

Robinson v. Dean Witter Reynolds, Inc.: Searching for the Basis of an Implied Cause of Action Under SEC Rule 10B-16

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ROBINSON V. DEAN WITTER
REYNOLDS, INC.: SEARCHING FOR THE
BASIS OF AN IMPLIED CAUSE OF
ACTION UNDER SEC RULE 10B-16

Margin trading is a method of stock acquisition that allows investors to buy securities by paying a portion of the purchase price, and obtaining a loan for the remaining amount.¹ Brokers extending credit in margin transactions are required to disclose the terms of the credit agreement under Securities and Exchange Commission (SEC) Rule 10b-16.² The SEC promulgated Rule 10b-16 in response to a congressional enactment that exempted securities margin transactions from the disclosure requirements of the

¹ See L. ENGEL & B. BOYD, *HOW TO BUY STOCKS* 174-81 (7th ed. 1982); B. STARK, *SPECIAL SITUATION INVESTING: HEDGING, ARBITRATION AND LIQUIDATION* 36-39 (1983). The term margin refers to the portion of the price that an investor contributes toward the purchase of a security. B. STARK, *supra*, at 36. The remaining amount is typically advanced to the investor by his broker or extended by a financial institution. See L. ENGEL & B. BOYD, *supra*, at 175-76. Interest is charged on the credit extended. B. STARK, *supra*, at 36-37. To secure its loan, the broker retains the securities in the street name of the brokerage firm as collateral. *Id.* at 37. If the value of the securities subsequently declines, thereby devaluing the broker's collateral, the broker may request additional margin (margin call). *Id.*; L. ENGEL & B. BOYD, *supra*, at 177. If a margin call is not met within a specified period, the broker may cancel the loan and sell the securities to affect repayment. *Id.* B. STARK, *supra*, at 37. This Comment will consider only margin transactions in a long account. See generally R. AUSTER, *OPTION WRITING AND HEDGING STRATEGIES* 7-15 (1975) (differentiating use of margin in long and short positions).

² 17 C.F.R. § 240.10b-16 (1985). The rule provides in pertinent part:

(a) *It shall be unlawful for any broker or dealer to extend credit, directly or indirectly, to any customer in connection with any securities transaction unless such broker or dealer has established procedures to assure that each customer: (1) Is given or sent at the time of opening the account, a written statement or statements disclosing (i) the conditions under which an interest charge will be imposed; (ii) the annual rate or rates of interest that can be imposed; (iii) the method of computing interest; (iv) if rates of interest are subject to change without prior notice, the specific conditions under which they can be changed; (v) the method of determining the debit balance or balances on which interest is to be charged and whether credit is to be given for credit balances in cash accounts; (vi) what other charges resulting from the extension of credit, if any, will be made and under what conditions; and (vii) the nature of any interest or lien retained by the broker or dealer in the security or other property held as collateral and the conditions under which additional collateral can be required*

Id. (emphasis added).

Truth In Lending Act (TILA).³ While a private right of action is explicitly granted for violations of the TILA provisions,⁴ Rule 10b-16 does not expressly provide such a remedy.⁵ Federal courts, adjudicating margin investors' actions against brokers who have violated the disclosure requirements of Rule 10b-16, have produced inconsistent holdings.⁶ Recently, in *Robertson v. Dean Witter*

³ See Consumer Credit Protection Act § 104, 15 U.S.C. § 1603(2) (1982); H.R. REP. NO. 1040, 90th Cong., 1st Sess. 28 (1967), reprinted in 1968 U.S. CODE CONG. & AD. NEWS 1962, 1986 [hereinafter cited as H.R. REP.]; S. REP. NO. 392, 90th Cong., 1st Sess. 9 (1967) [hereinafter cited as S. REP.].

At the time the TILA was enacted, Congress already had empowered the Federal Reserve Board (FRB) to "prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security (other than an exempted security)." Securities Exchange Act of 1934 § 7a, 15 U.S.C. § 78g(a) (1982). Although the FRB has been given the power to regulate the initial margin requirement (percentage of total purchase price investor must initially contribute), B. STARK, *supra* note 1, at 38, and the margin maintenance requirement (percentage of stock's current value that must be maintained in account), *id.* at 38-39, it has chosen to regulate only the initial margin requirement. See 12 C.F.R. § 220.1-220.130 (1986); Note, *Civil Liability of a Broker for Failure to Enforce Margin Requirements*, 10 WILLAMETTE L.J. 72, 73 (1973). Margin maintenance requirements are established by the rules of individual stock exchanges or brokers. L. ENGEL & B. BOYD, *supra* note 1, at 177; 2 L. LOSS, SECURITIES REGULATION 1250-51 (2d ed. 1961); 5 L. LOSS, SECURITIES REGULATION 3266 (2d ed. 1961 & Supp. 1969).

The FRB's initial margin requirement has fluctuated from as low as 40% (1937-1945) to as high as 100% (Jan. 1946-Feb. 1947), L. ENGEL & B. BOYD, *supra* note 1, at 175; 2 L. LOSS, *supra*, at 1244-48; 5 L. LOSS, *supra*, at 3262-64, and is presently at 50% of the current market value for most securities. 12 C.F.R. § 220.18(a) (1986). The margin maintenance requirement imposed by the New York Stock Exchange is 25% of the market value of the securities held long. N.Y.S.E. Rule 431(b)(1). Many brokers impose a 30% minimum margin maintenance requirement on both long and short positions. R. AUSTER, *supra* note 1, at 12.

