

A NEW RATIONALE FOR IMPLYING PRIVATE RIGHTS OF ACTION AND SECTION 7 OF THE SECURITIES EXCHANGE ACT OF 1934

I. INTRODUCTION

In 1974, two Circuit Courts of Appeals refined a technique used to imply a private right of action on behalf of plaintiffs who were without express statutory remedies.¹ These new rationales, notwithstanding a later rebuke by the Supreme Court, are of particular importance to the administration of some areas of the Securities Exchange Act of 1934² (Exchange Act) because much of the litigation under this Act results from the implication of private rights of action.³ For example, some

1. *Stewart v. Travelers Corp.*, 503 F.2d 108 (9th Cir. 1974); *Ash v. Cort*, 496 F.2d 416 (3d Cir. 1974), *rev'd*, 422 U.S. 66 (1975).

2. Securities Exchange Act of 1934 §§ 1-34, 15 U.S.C. §§ 78a-78hh (1970) [hereinafter cited as Exchange Act].

3. For examples of private rights of action under § 10(b) of the Exchange Act, see *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 (1971); *Deckert v. Independence Shares Corp.*, 311 U.S. 282, 288 (1940); *Ruckle v. Roto Am. Corp.*, 339 F.2d 24 (2d Cir. 1964); *Boone v. Baugh*, 308 F.2d 711 (8th Cir. 1962); *Texas Continental Life Ins. Co. v. Dunne*, 307 F.2d 242 (6th Cir. 1962); *Estate Counselling Serv., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527 (10th Cir. 1962); *McClure v. Borne Chem. Co.*, 292 F.2d 824 (3d Cir.), *cert. denied*, 368 U.S. 939 (1961); *Ellis v. Carter*, 291 F.2d 270 (9th Cir. 1961); *Matheson v. Armbrust*, 284 F.2d 670 (9th Cir. 1960); *Hooper v. Mountain States Sec. Corp.*, 282 F.2d 195 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961); *Errion v. Connell*, 236 F.2d 447 (9th Cir. 1956); *Speed v. Transamerica Corp.*, 235 F.2d 369 (3d Cir. 1956); *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953); *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951); *Slavin v. Germantown Fire Ins. Co.*, 174 F.2d 799 (3d Cir. 1949); *Northern Trust Co. v. Essaness Theatres Corp.*, 103 F. Supp. 954 (N.D. Ill. 1952); *Rosenberg v. Globe Aircraft Corp.*, 80 F. Supp. 123 (E.D. Pa. 1948); *Fry v. Schumaker*, 83 F. Supp. 476 (E.D. Pa. 1947); *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946).

For examples of private rights of action under § 14(a) of the Exchange Act, see *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), *discussed in text* accompanying notes 23-26 *infra*; *Brown v. Bullock*, 294 F.2d 415 (2d Cir. 1961); *Dann v. Studebaker-Packard Corp.*, 288 F.2d 201 (6th Cir. 1961); *Central Foundry Co. v. Gondelman*, 166 F. Supp. 429 (S.D.N.Y. 1958); *Rosen v. Alleghany Corp.*, 133 F. Supp. 858 (S.D.N.Y. 1955); *Textron v. American Woolen Co.*, 122 F. Supp. 305 (D. Mass. 1954).

See also *Baird v. Franklin*, 141 F.2d 238 (2d Cir. 1944) (§ 27 of the Exchange Act); *Standard Fruit & S.S. Co. v. Midwest Stock Exch.*, 178 F. Supp. 669 (N.D. Ill. 1959) (§ 12(f) of the Exchange Act); *Thiele v. Shields*, 131 F. Supp. 416 (S.D.N.Y. 1955) (Securities Act of 1933 § 17(a), 15 U.S.C. § 779 (1970) [hereinafter cited as Securities Act]);

courts have allowed private actions under section 7 of the Exchange Act,⁴ the credit regulation section, but their reliance on traditional rationales has caused great difficulties.⁵ The 1974 cases could elimi-

Osborne v. Mallory, 86 F. Supp. 869 (S.D.N.Y. 1949) (same); Hawkins v. Merrill Lynch, Pierce, Fenner & Beane, 85 F. Supp. 104 (W.D. Ark. 1949) (§§ 17(a) and 11 (d)(2) of the Securities Act). See generally Comment, *Private Rights and Federal Remedies: Herein of J.I. Case Co. v. Borak*, 12 U.C.L.A. L. REV. 1150 (1965); Comment, *Private Actions and the Proxy Rules: The Basis and the Breadth of the Federal Remedy*, 31 U. CHI. L. REV. 328 (1964); Note, *Civil Liability Under Rule X-10b-5*, 42 VA. L. REV. 537 (1956); Comment, *Civil Remedies Available to Buyers and Sellers Under the 1933 and 1934 Federal Securities Laws*, 38 WASH. L. REV. 627 (1963).

For examples of other securities-type private rights, see Deaktor v. L.D. Schreiber & Co., 479 F.2d 529 (7th Cir.), *rev'd on other grounds*, 414 U.S. 113 (1973) (recognizing private right under Commodity Exchange Act, 7 U.S.C. §§ 1 to 17b (1970), *as amended*, (Supp. IV 1974)); Kauffman v. Dreyfus, Inc., 434 F.2d 727 (3d Cir. 1970), *cert. denied*, 401 U.S. 974 (1971) (no private right of action under Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to -21 (1970)); Colonial Realty Corp. v. Bache & Co., 358 F.2d 178 (2d Cir.), *cert. denied*, 385 U.S. 817 (1966) (no private right of action under stock exchange rules); Brouk v. Managed Funds, Inc., 286 F.2d 901 (8th Cir. 1961) (no private right of action for customer of adviser under Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to -21 (1970)); Bell v. J.D. Winer & Co., 392 F. Supp. 646, 651 (S.D.N.Y. 1975) (generally no private right of action under New York Stock Exchange rules); Seligson v. New York Produce Exch., 378 F. Supp. 1076, 1084 (S.D.N.Y. 1974) (recognized private right of action under Commodity Exchange Act, 7 U.S.C. §§ 1 to 17b (1970), *as amended*, (Supp. IV 1974). See generally Comment, *Exchange Liability for Improper Enforcement of Its Constitution and Rules: The Investor's Right of Action Under the Securities Exchange Act of 1934*, 24 EMORY L.J. 865 (1975); Comment, *Private Actions for the Broker's "Churning" of a Securities Account*, 40 MO. L. REV. 281 (1975).

