St. John's Law Review

Volume 52, Winter 1978, Number 2 Article 15

Implied Private Right of Action Recognized Under the Investment Advisers Act (Abrahamson v. Fleschner)

Denise M. Dalton

SECURITIES LAW

IMPLIED PRIVATE RIGHT OF ACTION RECOGNIZED UNDER THE INVESTMENT ADVISERS ACT

Abrahamson v. Fleschner

Statutory enactments in many instances do not contain express provisions authorizing or prohibiting private damage actions as a means of enforcement. Courts have often recognized implied private rights of action, however, in order effectively to implement the spirit and policy of particular legislation.[1] The Investment Advisers Act of 1940,[2] one phase in a series of securities legislation,[3] was enacted "to protect the public from the frauds and misrepresentations of

[1] The Supreme Court first recognized an implied private right of action in Texas & Pac. Ry. v. Rigsby, 241 U.S. 33 (1916). The case involved a claim brought under the Federal Safety Appliance Acts, Act of March 2, 1893, Pub. L. No. 196, 27 Stat. 531, *as amended by* Act of March 2, 1903, Pub. L. No. 976, 32 Stat. 943, *and* Act of April 14, 1910, Pub. L. No. 160, 368 Stat. 298. The plaintiff in *Rigsby* sought damages for personal injuries incurred in a fall caused by a defect in the ladder of one of defendant's railroad cars. The Safety Appliance Acts required that each car be equipped with secure ladders and handgrips. Despite the absence of any express provision in the Act for a private right of action, the *Rigsby* Court found that since "[a] disregard of . . . the statute [was] a wrongful act, and . . . result[ed] in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages . . . [was] implied." 241 U.S. at 39. The implied-right-of-action doctrine has been invoked in numerous situations in order to afford injured parties just and adequate compensation and to effectuate legislative intent. *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971); J.I. Case Co. v. Borak, 377 U.S. 426 (1964); Note, *Federal Jurisdiction in Suits for Damages Under Statutes not Affording Such Remedy*, 48 COLUM. L. REV. 1090 (1948), wherein it is stated that "[t]he most satisfactory rationale of such assumption of jurisdiction . . . is found in the general proposition that federal courts have the power to afford all remedies necessary to the vindication of federal substantive rights defined in statutory and constitutional provisions, except where Congress has explicitly indicated that such remedy is not available." *Id.* at 1094. *See also* 2A J. SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 54.05, at 359 (4th ed. C. Sands 1973).

In considering whether a private action should be recognized under a particular enactment, the courts must often look beyond the statutory language to determine the underlying policy of the legislation. *See id.* § 48.04, at 197:

> [T]he history of events transpiring during the process of enacting [a statute] . . . has generally been the first extrinsic aid to which courts have turned in attempting to construe an ambiguous act. . . . Contemporary history also includes information concerning the activities of pressure groups, economic conditions in the country during times when the legislation in question was under consideration, prevailing business practices, and the prior state of the law . . . .

Id. (footnotes omitted). *See also* E. CRAWFORD, THE CONSTRUCTION OF STATUTES § 172, at 273 (1940).

[2] 15 U.S.C. §§ 80b-1 to -21 (1970 & Supp. V 1975).

[3] *See* Dean, *Twenty-five Years of Federal Securities Regulation by the Securities and Exchange Commission*, 59 COLUM. L. REV. 697 (1959) [hereinafter cited as Dean], in which the author examined the inception and development of the various federal securities acts.

unscrupulous tipsters and touts . . . by making fraudulent practices by investment advisers unlawful."[4] The language of the 1940 enactment contained ambiguities concerning not only the type of conduct proscribed, but also the available mechanisms for enforcement.[5] Subsequent amendments filled certain of the Act's interstices.[6] While injunctive relief is now available in actions brought by the SEC,[7] and a fine or a term of imprisonment may be imposed for an adviser's willful violation of the Act,[8] a client whose adviser has violated the Act is afforded no express statutory right of action for damages directly imputable to the adviser's wrongful conduct. Recently, however, in *Abrahamson v. Fleschner*,[9] the Second Circuit held that an *implied* private right of action for damages exists under the Investment Advisers Act.[10]

The *Abrahamson* plaintiffs were limited partners in an investment partnership,[11] Fleschner Becker Associates (FBA), and the

---

[4] H.R. REP. No. 2639, 76th Cong., 3d Sess. 28 (1940). It was recognized by Congress that the ease of entry and difficulty of evaluation of practitioners in the field of investment advising, together with the relative naivete of the clientele, created a need for regulation in this sector of the securities industry which was particularly compelling. *See* Note, *The Regulation of Investment Advisers*, 14 STAN. L. REV. 827, 831 (1962). Although "[i]t might be argued that anyone who plays the market deserves to be burned, . . . the modern legal trend . . . runs counter to such an approach. The current question is not whether the investor should be protected, but to what extent." *Id.*

[5] *See* Dean, *supra* note 3, at 706. By 1959, "[t]here [had] been no change in the Investment Advisers Act since its original promulgation; and since the SEC [had] very limited powers under it, it [was] relatively unimportant in the over-all picture." *Id.*

[6] Pub. L. No. 86-750, 74 Stat. 885 (1960); Pub. L. No. 91-547, 84 Stat. 1413, 1430 (1970). The Act was substantially amended in 1960 and 1970, giving the law wider coverage and extending the role of the SEC. *See* Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, 74 MICH. L. REV. 308, 310-11 (1975) [hereinafter cited as *Private Causes of Action*]; Note, *The Regulation of Investment Advisers*, 14 STAN. L. REV. 827, 838 (1962).

[7] Investment Advisers Act of 1940, § 209, 15 U.S.C. § 80b-9 (1970) provides in pertinent part:

> (e) Whenever it shall appear to the Commission that any person has engaged . . . in any act . . . constituting a violation of any provision of this subchapter, or of any rule, regulation, or order hereunder, or that any person has aided [or] abetted . . . such a violation, it may in its discretion bring an action in the proper district court . . . to enjoin such acts or practices and to enforce compliance with this subchapter . . . .

[8] Investment Advisers Act of 1940, § 217, 15 U.S.C. § 80b-17 (Supp. V 1975) provides that "[a]ny person who willfully violates any provision of this subchapter, or any rule, regulation, or order promulgated by the Commission under the authority thereof, shall, upon conviction, be fined not more than $10,000, imprisoned for not more than five years, or both."

[9] 568 F.2d 862 (2d Cir. 1977), *aff'g in part and rev'g in part* 392 F. Supp. 740 (S.D.N.Y. 1975).

[10] 568 F.2d at 876.

