance where the law-maker has determined to make men know and obey, and justice to the individual is rightly outweighed by the larger interests on the other side of the scales."²¹

B. Exceptions

Whatever the justification, the Supreme Court has repeatedly noted the traditional rule that ignorance of the law is no excuse—even when creating exceptions to it.²² As a result, though the rule itself does not appear to be in any danger of extinction, the exceptions are also quite relevant.

There are two traditional exceptions to this rule, and the Model Penal Code (MPC) contains both of them. According to the MPC, ignorance of the law *does* excuse when it either (1) negates an element of the offense, or (2) is specifically established as a defense by statute.²³ The first "exception," however, may arguably be thought of as limiting the scope of the maxim to pure questions of law, as opposed to mixed questions of law and fact.²⁴ If, for example, someone takes or

¹⁹ William Blackstone, 4 *Commentaries on the Laws of England* *27 (Chicago 1979).

²⁰ See Keedy, 22 *Harv L Rev* at 78–81 (cited in note 13) (citing Sir Matthew Hale's proposition that everyone "of the age of discretion and *compos mentis*" is presumed to know the law).

²¹ Hall and Seligman, 8 *U Chi L Rev* at 648 (cited in note 16), quoting O.W. Holmes, Jr., *The Common Law* 48 (Little, Brown 1881). See also generally Richard S. Murphy and Erin A. O'Hara, *Mistake of Federal Criminal Law: A Study of Coalitions and Costly Information*, 5 *S Ct Econ Rev* 217 (1997) (advancing an economic model based on information costs that explains the exceptions to the general rule that ignorance of the law is no excuse).

²² See, for example, *Bryan v United States*, 524 US 184, 196 (1998) (noting "the traditional rule that ignorance of the law is no excuse") (internal quotation marks omitted); *Ratzlaf v United States*, 510 US 135, 149 (1994) (calling the principle "venerable"); *Cheek v United States*, 498 US 192, 199 (1991) (noting that "[t]he general rule" is that "ignorance of the law or mistake of law is no defense to criminal prosecution" and that this principle "is deeply rooted in the American legal system").

²³ See MPC §§ 2.02(9), 2.04(1)–(2) (ALI 1962).

²⁴ One example of a mixed question of law and fact that allows an ignorance of the law defense arises when a tenant damaged flooring he had installed in his landlord's unit in violation of a statute that prohibited "damaging any property belonging to another." As a matter of law,

destroys a piece of property belonging to someone else under the mistaken belief that the property actually belongs to her, that mistake is arguably a factual one regarding the legal status of some physically existent object, and is therefore not a pure mistake of law defense.²⁵ The second exception is an express mistake of law defense provided by statute, and courts will generally look for certain words in the statute that might signal legislative intent to create a mistake of law defense.²⁶

In the past few decades, the mistake of law defense has made significant inroads in certain areas of federal criminal law,²⁷ primarily based on a statutory requirement of “willful” conduct.²⁸ The Supreme Court has remarked that “[w]illful . . . is a word of many meanings, and its construction is often influenced by its context.”²⁹ In the context of criminal cases involving the tax and currency reporting laws, the Court has “carve[d] out an exception to the traditional rule that ignorance of the law is no excuse”³⁰ on the ground that these statutes were “highly technical statutes that presented the danger of ensnaring individuals engaged in apparently innocent conduct.”³¹ Commentators have noted that the courts have generally been more likely to read “willful” as allowing a mistake of law defense in criminal contexts where, all things equal, the statute is complex or risks punishing individuals with morally blameless motives, or where the term appears with other mens rea terms, leading courts to try to avoid surplusage.³²

the flooring belonged to the landlord once installed, but the tenant had a good faith belief that the property was his own, and the statute required a mental state of intent, knowledge, or recklessness as to whether the property belonged to another. Sanford H. Kadish and Stephen J. Schulhofer, *Criminal Law and Its Processes* 261 (Aspen 7th ed 2001), quoting *Regina v Smith*, 2 QB 354 (1974).

²⁵ See, for example, *Morrisette v United States*, 342 US 246, 270–71 (1952) (“[K]nowing conversion requires more than knowledge that defendant was taking the property He must have had knowledge of the facts, though not necessarily the law, that made the taking a conversion.”).

²⁶ See *Cheek*, 498 US at 200 (“[T]he Court almost 60 years ago interpreted the statutory term ‘willfully’ as used in the federal criminal tax statutes as carving out an exception to the traditional rule.”).

²⁷ See Davies, 48 Duke L J at 343–46 (cited in note 1) (listing a number of examples, ranging from criminal prosecutions under “the federal tax provisions” to prosecutions for “knowingly acquiring or possessing food coupons in a manner not authorized by law”).

²⁸ See *id* at 348 (defining the trend of courts allowing an ignorance of law defense when a statute requires willful conduct as the “jurisprudence of willfulness”).

²⁹ *Ratzlaf*, 510 US at 141 (quotation marks and original alterations omitted). See also *Cheek*, 498 US at 200–01 (holding, in the context of a criminal prosecution for tax evasion, that the word “willfully” adds knowledge of illegality as an element of a crime).

³⁰ *Bryan*, 524 US at 195 (internal quotation marks omitted), citing *Ratzlaf*, 510 US at 149, and *Cheek*, 498 US at 200.

³¹ *Bryan*, 524 US at 194.

³² See Davies, 48 Duke L J at 362 (cited in note 1) (listing reasons courts construe the term “willfully” as imposing a requirement of knowledge of the law); Murphy and O’Hara, 5 S Ct Econ Rev at 277 (cited in note 21) (arguing that ignorance of the law is most often a defense

The mistake of law defense has not, however, made similar inroads in the securities laws, even with respect to the criminal provisions of the securities laws that require “willful” violations.³³ Although arguably these provisions should be eligible for a mistake of law defense based on the word “willful,” a number of circuits have specifically rejected this argument. The Eighth Circuit noted that the Exchange Act expressly allows ignorance of the law as an affirmative defense to *imprisonment*;³⁴ thus, by negative implication, it reasoned that ignorance of the law does not apply to any other forms of punishment.³⁵ The Ninth Circuit similarly held that the word “willful” did not create a mistake of law defense to criminal violations of the Securities Act of 1933 (Securities Act).³⁶

II. IGNORANCE OF THE LAW IN SEC ADMINISTRATIVE ACTIONS

In 2004, the D.C. and Seventh Circuits produced opinions that seem to allow a mistake of law defense in a very specific context: non-criminal administrative actions for aiding and abetting violations of the securities laws. This Part will offer an overview of SEC administrative actions, summarize the case law applying the general rule *ignorantia legis non excusat* to administrative actions, and then describe the two recent cases that appear to reject the rule and create a circuit split.

A. “Administrative Actions” Defined

The SEC has the power to bring two distinct types of enforcement actions against a person³⁷ who has violated the securities laws.³⁸

when the costs of informing the target population of the law are prohibitively high, either because the population is large, the law is complex, or the conduct is not obviously bad).

³³ See 15 USC §§ 77x (“willfully violates”), 78ff(a) (“[w]illful violations”) (2000 & Supp 2002).

³⁴ See 15 USC § 78ff(a) (“[N]o person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.”).

³⁵ *United States v O’Hagan*, 139 F3d 641, 647 (8th Cir 1998) (distinguishing imprisonment from conviction), on remand from 521 US 642 (1997). The Supreme Court also noted this fact, and said nothing that suggested a contrary reading. See 521 US at 665–66 & nn 12–13 (describing “two sturdy safeguards Congress has provided regarding scienter”: the government must prove willful violation and, to imprison a defendant, knowledge of the violated rule).

³⁶ *United States v English*, 92 F3d 909, 914 (9th Cir 1996) (rejecting the argument that “willful,” in the context of a criminal violation of the Securities Act, 15 USC § 77x, “require[d] proof that the defendant knew that his actions were illegal”). See also *Mueller v Sullivan*, 141 F3d 1232, 1235 (7th Cir 1998) (Easterbrook) (holding that the word “willful” does not necessarily create a mistake of law defense to criminal violations of a state’s securities laws), citing *English*, 92 F3d at 914–16; Louis Loss and Joel Seligman, *Securities Regulation* § 12-B-2 (Aspen 3d ed 2004) (noting the possibility that “‘willfully’ might mean something more in the penal provisions than in § 15(b)(4) of the Exchange Act”).

³⁷ A person in this context can be either a legal entity or a human being. See 15 USC § 78c(9) (2000 & Supp 2004).

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First, the SEC can bring a civil enforcement action as a plaintiff in federal district court. Alternatively, it can bring an administrative enforcement action before an SEC administrative law judge (ALJ). In an administrative action, a respondent has a right to appeal the ALJ's decision to the Commission itself—that is, to the five commissioners sitting in an adjudicatory role³⁹—and after that may submit a petition for review to the court of appeals for either the D.C. Circuit or the circuit in which the respondent resides.⁴⁰ Moreover, as a general matter, administrative actions are only used against entities and individuals who are required to be registered with the SEC in order to conduct business, and as a result are sometimes referred to as “disciplinary proceedings.”⁴¹

The most common administrative action is against broker-dealers⁴² under § 15(b) of the Exchange Act.⁴³ Section 15(b)(4) allows the SEC to suspend or revoke the registration of a broker-dealer,⁴⁴ and § 21B allows the SEC to assess monetary penalties and order disgorgement.⁴⁵ These remedies may apply to both primary violators and secondary violators of the securities laws.⁴⁶ Although only the Department of Justice can bring criminal prosecutions,⁴⁷ leading commentators have described the SEC's administrative enforcement powers as “awesome.”⁴⁸

³⁸ See SEC, *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, online at <http://www.sec.gov/about/whatwedo.shtml> (visited Jan 22, 2007).

