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I. INTRODUCTION

This Article addresses the question of whether an employee's act or acts of fraud may be imputed to his employer, even when those acts were against the interest of the employer under agency principles.[1] In *Costa Brava P'ship III LP v. ChinaCast Educ. Corp.* (*In re ChinaCast Educ. Corp. Sec. Litig.*) (hereinafter "*ChinaCast Sec. Litig.*"), this was a first impression on the Ninth Circuit.[2] Agency principles have histor-

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1. In this Article: agent/employee are synonymous; and company/corporation/employer/principal are synonymous.

2. Costa Brava P'ship III LP v. ChinaCast Educ. Corp. (*In re* ChinaCast Educ. Corp. Sec. Litig.) (hereinafter "*ChinaCast Sec. Litig.*"), 809 F.3d 471, 472 (9th Cir. 2015).

ically been applied in the context of contracts or torts.[3] The Ninth Circuit stretched agency principles and applied them to securities law, notwithstanding agency principles are not applicable to securities law.

The Supreme Court of the United States ("SCOTUS") applies agency principles when it is in harmony with congressional intent.[4] There is no interpretation of intent that securities law was meant to be expanded to cover common law fraud. Additionally, federal securities law does not provide explicit rules for corporate liability.[5] Thus, it would be against congressional intent to apply agency principles in this context.

The Restatement (Third) of Agency proclaims "[a]gency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act."[6] Justice Oliver Wendell Holmes declared:

> A man is not bound by his servant's contracts unless they are made on his behalf and by his authority, and that he should be bound then is plain common-sense. It is true that in determining how far authority extends, the question is of ostensible authority and not of secret order. But this merely illustrates the general rule which governs a man's responsibility for his acts throughout law. If, under the circumstances known to him, the obvious consequence of the principal's own conduct in employing the agent is that the public understand him to have given the agent certain powers, he gives the agent those powers. And he gives them just as truly when he forbids their exercise as when he commands it. It seems always to have been recognized that an agent's ostensible powers were his real powers[7]

This Article argues that an employee's act or acts of fraud may not be imputed to his employer even when those acts were against the interest of the employer under agency principles. To elucidate, "a corporation can only act through its employees and agents and can likewise only have scienter through them."[8] Since corporations do not

3. *See* Deborah A. DeMott, *The First Restatement of Agency: What Was the Agenda?*, 32 S. ILL. U. L.J. 17, 29–30 (2007).

4. Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. CIN. L. REV. 1187, 1226 n. 152 (2003) (Some courts may apply agency principles in statutory interpretation where the intent is ambiguous, "either because agency principles are persuasive authority, or because Congress [is] deemed to have enacted the law with the common law in mind.").

5. *ChinaCast Sec. Litig.*, 809 F.3d at 475–76.

6. RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

7. Holmes, *Agency II*, HARV. L. REV. 1 (1891).

8. *ChinaCast Sec. Litig.*, 809 F.3d at 475 (citation and internal quotation marks omitted).

think or act on their own,[9] principles of agency law allow courts to impute the knowledge of employees to their employers when employees act within the scope of their employment.[10] The exception to this is the adverse interest exception[11] which rebuts the presumption of imputation if an agent acts adversely to the principal.[12] Although the adverse interest exception is narrow,[13] it exists to protect innocent parties from certain harm inflicted by agents.[14] The Ninth Circuit's decision is anathema to the adverse interest exception.[15]

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9. Karen Freifeld, *New York's Lawksy wants senior BNP executives fired in probe: report*, Reuters, June 1, 2014, 4:35 AM, *available at* https://www.reuters.com/article/us-bnp-investigation/new-yorks-lawsky-wants-senior-bnp-executives-fired-in-probe-sources-idUSKBN0EC16K20140601.

10. RESTATEMENT (THIRD) OF AGENCY § 5.04 (2006). The full section reads:

Section 5.04 An Agent Who Acts Adversely to a Principal

For purposes of determining a principal's legal relations with a third party, notice of a fact that an agent knows or has reason to know is not imputed to the principal if the agent acts adversely to the principal in a transaction or matter, intending to act solely for the agent's own purposes or those of another person. Nevertheless, notice is imputed

(a) when necessary to protect the rights of a third party who dealt with the principal in good faith; or

(b) when the principal has ratified or knowingly retained a benefit from the agent's action.

11. RESTATEMENT (THIRD) OF AGENCY § 5.03 (2006):

For purposes of determining a principal's legal relations with a third party, notice of a fact that an agent knows or has reason to know is imputed to the principal if knowledge of the fact is material to the agent's duties to the principal, unless the agent

(a) acts adversely to the principal as stated in § 5.04, or

(b) is subject to a duty to another not to disclose the fact to the principal.

12. FDIC v. Ernst & Young, 967 F.2d 166, 171 (5th Cir. 1992) ("Generally, courts impute a bank officer or director's knowledge to the bank unless the officer or director acts with an interest adverse to the bank.").

13. Kirschner v. KPMG LLP, 15 N.Y.3d 446, 469, 477 (N.Y. 2010) ("No one disputes that traditional imputation principles, including a narrowly confined adverse interest exception, should remain unchanged[.]"; "The principles of [ ] imputation, with its narrow adverse interest exception, which are embedded in New York law, remain sound.").

14. State Farm Fire & Cas. Co. v. Sevier, 537 P.2d 88, 96 (Or. 1975) (en banc) ("The rule that knowledge of an agent is to be imputed to his principal, regardless of actual knowledge by the principal, is a rule based upon considerations of public policy to the effect that one who selects an agent and delegates authority to him should incur the risks of the agent's infidelity or want of diligence rather than innocent third persons. See 3 Merrill on Notice §§ 1204, 1268, at 132-34, 252 (1952). Cf. Restatement of Agency 2d § 282(2)(a)."); *see also* NCP Litig. Trust v. KPMG LLP, 901 A.2d 871, 887 (N.J. 2006), *remanded sub nom* NCP Litig. Trust v. KPMG, 934 A.2d 132 (N.J. Super. Ct. Law Div. 2007) (hereinafter "NCP Litig. Trust") ("Regardless of the terminology, the purpose of the doctrine is the same — to protect innocent third parties with whom an agent deals on the principal's behalf.").

15. *In re* Sunpoint Sec., Inc., 377 B.R. 513, 564 (Bankr. E.D. Tex. 2007) ("The adverse interest exception is a narrow one; for it to apply, "the agent must have totally abandoned his principal's interests and be acting entirely for his own or another's purposes."") (quoting Center v. Hampton Affiliates, Inc., 66 N.Y.2d 782, 784-85, 497 N.Y.S.2d 898, 488 N.E.2d 828 (1985)); *see also* Reynolds B. Brissenden IV, In Pari Delicto *Doctrine May Bar Receiver's Third-Party Claims - Knauer v. Jonathon Roberts, Inc., et al.*, 3 DEPAUL BUS. & COM. L.J. 169 (2005) (Discussing Official Committee v. R.F. Lafferty Co., 267 F.3d 340 (3d Cir. 2001): "*the Third Circuit found*

Part II analyzes case law and how the Ninth Circuit interpreted the issue, and whether the interpretation is or is not consistent with agency principles. Part III assesses agency law principles of authority, specifically apparent authority and actual authority. Part IV discusses the imputation doctrine. Part V discusses the applicability of the adverse interest exception. Part VI examines what constitutes fraud. Part VII identifies the public policy arguments against holding employers liable for their employee's act or acts of fraud. Part VIII emphasizes that if an employee's act or acts of fraud may be imputed to his employer even when those acts were against the interest of the employer under agency principles it is subject to *reductio ad absurdum*. Part IX concludes that eliminating the adverse interest exception as a defense to fraud-on-the-market claims will have deleterious consequences.

II. Current State of the Law

A. Costa Brava P'ship III LP v. ChinaCast Educ. Corp.[16]

In *ChinaCast Sec. Litig.*, the Ninth Circuit offers a circuitous explanation as to why an employee's act or acts of fraud may be imputed to his employer even when said act or acts were against the interest of the employer under agency principles.[17] The court held that there is an exception to the adverse exception rule:[18] a principal is still liable for the fraud of a rogue agent when an innocent third party relies in good faith on the agent's apparent authority.[19]

The Court's opinion refers to federal securities laws, citing the Securities Act of 1933 and the Securities Exchange Act of 1934.[20] Second, it focuses on Rule 10b-5 of the Securities Exchange Act of 1934 ("Rule 10b-5").[21] The syllogism then jumps to the scienter of Ron Chan Tze Ngon ("Chan"), the founder, Chief Executive Officer

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that the fraudulent conduct of the principal wrongdoers could be imputed to the corporations. This is due to the fact the wrongdoers perpetrated the fraud in the course of their employment and since, even though the wrongdoers acted adversely to the interests of the corporations, they were the sole actors engaged in the alleged wrongdoing.") (emphasis added).

16. Costa Brava P'ship III LP v. ChinaCast Educ. Corp. (*In re* ChinaCast Educ. Corp. Sec. Litig.) (hereinafter "*ChinaCast Sec. Litig.*"), 809 F.3d 471, 472 (9th Cir. 2015).

17. *Id.* at 471.

18. *Id.* at 477 ("In other words, there is an exception to the exception: the adverse interest rule collapses in the face of an innocent third party who relies on the agent's apparent authority.); *see infra* § Adverse Interest Exception section.

19. *Id.* at 477–78.

20. *Id.* at 472–73.

21. Rule 10b-5 prohibits "mak[ing] any untrue statement of a material fact . . . in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5 (2015).

("CEO") and chairman of the board of ChinaCast.[22] It concludes by holding that imputation is correct, under agency principles, because Chan's scienter is that he acted with apparent authority.[23] The 'court's reasoning, needless to say, is erratic.

The court is cognizant that its ruling eliminates the adverse interest exception for clean hands plaintiffs.[24] 'However, this reasoning is flawed because the CEO was authorized to speak on the defendant's behalf and the shareholders had innocently relied on the CEO's fraudulent misrepresentations. The CEO's scienter could be imputed to the defendant corporation. This effectively defeats the purpose of the adverse interest exception and it shifts the burden of losses onto the very class it intends to protect: innocent third parties.[25]

1. Judicial Activism

In *ChinaCast Sec. Litig.*, the Ninth Circuit engaged in judicial activism[26] when it sought to find ChinaCast guilty of a crime. The parties did not allege any violation of agency principles at the Federal District

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22. *ChinaCast Sec. Litig.*, 809 F.3d at 476 ("In the context of Rule 10b-5, we have adopted the general rule of imputation and held that a corporation is responsible for a corporate officer's fraud committed "within the scope of his employment" or "for a misleading statement made by an employee or other agent who has actual or apparent authority.") (quoting Hollinger v Titan Capital Corp., 914 F.2d 1564, 1577 n.28 (9th Cir. 1990) (en banc)).