⁴ 15 U.S.C. § 1640(a) (1982). The TILA states, in pertinent part:

[A]ny creditor who fails to comply with any requirement imposed under this part . . . with respect to any person is liable to such person in an amount equal to the sum of —

(1) any actual damage sustained by such person as a result of the failure; . . .

Id. The TILA also provides for criminal liability for willful and knowing violations of the statute. 15 U.S.C. § 1611 (1982).

⁵ 17 C.F.R. § 240.10b-16 (1985); see *supra* note 2.

⁶ Compare *Abeles v. Oppenheimer & Co.*, 597 F. Supp. 532, 535 (N.D. Ill. 1983) (recognizing an implied cause of action under Rule 10b-16) with *Furer v. Paine, Weber, Jackson & Curtis, Inc.*, [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,701 at 93,495 (C.D. Cal. 1982) (denying implied cause of action when Rule 10b-16). Five district courts have recognized an implied private cause of action under Rule 10b-16. See *Granville Mkt. Letter, Inc. v. Oppenheimer & Co.*, 610 F. Supp. 922, 922 (S.D. Fla. 1985); *Slomiak v. Bear Stearns & Co.*, 597 F. Supp. 676, 681 (S.D.N.Y. 1984); *Abeles*, 597 F. Supp. at 536; *Angelastro v. Prudential-Bache Sec., Inc.*, 575 F. Supp. 270, 274 (D.N.J. 1983); *Haynes v. Anderson & Strudwick, Inc.*, 508 F. Supp. 1303, 1321 (E.D. Va. 1981). The Court of Appeals for the District of Columbia Circuit has suggested that an implied private right of action exists under Rule 10b-16. See *Liang v. Dean Witter & Co.*, 540 F.2d 1107, 1113 & n.25 (D.C. Cir. 1976). The Courts of Appeals for the Second and Eleventh Circuits have declined to rule on the question, since the plaintiffs before the courts failed to establish violations of Rule 10b-16. See

Reynolds, Inc.,⁷ the Court of Appeals for the Ninth Circuit recognized an implied private cause of action for violations of Rule 10b-16 and required proof of scienter as a prerequisite to recovery of damages.⁸

In *Robertson*, the plaintiff-investor (Robertson) purchased treasury bonds on margin⁹ through his broker Dean Witter Reynolds, Inc. (Dean Witter).¹⁰ As interest rates rose, the value of the bonds, which represented the collateral for Dean Witter's loan, fell.¹¹ To secure its loan, Dean Witter made several requests for additional collateral over a period of seven months.¹² When Robertson failed to meet these margin calls, Dean Witter sold the bonds to satisfy its outstanding loan, and Robertson suffered a substantial loss.¹³ Claiming that his loss was caused by Dean Witter's failure to disclose the conditions on which credit was extended to him,¹⁴ Robertson brought suit alleging violations of sec-

Zerman v. Ball, 735 F.2d 15, 23 (2d Cir. 1984); Greenblatt v. Drexel Burnham Lambert, Inc., 763 F.2d 1352, 1358 (11th Cir. 1985). Three district courts have failed to reach a conclusion for the same reason. See Nick v. Shearson/American Express, Inc., 612 F. Supp. 15, 18 & n.3 (D. Minn. 1984); Steinberg v. Sherson Hayden Stone, Inc., 546 F. Supp. 699, 700 (D. Del. 1982); Stephens v. Reynolds Secs., Inc., 413 F. Supp. 50, 52 (N.D. Ala. 1976). One district court has found that an implied private cause of action does not exist under Rule 10b-16. See Furer v. Paine, Webber, Jackson & Curtis, Inc., [1982 Transfer Binder] FED. SEC. L. REP. ¶ 98,701, at 93,495 (C.D. Cal. 1982).

⁷ 749 F.2d 530 (9th Cir. 1984).

⁸ *Id.* at 534, 539-41.

⁹ *Id.* at 533; see *supra* note 1.

¹⁰ *Robertson*, 749 F.2d at 532-33. In *Robertson*, the plaintiff (Robertson) opened a brokerage account on Aug. 15, 1980. *Id.* On Jan. 22, 1981, Robertson purchased margin treasury bonds with a face value of \$500,000 for \$367,138 by paying \$36,714 down. *Id.* at 533. The treasury bonds in question were substantially discounted from their face value because interest rates had risen since their issuance. *Id.*

¹¹ *Id.* at 533; see *supra* note 1.

¹² *Robertson*, 749 F.2d at 533; see *supra* note 1.