³⁹ See *id.* See also Loss and Seligman, *Securities Regulation* § 8-A-5(a)(iv) (cited in note 36) (discussing how the appeal structure allows the SEC to “litigate in its own forum” and enjoy deferential review on appeal with respect to its findings of fact and choice of sanction).

⁴⁰ See Loss and Seligman, *Securities Regulation* at § 12-C(a)(1) (cited in note 36).

⁴¹ See *id.* § at 12-C.

⁴² “Broker” and “dealer” are catchall terms used to denote securities brokers and dealers, both of whom are required to register with the SEC. See *id.* at § 1-B-4(b)(i).

⁴³ See *id.* at § 13-C (describing the types of quasi-judicial proceedings under the SEC statutes).

⁴⁴ See 15 USC § 78o(b)(4) (allowing the SEC, additionally, to censure brokers and “place limitations on [their] activities, functions, or operations”).

⁴⁵ See 15 USC § 78u-2(a), (e) (2000 & Supp 2002) (giving the SEC authority “to assess money penalties” and “requir[e] an accounting and disgorgement”). Disgorgement is an equitable remedy that “forc[es] a defendant [or respondent] to give up the amount by which he was unjustly enriched” through his illegal conduct. *SEC v Tome*, 833 F2d 1086, 1096 (2d Cir 1987), quoting *SEC v Commonwealth Chemical Securities, Inc.*, 574 F2d 90, 102 (2d Cir 1978).

⁴⁶ The actual statutory language refers to a person who “has willfully aided, abetted, counseled, commanded, induced, or procured” a “violation by any other person” of the securities laws. 15 USC §§ 78o(b)(4)(E), 78u-2(a)(2).

⁴⁷ See Loss and Seligman, *Securities Regulation* at § 1-J-2 (cited in note 36).

⁴⁸ *Id.* at § 13-D (“It would be hard to think of any further sanction (except perhaps the return of the whipping post, abolished by Delaware not too many years ago).”).

B. The General Rule in SEC Administrative Actions:
Ignorance of the Law Is Not a Defense

Although penalties under §§ 15(b) and 21B of the Exchange Act require “willful[ness],”⁴⁹ no court has held that the word creates a mistake of law defense under these statutes. In 1965, the D.C. Circuit expressly rejected the argument “that specific intent to violate the law is an essential element of the willfulness required to violate Section 15(b)” of the Exchange Act.⁵⁰ The court noted that such a “definition of ‘willfully’ under Section 15(b) ha[d] been rejected by this court, by the Second Circuit, and by the Commission.”⁵¹ Two subsequent decisions from the D.C. and Second Circuits have actually become part of a boilerplate footnote to the word “willfully” when it first appears in SEC administrative orders, which reads as follows:⁵²

“Willfully” as used in this Order means intentionally committing the act which constitutes the violation. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he or she is violating one of the Rules or Acts.⁵³

Based on this line of decisions rejecting a statutory mistake of law defense to primary liability⁵⁴ under § 15(b) of the Exchange Act, prominent commentators have asserted more generally that in administrative actions, “[t]he SEC is not required to prove that the actor is also aware that he or she is violating a provision of the federal securities laws.”⁵⁵

⁴⁹ See, for example, 15 USC § 78o(b)(4)(E) (prohibiting willful aiding and abetting).

⁵⁰ *Gearhart & Otis, Inc v SEC*, 348 F.2d 798, 802 (DC Cir 1965).

⁵¹ *Id* at 802–03 (“[W]e are cited to no case wherein it has been accepted, and we have found none.”). The D.C. Circuit has also held, again in an SEC administrative action (although not one that required interpretation of the word “willfully”), that, “[e]xcept in very rare instances, no area of the law—not even the criminal law—demands that a defendant have thought his actions were illegal.” *SEC v Falstaff Brewing Corp.*, 629 F.2d 62, 77 (DC Cir 1980) (rejecting the argument “that scienter requires an inquiry into [the defendant’s] subjective belief as to the legality of his action”).

⁵² A LEXIS search of the “SEC Decisions, Orders & Releases” database for “(wonsover w/s tager) and willful!” yielded 138 hits on January 16, 2007.

⁵³ *In the Matter of Cemo*, 2005 SEC LEXIS 1743, *9 n 1 (2005). See also *In the Matter of OppenheimerFunds, Inc*, 2005 SEC LEXIS 2350, *14 n 4 (2005) (using slightly different language but making the same point and citing the same cases).

⁵⁴ Although the decisions being discussed all involve primary liability, none specifically notes this fact or makes any distinction between primary and secondary liability.

⁵⁵ Ralph C. Ferrara and Philip S. Khinda, *SEC Enforcement Proceedings: Strategic Considerations for When the Agency Comes Calling*, 51 Admin L Rev 1143, 1187 (1999), citing *Tager*, 344 F.2d at 8. See also Loss and Seligman, *Securities Regulation* at § 8-A-5 n 134 (cited in note 36) (discussing at length the various constructions of the term “willfully” in different jurisdictions).

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Like criminal liability under the securities laws, administrative aiding and abetting liability requires that a violation be committed “willfully.”⁵⁶ Given the “normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning,”⁵⁷ one would expect that administrative aiding and abetting liability, like primary liability under the same provisions, would lack a mistake of law defense. Indeed, the Second Circuit did reject ignorance of the law as a defense to administrative aiding and abetting—holding that, like primary violations, aiding and abetting “does not require proof of evil motive, or intent to violate the law, or knowledge that the law was being violated.”⁵⁸

C. A Possible New Rule: *Howard* and *Monetta*

Two cases decided in 2004—one from the D.C. Circuit and one from the Seventh Circuit—appear to accept ignorance of the law as a defense, though it is not entirely clear on what grounds they do so.

In *Howard*, the D.C. Circuit vacated sanctions that the SEC had imposed against Nicholas P. Howard, an officer of a registered broker-dealer firm, for aiding and abetting securities fraud in the course of marketing two private placement offerings of common stock.⁵⁹ The broker-dealer firm had illegally bought some of the shares in the first offering in order to put the total number of purchased shares above the minimum threshold required to close, thereby making it appear that there was greater market demand for the shares than actually existed. Howard, apparently unaware that this maneuver was illegal, continued to market the shares, helped close the offering, and then marketed a second offering without disclosing the fact that the first one had illegally closed.⁶⁰ The SEC distinguished ignorance of the law from ignorance of facts,⁶¹ and found that Howard had “full knowledge

⁵⁶ 15 USC §§ 78o(b)(4)(E), 78u-2(e).

⁵⁷ *Sullivan v Stroop*, 496 US 478, 484 (1990) (internal quotations omitted). There is an exception to this rule when the words appear in different contexts. See *General Dynamic Land Systems, Inc v Cline*, 540 US 581, 595 (“The [rule] is not rigid and readily yields whenever there is such variation in the connection in which the words are used as reasonably to warrant the conclusion that they were employed in different parts of the act with different intent.”). However, there is no such contextual difference in § 15(b)(4). For further discussion on tight contextual links between the primary and secondary violation statutes, see text accompanying note 86.

⁵⁸ *Arthur Lipper Corp v SEC*, 547 F2d 171, 180 (2d Cir 1976).

⁵⁹ See 376 F3d at 1138, 1140–41 & n 2.

⁶⁰ See *id* at 1140–41.

⁶¹ See *In the Matter of Howard*, 2003 SEC LEXIS 377, *15–16 (“Knowledge means awareness of the underlying facts, not the labels that the law places on those facts.”), quoting *Falstaff*, 629 F2d at 77.

of the underlying facts.”⁶² Accordingly, the SEC found Howard liable for aiding and abetting his employer’s fraud.⁶³

The D.C. Circuit questioned but did not overturn the SEC’s legal conclusions regarding the primary violations by Howard’s firm,⁶⁴ and it left undisturbed the SEC’s findings that Howard had full knowledge of the facts underlying the primary violations.⁶⁵ The court did, however, reverse the SEC’s determination that Howard was liable for aiding and abetting. Since Howard “did not know that his role was part of an overall activity that was improper,”⁶⁶ the court held that, “[i]n short, the evidence showed that Howard was not aware, generally or otherwise, of any wrongdoing. To the extent the SEC explained itself, its point was the opposite—Howard’s fault was in *not* being aware.”⁶⁷ Nowhere did the *Howard* court acknowledge the traditional rule that ignorance of the law is not a defense, or distinguish questions of law from question of fact as the SEC did in its opinion.⁶⁸

A few months after *Howard*, the Seventh Circuit in *Monetta* followed the D.C. Circuit and similarly accepted ignorance of the law as a defense to administrative aiding and abetting liability. In *Monetta*, the SEC sanctioned Robert Bacarella, the president of Monetta Financial Services, a registered investment adviser, for violating § 206(2) of the Investment Advisers Act of 1940 (Investment Advisers Act)⁶⁹ when it allocated shares to some of its own directors without disclosing that fact to its other clients who received shares from the same

⁶² *Id.* at *16–17.

⁶³ The court observed that the

violation of Rule 10b-9 consisted of improperly closing the initial offering rather than returning the proceeds of the sales to the investors. The violations of Rule 10b-5 were the failure to disclose in the first offering that these purchases would be counted toward the minimum and the failure to disclose in the second offering that the first offering had closed improperly.