23. *Id.; see also* NCP Litig. Trust, 901 A.2d at 873, 882 ("The trial court granted the auditor's motion to dismiss based on *the imputation doctrine*, *which holds that knowledge of an agent generally is attributed to its principal*."; "Accordingly, *the imputation defense properly applies to prevent suits by a principal against a third party in instances where an agent of the principal has defrauded the third party*.") (emphasis added).

24. *ChinaCast Sec. Litig.*, 809 F.3d at 479 ("Assuming a well-pled complaint, we recognize that, as a practical matter, *having a clean hands plaintiff eliminates the adverse interest exception in fraud on the market suits* because a bona fide plaintiff will always be an innocent third party.") (emphasis added).

25. *Id.* at 476–77 ("Specifically, the very same Restatement provision that sets out the adverse interest exception also provides: "Nevertheless, notice is imputed. . . *when necessary to protect the rights of a third party who dealt with the principal in good faith*." Restatement (Third) of Agency § 504 (2006); *see also Jensen v. IHC Hosps., Inc.*, 82 P.3d 1076, 1091 n. 13 (Utah 2003) ("Although typically an agent's knowledge will not be imputed to its principal when an agent is involved in fraud or other adverse dealings, *an exception exists for innocent third parties*."); *In re Am. Int'l Grp., Inc.*, *Consol. Derivative Litig.*, 976 A.2d 872, 891 (Del.Ch.2009) *aff'd sub. nom. Teacher's Ret. Sys. of Louisiana v. Gen. Re Corp.*, 11 A.3d 228 (Del. 2010) (even when the adverse interest exception applies, "the corporation . . . [remains] *responsible to innocent third parties* and the polity for any offense to them"); *cf.* Restatement (Second) of Agency § 262 & cmt. a (1958) (explaining how apparent authority protects third-party reliance).") (emphasis added).

26. *Judicial Activism*, BLACK'S LAW DICTIONARY (11th ed. 2019) ("philosophy of judicial decision-making whereby judges allow their personal views about public policy, among other factors, to guide their decisions.").

Court.[27] In fact, the only mention of agency principles by the Federal District Court was in reference to the adverse interest exception.[28] Accordingly, the Ninth Circuit based its decision on an issue that was not raised by either party.

Courts generally show restraint and preside over the issues before it.[29] In *United States v. Sineneng-Smith*, SCOTUS overturned the Ninth Circuit after it engaged in judicial activism with regard to its handling of the case.[30] In *Sineneng-Smith*, after the defendant briefed and argued before the Court, the Ninth Circuit raised the issue as to whether the statute was unconstitutionally overbroad.[31] This was an issue that was not raised by either party.[32] The court ordered specified *amici curiae* ("friends of the court") for additional briefing on the issue of the statute being unconstitutionally overbroad, although the parties and other *amici curiae* could elect to participate.[33] After the additional briefings, the Ninth Circuit reversed the conviction of the Federal District Court. SCOTUS held that due to Ninth Circuit's "takeover of the appeal" the case should be reversed and remanded.[34] Similarly in *ChinaCast Sec. Litig.*, the Ninth Circuit had a takeover of the appeal by deciding the case on an issue that was not raised by either party. SCOTUS declared that a court soliciting briefs on issues not raised by either party is such a drastic departure from the principle of party presentation that it constitutes an abuse of discretion.[35] In *ChinaCast Sec. Litig.*, the Ninth Circuit did not order specified *amici*

27. *In re* ChinaCast Educ. Corp. Sec. Litig., CV 12–4621–JFW (PLAx) at *2 (C.D. Cal. Dec. 7, 2012).

28. *Id.* ("In their Complaint, Plaintiffs allege claims for relief for: (1) violation of Section 10(b) of the 1934 Act and Rule 10b-5; and (2) violation of Section 20(a) of the 1934 Act.").

29. *See generally* United States v. Dunkel, 927 F.2d 955, 956 (7th Cir. 1991) ("A skeletal 'argument', really nothing more than an assertion, does not preserve a claim. . . . Especially not when the brief presents a passel of other arguments. . . . Judges are not like pigs, hunting for truffles buried in briefs."); Erie R.R. v. Tompkins, 304 U.S. 64, 82 (1938) (dissenting opinion) ("No constitutional question was suggested or argued below or here. And as a general rule, this Court will not consider any question not raised below and presented by the petition. . . . Here it does not decide either of the questions presented but, changing the rule of decision in force since the foundation of the Government, remands the case to be adjudged according to a standard never before deemed permissible."); Erie R.R. v. Tompkins, 304 U.S. 64, 82 (1938) (dissenting opinion). Morehead v. New York ex rel. Tipaldo, 298 U.S. 587, 604, 605 (1936) ("No application has been made for reconsideration of the constitutional question there decided . . . [the State of New York] is not entitled and does not ask to be heard upon the question whether the Adkins case should be overruled."); Esselstyn v. Casteel, 205 Ore. 344, 347, 288 P.2d 215, 217 (1955) ("The court can only decide questions that are before it.").

30. United States v. Sineneng–Smith, 590 U.S. __ (2020).

31. *Id.* at 3.

32. *Id.*

33. *Id.*

34. *Id.* at 8.

35. *Id.* at 3.

curiae for additional briefings, but it nonetheless based its opinion on an issue that was not raised by either party. This flies in the face of the adversarial adjudication system.

2. Federal Securities Laws Are Not Applicable in *ChinaCast Sec. Litig.*

The mention of federal securities law undermines the presentation of the merits of the arguments of the *ChinaCast Sec. Litig.*.[36] The court freely admits that federal securities law does not provide explicit rules for corporate liability.[37] Accordingly, the mere mention of federal securities law, if they are not applicable in the present case, confuses the reasoning. The Court mentions law that is not apropos, to which the court confesses,[38] because it is engaging in judicial activism.[39]

Moreover, Rule 10b-5 is completely irrelevant to *ChinaCast*. Rule 10(b) makes it unlawful:

> [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[40]

Rule 10b-5 makes it unlawful for any person to use interstate commerce:

> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[41]

Notwithstanding, agency law controls even when federal law is at issue in this context "[b]ecause the Securities Exchange Act and accompanying regulations do not contain any explicit instructions on

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36. *ChinaCast Sec. Litig.*, 809 F.3d at 474–79.

37. *Id.* at 475–76.

38. *Id.* (The court reasoned that because federal securities laws do not provide explicit rules for corporate liability, agency principles should apply.).

39. *See infra* § II(A)(i) Judicial Activism section; *see also* Max Birmingham, *Whistle While You Work: Interpreting Retaliation Remedies Available to Whistleblowers in the Dodd-Frank Act*, 13 FLA. A&M U. L. REV. 1 (2017) (see § I, Judicial Activism section).

40. 15 U.S.C. § 78j(b) (2006)).

41. 17 C.F.R. § 240.10-b5.

when an employee's acts and intent are to be imputed as those of the company, courts have looked to agency principles for guidance."[42] Even *assuming arguendo* that the court wanted to skip agency law, it is clear that the plaintiffs have standing pursuant to the aforementioned securities law. To be successful under a Rule 10b-5 claim, the plaintiff must show that the injury was substantial in connection to the sale or purchase of the securities.[43] A *de minimus* injury is not sufficient, and the claim will be rejected.[44] There is no bright-line rule as to what constitutes materiality.[45] In the instant case, the court reaches a conclusion that is subject to *non causa pro causa*, which translates to "mistake[s] what is not the cause of a given effect for its real cause."[46] The court blazons that none of thedefendants sold one share of stock was sold during the putative class period.[47] One of the defendants ac-

42. *ChinaCast Sec. Litig.*, 809 F.3d at 475.

43. *In re* ChinaCast Educ. Corp. Sec. Litig., CV 12–4621–JFW (PLAx) at *11 (C.D. Cal. Dec. 7, 2012) ("Even if Plaintiffs had alleged facts that might be sufficient to give rise to a strong inference of scienter, a strong inference of scienter is negated when there is an absence of stock sales or where such sales are minimal. *In re* Apple Computer Sec. Litig., 886 F.2d 1109, 1117 (9th Cir. 1989) (holding that despite sales of $84 million in shares, the defendants still retained such a large percentage of their holdings – 92 percent – that an inference of scienter was functionally negated); *In re* Silicon Graphics, 183 F.3d at 987-88 (no scienter where despite over $13.8 million in stock sales, the defendants still retained over 90 percent of their holdings); *In re* Wet Seal, Inc. Sec. Litig., 518 F.Supp. 2d 1148, 1177-78 (C.D. Cal. 2007) ("while allegations of insider sales are not required in securities fraud cases, the lack of any tangible, personal benefit here further weighs against the Officer Defendants having scienter") (internal citations omitted).").

44. Ganino v. Citizens Utilities Co., 228 F.3d 154, 163 (2d Cir. 2000) ("We held that the materiality of merger negotiations depends on the specific facts of each case. *See id. See also In re Home Health Corp. of America, Inc. Sec. Litig.*, No. Civ. A. 98-834, 1999 WL 79057, at *6-7 (E.D.Pa. Jan. 29, 1999) (declining to hold immaterial as a matter of law failure to report loss of a *de minimis* percentage of total revenue where qualitative factor rendered the loss significant).").

45. Basic Inc. v. Levinson, 485 U.S. 224 (1988) ("A bright-line rule indeed is easier to follow than a standard that requires the exercise of judgment in the light of all the circumstances. But ease of application alone is not an excuse for ignoring the purposes of the Securities Acts and Congress' policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive.").

46. Irving M. Copi & Carl Cohen, Introduction to Logic 134 (2014) ("It is obvious that any reasoning that relies on treating as the cause of some thing or event what is not really its cause must be seriously mistaken. Often we are tempted to suppose, or led to suppose, that we understand some specific cause-and-effect relation when in fact we do not. The nature of the connection between cause and effect, and how we determine whether such a connection is present, are central problems of inductive logic and scientific method. Presuming the reality of a causal connection that does not really exist is a common mistake; in Latin the mistake is called the fallacy of *non causa pro causa*.")

