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Section 17(a) of the Securities Act of 1933 and an Implied Action: An Answer Is In Sight

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ARTICLES

SECTION 17(a) OF THE SECURITIES ACT OF 1933 AND AN IMPLIED ACTION: AN ANSWER IS IN SIGHT

The Securities Act of 1933¹ ('33 Act) and the Securities Exchange Act of 1934² ('34 Act) constitute interrelated elements of the federal plan governing transactions in securities.³ The '33 Act emerged in the aftermath of the market crash of 1929.⁴ Congress'

¹ Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1976) [hereinafter '33 Act].

² Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1976) [hereinafter '34 Act].

³ See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976) ('33 Act and '34 Act are part of a complex securities scheme); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 727-28 (1975) ('33 and '34 Acts are landmark statutes regulating securities). See also H.R. REP. No. 85, 73d Cong., 1st Sess. 1-5 (1933) [hereinafter HOUSE REPORT]. Representative (later Speaker) Rayburn, for the Committee on Interstate and Foreign Commerce stated, "the bill (H.R. 5480) [is] to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof . . ." *Id.* at 1. The Senate Report stated: "[the] purpose of this bill is to protect the investing public and honest business. The basic policy is that of informing the investor of the facts concerning securities to be offered for sale in interstate and foreign commerce and providing protection against fraud and misrepresentation." S. REP. No. 47, 73d Cong., 1st Sess. (1933) [hereinafter SENATE REPORT]. See also Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 172 (1933) (purpose of '33 Act is to prevent fraudulent and excessive practices and to ensure full and open disclosure at every stage in securities transactions).

⁴ See *Ernst & Ernst*, 425 U.S. at 194 (market crash inspired the '33 and '34 Acts). See also *United States v. Naftalin*, 441 U.S. 768, 775 (1979) ('33 and '34 Acts enacted in response to events surrounding the Crash). President Franklin Roosevelt sent a message to Congress on March 29, 1933 in which he submitted, "[i]n spite of many state statutes the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities." HOUSE REPORT, *supra* note 3, at 1. However, Professor Loss, a renowned securities scholar has stated, "The Securities Act of 1933 did not spring full grown from the brow of any New Deal Zeus." L. LOSS, *FUNDAMENTALS OF FEDERAL SECURITIES REGULATION* 1 (2d ed. 1988). In actuality, the '33 Act, the

initial contemplation was that regulation of the securities arena might effectuate a national economic recovery by inspiring honest dealings in securities and thereby restoring public confidence.⁵ To that end, the '33 Act and the '34 Act have an arsenal of anti-fraud provisions⁶ to protect the public against the deceptive practices of individuals and corporations selling securities. Section 17(a) of the '33 Act (17(a)) generally proscribes fraud in the offer or sale of securities;⁷ however, the extent of its enforcement is a question

springboard for the '34 Act, evolved during an era of state regulation of securities and after several centuries of legislation in England. *Id.* at 1-3.

⁵ See HOUSE REPORT, *supra* note 3, at 2. President Roosevelt's presidential message was included in the introductory statement of the House Report. *Id.* at 1-2. President Roosevelt reiterated the need for full publicity and information on every issue of new securities to be sold in interstate commerce. *Id.* at 2.

⁶ See, e.g., '33 Act § 11, 15 U.S.C. § 77k (1976) (civil liability results from misstatements or omissions in the registration statement required for a security); '33 Act § 12(1), 15 U.S.C. § 77l(1) (1976) (private remedy permitted for violation of registration or prospectus provisions of the '33 Act); '33 Act § 12(2), 15 U.S.C. § 77l(2) (1976) (statutory fraud provision conferring private right to sue).

The '34 Act is also replete with enforcement provisions. See, e.g., '34 Act § 9, 15 U.S.C. § 78i (1976) (civil liability for fraudulent manipulation of stock prices); '34 Act § 16, 15 U.S.C. § 78p (1976) (civil liability for directors, officers and principal stockholders for negligent conduct); '34 Act § 10, 15 U.S.C. § 78j (1976) (liability for fraud in connection with purchase or sale of any security).

The Securities and Exchange Commission [hereinafter SEC] was created in 1934 by the '34 Act. The SEC is an independent, bipartisan agency of the United States government charged with administering federal securities legislation. See L. LOSS, *supra* note 4, at 35. Federal securities law consists of six statutes enacted between 1933 and 1940. See L. SODERQUIST, *SECURITIES REGULATION* 4-5 (1980). The six statutes are: the '33 Act; the '34 Act; the Public Utility Holding Company Act of 1935; the Trust Indenture Act of 1939; the Investment Company Act of 1940; and the Investment Advisors Act of 1940. See D. RATNER, *SECURITIES REGULATION* 6 (1980). The enforcement powers of the SEC include the power to permanently or temporarily enjoin proscribed acts, and to transmit information to the United States Attorney General in order to properly pursue criminal proceedings. See '33 Act § 20, 15 U.S.C. § 77t (1976); '34 Act § 21, 15 U.S.C. § 78u (1976).

⁷ See '33 Act § 17(a), 15 U.S.C. § 77q(a) (1976). Section 17(a) provides:

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 of 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 statement 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.

Id. It should be noted that 17(a) does not expressly provide for civil liability. *Id.* See also Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 Nw. U.L. REV. 627, 656 (1962). Senator Fletcher, one of the original drafters of the '33 Act con-

Section 17(a)

that has spurred considerable debate.⁸

The purpose of this Article is to present the current state of the law on the issue of whether a private right to sue exists under 17(a). The primary focus will be on the conflicting views among the courts, including a review of the controversial Ninth Circuit decision in *In re Washington Public Power Supply System Security Litigation*.⁹ This Article will also investigate the prevailing views among the commentators in the securities field. Finally, this Article will suggest that an analysis of this issue, using a modified *Cort*¹⁰ test, leads to the conclusion that an implied cause of action does not exist under 17(a).

I. BACKGROUND

A. *Implied Right of Action: Section 10(b) of the Securities Exchange Act of 1934*

Congress expressly granted a private right to sue in section eleven¹¹ and section twelve¹² of the '33 Act and in sections 9(e),¹³

tended, "[t]he most reasonable view regarding 17(a) of the 1933 Act is that Congress intended that the Commission would use it to deal with flagrant cases of abuse." *Id.* Cf. *United States v. Naftalin*, 441 U.S. 768, 772 (1979) (17(a) does not apply solely to fraud).

⁸ See Scholl & Perkowski, *An Implied Right of Action Under Section 17(a): The Supreme Court Has Said "No", But Is Anybody Listening?* 36 U. MIAMI L. REV. 41, 42 (1981); Comment, § 17(a) of the '33 Act: An Alternative to the Recently Restricted Rule 10b-5, 9 RUT.-CAM. L.J. 340, 348 (1978).