Howard, 376 F3d at 1141.

⁶⁴ The court remarked that although “[n]either Rule 10b-9, nor the SEC’s contemporaneous explanation of it, mention sales to insiders or persons affiliated with the offeror or whether—as occurred here—these sales may be counted toward the minimum,” *id.* at 1145, and that “[w]e do not suggest that the SEC erred in concluding that JCI and New Europe Hotels violated Rule 10b-9.” *Id.* at 1146 n 17.

⁶⁵ *Id.* at 1142 (“Howard knew the first offering could not close unless 2,000,000 shares were sold, and [] he knew that [his employer] engaged in efforts to reach that number through transactions which, the SEC charged, violated Rule 10b-9 [He] also knew of the second offering.”).

⁶⁶ *Id.* (emphasis omitted).

⁶⁷ *Id.* at 1143.

⁶⁸ See *Howard*, 2003 SEC LEXIS 377, *15.

⁶⁹ 15 USC § 80b-6 (2000) (“It shall be unlawful for any investment adviser . . . to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.”).

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offering.⁷⁰ The SEC held Bacarella's firm liable for nondisclosure of a potential conflict of interest.⁷¹ Section 206(2), however, applies only to registered investment advisors like Bacarella's firm—not to officers like Bacarella. Thus the SEC held Bacarella individually liable as an aider and abettor⁷² based on the ALJ's finding that he had full knowledge of the facts underlying the primary violation⁷³ as well as intent to deceive.⁷⁴

On appeal, the Seventh Circuit, like the D.C. Circuit in *Howard*, accepted the SEC's findings with respect to liability for the primary violations.⁷⁵ The court also left the SEC's findings of fact undisturbed, with one exception: it held that "the SEC's finding that Bacarella was aware that disclosure was required" was unsupported by substantial evidence.⁷⁶ On this basis the court also vacated the SEC's legal conclusion that Bacarella was liable for aiding and abetting his firm's violation.⁷⁷

Citing *Howard*, the court reasoned that "[n]o rules expressly required disclosure of the IPO allocations," and that, "[m]oreover, the SEC did not find that [the firm] allocated the shares inequitably—the presence of inequitable allocations surely should have alerted Bacarella to the fact that disclosure, at the very least, was required."⁷⁸ In

⁷⁰ See *Monetta*, 390 F3d at 953–54.

⁷¹ *In the Matter of Monetta Financial Services, Inc.*, 2003 SEC LEXIS 1377, *30–31 (concluding that "[Monetta Financial Services], acting through Bacarella, willfully violated, and Bacarella willfully aided and abetted and was a cause of MFS' violations of [Investment] Advisers Act § 206(2)"). Note that § 206(2), unlike § 10(b), can be violated even without scienter. See *Aaron v SEC*, 446 US 680, 696–97 (1980) (noting that § 10(b) "embraces a scienter requirement," while citing *SEC v Capital Gains Research Bureau, Inc.*, 375 US 180, 200 (1963), for the proposition that § 206(2) of the Investment Advisers Act does not require scienter).

⁷² *Monetta*, 2003 SEC LEXIS 1377 at *30–31.

⁷³ *Id.* at *26–27 ("[Bacarella] exercised complete discretion over the . . . accounts and determined [who] received IPO allocations. He invited [the] trustees and permitted [] an existing director to receive IPOs. He did not disclose these transactions to the remaining members of the Board.").

⁷⁴ The ALJ reasoned that

Mr. Bacarella possessed all the attributes which indicate that he was aware of the implications of his actions: a high level of formal education in the field of business, over twenty years experience in the securities industry, success in managing investments, and a reputation for high ethical standards.

Mr. Bacarella's lack of candor and his attempts to hide his actions support [the] finding that he acted with the intent to deceive.

In the Matter of Monetta Financial Services, Inc., 2000 SEC LEXIS 574, *62–63 (internal citations omitted).

⁷⁵ See *Monetta*, 390 F3d at 956–57 (agreeing "with the SEC that MFS had a duty to disclose the fact that it allocated IPO shares to the director-clients," and that "[i]ts failure to do so constituted fraud or deceit within the meaning of Section 206(2)" even though "[n]o rules expressly required disclosure of the IPO allocations").

⁷⁶ *Id.* at 957.

⁷⁷ *Id.*

⁷⁸ *Id.* at 956–57 (citing *Howard* for the proposition that "the absence of red flags [is significant] in assessing one's liability as an aider and abettor").

other words, Bacarella's full knowledge of the underlying facts—without knowledge that he was breaking the law—was insufficient to establish his liability as an aider and abettor, even where, in contrast to *Howard*, the primary violation did not require scienter. Like *Howard*, *Monetta* fails to acknowledge either the general rule that ignorance of the law is no defense or the authority applying that rule to SEC administrative actions.

D. Circuit Split

The current state of the law is murky at best. The status of the mistake of law defense in SEC administrative proceedings is critical to the disciplinary system that regulates the United States's capital markets, and yet it remains an open question. At the very least there appears to be a split between the D.C. and Seventh Circuits on one hand and the Second and Ninth Circuits on the other over whether ignorance of the law is a defense to administrative aiding and abetting liability.⁷⁹

III. EVALUATION OF A MISTAKE OF LAW DEFENSE TO AIDING AND ABETTING LIABILITY

This Part evaluates and rejects the two primary arguments for allowing a mistake of law defense to administrative aiding and abetting liability. The first argument is based on the fact that the SEC can only sanction those who “willfully” violate the securities laws, where “willfulness” might require knowledge that one is acting illegally, as discussed in Part I.B. The second argument is based on a distinction between primary and secondary liability, and would provide a mistake of law defense specifically for the latter. Both arguments are advanced only implicitly in *Howard* and *Monetta*, and both are ultimately untenable.

A. Willfulness

One argument that ignorance of the law is a defense to administrative aiding and abetting liability is based on the word “willfully” in the statutes authorizing administrative punishments.⁸⁰ The *Howard* court hinted at this argument when it asked how “one decide[s]

⁷⁹ Compare *United States v English*, 92 F3d 909, 914 (9th Cir 1996) and *Arthur Lipper*, 547 F2d at 180 (holding that ignorance of the law is not a defense), with *Howard*, 376 F3d at 1142–43 and *Monetta*, 390 F3d at 956–57 (implying that ignorance of the law is a defense).

⁸⁰ See 15 USC §§ 78o(b)(4)(D) (authorizing suspension and revocation), 78u-2(a)(1) (authorizing monetary penalties).

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whether a person willfully aided and abetted a securities violation.”⁸¹ It declined to elaborate on the possible answer, however, before going on to discuss the “awareness of wrongdoing” requirement.⁸² Nevertheless, even if implicit, one possible justification for the mistake of law defense in *Howard* might be based on the word “willfully,” particularly in light of the fact that other courts have similarly construed the word in different contexts.

Such a statutory mistake of law defense would have a wide-ranging impact on the securities laws,⁸³ and it would conflict with well-established precedent. The D.C. Circuit has explicitly rejected a mistake of law defense in the word “willfully” in the context of administrative liability for *primary* violations.⁸⁴ As a result, allowing “willfully” to create a mistake of law defense to administrative aiding and abetting would require reading the word one way in § 15(b)(4)(E) of the Exchange Act (aiding and abetting liability) and another way in § 15(b)(4)(D) (primary liability).⁸⁵ If the “normal rule of statutory construction [is] that identical words used in different parts of the same act are intended to have the same meaning,”⁸⁶ it is hard to see how identical words used in identical contexts in neighboring subsections of a statute could have such different meanings.

Furthermore, allowing “willfully” to create a mistake of law defense to administrative aiding and abetting liability would also conflict with the Eighth Circuit’s unchallenged interpretation of the Supreme Court’s reasoning in a remanded case involving criminal insider trading—namely, that ignorance of the law is not a defense in criminal prosecutions for securities fraud.⁸⁷ As the Second Circuit observed, it would be “inconceivable” that the word “willfully” could set a higher intent standard in administrative actions than in criminal prosecutions

⁸¹ See 376 F3d at 1142 (lamenting that the “rules for determining aiding and abetting [securities violations] are unclear, in an area that demands certainty and predictability”) (alteration in original) (internal quotation marks omitted).

⁸² See *id.*

⁸³ A whole host of provisions in the securities laws also employ the term. See, for example, 15 USC §§ 77x; 78u-2(a)(2); 78ff(a). See also Loss and Seligman, *Securities Regulation* § 8-A-5 n 134 (cited in note 36) (“[‘Willfully’] appears not only in most of the disciplinary provisions but also in all the SEC statutes’ penal provisions and in a few miscellaneous sections.”).

⁸⁴ See Part II.B, citing *Wonsover*, 205 F3d at 414; *Gearhart & Otis, Inc v SEC*, 348 F2d 798, 802–03 (DC Cir 1965).

⁸⁵ See 15 USC § 78o(b)(4)(D)–(E).

⁸⁶ *Sullivan v Stroop*, 496 US 478, 484 (1990) (internal quotation marks and citations omitted).

⁸⁷ *United States v O’Hagan*, 139 F3d 641, 647 (8th Cir 1998) (holding that because § 32(a) of the Exchange Act provides that “no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation,” the statute by negative implication allows a criminal penalty other than imprisonment even when the defendant did not have such knowledge), on remand from 521 US 642 (1997).

under the securities laws.⁸⁸ Moreover, the Supreme Court decisions that have based a mistake of law defense on the term “willfully”⁸⁹ postdate the codification of § 15(b)(4)(E) in 1975,⁹⁰ which forecloses the argument that Congress intended to adopt a new meaning of willfulness based on its presumed awareness of those decisions.