For examples of other private rights, see Schiaffo v. Helstocki, 350 F. Supp. 1076, 1097 (D.N.J. 1972) (implied right under 39 U.S.C. §§ 3210-13, the congressional franking privilege). In *Farmland Indus., Inc. v. Kansas-Nebraska Natural Gas Co.*, 349 F. Supp. 670, 678-79 & n.1 (D. Neb. 1972), the court cites cases implying private rights of action in § 14 of the Exchange Act, 15 U.S.C. § 78n (1970); § 10b of the Exchange Act, 15 U.S.C. § 78j (1970); the fourth amendment; § 5 of the Voting Rights Act of 1965, 42 U.S.C. § 1973c (1970); § 16 of the Rivers and Harbors Act of 1899, ch. 425, 30 Stat. 1121; § 301(a) of the National Labor Relations Act, 29 U.S.C. § 185(a) (1970); § 2 of the Safety Appliance Act, 45 U.S.C. § 2 (1970); § 605 of the Communications Act of 1934, 47 U.S.C. § 605 (1970); § 44 of the Investment Company Act of 1940, 15 U.S.C. § 80a-43 (1970); and § 2 of the Railway Labor Act, 45 U.S.C. § 152 (1970). See generally Gard, *Purpose and Promise Unfulfilled: A Different View of Private Enforcement under the Federal Trade Commission Act*, 70 NW. U.L. REV. 274 (1975).

4. Exchange Act § 7, 15 U.S.C. § 78g (1970).

5. See, e.g., *Goldman v. Bank of the Commonwealth*, 467 F.2d 439 (6th Cir. 1972); *Pearlstein v. Scudder & German*, 429 F.2d 1136 (2d Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971); *Remar v. Clayton Sec. Corp.*, 81 F. Supp. 1014 (D. Mass. 1949). See generally Note, *Federal Margin Requirements As a Basis for Civil Liability*, 66 COLUM. L. REV. 1462 (1966); Comment, *Civil Liability for Margin Violations—The Effect of Section 7(f) and Regulation X*, 43 FORD. L. REV. 93 (1974); Note, *Regulation X and*

nate much of the confusion under section 7 because they provide the means to explore fully the statutory and policy implications of a private right of action. This Note will examine the traditional private right rationales, the 1974 cases, the operation of the credit provisions, and the application of the recent developments to section 7.

II. TRADITIONAL RATIONALES

On its surface, the Exchange Act seems to provide a formidable barrier to the implication of a private right of action. Congress enacted a broad regulatory scheme following the 1929 market crash.⁶ The breadth of this regulation suggests a major argument, based on the maxim of statutory construction *expressio unius est exclusio alterius*, against the implication of additional remedies. Congress clearly could have provided private rights throughout the Exchange Act. Instead, only certain sections expressly provide a private right of action.⁷ Thus, the omission of such rights elsewhere indicates an intent to limit private remedies to those select areas where clearly expressed.⁸ As compelling as this argument may be, courts have, with little reluctance, implied private rights of action by employing three rationales.⁹

The first attempts to broaden the investor protection of the Exchange Act by implying private rights of action were based upon section 29(b) of the Act.¹⁰ As originally enacted, section 29(b) provided that every contract in violation of the Exchange Act or its rules or regulations was void "as regards" the rights of the violator or anyone acquiring rights under the contract with knowledge of the violation.¹¹ In 1938, section 29(b) was amended to include a statute of limitations that applied to "any person"¹² and reached "any action maintained in reliance upon this

Investor-Lender Margin Violation Disputes, 57 MINN. L. REV. 208 (1972); Note, *In Pari Delicto As a Defense to Violations of Margin Legislation Under the Securities and Exchange Act of 1934*, 9 U. SAN. FRAN. L. REV. 113 (1974).

6. See Securities Act §§ 1-26, 15 U.S.C. §§ 77a-77z (1970); Exchange Act §§ 1-34, 15 U.S.C. §§ 78a-78hh (1970).

7. See Securities Act §§ 11, 12(1), 12(2), 15 U.S.C. §§ 77k, 77l(1), 77l(2) (1970); Exchange Act §§ 9(e), 16(b), 18, 15 U.S.C. §§ 78i(e), 78p(b), 78r (1970).

8. See Securities Act §§ 11, 12(1), 12(2), 15 U.S.C. §§ 77k, 77l(1), 77l(2) (1970); Exchange Act §§ 9(e), 16(b), 18, 15 U.S.C. §§ 78i(e), 78p(b), 78r (1970).

9. See sources cited notes 10-28 *infra* and accompanying text. See, e.g., *Goldman v. Bank of the Commonwealth*, 467 F.2d 439 (6th Cir. 1972); *Pearlstein v. Scudder & German*, 429 F.2d 1136 (2d Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971); *Remar v. Clayton Sec. Corp.*, 81 F. Supp. 1014 (D. Mass. 1949).

10. Exchange Act § 29(b), 15 U.S.C. § 78cc(b) (1970).

11. See Act of June 6, 1934, ch. 404, § 29b, 48 Stat. 903.

12. Exchange Act § 29(b), 15 U.S.C. § 78cc(b) (1970).

section."¹³ The courts interpreted this language as an affirmative sign that Congress, by its 1938 amendment, intended to provide implied private rights within the scheme of the Exchange Act.¹⁴ This reasoning resulted in the proliferation of private rights of action.¹⁵ The section 29(b) approach has been criticized for lacking liability limiters and precluding policy considerations.¹⁶

The second rationale used to imply private rights was based upon the concept that a statutory violation constitutes a tort.¹⁷ At common law, four requirements had to be met for the violation of a statute to be tortious. First, the individual must have been harmed by an act proscribed by the statute.¹⁸ Second, he must have been in the class of persons that the statute was intended to protect.¹⁹ Third, his injury must have been of the kind the statute was intended to prevent.²⁰ Finally, the injury must have been to an interest that the statute was intended to protect.²¹ One potential advantage of this approach is that it contains the liability limiters found in tort law.²² This rationale,

13. *Id.*

14. *See, e.g.,* Goldstein v. Groesbeck, 142 F.2d 422 (2d Cir.), *cert. denied*, 323 U.S. 737 (1944); Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946); Geismar v. Bond & Goodwin, Inc., 40 F. Supp. 876 (S.D.N.Y. 1941). *See also* Note, *Implying Civil Remedies From Federal Regulatory Statutes*, 77 HARV. L. REV. 285 (1963).

For the legislative history of § 29(b), see H.R. REP. No. 1383, 73d Cong., 2d Sess. 28 (1934); S. REP. No. 792, 73d Cong., 2d Sess. 23 (1934); H.R. REP. No. 1838, 73d Cong., 2d Sess. 37-38 (1934) (conference report; same text as S. DOC. No. 185, 73d Cong., 2d Sess. (1934)); S. REP. No. 1455, 75th Cong., 3d Sess. (1938).

15. *See* cases cited note 3 *supra* and accompanying text.

16. *See* Note, *Federal Margin Requirements As a Basis For Civil Liability*, 66 COLUM. L. REV. 1462, 1482 (1966).