⁹ 823 F.2d 1349 (9th Cir. 1987).

¹⁰ *Cort v. Ash*, 422 U.S. 66 (1975). The Supreme Court in *Cort* espoused a four pronged analysis to be used when determining whether an implied remedy exists in a statute not expressly providing for one. *Id.* at 78. For a discussion of the *Cort* analysis see *infra* note 36.

¹¹ '33 Act § 11, 15 U.S.C. § 77k (1976). Liability pursuant to § 11 of the '33 Act is imposed for material statements in the registration statement which are false or misleading, and for failure to disclose material facts. *Id.* Defenses to § 11 liability do exist. *Id.* See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 727 (1975) (section 11 liability exists for a false registration statement). See generally *Escott v. Barchris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968) (elements of a § 11 cause of action).

Parties subject to § 11 liability include directors, chief executives, financial officers, accountants who certify statements and underwriters. See R. JENNINGS & H. MARSH, *SECURITIES REGULATION* 142 (6th ed. 1987). See also *Barnes v. Osofsky*, 373 F.2d 269, 271-73 (2d Cir. 1967) (court discussed who can sue under § 11).

¹² '33 Act §§ 12(1)-(2), 15 U.S.C. §§ 77l(1)-(2) (1976). Section 12(1) imposes civil liability for sale of a security in violation of § 5 of the '33 Act. *Id.* Section 5 is the provision governing the registration of a security in the initial public offering of a security, § 5 also covers the issuance of a prospectus. '33 Act § 5, 15 U.S.C. § 77e (1976). Civil liability pursuant to 12(1) is absolute, there is no defense. See 15 U.S.C. § 77l(1) (1976). See also

10(b),¹⁴ and 18(a)¹⁵ of the '34 Act. Despite these express liability provisions, the bulwark of fraud liability has been grounded upon section 10(b) of the '34 Act¹⁶ and, more specifically, upon rule 10b-5.¹⁷

Dahl v. Pinter, 787 F.2d 985, 988 (5th Cir. 1986). Section 12(2) is a general anti-fraud provision. See generally *Collins v. Signetics Corp.*, 443 F. Supp. 552 (E.D. Pa. 1977) (elements of cause of action under § 12(2)), *aff'd*, 605 F.2d 110 (3rd Cir. 1979). Civil liability is imposed for false or misleading statements in connection with a sale (not a purchase) of a security through interstate commerce or the mails. See '33 Act § 12(2), 15 U.S.C. § 771(2) (1976). Section 12(2) does not require a false or misleading statement in the prospectus or registration statement. See *Gridley v. Sayre & Fisher Co.*, 409 F. Supp. 1266 (D.C. S.D. 1976) (negligent misstatement was actionable under § 12(2) of '33 Act). See also *R. JENNINGS & H. MARSH*, *supra* note 11, at 834. Section 12(2) liability is broad enough to include a false or misleading oral statement made in the sale of securities. *Id.*

¹⁵ '34 Act § 9(e), 15 U.S.C. § 78i(e) (1976). Civil liability is imposed for unlawful manipulation of stock prices. *Id.* See generally *T. HAZEN, LAW OF SECURITIES REGULATION* 645 (1983) (section 9(e) liability detailed).

¹⁴ '34 Act § 16(b), 15 U.S.C. § 78p(b) (1976). Section 16(b) is a narrow provision which protects against fraud in the sale of securities by corporate insiders. *Id.* For a discussion of persons subject to section 16(b) liability see *Feder v. Martin Marietta Corp.*, 406 F.2d 260 (2d Cir. 1969) (discussion of persons subject to 16(b) liability), *cert. denied*, 396 U.S. 1036 (1970). See also *Smolowe v. Delendo Corp.*, 136 F.2d 231 (2d Cir.) (difficulties in interpretation of § 16(b)), *cert. denied*, 320 U.S. 751 (1943). See generally *Hazen, The New Pragmatism Under Section 16(b) of the Securities Exchange Act of 1934*, 54 N.C.L. REV. 1 (1975) (complete analysis of § 16(b)).

¹⁵ '34 Act § 18(a), 15 U.S.C. § 78r(a) (1976). Civil liability under 18(a) is imposed for false or misleading statements made in any report or document filed pursuant to the '34 Act or any rule thereunder. *Id.* See, e.g., *Heit v. Weitzen*, 402 F.2d 909 (2d Cir. 1968) (private remedy for defrauded investor who relied on a document filed with the SEC), *cert. denied*, 395 U.S. 903 (1969).

¹⁶ '34 Act § 10(b), 15 U.S.C. § 78j(b) (1976). Section 10(b) is a general provision proscribing any "manipulative or deceptive device or contrivance" in violation of any rule promulgated by the SEC which is deemed "necessary or appropriate in the public interest or for the protection of investors." *Id.* See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 203 (1976) (10(b) is characterized as a "catchall" by the SEC); *L. Loss, supra* note 4, at 702 (10(b) is an omnibus provision created by Congress to combat securities fraud).

¹⁷ '34 Act, Rule 10b-5, 17 C.F.R. § 240 10b-5 (1981). Rule 10b-5 reads as follows:

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 any facility of any national securities exchange,

- (1) to employ any device, or scheme, or artifice to defraud,
- (2) 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 light of the circumstances under which they were made not misleading, or
- (3) to engage in any act, practice, or course of business which operated or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id. Rule 10b-5 was adopted by the SEC to close a gap in the anti-fraud provisions of the securities laws. See *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 463 (2d Cir.), *cert. denied*, 393 U.S. 956 (1952). See also *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971) (section 10(b) must be read flexibly, not technically or restrictively).

Section 17(a)

An implied right of action pursuant to rule 10b-5 was first recognized in 1946,¹⁸ and three years later a concurrent implied remedy was granted under 17(a).¹⁹ In the succeeding years a substantial number of courts followed suit by declaring parallel implied remedies under 17(a) and rule 10b-5.²⁰ However, the language of rule 10b-5 has enabled the courts to confer civil liability

See generally L. SODERQUIST, *supra* note 6, at 531 (review of rule 10b-5); D. RATNER, *supra* note 6, at 404 (same).

The impetus for the drafting of rule 10b-5 arose from the need to combat an imminent fraud being perpetuated by a company president on the shareholders of the corporation. *See Proceedings, Conference on the Codification of Federal Securities Laws*, 22 BUS. LAW. 793, 922 (1967) [hereinafter *Proceedings*]. Milton Freeman, one of the drafters of the rule 10b-5, stated that he received a phone call while on the staff of the SEC, from an SEC regional administrator who alerted Freeman to the imminent corporate fraud. *Id.* In response, Freeman, along with the Director of the SEC's Trading and Exchange Commission, promptly drafted rule 10b-5. Rule 10b-5 is a conglomeration of § 10(b) of the '34 Act and § 17(a) of the '33 Act. *Id. Contra Hazen, A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641, 646 (1978) (author emphasizes the differences between 17(a) and rule 10b-5). After being drafted, rule 10b-5 was immediately presented to the SEC and was unanimously approved. *Proceedings*, at 922. *See generally* L. LOSS, *supra* note 4, at 699-810 (author provides useful background information of the extent of the enforcement of rule 10b-5).