B. Primary versus Secondary Liability

The main basis for the mistake of law defense in *Howard* and *Monetta* was a distinction between primary and secondary liability, which would allow ignorance of the law to serve as a defense specifically to aiding and abetting liability. Such a mistake of law defense, by being specific to aiding and abetting, avoids the objection that ignorance of the law is not a defense to administrative liability for primary violations of the securities laws. What this mistake of law defense lacks, however, is any justification for existing in the first place: it has no basis in statute, and the precedent on which it relies is both inapplicable and defunct.

1. *Howard*, *Monetta*, and their administrative precedent.

The concurring opinion in *Howard* expressly argues for a distinct standard of intent for aiding and abetting,⁹¹ and the majority opinions in both *Howard* and *Monetta* do so implicitly by framing the intent standard as being particular to aiders and abettors.⁹² The line of cases they rely on for their aiding and abetting standard leads back to *Inves-*

⁸⁸ See *Tager*, 344 F2d at 8 (“It is conceivable, therefore, that ‘willfully’ means something less in § 15(b) than it does in the penal provisions of the SEC acts. It is inconceivable that it means something more.”) (internal quotation marks and citations omitted).

⁸⁹ See *Ratzlaf v United States*, 510 US 135, 137 (1994) (“[T]he Government must prove that the defendant acted with knowledge that his conduct was unlawful.”). See also *Cheek v United States*, 498 US 192, 201 (1991) (“Willfulness . . . requires the Government to prove that . . . the defendant knew of [a violated legal] duty.”).

⁹⁰ See Act of June 4, 1975, Pub L No 94-29 § 11, 89 Stat 97, 123 (1975), codified at 15 USC § 78o(b)(4)(E). See also *Nees v SEC*, 414 F2d 211, 220 (9th Cir 1969) (“The relevant statute . . . was 15 U.S.C. § 78o(b). This provision was amended after the petitioner’s hearing.”).

⁹¹ 376 F3d at 1152 (Henderson concurring) (using a “*separate* [recklessness] standard applicable to an element of aiding and abetting, but not primary, liability”), citing *Investors Research Corp v SEC*, 628 F2d 168, 178 (DC Cir 1980) (adopting a three-part test for aider and abettor liability: (1) that another party has committed a securities law violation; (2) that the accused aider and abettor had a general awareness that his role was part of an overall activity that was improper; and (3) that the accused aider and abettor knowingly and substantially assisted the principal violation).

⁹² See *Howard*, 376 F3d at 1142 (discussing “the awareness of wrong-doing requirement in aiding and abetting disciplinary cases”) (internal quotation marks omitted); *Monetta*, 390 F3d at 956 (“The SEC will find one liable for aiding and abetting where . . . the aider and abettor generally was aware or knew that his or her actions were part of an overall course of conduct that was improper or illegal.”).

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tors Research Corp v SEC,⁹³ a D.C. Circuit opinion allowing ignorance of the law to serve as a defense⁹⁴ to an administrative action under a different but almost identically worded provision of the securities laws.⁹⁵ In *Investors Research*, Judge Bazelon explained that “[t]he awareness of wrong-doing requirement for aiding and abetting liability is designed to insure that innocent, incidental participants in transactions later found to be illegal are not subjected to harsh, [sic] civil, criminal, or administrative penalties.”⁹⁶

2. Origins of the “awareness of wrong-doing” requirement.

Investors Research, however, was exceptional in administrative securities law.⁹⁷ Until *Howard*, there do not seem to be any published appellate decisions applying the intent standard from *Investors Research* to an administrative action.⁹⁸ Nor was *Investors Research* based on administrative precedent. Although the case concerned an appeal from an SEC administrative action, the D.C. Circuit’s “awareness of wrong-doing” requirement was based on a whole line of cases involving civil rather than administrative aiding and abetting liability. Unlike administrative aiding and abetting liability, civil aiding and abetting liability was not based on any express statutory authority until recently.⁹⁹ Accordingly, this “implied right” aiding and abetting liability—

⁹³ 628 F2d 168 (DC Cir 1980). *Monetta* follows *Howard* and *SEC v Steadman (Steadman I)*, both of which in turn follow *Investors Research*. See *Monetta*, 390 F3d at 957, citing *Howard*, 376 F3d at 1142–43, and *Steadman I*, 967 F2d 636, 647 (DC Cir 1992).

⁹⁴ See *Investors Research*, 628 F2d at 178–79 (vacating the SEC’s order against the accused aider and abettor on the grounds that the Commission’s inconsistent findings on the respondent’s state of mind could not support “a general awareness that he was assisting [] in wrongful conduct”; the Commission found both that the respondent’s “belief that the law permitted [the violators] to engage in these transactions may well have been entertained in good faith” and that he was “involved in every aspect of the relevant transactions”).

⁹⁵ Compare the Investment Company Act of 1940, 15 USC § 80a-9(b) (2000), with the Exchange Act, 15 USC § 78o(b)(4)(E).

⁹⁶ 628 F2d at 177.

⁹⁷ See generally Part II.B (describing ignorance of law in SEC administrative actions).

⁹⁸ A Lexis Shepard’s report shows that only two other circuit decisions cited the *Investors Research* intent standard for aiding and abetting in the context of an appeal from an SEC administrative decision. See *Graham v SEC*, 222 F3d 994, 1000 (DC Cir 2000); *Dirks v SEC*, 681 F2d 824, 829, 844 & n 25 (DC Cir 1982). In neither was ignorance of law an issue—the ignorance in question was always with respect to facts.

⁹⁹ Aiding and abetting was an implied civil right of action for both the SEC and for private litigants in every circuit until the Supreme Court eliminated it in 1994. See *Central Bank of Denver v First Interstate Bank of Denver*, 511 US 164, 192 (1994) (Stevens dissenting) (“[A]ll 11 Courts of Appeals to have considered the question have recognized a private action against aiders and abettors.”). The next year, Congress passed the Private Securities Litigation Reform Act of 1995 (PSLRA), Pub L No 104-67, Title I § 104, 109 Stat 737, 757 (1998), codified at 15 USC § 78t (2000), which gave the SEC—although *not* private litigants—the express authority to bring civil actions against aiders and abettors of the securities laws. See *SEC v Fehn*, 97 F3d 1276,

with the exception of *Investors Research* itself—developed along an entirely distinct line of decisions, some of which accepted ignorance of the law as a defense. They did so, however, in the peculiar context of applying a judicially created exception to a judicially created right of action that was later abolished by the Supreme Court.¹⁰⁰

A Sixth Circuit case, *SEC v Coffey*,¹⁰¹ originated this line of civil aiding and abetting decisions. *Coffey* adopted a test¹⁰² for implied civil aiding and abetting liability from an article by Professor David Ruder, which will be referred to as the “Ruder test” after its original author.¹⁰³ As formulated by the Sixth Circuit, the intent prong of the Ruder test requires that the “accused [aider and abettor have] general awareness that his role was part of an overall activity that is improper,”¹⁰⁴ leaving it somewhat unclear whether ignorance of the law is a defense—that is, whether the “awareness” requirement applies to the word “improper” as well as the word “activity.” The Ruder test is what *Investors Research* (and therefore *Howard* and *Monetta*) ultimately relied on,¹⁰⁵ although the civil aiding and abetting decisions applying the test often left unclear whether ignorance of the law was a valid defense.¹⁰⁶ The

1282–84 (9th Cir 1996) (“Legislative history confirms that Section 104 was intended to override *Central Bank*’s apparent elimination of the SEC’s power to enjoin the aiding and abetting of securities law violations.”).

¹⁰⁰ See *Central Bank*, 511 US at 190–91 (“If we were to rely on this reasoning now, we would be obliged . . . to hold that a civil aiding and abetting cause of action is available for every provision of the [Exchange] Act. There would be no logical stopping point.”).

¹⁰¹ 493 F2d 1304 (6th Cir 1974).

¹⁰² The test is as follows:

[A] person may be held as an aider and abettor only if [1] some other party has committed a securities law violation, [2] if the accused party had general awareness that his role was part of an overall activity that is improper, and [3] if the accused aider-abettor knowingly and substantially assisted the violation.

Id at 1316.

¹⁰³ Id at 1315 n 23, citing generally David S. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, in Pari Delicto, Indemnification, and Contribution*, 120 U Pa L Rev 597 (1972). The Supreme Court also cited the Ruder test when expressly reserving the question “whether civil liability for aiding and abetting is appropriate” under “§ 10(b) and Rule 10b-5.” *Ernst & Ernst v Hochfelder*, 425 US 185, 191–92 n 7 (1976). This history is also noted in *Dirks*, 681 F2d at 844 n 25.

¹⁰⁴ *Coffey*, 493 F2d at 1316. The particular facts of that case also leave some doubt as to whether ignorance of the law was necessarily a defense. Both the defendant and the purportedly defrauded State of Ohio held a mistaken belief regarding the legality of a certain type of security under Ohio law. The court observed that a state treasurer ought to know state law, stating that “[w]e cannot describe the Treasurer’s failure to fulfill this elementary duty as a fraud practiced upon it by a securities offeror.” Id at 1312 n 17.

¹⁰⁵ See *Investors Research*, 628 F2d at 177 & n 56, citing *Coffey*, 493 F2d at 1316 n 23.

