Implied Private Rights of Action Under the Securities Act of 1933 Section 17(A)

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Implied rights of action are a recognized means of expanding access to the courts where a statute does not expressly grant a private cause of action.¹ Courts have been willing to imply rights of action under federal securities laws in order to effectuate the legislations' remedial purpose.² Recently, however, the Supreme Court has narrowed the scope of several securities regulations, most notably rule 10b-5 of the Securities Exchange Act of 1934,³

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¹ See generally Note, Implying Civil Remedies From Federal Regulatory Statutes, 77 Harv. L. Rev. 285 (1963) [hereinafter cited as Implying Civil Remedies].

² Courts have opened their dockets to private parties through various rationales. An early theory, based upon tort concepts, was that breach of a statutory duty of care established a cause of action. See Greater Iowa Corp. v. McLendon, 378 F.2d 783 (8th Cir. 1967); Implying Civil Remedies, supra, at 286.

³ A more potent theory developed from the combination of the remedial nature of a statute and the legal maxim ubi jus, ibi remedium — "where there is a right, there is a remedy". See California v. Sierra Club, 49 U.S.L.W. 4441, 4444 (U.S. April 28, 1981) (Nos. 79-1252 & 79-1502) (Stevens, J., concurring); notes 15-19 and accompanying text infra. See generally McMahon & Rodas, Judicial Implication of Private Causes of Action: Reappraisal and Retrenchment, 80 Dick. L. Rev. 167 (1966); Mowe, Federal Statutes and Implied Private Actions, 55 Or. L. Rev. 3 (1976).


⁵ Rule 10b-5 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 of any facility of any national securities exchange,

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

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

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

17 C.F.R. § 240.10b-5.
the widely used antifraud provision. Private parties seeking a remedy for securities fraud therefore must look to provisions other than section 10(b) as possible replacements for the weakened rule 10b-5. One such provision is section 17(a) of the Securities Act of 1933. Congress included section 17(a) in the Securities Act of 1933 to combat fraudulent practices in the offer or sale of securities. Section 17(a), however, does not include an express private remedy.

The Supreme Court has not ruled directly, in recent implication cases from the securities field, whether an implied private right of action exists under section 17(a). The Court's general trend in recent implication cases has been to construe narrowly the statute in question, thus denying implied causes of action. Nevertheless, because the Supreme Court has neither articulated a clear standard nor applied any implication test consistently, whether an implied right of action exists under section 17(a) is uncertain.

This article considers the existence of a private right of action under Securities Act section 17(a). Part I examines the evolving implication doctrines, and their applicability to section 17(a).

* See Hazen, A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933, 64 Va. L. Rev. 641 (1978); Comment, 17(a) of the 1933 Securities Act: An Alternative to the Recently Restricted Rule 10b-5, 9 Rut.-Cam. L. Rev. 340 (1978).

* § 17(a) provides:

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

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

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

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


* § 17(a) provides expressly for criminal sanctions and government-injunctive relief. See note 48 and accompanying text infra.

* See Aaron v. SEC, 446 U.S. 680, 689 (1980) (The Supreme Court "has not had occasion to address the question whether a private cause of action exists under § 17(a).""); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 733 n.6 (1975).


* See generally A New Direction, supra note 9.
Part II discusses the need for a statutory solution and the treatment of implied rights of action under the American Law Institute's proposed Federal Securities Code.\(^{11}\)

### I. THE SUPREME COURT AND AN IMPLIED RIGHT OF ACTION UNDER SECTION 17(A)

#### A. Implication Tests

The Supreme Court has used several tests over the last decade for determining whether a private right of action should be implied where a statute fails to provide one expressly. The two most recent tests, presented in *Cort v. Ash*\(^{11}\) and *Touche Ross & Co. v. Redington*,\(^{18}\) reflect the divergent development of case law and statutory construction in the implication area.

1. The *Cort* test — The Supreme Court unanimously approved a four-part implication test in *Cort v. Ash*\(^{14}\) which reconciled several inconsistent cases. One line of cases, stemming from the Warren Court era, had utilized an expansive doctrine of statutory construction\(^{16}\) based on the maxim *ubi jus, ibi remedium*: "where there is a right, there is a remedy."\(^{16}\) This broad construction emphasized effectuating a statute’s remedial purpose,\(^{17}\) and resulted in the implication of a private cause of action, under the securities statutes, in *J.I. Case v. Borak*\(^{18}\) and *Super-
In addition to these decisions, Cort considered a pair of early Burger Court holdings. These holdings reflected a change in judicial philosophy from the broad remedial approach of the Warren Court, to a more stringent reading of the implication doctrine derived from the maxim *expressio unius est exclusio alterius*: “expression of one thing is the exclusion of others.” 20 In National Railroad Passenger Corp. v. National Association of Railroad Passengers (Amtrak) 21 and Securities Investor Protection Corporation v. Barbour (SIPC) 22 the Court had denied implied rights of action by focusing on the language and legislative intent, rather than remedial purpose, of the statutes.

Cort reconciled these divergent approaches to implication of a private right of action. By essentially merging the relevant factors of Borak and Bankers Life with those of Amtrak and SIPC, Cort charted a middle course for the implication doctrine, with four factors to be considered explicitly: (1) whether the plaintiff is “one of the class for whose especial benefit the statute was enacted”; (2) whether there exists “any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one”; (3) whether implication of an implied right of action is “consistent with the underlying purposes of the legislative scheme”; and (4) whether the cause of action is “traditionally relegated to state law . . . so that it would be inappropriate to infer a cause of action based solely on federal law.” 23

Despite this reconciliation, the Cort test has not been uniformly accepted. Piper v. Chris-Craft Industries, Inc. 24 presented the Supreme Court’s first opportunity to apply Cort. The majority, without mentioning Cort, reviewed the statutory language, the legislative history, and whether an implied cause of action would be “necessary to effectuate Congress’ goals” 25 in evaluating whether to imply a cause of action under section 14(e) of the Securities Exchange Act of 1934. After rejecting an implied cause of action under this test, the majority confirmed its holding by applying the Cort test. 26 Although the Court de-

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19 404 U.S. 6 (1971) (Securities Exchange Act of 1934, § 10(b)). Although this decision actually was reached during Chief Justice Burger’s tenure, the holding was essentially a fait accompli, reflecting years that lower courts had recognized the right.