[11] Limited partnerships formed for the purpose of trading in securities with a view toward capital appreciation are usually called "hedge funds." The term hedge funds is derived from

defendants were the partnership itself, the accounting firm which audited FBA, and the individual general partners of FBA.[12] Prior to the formation of the partnership, the plaintiffs had expressed a concern for financial security and conservatism in their investments. At that time, and repeatedly thereafter, the general partners represented that FBA would maintain a "low risk stance" and a "most conservative posture" in its investments.[13] The partnership's portfolio, however, contained a large percentage of high-risk unregistered securities.[14] After disclosure of the extent of FBA's investment in unregistered securities,[15] the plaintiffs sought to withdraw from the partnership. According to the termination provisions of the partnership agreement, they could withdraw only at the end of a fiscal year and upon proper notice. Since the plaintiffs learned of the unregistered securities soon after the beginning of a new fiscal year, approximately 8 months elapsed before the withdrawal could be effected.[16] During this period, the plaintiffs maintained, their FBA accounts sustained significant losses.[17] Alleging that the defendants fraudulently and willfully concealed FBA's investment in high-risk securities by not revealing these investments in reports furnished all limited partners, the plaintiffs commenced an action

---

the use of short sales and options as hedging devices againt the partnership's heavily leveraged long-term investments. *See* Berkowitz, *Regulation of Hedge Funds,* 2 REV. SEC. REG. 961 (1969), *reprinted in* 1969 SEC. L. REV. 668.

[12] 568 F.2d at 865-66. The original partnership was comprised of one general and eight limited partners. The account of each partner was computed on the basis of the appreciated value of his contributions to the pooled funds, from which withdrawals and certain fees were deducted. Within 3 years of its formation, the partnership had expanded to three general partners and 66 limited partners, and possessed assets amounting to approximately $60 million. *Id.* at 866.

[13] *Id.* In addition to receiving year-end balance sheets and financial reports, all limited partners also received monthly statements which reiterated the firm's conservative investment policy and indicated the increase or decrease in the value of FBA's investments.

[14] *Id.* at 867. The reports furnished the partners for fiscal years 1966, 1967, and 1968, prepared by the defendant accounting firm Goodkin, failed to give any indication to the plaintiffs that FBA had substantial investment in unregistered securities. *Id.* at 866-67.

[15] In either December 1969 or January 1970, plaintiffs received the partnership financial report covering the fiscal year ending September 1969. This report was prepared by a different accounting firm from that which had prepared the reports for previous fiscal years. Plaintiffs were first apprised of the extent of unregistered securities in FBA's portfolio in a footnote contained in this year-end report. *Id.* at 867.

[16] *Id.* Upon giving the required advance notice, any limited partner could make withdrawals from his capital account at the end of any fiscal year. After October 1, 1968, 60 days advance notice was necessary. *Id.* at 866. Since the financial report which disclosed the existence of the unregistered securities covered the fiscal year ending September 30, 1969, plaintiffs did not receive it until December 1969 or January 1970. Therefore, it was too late for them to withdraw at the end of the 1969 fiscal year. *Id.* at 867.

[17] *Id.* The plaintiffs claimed that between September 30, 1968 and the date of their withdrawal from the partnership, they incurred losses of $1,254,800. *Id.*

under the antifraud provisions of the Investment Advisers Act of 1940.[18] The district court dismissed the complaint without determining whether a private damage action may be maintained under the Advisers Act.[19]

---

[18] *Id.* at 865. Investment Advisers Act § 206, 15 U.S.C. § 80b-6 (1970) provides in part:

> It shall be unlawful for any investment adviser by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
>
> (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
>
> . . . .
>
> (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative.

Rule 206(4)-1, 17 C.F.R. § 275.206(4)-1 (1977), promulgated thereunder, prescribes that

> (a) It shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act, for any investment adviser, directly or indirectly, to publish, circulate or distribute any advertisement:
>
> . . . .
>
> (5) Which contains any untrue statement of a material fact, or which is otherwise false or misleading.
>
> (b) For the purpose of this section the term "advertisement" shall include any notice, circular, letter or other written communication addressed to more than one person . . . which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell . . . .

The plaintiffs also sought to recover damages under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970), and rule 10b-5, 17 C.F.R. § 240.10b-5 (1977). Section 10(b) provides in part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> . . . .
>
> (b) To use or employ, *in connection with the purchase or sale of any security* . . . any manipulative or deceptive device or contrivance . . . .

15 U.S.C. § 78j(b) (1970).

The district court had dismissed the Exchange Act claim on the ground that there was "no support for [the] claim that [plaintiffs were] entitled to damages . . . where no loss ha[d] been suffered and where a substantial gain ha[d] in fact been made." 392 F. Supp. at 746-47. The Second Circuit affirmed the dismissal of the Exchange Act claim. The affirmance, however, was not based on plaintiffs' realization of a net profit from their investments; rather it rested upon the ground that the complaint failed to state a claim upon which relief could be granted, since the alleged fraud had not occurred "in connection with the purchase or sale of any security." 568 F.2d at 868; *see* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975). The Supreme Court in *Blue Chip* reaffirmed the doctrine set forth in Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952), that a complaint under § 10(b) must allege fraud "in connection with the purchase or sale of a security," and held that an allegation that plaintiffs were fraudulently induced not to sell their securities does not satisfy that requirement. 421 U.S. at 730-31.

[19] 392 F. Supp. at 750. The thrust of the district court's opinion was that since plaintiffs had realized a net profit in their overall limited partnership investment, they had suffered

A divided Second Circuit reversed the district court, holding that there exists an implied right of action for damages under the statute.[20] Judge Timbers, writing for the majority,[21] applied the four-pronged test utilized by the Supreme Court in *Cort v. Ash*[22] to decide "whether a private remedy is implicit in a statute not expressly providing one . . . ."[23] The *Cort* test requires an examination of whether a private right of action would be consistent with the underlying purposes of the legislative scheme; whether the plaintiff is "one of the class for whose *especial* benefit the statute was created;"[24] whether there is any indication of legislative intent

no damages. *Id.* at 746-47. In addition, the lower court found that plaintiffs would not be entitled to recover the difference between the amount they had actually received and the amount they would have received upon withdrawing earlier, since recoverable damages under the statute are limited to "out of pocket" loss. *Id.* at 747, 749-50. *See* note 18 *supra.*

[20] 568 F.2d at 879. As a threshold issue, the *Abrahamson* court was faced with the question whether the defendants were "investment advisers" as that term is defined in the Advisers Act. *Id.* at 869-70. Section 202(11) of the Act, 15 U.S.C. § 80b-2(a)(11) defines investment adviser as:

> any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities . . . .

This subsection excludes from the definition, among others, banks, lawyers, accountants, engineers, teachers, brokers (insofar as advising is incidental to brokerage), and publishers of bona fide newspapers, news magazines, and financial publications. *See* H.R. REP. No. 2639, 76th Cong., 2d Sess. 27, 28 (1940).

The Second Circuit noted that extensive governmental investigation into the problems and abuses of investment advisory services had culminated in the finding that the elimination of such abuses and problems, which were caused by individuals and companies handling pools of liquid funds or advising the public as to security transactions, could not be achieved without federal legislation. 568 F.2d at 871 (citing S. REP. No. 1775, 76th Cong., 3d Sess. 21 (1940)). Guided by these policy considerations, the *Abrahamson* court held that the defendants fulfilled all criteria set forth in the definition section of the Act so as properly to be classified as investment advisers. 568 F.2d at 870-71. In reaching this determination, the court addressed itself to the question whether defendants were "engage[d] in the business of advising others" with respect to investments within the meaning of the Act. *Id.* at 870. Given the substantial compensation defendants received for managing the limited partners' investments and the heavy reliance the limited partners placed upon defendants' monthly financial reports in determining whether or not to withdraw any or all of their funds, the Second Circuit concluded that defendants' activities clearly were within the ambit of the statute. *Id.*

[21] Judge Timbers authored the majority opinion in which Judge Mansfield concurred. In a separate opinion, Judge Gurfein concurred in the dismissal of the claim based upon § 10(b) of the Securities Exchange Act and dissented from the majority's recognition of an implied private right of action under the Advisers Act.

[22] 422 U.S. 66 (1975).

[23] *Id.* at 78.

[24] *Id.* (citation omitted). The plaintiff stockholder in *Cort* sought damages and injunctive relief against the corporate directors after the latter had authorized the use of corporate funds for advertising purposes during the 1972 presidential elections. The action was brought under § 610 of the Federal Election Campaign Act, 18 U.S.C. § 610 (1970), which prohibits corpo-

either to create or to deny the right of action; and whether the action is one traditionally relegated to state law. In concluding that recognition of an implied private right of action would be proper in the instant case, the Second Circuit relied heavily upon the apparent purposes of the Advisers Act.[25] The court found those purposes to be the " 'protect[ion] [of] the public and investors against malpractice by persons paid for advising others about securities' "[26] as well as "effective *federal* regulation of an important segment of the securities industry."[27] According to the *Abrahamson* majority, these purposes would be effectively frustrated by a failure to recognize an implied private right of action, since the resources of the SEC are not sufficient to enforce all securities legislation.[28] Noting that the Act was designed especially for the benefit of persons relying upon investment advisers for guidance,[29] Judge Timbers concluded that a private right of action would serve as both an effective supplement to SEC enforcement of the statute and a deterrent to its violation.[30]

Turning to the express language of the statute in order to discern any indication of legislative intent with respect to private actions, the Second Circuit examined the jurisdictional provisions of the Act, which accord the district courts jurisdiction over " 'all suits in equity to enjoin any violation of [the Act].' "[31] Judge Timbers rejected the notion that since the Act, unlike other securities legislation, does not contain a provision expressly authorizing the exercise of jurisdiction over actions at law,[32] a legislative intention to pre-

rations from making contributions or expenditures for certain federal elections. According to the Court, "the legislation was primarily concerned with corporations as a source of aggregated wealth and . . . . possibl[y] corrupting influence," 422 U.S. at 82, and was intended to reduce corporate influence over federal elections. *Id.* at 85. Any legislative intent to protect stockholders was, at most, subsidiary to Congress' principal goal. *Id.* Primarily because implication of a private right of action was not consistent with the underlying policy of the legislation, and due to evidence that it was not within the contemplation of the legislature that a private right of action should exist, the Court refused to imply such an action. *Id.* at 77-82.

[25] 568 F.2d at 873-76.

[26] *Id.* at 873 (quoting S. REP. No. 1760, 86th Cong., 2d Sess. 1 (1960)).

[27] 568 F.2d at 874.

[28] *Id.*

[29] *Id.* at 873 (citing SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186-91 (1963)).

[30] 568 F.2d at 874-76.

[31] *Id.* at 874 (quoting Investment Advisers Act of 1940, § 214, 15 U.S.C. § 80b-14 (1970 & Supp. V 1975)).

[32] The jurisdictional provision of the Advisers Act, § 214, provides: "The district courts of the United States . . . shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations or orders thereunder." 15 U.S.C. § 80b-14 (1970 & Supp. V 1975). Section 22 of the Securities Act of

clude private rights of action is thereby manifested.[33] The court minimized the significance of this apparent dichotomy, reasoning that, while other securities laws contain "one or more sections *expressly* granting injured parties a private right of action for damages," no such provision exists under the Advisers Act and any reference to actions at law in the jurisdictional section of the latter would therefore be superfluous.[34] Although the Act thus does not expressly confer jurisdiction over actions at law, the *Abrahamson* court observed, neither does it expressly deny such jurisdiction. It was therefore determined that the precise issue of a private right of action under the Act was never considered by Congress.[35] The absence of clear legislative intent to preclude a private right of action, coupled with the finding that such an action would strongly promote the remedial purposes of the Act, led the Second Circuit to conclude that a private damage action may be maintained under the antifraud provisions of the Advisers Act.[36]

1933, 15 U.S.C. § 77v (1970), § 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa (1970), and § 44 of the Investment Company Act, 15 U.S.C. § 80a-43 (1970), all state that the district courts shall have jurisdiction of "all suits in equity and actions at law brought to enforce any liability or duty created by" those Acts.

[33] 568 F.2d at 874-75.

[34] *Id.*

[35] *Id.* at 875.

[36] *Id.* at 875-76. Having determined that there exists a private right of action under the Advisers Act, the *Abrahamson* court was faced with the question whether the plaintiffs' complaint alleged compensable damages under that Act. *Id.* at 877. Unlike the district court, *see* note 18 *supra,* the Second Circuit concluded that the plaintiffs had alleged compensable damages even though they had not incurred a net loss in their overall investments. According to the court, the damages of a client whose adviser has mismanaged his funds are not rendered overly speculative by the fact that the client failed to claim he would have "taken some remedial action if he had known the truth." 568 F.2d at 877-78. Issuing instructions to guide the district court upon remand, the Second Circuit stated that the damages awarded should equal "that part of net losses incurred on unregistered securities after the point when defendants' representations became fraudulent which stems from the portion of those investments inconsistent with defendants' representations." *Id.* at 879. In other words, plaintiffs would be entitled to recover their proportionate share of the partnership's losses on unregistered securities computed from the time defendants made misrepresentations to plaintiffs concerning the nature of the partnership's investments. *See id.* at 878-79.