¹⁸ *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946). Rule 10b-5 does not expressly provide for civil liability. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 729 (1979) (civil liability pursuant to rule 10b-5 not expressly granted). However, the history of the courts' recognition of an implied remedy is extensive. *See, e.g., A. BROMBERG, SECURITIES FRAUD AND COMMODITIES FRAUD* (1981) (emphasizing the Supreme Court's recognition of a right to sue); Lowenfels, *Recent Supreme Court Decisions Under the Federal Securities Laws: The Pendulum Swings*, 65 GEO. L.J. 891 (1977) (courts created an implied right despite evidence of congressional intent to grant such a remedy).

There is no evidence that the SEC contemplated a private remedy under rule 10b-5. *Birnbaum*, 193 F.2d at 463. The drafter of the rule, Freeman, contended that rule 10b-5 was enacted to delegate to the SEC the power to effectively combat fraud; private proceedings were not considered. *See Proceedings, supra* note 17, at 922. Freeman stated, "[h]ow it [rule 10b-5] got into private proceedings was by the ingenuity of members of the private Bar starting with the *Kardon* case." *Id.* Freeman also asserted, "[i]t has been developed by the private lawyers, the members of the Bar, with the assistance or . . . the connivance of the federal judiciary who thought it was a very fine fundamental idea and that it should be extended." *Id.* *See generally* SEC v. National Sec. Inc., 393 U.S. 453, 465 (1969) (section 10(b) and rule 10b-5 are most litigated provisions in federal securities laws).

¹⁹ *See Osborne v. Mallory*, 86 F. Supp. 869, 879 (S.D.N.Y. 1949). *See generally* Shulman, *Civil Liabilities and Securities*, 43 YALE L.J. 227, 253 (1933) (civil liability is imposed for two reasons: compensating investors and compelling compliance with the '33 and '34 Acts).

²⁰ *See, e.g., Kirshner v. United States*, 603 F.2d 234, 241 (2d Cir. 1978) (recognition of a private right), *cert. denied*, 442 U.S. 909 (1979); *Newman v. Prior*, 518 F.2d 97, 99 (4th Cir. 1975) (civil liability found under § 17(a)). *See also Hazen, supra* note 17, 648 n.35. Despite the recognized differences between 17(a) and rule 10b-5 the court concurrently granted implied remedies. *Id.* *But see Horton, Section 17(a) of the 1933 Securities Act: The Wrong Place For a Private Right*, 68 NW. U.L. REV. 44 (1973) (court erred in implying a civil remedy under 17(a)).

encompassing a broader array of fraudulent practices.²¹ A private cause of action under rule 10b-5 had become a "judicial oak which ha[d] grown from little more than a legislative acorn".²² In comparison, 17(a) had an identity as a dormant cause of action.²³

B. 17(a) Gains Recognition

Section 17(a) emerged as a viable cause of action after a series of Supreme Court decisions systematically restricted the availability of a private right to sue under rule 10b-5.²⁴ In effect, the Supreme Court placed 17(a) in the forefront as a private remedy for defrauded investors.²⁵

²¹ See *supra* note 17. See also Scholl & Perkowski, *supra* note 8, at 45-47. See generally *Herman & MacClean v. Huddleston*, 459 U.S. 375, 380 (1983) (existence of implied remedy under rule 10b-5 has been found and is now beyond "peradventure").

²² See *Blue Chip Stamps*, 421 U.S. at 737. Supreme Court recognized that there was no evidence of congressional intent to grant a private remedy under rule 10b-5, but a right was conferred anyway. *Id.* See also *Hazen*, *supra* note 17, at 648 (Supreme Court caveat in *Blue Chip Stamps* that a rule 10b-5 problem should be resolved in broad context of policy of '34 Act).

²³ See Scholl & Perkowski, *supra* note 8, at 42. Section 17(a) has a narrow scope that led to its being doomed to the existence of an alternate cause of action. *Id.* See also *Hazen*, *supra* note 20, at 649 (17(a) exists as a shadow of rule 10b-5). *But see* Comment, *supra* note 8, at 351-55 (favored 17(a) as a viable cause of action to rule 10b-5).

²⁴ See, e.g., *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Blue Chip Stamps*, 421 U.S. at 723. In its first restrictive ruling, the Supreme Court endorsed the *Birnbaum* rule enunciated by the circuit courts. See *Blue Chip Stamps*, 421 U.S. at 749. The *Birnbaum* rule requires that a private plaintiff seeking relief under rule 10b-5 be either a purchaser or a seller of securities. *Id.* at 731-32. The Court further curtailed the plaintiff's ability to pursue civil litigation under rule 10b-5 in the *Hochfelder* decision. In *Hochfelder* the Court held that in a rule 10b-5 action a private plaintiff must prove that the defendant acted with scienter, and not mere negligence, in perpetuating the fraud. 425 U.S. at 193. Hence, a negligence standard will not support a private remedy under section 10(b) of the '34 Act or rule 10b-5. *Id.* In so holding, the Court emphasized the fact that the express civil remedies of the '33 Act that permit recovery for negligent conduct have strict procedural safeguards not provided in section 10(b) of the '34 Act or rule 10b-5. See *Hazen*, *supra* note 20, at 668 (absence of procedural safeguards would open the door to bothersome litigation). Moreover, the Supreme Court declared that a plaintiff must prove an element of deception in the sale or purchase of a security to recover in a rule 10b-5 action. *Santa Fe Indus.*, 430 U.S. at 473-77. See generally *L. Loss*, *supra* note 4, at 926 (federal courts creating tort actions can place reasonable restrictions on them).

