

## In *SEC v. Apuzzo*, Second Circuit Clarifies “Substantial Assistance” Standard for SEC Aiding and Abetting Claims

An August 8th Second Circuit decision meaningfully lowers the bar for liability in Securities and Exchange Commission (SEC) enforcement actions based on aiding and abetting theories. As discussed below, parties who assist in transactions designed primarily to enhance financial reporting should be wary of the SEC’s increased ability to civilly prosecute aiders and abettors.

### Background

From 1998 to 2002, Joseph Apuzzo was the Chief Financial Officer (CFO) of the Terex Corporation (Terex), a construction and mining equipment manufacturer. Terex bought equipment from, and sold equipment to, a large equipment rental company (Rental Company). The SEC’s complaint alleged that Apuzzo aided and abetted violations of the federal securities laws, including Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, by assisting the Rental Company in carrying out two fraudulent “sale-leaseback” transactions designed to allow the Rental Company to “recognize revenue prematurely and to inflate the profit generated from [the Rental Company’s] sales.”

According to the SEC, the Rental Company sold used equipment to a financing corporation (Financing Corporation), and then leased it back temporarily. In order to induce the Financing Corporation to enter into the transaction, the Rental Company had Terex promise to purchase the equipment from the Financing Corporation at the end of the lease period. Terex guaranteed that the Financing Corporation would receive no less than 96 percent of the purchase price that the Financing Corporation paid the Rental Company for the equipment, and the Rental Company secretly agreed to indemnify Terex for any losses that it incurred as a result of performing under the guarantee. The Rental Company’s indemnity payments to Terex were disguised as either overpayments or “prepayments” on the Rental Company’s subsequent purchases of other equipment from Terex.

To carry out the alleged scheme, Apuzzo executed agreements disguising the Rental Company’s risks and financial obligations and approved inflated invoices that hid the Rental Company’s indemnification payment. Apuzzo also allegedly offered to provide the Rental Company’s auditor with a letter stating that “nothing had come to [his] attention” to cause him to believe that the Rental Company’s valuation of the certain equipment was incorrect, after having received an internal appraisal of that same equipment showing that it was overvalued.

Apuzzo moved to dismiss the complaint, arguing, among other things, that the SEC had failed to allege his knowledge of, and substantial assistance to, the primary securities law violation. The district court agreed as to the substantial assistance element and dismissed the complaint, reasoning that “the complaint contains factual allegations which taken as true ... do not support a conclusion that Apuzzo’s conduct proximately caused the primary violation.” *SEC v. Apuzzo*, 758 F. Supp. 2d 136, 152 (D. Conn. 2010).

### The Second Circuit Decision

The SEC appealed the dismissal of the complaint and the Second Circuit reversed. Citing *US v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938), the court held that “the test for substantial assistance is that the aider and abettor ‘in some sort associate[d] himself with the venture, that he participate[d] in it as in something that he wishe[d] to bring about [and] that he [sought] by his action to make succeed.’” Drawing from a criminal case, the court noted that, “if the conduct of an aider and abettor is sufficient to impose criminal liability, *a fortiori* it is sufficient to impose civil liability in an enforcement action.” In other words, if a party participates in a scheme with the intention that the scheme succeed, he has provided substantial assistance.

The Second Circuit also squarely rejected the district court's holding that, in order to be liable, an aider and abettor must proximately cause the primary violation. "Proximate cause," the court reasoned, "is the language of private tort actions; it derives from the need of a private plaintiff, seeking compensation, to show that his injury was proximately caused by the defendants' actions. But, in an enforcement action, civil or criminal, there is no requirement that the government prove injury, because the purpose of such actions is deterrence, not compensation."

## Conclusions

In *SEC v. Apuzzo*, the Second Circuit's clarification of the substantial assistance standard meaningfully lowers the bar for liability in SEC enforcement actions. Because only the SEC can bring civil claims for aiding and abetting securities law violations, this development will have no effect on private litigations, but it will surely be evident in future SEC enforcement actions. In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), passed in 2010, further enhanced the SEC's ability to prevail on aiding and abetting claims. Prior to Dodd-Frank, in some circuits, the SEC was required to show that an alleged violator "knowingly" aided and abetted the primary violation. Dodd-Frank reduced the SEC's standard to "recklessly," thereby enlarging the universe of potential violators that will fall within the ambit of the federal securities laws. This new authority increases the risk of aiding and abetting liability for all transactions, especially for those that are designed to enhance financial statements.

In light of both the heightened enforcement environment and the clarified standard set forth by the Second Circuit, parties would be well-advised to consider the structure of any transaction that may be designed primarily to satisfy revenue recognition principles, as opposed to genuine business needs. To be sure, attention to revenue recognition principles in structuring a deal does not violate the law. Rather, the lesson of *Apuzzo* is that a transaction that appears to have little or no business purpose other than to recognize revenue can give rise to a viable SEC enforcement action for both the party seeking to report the revenue and any party who assists.

For more information, please contact [Henry Morriello](#), [H. Peter Haveles, Jr.](#) or [Jonathan Green](#).

**Chicago**  
+1.312.583.2300

**Los Angeles**  
+1.310.788.1000

**Shanghai**  
+86.21.2208.3600

**Frankfurt**  
+49.69.25494.0

**New York**  
+1.212.836.8000

**Washington, DC**  
+1.202.682.3500

**London**  
+44.20.7105.0500

**Palo Alto**  
+1.650.319.4500

**West Palm Beach**  
+1.561.802.3230

Copyright ©2012 by Kaye Scholer LLP. All rights reserved. This publication is intended as a general guide only. It does not contain a general legal analysis or constitute an opinion of Kaye Scholer LLP or any member of the firm on the legal issues described. It is recommended that readers not rely on this general guide but that professional advice be sought in connection with individual matters. Attorney Advertising: Prior results do not guarantee future outcomes.