¹³ *Robertson*, 749 F.2d at 533. Robertson incurred a loss exceeding \$149,000, including his \$36,714 down payment, \$76,753 paid in interest charges to Dean Witter, and \$36,000 paid to reduce the principal of his debt. *Id.*

¹⁴ *Id.* at 533. The *Robertson* court tacitly accepted the allegation that the failure of Dean Witter to disclose credit information caused the loss of Robertson's investment in the bonds. See *id.* at 533-41. In securities cases where the defendant has an obligation to disclose information but fails to do so, the causal connection between nondisclosure and the injury can be established by showing that the information withheld was material. See *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972). A fact is material when a reasonable investor would have considered it important in deciding whether to invest. See *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 446-49 (1976). By violating the specific disclosure requirements of Rule 10b-16, Dean Witter withheld information that Congress and the SEC determined investors needed to know to intelligently select a broker for a credit transaction. See SEC Release No. 34-8773 (December 16, 1969), 34 Fed. Reg. 19,717,

tion 10(b) of the Securities Exchange Act of 1934 (Exchange Act)¹⁵ and SEC Rule 10b-16.¹⁶ The district court dismissed the suit for failure to state a claim upon which relief could be granted.¹⁷ On appeal, the Ninth Circuit reversed.¹⁸

Writing for a unanimous court, Judge Nelson employed a two-step analysis¹⁹ determining first that the SEC was congressionally authorized to establish rules implying a private cause of action under section 10(b) of the Exchange Act,²⁰ and that Rule 10b-16 was drafted such that the private right of action in section 10(b) could legitimately be implied into the Rule.²¹ The Court of Appeals for the Ninth Circuit rejected Robertson's argument that the necessary congressional intent for an implied right of action is in the TILA, and held that the proper source of statutory authority is section 10(b) of the Exchange Act.²² The court declared that the existence of an implied cause of action under section 10(b) is "well-established"²³ and that Congress gave the SEC broad authority to promulgate rules pursuant to section 10(b).²⁴ The court reasoned

19,717 (1969) [hereinafter cited as SEC Release]. Therefore, mere violation of the specific disclosure requirements of Rule 10b-16 is sufficient to establish materiality and thereby causation. See *Slomiak v. Bear Stearns & Co.*, 592 F. Supp. 676, 683 (S.D.N.Y. 1984). See generally Comment, *Securities Fraud—Proof of Causation in 10b-5 Nondisclosure Cases Involving Trading on Impersonal Markets*, 30 VAND. L. REV. 122, 125-26 (1976) (presumption in nondisclosure cases that causation is shown is undisclosed information is material).

¹⁵ 15 U.S.C. § 78j(b) (1982).

¹⁶ 17 C.F.R. § 240.10b-16 (1986); *Robertson*, 749 F.2d at 533.

¹⁷ *Robertson*, 749 F.2d at 532. "A complaint may be dismissed as a matter of law for two reasons: [1] lack of a cognizable legal theory, or [2] insufficient facts under a cognizable legal claim." 2A J. MOORE, MOORE'S FEDERAL PRACTICE ¶ 12.08 at 2271 (2d ed. 1982). Robertson exposed himself to dismissal on both grounds by asserting that Rule 10b-16 provides an implied cause of action, and by failing to plead facts alleging scienter. See *Robertson*, 749 F.2d at 534. The district court did not indicate whether the dismissal was based on lack of a private cause of action or the failure to plead scienter; to prevent an immediate successive appeal by either party, therefore, the Ninth Circuit addressed both issues. *Id.*

¹⁸ See *Robertson*, 749 F.2d at 534.

¹⁹ *Id.* at 534; see *infra* notes 43-46 and accompanying text.

²⁰ See *Robertson*, 749 F.2d at 534-36.

²¹ See *id.* at 536-39.

²² See *id.* at 534-35.

²³ *Id.* at 535; see *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 n.10 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976); *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971).

²⁴ 749 F.2d at 536. Section 10(b) proscribes the "contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b) (1982); see *infra* note 47 (§ 10(b) set forth). Section 23(a) grants the SEC "power to make such rules and regulations as may be necessary or appropriate to implement the provisions of this chapter . . . or for the execution of the functions vested in [the SEC] by this chapter . . ." Securities Exchange Act of 1934, §

that although a private remedy under section 10(b) is implied on the basis of judicial construction rather than congressional intent,²⁵ such remedy should be implied into rule 10b-16 because the rule is reasonably related to the anti-fraud goals of section 10(b).²⁶

The *Robertson* court held that the pleadings of a plaintiff could not be complete without an allegation of scienter.²⁷ Judge Nelson declared that the rationale of *Ernst & Ernst v. Hochfelder*,²⁸ in which the Supreme Court held that plaintiffs who brought private actions under section 10(b) and Rule 10b-5 must allege scienter,²⁹ "requires us to hold that pleading scienter is requisite to maintaining an action brought pursuant to Rule 10b-16."³⁰ While the court recognized that requiring scienter in actions based on the disclosure standards of Rule 10b-16 might undercut the effectiveness of the margin disclosure regulation,³¹ it nonetheless maintained that the resolution of such inequalities was beyond judicial power.³²

Although the Ninth Circuit determined that an implied cause of action is available to margin investors suffering losses as a result

23a, 15 U.S.C. § 78w(a)(1) (1982). The authority of the SEC to adopt rules and regulations necessary for the execution of its functions has been interpreted as "broad." See *Commercial Capital Corp. v. SEC*, 360 F.2d 856, 857 (7th Cir. 1966); see also *Hooper v. Mountain States Sec. Corp.*, 282 F.2d 195, 202 (5th Cir. 1960) (suggestion that SEC has broad authority to regulate under section 10(b)), *cert. denied*, 365 U.S. 814 (1961).

²⁵ See *Robertson*, 749 F.2d at 536. An implied right of action under section 10(b) was first recognized in *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 513-14 (E.D. Pa. 1946). By 1969, this implied cause of action, and specifically Rule 10b-5, had been recognized by ten of the eleven courts of appeals. 6 L. LOSS, *SECURITIES REGULATION* 3871-73 (2d ed. 1961 & Supp. 1969). The Supreme Court continued the application of an implied cause of action under section 10(b) and Rule 10b-5 without extended discussion. See *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971). The Court has consistently reaffirmed this position as "well established." See, e.g., *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976) (existence of private cause of action for violations of Rule well settled).