25 Id. at 26.

26 Id. at 37.
rived the same conclusion under both tests, its hesitation in applying the *Cort* test is puzzling.

The Court had not discarded the *Cort* test, however, for it utilized a full *Cort* analysis in *Cannon v. University of Chicago.* The majority in *Cannon*, including several *Piper* dissenters, recognized an implied right of action under Title IX. Although *Cannon* dealt with a non-securities statute, whereas *Piper* involved a securities act, the Court has not chosen to justify its use of *Cort* in different circumstances on this basis.

2. The strict construction test—Shortly after *Cannon*, the Supreme Court, in *Touche Ross & Co. v. Redington*, again addressed the issue of implication in the securities field. The Court addressed whether Congress intended to imply a right of action under section 17(a) of the Securities Exchange Act of 1934. Justice Rehnquist, for the majority, examined the language of the statute, the intent of the legislature, and the statutory scheme. He applied this test without clearly overruling or distinguishing the *Cort* test used in *Cannon*.

Justice Rehnquist attempted to reconcile his analysis with the four factors of the *Cort* test by explaining that each *Cort* factor is not “entitled to equal weight.” Stressing that “[t]he central inquiry remains whether Congress intended to create . . . a private cause of action,” he concluded by observing that “the first three factors discussed in *Cort* — the language and focus of the statute, its legislative history, and its purpose . . . — are ones traditionally relied upon in determining legislative intent.”

But this reconciliation is illusory. Justice Rehnquist did more than shift the weight of the *Cort* factors; he fundamentally altered the test. The significance of the *Cort* test lies not in the sources examined but in the manner of examination. In failing to focus the inquiry through the *Cort* factors, particularly the threshold inquiry of whether the statute is intended to benefit a specific class of plaintiffs, Justice Rehnquist embraced a wholly different test — the strict construction test.

3. The present disagreement between supporters of the *Cort*
and strict construction tests— The Court's inconsistent approach to implication questions indicates a deeply rooted disagreement between the proponents of the Cort and strict construction tests. The strict-construction-test advocates argue the need to limit jurisdiction of the courts by using a literal construction for statutory rights of action. This approach avoids judicial intrusion into matters properly reserved to the legislature.34 In contrast, supporters of the Cort test advocate a flexible, yet firm, approach more attuned to the compromise and ambiguity of legislating and more likely to achieve overriding statutory purposes.35

A recent implied rights case makes apparent the existence of two divergent implication tests. In Transamerica Mortgage Advisers, Inc. v. Lewis,36 the Court considered whether to imply a private right of action enabling equitable and legal relief under the Investment Advisors Act of 1940.37 The majority applied the strict construction test of Redington, examining the language of the statute, its history and legislative scheme, to deny a private damage action while enabling an implied action for equitable relief. The majority, after determining that the first two Cort factors did not support an implied right, refused to consider further the remaining two factors.38

The treatment of Cort in Transamerica does not address the fundamental differences between the Cort and strict construction tests. Although both tests draw upon the same sources — the language of the statute, the legislative intent, and the overall purpose and scheme — the Cort test differs in its approach to focusing these sources to render a conclusion. The essential conflict distills into whether these factors are themselves to be the vehicle for determining legislative intent, as Cort would suggest, or whether instead these factors are merely a convenient guide that need not necessarily channel the inquiry into legisla-

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34 Perhaps the most vocal supporter of the strict construction test is Justice Powell. Dissenting in Cannon v. University of Chicago, 441 U.S. 677, 745-46 (1979), he argued that the Cort test represents an impermissible judicial encroachment upon legislative power.

35 The Cort test was designed "to restrict the creation of implied actions." A New Direction, supra note 9, at 523 n.142. But at the same time it will allow an implied right of action where "Congress intended to make a remedy available to a special class of litigants [utilizing] the four factors that Cort identifies as indicative of such intent." Cannon v. University of Chicago, 441 U.S. 677, 688 (1979).


38 444 U.S. at 23-24. A full Cort analysis, in contrast, inquires into all four factors, often producing conflicting conclusions regarding implication from the various factors. See notes 117-19 and accompanying text infra.
tive intent, as the Redington court reasoned. Transamerica does provide additional support for the strict construction test, but this support is weakened by the Court's failure to confront the Cort test clearly. Transamerica, in fact, exemplifies the tension between the Cort test and the strict construction test.

This tension surfaced again in the most recent implication decision, California v. Sierra Club. The Court, although unanimously opposed to implying a right of action, split regarding the question of the appropriate test to be employed in deciding the implication issue. The majority applied the Cort test, while Justice Rehnquist, in a concurrence joined by three others, urged utilization of the strict construction test. Thus Sierra Club mirrors Transamerica, except that it accords the Cort test majority status.

B. Analysis of Section 17(a) of the Securities Act in the Light of the Implication Tests.

The recent implication cases of Cannon, Redington, Transamerica, and Sierra Club demonstrate the viability of both the Cort and strict construction tests. The Supreme Court, decisively divided over the issue, has failed to apply consistently one implication test. Furthermore, the Court has obfuscated the issue by not articulating a clear distinction between the cases using different tests. One straightforward reconciliation available to the Court would limit Cort to non-security cases. This post

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99 See Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 26-27 (White, J., dissenting) ("although subsequent decisions have indicated that the implication of a private right of action 'is limited solely to determining whether Congress intended to create the private right of action,' . . . these four factors are 'the criteria through which this intent could be discerned'").


