Summer 1988

What Did Congress Really Want? An Implied Private Right of Action Under Section 17(a) of the 1933 Securities Act

Mark A. Ryan
Indiana University School of Law

Follow this and additional works at: http://www.repository.law.indiana.edu/ilj

Part of the Securities Law Commons

Recommended Citation
Available at: http://www.repository.law.indiana.edu/ilj/vol63/iss3/6

This Note is brought to you for free and open access by the Law School Journals at Digital Repository @ Maurer Law. It has been accepted for inclusion in Indiana Law Journal by an authorized editor of Digital Repository @ Maurer Law. For more information, please contact wattn@indiana.edu.
INTRODUCTION

Section 17(a) of the 1933 Securities Act makes fraud unlawful in connection with the offer or sale of certain securities. It is a criminal statute and does not expressly provide a private remedy for those who suffer a loss resulting from a securities fraud. Thus, for an implicit private right of action to exist under section 17(a), the courts must create one. The question whether the courts should imply such a remedy under section 17(a) has become more significant in recent years because of developments in related antifraud provisions of the federal securities laws.

Courts and commentators have grappled for some time with the question of whether a private right of action exists under section 17(a). The inability to conclude this issue, however, is not the result of lack of attention from

1. Section 17(a) 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.
2. Congress did provide, however, for more limited private remedies under sections 11 and 12 of the 1933 Securities Act, 15 U.S.C. §§ 77k, 77l, respectively. See infra notes 125, 131.
3. In Cannon v. University of Chicago, the Supreme Court stated:
   When Congress intends private litigants to have a cause of action to support their statutory rights, the far better course is for it to specify as much when it creates those rights. But the Court has long recognized that under certain limited circumstances the failure of Congress to do so is not inconsistent with an intent on its part to have such a remedy available to the persons benefited by its legislation.
441 U.S. 677, 717 (1979). See also infra text accompanying notes 21-44.
4. See infra text accompanying notes 14-19.
scholars or from the courts. The circuits have disagreed on the issue for some time and the analyses they employ vary considerably. The United States Supreme Court has repeatedly declined to review the issue. Until the Supreme Court rules, however, a more unified approach is needed in the lower courts to ensure a more consistent answer to the interpretation of this federal statute.

This Note analyzes the relevant precedents in this area of the law and the legislative history of section 17(a) in an effort to suggest how the Supreme Court might best decide the issue. Section I of this Note reviews and discusses Supreme Court precedent in the area of implied private rights under federal statutes generally. It also reviews the positions that the lower courts have taken with respect to the section 17(a) private right of action issue. Section II examines the legislative history of the 1933 Securities Act (1933 Act) and discusses the advantages and disadvantages of relying on such a record to resolve the section 17(a) private right question. Section III then points out the problems the Court will encounter reconciling the implication of a private right of action with recent precedent in related areas of securities law.


7. When the Supreme Court decided Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), section 17(a) took on a new significance. See infra notes 15-19 and accompanying text.

8. Compare, e.g., Landry v. All Am. Assurance Co., 688 F.2d 381 (5th Cir. 1982) (legislative record dictates conclusion that Congress did not intend there to be a private right of action under section 17(a)) with Kirshner v. United States, 603 F.2d 234 (2d Cir. 1979) (language of section 17(a) is broad enough to imply a private right of action), cert. denied, 444 U.S. 995 (1979).


10. A cause of action under section 17(a) enjoys several advantages over one under section 17(a)'s counterpart, Rule 10b-5. See infra note 12 and accompanying text. Plaintiffs, therefore, have an incentive to shop for the forum in which they may assert a private right of action under section 17(a). Given the nationwide sales of most securities, it is not difficult for most plaintiffs to gain jurisdiction in any of the jurisdictions which recognize the section 17(a) private right of action.
I. JUDICIAL HISTORY OF THE IMPLIED RIGHT OF ACTION UNDER SECTION 17(a)

The question of the existence of a private remedy under section 17(a) first arose in 1949.\textsuperscript{11} Rule 10b-5,\textsuperscript{12} the 1934 Securities and Exchange Act (1934 Act) counterpart of section 17(a), dominated securities fraud case law until the mid-1970's.\textsuperscript{13} Prior to the Supreme Court's decision in \textit{Ernst & Ernst v. Hochfelder},\textsuperscript{14} plaintiffs generally pleaded section 17(a) claims in tandem with Rule 10b-5 claims, with the Rule 10b-5 claim usually overshadowing the section 17(a) cause of action.\textsuperscript{15}

\textbf{A. Life After Hochfelder}

The Supreme Court's 1976 decision in \textit{Hochfelder} made section 17(a) much more attractive to plaintiffs. \textit{Hochfelder} required that plaintiffs prove scienter...
under Rule 10b-5, thus barring claims based on the more favorable negligence standard under that Rule. Thus, if a plaintiff wanted to bring an action for fraud based on negligence, she would have to find an alternative to Rule 10b-5.

Section 17(a) took on a new significance after Hochfelder. A plaintiff who could not prove scienter might be successful under a negligence standard applied under section 17(a). After Hochfelder, the Court decided Aaron v. SEC. In Aaron, it held that in order to convict for securities fraud the SEC must prove scienter under section 17(a)(1). However, the SEC need only prove negligence under subsections (a)(2) or (a)(3). This decision further increased the possibility that a plaintiff could proceed with a section 17(a) claim under a negligence standard. Plaintiffs could now—theoretically at least—bring negligence-based fraud claims under section 17(a) which they had formerly brought under Rule 10b-5. The courts consequently experienced an explosion of section 17(a) claims, and the split among the circuits as to the existence of a private right of action widened. The Court has yet to address the issue of a private right of action under section 17(a). One must therefore look to related Supreme Court precedent in the area of implied private rights in order to determine whether the Court will imply such a right under section 17(a).

B. The Supreme Court and Private Rights of Action Generally

The line of relevant cases begins in 1975. In that year, the Court abandoned its prior unstructured approach to analysis of private rights under federal statutes in Cort v. Ash. In Cort, the Court formulated a four-part test to

---


17. Aaron was a criminal case in which the Court expressly limited the issue to whether the SEC in seeking injunctive relief under section 20(b) for violations of section 17(a) is required to establish scienter. As a result of this limitation, it is questionable whether this case applies to civil causes of action under section 17(a). See infra text accompanying note 116.

18. A Westlaw search showed that prior to the Hochfelder decision in 1976, lower courts reported approximately four cases based on section 17(a) claims. Between the time of the decision and the end of 1986, the lower courts reported over 74 decisions on point, with the vast majority coming after the Aaron decision in 1979.

19. See infra notes 45-68 and accompanying text.

20. Prior to 1975, if Congress enacted a statute for the benefit of a special class, the judiciary normally recognized a remedy for members of that class. See, e.g., Texas & Pacific R.R. v. Rigsby, 241 U.S. 33 (1916). The Court occasionally refused to recognize an implied remedy, either because the statute in question was a general regulatory prohibition enacted for the benefit of the public at large, or because there was evidence that Congress intended an express remedy to provide the exclusive method of enforcement. See, e.g., National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers, 414 U.S. 453 (1974); T.I.M.E. Inc. v. United States, 359 U.S. 464 (1959). Significantly, congressional silence or ambiguity was an insufficient reason for the denial of a remedy for a member of the class which a statute was enacted to protect. See, e.g., Wyandotte Transp. Co. v. United States, 389 U.S. 191 (1967); J. I. Case Co. v. Borak, 377 U.S. 426 (1964).


determine whether or not a federal statute affords a private right of action. The private right cases that the Court has decided since Cort demonstrate the progression the Court has made in this area toward strict statutory construction and heavy reliance on legislative history.

