ORAL ARGUMENT – 9/29/04
03-1001
STERLING TRUST CO V. ADDERLEY, ET AL.

HERRMANN: In this case of first impression, Sterling Trust Co., a custodian of self directed IRA custodial accounts, has been held liable for investment losses in those accounts. It's not contested that the investment losses resulted from a Ponzi scheme and securities fraud. It is similarly not contested that the specific investments were all specifically directed by the account holders.

At the trial the jury found that Sterling had aided and abetted securities fraud under the Texas Securities Act. The jury also found that Sterling had breached broadly defined fiduciary duties. The plaintiffs elected to take judgment on the aiding and abetting claim, and the trial judge entered judgment against Sterling notwithstanding the fact that the jury in response to a specific question had held unanimously that Sterling did not know and had no reason to know of the fraudulent scheme that led to the losses.

The Ft. Worth CA affirmed, and in doing so, the Ft. Worth CA decided that Sterling under the aiding and abetting theory was to be denied the reasonable care defense that is available under the Texas Securities Act. Essentially the CA determined that the finding of no knowledge and the reasonable care defense were irrelevant.

The CA also declined to follow established case law holding that awareness of the fraudulent scheme is an essential element of aider and abettor liability. The CA also decided to make Sterling liable for losses that occurred even though it was undisputed that in some transactions Sterling had no connection to the transaction whatsoever. The Ft. Worth court did not address the fiduciary duty finding.

I would like to start with a discussion of the reasonable care defense, and the jury's answer to question 8, which I submit compels reversal and rendition on the aiding and abetting theory.

HECHT: In that regard, aider/abettor liability requires the plaintiff to prove intent to deceive or to fraud or reckless disregard.

HERRMANN: That's correct.

HECHT: It's hard for me to see what sense it makes to then add a defense that the defendant must prove, which is the kind of defense you are advocating, that he didn't know or in the exercise of reasonable care should have known of the fraud. How does that make sense when it seems to me under the statute it's already the plaintiff's burden to prove at least that and maybe more?

HERRMANN: There is no question that both involves scienter issues. But the fact that the plaintiffs had a burden of proof on scienter should not deny Sterling the affirmative defense that is given under the statute.

HECHT: But why? It's not clear to me it's given under the statute. And the reason is, if the plaintiff already has to prove this much, then what sense does it make to say but even if he does the defendant can somehow disprove it in a defense?

HERRMANN: If I may explore the question of whether it is indeed given under the statute. When one reads the Texas Securities Act as a whole, and of course the court is very familiar that the role in statutory construction is to give meaning to the entire statute. When one reads the statute as a whole it's obvious that there are two primary defenses given under the Texas Securities Act. They are shown in §§33a, 33b, and 33c. Those two defenses are: the defendant can demonstrate that the buyer knew of the untruth or the omission, and that is an affirmative defense; and the defendant can demonstrate that it did not know and in the exercise of reasonable care could not have known of the untruth or omission.

Now the Ft. Worth CA concluded that the reasonable care defense - the did not know defense - is not available to Sterling, because in the aider and abettor section 33(f)(2) that language is not specifically included. If that is a correct method of statutory construction, doesn't that also mean that if Sterling had been able to show that the plaintiffs actually knew of the untruth or omission, it would be denied that defense as well. And I submit that that makes no sense whatsoever in the process of statutory construction.

HECHT: But can there be a case where the plaintiff proved that the aider and abettor acted intentional or with recklessness, and still the defendant managed to prove that he didn't know and shouldn't have known?

HERRMANN: Whether there can be a case or not, I can't answer. I am unaware of any case where a court - federal or state, has sustained aider and abettor liability where it was demonstrated that the alleged aider was unaware of the fraud or its ____ fraud.

HECHT: But under this statute if the alleged aider and abettor was unaware, then presumably you couldn't find recklessness.

HERRMANN: Presumably.

HECHT: Because recklessness is not defined, but I assume it means something like the penal code which is you've got strong suspicions and you just don't care.