42 Justice Rehnquist was joined by Chief Justice Burger, Justice Stewart, and Justice Powell.

43 Two other recent Supreme Court decisions, Universities Research Ass'n, Inc. v. Coutu, 49 U.S.L.W. 4354 (U.S. April 6, 1981) (No. 78-1845); and Northwest Airlines, Inc. v. Transportation Workers Union, 49 U.S.L.W. 4383 (U.S. April 20, 1981) (No. 79-1056), do little to reconcile the Cort and strict construction tests. In Coutu, the Court followed substantially the strict construction test, although making passing reference to the Cort factors. In contrast, Northwest Airlines pursued a more straightforward Cort analysis, with heavy emphasis upon the Cort threshold inquiry.

44 Compare Davis v. Passman, 442 U.S. 228 (1979) (5th Amendment), and Cannon v. Univ. of Chicago, 441 U.S. 677 (1979) (Education Amendments of 1972), and Cort v.
hoc explanation would be supportable by the unique status and policy considerations of the securities laws. While this may be a valid, albeit unarticulated, rationale, it has yet to be adopted.

In contrast, the Court's attempted reconciliation of the Cort and strict construction tests in Redington is unsuccessful.\footnote{See text accompanying notes 31-33 supra.} One basic difference between the two tests turns on the threshold inquiry of Cort, which focuses the implication question upon whether the plaintiff is of the class "especially benefited" by the statute.\footnote{Cort v. Ash, 422 U.S. 66, 78 (1975); see text accompanying note 23 supra.} Although the two tests consider the same substantive material, the strict construction test's rejection of the threshold inquiry\footnote{See text accompanying notes 31-33 supra.} creates a fundamental difference between the two tests. In order to clarify the area, the Court should address this difference directly by consistently applying and developing one of the tests. Until this clarification occurs, however, the uncertainty regarding which test governs the implication of a cause of action under section 17(a) necessitates that both the strict construction and Cort tests be examined.

1. Applying the strict construction test—Deciding whether a private right of action may be implied under the strict construction test of Transamerica and Redington requires evaluation of three factors: (1) the language of the statute; (2) the intent of Congress as evidenced by the legislative history; and (3) the statutory scheme.

a. Statutory language—Section 17(a) on its face seems not to satisfy the first factor of the strict construction test, for the statutory language does not suggest a private cause of action. The statute represents a general interdict of fraudulent practices; only subsequent provisions enable equitable and criminal causes of action.\footnote{Securities Act of 1933, § 20, 15 U.S.C. § 77t (1976) (injunctions and prosecution of offenses); Securities Act of 1933, § 24, 15 U.S.C. § 77x (1976) (penalties).} This does not foreclose, however, all possibility of discovering an implied right of action in the language of the Act. A private right of action for rescission of an illegal contract could plausibly be derived from the jurisdictional provision\footnote{Securities Act of 1933, § 22, 15 U.S.C. § 77v (1976) (district courts shall have jurisdiction "of all suits in equity and actions at law brought to enforce any liability or duty created by this title"); see Osborne v. Mallory, 86 F. Supp. 869, 878-79 (1949) (using Securities Act of 1933, § 22, as a basis for finding a private right of action under § 17(a)); \textit{cf.} H. Sowards, \textit{The Federal Securities Act} § 10.01[1], at 10-10 (11 Business Organi-}
and the provision retaining all previous suits in law or equity.\textsuperscript{60} An analogy to the holding of \textit{Transamerica},\textsuperscript{61} however, undercuts this possibility. The Court there allowed an action for rescission because the statutory provision under scrutiny expressly classified as void a contract in violation of the Act.\textsuperscript{62} In contrast, the Securities Act does not contain this type of express language; the action for rescission, premised only on general contract principles,\textsuperscript{63} would not likely fall within the \textit{Transamerica} reasoning. Thus, a strict reading of the Securities Act's language does not support a private right of action, and one should not be implied under the \textit{expressio unius} maxim of statutory construction.

\textit{b. Congressional intent}— Despite this finding regarding the statutory language, settled rules of construction "could yield, of course, to persuasive evidence of a contrary legislative intent."\textsuperscript{64} Examination of the legislative intent in this case, however, only buttresses the conclusion drawn from the language of the statute. Nothing in the legislative history of the Securities Act supports the assertion that Congress intended to create a private right of action under section 17(a). Congressional discussion of civil liability under the Securities Act centered on sections 11 and 12.\textsuperscript{65} The legislative discussions of section 17(a) made no mention of a private right of action,\textsuperscript{66} as reflected in the original
draft of the House measure, which implies that a right of action was meant only for the government. In fact, the drafters modeled section 17(a) after state Blue Sky fraud provisions, particularly the Martin Act of New York, which did not have a private cause of action. Furthermore, the legislative history surrounding the 1954 Securities Act amendment does not mention any private cause of action under section 17(a).

c. Statutory scheme— Following consideration of the test's first two elements, whatever doubt remains regarding implication of a private right of action for section 17(a) under the strict construction test dissipates upon examination of the statutory scheme. The Securities Act of 1933 has two primary goals: (1) to provide full and fair disclosure of material information about securities being initially issued, and (2) to prohibit generally fraud and misrepresentation in the sale of securities. Section 5 contains the substantive disclosure requirements, with noncompliance or faulty compliance resulting in civil liability under section 12(1) and section 11. In addition to these disclosure


An implied right of action had been allowed prior to the enactment of the amendments, in Osborne v. Mallory, 86 F. Supp. 869 (S.D.N.Y. 1949). The congressional silence in the face of this precedent might be taken as an endorsement of implied private actions under § 17(a). Compare Piper v. Chris-Craft Industries, Inc., 430 U.S. 1, 55 n.4 (1977) (Stevens, J., dissenting) (arguing that congressional awareness of implied rights of action would constitute an endorsement of the implied rights), with Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 33 n.9 (1979) (White, J., dissenting) (urging that congressional intent at the time of the original statutory enactment be controlling).

