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A Broker-Dealer's Civil Liability to Investors for Fraud: An Implied Private Right of Action Under Section 15(c)(1) of the Securities Exchange Act of 1934

CHARITY SCOTT*

"The proper definition of an average investor is a bankrupt investor"

—A witness during the 1934
Senate hearings on the Securities
Exchange Act of 1934.¹

INTRODUCTION

An individual investor's right to sue his stockbroker for fraud under section 10(b) of the Securities Exchange Act of 1934² is well established.³ Less well recognized is the possibility of a private right of action under section 15(c)(1)

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1. *Stock Exchange Practices: Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 7157 (1934).

2. 15 U.S.C. §§ 78a-78kk (1982) (referred to throughout this Article as the 1934 Act or the Exchange Act).

3. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975); *Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971). Section 10(b), 15 U.S.C. § 78j(b) (1982), provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

. . . .

(b) To 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.

Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987), enacted pursuant to § 10(b), provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means

of the same Act.⁴ While there has been a fair amount of private litigation

or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(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.

4. The first three clauses of § 15(c) of the 1934 Act, 15 U.S.C. § 78o(c) (1982), provide:

(c)(1) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange of which it is a member by means of any manipulative, deceptive, or other fraudulent device or contrivance, and no municipal securities dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this paragraph, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

(2) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange of which it is a member, in connection with which such broker or dealer engages in any fraudulent, deceptive, or manipulative act or practice, or makes any fictitious quotation, and no municipal securities dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security in connection with which such municipal securities dealer engages in any fraudulent, deceptive, or manipulative act or practice, or makes any fictitious quotation. The Commission shall, for the purposes of this paragraph, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative and such quotations as are fictitious.

(3) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) in contravention of such rules and regulations as the Commission shall prescribe as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility and related practices of brokers and dealers including, but not limited to, the acceptance of custody and use of customers' securities and the carrying and use of customers' deposits or credit balances. Such rules and regulations shall (A) require the maintenance of reserves with respect to customers' deposits or credit balances, and (B) no later than September 1, 1975, establish minimum financial responsibility requirements for all brokers and dealers.

Rule 15c1-2, 17 C.F.R. § 240.15c1-2 (1987), provides:

(a) The term "manipulative, deceptive, or other fraudulent device or contrivance", as used in section 15(c)(1) of the Act (section 2, 52 Stat. 1075; 15 U.S.C. 78o(c)(1) [sic], is hereby defined to include any act, practice, or course of business which

brought under section 15(c)(1), there is no consensus among the circuits as to whether to imply a private right of action under this provision.⁵ In all the on-

operates or would operate as a fraud or deceit upon any person.

(b) The term "manipulative, deceptive, or other fraudulent device or contrivance", as used in section 15(c)(1) of the Act, is hereby defined to include any untrue statement of a material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading.

(c) The scope of this section shall not be limited by any specific definitions of the term "manipulative, deceptive, or other fraudulent device or contrivance" contained in other rules adopted pursuant to section 15(c)(1) of the act.

This Article does not directly analyze the possibility of implication of private rights under § 15(c)(2) and § 15(c)(3), but rather focuses on an implied private right of action under § 15(c)(1). An argument could be advanced for implying private rights of action for damages (but not for rescission) under clauses (c)(2) and (c)(3) of § 15. See *infra* note 219.

5. The federal courts have split on the issue. By and large, the older cases support the implication of a private right of action under § 15(c)(1), while more of the recent cases decline to imply a private right. For a discussion of the significance of the older precedent, see *infra* notes 254-65 and accompanying text.

(a) Some courts have found—by way of holding or dictum or by assuming *sub silentio*—that there is an implied private right of action under § 15(c)(1). See, e.g.:

First Circuit: Landry v. Hemphill, Noyes & Co., 473 F.2d 365, 368 n.1 (1st Cir.) ("Churning may give rise to a civil cause of action under either § 10(b) or § 15(c) . . ."), *cert. denied*, 414 U.S. 1002 (1973); Gilman v. Shearson/American Express, Inc., 577 F. Supp. 492, 496 (D.N.H. 1983) (court refused to dismiss claim alleging violations of § 15(c)(1) and § 15(c)(2)).

Second Circuit: Beres v. Thomson McKinnon Sec., Inc., [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,395, at 97,069 (S.D.N.Y. 1987) (plaintiff bringing private action under § 15(c)(1) must allege facts showing compliance with limitations period of § 29(b)); *In re Gas Reclamation, Inc. Sec. Litig.*, 659 F. Supp. 493, 509-10 (S.D.N.Y. 1987) ("Second Circuit unequivocally has held that a private right of action exists under section 15(c)(1)."); Darvin v. Bache Halsey Stuart Shields, Inc., 479 F. Supp. 460, 464 (S.D.N.Y. 1979) (same scienter standard applies to § 10(b) and § 15(c) in private action against brokerage firm); Resnick v. Touche Ross & Co., 470 F. Supp. 1020, 1023 n.2 (S.D.N.Y. 1979) (claim alleging violations of § 15(c) brought by investors in brokerage firm dismissed because private right of action under § 15(c) runs in favor of customers of broker-dealer); Koch v. Moseley, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,283, at 92,810 (E.D.N.Y. 1977) (private claims brought under § 15(c) held time-barred under statute of limitations embodied in § 29(b)); Odette v. Shearson, Hammill & Co., 394 F. Supp. 946, 956 n.12 (S.D.N.Y. 1975) (claim in private action under § 15(c) requires proof of scienter comparable to that which must be shown under Rule 10b-5); Handelman v. Weiss, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,749, at 96,483 (S.D.N.Y. 1974) (plaintiffs stated cause of action under § 15(c)(1)); Newburger, Loeb & Co. v. Gross, 365 F. Supp. 1364, 1371-72 (S.D.N.Y. 1973) (private cause of action predicated on § 15(c)(1) held time-barred under section 29(b)); Smachlo v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,148, at 91,137 (S.D.N.Y. 1971) (private action under § 15(c)(1) assumed permissible but count under that section dismissed because no allegation that defendant induced the purchase or sale of any security by plaintiffs); Franklin Nat'l Bank v. L.B. Meadows & Co., 318 F. Supp. 1339, 1341-43 (E.D.N.Y. 1970) (private right of action exists under § 15(c)(2)); Maher v. J.R. Williston & Beane, Inc., 280 F. Supp. 133, 137-39 (S.D.N.Y. 1967) (private causes of action based on § 15(c)(1) held time-barred by limitations period under § 29(b)); Opper v. Hancock Sec. Corp., 250 F. Supp. 668, 673 (S.D.N.Y.), *aff'd*, 367 F.2d 157 (2d Cir. 1966) (plaintiff correctly brought private lawsuit under § 10(b) and § 15(c)(1)); List v. Fashion Park, Inc., 222 F. Supp. 798, 803 (S.D.N.Y. 1963) (plaintiff would have been entitled to bring private lawsuit under § 15(c)(1)); Howard v. Furst, 140 F. Supp. 507, 510-11 (S.D.N.Y.) (private right of action has been found

going legal excitement over section 10(b), few legal scholars have considered

for violations of § 15(c)), *aff'd*, 238 F.2d 790 (2d Cir. 1956), *cert. denied*, 353 U.S. 937 (1957); *Coburn v. Warner*, 110 F. Supp. 850, 851 (S.D.N.Y. 1953) (private action based on alleged violation of Rule 15c1-4 permitted to proceed); *Osborne v. Mallory*, 86 F. Supp. 869, 878 (S.D.N.Y. 1949) (private actions for violation of § 15(c) are specifically provided for in § 29(b)).

Third Circuit: *Hill v. Equitable Trust Co.*, 562 F. Supp. 1324, 1346 (D. Del. 1983) (private claims under § 15(c) and § 15(b) were dismissed because defendants were banks, not brokers or dealers within the meaning of the 1934 Act); *Hill v. Der*, 521 F. Supp. 1370, 1388-89 (D. Del. 1981) (plaintiff bringing private claim under § 15(c)(1) must allege due diligence in seeking to discover securities violation or be time-barred under § 29(b)); *Stevens v. Abbott, Proctor & Paine*, 288 F. Supp. 836, 843, 845-46 (E.D. Va. 1968) (private right of action based on § 10(b) and § 15(c)(1) against brokerage firm for churning permitted). *See also* *Lorenz v. Watson*, 258 F. Supp. 724, 734 (E.D. Pa. 1966) ("Without deciding the question, it may be that the plaintiffs could have brought their action against [defendants] under Section 15(c)(1) . . .").

Fourth Circuit: *Blomquist v. Churchill*, 633 F. Supp. 131, 132 (D.S.C. 1985) (private claim under § 15(c)(1) survived motion to dismiss and to compel arbitration (arbitration aspect of decision may be affected by *Shearson/American Express, Inc. v. McMahon*, 107 S. Ct. 2332 (1987), *see infra* note 7); *accord* *Levendag v. Churchill*, 623 F. Supp. 620, 621 (D.S.C. 1985); *Mid-Carolina Oil, Inc. v. Klippel*, 526 F. Supp. 694, 696 (D.S.C. 1981) (§ 15 held inapplicable in private lawsuit where defendants were not alleged or shown to be broker-dealers), *aff'd*, 673 F.2d 1313 (4th Cir.), *cert. denied*, 457 U.S. 1107 (1982); *Gilbert v. Bagley*, 492 F. Supp. 714, 732-13 (M.D.N.C. 1980) (count under § 15(c)(1) in private action permitted in part and dismissed in part).

Fifth Circuit: *Vigman v. Community Nat'l Bank & Trust Co.*, 635 F.2d 455, 460 n.12 (5th Cir. 1981) (limitations period of § 29(b) applies to actions under § 15(c)(1)); *Kasner v. H. Hentz & Co.*, 475 F.2d 119, 121 (5th Cir.) (directed verdict in defendant's favor was inappropriate where investor alleged, *inter alia*, violations of §§ 15(c)(1) and (2)), *cert. denied*, 414 U.S. 823 (1973); *Goldenberg v. Bache & Co.*, 270 F.2d 675, 680-81 (5th Cir. 1959) (private action under section 15(c) must be brought within the limitations period of section 29(b)).

Sixth Circuit: *Davis v. Avco Corp.*, 371 F. Supp. 782, 789 (N.D. Ohio 1974) (allegation in private lawsuit of use of deceptive devices by unregistered broker or dealer states a valid claim under § 15(c)). Some courts have declined to reach the issue of whether a private right of action exists under § 15(c)(1). *See, e.g.,* *Smith v. Oppenheimer & Co.*, 635 F. Supp. 936, 941 (W.D. Mich. 1985); *Kirkland v. E.F. Hutton & Co.*, 564 F. Supp. 427, 440 (E.D. Mich. 1983).

Seventh Circuit: *Jordan Bldg. Corp. v. Doyle, O'Connor & Co.*, [1967-1969 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,256, at 92,226-27 (7th Cir. 1968) (private action may be maintained under both § 10(b) and § 15(c)(1)); *Dopocyk v. Weber*, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,635, at 93,144 (N.D. Ill. 1982) (claim in private lawsuit alleging violation of § 15(c)(1) survived motion to strike); *Sennett v. Oppenheimer & Co.*, 502 F. Supp. 939, 942 (N.D. Ill. 1980) (plaintiff stated cause of action under, *inter alia*, §§ 15(c)(1) and (2)).

Eighth Circuit: *Buder v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 486 F. Supp. 56, 57 (E.D. Mo. 1980) (time limitations of § 29(b) apply to private claims under §§ 15(c)(1) and (2)), *aff'd*, 644 F.2d 690 (8th Cir. 1981).

Ninth Circuit: *Badart v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 775, 777 (9th Cir. 1986) (private claims under § 15 held not arbitrable), *vacated*, 107 S. Ct. 3204 (1987), *for reconsideration in light of* *Shearson/American Express, Inc. v. McMahon*, 107 S. Ct. 2332 (1987), *see infra* note 7); *Watson v. Roberts, Scott & Co.*, 466 F.2d 1348, 1350 (9th Cir. 1972) (judgment in state breach of contract action might not collaterally estop plaintiffs from bringing subsequent private action against securities brokers for alleged violation of § 15(c)(1)); *Speck v. Oppenheimer & Co.*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,461, at 98,311 (W.D. Mo. 1984) (private right of action may be implied from § 15(c)(1)); *Amunrud v. Taurus Drilling Ltd.*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,649, at 97,595-96 (D. Mont. 1983) (express remedy under § 15(c) excludes implied remedy under § 10(b)).

Tenth Circuit: *Valley Bank of Nev. v. Foster & Marshall, Inc.*, 585 F. Supp. 1351, 1352 (D. Utah 1984) (time limitations of § 29(b) applicable to private action for churning under § 15(c)(1)); *Coronado Credit Union, Inc. v. Bevill, Bresler & Schulman Inc.*, [1983-1984 Transfer Binder] Fed.

the possibility of employing section 15(c)(1) as an alternative remedy.⁶ Curi-

Sec. L. Rep. (CCH) ¶ 99,715, at 97,883 n.8, 97,884-85 (D.N.M. 1983) (court had jurisdiction over private action brought under, *inter alia*, § 15, but claim under § 15(c)(1) failed for lack of proof of fraud).

Eleventh Circuit: Sigvartsen v. Smith Barney, Harris Upham & Co., No. 84-540-Civ-T-15, screens 2-3 (M.D. Fla. July 31, 1984, Order Sept. 11, 1986) (WESTLAW, Fsec-cs database) (assuming private action lies under § 15, it was time-barred under § 29(b)). *See also supra* Fifth Circuit cases for pre-1982 authority; Bonner v. City of Prichard, 661 F.2d 1206, 1207 (11th Cir. 1981).

D.C. Circuit: Moholt v. Dean Witter Reynolds, Inc., 478 F. Supp. 451, 452-53 (D.D.C. 1979) (court denied availability of *in pari delicto* defense in private suit under, *inter alia*, § 15(c)).

(b) Other courts have found—by way of holding or dictum or assumption—that there is no implied private right of action under § 15(c)(1). *See, e.g.:*

First Circuit: Prester v. Shearson Lehman Bros., [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,884, at 94,290 (D. Mass. 1986) (§ 15(c)(1) and § 15(c)(3) provide no private right of action); Roberts v. Smith Barney, Harris Upham & Co., 653 F. Supp. 406, 413-15 (D. Mass. 1986) (§ 15(c)(1) does not authorize a private right of action).

Second Circuit: Baum v. Phillips, Appel & Walden, Inc., 648 F. Supp. 1518, 1529 (S.D.N.Y. 1986).

Third Circuit: Walck v. American Stock Exch., Inc., 565 F. Supp. 1051, 1059 (E.D. Pa. 1981) (no implied right of action for money damages under § 15), *aff'd*, 687 F.2d 778 (3rd Cir. 1982), *cert. denied*, 461 U.S. 942 (1983); *accord* Pennington v. Thomson McKinnon Sec., Inc., Civ. Action No. 86-3672 (E.D. Pa. Dec. 23, 1986) (LEXIS, Genfed library, Dist. file).

Fourth Circuit: Shotto v. Laub, 632 F. Supp. 516, 518 n.2 (D. Md. 1986); Chapman v. Merrill Lynch, Pierce, Fennner & Smith, Inc., [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,419, at 96,409 (D. Md. 1983).

Seventh Circuit: Wagman v. FSC Sec. Corp., [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,445, at 92,716 (N.D. Ill. 1985) (no private right of action exists under § 15(c)(1)); Hughes v. Paine, Webber, Jackson & Curtis, Inc., No. 81 C 5075, screens 4-5 (N.D. Ill. June 25, 1984) (WESTLAW, Fsec-cs database); Berk v. Oppenheimer & Co., [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,603, at 97,371 (N.D. Ill. 1983); Pierson v. Dean Witter Reynolds, Inc., 551 F. Supp. 497, 502-03 (C.D. Ill. 1982) (no congressional intent to imply a private right of action under § 15(c)(1)).

Eighth Circuit: Brannan v. Eisenstein, 804 F.2d 1041, 1043 n.1 (8th Cir. 1986) (affirming district court's dismissal of § 15(c) claim on ground that section confers no private right of action); Corbey v. Grace, 605 F. Supp. 247, 250-51 (D. Minn. 1985) (no private right of action exists under § 15(c)(1)).

Ninth Circuit: Berner v. Lazzaro, 730 F.2d 1319, 1320 n.1 (9th Cir. 1984), *aff'd on other grounds sub nom.* Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299 (1985); SEC v. Seaboard Corp., 677 F.2d 1301, 1313-14 (9th Cir. 1982); Rhoades v. Powell, 644 F. Supp. 645, 661 (E.D. Cal. 1986) (no private right of action exists under § 15(c)).

Tenth Circuit: O'Crowley v. E.F. Hutton & Co., Civ. Action No. 83-2114-S, slip op., screens 3-4 (D. Kan. May 14, 1986) (LEXIS, Fedsec library, Courts file) (private cause of action does not exist for violation of § 15).

Eleventh Circuit: Olsen v. Paine Webber, Jackson & Curtis, Inc., 623 F. Supp. 17, 18 (M.D. Fla. 1985).

6. This author has found no law review article or other scholarly work devoted to this subject. A few commentators have in passing suggested that an implied private right of action exists for violations of § 15(c)(1). *See, e.g.,* 3B H. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW 9-161 (rev. 1987) ("[I]t should be difficult to deny an implied remedy with respect to an action based on Section 15(c)."); 3 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD AND COMMODITIES FRAUD § 8.4(450-59), § 8.5(450) (1986) (assuming implied civil liability under § 15(c)(1) and Rule 15c1-2); L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 988 (3d ed. 1988) [hereinafter L. LOSS (1988)] (observing that cases go "both ways" on the question of an implied right of action under § 15(c)(1)); 3 L. LOSS, SECURITIES REGULATION 1760 n.253 (2d. ed 1961) [hereinafter L. LOSS

ously, section 15(c)(1) has long been overlooked as a means for combatting securities fraud by brokers and dealers. The objective of this Article is to demonstrate that Congress has nonetheless intended that a private right of action be available under section 15(c)(1), and to suggest how such an action would differ from a civil action for fraud under section 10(b).⁷

Section 15(c)(1) and section 10(b) are similar in that both are general antifraud provisions, and both proscribe the effectuation of a securities transaction by means of any "manipulative" or "deceptive" "device or contrivance." In some respects, section 15(c)(1) is a narrower provision than section 10(b). Unlike section 10(b) which applies to "any person," section 15(c)(1) applies only to brokers and dealers.⁸ Also, unlike section 10(b) which applies to any purchase or sale of securities, section 15(c)(1) covers only securities transactions in the over-the-counter (OTC) market and on exchanges of which

(1961)] ("The legislative history of the 1938 amendments . . . reflects a recognition that a private right of action might be maintained under § 29(b) for violation of § 15(c)."); Gruenbaum & Steinberg, *Section 29(b) of the Securities Exchange Act of 1934: A Viable Remedy Awakened*, 48 GEO. WASH. L. REV. 1, 45-50 (1979) (discussing the application of § 29(b) to violations of § 15(c)(1)); Note, *The Prospects for Rule X-10B-5: An Emerging Remedy for Defrauded Investors*, 59 YALE L.J. 1120, 1134 (1950). In that Note, the author stated:

In 1938, Congress passed an amendment to Section 29(b) imposing a short statute of limitations on actions brought for violations of Commission rules under Section 15(c)(1). Since Section 15(c)(1), like Section 10(b), does not specifically provide for a private action, the implication of the amendment was that Congress had always assumed that private actions under those and similar provisions were available.

Id. (citation omitted).

To this author's knowledge, no commentator has analyzed this topic in light of the jurisprudence on implied private rights of action that has been developed over the last decade by the Supreme Court since *Cort v. Ash*, 422 U.S. 66 (1975).

7. An investor who has signed a customer agreement providing for arbitration of any controversies with his brokerage firm may find that his right to sue in federal court under the provisions of the 1934 Act has been curtailed. See *Shearson/American Express, Inc. v. McMahon*, 107 S. Ct. 2332, 2343 (1987) (claims under § 10(b) of the 1934 Act were held arbitrable under predispute arbitration agreements between broker and customers). In light of *McMahon*, the SEC predicts that the number of arbitration cases may double over the next year. N.Y. Times, Sept. 11, 1987, at D14, col. 1. Whether *McMahon*, which involved § 10(b) claims, will be extended to § 15(c)(1) claims is, of course, an open question. Certainly the dissent strongly disagreed with the majority's position: "[The Court] approves the abandonment of the judiciary's role in the resolution of claims under the Exchange Act . . . at a time when the industry's abuses towards investors are more apparent than ever." *McMahon*, 107 S. Ct. at 2346 (Blackmun, J., dissenting in part and concurring in part). In any event, even assuming *McMahon*'s holding is extended, if no arbitration agreement applies, or if one exists and it is otherwise unenforceable, or if judicial review is obtainable of an arbitrator's decision under the Federal Arbitration Act, 9 U.S.C. §§ 1-14 (1982), then it is the position of this Article that a private investor is entitled to sue for fraud directly under § 15(c)(1) and Rule 15c1-2 of the Exchange Act. See also Casenote, *The Arbitrability of Federal Securities Claims: Wilko's Swan Song*, 42 U. MIAMI L. REV. 203 (1987).

8. "Although [§ 15(c)(1) and (2) and the rules thereunder] are limited to brokers and dealers, presumably an employee or other person may violate them as an accessory and hence become a principal under the federal aider and abettor statute. 18 U.S.C. § 2." L. Loss (1988), *supra* note 6, at 811 n.2.

the broker-dealers are not members.⁹ Moreover, a shorter statute of limitations arguably applies to some private actions brought under section 15(c)(1).¹⁰

Within these clear confines, however, section 15(c)(1) may be interpreted as a more flexible antifraud proscription than section 10(b). Over the past decade, the Supreme Court has, to the dismay of some of its members,¹¹ narrowed the scope of section 10(b). The Court began its restrictions by requiring the plaintiff in a private action under section 10(b) to be an actual purchaser or seller of securities in order to have standing to sue.¹² The Court then required proof of scienter in private actions for damages¹³ and later in enforcement actions brought by the Securities and Exchange Commission (SEC or Commission).¹⁴ The Court has interpreted the word "manipulative" as a term of art,¹⁵ and has found that a claim of fraud and breach of fiduciary duty states a cause of action under section 10(b) only if the conduct can be viewed as "manipulative or deceptive."¹⁶ This author believes that, whatever their merits under a section 10(b) claim, these limitations are inapplicable to a section

9. Specifically, § 15(c)(1) applies to a securities transaction by a broker or dealer "otherwise than on a national securities exchange of which it is a member." See *supra* note 4. A securities transaction not executed on a stock exchange is said to be executed in the OTC market. Poser, *Restructuring the Stock Markets: A Critical Look at the SEC's National Market System*, 56 N.Y.U. L. REV. 883, 894 (1981). The stock of approximately 90% of the publicly-traded corporations is traded over the counter. *Shivangi v. Dean Witter Reynolds, Inc.*, 825 F.2d 885, 886 n.1 (5th Cir. 1987). While a stock exchange functions much like a centralized auction for buying and selling securities, the OTC market:

is a decentralized market in which transactions are negotiated among broker-dealers and between broker-dealers and their customers. . . . [U]nlike the stock exchanges, the OTC market provides no way for the orders of a buying customer and a selling customer to meet directly; in virtually every OTC transaction, there is a professional dealer who participates by buying or selling for his own account. The OTC market is therefore known as a "dealer" market.

Poser, *supra*, at 895.

10. Section 29(b) of the 1934 Act, 15 U.S.C. § 78cc(b) (1982), provides that no contract may be voided in any action involving a purchase or sale of a security allegedly in violation of § 15(c)(1) unless such action is brought within one year after the discovery of the violation and within three years after such violation. For the full text of § 29(b), see *infra* note 134. In a case involving an alleged violation of § 10(b), however, the federal court "borrows" the most appropriate statute of limitations from the forum state. See, e.g., *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 n.29 (1976); *Osterneck v. E.T. Barwick Indus.*, 825 F.2d 1521, 1532 (11th Cir. 1987), *petition for cert. filed*, (Jan. 15, 1988). See also T. HAZEN, *THE LAW OF SECURITIES REGULATION* 476-77 (1985) (noting that the limitations period under Rule 10b-5 litigation can vary from two years, if the blue-sky limitations period is used, to six years based on a common-law fraud limitations period). Because § 29(b) refers only to declaring contracts "void," arguably only private suits for rescission for violation of § 15(c)(1) would be subject to the 1 year/3 year limitations period of § 29(b), while suits for damages would be subject to the applicable state statute of limitations. See *infra* note 218. See also Gruenbaum & Steinberg, *supra* note 6, at 47-48.

11. *Chiarella v. United States*, 445 U.S. 222, 246 (1980) (Blackmun, J., dissenting).

12. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730-31 (1975).

13. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976).

14. *Aaron v. SEC*, 446 U.S. 680, 695 (1980).

15. *Hochfelder*, 425 U.S. at 199.

16. *Santa Fe Indus. v. Green*, 430 U.S. 462, 473-74 (1977). Note that § 15(c)(1), but not § 10(b), directly proscribes "fraudulent" conduct. See *infra* note 309.

15(c)(1) claim. The reasons supporting this contention are taken up in Part II of this Article.¹⁷

The primary task and the principal focus of this Article, however, is to demonstrate why a private right of action should be implied under section 15(c)(1) in light of the Supreme Court's recent decisions in implied-rights jurisprudence, beginning with *Cort v. Ash*.¹⁸ To this end, Part I traces briefly the evolution of the Supreme Court's doctrine of implied private rights of action under federal statutes, especially the securities statutes.¹⁹ Part I then delves into an extensive analysis of the language and legislative history of section 15(c)(1) and its relation to other provisions of the 1934 Act, especially section 29(b).²⁰ Based on what this author discerns to be the Supreme Court's approach to implied-rights jurisprudence, the author concludes that a private right of action should be implied under section 15(c)(1).

For the reader unfamiliar with broker-dealer litigation in general, or with section 15(c)(1) litigation in particular, a few introductory words may be helpful. What follows is a brief overview of the general law governing the relationship between the broker-dealer and his customer, and an outline of the nature of the litigation that has been brought under section 15(c)(1) both by private litigants and by the SEC.

Although often embodied in a single individual or firm, a broker-dealer serves two different, potentially conflicting functions. As a "broker," he acts as an agent in the purchase and sale of securities for his customer's account.²¹ As a "dealer," he acts as a principal who buys and sells for his own account.²² Both the SEC and the courts have tended to extend to brokers and dealers similar general legal principles despite the different roles that they may have played in particular circumstances. The two main jurisprudential concepts which apply to the professional conduct of broker-dealers are the laws of fiduciary obligation and the so-called "shingle theory."

The fiduciary duties imposed on brokers and dealers arise from general agency concepts. In an early case, Judge Learned Hand stated that a "broker is indeed an agent, and as such a fiduciary."²³ The relationship between a

17. See *infra* notes 310-400, 430-48 and accompanying text.

18. 422 U.S. 66 (1975). For an overview of *Cort v. Ash*, see notes 55-61 and accompanying text.

19. See *infra* notes 47-82, 102-29, 266-80, 295-301 and accompanying text.

20. See *infra* notes 93-99, 132-251 and accompanying text. Section 29(b) of the 1934 Act, 15 U.S.C. § 78cc(b) (1982), is set out *infra* note 134.

21. Section 3(a)(4) of the 1934 Act, 15 U.S.C. § 78c(a)(4) (1982), provides: "The term 'broker' means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank."

22. Section 3(a)(5) of the 1934 Act, 15 U.S.C. § 78c(a)(5) (1982), provides:

The term "dealer" means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business.

23. *McMann v. SEC*, 87 F.2d 377, 378 (2d Cir.), cert. denied, 301 U.S. 684 (1937).

dealer and his customers has been described by the SEC as "one of special trust and confidence, approaching and perhaps even equaling that of a fiduciary."²⁴ In numerous cases under the securities laws, the relationship between a broker and his customer has been characterized as a fiduciary one, creating higher duties of care, good faith, and fair dealing.²⁵

A separate doctrine, independent of agency theory but related in practical effect, is the so-called "shingle theory." This theory states "that even a dealer at arm's length impliedly represents when he hangs out his shingle that he will deal fairly with the public."²⁶ Although Professor Louis Loss is credited with coining the phrase,²⁷ the analysis on which the shingle theory is based was first formulated by the SEC in *In re Duker & Duker*.²⁸ In *Duker*, the SEC revoked a broker-dealer's registration for selling securities at a price not reasonably related to the prevailing market price. In holding such a practice to violate section 15(c)(1) as well as section 17(a) of the 1933 Act, the SEC observed:

Inherent in the relationship between a dealer and his customer is the vital representation that the customer will be dealt with fairly, and in accordance with the standards of the profession. It is neither fair dealing, nor in accordance with such standards, to exploit trust and ignorance for profits far higher than might be realized from an informed customer.²⁹

Under the shingle theory, when a dealer engages in a securities transaction with or for a member of the public, he implicitly represents that he will deal with his customer fairly and in accordance with the standards of the securities profession.³⁰ This implied representation arises simply and solely because the

24. *In re Alexander Smith*, 22 S.E.C. 13, 17 (1946) (quoting *In re William J. Stelmack Corp.*, 11 S.E.C. 601, 623 (1942)).

25. See, e.g., *Magnum Corp. v. Lehman Bros. Kuhn Loeb, Inc.*, 794 F.2d 198, 200 (5th Cir. 1986); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1026 (6th Cir. 1979); *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 45 (2d Cir.), cert. denied, 439 U.S. 1039 (1978); *Moholt v. Dean Witter Reynolds, Inc.*, 478 F. Supp. 451, 453 (D.D.C. 1979); *Stevens v. Abbott, Proctor & Paine*, 288 F. Supp. 836, 847 (E.D. Va. 1968); *Opper v. Hancock*, 250 F. Supp. 668, 676 (S.D.N.Y.) (duties of a securities broker are, if anything, more stringent than those imposed by general agency law), aff'd, 367 F.2d 157 (2d Cir. 1966); *Hughes v. SEC*, 174 F.2d 969, 975 (D.C. Cir. 1949), aff'g *In re Arleen W. Hughes*, 27 S.E.C. 629 (1948). Cf. *Shearson Hayden Stone, Inc. v. Leach*, 583 F.2d 367, 371-72 (7th Cir. 1978) (no fiduciary relationship where plaintiff was a sophisticated investor who did not rely on his broker for advice); *Fey v. Walston & Co.*, 493 F.2d 1036, 1049 (7th Cir. 1974) (mere existence of a broker-customer relationship is not proof of its fiduciary character).

26. L. Loss (1988), *supra* note 6, at 813; 3 L. Loss (1961), *supra* note 6, at 1483.

27. 1 S. GOLDBERG, *FRAUDULENT BROKER-DEALER PRACTICES* 8-43 (1978).

28. 6 S.E.C. 386 (1939).

29. *Id.* at 388-89 (footnote omitted).

30. *University Hill Found. v. Goldman, Sachs & Co.*, 422 F. Supp. 879, 898 n.17 (S.D.N.Y. 1976); *Vernon J. Rockler & Co., v. Graphic Enters.*, 52 F.R.D. 335, 342 n.12 (D. Minn. 1971); *Brennan v. Midwestern United Life Ins. Co.*, 286 F. Supp. 702, 707 (N.D. Ind. 1968), aff'd, 417 F.2d 147 (7th Cir. 1969), cert. denied, 397 U.S. 989 (1970); *Harvey H. Shields, Jr.*, 39 S.E.C. 608, 609 (1959); *In re Lewis H. Ankeny*, 29 S.E.C. 514, 516 (1949); *In re Charles Hughes & Co.*,

dealer does business in securities, that is, simply because he "hangs out his shingle."³¹ The shingle theory has been adopted by the SEC in enforcement proceedings and by courts in suits brought by private investors against their broker-dealers.³²

As an agent, a broker always owes a fiduciary duty to his customers. The extent to which fiduciary obligations, independent of the shingle theory, apply to a dealer may depend on the closeness of his professional relationship with his customers.³³ The sorts of activity for which brokers and dealers may be held liable to their customers under these fiduciary concepts and under the shingle theory are varied and numerous.³⁴ For example, broker-dealers may be found liable for churning,³⁵ imposing unreasonable

13 S.E.C. 676, 679, *aff'd*, 139 F.2d 434 (2d Cir.), *cert. denied*, 321 U.S. 786 (1943); *In re Lawrence R. Leeby*, 13 S.E.C. 499, 505 (1943); *In re Scott McIntyre & Co.*, 11 S.E.C. 442, 445-46 (1942); *In re Jack Goldberg*, 10 S.E.C. 975, 980 (1942); *In re Allender Co.*, 9 S.E.C. 1043, 1055 (1941). *See also* Kahn v. SEC, 297 F.2d 112, 115 (2d Cir. 1961) (Clark, J., concurring) ("The essence of [the shingle] theory is that in certain circumstances one who sells securities to the public—who hangs out his shingle—implicitly warrants the soundness of statements of stock value, estimates of a firm's earnings potential, and the like."). The breadth of Judge Clark's characterization has been criticized. *See* R. JENNINGS & H. MARSH, *SECURITIES REGULATION: CASES AND MATERIALS* 553 (5th ed. 1982); L. LOSS (1988), *supra* note 6, at 814; 6 L. LOSS (1961), *supra* note 6, at 3712.

31. *Rockler and Co. v. Graphic Enters.*, 52 F.R.D. 335, 342 n.12 (D. Minn. 1971).

32. *See supra* cases collected at note 30. For a more in-depth review of the shingle theory and the law of fiduciary duty as applied to broker-dealers, the reader is invited to consult 1 S. GOLDBERG, *supra* note 27, at Ch. 8; 5B A. JACOBS, *LITIGATION AND PRACTICE UNDER RULE 10B-5* § 210.03 (rev. 1984); S. JAFFE, *BROKER-DEALERS AND SECURITIES MARKETS: A GUIDE TO THE REGULATORY PROCESS* § 7.09, at 145-48 (1977); L. LOSS (1988), *supra* note 6, at 811-43; 3 L. LOSS (1961), *supra* note 6, at 1482-1508; E. WEISS, *REGISTRATION AND REGULATION OF BROKERS AND DEALERS* 104-11, 171-83 (1965); N. WOLFSON, R. PHILLIPS, & T. RUSSO, *REGULATION OF BROKERS, DEALERS AND SECURITIES MARKETS* ¶¶ 2.03, 2.09 to .11 (1977) [hereinafter N. WOLFSON]; Cohen & Rabin, *Broker-Dealer Selling Practice Standards: The Importance of Administrative Adjudication in Their Development*, 29 LAW & CONTEMP. PROBS. 691, 702-05 (1964); Hibbard, *Private Suits Against Broker-Dealers: A Proposal to Limit the Availability of Rescissory Relief for Misrepresentations Implied by the Shingle Theory*, 13 HARV. J. ON LEGIS. 1 (1975); Note, *Broker Dealers, Market Makers and Fiduciary Duties*, 9 LOY. U. CHI. L.J. 746 (1978); Comment, *Differential Commissions as a Material Fact*, 34 EMORY L.J. 508, 523-31 (1985); Karmel, *Revisiting the Shingle, Fiduciary-Duty Theories*, N.Y.L.J., Oct. 16, 1986, at 1, col. 1. The shingle theory has been characterized as a legal fiction, *see* 5B A. JACOBS, *supra*, § 210.03, at 9-18, but nonetheless a useful fiction, *see* L. LOSS (1988), *supra* note 6, at 814 ("'happily'—the shingle theory not only is unchallenged but has been considerably refined").