¹⁰⁶ Compare *Harmsen v Smith*, 693 F2d 932, 943 (9th Cir 1982) (requiring “actual knowledge by the alleged aider and abettor of the wrong and of his or her role in furthering it”) and *Woodward v Metro Bank of Dallas*, 522 F2d 84, 97 (5th Cir 1975) (requiring “scienter of the high ‘conscious intent’ variety” for aiding and abetting liability “when it is impossible to find any duty of disclosure”), with *Anixter v Home-Stake Production Co.*, 77 F3d 1215, 1225 (10th Cir 1996)

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Ruder test itself is also ambiguous regarding whether ignorance of the law can serve as a defense: it requires “[k]nowledge of wrongful purpose . . . [as] a crucial element in aiding and abetting.”¹⁰⁷

Nevertheless, to the extent that a mistake of law defense might exist in the Ruder test and its civil aiding and abetting case law, such a defense is specific to aiding and abetting liability. Ruder expressly proposed that aiding and abetting should require an especially high standard of intent in order to protect innocent third parties from liability.¹⁰⁸

3. Anachronistic justifications for a heightened intent standard for aiding and abetting.

The context in which Ruder wrote may be relevant: the law regarding intent for securities fraud was still poorly defined. The intent standard in most circuits for securities fraud at the time of *Coffey* was mere negligence. Subsequently, in 1976, the Supreme Court raised this standard by holding that the most common form of securities fraud required scienter, or deceptive intent.¹⁰⁹ Accordingly, Ruder rested his proposal for protecting innocent third parties on the particular nature of aiding and abetting, as opposed to a more general theory regarding the intent required for securities fraud.¹¹⁰ Moreover, although the

(requiring “knowledge of the primary violation by alleged aider and abettor”); *Camp v Dema*, 948 F2d 455, 459 (8th Cir 1991) (noting that ignorance of the securities laws does not defeat the knowledge requirement for implied aiding and abetting liability); *Monsen v Consolidated Dressed Beef Co.*, 579 F2d 793, 799 (3d Cir 1978) (adopting *Woodward’s* test of aiding and abetting liability, but characterizing the second prong as requiring “that the alleged aider-abettor had knowledge of [a wrongful] act”).

¹⁰⁷ Ruder, 120 U Pa L Rev at 631 (cited in note 103).

¹⁰⁸ Ruder argued:

If all that is required in order to impose liability for aiding and abetting is that illegal activity under the securities laws exists and that a secondary defendant, such as a bank, gave aid to that illegal activity, the act of loaning funds to the market manipulator would clearly fall within that category and would expose the bank to liability for aiding and abetting. Imposition of such liability upon banks would virtually make them insurers regarding the conduct of insiders to whom they lend money. If it is assumed that an illegal scheme existed and that the bank’s loan or other activity provided assistance to that scheme, some remaining distinguishing factor must be found in order to prevent such automatic liability. The bank’s knowledge of the illegal scheme at the time it loaned the money or agreed to loan the money provides that additional factor.

Id at 630–31.

¹⁰⁹ See *Ernst & Ernst*, 425 US at 191–93 (concluding that one cannot violate § 10(b) of the Exchange Act without scienter).

¹¹⁰ Ruder expressly noted, but did not attempt to answer, the question of whether securities fraud required some particular form of deceptive intent:

The existence of a knowledge requirement in order to impose [aiding and abetting] liability should be distinguished from the question whether scienter is a necessary element to establish liability for the primary participant. The question whether scienter is a required ele-

Ruder test first entered into circuit precedent through *Coffey*, a civil enforcement action, it was later cited by a number of decisions involving aiding and abetting in the context of *private* civil actions.¹¹¹ Such private actions against aiders and abettors had no statutory basis and were subsequently abolished by the Supreme Court.¹¹²

Thus the best explanation for the courts' special approach to civil aiding and abetting liability might simply be a historical one. The courts of appeals had been applying an erroneously low standard of intent to an invalid private right of action against aiders and abettors. They then were faced with the task of cabining the sweeping implications of their own mistaken doctrines.¹¹³ This explanation is further buttressed by the fact that, until *Howard* and *Monetta*, *Investors Research* was the only decision applying the Ruder test to *administrative* aiding and abetting liability. Today, however, the implied civil aiding and abetting liability that was the subject of the Ruder test no longer exists, extinguishing whatever vexatious litigation it might have spawned in the first place.

Subsequent Supreme Court precedent undermines the holding of *Investors Research* as well as the authorities on which it relied. First, in holding that scienter was an element of securities fraud, the Court made no distinction between primary and secondary liability.¹¹⁴ Second, in abolishing the implied civil right of action for aiding and abetting under the Exchange Act, the Supreme Court cautioned the circuits to remember that “[p]olicy considerations cannot override . . . the text and structure of the Act.”¹¹⁵ As noted in Part III.A, the aiding and abetting provision at issue in *Howard* and *Monetta* is indistinguishable from the provision authorizing sanctions against primary violators. Even if there do remain sound policy justifications for the mistake of law defense that protected the respondents from administrative sanc-

ment under rule 10b-5, the primary federal regulation dealing with securities law fraud, must be regarded as open at this time.

Ruder, 120 U Pa L Rev at 631 (cited in note 103).

¹¹¹ See, for example, *Woodward*, 522 F2d at 96–97 (finding Ruder's example “remarkably similar to the case at hand”); *Cleary v Perfectune, Inc.*, 700 F2d 774, 777 (1st Cir 1983) (suggesting that the test “to determine whether a defendant is liable as an aider and abettor . . . is now well-settled”); *Woods v Barnett Bank of Fort Lauderdale*, 765 F2d 1004, 1009 (11th Cir 1985), citing *Woodward*, 522 F2d at 94–95, as binding precedent for the Eleventh Circuit.

¹¹² See *Central Bank*, 511 US at 190–91. See also note 100 and accompanying text.

¹¹³ Consider *Central Bank*, 511 US at 188–89 (noting the lack of clarity and ad hoc nature of aiding and abetting decisions, and the corresponding potential for “vexatious[]” litigation).

¹¹⁴ See *Ernst & Ernst*, 425 US at 193 (making no distinction, in a civil context, between scienter for aiding and abetting liability and for primary violations).

¹¹⁵ *Central Bank*, 511 US at 188. See also *id* at 192 (Stevens dissenting) (“The main themes of the Court's opinion are that the text of § 10(b) of the Securities Exchange Act of 1934 does not expressly mention aiding and abetting liability, and that Congress knows how to legislate.”) (internal citations omitted).

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tions in *Howard*, *Monetta*, and *Investors Research*, they cannot stand without some statutory justification.

In any event, it is doubtful that such policy considerations exist. An implied private right of action presents a very different set of policy concerns than a statutorily based administrative right of action. In addition to the fact that only one is clearly authorized by law, a private right of action allows suits to be brought by any plaintiff against any defendant. An administrative action, by contrast, can only be brought by the SEC, typically against a securities professional. The narrow class of potential respondents mitigates the need for the mistake of law defense—one primary justification for the defense is that it protects people from technical statutes whose reach is so broad that most affected individuals cannot reasonably be expected to know their legal duties.¹¹⁶

It is therefore somewhat perverse that, because of the demise of the private right of action against aiders and abettors, the only area of the law in which the Ruder test remains applicable is in administrative actions for aiding and abetting. A mistake of law defense specific to such actions is very much out of place: it has no policy justification, no statutory justification, and the authority it relies on is now defunct. If either *Howard* or *Monetta* was correct in allowing ignorance of the law to be a defense, there must be a better justification than actually appears in the opinions themselves.

IV. SCIENTER AS THE ALTERNATIVE

This Part proposes an alternative basis for a mistake of law defense in administrative actions, though one that applies equally to primary and secondary violators. Borrowing from the previous discussion regarding ignorance of the law generally, this Part argues that ignorance of the law is a valid defense when, and only when, it negates an intent element of the violation. In the context of the securities laws, this means that ignorance of the law will only be a defense when it negates the scienter, or deceptive intent, required for securities fraud.

A. Scienter as Distinct from a Separate Intent Requirement for Aiding and Abetting

However shaky the legal underpinnings of *Howard* and *Monetta*, the two holdings constitute the law of the D.C. and Seventh Circuits. Moreover, other courts might view *Howard* and *Monetta* as persuasive

¹¹⁶ See Murphy and O'Hara, 5 S Ct Econ Rev 217, 259–60 (cited in note 21) (discussing the mistake of law defense allowed for violations of criminal tax provisions, because tax regulations “are complex in order to channel behavior precisely, yet [] touch on the behavior of very large portions of the population as a whole, rather than being limited in scope to particular industries”).

because they are rooted in decades of securities law jurisprudence regarding private civil actions, even if those actions no longer exist.

Given the weakness of the stated arguments for a mistake of law defense, it may be worthwhile to examine alternative justifications for the defense. Since the body of precedent on which *Howard* and *Monetta* rely is almost entirely composed of civil actions, such a justification should explain how courts have evaluated the culpability of aiders and abettors in practice, both in administrative and civil contexts. Most importantly, a good justification will be one that is well founded in securities jurisprudence generally and does not rely on any distinct property of aiding and abetting liability.