See R. JENNINGS & H. MARSH, supra note 6, at 30.


Securities Act of 1933, § 12, 15 U.S.C. § 77l (1976) (civil liabilities arising in connection with prospectuses and communications); see R. JENNINGS & H. MARSH, supra note 6,
requirements, section 12(2) provides a private right of action to any purchaser of a security, against a seller that has made a ma-

terial misstatement or omission regarding any exempted or non-
exempted security. § 839. Another substantive antifraud provision,

section 17(a), also forbids fraudulent or manipulative practices. § 86

In contrast to section 12(2), however, section 17(a) makes no ex-

press allowance for a private cause of action.

The express private remedies for the Securities Act have dis-


tinctly drawn boundaries. Section 11 imposes liability only on
designated persons for faulty compliance with the registration
requirement, does not cover exempted securities, and limits re-
covery to the purchase price. § 87 Section 12(1) applies solely to the
registration and prospectus requirements of section 5. § 88 Likewise,
section 12(2) covers a narrow type of activity — untrue

statements of material facts or omissions thereof in the offer or
sale of a security. § 89 Section 12 is further limited by a require-
ment of purchaser-seller privity and restricted to a remedy of
rescission or, if the purchaser no longer owns the security, dam-
ages. § 90 Sections 11 and 12 also are subject to an explicit statute
of limitations. § 91

Although sections 17(a), 11, and 12 overlap somewhat, section
17(a) spans more broadly sections 11 and 12, considered either
singly or combined. Section 17(a), unlike sections 11 and 12(1),

covers exempted securities, and may be invoked against any vi-

olation occurring “in the offer or sale” § 92 of a security, in contrast
to sections 11 and 12, which apply to only narrow aspects of a

securities distribution. Additionally, section 17(a) has no privity

requirements or limits on damages, and the Act makes no spe-

Securities Act of 1933, § 11, 15 U.S.C. § 77k (1976) (civil liabilities on account of
false registration statement); see R. JENNINGS & H. MARSH, supra note 6, at 825-35. See
also 3 L. Loss, supra note 56, at 1784-85.

MARSH, supra note 6, at 840-41.

Securities Act of 1933, § 17(a), 15 U.S.C. § 77q(a) (1976) (fraudulent interstate
transactions).

In contrast to § 12(2), there is no need for contractual privity under § 11. The re-
covery is limited to a difference money formula (price paid, not exceeding the offering
price, compared with the stock value at the time of suit or when previously sold). See R.
JENNINGS & H. MARSH, supra note 6, at 833.

See id. at 839.

Id. at 840-41.

Id. The privity requirement has been diminished by various theories. See generally


cific provision for a statute of limitations under section 17(a).\textsuperscript{73}

The statutory scheme makes apparent that Congress considered and implemented strict requirements for civil liability under sections 11 and 12. A private right of action under section 17(a) would substantially overlap sections 11 and 12. Congress did not, however, place restrictions similar to sections 11 and 12 on section 17(a), so that an implied right of action under section 17(a) would tend to undermine the express requirements of sections 11 and 12. Therefore, the third element of the strict construction test also weighs against implication of a private right of action for section 17(a).\textsuperscript{74}

The tripartite strict construction test does not support an implied right of action under Securities Act section 17(a). Neither the language of the Act, nor the legislative history, nor the interrelationship of the Act’s provisions favor an implied right.

2. An implied right of action under the Cort test— The potential viability of the Cort test mandates that the inquiry into an implied right of action under section 17(a) include consideration of the Cort factors.

a. Statutory intent to benefit a specific class— In assessing whether the Cort test enables an implied right of action under section 17(a), the threshold question “is whether the statute was enacted for the benefit of a special class of which the plaintiff is a member.”\textsuperscript{75} In determining whether the plaintiff stands within the class for whose benefit the statute was enacted, the Court observed that where an implied right has been found “there has generally been a clearly articulated federal right in the plaintiff, or a pervasive legislative scheme governing” the defendant and plaintiff classes.\textsuperscript{76}

The Court in Cannon examined the implication cases thoroughly and reached several conclusions regarding the type of statute satisfying the threshold inquiry. The Court found that, with few exceptions, implied rights of action have been granted

\textsuperscript{73} See H. Sowards, supra note 49, at § 10.06.
\textsuperscript{76} Cort v. Ash, 422 U.S. 66, 82 (1975); see California v. Sierra Club, 49 U.S.L.W. 4441, 4444 (U.S. April 28, 1981) (Nos. 79-1252 & 79-1502) (“The question is not simply who would benefit from the Act, but whether Congress intended to confer federal rights upon those beneficiaries.”).
"where the language of the statute explicitly conferred a right directly on a class of persons that included the plaintiff in the case." 77 "Conversely, the Court has been especially reluctant to imply causes of actions under statutes that create duties on the part of persons for the benefit of the public at large." 78 This serves to separate those statutes protecting the general public from those embodying a narrower protective intent. 79

The threshold Cort inquiry for section 17(a), requiring there to be a sufficiently identified plaintiff class in order to imply a private right of action, appears satisfied only by subsection 17(a)(3). Subsection 17(a)(3), which forbids the perpetration of fraud or deceit "upon the purchaser," 80 sufficiently identifies a group to be protected by the statute. 81 If this group, however, represents the sole plaintiff class sufficiently identified within the meaning of Cort, the reach of an implied right of action under section 17(a) will be limited substantially.