33. 5B A. JACOBS, *supra* note 32, § 210.02, at 9-6, § 210.03, at 9-14 to 9-15, § 211.01[a], at 9-27 to 9-28; L. LOSS (1988), *supra* note 6, at 826-29.

34. For detailed discussions of the sorts of misconduct by broker-dealers proscribed under these theories in particular and under the antifraud provisions of securities acts in general, *see* 2 A. BROMBERG & L. LOWENFELS, *supra* note 6, § 5.7; 5B A. JACOBS, *supra* note 32, §§ 210-213; S. JAFFE, *supra* note 32, §§ 7.01 to 7.06, at 127-38; 3 L. LOSS (1961), *supra* note 6, at 1482-1508; N. WOLFSON, *supra* note 32, ¶¶ 2.09 to 2.11; Hibbard, *supra* note 32, at 4-7.

35. *Hotmar v. Lowell H. Listrom & Co.*, 808 F.2d 1384, 1385 (10th Cir. 1987) ("Churning is defined as 'excessive trading by a broker disproportionate to the size of the account involved in order to generate commissions'"); *Costello v. Oppenheimer & Co.*, 711 F.2d 1361, 1367-68 (7th Cir. 1983); *Armstrong v. McAlpin*, 699 F.2d 79, 90-91 (2d Cir. 1983); *Miley v. Oppenheimer*

mark-ups,³⁶ recommending a security without an adequate or reasonable basis for such recommendation,³⁷ engaging in high-pressure sales techniques or so-called "boiler room" tactics,³⁸ failing to disclose material information to a customer,³⁹ and many other activities.

Whether, as a legal matter, the fiduciary principles of agency law or the shingle theory are imposed to find misconduct, the practical effect is to hold the broker-dealer to a higher standard of professional responsibility than would pertain to a nonfiduciary in an impersonal or otherwise arm's length transaction.⁴⁰ This difference in legal liability forms a basis for distinguishing an implied right of action under section 15(c)(1), a provision devoted exclusively to the conduct of brokers and dealers, from an implied right of action under section 10(b), which governs conduct by "any person." This distinction is taken up in Part II of this Article.⁴¹

In light of the Supreme Court's recent shifts in jurisprudential attitude toward implied rights of action,⁴² some of the lower courts that have considered the issue in the last decade have declined to imply a private right under section

& Co., 637 F.2d 318, 324 (5th Cir. 1981); *Mihara v. Dean Witter & Co.*, 619 F.2d 814, 820-21 (9th Cir. 1980); *Siegel v. Tucker, Anthony & R.L. Day, Inc.*, 658 F. Supp. 550, 553-54 (S.D.N.Y. 1987); *Rhoades v. Powell*, 644 F. Supp. 645, 665-66 (E.D. Cal. 1986); *Hecht v. Harris, Upham & Co.*, 283 F. Supp. 417, 432-33 (N.D. Cal. 1968), *modified*, 430 F.2d 1202 (9th Cir. 1970). *See also* Rule 15c1-7(a), 17 C.F.R. § 240.15c1-7(a) (1987); 2 A. BROMBERG & L. LOWENFELS, *supra* note 6, § 5.7, at 300-10; Note, *Customer Sophistication and a Plaintiff's Duty of Due Diligence: Proposed Framework for Churning Actions in Nondiscretionary Accounts Under SEC Rule 10b-5*, 54 *FORDHAM L. REV.* 1101 (1986); Note, *Churning by Securities Dealers*, 80 *HARV. L. REV.* 869 (1967); Comment, *Churning and the Death of Low Risk Larceny: Calculating Damages to Redress the Churning Client's Loss in Portfolio Value*, 21 *CAL. W. L. REV.* 149 (1984).

36. *Barnett v. United States*, 319 F.2d 340, 344 (8th Cir. 1963); *Charles Hughes & Co. v. SEC*, 139 F.2d 434, 436-37 (2d Cir.), *cert. denied*, 321 U.S. 786 (1943); *Krome v. Merrill Lynch & Co.*, 637 F. Supp. 910, 916 n.2 (S.D.N.Y.), *vacated in part*, 110 F.R.D. 693 (1986). *See also* cases cited *supra* note 30.

37. *Nassar & Co. v. SEC*, 566 F.2d 790, 795 (D.C. Cir. 1977); *Hiller v. SEC*, 429 F.2d 856, 858 (2d Cir. 1970); *SEC v. North Am. Research & Dev. Corp.*, 424 F.2d 63, 84 (2d Cir. 1970); *Hanly v. SEC*, 415 F.2d 589, 596-97 (2d Cir. 1969); *Quincy Co-op Bank v. A.G. Edwards & Sons, Inc.*, 655 F. Supp. 78, 86 (D. Mass. 1986); *Seiler v. E.F. Hutton & Co.*, 584 F. Supp. 607, 612 (D.N.J. 1984); *Canizaro v. Kohlmeyer & Co.*, 370 F. Supp. 282, 288-89 (E.D. La. 1974), *aff'd*, 512 F.2d 484 (5th Cir. 1975). *See also* 5B A. JACOBS, *supra* note 32, cases cited at § 211.01.

38. *Hanly v. SEC*, 415 F.2d 589, 597 n.14 (2d Cir. 1969); *Berko v. SEC*, 316 F.2d 137, 139 n.3 (2d Cir. 1963); *SEC v. MV Sec., Inc.*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,677, at 97,724-25 (S.D.N.Y. 1984); *SEC v. R. J. Allen & Assocs., Inc.*, 386 F. Supp. 866, 874 (S.D. Fla. 1974).

39. *Vucinich v. Paine, Webber, Jackson & Curtis, Inc.*, 803 F.2d 454, 460 (9th Cir. 1986); *Alton Box Bd. Co. v. Goldman, Sachs & Co.*, 560 F.2d 916, 920-22 (8th Cir. 1977); *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1172 (2d Cir. 1970); *Jaksich v. Thomson McKinnon Sec., Inc.*, 582 F. Supp. 485, 493-94 (S.D.N.Y. 1984).

40. *See* N. WOLFSON, *supra* note 32, ¶ 2.03, at 2-15; *Cohen & Rabin*, *supra* note 32, at 703-04 (fiduciary and shingle theories are different ways of characterizing the obligation imposed on broker-dealers under the securities acts); Note, *supra* note 32, at 755-56.

41. *See infra* notes 307-33 and accompanying text.

42. *See infra* notes 69-82, 100-29, 267-80 and accompanying text.

15(c)(1).⁴³ Very few of these cases, however, have analyzed the issue within the context of *Cort v. Ash*.⁴⁴ Those that have undertaken such an analysis have done so cursorily and without, apparently, the benefit of the legislative history of this section,⁴⁵ which contemplates civil liability thereunder.⁴⁶ It is this author's contention that recent jurisprudence and consistency with original legislative intent strongly favor the implication of a private right of action under section 15(c)(1).

I. IMPLICATION OF A PRIVATE RIGHT OF ACTION UNDER SECTION 15(c)(1)

A. *The Supreme Court and the Implication of Private Rights of Action*

If somebody violates a federal statute, and in doing so he injures somebody else, can the victim sue the violator for his damages in federal court? In other words, may the court imply a private right of action under the statute?⁴⁷ This seemingly simple question has proven elusive of a simple answer. It has taken up a significant portion of the Supreme Court's docket in recent years and has presented the Court with more difficulty than most substantive questions

43. See *supra* note 5.

44. 422 U.S. 66 (1975). For an overview of *Cort v. Ash*, see notes 55-61 and accompanying text.

45. See, e.g., *Corbey v. Grace*, 605 F. Supp. 247, 250-51 (D. Minn. 1985); *Pierson v. Dean Witter Reynolds, Inc.*, 551 F. Supp. 497, 502-03 (C.D. Ill. 1982).

46. See *infra* notes 156-251 (see especially notes 194-219) and accompanying text.

47. In implication cases, the Supreme Court frequently uses, interchangeably, the terms "private cause of action," "private claim for relief," and "private remedy," see, e.g., *Cort v. Ash*, 422 U.S. 66, 68, 78 (1975), as well as "private rights of action," see, e.g., *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 15 (1979). Although the interchangeability of these terms has been criticized, see, e.g., *Schneider, Implying Private Rights and Remedies Under the Federal Securities Acts*, 62 N.C.L. Rev. 853, 858-59 (1984), in this Article the author uses them all to refer to "the right of a private party to seek judicial relief from injuries caused by another's violation of a" federal statute. *Cannon v. University of Chicago*, 441 U.S. 677, 730 n.1 (1979) (Powell, J., dissenting). This Article is organized on the premise that "the question whether a litigant has a 'cause of action' is analytically distinct and prior to the question of what relief, if any, a litigant may be entitled to receive." *Davis v. Passman*, 442 U.S. 228, 239 (1979). Thus, Part I of this Article analyzes the right of the private investor to bring a lawsuit at all in federal court for violation of § 15(c)(1). Part II then addresses the particular nature of the remedy (i.e., legal or equitable relief) that a court may afford the plaintiff, assuming his right to be heard there in the first instance.

that come before it.⁴⁸ The answer to the question depends on which federal statute has been violated, and even within the same statute, which particular

48. *Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n*, 453 U.S. 1, 22-23 (1981) (Stevens, J., concurring in part and dissenting in part). The issue of implied private rights of action has been repeatedly presented to the Court in a multitude of cases over the last decade. See, e.g., *Thompson v. Thompson*, 108 S. Ct. 513 (1988) (Parental Kidnaping Prevention Act of 1980 does not create implied private right of action to determine the validity of two conflicting state custody decrees); *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134 (1985) (beneficiary has no implied right of action for extra-contractual damages under § 409(a) of Employee Retirement Income Security Act of 1974); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299 (1985) (implied private damages action under Rule 10b-5 will not automatically be barred by *in pari delicto* defense); *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523 (1984) (investment company has no implied right of action under § 36(b) of the Investment Company Act of 1940); *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983) (recognizing an implied private right of action under § 10(b) of the 1934 Act); *Jackson Transit Auth. v. Local Div. 1285, Amalgamated Transit Union*, 457 U.S. 15 (1982) (no implied federal cause of action under § 13(c) of Urban Mass Transportation Act of 1964); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982) (recognizing an implied private right of action for damages under the Commodity Exchange Act); *Texas Indus. v. Radcliff Materials, Inc.*, 451 U.S. 630 (1981) (no implied right to contribution under § 1 of Sherman Act and § 4 of Clayton Act); *California v. Sierra Club*, 451 U.S. 287 (1981) (no implied right of action under § 10 of Rivers and Harbors Appropriation Act of 1899); *Northwest Airlines, Inc. v. Transport Workers Union of Am.*, 451 U.S. 77 (1981) (no implied right of action for contribution under Equal Pay Act of 1963 or Title VII of the Civil Rights Act of 1964); *Universities Research Ass'n v. Coutu*, 450 U.S. 754 (1981) (no implied right of action for back wages under § 1 of the Davis-Bacon Act); *Kissinger v. Reporters Comm. for Freedom of the Press*, 445 U.S. 136 (1980) (no implied private right of action under the Federal Records Act of 1950); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979) (no implied private cause of action for damages under § 206 of the Investment Advisers Act of 1940); *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979) (no implied right of action under § 17(a) of the 1934 Act); *Cannon v. University of Chicago*, 441 U.S. 677 (1979) (recognizing an implied right of action under Title IX of the Education Amendments of 1972); *Chrysler Corp. v. Brown*, 441 U.S. 281 (1979) (no implied right of action under the Freedom of Information Act or the Trade Secrets Act); *Santa Clara Pueblo v. Martinez*, 436 U.S. 49 (1978) (no implied right of action under § 1302 of Indian Civil Rights Act of 1968); *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977) (no implied right of action under § 10(b) of the 1934 Act absent allegation that conduct involved "manipulation" or "deception"); *Piper v. Chris-Craft Indus.*, 430 U.S. 1 (1977) (no implied right of action under § 14(e) of 1934 Act for unsuccessful tender offerors).

For a related line of cases discussing the extent to which private rights of action may exist under 42 U.S.C. § 1983 for violations of other federal statutes by state agents, see *Wright v. City of Roanoke Redevelopment and Hous. Auth.*, 107 S. Ct. 766 (1987) (permitting private § 1983 action by tenants for violation of the Brooke Amendment to the Housing Act of 1937); *Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n*, 453 U.S. 1 (1981) (no private action under § 1983 for violation of the Federal Water Pollution Control Act or Marine Protection, Research, and Sanctuaries Act of 1972); *Pennhurst State School and Hosp. v. Halderman*, 451 U.S. 1 (1981) (remand to determine whether private action permissible under § 1983 for violation, if any, of § 6011(a) and § 6063(b)(5)(C) of the Developmentally Disabled Assistance and Bill of Rights Act); *Maine v. Thiboutot*, 448 U.S. 1 (1980) (§ 1983 provides a private cause of action for state deprivations of rights secured by federal laws). See also Wartelle & Loudon, *Private Enforcement of Federal Statutes: The Role of the Section 1983 Remedy*, 9 HASTINGS CONST. L.Q. 487 (1982).

For cases discussing implication of private rights of action under the Federal Constitution, see *Bush v. Lucas*, 462 U.S. 367 (1983) (first amendment); *Carlson v. Green*, 446 U.S. 14 (1980) (eighth amendment); *Davis v. Passman*, 442 U.S. 228 (1979) (fifth amendment); *Bivens v. Six Unknown Named Agents of Fed. Bureau of Narcotics*, 403 U.S. 388 (1971) (fourth amendment); *Bell v. Hood*, 327 U.S. 678 (1946) (fourth and fifth amendments). See also Note, *Two Approaches to Determine Whether an Implied Cause of Action Under the Constitution Is Necessary: The Changing Scope of the Bivens Action*, 19 GA. L. REV. 683 (1985).

provision has been violated. The 1934 Act is a good example. The Supreme Court has found implied private rights of action for violations of sections 10(b)⁴⁹ and 14(a),⁵⁰ but has declined to find them for violations of sections 14(e)⁵¹ and 17(a).⁵² The lower courts are split on whether private rights of action may be implied under sections 6⁵³ and 13(d).⁵⁴

*Cort v. Ash*⁵⁵ is the centerpiece in the development of the Supreme Court's analysis of implied rights of action. In that unanimous decision, the Supreme Court brought together four threads of analysis that had been used, at one time or another, throughout its decisions on this issue. Since that decision in 1975, however, the threads have started to unravel again, and recent Supreme Court decisions in the area of implied rights have been marked by internal dissension among members of the Court.⁵⁶ Moreover, the lower courts have

49. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983). *See also supra* note 3.

50. 15 U.S.C. § 78n(a) (1982). *See J. I. Case Co. v. Borak*, 377 U.S. 426, 430-31 (1964).

51. 15 U.S.C. § 78n(e) (1982). *See also Piper v. Chris-Craft Indus.*, 430 U.S. 1, 42 (1977) (defeated tender offeror has no implied cause of action for damages under § 14(e)). In his dissent, however, Justice Stevens argued that "[n]o one seriously questions the premise that Congress implicitly created a private right of action when it enacted § 14(e) in 1968." *Id.* at 55. Instead, "the question presented [here] is *who* may invoke that remedy." *Id.* at n.4 (emphasis in original). For discussions of an implied private right of action under § 14(e), see Note, *Private Causes of Action Under SEC Rule 14e-3*, 51 GEO. WASH. L. REV. 290 (1983); Note, *Securities Law: Implied Causes of Action Under Section 14(e) of the Williams Act*, 66 MINN. L. REV. 865 (1982); Comment, *Critical Survey of Target Company Disclosure Obligations Under the Williams Act*, 59 TEMP. L.Q. 1189, 1195-1202 (1986).

52. 15 U.S.C. § 78q(a) (1982). *See also Touche Ross & Co. v. Redington*, 442 U.S. 560, 576 (1979).

53. 15 U.S.C. § 78f(b) (1982). *Compare Baird v. Franklin*, 141 F.2d 238 (2d Cir.) (implying private right of action under § 6(b)), *cert. denied*, 323 U.S. 737 (1944) with *Walck v. American Stock Exch., Inc.*, 687 F.2d 778, 786 (3d Cir. 1982) (no implied right of action under § 6), *cert. denied*, 461 U.S. 942 (1983). *See generally* Dropkin, *National Securities Exchange Liability to Public Investors: Time to Overcome Inertia?*, 56 NOTRE DAME LAW. 419 (1981); Note, *Implied Private Rights of Action Under Section 6(b) of the Securities Exchange Act of 1934*, 39 WASH. & LEE L. REV. 1047 (1982).

54. 15 U.S.C. § 78m(d) (1982). *See Florida Commercial Banks v. Culverhouse*, 772 F.2d 1513 (11th Cir. 1985); *Gearhart Indus. v. Smith Int'l*, 741 F.2d 707 (5th Cir. 1984). *See also Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 62-65 (1975) (the availability of a "so-called implied private right of action" under § 13(d) was not questioned by the parties and therefore the Court did not address the issue directly); Note, *An Implied Right of Action for Issuers Under Section 13(d) of the Securities Exchange Act of 1934*, 61 B.U.L. REV. 933 (1981); Note, *Private Rights of Action for Damages Under Section 13(d)*, 32 STAN. L. REV. 581 (1980).

55. 422 U.S. 66 (1975).

56. Justice Powell opposed the *Cort* analysis and urged that it be abandoned; he would have created a presumption against "the implication of any private action from a federal statute absent the most compelling evidence that Congress in fact intended such an action to exist." *Cannon v. University of Chicago*, 441 U.S. 677, 742, 749 (1979) (Powell, J., dissenting). Recently insisting that *Cort* has been "effectively overruled," Justice Scalia has sharply disagreed with Justice Marshall's *Cort* style formulation of the Court's approach to implied rights of action. *Thompson v. Thompson*, 108 S. Ct. 513, 521 (1988) (Scalia, J., concurring). Reminiscent of Justice Powell's attitude toward implied rights jurisprudence, Justice Scalia believes that "[i]f a change is to be made, we should get out of the business of implied private rights of action altogether." *Id.* at 523. Justice Rehnquist is likewise inclined to apply a "stricter standard" to the issue of implied

been unable to apply *Cort* with any degree of consistency. A rueful Justice Rehnquist has remarked that judicial application of the *Cort* analysis has failed to lend "predictability" in implied-rights-of-action jurisprudence, and that the only uniformity that seems to have ensued after *Cort* is the regularity with which the Supreme Court reverses lower federal courts' decisions on this issue.⁵⁷

Cort v. Ash raised the question of whether a private cause of action for damages against corporate directors should be implied in favor of a stockholder under a federal criminal statute prohibiting corporations from making certain election campaign contributions.⁵⁸ In analyzing that question, the Court announced its now-famous "four factor" approach:

In determining whether a private remedy is implicit in a statute not expressly providing one, several factors are relevant. First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted," . . .—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? . . . Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? . . . And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?⁵⁹

As the author will discuss below,⁶⁰ none of these so-called "factors" represented an entirely new approach to the question of when the judiciary may allow a private party to sue for violation of a federal statute. Each "factor" had solid historical antecedents in numerous cases before *Cort*. Rather than being a revolutionary opinion, *Cort* can be viewed as a consensus among all justices as to the traditional tools which should be used when a federal court decides whether to imply a private right of action under a federal statute. The only particularly new aspect in the *Cort* decision was the conscious

rights. See, e.g., *California v. Sierra Club*, 451 U.S. 287, 302-03 (1981); *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979). Justice Stevens persistently has attempted to put the issue of implied private remedies into broad historical perspective based on the Court's traditional approach to the issue, and while in some cases, if "writing on a clean slate," he might have followed the court's original common-law presumption in favor of implied private remedies, see *infra* notes 69-82 and accompanying text, he now feels compelled to "adhere to the analytical approach the Court has adopted" since *Cort v. Ash*, see *Sierra Club*, 451 U.S. at 299-301. See also *Bush v. Lucas*, 462 U.S. 367, 373-80 (1983); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 374-78 (1982); *Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n*, 453 U.S. 1, 22-26 (1981) (Stevens, J., concurring in part and dissenting in part). For a discussion of the implied-rights opinions of individual justices and an attempt to discern their individual positions and allegiances on the implication question in general, see Note, *Howard v. Pierce: Implied Causes of Action and the On-Going Vitality of Cort v. Ash*, 80 Nw. U.L. Rev. 722, 735-42, 744-47 (1985).

57. *Sierra Club*, 451 U.S. at 302-03 (Rehnquist, J., concurring).

58. *Cort*, 422 U.S. at 68.

59. *Id.* at 78 (citations omitted).

60. See *infra* notes 67-82, 102-19, 266-80, 295-301 and accompanying text.

decision to bring together in one opinion the various principles of analysis that had been employed to date.⁶¹

It was, however, in the very bringing together of distinct lines of analysis that the foundation was laid for the future disagreements among the justices. Principal among the disagreements is the relative importance of each of the factors.⁶² The relative weight that different justices may give to a factor seems to reflect, at bottom, marked differences in philosophical and jurisprudential attitudes toward the issue of implied rights of action.⁶³

61. Even this consolidation of analytical tools was not particularly new. In numerous prior cases, the Court had used a multi-factor approach in deciding whether to imply a private right of action. See, e.g., *Securities Investor Protection Corp. v. Barbour*, 421 U.S. 412 (1975); *National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers*, 414 U.S. 453 (1974); *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964); *Hewitt-Robins, Inc. v. Eastern Freight-Ways, Inc.*, 371 U.S. 84 (1962); *T.I.M.E. Inc. v. United States*, 359 U.S. 464 (1959). Professor Ashford argues that the four-factor approach can be traced back to *Texas & Pac. R.R. v. Rigsby*, 241 U.S. 33 (1916). See Ashford, *Implied Causes of Action Under Federal Laws: Calling the Court Back to Borak*, 79 Nw. U.L. Rev. 227, 247-58 (1984). That the *Cort* four-factor approach was not a conceptually new approach is illustrated by two contemporary student comments published just prior to *Cort* in which the same factors are unremarkably set forth as the traditional tools to use in implication cases. See Note, *The Phenomenon of Implied Private Actions Under Federal Statutes: Judicial Insight, Legislative Oversight or Legislation by the Judiciary?*, 43 FORDHAM L. REV. 441 (1974); Comment, *Private Rights of Action Under Amtrak and Ash: Some Implications for Implication*, 123 U. PA. L. REV. 1392, 1408-36 (1975). For the proposition that *Cort* itself did not adopt a fundamentally new approach in implication cases, see also Brown, *Of Activism and Erie—The Implication Doctrine's Implications for the Nature and Role of the Federal Courts*, 69 IOWA L. REV. 617, 629-30 (1984); Creswell, *The Separation of Powers Implications of Implied Rights of Action*, 34 MERCER L. REV. 973, 981-82 (1983). For a view that *Cort* did adopt a new approach to implied private rights of action, see *infra* note 114.

62. For example, the majority opinions in *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 23-24 (1979), and *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575-76 (1979), held that the issue of whether to imply a private cause of action could be disposed of after consideration of only the first two factors, without consideration of the others. The dissenting justices in these opinions believed that all four factors should have been considered. *Transamerica*, 444 U.S. at 26-36 (White, J., dissenting); *Touche Ross*, 442 U.S. at 580-83 (Marshall, J., dissenting). Similarly, the Court in *California v. Sierra Club*, 451 U.S. 287, 297-98 (1981), found consideration of the first two *Cort* factors dispositive of the implied rights issue and found it unnecessary to consider the last two factors in reaching its decision. See also *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 388 (1982); *Texas Indus. v. Radcliff Materials, Inc.*, 451 U.S. 630, 639-40 (1981) (consideration of legislative history "makes examination of other factors unnecessary"); *Northwest Airlines, Inc. v. Transport Workers Union of Am.*, 451 U.S. 77, 94 n.31 (1981) ("In a case in which neither the statute nor the legislative history reveals a congressional intent to create a private right of action for the benefit of the plaintiff, we need not carry the *Cort v. Ash* inquiry further."); *Kissinger v. Reporters Comm. for Freedom of the Press*, 445 U.S. 136, 148-50 (1980) (though the Court does not refer to the *Cort* factors, its decision to deny an implied remedy under the Federal Records Act of 1950 appears to be supported by consideration of the first two factors only). In *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 145-48 (1985), the Court acknowledged that the plaintiff had squarely met the first and fourth *Cort* factors, but held that he had no implied cause of action because the second and third factors had not been met.

63. For example, Justice Powell viewed the judicial implication of private remedies under federal statutes as an encroachment on the legislative function, and treated the implication issue as one fundamentally involving the constitutional separation of powers. *Jackson Transit Auth. v.*

In this Article, the author does not attempt to cover ground that has been more extensively reviewed by other commentators tracing the development of implied rights of action.⁶⁴ Rather, the author's purpose is primarily to identify the criteria that the Supreme Court continues to deem relevant to the judicial implication of private rights of action, and to demonstrate that even under the "stricter standard"⁶⁵ sometimes applied in cases subsequent to *Cort*, a private right of action should be implied under section 15(c)(1) of the 1934 Act.

The author is mindful that the Court has suggested that it is not necessary to "trudge through all four of the factors"⁶⁶ when the disposition of certain factors seems to conclude the analysis. Nevertheless, inasmuch as *Cort v. Ash* remains good law and the Court appears unsettled as to the relative weight it places on each factor from case to case, prudence would seem to dictate

Local Div. 1285, *Amalgamated Transit Union*, 457 U.S. 15, 29-30 (1982) (Powell, J., concurring); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 408 (1982) (Powell, J., dissenting); *Cannon v. University of Chicago*, 441 U.S. 677, 730-32, 742-49 (1979) (Powell, J., dissenting). Justice Stevens and other members of the Court have disputed the applicability of the separation-of-powers doctrine to the issue of implied rights of action. *Curran*, 456 U.S. at 375-76.

64. See, e.g., Foy, *Some Reflections on Legislation, Adjudication, and Implied Private Actions in the State and Federal Courts*, 71 CORNELL L. REV. 501 (1986); Frankel, *Implied Rights of Action*, 67 VA. L. REV. 553 (1981); Greene, *Judicial Implication of Remedies for Federal Statutory Violations: The Separation of Powers Concerns*, 53 TEMP. L.Q. 469 (1980); Hazen, *Implied Private Remedies Under Federal Statutes: Neither a Death Knell Nor a Moratorium—Civil Rights, Securities Regulation, and Beyond*, 33 VAND. L. REV. 1333 (1980); Maher, *Implied Private Rights of Action and the Federal Securities Laws: A Historical Perspective*, 37 WASH. & LEE L. REV. 783 (1980); Maher & Maher, *Statutorily Implied Federal Causes of Action After Merrill Lynch: How Sad It Is; How Simple It Could Be*, 88 DICK. L. REV. 593 (1984); Mezey, *Judicial Interpretation of Legislative Intent: The Role of the Supreme Court in the Implication of Private Rights of Action*, 36 RUTGERS L. REV. 53 (1983); Noyes, *Implied Rights of Action and the Use and Misuse of Precedent*, 56 U. CINN. L. REV. 145 (1987); Schneider, *Implying Private Rights and Remedies Under the Federal Securities Acts*, 62 N.C.L. REV. 853 (1984); Steinberg, *Implied Private Rights of Action Under Federal Law*, 55 NOTRE DAME LAW. 33 (1979); Stewart & Sunstein, *Public Programs and Private Rights*, 95 HARV. L. REV. 1195 (1982); Note, *Implied Private Rights of Action: The Courts Search for Limitations in a Confused Area of the Law*, 13 CUMB. L. REV. 569 (1983); Note, *Third Party Beneficiary and Implied Right of Action Analysis: The Fiction of One Governmental Intent*, 94 YALE L.J. 875 (1985); Comment, *Implied Causes of Action: A Product of Statutory Construction or the Federal Common Law Power?*, 51 U. COLO. L. REV. 355 (1980). See also law review articles cited *supra* note 61.

65. *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979). The genesis of the "stricter" standard can be seen in the shift away from an inquiry into congressional intent to create a substantive private right and toward an examination of congressional intent to create a private remedy. See *infra* notes 102-29 and accompanying text. See also *Cannon v. University of Chicago*, 441 U.S. 677, 698 (1979) ("We, of course, adhere to the strict approach followed in our recent cases . . .").

66. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 388 (1982) (quoting *California v. Sierra Club*, 451 U.S. 287, 302 (1981) (Rehnquist, J., concurring)). In a separate opinion, Justice Scalia has recently gone even further and declared that *Cort* has been "effectively overruled." *Thompson v. Thompson*, 108 S. Ct. 513, 521 (1988) (Scalia, J., concurring in the judgment). The Court itself has never overruled *Cort*, and most recently employed the four-factor *Cort* analysis in the majority opinion in *Thompson*. *Id.* at 516.

consideration of all four factors when deciding whether to imply a private right under section 15(c)(1).

*B. Plaintiff's Membership in the Benefitted Class:
Creation of a Federal Right*

The first *Cort* factor is whether the plaintiff is "one of the class for whose especial benefit the statute was enacted."⁶⁷ The purpose of this test, according to the Court, is to determine whether the statute creates a "federal right in favor of the plaintiff."⁶⁸

This factor can be traced to *Texas & Pacific Railway Co. v. Rigsby*,⁶⁹ sometimes cited as the first case in which the Supreme Court implied a private right of action under a federal statute.⁷⁰ The Supreme Court in that case took what was the prevailing common-law approach to the implication question: *ubi jus, ibi remedium* ("where there is a right, there is a remedy").⁷¹ The *Rigsby* common-law approach to implication was simple and straightforward: "[W]here [the violation of a statute] results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied, according to the doctrine of the common law."⁷² Under this common-law approach, all the plaintiff needed to prove was that a statute was enacted to protect or benefit him and others like him—that is, to give him a substantive "right" under federal law. If the plaintiff could show he had such a right under federal law, then under the common-law approach, the courts were empowered to create automatically a remedy to protect that substantive right.⁷³ The remedy, of course, was the implication

67. *Cort*, 422 U.S. at 78.

68. *Id.*

69. 241 U.S. 33, 39 (1916).

70. *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 26 (1979) (White, J., dissenting); *Cannon v. University of Chicago*, 441 U.S. 677, 689 (1979). Whether *Rigsby* was in fact the first Supreme Court case to imply a private remedy under a federal statute has been questioned. See Ashford, *supra* note 61, at 229 n.2; Noyes, *supra* note 64, at 149.

71. *Rigsby*, 241 U.S. at 39-40. The pertinent language in *Rigsby* provides:

A disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied, according to a doctrine of the common law expressed . . . in these words: "So, in every case, where a statute enacts, or prohibits a thing for the benefit of a person, he shall have a remedy upon the same statute for the thing enacted for his advantage, or for the recompense of a wrong done to him contrary to the said law." . . . This is but an application of the maxim, *Ubi jus ibi remedium*.

Id. (citations omitted).

72. *Id.*

73. Justice Stevens in *Curran* indicated that this common-law presumption had been recognized long before *Rigsby*, citing, among other cases, *Marbury v. Madison*, 1 Cranch 137, 163 (1803) ("[I]t is a general and indisputable rule, that where there is a legal right, there is also a legal remedy by suit, or action at law whenever that right is invaded." (quoting 3 W. BLACKSTONE, COMMENTARIES 23)). *Curran*, 456 U.S. at 375 n.54.

of a private cause of action for damages or other relief which the plaintiff could bring in federal court.

Until recently, this common-law approach, which is reflected in tort doctrine,⁷⁴ dominated the federal courts' approach to the implication of private remedies under federal statutes.⁷⁵ In particular, it was followed in the landmark decision of *Kardon v. National Gypsum Co.*,⁷⁶ the "seminal" case⁷⁷ holding that a private cause of action existed under section 10(b) of the 1934 Act. Citing the Restatement of Torts, the *Kardon* court ruled that anyone who violates a statute is liable to another person who is injured by such violation if "(a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and (b) the interest invaded is one which the enactment is designed to protect."⁷⁸ The court went on to cite *Rigsby* for

74. Justice Stevens in *Curran* cited T. COOLEY, LAW OF TORTS 790 (2d ed. 1888) for a description of the common-law approach for breach of a statutory duty: "[W]hen the duty imposed by statute is manifestly intended for the protection and benefit of individuals, the common law, when an individual is injured by breach of the duty, will supply a remedy, if the statute gives none." *Curran*, 456 U.S. at 375 n.53. The so-called negligence per se approach is set forth in the § 286 of the Second Restatement of Torts. The Restatement provides:

The court may adopt as the standard of conduct of a reasonable man the requirements of a legislative enactment or an administrative regulation whose purpose is found to be exclusively or in part

- (a) to protect a class of persons which includes the one whose interest is invaded, and
- (b) to protect the particular interest which is invaded, and
- (c) to protect that interest against the kind of harm which has resulted, and
- (d) to protect that interest against the particular hazard from which the harm results.

RESTATEMENT (SECOND) OF TORTS § 286 (1965). See also *infra* note 277. Professor Hazen has suggested that these statutory tort principles should continue to be applied to federal statutes which predate *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938), on the ground that Congress, aware of these principles, knew its legislation would affect the most analogous federal common-law remedy. See Hazen, *supra* note 64, at 1336-81. Similarly, Professor Loss observed that "the fact remains that the skilled draftsmen of the Securities Exchange Act were presumably quite familiar with the [Restatement's statutory tort] doctrine even if the members of Congress were not." 2 L. Loss (1961), *supra* note 6, at 942. For a discussion distinguishing the negligence per se approach from the "where there is a right, there is a remedy" approach, see Noyes, *supra* note 64, at 166-69.

75. Foy, *supra* note 64, at 548-57. For additional cases under the securities laws citing the Restatement approach to implication of private rights of action, see *Deaktor v. L. D. Schreiber & Co.*, 479 F.2d 529, 533-34 (7th Cir.), *rev'd on other grounds*, 414 U.S. 113 (1973); *Greater Iowa Corp. v. McLendon*, 378 F.2d 783, 789-90 (8th Cir. 1967); *Dann v. Studebaker-Packard Corp.*, 288 F.2d 201, 208-09 (6th Cir. 1961); *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783, 787 (2d Cir. 1951); *Baird v. Franklin*, 141 F.2d 238, 245 (2d Cir.) (Clark, J., dissenting), *cert. denied*, 323 U.S. 737 (1944); *Kerber v. Kakos*, 383 F. Supp. 625, 627 (N.D. Ill. 1974); *Goodman v. H. Hentz & Co.*, 265 F. Supp. 440, 447 (N.D. Ill. 1967); *Remar v. Clayton Sec. Corp.*, 81 F. Supp. 1014, 1017 (D. Mass. 1949). See also L. Loss (1988), *supra* note 6, at 938 ("The statutory tort doctrine, more or less expounded in the Restatement, is now an accepted part of American law." (footnote omitted)); 2 L. Loss (1961), *supra* note 6, at 942.

76. 69 F. Supp. 512 (E.D. Pa. 1946).

77. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975).