1. Cort v. Ash and Its Progeny

The issue before the Court in Cort was whether a plaintiff-shareholder could bring a derivative suit against the directors of a corporation for an alleged violation of 18 U.S.C. § 610, a criminal statute which prohibited corporations from contributing to presidential political campaigns. The Supreme Court set forth the following test:

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? The Court held that section 610 did not imply a private right of action. Implicit in the Court's new test was a recognition of the increased complexity of federal legislation and of the need to curb the increased volume of federal litigation.

The Court made the first significant amendment to the standard Cort test in 1979 in Touche Ross & Co. v. Redington. In Touche Ross, the Court

22. Id. at 78 (citations omitted) (emphasis in original). One of the cases cited in Cort was Securities Investor Protection Corp. v. Barbour, 421 U.S. 412 (1975). Barbour was decided prior to, but during the same Term as Cort. Barbour held that the Securities Investor Protection Act (SIPA), codified at 15 U.S.C. §§ 78aaa-78eee, did not contain an implied private right of action. The Court premised this holding on the theory that SIPA specifically provides for one form of enforcement and there was no evidence of congressional will to also provide for a private right. The analysis used by the Court in Barbour was substantially the same as that implemented in Cort.

23. The Court reasoned that: (1) Congress did not enact the statute for the benefit of a corporation's stockholders, but to protect the general public from political corruption, Cort, 422 U.S. at 81-82; (2) the Congressional record does not support a theory that Congress intended to invest the shareholders with a private right of action for the violation of this statute, id. at 82; (3) the remedy sought would not further the goal of the statute, i.e., such an inference would be inconsistent with the legislative scheme, id. at 84; and (4) state corporate law was the traditional recourse for such acts, id. at 84. After Cort was decided, 18 U.S.C. § 610 was repealed in 1976. See Pub. L. No. 94-283, § 201(a), 90 Stat. 496 (1976).


25. 442 U.S. 560 (1979). Defrauded investors sought to impose liability upon an auditor of a defunct brokerage, which the SEC found in violation of section 17(a) of the 1934 Act, by
denied a private right of action under the financial auditor provisions of the 1934 Securities and Exchange Act. In so doing, it shifted the weight of the Cort test onto the statutory scheme and legislative intent elements. The Court pointed out that each of the four parts of the Cort test did not deserve equal weight. The central question was whether Congress intended there to be a private right of action under the statute. The Court concluded that there is no evidence that the statute by its terms grants a private right to any identifiable class and the legislative history is silent on the issue. As the majority opinion states: "At least in such a case as this, the inquiry ends there . . . "

In 1980, the Court decided Middlesex County Sewage Authority v. National Sea Clammers Association. The Middlesex decision, more than others before it, evinced the Court's conviction to look primarily to the perceived intent of the legislature in order to determine whether a private right lies under the reason of an allegedly improper audit and certification of the brokerage's financial statements.

Subsequent to Cort and prior to Touche Ross, the Court heard three private right of action cases: Cannon, 441 U.S. 677 (plaintiff sued the University of Chicago, claiming it had denied her admission to its medical school on the basis of her sex, and the Court held that Title IX of the Education Amendments of 1972 implies a private right of action for those discriminated against in violation of Title IX); Santa Fe Indus. v. Green, 430 U.S. 462 (1977) (minority shareholder cannot bring Rule 10b-5 action against majority shareholders and the company for breach of fiduciary duty because Congress intended Rule 10b-5 to reach only manipulative or deceptive conduct); Piper v. Chris-Craft Indus., 430 U.S. 1 (1977) (tender offeror, suing in his capacity as a takeover bidder, does not have a private right of action under section 14(e) of the 1934 Act).


Current Chief Justice Rehnquist wrote this opinion, perhaps indicating the direction the present Court would take on the section 17(a) private right question.

Chief Justice Rehnquist also filed a concurring opinion in California v. Sierra Club, 451 U.S. 287 (1981), in which he opined that the majority had placed too much emphasis on Cort in light of the subsequent implied rights cases which limit it. Sierra Club, 451 U.S. at 302 (Rehnquist, J., concurring) (discussing Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979)). See also Touche Ross, 442 U.S. 560; Cannon, 441 U.S. 677.

27. 453 U.S. 1 (1980).

Between its decisions in Touche Ross and Middlesex, the Court heard several private right cases. During the next term the Court had occasion to limit even further the Cort analysis in the case of Transamerica, 444 U.S. 11 (shareholder of a real estate investment trust filed shareholder derivative suits for violation of sections 206 and 215 of the Investment Advisers Act, 15 U.S.C. §§ 80b-1 to 80b-19 (1983)). The Court re-emphasized that congressional intent is the primary factor to consider in determining whether to infer a private remedy or not—previous decisions to the contrary notwithstanding. Relying on what it perceived to be the intent of Congress, the Court never reached the third or fourth Cort factors.

In Universities Research Ass'n v. Coutu, 450 U.S. 754 (1981), the Court held that the Davis-Bacon Act, 40 U.S.C. § 276(a) (1983), does not confer a private right of action upon an employee under a contract which is by its terms not subject to that Act.

In Sierra Club, 451 U.S. 287, the Court held that the Rivers and Harbors Appropriation Act of 1899, codified as 33 U.S.C. § 403 (1983), does not afford a private right of action to citizens allegedly injured by a claimed violation of section 10 of that Act.

IMPLIED RIGHT OF ACTION

statute in question. "The key to the inquiry is the intent of the legislature."28

The issue in Middlesex was whether fishermen had a cause of action for damages to their fishing grounds, caused by ocean dumping of sewage, under the Federal Water Pollution Control Act29 or the Marine Protection, Research, and Sanctuaries Act of 1972.30 The Court looked to the express enforcement provisions of the acts to conclude that Congress knew how to create such rights when it so desired.31 The Court thus decided that legislative history did not support an interpretation that Congress had desired to provide private rights in addition to the express remedies it supplied in those acts.