A second potential identified class which might satisfy the Cort threshold requirement, and significantly expand the potential scope of implied causes of action for section 17(a) under the Cort test, would be participants in a selling transaction who are harmed by the offeror or seller. Section 17(a) has been read to apply to the "entire selling process." 82 Yet the group of market participants who will receive protection under section 17(a) are defined by the violation; they are not a clearly identified class, in contrast to purchasers, until the violation occurs. Hence, this group is no more clearly identified than the general public, 83 and

77 Cannon v. University of Chicago, 441 U.S. 677, 690 n.13 (1979). Alternatively, a statute might be found to protect a special class, not where the statute confers a right, but where the statute instructs that a particular group is not to be harmed. For example, the Investment Advisors Act of 1940, § 206, 15 U.S.C. § 80b-15 (1976), at issue in Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979), was written explicitly to prevent the perpetration of certain acts upon "clients."

78 Cannon, 441 U.S. at 690 n.13.

79 See id.; California v. Sierra Club, 49 U.S.L.W. 4441, 4443 (U.S. April 28, 1981) (Nos. 79-1252 & 79-1502) (statute at issue "states no more than a general proscription of certain activities [and] does not unmistakably focus on any particular class of beneficiaries").


81 See Demoe v. Dean Witter & Co., 476 F. Supp. 275 (D. Alaska 1979); cf. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 27 (1979) (White, J., dissenting) (arguing that "clients" under the Investment Advisors Act of 1940 are a sufficiently identified class to satisfy the Cort threshold inquiry).

82 In United States v. Naftalin, 441 U.S. 769 (1979), defendant argued that § 17(a)'s reference to "the offer and sale" limited its application to investors. The Court rejected this contention and found that § 17(a) applied to the "entire selling process," id. at 772-74, making reference to the congressional intent that all who fall prey to fraudulent practices were meant to be included. Id. at 775.

83 When a statute means to protect only the general public, it fails to "explicitly [con-
cannot satisfy the *Cort* threshold inquiry. If *Cort* enables an implied cause of action, it must therefore be limited to purchasers under subsection 17(a)(3).\footnote{See Demoe v. Dean Witter & Co., 476 F. Supp. 275 (D. Alaska 1979).}

\textit{b. Legislative intent to deny a private cause of action—} The second *Cort* factor asks whether "any indication of legislative intent, explicit or implicit, [exists] either to create such a remedy or to deny one."\footnote{Cort v. Ash, 422 U.S. 66, 78 (1975).} Although legislative intent to create a private cause of action need not be shown where the class of plaintiffs clearly is granted certain rights, "an explicit purpose to deny such cause of action would be controlling."\footnote{Id. at 82. In fact, the *Transamerica* dissent restated the inquiry as being "whether there is evidence of an expression of implicit legislative intent to negate the claimed private right of action." 444 U.S. at 28. See Cannon v. University of Chicago, 441 U.S. 677, 694 (1979); Cort v. Ash, 422 U.S. at 82.}

The legislative history of the Securities Act suggests that Congress paid scant attention, either pro or con, to the existence of a private right of action. No "explicit purpose" to bar a private action may be discerned in the legislative history.\footnote{See notes 54-60 and accompanying text supra.} Perhaps the congressional intent to deny a private right of action may be inferred from the existence of civil liabilities under sections 11 and 12 of the Act, which arguably preclude any additional causes of action.\footnote{See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 867 (1968) (Friendly, J., concurring); 3 L. Loss, supra note 56, at 1785. But see Horton, supra note 56, at 58 (Loss' analysis "is simply too sophisticated to be persuasive").} This conjectural argument, however, rests upon the \textit{expressio unius} maxim rejected in *Cort*.\footnote{See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 867 (1968) (Friendly, J., concurring); 3 L. Loss, supra note 56, at 1785.} Without a more explicit showing of contrary congressional intent, the second prong of the *Cort* test will not bar implication of a cause of action under section 17(a).

\textit{c. Necessity of an implied right of action for effectuating the statutory scheme—} The third *Cort* factor to be considered is whether implication of a private right of action is "consistent
with the underlying purposes of the legislative scheme. . . .90
Cannon reformulated this third prong, noting the Court's receptivity to implication when "necessary or at least helpful to the accomplishment of the statutory purpose. . . ."91 With the question framed in this fashion, an implied right of action would likely be found incompatible with the legislative scheme only when in direct conflict with an express statutory provision.

An implied right of action under section 17(a) is not clearly "necessary or at least helpful" to achieving the statutory purpose. Extending section 17(a) liability would further the legislative purpose to eliminate securities fraud only so long as it did not infringe upon sections 11 and 12. But this raises two issues: first, whether a private right of action for section 17(a) is "necessary or helpful," given the express remedies of sections 11 and 12 in addition to rule 10b-5; second, whether implication of a cause of action is counterproductive, given the strict requirements of sections 11 and 12.

Section 17(a) covers a broader range of acts than do the express provisions of sections 11 and 12.92 Unless a private remedy under section 17(a) undermines the express provisions of sections 11 and 12, the additional antifraud liability afforded by such private actions would be beneficial, advancing a basic purpose of the Securities Act.93 This is true, however, only to the extent that private actions under section 17(a) do not overlap with rule 10b-5 of the Securities Exchange Act.94 If rule 10b-5 already provides the additional enforcement to be provided by section 17(a), implication under section 17(a) would be superfluous to the statutory scheme.95 In fact, section 17(a), although more limited in scope, has less stringent requirements than rule 10b-5.96 Therefore, section 17(a) would extend fraud liability be-