²⁶ See *Robertson*, 749 F.2d at 539; *Abeles v. Oppenheimer & Co.*, 597 F. Supp. 532, 536 (N.D. Ill. 1983). But see *infra* notes 54-65 and accompanying text.

²⁷ See *Robertson*, 749 F.2d at 541.

²⁸ 425 U.S. 185 (1976).

²⁹ *Id.* at 194-214. See generally Note, *Scienter's Scope and Application in Rule 10b-5 Actions: An Analysis in Light of Hochfelder*, 52 NOTRE DAME LAW. 925 (1977) (examining import and suggesting appropriate treatment of scienter standard enunciated by *Hochfelder* on private suits seeking damages or SEC injunctions).

³⁰ *Robertson*, 749 F.2d at 540.

³¹ See *id.*; Note, *SEC Rule 10b-16 and the Regulation of Margin Credit*, 87 YALE L.J. 372, 384-94 (1977) [hereinafter cited as *Margin Credit*]; Comment, *SEC Rule 10b-16—District of Columbia Circuit Limits Margin Call Disclosure By Broker-Dealers*—Liang v. Dean Witter & Co., 51 N.Y.U. L. REV. 1050, 1066-76 (1976).

³² See *Robertson*, 749 F.2d at 541.

of inadequate disclosure of credit terms, the court's conclusion that section 10(b) of the Exchange Act provides the basis for an implied remedy unduly limits the availability of such relief for injured investors. It is asserted that an analysis originating from section 10(b) of the Exchange Act mistakenly permits courts to infuse that section's judicially created scienter requirement into an implied 10b-16 nondisclosure action. Such an infusion frustrates the congressional mandate to ensure disclosure in securities margin transactions. This Comment will suggest that the TILA, not section 10(b) of the Exchange Act, provides the congressional intent supporting a private remedy under Rule 10b-16, and therefore the plaintiff should not be required to alleged scienter.

APPROPRIATENESS OF SECTION 10(B) AS THE BASIS FOR SECURITIES MARGIN NON-DISCLOSURE ACTIONS

The judicial standard for finding an implied cause of action³³ within a federal statute was enunciated by a unanimous Supreme Court in *Cort v. Ash*.³⁴ Restraining a previously expansive trend,³⁵ the Court articulated four factors relevant to determining whether an implicit cause of action should exist.³⁶ The Supreme Court has

³³ See *Cannon v. University of Chicago*, 441 U.S. 677, 730 n.1 (1979) (Powell, J., dissenting). A private cause of action has been defined as "the right of a private party to seek judicial relief from injuries caused by another's violation of a legal requirement. *Id.* In the context of legislation enacted by Congress, the legal requirement involved is a statutory duty." *Id.*

³⁴ 422 U.S. 66 (1975). In *Cort*, stockholders brought a derivative suit against the corporate directors of Bethlehem Steel Corp. and sought an implied right of action under section 610 of the Federal Elections Law, 18 U.S.C. § 610 (1970 & Supp. III 1973) (repealed 1976), which prohibited corporations from making contributions or expenditures in connection with certain federal elections. *Cort*, 422 U.S. at 68-74. Holding that no implied remedy existed, *id.* at 68-69, the Supreme Court sought to delineate the appropriate standard for implying a private cause of action. See *id.* at 78; Steinberg, *Implied Private Right of Action Under Federal Law*, 12 SEC. L. REV. 433, 434 (1980); Note, *Confusing Signals from the Burger Court: Judicial Refinement of Private Causes of Action*, 16 TULSA L.J. 91, 98 (1980).

³⁵ See Greene, *Judicial Implication of Remedies for Federal Statutory Violations: The Separation of Powers Concerns*, 16 TEMP. L.Q. 469, 478 (1981). For cases reflecting an expansive analysis, see, e.g., *Allen v. State Bd. of Elections*, 393 U.S. 544, 556-57 (1969) (§ 5 of the Voting Rights Act of 1965); *Wyandotte Transp. Co. v. United States*, 389 U.S. 191, 204 (1967) (§ 15 of the Rivers and Harbors Act of 1899); *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964) (§ 14(a) of the Securities Exchange Act of 1934).

³⁶ See *Cort*, 422 U.S. at 78. The four factors are:

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

recently applied an even more restrictive approach toward implied causes of action³⁷ and has virtually relegated the *Cort* factors to mere guidelines³⁸ used to reach the dispositive question of "whether Congress *intended* to create [a] private right of action."³⁹ The *Robertson* court utilized a two-step inquiry to ascertain whether Congress intended to create an implied remedy for violations of Rule 10b-16.⁴⁰ Enunciated by the District of Columbia Cir-

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?

Id. (citations omitted).