47. *In re* ChinaCast Educ. Corp. Sec. Litig., CV 12–4621–JFW (PLAx) at *11–12 (C.D. Cal. Dec. 7, 2012) ("In fact, not a single Individual Defendant sold any shares of stock during the putative class period, notwithstanding Plaintiffs' claims that the Individual Defendants knew that ChinaCast's stock was artificially inflated during that time period. In fact, one of the Individual Defendants, Sherwood, purchased more than 2.7 million shares during the putative class period. Therefore, the substantial losses suffered by the Individual Defendants due to their failure to sell

tually purchased more than 2.7 million shares during the putative class period.[48] This does not necessarily address the plaintiff's claims. The complaint[49] did make an allegation of a pump-and-dump scheme.[50] Instead, the plaintiffs alleged the defendants of looting the company, which the court acknowledged is the question presented.[51] In addition, the company was looted from June 2011 through April 2012,[52] at which point it was finally disclosed to investors.[53] Five months later, in September 2012, the investors filed suit.[54] It is plausible that the fraudsters did not want to sell the stock because they did not want to bring attention to themselves. The court also does not discuss when, during the putative class period, the one defendant purchased the shares. Perhaps he could have purchased them early during the putative class period, thinking that he wouldn't get caught. Either way, the plaintiffs did not make a "pump-and-dump" claim, which is what the court attributed to them. A person can loot a company and not erect a "pump-and-dump" scheme.[55]

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any stock during the class period sufficiently negates any inference of scienter that may have been raised by other allegations of the Complaint.").

48. *Id*.

49. Emergent Capital Inv. v. Stonepath Group, Inc., 343 F.3d 189, 197 (2d Cir. 2003) ("Moreover, plaintiff has declared that the other Panzo-Appel ventures described in the complaint were "pump and dump" schemes.").

50. United States v. Salmonese, 352 F.3d 608, 612 (2d Cir. 2003) ("The conspiracy, a variation on the classic "pump and dump" scheme — whereby persons holding certain securities fraudulently inflate their price (the "pump") in order to sell at an artificial profit (the "dump") — is described in detail in Judge Kaplan's comprehensive opinion denying Benussi's Rule 33 motion."); S.E.C. v. Cavanagh, 445 F.3d 105, 107 (2d Cir. 2006) ("These consolidated cases concern a "pump-and-dump" securities fraud scheme whereby certain defendants artificially inflated a company's stock price, sold high, and left investors holding nearly worthless shares when the price plummeted to a realistic value.").

51. *ChinaCast Sec. Litig.*, 809 F.3d at 472, 475 ("Can Chan's fraud be imputed to ChinaCast, his corporate employer, even though Chan's looting of the corporate coffers was adverse to ChinaCast's interests?"; "ChinaCast itself describes Chan's dealings as a "massive scheme . . . to loot the Company of its most valuable assets," which wrought "catastrophic" damage.").

52. *See infra* note 61 and accompanying text.

53. *ChinaCast Sec. Litig.*, 809 F.3d at 473 ("In early 2012, ChinaCast's board discovered that Chan had attempted to interfere with an annual audit. The board removed him as chairman and CEO on March 26, 2012, and Sena resigned the next day. Beginning in April 2012, ChinaCast disclosed in a series of SEC forms that it had "uncovered questionable activities" and illegal conduct on the part of its senior officers.").

54. *Id.* at 474.

55. Alumax Foils, Inc. v. City of St. Louis, 939 S.W.2d 907 (Mo. 1997) ("Appellants' syllogism adopts the fallacy of false cause (non causa pro causa), confusing what is not the cause for its real cause."); Haines v. Liggett Group Inc., 975 F.2d 81, 90 (3d Cir. 1992) ("We must always keep in mind that the purpose of the crime-fraud exception is to assure that the "seal of secrecy" between lawyer and client does not extend to communications from the *lawyer* to the client made by the *lawyer* for the purpose of giving advice for the commission of a fraud or crime. The seal is broken when the lawyer's communication is meant to facilitate future wrongdoing by the client. Where the client commits a fraud or crime for reasons completely independent of legitimate

Notwithstanding, the inability to show injury in connection with the sale or purchase of securities during the putative class period should have been fatal to Plaintiffs' claim because they did not demonstrate they suffered an injury as a result ofin connection to the Defendant's act or acts of fraud.Plaintiffs brought their claims under securities law.[56] To reiterate, there was no allegation that they were harmed by being lied to or mislead.[57]

3. Scienter

In *ChinaCast Sec. Litig.*, the Ninth Circuit erroneously held that "[t]he scienter requirement is at the center of this appeal."[58] If federal securities laws are not applicable in this case, there is no need for any further analysis.[59] Consequently, scienter should not be at the center of this appeal.

Notwithstanding, assuming *arguendo* that federal securities laws were applicable in this case, the court conflated the scienter of Chan with that of ChinaCast.[60] Chan looted the company coffers.[61] Plaintiffs alleged that ChinaCast had scienter because the act or acts of fraud were conducted by high-level executives and because they also served

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advice communicated by the lawyer, the seal is not broken, for the advice is, as the logicians explain, *non causa pro causa*. The communication condemned and unprotected by the attorney-client privilege is advice that is illicit because it gives direction for the commission of future fraud or crime. The advice must relate to future illicit conduct by the client; it is the *causa pro causa*, the advice that leads to the deed.") (emphasis in original).

56. *In re* ChinaCast Educ. Corp. Sec. Litig., CV 12–4621–JFW (PLAx) at *2 (C.D. Cal. Dec. 7, 2012) ("In their Complaint, Plaintiffs allege claims for relief for: (1) violation of Section 10(b) of the 1934 Act and Rule 10b-5; and (2) violation of Section 20(a) of the 1934 Act."); *see also supra* note 47 and accompanying text.

57. *See, e.g.*, Pasley v. Freeman, 3 T. R. 51, 65, 100 Eng. Rep. 450, 457 (1789) (if "no injury is occasioned by the lie, it is not actionable: but if it be attended with a damage, it then becomes the subject of an action").

58. *ChinaCast Sec. Litig.*, 809 F.3d at 474.

59. *See infra* § II(A)(ii) Federal Securities Laws Are Not Applicable In This Case section.

60. *ChinaCast Sec. Litig.*, 809 F.3d at 475 ("The question is whether Chan's scienter can be imputed to his corporate employer, ChinaCast.").

61. *Id.* at 473 ("From June 2011 through April 2012, Chan "transferred" $120 million of corporate assets to outside accounts that were controlled by him and his allies. In addition, Chan permitted a company vice president to move $5.6 million in company funds to his son; "unlawfully transferred control" of two of ChinaCast's private colleges outside the company; and pledged $37 million in company assets to secure third-party loans unrelated to ChinaCast's business."); *see also* Schacht v. Brown, 711 F.2d 1343, 1347-48 (7th Cir. 1983) ("[T]he complaint in the instant case alleges a far-reaching scheme in which, as a consequence of the illegal activities of Reserve's directors and the outside defendants, Reserve was, *inter alia*, fraudulently continued in business past its point of insolvency and systematically looted of its most profitable and least risky business and more than $3,000,000 in income — all actions which aggravated Reserve's insolvency. In no way can these results be described as beneficial to Reserve.").

on various committees, including the audit committee.[62] However, on March 26, 2012, the board of directors removed Chan from his roles CEO and chairman of the board after he attempted to interfere with an audit.[63] Additionally, Antonio Sena, the Chief Financial Officer ("CFO") resigned the next day.[64]

On April 2, 2012, after Chan's removal, ChinaCast declared that it uncovered unscrupulous commercial conduct by Chan, and that it would continue its investigation into the looting of the company coffers.[65] On April 9, 2012, ChinaCast filed a Form 8–K with U.S. Securities and Exchange Commission ("SEC") which stated, in part:

> The Company is also continuing to investigate whether there were questionable activities involving current and former employees, and if so, whether to pursue relevant civil and criminal legal remedies. In this regard, the Company's interim management team, along with various legal advisors and forensic consultants, has discovered the following matters which remain under investigation:
>
> > the unauthorized transfer of subsidiaries holding interests in two of the Company's colleges . . . to unauthorized persons outside of the Company group structure. The Company believes that its former chief investment officer and president-China, Mr. Xiangyuan Jiang [("Jiang")], who was terminated on March 29, 2012, may have been involved in these unauthorized transfers.[66]

The Ninth Circuit posits if Chan had the "scienter to defraud,"[67] which he obviously did.[68] But the court did not adequately explain how this may be imputed to ChinaCast.[69] The company initiated an investigation into the looting of the company coffers, notified the SEC of its findings, and then promised to continue investigating the matter.[70]

These steps taken by the company do not indicate that it had the scienter to defraud. The court failed to elucidate how Chan's act or acts of fraud benefitted or intended to benefit ChinaCast. The court also failed to discussthe actions that ChinaCast took in response to

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62. *Id.*

63. *Id.* at 473.

64. *Id.*

65. *In re* ChinaCast Educ. Corp. Sec. Litig., CV 12–4621–JFW (PLAx) at *2 (C.D. Cal. Dec. 7, 2012).

66. *Id.*

67. *ChinaCast Sec. Litig.*, 809 F.3d at 472.

68. *See supra* footnotes 60–66 and accompanying text.

69. *See infra* § IV Imputation Doctrine section.

70. *In re* ChinaCast Educ. Corp. Sec. Litig., CV 12–4621–JFW (PLAx) at *2 (C.D. Cal. Dec. 7, 2012).

Chan after discovering his uncovered unscrupulous commercial conduct.

4. False Equivalence to Another Case

The *ChinaCast Sec. Litig.* court makes a false equivalence when it compares it to *Belmont v. MB Inv. Partners, Inc.* (hereinafter "*Belmont*"), since the latter is a case which centered on a "Ponzi scheme."[71] Named after Charles Ponzi, a man who convinced ten thousand investors to part with an aggregate of $9.5 million in the 1920s,[72] it is a class of fraud where extraordinary returns are promised to investors by drawing on newly invested funds.[73]

Here, ChinaCast is distinguished from being a Ponzi Scheme because company offered actual services from which it generated revenue.[74] In *Belmont*, the company was created for the sole purpose of fraud.[75] Additionally, the defendants in *Belmont* did not investigate into the looting of the company coffers, notify the SEC about what it found, and then promise to continue investigation the matter.[76] The differences in the facts of the defendants' conduct in *ChinaCast Sec. Litig.* compared with *Belmont* are stark. ChinaCast was never alleged

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71. *ChinaCast Sec. Litig.*, 809 F.3d at 476–78.