17. *See, e.g.,* Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953); Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951); Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).

18. *See* Brown v. Bullock, 294 F.2d 415 (2d Cir. 1961); Dann v. Studebaker-Packard Corp., 288 F.2d 201 (6th Cir. 1961); Hooper v. Mountain States Sec. Corp., 282 F.2d 195 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961); Howard v. Furst, 238 F.2d 790 (2d Cir. 1956), *cert. denied*, 353 U.S. 937 (1957); Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951); Remar v. Clayton Sec. Corp., 81 F. Supp. 1014 (D. Mass. 1949); Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946); RESTATEMENT (SECOND) OF TORTS § 286 (1965).

19. RESTATEMENT (SECOND) OF TORTS § 286 (1965).

20. *Id.*

21. *Id.*

22. *See* Note, *supra* note 16, at 1471-73 (1966).

however, necessarily places great reliance on the stated purposes and legislative history of a statute. Consequently, the strict application of this approach may be crippled by an equivocal legislative history.

The third method used to imply private rights was the enforcement rationale expressed in *J.I. Case Co. v. Borak*.²³ Under this approach, courts have allowed private suits when necessary to enforce statutory provisions completely and effectively and to effectuate the goals of the statute.²⁴ This approach differed from the section 29(b) and tort rationales because the purpose and legislative history of the statute were not examined to determine whether the plaintiff met the fixed criteria for protection. Rather, the legislative history and purpose of an act were examined to determine whether the act required additional means of enforcement. If public enforcement was not fulfilling the congressional purpose, and an implied private right could provide a "necessary supplement"²⁵ to the act's enforcement, the implication was proper.²⁶ Although the enforcement approach is less dependent upon legislative history than the tort rationale, it lacks the guidelines for application found in tort law.²⁷ Each court, in its discretion, must decide what factors will establish a "necessary supplement"²⁸ and what factors should limit liability.

Although the three traditional rationales provide varied routes for the implication of private rights, each suffers from its own infirmity. The administration of the Exchange Act requires flexibility beyond that offered by the section 29(b) approach. Moreover, persons subject to Exchange Act regulation require uniformity of administration so they may plan their activities accordingly. The enforcement rationale may offer great flexibility, but because it calls for a wide-open inquiry into policy considerations, it presents a great threat to uniformity. The tort rationale, although it offers greater policy input and flexibility than the section 29(b) approach and includes clearly articulated liability limiters

23. 377 U.S. 426 (1964).

24. See, e.g., *Pearlstein v. Scudder & German*, 429 F.2d 1136 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971); *Goldstein v. Groesbeck*, 142 F.2d 422 (2d Cir.), cert. denied, 323 U.S. 737 (1944); *Baird v. Franklin*, 141 F.2d 238 (2d Cir.), cert. denied, 323 U.S. 737 (1944).

25. 377 U.S. at 432.

26. *Id.*

27. See notes 17-22 *supra* and accompanying text.

28. 377 U.S. at 432.

that are lacking in the enforcement rationale, must rely upon legislative history that may not be helpful.

III. NEW RATIONALES

A. *Circuit Court Cases*

In *Ash v. Cort*,²⁹ the plaintiff, a shareholder of Bethlehem Steel Corporation, brought suit against Bethlehem's directors for a corporate contribution to the Republican Party's 1972 presidential campaign in violation of 18 U.S.C. § 610 (1970).³⁰ Section 610 provided only a criminal penalty. Using a multi-pronged analysis that both synthesized the traditional rationales and added a new perspective, the Third Circuit stated first that in the absence of a clear congressional intention, the test for implying a private right rests initially upon determination of whether the plaintiff was within the class of persons that Congress intended to protect and whether the harm suffered was of the type that Congress intended to forestall.³¹ Since the plaintiff satisfied these criteria, the court proceeded to the second stage of its analysis: whether the requested remedy was appropriate in light of the statute's purposes.³² Like the enforcement rationale, this propriety test shifted the focus of inquiry from the tort rationale's reliance on legislative history to the statute's underlying purpose. The court stated:

Absent some reasonably clear indication of legislative attention to the possible creation of a cause of action, however, courts ascertain the policies underlying the substantive law and determine the propriety, as a means of effectuating those policies, of affording litigants a particular remedy.³³

29. 496 F.2d 418 (3d Cir. 1974), *rev'd*, 422 U.S. 66 (1975). See 53 TEXAS L. REV. 168 (1974). See generally McMahon & Rodos, *Judicial Implication of Private Causes of Action: Reappraisal and Retrenchment*, 80 DICK. L. REV. 167 (1976); Comment, *Civil Responsibility for Corporate Political Expenditures*, 20 U.C.L.A.L. REV. 1327 (1973); Comment, *Private Rights of Action Under Amtrak and Ash: Some Implications for Implication*, 123 U. PA. L. REV. 1392 (1975); 63 GEO. L.J. 1159 (1975); 12 HOUS. L. REV. 211 (1974); 47 MISS. L.J. 156 (1976); 6 RUTGERS-CAMDEN L.J. 453 (1974).

30. 18 U.S.C. § 610, *as amended*, (Supp. IV 1974), is part of the Federal Corrupt Practices Act, § 313, 43 Stat. 1074 (1925) (codified in scattered sections of 7, 18, 26 U.S.C.).

31. 496 F.2d at 421-22. Ash qualified as a voter and citizen. The harm to be forestalled was the "reduced . . . ability of voters to secure a government responsive to their wishes and [the] increased . . . likelihood of governmental actions favorable to particular economic blocks but inimical to the general welfare." *Id.* at 422.

32. *Id.*

33. *Id.* at 421, *citing* *Bivens v. Six Unknown Named Agents of Fed. Bureau of Narcotics*, 403 U.S. 388, 395-97 (1971) (opinion of the Court), 402-03 n.4 (Harlan, J.,

As part of this second stage of analysis, the court discussed two questions: whether the requested remedy would be inconsistent with the expressly provided remedies and whether an implied right would effectuate the purpose of the Act.³⁴ The *Ash* court found that section 610's express criminal sanction did not impede the implication of a private civil right because, as a penal statute, section 610 provided no remedy to the plaintiff.³⁵ Furthermore, the court found an implied private right consonant with the statute's purpose.³⁶

Finally, at its third stage of analysis, the court made its most important contribution by asking whether any "collateral" considerations³⁷ would inhibit the implication of a private right. First, the court disposed of the argument that the implication of a private right would bring a multiplicity of suits. Although limiting enforcement to criminal sanctions would prevent many suits, the underlying policy purposes, presumably as evidenced by the design of the statute, was "to protect many people from many possible violations."³⁸ Second, civil suits would help enforce the Act since "the number of putative defendants, committing acts more likely to be covert than notorious, is so great that government enforcement alone might prove insufficient . . ."³⁹ Third, the court considered whether the Act needed speedy enforcement. In the case of section 610, the court felt that election contribution violations, in particular, required quick enforcement because an election might be over before a violation could be remedied by criminal prosecution.⁴⁰ In contrast, civil remedies offered swift enforcement.⁴¹ Finally, the court asked whether an implied right would interfere with "a regulatory agency whose policy determinations on this or other matters might be threatened by allowing private enforcement."⁴² The court reasoned that the "nature" of the violation justified the interference.⁴³

concurring), and *Holloway v. Bristol-Myers Corp.*, 485 F.2d 986, 989-99 (D.C. Cir. 1973).