HERRMANN: And I think the 14th court left us in a bit of a vacuum when the court said Sterling is not entitled to rely on the reasonable care defense, and, therefore, question 8 is irrelevant. And then said that the burden is intent to defraud or reckless disregard, and then did not tell us what

character of activity or scienter allows a person who does not know or have any knowledge of the fraud to still be considered reckless or to be in reckless disregard. I think the Ft. Worth court stopped at that point and left us without any guidance.

HECHT: It seems to me the real problem here is the conflict in the two answers, in the two findings.

HERRMANN: There is no question that there is conflict. I don't agree that is the real problem. I submit that if the jury had been properly instructed on question 4, and had been told that awareness was an essential element of aider and abettor liability, that jury would not have answered that question the way it did. As it is, the jury was allowed to speculate just as the court in Ft. Worth left us to speculate what constitutes reckless disregard.

BRISTER: So isn't question 8 an inferential rebuttal of question 4?

HERRMANN: No. Not at all. Question 8 is an affirmative defense question.

BRISTER: And you're not complaining to this court that the answers to the two questions are conflicting?

HERRMANN: We're not complaining in this court that the answer is conflicting. But I am submitting that if we are correct on the reasonable care issue, if it is correct that the defendant Sterling was entitled to the reasonable care defense, then question 4 becomes irrelevant. And therefore there would be no conflict. The answer to question 8...

BRISTER: If they asked the same thing either one can be considered. One could say four is all you needed as well.

HERRMANN: But if we establish the affirmative defense, we are absolved from liability even if there are otherwise liability facts.

BRISTER: That's true for all inferential rebuttal issues? Inferential rebuttal issue negates some part of the earlier issue. And the reason we don't do both of them is because sometimes juries answer them opposite and we have to try the case all over again.

HERRMANN: But I don't think question 8 negated an element of...

BRISTER: J. Hecht asked, how can you scienter but not know that what you were saying was false?

HERRMANN: And I agree that it would be difficult to comprehend of a scenario like that.

HECHT: You say the jury should be instructed that the defendant was generally aware

of his role of the fraud?

HERRMANN: Yes.

HECHT: But how in the world could you act - you certainly couldn't act intentionally and be unaware of your role in the fraud. And how could you act recklessly and not be aware of your role in the fraud?

HERRMANN: I believe recklessness implicates at least a knowing appreciation of the risk. I believe that to be the case.

HECHT: But if that's the case why then would you have a know or should have known defense for a general awareness instruction?

HERRMANN: Why should you have both?

HECHT: Why should you have either? If recklessness already implicates that, then why would you have either other than to clarify what reckless means? Maybe recklessness should have been defined here, but if it's defined the way you think it means, I am inclined to agree with you.

HERRMANN: Actually our requested instruction simply said awareness is an element that the...

HECHT: But if you prove a reckless action at least under the penal code or restatement or some effort to define recklessness, that would incorporate actual knowledge.

HERRMANN: What's at work here is that the primary liability sections under the Texas Securities Act are strict liability type section. The plaintiff must only prove that the event, the prohibitive event occurred. And the decision was made to reverse that burden in the aider/abettor statute. And by virtue of that this language comes in to demonstrate that it is the plaintiff's burden to prove those things. But I don't think it was the intent of the drafters or the legislature to take away the affirmative defenses that would otherwise be available. And that is the reason that the comments make clear that the affirmative defenses, both with respect to the plaintiff's knowing the truth of the misrepresentation, and the affirmative defense of the defendant not having knowledge, the comments say both of those are available to all defendants in all circumstances, or all situations.

HECHT: And I could agree with you that the legislature wanted to shift the burden proof between strict liability seller and the aider and abettor. But wonders still why they didn't accomplish that by putting the burden on the plaintiff to prove reckless in aider and abettor.