²⁵ See Scholl & Perkowski, *supra* note 8, at 42. The demise of rule 10b-5 implied liability led to the revitalization of section 17(a) as a massive anti-fraud weapon for investors. *Id.* See also Pitt, *An SEC's Insider's View of the Utility of Private Litigation Under the Federal Securities Laws*, 5 SEC. REG. L.J. 3 (1977) (review of the feasibility of 17(a) cause of action). The recognition of a private action under 17(a) invites the question of what standard to apply in civil liability cases. See generally *L. Loss*, *supra* note 4, at 979-80 (discussion of recent Supreme Court decision which elaborated on this question). The Supreme Court has focused on this

Section 17(a)

II. CONFLICTING VIEWS AMONG THE CIRCUIT COURTS

A. *Private Cause of Action Exists in Some Circuits*

The circuit courts justified an implied right of action under 17(a) by focusing on the similarities between 17(a) and rule 10b-5.²⁶ The decisions of the Second Circuit along with the decisions of the Fourth, Sixth, Seventh and Ninth Circuits supported the conclusion that civil liability for damages exists under 17(a).²⁷ The common thread in those decisions is a comment made in a footnote written by Judge Friendly in his concurring opinion of *SEC v. Texas Gulf Sulphur*.²⁸ The essence of Judge Friendly's often cited

issue in the context of an SEC injunction brought under 17(a). *See Aaron v. SEC*, 446 U.S. 680 (1980). The Court held that scienter was the required showing to support an injunction brought by the SEC pursuant to rule 10b-5 and section 17(a) of the '33 Act, but not pursuant to 17(a)(2) or 17(a)(3). *Id.* at 697. The Court was influenced by its previous decisions on the standards to be applied in a rule 10-5 action. *Id.* at 689-90. *See also Steadman v. SEC*, 603 F.2d 1126, 1133 (5th Cir. 1979) (scienter not required under 17(a)(2) or 17(a)(3)).

²⁶ *See, e.g., Kirshner v. United States*, 603 F.2d 234, 241 (2d Cir. 1978) ("[T]here is little practical point in denying the existence of an action under §17(a) once it has been established that an aggrieved buyer has a private action under §10(b)"), *cert. denied*, 442 U.S. 909 (1979), *cert. denied sub nom. Goldberg v. Kirshner*, 444 U.S. 995 (1979); *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223, 1245 (7th Cir. 1977) (section 10(b) liability also gives rise to a §17(a) action, *rev'd on other grounds*, 439 U.S. 551 (1979). *See also Schaefer v. First Nat'l Bank of Lincolnwood*, 509 F.2d 1287, 1293 (7th Cir. 1975) (once § 10(b) claim was established §17(a) liability allowed to stand). Furthermore, the circuit courts' recognition of an implied remedy under rule 10b-5 and the express reservation on the issue of section 17(a) liability by the Supreme Court, opened the door for the lower courts to find a private remedy under 17(a). *See infra* notes 41-42 and accompanying text. For the statement by the Supreme Court on this issue *see Hochfelder*, 425 U.S. at 194 n.13.

²⁷ *See Gaff v. FDIC*, 814 F.2d 311 (6th Cir. 1987); *Mosher v. Kane*, 784 F.2d 1385 (9th Cir. 1986), *overruled in In re Washington Pub. Power Supply Sys. Sec. Litig.*, 823 F.2d 1349 (9th Cir. 1987); *Kirshner*, 603 F.2d 234; *Newman v. Prior*, 518 F.2d 97 (4th Cir. 1978); *Daniel*, 561 F.2d 1223.

²⁸ 401 F.2d 833, 867 (2d Cir. 1968), *cert. denied sub nom. Coates v. SEC and Kline v. SEC*, 394 U.S. 976 (1969). Although the issue in this case was whether scienter is required in a rule 10b-5 action, the prominence of the decision stems from Judge Friendly's concurring opinion. *Id.* at 867 (Friendly, J., concurring). Friendly recognized that the White House Committee Report and the legislative history of 17(a) indicates that 17(a) was probably only intended by the legislature to afford plaintiff injunctive relief. *Id.* However, in his concurring opinion Friendly glossed over this issue when he stated, "there is little practical point in denying the existence of a right under 17(a) once it has been established that an aggrieved buyer has a private action under § 10(b) of the 1934 Act — with the important proviso that fraud, as distinct from mere negligence must be alleged." *Id.* In addition, Friendly stated that to go further, "would totally undermine the carefully framed limitations imposed on the buyer's right to recover pursuant to § 12(2) of the 1933 Act." *Id.* This view was followed by other circuit courts. *See, e.g., Sanders v. John Nuveen & Co.*, 554 F.2d 790, 795-96 (7th Cir. 1977) (action under 17(a) must allege scienter or it would nullify

opinion is that the similarities of rule 10b-5 and 17(a) should allow a plaintiff who establishes the elements of a private cause of action under rule 10b-5 to pursue a private remedy under 17(a) provided fraud, as distinguished from mere negligence, is also alleged.³⁰

It should be emphasized that while the circuit courts have recognized an implied cause of action under 17(a), most have done so with little or no analysis in the rationale of their decisions.³⁰ Instead, the early circuit court decisions relied on an incomplete version of Judge Friendly's statement along with a conviction that the language of 17(a) is broad enough to support their conclusion that a private right of enforcement exists.³¹ Later courts were either bound by *stare decisis* or were influenced by the persuasive

civil provisions of the '33 Act). See generally L. Loss, *supra* note 4, at 978 (discussion of 17(a) in context of *Texas Gulf Sulphur*). But see Scholl & Perkowski, *supra* note 8, at 52 (implication of remedy under 17(a) takes on greater significance today than when Friendly casually addressed the issue).

³⁰ *Texas Gulf Sulphur*, 401 F.2d at 867 (Friendly, J., concurring). See *In re Washington*, 823 F.2d at 1351; *Sanders*, 554 F.2d at 796. However, in relying on Judge Friendly's statement, courts have frequently relied solely on a portion of the statement, and have failed to consider Judge Friendly's reliance on §17(a) cases on the assumed applicability of the scienter standard required in private actions under 10(b). See, e.g., *Kirshner*, 603 F.2d at 241. See also *infra* note 30 and accompanying text (further discussion on this point).

³⁰ *In re Washington*, 823 F.2d 1349, 1351 (9th Cir. 1987). The courts that have adopted Judge Friendly's statement, quoted it omitting, "the important proviso that fraud, as distinct from mere negligence must be alleged." *Id.* See, e.g., *Kirshner*, 603 F.2d at 241; *Daniel*, 561 F.2d at 1283-84.

This omission has grown in significance as the standard of conduct governing securities litigation has become more refined. *In re Washington*, 823 F.2d at 1351. See, e.g., *Aaron v. SEC*, 446 U.S. 680, 701-02 (1979) (application of scienter standard for 17(a)(1), but not 17(a)(2) or 17(a)(3)). The circuit courts' categorical reliance on a cite from *Texas Gulf Sulphur* was an indication to some commentators that the courts did not perceive the complexity of this securities issue. See Scholl & Perkowski, *supra* note 8, at 52-57 (issue deserved a more thorough analysis than was given by the courts).

The courts that misquoted Judge Friendly were effectively eliminating any need to show scienter under 17(a), and furthermore, eliminating any need to proceed under rule 10b-5. *In re Washington*, 823 F.2d at 1352.