34. 496 F.2d at 421-22.

35. *Id.* at 422, citing *Wyandotte Transp. Co. v. United States*, 389 U.S. 191, 200-02 (1967), and *Texas & Pac. Ry. v. Rigsby*, 241 U.S. 33, 39-41 (1916).

36. 496 F.2d at 422-24.

37. *Id.* at 423.

38. *Id.*

39. *Id.*

40. *Id.* at 423-24.

41. *Id.* at 424.

42. *Id.*

43. *Id.* at 423-24. This justification was based upon the apparent conflict of interest

The *Ash* analysis is significant because it established qualitative guidelines that enable courts to explore more thoroughly the ramifications of implying a private right. It also provided a stage of analysis at which policy considerations could operate as the liability limiters that were lacking under the traditional rationales. The *Ash* court freed the private right analysis from the tort rationale's dependence upon what might be an equivocal legislative history. Moreover, the *Ash* "collateral considerations" supplied policy centered guideposts that the enforcement rationale failed to provide. The result was a more reasoned approach to implied private rights because the court attempted to square the purpose of the statute with the reality of agency administration without simply opening the doors to litigation.

The second case adding a dimension to the implication of private rights was *Stewart v. Travelers Corp.*⁴⁴ Plaintiff was discharged from his employment in violation of section 304 of the Consumer Credit Protection Act which forbids an employee's discharge for garnishment of wages due to one indebtedness.⁴⁵ After the Department of Labor refused to take action on Stewart's complaint, he brought suit against his former employer although the statute did not authorize a private remedy.

The *Stewart* court's initial analysis parallels that of *Ash*. First, the court determined whether the legislative history demonstrated an intent to imply a private right.⁴⁶ Since the legislative history was equivocal, the analysis incorporated a portion of the tort rationale to determine whether the plaintiff had met the criteria to justify further analysis.⁴⁷ The second stage of analysis determined whether the stat-

between a presidential administration as both prosecutor of the violation and the recipient of the violation's benefits; a successful presidential candidate receiving contributions in violation of the Act would be charged with enforcing the Act. Citing *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), the court stated in its "collateral considerations" analysis that "[t]he matter before us involves none of the 'special circumstances' discussed in *Borak* as counselling denial of a private cause of action." 496 F.2d at 424. The court failed to enumerate the "special circumstances" it considered.

44. 503 F.2d 108 (9th Cir. 1974). See generally Comment, *Restrictions on Garnishment and Their Enforcement: Focus on Judicial Implication of a Private Remedy*, 23 U. KAN. L. REV. 729 (1975); 54 NEB. L. REV. 744 (1975); 77 W. VA. L. REV. 601 (1974-75).

45. 15 U.S.C. § 1674(a) (1970).

46. 503 F.2d at 110-12.

47. *Id.*

ute's express remedies ensured the full effectiveness of its underlying purpose.⁴⁸

"In the absence of a clear congressional intent to the contrary, the courts are free to fashion appropriate civil remedies based on the violation of a penal statute where necessary to ensure the full effectiveness of the congressional purpose. . . . Where the interest asserted by the plaintiff is within the class that the statute was intended to protect, the harm of the type the statute was intended to forestall and the statutory criminal penalty inadequate to fully protect the asserted interest, a civil action for damages arises by implication."⁴⁹

At this second stage the court explored factors that might either bolster or weaken the argument for finding an implied private right. First, the court felt that an implied civil remedy would aid the achievement of the statute's purpose since the criminal sanctions failed to remedy the harm the statute was designed to forestall. Without a private right an individual was left unemplyed and "credit stricken."⁵⁰

Whatever may be the rule of "adequacy" elsewhere, we believe that when there is no clear congressional intent contrary to the implication of private civil remedies, the adequacy of a statute's express remedies (or alternatively, the necessity of implied private ones) must be determined according to whether those express remedies ensure the full effectiveness of the congressional purpose underlying the statute. . . . [T]he initial question is whether the statute's protection might be enhanced by allowing private civil relief.⁵¹

Second, the court found that the need to imply a private right was overcome by neither the Department of Labor's mandate nor alternative statutory or state law remedies. Third, the court asked whether an implied private right "might diminish the efficient and fair administration of the statute in question given the complexity of the act and the interests of those regulated by it."⁵² The court found that an implied right would not disrupt the "general administration of . . . the Act, or unfairly affect the interests of employers."⁵³

48. *Id.* at 112.

49. *Id.* at 110, *quoting* *Burke v. Compania Mexicana de Aviacion, S.A.*, 433 F.2d 1031, 1033-34 (9th Cir. 1970), *and citing* *Wyandotte Transp. Co. v. United States*, 389 U.S. 191 (1967), *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), *and* *Texas & Pac. Ry. v. Rigsby*, 241 U.S. 33 (1916).

50. 503 F.2d at 113.

51. *Id.* at 112.

52. *Id.* (footnote omitted).

53. *Id.* at 113 (footnote omitted). "The issues raised in § 1674(a) claim [*sic*] are

While consistent with the *Ash* rationale, *Stewart* dealt more completely with the questions of discretionary agency enforcement and the effect of a private right upon both the regulators and the subjects of regulation. When taken together, *Ash* and *Stewart* provide a comprehensive scheme of analysis applicable to the administration of the securities acts.