78. *Kardon*, 69 F. Supp. at 513.

the proposition that "[t]his is but an application of the maxim, *Ubi jus ibi remedium*."⁷⁹

Congressional intent, later to become the crucible of implication cases,⁸⁰ was also important under the *Rigsby* common-law approach. The key difference, however, was that under the common-law approach, the congressional intent to be deciphered was the intent to protect the class of persons of which the plaintiff was a member. Upon a finding of such intent, the courts presumptively implied a private right of action in favor of the plaintiff in order to vindicate that statutory protection.⁸¹ This common-law presumption in favor of implication (once the court determined that Congress intended the statute to protect persons like the plaintiff) could be overcome only by a showing of a deliberate congressional intent to deny such persons a federal remedy. As the *Kardon* court observed:

Of course, the legislature may withhold from parties injured the right to recover damages arising by reason of violation of a statute but the right is so fundamental and so deeply ingrained in the law that where it is not expressly denied the intention to withhold it should appear very clearly and plainly.⁸²

Under this common-law approach—the first *Cort* factor—it is easy to conclude that a private right of action under section 15(c)(1) should be implied. That an investor injured by broker-dealer fraud was intended to be given protection under the federal securities laws is more than amply supported by the cases and the legislative history.

79. *Id.*

80. See *infra* notes 102-29 and accompanying text.

81. For Supreme Court cases applying this *Rigsby* approach, see, e.g., *Sullivan v. Little Hunting Park, Inc.*, 396 U.S. 229, 239 (1969) ("The existence of a statutory right implies the existence of all necessary and appropriate remedies."); *Allen v. State Bd. of Elections*, 393 U.S. 544, 557 (1969) ("We have previously held that a federal statute passed to protect a class of citizens, although not specifically authorizing members of the protected class to institute suit, nevertheless implied a private right of action. . . . A similar analysis is applicable here." (citations omitted)); *Wyandotte Transp. Co. v. United States*, 389 U.S. 191, 202 (1967); *Bell v. Hood*, 327 U.S. 678, 684 (1946) ("Moreover, where federally protected rights have been invaded, it has been the rule from the beginning that courts will be alert to adjust their remedies so as to grant the necessary relief." (citing at n.6 *Marbury v. Madison*, 1 Cranch 137, 162, 163)); *Tunstall v. Brotherhood of Locomotive Firemen & Enginemen*, 323 U.S. 210, 213 (1944); *Steele v. Louisville & Nashville R.R.*, 323 U.S. 192, 207 (1944); *Texas & New Orleans R.R. v. Brotherhood of Ry. & S.S. Clerks*, 281 U.S. 548, 567-70 (1930) ("The absence of penalty is not controlling. . . . Many rights are enforced for which no statutory penalties are provided. . . . The right is created and the remedy exists. *Marbury v. Madison*, 1 Cranch 137, 162, 163."). See also *Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 261 (1951) (Frankfurter, J., dissenting). Justice Frankfurter stated:

[Courts] do not require explicit statutory authorization for familiar remedies to enforce statutory obligations. . . . A duty declared by Congress does not evaporate for want of a formulated sanction. . . . If civil liability is appropriate to effectuate the purposes of a statute, courts are not denied this traditional remedy because it is not specifically authorized.

Id. at 261.

82. *Kardon*, 69 F. Supp. at 514.

The Supreme Court has repeatedly announced that “[d]efrauded investors are among the very individuals Congress sought to protect in the securities laws.”⁸³ Some thirty-five other sections in the 1934 Act make reference to the Act’s goal to protect investors.⁸⁴ The legislative history of the 1934 Act illustrates that one primary form such protection was to take was protection of investors from fraud by those through whom investors bought and sold their securities, namely, brokers and dealers.⁸⁵ As the very title of the Securities Exchange Act⁸⁶ suggests, the focus of the Act is on the regulation of the stock exchanges and their members. It was clear, however, that regulating the exchanges and their members would not suffice to regulate the broker-dealers who traded in the OTC market. It was openly recognized that failing to regulate securities transactions in the OTC market would have left an enormous gap in the regulatory machinery. The regulation of the exchanges required, “as a corollary,”⁸⁷ the regulation of the OTC market. As an oft-cited contemporary report of the Twentieth Century Fund, Inc. on stock market regulation observed:

The benefits that would accrue as the result of raising the standards of security exchanges might be nullified if the over-the-counter markets were left unregulated and uncontrolled. They are of vast proportions and they would serve as a refuge for any business that might seek to escape the discipline of the exchanges; and the more exacting that discipline, the greater the temptation to escape from it. Over-the-counter markets offer facilities that are useful under certain conditions, but they should not be

83. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 (1983). In a message to Congress urging enactment of legislation that was to become the 1934 Act, President Franklin D. Roosevelt expressly recommended such legislation “for the protection of investors, for the safeguarding of values, and, so far as it may be possible, for the elimination of unnecessary, unwise, and destructive speculation.” 78 CONG. REC. 2264 (1934). Even Congressional representatives opposed to the specific provisions of the bill fully endorsed these general purposes of the 1934 Act. *See, e.g.*, 78 CONG. REC. 7937 (1934) (statement of Rep. Bakewell) (“With regard to this general purpose [referring to the President’s message] there is no disagreement whatsoever amongst us. We are all in favor of that.”).

84. For a list of these provisions, see *Baird v. Franklin*, 141 F.2d 238, 244 n.4 (2d Cir.) (Clark, J., dissenting), *cert. denied*, 323 U.S. 737 (1944).

85. As originally drafted, § 15 prohibited “any person” from effecting a security transaction in the OTC market without complying with the rules and regulations of the SEC. There was objection that as so phrased, the proscription was too broad and possibly unconstitutional. *Stock Exchange Practices: Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and 97 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 6547-50, 6598-99, 6636-37 (1934) [hereinafter *Senate Hearings on S. Res. 84*]. *See also Stock Exchange Regulation: Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 225, 669 (1934) [hereinafter *House Hearings on H.R. 7852*]. It was conceded that the primary aim was to protect investors from fraudulent conduct of professional broker-dealers and was not to regulate informal sales of securities by an individual seller not in the business of selling securities. *Senate Hearings on S. Res. 84, supra*, at 6550-55. The language of § 15 was ultimately changed to limit its proscriptions to broker-dealers.

86. Securities Exchange Act of 1934 § 1, 15 U.S.C. § 78a (1982).

87. H.R. REP. NO. 1383, 73d Cong., 2d Sess. 15-16 (1934). *See also* S. REP. NO. 792, 73d Cong., 2d Sess. 6 (1934).

permitted to expand beyond their proper sphere and compete with the exchanges for business that, from the point of view of public interest, should be confined to the organized markets. This constitutes the sanction for Federal regulation of over-the-counter dealers and brokers. To leave the over-the-counter markets out of a regulatory system would be to destroy the effects of regulating the organized exchanges.⁸⁸

The reasons for concern about leaving the OTC market unregulated while regulating the exchanges were numerous. To begin with, it was felt in some quarters that the opportunities for fraudulent and unscrupulous practices in the OTC market were at least as great as, if not greater than, such opportunities on the exchanges.⁸⁹ More particularly, many people feared that if only the exchanges and their members were regulated, a mass exodus from the exchanges would result: corporations whose securities were traded on the exchanges would delist in order to avoid regulation, and would allow their securities to be traded over-the-counter in "bootleg" markets.⁹⁰ Others feared that failure to regulate the OTC market would also leave the exchanges open to unfair competition.⁹¹

Thus, it was clear to legislators in 1934 that regulation of the OTC market, and of the broker-dealers who traded securities in that market, was an essential corollary to regulation of the exchanges. It was correspondingly unclear, however, how to go about regulating the unorganized OTC market. Mr. Thomas Gardiner Corcoran, a principal drafter of the proposed legislation, captured the uncertainty of the times:

Just how [regulation of the OTC market] will be worked out, nobody knows. Neither the Dickinson report, nor the Twentieth Century Fund, nor this bill has any specific ideas as to how you would reach the over-the-counter market, but certainly there is some way it can be reached.⁹²

88. H.R. REP. No. 1383, *supra* note 87, at 16. See also 78 CONG. REC. 7868 (1934). The Twentieth Century Fund, Inc. prepared an extensive and influential report on the securities markets which formed a basis for much of the subsequent draft legislation and ensuing debate. TWENTIETH CENTURY FUND, INC., STOCK MARKET CONTROL: A SUMMARY OF THE RESEARCH FINDINGS AND RECOMMENDATIONS OF THE SECURITY MARKETS SURVEY STAFF OF THE TWENTIETH CENTURY FUND (Clark, Dewhurst, Bernheim, & Schneider eds. 1934) [hereinafter TWENTIETH CENTURY FUND REPORT]. See also *House Hearings on H.R. 7852, supra* note 85, at 83-84; *Stock Exchange Regulation: Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 773-87 (1934) [hereinafter *House Hearings on H.R. 8720*] (testimony of Evans Clark on behalf of the Twentieth Century Fund).

89. *Senate Hearings on S. Res. 84, supra* note 85, at 7078.

90. *Id.* at 6495-96, 6540, 6714-15, 6996-97, 7486; S. REP. No. 792, *supra* note 87, at 6.

91. *Senate Hearings on S. Res. 84, supra* note 85, at 6547.

92. *Id.* at 6541, 6551, 6554-55; *House Hearings on H.R. 7852, supra* note 85, at 26 ("[T]he Roper Report concludes by saying that something ought to be done about regulating over-the-counter transactions, but it has not yet thought out an effective way of regulation. I think [§ 15] tells the Commission to think out an effective way of regulating 'over-the-counter' transactions." (statement of Commissioner Landis)). For a discussion of the various drafters of the 1934 legislation, see *id.* at 82-83; *Senate Hearings on S. Res. 84, supra* note 85, at 6463, 6500.

Resisting recommendations to postpone or eliminate all OTC regulation until a clearer understanding emerged of what form that regulation should take,⁹³ Congress took one small step in 1934 toward such regulation by enacting section 15. As originally enacted, section 15 was a single brief provision that, in effect, left the entire matter of OTC regulation in the hands of the Commission.⁹⁴ The section was necessarily drafted broadly to allow the Commission considerable flexibility to study and work out a reasonable program of regulation.⁹⁵

Section 15 expressly authorized the Commission to determine what form such regulation should take, and it was empowered to do so along the following three lines: (1) regulation of all transactions by OTC broker-dealers; (2) registration with the Commission of all such broker-dealers; and (3) registration with the Commission of securities traded in the OTC market. The only guideline the Commission had to follow in deciding what rules and regulations it should promulgate—apart from their being “necessary or appropriate in the public interest”—was that the OTC regulation should be designed “to insure to investors protection comparable to that which is accorded in the case of registered exchanges.”⁹⁶ Thus, it was expressly mandated from the outset that investors in the OTC market were to be given protection at least equal to that given investors on the exchanges.

This mandate was reaffirmed in 1938, when section 15 was amended.⁹⁷ A Senate committee report identified the goals sought to be achieved by amendments to section 15 as follows:

93. *Senate Hearings on S. Res. 84, supra* note 85, at 6746-47, 7074-75, 7586; *Hearings on H.R. 7852, supra* note 85, at 262, 425, 500-01, 618-19. One of the first formal studies of exchange regulation—variously called the “Roper Report” after Secretary of Commerce Daniel Roper who appointed the Committee at the direction of President Roosevelt in 1933, or the “Dickinson Report” after the Chairman of the Committee, John Dickinson—concluded that the “problem of the ‘over-the-counter’ markets cannot be satisfactorily dealt with by Federal governmental action” and declined to recommend any regulation of OTC markets without further study and analysis. STOCK EXCHANGE REGULATION: LETTER FROM THE PRESIDENT OF THE UNITED STATES TO THE CHAIRMAN OF THE COMMITTEE ON BANKING AND CURRENCY WITH AN ACCOMPANYING REPORT RELATIVE TO STOCK EXCHANGE REGULATION, 73d Cong., 2d Sess. 20 (Senate Comm. Print 1934) [hereinafter *ROPER REPORT*] (John Dickinson, Chairman). Beyond these efforts to postpone OTC regulation, there appears to have been little opposition to § 15. *See* 78 CONG. REC. 8036 (1934) (statement of Rep. Sam Rayburn, Chairman of House Committee on Interstate and Foreign Commerce who presided over the House hearings on the legislation, before defeat of a proposed amendment to § 15 [§ 14 in the bill]) (“I did not know that there was any objection to this section.”).

94. *See infra* note 156 for original enactment of § 15 in 1934.

95. *Senate Hearings on S. Res. 84, supra* note 85, at 6547, 6551, 6554-55. *See also* S. REP. NO. 1455, 75th Cong., 3d Sess. 4 (1938):

The brevity and generality of this treatment [in the 1934 enactment of § 15] arose from a realistic recognition of the great difficulties of working out in any detail a suitable plan of regulation at that time, in view of the fact that so little was then known concerning these markets.

Id. See also H.R. REP. NO. 2307, 75th Cong., 3d Sess. 5 (1938).

96. S. REP. NO. 792, *supra* note 87, at 20; H.R. REP. NO. 1383, *supra* note 87, at 24.

97. *Regulation of Over-the-Counter Markets: Hearings Before the Senate Comm. on Banking*

The problem of regulation of the over-the-counter markets has three aspects: First, to protect the investor and the honest dealer alike from dishonest and unfair practices by the submarginal element in the industry; second, to cope with those methods of doing business which, while technically outside the area of definite illegality, are nevertheless unfair both to customer and to decent competitor, and are seriously damaging to the mechanism of the free and open market; and third, to afford to the investor an economic service the efficiency of which will be commensurate with its economic importance, so that the machinery of the nation's markets will operate to avoid the misdirection of the nation's savings, which contributes powerfully toward economic depressions and breeds distrust of our financial processes.⁹⁸

That Congress specifically intended that section 15 would protect the investing public from "dishonest and unfair" practices by broker-dealers is beyond debate. As will be discussed later, the method of assuring such protection developed slowly over time, but the congressional intent to afford protection to this class of persons has been manifest with every amendment to section 15.⁹⁹ Without a doubt, Congress intended to protect investors from broker-dealer fraud under section 15(c)(1). Thus, the first *Cort* factor is met.

Today, however, whether Congress intended to protect private investors from broker-dealer fraud is treated as analytically distinct from whether Congress intended investors to be able to sue for such fraud in federal court. Under the common-law approach, as shown above, the lines of analysis were merged, and a finding of the intent to protect the investor under section 15(c)(1) automatically would have entailed—absent compelling evidence of congressional intent to the contrary—the implication of a private remedy to effectuate such protection. *Cort v. Ash* relegated this common-law approach, decisive in its time and important in *Cort* itself,¹⁰⁰ to a single factor among several. Indeed, in some later decisions, it seems to have been given little or no weight at all.¹⁰¹

C. *Legislative Intent: Creation of a Federal Remedy*

The second *Cort* factor in determining whether to imply a private remedy under a federal statute is to ascertain evidence of a legislative intent "either

and Currency on S. 3255, 75th Cong., 2d Sess. 19-20, 52 (1938) [hereinafter *Senate Hearings on S. 3255*] ("The purpose of the bill is to assure the single investor here and there who wants to know that he can rely upon those with whom he deals." (statement of Sen. Adams)); S. REP. NO. 1455, *supra* note 95, at 4; H.R. REP. NO. 2307, *supra* note 95, at 5.

98. S. REP. NO. 1455, *supra* note 95, at 3. See also H.R. REP. NO. 2307, *supra* note 95, at 4.

99. See *infra* notes 175-251 and accompanying text.

100. 422 U.S. at 80-82.

101. See, e.g., *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 145, 148 (1985); *Universities Research Ass'n v. Coutu*, 450 U.S. 754, 771-72 (1981); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 24 (1979).

to create such a remedy or to deny one.”¹⁰² This factor also originally derived from the common-law approach, with one key distinction. Under the common-law approach, the courts acknowledged that the presumption in favor of an implied federal remedy could be overcome by proof of congressional intent to *deny* the remedy.¹⁰³ Cases after *Cort* have redefined the judicial obligation as one to ascertain congressional intent to *create* the remedy.¹⁰⁴ This change in focus in effect obliterated the common-law presumption in favor of implied rights of action, and it justified the shift in the Supreme Court’s approach to an implicit presumption against implied private rights.

Under the common-law approach (the first *Cort* factor), the inquiry into congressional intent regarding the private *remedy* was subsidiary to the principal inquiry into congressional intent regarding the substantive federal *right*. Positive proof of the legislature’s intent to deny a remedy served simply as a qualification on the judiciary’s authority to imply one, where a federal statute had been violated and the plaintiff was a member of the class protected by the statute. Under the common-law approach, the plaintiff was not required to offer affirmative proof of legislative intent to create a private remedy; it sufficed to show that Congress intended to create a substantive federal *right* in the plaintiff. The judiciary would then automatically imply a judicial remedy to vindicate that right absent contrary congressional intent concerning a private remedy.¹⁰⁵ However, the almost *sub silentio* introduction in *Cort* of an inquiry into congressional intent to *create* a private remedy resulted in a substantial shift in judicial treatment of implication cases.

This shift was not immediately felt. *Cort v. Ash* itself did not justify such a shift, for the Supreme Court in *Cort*, just like the federal district court earlier in *Kardon*, acknowledged the common-law presumption in favor of permitting a private remedy absent proof of congressional intent to deny one. As the Court observed, “in situations in which it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an

102. 422 U.S. at 78.

103. See *supra* text accompanying note 82.

104. See, e.g., *Middlesex County Sewerage Auth. v. National Sea Clammers Ass’n*, 453 U.S. 1, 13 (1981) (“recurring question whether Congress intended to create a private right of action under a federal statute”); *California v. Sierra Club*, 451 U.S. 287, 297 (1981) (“As recently emphasized, the focus of the inquiry is on whether Congress intended to create a remedy”); *Northwest Airlines, Inc. v. Transport Workers Union of Am.*, 451 U.S. 77, 91 (1981) (“The ultimate question in cases such as this is whether Congress intended to create the private remedy”); *Universities Research Ass’n v. Coutu*, 450 U.S. 754, 770 (1981) (“In order to determine whether Congress intended to create the private right of action asserted here, we consider three factors set forth in *Cort v. Ash*”). See also *infra* notes 108-10 and accompanying text.

105. “[I]n those situations in which we have inferred a federal private cause of action not expressly provided, there has generally been a clearly articulated federal right in the plaintiff, . . . or a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard.” *Cort*, 422 U.S. at 82.

intention to *create* a private cause of action, although an explicit purpose to *deny* such cause of action would be controlling."¹⁰⁶

Even though *Cort* and its common-law predecessors had not required proof of congressional intent to create a private remedy, within a few years after *Cort* the Court began to require such an affirmative showing. In *Touche Ross & Co. v. Redington*,¹⁰⁷ Justice Rehnquist writing for the majority flatly stated: "[O]ur task is limited solely to determining whether Congress intended to create the private right of action asserted."¹⁰⁸ Similarly, Justice Stewart writing for the majority in *Transamerica Mortgage Advisors, Inc. v. Lewis*¹⁰⁹ stated: "[W]hat must ultimately be determined is whether Congress intended to create the private remedy asserted."¹¹⁰ These two cases, arguably far more than *Cort*, have represented a shift in the Supreme Court's treatment of implied rights of action.

This shift to focus on congressional intent to create, rather than to deny, a private right of action is not the only transformation which the second *Cort* factor has undergone. In a variety of cases after *Touche Ross* and *Transamerica*, the Court has elevated the inquiry into the congressional intent to create a private remedy to the status of the "ultimate question," to which the other *Cort* factors are subsidiarily "relevant."¹¹¹ Although the Court as a whole has never expressly adopted a presumption against implied private rights of action,¹¹² this elevation of the second *Cort* factor seems to have created, de facto, such a presumption. As a practical matter, in the vast majority of its cases since *Touche Ross* and *Transamerica*, the Court has not implied a private remedy under a federal statute.¹¹³ Certainly at least some of the justices themselves perceive a new, less receptive attitude on the part of the Court, even if they do not characterize it as a presumption against implied remedies.¹¹⁴

106. *Id.* at 82 (emphasis in original); accord *Cannon v. University of Chicago*, 441 U.S. 677, 694 (1979).

107. 442 U.S. 560 (1979).

108. *Id.* at 568.

109. 444 U.S. 11 (1979).

110. *Id.* at 15-16. In the strong 4-member dissent in *Transamerica*, however, the inquiry is phrased in terms of whether there is evidence of legislative intent to "negate" or "foreclose" the claimed private rights of action. *Id.* at 28 (White, J., dissenting). For other cases calling for a determination of an intent to "create" a private cause of action, see cases cited *supra* note 104.

111. *Northwest Airlines, Inc. v. Transport Workers Union of Am.*, 451 U.S. 77, 91 (1981). See also *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 535-36 (1984); *Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n*, 453 U.S. 1, 13 (1981); *Texas Indus. v. Radcliff Materials, Inc.*, 451 U.S. 630, 639 (1981); *California v. Sierra Club*, 451 U.S. 287, 293 (1981); *Universities Research Ass'n v. Coutu*, 450 U.S. 754, 770 (1981).

112. *Cf. Bush v. Lucas*, 462 U.S. 367, 373 (1983) (the Supreme Court's prior cases have unequivocally rejected the "premise that federal courts are courts of limited jurisdiction whose remedial powers do not extend beyond the granting of relief expressly authorized by Congress.").

113. See cases cited *supra* note 48.

114. Justice Stevens in particular has repeatedly contended that *Cort* marked a new direction in the Supreme Court's approach to implied private rights of action. See *Merrell Dow Pharma-*

Finally, some members have urged the Court to adopt a formal presumption against implication.¹¹⁵

The creation of a de facto presumption against implication is best evidenced by the Court's repeated resurrections of the legal argument expressed by the maxim of statutory construction: *expressio unius est exclusio alterius*.¹¹⁶ Since *Transamerica*, the Court has frequently reiterated in implied-rights cases that "it is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it. 'When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.'"¹¹⁷ Once the Court decided

ceuticals, Inc. v. Thompson, 106 S. Ct. 3229, 3234 (1986) ("The development of our framework for determining whether a private cause of action exists has proceeded only in the last 11 years, and its inception represented a significant change in our approach to congressional silence on the provision of federal remedies."); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 377 (1982) ("In 1975 the Court unanimously decided to modify its approach to the question whether a federal statute includes a private right of action." (footnote omitted)); *Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n*, 453 U.S. 1, 25 (1981) (Stevens, J., concurring in part and dissenting in part) ("In 1975, in *Cort v. Ash*, the Court cut back on the simple common-law presumption by fashioning a four-factor formula that led to the denial of relief in that case." (footnote omitted)).

115. Former Justice Powell urged that no private right of action should be implied from a federal statute "absent the most compelling evidence that Congress in fact intended such an action to exist." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 408 (1982) (Powell, J., dissenting) (citing *Cannon v. University of Chicago*, 441 U.S. 677, 749 (1979) (Powell, J., dissenting)). Along this line, Justice Scalia has suggested that any change in the Court's development of implied-rights jurisprudence should be in the direction "away from our current congressional intent test to the categorical position that federal private rights of action will not be implied." *Thompson v. Thompson*, 108 S. Ct. 513, 522 (1988) (Scalia, J., concurring in the judgment). Justice Rehnquist similarly seems inclined to favor a presumption against implied rights and has admonished Congress to make clear its intentions with respect to private remedies. See, e.g., *Touche Ross & Co. v. Redington*, 442 U.S. 560, 579 (1979) ("But if Congress intends those customers to have such a federal right of action, it is well aware of how it may effectuate that intent."); *Cannon v. University of Chicago*, 441 U.S. 677, 718 (1979) (Rehnquist, J., concurring). In *Cannon*, Justice Rehnquist, in a concurrence, stated:

It seems to me that the factors to which I have here briefly adverted apprise the lawmaking branch of the Federal Government that the ball, so as to speak, may well now be in its court. Not only is it "far better" for Congress to so specify when it intends private litigants to have a cause of action, but for this very reason this Court in the future should be extremely reluctant to imply a cause of action absent such specificity on the part of the Legislative Branch.

Id.

116. "The expression of one thing is the exclusion of another."

117. *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 19-20 (1979) (quoting *Botany Mills v. United States*, 278 U.S. 282, 289 (1929)). See also *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 147 (1985); *Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n*, 453 U.S. 1, 14-15 (1981); *Northwest Airlines, Inc. v. Transport Workers Union of Am.*, 451 U.S. 77, 94 n.30 (1981); *Universities Research Ass'n v. Coutu*, 450 U.S. 754, 773 n.24 (1981); *Kissinger v. Reporters Comm. for Freedom of the Press*, 445 U.S. 136, 149 (1980).

The use of this "strict constructionist" approach to the implication issue was foreshadowed in a few pre-*Cort* decisions, which evidence the beginning of a presumption against implication, absent clear congressional intent to create an implied private remedy. See *Securities Investor Protection Corp. v. Barbour*, 421 U.S. 412, 419 (1975); *National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers*, 414 U.S. 453, 458 (1974).

to characterize the implication issue as "basically a matter of statutory construction,"¹¹⁸ it was logically free to apply the philosophy expressed in such a maxim of statutory construction, despite repeated discrediting of the maxim, even in *Cort* itself.¹¹⁹

The application of the maxim *expressio unius est exclusio alterius* creates, as a practical matter, a presumption against implied remedies in any statutory scheme where Congress has provided at least one express remedy. Unlike *Rigsby* and *Kardon* where the plaintiff was presumed to have a right of action if he was a member of the benefitted class, absent evidence appearing "very clearly and plainly"¹²⁰ that Congress intended to *deny* him one, after *Transamerica* the plaintiff appears to be presumed not to have an implied private remedy if the statute contains another express remedy, absent compelling evidence of congressional intent to *create* one. If the statute creates an express remedy somewhere, then "[i]n the absence of strong indicia of a contrary congressional intent [that is, to create another private remedy], we are compelled to conclude that Congress provided precisely the remedies it considered appropriate."¹²¹

The substantial departure from the common-law approach—an almost 180 degree reversal in presumptions concerning implied private rights of action¹²²—has been criticized both by academic commentators¹²³ and by Congress.¹²⁴ The reasons given for it have been varied,¹²⁵ but whatever the justifications for the

118. *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 15 (1979).

119. *See id.* at 29 n.6 (White, J., dissenting) ("This application of the oft-criticized maxim *expressio unius est exclusio alterius* ignores our rejection of it in *Cort v. Ash* . . ."). *See also* *Herman & MacLean v. Huddleston*, 459 U.S. 375, 387 n.23 (1983) ("We also reject application of the maxim of statutory construction, *expressio unius est exclusio alterius*"); *Cannon v. University of Chicago*, 441 U.S. 677, 711 (1979); *Cort v. Ash*, 422 U.S. 66, 82-83 n.14 (1975); *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350-51 (1943). In *C. M. Joiner*, the Court stated:

However well these rules [the "*ejusdem generis* rule" and the maxim "*expressio unius est exclusio alterius*"] may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy.

Id. (footnotes omitted).

120. *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946).

121. *Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n*, 453 U.S. 1, 15 (1981).

122. Logically, the maxim *ubi jus ibi remedium* creates a presumption directly opposite to that created by the maxim *expressio unius est exclusio alterius*. *See* RESTATEMENT (SECOND) OF TORTS § 874A comment c (1979).

123. *See, e.g.*, Foy, *supra* note 64, at 581-85.

124. Professor Ashford contends that portions of the legislative history of the Small Business Investment Incentive Act of 1980 represent congressional disapproval of the shift represented by *Touche Ross* and *Transamerica*, and congressional approval of a three-factor test essentially like that in *Cort v. Ash* as the proper test for implying private causes of action under the Small Business Investment Incentive Act of 1980, and arguably under other federal statutes as well. Ashford, *supra* note 61, at 290-341.

125. Justice Powell believed that the constitutional doctrine of separation of powers justified a

departure, it has created an uphill battle for plaintiffs trying to convince the courts to recognize a private remedy.¹²⁶ This second *Cort* factor has become the hardest factor to meet, largely because the clues for discerning congressional intent are so often ambiguous or nonexistent. The Court has suggested that the clues can be found in the statute's specific language, its legislative history, and overall purpose.¹²⁷ The language will almost naturally be inconclusive, because the issue regarding an implied remedy under a particular statute or provision of a statute arises only when no express remedy exists under that statute or provision. Likely as not, the legislative history will similarly be totally silent on the subject.¹²⁸ As a practical matter, the legislature may not have intended anything with respect to implied remedies, or may have intended for the judiciary to decide the issue.¹²⁹

In the face of such ambiguous evidence, the critical question in implied-rights jurisprudence becomes whether the Supreme Court will continue to apply an implicit presumption against implied remedies, or will reassess the *Rigsby* common-law presumption in their favor. This Article argues that even under the most stringent application of this second *Cort* factor, a private remedy under section 15(c)(1) should be implied.

1. The Language of Section 15(c)(1)

Although the language of section 15(c)(1) does not expressly create a private remedy for violation of its provisions, the language does afford a basis for

judicial presumption against implied rights absent compelling evidence of legislative intent to the contrary. See *supra* note 63. Justice Stevens has suggested that the Court's increasing reluctance to imply private remedies under federal statutes stems from its being "properly concerned about the burdens imposed upon the federal judiciary, the quality of the work product of Congress, and the sheer bulk of new federal legislation . . ." *Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n*, 453 U.S. 1, 24-25 (1981) (Stevens, J., concurring in part and dissenting in part). See also *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 374, 377 (1982).

126. Indeed, the test itself tends to suggest a negative response, for it requires the plaintiff to prove that Congress affirmatively intended to "create" something which historically had been "implied" by the judiciary. See Foy, *supra* note 64, at 556 (The Court "ultimately accepted the paradoxical proposition that implied private rights of action existed in the federal system only where Congress had actually intended to create them.").

127. *Universities Research Ass'n v. Coutu*, 450 U.S. 754, 770 (1981); *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575-76 (1979).

128. See *Cannon v. University of Chicago*, 441 U.S. 677, 694 (1979) ("We must recognize, however, that the legislative history of a statute that does not expressly create or deny a private remedy will typically be equally silent or ambiguous on the question."); *Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n*, 453 U.S. 1, 25 (1981) (Stevens, J., concurring in part and dissenting in part) ("Because legislative history is unlikely to reveal affirmative evidence of a congressional intent to authorize a specific procedure that the statute itself fails to mention, that touchstone will further restrict the availability of private remedies." (footnote omitted)).

129. See L. Loss (1988), *supra* note 6, at 938 ("Consequently, if the silence of the statute does not justify the conclusion that the legislature affirmatively 'intended' that there should be a private remedy, neither does it justify the conclusion that Congress had the contrary 'intention.'"); 2 L. Loss (1961), *supra* note 6, at 942.

implying one. In numerous cases where the Supreme Court has found an implied private remedy, the statute in question expressly either "prohibited certain conduct or created federal rights in favor of private parties."¹³⁰ As the Court in *Cannon v. University of Chicago* observed, "[n]ot surprisingly, the right- or duty-creating language of the statute has generally been the most accurate indicator of the propriety of implication of a cause of action."¹³¹

Section 15(c)(1) expressly "prohibit[s] certain conduct" and does contain "duty-creating language." The section states that "[n]o broker or dealer shall . . . effect any transaction in . . . any security . . . otherwise than on a national security exchange . . . by means of any manipulative, deceptive, or other fraudulent device or contrivance."¹³² This "duty" is clearly imposed on brokers and dealers in the OTC market. Arguably, the statute does not specify the class of persons in whom the correlative "right" to be free from fraudulent conduct by brokers and dealers is placed. Nonetheless, it is clear that at a minimum this class must include investors.¹³³

That the duty created under section 15(c)(1) was intended to be enforced by private litigation is evidenced by the language of another provision of the 1934 Act, section 29(b).¹³⁴ Section 29(b) generally renders void any contract made or performed in violation of any provision of the 1934 Act, and specifically provides for a limitations period for actions brought to avoid contracts made in violation of section 15(c)(1). Although strictly speaking

130. *Touche Ross & Co. v. Redington*, 442 U.S. 560, 569 and cases cited therein. Cf. *Securities Investor Protection Corp. v. Barbour*, 421 U.S. 412, 424 (1975) ("Unlike the Securities Exchange Act, the SIPA contains no standards of conduct that a private action could help to enforce . . .").

131. 441 U.S. 677, 690 n.13 (1979).

132. See *supra* note 4.

133. See *supra* notes 83-99 and accompanying text.

134. Section 29(b), 15 U.S.C. § 78cc(b) (1982), provides:

(b) Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: *Provided*, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of section [15] of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section [15] of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation.

section 29(b) does not expressly state that private suits may be brought for violation of section 15(c)(1), it comes as close as possible to doing so. Indeed, the limitations period provided in section 29(b) makes no sense unless it presupposes a private right to sue under section 15(c)(1) that is being limited by this express limitations period.

In *Transamerica Mortgage Advisors, Inc. v Lewis*,¹³⁵ the Court interpreted analogous language in two provisions of the Investment Advisers Act of 1940.¹³⁶ Section 15(c)(1) is analogous to section 206 of the 1940 Act, which broadly proscribes fraudulent practices by investment advisers, and makes it unlawful for any investment adviser to "employ any device, scheme or artifice to defraud any client or to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative."¹³⁷ Section 29(b) is analogous to section 215 of the 1940 Act, which provides that contracts whose formation or performance would violate the 1940 Act "shall be void"¹³⁸

135. 444 U.S. 11 (1979).

136. 15 U.S.C. §§ 80b-1 to -21 (1982).

137. Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 (1982) [hereinafter 1940 Act], provides:

It shall be unlawful for any investment adviser by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction.

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Clause (4) appears to have been patterned on § 15(c)(2), *supra* note 4. See *SEC Legislation: Hearings on S. 1178-1182 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 86th Cong., 1st Sess. 137 (1959) (statement of SEC Commissioner Philip A. Loomis).

138. Section 215 of the 1940 Act, 15 U.S.C. § 80b-15 (1982), provides in pertinent part:

(b) Every contract made in violation of any provision of this subchapter and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this subchapter, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision.

Compare § 29(b) of the Exchange Act, *supra* note 134.

The Court concluded that a private right of action might be implied from the language of section 215, reasoning that "[b]y declaring certain contracts void, § 215 by its terms necessarily contemplates that the issue of voidness under its criteria may be litigated somewhere."¹³⁹ The majority in *Transamerica* concluded that "when Congress declared in § 215 that certain contracts are void, it intended that the customary legal incidents of voidness would follow, including the availability of a [private] suit for rescission . . . and for restitution."¹⁴⁰ By analogy, the language of section 29(b) of the 1934 Act would at a minimum suggest the availability of a private suit for rescission and restitution for violation of section 15(c)(1).

But where should the private right be implied: under section 15(c)(1) or under section 29(b)? The *Transamerica* majority found that a private right of action for rescission could be implied under section 215 of the 1940 Act, the analog to section 29(b) of the 1934 Act, and found that no private right of action for damages could be implied under section 206 of the 1940 Act, the analog to section 15(c)(1).¹⁴¹ A literal extension of the *Transamerica* analogy to limit an implied remedy under section 29(b) to rescission, and to deny a private right of action for damages under section 15(c)(1), would superficially seem to accord with the majority's reasoning in *Transamerica*. As the dissent points out, however, that reasoning is flawed.¹⁴² Moreover, a conclusion that the private right of action arises under section 29(b), rather than under section 15(c)(1), would not comport with the historical development of implied rights of action under the 1934 Act, nor would it be supported by the language of those provisions and their legislative histories.