HERRMANN: I think I agree with you in this respect. That if a jury is properly instructed regarding the awareness element of aider and abettor liability, and if that jury is also asked the reasonable care defense, the answers are likely to be consistent in response to those two questions.

It would be extraordinary I think to find an inconsistent.

OWEN: But you're not complaining here that the reckless issue was inadequate or error erroneous because it didn't have such an instruction?

HERRMANN: Yes, we are. We are complaining that the TC received a request for an instruction on aider and abettor that included the awareness element. We did request that and that was denied. The TC chose instead to limit the instruction to the specific language of the statute.

OWEN: Let me ask you about the statute. It looks like you can be held liable as an aider for reckless disregard of the law even if you are not in reckless disregard of the truth. What does that mean?

HERRMANN: I would suppose that, for example might mean, someone who is aiding an issuer, who has certain legal requirements with respect to registration or prospectus disclosure or whatever and a person who aides the issuer, and the issuer recklessly disregards the legal requirements, that person could be responsible.

I think there is a point here that's also important to the statutory construction. And it is, if one looks at §33(f)(1), which deals with control persons, you see that the legislature did include the reasonable care defense specifically in 33(f)(1), and did not in 33(f)(2). And I am sure it's going to be urged to you, well that's an indication that the legislature intended not to have the reasonable care defense available to aider and abettors. That is not the circumstance.

O'NEILL: You would agree that the defense would not be available if the general awareness instruction were included in the aider and abettor question.

HERRMANN: I don't know that I agree with that. I agree that the issues addressed the same scienter.

O'NEILL: But if you had a general awareness instruction in the aider and abettor liability question and then you've got a defense that they exercised reasonable care, those would be conflicting answers. So it seems like you can't have one without the other. I can see if you're not going to put a general awareness in you should have the benefit of the affirmative defense for reasonable care, or else you instruct what reckless disregard means to include general awareness.

HERRMANN: And I guess our complaint is, we were denied both.

O'NEILL: I guess what I am asking is, if we were to determine that the TC erred in not including the general awareness instruction, it would be logical then to conclude for that reason that the affirmative defense doesn't go with that liability.

HERRMANN: I would probably answer it the reverse of the way that you have stated it. And

that is, if this court were to conclude that the reasonable care defense is not available to an aider and abettor, then I think the court would go to the instruction and inquire whether the failure to instruction on awareness was harmful error in that context. Does that answer your question?

O'NEILL: It's just sort of where to start. If you determine the defense is available, then it seems to me that the general awareness instruction puts your phone on the scale and leads you to the possibility of conflicting things.

HERRMANN: I think the answer is, if you determine that the defense is available and if the charge is structured properly, then the jury perhaps never gets to the other question.

O'NEILL: If this charge had had the general awareness instruction in the aider and abettor liability question and answered the same way it did here, and if it had had the reasonable care defense and answered the same way it did here, what then?

HERRMANN: I don't know the answer. But I think my response is, I do not believe that would happen given the jury's...

HECHT: Well it would have to. It is kind of curious that they would answer one question one way and the other question.

HERRMANN: Because I believe the jury concluded - the jury was in essence not instructed and was allowed to speculate on what kind of activity might constitute reckless disregard. My belief is, the jury speculated that because Sterling Trust Co. did not investigate the securities, did not investigate the security dealer, did not monitor the securities, none of which were any of its duties under its agreement, but my belief is the jury concluded that because Sterling did not do those things, that the jury might have considered to be reasonable, Sterling was perhaps in reckless disregard of the truth. That's the only explanation I have for this jury verdict.

WAINWRIGHT: It looks like bits and pieces of our securities act at issue here were taken from the federal statutes. Not entirely from the 1933 Securities Act, not entirely from 1934 Securities Exchange Act, but bits from each of those were incorporated into our statute, so that case law interpreting either one separately would not be a very good analog for what we've done with our state act. Do you agree with that?