It should be noted that the Advisers Act contains no provision whatsoever which places a limitation on the type or extent of recoverable damages. This omission can be traced to the absence of any provision in the statute which authorizes actions for damages. In contrast, other securities laws expressly provide for private actions and contain specific damage provisions. For instance, the Public Utility Holding Co. Act of 1935, 15 U.S.C. § 79p (1970), the Trust Indenture Act of 1939, 15 U.S.C. § 77www (1970), and the Securities Exchange Act of 1934, 15 U.S.C. § 78bb (1970 & Supp. V 1975), state that "no person permitted to maintain a suit for damages under the provisions of [these Acts] shall recover . . . a total amount in excess of his actual damages on account of the act complained of."

Many courts have encountered difficulty in accurately calculating the amount of damages in securities actions. Various formulae have been enunciated, some of which limited

Judge Gurfein, in a separate opinion, objected to the implication of a private damage action.[37] In reaching this conclusion, the dissent relied chiefly on the jurisdictional provisions of the Act—specifically, the absence of a grant of jurisdiction over "actions at law."[38] According to Judge Gurfein, the key issue was not whether there should be an implied private right of action, but rather whether there should be an implied private right of action for damages. The judge was of the opinion that the absence of a grant of jurisdiction over actions at law "indicates that Congress was not intending to provide for *any* liability beyond injunctive relief."[39] He went on to note that a strict construction of the statutory language was especially warranted in view of the legislative history of the Act which reveals it to be merely "a tentative attempt to effect a 'compulsory census' . . . rather than to provide a full regulatory scheme."[40] Distinguishing the Investment Advisers Act from other

plaintiffs' recovery to actual or "out of pocket" losses. *See* Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281 (2d Cir. 1973); Richardson v. MacArthur, 451 F.2d 35 (10th Cir. 1971); Estate Counseling Serv., Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 303 F.2d 527 (10th Cir. 1962) (damages are not what plaintiff might have gained, but what he has lost as a result of his fraudulently induced purchase of securities). *But see* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972) (plaintiff is entitled to windfall when defendant is forced to disgorge profits made through the fraudulent transaction); Zeller v. Bogue Elec. Mfg. Corp., 476 F.2d 795 (2d Cir. 1973) (remedy is to give plaintiff a windfall by forcing defendant to disgorge profits); Janigan v. Taylor, 344 F.2d 781 (1st Cir.), *cert. denied,* 382 U.S. 879 (1965) (more appropriate to give defrauded party benefit of windfall than to allow fraudulent party to benefit from his misconduct). *See also* 3 A. BROMBERG, SECURITIES LAW: FRAUD § 9.1, at 225 (1973); Note, *The Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities,* 26 STAN. L. REV. 371, 379 (1974).

In order to assess accurately the damages directly resulting from the fraudulent misrepresentations, it will be necessary for the *Abrahamson* district court on remand to isolate the losses incurred by the partnership on its investments which were due to natural market forces. This may prove to be a difficult and highly technical endeavor. For an in depth analysis of the various methods of computing damages in actions brought under the securities laws, see Mullaney, *Theories of Measuring Damages in Security Cases and the Effects of Damages on Liability,* 46 FORDHAM L. REV. 277 (1977) [hereinafter cited as Mullaney]. The author examined several traditional approaches to the calculation of damages, including "out of pocket," out of pocket plus recovery of subsequent profit, rescission, and a cover remedy. As to the difficulty in separating those losses attributable to a defendant's conduct from those occasioned by market forces, the author noted that "some courts, with the help of expert witnesses, have undertaken a detailed, technical analysis of securities prices." *Id.* at 278-79. *See, e.g.,* Bonime v. Doyle, 416 F. Supp. 1372 (S.D.N.Y. 1976), wherein, in addition to separating losses due to market forces, the court also "separate[d] the losses suffered by short-term speculators from those losses suffered by longer-term investors who, presumably, relied on defendants' statements." Mullaney, *supra,* at 288 (citing 416 F. Supp. at 1377).

[37] 568 F.2d at 879 (Gurfein, J., dissenting).

[38] *Id.* at 880-81 (Gurfein, J., dissenting).

[39] *Id.* at 880 (footnotes omitted) (Gurfein, J., dissenting).

[40] *Id.* at 879 (Gurfein, J., dissenting) (citing *Hearings on S. 3580 Before the Subcomm. of the Senate Comm. on Banking & Currency,* 76th Cong., 3d Sess. 48 (1940)(remarks of

securities legislation,[41] the dissent found that the Act represents a compromise between the SEC and the investment advisory industry, the basis of which was "congressional reluctance to 'over-regulate' the advisory industry . . . and a desire to minimize the potential liability of [investment] advisers."[42] While Judge Gurfein acknowledged that one purpose of the Act is to protect investors, he indicated that the danger of vexatious suits requires that this purpose not be implemented without limitation.[43] Pointing out that subsequent amendments to the Act have failed to alter its jurisdictional provisions or otherwise expand the liability of advisers,[44] Judge Gurfein could find no evidence of a legislative preference for a private damage action and no basis for judicial creation of such an action.[45]

The Second Circuit decision in *Abrahamson* marks the first time a federal appellate court has addressed the question whether

David Schenker representing the SEC)). Judge Gurfein read the legislative history of the Act as indicative of a congressional intent to require only registration of investment advisers. 568 F.2d at 879.

[41] *Id.* at 880 (Gurfein, J., dissenting).

[42] *Private Causes of Action, supra* note 6, at 319-20 & n.69.

[43] 568 F.2d at 882 (Gurfein, J., dissenting). The dissent pointed in particular to the danger that "[i]mplying a claim for relief without limitation will encourage actions against investment advisers for poor judgment, disguised by pleadings subtly implying fraud and deceit. . . . The blackmail effect of allowing customers to sue investment advisers for damages for what the customer might have done if he had but known, seems obvious . . . ." *Id.* at 886 (Gurfein, J., dissenting).

[44] Judge Gurfein emphasized that when Congress amended the Investment Advisers Act in 1970, it addressed the issue of civil liability of investment advisers, but failed to include any provision for liability to individual clients. *Id.* at 883 (Gurfein, J., dissenting). The dissent also pointed out that in 1960 Congress granted the SEC authority to seek injunctive relief, but neither created any express liability for damages nor provided for actions at law. *Id.* at 883 & n.13. (Gurfein, J., dissenting). Lastly, Judge Gurfein argued, Congress had a recent opportunity to authorize a private right of action when an amendment containing such a provision was proposed by the SEC, but failed to do so. *Id.* at 884 (Gurfein, J., dissenting).