B. Supreme Court Case

In June 1975, the United States Supreme Court reversed *Ash*, but did little damage to the Third Circuit's analytical framework.⁵⁴ The Court found an implied private right inappropriate because of intervening law⁵⁵—the Federal Election Campaign Act Amendments of 1974⁵⁶—a different interpretation of section 610's underlying purpose,⁵⁷ and what the Court considered an "intru[sion] into an area traditionally committed to state law without aiding the main purpose of § 610"⁵⁸

Despite the reversal, the Court's private right analysis was remarkably similar to the Third Circuit's analysis.

simple ones, not requiring special knowledge of the economics or other intricacies of a particular industry or type of employer." *Id.*

54. *Cort v. Ash*, 422 U.S. 66 (1975). Recently, the Third Circuit faced another implied private right of action case, *Polansky v. Trans World Airlines, Inc.*, 523 F.2d 332 (3d Cir. 1975). Plaintiffs brought suit under the Federal Aviation Act §§ 404(b), 411, 49 U.S.C. §§ 1374(b), 1381 (1970), which prohibits discrimination in air transportation and gives the Civil Aeronautics Board power to investigate unfair or deceptive practices in air transportation. Plaintiffs argued that they were the subjects of discrimination because they purchased first class hotel accommodations, but were given accommodations inferior to those given other members of the tour who paid less. After reciting the test used by the Supreme Court in *Cort v. Ash*, the court refused to imply a private right of action because the "plaintiff-appellants did not suffer the harm the statute was designed to prevent;" a private right of action "would serve no statutory purpose;" state law offered an adequate remedy; and a private right of action would "undercut . . . [the Civil Aeronautics Board's] discretion." 523 F.2d at 335, 337, 338, 339. See *Securities Investor Protection Corp. v. Barbour*, 421 U.S. 412 (1975); *National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers*, 414 U.S. 453 (1974).

55. 422 U.S. at 76-77.

56. Pub. L. No. 93-443, 88 Stat. 1263 (codified in scattered sections of 2, 5, 18, 26, 47 U.S.C.), amending Federal Election Campaign Act of 1971, Pub. L. No. 92-225, 86 Stat. 3 (codified in scattered sections of 2, 18, 47 U.S.C.). The Supreme Court struck down the contribution and expenditure limitations and the appointment provisions of the Federal Election Campaign Act Amendments of 1974 in *Buckley v. Valeo*, 96 S. Ct. 612 (1976).

57. 422 U.S. at 80-81.

58. *Id.* at 85.

First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted . . . ?"⁵⁹ Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one?⁶⁰ Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff?⁶¹ And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?⁶²

The Court was concerned initially with the Federal Election Campaign Act Amendments of 1974 that established the Federal Election Commission (FEC) and provided procedures under which an individual who suspects a section 610 violation may file a complaint with the FEC.⁶³ The FEC may transfer a complaint to the Attorney General, or investigate it and then request the Attorney General to file a civil suit.⁶⁴ The Court held:

if subsequent to the judgment and before the decision of the appellate court, a law intervenes and positively changes the rule that governs, the law must be obeyed In such a case the court must decide according to existing laws, and if it be necessary to set aside a judgment, rightful when rendered, but which cannot be affirmed but in violation of law, the judgment must be set aside.⁶⁵

Second, the Court believed that the underlying purpose of section 610 was to "[destroy] the influence over elections which corporations exer-

59. *Id.* at 78, quoting *Texas & Pac. Ry. v. Rigsby*, 241 U.S. 33, 39 (1916) (emphasis added by Court).

60. 422 U.S. at 78, citing *National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers*, 414 U.S. 453, 458, 460 (1974).

61. 422 U.S. at 78, citing *Securities Investor Protection Corp. v. Barbour*, 421 U.S. 412, 423 (1975), *National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers*, 414 U.S. 453 (1974), and *Calhoun v. Harvey*, 379 U.S. 134 (1964).

62. 422 U.S. at 78, citing *Wheeldin v. Wheeler*, 373 U.S. 647, 652 (1963), *Bivens v. Six Unknown Named Agents of Fed. Bureau of Narcotics*, 403 U.S. 388, 394-95 (1971), *id.* at 400 (Harlan, J., concurring), and *J.I. Case Co. v. Borak*, 377 U.S. 426, 434 (1964).

63. 2 U.S.C. §§ 437c(a)(1), 437g (Supp. V 1975).

64. 2 U.S.C. §§ 437g(a)(2)(A), (a)(2)(B), (a)(7) (Supp. V 1975).

65. 422 U.S. at 76, quoting *United States v. Schooner Peggy*, 5 U.S. (1 Cranch) 103, 110 (1801). The Court went on to quote *Bradley v. Richmond School Bd.*, 416 U.S. 696, 711 (1974), to the effect that had the decision under the intervening law "[resulted] in manifest injustice" or had there been "statutory direction or legislative history to the contrary," application of the intervening law would have been denied. 422 U.S. at 77.

cised through financial contribution,"⁶⁶ and that the protection of corporate shareholders, although a subsidiary purpose, was not a sufficiently compelling basis for implying a private right without the added impetus of other factors counselling for the implication.⁶⁷

The Court's third basis for the reversal was its belief that shareholder affairs are largely a concern of the states. Since there was no indication that Congress intended to broaden the protection available under state law, the Court thought that no right of action should be implied.⁶⁸ Therefore, the Court reasoned that a private right of action would not further the purpose of section 610, but would interfere with state law.

It is important to note that the Court did not criticize the Third Circuit's analytical framework; the Court simply disagreed with the answers the Third Circuit supplied to flesh out the structure. It is not difficult to reconcile the analyses of the Court and the Third Circuit. First, the enactment of intervening law clearly does no violence to the Third Circuit's analysis. Presumably, had the Amendments been the law at the time of the Third Circuit's decision, that court would have been presented with a different case. Likewise, the Court's understanding of section 610's underlying purpose does not damage the analysis, but rather substitutes a different answer to the same question. Finally, the Court's consideration of the possibility of interference with state law easily fits into the Third Circuit's "collateral considerations" inquiry. The Third Circuit's failure to evaluate interference with state law may be attributed to oversight or a failure to develop fully all relevant collateral considerations.

The Third Circuit's class of persons-type of harm analysis easily fits within the Supreme Court's "especial benefit" test. Likewise, the Third Circuit's inquiry into the propriety of the implication in light of the statute's purpose, including the implication's consistency with the express remedies and its ability to further effectuate the statute, clearly comports with the Supreme Court's inquiry into the statute's underlying

66. 422 U.S. at 80.

67. *Id.*

68. *Id.* at 82-83. The Supreme Court's belief that shareholder affairs are largely a concern of the states is disputable. See generally Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974); Fleischer, *Federal Regulation of Internal Corporate Affairs*, 29 BUS. LAW, 179 (1974) (special issue); Malley, *Far-Reaching Equitable Remedies Under the Securities Acts and the Growth of Federal Corporate Law*, 17 WM. & MARY L. REV. 47 (1975).

purpose and congressional intent to create or deny the remedy. Moreover, the Court's concern with federal interference with state matters is a "collateral consideration" that the Third Circuit apparently would have deemed appropriate to investigate, although it did not do so.