³¹ See *supra* note 30. But see Scholl & Perkowski, *supra* note 8, at 56 (courts' justification for implied remedies based on broad language of statute has disturbing ramifications). Some courts have rationalized the decision to grant an implied remedy in two ways. The first has been the courts' desire to aid the SEC in enforcing 17(a). See, e.g., *Demoe v. Dean Witter & Co.*, 476 F. Supp. 275, 281 (D. Alaska 1976) (court grounded decision to grant private remedy under 17(a)(3) on desire to assist SEC). The second rationale offered by the courts to justify their granting of a remedy was that the cases decided under rule 10b-5 provided precedent for the judiciary to compel its own ideas of equity upon the law. See Scholl & Perkowski, *supra* note 8, at 56 (authors discuss this theory relied on by some courts).

Section 17(a)

authority of other circuit court decisions in holding that 17(a) permits a private remedy; again, an extensive analysis was conspicuously lacking.³²

B. No Private Cause of Action Exists In Some Circuits Courts

Prior to 1987, the Fifth and Eighth Circuits determined that no implied right to sue existed under 17(a),³³ while the Tenth Circuit expressed "considerable doubt"³⁴ as to whether an implied remedy was justifiable. The Ninth Circuit stood firmly behind the position of the Second Circuit until *In re Washington*,³⁵ the controversial decision that resulted in a direct clash between these two circuits on this issue.

³² See, e.g., *Mosher v. Kane*, 784 F.2d 1384, 1386 (9th Cir. 1986) (implied a private right of action following *Stephenson*) overruled in *In re Washington*, 823 F.2d 1349 (9th Cir. 1987); *Wigand v. Floteck*, 609 F.2d 1028, 1038 (2d Cir. 1980) (found implied right to sue under 17(a) in light of *Kirshner* holding); *Newman v. Prior*, 518 F.2d 97, 99 (4th Cir. 1978) (implied civil liability under 17(a) relying on precedent). See also L. Loss, *supra* note 4, 978 (author recognizes that the Second Circuit was in the forefront of denying an implied action without an analysis). But see *In re Washington*, 823 F.2d at 1350 (overruled *Stephenson* and *Mosher*, found no private action under 17(a)); *Yoder v. Orthomolecular Nutrition Inst. Inc.*, 751 F.2d 555, 559 n.3 (2d Cir. 1985) (Judge Friendly's subsequent criticism of the Second Circuit's variation of his statement, and his characterization of *Kirshner* as being with "no analysis"); *infra* note 39 (circuits which have implied right to sue have recently reversed or modified their prior positions).

³³ See, e.g., *Devires v. Prudential-Bache Sec., Inc.*, 805 F.2d 326 (8th Cir. 1986); *Landry v. All Am. Assurance Co.*, 688 F.2d 381 (5th Cir. 1982). The circuits that denied a private a right to sue reached this conclusion through a *Cort* analysis. See *Cort v. Ash*, 422 U.S. 66, 78 (1975). See also *infra* note 36 (four pronged approach discussed). See generally Note, *Section 17(a) of the '33 Act: Defining the Scope of Anti-Fraud Protection*, 37 WASH. & LEE L. REV. 859, 866-76 (1980) (*Cort* analysis does not support a private remedy under 17(a)).

³⁴ *Ohio v. Peterson, Rall, & Barbara Ross*, 651 F.2d 687, 689 n.1 (10th Cir.), *cert. denied*, 454 U.S. 895 (1981). The Ohio court noted that the appellant brought the claim under rule 10b-5 and 17(a). *Id.* The court stated that this was not of any significance in the analysis, due to the substantive similarities between rule 10b-5 and 17(a). *Id.* However, the court emphasized its "considerable doubt" whether an implied remedy exists under 17(a). *Id.*

³⁵ *In re Washington*, 823 F.2d 1349 (9th Cir. 1987). The Ninth Circuit granted a suggestion for rehearing en banc to consider a summary reversal of the district court's decision to dismiss a 17(a) claim. *Id.* at 1350. This rehearing also considered whether to overrule two previous Ninth Circuit decisions on this issue. *Id.* The court concluded that the *Stephenson* and *Mosher* decisions were "incorrectly decided and are no longer precedent in this circuit." *Id.* at 1351. The court emphasized that the precedent in the Ninth Circuit held that an implied remedy existed because of authority emanating from the Second Circuit. *Id.* The Court refuted the Ninth Circuit's categorical reliance on the Second Circuit. *Id.* Furthermore, the Ninth Circuit recognized that the Second Circuit has indicated a willingness to re-examine its prior position on this issue. *Id.* at 1352-53 n.5. See *Yoder*, 751 F.2d at 559 n.3 (Judge Friendly reconsidered Second Circuit's stance).

The courts have relied on the four pronged test established by the Supreme Court in *Cort v. Ash*.³⁶ The *Cort* analysis is to be applied in determining whether a private remedy is implicit in a statute not expressly providing one.³⁷ A private cause of action under 17(a) has been consistently denied by the courts relying on this approach because 17(a) fails the second and third prongs of the *Cort* test.³⁸ Furthermore, the Ninth Circuit recognized in *In Re Washington* that even the circuits which had found an implied right to sue under 17(a) have recently reversed or modified their prior positions.³⁹

C. Lower Courts: Recent Trend Denying an Implied Remedy

While the district courts have historically been fragmented on

³⁶ *Cort v. Ash*, 422 U.S. 66 (1975). *Cort* was a unanimous decision by the Supreme Court that appeared to be a guide to the bench and bar on the relevant factors to consider when deciding whether to imply a remedy from a statute not expressly providing for one. *Id.* at 78. The Supreme Court in *Cort* held that a private remedy does not exist under the Federal Elections Campaign Act. *Id.* at 84. The four factors to consider are: (1) whether the statute creates a federal remedy in favor of the plaintiff; (2) whether the legislature intended an implied remedy; (3) whether an implied action is consistent with the legislative scheme; and (4) whether the cause of action is traditionally relegated to state law. *Id.* at 78. Subsequently, the Supreme Court has indicated that the legislative intent is the central inquiry of the *Cort* analysis. See *Touche Ross & Co., v. Redington*, 442 U.S. 560 (1979). See also L. Loss, *supra* note 4, at 930-35 (discussion of the *Cort* analysis and subsequent Supreme Court cases which have modified the inquiry): Aiken, *Availability of an Implied Civil Cause of Action Under 17(a) of the Securities Act of 1933*, 9 N.C. J. INT. LAW. COMM. REC. 207 (1984) (test currently applied by the courts is a more restrictive analysis). *But see* *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 16 (1979) (notwithstanding the *Cort* test, the *Transamerica* Court stressed the fact that when a statute expressly states certain types of remedies, such as an injunction, no other remedies were intended by Congress).

³⁷ *Cort*, 422 U.S. at 78.