HERRMANN: I agree that the statute was influenced by the federal laws. I do not agree that the case law precedent in the federal courts is not relevant to understanding aider and abettor liability under the Texas Securities Act. Because the act itself acknowledges that federal law is to be considered and is influential, and the commentary has also acknowledged the influence of the federal cases.

WAINWRIGHT: Of course the US SC abolished aider and abettor liability under the 1934 act as well. You would like us to incorporate that part I assume.

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RESPONDENT

WAINWRIGHT: Would you agree that there has to be some knowledge on the part of the aider and abettor to be liable?

KELTNER: Yes.

WAINWRIGHT: Acknowledge of the tort _____?

KELTNER: No. There is a crucial distinction in the statute - and remember this statutory scheme was written in ___ paper. There is no aider and abettor liability in a private cause of action under the 1933 or 1934 act. As a result, the legislature was looking at something different in creating aider and abettor liability and it do so rather specifically. As a result of that, I think the federal case law is not helpful. Here's why. Central Bank, a US SC case, criticized the federal appellate courts for establishing aider liability. These cases are cited by Sterling. What occurred was, the federal circuit courts came up with a federal common law on aider and abettor liability. They couldn't even determine whether general awareness was a part of that. There was a disagreement among the circuits. They go up to the US SC in Central Bank, and the SC did something that nobody expected them to do, especially not the parties. What the SC said is, look, aider and abettor isn't in this statute. It's in neither act. There is no private cause of action for that. As a result, we place strict adherence to the act itself. It is judicial activism to try to create something that is not in the statute. We refuse to do so. And that's what you should do here.

OWEN: Let's talk about your construction of the statute. Because if we just look at (2), an aider can be liable for reckless disregard of the law even though they don't have any knowledge of any fraudulent misrepresentation, or anything else. They have no defenses whatsoever. They seem to be liable far beyond what the issuer or the seller _____.

KELTNER: I don't agree with that. I will respond to one of the things Mr. Herrmann said. He said, isn't it curious that there is a defense of the plaintiffs knowing of the untrue truth or omission. That's always the defense in these cases and here is the reason why. To get aider and abettor liability, you have to prove the primary seller, issuer or controller liable. If you do that, if that can be submitted, and what then gets submitted is what the plaintiffs knew. If they knew the untruth or omission.

OWEN: It says or the law. You can be found liable as an aider for reckless disregard of the law without any knowledge at all if there are material misrepresentations of fact. So how does that all fit?

KELTNER: It is difficult. I will tell you in this case it doesn't have to.

OWEN: I'm not asking about this case. I am asking about your statute. How do you make all this fit in the grand scheme?

KELTNER: Again, that's what the legislature did. I think Mr. Herrmann's example is probably correct of someone having a reckless disregard for what the securities laws were in an aider concept when they are dealing with securities. Especially like someone like Sterling in this case whose whole reason to exist is to deal with these securities - hold them and deal with them like that. But the truth of the matter here is, I think that the disregard for the facts is what they jury centered on.

OWEN: I'm trying to get to statutory construction here. How we should make this fit. And it seems as if we just looked at (2) and say, if you draw a line around (2), all you look at in aider's liability that under that statute I could have no knowledge whatsoever that there is a material representations and a prospectus. I may have recklessly disregarded some aspect of the law in helping the issuer sell that security, but I had no knowledge at all that it was fraudulent or anything else. I could be liable if we just look at (2), and I would not have any defenses at all.

KELTNER: I don't agree. I think the statutory framework when you look outside of (2) makes clear what the legislature was trying to do. In that regard, we have an oral argument handout. Look at item 3, which is question 8. This is what was actually submitted in 8, despite everything you've heard. It is a general awareness of what happened in the scheme or our general role in the scheme. It is whether they had knowledge of the specific representation. That was what is submitted. That's what the statute says is submitted. It makes sense that that is a primary violater's standard. It makes sense that that would give you an affirmative defense. If a seller/buyer or controller did not know of the false statement, then they ought not to be liable because each of them can do something about it. The same is not true with aider. And that's the key.