Despite the broad language of section 29(b) declaring void all contracts made in violation of "any" provision of the 1934 Act, the Supreme Court has never before considered section 29(b) itself to create an implied remedy for violation of the Act. For example, the Supreme Court has found the private right of action for violation of section 10(b) to be implied under that section, not under section 29(b).¹⁴³ On the contrary, the Supreme Court suggested that the language in section 29(b) making a contract "voidable at the option of the deceived party" was one reason for implying a private right of action under section 10(b).¹⁴⁴ Although the Supreme Court in *J. I. Case Co. v. Borak*¹⁴⁵ originally found a private right of action for violation of

139. *Transamerica*, 444 U.S. at 18.

140. *Id.* at 19.

141. *Id.* at 18-24.

142. *Id.* at 25-26, 28-30 (White, J., dissenting). Justice White was joined by Justices Brennan, Marshall, and Stevens in his strong dissent characterizing the majority's position as "anomalous." *Id.* at 26.

143. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983); *Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971).

144. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 735 (1975).

145. 377 U.S. 426 (1964).

section 14(a) of the Exchange Act to be implied under section 27,¹⁴⁶ the Court in *Touche Ross & Co. v. Redington*¹⁴⁷ subsequently questioned the propriety of finding an implied private remedy under the Act by such reliance on some other provision outside the specific provision alleged to have been violated. As the Court has stated, "[section 27] creates no cause of action of its own force and effect; it imposes no liabilities. The source of plaintiffs' rights must be found, if at all, in the substantive provisions of the 1934 Act which they seek to enforce, not in the jurisdictional provision."¹⁴⁸ The *Touche Ross* Court went on to observe that in *Borak* it had "found a private cause of action implicit in § 14(a)."¹⁴⁹ Moreover, when the Court has declined to imply private remedies for violations of the 1934 Act, it has done so under the provisions that were allegedly violated, without any reference to section 29(b).¹⁵⁰

Some lower courts have nonetheless concluded that a private right of action may be implied under section 29(b).¹⁵¹ However, reliance on section 29(b) "confuses the question whether a cause of action exists with the question of the nature of relief available in such an action."¹⁵² As both the majority and dissent in *Transamerica* recognized, a provision like section 29(b) which renders void contracts made in violation of the Act "clearly contemplates the existence of private rights under the Act."¹⁵³ But in the words of the dissent, such a provision "'creates no cause of action of its own force and effect; it imposes no liabilities.' . . . [It] merely specifies one consequence of a violation of the substantive prohibitions of"¹⁵⁴ another section of the Act which proscribes fraudulent conduct. Moreover, rather than creating the private right of action for violation of section 15(c)(1), section 29(b) specifically restricts it with a limitations provision.¹⁵⁵

146. *Id.* at 430-31.

147. 442 U.S. 560 (1979).

148. *Id.* at 577.

149. *Id.*

150. See, e.g., *id.* at 576 (no implied right under § 17(a) of the 1934 Act); *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 42 (1977) (no implied right for defeated tender offeror under § 14(e)). See also *supra* note 51.

151. *Western Fed. Corp. v. Erickson*, 739 F.2d 1439, 1443 n.5 (9th Cir. 1984); *Regional Properties, Inc. v. Financial & Real Estate Consulting Co.*, 678 F.2d 552, 558 (5th Cir. 1982), *after remand*, 752 F.2d 178, 182 (5th Cir. 1985); *Eastside Church of Christ v. National Plan, Inc.*, 391 F.2d 357, 362 (5th Cir.), *cert. denied*, 393 U.S. 913 (1968); *Goldstein v. Groesbeck*, 142 F.2d 422, 427 (2d Cir.), *cert. denied*, 323 U.S. 737 (1944); *Rhoades v. Powell*, 644 F. Supp. 645, 661-64 (E.D. Cal. 1986); *Warshow v. H. Hentz & Co.*, 199 F. Supp. 581, 582 (S.D.N.Y. 1961) (permitting private claim for rescission under § 29(b) and private claim for damages under § 7(c)); *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946) (separate causes of action under § 10(b) and § 29(b)); *Geismar v. Bond & Goodwin, Inc.*, 40 F. Supp. 876, 878 (S.D.N.Y. 1941). See generally *Gruenbaum & Steinberg*, *supra* note 6.

152. *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 30 (White, J., dissenting).

153. *Id.* at 29 (White, J., dissenting).

154. *Id.* (quoting *Touche Ross & Co. v. Redington*, 442 U.S. 560, 577 (1979)).

155. See *supra* note 134. See also *infra* notes 417-26 and accompanying text.

Logically, either all the private rights of action under the 1934 Act should arise under the substantive provisions of the Act that allegedly have been violated, or they should all arise under section 29(b), which broadly applies to "any" provision of the 1934 Act. It would be anomalous, at this late date, to hold that a private right for violation of section 15(c)(1) arises, not under itself as do other implied remedies in the 1934 Act, but under the separate provisions of section 29(b). Furthermore, the legislative histories of these two sections support the conclusion that the implied remedy should be found under section 15(c)(1) rather than section 29(b).

2. The Legislative History of Section 15(c)(1)

a. Introduction

The history of the amendments to section 15 reflects the evolution of government regulation of the OTC market and of the brokers and dealers in that market. From its small beginning as a single-paragraph provision with a broad grant of authority to the Commission,¹⁵⁶ section 15 now spans several

156. As originally enacted in 1934, § 15 provided:

Sec. 15. It shall be unlawful, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest and to insure to investors protection comparable to that provided by and under authority of this title in the case of national securities exchanges, (1) for any broker or dealer, singly or with any other person or persons, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of making or creating, or enabling another to make or create, a market, otherwise than on a national securities exchange, for both the purchase and sale of any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills, or unregistered securities the market in which is predominantly intrastate and which have not previously been registered or listed), or (2) for any broker or dealer to use any facility of any such market. Such rules and regulations may provide for the regulation of all transactions by brokers and dealers on any such market, for the registration with the Commission of dealers and/or brokers making or creating such a market, and for the registration of the securities for which they make or create a market and may make special provision with respect to securities or specified classes thereof listed, or entitled to unlisted trading privileges, upon any exchange on the date of the enactment of this title, which securities are not registered under the provisions of section 12 of this title.

Pub. L. No. 291, Ch. 404, 48 Stat. 881, 895-96 (1934). As originally enacted in 1934, § 29(b) provided:

Sec. 29(b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall

pages of text, and sections 15A,¹⁵⁷ 15B,¹⁵⁸ and 15C¹⁵⁹ are even longer. As originally enacted in 1934, section 15 broadly set forth Congress's regulatory goals in this field by defining the areas in which such regulation should take place, namely: (1) regulation of conduct by OTC broker-dealers, (2) registration of OTC broker-dealers with the SEC, and (3) registration of securities traded in the OTC market.

These goals have remained unchanged since 1934.¹⁶⁰ All of the amendments to section 15, including sections 15A, 15B, and 15C, represent continuing legislative efforts to achieve these goals appropriately and effectively by a combination of self-regulation and direct governmental regulation of brokers and dealers. Indeed, the history of these amendments can be seen as a history of the tension between, and the (mostly) cooperative efforts by, the SEC and the so-called self-regulatory organizations as each attempts to regulate the activities of brokers and dealers.

Section 15(c)(1) was enacted amidst this evolving regulation of brokers and dealers in the securities industry. At only one point in the history of the amendments to section 15(c)(1)—in 1938—is civil liability under the section discussed directly, and those legislative discussions rather pointedly demonstrate congressional recognition of private litigation under section 15(c)(1).¹⁶¹ Since 1938, section 15(c)(1) has been amended only once, in a fashion that did not address directly the implication of a private remedy.¹⁶² It is nonetheless useful to review the legislative amendments to other provisions of section 15, both to demonstrate that there has been no congressional reconsideration of civil liability under section 15(c)(1) and to understand how civil lawsuits play a supporting role in the regulatory scheme in which, unquestionably, the SEC and the self-regulatory organizations were cast in the leading parts.¹⁶³

be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or regulation.

Pub. L. No. 291, Ch. 404, 48 Stat. 881, 903 (1934).

157. 15 U.S.C. § 78o-3 (1982 & Supp. IV 1986).

158. 15 U.S.C. § 78o-4 (1982 & Supp. IV 1985).

159. 15 U.S.C.A. § 78o-5 (West Supp. 1987).

160. The 1938 amendments to § 15 were among the most important of the amendments to this section, *see infra* notes 181-219 and accompanying text, yet Congress acknowledged adherence to the original legislative goals of this section:

In the judgment of the committee this bill, like the amendment of section 15 enacted in May 1936, does not enlarge the objectives or the outline of regulatory functions initially set forth in the original section 15. On the contrary, it represents the essential process of filling in and implementing the original outline in order to make possible the realization of the original objectives.

S. REP. No. 1455, *supra* note 95, at 4; H.R. REP. No. 2307, *supra* note 95, at 5.

161. *See infra* notes 194-214 and accompanying text.

162. *See infra* notes 247-48 and accompanying text.

163. The role of civil litigation as a supplement to the enforcement efforts of the SEC and the self-regulatory organizations is examined in connection with the third *Cort* factor, *see infra* notes 283-94 and accompanying text.

The provisions of the 1934 Act governing the regulation of brokers and dealers on the exchanges and in the OTC market have been substantially amended and expanded over the years as the federal government better understood the nature and necessity of regulation of this group of professionals and responded to specific crises in the securities markets that arose over the last 50 years. This portion of the Article delineates the way in which these pieces of legislation have been patched together.

b. 1934—Original Enactment of Section 15

Federal regulation of brokers and dealers began in 1934 with a focus on the regulation of the stock exchanges. Until the 1934 Act was enacted, stock exchanges were "subject to regulation by no governmental authority and . . . exercised unrestricted dominion over the activities of their members."¹⁶⁴ After a thorough investigation begun in 1932 into the role of the stock exchanges in the stock market crisis, a Senate Committee on Banking and Currency stated that the "exposures before the subcommittee of the evils and abuses which flourished on the exchanges, and their disastrous effects upon the entire Nation, finally compelled the conclusion, even among partisan advocates of the exchanges themselves, that Federal regulation was necessary and desirable."¹⁶⁵

Although there was general agreement on the need to regulate the exchanges and their broker-dealer members, there were differing views over the form such regulation should take. On the one hand was the report of a Committee on Stock Exchange Regulation, often referred to as the "Roper Report." The Roper Report recommended that latitude be given to the exchanges to regulate their members with some governmental oversight to ensure they performed such self-regulation.¹⁶⁶ "In the report of the Roper committee, . . . the regulatory functions of this governmental agency [ultimately to be the SEC] were held in reserve and were employed only to supplement and supervise what in the first instance was self-regulation of the exchanges."¹⁶⁷ As Roper

164. S. REP. No. 1455, 73d Cong., 2d Sess. 77 (1934) (so-called "Fletcher Report").

165. *Id.* at 81.

166. ROPER REPORT, *supra* note 93, at 8-10. The Roper Report recommended that the stock exchanges themselves rather than the federal government take primary responsibility for regulating the conduct of their broker-dealer members:

At the same time, it must be recognized that a Government agency operating in this field, and endowed with wide powers to license or close exchanges, coupled with a reserve power to license individual brokers as more fully discussed hereafter, and to make rules and regulations concerning a delicate mechanism like the stock exchange must be in the highest degree effective, nonpolitical, able to act rapidly, and at the same time so constituted as to place responsibility to the fullest extent possible on the private bodies now handling the work of security exchanges.

Id. at 7.

167. *House Hearings on H.R. 7852, supra* note 85, at 513 (statement of John Dickinson).

Committee Chairman John Dickinson explained in the legislative hearings:

The Roper committee report went on the theory that if governmental regulation attempts to do too much directly and to control and intervene directly in the first instance over the whole field which it covers, it is in danger of breaking down and proving ineffective. . . .

No doubt the exchanges will frequently fail to do a good job of regulating their members, but even so, it seemed to the Roper committee during its deliberations likely that Government regulation was likely to be more effective and less unwieldy it [sic] it was applied to the exchanges in an effort to make them do their own job and to come down on them like a ton of bricks if they did not do their job, rather than for the Government itself to take over from them that job of direct regulation and attempt to perform it from the very beginning and in the first instance by governmental policing methods.¹⁶⁸

On the other hand was the initial legislative proposal, the Fletcher-Rayburn bill, which:

provided for far more direct governmental regulation of the exchanges and the industry than the Roper Committee had recommended. . . . The Fletcher-Rayburn bill . . . gave to a federal Commission extensive direct powers to establish standards for broker-dealer and exchange activity. The legislation which finally became the Exchange Act represented a compromise between the two approaches.¹⁶⁹

A member of the House Committee observed: "I understand that the fundamental principle . . . is this—that exchanges should be permitted or required to regulate themselves; but there should be Federal authority holding the power which in a previous administration would have been referred to as 'a big stick.'"¹⁷⁰ The final House report summed up the concept of self-regulation as it was to be applied to broker-dealer members of the exchanges:

Although a wide measure of initiative and responsibility is left with the exchanges, reserved control is in the Commission if the exchanges do not meet their responsibility. It is hoped that the effect of the bill will be to give to the well-managed exchanges that power necessary to enable them to effect themselves needed reforms and that the occasion for direct action by the Commission will not arise.¹⁷¹

This concept of self-regulation by the industry coupled with "reserved control" by the federal government became the foundation supporting future regulation of all brokers and dealers both on the exchanges and in the OTC

168. *Id.* at 513-14.

169. SECURITIES INDUSTRY STUDY, REPORT OF THE SUBCOMM. ON SECURITIES: COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 93D CONG., 1ST SESS. 139-40 (Comm. Print 1973) [hereinafter SECURITIES INDUSTRY STUDY]. A good discussion of this aspect of the history of the 1934 Act is found in this Committee Print at pages 137-43. See also *House Hearings on H.R. 7852, supra* note 85, at 26-27.

170. *House Hearings on H.R. 7852, supra* note 85, at 544.

171. H.R. REP. NO. 1383, *supra* note 87, at 15.

market. Indeed, Congress had reached the same conclusion on the need to regulate trading in the OTC markets that it had reached with respect to the exchanges:

It has been deemed advisable to authorize the Commission to subject such activities [trading on the OTC markets] to regulation similar to that prescribed for transactions on organized exchanges. This power is vitally necessary to forestall the widespread evasion of stock exchange regulation by the withdrawal of securities from listing on exchanges, and by transferring trading therein to "over-the-counter" markets where manipulative evils could continue to flourish, unchecked by any regulatory authority.¹⁷²

In 1934, however, no self-regulatory organization existed in the OTC market that was comparable to the exchanges, and Congress had little understanding of the nature of the OTC market itself.¹⁷³ Consequently, the original enactment of section 15 was intended as a broad congressional directive that "[told] the Commission to think out an effective way of regulating 'over-the-counter' transactions,"¹⁷⁴ and was a simple recognition of the need to begin investigation into how to regulate the unorganized OTC market and the brokers and dealers who traded in it.

c. 1936 Amendments

In 1936, Congress amended section 15 to provide four subsections.¹⁷⁵ These subsections reflected the progress the SEC had made toward achieving the

172. S. REP. NO. 792, *supra* note 87, at 6.

173. The Roper committee was at a complete loss as to how to begin to formulate a federal regulatory policy governing the OTC market:

On the basis of the consideration which it has been able to give to this subject, your committee has come to the conclusion that the problem of the "over-the-counter" markets cannot be satisfactorily dealt with by Federal governmental action. It has not yet found any method of controlling such markets which it considers feasible or which could be applied without building up a Federal policing agency on such a scale as to be impracticable.

ROPER REPORT, *supra* note 93, at 20.

174. *House Hearings on H.R. 7852*, *supra* note 85, at 26.

175. The 1936 amendment to § 15 renumbered that section as § 15(c):

(c) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

Pub. L. No. 621, Ch. 462, 49 Stat. 1375, 1378 (1936). No change was made to § 29(b). Sections 15(a), (b), and (d) were completely new additions; section 15(c) largely adopted the 1934 version of section 15. Subsections (a), (b), and (c) incorporated into statutory law the rules and regulations that had been adopted by the SEC up to that time pursuant to its authority under the original 1934 enactment of § 15. S. REP. NO. 1739, 74th Cong., 2d Sess. 3-4 (1936); H.R. REP. NO. 2601, 74th Cong., 2d Sess. 4-5 (1936).

three goals of the original enactment.¹⁷⁶ Since 1934, the SEC had progressed toward the second goal by adopting rules and regulations governing the registration of OTC brokers and dealers. Sections 15(a) and (b) incorporated this regulatory scheme into statutory law.¹⁷⁷ Congress also added section 15(d) in an effort to realize the third goal: the gradual process of registering OTC securities.¹⁷⁸ It was the lot of section 15(c) to become the principal tool in achieving the first goal identified in the original section 15, that is, the regulation of broker-dealer conduct.¹⁷⁹

The new section 15(c) basically incorporated the original section 15, with two distinctions. First, section 15(c) expressly became an antifraud statute. Whereas the 1934 version had broadly prohibited conduct in violation of SEC rules governing OTC transactions, the 1936 amendment specifically prohibited the effectuation of OTC transactions "by means of any manipulative, deceptive, or other fraudulent device or contrivance." Second, the 1936 amendment changed the standard of inclusion. After amendment, the standard was based upon the use of mails or any means or instrumentality of interstate commerce "to effect any transaction in, or to induce the purchase or sale of" an OTC security, rather than upon the use of such facilities for "making or creating . . . a market" for such securities.¹⁸⁰

The thrust of the 1936 amendments to section 15 was to incorporate into the statute the regulations the SEC had adopted up to that time to govern brokers and dealers in the OTC market and corporations whose securities were traded over-the-counter. However, nothing in the legislative history to the 1936 amendment suggests that Congress considered, one way or the other, the issue of a private right of action under section 15(c).

d. 1938 Amendments—The Maloney Act

The 1938 amendments¹⁸¹ to the Exchange Act represented a continuation of efforts by the SEC and Congress to effect a comprehensive regulation of the

176. See *supra* text accompanying notes 156-63.

177. *Unlisted Securities: Hearings on S. 4023 Before the House Comm. on Interstate and Foreign Commerce*, 74th Cong., 2d Sess. 10 (1936) [hereinafter *Hearings on S. 4023*].

178. *Hearings on S. 4023, supra* note 177, at 10-11; S. REP. No. 1739, *supra* note 175, at 4; H.R. REP. No. 2601, *supra* note 175, at 4-5.

179. *Hearings on S. 4023, supra* note 177, at 11-12.

180. The only reason given for this change in the standard of inclusion was simply that it was "[i]n the interest of clarity and ease of administration." S. REP. No. 1739, *supra* note 175, at 3-4; H.R. REP. No. 2601, *supra* note 175, at 4. Particularly noteworthy about the change is that § 15(c) thereby introduced a distinction between, on the one hand, "any transaction" in an OTC security effectuated by fraud, and, on the other hand, a "purchase or sale" of an OTC security effectuated by fraud. That § 15(c) thus applied not only when a broker-dealer induced a "purchase or sale" of an OTC security but also when he effected "any transaction" involving an OTC security by means of a fraudulent device or contrivance suggests that § 15(c) was not intended to require an actual purchase or sale. This conclusion is bolstered by the fact that in 1975 § 15(c) was further amended to apply to a broker-dealer's "attempt to induce" a purchase or sale. See *infra* notes 247-48, 387-94 and accompanying text.

181. Pub. L. No. 719, Ch. 677, 52 Stat. 1070, 1070 (1938). As amended in 1938, § 15(c)

brokers and dealers in the OTC market. The preamble to the Maloney Act (as these 1938 amendments were called) stated that it was an Act to "provide for the establishment of a mechanism of regulation among over-the-counter brokers and dealers . . . [and] to prevent acts and practices inconsistent with just and equitable principles of trade."¹⁸² The "mechanism" of regulation was to be two-fold: first, to provide for one or more voluntary self-regulatory associations of OTC broker-dealers, and second, to give the SEC direct rule-making power over all broker-dealers, whether they joined such voluntary associations or not.¹⁸³ The first aspect was accomplished by the addition of

provided:

(c)(1) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of the subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

(2) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, in connection with which such broker or dealer engages in any fraudulent, deceptive, or manipulative act or practice, or makes any fictitious quotation. The Commission shall, for the purposes of this paragraph, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative and such quotations as are fictitious.

(3) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, 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 to provide safeguards with respect to the financial responsibility of brokers and dealers.

Id. at 1075.

As amended in 1938 and as it remains today, § 29(b) was identical to the 1934 enactment, except that it added the following proviso at the end:

Provided, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of section 15 of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of Section 15 of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation.

Id. at 1076. Section 29(b) has not been amended since 1938. *See supra* note 134 for complete text.

182. 52 Stat. at 1070.

183. *Senate Hearings on S. 3255, supra* note 97, at 17-18 (statement of SEC Commissioner George C. Mathews).

an entirely new section 15A.¹⁸⁴ The second was contained in the amendments to section 15(c).¹⁸⁵

By adding section 15A, Congress was adopting a program of self-regulation of OTC broker-dealers closely modelled on the framework created under the 1934 Act for the stock exchanges.¹⁸⁶ The witnesses in the 1938 hearings and the reports of the committees recognized that direct governmental regulation by the SEC of each individual broker-dealer in the OTC market could not be as practical, efficient, or comprehensive a program of policing that a voluntary self-regulatory association of broker-dealers could be.¹⁸⁷ Just as in 1934 Congress was faced with a choice between self-regulation by the stock exchanges and direct governmental control of the brokerage industry, so Congress in 1938 faced the same two alternatives in the OTC market and effected a similar compromise between self-regulation and governmental control.¹⁸⁸ The intent of the new section 15A was to establish a program of "cooperative regulation"¹⁸⁹

184. 5 U.S.C. § 78o-3 (1982).

185. S. REP. No. 1455, *supra* note 95, at 1; H.R. REP. No. 2307, *supra* note 95, at 2.

186. *Senate Hearings on S. 3255, supra* note 97, at 18-20 (statement of Commissioner Mathews); *Regulation of Over-the-Counter Markets: Hearings Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce on S. 3255 and H.R. 9634, 75th Cong., 3d Sess. 17* (1938) [hereinafter *House Hearings on S. 3255*] (statement of Commissioner Mathews). *See also* S. REP. No. 1455, *supra* note 95, at 4; H.R. REP. No. 2307, *supra* note 95, at 5.

187. *Senate Hearings on S. 3255, supra* note 97, at 7-11, 16; S. REP. No. 1455, *supra* note 95, at 3-4; H.R. REP. No. 2307, *supra* note 95, at 4-5.

188. A Senate report observed:

The committee believes that there are two alternative programs by which this problem [how to regulate the OTC market] could be met. The first would involve a pronounced expansion of the organization of the Securities and Exchange Commission; the multiplication of branch offices; a large increase in the expenditure of public funds; an increase in the problem of avoiding the evils of bureaucracy; and a minute, detailed, and rigid regulation of business conduct by law. It might very well mean expanding the present process of registration of brokers and dealers with the Commission to include the proscription not only of the dishonest, but also of those unwilling or unable to conform to rigid standards of financial responsibility, professional conduct, and technical proficiency. The second of these alternative programs, which the committee believes distinctly preferable to the first, is embodied in S. 3255. This program is based upon cooperative regulation, in which the task will be largely performed by representative organizations of investment bankers, dealers, and brokers, with the Government exercising appropriate supervision in the public interest, and exercising supplementary powers of direct regulation. In the concept of a really well organized and well-conducted stock exchange, under the supervision provided by the Securities Exchange Act of 1934, one may perceive something of the possibilities of such a program.

S. REP. No. 1455, *supra* note 95, at 3-4; H.R. REP. No. 2307, *supra* note 95, at 4-5. *See also House Hearings on S. 3255, supra* note 186, at 67.

189. On the nature of "cooperative regulation":

The framework of the Maloney bill is an effort to foster self-discipline within the law and the confines of the National Constitution, to permit self-regulation subject to a tolerant Government supervision designed to help set the general course and not permit private interests to overcome the public interest. It is an effort to create a legal framework for cooperation between your Government and your business. It

in which one or more professional associations of broker-dealers would substantially shoulder the job of regulation and disciplining its members, while the SEC exercised a surveillance and supervisory role over the associations. As a result of this legislation, the National Association of Securities Dealers (NASD) was born.¹⁹⁰

Under the Maloney Act, the national association was not to have plenary or exclusive power over broker-dealers in the OTC market. Just as in the case of the stock exchanges, the SEC itself was to have the power to adopt rules and regulations designed "to prevent conduct inconsistent with just and equitable principles of trade and to assure to investors in the over-the-counter markets protection comparable to that provided under the Exchange Act with respect to exchanges."¹⁹¹ The amendments to section 15(c) provided some of this power. The prior section 15(c) was renumbered and in its entirety reenacted as section 15(c)(1); new sections 15(c)(2) and 15(c)(3) were added.¹⁹² All three

is not enough to say that we favor cooperation between business and Government. It is necessary to work out the mechanics and tools for that cooperation. One way to cooperate is for business and Government to sit down together and try to devise intelligent laws and then for business associations to insist upon its members obeying those laws.

Extension of Remarks of Senator Maloney in Appendix to the Congressional Record, Address of Robert E. Healy, Commissioner, Securities and Exchange Commission, at the Annual Dinner of the New York Security Dealers' Association, March 10, 1938, 83 CONG. REC. 978 (1938).

190. Although the Maloney Act did not limit the number of these broker-dealer associations, the SEC and industry representatives ultimately agreed that a single national association would be the most appropriate way to implement section 15A. In 1939, the National Association of Securities Dealers (NASD) was formed, and no other broker-dealer organization has ever registered under this provision of the Act. H.R. REP. NO. 1519, 92d Cong., 2d Sess. 82 (1972).

191. *Senate Hearings on S. 3255, supra* note 97, at 26.

192. The most complete congressional statement of the 1938 amendments to § 15(c) is contained in H.R. REP. NO. 2307, *supra* note 95, at 10-11. The House Report states:

[Section 15(c)] relates to the direct powers of the Commission to adopt rules generally applicable to over-the-counter brokers and dealers.

As has been explained, paragraph (1) of the proposed new subsection (c) is identical with the present subsection (c), under which the Commission has adopted rules and regulations which have withstood the test of experience and have met with the approval of representative groups of brokers and dealers subject thereto. It is contemplated that rules of similar character and additional appropriate rules will be adopted under paragraph (1) of the proposed new subsection (c).

Paragraph (2) of the proposed new subsection (c), which does not apply to transactions in exempted securities, clarifies and broadens the power of the Commission by rules and regulations to prevent fraudulent, manipulative, and deceptive acts and practices and fictitious quotations.

Paragraph (3) of the proposed new subsection (c), which likewise does not apply to transactions in exempted securities, empowers the Commission by rule and regulation to take action against certain other abuses and to promote orderly and efficient business practices in connection with specified subjects.

The need of these additional powers has been demonstrated by the administrative experience of the Commission. Thus, paragraphs (2) and (3) represent a necessary step forward toward realizing the original objectives and implementing the original standards of regulation set forth in section 15 of the Exchange Act in its original form.

Id.

subsections gave the SEC the power to adopt regulations aimed directly at fraudulent practices by brokers and dealers. The retention (in the case of section 15(c)(1)) and enactment (in the cases of sections 15(c)(2) and 15(c)(3)) of direct rule-making power was designed, in large part, to ensure that broker-dealers who declined to join the voluntary association would not escape regulation altogether or be subject to less stringent regulation than fellow broker-dealers who did join it.¹⁹³

Thus, Congress intended to subject OTC brokers and dealers to regulation by both the SEC and the new voluntary professional association. But what about the private investor—did Congress contemplate that he would have a role in policing broker-dealer unfair trade practices? The hearings and reports suggest affirmatively that he was to have a such role.

In an early draft of the 1938 amendments, SEC rule-making power under section 15(c) was directed at five categories of broker-dealer conduct: (1) fraudulent, deceptive, or manipulative acts or practices; (2) fictitious quotations; (3) financial responsibility; (4) manner, method, and place of soliciting business; and (5) time and method of making settlements, payments, or deliveries.¹⁹⁴ These five clauses were treated separately in the draft amendment to section 29(b).¹⁹⁵ Previously, section 29(b) had made no reference at all to

193. *Senate Hearings on S. 3255*, *supra* note 97, at 26, 41-42 (statements of Commissioner Mathews and Senator Maloney); *House Hearings on S. 3255*, *supra* note 186, at 38 (statement of Mr. Lothrop Withington).

194. The text of one of the early drafts of the 1938 amendment to § 15(c) provided:

(c) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, *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* (1) to prevent fraudulent, deceptive, or manipulative acts or practices; (2) to prevent fictitious quotations; (3) to provide safeguards with respect to the financial responsibility of brokers and dealers; (4) to regulate the manner, method, and place of soliciting business; and (5) to regulate the time and method of making settlements, payments, or deliveries: *Provided, That nothing in clause (3), (4), or (5) of this subsection shall be construed to apply with respect to any transaction by a broker or dealer in any exempted security.*

H.R. REP. NO. 2307, *supra* note 95, at 13 (emphasis shows draft changes to § 15(c)).

195. The text of an early draft of the 1938 amendment to § 29(b) provided:

(b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or [regulation.] *regulation: Provided, That*

section 15, but rather had declared all contracts made in violation of any provision of the Act "void."¹⁹⁶ The draft amendment to section 29(b) declared that contracts made in violation of clauses (3), (4) and (5) of section 15(c) would not be void unless the SEC by rule permitted them to be.

The reasoning for the distinction among the five draft clauses of section 15(c) is worth quoting in full, because it demonstrates an intent to allow civil lawsuits for certain kinds of broker-dealer abuses, but not for others:

Clauses (1) and (2) of the proposed new subsection (c) substantially reenact, but clarify and broaden, the substance of this subsection in its present form. Under the present form of this subsection, the Commission has adopted rules and regulations which have withstood the test of experience and have met with the approval of representative groups of brokers and dealers subject thereto. It is contemplated that rules of similar character and additional appropriate rules will be adopted under clauses (1) and (2) of the proposed new subsection (c).

Clauses (3), (4), and (5) empower the Commission by rule and regulation to take action against certain other abuses and to promote orderly and efficient business practices in connection with specified subjects. The need of these additional powers have been demonstrated by the administrative experience of the Commission. These clauses thus represent a necessary step forward toward realizing the original objectives and implementing the original standards of regulation set forth in section 15 of the Exchange Act in its original form.

.....
Reference has been made hereinabove to the two types of rules and regulations which it is contemplated the Commission will adopt under clauses (3), (4) and (5) of the proposed new subsection (c) of section 15: First, rules and regulations striking at abuses in the form of dishonest or overreaching conduct within the scope of the standards set forth in clauses (3), (4) and (5); second, rules and regulations designed to promote orderly and efficient business practices in connection with matters falling within the scope of these standards. *Clearly, contracts entered into by brokers and dealers with customers in violation of any rule or regulation of the first type should be void in accordance with subsection (b) of section 29 of the Exchange Act, so that the innocent customer may rescind the contract and recover such payment as he may have made.* On the other hand, there appears to be no sound reason why contracts entered into in violation of the second type of rule or regulation should be void under subsection (b) of section 29. Accordingly, section 3 of the bill amends subsection (b) of section 29 to provide that contracts entered into in violation of any rule or regulation under clauses (3), (4), or (5) shall not

no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to clause (3), (4), or (5) of subsection (c) of section 15 of this title, except insofar as the Commission, having determined that such action is necessary or appropriate for the protection of investors, shall have expressly provided in such rule or regulation that the provisions of this subsection shall apply in the case of any violation thereof.

H.R. REP. NO. 2307, *supra* note 95, at 18 (emphasis shows draft changes to § 29(b)).

196. See *supra* note 156.

be void by reason of subsection (b) of section 29, unless the Commission has determined that it is necessary or appropriate for the protection of those persons within the purposes of such subsection that the subsection apply. The Commission must, moreover, upon making such a determination, expressly provide in the particular rule or regulation that the provisions of subsection (b) of section 29 apply. It is contemplated that the Commission will take such action only with respect to rules and regulations of the first type above described.¹⁹⁷

These draft amendments to section 15(c) thus distinguish between two types of rules under section 15(c): rules aimed at "dishonest or overreaching conduct" on the one hand, and rules aimed at promoting "orderly and efficient business practices" on the other. The intent, as demonstrated in the above passage, was to allow a private investor to sue for violation of the first type of rule, but not for violation of the second type of rule, unless the Commission deemed it "necessary or appropriate in the public interest or for the protection of investors."¹⁹⁸

The reason for making this distinction is found in the House hearings, which further demonstrated that civil lawsuits were contemplated under these amendments to sections 15(c) and 29(b). The securities brokerage industry protested strenuously over the threat of civil liability posed by these amendments. As one witness representing broker-dealer interests stated: "The chief objection, however, which our committee has to this bill is directed to the civil liabilities that arise or are apt to arise under it."¹⁹⁹ Broker-dealer witnesses at the House hearings raised three principal objections to these drafts: (1) civil liability could result for violation of "technical" rules; (2) there was no statute of limitations for civil lawsuits involving violations of section 15(c); and (3) rescission was thought too severe a remedy for such violations.²⁰⁰

As to the first issue, broker-dealers opposed any kind of civil liability for violations of clauses (3), (4), and (5), which were perceived to be "technical" rules rather than rules designed to check forms of dishonest or overreaching conduct.²⁰¹ In addition, it was pointed out that in allowing the SEC discretion

197. S. REP. No. 1455, *supra* note 95, at 10-11 (emphasis added).

198. See *supra* note 194.

199. *House Hearings on S. 3255, supra* note 186, at 38 (statement of Mr. Lothrop Withington, representing a group of dealers and brokers in New England).

200. *Id.* at 34-35, 37-48. These were the principal remaining objections identified by SEC Commissioner Mathews during the House committee's consideration of the bill. *Id.* at 6-9.

201. The testimony of Mr. John K. Starkweather, on behalf of the Investment Bankers Association, expressed this viewpoint:

But in general this situation has to do with the civil liabilities which may be incurred for violations of items 3, 4, and 5 of section 2 [of the draft bill (referring to clauses (3), (4) and (5) of the draft of § 15(c)—see *supra* note 194)].

....

I do not know what type of regulation the Commission has in mind under those sections. It is obvious for the most part they will have to do with routine and highly technical subjects. For instance, time and method of making settlement: I cannot

to determine when suit may be brought under clauses (3), (4), and (5), "it puts the Commission in the position of creating a civil liability."²⁰² Both the SEC²⁰³ and the Senate committee²⁰⁴ agreed that violation of "technical" rules involving business practices should not give rise to liability under section 29(b) to avoid a contract. However, there appeared to be no objection to civil liability for "dishonest or overreaching" (that is, fraudulent) conduct.²⁰⁵

In the final version of section 15(c)(1), Congress accommodated the objectors on this first issue. SEC rule-making authority under clauses (4) and (5) was eliminated altogether. The SEC was not given discretion to determine whether to permit civil actions for any violations under section 15(c), and section 29(b) expressly disallowed civil actions to avoid a contract made in violation of clauses (2) and (3) of section 15(c).²⁰⁶ By eliminating civil liability (at least for rescission) under these other clauses, Congress must have intended to retain civil liability for violations of clause (1) of section 15(c), to which no objection had been raised.²⁰⁷

imagine why such a section as that should require power on the part of the Commission to put into effect a penalty which may involve recession [sic] at some date later which is always after the market has gone substantially down

. . . .