Nevertheless, the Supreme Court's analysis appears to modify the Third Circuit's technique. The modification is twofold. First, the Court more narrowly defined the class for whose "especial benefit" the statute was enacted and the underlying purpose of the statute. Presumably, a class of persons attempting to convince a court of the propriety of an implied private right will have to make a strong showing that they are especial beneficiaries of congressional action. The Court also denied the ability of a court to imply a private right based upon a secondary purpose of a statute without additional supporting circumstances.⁶⁹ This is a significant narrowing that may have a great effect in the securities area. The Court's last point of analysis, interference with state law, may appear to be in conflict with the Third Circuit's wide-open collateral considerations inquiry, but the Court did consider the effect of intervening law, a collateral consideration itself, and presumably the Third Circuit would have investigated any other collateral considerations it believed were relevant.

IV. CREDIT REGULATION

The *Ash* and *Stewart* rationales are peculiarly suited for application to the Exchange Act. They are valuable because they take into account the complications of implying a private right under a broad regulatory scheme that is administered by an agency whose efficacy may be impaired by such an implication. Furthermore, the collateral considerations and underlying statutory purpose inquiries of these rationales accommodate the delicate control that the Securities and Exchange Commission must maintain to administer the complexities of the acts and monitor the effects of its administration. These complexities are present in the area of credit regulation under section 7 of the Exchange Act.⁷⁰ This area, therefore, offers a suitable vehicle for testing the *Ash*

69. 422 U.S. at 80-83.

70. 15 U.S.C. § 78g (1970). For examples of cases recognizing a private right of action, see *Zapach v. Elkins, Morris, Stroud & Co.*, 375 F. Supp. 669, 672 n.8 (M.D. Pa. 1973) (private right recognized, but not granted); *Hornblower & Weeks-Hemphill*, *Noyes v. Burchfield*, 366 F. Supp. 1364, 1368 (S.D.N.Y. 1973) (same); *Golob v. Nauman Vandervoort, Inc.*, 353 F. Supp. 1264, 1268 (N.D. Ohio 1972) (same); *Spoon*

and *Stewart* rationales. In addition to the complexity of the Exchange Act's administration, section 7 has an equivocal legislative history. Moreover, private rights of action for credit provision violations have had a confused and turbulent history. Finally, the confusion has been sustained by developments in the last several years that appear to have restricted the availability of implied private rights under section 7.

A. *Background of Credit Regulation*

Section 7 of the Exchange Act and regulations promulgated by the Federal Reserve Board (FRB) pursuant to this section provide the statutory framework within which credit is extended for the purpose of purchasing or carrying securities. Section 7 directs that:

(a) For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall . . . prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained⁷¹

Furthermore, the FRB has the authority to raise and lower the margin requirements when

necessary or appropriate for the accommodation of commerce and industry, having due regard to the general credit situation of the country, and . . . as it may deem necessary or appropriate to prevent the excessive use of credit to finance transactions in securities.⁷²

Section 7(c)⁷³ subjects brokers, dealers, and members of any national securities exchange to the rule and regulation-making power of the FRB. Section 7(d)⁷⁴ is a catchall provision that subjects persons not covered by section 7(c) to the FRB's authority.

v. *Walston & Co.*, 345 F. Supp. 518, 521 (E.D. Mich. 1972), *aff'd*, 478 F.2d 246 (6th Cir. 1973) (private right recognized; loss split between the parties); *Manevich v. duPont*, 338 F. Supp. 1124, 1126, 1129 (S.D.N.Y.), *aff'd mem.*, 465 F.2d 1398 (2d Cir. 1972) (private right recognized, but not granted); *Bowman v. Hartig*, 334 F. Supp. 1323, 1327 (S.D.N.Y. 1971) (same).

71. 15 U.S.C. § 78g(a) (1970). Margin transactions operate such that, for example, if the margin requirement is 70 percent, a margin purchase in a general account requires the investor to deposit with the lender 70 percent of the purchase price in either cash or securities. See 12 C.F.R. §§ 220.3, 220.8 (1976). The FRB also establishes the loan value of margin securities that may be deposited to meet the required downpayment. See 12 C.F.R. §§ 220.3(c), 220.8 (1976).

72. Exchange Act § 7(h), 15 U.S.C. § 72g(b) (1970).

73. Exchange Act § 7(c), 15 U.S.C. § 78g(c) (1970).

74. Exchange Act § 7(d), 15 U.S.C. § 78g(d) (1970).

The FRB, pursuant to section 7, promulgated Regulations T, U, and G. Regulation T⁷⁵ applies to every broker, dealer, or member of a national securities exchange extending credit for the purpose of purchasing or carrying securities. Similarly, Regulation U⁷⁶ applies to banks and Regulation G⁷⁷ applies to other lenders. Although it would be instructive for those desiring to understand the comprehensive scheme of federal credit regulation to explore Regulations G and U in addition to Regulation T, the application and underlying considerations of Regulations G and U are closely related to those of Regulation T. Therefore, the following discussion will be limited to Regulation T.

75. 12 C.F.R. § 220 (1976). For examples of cases dealing with Regulation T, see *Grimes, Hooper & Messer, Inc. v. Pierce*, 519 F.2d 1089 (9th Cir. 1975); *McCormick v. Esposito*, 500 F.2d 620, 622, 623 (5th Cir. 1974); *Kavit v. A.L. Stamm & Co.*, 491 F.2d 1176, 1181 n.6, 1182 (2d Cir. 1974); *Landry v. Hemphill, Noyes & Co.*, 473 F.2d 365, 370 (1st Cir. 1973); *Naftalin & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 469 F.2d 1166, 1171, 1180 (8th Cir. 1972); *Pearlstein v. Scudder & German*, 429 F.2d 1136, 1140 (2d Cir. 1970) (*citing* *Bronner v. Goldman*, 361 F.2d 759 (1st Cir.), *cert. denied*, 385 U.S. 933 (1966), *Washow v. H. Hentz & Co.*, 199 F. Supp. 581 (S.D.N.Y. 1961), *and Remar v. Clayton Sec. Corp.*, 81 F. Supp. 1014 (D. Mass. 1949)); *Junger v. Hertz, Neumark & Warner*, 426 F.2d 805, 806 (2d Cir. 1970) (*citing* *Smith v. Bear*, 237 F.2d 79 (2d Cir. 1956), *and Remar v. Clayton Sec. Corp.*, 81 F. Supp. 1014 (D. Mass. 1949)); *Bronner v. Goldman*, 361 F.2d 759, 762 (1st Cir.), *cert. denied*, 385 U.S. 933 (1966); *Goldenberg v. Bache & Co.*, 270 F.2d 675, 680 (5th Cir. 1959); *Newman v. Pershing & Co.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,060 (S.D.N.Y. 1975); *Jennings v. Boenning & Co.*, 388 F. Supp. 1294, 1298 (E.D. Pa. 1975); *Utah v. duPont Walston, Inc.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,812, at 96,715 (D. Utah 1974); *Zapach v. Elkins, Morris, Stroud & Co.*, 375 F. Supp. 669, 670, 672 n.8 (M.D. Pa. 1973); *Hornblower & Weeks-Hemphill, Noyes v. Burchfield*, 366 F. Supp. 1364, 1368 (S.D.N.Y. 1973); *Spoon v. Walston & Co.*, 345 F. Supp. 518, 519, 521 (E.D. Mich. 1972), *aff'd*, 478 F.2d 246 (6th Cir. 1973); *Manevich v. duPont*, 338 F. Supp. 1124, 1125-26 (S.D.N.Y.), *aff'd mem.*, 465 F.2d 1398 (2d Cir. 1972); *Avery v. Merrill Lynch, Pierce, Fenner & Smith*, 328 F. Supp. 677, 677 (D.D.C. 1971).