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90 Cort v. Ash, 422 U.S. at 78. The inquiry will not proceed to the third factor unless one of the first two Cort factors would support an implied right of action. See California v. Sierra Club, 49 U.S.L.W. 4441, 4444 (U.S. April 28, 1981) (Nos. 79-1252 & 79-1502).
92 See notes 72-73 and accompanying text supra.
93 A primary purpose of the Securities Act is to protect investors, United States v. Naftalin, 441 U.S. 768, 774-76 (1979), and any method of achieving that purpose should be favored unless counterbalanced by negative side effects. See also J.I. Case v. Borak, 377 U.S. 426, 431-35 (1963) (remedial purpose supported implication).
94 Rule 10b-5 was drafted to provide a device for avoiding § 17(a)'s nonapplicability to fraud by a purchaser. See H. Sowards, supra note 49, § 10.01[1], at 10-4.
96 On their face, rule 10b-5 and § 17(a) have several differences. First, rule 10b-5 applies to any "purchase or sale" of a security, while the scope of § 17(a) is limited to "the offer or sale" of a security. Although this phrasing of § 17(a) is "expansive enough to
yond that presently existing under rule 10b-5.

Even though the right of action for section 17(a) would advance a statutory purpose, private actions under section 17(a) might still detract from the overriding congressional desire to facilitate capital formation. Congress enacted exacting requirements for sections 11 and 12 to limit the scope of liability. A major concern of the security market participants, upon enactment of the statute, was that crushing civil liability would cripple capital markets. This concern caused Congress to circumscribe carefully the liability sections of the Securities Act.

Courts did not expand private remedies under the securities statutes until years after passage of the Act. This trend culminated in 1971 with the recognition of an implied right of action for rule 10b-5. The trend during the last decade, however, has been to limit the application of the securities laws in general. The Supreme Court has commented, in fact, upon the counterproductivity of additional securities liability.

To suppose that the Court would narrow the scope of private causes of action under rule 10b-5, while expanding private actions under section 17(a), is not necessarily anomalous. Section 17(a) is a more narrowly drawn provision than rule 10b-5. Furthermore, section 17(a) is the work of Congress, unlike rule

cover the entire selling process,” United States v. Naftalin, 441 U.S. 768, 773 (1978), it cannot be used to remedy fraud by a purchaser. H. Sowards, supra note 49, § 10.01[1], at 10-4. Second, rule 10b-5 incorporated § 10(b)’s wording of “manipulative or deceptive devices”; § 17(a) contains no such phrasing. Finally, while rule 10b-5 is an exclusively federal cause of action, § 17(a) can be asserted in state court under the dual jurisdiction provision of the Securities Act.

Although § 17(a) is not limited to the original issuance of a security, rule 10b-5 is the more frequently chosen litigation vehicle, due to its broader scope and more certain private right of action. Consequently, rule 10b-5’s bounds have been more clearly defined by adjudication.


See id. at 2, 5; Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 753-54 (1975).


See Aaron v. SEC, 466 U.S. 680 (1980); United States v. Naftalin, 441 U.S. 768 (1979). Perhaps the best explanation for this expansive holding in contrast to the narrowing of rule 10b-5 is found in the Court’s reasoning that “[p]lacing brokers outside the aegis of § 17(a) would create a loophole in the statute that Congress simply did not intend to create.” Id. at 777. This approach, as one commentator suggested, “is sound and firmly rooted in the reality of the operations of the securities markets.” Steinberg, Section 17(a) of the Securities Act of 1933 After Naftalin and Redington, 68 Geo. L.J. 163, 170 (1979).

See note 96 and accompanying text supra.
10b-5, which was promulgated by the Securities Exchange Commission. Thus there may be logical consistency in the Court's expanding liability under section 17(a) while simultaneously restricting it under 10b-5.

Nonetheless, the conclusion as to whether an implied right of action under section 17(a) advances the statutory scheme remains unclear. The chilling effects upon capital formulation, and the potential undermining of the express liability provisions of sections 11 and 12, cannot be ignored. The appropriate response, adopted by several lower courts, is to dovetail section 17(a) with sections 11 and 12, construing separately the subsections of 17(a) to enable an implied right of action for any subsection not overlapping substantially with sections 11 and 12.\textsuperscript{104}

This approach has led to implication of private causes of action under both sections 17(a)(1) and 17(a)(3). SEC injunctions under 17(a)(1) require scienter; extending this scienter requirement to embrace private damage actions would create a higher standard of culpability than necessary for liability under sections 11 and 12,\textsuperscript{105} thereby avoiding overlap with these sections.\textsuperscript{106} Similarly, implication of a private right of action under section 17(a)(3) will not overlap with the express provisions of sections 11 and 12 because section 17(a)(3) addresses itself to different concerns than sections 11 and 12.\textsuperscript{107}

d. Within traditional state sphere—Cort rejects implication of a private cause of action for matters traditionally relegated to state courts. Liability for the sorts of transactions arising under

\textsuperscript{104} See Demoe v. Dean Witter & Co., 476 F. Supp. 275 (D. Alaska 1979) (implied right of action under § 17(a)(3), but not under § 17(a)(1) and (2)); Dorfman v. First Boston Corp., 336 F. Supp. 1089 (E.D. Pa. 1972) (implied private right of action for fraud under § 17(a)(1) and (3), but actions under § 17(a)(2) are subject to § 12 limitations).

\textsuperscript{105} Aaron v. SEC, 446 U.S. 680 (1980). The assumption that the scienter requirement for SEC-injunctive actions would extend to private damage actions receives support from the pattern followed by the Supreme Court in the development of rule 10b-5. See Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (private damage action); Chiarella v. United States, 445 U.S. 222 (1980) (criminal action).