Now, I have no objection, of course, to any man asking for his money back if I have done something which was improper. If, for instance, I have given him improper information, if I have misled him, or deceived him in any way, obviously there is no objection

. . . .

Now, if it is a question of fraud; if it is a question of fraudulent manipulation, I have no objection at all; but when it comes to a question of a violation of a highly technical rule, I see no reason why the Commission should have the power to say to me that this particular rule for reasons that seem to us desirable, shall make you subject to the voiding of that contract.

Id. at 34-35. *See also id.* at 7 (statement of Commissioner Mathews), 38-39 (statement of Mr. Withington).

202. *Id.* at 41 (statement of Mr. Washington).

203. *Id.* at 7-9 (statement of Commissioner Mathews).

204. *See supra* note 197 and accompanying text.

205. On the contrary, the witnesses openly acknowledged the propriety of a civil lawsuit where the broker-dealer had committed fraud. *See House Hearings on S. 3255, supra* note 186, at 35, 42.

206. *See supra* note 181.

207. If the thrust of the objections was that broker-dealers should be held civilly liable only for "manipulative, deceptive, or otherwise fraudulent" conduct, and not for violation of so-called "technical" rules, then it is not immediately clear from the language of these provisions why liability under clause (c)(2) should be treated differently from civil liability under clause (c)(1), for the language of these two clauses is very similar. *See supra* note 4. The debates at the hearings help to give an insight into this different treatment. The House committee report indicated that the proposed amendments to § 15(c) would "clarify and strengthen" the SEC's regulatory powers over the OTC market. H.R. REP. NO. 2307, *supra* note 95, at 2. Since clause (c)(1) was ultimately a re-enactment of the 1936 version of § 15(c), the broadening of SEC powers is contained in clauses (c)(2) and (c)(3). *Id.* at 10-11. *See also* S. REP. NO. 1455, *supra* note 95, at 1, 10. It is understandable from the language of clause (c)(3) why rules "to provide safeguards with respect to the financial responsibility of brokers and dealers" would strike the witnesses and congressional

As to the second issue, broker-dealers objected that the drafters of the amendments "have created this civil liability without realizing there is no general statute of limitation in the act."²⁰⁸ An objection was raised that under the express liability provisions of sections 9(e)²⁰⁹ and 18(c)²¹⁰ there was a limitations period, and it was urged that a comparable provision be adopted for violations of section 15(c).²¹¹ Congress satisfied this objection in the final version of section 29(b) by adopting the provision that suits to avoid a contract in violation of section 15(c)(1) be brought within 1 year of discovery of the violation of the statute and within 3 years of the violation itself.²¹² This limitations period is identical to those of the express liability provisions of sections 9(e) and 18(c).

The third major objection to the 1938 amendment was that, in a civil lawsuit for violation of section 15(c), it could be argued that the investor need not show actual damages, but rather he could get rescission of the contract under section 29(b) in the absence of proof of causation of injury for a violation of section 15(c).²¹³ The objectors urged that Congress limit recovery

committees as "technical." It is not immediately clear from the language of clause (c)(2), however, why SEC rules defining "acts or practices as are fraudulent, deceptive, or manipulative" or "fictitious quotations" would be considered any more "technical" than SEC rules under clause (c)(1), which refers to "any manipulative, deceptive, or other fraudulent device or contrivance."

The explanation lies largely in the empowering of the SEC, under (c)(2), by rule to "prescribe means reasonably designed to prevent" the proscribed fraudulent conduct. The draft amendment to § 15(c) first introduced this "prevent" language, *see supra* note 194, and it was strenuously objected to. The witnesses at the hearings distinguished rules defining fraudulent conduct from rules designed to *prevent* fraudulent conduct. The latter rules were considered potentially "technical," and the power to make them was considered an extension of SEC power which threatened to open up a broader range of business activity to civil liability. *House Hearings on S. 3255, supra* note 186, at 38-41. *See also id.* at 13-14, 32, 48-50, 54-55, 57-58, 60-68. Similar "prevent" language had been introduced into § 15(c) in 1936 and was ultimately discarded after similar protests from the brokerage industry. *See id.* at 57; *Hearings on S. 4023, supra* note 177, at 12-14, 23. Significantly, although such "prevent" language likewise re-appeared in the early draft of clauses (c)(1) and (c)(2) in 1938, it also was ultimately discarded from clause (c)(1). *Compare supra* note 194 with *supra* note 181. *Cf. infra* note 248 (discussing "attempt to induce" language as a backdoor way to effect "prevent" language). Another difference to which some witnesses attached considerable significance was the inversion of the 1936 phrase "manipulative, deceptive, or otherwise fraudulent" in § 15(c) to "fraudulent, deceptive, or manipulative" in the draft amendment to § 15(c) (*supra* note 194). *House Hearings on S. 3255, supra* note 186, at 74, 83-86. The former phrase was retained in clause (c)(1), but the latter phrase (which the witnesses and the SEC considered broader) was enacted into clause (c)(2).

208. *House Hearings on S. 3255, supra* note 186, at 40 (statement of Mr. Withington).

209. 15 U.S.C. § 78i(e).

210. 15 U.S.C. § 78r(c).

211. *House Hearings on S. 3255, supra* note 186, at 40.

212. *See supra* note 181.

213. *House Hearings on S. 3255, supra* note 186, at 39-42. As one witness stated:

It seems to me that with regard to sections 1 and 2 [of the draft bill], that there should be an entire elimination of any recession [sic] and that damages for violation should be actual damages; and it seems to me that is all the investor is entitled to, and that is all the limit that the broker or dealer should be subjected to.

Id. at 41 (statement of Mr. Withington).

in a civil lawsuit under section 15(c) to actual damages—as was done in the express liability provision of section 9(e)—and not permit rescission. Rescission was viewed as too drastic a remedy.²¹⁴ Congress did not accommodate the objectors on this ground, however. No amendment was made in either section 29(b) or section 15(c) limiting a civil lawsuit under section 15(c) to damages.

Why did Congress choose to address these objections to civil liability under section 15(c)(1), not in that section, but rather in section 29(b)? The reports and hearings do not directly answer this question. By its language, section 29(b) addresses only the voiding of contracts made or performed in violation of the Act. Literally, it thus applies only to suits for rescission, not to suits for money damages. One possible explanation for Congress's answering these 1938 objectors in section 29(b), rather than in section 15(c)(1), is that Congress deliberately chose to make the limitations on civil liability applicable only to private actions for rescission, but not to private actions for damages.²¹⁵

In addition to the literal language of section 29(b), support for this interpretation can be found in the testimony of the witnesses and in the reports at the time the Maloney Act was under consideration. As already noted, the witnesses did not urge the elimination of *all* civil liability under section 15(c)(1). On the contrary, they urged that three specific restrictions be placed on that civil liability.²¹⁶ Their objections were repeatedly framed in terms of the threat which rescission actions in particular were thought to pose.²¹⁷ Rather than oppose civil liability for damages as well as rescission, the witnesses thus concentrated their opposition on civil liability for rescission. It would not be unreasonable to conclude, therefore, that by amending section 29(b), Congress deliberately addressed the witnesses' objections only with respect to civil actions for rescission.

By the 1938 amendment, Congress placed two express restrictions on civil lawsuits for violation of section 15(c): first, a 1 year/3 year limitations period was set for such actions,²¹⁸ and second, civil lawsuits to avoid contracts in

214. *Id.* For a fuller discussion of the brokerage opposition to rescission as a remedy for violation of § 15(c), see *infra* notes 434-41 and accompanying text.

215. Another possible explanation is that Congress intended only to permit private actions for rescission for violation of § 15(c)(1) and to exclude altogether private actions for damages. The problems with this interpretation are discussed *infra* at notes 406-29 and accompanying text. Yet another possible interpretation is that Congress was indifferent to legislative draftsmanship, and that it intended the same interpretive result whether the restrictions on civil liability were placed in § 15(c)(1) or in § 29(b). Such an interpretation would seem *ipso facto* unsatisfactory.

216. See *supra* notes 200-14 and accompanying text.

217. See *supra* notes 213-14 and accompanying text. See also *infra* notes 434-41 and accompanying text.

218. Along this line, a literal reading of the § 29(b) proviso suggests that the 1 year/3 year limitations period applies only to actions for rescission, not to actions for damages. By this proviso, a suit to avoid a contract which, in its making or performance, violates § 15(c)(1) is permitted, but only if brought within the prescribed time limits. The proviso expressly creates a limitations period only for an action "maintained in reliance upon this subsection [§ 29(b)]." Since

violation of sections 15(c)(2) and 15(c)(3) were disallowed.²¹⁹ Regardless of whether these restrictions are interpreted to apply to all private civil actions for violation of section 15(c), or only to private actions for rescission, from the fact that Congress imposed these limitations on civil lawsuits in response to the urgings of representatives of the broker-dealer industry who wanted civil liability to be so limited, one may logically conclude that Congress intended to permit civil litigation under section 15(c), subject to those limitations.

e. 1964 Amendments

Ferdinand Pecora, counsel to the Senate committee during the 1934 hearings, proved an accurate forecaster when in 1934 he predicted: "Perhaps 20 years from now there will be persons coming to Congress, if this bill becomes law, who will think that its provisions ought to be strengthened and the powers of the Federal Trade Commission [later to be the SEC] increased."²²⁰ Congress substantially amended the Exchange Act in 1964, after many years of study and investigation.²²¹

The 1964 amendments represent a continuation of congressional efforts to put regulation of the OTC market on a parity with that of the exchange

§ 29(b) itself is limited to rendering contracts "void" which are made or performed in violation of some other provision of the Act, an action "in reliance" on § 29(b) would be one to avoid a contract—i.e., an action for rescission. Under this reading, an action for damages would not be "in reliance" on § 29(b), and thus the limitations period would not apply to it. Arguably, if Congress had wanted to prescribe a time limit for suits for damages as well, it would have done so by placing the proviso directly in § 15(c) itself, as it did in the express liability provisions of § 9(e) and § 18(c). See *infra* note 367. For a case applying the limitations period of § 29(b) only to suits for rescission, see *Douglass v. Glenn E. Hinton Inv., Inc.*, 440 F.2d 912, 914 (9th Cir. 1971). See also *Gruenbaum & Steinberg, supra* note 6, at 47-48 (arguing that the limitations period should apply only to suits for rescission). For cases applying the limitations period of § 29(b) to both actions for rescission and actions for damages, see *Valley Bank of Nevada v. Foster & Marshall, Inc.*, 585 F. Supp. 1351, 1352 (D. Utah 1984); *Newburger, Loeb & Co. v. Gross*, 365 F. Supp. 1364, 1372 (S.D.N.Y. 1973); *Maher v. J.R. Williston & Beane, Inc.*, 280 F. Supp. 133, 138-39 (S.D.N.Y. 1967).

219. Similarly, does the proviso of § 29(b) bar all private actions for violations of §§ 15(c)(2) and 15(c)(3), or only actions for rescission? The language literally seems to bar only actions for rescission, for it states "[t]hat no contract shall be void by reason of [§ 29(b)] because of any violation of any rule or regulation prescribed pursuant to [§ 15(c)(2) or § 15(c)(3)]." Only private actions to "void" a contract are thus proscribed, not private actions for damages. As discussed above, the focus of the witnesses' objections was specifically the threat of a rescission action for violation of "technical rules," which clauses (c)(2) and (c)(3) were thought to be addressed to. See *supra* notes 201-05 and accompanying text. A congressional report similarly distinguished rescission actions based on "dishonest or overreaching conduct" and rescission actions for violation of "technical rules." See *supra* notes 197-98 and accompanying text. That Congress addressed this concern about civil liability for "technical rules" in § 29(b)—and prohibited the voiding of a contract in violation of clauses (c)(2) and (c)(3)—suggests that Congress was deliberately leaving intact private actions for monetary damages under these sections. See *infra* notes 418-24 and accompanying text.

220. *Senate Hearings on S. Res. 84, supra* note 85, at 6972.

221. Securities Acts Amendments of 1964, Pub. L. No. 88-467, 78 Stat. 565.

markets. None of the 1964 amendments affected section 15(c)(1), however, and therefore the legislative history to these amendments does not change the congressional attitude toward permitting civil lawsuits that was demonstrated by the Maloney Act. A brief discussion of these 1964 amendments is nonetheless useful to an understanding of how section 15(c)(1) fits into the scheme of regulation of brokers and dealers generally.

The amendments grew out of a voluminous *Special Study of Securities Markets*,²²² which provided the most comprehensive review of securities markets in twenty-five years. The 1964 amendments were aimed at improved regulation of two different groups: first, the companies whose securities were traded in the OTC market; and second, the broker-dealers and associated persons who traded securities, particularly in the OTC market.²²³ The overall goal of the amendments was to raise the standards in the OTC market by a combination of better information and fuller disclosure about the securities on the one hand, and better qualified people to sell them on the other.²²⁴

As with the prior amendments already discussed, Congress recognized a serious disparity between the amount and effectiveness of regulation in the exchange markets and that in the OTC market, and also recognized the need to eliminate this disparity.²²⁵ To this end, the amendments extended to those companies whose securities were traded in the OTC market the coverage of sections 12 (registration), 13 (reporting), 14 (proxy), and 16 (insider trading). These sections had previously applied primarily or exclusively to companies listed on an exchange.²²⁶

To provide the SEC with enforcement powers over this new extension of applicability of the 1934 Act to companies whose securities were traded in the OTC market, section 15(c) was amended to add subsection (c)(4). Section 15(c)(4) basically provides that if any person subject to the disclosure requirements of sections 12, 13, or 15(d) failed to comply with them, the SEC could order compliance.²²⁷ Likewise, section 15(c)(5) was added to grant the SEC the power to suspend trading temporarily in an OTC security if necessary

222. REPORT OF SPECIAL STUDY OF SECURITIES MARKETS OF THE SECURITIES AND EXCHANGE COMMISSION, H.R. DOC. NO. 95, 88th Cong., 1st Sess., pts. 1-5 (1963) [hereinafter *SPECIAL STUDY*]. The purpose of the amendments was to carry out the legislative recommendations made by the SEC in the Special Study. H.R. REP. NO. 1418, 88th Cong., 2d Sess. 1 (1964).

223. H.R. REP. NO. 1418, *supra* note 222, at 1-2; S. REP. NO. 379, 88th Cong., 1st Sess. 1 (1963). See also 110 CONG. REC. 17,916-17 (1964) (statement of Rep. Harris) (passages from the congressional debates on the amendments); *id.* at 17,921-22 (statement of Rep. Springer); *id.* at 17,925 (statement of Rep. Keith); *id.* at 18,383 (statement of Sen. Javits); 109 CONG. REC. 13,725-26 (1963) (statement of Sen. Williams).

224. S. REP. NO. 379, *supra* note 223, at 5. As to regulation of brokers and dealers, "the Report of the Special Study concludes that the minimal controls furnished by existing regulation are inadequate." *SPECIAL STUDY*, *supra* note 222, pt. 5, at 3.

225. S. REP. NO. 379, *supra* note 223, at 9-12, 14, 18-19.

226. *Id.* at 1, 9; H.R. REP. NO. 1418, *supra* note 222, at 2, 15-19, 29-30.

227. S. REP. NO. 379, *supra* note 223, at 25-26; H.R. REP. NO. 1418, *supra* note 222, at 24, 61.

because of fraud or manipulative practices—a power it already had with respect to securities traded on the exchanges under section 19(a)(4).²²⁸

The second major objective of the 1964 amendments was “to strengthen the standards of entrance into the securities business, enlarge the scope of self-regulation, and strengthen Commission disciplinary controls over brokers, dealers, and their employees.”²²⁹ In large part, Congress designed the amendments to give the SEC similar powers to discipline broker-dealers as it had for the exchanges. This objective was achieved by numerous amendments which, among other things, required the NASD to establish standards of training, experience, competence, and other qualifications for its broker-dealer members and persons associated with its members; empowered the SEC to

228. *Id.*

229. S. REP. NO. 379, *supra* note 223, at 1. See also H.R. REP. NO. 1418, *supra* note 222, at 2. The Special Study summarized some of the problems it found in the brokerage industry as follows:

The ease with which almost anyone can start his own securities firm and deal with the public has permitted many an amateur to embark on the deep waters of broker-dealer entrepreneurship. The statistics and cases reviewed in this chapter indicate a surprisingly high incidence of inexperience in the securities business on the part of principals of new firms, and concurrently a lack of awareness of and respect for a broker-dealer's obligations to the investing public. . . . Many of these [new] firms quickly become sources of concern to the Commission and the NASD; the Special Study's analyses and observations revealed a distinct tendency on the part of newcomers to become involved in the more serious securities violations more often than experienced firms. . . . Many new firms include among their salesmen “boiler-room” veterans or totally inexperienced newcomers, or both. The training which such firms give their inexperienced salesmen rarely goes beyond a modicum of orientation to the firm and a brief introduction to its merchandise.

. . . .
The qualifications of salesmen, who more than any other group represent the securities industry to the investing public, require particular attention. Out of the recent rapid growth and heavy turnover of salesmen have arisen two types of problems for the industry: the large number of inexperienced salesmen it has attempted to absorb, and the reservoir of “boiler-room floaters” who circulate from firm to firm.”

. . . Among firms specializing in mutual fund sales, inexperience is often preferred. This mass of inexperienced salesmen encompasses the broadest range of educational achievement, from those with graduate degrees to those without high school diplomas, and the greatest diversity of backgrounds, from a number with business, supervisory, selling, or professional histories to persons with such occupations as machinist, chef, or baseball player. . . .

The “floater” represents a problem of an entirely different kind. Because of the brief lifespan of most “boiler-rooms” and the large numbers of salesmen they typically use, there exists a fairly sizable group of alumni of these organizations, forming a reservoir of high-pressure salesmen available for employment. . . . These floaters carry the virus of high-pressure salesmanship from firm to firm, and find inexperienced proprietors and salesmen—often well intentioned—particularly vulnerable to infection with their irresponsible selling practices.

SPECIAL STUDY, *supra* note 222, pt. 5, at 39-41 (footnotes omitted). See also *id.* at 49-54. The Special Study also found serious deficiencies in the qualification, training, and competence among supervisors and persons providing investment advice, and detailed objectionable or often illegal practices by the brokerage segment of the securities industry. *Id.* at pt. 5, at 44-45, 51-52, 56-59.

proceed directly against an individual associated with a broker-dealer in lieu of proceeding against the entire brokerage firm; permitted the SEC to impose sanctions, such as suspension, short of revoking registration; empowered the SEC to impose on the NASD rules relating to its organization, discipline, and eligibility for membership; and empowered the SEC directly to regulate brokers and dealers who chose not to join the NASD.²³⁰ In this respect, the 1964 amendments extensively revised sections 15(a) and (b) and section 15A, but left section 15(c)(1) unchanged.

f. 1970 Amendments

During the years 1967-1970, the securities industry suffered an enormous crisis as a result of a so-called "Paper Crunch."²³¹ In late 1967 and in 1968, trading volume increased dramatically on a rapidly rising market, and brokerage firms found themselves clogged with paper work. In 1969-1970, the stock market took an equally dramatic decline, and brokerage firms which had earlier expanded during the rise faced the prospect of financing increased overhead with declining revenues. As a result of these financial pressures, a large number of broker-dealer firms collapsed.²³²

230. S. REP. NO. 379, *supra* note 223, at 41, 74-88; H.R. REP. NO. 1418, *supra* note 222, at 2-3, 20-29.

231. STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS, REPORT AND RECOMMENDATIONS OF THE SECURITIES AND EXCHANGE COMMISSION (PURSUANT TO SECTION 11(h) OF THE SECURITIES INVESTOR PROTECTION ACT OF 1970), H.R. DOC. NO. 231, 92d Cong., 2d Sess. 27-28 (1971) [hereinafter STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS].

232. *Id.* at 28-29. The SEC described the period 1967-1970 as follows:

The years 1967-1970 were a period of great turmoil and upheaval for the economy in general and the securities industry in particular. During this short period more than a dozen NYSE member firms failed, and another seventy or more were merged into or acquired [sic] by other firms. Further, numerous smaller brokerage firms, members of regional stock exchanges and the NASD, were also merged or liquidated. The losses of these firms, which have not been fully tabulated, already exceed \$130 million. . . .

^ . . . [T]he primary cause of the industry's problems was its inability to accurately, promptly and inexpensively record and process the substantially increased trading volume of the late 1960's. This inability resulted in what has been termed the "Paper Crunch." Brokerage firms were literally inundated with pieces of paper of all types, sizes, quality, descriptions and values which had to be received, processed, recorded and delivered, all within a short time span. . . .

. . . The "Paper Crunch" became so severe that the exchanges reduced trading hours and even closed one day per week in an effort to resolve these problems. However, these measures were at best only partially effective.

As a result of the "Paper Crunch" many brokerage firms soon became unable to accurately and promptly record and process securities transactions and were unable to properly maintain their books and records. This operational chaos brought to light and exacerbated other structural problems inherent in the securities industry at that time.

^ . . .
Unfortunately the downturn in trading volume [in 1969-70] was not a cure to the

In late 1970, Congress responded to this crisis by enacting the Securities Investor Protection Act of 1970 (SIPA),²³³ which established the Securities Investor Protection Corporation.²³⁴ The primary purpose of SIPA was to afford financial protection for investors if the broker-dealer with whom they were doing business encountered financial troubles. In addition, the SIPA amendments mandated a general upgrading and strengthening of financial responsibility requirements of broker-dealers.²³⁵

SIPA did not affect section 15(c)(1), though it did amend section 15(c)(3).²³⁶ Section 15(c)(3) governs the SEC's power to provide safeguards with respect to the financial responsibility of broker-dealers, and the amendment was

operational problems of the "Paper Crunch." The downturn in trading volume and securities prices during the 1969-70 "Bear Market" which was supposed to allow firms to "catch up" on their paperwork processing resulted in a financial crisis which ultimately caused many firms to fail. Many firms which undertook substantial expansion during the Bull Market and contracted for additional personnel and equipment to solve the "Paper Crunch" had substantial on-going overhead expenses, but with the decreased trading volume revenues were not sufficient to meet their costs. . . . Thus, the lack of adequate permanent capital coupled with the shrinking capital provided by securities whose values were declining rendered many firms unable to survive the financial problems caused by decreasing revenues and increasing expenses during the Bear Market.

The major self-regulatory organizations which have responsibility for supervising the financial and operational conditions of their members were equally unprepared. . . .

Further, in many instances, the self-regulatory organizations were reluctant to take decisive action such as suspending a firm.

Id. at 27-29. These factual findings by the SEC are supported by those of congressional committees which investigated this period. *See, e.g.,* S. REP. NO. 1009, 92d Cong., 2d Sess. 1-2 (1972); H.R. REP. NO. 1519, *supra* note 190, at 1-13; REPORT OF THE SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, 92D CONG., 2D SESS., REPORT ON SECURITIES INDUSTRY STUDY 7-11 (Comm. Print 1972); S. REP. NO. 1218, 91st Cong., 2d Sess. 2-3 (1970); H.R. REP. NO. 1613, 91st Cong., 2d Sess. 2-3 (1970).

233. Pub. L. No. 91-598, 84 Stat. 1636 (1970), renumbered Security Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, 92 Stat. 260 (1978) [hereinafter SIPA]. As amended, § 15(e)(3) provided (emphasis shows new language):

(3) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) in contravention of such rules and regulations as the Commission shall prescribe as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility and related practices of brokers and dealers including, but not limited to, the acceptance of custody and use of customers' securities, and the carrying and use of customers' deposits or credit balances. Such rules and regulations shall require the maintenance of reserves with respect to customers' deposits or credit balances, as determined by such rules and regulations.

84 Stat. 1653.

234. 15 U.S.C. § 78ccc (1982).

235. S. REP. NO. 1218, *supra* note 232, at 1, 4; H.R. REP. NO. 1613, *supra* note 232, at 1, 3-4.

236. SIPA, *supra* note 233, 84 Stat. 1653.

designed to clarify the applicability of that section to broker-dealers who do business only on an exchange as well as to broker-dealers who transact business in the OTC market.²³⁷ "By amending section 15(c)(3) of the Securities Exchange Act of 1934, Congress made it clear that more effective direct regulation by the Commission was called for concerning the custody and use of customers' securities and establishing reserves for the protection of customers' credit balances."²³⁸

g. 1975 and Later Amendments

In light of the financial failure of brokerage firms in the late 1960s, SIPA directed the SEC to compile a list of unsafe or unsound practices by brokers and dealers and to make recommendations concerning additional legislation which might be needed to eliminate such practices in the future.²³⁹ In 1971, pursuant to this directive, the SEC submitted a report which identified fourteen industry practices by brokers and dealers contributing to the crisis, including: inadequate capital; over-expanded budgets; inaccurate record-keeping; inadequate delivery, clearing and transfer facilities to keep pace with a high volume of trading activity; and insufficient talent and training effort among "back office" personnel.²⁴⁰

The SEC report concluded that, while the scheme of self-regulation adopted by Congress through the Maloney Act in 1938 had been reasonably effective prior to 1967, by the late 1960s it was clear that these self-regulatory organizations had not, and could not, adequately regulate the broker-dealer industry without greater government involvement and supervision.²⁴¹ In its report the

237. S. REP. NO. 1218, *supra* note 232, at 16; H.R. REP. NO. 1613, *supra* note 232, at 14.

238. H.R. REP. NO. 1519, *supra* note 190, at 13 (citation omitted).

239. SIPA, *supra* note 233, § 11(h), 84 Stat. 1656.

240. STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS, *supra* note 231, at 2-3. "Apart from the inability of broker-dealers to keep their records current, the number of errors in the handling and recording of transactions multiplied. The back offices of many a broker-dealer resembled a trackless forest." *Id.* at 13.

241. *Id.* at 22-23, 214-17.

Self-regulation has worked, but not well enough. The events of the past three years have demonstrated this. Self-regulation should not be replaced, but it should be improved.

After considering the alternatives of more pervasive government regulation or self-regulation, Congress [in 1938] recognized that self-regulation was a desirable recourse because the sheer magnitude of the job of securities regulation precluded direct, governmental controls in all aspects. Congress also recognized that self-regulatory agencies might act with less diligence than would the Government. Its solution was self-regulation supervised by the Government.

....
In the Commission's opinion, nothing has happened that demands that self-regulation be replaced by Government regulation. It is more true now than in 1934 that the sheer magnitude of the task of regulation necessitates self-regulation. It is obvious that for the Government to undertake complete, direct regulation of the

SEC recommended, among other things, that Congress authorize it to perform additional and closer oversight in four critical areas: (1) the processing of securities transactions; (2) the rulemaking authority of self-regulatory organizations; (3) the enforcement of the rules of the self-regulatory organizations, and (4) the administration of disciplinary proceedings conducted by the self-regulatory organizations.²⁴²

Some of these recommendations were ultimately to come to fruition in the Securities Acts Amendments of 1975,²⁴³ after four years of congressional hearings, debates, and committee reports. A good portion of this legislative history is devoted to congressional criticism of the SEC's role in the regulation of brokers and dealers. Reviewing the history of the 1967-1970 crisis, a House report observed that, while the failings of the self-regulatory organizations had certainly contributed in a major way to the operational and financial breakdowns, the SEC itself was not without blame and had failed adequately to regulate the brokerage industry.²⁴⁴ A Senate report agreed with this assessment, finding that throughout the 1960s the SEC had adopted a passive approach toward regulation of broker-dealers.²⁴⁵

securities markets would require drastic increases in money and manpower.

On the other hand it is manifest that more effective governmental action is necessary, whether it be called governmental oversight or more governmental regulation.

Id. at 214-15 (footnotes omitted).

242. *Id.* at 5.

243. Pub. L. No. 94-29, 89 Stat. 97 (1975). *See also generally* Rowen, *The Securities Acts Amendments of 1975: A Legislative History*, 3 SEC. REG. L.J. 329 (1976).

244. A House report observed:

Nor is the Commission without responsibility for the 1967-70 debacle: instead of regulating or supervising the self-regulators, the Commission has usually negotiated with them as if they were coordinate bodies. Losing sight of Congress' intention, the Commission's role became much more "reserved" than "control." Since the Commission has the ultimate responsibility for regulating the securities industry, subject to Congressional oversight, with the exchanges and the National Association of Securities Dealers charged with cooperating with the SEC in its regulatory responsibility, the phrase "self-regulation" must be consigned to the past; a more appropriate term for the relationship Congress intended is "cooperative regulation."

H.R. REP. No. 1519, *supra* note 190, at viii-ix. *See also id.* at 80-85, 91, 110, 116.

245. A Senate subcommittee observed:

However, the Subcommittee has found in its case studies that the major regulatory problems in the securities industry have not by and large been the result of the SEC's lack of authority but rather of its apparent lack of the will to use the powers it already has. . . .

....

The Subcommittee's case studies . . . indicate that in overseeing the self-regulatory agencies the SEC has relied primarily on informal cajoling under the threat of its "big stick," and that it has not utilized the flexible regulatory techniques available to it under the Exchange Act. The obvious limitation of the SEC's approach is that if a self-regulatory agency balks at the Commission's recommendations, it is faced with the choice of using the "big stick" or doing nothing. Confronted with such a choice, the SEC has generally done nothing.

SECURITIES INDUSTRY STUDY, *supra* note 169, at 188. *See also id.* at 17.

The majority of the 1975 amendments were aimed at improving operational and financial systems of the securities industry, and an entirely new section 15B was enacted which provides for the establishment of a self-regulatory organization for the municipal securities industry designated the Municipal Securities Rulemaking Board.²⁴⁶ Section 15(c)(1) was amended in three respects: (1) a proscription against an "attempt to induce" the purchase or sale of a security through fraud was added; (2) the new phrase "otherwise than on a national security exchange of which it is a member" was substituted for the prior phrase "otherwise than on a national security exchange"; and (3) the SEC's authority to define fraudulent practices under that section was expanded to cover municipal securities dealers.²⁴⁷ All three changes broaden the applicability of section 15(c)(1).²⁴⁸ The legislative history of this particular amend-

246. Pub. L. No. 94-29, 89 Stat. 132 (1975); 15 U.S.C. § 78o-4 (1982 and Supp. III 1985).

247. The 1975 amendment to § 15(c) provided:

(c)(1) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange of which it is a member by means of any manipulative, deceptive, or other fraudulent device or contrivance, and no municipal securities dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this paragraph, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

Pub. L. No. 94-29, 89 Stat. 125 (1975) (emphasis shows amended language). See also S. REP. No. 75, 94th Cong., 1st Sess. 197 (1975). This has remained the text of § 15(c)(1) to date.

248. There is no direct reference in the congressional reports to Congress's intent behind the first change in section 15(c)(1), although the addition of the phrase "attempt to induce" now makes the section parallel to § 15(c)(2) and § 15(c)(3). See *supra* note 4. While there appears to have been no controversy over this first change to § 15(c)(1), when such a change was proposed in 1959 for § 10(b), it engendered a storm of broker-dealer protest. See discussion *infra* notes 387-89 and accompanying text. As a result, the second change, § 15(c)(1) now applies to brokers and dealers who effect transactions on exchanges of which they are not members. S. REP. No. 75, *supra* note 247, at 110. The third change brought municipal securities dealers into the federal regulatory scheme along with all other brokers and dealers, which was thought to be justified by the SEC's exposure of a pattern of misconduct by municipal securities professionals in recent years. *Id.* at 3-4, 43, 111. The last two changes were also made to § 15(c)(2) in the 1975 amendments. 89 Stat. 125-26. Very little is reported in the legislative history concerning these amendments to § 15(c)(1). Indeed, the most comprehensive gloss on this section is contained in a single paragraph of a Senate report:

In contrast to the expansive rulemaking functions of the Board, the SEC's direct rulemaking with respect to transactions in municipal securities would be limited to the control of fraudulent, manipulative, and deceptive [sic] acts and practices. (Sections 15(c)(1) and (2)). This power, which the SEC arguably already has under Section 10(b) of the Exchange Act, is included in the bill to make clear that the Commission's responsibility extends beyond sanctioning those who have engaged in manipulative or deceptive [sic] practices with respect to municipal securities and includes the promulgation of prophylactic rules.

S. REP. No. 75, *supra* note 247, at 50. See also *id.* at 111, 197. Was the amendment introducing the phrase "attempt to induce" a back-door way to effect the "prevent" (*i.e.*, "prophylactic") language which had in previous amendments been rejected? See *supra* note 207.

ment of section 15(c)(1) is silent, however, on any further congressional intent concerning civil liability under it.

Even if Congress did not speak to private liability under section 15(c)(1), Congress was openly aware in 1975 that private civil litigation was being brought under the 1934 Act, and was concerned about its potential impact on SEC enforcement efforts. Specifically, Congress was concerned that when SEC enforcement actions were consolidated in multidistrict litigation with private actions, delay might ensue:

which is potentially damaging to the public interest in securing prompt relief from illegal practices and preventing such practices in the future. Private plaintiffs seeking only money damages lack the same incentive to hasten pretrial proceedings which the Commission is required to have. The countervailing factors—conservation of work and expense by the courts and the litigants, their counsel, and witnesses—would be well served by combining related private suits whenever appropriate and allowing the Commission's public action to proceed unfettered by them.²⁴⁹

Congress's solution was to amend section 21 of the Exchange Act by adding a new subsection (g) prohibiting consolidation of SEC injunctive actions with private actions absent the SEC's consent.²⁵⁰ While certainly this amendment to section 21 does not constitute direct evidence of congressional intent concerning section 15(c)(1), it seems to suggest a favorable congressional attitude in 1975 toward private litigation in general under the Exchange Act. Rather than restrict or limit such private litigation, Congress chose simply to prohibit its consolidation with public (SEC) actions, absent SEC consent.²⁵¹

h. Conclusions from the Legislative History

The history of the amendments to section 15 evidences a continual congressional effort to create a securities market in which the public can have confidence. In particular, many of these amendments have been designed to raise the standards of professional conduct by brokers and dealers through

249. S. REP. NO. 75, *supra* note 247, at 77. See also H.R. REP. NO. 229, 94th Cong., 1st Sess. 102 (1975); 121 CONG. REC. 11,766-67, 15,849 (1975).

250. Subsection (g) to § 21 provided that:

no action for equitable relief instituted by the Commission pursuant to the securities laws shall be consolidated or coordinated with other actions not brought by the Commission, even though such other actions may involve common questions of fact, unless such consolidation is consented to by the Commission.

Pub. L. No. 94-29, 89 Stat. 155 (1975); 15 U.S.C. § 78u(g) (1982).

251. The only other amendments to § 15(c) after 1975 are not directly relevant to this Article. For the sake of completeness, however, the reader is advised that § 15(c)(4) was amended in 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984), and that § 15(c)(3) was amended in 1986 to exclude government securities brokers and dealers, Pub. L. No. 99-571, 100 Stat. 3218 (1986). By the 1986 amendment, an entirely new § 15C governing government securities brokers and dealers was enacted. 15 U.S.C.A. §§ 78o-5 (West Supp. 1987).