In 1982, the Court added a new dimension to the implied private right question. In Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran,32 the Court addressed the issue of how much weight courts should lend to the inference that Congress tacitly approves established judicial interpretation of a statute when it subsequently amends a body of legislation.33 Justice Stevens, who wrote for the majority, concluded that the key to the case was the understanding of the intent of Congress in 1974, the time when it comprehensively reexamined and strengthened the federal regulation of futures trading.34 Stevens pointed out that the Court was not faced with a Cort inquiry because Congress intended to preserve a preexisting remedy when it reenacted the Commodities Exchange Act (CEA) in 1974.35

At the time Congress reexamined the CEA in 1974, the federal courts had already "routinely and consistently"36 recognized a private right of action under it. The Court held that in the absence of any dispute about the existence of an implied right of action under the CEA prior to the decision in Cort in 1975, an implied cause of action was clearly a part of the "contemporary legal context" in which Congress legislated in 1974.37 Moreover, the Court stated that its review of the legislative history presented a compelling record that Congress intended to preserve the preexisting private remedy. In view of

30. Id. §§ 1401-1445.
33. In 1974, Congress reviewed and amended the Commodity Exchange Act, leaving intact the sections of the Act which do not expressly provide for a private right of action, but under which several courts had implied private rights. Merrill Lynch, 456 U.S. at 365.
34. Id. at 378. See also infra text accompanying note 102.
36. Id. at 379.
37. Id. at 381.
the conclusive evidence of legislative intent, the Court declined to consider the other factors usually associated with the Cort test.\(^{38}\)

2. Contemporary Private Right Analysis

The fundamental question the Court will consider in Cort-type inquiries is whether Congress intended to create a private right of action.\(^{39}\) In order to establish intent, the present Supreme Court will first look to the language of the statute to see whether it evinces a will by Congress to provide a private right. The line of decisions since Touche Ross\(^{40}\) has effectively pared the traditional four-part Cort test to the second and third questions. Congressional intent and statutory consistency constitute the "essential predicate for implication of a private remedy."\(^{41}\) The requirements are strict. As a result, the

\(^{38}\) Id. at 387 n.86. Justice Powell, joined by Justices Rehnquist and O'Connor, filed a strongly-worded dissent. He deplored the Court's deviation from the standard set forth in Transamerica—that is, the Court looked to congressional inaction, rather than positive congressional approval of such an implied right. He emphasized that only a dozen lower courts had wrongly found an implied right under the statute and that Congress' inaction in 1974 with respect to the CEA was not "affirmative intent" of Congress to approve a private right of action under the CEA.

\(^{39}\) Touche Ross, 442 U.S. 560. The question for the Court to consider is "not one of whether this Court thinks it can improve upon the statutory scheme that Congress enacted into law." Id. at 578.

\(^{40}\) The table below is a breakdown of the private right of action cases showing whether the justice voted for or against the implication of a private right. Italics denotes that the particular justice wrote the opinion, a concurrence, or a dissent. A subscripted number 1 denotes a concurring opinion. Transamerica dealt with two private right issues. In the chart below, Transamerica-A refers to section 215, while Transamerica-B refers to section 206.

An "X" denotes that the justice did not participate in the decision. Justice Scalia did not participate in any of the listed decisions.

<table>
<thead>
<tr>
<th>Case</th>
<th>Rehnquist</th>
<th>Blackmun</th>
<th>Powell</th>
<th>Stevens</th>
<th>O'Connor</th>
<th>Marshall</th>
<th>Brennan</th>
<th>White</th>
<th>Stewart</th>
<th>Burger</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cort</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>X</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Piper</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>X</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Santa Fe</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>X</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Cannon</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>X</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Touche Ross</td>
<td>No</td>
<td>No</td>
<td>X</td>
<td>No</td>
<td>X</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Transamerica-A</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>X</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Transamerica-B</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Universities</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>X</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Sierra Club</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>X</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Middlesex</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>X</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Merrill Lynch</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>X</td>
</tr>
<tr>
<td>Russell</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

\(^{41}\) Russell, 473 U.S. at 145 (quoting Northwest Airlines, Inc. v. Transport Workers, 451 U.S. 77, 94 (1981)).
Court "will not engraft a remedy on a statute, no matter how salutary, that Congress did not intend to provide,"\textsuperscript{42} even if the plaintiff can satisfy the first part of the \textit{Cort} test.

If the language of the specific statute is inconclusive, one must look at it in the context of the surrounding sections. The Court considers persuasive the existence of provisions within the same act which expressly provide for private remedies as evidence of a desire by Congress not to provide for private remedies elsewhere. The Court will also pay special attention to the legislative record. Given the existence of a usable record, the analysis is similar to the analysis of statutory language. One must query whether there is evidence of a congressional will to allow private suits under the statute in question. In the absence of explicit evidence of congressional intent, the language of the statute controls.

Only if the language and the history are both ambiguous would one proceed to analyze the statute under the first and fourth criteria set forth in \textit{Cort}.\textsuperscript{43} These two criteria, however, are probably only of academic value given the Court's strong predisposition toward the explicit congressional intent element of the analysis. If the language of the statute does not reasonably imply the existence of a private right of action, the Court is unlikely to find that one exists.

Under the first \textit{Cort} factor, the statute must explicitly confer by its language a right directly on a class of persons of which the plaintiff is a member. Stated another way, the \textit{especial} benefit spoken of in the first \textit{Cort} factor refers not simply to the party benefiting from the statute, but whether Congress intended to confer federal rights upon that party. If the statute constitutes merely a general ban which carries with it no implication of intent to confer rights on a particular class of persons, the Court is unlikely to infer a private remedy. Finally, subsequent legislative treatment of the statute at issue—for example, amendment—may give rise to an inference, in the presence of established judicial authority, that Congress tacitly approved of the courts' interpretation of the statute in question.\textsuperscript{44}

\textbf{C. The Courts of Appeals}

The circuits are split on the issue of whether a private right of action exists under section 17(a) of the 1933 Act,\textsuperscript{45} although the trend is clearly toward

\textsuperscript{42} Sierra Club, 451 U.S. at 297.
\textsuperscript{43} Cort, 422 U.S. at 78. See supra text accompanying note 22.
\textsuperscript{44} See Merrill Lynch, 456 U.S. 353.
\textsuperscript{45} One court noted that:
the reason for the somewhat awkward development of the law under section 17(a) 
... is the fact that it has traditionally lived in the shadow of ... Rule 10b-5. Rule 10b-5 ... is substantially identical to section 17(a). When the judiciary recognized a private cause of action under Rule 10b-5 ... cases that might have fit a section 17(a) cause of action were instead developed under Rule 10b-5.
Landry v. All Am. Assurance Co., 688 F.2d 381, 386 (5th Cir. 1982) (footnotes omitted).
denying a private right. Two circuits have squarely held in favor of a private right of action under section 17(a), four circuits have held no private right exists, and the remaining seven have not addressed the issue or their position remains unclear. Many of the precedents in this area were established prior to the Cort decision and its progeny. Consequently, some of the circuits may reverse their decisions in the near future.

Those circuits which have clearly held in favor of a private right of action under section 17(a) are the Second and Fourth Circuits. The Second Circuit has, however, called into question the soundness of its decision in Kirshner v. United States in light of subsequent Supreme Court authority. The Fourth Circuit decision in Newman v. Prior, like most of its kindred, simply glossed over the issue. Although this case is frequently cited to support the existence of a private right of action under section 17(a), it contains almost no discussion of the issue, and cites as authority a case equally lacking in analysis.