72. *See Cunningham v. Brown*, 265 U.S. 1, 7-8 (1923); *see also Ponzi to Start Back in New York: Boston 'Wizard' Says He Needs Larger Field and Will Come Here at Once*, N.Y. Times, July 30, 1920, at 2.

73. *See Lowell v. Brown*, 280 F. 193, 196 (D. Mass. 1922) ("His scheme was simply the old fraud of paying the early comers profits out of the contributions of the later comers."); Office of Investor Education and Advocacy, Ponzi Schemes, U.S. Sec. & Exchange Comm'n (Oct. 9, 2013), https://www.sec.gov/fast-answers/answersponzihtm.html.

74. *ChinaCast Sec. Litig.*, 809 F.3d at 473 ("ChinaCast, founded in 1999, is a for-profit post-secondary education and e-learning services provider that sells distance learning and "multimedia education content" over the Internet and from three campuses in China. Before its abrupt downfall, ChinaCast boasted a market capitalization topping $200 million and was listed on the NASDAQ Global Select Market. ChinaCast's stock offerings in the United States in 2008 and 2009 generated $48 million in net proceeds."); *Ponzi Scheme*, Black's Law Dictionary (11th ed. 2019) ("A fraudulent investment scheme in which money contributed by later investors generates artificially high dividends or returns for the original investors, whose example attracts even larger investments. Money from the new investors is used directly to repay or pay interest to earlier investors, usu. without any operation or revenue-producing activity other than the continual raising of new funds.")

75. *Belmont v. MB Inv. Partners, Inc.*, 708 3d 470, 477 (3d Cir. 2013) ("This case arises from a now-defunct Ponzi scheme. The defendants are MB Investment Partners, Inc. ("MB"), a registered investment adviser, and various persons affiliated with MB. The fraudulent scheme was perpetrated by Mark Bloom while he was an employee and officer of MB, through a hedge fund called North Hills, L.P. ("North Hills") that Bloom controlled and managed outside the scope of his responsibilities at MB. Bloom was arrested and indicted in the Southern District of New York in 2009 on a variety of charges relating to the Ponzi scheme, by which time most of the money invested in North Hills was gone.").

76. *Contr*a footnote 70.

to be a Ponzi scheme. The Ninth Circuit made a false equivalence when it compared the aforementioned cases.

III. AGENCY LAW PRINCIPLES OF AUTHORITY

Generally speaking, agency law is a hybrid of contract and tort.[77] There is debate as to whether agency law is in it of itself an independent branch of law with its own substance.[78] However, when one classifies authority, it has sufficient basis to be "proper title in the law."[79]

With regard to the Ninth Circuit's opinion, in *ChinaCast Sec. Litig.*, it improperly held that Chan acted with apparent authority on behalf of ChinaCast and thus imputation is proper.[80] Moreover, the court ensconced its apparent authority conclusion in the context of a Rule 10b-5 claim.[81] In a brazen admission of contradiction, Judge McKeown, writing for the panel, concedes that "[b]ecause the Securities Exchange Act and accompanying regulations do not contain any explicit instructions on when an employee's acts and intent are to be imputed as those of the company, courts have looked to agency principles for guidance."[82] The opinion does not explicate why the court disregarded agency principles. Rather, the court opines on the gravity of weighing

77. *See* Ronald C. Wyse, *A Framework of Analysis for the Law of Agency*, 40 MONT. L. REV. 31 (1979); *but see* Daniel Harris, *The Lost Rationale of Agency Law*, 3 BUS. & FIN. L. REV. 1 (arguing that agency law is its own law in and of itself. "The legal academy has lost sight of the rationale of agency law and tried to recast agency doctrines in the image of other areas of the law, such as contracts or torts. The misunderstanding hampers scholarship and poses a danger to the important values that agency law protects.").

78. Lance Liebman, *Foreword* to RESTATEMENT (THIRD) OF AGENCY at xi (Is agency "only the sum of a variety of legally regulated relationships . . . [?]"); *see also* Thomas Krebs, *Agency Law for Muggles: Why There Is No Magic in Agency*, *in* CONTRACT FORMATION AND PARTIES 205, 205 (Andrew Burrows & Edwin Peel eds., 2010) ("There is much to be said for a view . . . which maintains that the rights and liabilities of the parties must generally be derived from and explained by an application of the general rules of contract, tort, and unjust enrichment.").

79. Oliver Wendell Holmes, Jr., Agency, 4 HARV. L. REV. 345, 345 (1891).

80. *ChinaCast Sec. Litig.*, 809 F.3d at 473, 476–79; *see also* Harris, *supra* note 78, at 22 ("Thus, for example, vicarious liability under respondeat superior is limited to employees and does not extend to independent contractors even if the enterprise had a regular relationship with the errant worker and could have established a right of control if it wished to do so. This doctrine does not appear to be going away. On the contrary, the *California Supreme Court*, *one of the most liberal in the country*, held in 2014 that Domino's Pizza was not vicariously responsible for the misconduct of an employee of one of its franchisees.") (emphasis added).

81. *ChinaCast Sec. Litig.*, 809 F.3d at 474 (quoting 15 U.S.C. § 78u-4(b)(2)(A) (2012)).

82. *Id.* ("To balance these competing forces, and "[a]s a check against abusive litigation by private parties, Congress enacted the Private Securities Litigation Reform Act of 1995," or PSLRA. *Id.* The PSLRA, among other things, imposes "[e]xacting pleading requirements" that require "plaintiffs to state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter, i.e., the defendant's intention 'to deceive, manipulate, or defraud.'").

fraud deterrence and vexatious litigation.[83] It uses this inapt reasoning as a public policy justification. Conveniently, the court also forgets to make mention of the policy reasons for availing the adverse interest exception in this case – namely, to protect innocent third parties.[84] Whether the court is alleging that agency law is an independent branch of law or a novel theory that agency law is applicable to laws beyond contract and tort (in this instance, securities), it does not explain why the court failed to perform a proper analysis. It is abundantly obvious that the acts of fraud perpetrated by Chan were committed without actual or apparent authority. Rather, Chan was acting of his own volition.

A. *Apparent Authority*

Apparent authority is when a third party reasonably believes the principal's agent has authority and "that belief is traceable to the principal's manifestations."[85] This is a broader definition than that provided in the Restatement (Second) of Agency which requires that the principal manifest consent to the transaction, instead of manifest consent to an act or acts that a third party reasonably believes the principal's agent was authorized to conduct or engage in.[86] Nevertheless, if a third party holds a belief that the agent had consented to the acts which make the principal responsible, it is reasonable to infer that said agent has been delegated some actual authority.[87] If the agent did not have actual authority, it would not be reasonable for a third party to trace its' beliefs to the principal's manifestations.

The court's analysis focuses on Chan's acts under apparent authority. The problem here is that ChinaCast made a strategic error when it conceded, for some unknown reason, that Chan "acted within the scope of his apparent authority."[88] Perhaps this had something to do with ChinaCast not being able to mount a vigorous defense,[89] and thus wanted to be economical and focus its defense on the adverse

83. *Id.* at 475.

84. *Id.* at 478 ("In the circumstances of this case, imputation also comports with the public policy goals of both securities and agency law — namely, fair risk allocation and ensuring close and careful oversight of high-ranking corporate officials to deter securities fraud.").

85. Restatement (Third) of Agency § 2.03 (2006).

86. Restatement (Second) of Agency § 27 cmt. a (1958) ("[E]ither the principal must intend to cause the third person to believe that the agent is authorized to act for him, or he should realize that his conduct is likely to create such belief.").

87. Reifsnyder v. Dougherty, 301 Pa. 328, 335, 152 A. 98, 101 (1930); Hoddeson v. Koos Bros., 47 N.J. Super. 224, 135 A.2d 702 (1957); Barrett v. Deere, M. & M. 200, 173 Eng. Rep. 1131 (1828).

88. *ChinaCast Sec. Litig.*, 809 F.3d at 476.

89. *Id.* at 473 ("These [Chan's] actions brought ChinaCast to financial ruin.").

interest exception.[90] Either way, stating that Chan acted within the scope of his authority is illogical. ChinaCast did not have to prove that Chan acted outside the scope of his authority to assert the adverse interest exception.[91] ChinaCast could have simply stated that Chan acted outside the scope of his authority, and thus shifted the burden back to the plaintiffs to prove that Chan acted within the scope of his authority.

However, the court did not explicate how Chan could have committed the acts of fraud under apparent authority if he did not actual authority to do so. The court remarked *"[b]oth parties agree such deception occurred in this case*: ChinaCast founder and CEO Ron Chan *embezzled* millions from his corporation and misled investors through omissions and false statements — textbook securities *fraud*."[92] If deception occurred, then it is reasonable to presume that Chan did not have authority over the acts at issue. The court confessed Chan embezzled from the principal. It is not reasonable to infer that the third party had a reasonable belief that the principal manifested consent to the agent for the acts at issue when the court acknowledges that said acts included the agent embezzling from the principal. Therefore, the third party cannot rely on apparent authority for its claim.

B. *Actual Authority*

Comparatively, actual authority is when a principal manifests authority to an agent to act upon. If the principal explicitly manifests authority to the agent, it is called "expressed actual authority."[93] If the principal does not explicitly manifest, but still manifests authority to the agent, the agent may have "implied actual authority."[94]

In *ChinaCast Sec. Litig.*, Chan did not have actual authority for the acts of fraud he committed, as the court noted that both the principal

90. *See infra* § V Adverse Interest Exception section.

91. *Id.*

92. *ChinaCast Sec. Litig.*, 809 F.3d at 472 (emphasis added).

93. RESTATEMENT (THIRD) OF AGENCY § 2.01 cmt. b (2006) ("As commonly used, the term 'express authority' often means actual authority that a principal has stated in very specific or detailed language."); RESTATEMENT (SECOND) OF AGENCY § 7 cmt. c ("It is possible for a principal to specify minutely what the agent is to do. To the extent that he does this, the agent may be said to have express authority.").