An aider just generally has no dealings with the plaintiffs in a case. Doesn't know the misrepresentations made or the omissions made. They are in a dusty, dirty, backroom somewhere. And they are doing things that are aiding the entire scheme. But they might not know and probably in every instance don't know what happened.

HECHT: That imposes a strict liability for aiding that you don't even have for seller.

KELTNER: No. And here's why. I don't have to necessarily know of the untruth of this statement as an aider as long as I'm acting with reckless disregard or intent to deceive or intent to defraud.

HECHT: How can you intend to defraud somebody if you don't know what you are telling them is false?

KELTNER: Let's assume a real life situation that happens in securities cases all the time. Admittedly more often in criminal cases than in defendant cases. Texas company is making

representations to buyers. Just like here, Cornelius's representations were these were investments that were risk free. Now Sterling could not have known of that because they weren't there. Heavens, they tried not to be there. They tried not to know. Let's take my Texas corporation that is making the representations. They hire a Cayman island company beyond the jurisdiction to falsify financial statements. Now the accounts down in the Cayman certainly have the intent to deceive, and they are materially aiding the enterprise. But they don't know of the statements that are being made to the investors. That's what aider is put in the statute for, to...

HECHT: I don't understand that. If there is a seller and a statement is made without his knowledge that turns out to be false, then he is liable. Then he's got a defense, which he can try to prove under (a)(2)(b). But if he fails, he's strictly liable even though he didn't know at the time it was true. But he does has a defense. But you're saying now if there is an aider/abettor and a statement is made that's untrue and he doesn't know it, he is stuck. He has no defense.

KELTNER: No. I am not. What you do is you look at the statute. And the statute is very clear as you said before. (f)(2) makes clear what it is. If you materially aid, in other words you are involved in it, you're not outside of it, you materially aid and then what you do you materially aid with the intent to deceive or the intent to defraud or with reckless disregard especially of facts.

HECHT: But you say reckless disregard can mean you don't know.

KELTNER: No. I'm not saying you don't know. I'm trying to say you're trying not to know.

HECHT: Do you know or do you don't know?

WAINWRIGHT: There needs to be a specific intent of a seller controlled person to be liable, which means knowledge of the specific falsehoods.

KELTNER: That's the affirmative defense that is available to a seller, buyer or controller.

WAINWRIGHT: With regard to the aider, what knowledge must they have in order to be liable under this intent or reckless disregard for the truth? What are they disregarding? Truth of what? What's the fact? Is it the same fact or knowledge as the seller, or is it some different? Perhaps as you are suggesting a little bit removed knowledge of the circumstances. Is it the same fact that's going to make the seller liable, or are you asserting it's something that's more general knowledge that something wrong is going on?

KELTNER: It's more general knowledge, and it's not necessarily the specific misrepresentation.

WAINWRIGHT: It's more general knowledge. What is it?

KELTNER: It is general knowledge of what is going on in the scheme. Or put it a different way. Ignoring facts that would put one on notice of a securities violation.

WAINWRIGHT: But you don't know the specific misrepresentations that the seller made to the purchaser in the office. At least that's your position.

KELTNER: Heavens no.

WAINWRIGHT: Now give me the example.

KELTNER: If that is what it is, then there isn't going to be any aider liability because you would be liable as a principal in that issue as well. It would write aider pretty much out of the statute. Here's the example and it's this case. Here is what happened. Sterling says in his brief repeatedly that it is holing these securities. And that's what it is supposed to do. But in truth of the matter here's what the evidence said. None, and it's very important from J. Owen's your question as well, there is no sufficiency of the evidence attack on the aider finding at all.

The statutory scheme recognizes the reality of the market place.

OWEN: It seems as if a seller would be able to prove, well the buyer knew of the fraud and, therefore, I'm not liable. And that defense is not available to an aider.

KELTNER: It is under the statute. An aider must prove that the primary seller is liable, or buyer, or control person. And you get that defense.