Such a justification was actually articulated, though rejected, by Ruder himself. As noted above, Ruder explicitly distinguished the “existence of a knowledge requirement in order to impose [aiding and abetting] liability . . . from the question whether scienter is a necessary element to establish liability for the primary participant.”¹¹⁷ Although at the time Ruder wrote that “[t]he question whether scienter [was] a required element under rule 10b-5, the primary federal regulation dealing with securities law fraud, [was] regarded as open,”¹¹⁸ that question is now closed—scienter *is* required.¹¹⁹ The Supreme Court has interpreted scienter in the context of the securities laws as “a mental state embracing intent to deceive, manipulate, or defraud.”¹²⁰ The Court has held that scienter is an independent and necessary element of a securities fraud, regardless of whether a particular action is brought by a private party¹²¹ or by the SEC as a civil¹²² or administrative¹²³ enforcement action. By contrast, the existence of an implied private right of action for aiding and abetting, widely accepted at the time Ruder wrote,¹²⁴ no longer exists. This shift in the law suggests that Ruder was wrong to found his test—and its mistake of law defense—on the particular nature of aiding and abetting liability.

¹¹⁷ Ruder, 120 U Pa L Rev at 631 (cited in note 103).

¹¹⁸ *Id.*

¹¹⁹ See *Ernst & Ernst v Hochfelder*, 425 US 185, 191–93 (1976) (concluding that a private cause of action for damages will not lie without intent to deceive).

¹²⁰ *Aaron v SEC*, 446 US 680, 686 n 5 (1980), citing *Ernst & Ernst*, 425 US at 193–94 n 12. The *Aaron* Court, “[i]n determining whether proof of scienter is a necessary element of a violation of § 17(a)” of the Securities Act, reasoned that “[t]he language of § 17 (a)(1), which makes it unlawful ‘to employ any device, scheme, or artifice to defraud,’ plainly evinces an intent on the part of Congress to proscribe only knowing or intentional misconduct.” 446 US at 695–96.

¹²¹ See, for example, *Basic Inc v Levinson*, 485 US 224, 231 (1988).

¹²² See, for example, *Aaron*, 446 US at 697.

¹²³ See, for example, *Dirks v SEC*, 463 US 646, 663 n 23 (1983).

¹²⁴ See *Central Bank of Denver v First Interstate Bank of Denver*, 511 US 164, 192 (1994) (Stevens dissenting) (noting that an implied private right of action for aiding and abetting had existed in every circuit that had considered the question).

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Unlike the arguable mistake of law defense based on the “willfulness” requirement of § 15(b)(4) of the Exchange Act, scienter requirements are based on the *underlying* provision being violated rather than on the manner of its violation.¹²⁵ Given that scienter is now a necessary element for all securities fraud, both primary and secondary, Ruder’s bank example above¹²⁶ makes a strong policy case for what is already a well-accepted proposition in criminal law: that the intent required for a secondary violation must match the intent required for the primary violation.¹²⁷

In the case of the securities laws, such an equivalence would simply mean that scienter is required for aiders and abettors whenever it is required for primary violators. Thus the innocent bank in Ruder’s above hypothetical would not be liable for the same reason Ruder advanced: because it had no “knowledge of the illegal scheme” that it was facilitating.¹²⁸ Only the legal basis for the rule would be different. There is no need to invent a mistake of the law defense unique to aiding and abetting when there is a much more plausible one to be found in the doctrine of scienter, which would encompass aiding and abetting anyway.¹²⁹

Although these two approaches yield the same result in Ruder’s bank hypothetical, they will yield different results in a significant number of cases. Ruder’s mistake of law defense is specific to the type of legal liability (aiding and abetting). It would therefore apply to *all* aiding and abetting of securities law violations, from the egregiously fraudulent to the merely technical, but not to *any* primary violations.¹³⁰ By contrast, a mistake of law defense rooted in scienter would be specific to the type of underlying violation (namely, fraud), and would apply to primary as well as secondary violations. Thus the Ruder test would give a mistake of law defense to the aider and abettor of a technical violation, while the scienter-based approach would not; the

¹²⁵ For instance, a person who acts without scienter does not violate some provisions of the securities laws *at all*—and therefore cannot violate them willfully, as required for administrative enforcement actions under § 15(b). See, for example, *Aaron*, 446 US at 697.

¹²⁶ See note 108.

¹²⁷ Compare MPC § 2.06(4) (requiring the same mens rea for accomplice liability as for the primary violation when “causing a particular result is an element of an offense”); Restatement (Second) of Torts § 877(a) (1979) (allowing an actor to be held liable for conduct where he “orders or induces the conduct, if he knows or should know of circumstances that would make the conduct tortious if it were his own”).

¹²⁸ Ruder, 120 U Pa L Rev at 631 (cited in note 103).

¹²⁹ See, for example, *Ernst & Ernst*, 425 US at 191–93 & n 7 (requiring scienter for aiding and abetting a violation of § 10(b) of the Exchange Act).

¹³⁰ See, for example, *SEC v Steadman (Steadman I)*, 967 F2d 636, 647 (DC Cir 1992) (holding that ignorance of the law was a defense to aiding and abetting even when some of the primary violations required scienter and some did not).

scienter-based approach would give a mistake of law defense to a primary violator who acted without fraudulent intent, while the Ruder test would not. One approach focuses on the violator; the other focuses on the violation.

This distinction is almost never made explicit. Some courts conflate the Ruder test's "general awareness" requirement for aiding and abetting liability with the scienter requirement for all antifraud liability.¹³¹ Other courts have implicitly kept the two separate, applying the Ruder test to create a mistake of law defense even where the primary violation did not require scienter.¹³² In none of these decisions did the courts explain precisely what they were doing or how scienter might relate to the "general awareness" test for aiding and abetting liability. In fact, it appears that no published article or decision has ever sketched out the contours of an ignorance of the law defense based on the Supreme Court's scienter jurisprudence.¹³³

B. Ignorance of the Law as a Defense Rooted in Scienter

This section lays out an alternate rule under which ignorance of the law can sometimes serve as a defense to SEC administrative actions. This rule is based on the Supreme Court's scienter jurisprudence rather than defunct aiding and abetting case law, and draws on both the MPC and Supreme Court precedent regarding ignorance of the law generally. Consistent with the general rule that ignorance of the law is no defense, this section argues that ignorance of the law is only a defense when it negates the scienter required for a particular violation of the securities laws. It also argues that this rule describes how the courts of appeals have decided cases in practice.

1. Scienter and mistakes of law.

If, as discussed in Part III.A, ignorance of the law is not a defense created by the word "willfully," and is also not somehow specific to the nature of administrative aiding and abetting violations, there remains the question of when or whether it is a defense. The MPC, as discussed in Part I.B, allows for two exceptions to the rule that ignorance of the law is no defense. One is when the statute expressly provides for such a

¹³¹ See, for example, *Dirks*, 681 F2d at 844 (labeling a section as "Aiding or Abetting Scienter").

¹³² See, for example, *Steadman I*, 967 F2d at 647 (holding that Steadman was not shown to have been "generally aware" of the primary violations).

¹³³ As noted earlier, Ruder himself did make such a distinction, though he did so prior to the Supreme Court's adoption of scienter as an element of securities fraud. See Ruder, 120 U Pa L Rev at 631 (cited in note 103).

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defense.¹³⁴ The other exception relates to the scope of the rule that ignorance of the law is not a defense, allowing the defense when ignorance of the law negates a necessary intent element.¹³⁵ Applying this second exception to administrative violations of the securities laws, ignorance of the law should be a defense when it negates the scienter required for a violation of a particular provision of the securities laws. When scienter is not required, or when it is satisfied by some other deception that was unrelated to the contents of the law, ignorance of the law would not be a defense.

The Supreme Court's definition of scienter requires deceptive, manipulative, or fraudulent intent.¹³⁶ Deception¹³⁷ in the form of an omission, however, is only a violation of the securities laws where there is some sort of legal duty to disclose¹³⁸ and where the omission is material.¹³⁹ Furthermore, as a general rule, a violation of the law that occurred as part of a relevant transaction is a material fact that must be disclosed.¹⁴⁰ Thus in some circumstances scienter might require knowledge that some aspect of a transaction was illegal, since otherwise the actor would not know the *fact* that her omission was material.¹⁴¹

¹³⁴ For example, as discussed in Part III.A, the courts have sometimes held that a statutory requirement of "willfulness" creates a mistake of law defense.

¹³⁵ See MPC § 2.04(1) ("Ignorance or mistake as to a matter of . . . law is a defense if: [] the ignorance or mistake negatives the purpose, knowledge, belief, recklessness or negligence required to establish a material element of the offense."); *MPC and Commentaries* § 2.02 at 250 (ALI 1985) ("Claim of right is a defense [to theft] because the property must belong to someone else for the theft to occur and the defendant must have culpable awareness of that fact.").

¹³⁶ See *Aaron*, 446 US at 686 n 5.

¹³⁷ For convenience, this term will be employed broadly to include manipulation and fraud as well.

¹³⁸ See *Chiarella v United States*, 445 US 222, 232 (1980).

¹³⁹ See *Basic Inc*, 485 US at 240 ("[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information.").

¹⁴⁰ See, for example, *In the Matter of Howard*, 2003 SEC LEXIS 377, *20 (holding that because the respondent violated Rule 10b-9 by failing to disclose that "the required minimum for the first offering could not be sold to investors, a fact that would clearly have been material to customers determining whether or not to invest in the second offering," he also violated Rule 10b-5). See also *Steadman I*, 967 F2d at 645 (affirming that where a firm's "failure to register under state Blue Sky laws subjected [it] to large potential liabilities," disclosure of the general nature of the potential liability was required). But consider *Oran v Stafford*, 226 F3d 275, 288 (3d Cir 2000) ("[D]emonstration of a violation of the disclosure requirements . . . does not lead inevitably to the conclusion that such disclosure would be required under Rule 10b-5."); *Gaines v Haughton*, 645 F2d 761, 776 (9th Cir 1981) (drawing "a sharp distinction" between allegations of nondisclosure of matters which are presumptively material and "allegations of simple breach of fiduciary duty/waste of corporate assets—the nondisclosure of which is never material for § 14(a) purposes").