³⁸ See, e.g., *In re Washington* 823 F.2d 1349, 1355-56 (9th Cir. 1987) (remedy denied due to inconsistency with congressional intent and statutory scheme); *Landry v. All Am. Assurance Co.*, 688 F.2d 381, 389-91 (5th Cir. 1982) (same); *Roskos v. Shearson-American Express Inc.*, 589 F. Supp. 627, 631 (E.D. Wis. 1984) (private action under 17(a) would undermine statutory scheme of '33 Act). See also R. JENNINGS & H. MARSH, *supra* note 11, at 874 (authors apply the *Cort* analysis to heed same results); Note, *supra* note 33, at 871-76 (language and legislative history of 17(a) leads to conclusion that no implied action exists pursuant to 17(a)).

³⁹ *In re Washington*, 823 F.2d at 1352-53 n.5. The Ninth Circuit indicated that the *Kirshner* decision was "open to re-examination". *Id.* Furthermore, the Ninth Circuit indicated that the Fourth Circuit has also expressed a lack of conviction in its prior position. *Id.* See *SEC v. American Realty Trust*, 586 F.2d 1001, 1006-07 (4th Cir. 1978). The Seventh Circuit has determined that the issue is an "open question". See *Teamsters Local 282 Pension Fund v. Angelos*, 762 F.2d 522, 530-31 (7th Cir. 1985).

Section 17(a)

this issue,⁴⁰ the current trend denying a private right to sue under 17(a) cannot be ignored.⁴¹ The recent district court decisions that have addressed this question have employed the *Cort* test and, with reasoning similar to the circuit courts that have denied an implied remedy, have found that civil liability pursuant to 17(a) would be inconsistent with congressional intent and the overall statutory scheme of the '33 Act.⁴² An examination of these decisions indicates that the district court judges were influenced by the recent realignment of the circuit courts.⁴³ A survey of the recent state court decisions illustrates that the decisive trend away from denying an implied remedy has permeated the state level.⁴⁴

⁴⁰ See, e.g., *Bruns v. Ledbetter*, 583 F. Supp. 1050, 1053 (S.D. Cal. 1984) (no implied action); *Warner Communications, Inc. v. Murdoch*, 581 F. Supp. 1482, 1496 (D. Del. 1984) (no private action). But see *Savino v. E.F. Hutton & Co.*, 507 F. Supp. 1225, 1231 n.4 (S.D.N.Y. 1981) (private right of action granted).

⁴¹ See, e.g., *Mursan Corp. v. Florida Penn Oil & Gas*, 638 F. Supp. 259, 261 (W.D. Pa. 1986) (court denied private remedy noting trend away from implied remedies in circuit courts), *aff'd*, 813 F.2d 398 (3d Cir. 1987); *Pennington v. Thomas McKinnon Sec. Inc.*, No. 86 - 3672, slip op. (E.D. Pa. Dec. 21, 1986) (same).

⁴² See, e.g., *Jiffy Lube Int'l Inc. v. Grease Monkey Holding Co.*, No. 87-k-1082, slip op. (D.Del. Oct. 8, 1987) (no indication of legislative intent and an inconsistency with statutory scheme); *Kimmel v. Peterson*, 565 F. Supp. 476, 482-88 (E.D. Pa. 1983) (same); *Hudson v. Capital Management Int'l Inc.*, 565 F. Supp. 615, 625-27 (N.D. Cal. 1983) (private right of action under 17(a) would undermine Congress' careful statutory scheme).

⁴³ See *supra* note 41.

⁴⁴ See, e.g., *Mann v. Oppenheimer & Co.*, 517 A.2d 1056, 1064-66 (D. Del. 1986) (Supreme Court of Delaware denied a private action); *CPC Int'l Inc. v. Mckesson Corp.*, 70 N.Y.2d 268, 275, 514 N.E.2d 116, 123, 519 N.Y.S.2d 804, 812 (1987) (New York Court of Appeals denied a private remedy); *Mauersberg v. E.F. Hutton & Co.*, 116 App. Div. 2d 417, 501 N.Y.S.2d 748, 751 (3d Dep't 1986) (appellate court of New York refused to recognize a private action). The state court decisions rely on a thorough *Cort* analysis. See *CPC Int'l Inc.*, 70 N.Y.2d at 280-84, 514 N.E. 2d at 121-24, 519 N.Y.S. 2d. at 809-12. Furthermore, the state courts noted the recent decisions of the circuits which reflected a change in their prior positions allowing a private remedy or which indicated a willingness to reconsider their opinions granting civil liability. *Id.* at 280. 514 N.E. at 120-21, 519 N.Y.S. 2d at 808-09.

The '33 Act confers jurisdiction on both the state and federal courts, as opposed to the '34 Act over which the federal courts have exclusive jurisdiction. See *Hazen*, *supra* note 20, at 646. Allowance of a statutory cause of action in state court could prompt a defrauded investor either to bring or remove a case to that court when no common law or federal remedy would otherwise be granted. See *Cherner, Considering The State Court As A Forum For Securities Actions*, 9 *CUMB. L. REV.* 663, 669 (1979) (recent decisions of the federal courts should alert an attorney to consider the state court as an attractive forum whenever feasible).

III. THE CONSENSUS OF THE COMMENTATORS

A strong argument for denying a private right to sue pursuant to 17(a) can be found among the commentators in the securities field.⁴⁵ Support for their conclusion is derived from the legislative history of the '33 Act.⁴⁶ Furthermore, the commentators emphasize that where Congress intended civil liability in the '33 Act the provision expressly stated it.⁴⁷ Commentators have suggested that

⁴⁵ See, e.g., Douglas & Bates, *supra* note 3, at 182. Section 17(a) does not broaden civil remedies, "This seems clear by negative implication, since sections 11 and 12 expressly state the remedies which are available." *Id.* See also L. Loss, *supra* note 4, at 977-80 (regarding private right to sue under 17(a), "if anything can be stated categorically, the answer should be no."); Ruder, *supra* note 7, at 656-57 ("[the] history can be interpreted as demonstrating that Congress did not intend that a private right of action exist for violation of Section 17(a) . . ."). Cf. H. BLOOMENTHAL, *SECURITIES LAW HANDBOOK* (1982) (on issue of 17(a), "an implied remedy could be based on Rule 10b-5, making the Section 17(a) remedy redundant.") *But see* Hazen, *supra* note 20, at 655-58 (support for 17(a) private remedy). See generally *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, J., concurring, *cert. denied sub nom. Coates v. SEC*, 394 U.S. 976 (1968) (Judge Friendly stated: "[T]here is unanimity among the commentators . . . [17(a)] was intended only to afford a basis for injunctive relief and, on a proper showing, for criminal liability").