The majority in *Abrahamson* interpreted congressional silence on the propriety of a private right of action as evidence that Congress never considered creating a private right of action. *Id.* at 875. Congressional inaction, either at the time of the initial enactment or after the proposed SEC amendment, it is submitted, should not be the basis of a finding that the legislature deliberately intended to preclude a private right of action. The *Abrahamson* situation may be distinguished from that in National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers, 414 U.S. 453 (1974), a case relied upon by the dissent, wherein the original draft of the statute in question contained a provision for a private damage action, but as redrafted and finally enacted the statute "did *not* authorize suits by 'any person adversely affected or aggrieved.'" *Id.* at 460. While evidence of congressional intent to deny a private right of action thus may be gleaned from the deletion of a particular provision authorizing such an action, mere failure to enact a provision authorizing the action does not seem to support a similar conclusion. *See* note 61 *infra.*

[45] 568 F.2d at 883-84 & n.13 (Gurfein, J., dissenting).

an implied right of action exists under the antifraud provisions of the Advisers Act. Although the courts which have dealt with the issue have not arrived at uniform conclusions,[46] it is submitted that the majority holding in *Abrahamson* accurately implements relevant Supreme Court authority and is supported by sound policy considerations. The test enunciated in *Cort v. Ash*[47] seems to be the appropriate point of departure in determining whether a cause of action for damages should be implied.[48] Two important considerations under that standard are the intent of Congress with respect to a private action and the consistency of such an action with the underlying statutory scheme.[49] In weighing these factors, several courts have refused to imply a damage suit under the Act, relying upon the failure of the statute to grant jurisdiction over actions at law.[50] Other courts, however, like the *Abrahamson* panel, have dis-

---

[46] *See, e.g.,* Sullivan v. Chase Inv. Servs. of Boston, Inc., 434 F. Supp. 171 (N.D. Cal. 1977) (private right of action for damages exists under the Advisers Act); *accord,* Jones v. Equitable Life Assurance Soc'y of the United States, 409 F. Supp. 370 (S.D.N.Y. 1975); Angelakis v. Churchill Management Corp., [1975-1976] FED. SEC. L. REP. (CCH) ¶ 95,285 (N.D. Cal. 1975); Bolger v. Laventhol, Krekstein, Horwath & Horwath, 381 F. Supp. 260 (S.D.N.Y. 1974). *Contra,* Greenspan v. Del Toro, [1975-1976] FED. SEC. L. REP. (CCH) ¶ 95,488 (S.D. Fla. 1974); Gammage v. Roberts, Scott & Co., [1974-1975] FED. SEC. L. REP. (CCH) ¶ 94,761 (S.D. Cal. 1974). *See* notes 50-51 and accompanying text *infra.*

[47] 422 U.S. 66 (1975).

[48] *See* 422 U.S. at 78. The applicability of the *Cort* test recently was reaffirmed by the Supreme Court's decision in Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977). *Chris-Craft* involved an action for damages brought under section 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(e) (1970 & Supp. V 1975), which prohibits fraud in connection with tender offers, and rule 10b-6, 17 C.F.R. § 240.10b-6 (1977), which prohibits an issuer from market tampering by purchasing his own stock while it is in the process of distribution. The gravamen of plaintiff Chris-Craft's complaint was that it had been prevented from gaining control of the target corporation Piper by virtue of defendants' § 14(e) and rule 10b-6 violations. The Court held that Chris-Craft possessed no implied private right of action under § 14(e), since the sole purpose of that provision was to protect the shareholder-investor who is faced with the decision of accepting or rejecting a tender offer. 430 U.S. at 35, 42. The 10b-6 claim also was disallowed as there had been no allegation that the price plaintiffs paid for the Piper stock was influenced by the defendants' misrepresentations. *Id.* at 45.

The *Chris-Craft* Court applied the *Cort* test in determining whether plaintiffs should be granted a private right of action. *Id.* at 37-41. Interestingly, while the majority warned that the Court "must be wary against interpolating its notions of policy in the interstices of legislative provisions," *id.* at 26 (citing Scripps-Howard Radio v. FCC, 316 U.S. 4, 11 (1942)), the Court's refusal to recognize an implied private right of action nevertheless depended to a great extent on its view of the applicable legislative intent. *See* 430 U.S. at 37-41. The *Chris-Craft* Court also found it consistent with the underlying legislative scheme to relegate the plaintiffs " 'to whatever remedy is created by state law.' " *Id.* at 41 (quoting Cort v. Ash, 422 U.S. 66, 84 (1975)).

[49] 422 U.S. at 78.

[50] *See, e.g.,* Greenspan v. Del Toro, [1975-1976] FED. SEC. L. REP. (CCH) ¶ 95,488 (S.D. Fla. 1974). The *Greenspan* court espoused a jurisdictional rationale for its holding similar to that of the *Abrahamson* dissent. Reasoning that § 14 of the Advisers Act failed to grant district courts jurisdiction over "actions at law," the court concluded that, at most, a private

counted this omission and permitted the action to be maintained.[51] As witnessed by this division of authority, the absence of an express jurisdictional grant concerning legal actions is at best an ambiguous indication of congressional intent.[52] There exists much in the legisla-

right of action could extend only to actions in equity for injunctive relief. *Id.* at 99,459-60. In Gammage v. Roberts, Scott & Co., [1974-1975] FED. SEC. L. REP. (CCH) ¶ 94,761 (S.D. Cal. 1974), an action alleging violations of margin account restrictions, the court also held that no private right of action exists under the Advisers Act. The *Gammage* court, however, indicated that even "[a]ssuming a private right of action exist[ed], any violation of the Investment Advisers Act must be wilful." *Id.*

[51] *See, e.g.,* Sullivan v. Chase Inv. Servs. of Boston, Inc., 434 F. Supp. 171 (N.D. Cal. 1977). Applying the *Cort* test, the *Sullivan* court held that an implied right of action exists under the Advisers Act. Interestingly, the *Sullivan* court posited that in the aftermath of the Supreme Court's decision in Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977), *discussed in* note 48 *supra,* "a new and more stringent standard of conformance to legislative purpose" is required, 434 F. Supp. at 182 n.17. This element of the *Cort* test may now be read to mandate a determination that a private right of action " 'is *necessary* to effectuate Congress' goals,' " *id.* (emphasis in original), rather than merely consistent with the underlying legislative scheme. Applying either standard, the court found implication of a private right of action for damages to be warranted. *Id.* Furthermore, the court noted that "the existence of private actions will significantly increase the statute's effectiveness" and may provide "the only way injured investors can recover money they have lost to dishonest investment advisers." *Id.* at 183.