Although it is not necessary to satisfy all four *Cort* factors, *see* *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 388 (1982), it is submitted that the four factors are met when Rule 10b-16 is violated. First, Rule 10b-16 was clearly created for the "especial benefit" of persons, such as *Robertson*, who purchased securities on margin from federally registered brokers. *See* SEC Release, *supra* note 14, at 19,717. Second, while explicit indicators of legislative intent do not negate an implied right of action, *see* H.R. REP., *supra* note 3; S. REP., *supra* note 3, implicit indicators strongly suggest a congressional intent to create a private remedy. *See* *Haynes v. Anderson & Strudwick, Inc.*, 508 F. Supp. 1303, 1320-21 (E.D. Va. 1981); *infra* notes 68-69 and accompanying text. Third, implication of a private right of action is consistent with the legislative scheme of the TILA. *See* 15 U.S.C. §§ 1635, 1640 (1982); *cf.* *Haynes*, 508 F. Supp. at 1319 ("the [TILA] and the Rule should be read in harmony, if at all possible"). It is also consistent with the legislative scheme of the federal securities acts to imply a private right of action. *See, e.g.*, *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983) ("[i]n addition to the private actions created explicitly by the 1933 and 1934 Acts, federal courts have implied private remedies under other provisions of the two laws."); *J.I. Case Co. v. Borak*, 377 U.S. 426, 431-35 (1964) (private cause of action implied under § 14(a) of the 1934 Act); *Dan River, Inc. v. Unitex, Ltd.*, 624 F.2d 1216, 1222-24 (4th Cir. 1980) (private cause of action implied under section 13(d) of the 1934 Act), *cert. denied*, 449 U.S. 1101 (1981). Fourth, the TILA and the federal securities acts were created by Congress to fill specific needs previously unmet by state regulation, one of which was the disclosure of credit terms in connection with federal securities transactions. *See* S. REP. *supra* note 3, at 1-3; H.R. REP. *supra* note 3, at 8-9, 13; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194-95 (1976).

³⁷ *See* *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979); *Cannon v. University of Chicago*, 411 U.S. 677, 698 (1979); Note, *Implied Private Rights of Action Under Federal Statutes: Congressional Intent, Judicial Deference, or Mutual Abdication?*, 50 *FORDHAM L. REV.* 611, 629 (1982); Comment, *Implied Rights of Action In Federal Legislation: Harmonization with the Statutory Scheme*, 1980 *DUKE L.J.* 928, 929-39.

³⁸ *Cf.* *California v. Sierra Club*, 451 U.S. 287, 302 (1980) (Rehnquist, J., concurring). Four justices have agreed that "the so-called *Cort* factors are merely guides in the central task of ascertaining legislative intent." *Id.*

³⁹ *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979) (emphasis added); *see also* *Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. 11, 15-16 (1979) ("what must ultimately be determined is whether Congress intended to create the private remedy asserted"); *Maher, Implied Private Rights of Action and the Federal Securities Laws: A Historical Perspective*, 37 *WASH. & LEE L. REV.* 783, 804-08 (1980) (discussing the effect of *Touche Ross* and *Transamerica on Cort*).

⁴⁰ *Robertson*, 749 F.2d at 534. Because the rule was not enacted directly by Congress,

cuit in *Jablon v. Dean Witter & Co.*,⁴¹ the bifurcated test requires a court to determine “(1) whether Congress intended to delegate authority to establish rules implying a private right of action; [and] (2) whether the . . . rules were drafted such that a private action may legitimately be implied.”⁴² It is submitted that the components of the *Jablon* test were misstated and misapplied by the *Robertson* court, thus rendering its reasoning and result erroneous.

The *Robertson* court did not correctly state the first prong of the *Jablon* test as “whether Congress *intended to delegate* authority to establish [a rule] implying a private right of action,”⁴³ but rather misstated the test as “whether Congress *delegated* authority to establish [a rule] implying a private right of action.”⁴⁴ Premising the inquiry in this manner, the *Robertson* court confused the fundamental question of congressional intent to permit a private action for violations of margin disclosure rules⁴⁵ with the SEC’s authority to issue Rule 10b-16.⁴⁶ Unquestionably, Congress intended that the SEC promulgate rules to supplement section 10(b) of the Exchange Act,⁴⁷ but congressional intent to provide disclosure of

but by the SEC acting on authority delegated by Congress, the *Robertson* court used the *Jablon* consideration. See *infra* notes 41-42 and accompanying text. The existence of a cause of action derived from a federal statute is a question of statutory construction. See *Touche Ross v. Redington*, 442 U.S. 560, 568 (1979); *Cannon v. University of Chicago*, 441 U.S. 677, 688 (1979). Since Rule 10b-16 is not a statute but a rule promulgated pursuant to a statute, a two-step analysis was necessary. See *Robertson*, 749 F.2d at 536.

⁴¹ 614 F.2d 677, 679 (9th Cir. 1980). The *Jablon* court considered whether a private right of action could be implied from stock exchange rules enacted by an exchange acting on a congressional delegation of authority. *Id.* See generally Note, *Securities—Private Right of Action Under Stock Exchange Rules—Jablon v. Dean Witter & Co.*, 1981 ARIZ. ST. L.J. 337, 346-52 (discussing the *Jablon* Court’s analysis).

⁴² *Jablon*, 614 F.2d at 679.

⁴³ *Id.* (emphasis added).

⁴⁴ *Robertson*, 749 F.2d at 534 (emphasis added).

⁴⁵ See *supra* note 42 and accompanying text.

⁴⁶ See *Robertson*, 749 F.2d at 535.

⁴⁷ See 15 U.S.C. § 78j(b) (1982). Section 10(b) states:

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—

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a securities national exchange or any security not so registered, any manipulative or deceptive device or contrivance *in contravention of such rules and regulations as the Commission may prescribe* as necessary or appropriate in the public interest or for the protection of investors.