⁴⁶ See, e.g., L. Loss, *supra* note 4, at 977. Loss regards the comments made by Commissioner Landis of the Federal Trade Commission, who played an active role in drafting the '33 Act, as a reflection of congressional intent:

The suggestion has been made on occasion that civil liabilities arise 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 the 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.

Id. (citing Landis, *Liability Sections of The Securities Act*, 18 AM. ACCOUNTANT 330, 331 (1933)).

Congressional intent has been further evidenced by statements made by Senator Fletcher, another drafter of the '33 Act. See Ruder, *supra* note 7, at 656. Senator Fletcher wrote, in a memo on 17(a): "It is to be noted that enforcement of the provision of the new subsection is left to injunction, stop order, and criminal prosecution. No civil liability attaches for any violation thereof." *Id.* (quoting 78 CONG. REC. 8711-12 (1934)).

While Congress did not expressly state its intent regarding a private action under 17(a), the House Committee Report has been relied on to support the notion that no implied remedy was intended. See HOUSE REPORT, *supra* note 3, at 9-10. The House Report listed sections 11 and 12 as those that define civil liability imposed by the '33 Act. *Id.* The report stated: "To impose a greater responsibility apart from constitutional doubts, would unnecessarily restrain the conscientious administration of honest business with no compensating advantage to the public." *Id.* at 10. The Senate Report supports the same conclusion. See S. REP. NO. 47, 73d Cong., 1st Sess. (1933).

⁴⁷ See HOUSE REPORT, *supra* note 3, at 1-10. Another argument which is frequently asserted rests on the principle of *inclusio unius est exclusio alterius*. See L. Loss, *supra* note 4, at 979; Ruder, *supra* note 7, at 656-57 (author discusses the application of this latin maxim). *But see* Piper v. Chris-Craft Indus., Inc., 430 U.S. at 126-37 (1977) (proper focus should be

Section 17(a)

the objectives sought by Congress, mainly, investor protection, maintenance of a stable securities market and an attempt to prevent unnecessary costs in securities transactions, are best fostered through the interpretation that a private remedy does not exist under 17(a).⁴⁸

IV. PROPOSED ANALYSIS

The analysis proposed for reaching a final determination on whether a private cause of action exists under 17(a) involves a threshold examination of the contemporary legal context in which the issue arises and an application of a modified *Cort* test.⁴⁹

A. Conservative Trend of the Supreme Court

The growing tendency of the courts to imply a cause of action prompted the Supreme Court to intervene and mandate the application of a more stringent analysis to be applied in implied action cases.⁵⁰ As a result, the recognition of an implied right to sue has been curtailed in the securities field, as well as in other areas of the law.⁵¹ Furthermore, the Supreme Court has indicated its reluctance to fashion a remedy in securities law when the Court is not certain that Congress intended such a remedy.⁵² Therefore, the question of whether or not a private remedy is implied in 17(a) is contemplated against a backdrop which indicates that civil

on investor protection and statutory purpose rather than mechanical methods of statutory construction).

⁴⁸ See generally Scholl & Perkowski, *supra* note 8, at 64 (authors believe courts that imply a remedy based on "investor protection at all costs" create an incongruity in securities laws).

⁴⁹ *Cort v. Ash*, 422 U.S. 66 (1975). See *infra* notes 54-67 (discussion of *Cort* and its progeny).

⁵⁰ See Aiken, *supra* note 36, at 214 (current version of the *Cort* analysis is stringent).

⁵¹ See, e.g., *Touche Ross & Co v. Redington*, 442 U.S. 560, 569 (1979) (denial of remedy under 17(a) of '34 Act); *Transamerica Mortgage Advisors v. Lewis*, 444 U.S. 11, 19 (1979). *Transamerica* involved a question whether an implied remedy existed under section 206 of the Investors Advisors Act. *Id.*

The Supreme Court has been reluctant to imply a remedy in other areas of the law. See, e.g., *Cort*, 422 U.S. at 82-84 (no implied remedy under Federal Election Campaign Act); *Northwest Airlines, Inc. v. Transportation Workers*, 451 U.S. 77, 98 (1981) (no implied remedy found in Equal Pay Act).

⁵² See *Transamerica*, 444 U.S. at 20-23 The Supreme Court took the stance that the complexity of the security statute led to the determination that Congress deliberately omitted civil liability. *Id.*

liability would not be recognized by the Supreme Court.⁵³

B. *Modified Cort Analysis*

It is suggested that a modified *Cort* analysis should be used to determine whether an implied remedy exists under 17(a). This analysis would balance investor protection and the preservation of the complex statutory scheme of the '33 Act.⁵⁴

It is submitted that the four prongs of the *Cort* analysis should be reprioritized to include a primary focus on the statutory scheme of the '33 Act, followed by an inquiry into the legislative intent. The tertiary consideration should be whether the plaintiff is a member of the class the statute intended to benefit, and finally, it should be determined whether the question is properly one of state or federal law.⁵⁵

The first question posed in this analysis is whether an implied remedy is consistent with the underlying statutory scheme of the '33 Act. Section 17(a) must be reviewed in light of the Supreme Court's decision in *Aaron v. SEC*.⁵⁶ In *Aaron*, the Court held that an imposition of an SEC injunction pursuant to 17(a)(1) must be based on the establishment of scienter, while the appropriate standard of relief under 17(a)(2) and 17(a)(3) requires only a showing of negligence.⁵⁷ Provisions of the '33 Act which expressly permit

⁵³ See Scholl & Perkowski, *supra* note 8, at 59 n.108 (chart evidencing the conservative attitude of the Supreme Court on securities questions).

⁵⁴ See *Massachusetts Mutual Life Ins. Co. v. Russell*, 473 U.S. 134, 147 (1985). The Supreme Court indicated a reluctance to tamper with the '33 Act, calling it an "enforcement scheme crafted with such evident care." *Id.* See generally Scholl & Perkowski, *supra* note 8, at 64 (implication of remedy under section 17(a) based on "investor protection at all costs" creates substantial imbalance in federal securities laws).

⁵⁵ Compare *Cort v. Ash*, 422 U.S. 66 (1975) (Supreme Court's analysis) with *infra* notes 56-67 and accompanying text (modified *Cort* test proposed for securities law questions).

⁵⁶ *SEC v. Aaron*, 446 U.S. 680 (1980). *Aaron* involved an SEC injunction under 17(a) of the '34 Act. *Id.* at 682. See generally L. Loss, *supra* note 4, at 783-85 (discussion of *Aaron* decision and implication of a 17(a) action).