In Bolger v. Laventhol, Krekstein, Horwath & Horwath, 381 F. Supp. 260 (S.D.N.Y. 1974), limited partners were held to have a right of action under the Advisers Act. In light of the clear legislative intent to protect persons who pay for investment advice, the court found that the "plaintiffs . . . f[e]ll squarely within the class of persons whom the antifraud provisions . . . were designed to protect." *Id.* at 263. The *Bolger* court rejected the argument that the omission of "actions at law" from the jurisdictional grant of the statute precluded implication of a right of action for damages on the ground that it was unnecessary to include reference to "actions at law" given the absence of any express provision in the Act authorizing a civil action by a private person. *Id.* at 264; *accord,* Jones v. Equitable Life Assurance Soc'y of the United States, 409 F. Supp. 370 (S.D.N.Y. 1975); Angelakis v. Churchill Management Corp., [1975-1976] FED. SEC. L. REP. (CCH) ¶ 95,285 (N.D. Cal. 1975).

In a very recent case, the Fifth Circuit has adopted the reasoning of the *Abrahamson* court and held that a private right of action may be implied under the Investment Advisers Act. Wilson v. First Houston Inv. Corp., 566 F.2d 1235 (5th Cir. 1978). The plaintiff in *Wilson* had given the defendant adviser a power of attorney to manage his stock portfolio. Defendant converted all of plaintiff's securities (valued at the time the power of attorney was given at over $100,000) into other securities chosen by him. In approximately 1½ years, the value of plaintiff's account had diminished to a little over $5,000. *Id.* at 1237. Defendant had advertised the use of computer analysis of the market to eliminate investment in substandard securities, but never advised plaintiff that utilization of the computer method had ceased. *Id.* Utilizing the *Cort* test and discussing both the majority and dissenting opinions in *Abrahamson, see id.* at 1239-43, the *Wilson* court found Judge Gurfein's jurisdictional argument as to legislative intent to preclude a private right of action as well as his similar interpretation of the omission of any damage provision in the Act, "no more persuasive than the reading given this matter by the [*Abrahamson*] majority . . . [and found] no substantial assistance from the legislative history with respect to Congress' intentions." *Id.* at 1242.

[52] The ambiguity surrounding the jurisdictional omission is enhanced by language in both the House and Senate reports describing the enforcement provisions of the Advisers Act as "generally comparable" to those of the Investment Company Act under which courts have

tive history, on the other hand, to support the position that a damage action premised upon the Act's antifraud provisions should be recognized.[53]

Notwithstanding the dissent's view of the statute as merely envisioning a compulsory census of investment advisers, "[a] careful reading [of it] . . . shows that . . . the Act is an integral part of a comprehensive regulatory scheme intended by Congress to eliminate certain abuses in the securities industry."[54] Both the Advisers Act and the Investment Company Act[55] are the outgrowth of an investigation of investment trusts and investment advisers undertaken by the SEC.[56] The investigation revealed not only that organizational and operational abuses were prevalent, but also that losses by investors often were attributable to selfish and unscrupulous mismanagment.[57] Perhaps prompted by these findings, Congress recognized that the "perpetrations of . . . misfeasances and the recurrence of . . . abuses [could not] be completely abated nor . . . deficiencies eliminated without the enactment of *adequate* Federal [regulatory] legislation . . . ."[58]

By creating a vehicle for clients who have suffered damages as

---

implied a private right of action and whose jurisdictional provision contains the "actions at law" language. *See* H.R. REP. No. 2639, 76th Cong., 3d Sess. 30 (1940); S. REP. No. 1775, 76th Cong., 3d Sess. 23 (1940).

It should be noted that the absence of a jurisdictional provision does not deprive the federal courts of subject matter jurisdiction over implied causes of action under the Advisers Act. Such jurisdiction may be predicated upon 28 U.S.C. § 1331 (1970 & Supp. V 1975), which confers jurisdiction over cases arising under federal law.

[53] *See* S. REP. No. 1760, 86th Cong., 2d Sess. 1, *reprinted in* [1960] U.S. CODE CONG. & AD. NEWS 3502; H.R. REP. No. 2639, 76th Cong., 3d Sess. 1 (1940); S. REP. No. 1775, 76th Cong., 3d Sess. 1 (1940); H.R. Doc. No. 477, 76th Cong., 2d Sess. 1 (1939).

[54] 568 F.2d at 876 n.23. The need for securities legislation resulted to a large degree from

> underlying social and economic elements, such as the use of the great national corporation, the separation of ownership among an increasing segment of the population, and the intangible and liquid character of that vast share of the national wealth represented by corporate securities . . . .

Loomis, *The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940*, 28 GEO. WASH. L. REV. 214, 214-15 (1959). As another commentator has noted, the Investment Advisers Act represents an attempt by Congress to establish some measure of control over a previously unregulated business, a business which was assuming a growing and important role in the securities industry. The enactment of the Act primarily was intended "to protect investors from those whose superior knowledge of the securities industry enabled them to capitalize on the credulity of the less financially sophisticated members of the public." 19 U. MIAMI L. REV. 148, 149 (1964) (footnotes omitted). *See also* 38 TUL. L. REV. 778, 779 (1964).

[55] 15 U.S.C. §§ 80a-1 to -52 (1970 & Supp. V 1975).

[56] *See* Loomis, *The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940*, 28 GEO. WASH. L. REV. 214, 244 (1959).

[57] H.R. REP. No. 2639, 76th Cong., 3d Sess. 4, 7 (1940) (emphasis added).

[58] S. REP. No. 1775, 76th Cong., 3d Sess. 11 (1940).

a result of the fraudulent conduct of investment advisers to seek direct compensation for their losses, implication of a private right of action for damages seems consistent with and in furtherance of the purposes of the Act.[59] Since a defrauded client denied a private right of action might receive no compensation for his losses, especially in instances similar to the instant case where the purchase or sale prerequisite to suit under section 10(b) of the Securities Exchange Act[60] is not satisfied, the Advisers Act's remedial objectives could be eviscerated if such an action were not implied.[61] The remedies expressly provided by the statute appear insufficient to afford full relief to injured clients, as neither a criminal prosecution nor injunctive relief will assist the defrauded client in recouping his losses. Since the main impetus to passage of the Act was concern for the interests of the investor,[62] an implied private right of action

---

[59] *See* Wilson v. First Houston Inv. Corp., 566 F.2d 1235 (5th Cir. 1978); Sullivan v. Chase Inv. Servs. of Boston, Inc., 434 F. Supp. 171 (N.D. Cal. 1977); Jones v. Equitable Life Assurance Soc'y of the United States, 409 F. Supp. 370 (S.D.N.Y. 1975); Angelakis v. Churchill Management Corp., [1975-1976] FED. SEC. L. REP. (CCH) ¶ 95,285 (N.D. Cal. 1975); Bolger v. Laventhol, Krekstein, Horwath & Horwath, 381 F. Supp. 260 (S.D.N.Y. 1974).