OWEN: Why do you say that?

KELTNER: All the parties admit that to you. It's in both of our briefs. It's also in the statute.

OWEN: Again, show me in the scheme where you get that piece tied into it.

KELTNER: It is (f)(2).

O'NEILL: It's the predicate to the jury question.

OWEN: I'm not talking about the jury. I'm talking about the statute. How do we - lead me to the trail that says okay an aider can't be liable unless the seller is also liable.

KELTNER: Under the predicate to (f)(2), that presumption is made. It has been interpreted by Professor Bromburg(?), Professor Bateman, everybody to look at it that it requires a primary person to be liable.

OWEN: But they are not getting it from the language. That's just an overlay they put on it.

KELTNER: No. I don't think that is actually true. They say it is in the statute. But that is what they say. Both parties admit that to you in this case.

BRISTER: It would have to be an implication of materially aids.

KELTNER: I would think so.

BRISTER: And you wouldn't be liable as an aider if you aid them by selling them medical supplies or band-aids. You are aiding them but if - we have to imply into the statute you're materially aiding them to do the fraud, which is back earlier in the statute. And then how can you say though the folks in the Caymans who are doing some accounting stuff which other people never see, have aided - if the implication is the aids got to be in the fraud that you didn't know about.

KELTNER: Remember. There are two separate questions. Question 8 asked about, and this is how this arises. Again, the scheme was that there is a misrepresentation or omission by a seller, buyer or controller. All of those people can control what happens with those folks to stop that statement. It makes sense that it is a defense that they did not know of the untruth of the statement or omission. It makes great sense. It's wise. That is why there is an affirmative defense. What happens here is, that is an affirmative defense. It wasn't submitted in this case quite that way, although there was that finding. In fact, that affirmative defense about what the plaintiff's knew was submitted and they found out they - the jury's answer was, the plaintiffs did not know or did not have reason to believe that it was truthful or untruthful.

OWEN: You agree that piece is in there, that defense is in there?

KELTNER: Yes. It certainly is in there. But it's in there through the primary. It could directly be submitted by any aider that wanted it submitted. In answer to your question, here is the reason that what you say doesn't make sense in the statutory scheme. The statutory scheme assumes that the primary seller/buyer or controller all can control what the statement is, and if they don't know it's untrue, affirmative defense. On an aider, an aider may not know anything about the statement, but does know about involvement in a Ponzi scheme.

HECHT: Then doesn't it result that if you prove (a)(2), the statement was made by seller, and then the seller proves that he didn't know, can then the aider and abettor still be liable?

KELTNER: No. Because if the primary defendant is not liable, there isn't an aid and abetting because there is no material aid of an illegal enterprise.

HECHT: It was illegal in the sense that stocks were sold by means of untrue statements. It's just that the seller has a defense.

KELTNER: That's exactly right but the material aiding portion of that would mean that there is no liability. And all commentators to the act have said that is true.

O'NEILL: If we are confused about what reckless disregard means wouldn't the jury be confused as well? Shouldn't we decide legally what it is and instruct a jury on it? To you what is reckless disregard?

KELTNER: Reckless disregard can mean many things. It can mean...

O'NEILL: Stop there. It can mean many things. Why don't we then instruct the jury what it means?

KELTNER: You could, and there could have been an opportunity to do it in this case. It wasn't taken. It wasn't complained of. That's not an issue before you today. It might be something that the court wants to write on, but it is not before you in terms of a way to reverse this case.

O'NEILL: You don't have a problem with the general awareness requirement?

KELTNER: No. General awareness is different from the reasonable care defense which we've been discussing. General awareness is not in the statute at all. One of the problems I think that Sterling has with this. If you look at chart 2 in the oral argument things. We set out the statute with the court's submission and with a side-by-side what Sterling requested. Sterling didn't request general awareness. They requested actual awareness of the specific statement. In candor, their objection was a little better. But that's what they asked for. That's not what the statute says. We submitted from the statute verbatim. I mean literally quoting directly from the statute as this court told us to do in Spencer v. Eagle Star, in Barnaman v. Steak & Ale. Our theory being that if you follow the statute, you've got to be doing what the legislature intended to do. The words general awareness never appeared. The only way general awareness ever got into the law of the State of Texas is a professor at UNLV, Keith Riley, who was at Baylor at the time, wrote a law review article...