\textsuperscript{107} This point never was reached by the two decisions enabling an implied right of action under § 17(a)(3). See Demoe v. Dean Witter & Co., 476 F. Supp. 275 (D. Alaska 1979); Dorfman v. First Boston Corp., 336 F. Supp. 1089 (E.D. Pa. 1972). Those decisions—decided before Aaron v. SEC, 446 U.S. 680 (1980), rejected the scienter requirement in § 17(a)(3) actions—assumed a § 17(a)(3) scienter requirement and thus did not confront the question of whether the statutory language of § 17(a)(3) was sufficiently distinct from §§ 11 and 12 to dispel concerns that a private right of action under § 17(a)(3) would overlap with §§ 11 and 12.

The conclusion that § 17(a)(3) addresses different matters than §§ 11 and 12 draws support from Aaron. The Court described § 17(a)(3) as dealing with effects, whereas § 17(a)(2), and by implication § 12(2), concerns itself with conduct. Id. at 696-97.
section 17(a), however, is not such a matter. The congressional hearings regarding enactment of the Securities Act are replete with testimony regarding the states' inability to deal with securities fraud. In addition, the Securities Act confers concurrent jurisdiction upon federal and state courts, providing strong support for the proposition that section 17(a) matters are not solely within the state sphere.

The foregoing four-factor analysis demonstrates that Cort would enable an implied private right of action under section 17(a). The most vexing question is whether an implied action under section 17(a) would detract from the statutory scheme by overlapping with the explicit provisions of sections 11 and 12. This difficulty may be resolved if private actions are implied only under sections 17(a)(1) and 17(a)(3), which do not impinge unduly upon sections 11 and 12. A further requirement, imposed by the Cort threshold inquiry, is that implied actions be limited to statutes enacted for the special benefit of a specific class of plaintiffs. Section 17(a)(3) satisfies this threshold requirement, in addition to avoiding problems of overlap with sections 11 and 12. Thus an implied right of action will be available, applying the Cort test, under section 17(a)(3).

II. A STATUTORY ALTERNATIVE

A. The Need for a Statutory Solution

The Supreme Court speaks explicitly of the need for a statutory solution to the implication question. In Cannon, the Court addressed itself directly to the legislature: "When Congress intends private litigants to have a cause of action to support their statutory rights, the far better course is for it to specify as much when it creates those rights." Justice Rehnquist, concurring in Cannon, agreed with the majority although going one step further, stating that "this Court in the future should be extremely reluctant to imply a cause of action absent such specificity on the part of the Legislative Branch."

The call for a legislative solution derives considerable support

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108 441 U.S. at 717.
109 Id. at 718 (Rehnquist, J., concurring).
from the Supreme Court's uncertainty in the area. The leading decisions demonstrate the shifting nature of implication doctrine. The Court has employed the Cort test in Cannon and Sierra Club, while utilizing the strict construction test in Redington and Transamerica.113

The inadequacy of both the Cort and strict construction tests favors a statutory resolution. The strict construction test is flawed by its reliance upon statutory language to determine congressional intent. Such reliance casts implication in a disfavored light; searching for the justification for an implied right in an express provision may, to some extent, be assuming the answer in the question. This does not represent an evenhanded approach to the implication question.113 Moreover, the strict construction test's emphasis upon manifest legislative intent appears to ignore the compromise and ambiguity inherent in much legislation.114 Courts frequently must act to determine the proper scope of ambiguous legislation.115 Recognition of legislation's inherent ambiguity appears especially appropriate in the securities field, where exhaustive specification of express liabilities would be both difficult and unwieldy.116

The Cort test presents several problems as well. The test provides little guidance for balancing inconsistent factors. As the Cannon Court observed, typically the four Cort factors will not all support an implied right of action.117 Because implication still may be granted even when all four factors do not support an implied right, a balancing problem results in applying the

113 See pt. I A supra.

114 The contradictory conclusions reached in Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979), regarding an implied right of action demonstrate that the orientation of the approach can determine the outcome. While the majority insisted upon "persuasive evidence of a contrary legislative intent," id. at 20, when the statute failed to provide expressly a private cause of action, the dissent would require instead "explicit purpose to deny such cause of action." Id. at 28, quoting Cort v. Ash, 422 U.S. 66, 82 (1975).

115 See Steinberg, Implied Private Rights of Action Under Federal Law, 55 Notre Dame Law. 33, 41 (1979) ("Legislation is often ambiguous, not because ambiguity is desirable, but because compromise, with the attendant loss of clarity, is required for passage of the legislation."). See generally J. SUTHERLAND, supra note 15, at ¶ 48.02.

116 See Cannon v. University of Chicago, 441 U.S. 677, 718 (1979) (Rehnquist, J., concurring) (Congress has "tended to rely [upon] the courts to decide whether there should be a private right of action, rather than determining the question for itself.").


test. Exacerbating the difficulty is Cort's description of the test elements as merely "relevant factors." This creates ambiguity which could be eliminated if the test were a step-by-step analysis, with each step a prerequisite to the next. Furthermore, the Cort test allows and perhaps encourages congressional laxity in drafting. This laxity enables judicial legislating — and to such an extent that Justice Powell, at least, has called for abandonment of the Cort test to avert "political default by Congress."

B. Alternative Legislative Solutions

Two critical parameters are involved in determining the desired form for a legislative solution to this dissatisfaction with the strict construction and Cort tests. First, the solution should be a comprehensive, rather than piecemeal, approach to implication questions in the securities field. The recent rash of implication cases demonstrates the potential scope of implied private rights of action in the securities field. Rather than undertaking the burdensome task of piecemeal consideration of prior enactments, Congress should endorse a private remedy for all securities statutes. Not only would a comprehensive statute place less burden on Congress, but it would also diminish the chance of inconsistent enactments or forgotten provisions.