Id. (emphasis added).

securities margin credit terms is not found within section 10(b). Congress intended that a securities margin disclosure rule analogous to the TILA regulations be enacted,⁴⁸ but allowed the SEC discretion to choose an appropriate power base.⁴⁹ After Congress exempted securities margin disclosures from TILA,⁵⁰ the SEC chose section 10(b) and the general regulatory power under section 23(a) of the Exchange Act⁵¹ as the authority under which to issue Rule 10b-16.⁵²

Allowing congressional intent for an implied cause of action to be derived from a power base selected by the SEC would permit the intent of Congress to vacillate according to the choice made by the SEC.⁵³ Therefore, it is submitted that the Ninth Circuit improperly concluded that the congressional intent necessary to imply a private cause of action is found in section 10(b) of the Exchange Act.

The *Robertson* court next considered the second prong of the *Jablon* test,⁵⁴ determining whether Rule 10b-16 "was drafted such that [a] private action may legitimately be implied."⁵⁵ Accepting

⁴⁸ See S. REP. *supra* note 3, at 9; SEC Release *supra* note 14, at 19,717; *Margin Credit*, *supra* note 33, at 391 n.71; Comment, *supra* note 31, at 1059-60; see also *Haynes v. Anderson & Strudwick, Inc.*, 508 F. Supp. 1303, 1320 (E.D. Va. 1981) (since Rule 10b-16 was promulgated as the analogue of TILA, court should be guided by whether Congress created a private right of action under TILA in determining whether a private right of action should be implied under Rule 10b-16). But see *Furer v. Paine, Webber, Jackson & Curtis, Inc.*, [1982 Transfer Binder] FED. SEC. L. REP. CCH ¶ 98,701 at 93, 495 (C.D. Cal. 1982); *Abeles v. Oppenheimer & Co.*, 597 F. Supp. 532, 536 (N.D. Ill. 1983). The Senate Report stated: "In recommending an exemption for stockbroker margin loans in the [TILA], the Committee intends for the SEC to require *substantially similar* disclosure by regulation as soon as it is possible to issue such regulation." S. REP. *supra* note 3, at 9 (emphasis added).

⁴⁹ See S. REP. *supra* note 3, at 9. The Senate Report stated that "[t]he committee has been informed by the Securities and Exchange Commission that the Commission has adequate regulatory authority under the Securities Exchange Act of 1934 to require adequate disclosure of the costs of such credit." *Id.* The Senate Report also stated that the "SEC already has the power to require margin disclosure under the 1933 Securities Act." *Id.* at 22. Additionally, the House Report indicated that the SEC's authority to issue a margin disclosure regulation was embodied in the 1933 Act, not section 10(b) of the 1934 Act. See H.R. REP. *supra* note 3, at 28 ("the SEC is authorized to require disclosure as to [margin] transactions under the Securities Act of 1933").

⁵⁰ See Consumer Credit Protection Act § 104, 15 U.S.C. § 1603(2) (1982).

⁵¹ 15 U.S.C. § 78w (1981).

⁵² See SEC Release, *supra* note 14, at 19,717.

⁵³ See *Robertson*, 749 F.2d at 535; *supra* notes 48-52 and accompanying text; *infra* notes 54-57 and accompanying text.

⁵⁴ See *Jablon v. Dean Witter & Co.*, 614 F.2d 677, 679 (9th Cir. 1980); *supra* notes 41-43 and accompanying text.

⁵⁵ *Robertson*, 749 F.2d at 534.

arguendo the court's determination that section 10(b) is the proper source of the congressional intent for securities margin disclosure rules with an implied private remedy,⁵⁶ it is submitted that Rule 10b-16 was not drafted so that a cause of action under section 10(b) may legitimately be implied into it. Section 10(b) is a "catch-all" anti-fraud statute designed to prohibit knowing and intentional misconduct.⁵⁷ Rule 10b-16, however, is a mechanical disclosure provision designed to protect and inform investors.⁵⁸ The *Robertson* court affixed an anti-fraud statute cause of action to a disclosure rule because it determined that fraud prevention and disclosure were reasonably related goals.⁵⁹ Admittedly, the promotion of disclosure helps prevent fraud,⁶⁰ but it is suggested that the *Robertson* court's action was illegitimate in a section 10(b) context. The language used by Congress in section 10(b)⁶¹ necessitates a re-

⁵⁶ *Id.* at 535.

⁵⁷ *Id.* at 538 (quoting *Chiarella v. United States*, 445 U.S. 222, 234-35 (1980)). See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1975); Siegel, *The Interplay Between the Implied Remedy Under Section 10(b) and the Express Causes of Action of the Federal Securities Laws*, 62 B.U.L. Rev. 385, 385 (1982); Note, *Establishment of Liability for Aiding and Abetting Fraud Under Rule 10b-5 and the Common Law*, 25 UCLA L. Rev. 862, 862 (1978); Comment, *Section 10(b)—All That Is Unfair Is Not Fraud: Sante Fe Industries, Inc. v. Green*, 19 B.C.L. Rev. 939, 949-51 (1978); *supra* note 47 (section 10(b) set forth in pertinent part).