The Fifth, Eighth, and Ninth Circuits have clearly rejected the proposition of an implied private right under section 17(a). The Fifth Circuit

---

46. See infra notes 50-51.
47. See infra notes 56-58.
48. See infra notes 62-68.
49. The Court of Appeals for the Second Circuit acknowledged that its holding in Kirshner v. United States, 603 F.2d 234 (2d Cir. 1978), cert. denied, 442 U.S. 909 (1979), may be open to re-examination in light of subsequent Supreme Court decisions. Yoder v. Orthomolecular Nutrition Inst., Inc., 751 F.2d 555, 559 n.3 (2d Cir. 1985).
50. Kirshner, 603 F.2d 234.
52. 603 F.2d 234 (2d Cir. 1978).
53. See supra note 49. Moreover, the Kirshner court, as have several others, relied heavily on the language of Judge Friendly's concurring opinion in SEC v. Texas Gulf Sulphur, 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969), cert. denied, 404 U.S. 976 (1971). Judge Friendly noted, "[i]t goes without saying that once it has been established ... that an aggrieved buyer has a private action under § 10(b) of the 1934 Act, there seems little practical point in denying the existence of an action under § 17—with the important proviso that fraud, as distinct from mere negligence, must be alleged." Id. at 867 (Friendly, J., concurring).
54. 518 F.2d 97 (4th Cir. 1975).
56. Landry, 688 F.2d 381.
opinion in *Landry v. All American Assurance Co.* was the first appellate court decision to carefully implement the most recent Supreme Court precedent in this area. The *Landry* court discussed at length the history of the section 17(a) private right question and carefully analyzed all four of the *Cort* factors before concluding that Congress did not intend a private right of action under section 17(a). The recent Ninth Circuit opinion is equally well-reasoned.

The bulk of the circuits either have not yet addressed the issue or have not made clear their positions, leaving some doubt as to where each individual circuit stands. The First, Third, Sixth, and Washington Public Power, 823 F.2d 1349.

60. *Landry* held that section 17(a) on its face did not satisfy the first factor of the *Cort* test because the statutory language does not suggest a private cause of action. It concluded that the statute merely represented a general censure of fraudulent practices. 688 F.2d at 389. This is probably the weakest part of the *Landry* opinion. It stated in a conclusory fashion a proposition which is open to reasonable disagreement. The First *Cort* factor asks whether the statute protects a special class or proscribes certain conduct as unlawful. Section 17(a) is clearly designed to protect "purchasers" who might bring suit under it if a private cause of action is allowed and it prohibits as unlawful the conduct described in subsection 1-3. Note, *Section 17(a) of the Securities Act of 1933: Implication of a Private Right of Action*, supra note 6, at 257-58. See also Scholl & Perkowski, supra note 6, at 121 (stating that "[s]ection 17(a) clearly makes certain conduct unlawful. Thus, the first part of the modified *Cort*-Redington threshold test is met").

The second *Cort* factor addressed by the *Landry* court deals with congressional intent. As to this the court concluded that there was no explicit or implicit legislative intent to create such a private remedy. It noted the express provisions for civil liability in sections 11 and 12 of the 1933 Act as evidence of a Congressional intent to not allow a private right under section 17(a). It further cited evidence from the congressional record that spoke against the implication of a private right of action. *Landry*, 688 F.2d at 389-90. See also infra note 124 and accompanying text.

Although *Touche Ross* would have allowed the court to stop its analysis at this point, 442 U.S. at 575-76, the *Landry* court went on to the third and fourth factors in the test. As to the third, whether it is consistent with the underlying purposes of the legislative scheme to imply a private right, the court concluded it is not, owing to the presence of sections 11 and 12, which already expressly provide for such a remedy. "Section 17(a)(2) prohibits the same type of conduct as §§ 11 and 12, but has none of the limitations imposed by Congress. The creation of an implied cause of action § 17(a) [sic] under these circumstances would effectively frustrate the carefully laid framework of the Act." *Landry*, 688 F.2d at 390.

As to the fourth *Cort* factor, the court concluded that section 17(a) is not a cause of action traditionally relegated to state courts. *Id.* at 390-91.


63. See *Schultz v. Cally*, 528 F.2d 470 (3d Cir. 1975) (reserves ruling). But see *Ohio v. Peterson*, Lowry, Rall, Barber & Ross, 651 F.2d 687, 689 n.1 (10th Cir. 1981) ("considerable doubt" exists as to whether there is a private right under section 17(a)), cert. denied, 454 U.S. 895 (1981); *Binkley v. Sheaffer*, 609 F. Supp. 601 (E.D. Pa. 1985) (no private right of action under section 17(a)); *Hill v. Der*, 521 F. Supp. 1370 (D. Del. 1981) (in a thorough analysis of the issue, carefully tracing the evolution of Supreme Court treatment of implied private rights, the court held no private right to exist under section 17(a)).

64. See *Jones v. First Equity Corp. of Fla.*, 607 F. Supp. 350 (D.C. Tenn. 1985) (concluded no private right after applying the *Cort* test); *Basile v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 688 F.2d at 389-90.
Tenth, Eleventh, and D.C. Circuits have not ruled on the question. The position of the Seventh Circuit likewise is uncertain.

II. LEGISLATIVE HISTORY OF THE 1933 SECURITIES ACT

Cort v. Ash and its progeny hold legislative intent to be the touchstone of a Section 17(a) private right of action inquiry. Before turning to a discussion of the utility of the relevant legislative history, it is beneficial to examine the history of the 1933 Act in general and section 17(a) of the Act in particular.

A. What the 1933 Act Does and Does Not Say

The 1933 Act "was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealings." Congress, working feverishly to enact emergency legislation in the heat of the depression, devoted little time to debate of the 1933 Securities Act. On March 5, 1933, the Act received preliminary approval. On March 5, 1934, the Act was signed into law.


66. See Gordon v. Terry, 684 F.2d 736, 739 n.2 (11th Cir. 1982) (question of a private right of action reserved); Merrill Lynch, Pierce, Fenner & Smith v. Haydu, 675 F.2d 1169, 1172 n.1 (11th Cir. 1982) (Eleventh Circuit does not disagree with the holding that there is no private right of action under section 17(a)). But see Akers v. Bonifasi, 629 F. Supp. 1212 (M.D. Tenn. 1984); Zelman v. Cook, 616 F. Supp. 1121 (D.C. Fla. 1985) (no private right of action under section 17(a)).


68. Lincoln Nat'l Bank v. Herber, 604 F.2d 1038, 1040 n.2 (7th Cir. 1979) (private right exists); Daniel v. International Bhd. of Teamsters, 561 F.2d 1223 (7th Cir. 1977), rev'd on other grounds, 439 U.S. 551 (1979). But see Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522, 530-31 (7th Cir. 1985) (private right of action under section 17(a) still open question in Seventh Circuit); Beck v. Cantor, Fitzgerald & Co., 621 F. Supp. 1547 (D.C. Ill. 1985) (citing Landry, 688 F.2d 381, in holding that no private right exists under section 17(a)).


70. See supra note 39 and accompanying text.


72. The figures were staggering. In the decade following the First World War approximately $50 billion worth of new securities were floated in the United States, fully half of which proved worthless. H.R. Rep. No. 85, 73d Cong., 1st Sess. 2-3 (1933).
29, 1933, barely three weeks after his inauguration, President Roosevelt delivered a message to the Senate in which he implored Congress to take broad steps to protect the investor in America from unscrupulous sellers. Congress responded with several bills. The House allowed only five hours for debate and no amendments by the time the final bill reached the House on May 5, 1933. The bill passed without roll call the same day. The Senate took no more time and passed its version of the bill with practically no discussion. Both houses passed the final bill without discussion or a roll call: the House on May 22, 1933 and the Senate on May 23, 1933. President Roosevelt signed the bill into law on May 27, 1933, barely two months after its introduction into Congress.