76. 12 C.F.R. § 221 (1976). *See, e.g.*, *Daley v. Capitol Bank & Trust Co.*, 506 F.2d 1375, 1376 (1st Cir. 1974) (recognized private right of action under Regulation U and granted rescission under § 29(b) of Exchange Act); *Goldman v. Bank of the Commonwealth*, 467 F.2d 439, 440, 445 (6th Cir. 1972) (recognized private right of action under Regulation U, but plaintiff did not prevail); *Stonehill v. Security Nat'l Bank*, [Current] CCH FED. SEC. L. REP. ¶ 95,224 (S.D.N.Y. July 1, 1975) (recognized private right of action under Regulation U); *Teitelbaum v. Scranton Nat'l Bank*, 384 F. Supp. 1139, 1141 (M.D. Pa. 1974) (same); *Cooper v. Union Bank*, 354 F. Supp. 669, 676 (C.D. Cal. 1973) (same); *Tartell v. Chelsea Nat'l Bank*, 351 F. Supp. 1071, 1077 (S.D.N.Y.), *aff'd per curiam*, 470 F.2d 994 (2d Cir. 1972) (recognized private right of action under Regulation U, but plaintiff did not prevail).

77. 12 C.F.R. § 207 (1976). *See, e.g.*, *Caldwell v. Genesco Employees Credit Ass'n*, 393 F. Supp. 741, 743 (M.D. Tenn. 1975) (private right of action recognized under Regulation G).

Regulation T permits brokers to maintain several different types of investor accounts. In the "general account,"⁷⁸ the required margin payment must be deposited in the account within "5 full business days following the date of such transaction"⁷⁹ Margin payments may be in the form of either cash, securities that have been assigned a loan value by the FRB, or both.⁸⁰ Investors may not withdraw cash or securities deposited in such an account if the withdrawal would reduce the value of the account below the required level.⁸¹ If the deposit has not been made within the specified time, Regulation T requires the broker-creditor to liquidate securities sufficient to reestablish the proper margin level.⁸²

In a "special cash account,"⁸³ a creditor may purchase or sell securities for a customer if the cash necessary for the purchase is in the margin account or if the investor has in good faith agreed that he does not contemplate selling the securities before payment and that payment will be made "within 7 days after the date on which the security is so purchased"⁸⁴ Like "general account" transactions, if payment is not made within the specified time, the creditor must either cancel the transaction or liquidate the securities.⁸⁵

B. *The Law Before Regulation X*

Before 1971, creditors who violated section 7 had little hope of successfully defending against a private right regardless of the investor's knowledge of the illegal extension of credit. Courts implied a private right of action in favor of investors objecting to credit extensions larger than that initially allowed⁸⁶ or for the creditor's failure to liquidate

78. 12 C.F.R. § 220.3 (1976).

79. *Id.* § 220.3(b)(1)(i) (1976).

80. *Id.*

81. *Id.* § 220.3(b)(2) (1976).

82. *Id.* § 220.3(e) (1976).

83. *Id.* § 220.4(c) (1976).

84. *Id.* § 220.4(c)(2) (1976).

85. *Id.*

86. *See, e.g.,* Landry v. Hemphill, Noyes & Co., 473 F.2d 365 (1st Cir.), *cert. denied*, 414 U.S. 1002 (1973); Goldman v. Bank of the Commonwealth, 467 F.2d 439 (6th Cir. 1972); Avery v. Merrill Lynch, Pierce, Fenner & Smith, 328 F. Supp. 677 (D.D.C. 1971); Cooper v. North Jersey Trust Co., 226 F. Supp. 972 (S.D.N.Y. 1964); Warshaw v. H. Hentz & Co., 199 F. Supp. 581 (S.D.N.Y. 1961); Remar v. Clayton Sec. Corp., 81 F. Supp. 1014 (D. Mass. 1949). *See also* source cited note 72 *supra* and accompanying text.

securities when required by the regulations.⁸⁷ Courts used all three private right rationales.

The section 29(b) rationale for finding an implied private right has been the least controversial approach.⁸⁸ This may be due in large part to the resemblance of the rationale to an express remedy.⁸⁹ Consequently, courts provided investors suing for margin violations several avenues for relief. First, courts granted rescission.⁹⁰ Second, investors recovered damages.⁹¹ Third, investors enforced their contracts,⁹² and finally, courts allowed investors to use section 29(b) as a defense to creditors' claims for unpaid monies required to finance transactions.⁹³

Under this section 29(b) approach, an investor may be able to rescind his contract with a broker who simply arranged with a third party for a loan to the investor even though the contract between the investor and his broker was not illegal. Furthermore, in an action

87. See, e.g., *Spoon v. Walston & Co.*, 478 F.2d 246 (6th Cir. 1973) (per curiam); *Naftalin & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 469 F.2d 1166 (8th Cir. 1972); *Pearlstein v. Scudder & German*, 429 F.2d 1136 (2d Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971). See also sources cited notes 81-86 *supra* and accompanying text.

88. For examples of the § 29(b) rationale, see *Daley v. Capitol Bank & Trust Co.*, 506 F.2d 1375, 1376 (1st Cir. 1974); *Naftalin & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 469 F.2d 1166 (8th Cir. 1972); *Goldman v. Bank of the Commonwealth*, 467 F.2d 439, 444, 446 (6th Cir. 1972); *Goldenberg v. Bache & Co.*, 270 F.2d 675 (5th Cir. 1959); *Stonehill v. Security Nat'l Bank*, [Current] CCH FED. SEC. L. REP. ¶ 95,224, at 98,172 (S.D.N.Y. July 1, 1975); *Newman v. Pershing & Co.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,060 (S.D.N.Y. 1975) (recognized private right of action under § 29(b), but plaintiff did not prevail); *Caldwell v. Genesco Employees Credit Ass'n*, 393 F. Supp. 741 (M.D. Tenn. 1975); *Cooper v. Union Bank*, 354 F. Supp. 669, 674 (C.D. Cal. 1973); *Avery v. Merrill Lynch, Pierce, Fenner & Smith*, 328 F. Supp. 677, 678 (D.D.C. 1971); text accompanying notes 10-16 *supra*.