94. RESTATEMENT (THIRD) OF AGENCY § 2.02 (2006) (An agent has actual authority "to take action designated or implied" in the principal's manifestations to the agent.); RESTATEMENT (SECOND) OF AGENCY § 7 cmt. c (1958) (("It is possible for a principal to specify minutely what the agent is to do. To the extent that he does this, the agent may be said to have express authority. But most authority is created by implication. [Such authority may be] implied or inferred from the words used, from customs and from the relations of the parties. [It is] described as 'implied authority.'")).

and the third party were deceived. ChinaCast was, at one point, listed on NASDAQ.[95] As NASDAQ has corporate governance rules for companies,[96] and from Chan attempting to interfere with an audit that may have uncovered his embezzlement,[97] it is demonstrable that he did not have actual authority for the acts of fraud he perpetrated. While Chan had some actual authority, as he was the founder and CEO,[98] actual authority would examine whether the principal manifested authority to the employer for the acts at issue. As the agent deceived the principal for the acts at issue, it is not reasonable to presume that the principal manifested authority for the agent to act upon. Consequently, the third party cannot rely on actual authority for its claim.

IV. Imputation Doctrine

The imputation doctrine holds that notice or knowledge of an agent, while they are acting in their official capacity or within the scope of their authority, and in connection with a matter which their authority comprehends is imputable to the principal.[99]

The purpose of the imputation doctrine is: (1) an agent has a duty to its principal to disclose material information material regarding the agent's responsibilities; and (2) a "more comprehensive justification" is that the imputation doctrine "creates strong incentives for principals to design and implement effective systems through which agents handle and report information."[100]

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95. NASDAQ delisted ChinaCast in May 2012. ChinaCast Education Received NASDAQ Notification Letter Regarding Delisting Determination, PR NEWSWIRE (May 8, 2012, 4:30 PM), http://www.prnewswire.com/news-releases/chinacast-education-received-nasdaq-notification-letter-regarding-delisting-determination-150662565.html [http://perma.cc/FQC2-SJK6].

96. https://www.sec.gov/rules/sro/34-48745.htm; *see also* Douglas C. Michael, *Untenable Status of Corporate Governance Listing Standards Under the Securities Exchange Act*, 47 Bus. Law. 1461, 1475 (1992).

97. *ChinaCast Sec. Litig.*, 809 F.3d at 473.

98. *Id.* at 479.

99. Simmons Creek Coal Co. v. Doran, 142 U. S. 417, 12 Sup. Ct. 239, 35 L. ed. 1063 (1892).

100. Restatement (Third) of Agency § 5.03, cmt. b (2006); *see also* Huston v. Procter Gamble Paper Prods., 568 F.3d 100, 106-07 (3d Cir. 2009)

> *First*, "[t]he scope of an agent's duties delimits the content of knowledge that is Imputed to principal." *Id.* § 5.03 cmt. B. The Restatement (Third) of Agency illustrates this point with the following example:
>
> > P Corporation manufactures construction supplies, using numerous chemicals in its manufacturing processes. Governmental regulations applicable to P Corporation require that it dispose of chemicals used in manufacturing in a manner that does not degrade the natural environment and that it promptly investigate and rectify environmentally damaging spills of chemicals. P Corporation employs A, an environmental engineer, whose duties include monitoring P Corporation's facilities for compliance with applicable environmental regulations and reporting the results of A's findings to

The parallels between the imputation doctrine and *respondeat superior* have been acknowledged.[101] The Restatement (First) of Agency noted the similarities, but illuminated how they are distinguished from each other:

> The mere fact that the agent's primary interests are not coincident with those of the principal does not prevent the latter from being affected by the knowledge of the agent if the agent is acting for the principal's interests. The rule as stated herein [the adverse interest exception to the imputation rule] is substantially similar to the rule . . . [relating to acting outside of the within scope of employment in relation to respondeat superior][102]

Since the imputation doctrine and *respondeat superior* are similar, when they are conflated it is usually when there is no noted differentiation of the agent's scope of employment or whether the act or acts are for the principal's benefit.[103]

> S, a superior agent within P Corporation. While touring the exterior of P Corporation's plant, A inspects a pipe that drains used chemicals into storage vats. A observes that a chemical is leaking from a pipe into the ground in close proximity to a stream. Notice of the fact that the pipe leaks, known to A, is imputed to P Corporation. . . . [But under a different scenario where] the leaky pipe is observed by B, a clerk in P Corporation's accounts-payable department[, and where] B's duties do not include monitoring P Corporation's compliance with environmental regulations[,][n]otice of the fact that the pipe leaks, known to B, is not imputed to P Corporation.

Id. § 5.03 cmt. b, illus. 5 & 7 (emphasis added). In this example, B's knowledge of the pipe leak is not imputed to P Corporation because that knowledge is beyond the scope of B's duties. P Corporation does not employ B to monitor compliance with environmental laws but rather to work as an accounting clerk. In contrast, A's knowledge of the leak is imputed to P Corporation because P Corporation employs A specifically to monitor and report on its compliance with environmental laws. A's knowledge of the chemical leak thus lies squarely within the scope of A's employment duties. *Id.* § 5.03 cmt. e ("The breadth of notice imputed to a principal of facts that an agent knows or has reason to know mirrors the agent's duty to the principal.").

101. E.g., Official Comm. of Unsecured Creditors of Allegheny Health, Educ. & Research Found. v. PricewaterhouseCoopers, LLP, No. 07-1397, 2008 WL 3895559 (3d Cir. July 1, 2008) ("If the agent intended to serve the principal, the fraud is imputed; if, however, the agent intended only to serve himself, the fraud is not imputed . . . Moreover, this approach is familiar in Pennsylvania law, as it is the approach followed in *respondeat superior* cases."); Battenfeld of Am. Holding Co., Inc. v. Baird, Kurtz & Dobson, 60 F. Supp. 2d 1189, 1215 (D. Kan. 1999) (The court analogizes *respondeat superior* to the adverse interest exception when it discusses an employee acts adversely to their employer.).

102. RESTATEMENT (FIRST) OF AGENCY § 282, cmt. 1b.

103. *See generally In re* Rent-Way Sec. Litig., 209 F. Supp. 2d 493, 522 (W.D. Pa. 2002) ("[t]he fraud of an officer . . . is imputable to the corporation when the officer . . . commits the fraud: (1) in the scope of his employment, and (2) for the corporation's benefit."); *see also* Zachary Bookman, *Convergences and Omissions in Reporting Corporate and White Collar Crime*, 6 DEPAUL BUS. & COM. L.J. 347, 353 (2008) ("Yet in order to find corporations liable for misfeasance, courts had to find a way to attribute agent conduct to corporations. Khanna explains that the imputation relied, for logical consistency, on the doctrine of *respondeat superior* ("let the master answer") and, further, that this development eventually paved the way for courts to extend corporate criminal liability to all crimes not requiring intent.) (internal quotations omitted).

With regard to the imputation doctrine, courts have traditionally looked to see if the principal benefitted in any manner. This is to prevent principals from escaping liability by claiming that they have a policy against illegal and illicit activities, yet tacitly and/or surreptitiously encouraging such behavior.[104] The imputation doctrine is not meant to expose principal's to unlimited liability for the conduct of their agents. However, courts hold a low threshold of the standard for the principal benefitting. For instance, if senior-level employees overstate the value of inventories, the employer benefits by having its value increased which results in a higher share price and a lower cost of borrowing capital.[105]

ChinaCast had a system in place for monitoring wrongdoing.[106] ChinaCast removed Chan from his roles of CEO and chairman of the board after he attempted to interfered with said system in place (audit committee).[107] ChinaCast was left in financial ruin.[108] The plaintiffs did not make any arguments as to how ChinaCast benefitted from Chan's act or acts for fraud. In this case, holding that Chan's acts may be imputed to ChinaCast is incongruent with the imputation doctrine.

V. Adverse Interest Exception

Corporations are innate.[109] Ipso facto, agency principles impute employee conduct to their employers when the employee acts within the scope of their employment.[110] However, employee conduct is not imputed to their employer when the agent's conduct is adverse to their principal's interest. As expressed in the Restatement (Third) of Agency, the adverse interest exception holds that "notice of a fact that an agent knows or has reason to know is not imputed to the principal if the agent acts *adversely* to the principal in a transaction or matter, *intending* to act *solely* for the agent's own purposes or those of another person."[111] Case law took the position that the adverse interest exception is not applicable if an agent's conduct is motivated to bene-

104. *See* Restatement (Third) of Agency § 5.03, cmt. b (2006), *cf. supra* note 101 (Reduce the incentive for principals to use agents to avoid or evade legal consequences); *see also* American Nat. Bank of Nashville v. Miller, 229 U. S. 517, 33 Sup. Ct. 883, 57 L. ed 1310 (1913).

105. Cenco, Inc. v. Seidman & Seidman, 686 F.2d 449, 451–54 (7th Cir. 1982).

106. *See supra* notes 62–64 and accompanying text.

107. *See supra* notes 62–64 and accompanying text.

108. *See supra* note 90 and accompanying text.

109. *See supra* note 9 and accompanying text.

110. "Agency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or ot[h]erwise consents so to act." Restatement (Third) of Agency § 1.01 (2006).

111. *See* Restatement (Third) of Agency § 5.04 (2006), *supra* note 10.

fit the principal, regardless as to whether the principal actually benefited.[112] The New York Court of Appeals clarified:

> The rationale for the adverse interest exception illustrates its narrow scope. As already discussed, the presumption that an agent will communicate all material information to the principal operates except in the narrow circumstance where the corporation is actually the victim of a scheme undertaken by the agent to benefit himself or a third party personally, which is therefore entirely opposed (i.e., "dverse") to the corporation's own interests. Where the agent is perpetrating a fraud that will benefit his principal, this rationale does not make sense.[113]

In *Chinacast Sec. Litig.*, the court did not explain how Chan's act or acts of fraud benefitted or were motivated to benefit ChinaCast. After Chan attempted to interfere with an audit, ChinaCast removed Chan from his roles as CEO and chairman of the board.[114] It then announced that ChinaCast unearthed Chan's unscrupulous commercial conduct,[115] and promptly notified the SEC.[116][117] Chan raided ChinaCast's coffers for more than $162 million.[118] There is no claim or evidence that Chan's act or acts of fraud benefitted ChinaCast, or that his acts were motivated to benefit ChinaCast.