The two bills of interest with respect to the section 17(a) private right question were House Report 5480 and Senate bill 875. Both bills went through two or three drafts before they were submitted to their respective houses for approval. The two bills differed from one another substantially in approach, although each had the same basic goal. The House and Senate ironed out the differences, and the final product more closely resembled the House's version of the bill.

74. The House introduced House Reports 4314, 4500, and 5480. The Senate introduced Senate bills 875 and 882. See 1 J. ELLENBERGER, LEGISLATIVE HISTORY OF SECURITIES ACT OF 1933 AND SECURITIES ACT OF 1934 xvii-xviii (1973). This three-volume series on the 1933 Act is probably the most comprehensive collection of the legislative record of the 1933 Act available.
75. B. SCHWARTZ, supra note 73, at 2549. The debate and amendment-attaching ability was restricted because of the "complexities [of the bill] and the danger that an unstudied amendment, apparently fair on its face, might unbalance the careful articulation of its various sections." Landis, The Legislative History of the Securities Act of 1933, 28 GEO. WASH. L. REV. 29, 41 (1959). James Landis, who was instrumental in the drafting of the House bill, see infra note 91, presented an informative narrative of the development of the 1933 Act in this Article.
76. For a chronology of the events from the introduction of the bill up through its enactment into law, see 1 J. ELLENBERGER, supra note 74, and B. SCHWARTZ, supra note 73, at 2549-50.
77. Other bills were introduced contemporaneously with House Report 5480 and Senate bill 875. House Report 4314, 73d Cong., 1st Sess. (1933), was substantially similar to Senate bill 875 and was apparently subsumed to House Report 5480. House Report 4500, 73d Cong., 1st Sess. 27 (1933), dealt with the founding of the Securities Division in the Department of Commerce. Senate bill 882, 73d Cong., 1st Sess. 151 (1933), introduced legislation to deal with foreign commercial transactions.
78. Section 9 of Senate bill 875 was the most notable difference between the House and Senate bills with respect to this discussion. Section 9 provided for a much broader damage award and longer limitations period. Whereas the corresponding sections 12 and 13 of the Act provide only for rescission and a two-year statute of limitations, respectively, section 9 of Senate bill 875 would have allowed a defrauded purchaser to sue for damages in addition to the purchase price any time within 5 years of the purchase. See H.R. 5480, as passed with Senate amendments, May 10, 1933.
79. See H.R. CONF. REP. No. 152, 73d Cong., 1st Sess. 11 (Conference Report to accompany H.R. 5480, May 20, 1933). This report details in somewhat sketchy fashion the compromises between the Senate and House bills. For an insider's account of discussions in the Conference Committee, see Landis, supra note 75, at 43-48.
The debate in the House was very general in nature, with the bulk of the discussion centering around the purpose of the Act and what Congress hoped to achieve with it. Representatives devoted much of the allotted five hours to depicting the evil practices of the past which needed correction. They spent very little time discussing the merits of individual sections of the Act. Consequently, one does not find any substantive discussion of section 17(a) in the House debate.

What one does find, however, is a significant amount of discussion regarding the civil liability provisions of the Act, especially as they apply to directors. The Committee hearings also reflected this concern. The record reveals that there was some concern that the courts would hold directors civilly liable for misstatements or material omissions from prospectuses in cases in which they had in good faith relied on information which accountants and other subordinates provided them.

One can surmise from this record that, to the extent it had a unified "intent" with respect to what was to become section 17(a), Congress specifically envisioned separate and distinct civil and criminal liability sections. Although this is evident in the language of the Act, the legislative record corroborates a desire by Congress to provide only for civil liability in specific, limited contexts. The legislative history reasonably leads to the inference that Congress—or at least the drafters of the Act—did not intend for civil liability to

80. See 77 Cong. Rec. 2910-55 (1933).
84. Under the section of the House Committee Report entitled "Civil Liabilities," H.R. REP. No. 85, 73d Cong., 1st Sess. 9-10 (1933), the report stated: "Sections 11 and 12 create and define the civil liabilities imposed by the act and the machinery for their enforcement which renders them practically valuable." Id. at 9. The report also stated: "To impose a greater responsibility [than those provided by sections 11 and 12] ... would unnecessarily restrain the conscientious administration of honest business with no compensating advantage to the public." Id. at 10. See also id. at 21-24.
85. H.R. Rep. No. 85, 73d Cong., 1st Sess. 25-26 (1933). The drafters of the 1933 Act assuaged this fear by placing strict limitations on the civil liability provisions of the Act. A law journal comment in 1934 regarding the 1934 amendments to the 1933 Act stated: "No part of the original Act caused more comment or justifiable criticism than those sections providing civil liabilities. It is not surprising, therefore, to find some modifications of these sections." Comment, Amendments to the Securities Act of 1933, 32 Mich. L. Rev. 1130, 1134 (1934).
86. Justice Frankfurter said, "[W]hen the legislative history is doubtful, go to the statute." Greenwood v. United States, 350 U.S. 366, 374 (1956). In the present case, the 1933 Act specifically provided for limited civil liabilities in sections 11 (Civil Liabilities on Account of False Registration Statement) and 12 (Civil Liabilities Arising in Connection with Prospectuses and Communications), with a strict limitations period defined in section 13 (Limitation of Actions). See infra notes 125, 131.
lie under any provision within the Act, apart from the express civil liability sections. A corollary of this proposition is that Congress did not intend to provide a private right of action under section 17(a), the criminal provision. One must, however, exercise caution against reading "intent" into legislative voids. The best answer to this enigma is probably that, in their haste to enact the new legislation, most members of Congress never considered the issue of a private right of action under section 17(a).

Interestingly enough, the most explicit evidence of intent given by any member of Congress with respect to civil liability under section 17(a) of the 1933 Act, came in debate regarding the 1934 Act. Senator Fletcher, who sought to amend section 17(a) of the 1933 Act, stated in a memorandum: "It is to be noted that enforcement of the provisions of the new subsection is left to injunction, stop order, and criminal prosecution. No civil liability attaches for any violation thereof." One commentator has noted that Senator Fletcher was commonly associated with the 1934 Act and that he was probably well acquainted with the 1933 Act as well.