[60] *See* § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970), *discussed in* note 18 *supra*.

[61] *See* Sullivan v. Chase Inv. Servs. of Boston, Inc., 434 F. Supp. 171, 183 (N.D. Cal. 1977). The nature of the underlying legislative scheme and the importance of an implied private right of action in effectuating the purposes of the Advisers Act clearly distinguish the *Abrahamson* case from National R.R. Passenger Corp. (Amtrak) v. National Ass'n of R.R. Passengers, 414 U.S. 453 (1974). The plaintiffs in *Amtrak* sought an injunction under the Rail Passenger Service Act of 1970, 45 U.S.C. §§ 501-645 (1970 & Supp. V. 1975), to prevent the discontinuance of certain rail service. There was convincing evidence that Congress intentionally failed to include a provision for a private right of action since the purpose of the Act was not the protection of plaintiffs' class, but rather the most effective and economically feasible operation of the railroad. Although Judge Gurfein in his dissenting opinion in *Abrahamson* relied on the language in *Amtrak*, 414 U.S. 453, 458 (1974) (quoting Botany Mills v. United States, 278 U.S. 282, 289 (1929)), that "'when a statute limits a thing to be done in a particular mode, it includes the negative of any other mode,'" 568 F.2d at 882 (Gurfein, J., dissenting), it would nevertheless appear that the underlying purposes of the Advisers Act would be sufficient to satisfy the requirement of "clear contrary evidence of legislative intent" necessary to refute that rule of statutory construction. 414 U.S. at 458; *see* Note, *Private Rights of Action Under* Amtrak *and* Ash: *Some Implications for Implication*, 123 U. PA. L. REV. 1392 (1975).

[62] *See* S. REP. No. 1760, 86th Cong., 2d Sess. 1, *reprinted in* [1960] U.S. CODE CONG. & AD. NEWS 3502; H.R. REP. No. 2639, 76th Cong., 3d Sess. 1 (1940); S. REP. No. 1775, 76th Cong., 3d Sess. 1 (1940); H.R. Doc. No. 477, 76th Cong., 2d Sess. 1 (1939).

The Advisers Act received extensive discussion by the Supreme Court in SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963). Although the issue whether a private right of action for damages should be implied was not directly addressed by the Court, statutory interpretation of the antifraud provisions of § 206 was involved. The Court stated that "Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation 'enacted for the purpose of avoiding frauds,' *not technically and restrictively, but flexibly to effectuate its remedial purposes.*" *Id.* at 195 (emphasis added)(footnote omitted).

seems to be an essential supplement to its effective implementation.

The two remaining factors to be examined under the *Cort* test are whether the cause of action under consideration is one traditionally relegated to the state sphere and whether the statute from which the action is to be implied was intended especially to benefit persons in the plaintiff's class.[63] Although it is possible for a defrauded plaintiff to pursue his claim under state law, it is suggested that the extensive federal and limited state regulation in the securities area militates against classifying such an action as traditionally state in nature.[64] With respect to the intended beneficiaries of the Investment Advisers Act, the legislative history clearly indicates, as Judge Gurfein acknowledged in his dissenting opinion,[65] that Congress was endeavoring "to protect the public and investors against malpractice by persons paid for advising others about securities."[66]

As one commentator has noted, "Congress has seen the need for general and flexible antifraud provisions in the field of securities regulation in order to control 'the versatile inventions of fraud-doers.' " 5 B.C. INDUS. & COMM. L. REV. 838, 841 (1964).

[63] 422 U.S. at 78.

[64] Securities laws pertaining to investment advisory services have not been enacted on the state level in a uniform fashion. *See Private Causes of Action, supra* note 6, at 324. Only 27 states have statutes dealing with regulation of investment advisers and these, for the most part, are modeled after the federal statutes. *See* ALASKA STAT. § 45.55.020 (1962); ARK. STAT. ANN. § 67-1236 (1966); CAL. CORP. CODE § 25235 (West Supp. 1975); CONN. GEN. STAT. ANN. § 36-338(b) (West 1969); HAW. REV. STAT. § 485-25(b) (1976); IDAHO CODE § 30-1404 (1967); ILL. ANN. STAT. ch. 121 ½, § 137.12j (Smith-Hurd Supp. 1975); IND. CODE ANN. § 23-2-1-12.1 (Burns Supp. 1977); KAN. STAT. § 17-1253(b) (1974); KY. REV. STAT. ANN. § 292.320 (Baldwin 1972); MD. CORP. & ASS'NS CODE ANN. § 11-302 (1975); MICH. COMP. LAWS § 451.502 (1968); MINN. STAT. ANN. § 80A.02 (West Supp. 1978); MO. REV. STAT. § 409.102 (1969); MONT. REV. CODES ANN. § 15-2005(2) (1967); NEB. REV. STAT. § 8-1102(2) (1977); N.J. STAT. ANN. § 49:3-53 (West 1970); N.M. STAT. ANN. § 48-18-29B (1966); OHIO REV. CODE ANN. § 1707.42 (Page 1964); OKLA. STAT. ANN. tit. 71, § 102 (West 1971); PA. STAT. ANN. tit. 70, § 1-404 (Purdon Supp. 1978); S.C. CODE § 35-1-1220 (1976); UTAH CODE ANN. § 61-1-2 (1968); VA. CODE § 13.1-503 (1973); WASH. REV. CODE § 21.20.020 (1974); WIS. STAT. ANN. § 551.44 (West 1975); WYO. STAT. § 17-117.2 (1965).

The existence of an implied right of action under the Advisers Act, it is suggested, will not prevent an injured party from pursuing whatever remedy may be available under state law. Section 18 of the Advisers Act, 15 U.S.C. § 80b-18a (1970), provides that "[n]othing in [the Act] shall affect the jurisdiction of the securities commissioner . . . of any State over any security or any person insofar as it does not conflict with the provisions of [the Act]." The Securities Act of 1933 contains a similar provision preserving state jurisdiction, 15 U.S.C. § 77r (1970), which has been interpreted to mean that federal courts and state courts may exercise concurrent jurisdiction over securities transactions. *See, e.g.*, Traveler's Health Ass'n v. Commonwealth, 188 Va. 877, 51 S.E.2d 263 (1949), *aff'd*, 339 U.S. 643 (1950); Grenader v. Lefkowitz, 47 App. Div. 2d 359, 367 N.Y.S.2d 17 (1st Dep't 1975). Similarly, the provisions of the Securities Exchange Act of 1934 have not been viewed as precluding the pursuit of a state cause of action based on conduct that would amount to a violation of that Act. *See, e.g.*, McCollum v. Billings, 53 Misc. 2d 661, 279 N.Y.S.2d 609 (Sup. Ct. Onondaga County 1967).