O'NEILL: Regardless of how it ever got in, don't you have to have a general awareness for there to be a reckless disregard?

KELTNER: You have to have an awareness to materially aid of some things that were going on and that is submitted. To materially aid you must.

O'NEILL: Would you agree the jury could have been confused on what reckless disregard means _____?

KELTNER: No. For several reasons. One, I don't think it makes any difference to your decision. Remember sufficiency of the evidence isn't challenged. There wasn't any confusion about this. The question that was asked in No. 8, which is at Tab 3, isn't about general awareness. It's

whether they knew the representation, and representation wasn't even a risk free, that the aider knew, that Sterling knew about that.

In this case it is undisputed from paper work that Sterling knew that Cornelius was co-mingling funds. This wasn't an inadvertent situation either. There is a memo from the accounting department to the operating department saying he's co-mingling funds from one entity that owes it to another. And interestingly that could have some IRS complications as well because these were qualified plans. What should we do with it? What Sterling did was ignore it and no do anything with it; turned it's head. It tried not to know. Then they learned some other things. One of the things they aggressively did is they said in their paperwork that they had to hold all the documents, including the deeds of trust.

OWEN: Let's assume there's a trust department at the bank, and I have an IRA that I control. And in the wonting days of Enron I tell that bank trust department to go buy Enron stock for me. And they have read probably more in detail on Enron than I had, and they buy the stock. And I keep telling them to buy Enron stock. They had reservations, but they don't communicate to me. Is the bank trust department liable for my directions to them to keep buying Enron stock?

KELTNER: Heavens no. Under no situation and certainly not under aider an abettor liability. That is not materially aiding any securities scheme at all and certainly not with the intent to deceive or the intent to defraud or with reckless disregard.

OWEN: Why isn't it?

KELTNER: It's just sort of like a postman that delivers the mail. It's pretty much the same kind of situation. The burden of proof on these is very heavy. Now it's not challenged in this case and it is not before you in this case. But...

OWEN: Let's say that a lot of information is out there and, I, the investor, don't know it all. But I want to speculate. But the bank knows that there has probably been some fraud in the securities, but they go ahead and honor my buy order and they go and buy Enron stock and put it in my account. Now why isn't that aiding?

KELTNER: There is no obligation to police the other side in this case. There's an obligation to police yourself. First off with the facts of this case. These facts are erratically different because it is what Sterling didn't do and aggressively did that made a difference in this case.

OWEN: Why am I not liable?

KELTNER: Because you are not materially aiding that scheme. The burden of proof wouldn't come close to covering that.

WAINWRIGHT: You agree with the CA when it addressed question 8 verses question 4 in the

charge issue that one deals with the primary violation, the 33(a)(2) violation. Question 4 deals with the aiding and abettor liability. Do they make sense?

KELTNER: Yes, they do.

WAINWRIGHT: So if I take it from bits and pieces that I've heard you say since my earlier question, what knowledge is required for a (2)? what knowledge is required for aider and abetter liability? And for aider and abettor liability, once you said Sterling was aware that there was a Ponzi scheme going on. And then you mentioned some specific facts that Cornelius was co-mingling funds and something about the original documents. I take it you would agree that the knowledge necessary for aider and abettor liability has to be knowledge of something wrong going on with a securities fraud, not just something wrong in handling papers or generally violating trust principles and co-mingling funds. It has to be something related to a securities fraud. Correct?

KELTNER: Facts that would put you on suspicion of that. That's precisely right.

WAINWRIGHT: A securities fraud?

KELTNER: Yes.