The Ninth Circuit incorrectly reversed the Federal District Court's opinion and observed that the adverse interest exception was not available.[119] The court held that because the plaintiffs were innocent third parties who relied in good faith on Chan's statements, which the court held were made under apparent authority.[120] The court bases its reasoning on "good faith" pursuant to the Restatement.[121] Good faith

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112. *See, e.g.*, Baena v. KPMG, 453 F.3d 1, 8 (1st Cir. 2006) ("'Adverse interest' in the context of imputation means that the manager is motivated by a desire to serve himself or a third party, and not the company, the classic example being looting."); *In re Wedtech Securities Litigation*, 138 B.R. 5, 9 (S.D.N.Y. 1992) ("The New York courts have found that '[t]o come within the exception, the agent must have totally abandoned his principal's interests and be acting entirely for his own or another's purposes. It cannot be invoked merely because he has a conflict of interest or because he is not acting primarily for his principal.' As we stated in our earlier opinion, '[t]he relevant issue is short term benefit or detriment to the corporation, not any detriment to the corporation resulting from the unmasking of the fraud."') (citations omitted)).

113. Kirschner, 15 N.Y.3d at 467 (internal citation omitted).

114. *See supra* note 63 and accompanying text.

115. *See supra* note 65 and accompanying text.

116. *See supra* note 65 and accompanying text.

117. *See supra* note 66 and accompanying text.

118. *See supra* note 61 and accompanying text.

119. *ChinaCast Sec. Litig.*, 809 F.3d at 473.

120. *Id.* at 478–79.

121. *See supra* note 10 and accompanying text.

is indicative of the parties of being in privity of contract.[122] Further, the subsection in focus states, in part, " . . . to protect the rights of a third party who dealt with the principal in good faith."[123] The Restatement (Second) of Agency did not mention good faith[124] because out of concern over deleterious effects, such as the following illustration:

> A is authorized by P to sell Ps horse and to represent it as it is. A, intending to keep the proceeds from the sale and intending also to defraud the purchaser, sells the horse to T, representing the horse to be sound, although knowing the horse to be unsound. A absconds with the proceeds. P is bound by As knowledge that the horse is unsound.[125]

Analogizing the above illustration to the present case, Chan ("A") was authorized by ChinaCast ("P") to represent the company as it was, which included making statements about its financial and prospects, *inter alia*, to shareholders ("T").[126] Chan represented to shareholders that the Company was financially healthy and stable while he was looting the company coffers.[127] Ultimately, Chan absconded with the proceeds.[128] It is noteworthy that the company hired Deloitte to

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122. Restatement (Second) of Contracts § 205 (1979). §205. Duty of Good Faith and Fair Dealing Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.

123. *See supra* note 10 and accompanying text.

124. Restatement (Second) of Agency § Section 282 (1959).

(1) A principal is not affected by the knowledge of an agent in a transaction in which the agent secretly is acting adversely to the principal and entirely for his own or another's purposes, except as stated in Subsection (2).

(2) The principal is affected by the knowledge of an agent who acts adversely to the principal:
(a) if the failure of the agent to act upon or to reveal the information results in a violation of a contractual or relational duty of the principal to a person harmed thereby;
(b) if the agent enters into negotiations within the scope of his powers and the person with whom he deals reasonably believes him to be authorized to conduct the transaction; or
(c) if, before he has changed his position, the principal knowingly retains a benefit through the act of the agent which otherwise he would not have received.

125. Restatement (Second) of Agency § 282 cmt. f, illus. 7 (1959).

126. *See supra* notes 61–63 and accompanying text.

127. *ChinaCast Sec. Litig.*, 809 F.3d at 473 ("In the midst of this fraud on multiple fronts, Chan and ChinaCast Chief Financial Officer Antonio Sena participated in a series of earnings calls and other communication with investors. During these calls, neither official disclosed the fraudulent activities taking place; instead, Chan emphasized the company's financial health and stability. For example, in a press release and conference call in fall 2011, Chan reassured investors that "no questions or concern[s] have ever been raised by the company''s auditors or audit committee about our cash balances." Throughout 2011, Chan signed SEC filings on behalf of ChinaCast and never disclosed the $120 million in transfers and other fraudulent activities afoot.").

128. https://www.sec.gov/litigation/complaints/2013/comp-pr2013-200.pdf ("Chan, 57, is a Chinese national who resides in the PRC [People's Republic of China]. Chan served as the CEO and Chairman of the Board of Directors of ChinaCast from February 9, 2007 through March 26, 2012, when he was terminated.").

perform an independent audit.[129] The Board of Directors stated they would take Deloitte's recommendations seriously, yet they failed to follow through.[130] In their complaint, plaintiffs stated that ""despite this clear warning from Deloitte" regarding its lax financial oversight, the company and its board "turned a blind eye" to the problem."[131] After Deloitte issued a report detailing "material internal control weaknesses," it did not stop the madness as Chan continued to loot the company.[132] The issue from the shareholders perspective is that the corruption ran so deep at ChinaCast that investors were not able to stop it because there was no adequate oversight.[133] It is not clear how any of these acts benefited ChinaCast.[134] "If a bank commits a criminal act or if a bank commits serious regulatory violations, some-

129. *In re* ChinaCast Educ. Corp. Sec. Litig., CV 12–4621–JFW (PLAx) at *3 (C.D. Cal. Dec. 7, 2012) ("According to Plaintiffs, Defendants were aware of the weaknesses in ChinaCast's internal controls substantially before Chan's removal as CEO and Chairman. Specifically, Plaintiff alleges that in its 10-K for the year ending December 31, 2010, ChinaCast noted that its auditor, Deloitte Touche Tohmatsu CPA Ltd. (an affiliate of Deloitte & Touche, LLP) ("Deloitte"), had uncovered at least two material weaknesses in ChinaCast's internal controls. According to Deloitte, one of those weaknesses involved the Board of Director's failure to authorize a non-recurring, irregular contract that should have been approved by the Board of Directors before that contract was signed. In response to Deloitte's findings, the Board of Directors vowed to "step up" its efforts to approve all non-recurring, irregular contracts before they were signed, and assured investors that "the board and the management took Deloitte's points seriously and we basically will be putting all the resources to rectify these problems and make sure that we get that clean report again come the New Year.""").

130. *Id.*

131. *ChinaCast Sec. Litig.*, 809 F.3d at 473.

132. *Id.* at 478–79 ("According to the complaint, which governs our analysis at this early procedural stage, ChinaCast received an audit from Deloitte in 2011 detailing "material internal control weaknesses." Yet the corporation and its board "turned a blind eye" and failed to take significant action or heighten oversight. Had they done so, they may have prevented much of the decimation of ChinaCast's bottom line and share value. Indeed, the $120 million in illicit withdrawals began several months after the Deloitte report was issued. *What's more, Chan was hardly a random corporate bureaucrat or mid-level manager. He was ChinaCast's founder and CEO, the one person on whom the board undoubtedly should have kept close tabs. See In re Fin. Mgmt.*, 784 F.2d 29, 31-32 (1st Cir. 1986) (noting courts have applied apparent authority rule against corporations "particularly when the person making the misrepresentation is an important corporate official"). Permitting imputation under these circumstances encourages appropriate corporate oversight.") (emphasis added).

133. *Id.* at 473 ("In its March 2011 Form 10-K filing with the Securities and Exchange Commission ("SEC"), ChinaCast disclosed that its out-side accounting firm Deloitte Tohmatsu CPA Ltd. (an affiliate of Deloitte & Touche LLP) ("Deloitte") had identified "serious internal control weaknesses" with respect to its financial oversight. The complaint alleged that, despite this "clear warning from Deloitte" regarding its lax financial oversight, *the company and its board "turned a blind eye" to the problem. Soon after, the complaint alleges, ChinaCast's founder and CEO, Ron Chan Tze Ngon ("Chan"), looted the company's coffers, including proceeds from the U.S. stock offerings*.") (emphasis added).

134. *See* RESTATEMENT (THIRD) OF AGENCY § 5.04 (2006), *supra* note 10 (stating in part, "For purposes of determining a principal's legal relations with a third party, notice of a fact that an agent knows or has reason to know is not imputed to the principal if the agent acts adversely to

one within that bank did it. *The corporation is an inanimate thing*."[135] "[E]liminating the adverse interest exception in [a] fraud on the market suit[ ]"[136] now subjects corporations to losing thrice: (1) the funds siphoned off by the unscrupulous actors; (2) the drop in share price;[137] and (3) shifting dollars in the form of damages from plaintiff shareholders to other shareholders.[138] With regard to the latter point, those dollars could be put to better use, such as investing in the company (such as hiring executives to steer it in the right direction, implement robust controls, hire lawyers to go after the bad actors, or any number of other alternatives). The Ninth Circuit decided to eliminate the adverse interest exception in order to promote its judicial activism.

ChinaCast is bound by Chan's knowledge that ChinaCast was financially unsound. Using this rationale , the Ninth Circuit interpretation of "good faith"" directly contradicts how the drafters of the Restatement intended it to be interpreted. ChinaCast should not be held liable for Chan's act or acts of fraud under the adverse interest exception.

VI. PUBLIC POLICY

During the era of masters and servants, respondeat superior emanated as a way to hold those in power accountable for the actions of the people they oversaw.[139] There is still much debate today about

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the principal in a transaction or matter, intending to act solely for the agent's own purposes or those of another person.")

135. *See supra* note 9 (quoting New York Department of Financial Services Superintendent Benjamin Lawsky) (emphasis added).

136. *ChinaCast Sec. Litig.*, 809 F.3d at 479.

137. *In re* ChinaCast Educ. Corp. Sec. Litig., CV 12–4621–JFW (PLAx) at *4 (C.D. Cal. Dec. 7, 2012) ("Defendant Sena informed the Board of Directors that ChinaCast had received a bid from another company ("Company B") to acquire all of ChinaCast's shares, and this bid offered ChinaCast between $6.46 and $6.94 per share, which included a significant premium over the *July 29, 2011 closing price of $4.92*."; "Plaintiffs allege that the truth regarding the fraud began to be revealed *on October 3, 2011*, when ChinaCast announced that it was suspending its previously-announced stock buyback plan, and disclosed that it was hiring an independent auditing firm, FTI Consulting, Inc. ("FTI"), to audit its cash balances. That day, *ChinaCast's stock price fell $1.11 per share, and closed at $2.58 per share*.") (emphasis added).