[65] 568 F.2d at 882 (Gurfein, J., dissenting).

[66] *Id.* at 873 (Gurfein, J., dissenting) (quoting S. REP. No. 1760, 86th Cong., 2d Sess. 1,

Such an express statement of legislative intent would seem sufficient to satisfy the *Cort* criterion.[67]

Judge Gurfein nonetheless emphasized that investors were not the sole intended beneficiaries of the Act.[68] Pointing to the fact that the Advisers Act represents a compromise between the lawmakers and the investment advisory industry, the dissent suggested that a judicially created action for damages would impose increased liability upon the industry, contrary to the intent of Congress.[69] The existence of such a compromise, however, would not seem to serve as an absolute bar to implication of a private right of action. While some degree of disruption within the industry will probably ensue, the greater protection afforded investors appears more in accord with the overriding congressional purpose.[70] Furthermore, the industry itself might realize some benefits as a result of the investor's additional protection. Undoubtedly, the possibility of civil liability will encourage compliance with the provisions of the statute.[71] The goals of the industry would seem to be furthered by substantial compliance with the statute, since the public's confidence in the industry would thereby be enhanced and the individual bona fide adviser would be shielded from the stigma of the activities of less trustworthy practitioners.[72]

Moreover, the concern voiced by the dissent—that investment advisers would be constantly burdened with vexatious and specious actions commenced for their settlement value[73]—could be assuaged by placing limitations on the class of persons entitled to bring a private action, as well as the type of damages compensable under the Act. These limitations would be consistent with the recent decisions of the Supreme Court delineating the conduct actionable

reprinted in [1960] U.S. CODE CONG. & AD. NEWS 3502).

[67] *See* 422 U.S. at 82-84; *Private Causes of Action, supra* note 6, at 316-20.

[68] 568 F.2d at 882 (Gurfein, J., dissenting).

[69] *Id.* at 880-81 (Gurfein, J., dissenting).

[70] *See* notes 49-62 and accompanying text *supra.*

[71] 568 F.2d at 872-73. As one commentator has pointed out, the SEC's investigatory powers come into effect only after it has reason to believe that the Advisers Act has been or is about to be violated. *Private Causes of Action, supra* note 6, at 323 n.93. Therefore, SEC action is predicated upon the not-so-certain condition that a particular violation will be brought to the Commission's attention or viewed as warranting SEC investigation. It is submitted that there exists an increased likelihood that action would be taken by a defrauded client, most likely in the form of a civil damage suit. This enhanced possibility of action should result in an implied right of action being a greater deterrent to violation of the Act than an SEC investigation.

[72] *See* H.R. REP. No. 2639, 76th Cong., 3d Sess. 28 (1940).

[73] 568 F.2d at 886 (Gurfein, J., dissenting).

under the Securities Exchange Act of 1934.[74] The Court has indicated its refusal to permit the extension of cognizable claims under the securities laws beyond controllable and definitive boundaries.[75] Although these cases were decided under the 1934 Act, the apparent policy enunciated in them—to ensure that normal business practices and activities are not disrupted by expansive application of the federal securities laws—[76] is equally applicable to the Advisers Act.

The *Abrahamson* ruling is not necessarily inconsistent with such a policy. While it may be true that the Second Circuit decision has extended, rather than restricted, the class of persons entitled to bring an action under the securities laws, it is submitted that such an extension is within the ambit of the underlying goals of securities legislation and is consistent with the limitations established by the Supreme Court. Indeed, the *Abrahamson* decision does not create an overly broad potential plaintiff class, since the adviser-client relationship is a clearly definable one in which the client normally has personal contact with the adviser and acts in reliance upon the latter's judgment.[77] This client limitation, analogous to the purchaser-seller limitation under the Securities Exchange Act,[78] should be strictly imposed.

In recognizing an implied suit for damages under the Investment Advisers Act, the Second Circuit in *Abrahamson* seems to

---

[74] *See, e.g.,* Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). The *Hochfelder* Court restricted potential causes of action by holding that scienter is a requisite element of a private damage action under § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (1970). To satisfy a scienter standard, more than ordinary negligence on the part of the defendant must be shown. *See* Sanders v. John Nuveen & Co., 554 F.2d 790, 792-93 (7th Cir. 1977); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1039-40 (7th Cir. 1977); Hirsch v. DuPont, 553 F.2d 750, 759 (2d Cir. 1977). For a discussion of scienter requirements with respect to 10(b) violations, see 2 A. BROMBERG, SECURITIES LAW: FRAUD §§ 8.4(000), (500)-(690) (1973). *See generally* Van Graafeiland, *Foreword: A Lawyer's Observations on* Hochfelder, 51 ST. JOHN'S L. REV. 239 (1977).

[75] *See, e.g.,* Blue Chip Stamps v. Manor Drug Store, 421 U.S. 723 (1975). The Court in *Blue Chip* reaffirmed its adherence to the purchaser-seller requirement in actions brought pursuant to § 10(b) of the Securities Exchange Act. *See* note 18 *supra.*

[76] *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), wherein the Court pointed out that the absence of the purchaser-seller restriction would increase the incidence of vexatious suits which are particularly damaging to the securities business. Indeed, "[t]he very pendency of the lawsuit may frustrate or delay normal business activity on the defendant which is totally unrelated to the lawsuit." *Id.* at 740; *cf.* Note, *New Light on an Old Debate: Negligence v. Scienter in an SEC Fraud Injunctive Suit,* 51 ST. JOHN'S L. REV. 759 (1977), wherein the author states that "requiring the SEC to plead and prove scienter . . . would merely serve to prevent the waste and unfairness of an unsuccessful suit." *Id.* at 783 (footnote omitted).

[77] *See* 568 F.2d at 870-71.

[78] *See* § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b)(1970) *and* rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1977); note 18 *supra.*

have rendered a decision in consonance with the principles governing judicial creation of private rights of action. An analysis of the considerations relevant to determining the propriety of such an action points to the conclusion that the court's holding was fully warranted. In terms of legislative purpose, the specter of civil liability should contribute to reducing the perpetration of fraudulent practices by advisers.[79] Since the protection of the investor against such practices is the ultimate and overriding goal of the Investment Advisers Act,[80] the Second Circuit's recognition of an implied damage action appears to provide an efficacious mechanism for achieving the desired objective of the legislation.

Denise M. Dalton

---

[79] *See* note 71 *supra.*

[80] *See* notes 49-61 and accompanying text *supra.*