⁵⁷ *Aaron*, 446 U.S. at 697. The Court in *Aaron* concentrated on the language of the statute rather than the relief sought. *Id.* at 696-97. A scienter standard is mandated under rule 10b-5 for injunctions and private remedies because of the "deception" requirement. *Id.* at 696. Applying this reasoning, scienter would be required under 17(a)(1) only, due to the language of the statute. *Id.* In comparison, the language of 17(a)(2) does not suggest a scienter requirement. *Id.* Moreover, 17(a)(3) focuses on the effect of particular conduct on an investor rather than the culpability of the person involved; therefore, scienter is not required. *Id.*

Section 17(a)

civil liability must be compared to 17(a). Sections eleven and twelve grant a private remedy upon mere proof of negligence; however, section eleven and twelve liability hinges on the satisfaction of strict procedural requirements.⁵⁸ The *Aaron* decision suggests that a private right of action under 17(a)(2) and 17(a)(3) would permit recovery upon a showing of negligence, absent any procedural limitations.⁵⁹ A major criticism of this result lies in the fact that a plaintiff who alleges negligence pursuant to 17(a)(2) or 17(a)(3) could circumvent the procedural restraints of sections eleven and twelve.⁶⁰ Implication of a private remedy under 17(a) would undermine the comprehensive legislative scheme of the '33 Act.⁶¹

The second prong of the modified *Cort* test is the determination of congressional intent. A private remedy should not be inferred from the language of 17(a).⁶² The legislative history of the '33 Act indicates that Congress was concerned with the perpetuation of honest business to the benefit of the public; this goal is best effec-

⁵⁸ See *supra* notes 11 & 12 for discussion of sections 11 and 12. See also L. Loss, *supra* note 4, at 883-912 (elaboration on substantive and procedural aspects of these provisions).

⁵⁹ See '33 Act §§ 11 & 12, 15 U.S.C. § 77k(e) (1976); 15 U.S.C. § 77l (1976). An example of a procedural safeguard is found in section 11(e). Section 11(e) provides that in any action brought under this provision, the court may require the plaintiff to post security for costs. See 15 U.S.C. § 77k(e). Furthermore, sections 11 and 12 are subject to the two-pronged statute of limitations of section 13 of the '33 Act. '33 Act § 13, 15 U.S.C. § 77m (1976). *But see* Bateman, Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 304 n.9 (1985) (*Aaron* decision involved SEC injunction under 17(a), Court did not expressly state that same standards would apply for an implied 17(a) remedy). See generally *In re Washington Pub. Power Sup. Sys. Sec. Litig.*, 823 F.2d 1349, 1352 (9th Cir. 1987) (*Aaron* suggests that if an implied action is brought pursuant to 17(a), a scienter standard would govern only 17(a)(1)).

⁶⁰ See L. Loss, *supra* note 4, at 784. Loss contends that the effect of granting an implied remedy under 17(a) would render sections 11 and 12 superfluous. *Id.* See also *Dyer v. Eastern Trust & Banking Co.*, 336 F. Supp. 890, 904-05 (D. Me. 1971) (analysis of 17(a) and sections 11 and 12 in the context of the '33 Act).

⁶¹ *In re Washington*, 823 F.2d at 1355. See *Landry v. All Am. Assurance Co.*, 688 F.2d 381 (1982). The *Landry* court stated: "The creation of an implied cause of action [under 17(a)] would effectively frustrate the carefully laid framework of the Act." *Id.* at 390. See also *Roskos v. Shearson-American Express, Inc.*, 589 F. Supp. 627, 631 (E.D. Wis. 1984) (private remedy under 17(a) "would cause the statutory and judicially-crafted restrictions on § 10(b) of the 1934 Act and §§ 11 and 12 of the 1933 Act to atrophy and fall away as securities fraud cases hustle in the back door of § 17."). See generally *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976) (legislative scheme of the securities laws work as an integrated whole).

⁶² See *supra* note 7. See also *In re Washington*, 823 F.2d at 1353 ("The language of section 17(a) reveals no intent to create a private remedy.").

tuated by limiting civil liability to an action grounded upon sections eleven and twelve.⁶³

It is conceded that the third and fourth prong of this analysis can be easily satisfied. Section 17(a) was established to protect investors and therefore, based on this fact, a federal right of action exists.⁶⁴ However, even if an implied remedy is not recognized under 17(a) there exist considerable alternatives for investor redress.⁶⁵

The least important element of this analysis is the determination of whether the cause of action is traditionally in the domain of state law. Federal securities law exerts a pervasive influence on the national securities market.⁶⁶ The purpose and scope of federal securities regulation indicates that the question of an implied remedy under 17(a) is not traditionally relegated to state law.⁶⁷ Notwithstanding the fact that the fourth prong encourages civil liability, an implied remedy does not exist because the first and second prongs are the most substantial considerations in this analysis.

V. CONCLUSION

The results of this analysis lead to only one conclusion—that an implied remedy does not exist pursuant to 17(a). Yet, until this debate is resolved by the Supreme Court it will continue to be one of the more controversial issues in securities law.

The Supreme Court on several occasions has declined to confront this issue;⁶⁸ however, this hands-off position may change in

⁶³ See HOUSE REPORT, *supra* note 3, at 9-10. See also SENATE REPORT *supra* note 3, at 1 (aim is to protect honest enterprise, restore public confidence and aid in restoring buying and consuming power). For other indications of congressional intent, see *supra* note 46.

⁶⁴ See Scholl & Perkowski, *supra* note 8, at 60 (investor is in the class the statute intended to benefit). But see *In re Washington*, 823 F.2d at 1354 (even if plaintiff is in class statute intended to benefit, second and third prong must be satisfied). See generally *Northwest Airlines, Inc. v. Transportation Workers*, 451 U.S. 77, 94 (1981) (Supreme Court will not engraft a remedy when there is no indication of congressional intent).

⁶⁵ See *supra* notes 6 and accompanying text. See also *supra* notes 11-17 (express liability provisions of '33 and '34 Act). See generally *Ernst & Ernst*, 425 U.S. at 195 (aim of the '33 and '34 Acts is to provide flexible enforcement mechanisms to ensure investor protection).

⁶⁶ See Note, *supra* note 33, at 875 (securities law questions traditionally in the federal domain).

⁶⁷ See R. JENNINGS & H. MARSH, *supra* note 11, at 878.

⁶⁸ See, e.g., *Herman & MacClean v. Huddleston*, 459 U.S. 375, 378 n.2 (1983) (Court expressly reserved decision on whether 17(a) affords private remedy); *Teamsters v. Daniel*,

Section 17(a)

light of the recent Ninth Circuit decision in *In re Washington*. The result of that decision is a direct clash between the Second and the Ninth Circuits. This is an opportune time for the Supreme Court to take a stance.

Julianne Gennuso

439 U.S. 551, 557 n.9 (1979) ("In light of our disposition of this case, we express no views on this issue."); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 734 n.6 (1975) ("We express, of course, no opinion on whether § 17(a) in light of the express civil remedies of the 1933 Act gives rise to an implied cause of action.").