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REBUTTAL

O'NEILL: Let me make sure I understand the import of question 8. Was question 8 - the only liability that has ever been sought to be imposed on Sterling is aider and abettor. Right?

HERRMANN: The jury was asked in question 1 if Sterling was a primary violator.

O'NEILL: So I take it that what I'm hearing from the other side is that question 8 was only put in there if answer yes was as to Sterling in question 1.

HERRMANN: I disagree. But I also submit that if the jury has answered a conclusive fact in the fashion that it answered question 8, that fact can't simply be ignored and deemed irrelevant particularly in light of the refusal of the TC to instruct the jury on the awareness requirement.

Counsel has commented several times about how Sterling tried not to know about what was going on. This is the significance of this case involving IRA custodian accounts. In the account agreements, the customers were told we are not going to investigate. We are not going to monitor. All we are going to do is hold the asset and report periodically to you.

JEFFERSON: There's not a sufficiency challenge up here. So I assume that - or can we presume that you agree that there is a fact issue even if general awareness were submitted?

HERRMANN: I think the answer is no. We have in our issues contended and we do contend that there was no evidence that Sterling had sufficient knowledge or awareness. There is no evidence. And that is because the jury found we had no knowledge and the jury was not instructed on the requisite element of awareness.

JEFFERSON: The latter would be a new trial point right? The failure to instruct on that.

HERRMANN: If the court determines that we are not entitled to the reasonable care defense and that the instruction was inappropriate, I believe the correct result is to remand for a new trial.

JEFFERSON: You could have argued, I suppose, that Sterling was not liable as a matter of law with or without question no. 8. But there is no evidence to support the jury's affirmative finding on the aider and abettor.

HERRMANN: Perhaps. And I think we have that in our issue. I think what we have here is a jury that was invited to speculate regarding the scienter element of aiding and abetting. And speculation is exactly what they did.

WAINWRIGHT: Do you agree with your opposing counsel that there are two levels of knowledge at work here. One for the primary violation and the other one aider and abettor.

HERRMANN: I do disagree.

WAINWRIGHT: So you believe an aider or abettor has to have knowledge of the specific untruth or omission?

HERRMANN: No. I do not agree with that. Nor do I agree that a primary violator has to have such knowledge. Nor do I agree that the issues that were submitted in this case asked that question.

SIDE A RUNS OUT

WAINWRIGHT: If an untrue statement slips into a 30 page prospectus and it's material, whether the seller actually read it or not, or just signed it after the lawyer gave it to him, they are still going to be liable. Is that what you are saying?

HERRMANN: Yes.

WAINWRIGHT: And so if that's the primary violation, then what knowledge does the aider and abettor in that circumstance have to have, assuming the other elements are met to be liable in your mind?

HERRMANN: The aider and abettor would have to have some awareness that the security

was being sold with a misrepresentation in place.

WAINWRIGHT: So they would have to know the misrepresentation?

HERRMANN: Not the precise misrepresentation. I think it might be sufficient if someone simply told the aider and abettor this security is being sold under a misrepresentation. I don't know that the aider and abettor would necessarily have to determine that the specific accounting entry was in error and what that error might be.

O'NEILL: There appears to be some evidence recited in the CA's opinion that Sterling did not follow its own directions in terms of who directed these investments. There is a line that says Sterling took instructions from Cornelius personnel even though those persons had not been designated as having authority to take action on the appellant's account. Why would that not be some sort of scienter for aider and abettor liability?

HERRMANN: Obviously the evidence at trial was hotly contested both with respect to what Sterling did and did not do. And the plaintiffs/respondents in the court below and in this court have picked the evidence that they think most supports their contentions that would suggest a degree of knowledge. My response is, and I think it's in the brief, when the jury tells us that Sterling did not know and had no reason to know of the fraud, the jury tells us we do not accept as true this evidence. We do not consider that fact to be proof. The jury has told us I think conclusively that the plaintiffs did not prove that Sterling had scienter.