B. What the Commentators Said

Several commentators wrote on the 1933 Securities Act around the time of its enactment. Some, such as SEC Commissioner Douglas and Federal Trade Commissioner Landis, were well positioned to best know Congress' intent with respect to section 17 of the new securities act—to the extent Congress had a unified "intent." Douglas stated in the section of his Article on criminal penalties under the new Act: "No penalties are stated nor any civil rights expressly given. Section 17 does not enlarge civil remedies of purchasers. This seems clear by implication, since Sections 11 and 12 expressly state the remedies which are available." In a 1933 address to the New York Accountants, Commissioner Landis stated:

86. See infra note 108 and accompanying text.
87. See Note, Section 17(a) of the Securities Act of 1933: Implication of a Private Right of Action, supra note 6, at 260 n.112 (The five hour debate and no amendment constraint may have precluded any discussion of a private right under section 17(a).). There is, however, evidence that the drafters of the House bill did consider the section 17(a) private right issue. See supra notes 82, 84 and accompanying text.
88. 78 Cong. Rec. 8711-12 (1934).
89. Ruder, Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?, 57 NW. U. L. Rev. 627, 656-57 (1963) ("It seems clear that in Senator Fletcher's opinion no civil liability attached under Section 17 of the 1933 Act.").
90. William O. Douglas left his post as the first Commissioner of the SEC to become a Justice on the United States Supreme Court.
91. James Landis was a professor at Harvard Law School at the inception of the development of the 1933 Act. After the completion of his work on the bill, he left his teaching post at Harvard to work for the Federal Trade Commission. See Landis, supra note 75.
92. Douglas & Bates, supra note 5, at 181-82. In an omitted footnote to this quote, the
The suggestion has been made on occasion that civil liabilities arise also from a violation of Section 17, the first subsection of which makes unlawful the circulation of falsehoods and untruths in connection with the sale of a security in interstate commerce or through the mails. But a reading of this section in light of the entire Act leaves no doubt but that violations of its provisions give rise only to a liability to be restrained by injunctive action or, if willfully done, to a liability to be punished criminally.93

James Landis, in his 1959 Article on the legislative history of the 1933 Act,94 recounted that the authors of the Conference Report95 deliberately included language regarding some of the more controversial provisions of the bill in the hope that courts and administrative bodies would construe it to be the "intent" of Congress. The authors hoped the language chosen would control judicial and administrative interpretation of the Act.96 There was especial concern regarding the civil liabilities of directors. Landis considered it a victory to have won out in the Conference Committee over the Senate civil liabilities provision, which effectively would have made all directors insurers of the accuracy of their statements contained in registration statements required by the Act. To not have adopted the House version, with its limited civil liability provisions, would have "imposed an unjust and unsurmountable burden" on directors.97 Imposing civil liability under section 17(a) now might result in exactly the type of liability the Committee agreed to avoid.

C. Subsequent Amendments

The question is whether the case law in favor of, or contrary to, finding an implied right under section 17(a) was sufficiently well established at the time of the subsequent amendments to the 1933 Act for a court today to infer that Congress tacitly approved of the judiciary's position on the private right question. The Supreme Court stated in Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran:

\[\text{Authors queried whether the making of an act unlawful under section 17(a) gives to purchasers an action of rescission on the grounds of illegality.}\]

The Supreme Court apparently rejected the doctrine of ex pressio unius in this context. California v. Sierra Club, 451 U.S. 287, 295 n.6 (1981); Cort, 422 U.S. at 82 n.14 (1975); SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 350-51 (1934). The creation of one explicit mode of enforcement is not dispositive of congressional intent with respect to other complementary remedies. The Court has, however, in later decisions taken such provisions into account. See, e.g., Touche Ross & Co. v. Redington, 442 U.S. 560, 575-76 (1979).

93. Landis, Liability Sections of Securities Act Authoritatively Discussed, 18 Am. Acct. 330, 331 (1933). A further review of the literature of the time by this writer yielded either no mention of civil liability under section 17(a) or opinions concurring that none existed. No comments were unearthed in that body of literature opining that a private cause of action exists under section 17(a).

94. Landis, supra note 75.


96. Landis, supra note 75, at 47.

97. Id. at 48.
In determining whether a private cause of action is implicit in a federal statutory scheme when the statute by its terms is silent on that issue, the initial focus must be on the state of the law at the time the legislation was enacted. More precisely, we 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 logically is 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.

Congress amended different sections of the 1933 Act in 1934, 1954, and again in 1975. Although Congress concentrated its work in 1934 on the express civil liability sections of the 1933 Act, no body of case law regarding section 17(a) had yet been developed to enable one to infer a tacit approval of any private right of action. In 1954, Congress amended section 17(a) to add the words "offeror" before the word "sale," but otherwise gave no hint of providing for a private right or condoning a judicially implied one. By 1954, only one circuit had addressed the issue in any form. In 1975, Congress again amended the Act with minor changes, but left section 17(a) intact and there is no indication in the legislative record that Congress even considered the section 17(a) private right issue.

The Ninth Circuit recently addressed this issue and concluded that one could not reasonably infer that Congress tacitly condoned a private right of

99. See 78 CONG. REC. 8711-12 (1934).
100. The House Committee Report states under the section entitled "Liabilities Attaching to Registration and Investor Protection," that "[t]he law ... prohibit[s] false and misleading statements under penalty of fine or imprisonment, or both. In addition, if an investor suffers a loss in the purchase of a registered security, the law does provide him with important recovery rights. Section 11 of the act provides [for damages]." H.R. REP. No. 1542, 83d Cong., 2d Sess. 97 (1954), reprinted in 1954 U.S. CODE CONG. & AD. NEWS 2973, 2978.

The report also states:

[Sections 9, 10, and 11] of the bill add the word "offer" to sections 12, 17, and 22 of the Securities Act in order to make clear that the civil and penal liabilities and sanctions imposed by the statute shall remain unchanged, notwithstanding the changes made elsewhere in the statute. Section 12 of the present statute provides that a purchaser of a security may recover from the seller ... Section 17 is the general fraud provision under which criminal and injunctive actions are brought ..." Id. at 2999.

101. Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 787 n.2 (2d Cir. 1951) (action by stockholders against company for fraudulent statements in prospectus; the court noted in a footnote that plaintiff could plead a section 17(a) cause with a section 11 cause of action so long as the section 17(a) claim added adequate allegations of fraud).
102. See 121 CONG. REC. 10,711-10,759, 11,740-11,786 (1975). The courts were also split at that time and no overwhelming consensus existed as to the § 17(a) issue. In re Washington Public Power Supply Sys. Sec. Litig., 823 F.2d 1349, 1357 (9th Cir. 1987) (en banc).
action when it amended the securities laws in 1975. Plaintiffs had argued that, although the decisions in the district courts were not unanimous, all the circuits which had reviewed the issue at the time had ruled in favor of an implied right. The court nevertheless concluded that no overwhelming consensus ever existed in section 17(a) precedent, and it could not reasonably determine whether or not Congress approved of a section 17(a) private right when it amended the laws in 1975.104

Until the Hochfelder decision in 1976, the courts ignored section 17(a) causes of action for the most part.105 The Court in Merrill Lynch stated that Congress is presumed to know the law.106 However, even if one assumes that the courts substantially agreed on this issue in 1975, it is unlikely that Congress would have had much notice. Rule 10b-5 actions completely dominated securities fraud cases at this time107 and the section 17(a) question was not considered very important. The Court today would probably not accept an argument based on subsequent legislative amendments absent evidence from the legislative record that Congress considered the question.

D. Reliance on the Legislative Record

In determining implied private rights cases, the Supreme Court has placed heavy emphasis on the "intent" of Congress as evinced by the language of the statute and the legislative record. In the case of section 17(a), the statute is silent and the legislative history is nearly silent on the issue. Numerous courts and commentators have warned that one must tread cautiously in the murky waters of congressional silence.108 It is nevertheless worth highlighting some of the significant shortcomings of reliance on the legislative record of the 1933 Act in light of the criticisms leveled at such reliance.