¹⁴¹ Consider *Morissette v United States*, 342 US 246, 271 (1952) (overturning a conviction for conversion of government property, because it was "not apparent how [the defendant] could have knowingly or intentionally converted property that he did not know could be converted, as would be the case it was in fact abandoned or if he truly believed it to be abandoned").

Illegality, however, is only one type of materiality; an omitted fact may be material for reasons unrelated to the requirements of the law. *Howard* provides a good illustration of this principle. Howard helped his firm market a “part-or-none offering”—an offering in which investors make their purchase subject to the condition that the offeror will sell a minimum total number of shares at the same price.¹⁴² A given investor with whom Howard dealt was likely “comforted by the knowledge that unless his judgment to take the risk [was] shared by enough others to sell out the issue, his money [would] be returned.”¹⁴³ A rational investor would therefore probably consider it significant that his assessment of the offering’s value was not so widely shared by the market as to put the offering past the amount required to close. Accordingly, Howard could have had deceptive intent if he realized that investors would attach significance to the fact that the offering¹⁴⁴ only closed because his firm purchased the necessary additional shares.¹⁴⁵ Alternatively, Howard could have had deceptive intent if he realized that this ploy violated Rule 10b-9 even if he *did not* realize that investors would care whether his firm purchased part of the offering that it was marketing. Howard lacked scienter only if he was both ignorant of the fact that investors would care about his firm’s purchases *and* ignorant of the fact that those purchases were illegal. Thus illegality is sufficient but not necessary to make an omission deceptive, and so ignorance of the law may sometimes—but not necessarily—negate scienter.

In other words, even if there is no freestanding or complete mistake of law defense, there may be circumstances in which a key *fact* somehow involves the law. Under those circumstances ignorance of the law may excuse, at least with respect to that fact. The Supreme Court expressly made this distinction in a case involving food stamp fraud:

The dissent repeatedly claims that our holding today creates a defense of “mistake of law.” Our holding today no more creates a “mistake of law” defense than does a statute making knowing receipt of stolen goods unlawful. In both cases, there is a legal element in the definition of the offense. In the case of a receipt-of-

¹⁴² See Part II.C (discussing *Howard* generally).

¹⁴³ *SEC v Blinder, Robinson & Co*, 542 F Supp 468, 476 (D Colo 1982) (discussing investor confidence in the context of an “all or none” offering, a similar device in which all shares must be sold, rather than a certain minimum number of shares).

¹⁴⁴ There were actually two offerings, and the SEC also found Howard liable for not disclosing to purchasers of the second offering the fact that the first offering had closed improperly. See *Howard*, 376 F3d at 1141. This illustration refers to the first offering as “the offering” for the sake of simplicity.

¹⁴⁵ No such finding was actually made by the SEC, but it appears to have been assumed. See generally *In the Matter of Howard*, 2003 SEC LEXIS 377.

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stolen-goods statute, the legal element is that the goods were stolen; in this case, the legal element is that the “use, transfer, acquisition,” etc. were in a manner not authorized by statute or regulations. It is not a defense to a charge of receipt of stolen goods that one did not know that such receipt was illegal, and it is not a defense to a charge of [food stamp fraud] that one did not know that possessing food stamps in a manner unauthorized by statute or regulations was illegal. It *is*, however, a defense to a charge of knowing receipt of stolen goods that one did not know that the goods were stolen, just as it is a defense to a charge of [food stamp fraud] that one did not know that one’s possession was unauthorized.¹⁴⁶

In other words, ignorance of the law can be a defense when it negates an element of the violation. Thus in the securities laws, when scienter is an element of the violation, ignorance of the law should be a defense when it negates deceptive intent, and should not be a defense when it does not.

2. Consistency with the case law.

The Second and D.C. Circuits have defined scienter in a manner consistent with the above interpretation: they require an intent to deceive, but not necessarily knowledge of illegality.¹⁴⁷ Furthermore, the vast majority of the actual holdings of the cases discussed in this Comment are similarly consistent with the theory that ignorance of the law is a defense when it negates the scienter required for a securities violation. With the notable exceptions of *Investors Research* and *Monetta*,¹⁴⁸ this understanding of scienter is consistent with all of the other decisions discussed in this Comment, both administrative and civil¹⁴⁹ as well as primary and secondary.¹⁵⁰

¹⁴⁶ *Liparota v United States*, 471 US 419, 425–26 n 9 (1985) (citations omitted).

¹⁴⁷ See *Arthur Lipper Corp v SEC*, 547 F2d 171, 180 (2d Cir 1976) (conflating willfulness with scienter and holding that neither requires “knowledge that the law was being violated”). See also *SEC v Falstaff Brewing Corp*, 629 F2d 62, 77 (DC Cir 1980) (“Knowledge means awareness of the underlying facts, not the labels that the law places on those facts. Except in very rare instances, no area of the law—not even the criminal law—demands that a defendant have thought his actions were illegal.”). See generally Loss and Seligman, *Securities Regulation* § 9-B-6 (cited in note 36).

¹⁴⁸ *Howard*, in fact, may arguably be consistent with the scienter-based mistake of law defense, as discussed below.

¹⁴⁹ Scienter is a property of the underlying violation and not the type of legal action, as noted in Part IV.A.

¹⁵⁰ See *Aaron*, 446 US at 696 (making no distinction, in a civil action, between scienter for aiding and abetting liability and for primary violations); *Ernst & Ernst*, 425 US at 193 (same).

a) *Consistent decisions.* With few exceptions, ignorance of the law was not a defense when there was no scienter requirement for the underlying violation. A number of older administrative decisions involving antifraud provisions rejected ignorance of the law as a defense.¹⁵¹ While these antifraud provisions currently require scienter as a defense,¹⁵² they did not at the time the cases were decided, so those opinions are still consistent with a mistake of law defense derived from the requirement of scienter. Another decision rejected the defense when the underlying provisions that were violated did not require scienter and where the only reason that ignorance of the law was an issue was that the respondent unsuccessfully claimed it as a defense based on the willfulness requirement for administrative liability.¹⁵³

Furthermore, in those cases where a scienter requirement was fulfilled by some deceptive conduct unrelated to the deceiver's knowledge of the law, ignorance of the law was still not a defense. Two of these decisions expressly followed the Supreme Court's scienter precedent and distinguished scienter from knowledge of illegality by finding the violators' conduct to be deceptive without respect to their ignorance or knowledge of the law.¹⁵⁴ A number of other cases followed suit, rejecting ignorance of the law as a defense when an aider and abettor already had intent with respect to some *fact* that made his conduct deceptive.¹⁵⁵

¹⁵¹ See, for example, *Tager*, 344 F2d at 8 (“[A]ctual knowledge is not necessary for finding criminal liability.”); *Gearhart & Otis, Inc v SEC*, 348 F2d 798, 802 (DC Cir 1965) (rejecting the argument “that specific intent to violate the law is an essential element of the willfulness required to violate Section 15(b)”).

¹⁵² See 15 USC § 78o(b) (codifying § 10(b) of the Exchange Act); 15 USC § 77q(a) (2000) (codifying § 17(a) of the Securities Act).

¹⁵³ See *Wonsover*, 205 F3d at 414 (holding that the defendant only needs to know what he is doing, not that he is breaking the law).

¹⁵⁴ See *Arthur Lipper*, 547 F2d at 181 (holding that “there must be proof of intention ‘to deceive, manipulate, or defraud’—not an intention to do this in knowing violation of the law”). See also *Falstaff*, 629 F2d at 77 (“Kalmanovitz contends that scienter requires an inquiry into the defendant's state of mind—his subjective belief as to the legality of his action We strongly disagree.”) (omission in original) (internal quotation marks omitted).

¹⁵⁵ In *Graham v SEC*, 222 F3d 994 (DC Cir 2000), the aider and abettor was liable for recklessly facilitating the primary violator's “wash trades,” which gave the false appearance of market activity and thus defrauded other broker-dealers who dealt with him. See *id* at 1004. In *SEC v Fehn*, 97 F3d 1276 (9th Cir 1996), the aider and abettor helped prepare and mail a number of required filings that he knew to contain false information, see *id* at 1281, thus acting with the deceptive intent necessary for scienter, whether or not he knew of the illegality of his actions. See *id* at 1295. In *United States v O'Hagan*, 139 F3d 641 (8th Cir 1998), on remand from 521 US 642 (1997), the defendant “was convicted under the misappropriation theory [of insider trading], which requires the government to prove that he obtained information that was material and nonpublic, that he used this information to trade securities, and that he breached a duty owed to the source of the information.” 139 F3d at 647–48 (internal quotation marks omitted). Misappropriators “deal in deception” by pretending “loyalty to the principal while secretly converting the principal's information for personal gain.” 521 US at 653.