"cooperative regulation" by the SEC and the NASD.²⁵² Enumeration of a multitude of broker-dealer practices which are injurious to the public interest is a constant theme throughout the legislative history.

Only once during the legislative history did the question of a broker-dealer's civil liability to investors under section 15(c) arise directly. The hearings on the Maloney Act in 1938 evidence the concern of broker-dealers over the nature and extent of their civil liability under section 15(c), and the amendments enacted in 1938 illustrate the congressional response to those concerns. In particular, Congress limited civil liability under section 15(c)(1) by enacting a limitations period for the bringing of lawsuits under that section, which limitations period is identical to the express liability provisions of sections 9(e) and 18(c). In addition, Congress expressly disallowed private lawsuits to void a contract in violation of sections 15(c)(2) and 15(c)(3). Enacting these limitations on civil liability surely must imply an intent to permit civil liability, subject to those limitations.

Neither section 15(c) nor section 29(b) expressly states that a civil lawsuit is permitted, but certainly the witnesses in 1938 assumed that civil liability existed under these provisions. Moreover, not a single congressional witness or representative, nor anything in the reports, contradicted the witnesses' assumption that civil liability for a violation of section 15(c) was permissible under the Act. As the Supreme Court observed in another case involving the interpretation of legislative history: "Although the transcript of the House Committee hearings does not indicate that any Committee member voiced explicit affirmative agreement with this interpretation, it is surely most unlikely that the members of the Committee would have stood mute if they had disagreed with it."²⁵³

Since 1938, Congress has not again addressed the issue of civil liability under section 15(c)(1), although it has extensively revised section 15 and enacted new sections 15A, 15B, and 15C governing broker-dealer conduct. These revisions are largely aimed at improving the qualifications and competence of brokers and dealers, ensuring their financial responsibility, providing safeguards in the event of financial disaster, and generally improving the way brokers and dealers do business both on the exchanges and in the OTC market. These amendments unquestionably extend the authority of the SEC and the self-regulatory organizations over brokers and dealers. These extensions of power to the SEC and the self-regulatory organizations are in no way incon-

252. For a fuller discussion of the evolution of the concept of "cooperative regulation" than can be provided by this Article, see, *e.g.*, H.R. REP. NO. 123, 94th Cong., 1st Sess. 48-49 (1975); H.R. REP. NO. 1519, *supra* note 190, at 79-116; SECURITIES INDUSTRY STUDY, *supra* note 169, at 137-48.

253. *National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers*, 414 U.S. 453, 460 (1974).

sistent with an intent to continue to allow private enforcement through civil litigation. Indeed, from the congressional silence since 1938 on the issue of civil liability amidst all these extensive new regulatory measures, one may conclude that the role of private litigation as it was contemplated in 1938 remains intact.

This conclusion is supported by *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*.²⁵⁴ In that case the Court stated that it must examine the "contemporary legal context"²⁵⁵ of a given statute in determining congressional intent to allow (or disallow) a private right of action under it.²⁵⁶ At issue in *Curran* was the existence of implied private rights under the Commodity Exchange Act (CEA).²⁵⁷ The CEA had been extensively amended in 1974. Prior to these amendments, the lower federal courts had "routinely and consistently"²⁵⁸ implied private rights under the CEA. In the context of such federal judicial interpretation of the CEA, said the Court, when Congress re-enacted without amendment those provisions under which a private remedy had been implied, Congress must have intended to "preserve that remedy."²⁵⁹

The logic of *Curran* applies directly to the discernment of congressional intent concerning section 15(c)(1). Although recent cases have tended to refuse to imply a private remedy,²⁶⁰ certainly at the time of the enactment of the Exchange Act and the amendments of 1936 and 1938, the accepted approach among federal courts was generally to imply private remedies from federal statutes upon the relatively minimal showing that the statute was intended to protect persons like the plaintiff.²⁶¹ Specifically, until the post-*Cort* era, the lower federal courts "routinely and consistently" either assumed without deciding, or actually decided, that there was an implied private remedy under section 15(c)(1).²⁶² As the foregoing discussion of the legislative history demonstrates, Congress had several significant opportunities—particularly in 1964

254. 456 U.S. 353 (1982).

255. *Id.* at 379, 381.

256. *Id.* at 378-79. The Court explained:

[W]e must examine Congress' perception of the law that it was shaping or reshaping. When Congress enacts new legislation, the question is whether Congress intended to create a private remedy as a supplement to the express enforcement provisions of the statute. When Congress acts in a statutory context in which an implied private remedy has already been recognized by the courts, however, the inquiry is logically different. Congress need not have intended to create a new remedy since one already existed; the question is whether Congress intended to preserve the pre-existing remedy.

Id.

257. 7 U.S.C. §§ 1-26 (1982).

258. *Curran*, 456 U.S. at 379.

259. *Id.* at 381-82.

260. See *supra* note 5, paragraph (b).

261. See *supra* notes 69-82 and accompanying text.

262. See *supra* note 5, paragraph (a).

and 1975²⁶³—to overturn legislatively the lower federal courts' interpretation of section 15(c)(1). Despite these opportunities, Congress did not disturb these judicial interpretations of section 15(c)(1). Indeed, the 1975 amendments evidenced a clear congressional awareness that private suits were being brought under the securities acts, and effected a legislative solution to allow such suits to complement, and not to hinder, SEC injunctive actions.²⁶⁴ Under the *Curran* Court's reasoning, "the fact that a comprehensive reexamination and significant amendment of the [federal securities laws] left intact the statutory provisions under which the federal courts had implied a cause of action is itself evidence that Congress affirmatively intended to preserve that remedy."²⁶⁵

D. Effectuation of Congressional Purpose: Would the Private Remedy Support the Substantive Right?

The third *Cort* factor inquires into whether it is "consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff."²⁶⁶ *J. I. Case Co. v. Borak*²⁶⁷ is a leading case using analysis along this line.²⁶⁸ The issue in *Borak* was whether to imply a private right of action for violation of section 14(a) of the 1934 Act. The Supreme Court swiftly disposed of that issue by stating that it was "clear that private parties have a right under § 27 to bring suit for violation of § 14(a) of the Act."²⁶⁹ Having summarily concluded that a private right of action existed, the Court spent the remainder of its unanimous opinion on ascertaining the scope of that right: whether it was limited to direct (and not derivative) causes of action, and whether the remedy the Court may afford was limited to declaratory relief. In deciding against these limitations on the private right of action, the Court looked to the purpose of section 14(a), and asked whether the requested

263. The Supreme Court has called the 1975 amendments "the most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act of 1934." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 384-85 (1983) (quoting from the congressional hearings on the amendments).

264. See *supra* notes 249-51 and accompanying text.

265. *Curran*, 456 U.S. at 381-82. In *Herman & MacLean v. Huddleston*, the Supreme Court upheld the *Curran* analysis in the context of an implied remedy under § 10(b) of the Exchange Act. 459 U.S. 375 (1983). The Court stated:

When Congress acted [in the 1975 amendments to the Exchange Act], federal courts had consistently and routinely permitted a plaintiff to proceed under § 10(b) even where express remedies under § 11 or other provisions were available. In light of this well-established judicial interpretation, Congress' decision to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action.

Id. at 385-86 (footnote omitted) (citations omitted). See also *Thompson v. Thompson*, 108 S. Ct. 513, 516-17 (1988) (reaffirming the appropriateness of *Curran's* analysis of the "context" of Congress's legislative enactments).

266. *Cort v. Ash*, 422 U.S. 66, 78 (1975).

267. 377 U.S. 426 (1964).

268. *Cort*, 422 U.S. at 84.

269. *Borak*, 377 U.S. at 430-31. But see *supra* notes 145-49 and accompanying text.

forms of relief would further the broad remedial purposes of that section. The Court concluded that disallowance of derivative actions would "be tantamount to a denial of the private relief," and that "the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements."²⁷⁰ The Court thus declared it was the "duty" of courts to provide those remedies (necessarily including private rights of action) that would further congressional purposes in enacting the statute.²⁷¹

Justice Powell called *Borak* "unprecedented," "incomprehensible," and "aberrant."²⁷² Although *Borak* has never been overruled, the Supreme Court has on occasion said that under its more recent lines of analysis, it now applies a "stricter standard"²⁷³ than the one applied in *Borak*. These attempts to discredit *Borak* are curious, for *Borak* was not without precedent,²⁷⁴ nor has its congressional-purposes approach been abandoned by the Supreme Court in later cases decided before and after *Cort*.²⁷⁵ Moreover, the suggestion that

270. *Id.* at 432. The Court said:

To hold that derivative actions are not within the sweep of the section would therefore be tantamount to a denial of private relief. Private enforcement of the proxy rules provides a necessary supplement to Commission action. As in antitrust treble damage litigation, the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements. . . .

We, therefore, believe that under the circumstances here it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose.

Id. at 432-33.

271. *Id.* at 433.

272. *Cannon v. University of Chicago*, 441 U.S. 677, 735-36 (1979) (Powell, J., dissenting).

273. *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979).

274. *See, e.g., Hewitt-Robins, Inc. v. Eastern Freight-Ways*, 371 U.S. 84, 88 (1962) ("Moreover, the allowance of misrouting actions would have a healthy deterrent effect upon the utilization of misrouting practices in the motor carrier field, which, in turn, would minimize 'cease and desist' proceedings before the Commission."). The *Borak* approach seems squarely in accord with traditional principles of statutory construction which mandate construing a statute in light of overall congressional purposes. *See SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350-51 (1943) (*see supra* note 119).

275. For cases after *Borak* and before *Cort* which use, at least in part, the *Borak* congressional-purposes approach to determine whether to imply a federal private right of action by ascertaining whether a private civil suit would or would not advance Congress's overall goals in enacting a statute, *see, e.g., Securities Investor Protection Corp. v. Barbour*, 421 U.S. 412, 421, 423 (1975); *National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers*, 414 U.S. 453, 463 (1974); *Allen v. State Bd. of Elections*, 393 U.S. 544, 556-57 (1969); *Wyandotte Transp. Co. v. United States*, 389 U.S. 191, 204 (1967); *Calhoon v. Harvey*, 379 U.S. 134, 138-40 (1964). For example, in *Barbour*, the Court stated:

[I]t is clear that the overall structure and purpose of the SIPC scheme are incompatible with such an implied right.

Congress' primary purpose in enacting the SIPA and creating the SIPC was, of course, the protection of investors. It does not follow, however, that an implied right of action by investors who deem themselves to be in need of the Act's protection, is either necessary to or indeed capable of furthering that purpose. . . .

...

... These consequences [of allowing a private lawsuit] are too grave, and when

the *Borak* approach is not "strict"—that it somehow inappropriately invites the conclusion to imply a private remedy—is unwarranted in light of numerous later cases (including *Cort* itself) in which the Court, adopting the *Borak* approach, held that an implied remedy would *not* further congressional purposes.²⁷⁶

unnecessary, too inimical to the purposes of the Act, for the Court to impute to Congress an intent to grant every member of the investing public control over their occurrence.

421 U.S. at 412-23. Similarly, in *National R.R. Passenger Corp.*, the Court stated:

Since suits could be brought in any district through which Amtrak trains pass and since there would be a myriad of possible plaintiffs, the potential would exist for a barrage of lawsuits that, either individually or collectively, could frustrate or severely delay any proposed passenger train discontinuance. . . . This would completely undercut the efficient apparatus that Congress sought to provide for Amtrak to use in the "paring of uneconomic routes."

414 U.S. at 463. Likewise, in *Allen*, the Court said:

The achievement of the [Voting Rights] Act's laudable goal could be severely hampered, however, if each citizen were required to depend solely on litigation instituted at the discretion of the Attorney General. . . . It is consistent with the broad purpose of the Act to allow the individual citizen standing to insure that his city or county government complies with the § 5 approval requirements.

393 U.S. at 556-57 (footnotes omitted). Finally, in *Wyandotte*, the Supreme Court stated: Denial of such a remedy [civil action for damages] to the United States would permit the result, extraordinary in our jurisprudence, of a wrong-doer shifting responsibility for the consequences of his negligence onto his victim. . . . We do not believe that Congress intended to withhold from the Government a remedy that ensures the full effectiveness of the Act.

389 U.S. at 204.

For such cases after *Cort*, see *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310-11 (1985) (*in pari delicto* defense narrowly construed in securities litigation involving implied causes of action); *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 539-41 (1984); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983); *Cannon v. University of Chicago*, 441 U.S. 677, 703 (1979) (under third *Cort* factor, when a private "remedy is necessary or at least helpful to the accomplishment of the statutory purpose, the Court is decidedly receptive to its implication under the statute"); *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 26, 39-42 (1977) ("Once we identify the legislative purpose, we must then determine whether the creation by judicial interpretation of the implied cause of action . . . is necessary to effectuate Congress' goals."). See also cases cited *infra* note 276.

276. *Cort*, 422 U.S. at 81, 84 ("[P]rotection of ordinary stockholders was at best a secondary concern. . . . [I]n this instance the remedy sought would not aid the primary congressional goal." (footnote omitted)). See also *Thompson v. Thompson*, 108 S. Ct. 513, 518 (1988) ("It thus is not compatible with the purpose and context of the [Parental Kidnaping Prevention Act of 1980] to infer a private cause of action."); *Universities Research Ass'n v. Coutu*, 450 U.S. 754, 782-83 (1981) ("To imply a private right of action . . . would destroy this careful balance [of the interests of parties affected by the Davis-Bacon Act . . . and] would undercut as well the elaborate administrative scheme . . ."); *Chrysler Corp. v. Brown*, 441 U.S. 281, 317 (1979) ("Most importantly, a private right of action under § 1905 [of the Trade Secrets Act] is not 'necessary to make effective the congressional purpose . . .'" (citing *Borak*, 377 U.S. at 433)); *Santa Clara Pueblo v. Martinez*, 436 U.S. 49, 64 (1978) ("Creation of a federal cause of action for the enforcement of rights created in Title I, however useful it might be in securing compliance with § 1302, plainly would be at odds with the congressional goal of protecting tribal self-government."); *Santa Fe Indus. v. Green*, 430 U.S. 462, 478 (1977) ("As in *Cort v. Ash*, . . . we are reluctant to recognize a cause of action here to serve what is 'at best a subsidiary purpose' of the federal

Far from novel, *Borak* in some respects can be viewed simply as a refinement of the *Rigsby* approach.²⁷⁷ In both *Rigsby* and *Borak*, the focus of judicial inquiry is on general congressional intent in enacting any given piece of legislation, rather than on the specific congressional intent to allow private lawsuits. Under the *Rigsby* approach, the Court would ask whether Congress intended to protect a certain class of individuals of which the injured plaintiff was a member. If the answer were yes, then the Court could automatically allow appropriate redress in a private lawsuit, absent some clear evidence of congressional intent to disallow such private lawsuits. In *Borak*, the Court asked whether a private lawsuit would further congressional purposes in enacting the legislation, and of necessity inquired as to what those purposes were. The *Borak* Court concluded, in effect, that the congressional purpose in enacting the legislation was to protect a certain class of individuals of which the injured plaintiff was a member, and that allowance of a private lawsuit would further that protective purpose.²⁷⁸

Thus, the third *Cort* factor—the *Borak* approach—can be seen as a corollary to the first *Cort* factor, the *Rigsby* approach. Under *Rigsby*, upon a finding that Congress intended to protect the plaintiff, the Court would allow a private remedy unless it discerned a contrary legislative intent. *Borak* suggests the way in which such contrary intent may be discerned: namely, when the allowance of a private remedy would be inconsistent in the overall legislative scheme.

legislation.”); *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 41 (1977) (“What we have said thus far suggests that, unlike *J. I. Case Co. v. Borak*, *supra*, judicially creating a damages action in favor of Chris-Craft is unnecessary to ensure the fulfillment of Congress’ purposes in adopting the Williams Act.”); *Securities Investor Protection Corp. v. Barbour*, 421 U.S. 412, 421-23 (1975); *National R.R. Passenger Corp. v. National Ass’n of R.R. Passengers*, 414 U.S. 453, 461-64 (1974).

277. For a discussion of *Rigsby*, see *supra* notes 69-82 and accompanying text. The common-law merger of the *Rigsby* approach (with its inquiry into whether plaintiff was a member of the class for whose “especial benefit” the statute was enacted) with the *Borak* approach is aptly illustrated in § 874A of the Second Restatement of Torts:

When a legislative provision protects a class of persons by proscribing or requiring certain conduct but does not provide a civil remedy for the violation, the court may, if it determines that the remedy is appropriate in furtherance of the purpose of the legislation and needed to assure the effectiveness of the provision, accord to an injured member of the class a right of action, using a suitable existing tort action or a new cause of action analogous to an existing tort action.

RESTATEMENT (SECOND) OF TORTS § 874A (1979). Even pre-*Cort* commentators observed the interrelationship between an inquiry into congressional purposes of the legislation and an inquiry into the class of beneficiaries the legislation was intended to protect. See, e.g., Note, *The Phenomenon of Implied Private Actions Under Federal Statutes: Judicial Insight, Legislative Oversight or Legislation by the Judiciary?*, 43 *FORDHAM L. REV.* 441, 446-47 (1974). Cf. *Stern v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 603 F.2d 1073, 1075-80 (4th Cir. 1979); *Serzysko v. Chase Manhattan Bank*, 290 F. Supp. 74, 85-89 (S.D.N.Y. 1968), *aff’d*, 409 F.2d 1360 (2d Cir.), *cert. denied*, 396 U.S. 904 (1969).

278. Reminiscent of the *Rigsby* maxim, *Ubi jus, ibi remedium*, the *Borak* Court declared: “While this language [of § 14(a)] makes no specific reference to a private right of action, among its chief purposes is ‘the protection of investors,’ which certainly implies the availability of judicial relief where necessary to achieve that result.” 377 U.S. at 432.

Obviously, whether an implied remedy would further or be consistent with congressional purposes depends upon what those congressional purposes are. When the Court under the first *Cort* factor finds a congressional intent or purpose to benefit or protect the class of which the plaintiff was a member, it often may be a reasonable conclusion that allowance of private lawsuits to enforce the rights created by the legislation will further that intent or purpose by more completely offering such protection than the agency charged with enforcement alone can offer.²⁷⁹ It is not, however, a necessary conclusion.²⁸⁰

Properly interpreted, *Borak*, or the third *Cort* factor, does not swing open the courthouse doors in an invitation for all potential plaintiffs to litigate their injuries under every federal statute. The third *Cort* factor adopts the *Borak* approach of determining underlying congressional purposes. Until either *Cort* or *Borak* is overruled or discarded, a prudent observer must still ask whether the third factor is met in any case considering the implication of a private right of action. In this regard one may now ask: Is it consistent with the overall scheme of the 1934 Act to imply a private right of action under section 15(c)(1)? Will such an implied remedy further the goals of the 1934 Act or of that particular section?

This Article has already established that the overall goal of the 1934 Act was to protect all securities investors, and that the specific goal of section 15(c)(1) was to protect investors from fraud by broker-dealers.²⁸¹ Are these goals furthered by allowing the defrauded customers to sue? Certainly the *Borak* Court, in light of its finding that civil litigation provided a "most effective weapon in the enforcement of the proxy requirements"²⁸² under section 14(a) of the 1934 Act, would have readily concluded that a private remedy under section 15(c)(1) would further that section's purpose of protecting investors from fraud. Indeed, in cases since *Cort* involving implied remedies for securities laws violations, the Court has expressly and unanimously concluded that implication of private rights of action (at least under section 10(b)) does further the "broad remedial purposes" of the Exchange Act.²⁸³ The

279. See, e.g., *Herpich v. Wallace*, 430 F.2d 792, 804 (5th Cir. 1970) ("Moreover, the Commission has neither the manpower nor the time that completely effective enforcement of the securities laws by it alone would require."); *Baird v. Franklin*, 141 F.2d 238, 244-45 (2d Cir.) (Clark, J., dissenting), *cert. denied*, 323 U.S. 737 (1944); *Moholt v. Dean Witter Reynolds, Inc.*, 478 F. Supp. 451, 453 (D.D.C. 1979).

280. For numerous cases in which the Supreme Court found that a private right of action would frustrate or otherwise be incompatible with the overall congressional goals of the legislation, see *supra* note 276. For an argument that implied private rights of action under the securities acts do not further the congressional goals of those acts, see Frankel, *supra* note 64, at 570-85. See also *Pearlstein v. Scudder & German*, 429 F.2d 1136, 1147-48 (2d Cir. 1970) (Friendly, J., dissenting) (implication of private right under § 7(c) of 1934 Act would not further purpose of that section, whereas implication of private rights under antifraud provisions is appropriate), *cert. denied*, 401 U.S. 1013 (1971).

281. See *supra* notes 83-99 and accompanying text.

282. *J. I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964).

283. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983).

Court has also viewed private enforcement actions favorably as a way to maximize deterrence of violations of the securities laws.²⁸⁴ Citing *Borak*, the Supreme Court in *Rondeau v. Mosinee Paper Corp.*²⁸⁵ observed: "[We] have not hesitated to recognize the power of federal courts to fashion private remedies for securities laws violations when to do so is consistent with the legislative scheme and necessary for the protection of investors as a supplement to enforcement by the Securities and Exchange Commission."²⁸⁶ Again citing *Borak*, the Supreme Court more recently observed in *Bateman Eichler, Hill Richards, Inc. v. Berner*.²⁸⁷ "Moreover, we repeatedly have emphasized that implied private actions provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action.'"²⁸⁸

Explicit in *Borak* is the recognition that the SEC could not possibly prosecute all proxy violations under the 1934 Act.²⁸⁹ More recently, the SEC has acknowledged that it cannot prosecute all violations of the insider-trading laws involving false tipping under the 1934 Act, and it has openly acknowledged that private actions are a very useful adjunct to SEC enforcement actions.²⁹⁰ There is certainly no reason to suppose that the SEC has more time and resources to handle every instance of broker-dealer fraud; indeed, there is evidence that it has even less inclination to do so.²⁹¹ Given the inability of the agency charged with the overall enforcement of the Exchange Act to police every violation of its antifraud provisions, as well as its inability to compensate investors for their losses in any event,²⁹² it seems that private suits by investors

284. See *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 315-19 (1985). See also *Goldstein v. Groesbeck*, 142 F.2d 422, 427 (2d Cir.) ("[W]e think a denial of a private right of action to those for whose ultimate protection the legislation is intended leaves legislation highly publicized as in the public interest in fact sadly wanting, and even delusive, to that end."), *cert. denied*, 323 U.S. 737 (1944); *Moholt v. Dean Witter Reynolds, Inc.*, 478 F. Supp. 451, 453 (D.D.C. 1979) ("Only through private enforcement actions can the rules requiring disclosure or abstention become the controlling standard of the securities market place.").

285. 422 U.S. 49 (1975).

286. *Id.* at 62.

287. 472 U.S. 299 (1985).

288. *Id.* at 310.

289. 377 U.S. at 432-33.

290. One of the reasons the Court in *Bateman Eichler* denied the *in pari delicto* defense in false tipping litigation was the inability of the SEC alone to discover and prosecute all such offenses and the consequent assistance that private litigation served to give the SEC. 472 U.S. at 315-16.

291. TWENTIETH CENTURY FUND REPORT, ABUSE ON WALL STREET: CONFLICTS OF INTEREST IN THE SECURITIES MARKETS 477 (1980) ("William J. Casey, while chairman of the SEC observed, 'The inside information thing is a lot more important than conflicts [of interest in broker-dealer activities]. Conflicts is mostly nickels and dimes; information is ten, twenty, thirty percent [of the work of the Commission].'").

292. See *Dolgow v. Anderson*, 43 F.R.D. 472 (E.D.N.Y. 1968), *rev'd on other grounds*, 438 F.2d 825 (2d Cir. 1970). In *Dolgow*, the district court stated:

[T]he Commission does not seek to make investors whole; it seeks merely to deter

under section 15(c)(1) would afford a "necessary supplement" to SEC enforcement efforts.²⁹³ Certainly Congress has contemplated that private suits under the 1934 Act continue to provide effective enforcement. To the extent such private litigation could possibly hinder the effectiveness of SEC enforcement efforts, Congress in 1975 acted solely to forbid the consolidation of private actions with SEC actions absent SEC consent to the consolidation.²⁹⁴ Significantly, in 1975 Congress did not otherwise restrict private actions under the 1934 Act.

E. A Remedy Under State Law or Federal Law?

The fourth *Cort* factor used to determine whether a federal court should imply a private right of action under a federal statute is whether such a right is one "traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law."²⁹⁵ Meeting this *Cort* factor is relatively easy under the federal securities acts. However, one must question whether the Supreme Court will continue to acknowledge the viability of this factor.

Borak is cited in *Cort* as precedent for this fourth factor,²⁹⁶ and indeed the *Borak* Court did suggest that the possible inadequacy of state securities law remedies supported the appropriateness of finding a federal cause of action for violation of the federal proxy regulations.²⁹⁷ Since *Cort*, the Supreme Court has acknowledged that the federal securities laws were intended, in large part, to correct inadequacies in traditional state law remedies, especially for cases involving fraud.²⁹⁸ Moreover, the Supreme Court has expressly refused to apply state common-law concepts to implied causes of action under the

violations by making violations unprofitable. . . . [N]one of the measures available to the Commission under the Securities Act or the Securities Exchange Act is designed to provide compensation to injured investors for the damages they have suffered

43 F.R.D. at 483 (emphasis omitted).

293. The inability of the agency charged with the enforcement of the statute in question to reach all the violations of the statute has been given weight by the Supreme Court in determining to permit a private remedy to supplement the agency's enforcement actions. See, e.g., *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 315-16 (1985); *Allen v. State Bd. of Elections*, 393 U.S. 544, 556-57 (1969).

294. See *supra* notes 249-50 and accompanying text.

295. *Cort*, 422 U.S. at 78.

296. *Id.*

297. *Borak*, 377 U.S. at 434-35.

298. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 388-89 (1983). In *Huddleston*, the Supreme Court stated: "Moreover, the antifraud provisions of the securities laws are not coextensive with common law doctrines of fraud. Indeed, an important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common law protections by establishing higher standards of conduct in the securities industry." *Id.* (citation omitted).

federal securities acts where to do so would " 'seriously hinder rather than aid the real purpose' of the securities laws."²⁹⁹

The legislative history of the 1934 Act demonstrates that the antifraud provisions of the Act were designed to displace the state common-law actions for fraud. As one senator pointed out to a witness who urged that fraud was best left to the common law: "You do know that there have been a great many frauds and impositions practiced upon the investor . . . ? And the common law has not protected against those things?"³⁰⁰ The legislative reports also recognized the failure of the stock exchanges to control fraud and abuses by their members, as well as the failure of state laws to provide adequate remedies to investors who were victims of such activities.³⁰¹ Indeed, the entire 1934 Act is testimony to the lack of adequate securities regulation as performed by the states and the stock exchanges before that date.

In light of the Supreme Court's acknowledgement of the inadequacies of state law in combatting securities fraud, and the evidence of congressional dissatisfaction with state common-law remedies for fraud at the time of the 1934 Act's enactment, application of the fourth *Cort* factor strongly supports the implication of a private remedy under section 15(c)(1). Securities fraud is manifestly not an area of law "traditionally relegated to state law," but rather is one in which the federal courts have accumulated considerable experience and expertise.

The significance or effect of demonstrating the federal nature of the right, and thereby satisfying the fourth *Cort* factor, is questionable under recent cases, however. In some cases, the Court has just ignored this fourth *Cort* factor.³⁰² In others, the Court has given little weight to, or even squarely refused to reach, this factor, having found the implication issue disposed of after consideration of the other factors.³⁰³ About the most that can be said about the fourth factor is that the Court has not abandoned it altogether, but continues, in a rather nominal way, to apply it both in cases implying³⁰⁴ and in cases refusing to imply³⁰⁵ private rights of action. In no case does consideration of the fourth factor seem to be given decisive weight.

299. *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (quoting *A. C. Frost & Co. v. Coeur d'Alene Mines Corp.*, 312 U.S. 38, 43 (1941)).

300. *Senate Hearings on S. Res. 84*, *supra* note 85, at 7229.

301. S. REP. No. 792, *supra* note 87, at 4-5, 12-13; H.R. REP. No. 1383, *supra* note 87, at 3-5 (1934).

302. *E.g.*, *Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n*, 453 U.S. 1, 13-18 (1981); *Texas Indus. v. Radcliff Materials, Inc.*, 451 U.S. 630, 639-40 (1981); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 15-25 (1979).

303. *E.g.*, *Middlesex County Sewerage Auth.*, 453 U.S. at 13-18; *Texas Indus.*, 451 U.S. at 639-40; *Transamerica Mortgage Advisors, Inc.*, 444 U.S. at 15-25. *See also, e.g.*, *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 145 (1985); *California v. Sierra Club*, 451 U.S. 287, 298 (1981); *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575-76 (1979).

304. *E.g.*, *Cannon v. University of Chicago*, 441 U.S. 677, 708-09 (1979).

305. *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 541 (1984); *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 40-41 (1977); *Santa Fe Indus. v. Green*, 430 U.S. 462, 478 (1977).

II. A COMPARISON OF SECTION 10(b) AND SECTION 15(c)(1)

Assuming, in light of the discussion so far, that a private cause of action may be implied under section 15(c)(1), what would it look like? An exhaustive analysis of the possible contours of a section 15(c)(1) claim is beyond the scope of this Article. Nonetheless, it is appropriate at this point to indicate some directions that such an analysis might take in the future. This author does not believe, unlike some courts, that the elements of a section 15(c)(1) claim would be coextensive with those of a section 10(b) claim.³⁰⁶ What follows are a few open questions for distinguishing a claim for fraud under section 15(c)(1) from one under section 10(b).

A. General Comparison

First and foremost, how should "manipulative, deceptive, or other fraudulent device or contrivance"³⁰⁷ be interpreted under section 15(c)(1)? Should these terms have the same definitions as they seem to have under the Supreme Court's recent restrictive interpretations of section 10(b)?³⁰⁸ Or should "fraud"³⁰⁹ be a more flexible, broader concept when applied to brokers and dealers? This author believes that as a general proposition, "fraud" should be more liberally interpreted when applied to the conduct of brokers and dealers. This liberal interpretation is justified by three considerations. First, the legislative history of the securities acts in general, and of section 15(c)(1) in particular, supports a broader interpretation.³¹⁰ Second, the common law itself recognizes a more liberal interpretation of fraud concepts as they are applied to fiduciaries.³¹¹ Third, the Supreme Court has recognized the appropriateness of

306. See, e.g., *Roberts v. Smith Barney, Harris Upham & Co.*, 653 F. Supp. 406, 414 (D. Mass. 1986); *Pretera v. Shearson Lehman Bros.*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,884, at 94,290 (D. Mass. 1986); *Bosio v. Norbay Sec., Inc.*, 599 F. Supp. 1563, 1567 (E.D.N.Y. 1985); *Speck v. Oppenheimer & Co.*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,461, at 98,311 n.6 (W.D. Mo. 1984); *Amunrud v. Taurus Drilling Ltd.*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,649, at 97,596 (D. Mont. 1983); *Pierson v. Dean Witter Reynolds, Inc.*, 551 F. Supp. 497, 503 (C.D. Ill. 1982); *Darvin v. Bache Halsey Stuart Shields, Inc.*, 479 F. Supp. 460, 464 (S.D.N.Y. 1979); *Odette v. Shearson, Hammill & Co.*, 394 F. Supp. 946, 956 n.12 (S.D.N.Y. 1975).

307. See *supra* note 4.

308. See *supra* text accompanying notes 12-16.

309. Interestingly, "fraud" itself is not expressly proscribed under § 10(b). Section 10(b) makes it unlawful to employ any "manipulative or deceptive device or contrivance" in contravention of SEC rules and regulations. It is only in Rule 10b-5(a) and (c) that the direct proscription against fraud appears. See *supra* note 3. In contrast, § 15(c)(1) itself flatly prohibits brokers and dealers from effecting securities transactions by means of "any manipulative, deceptive, or other fraudulent device or contrivance" (emphasis added). See *supra* note 4. Nevertheless, the Court has described § 10(b) as a "catchall clause to prevent fraudulent practices." *Chiarella v. United States*, 445 U.S. 222, 226 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 202, 206 (1976).

310. See *infra* text accompanying notes 313-16.

311. See *infra* text accompanying notes 317-22. See generally Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795 (1983); Scott, *The Fiduciary Principle*, 37 CALIF. L. REV. 539 (1949).

relaxing the requirements of a fraud claim against fiduciaries in other securities contexts.³¹²

The legislative history from 1934 amply demonstrates a major congressional concern with fraud committed specifically by broker-dealers: "The manipulative practices that have so stigmatized the stock market in recent years revolve largely around the broker and the dealer."³¹³ In enacting section 15, Congress was well aware that brokers stood in a fiduciary relationship to their customers.³¹⁴ Indeed, a very large portion of the 1934 hearings was devoted to congressional concern and debate over the conflicts of interest inherent in the combination of the roles of broker (as agent acting for others' accounts) and dealer (as principal acting for his or her own account) in a single person or firm, and over the proposal to enforce a segregation of the roles.³¹⁵ In amending

312. See *infra* text accompanying notes 323-28.

313. 78 CONG. REC. 7862 (1934) (statement of Rep. Lea).

314. During the congressional hearings, numerous witnesses acknowledged the fiduciary nature of the broker-customer relationship. See, e.g., *House Hearings on H.R. 7852, supra* note 85, at 123, 313, 337-38, 419-20, 443, 466-67; *Senate Hearings on S. Res. 84, supra* note 85, at 6772. The 1934 Act can be viewed as a deliberate effort to "federalize" the concept of fiduciary duty in the context of the securities industry:

If investor confidence is to come back to the benefit of exchanges and corporations alike, the law must advance. As a complex society so diffuses and differentiates the financial interests of the ordinary citizen that he has to trust others and cannot personally watch the managers of all his interests as one horse trader watches another, it becomes a condition of the very stability of that society that its rules of law and of business practice recognize and protect that ordinary citizen's dependent position. Unless constant extension of the legal conception of a fiduciary relationship—a guarantee of "straight shooting"—supports the constant extension of mutual confidence which is the foundation of a maturing and complicated economic system, easy liquidity of the resources in which wealth is invested is a danger rather than a prop to the stability of that system. When everything everyone owns can be sold at once, there must be confidence not to sell. Just in proportion as it becomes more liquid and complicated, an economic system must become more moderate, more honest, and more justifiably self-trusting. . . .

. . . .
Speculation, manipulation, faulty credit control, investors' ignorance, and disregard of trust relationships by those whom the law should regard as fiduciaries, are all a single seamless web. No one of these evils can be isolated for cure of itself alone.

H.R. REP. NO. 1383, *supra* note 87, at 5-6.