⁵⁸ SEC Release, *supra* note 14, at 19,717; see *Robertson*, 749 F.2d at 539; *Liang v. Dean Witter & Co.*, 540 F.2d 1107, 1113 (D.C. Cir. 1976); *Steinberg v. Shearson Hayden Stone, Inc.*, 546 F. Supp. 699, 700 (D. Del. 1982). The SEC Release stated:

The Rule requires an initial disclosure and periodic disclosures. The initial disclosure is designed to insure that the investor, before his account is opened, understands the terms and conditions under which credit charges will be made. This will enable him to compare the various credit terms available to him and to understand the methods used in computing the actual credit charges. The periodic statement will inform the investor of the actual cost of credit and, with the aid of the initial disclosure, enable him to accurately assess that cost.

SEC Release, *supra* note 14, at 19,717.

⁵⁹ *Robertson*, 749 F.2d at 539. Having found § 10(b) to be the proper basis for implication of a private right of action, *id.* at 535, the *Robertson* court reasoned that it need only review Rule 10b-16 to determine whether it was reasonably related to the purposes of its enabling statute, also section 10(b). See *id.* at 537; see *Mourning v. Family Pub. Serv. Inc.*, 411 U.S. 356, 359 (1973); *American Hosp. Management Corp. v. Harris*, 638 F.2d 1208, 1212 (9th Cir. 1981).

⁶⁰ See *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972); *O'Brien v. Continental Ill. Nat'l. Bank & Trust Co.*, 593 F.2d 54, 60 (7th Cir. 1979); *Arber v. Essex Wire Corp.*, 490 F.2d 414, 418 (6th Cir. 1974); *Dooley, Enforcement of Insider Trading Restriction*, 66 VA. L. Rev. 1, 62-63 (1980); Comment, *supra* note 57, at 949-58.

⁶¹ 15 U.S.C. § 78j(b) (1982). Section 10(b) states in pertinent part that: "It shall be unlawful . . . to use or employ . . . any manipulative or deceptive device or contrivance"; see also *supra* note 47 (§10(b) in greater detail).

quirement of scienter for an implied section 10(b) action.⁶² However, this strong anti-fraud language is manifestly absent from Rule 10b-16,⁶³ suggesting that Rule 10b-16 was not narrowly designed to thwart only manipulative and fraudulent conduct, but was broad in scope so as to encompass conduct that unintentionally causes harm.⁶⁴ Allowing an antifraud provision to act as the touchstone for a nondisclosure action illogically encumbers the remedy with a scienter burden, thereby frustrating the congressional purpose behind the margin disclosure provision.⁶⁵

THE TILA AS THE PROPER SOURCE OF CONGRESSIONAL INTENT

The TILA gives consumers an express right of action for non-disclosure of credit terms.⁶⁶ Since Congress intended the securities margin disclosure rules to be "substantially similar" to the TILA disclosure provisions,⁶⁷ it is suggested that the congressional intent behind the TILA should be utilized to imply a private cause of action for violations of Rule 10b-16.⁶⁸ This would demonstrate that Congress intended to delegate authority to the SEC to establish a securities margin disclosure rule implying a private right of action,⁶⁹ and that a disclosure rule like Rule 10b-16 could be drafted such that a private cause of action could legitimately be implied from the TILA.⁷⁰

⁶² Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197-99 (1976). The Court stated: "The words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct." *Id.* at 197.

⁶³ See 17 C.F.R. § 240.10b-16 (1985); *supra* note 2 (Rule 10b-16 set forth in pertinent part).

⁶⁴ See Steinberg v. Shearson Hayden Stone, Inc., 546 F. Supp. 699, 700-01 (D. Del. 1982); *infra* notes 67-69.

⁶⁵ See *Margin Credit*, *supra* note 31, at 376, 387, 390 n.66; Comment, *supra* note 31 at 1079.

⁶⁶ See *supra* note 4 and accompanying text.

⁶⁷ See S. REP., *supra* note 3, at 9; *supra* note 48 and accompanying text.

⁶⁸ See Liang v. Dean Witter & Co., 540 F.2d 1107, 1110-13 & 1113 n.4 (D.C. Cir. 1976); Angelastro v. Prudential-Bache Sec., Inc., 575 F. Supp. 270, 274 (D.N.J. 1983); Steinberg v. Shearson Hayden Stone, Inc., 546 F. Supp. 699, 701 n.4 (D. Del. 1982). *But see* Slomiak v. Bear Stearns & Co., 597 F. Supp. 676, 678-81 (S.D.N.Y. 1984); Abeles v. Oppenheimer & Co., 597 F. Supp. 532, 535-36 (N.D. Ill. 1983); Furer v. Paine, Webber, Jackson & Curtis, Inc., [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,701 at 93,495 (C.D. Cal. 1982).

⁶⁹ See *supra* notes 47-52 and accompanying text.

⁷⁰ See *supra* notes 66-68 and accompanying text.