Second, the comprehensive solution should be quasi-express. A quasi-express solution is a policy statement favoring implication, providing guidelines for the courts to decide when a right of action will be implied. The quasi-express remedy differs primarily from an express remedy in its flexibility of application.
The ultimate decision regarding any particular implied right of action is left, to some extent, with the courts.\textsuperscript{126} The quasi-express approach avoids the piecemeal consideration of implied rights of action that an express approach would necessitate, while still providing a greater measure of certainty and a more clear definition of congressional policy than are available under the Cort and strict construction tests.

\textbf{C. The ALI Proposal}

Proposed ALI Federal Securities Code section 1722(a)\textsuperscript{127} represents one such quasi-express legislative solution. Implication of a cause of action under the ALI proposal occurs upon satisfaction of four prerequisites. The plaintiff can then seek a right of action under a substantive provision, provided the substantive elements are met. Proposed section 1722(a) blends factual preconditions — directing the court to consider several factual elements, including “the nature of the defendant’s conduct, the degree of his culpability, the injury suffered . . . and the deterrent effect”\textsuperscript{128} — together with the Cort and strict construction tests.

The influence of the strict construction test is apparent in the ALI test’s first condition, limiting implication where inconsistent with express provisions. The Cort threshold inquiry surfaces in the second condition of the ALI test, requiring that implication occur under a provision “designed for the special benefit of a class of persons.” The last two parts of section 1722(a) emphasize the factual focus of the test. The third condition mandates that “under the circumstances” the remedy not be “disproportionate” to the violation, while the fourth condition sets a ceiling upon damages. Section 1722(a) thus creates a hurdle to be overcome before the underlying substantive provision can be ad-

\textsuperscript{126} See id. (judicial development of implied rights of action “as essential as it is unavoidable”).

\textsuperscript{127} Id. § 1722(a) provides:

A court, considering the nature of the defendant’s conduct, the degree of his culpability, the injury suffered by the plaintiff, and the deterrent effect of recognizing a private action may recognize [a private] action even though it is not expressly created . . . but only if (1) the action is not inconsistent with the conditions or restrictions in any of the actions expressly created or with the scheme of this [statute], (2) the provision, rule, or order that is the basis of the action is designed for the special benefit of a class of persons to which the plaintiff belongs against the kind of harm alleged, (3) the plaintiff satisfies the court that under the circumstances the type of remedy sought is not disproportionate to the alleged violation, and (4) in cases comparable to those [that expressly specify] a maximum measure of damages, a comparable maximum is imposed.

\textsuperscript{128} Id.
Thus, "satisfaction even of all four criteria" will not necessarily ensure recognition of a private right of action.\footnote{180} The ALI test represents a substantial improvement over the 
\textit{Cort} and strict construction tests.\footnote{181} The factual elements of the ALI test focus judicial attention in a consistent manner and also enable rejection of spurious suits.\footnote{182} The ALI test, by adopting a more even-handed approach to implication questions, eliminates the undue restrictiveness of the strict construction test.\footnote{183} The rigidity of the strict construction test may well have resulted from the difficulty encountered by the courts in restricting implied causes of action to deserving plaintiffs, once an implied right had been established.\footnote{184} The ALI test, with its factual prerequisites, substantially solves this difficulty.

In addition, the ALI test would provide greater certainty for those potentially liable under the securities laws. Under the 
\textit{Cort} and strict construction tests, implication is merely the first question addressed by the court. A host of collateral questions then are necessary to define the limits of the cause of action.\footnote{185} With-
out careful circumscription of the action, the securities participant faces uncertainty regarding his potential liability. The uncertainty and potential for expanded liability have a chilling effect upon actors in the securities industry.\textsuperscript{188} The ALI test, in contrast, likely will not have the same effect. The ALI test — by placing a ceiling on damages,\textsuperscript{187} and by allowing the imposition of liability only in egregious factual circumstances\textsuperscript{188} — creates a higher degree of certainty for securities market participants than either of the present implication tests.

The primary weakness of the ALI test is its imposition of a potentially heavy burden on the courts, by necessitating case-by-case analysis. Recent concerns with the federal court workload\textsuperscript{189} indicate the sensitivity of any proposal which might add to the already burgeoning federal docket. The increase occasioned by the ALI test, however, may be more illusory than real. Implied rights of action are litigated extensively under the Cort and strict construction tests; the new caseload would more than likely merely supplant the old. Furthermore, even assuming that the ALI test would increase the federal caseload, the burden of the new cases may be less than those arising under the present tests, because the issues are primarily factual rather than legal. Thus, the ALI test could reduce the workload at the appellate level.

Adding the fourth Cort prong — requiring consideration of whether implication impinges upon an area “traditionally relegated to state law” — to the ALI test would further diminish the likelihood of increasing federal court workloads.\textsuperscript{140} The Supreme Court has gone to great lengths to stress the importance of maintaining federal-state cooperation, especially in the securities area.\textsuperscript{141} This additional criterion would satisfy the Court’s concern, while limiting the federal caseload, by relegating cer-
tain causes of action to a state forum. Although this change would improve section 1722(a), its absence is not a fatal flaw.

CONCLUSION

Whether the Supreme Court will imply a private right of action under Securities Act section 17(a) is uncertain. The most recent cases indicate a marked split in the Court between the strict construction test of Redington and the Cort v. Ash analysis. While the strict construction test would not enable an implied private right of action for section 17(a), Cort would allow an implied private right of action under section 17(a)(3).

The divergent results for section 17(a) under the present implication tests amply demonstrate the need for legislative intervention. Congress should adopt a comprehensive, quasi-express implication statute — perhaps mirroring proposed ALI section 1722(a) — applying to all private causes of action arising under the securities statutes.

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143 The ALI drafters omitted the fourth Cort prong because they considered the desire for avoiding the needless addition of a federal action to be offset by the desire for "uniform federal coverage." ALI Fed. Sec. Code § 1722(a), Comment (3) (1978) (referring to id., § 1721, Comment 12).