315. As Duncan U. Fletcher, Chairman of the Senate Committee on Banking and Currency, observed during the hearings: "That seems to be the question here, whether one man can act for others in 1 minute and then act for himself at the same time or in the next minute." *Senate Hearings on S. Res. 84, supra* note 85, at 6793. As Ferdinand Pecora, counsel to the Senate Committee, phrased the question to one witness: "Don't you recognize that in such a situation a broker who is also a dealer is placed under the temptation of recommending transactions in securities in which that broker as dealer is also primarily interested?" *Id.* at 6923. As originally drafted, § 11 made it unlawful for a broker to act as a dealer in any securities transaction. This proposed segregation of functions caused a storm of protest from the broker-dealer industry. As a principal drafter, Mr. Thomas Corcoran, observed: "Now this bill provides for the kind of segregation [of broker and dealer functions] against which the stock exchange will put up the strongest argument, from their point of view, that you will hear down here [at the congressional hearings]." *House Hearings on H.R. 7852, supra* note 85, at 123. See also *infra* notes 372-78 and accompanying text.

section 15, Congress recognized that constant policing was required to ensure adherence by broker-dealers to their fiduciary obligations.³¹⁶

In addition, the common-law courts have long construed the scope of fraud more broadly with respect to fiduciaries than with respect to parties otherwise dealing at arm's length.³¹⁷ Such a relationship of trust and confidence has given rise to legal rules of conduct requiring high ethical conduct and "any breach of this higher standard was sometimes called constructive fraud or equitable fraud."³¹⁸ Constructive fraud "has been defined as an act which the law declares fraudulent without inquiry into its motive."³¹⁹ This common-law doctrine has long been applied by equity courts to condemn conduct that constituted a breach of fiduciary duty, but not an actual or intentional fraud.³²⁰ The doctrine allows (and even requires) courts to set aside as fraudulent those transactions which would otherwise have not been actionable in the absence of a fiduciary or confidential relationship.³²¹ That all the elements of actual

316. In 1936 at the direction of Congress, the SEC submitted a lengthy report discussing, *inter alia*, the fiduciary obligations of broker-dealers to their customers and the actual potential and abuses of this relationship. SECURITIES AND EXCHANGE COMMISSION, REPORT ON THE FEASIBILITY AND ADVISABILITY OF THE COMPLETE SEGREGATION OF THE FUNCTIONS OF DEALER AND BROKER PURSUANT TO SECTION 11(E) OF THE SECURITIES EXCHANGE ACT OF 1934 at XIV-XV, 4-5, 8-10, 75-77, 109, 113-14 (1936) [hereinafter SEC REPORT ON BROKER-DEALER SEGREGATION]. The Report stated that the rules promulgated by the SEC under § 15 "constituted an attempt to render more specific some of the fiduciary obligations which a broker owes to his customer," *id.* at 79, and that the SEC regarded itself as having a "continuing duty" to find means to reduce "the conflict of interest between the broker-dealer and his customer and the attending opportunities provocative of abuse of the fiduciary relationship," *id.* at 113. That conflicts of interest in the brokerage industry have continued to be a troublesome issue to Congress was evidenced in the legislative history to the 1975 amendments. See, e.g., S. REP. NO. 75, *supra* note 247, at 63-65.

317. D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 679-85 (1973).

318. *Id.* at 679 (characterizing the term "constructive fraud" as misleading). See also 1 J. STORY, EQUITY JURISPRUDENCE 350 (14th ed. 1918). Story states:

The use of the phrase "constructive fraud" has been severely criticized by the courts and law-writers as being misleading and unscientific, but it has become so fixed in the literature and terminology of the law that any attempt to substitute a more fitting name to the thing to which it is applied would result in confusion.

Id.

319. 1 J. STORY, *supra* note 318, at 350.

320. 3 J. POMEROY, A TREATISE ON EQUITY JURISPRUDENCE 625-26, 788-92 (5th ed. 1941); 1 J. STORY, *supra* note 318, at 349-51, 404-06.

321. 3 J. POMEROY, *supra* note 320, at 792; 1 J. STORY, *supra* note 318, at 405. The Supreme Court long ago and in the common-law tradition acknowledged the necessity for the law's intervention in and different treatment of fiduciary relationships. In the context of the proscription of an agent's purchasing on his own account property which he is required to sell for his principal, the Supreme Court observed:

The general rule stands upon our great moral obligation to refrain from placing ourselves in relations which ordinarily excite a conflict between self-interest and integrity. It restrains all agents, public and private; but the value of the prohibition is most felt, and its application is more frequent, in the private relations in which the vendor and purchaser may stand towards each other. . . . In this conflict of interest, the law wisely interposes. It acts not on the possibility, that, in some cases, the sense of that duty may prevail over the motives of self-interest, but it provides

fraud are not necessary to prove a claim of constructive fraud for breach of fiduciary duty is well established under the common law.³²²

In the context of the securities laws, the Supreme Court has in effect incorporated this common-law distinction between actual fraud and constructive fraud in its interpretation of the Investment Advisers Act of 1940. The issue in *SEC v. Capital Gains Research Bureau, Inc.*³²³ was whether Congress intended "fraud" under the 1940 Act to be interpreted in a "technical sense" requiring the SEC to prove both the defendant investment advisers' intent to injure, as well as actual injury to, their clients, or whether Congress intended a "broad remedial construction of the Act."³²⁴ In adopting the latter interpretation, the Court considered the Act's legislative history as it related both to the Act's overall purpose to raise the standard of business ethics in the securities industry,³²⁵ as well as to Congress's specific recognition of the fiduciary nature of the investment advisory relationship.³²⁶ The Court then concluded that the common-law distinctions between fraud at law and fraud in equity were applicable to its interpretation of the antifraud provisions of the 1940 Act, and used these distinctions to interpret the fraud proscriptions "remedially" rather than "technically":³²⁷

Nor is it necessary in a suit against a fiduciary, which Congress recognized the investment adviser to be, to establish all the elements required in a suit against a party to an arm's-length transaction. Courts have imposed

against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty.

Michoud v. Girod, 45 U.S. (4 How.) 503, 555 (1846).

322. For example, proof of intent to deceive is not required to make out a case of constructive fraud. *Hornaday v. First Nat'l Bank of Birmingham*, 259 Ala. 26, 38, 65 So. 2d 678, 687 (1952); *Lane v. Rachel*, 239 Ark. 400, 405, 389 S.W.2d 621, 624 (1965); *Obermaier v. Obermaier*, 128 Ill. App. 3d 602, 470 N.E.2d 1047, 1051 (1984); *Loucks v. McCormick*, 198 Kan. 351, 424 P.2d 555, 559 (1967). The concept of "constructive fraud" has been adopted by the federal courts in securities litigation involving broker-dealers, particularly churning cases. See, e.g., *Dzenits v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 494 F.2d 168, 170-71 (10th Cir. 1974); *Roche v. E.F. Hutton & Co.*, 603 F. Supp. 1411, 1414-15 (M.D. Pa. 1984) (see cases cited therein). See also *Langevoort, Fraud and Deception by Securities Professionals*, 61 TEX. L. REV. 1247 (1983) (discussing, *inter alia*, the role of constructive fraud in assessing breaches of fiduciary duty by securities professionals).

323. 375 U.S. 180 (1963). The provision of the Investment Advisers Act at issue in the case was § 206, 15 U.S.C. § 80b-6, which was also at issue in *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979), and is set out *supra* at note 137.

324. 375 U.S. at 185-86.

325. "A fundamental purpose, common to these [securities] statutes was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *Id.* at 186.

326. The Court observed:

The Investment Advisers Act of 1940 thus reflects a congressional recognition "of the delicate fiduciary nature of an investment advisory relationship," as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.

Id. at 191-92 (footnote omitted).

327. *Id.* at 194-95.

on a fiduciary an affirmative duty of "utmost good faith, and full and fair disclosure of all material facts," as well as an affirmative obligation "to employ reasonable care to avoid misleading" his clients. . . .

The foregoing analysis of the judicial treatment of common-law fraud reinforces our conclusion that Congress, in empowering the courts to enjoin any practice which operates "as a fraud or deceit" upon a client, did not intend to require proof of intent to injure and actual injury to the client.³²⁸

Although the Court has since refused to turn every breach of fiduciary duty into fraud in violation of section 10(b),³²⁹ given the fact that there has been long and consistent recognition by Congress, the courts, and the SEC of the fiduciary or quasi-fiduciary status of brokers and dealers,³³⁰ and given the fact that one of the principal goals of the 1934 Act was specifically to regulate the conduct of broker-dealers,³³¹ there is good reason to interpret the proscription against the use of "manipulative, deceptive, and other fraudulent devices or contrivances" by broker-dealers more broadly than the similar proscription against such conduct by "any person" under section 10(b). The Supreme Court has repeatedly observed that the securities acts were "enacted for the purpose of avoiding frauds," and as such are to be construed "not technically and restrictively, but flexibly to effectuate [their] remedial purposes."³³² That the Exchange Act is "remedial legislation" and as such is to be construed broadly is an old yet recurrent and still valid theme.³³³

B. Defendant's State of Mind

As noted earlier, the Supreme Court requires proof that the defendant acted with scienter in both private civil actions for damages and SEC enforcement

328. *Id.* (footnotes omitted).

329. *Santa Fe Indus. v. Green*, 430 U.S. 462, 479-80 (1977) (refusing to extend § 10(b) to all transactions involving corporate mismanagement and breach of corporate fiduciary duty). In light of the continuous and specific focus on regulating broker-dealer conduct throughout the legislative history of the 1934 Act, see *supra* notes 156-248 and accompanying text, the legal position of brokers-dealers to their customers under the 1934 Act is akin to the legal position of investment advisers to their clients under the 1940 Act. Thus, *Capital Gains* would seem more generally relevant to interpreting the legal obligations of broker-dealers under the 1934 Act than *Santa Fe*, which was a shareholder suit alleging corporate mismanagement by majority shareholders "in which the essence of the complaint [was] that shareholders were treated unfairly by a fiduciary." 430 U.S. at 477.

330. See *supra* text accompanying notes 23-40.

331. See *supra* notes 85-96 and accompanying text.

332. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963) (quoting 3 SUTHERLAND, STATUTORY CONSTRUCTION (3d ed. 1943)); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983). See *supra* note 298.

333. In addition to the cases *supra* note 332, see also *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972); *Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971); *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967) ("[W]e are guided by the familiar canon of statutory construction that remedial legislation should be construed broadly to effectuate its purposes. The Securities Exchange Act quite clearly falls into the category of remedial legislation." (footnote omitted)).

actions under section 10(b).³³⁴ The Court has defined scienter for section 10(b) purposes to mean a "mental state embracing intent to deceive, manipulate, or defraud."³³⁵ In *Ernst & Ernst v. Hochfelder*,³³⁶ the Court supported its holding that proof of scienter was required in a private action under section 10(b) on several grounds: the language of section 10(b), the section's legislative history, and its relationship to the overall structure of the 1934 Act. Regardless of their possible merits under section 10(b), these grounds do not apply with the same force under section 15(c)(1).

To begin with, in what one commentator has called the "dictionary approach" to statutory construction,³³⁷ the Court in *Hochfelder* found that the terms "manipulative," "device," and "contrivance" in section 10(b) "make unmistakable a congressional intent to proscribe a type of conduct quite different from negligence."³³⁸ The use of these same terms in section 15(c)(1)³³⁹ seems to auger a similar interpretive fate.³⁴⁰ However, the SEC's rules interpreting section 15(c), which were adopted shortly after the 1934 Act's enactment and have been expressly approved by Congress,³⁴¹ point to a different interpretive conclusion.

Rule 15c1-2³⁴² defines the terms "manipulative, deceptive, or other fraudulent device or contrivance" under section 15(c)(1). The first notable aspect of Rule

334. See *supra* notes 13-14 and accompanying text.

335. *Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976). The Supreme Court has left open the question of whether recklessness constitutes scienter. *Id.* The courts and commentators actively continue to debate this question, and even those that respond in the affirmative disagree on the meaning of the term "recklessness." See M. STEINBERG, *SECURITIES REGULATION: LIABILITIES AND REMEDIES* § 7.02 (rev. 1987).

336. 425 U.S. at 185-86.

337. 3A H. BLOOMENTHAL, *supra* note 6, at 8-13, 8-16. See L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* (1983 & Supp. 1986) at Supp. 183 (criticizing meaning given to scienter in *Hochfelder* as "antediluvian"); cf. L. LOSS (1988), *supra* note 6, at 780 (modifying his criticism, or at least his time frame, by asking why the *Hochfelder* majority opinion reached "back into history to the strictest common law definition").

338. 425 U.S. at 199.

339. Section 15(c)(1) adds the phrase "or other fraudulent" device or contrivance (emphasis added). See *supra* notes 4, 309.

340. See, e.g., 3A H. BLOOMENTHAL, *supra* note 6, at 8-16 to -17 (suggesting that under this *Hochfelder* "dictionary approach," scienter might be required under § 15(c)(1)). Cf. *id.* at 9-161 (suggesting that the rules under § 15(c)(2), in contrast to § 15(c)(1), may impose liability for negligent or even innocent misrepresentations).

341. See *infra* notes 355-56 and accompanying text.

342. Rule 15c1-2, 17 C.F.R. § 240.15c1-2 (1987), provides:

(a) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15(c)(1) of the Act (section 2, 52 Stat. 1075; 15 U.S.C. § 78o(c)(1) [sic], is hereby defined to include any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

(b) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15(c)(1) of the Act, is hereby defined to include any untrue statement of a material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge

15c1-2 is its resemblance to section 17(a) of the 1933 Act.³⁴³ Clauses (a) and (b) in Rule 15c1-2 are patterned after Clauses (3) and (2), respectively, of section 17(a).³⁴⁴ Under both clauses (2) and (3) of section 17(a), the Supreme Court held in *Aaron v. SEC*³⁴⁵ that scienter need not be established in an SEC enforcement action against representatives of a broker-dealer firm.³⁴⁶ Likewise, in *SEC v. Capital Gains Research Bureau, Inc.*,³⁴⁷ the Court found no requirement of proof of an actual intent to defraud in an SEC enforcement action under a similar provision of section 206(2) of the Investment Advisers Act of 1940.³⁴⁸

or reasonable grounds to believe that it is untrue or misleading.

(c) The scope of this section shall not be limited by any specific definitions of the term "manipulative, deceptive, or other fraudulent device or contrivance" contained in other rules adopted pursuant to section 15(c)(1) of the act.

343. Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (1982), provides:

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

344. 3 A. BROMBERG & L. LOWENFELS, *supra* note 6, § 8.4(451); L. Loss (1988), *supra* note 6, at 704 (noting that Rule 15c1-2 is modeled on clauses (2) and (3) of § 17(a) of the 1933 Act, "except that the portion comparable to Clause (2) applies only when the 'statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading' " (footnote omitted)).

345. 446 U.S. 680 (1980).

346. *Id.* at 702.

347. 375 U.S. 180 (1963).

348. *Id.* at 195. Section 206(2) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6(2) (1981), provides that it shall be unlawful for an investment adviser "to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client" The Court in *Capital Gains* refused to find that this language required a "showing [of] deliberate dishonesty as a condition precedent to protecting investors." *Id.* at 200. *See also* *Aaron v. SEC*, 446 U.S. 680, 697 (1980). In *Aaron*, the Court based its interpretation of clause (3) of § 17(a) on the above-quoted conclusion in *Capital Gains*:

Finally, the language of § 17(a)(3), under which it is unlawful for any person "to engage in any transaction, practice, or course of business which *operates or would operate* as a fraud or deceit," (emphasis added) quite plainly focuses upon the *effect* of particular conduct on members of the investing public, rather than upon the culpability of the person responsible. This reading follows directly from *Capital Gains*

446 U.S. 680, 696-97. Clause (a) of Rule 15c1-2 contains language identical to that in § 17(a)(3) of the 1933 Act and similar to that in § 206(2) of the 1940 Act, both of which have expressly been held to require no proof of actual intent to defraud. Thus, if Rule 15c1-2 is a valid interpretation of § 15(c)(1), *see infra* text accompanying notes 354-62, the conclusion follows under the Supreme Court's holdings in *Aaron* and *Capital Gains* that no proof of actual intent to defraud is necessary under § 15(c)(1).

A second notable aspect of Rule 15c1-2 is contained in clause (b), which is identical in relevant part to clause (b) of Rule 10b-5³⁴⁹ and to clause (2) of section 17(a) of the Securities Act of 1933, with the exception of the final phrase: "*which statement or omission is made with the knowledge or reasonable grounds to believe that it is untrue or misleading.*"³⁵⁰ The SEC's reference in clause (b) of the Rule to the requirement of "reasonable grounds to believe" that a statement is untrue or misleading suggests a negligence standard in the definition of "fraud" under section 15(c)(1). As has been observed of clause (b): "The belief language makes it clear that constructive knowledge, as well as actual knowledge, will sustain a violation. To this extent, negligence is a violation."³⁵¹ In *Aaron v. SEC*,³⁵² Justice Blackmun acknowledged that under Rule 15c1-2, section 15(c)(1) "has been interpreted with congressional approval to apply to negligent acts and practices."³⁵³

The relevance of the Court's analysis in *Capital Gains* (of section 206 of the Investment Advisers Act of 1940) and in *Aaron* (of section 17(a) of the 1933 Act) to section 15(c)(1) seems to depend on the weight that the Court will give to Rule 15c1-2. Certainly, the scope of Rule 15c1-2 cannot exceed the power granted the SEC under section 15(c)(1).³⁵⁴ However, in 1938 Congress expressly approved the SEC's interpretation of section 15(c)(1) under this Rule 15c1-2 (as well as under the other eight rules which had been adopted by the

349. 17 C.F.R. § 240.10b-5 (1987). See also *supra* note 3.

350. See *supra* note 342 (emphasis added).

351. 3 A. BROMBERG & L. LOWENFELS, *supra* note 6, § 8.4(451). These authors have argued that negligent conduct is probably covered under both Rule 15c1-2(a) and Rule 15c1-2(b), even though the knowledge-belief combination is contained only in the latter rule. These authors have also posited the following syllogism:

The syllogism suggested by these cases might not satisfy Aristotle. But it does produce results: SEA Rule 15c1-2(b) is violated by a broker-dealer who makes a statement or omission with reasonable grounds to believe it is untrue or misleading. A broker-dealer must have reasonable grounds (basis) for his statements. Therefore any statement made or transmitted by a broker-dealer, if untrue or misleading, is with reasonable grounds to believe that it is untrue or misleading; it is, consequently, a violation.

Id. §§ 204.84 to .85, quoted in S. JAFFE, *supra* note 32, at 128.

352. 446 U.S. 680 (1980) (Blackmun, J., concurring in part and dissenting in part).

353. *Id.* at 708. This additional language of clause (b) of Rule 15c1-2 would seem to negative a requirement of scienter. In his earlier treatise, Professor Loss appears to have suggested that "simple negligence" is sufficient under Rule 15c1-2. 6 L. Loss (1961), *supra* note 6, at 3885. However, he appears later to have suggested that scienter may be required. L. Loss (1988), *supra* note 6, at 814 (stating that "the scienter requirement of Rule 10b-5 presumably extends to the shingle theory whether the plaintiff relies on that rule or Rule 15c1-2"). Presumably Professor Loss's shift derives from the Court's holdings in *Hochfelder* and *Aaron* concerning § 10(b) requirements. However, more to the point in interpreting § 15(c)(1) would seem to be the Court's holdings in *Aaron* concerning § 17(a) of the 1933 Act, and in *SEC v. Capital Gains* concerning § 206 of the Investment Advisers Act of 1940.

354. See *Santa Fe Indus. v. Green*, 430 U.S. 462, 472-73 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14 (1976) (scope of Rule 10b-5 cannot exceed power granted the Commission by Congress under § 10(b)).

SEC).³⁵⁵ During the enactment of the 1938 amendments to section 15(c), a congressional report noted that these nine rules and regulations adopted by the SEC under section 15(c)(1) (formerly section 15(c)):

have withstood the test of experience and have met with the approval of representative groups of brokers and dealers subject thereto. It is contemplated that rules of similar character and additional appropriate rules will be adopted under clauses (1) and (2) of the proposed new subsection (c).³⁵⁶

While the Supreme Court has deemed it inappropriate to grant "administrative deference" to the SEC's position on the issue of implied causes of action, the Court has stated that the "administrative deference" rule is "more appropriately applicable in instances where . . . an agency has rendered binding, consistent, official interpretations of its statute over a long period of time."³⁵⁷ Not only did Rule 15c1-2 receive express congressional approval in 1938, the SEC has consistently applied a standard of "reasonableness" to the conduct of brokers and dealers under the antifraud proscription of section 15(c)(1). For example, a broker-dealer is required to have a "reasonable basis" for his recommendations concerning a security, and is required to undertake a "reasonable investigation" before making any such recommendation.³⁵⁸ A dealer must charge a price bearing a "reasonable" relationship to the prevailing price of the security.³⁵⁹ Generally, the courts have followed the SEC's position.³⁶⁰

Because Rule 15c1-2 has been given congressional approval and the SEC has consistently applied a "reasonableness" standard under it in enforcement

355. 3 L. Loss (1961), *supra* note 6, at 1426 ("Congress in 1938 reenacted the present § 15(c)(1), which had previously been numbered 15(c), and in the process gave its specific approval to the nine rules adopted by the Commission under that provision.").

356. S. REP. NO. 1455, *supra* note 95, at 10; H.R. REP. NO. 2307, *supra* note 95, at 10.

357. *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 41 n.27 (1977).

358. The SEC has:

repeatedly held that it is a violation of the anti-fraud provisions for a broker-dealer to recommend a security unless there is an adequate and reasonable basis for the recommendations and, further, that such recommendations should not be made without disclosure of facts known or reasonably ascertainable, bearing upon the justification for the recommendation. As indicated, the making of recommendations for the purchase of a security implies that the dealer has a reasonable basis for such recommendations which, in turn, requires that, as a prerequisite, he shall have made a reasonable investigation. In addition, if such a dealer lacks essential information about the issuer, such as knowledge of its financial condition, he must disclose this lack of knowledge and caution customers as to the risk involved in purchasing the securities without it.

Distribution by Broker-Dealers of Unregistered Securities, Exchange Act Release No. 6721, [1961-1964 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,820, at 81,065-68 (Feb. 2, 1962). *See generally* 5B A. JACOBS, *supra* note 32, § 211.01; L. Loss (1988), *supra* note 6, at 829-37.

359. *In re Duker & Duker*, 6 S.E.C. 386 (1939). *See also* cases cited *supra* note 36.

360. A. BROMBERG & L. LOWENFELS, *supra* note 6, § 8.4(454) ("The courts seem to be in agreement that no intent to defraud is necessary in an enforcement proceeding for violation of § 15(c)(1) or Rule 15c1-2."); 5B A. JACOBS, *supra* note 32, § 211.01[a]; S. JAFFE, *supra* note 32, at 131.

actions against broker-dealers, the Rule should be given great weight. "A contemporaneous and consistent construction of a statute by those charged with its enforcement combined with congressional acquiescence 'creates a presumption in favor of the administrative interpretation, to which we should give great weight, even if we doubted the correctness of the ruling of the Department'"³⁶¹ Thus, while the Supreme Court's interpretation in *Aaron* and *Hochfelder* of the language of section 10(b) would seem to suggest a scienter requirement under section 15(c)(1), the language of Rule 15c1-2, and the Supreme Court's interpretation of the language of section 17(a) of the 1933 Act in *Aaron*, and of section 206(2) of the 1940 Act in *Capital Gains*, seems more directly to suggest the opposite: that no proof of scienter is required under section 15(c)(1).³⁶²

The Supreme Court in *Hochfelder* found further support for its scienter requirement under section 10(b) in the overall structure of the 1934 Act.³⁶³ Specifically, the Court believed that failure to require scienter in an implied private right of action under section 10(b) would undercut the procedural limitations of the express civil remedies of the 1933 Act. The Court noted that a claim of negligence under sections 11, 12(2) or 15 of the 1933 Act, providing express civil remedies, was subject to, among other things, a statute of limitations of only one year after discovery of the violation and no more than three years after the violation occurred.³⁶⁴ The Court emphasized that extending section 10(b) to cover negligent conduct would allow a plaintiff to avoid this limitations period specified in section 13 of the 1933 Act by bringing the same action instead under section 10(b) of the 1934 Act, "thereby nullify[ing] the effectiveness of the carefully drawn procedural restrictions on these express actions."³⁶⁵

This rationale does not apply to section 15(c)(1). Like the express civil remedies provisions in the securities acts, section 15(c)(1) is subject to one of the principal "carefully drawn procedural restrictions" identified by the Court,

361. *Guardians Ass'n of N.Y. City Police Dep't, Inc. v. Civil Serv. Comm'n of N.Y.*, 463 U.S. 582, 621 (1983) (emphasis in original) (quoting *Costanzo v. Tillinghast*, 287 U.S. 341, 345 (1932)).

362. Both *Capital Gains* and *Aaron* involved civil injunctive actions brought by the SEC. Whether the Supreme Court would distinguish private actions from public enforcement actions in the interpretation of § 15(c)(1) is unclear. In *Capital Gains*, the Supreme Court appeared to suggest that the "prophylactic" nature of SEC injunctive action supported the Court's holding that proof of scienter was not required in such an action. 375 U.S. 180, 193 (1963). On the other hand, in *Aaron v. SEC*, despite the SEC's urgings to follow *Capital Gains*, the Supreme Court refused to limit its *Hochfelder* decision to private damages action and held that proof of scienter was required in both types of proceedings. 446 U.S. 680, 691-95 (1980).

363. 425 U.S. 185, 208-11 (1976).

364. *Id.* at 209-10.

365. *Id.* at 210. Another procedural restriction was found in § 11(e) of the 1933 Act, providing for payment of costs. *Id.*

namely, a relatively short statute of limitations.³⁶⁶ Thus, extending section 15(c)(1) to cover negligent conduct would not allow plaintiffs to circumvent one of the most significant procedural restrictions of the express civil liability provisions in the 1933 or 1934 Acts.³⁶⁷

But perhaps even more than the language and legislative history of section 15(c)(1) and Rule 15c1-2, and their relation to the overall structure of the 1934 Act, the very nature of the civil action itself under these provisions points to the conclusion that proof of scienter should not be required. By definition, such a suit is against a broker or dealer who, from the earliest cases, has been held to act as a fiduciary under agency law or as a quasi-fiduciary under the shingle theory.³⁶⁸ That Congress had recognized "the delicate fiduciary nature of an investment advisory relationship"³⁶⁹ was the Court's principal reason in *Capital Gains* for holding that no intent to defraud was required under section 206 of the Investment Advisers Act of 1940. In light of this fiduciary relationship, "as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested,"³⁷⁰ the Court flatly refused to require proof of intent to defraud in an SEC enforcement action under the 1940 Act. Instead, the Court wrote: "It would defeat the manifest purpose of the Investment Advisers Act of 1940 for us to hold, therefore, that Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit,' intended to require proof of intent to injure and actual injury to clients."³⁷¹

In enacting the 1934 Act, Congress recognized just as clearly that the broker-dealer's relationship to his customer was fraught with the same inherent potential for conflicts of interest. A large portion of the 1934 congressional hearings was devoted to debate over whether to resolve such conflicts statutorily by forcing the segregation of the roles of broker and dealer.³⁷² As originally

366. Section 29(b) of the 1934 Act, 15 U.S.C. § 78cc(b) (1982), provides that any suit for violation of § 15(c)(1) must be "brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation." See *supra* note 134.

367. The express civil liability provisions of the 1934 Act do not necessarily cover the same conduct as § 15(c)(1), but do provide similarly short limitations periods. See § 9(e) of the 1934 Act, 15 U.S.C. § 78i(e) (1982) (1 year/3 year limitations period for willful market manipulations of securities listed on a national securities exchange); § 16(b) of the 1934 Act, 15 U.S.C. § 78p(b) (1982) (2-year limitations period for certain insider trading violations); § 18(c) of the 1934 Act, 15 U.S.C. § 78r(c) (1982) (1 year/3 year limitations period for filing false documents with SEC). Whether the limitations period would apply to private actions for damages as well as to private actions for rescission is not clear. See *supra* note 218.

368. See *supra* text accompanying notes 23-40.

369. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191 (1963) (quoting 2 L. Loss (1961), *supra* note 6, at 1412).

370. *Id.* at 191-92.

371. *Id.* at 192.

372. The proposal to segregate completely the functions of broker and dealer "evoked very considerable opposition on the part of the exchanges all over the country. That is, perhaps, next

drafted, section 11 provided for the separation of the functions of brokers and dealers.³⁷³ One of the principal drafters of the 1934 Act, Mr. Thomas G. Corcoran, described these "conscious or unconscious" conflicts of interest inherent in the broker-dealer relationship to his customers as the principal reason for recommending the segregation of these functions:

In the first place, as recognized by the Glass-Steagall Act, you cannot expect disinterested service from a man on both sides of the fence. If a man is going to act as your broker and thus as your investment counsellor—for that is what your broker practically is, you go to him for advice on securities as you go to your lawyer for advice on the law, he should not have something of his own to sell.

And every underwriter and every dealer has securities of his own to sell, or some interest somewhere that he is watching. . . .

If you go to your own broker, who is also an underwriter and dealer, and announce to him that you want to buy something, you cannot expect an unbiased answer because he will either consciously push his own securities or will be so interested in them that he will unconsciously tend to advise you in favor of his own securities, although he seriously believes he is giving you the most disinterested advice in the world. That is just human nature.³⁷⁴

to [§ 7 of the Act], the section which has become the most controversial section of this bill." *Senate Hearings on S. Res. 84*, *supra* note 85, at 7738 (statement of Ferdinand Pecora). For additional discussion, debate, and protest over this proposal, see, e.g., *Senate Hearings on S. Res. 84*, *supra* note 85, at 6465, 6520-28, 6634, 6660-61, 6737, 6739, 6741-44, 6749-51, 6792-93, 6835, 6861-67, 6885-86, 6889-90, 6911, 6918, 6921-24, 6954, 6988, 7033-34, 7040-42, 7054, 7072-73, 7174-75, 7456-58, 7460-61, 7482, 7528, 7533, 7738-39, 7748; *House Hearings on H.R. 8720*, *supra* note 88, at 725-26, 739-40, 783-85, 883-85; *House Hearings on H.R. 7852*, *supra* note 85, at 115-17, 122-29, 209-10, 214, 258-59, 278, 283, 289, 334-35, 337-38, 363, 399-402, 403-04, 406-07, 413-16, 420-23, 449-51, 537-38, 548, 593-94, 616-17, 661-62, 666.

373. An early draft of § 11 (§ 10 in the draft bill) provided, *inter alia*:

It shall be unlawful for any member of a national securities exchange or any person who as a broker transacts a business in securities through the medium of any such member to act as a dealer in or underwriter of securities, whether or not registered on any national securities exchange.

H.R. 7852, 73d Cong., 2d. Sess., reprinted in *House Hearings on H.R. 7852*, *supra* note 85, at 7. The Twentieth Century Fund Report, *supra* note 88, had recommended the complete segregation of broker and dealer functions. THE TWENTIETH CENTURY FUND REPORT, *supra* note 88, at 176. See also *Hearings on S. Res. 84*, *supra* note 85, at 6525; *House Hearings on H.R. 7852*, *supra* note 85, at 117. The Twentieth Century Fund Report had further observed in connection with brokerage commissions and solicitation of business: "That a conflict of interest between the brokerage firm and the customer is thus likely to arise is to put it mildly." THE TWENTIETH CENTURY FUND REPORT, *supra* note 85, at 177. The Roper Report found that such segregation of broker-dealer functions "[a]s an abstract matter . . . has much to commend it," but proposed no action on it "before we are in a position to calculate its cost and foresee its repercussions." ROPER REPORT, *supra* note 93, at 20. See also *House Hearings on H.R. 7852*, *supra* note 85, at 26, 116.

374. *House Hearings on H.R. 7852*, *supra* note 85, at 123. Mr. Corcoran reiterated the drafters' concern over the "evils" that the combination of the broker-dealer functions was thought to pose at other points throughout the hearings. See, e.g., *Senate Hearings on S. Res. 84*, *supra* note 85, at 6465, 6521, 6522-24.

The congressional reports³⁷⁵ and congressional hearings³⁷⁶ echo this concern over the fiduciary dilemmas facing the broker-dealer.

Ultimately, in the face of strenuous protest from brokers-dealers and from the exchanges predicting severe economic hardship on broker-dealers if their roles were separated,³⁷⁷ Congress withdrew the draft segregation provision and in section 11(e) directed the Commission to make a study of and report on

375. As a House report noted:

Another perplexing problem in regard to the working of the exchanges has been that centering about the dealer-broker relationship. There is an inherent inconsistency in a man's acting both as a broker and a dealer. It is difficult to serve two masters. And it is particularly difficult to give impartial advice to a client if the dealer-broker has his own securities to sell, particularly when they are new securities for which there is no ready market.

H.R. REP. NO. 1383, *supra* note 87, at 15. *See also id.* at 22. A Senate report observed:

Many critics of the stockbrokerage business as now conducted assert that a fundamental evil is the commingling of the functions of broker and dealer by the same person or firm. The contention has been advanced, and evidence before the committee has tended to prove, that a broker who deals in securities for his own account finds it difficult to give disinterested advice to a customer with regard to the securities the customer seeks to buy. However honest the broker's intentions may be, it is argued that he should be placed beyond temptation, by a complete segregation of the broker and dealer functions.

S. REP. NO. 792, *supra* note 87, at 11.

376. As Evans Clark, executive director of the Twentieth Century Fund, Inc., observed:

It is hardly necessary to elaborate the reasons for this proposal [to segregate broker and dealer functions]. It is self-evident that anyone who is actively trading in the market for himself cannot possibly—with human nature as it is—be expected to act with complete detachment in handling the accounts of others.

House Hearings on H.R. 8720, supra note 88, at 783 (statement of Evans Clark, executive director of the Twentieth Century Fund, Inc.).

As Ferdinand Pecora, counsel to the Senate Committee and active participant in the hearings on the draft bills, observed:

The evidence which has been introduced before this committee will show that when dealers have in their inventories such securities they may and some have passed them on to unsuspecting [sic] clients who face a loss on them. It is only natural to assume that where an individual is called upon to serve two interests, the one his own and the other his customer's, there is a strong temptation that the advice he will give to his customer will be that advice which will best serve the dealer's own interest.

Senate Hearings on S. Res. 84, supra note 85, at 7458. *See also id.* at 7041 (In response to a broker-dealer witness remarking that "if I own bonds it is particularly exasperating to have a man pass over every bond I would like to sell him to buy a bond that someone else owned . . .," Mr. Pecora observed that "[e]vidence before this committee shows that one of the biggest bond houses [in] the country . . . pushed on their customers their own securities, particularly at times when they knew those securities were souring."). As Thomas G. Corcoran, a principal drafter of the bill, remarked:

There are certainly difficulties about having those first two functions [underwriter and dealer] combined with that of a broker. It is very hard for a man to sit on 3 sides of the fence at the same time, or even on 2 sides of the fence, particularly when as matter of practice your broker acts not only as an agent who executes your own orders, but also as your investment lawyer to give you advice as to what securities to buy and sell.

House Hearings on H.R. 7852, supra note 85, at 116.

377. *See supra* note 372.