THE SCIENTER REQUIREMENT

Relying on the Exchange Act and the *Hochfelder* decision, the *Robertson* court erroneously required scienter as a necessary element of an implied cause of action under Rule 10b-16.⁷¹ While Rule 10b-5 shares the anti-fraud language and legislative history of section 10(b), and thus warrants a scienter requirement, Rule 10b-16 shares neither the language nor the legislative history of section 10(b).⁷² Moreover, the concerns that prompted the *Hochfelder*

⁷¹ See *Robertson*, 749 F.2d at 539-41. Drawing from *Hochfelder*, the *Robertson* court based its Rule 10b-16 scienter requirement on the structure of the Securities Act of 1933 and the Exchange Act of 1934, noting that in each instance in which Congress had expressly created a civil remedy, it also specified the standard of liability. *Id.* at 540. See *Hochfelder*, 425 U.S. at 208-10. Therefore, the *Robertson* court reasoned, applying section 10(b) to merely negligent conduct ignores the fact that "when Congress intended to accomplish that result, it did so expressly, and subjected these actions to procedural restrictions not found under section 10(b)." See *Robertson*, 749 F.2d at 540; *Hochfelder*, 425 U.S. at 206-11. However, when Congress intended a scienter standard under the securities laws, it also specifically provided for such. See *Hochfelder*, 425 U.S. at 207-08. Therefore, this specificity-of-standards argument becomes a two-edged sword that can be used to preclude a scienter standard, as well as a negligence standard, for an implied cause of action under section 10(b). See Bucklo, *The Supreme Court Attempts to Define Scienter Under Rule 10b-5: Ernst & Ernst v. Hochfelder*, 29 STAN. L. REV. 213, 225 (1977). Because Congress did not provide an express remedy in section 10(b), the procedural context of the remedies it did expressly consider gives little insight into the extent of the section 10(b) duty. See Comment, *Securities Law—Private Cause of Action for Damages Under Rule 10b-5 Requires Scienter—Ernst & Ernst v. Hochfelder*, 25 EMORY L.J. 465, 467-68 (1976).

⁷² Compare 17 C.F.R. § 240.10b-5 (1985) with 15 U.S.C. §78j(b) (1982). Rule 10b-5 states in pertinent part:

Employment of manipulative and deceptive devices.

It shall be unlawful . . .

(a) *To employ any device, scheme, or artifice to defraud,*

(b) *To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or*

(c) *To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.*

17 C.F.R. § 240.10b-5 (1985) (emphasis added). See *supra* note 47 (section 10(b) set forth in pertinent part). While there is a "dearth of evidence" in legislative history concerning the congressional intent behind section 10(b), see 1 A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10B-5, § 2.2 (331) at 22.2 (1975), the pertinent legislative history that exists demonstrates a commonality between section 10(b) and Rule 10b-5. See *Hochfelder*, 425 U.S. at 201-06; S. REP. NO. 792, 73d Cong., 2d Sess. 7-9 (1934); H.R. REP. NO. 1383, 73d Cong., 2d Sess. 10-11, 20-21 (1934); H.R. CONF. REP. NO. 1838, 73d Cong., 2d Sess. 32-33 (1934); *Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934); see also SEC Exchange Act Release No. 3230 (May 21, 1942) (Rule 10b-5 expanded to include all individuals and companies within anti-fraud rules that theretofore applied only to brokers and dealers). See generally Berner & Franklin, *Scienter and Securities and Exchange Commission Rule 10b-5 Injunctive Actions: A*

court to impose a scienter requirement under section 10(b) and Rule 10b-5—that unless the scope of section 10(b) was limited to knowing or intentional misconduct, actions for negligence could be brought under section 10(b) rather than under the more limited express remedy provisions of the securities acts, undermining the overall effectiveness of the securities laws⁷³—are not present in a Rule 10b-16 situation. Because Rule 10b-16 is purely a “mechanical rule” that “sets forth objectives and specific disclosure requirements for credit terms in margin transactions,”⁷⁴ it is submitted that no interference with the comprehensive enforcement scheme of the securities acts will arise if scienter is not imposed under Rule 10b-16. Finally, when Rule 10b-16 was promulgated, there was no scienter requirement in actions brought under section 10(b).⁷⁵ Therefore, it cannot be argued that Congress or the SEC intended to make scienter a requirement in actions under Rule 10b-16.

CONCLUSION

The availability of an implied cause of action for a violation of Rule 10b-16 insures complete disclosure in margin securities transactions and fosters informed investment. While the essential question is whether Congress intended that the courts create a private remedy, the *Robertson* court mistakenly found the requisite congressional intent in section 10(b) of the Exchange Act. However, by deriving the intent of Congress from the TILA, as this Comment has suggested, the obtrusive requirement of scienter would be eliminated and the underlying purpose of Rule 10b-16 would be more effectively promoted.

Thomas G. Seaman

Reappraisal in Light of Hochfelder, 51 N.Y.U. L. REV. 769, 777 (1976) (language and history of Rule 10b-5 strongly support scienter conclusion).

⁷³ See *Hochfelder*, 425 U.S. at 208-11; Note, *The Scienter Requirement in SEC Injunctive Enforcement of Section 10(b) After Ernst & Ernst v. Hochfelder*, 77 COLUM. L. REV. 419, 422-24 (1977); 969 (1976); Note, *Civil Liability Under Section 10(b) and Rule 10b-5—The Scienter Requirement*, 51 TUL. L. REV. 177, 182-83 (1976); Comment, *Scienter Is Required in a Private Action Under Rule 10b-5—Ernst & Ernst v. Hochfelder*, 25 DE PAUL L. REV. 962, 969 (1976).

⁷⁴ *Steinberg v. Shearson Hayden Stone, Inc.*, 546 F. Supp. 699, 700 (D. Del. 1982).

⁷⁵ See SEC Release, *supra* note 14, at 19,717. Rule 10b-16 was promulgated on December 16, 1969. *Id.* The Supreme Court determined that scienter is a necessary element of a section 10(b) action in 1976. See *Hochfelder*, 425 U.S. at 193 (1976).