1. Interpreting the Statutory Language

The first Cort factor, for example, dictates that a court inquire into whether the statute protects a special class of persons, or, in the alternative, whether it proscribes certain conduct as unlawful. Section 17(a) complies with both of
these criteria but, as Justice Frankfurter warned in *Helvering v. Hallock*, the Court "walk[es] on quicksand when [it tries] to find in the absence of . . . legislation a controlling legal principle." If one is to infer a private remedy under section 17(a), one must essentially look to clues in the language of the 1933 Act in order to do so. By inferring meaning from such statutory hints, however, one obviously risks reading into section 17(a) a meaning which Congress never intended. In the alternative, one might ignore a purpose of the statute which Congress intended, yet failed to articulate in its rush to enact the 1933 Act. Both results would clearly contravene the avowed intention of the Court to abide by the original "intent" of the legislature enacting the statute. Also, as Professor Tribe has warned, by placing too much emphasis on the intent of Congress, the Court is not treating "the words of [the] statute as 'the best evidence of what Congress wanted,' " but rather is "making what Congress wanted the very object of our search rather than merely the frame for our understanding of what Congress said."  

2. Interpreting the Legislative History

Relying on the legislative record leads to numerous pitfalls. It is very difficult to speak of congressional "intent" as if Congress possessed a unified intent. Congress is comprised of two houses, ruled by two parties, which are made up of a myriad of individuals. One Senator might vote to approve a bill for reasons entirely different from those of another Senator. Also, when the legislative history is very sparse, one must be wary of reading too much into it. The gaps in the record render reliance on the balance of the evidence questionable. Similarly, statements by individual members of Congress do not necessarily reflect anything more than that particular person's opinion, rather than the will of Congress. One can draw inferences from such statements in the record, but only at a significant danger of inferring the wrong intent of Congress as a whole. The briefer the record, the greater is the danger of reaching the "wrong" conclusion.

In the present case, as discussed above, Congress spent very little time preparing and deliberating over the original 1933 Act, let alone section 17(a). One finds no mention of the private right issue under section 17(a). The substantial difference between the House and Senate bills speaks against the inference of a unitary congressional intent. Moreover, a review of the con-

---

109. Section 17(a) expressly includes bond purchasers in the class of persons it protects. *But see Landry v. All Am. Assurance Co.*, 688 F.2d 381 (5th Cir. 1982). *See also supra* note 60.

110. 309 U.S. 106, 121 (1940). *Accord Touche Ross*, 442 U.S. at 571. (Justice Rehnquist warned that implying a private right of action in the face of "congressional silence is a hazardous enterprise, at best.").


112. *See supra* text accompanying note 71.
The appropriate question in this case is not whether Congress wanted a private right of action under section 17(a), but rather, whether Congress had a desire at all. It appears from the record that Congress never really considered the issue in 1933. To interpret the intent of Congress with respect to a private right under section 17(a) runs the risk of finding the opposite of what Congress intended, or would have intended had it thought about the private right question when it enacted the 1933 Act. If the Supreme Court applies the standard private right of action analysis to this case, it must do so with the understanding that the test might not yield the result Congress would have wanted. A more honest approach to this particular problem would be to either admit that Congress never considered the option of an implied private right of action and to leave that decision to the present day Congress, or to make the same admission and then attempt to fashion a judicial result based on the policies underlying the 1933 Act.

III. HARMONIZING AN IMPLIED PRIVATE RIGHT WITH SECTION 17(a)

In the case of section 17(a), the issue of whether a private right of action exists is more complicated than an application of the four-part Cort v. Ash test. In addition to the problems involved in surmounting the ambiguities of the legislative record, the Supreme Court must deal with recent section 17(a) and Rule 10b-5 precedent that would conflict with a finding of an implied private right of action under section 17(a).

In Aaron v. SEC, the Supreme Court dealt with the standard of proof required under section 17(a) in the criminal context. The Court concluded that the government must establish scienter under section 17(a)(1) in order to convict, but only negligence under section 17(a)(2) or section 17(a)(3). It reached this conclusion after examining the language of the statute and the pertinent legislative history. It is questionable, however, whether the Court

---

114. 446 U.S. 680 (1980). See also supra text accompanying note 16.
115. Aaron, 446 U.S. at 695-96. The Court stated:

The language of § 17(a) strongly suggests that Congress contemplated a scienter requirement under § 17(a)(1), but not under § 17(a)(2) or § 17(a)(3). The language of § 17(a)(1), which makes it unlawful "to employ any device, scheme, or artifice to defraud," plainly evinces an intent on the part of Congress to proscribe only knowing or intentional misconduct.

Id. The Court relied primarily on the language of the statute because the legislative record lacks useful discussion of the standard of proof under section 17(a). Id. at 695-698.
will adhere to this scienter-negligence standard if it chooses to infer a private right of action under section 17(a).116

The Supreme Court adopted the scienter standard for Rule 10b-5 actions in Ernst & Ernst v. Hochfelder,117 basing its decision primarily on the language of section 10(b) of the 1934 Act. The SEC borrowed the language of Rule 10b-5 from section 17(a).118 Even though Rule 10b-5 and section 17(a) do not share a common genesis, it would be anomalous to require the scienter standard in one civil action and not the other. Moreover, to infer a negligence standard under section 17(a) in the civil context would effectively subvert the Hochfelder decision.119 Plaintiffs who could not prove scienter in order to sue under Rule 10b-5 could simply file under section 17(a)(2) or section 17(a)(3). Finally, the legislative record militates against the conclusion that a negligence standard would apply in the civil context under section 17(a).120

In the same year as Aaron, the Court decided United States v. Naftalin,121 a criminal case in which it held that to prove a violation of section 17(a)(1), the SEC need only prove that there was a fraud in connection with a "sale." More importantly, the victim need not be an investor.122 The Court further held that section 17(a) was an exception to the general policy of the 1933 Act,
which was designed to apply solely to the new issue of securities. Under the Court’s holding, section 17(a) covers all fraudulent schemes, regardless of whether the security is new or old.\textsuperscript{123}

\textit{Naftalin} interpreted section 17(a) rather expansively. That holding might prove troublesome in the civil context if the Court acknowledges a private right of action. As with \textit{Aaron}, the Court will have trouble harmonizing a private right of action under section 17(a) with this case. If the Court adheres to its holding in \textit{Naftalin} in civil actions, it would effectively negate the privity requirement of section 12(2), the express civil liability provisions of the 1933 Act.\textsuperscript{124} Under \textit{Naftalin}, section 17(a)(1) is not limited to fraud against offerees. Yet section 12 requires privity. An implication of a private right which incorporated the holding in \textit{Naftalin} would greatly expand the class of persons who could bring civil actions based on fraud under the 1933 Act.\textsuperscript{125}