"the feasibility and advisability of the complete segregation of the functions of dealer and broker" ³⁷⁸ While this draft provision and the debate over it was specifically directed to the position of brokers who were members of the stock exchanges, the controversy reflects an overall congressional recognition of the fiduciary problems of broker-dealers applicable equally to those in the OTC market. ³⁷⁹

Thus, in enacting both the 1934 Act governing broker-dealers and the 1940 Act governing investment advisers, Congress was equally concerned with conflicts of interests that might incline such securities professionals "—consciously or unconsciously—to render advice which was not disinterested." ³⁸⁰ Equally applicable to the 1934 Act, therefore, is the Supreme Court's conclusion in *Capital Gains* that it "would defeat the manifest purpose" of the 1934 Act for the Court to hold that Congress "intended to require proof of intent to injure and actual injury to clients." ³⁸¹

For all of these reasons—the language and legislative history of section 15(c)(1) (including express congressional approval of the SEC's interpretive Rule 15c1-2), its relationship to section 29(b) which gives an express limitations period of the same character as that found in the express civil liability provisions of the 1934 Act, and in light of the special fiduciary or quasi-fiduciary status of brokers and dealers—a plaintiff should not be required to prove scienter in a private civil action under section 15(c)(1). ³⁸²

378. Securities Exchange Act of 1934, Pub. L. No. 291, § 11(e), 48 Stat. 881, 892 (1934). See also S. REP. No. 792, *supra* note 87, at 11 (concluding that "for the present any such action [to segregate the broker-dealer functions] would be unwise").

The combination of the functions of dealer and broker has persisted over a long period of time in American investment banking and it was found difficult to break up this relationship at a time when the dealer business was in the doldrums and when it was feared that the bulk of the dealer-brokers would, if compelled to choose, give up their dealer business and leave, temporarily at least, an impaired mechanism for the distribution of new securities. Consequently it was deemed impracticable at this time to do more than require the dealer-broker to disclose to his customer the capacity in which he was acting and to refrain from taking into margin accounts new securities in the distribution of which he had participated during the preceding 6 months.

H.R. REP. No. 1383, *supra* note 87, at 15. See also 78 CONG. REC. 7713 (1934) (statement of Rep. Wadsworth). In its subsequent 1936 report to Congress, the SEC stressed the inherent conflicts of interest in the combination of broker and dealer functions, but nevertheless recommended against enacting legislation requiring complete segregation. SEC REPORT ON BROKER-DEALER SEGREGATION, *supra* note 316, at 109, 113-14.

379. Congress viewed the primary function of § 15 as originally enacted to serve as the "basis for such regulation of [the OTC] markets as the commission may find appropriate to insure to investors protection comparable to that which is accorded in the case of registered exchanges under the act." S. REP. No. 792, *supra* note 87, at 20. See also H.R. REP. No. 1383, *supra* note 87, at 24.

380. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-92 (1963).

381. *Id.* at 192.

382. That the scienter requirement is properly lowered when the defendant owes a fiduciary duty to plaintiff is currently recognized by the Second Circuit for private actions under § 10(b).

C. Plaintiff's Standing to Sue

Who should be allowed to sue for a violation of section 15(c)(1)? The language and legislative history of the section suggest that the standing requirement for a private lawsuit under section 15(c)(1) is different, and broader, than that under section 10(b).

Section 10(b) requires that the violation have occurred "in connection with the purchase or sale of any security."³⁸³ In *Blue Chip Stamps v. Manor Drug Stores*,³⁸⁴ the Supreme Court interpreted this phrase to require that the plaintiff have actually purchased or sold a security as a prerequisite to bringing a private civil action under section 10(b), in accordance with the so-called *Birnbaum* rule.³⁸⁵ The Supreme Court drew support for this narrow interpretation of the "in connection with" requirement under section 10(b) from, among other things, the legislative history, specifically Congress's failure to adopt amendments proposed by the SEC that would have broadened that section's scope.³⁸⁶ In 1957 and 1959, the SEC sought to have Congress change the wording of section 10(b) from "in connection with the purchase or sale of any security" to "in connection with the purchase or sale of, or any attempt to purchase or sell, any security."³⁸⁷ The SEC's purpose in seeking this amendment was to make clear that section 10(b) "reaches manipulative and deceptive activities in connection with attempts to buy or sell securities as well as in connection with consummated transactions."³⁸⁸ As the Supreme Court noted: "Opposition to the amendment was based on fears of the extension of civil liability under § 10(b) that it would cause. . . . Neither change was adopted by Congress."³⁸⁹

By contrast, in 1975 Congress amended section 15(c)(1) to adopt language very similar to that which was not adopted in section 10(b).³⁹⁰ By virtue of

The Second Circuit has adopted a "sliding scale" scienter requirement in aider and abettor cases, and has held that recklessness constitutes scienter if the parties stand in a fiduciary relationship. See *Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983); *IIT, An Int'l Inv. Trust v. Cornfield*, 619 F.2d 909, 923 (2d Cir. 1980). See also *Johnson v. Chilcott*, 658 F. Supp. 1213, 1222 (D. Colo. 1987). However, for cases finding the same scienter requirement under § 10(b) and § 15(c)(1), see *Amunrud v. Taurus Drilling, Ltd.*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,649, at 97,596 (D. Mont. 1983); *Darvin v. Bache Halsey Stuart Shields, Inc.*, 479 F. Supp. 460, 464 (S.D.N.Y. 1979); *Odette v. Shearson, Hammill & Co.*, 394 F. Supp. 946, 956 n.12 (S.D.N.Y. 1975).

383. See *supra* note 3.

384. 421 U.S. 723 (1975).

385. *Id.* at 731-49 (relying on *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952)).

386. *Blue Chip Stamps*, 421 U.S. at 732-33.

387. *Id.* (emphasis in original). See also 103 CONG. REC. 11,636 (1957); *SEC Legislation: Hearings on S. 1178-1182 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 86th Cong., 1st Sess., 331, 367-68 (1959) [hereinafter *Hearings on S. 1178-1182*].

388. *Hearings on S. 1178-1182*, *supra* note 387, at 331.

389. *Blue Chip Stamps*, 421 U.S. at 732.

390. Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 125.

the 1975 amendment, section 15(c)(1) makes it unlawful for any broker or dealer "to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security" by fraudulent means.³⁹¹

The 1975 legislative history is silent on Congress's intent concerning this phrase "attempt to induce the purchase or sale," although it does make parallel the construction with section 15(c)(2) and 15(c)(3).³⁹² At a minimum, the language "attempt to induce the purchase or sale" would seem to include offers to sell or purchase. Professor Loss has suggested that similar language in section 15(a) covered advertising.³⁹³ Going further, by its phrasing in the alternative, section 15(c)(1) proscribes the effectuation by a broker or dealer of "any transaction in . . . any security" by fraudulent means, without the apparent necessity of either a completed or even an attempted purchase or sale of a security. Moreover, contractual privity may be required only to the extent that a private investor sought under section 29(b) to rescind a contract made or performed in violation of section 15(c)(1).³⁹⁴

Just how broadly the phrases "attempt to induce" and "any transaction in . . . any security" will or should be interpreted is left to the courts and other commentators, although this language does pose some interesting questions. If under section 15(c)(1) the plaintiff need not be an actual purchaser or seller of a security, does the investor who holds on to a security because of "an unduly rosy representation"³⁹⁵ as to its value, or an investor who decides not to purchase because of "an unduly gloomy representation,"³⁹⁶ have standing

391. See *supra* note 4 (emphasis added). See also S. REP. NO. 75, *supra* note 247, at 197.

392. See *supra* note 248. However, the SEC explained the purpose of the similar proposal to amend § 10(b) as follows:

One of the purposes of this change is to make it entirely clear that the section covers the so-called "front money racket," that is, obtaining money from an issuer for alleged services in arranging an underwriting or financing for the issuer, without actually intending to or being in a position to arrange the proposed underwriting or financing. It would also reach manipulative and deceptive activities in connection with attempts to buy or sell securities as well as in connection with consummated transactions.

103 CONG. REC. 11,636 (1957). See also *Hearings on S. 1178-1182, supra* note 387, at 331.

393. 2 L. LOSS (1961), *supra* note 6, at 1289. Professor Loss's reference was to the phrases "effect any transaction" and "induce [a] purchase or sale" in § 15(a) as amended in 1936. The 1975 amendment to § 15(c)(1) adding the "attempt" language would, if anything, seem to expand the reach of the section.

394. Section 29(b) provides that no contract made or performed in violation of § 15(c)(1) "shall be void . . . in any action . . . by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases" a security unless brought within the specified limitations period. See *supra* note 134. Such language suggests that Congress contemplated contractual privity in suits invoking § 29(b). See 2 A. BROMBERG & L. LOWENFELS, *supra* note 6, § 8.5(450); Gruenbaum & Steinberg, *supra* note 6, at 32-36, 45 (authors argue that privity should be required only when to do so is consistent with the underlying purposes of the Exchange Act). On the other hand, the express language of § 15(c)(1) would seem to negative any requirement of contractual privity under that section, thus suggesting that Congress contemplated suits for damages as well as rescission under § 15(c)(1). See *infra* note 425 and accompanying text.

395. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737-38 (1975).

396. *Id.* at 737.

to sue when the representations ultimately appear to have been unfounded?³⁹⁷ In other words, does an attempt to discourage a sale or purchase amount to an "attempt to induce a sale or purchase," or does the broad phrase "any transaction in . . . any security" cover such a situation? More far-reaching, is it even necessary that the private investor be a customer of the broker-dealer in relation to a particular security, or may any investor sue a broker-dealer for fraudulent activities (such as scalping or insider trading in a security)?

If the term "fraudulent device or contrivance" is broadly construed, as suggested above,³⁹⁸ to include negligence and breaches of fiduciary duty by broker-dealers, then a real potential exists that section 15(c)(1) could, with respect to broker-dealers, develop into a true "catchall" provision to combat securities "misbehavior that all too often makes investment in securities a needlessly risky business for the uninitiated investor."³⁹⁹ What seems clear at this point, however, is that the literal language of section 15(c)(1) justifies a broader standing interpretation than has been accorded section 10(b) under *Blue Chip Stamps*.⁴⁰⁰

D. The Nature of the Relief

Although infrequently litigated in the past, section 29(b) of the Securities Exchange Act is an appropriate starting point to discuss the nature of the relief which might be afforded in a private action under section 15(c)(1). Section 29(b) provides that contracts made or performed in violation of any provision of the Act or a rule thereunder "shall be void."⁴⁰¹ Having observed that this language "does not compel the conclusion that the contract is a nullity," and that lower courts have interpreted section 29(b) as "rendering the contract merely voidable at the option of the innocent party,"⁴⁰² the

397. In *Blue Chip Stamps*, the Supreme Court determined that under § 10(b), such investors do not have standing to sue. *Id.* at 746-49. Whether they would have standing to sue under § 15(c)(1) would seem to depend on whether unduly "rosy" or "gloomy" representations constituted an "attempt to induce the purchase or sale of" a security. Arguably, the even broader phrase, "any transaction in . . . any security," would seem to bring such a plaintiff within the proscriptions of § 15(c)(1).

398. See *supra* text accompanying notes 342-82.

399. *Chiarella v. United States*, 445 U.S. 222, 246 (1980).

400. *But cf.* *Bosio v. Norbay Sec., Inc.*, 599 F. Supp. 1563, 1566-67 (E.D.N.Y. 1985) (plaintiff's claims under § 10(b) and § 15(c)(1) failed because alleged fraud by broker was not in connection with a purchase or sale of securities); *Gilbert v. Bagley*, 492 F. Supp. 714, 733 (M.D.N.C. 1980) (*Birnbaum* rule applies to § 15(c)(1) in private action).

401. See *supra* note 134.

402. *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 387-88 (1970) (calling the lower courts' interpretation "eminently sensible"). See also *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 735 (1975). For lower court cases both before and after *Mills* interpreting § 29(b) as rendering contracts voidable rather than void, see *Reserve Life Ins. Co. v. Provident Life Ins. Co.*, 499 F.2d 715, 726 (8th Cir. 1974), *cert. denied*, 419 U.S. 1107 (1975); *Occidental Life Ins. Co. v. Pat Ryan & Assocs., Inc.*, 496 F.2d 1255, 1265-67 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974);

Supreme Court has recognized that section 29(b) "confers a 'right to rescind' a contract void under the criteria of the [1934 Act]."⁴⁰³ As discussed earlier,⁴⁰⁴ Congress deliberately omitted contracts made or performed in violation of sections 15(c)(2) and 15(c)(3) from the voiding provisions of section 29(b). Congress's intentional exclusion of clauses (c)(2) and (c)(3) inevitably suggests that Congress intended that the voiding provisions of section 29(b) would apply to clause (1) of section 15(c), and that it "intended that the customary legal incidents of voidness would follow, including the availability of a suit for rescission . . . and for restitution."⁴⁰⁵

Even if it is assumed that Congress did intend to make available the remedy of rescission for a contract made or performed in violation of section 15(c)(1), does this also mean that Congress contemplated it would be the *exclusive* remedy under the Act? Lower courts have permitted recovery of damages under section 29(b) as well as rescission,⁴⁰⁶ and the Supreme Court in dicta has suggested that damages are an appropriate alternative remedy in suits under the 1934 Act.⁴⁰⁷ Under the majority's reasoning in *Transamerica Mortgage Advisors, Inc. v. Lewis*,⁴⁰⁸ however, section 29(b) might be deemed to

Daley v. Capitol Bank & Trust Co., 506 F.2d 1375, 1376 (1st Cir. 1974); Bache Halsey Stuart, Inc. v. Killop, 509 F. Supp. 256, 262 (E.D. Mich. 1980); Gannett Co. v. Register Publishing Co., 428 F. Supp. 818, 830-31 (D. Conn. 1977); Freeman v. Marine Midland Bank, 419 F. Supp. 440, 453 (E.D.N.Y. 1976). Cf. Myzel v. Fields, 386 F.2d 718, 742 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968) (contract "void as a matter of law"). See also 6 L. Loss (1961), *supra* note 6, at 3784.

403. *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 19 (1979). See also *Jackson Transit Auth. v. Local Div. 1285, Amalgamated Transit Union*, 457 U.S. 15, 22 (1982).

404. See *supra* notes 201-07, 219 and accompanying text.

405. *Transamerica*, 444 U.S. at 19.

406. See, e.g., *Myzel v. Fields*, 386 F.2d 718, 741-42 (8th Cir. 1967) (where rescission impossible, rescissional damages permitted), *cert. denied*, 390 U.S. 951 (1968); *American Gen. Ins. Co. v. Equitable Gen. Corp.*, 493 F. Supp. 721, 758-59 (E.D. Va. 1980) (where specific restitution of shares not possible, court possesses broad remedial power to award monetary equivalent of rescission as rescissional damages); *Freeman v. Marine Midland Bank*, 419 F. Supp. 440, 453 (E.D.N.Y. 1976); *Newburger, Loeb & Co. v. Gross*, 365 F. Supp. 1364, 1371 (S.D.N.Y. 1973) ("A reading of the limitation provision of § 29(b) to exclude actions for damages places a narrow, strained interpretation on the statute which the courts have not accepted."); *Maher v. J.R. Williston & Beane, Inc.*, 280 F. Supp. 133, 137 (S.D.N.Y. 1967); *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946); *Geismar v. Bond & Goodwin, Inc.*, 40 F. Supp. 876, 878 (S.D.N.Y. 1941). See also 5C A. Jacobs, *supra* note 32, § 260.03[c][vi]; L. Loss (1988), *supra* note 6, at 941 ("[I]t is arguable even in the face of *Transamerica* that § 29(b) of the 1934 Act makes the whole loaf available—damages as well as rescission . . ." (emphasis in original)). While approving the result of the cases which would permit alternative recovery of damages or rescission in implied private civil actions under the 1934 Act, this author believes the better reasoning would find that, whenever a private right of action is implied under a section of the 1934 Act, the remedy of damages arises under the same section, while the remedy of rescission arises under § 29(b) and is limited by the terms thereof. See *infra* notes 417-29 and accompanying text.

407. *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 388-89 (1970) (With reference to a private action under § 14(a), the court said: "Monetary relief will, of course, also be a possibility. . . . In short, damages should be recoverable only to the extent that they can be shown.").

408. 444 U.S. 11 (1979).

provide an exclusive rescission remedy for all violations of section 15(c)(1). In analyzing a similar provision of the Investment Advisers Act of 1940,⁴⁰⁹ the Court concluded that under the provision comparable to section 29(b), relief in a civil lawsuit would be limited to rescission and restitution, and that a damages remedy was not available.⁴¹⁰ However, the Court's reasoning to support this conclusion with respect to the Investment Advisers Act is not applicable to the Exchange Act, and *Transamerica* is readily distinguishable.

The *Transamerica* majority construed the language of the jurisdictional provision of the Investment Advisers Act of 1940, section 214,⁴¹¹ to limit the courts to granting equitable, but not legal (monetary), relief.⁴¹² The Court noted that the final version of section 214 granted the federal courts jurisdiction "of all suits in equity to enjoin any violation" of the Act and rules thereunder, but omitted the references found in earlier bills to "actions at law" or to "liability" created by the statute.⁴¹³ In part because of this language in the 1940 Act that appeared to grant equitable jurisdiction alone, the *Transamerica* Court felt constrained to permit only equitable relief.

By contrast, the comparable jurisdictional statute under the Exchange Act, section 27,⁴¹⁴ specifically grants jurisdiction to the federal courts "of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder." When civil remedies have been implied under sections 10(b) and 14(a), the Supreme Court has assumed the availability of a damages remedy.⁴¹⁵ Based on this jurisdictional distinction between the Exchange Act and the Investment Advisers Act, "the right to monetary relief under section 29(b) may be amply supported."⁴¹⁶

409. See *supra* notes 136-42 and accompanying text.

410. *Transamerica*, 444 U.S. at 19-24.

411. Section 214 of the Investment Advisers Act, 15 U.S.C. § 80b-14 (1982), provides in pertinent part:

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder.

Id.

412. *Transamerica*, 444 U.S. at 21-22.

413. *Id.*

414. Section 27 of the 1934 Act, 15 U.S.C. § 78aa (1982), provides in pertinent part:

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.

Id.

415. *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983) (§ 10(b)); *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 388 (in a private lawsuit under § 14(a) of the Exchange Act, the Court observed that "[m]onetary relief will, of course, also be a possibility.>").

416. *Gruenbaum & Steinberg*, *supra* note 6, at 26.

An interpretation limiting recovery in a private action under section 15(c)(1) to rescission and restitution would strain both the language and the spirit of the Act. On its face, section 29(b) contemplates only equitable relief. Section 29(b) authorizes this form of relief (the voiding of a contract) under certain conditions (when a contract was made or performed in violation of the Act). It forbids such relief under other conditions (when the contract was made or performed in violation of section 15(c)(2) or section 15(c)(3) or when an action to void a contract is brought under section 15(c)(1) after the 1 year/3 year limitations period).⁴¹⁷ On its face, section 29(b) does not create a private cause of action for money damages, nor does it bar such an action under other provisions of the Act; it simply does not address these issues. This interpretation of section 29(b)—which separates the issue of equitable relief from the issues of the availability of legal relief and the implication of private actions in general—comports with the literal language of the statute and with the understanding Congress would have had of the law in the 1930s.

An interpretation consistent with the structure and purposes of the 1934 Act would construe section 29(b) as giving an *additional* remedy in the form of rescission and restitution for private actions alleging violation of section 15(c)(1), not as providing a sole remedy.⁴¹⁸ When the 1934 Act and the 1938 amendments were enacted, Congress would have understood the state of the common law to favor implication of private rights of action, unless Congress had expressly denied them.⁴¹⁹ Theoretically, under the common-law approach, Congress need not have enacted section 29(b) at all, for once a private action was implied under a statute, the courts had broad powers to provide both legal and equitable relief to redress the injury.⁴²⁰ By enacting section 29(b), Congress made explicit its intention to permit equitable relief from “every” contract made or performed in violation of “any” of the provisions of the 1934 Act, but subject to the various limitations contained in that section.⁴²¹

417. See *supra* notes 218-19 and accompanying text. For the text of § 29(b), 15 U.S.C. § 78cc(b) (1982), see *supra* note 134.

418. See *Occidental Life Ins. Co. v. Pat Ryan & Assocs., Inc.*, 496 F.2d 1255, 1266 (4th Cir.) (“Section 29(b) is more properly viewed as an adjunct to the other remedies provided by the Securities Exchange Act of 1934 . . .”), *cert. denied*, 419 U.S. 1023 (1974); Gruenbaum & Steinberg, *supra* note 6, at 48-50.

419. See *supra* note 74 and accompanying text.

420. That this view of the law prevailed at the time of the enactment of the 1934 Act and the 1938 amendment is supported by the Supreme Court’s decision in *Deckert v. Independence Shares Corp.*, 311 U.S. 282, 288 (1940), which upheld the right of purchasers of securities to maintain a suit in equity to rescind a fraudulent sale and secure restitution of the consideration paid under the Securities Act of 1933, even though that Act contains no provision comparable to § 29(b) of the 1934 Act. The *Deckert* Court relied on § 22 of the 1933 Act, which finds its analogy in § 27 of the 1934 Act. Cf. *A.C. Frost & Co. v. Coeur D’Alene Mines Corp.*, 312 U.S. 38, 41-44 (1941).

421. That Congress understood it was restricting the right to rescission under the Exchange Act when it enacted § 29(b) in 1934 is illustrated by H.R. CONF. REP. No. 1838, 73d Cong., 2d Sess. 37-38 (1934).

However, suits for damages were left to the common-law approach of the judiciary which would take the Act section by section, and would imply private rights of action under those provisions that were intended to benefit a class of persons of which the plaintiff was a member.⁴²²

It would be inconsistent with the history of implied rights under the securities acts to suggest, with respect to section 29(b), that *expressio unius est exclusio alterius*,⁴²³ and that rescission is the sole remedy with respect to section 15(c)(1) violations. While the equitable remedy of rescission may be expressly provided for under—and limited by—section 29(b), the remedy of damages implicitly arises under section 15(c)(1) itself once a court implies the private right of action under that section. This interpretation is consistent with the approach the Supreme Court has taken in allowing recovery of damages in implied rights of action under other sections of the 1934 Act.⁴²⁴

Moreover, section 29(b) refers only to the voiding of *contracts* made or performed in violation of some other provision of the 1934 Act. Section 15(c)(1) makes unlawful a wide range of broker-dealer conduct independent of a contract: any “transaction in” and “attempt to induce the purchase or sale of” a security by fraudulent means. A narrow construction permitting private suits only for conduct involving a “contract” allegedly in violation of section 15(c)(1) rather than a “transaction in”⁴²⁵ or an “attempt to induce the purchase or sale of” a security in violation of section 15(c)(1) would run afoul of the Supreme Court’s repeated admonitions that the securities laws combating fraud “should be construed ‘not technically and restrictively, but flexibly to effectuate [their] remedial purposes.’ ”⁴²⁶

422. See *supra* notes 69-82 and accompanying text. This approach would not necessarily entail a finding of an implied right under every section of the 1934 Act, because the predominant purpose of every provision is not necessarily the protection of individual investors; another principal purpose of the Act was to achieve general stability of the economy as a whole. See *United States v. Naftalin*, 441 U.S. 768, 775-76 (1979). See also *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568-79 (1979) (no implied right under § 17(a) of the 1934 Act).

423. See *supra* notes 116-19.

424. See *supra* note 415.

425. Some courts have strictly construed § 29(b) as applying only to unlawful “contracts,” and not to unlawful “transactions.” See, e.g., *Slomiak v. Bear Stearns & Co.*, 597 F. Supp. 676, 681-82 (S.D.N.Y. 1984); *Zerman v. Jacobs*, 510 F. Supp. 132, 135 (S.D.N.Y.), *aff’d*, 672 F.2d 901 (2d Cir. 1981); *Palmer v. Thomson & McKinnon Auchincloss, Inc.*, 474 F. Supp. 286, 291 (D. Conn. 1979). To the extent that the relief sought in a private lawsuit is rescission, the requirement of a “contract” is not an unreasonable interpretation of § 29(b), which expressly refers to contracts. Accordingly, in a private suit for rescission under § 29(b) alleging a violation of § 15(c)(1), the requirement of a contract arguably may be appropriate. However, there is no logical reason to extend § 29(b)’s requirement of a contract to *all* private actions alleging violation of § 15(c)(1), including actions for damages, for § 15(c)(1) by its terms plainly proscribes a broader range of misconduct than that in connection with contract formation or performance.

426. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983) (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

The Supreme Court has favored a cumulative construction of the provisions of the securities acts.⁴²⁷ Moreover, a limited interpretation of the remedies available under section 15(c)(1) seems to conflict with the savings clause of section 28(a)⁴²⁸ of the Act, which provides that the "rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity." The Supreme Court has recently observed that this savings clause and the comparable one in the 1933 Act "confirm that the remedies in each Act were to be supplemented by 'any and all' additional remedies."⁴²⁹

E. Proof of Causation and Injury

In a private action for damages under section 10(b), the plaintiff must show that the defendant's conduct caused the plaintiff some injury.⁴³⁰ However, some lower courts have held that rescission is available in a private action against a broker-dealer under section 29(b), even in the absence of proof that the securities violation caused the investor's loss.⁴³¹ Acknowledging that permitting rescission without requiring proof of causation of injury might seem "harsh," from the standpoint of the broker, the Fifth Circuit has nevertheless stated that this "seems to be what Congress intended."⁴³²

While the 1934 legislative history is largely silent on section 29(b),⁴³³ later legislative history does seem to support this interpretation. As discussed

427. See *Huddleston*, 459 U.S. at 383-87; *United States v. Naftalin*, 441 U.S. 768, 778 (1979) ("But '[t]he fact that there may well be some overlap is neither unusual nor unfortunate.' " (quoting *SEC v. National Sec. Inc.*, 393 U.S. 453, 468 (1969))).

428. 15 U.S.C. § 78bb(a) (1982).

429. *Huddleston*, 459 U.S. at 383.

430. For a discussion of proof of causation under § 10(b) and under the proxy rules, see L. Loss (1988), *supra* note 6, at 945-48, 955-65. The measure of damages used by courts in private civil actions under § 10(b) varies by jurisdiction and depending on the nature of the case. See Comment, *The Measure of Damages Under Section 10(b) and Rule 10b-5*, 46 Md. L. Rev. 1266 (1987).

431. *Eastside Church of Christ v. National Plan, Inc.*, 391 F.2d 357, 362 (5th Cir.), *cert. denied*, 393 U.S. 913 (1968); *accord* *Regional Properties, Inc. v. Financial & Real Estate Consulting Co.*, 678 F.2d 552, 558-62 (5th Cir. 1982). *Cf.* *Moody v. Bache & Co.*, 570 F.2d 523, 527 n.6 (5th Cir. 1978). At least one commentator supports an interpretation of § 29(b) that eliminates the element of proof of proximate causation. Gruenbaum & Steinberg, *supra* note 6, at 29-30. See also L. Loss (1988), *supra* note 6, at 941, 959.

432. *Regional Properties*, 678 F.2d at 561; *Eastside Church of Christ*, 391 F.2d at 362. *Cf.* *Occidental Life Ins. Co. v. Pat Ryan & Assocs., Inc.*, 496 F.2d 1255, 1265-67 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974) (characterizing a literal interpretation of § 29(b) as "devastating" and "harsh"); *Pearlstein v. Scudder & German*, 429 F.2d 1136, 1149 (2d Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971) (Friendly, J., dissenting) (characterizing the language of § 29(b) as "Dragonian").

433. See, e.g., S. REP. NO. 792, *supra* note 87, at 23; H.R. REP. NO. 1383, *supra* note 87, at 28; H.R. CONF. REP. NO. 1838, *supra* note 421, at 37-38. The debate, such as it was, over § 29(b) seems to have been largely concerned with the possibility that the section would be applied retroactively to contracts entered into prior to enactment of the 1934 Act. See, e.g., *Senate*

earlier,⁴³⁴ during the hearings on the Maloney Act in 1938, representatives of the brokerage industry urged Congress to limit civil suits under section 15(c) to actual damages, as Congress had arguably done for civil suits under section 9(e).⁴³⁵ One witness strenuously opposed the availability of a rescission remedy in the absence of proof of damages as follows:

If a man violates a regulation and does no damage to the person who purchases the security, we fail to see why the penalty of revision [sic] should be placed upon the dealer, because after all, the penalty is so severe that in the long run it is going to come out of the public, because the dealer having that liability and he having to make a consequent charge to make up that liability—it may be so serious in recessions such as we are going through now, that inadvertently you will find a dealer is submerged with suits for revision [sic] because when one suit is brought everybody else knows about the situation and will say, "We can get back our money," because there is a technical violation and the result will be that the dealer will not only face serious financial difficulties, but the customers who deal with him are imperiled and we say that is not necessary for the enforcement of this act. It is a criminal offense.

. . . .

Hearings on S. Res. 84, supra note 85, at 6724-25, 6995; 78 CONG. REC. 8600-01 (1934). Interestingly, at least one Representative understood the broad implications of § 29(b), and presented them to Congress during floor debate:

The far-reaching consequence of this subsection is little comprehended. This provision, coupled with the use throughout the act of the words "it shall be unlawful," [sic] opens the door to a vast amount of litigation which may involve many of the daily commercial and banking transactions of our country. If, perchance, through the error of a clerk, or even of a partner, a miscalculation has been made as to the amount that could be legally loaned or borrowed, it could not be corrected, for if a transaction be void, neither party can seek redress in a court of law. The infinite number of questions which arise from an examination of this section makes it clear that it should be carefully considered by the House.

78 CONG. REC. 7929-30 (1934) (statement of Rep. Cooper). However, no change was ever made generally to limit the potential breadth of applicability of § 29(b) or specifically to require causation of injury in a claim under that section.

434. See *supra* text accompanying notes 213-14.

435. One of these witnesses, Lothrop Withington, in fact introduced a proposal to amend § 15 by adding a subparagraph (d) along the lines of § 9(e):

(d) Any broker or dealer who willfully violates any rule or regulation prescribed pursuant to clauses (1) and (2) of subsection (c) of section 15 of this title shall be liable to any person who shall purchase from or sell to such broker or dealer any security at a price which was affected by such violation, and the person so injured may sue in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such violation. No action shall be maintained to enforce any liability created under this section unless brought within 1 year after the discovery of the facts constituting the violation and within 3 years after such violation.

(Compare with subsec. (e) of sec. 9 of the Securities and Exchange Act [sic].)

Subsection (d) of section 15 of the present act would then become subsection (e).

House Hearings on S. 3255, supra note 186, at 43. Like § 9(e), this proposed amendment would have specified: (1) liability only for "willful" violations; (2) a limitation to actual damages; and (3) a limitations period. Only the third of these proposals was ultimately adopted by Congress in the 1938 amendment to § 29(b). See *supra* notes 208-14 and accompanying text.

It seems to me that with regard to sections 1 and 2 [of the bill], that there should be an entire elimination of any recession [sic] and that damages for violation should be actual damages; and it seems to me that is all the investor is entitled to, and that is all the limit that the broker or dealer should be subjected to.⁴³⁶

This witness explained that, although the term "rescission" was not in the Act and therefore arguably no right of rescission existed, he understood Senator Maloney to have intended a right of rescission to exist.⁴³⁷ Further, in light of the experience of some Massachusetts dealers who had been sued for rescission under a state securities statute, he urged an express limitation to actual damages under section 15(c).⁴³⁸

His importunings, and those of other witnesses,⁴³⁹ were not heeded. Senator Maloney had flatly stated that inasmuch as a broker-dealer entered into a contract in violation of rules under section 15(c) "striking at abuses in the form of dishonest or overreaching conduct," such a contract "should be void in accordance with subsection (b) of section 29 of the Securities Exchange Act, so that the innocent customer may rescind the contract and recover such payment as he may have made."⁴⁴⁰ However, he saw no reason to permit rescission for violation of rules aimed at "orderly and efficient business practices."⁴⁴¹ While Congress was thus made aware by these broker-dealers of the economic hardships that potentially could be created by the allowance of a rescissory remedy in the absence of proof that the broker-dealer's violation of section 15(c)(1) actually caused the investor's injury, Congress compromised and only partially accommodated these objectors by expressly removing violations of section 15(c)(2) and (c)(3)—but not section 15(c)(1)—from the voiding provisions of section 29(b).

It is not only the legislative history which supports the proposition that the remedy of rescission would be available in a private action against a broker-dealer even in the absence of proof that the broker-dealer's conduct in violation of section 15(c)(1) caused the investor loss. This proposition is further supported by the Supreme Court's decision in *SEC v. Capital Gains Research Bureau, Inc.*⁴⁴² This case arose under the Investment Advisers Act of 1940

436. *House Hearings on S. 3255*, *supra* note 186, at 40-41. *See also id.* at 44-46.

437. *Id.* at 42. As Mr. Withington explained:

Senator Maloney in his report to the Senate states clearly this right of rescission does exist. He says on page 10 [referring to S. REP. NO. 1455, *supra* note 95] clearly contracts entered into by brokers and dealers with customers in violation of any rule, or regulation of the first type should be void in accordance with subsection (b) of section 29 of the Exchange Act, so that the customer may rescind the contract and recover such payment as he may have made.

Id.

438. *Id.* at 42-43.

439. *Id.* at 44-46.

440. S. REP. NO. 1455, *supra* note 95, at 10.

441. *Id.* *See supra* notes 197-98, 201-07 and accompanying text.

442. 375 U.S. 180 (1963).

and involved an SEC injunctive action to compel a registered investment adviser to make certain disclosures to clients. The Supreme Court first reviewed the legislative history of the 1940 Act which reflected a congressional intent to eliminate or at least minimize conflicts of interests by investment advisers.⁴⁴³ The Court then employed evolving common-law interpretations of "fraud" to interpret that term in the 1940 Act "remedially" in the case of transactions involving fiduciaries, rather than "technically" as traditionally interpreted in arm's-length transactions.⁴⁴⁴ Based on the 1940 Act's legislative history and the Court's flexible interpretation to "effectuate its remedial purposes,"⁴⁴⁵ the Court held that neither proof of intent to defraud nor proof of injury to clients was required.⁴⁴⁶

While *Capital Gains* involved an SEC enforcement action, its reasoning applies with equal force to private actions under section 15(c)(1). Certainly the legislative history of the 1934 Act reflects an equally strong congressional concern about conflicts of interest among broker-dealers as did the 1940 Act with respect to investment advisers,⁴⁴⁷ independent of the question of public versus private enforcement. Certainly, the *Capital Gains* Court's discussion of the common law's treatment of suits involving fiduciaries applies equally to the interpretation of the 1934 Act. Indeed, the common-law distinctions between fraud in equity and fraud at law which the Court emphasized had nothing to do with a distinction between public actions and private lawsuits, but rather arose out of the distinction between transactions involving fiduciaries and ones involving non-fiduciaries.⁴⁴⁸ Thus, the *Capital Gains* conclusion declining to require proof of causation and actual injury should apply to a private action by investors under section 15(c)(1).

CONCLUSION

This Article has necessarily been introductory in nature. In light of the dearth of scholarly attention to section 15(c)(1) to date, the Article is intended to be the first, rather than the last, word on the issue of implying a private right of action under that section. The legislative history of section 15(c)(1) points clearly, to this author at least, to a congressional assumption that a private litigant could sue a broker-dealer for violation of that section. In light of the paucity of judicial interpretation of section 15(c)(1), however, the manner in which the courts will define the contours of a private action under it is a matter of some speculation. This Article was designed simply to lay a

443. *Id.* at 186-92.

444. *Id.* at 192-95.

445. *Id.* at 195.

446. *Id.* at 192, 195.

447. *See supra* notes 314-16, 372-81 and accompanying text.

448. 375 U.S. at 192-95. *See also supra* notes 317-22 and accompanying text.

framework for analysis for this often-overlooked section of the Exchange Act, and to suggest some open questions for further examination.

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