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By contrast, in those cases where there was a scienter requirement, and where deceptive intent depended on knowledge of illegality, ignorance of the law *was* a defense. In these cases ignorance of the law negated the requisite scienter because without knowledge of illegality there was no deception. One case from the D.C. Circuit provides a good example.¹⁵⁶ There the court held in a civil action that a group of mutual funds did not act with sufficient scienter when they failed to disclose that they were in violation of multiple state laws as a result of being unregistered in those states. The funds *did* disclose the fact that they were unregistered.¹⁵⁷ But since the funds' managers did not realize that this lack of registration was illegal, they understandably failed to disclose to investors the fact that it was illegal, and so they also failed to disclose the registration costs and fines they might have to pay once they were caught.¹⁵⁸ Because the record suggested that the funds (via their managers) had no intent to deceive, the court held that the funds were only liable for the violations that did not require scienter.¹⁵⁹ In a similar case, the Sixth Circuit held that a defendant was not liable for offering illegal securities that he thought were legal when he disclosed the underlying attributes of the securities that made them illegal.¹⁶⁰ Moreover, all of the implied-right aiding and abetting cases discussed in Part III.B.2 (as well as the bank hypothetical that Ruder offered to support his test) focused at least obliquely

¹⁵⁶ *Steadman I*, 967 F2d 636.

¹⁵⁷ *Id* at 639.

¹⁵⁸ The court concluded that "the [defendants] were not aware that they were required to register their shares under state . . . laws, because their attorney, in a formal, unqualified opinion letter, told them they did not have to. . . . [Additionally, t]here [was] no evidence that the [defendants] acted in bad faith." *Id* at 642.

¹⁵⁹ See *id* at 647:

Both parties agree that the claims of willful or reckless securities fraud were at the core of the SEC's case. The negligent fraud charges and the alleged pricing and disclosure violations were next in order of seriousness. . . . We have set aside the findings of violation in the most serious category, and . . . have affirmed the district court on this second category based only on the presumably negligent omission of a footnote in appellants' financial statements.

Consider also *Steadman v SEC (Steadman II)*, 603 F2d 1126 (5th Cir 1979). Here, in a totally separate case from the D.C. Circuit's *Steadman I* opinion, and in the context of an appeal from an SEC administrative action, the Fifth Circuit remanded the SEC's findings of scienter violations, affirmed the findings of nonscienter violations, and cited *Tager* and *Arthur Lipper* to reject a reliance-on-counsel defense based on the word "willfully." See *Steadman II*, 603 F2d at 1135 ("That the arrangement was approved by the funds' directors and on the advice of counsel does not render the violation any less willful, for 'willful' in this context simply means that the act constituting the violation was done intentionally.").

¹⁶⁰ See *SEC v Coffey*, 493 F2d 1304, 1312 (6th Cir 1974) (assuming that an investment in two-year notes was illegal in the state of Ohio, but concluding that "it is not fraudulent to offer a two-year note so long as it is represented as such").

on the issue of scienter,¹⁶¹ without reference to ignorance of the law as a distinct issue.¹⁶²

Finally, according to this scienter-based understanding of the mistake of law defense, *Howard* might have reached the correct result, regardless of its reasoning. As discussed above, Howard should have been held liable for aiding and abetting securities fraud if the SEC proved that he either (1) knew the offering violated Rule 10b-9, or (2) realized that a rational investor would find it material that his firm had to purchase shares itself in order to save the offering.¹⁶³ The D.C. Circuit held that Howard was ignorant of the law (that is, Rule 10b-9), so the key remaining question would, under this approach, be whether Howard knew that his deception was material to investors.¹⁶⁴ Common sense notwithstanding, the SEC did not appear to make such a finding,¹⁶⁵ and so the holding (if not the reasoning¹⁶⁶) of *Howard* is arguably consistent with the argument that ignorance of the law is only a defense where it negates the requisite scienter.

Either way, taken as a whole, the case law reveals a pattern it fails to recognize: ignorance of the law is a defense when the sole omitted material fact relates to the contents of the law. Ignorance of the law is only a defense when it negates an element of the offense¹⁶⁷—in the case of securities fraud, deceptive intent or scienter.

¹⁶¹ Some of these decisions focus on deception and fraud generally; a number of them predate the Supreme Court's 1976 articulation of scienter in *Ernst & Ernst*, 425 US at 193–94 & n 12.

¹⁶² For example, in *Woodward v Metro Bank of Dallas*, 522 F2d 84 (5th Cir 1975), the court held that the defendant bank was not liable for aiding and abetting securities fraud when it processed a customer's transactions in the ordinary course of business without any evidence of fraudulent intent. See *id* at 95. (“[An aider and abettor] must not only be aware of his role, but he should also know when and to what degree he is furthering the fraud.”). In *Cleary v Perfec-tune, Inc.*, 700 F2d 774 (1st Cir 1983), the court granted summary judgment in favor of an alleged aider and abettor in the absence of any information suggesting fraudulent or deceptive intent. See *id* at 778 (holding that there was “[in]sufficient evidence to raise as a genuine question whether the defendants consciously intended to further [the] allegedly fraudulent scheme”). Conversely, in *Woods v Barnett Bank of Fort Lauderdale*, 765 F2d 1004 (11th Cir 1985), the defendant was held liable for being reckless with respect to the truthfulness of information contained in a letter to a bank that unwittingly assisted in the fraudulent scheme. See *id* at 1012 (“[The defendant's employee] was under a duty to speak truthfully, or stated alternatively, a duty not to communicate something that he knew to be incorrect, or something for which he had little or no basis for belief.”).

¹⁶³ See Part IV.B.1.

¹⁶⁴ See *Basic Inc.*, 485 US at 240 (“[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information.”).

¹⁶⁵ See generally *Howard*, 2003 SEC LEXIS 377.

¹⁶⁶ See Part II.C.

¹⁶⁷ Consider *Liparota*, 471 US at 425 & n 9 (requiring, “absent indication of contrary purpose in the language or legislative history,” mens rea as to all elements in the statutory definition of a criminal offense).

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b) *Inconsistent decisions.* *Investors Research* and *Monetta* appear to be the only decisions that cannot be reconciled with the notion that ignorance of the law is only a defense where it negates scienter.¹⁶⁸ In both cases the courts held that an aider and abettor was not liable due to his ignorance of the law, despite the fact that in neither case did the underlying violation actually require scienter.¹⁶⁹

Neither can the mistake of law defense in these decisions be explained by the requirement of “willfulness.” As discussed in Part III.A, such an interpretation would squarely contradict decades of precedent regarding administrative liability under the securities laws (including precedent from the D.C. Circuit, which further forecloses this reading of *Investors Research*). Instead, as discussed in Part III.B.3, the two cases should be read as importing a mistake of law defense from now-defunct private civil actions for aiding and abetting and applying it to administrative aiding and abetting liability without any statutory justification and despite the general rule that ignorance of the law does not excuse. *Investors Research* and *Monetta* are not well founded and should be overturned.

V. CONCLUSION

Except for *Investors Research* and *Monetta*, securities law precedent is consistent with the idea that ignorance of the law is only a defense where it negates the scienter required for a particular violation.

This limited mistake of law defense is also consistent with the Supreme Court’s formulations of scienter and the mistake of law defense. When some alleged deception is based on an omission that involves the contents of the law, ignorance of the law will negate deceptive intent—just as ignorance of the law regarding the ownership of property negates theft when it leads one to wrongly believe that some piece of property is his.¹⁷⁰ Moreover, this scienter-based understanding of the mistake of law defense does not rely on the term “willfully,” and thus does not require that “willfully” create a mistake of law defense in one subsection of the Exchange Act but not in its neighbor, or for

¹⁶⁸ This scienter-based mistake of law defense also conflicts with the reasoning in *Steadman I*, 967 F2d at 647 (holding that ignorance of the law was a defense to aiding and abetting, even when some of the primary violations required scienter and some did not). However, since the aiding and abetting causes of action in *Steadman I* were based on the implied-right theory that the Supreme Court abolished two years later, the judgment of the court—holding the aider and abettor not liable—was correct.

¹⁶⁹ See Parts II.C and III.B.

¹⁷⁰ See *Morissette v United States*, 342 US 246, 247 (1952) (holding that a mistake regarding the ownership of property is a defense to theft). See also *Liparota v United States*, 471 US 419, 425 n 9 (1985) (holding that a mistake regarding the authorization of food stamp possession is a defense to food stamp fraud).

administrative but not for criminal violations of the securities laws. Nor does this version of the mistake of law defense rely on defunct precedent that sought to cabin judicially created aiding and abetting liability before the Supreme Court elevated the concept of scienter to such prominence in the securities laws. Finally, this approach maintains the traditional distinction between ignorance of facts and ignorance of the law.

The distinction is not trivial. For the legal system, it means the difference between the ad hoc application of a legally insupportable theory regarding the special nature of aiding and abetting versus a sensible application of well-accepted precedent regarding scienter. The distinction also matters in practice. If ignorance of the law is an exception specifically to aiding and abetting, then officers of primary broker-dealer and investment advisor firms will have far less to fear so long as they remain ignorant of the law—even if they purposefully deceive investors. Conversely, if ignorance of the law is never an excuse, then the same officers can be severely sanctioned for “fraud,” even if they did not intend to deceive anyone. Both outcomes seem intuitively unfair, and both are at odds with the relevant Supreme Court precedent. Deceit is necessary and sufficient for the fraud, just as intent to take something belonging to someone else is necessary and sufficient for theft.

It is true that, in practice, most courts have only allowed ignorance of the law as a defense where it negates scienter. Expressly announcing this rule, however, would go a long way toward reducing the confusion the D.C. Circuit complained about in *Howard*,¹⁷¹ and clarifying a sensitive area of the law that “demands certainty and predictability.”¹⁷²

¹⁷¹ See *Howard*, 376 F3d at 1138 (calling the SEC opinion “confused and confusing”).

¹⁷² *Central Bank of Denver v First Interstate Bank of Denver*, 511 US 164, 188 (1994).