138. *See* Cox, *infra* note 157.

139. RESTATEMENT (SECOND) OF AGENCY § 2(1)–(2). One might argue that a master–servant conception implies that at times the servant may not be acting as the agent of the master: an employer is liable for the actions of his employees only when their actions are taken "within the scope of their employment."; *See, e.g.*, Butler v. Circulus, Inc., 557 S.W.2d 469, 475 (Mo. Ct. App. 1977) ("Given the behavior modification program based on punishment, the allegations show that it was reasonably foreseeable that defendant's employees would abuse plaintiff if the employees were not properly qualified, trained and supervised. *See, Scheibel v. Hillis*, 531 S.W.2d 285, 288[7-9] (Mo.banc 1976); *Porter v. Thompson*, 357 Mo. 31, 206 S.W.2d 509, 512[5] (1947) (employer could be liable for assault committed by employee if employer knew or should have known of employee's vicious propensities); *Schulte v. Graff*, 481 S.W.2d 596, 600, 602

when employers are liable for their employees.[140] This is a crucial question for the reason that liability is a cornerstone of the law.[141] Most employer liability is vicarious liability imposed under the respondeat superior doctrine. A basis for the respondeat superior doctrine holding employers vicariously liable for employees is their employer's costs of monitoring or otherwise controlling employee behavior.[142]

Concerning the matter of an employee's act or acts of fraud, it would be outside the scope of *respondeat superior*. There will always be bad actors. Because employers cannot act or think on their own, the act or acts of employees are imputed to them when said act or acts occur within the scope of employment.[143] If said employee's act or acts of fraud were against the interest of the employer, it is illogical to hold that said act or acts could possibly be within the scope the employment.[144] If it is an act or acts of fraud, the employer was deceived and could not have consented nor authorized said act or acts. A fascinating aspect is courts determining what constitutes the scope of employment, as this can vary by state.[145] To boot, this can change over time.[146] The Supreme Court of California has expanded the scope of

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(Mo.App. 1972) (employer could be liable if plaintiff showed employee was unqualified or not properly trained or supervised); *Priest v. F. W. Woolworth Five Ten Cent Store*, 228 Mo.App. 23, 62 S.W.2d 926, 928[4] (1933) (employer could be liable for unauthorized act of employee in bending customer backwards over counter if plaintiff showed employer failed to exercise ordinary care in employing a proper servant). *See generally*, 6 Am.Jur.2d, Assault Battery § 134, pp. 113-114; 53 Am.Jur.2d, Master and Servant § 422, pp. 435-38; 57 C.J.S. Master and Servant § 559, pp. 270-77. Count I states a cause of action against defendant in negligence.").

140. Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 4 (1996) ("The liability system currently is mired in controversy over who should be liable, for what conduct, and for how much money.").

141. *See* LoPucki, *supra* note 142, at 3 ("Law is a system for controlling human behavior. In contemporary society, governments enforce law by essentially two mechanisms: incarceration and liability.").

142. Richard A. Posner and William M. Landes, *The Economic Structure of Tort Law*, HARVARD UNIVERSITY PRESS (1987), pg. 208.

143. *See supra* note 6 and accompanying text.

144. ""Parlato v. Equitable Life Assurance Society of United States, 299 A.D.2d 108, 749 N.Y.S.2d 216 (N.Y. App. Div. 2002) ("To succeed on a respondeat superior theory, a plaintiff need not show either apparent authority or reasonable reliance thereon, but must show that the agent was acting in furtherance of the principal's business and within the scope of employment.") (internal quotation marks and citations omitted).

145. Texas has a Conservative State Supreme Court. See Roxanna Asgarian, Republican dominance continues for the two highest courts, Texas Tribune, Nov. 9, 2022, 9 AM Central, *available at* https://www.texastribune.org/2022/11/09/texas-supreme-court-criminal-election/; *See also* Gareth A. DeVoe, *Frolicking Away: Texas Courts Shield Employers from Respondeat Superior Claims*, *available at* https://www.texasbar.com/AM/Template.cfm?Section=Articles&Template=/CM/HTMLDisplay.cfm&ContentID=47853. *Contra* note 148.

146. California has a Liberal State Supreme Court. *See supra note* 81; Christine W. Young, Comment, *Respondeat Superior: A Clarification and Broadening of the Current Scope of Em-*

employment to include acts that are not customary, or even acts that are unauthorized.[147]

Imposing liability on employers for their employee's act or acts of fraud when those acts were against the interest of the employer is repugnant to public policy. To do so may lead employers to be punished twice, with regard to suffering financial losses from the employee's act or acts of fraud as well as lawsuits by injured third party or parties. Forbye, doing so will undoubtedly lead to fewer employment opportunities, as a mandate of the business environment is to focus on maximizing shareholder value.[148]

Moreover, the more liability employers are subject to, the more deleterious effects it will have for employees.[149] While liability is central to law[150] and commerce,[151] there is not bright line as to when an em-

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ployment Test, 30 Santa Clara L. Rev. 599 (1990) (Discussing the evolution of respondeat superior under California law); *id.* at 603–04 ("California courts initially followed the principles set forth in Wright above. Employers were not found liable for the intentional torts of their employees. These wrongful acts were, by definition, outside the scope of employment. However, it was not long before California departed from strict adherence to this rule.").

147. Perez v. Van Groningen & Sons, Inc. (1986) 41 Cal.3d 962, 968, 970 (The scope of the employment for an employee under respondeat superior doctrine "have established a general rule of liability with a few exceptions for cases where the employee has *substantially deviated from his duties for personal purposes*."; "The presence of an unauthorized passenger was insufficient to take Garcia outside the scope of his employment since he was still carrying out his employer's business.") (emphasis added). Howbeit, the law can change, and likely will over time. id. at 971–72 (Lucas, J., dissenting) ("As the majority concedes, the record would support a finding that the employer had forbidden employees to allow any passengers aboard tractors because of the obvious dangers involved. Nonetheless, employee Garcia allowed plaintiff, his nephew, to ride while seated on a raised toolbox in the tractor. Quite predictably, an accident occurred when plaintiff was struck by a low-hanging branch. *The majority holds, contrary to the finding of the jury in this case, that Garcia was at all times acting within the scope of his employment.* The majority emphasizes that Garcia was busy with his usual work when the accident occurred. But the accident did not occur by reason of Garcia's attention to his authorized work — it arose because Garcia, for personal reasons, deviated from his employment and violated an express company rule forbidding passengers aboard tractors. Under these circumstances, respondeat superior liability should not be imposed. *The majority acknowledges that no liability may be imposed in cases where the employee has substantially deviated from his duties for personal purposes*.") (internal quotation marks and citations omitted) (emphasis added).

148. *See generally* Alwyn Scott, Ross Kerber, Jessica Napoli, Rebecca Spalding, *U.S. Companies criticized for cutting jobs rather than investor payouts*, Reuters, April 8, 2020, 10:37 AM, *available at* https://www.reuters.com/article/us-health-coronavirus-corporatelayoffs-a/u-s-companies-criticized-for-cutting-jobs-rather-than-investor-payouts-idUSKBN21Q24Z; Jia Lynn Yang, *Maximizing shareholder value: The goal that changed corporate America*, Wash. Post, Aug. 26, 2013, *available at* https://www.washingtonpost.com/business/economy/maximizing-shareholder-value-the-goal-that-changed-corporate-america/2013/08/26/26e9ca8e-ed74-11e2-9008-61e94a7ea20d_story.html.

149. *See supra* note 150; *see generally* https://www.bizjournals.com/seattle/news/2016/03/31/analyst-boeing-robbing-peter-to-pay-paul-with.html ("Boeing wants to make more money from the aircraft it sells. That's what's driving the push to reduce employment by 4,000 people– and possibly more later. The issue for Boeing (NYSE: BA) is related to margins.").

150. *See* LoPucki, *supra* note 142.

ployer is liable for its employees. The Ninth Circuit's public policy argument of deterrence through "fair risk allocation"[152] overlooks the machinations involved in fraud-on-the-market cases. The court's quest for justice is shortsighted in this context because its analysis is more pragmatic[153] with regard to traditional agency relationships. The court cited a law review article which discerned the difference.[154] In this matter, the shareholders have lost on both fronts.[155] Corporations are directed by "controlling persons."[156] But the corporations are not necessarily paying. In fraud-on-the-market suits, the damages paid to plaintiff shareholders comes from other shareholders, who are not culpable for the fraud. Employers already have significant liability. Imposing liability for employers for an employee's act or acts of fraud

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151. *See* Arthur Levitt, Jr., *How to Boost Shareholder Democracy*, WALL ST. J., July 1, 2008, at A17 ("The principle that shareholders own the companies in which they invest-and are the ultimate bosses of those running them-is central to modern capitalism."); *see also* Doug Bujakowski & Joan Schmit, *Economic Structural Transformation and Litigation: Evidence from Chinese Provinces, to Economic Change and Restructuring*, 19 DEPAUL BUS. & COM. L.J. 97, 97 (2005) ("The relationship between economic development and civil litigation has received notable empirical attention in recent years. Yet, despite numerous, thoughtful investigations, the connection between these phenomena remains a point of debate.").

152. *ChinaCast Sec. Litig.*, 809 F.3d at 478.

153. Doori Song, *Judicial Pragmatism: Strengths and Weaknesses in Common Law Adjudication, Legislative Interpretation, and Constitutional Interpretation*, 52 UIC J. MARSHALL L. REV. 369, 369 (2019) ("Judicial pragmatism is a judicial methodology known for its future-looking mode of analysis, empirically-based decision making, *and openness to judicial activism*.") (emphasis added).

154. *ChinaCast Sec. Litig.*, 809 F.3d at 477 ("The interplay between these principles has been explained as follows:

> The starting point is that all information known by the agent, at least when received within the scope of authority, is deemed known by the principal. But this is not so if the agent is acting contrary to the principal's interests — the so-called "adverse interest" exception. In turn, the adverse interest exception itself has an exception: the principal is charged with even the faithless agent's knowledge when an innocent third-party relies on representations made with apparent authority.