Finally, in \textit{Herman & MacLean v. Huddleston},\textsuperscript{126} the Supreme Court addressed the issue of whether an implied cause of action under section 10(b) of the 1934 Act would lie for conduct subject to the express remedy of section 11\textsuperscript{127} of the 1933 Act. The Court first stated that the 1933 and 1934 Acts were “interrelated components of the federal regulatory scheme governing transactions in securities.”\textsuperscript{128} It next precluded any argument that there was

\begin{itemize}
\item 123. \textit{Id.} at 777-78.
\item 124. Section 12 provides:
\begin{quote}
Any person who—
(1) offers or sells a security in violation of section 77e of this title [section 5 of the Act], or
(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title [section 3 of the Act], other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.
\end{quote}
\item 125. See Steinberg, \textit{supra} note 6, at 178. One thing the legislative record does show is a concern over capital formation. See \textit{supra} notes 81-83 and accompanying text. To enlarge the class of potential plaintiffs might contradict the measures taken by the drafters in response to this concern.
\item 126. 459 U.S. 375 (1983). Purchasers of securities brought an action against most of the participants in the offering, seeking recovery under section 10(b) of the 1934 Act. They alleged that defendants defrauded them by misrepresentations in a registration statement and prospectus for the securities they purchased.
\item 127. See \textit{infra} note 131.
\end{itemize}
no private right of action under Rule 10b-5. The Court then held that the express provisions of section 11 of the 1933 Act did not preclude defrauded purchasers of registered securities from maintaining an action under section 10(b) of the 1934 Act. It reasoned that: (1) exempting fraudulent conduct from liability under section 10(b) would conflict with the basic purpose of the 1933 Act: to provide greater protection to purchasers of registered securities; (2) in section 16, the savings clause of the 1933 Act, "Congress rejected the notion that express remedies of the securities laws would preempt all other rights of action;" and (3) the Court has "repeatedly recognized that securities laws combating fraud should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes." If the Court adheres to the modified Cort test, it will probably not find an implied private right of action under section 17(a). The language of the Huddleston opinion, however, is inconsistent with the result apparently mandated by that test. Rule 10b-5 is substantially the same as section 17(a); they both proscribe substantially the same conduct. If, under the Court's reasoning, section 10(b) furthers the goals of the 1933 Act—and consequently section 11 should not preclude a cause of action under section 10(b)—then the Court should treat section 17(a) the same. Applying this reasoning, section 17(a) of the 1933 Act is the most logical antifraud provision one could employ to further the goal of the 1933 Act. Moreover, if one interprets section 16 (the savings clause) as the Court did, then the express remedies of sections 11 and 12 should not preclude a private right under section 17(a). That a private right under section 17(a) might have achieved recognition long ago if plaintiffs had not relegated section 17(a) to the shadow of section 10(b) supports this reasoning. Finally, if the courts are to construe federal securities statutes "not technically and restrictively, but flexibly to effectuate [their] remedial purposes," then the Court should imply a private right under section

129. "[A] private right of action under § 10(b) of the 1934 Act and Rule 10b-5 has been consistently recognized for more than 35 years. The existence of this implied remedy is simply beyond peradventure." Huddleston, 459 U.S. at 380 (footnote omitted).

130. Section 11, now embodied in 15 U.S.C. § 77k, is one of the express civil liability sections of the 1933 Act. It provides for civil liability to defrauded purchasers arising out of materially misleading statements in a registration statement. For a discussion of section 12, the other express civil liability section of the 1933 Act, see supra note 124 and accompanying text.

131. Huddleston, 459 U.S. at 382-83.

132. Id. at 383.

133. Id. at 386-87 (quoting Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972)).

134. It is not inconsistent with a denial of a private remedy under section 17(a) of the 1933 Act to hold that section 11 does not preclude a section 10(b) remedy. Section 10(b) offers a different remedy that is free from any constraints of the express civil remedies section within the 1934 Act one finds in the 1933 Act. Moreover, section 11 and section 10(b) address different types of wrongdoing.

135. See supra note 12.

136. See supra note 45.
17(a) in order to best accomplish the purchaser-protection goal of the 1933 Act.

The analysis the Court employed in *Huddleston* is inconsistent with the major emphasis it placed on congressional intent in the line of cases beginning with *Cort v. Ash.* If the Court is willing to hear arguments in favor of an implied right of action under section 17(a) based on such policy-oriented arguments as it used in *Huddleston*, the answer to the private right question is not nearly as clear as *Cort* and its progeny would otherwise dictate. Once one departs from the traditional *Cort* test, numerous policy considerations come into play which have little to do with the will of the legislature in 1933 and which might require a very different result.

Nevertheless, despite the myriad of persuasive arguments commentators have made in favor of an implied private right of action under all or part of section 17(a), the Court is unlikely to delve any deeper into the issue than examining the statutory scheme and the legislative record. The dearth of evidence of a congressional will to imply such a private right will likely prove fatal to any arguments proponents of a private right of action might put forth. Also, problems the Court will encounter reconciling the section 17(a) private right issue with its section 17(a) and Rule 10b-5 precedents will likely dissuade it from finding an implied private right of action.

**CONCLUSION**

Under present Supreme Court precedent, the question of the existence of an implied private right of action under section 17(a) of the 1933 Securities Act is primarily one of statutory construction and legislative intent. The legislative record is, for the most part, silent on the subject, leaving the words of the statute and the coterminous express civil liability provisions of the 1933

---

137. See also *Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). *Chevron* presents another dimension to the Court's emphasis on congressional intent. In *Chevron*, the Court considered the question whether the Administrator of the Environmental Protection Agency was authorized to adopt a regulation permitting an industrial complex to be treated as a "bubble." The Court concluded that Congress had not directly addressed the precise question at issue. *Id.* at 851. Once a reviewing court reaches this conclusion, the Court stated, the question it has to consider is "not whether in its view the [bubble] concept is 'inappropriate' in the general context of a program designed to improve air quality, but whether the Administrator's view that it is appropriate in the context of this particular program is a reasonable one." *Id.* at 845.

*Chevron* is not a private right of action case, rather it deals with administrative agency authority. The rationale the Court employed is nevertheless remarkable given the Court's strong reliance on the legislative record in the private right of action cases. It seems inconsistent for the Court to depart from such reliance in cases involving agency discretion. If one applies the logic of *Chevron* to the section 17(a) issue, an implied private right of action under section 17(a) is clearly "reasonable" within the context of the 1933 Act. Although the Court is working with a different entity in agency authority cases, it appears arbitrary for the Court to apply different standards to two cases in which Congress clearly has not considered the proposed right or action.

138. See, e.g., sources cited *supra* note 6.
Act to aid the Court in answering the question. The Supreme Court, if faced with this question, will probably conclude that the express provisions, along with the circumstantial evidence in the legislative record and the opinions of commentators of the time, indicate that Congress did not intend civil liability to flow from section 17(a) of the 1933 Securities Act. The Court will also shy away from finding an implied private right of action because of conflicts with other Supreme Court rulings regarding section 17(a).

The legitimacy of this conclusion, however, is questionable given that Congress probably never considered the question of a private right of action under section 17(a). It is difficult, if not impossible, to divine an intention from this legislative silence. Nevertheless, should the Supreme Court go beyond a Cort-type analysis to consider the policies which animated enactment of the federal securities laws, a flexible interpretation of such policies might support the implication of a private right of action under section 17(a) of the 1933 Securities Act.

Mark A. Ryan