(citing Langevoort, *supra* note 4, at 1214). However, this passage is referring to traditional agency law principles, which are distinguishable from fraud on the market cases. In the same article, Langevoort goes on to explain: "[traditional agency law] doctrines . . . operate with substantial breadth, perhaps proving too much if incorporated in their entirety [into 10b-5 cases]," such as in situations when an employee "engage[s] in an intricate scheme to defraud both customers and his employer." Langevoort, *supra* note 4, at 1228.

155. *See* James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 ARIZ. L. REV. 497, 509 (1997) ("A reason that the securities class action poorly serves both a compensatory and a deterrent objective is the circuity problem that arises when the source of a settlement is the corporation that commits the misrepresentation.").

156. Section 15 of the 1933 Act, 15 U.S.C. § 77o (1976) provides that a controlling person shall be liable "unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." Section 20(a) of the 1934 Exchange Act, 15 U.S.C. § 78t(a) (1976), similarly provides that a controlling person shall be liable "unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action."

when those acts were against the interest of the employer is not grounded under any doctrine. Imposing liability on employers serves three goals: "(1) to prevent recurrence of the tortious conduct; (2) to give greater assurance of compensation for the victim; and (3) to ensure that the victim's losses will be equitably borne by those who benefit from the enterprise that gave rise to the injury."[157] The second and third goals are not accomplished by holding employers liable for an employee's act or acts of fraud when those acts were against the interest of the employer. Per the second goal, as is the case with *ChinaCast Sec. Litig.*, the employer may also be a victim. ChinaCast had its coffers looted and it faced liability from a third party or parties (shareholders). Thus, ChinaCast, as a victim, is not given any assurance of compensation. For the third goal, as is the case with *ChinaCast Sec. Litig.*, it is not ensured that ChinaCast or the third party or parties (shareholders) will be compensated for their losses by Chan, even though he benefited from the injury. The SEC brought charges against Chan, where a judgment was entered against Chan which required him to pay $41.4 million in disgorgement, $6.65 million in interest, and a $750,000 civil penalty.[158] ChinaCast did not benefit from Chan's acts, but was rather a victim of Chan's behavior. Accordingly, it is against public policy for a victim's losses to be borne by another victim of the same act or acts.

VII. Reductio Ad Absurdum

Holding that an employee's act or acts of fraud may be imputed to his employer even when those acts were against the interest of the employer is subject to *reductio ad absurdum*.[159] In *ChinaCast Sec. Litig.*, we see an extreme example of this absurdity when Chan, who was the founder and CEO committed fraud which left his employer destitute.[160] As a result of the financial ruin that was brought upon his employer by his acts of fraud, "[t]he company cannot even afford its legal bills, according to its lawyers, who submitted a bare-bones brief

157. Mary M. v. City of Los Angeles (1991) 54 Cal.3d 202, 209 (citations omitted).

158. SEC v. Chan Tze Ngon, No. 13-civ-6828 TPG, Dkt. No. 29 (S.D.N.Y. Jan. 16, 2015).

159. *Reductio Ad Absurdum*, Black's Law Dictionary (11th ed. 2019) ("In logic, disproof of an argument by showing that it leads to a ridiculous conclusion."); *see also* Max Birmingham, *Up in the Air: Analyzing Whether the Clean Air Act Preempts State Common Law Claims*, 14 Liberty U. L. Rev. 55 (2019) (see § VII, absurdity section); Max Birmingham, *Paid in Full: Interpreting and Defining "Market Value" Under the Lacey Act*," 25 Animal L. Rev. 125 (2019) (see § V, absurdity section); Max Birmingham, *Strictly for the Birds: The Scope of Strict Liability Under the Migratory Bird Act*, 13 J. Animal & Nat. Resource L. 1, 14-15 (2017) (discussing how Fifth Circuit's ill-founded use of a *reductio ad absurdum* argument in regard to the Migratory Bird Treaty Act).

160. *See supra* note 90 and accompanying text.

on appeal and stated that ChinaCast now, unfortunately, lacks the funds necessary to mount with full vigor the defense of this appeal."[161] An employer may be left impecunious as a result of the acts of fraud by an employee to such a degree that the employer cannot afford legal counsel to adequately represent it.

Moreover, if an employee's act or acts of fraud may be imputed to his employer, the employer may be penalized twice for the same said act or acts. In *ChinaCast Sec. Litig.*, Chan looted the coffers of ChinaCast. To then hold that ChinaCast is responsible to a third party for their injury, arising from the same act or acts, is absurd. Holding that an employer is a victim and liable for the same act or acts is illogical. Furthermore, to do so would re-victimize the employer, as they were injured and would then have to also be liable to the third party or parties, thereby having to financially pay twice for the same act or acts.

There are plausible scenarios that would undermine the justification holding that an employee's act or acts of fraud may be imputed to his employer even when those acts were against the interest of the employer. For example, Employee A and a Third Party Shareholder concoct a scheme to unjustly enrich themselves. Employee A commits an act of fraud by looting the coffers of Employer, a publicly traded company. Third Party Shareholder then files a lawsuit against Employer over said act of fraud. Employee A and Third Party Shareholder split the ill-gotten gains that were looted from the coffers as well as the amount they received from the lawsuit, whether granted from a court or from a settlement. Additionally, if it is a class action, or several shareholders bring forth claim, it is not certain that each shareholder owned stock before the act or acts of fraud were disclosed. In fact, some shareholders may have acquired stock after the act or acts of fraud were disclosed. Thus, said shareholders, who are no victims of the act or acts of fraud which are the basis of the claim, would be unjustly enriched as they would be rewarded for an act or act in which they were not injured.

An employee's act or acts of fraud which were against the interest of the employer are clearly outside the scope of employment.[162] If an employee acts outside the scope of employment and does not further

161. *ChinaCast Sec. Litig.*, 809 F.3d at 471.

162. *See supra* § V Averse Interest Exception section; *see also* Kish v. California State Auto. Assn. (1922) 190 Cal. 246, 249 (An employee is within the scope of employment when said employee is "engaged in the duties which he was employed to perform [or] those acts which incidentally or indirectly contribute to the [employer's] service.").

the interests of the principal, then the principal is not liable.[163] Accordingly, a third party or parties would not have standing to bring forth a claim against said employer.[164] This flies in the face of the adverse interest exception.[165]

VIII. CONCLUSION

Employers are not omnipresent. To reiterate, there will always be bad actors. It is absurd to hold that an employee is within their scope of employment if they use their positions to commit an act or acts of fraud. If said employee did not have their position with the employer, they would not have been in a position to commit the act or acts of fraud that are adverse to the interest of the employer.

Corporations cannot think or act on their own and are driven by what their employees think and act. To be clear, this Article is not arguing that employers should not face any sort of liability. Nor is this Article arguing that an employer should never be liable for the act or acts of their employees. Sometimes one tries to use corporations as shields for nefarious purposes or activities,[166] or to attempt to avoid or evade.[167] In these instances, there are usually widespread illegal and illicit activities.[168] In such instances, the corporations usually benefit by increasing the share price, inflate asset value, and raise capital, *in-*

163. Henderson v. Prof'l Coatings Corp., 819 P.2d 84, 89 (Haw. 1991) ("There was no intention to act in the employer's interest, nor was there any direct benefit to the employer'"); Gov't Employees Ins. Co. v. United States, 678 F. Supp. 454, 456 (D.N.J. 1988) ("Dunne's conduct was not actuated by a purpose to serve the master"); Miller v. Reiman-Wuerth Co., 598 P.2d 20, 24 (Wyo. 1979) ("Grandpre's conduct at the time of the collision was not actuated in any part by a purpose to serve appellee").

164. Beck v. Deloitte & Touche, 144 F.3d 732 (11th Cir. 1998) ("On September 28, 1994, the district court ruled that the Trustee had not satisfied the adverse interest exception because he had "failed to plead" that the directors of Southeast were acting adversely to Southeast's interest."); *contra* Pacific Mut. Life Ins. Co. v. Haslip, 553 So.2d 537, 541 (Ala. 1989) ("The courts have further held the principal liable for his agent's fraud committed within the actual or apparent scope of his employment, even where the fraud was committed strictly for the agent's own benefit and to the principal's detriment.") (quoting from the trial court's opinion).

165. *See* RESTATEMENT (THIRD) OF AGENCY § 5.04 (2006), *see supra* note 10.

166. *See supra* notes 101 and 105 and accompanying text.

167. *See, e.g.*, Kinney Shoe Corp. v. Polan, 939 F.2d 209 (4th Cir. 1991) (A corporation was attempted to be used to only shield a shareholder's other company from debts.).

168. *See, e.g.*, Enron (Edward Iwata, *Enron Faces "Hornet's Nest" of Charges*, USA TODAY, June 17, 2002, at lB; Daniel Kadlec et al., *Power Failure: As Enron Crashes, Angry Workers and Shareholders Ask, Where Were the Firm's Directors? The Regulators? The Stock Analysts?*, TIME, Dec. 10, 2001, at 68; Richard A. Oppel, Jr. & Andrew Ross Sorkin, *Enron's Collapse: The Overview; Enron Corp. Files Largest U.S. Claim for Bankruptcy*, N.Y. TIMES, Dec. 3, 2001, at Al.); WorldCom (Kurt Eichenwald and Seth Schiesel, *SEC Files New Charges on WorldCom*, N.Y. TIMES, Nov. 6, 2002, Cl, at C2; Barnaby J. Feder & Seth Schiesel, *WorldCom Finds $3.3 Billion More in Irregularities*, N.Y. TIMES, Aug. 9, 2002, at Al; Simon Romero & Riva D. Atlas, *WorldCom's Collapse: The Overview*, N.Y. TIMES, July 22, 2002, at Al.).

ter alia. If an employee's act or acts of fraud were against the interest of the employer, the employer will benefit. Rather, the employer will be harmed. ChinaCast did not see its share price rise, its asset value inflate, or able to raise capital as a result of what Chan did. The plaintiffs did not present evidence as to how ChinaCast benefitted from the act or acts of Chan that were at issue.

Moreover, if a plaintiff brings forth a claim under federal securities law, a court cannot then look for law to take over the case. The Ninth Circuit redefined the issues between the parties, departing from party presentation. Nonetheless, ChinaCast was not able to mount a vigorous defense because it was left insolvent as a result of Chan's looting. Perhaps the court's opinion would have come out differently if they had a vigorous defense, or at least filed more than a bare-bones brief.