89. See 3 L. LOSS, SECURITIES REGULATION 1759 (2d ed. 1961).

90. See, e.g., *Spoon v. Walston & Co.*, 478 F.2d 246 (6th Cir. 1973) (per curiam); *Avery v. Merrill Lynch, Pierce, Fenner & Smith*, 328 F. Supp. 677 (D.D.C. 1971); *Warshow v. H. Hentz & Co.*, 199 F. Supp. 581 (S.D.N.Y. 1961). *But see Landry v. Hemphill, Noyes & Co.*, 473 F.2d 365 (1st Cir.), *cert. denied*, 414 U.S. 1002 (1973) (rescission denied because plaintiff did not show Regulation T violation induced purchase that would not have occurred otherwise); *Newman v. Pershing & Co.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,060 (S.D.N.Y. 1975) (same).

91. See, e.g., *Landry v. Hemphill, Noyes & Co.*, 473 F.2d 365, 372 (1st Cir.), *cert. denied*, 414 U.S. 1002 (1973); *Warshow v. H. Hentz & Co.*, 199 F. Supp. 581 (S.D.N.Y. 1961); *Geismar v. Bond & Goodwin, Inc.*, 40 F. Supp. 876 (S.D.N.Y. 1941) (damages recoverable under § 29(b), but not a margin violation case).

92. See, e.g., *Myer v. Shields & Co.*, 25 App. Div. 2d 126, 267 N.Y.S.2d 872 (1966).

93. See, e.g., *Goldman v. Bank of the Commonwealth*, 467 F.2d 439 (6th Cir. 1972); *Goldenberg v. Bache & Co.*, 270 F.2d 675 (5th Cir. 1959); *Cooper v. Union Bank*, 354 F. Supp. 669 (C.D. Cal. 1973).

under section 29(b), even investors who knowingly received illegal credit could prevail because the lenders' rights under the contracts were voidable.⁹⁴

The application of the tort rationale to margin violations first appeared in *Remar v. Clayton Securities Corp.*⁹⁵ In *Remar*, the court allowed the plaintiff-investor to recover even though he received credit with knowledge of its illegality. To use this rationale, the court grasped what it considered to be a secondary purpose of section 7, the protection of investors, and elevated it to a position sufficient to support the implication of a private right.⁹⁶ Further, because section 7 charged the creditor with the duty to comply with the margin requirements, the investor's knowledge of the violation was irrelevant to the determination whether to afford him a right of action.⁹⁷

The courts have been criticized for using the tort rationale in a way inconsistent with section 7's legislative history, which indicated that Congress was concerned not with the protection of investors, but rather with the effect of excessive credit on the securities markets and the economy.⁹⁸ Congress considered the protection of investors only a by-

94. See, e.g., *Spoon v. Walston & Co.*, 478 F.2d 246 (6th Cir. 1973) (per curiam); *Goldman v. Bank of the Commonwealth*, 467 F.2d 439 (6th Cir. 1972); *Goldenberg v. Bache & Co.*, 270 F.2d 675 (5th Cir. 1959); *Avery v. Merrill Lynch, Pierce, Fenner & Smith*, 328 F. Supp. 677 (D.D.C. 1971).

95. 81 F. Supp. 1014 (D. Mass. 1949).

96. *Id.* at 1017. For the further development of a private right via the tort rationale under § 7 of the Exchange Act, see *Landry v. Hemphill, Noyes & Co.*, 473 F.2d 365 (1st Cir.), cert. denied, 414 U.S. 1002 (1973); *Goldman v. Bank of the Commonwealth*, 467 F.2d 439, 446 (6th Cir. 1972); *Junger v. Hertz, Neumark & Warner*, 426 F.2d 805, 806 n.1 (2d Cir.), cert. denied, 400 U.S. 880 (1970) (recognized private right of action under the tort rationale, but plaintiff failed to prove the cause of action); *Bronner v. Goldman*, 361 F.2d 759 (1st Cir.), cert. denied, 385 U.S. 933 (1966); *Goldenberg v. Bache & Co.*, 270 F.2d 675, 680 (5th Cir. 1959); *Hornblower & Weeks-Hemphill, Noyes v. Burchfield*, 366 F. Supp. 1364, 1368 (S.D.N.Y. 1973) (recognized private right of action under tort rationale, but action barred by statute of limitations); *Aubin v. H. Hentz & Co.*, 303 F. Supp. 1119 (S.D. Fla. 1969); *Cooper v. North Jersey Trust Co.*, 226 F. Supp. 972 (S.D.N.Y. 1964).

97. See, e.g., *Avery v. Merrill Lynch, Pierce, Fenner & Smith*, 328 F. Supp. 677 (D.D.C. 1971).

98. See *Pearlstein v. Scudder & German*, 429 F.2d 1136, 1140 n.7 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971).

The House Committee on Interstate and Foreign Commerce stated:

The main purpose [of margin provisions] is to give a Government credit agency an effective method of reducing the aggregate amount of the nation's credit resources which can be directed by speculation into the stock market and out of other more desirable uses of commerce and industry—to prevent a recur-

product of the credit regulation legislation.⁹⁹ Furthermore, under this approach, courts have largely defused the liability limiters normally found within tort law. For example, contributory negligence has been removed as a lender's defense because section 7 and the regulations place the "burden of compliance" upon the lender.¹⁰⁰

Likewise, under the enforcement rationale in *Pearlstein v. Scudder & German*,¹⁰¹ an investor who knowingly participated in an illegal credit extension recovered against his creditor. Although a strong dissent urged that a private right under the circumstances would tend to encourage margin violations by investors,¹⁰² the majority felt that the aid an implied right offered to enforcement justified the "windfall . . . an

rence of the pre-crash situation where funds which would otherwise have been available at normal interest rates for uses of local commerce, industry and agriculture, were drained by far higher rates into security loans and the New York call market.

H.R. REP. NO. 1383, 73d Cong., 2d Sess. 8 (1934).

99. See H.R. REP. NO. 1383, 73d Cong., 2d Sess. 7, 8 (1934).

100. See *Pearlstein v. Scudder & German*, 429 F.2d 1136 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971); *Avery v. Merrill Lynch, Pierce, Fenner & Smith*, 328 F. Supp. 677, 680 (D.D.C. 1971); *Remar v. Clayton Sec. Corp.*, 81 F. Supp. 1014, 1017 (D. Mass. 1949). The courts generally have felt that to superimpose contributory negligence and causation on an implied private right of action under § 7 would obviate the statute's purpose. *Avery v. Merrill Lynch, Pierce, Fenner & Smith*, supra. Another limiter discussed recently by the courts is the statute of limitations applicable to a private right of action under § 7 of the Exchange Act. Since there is no statute of limitations in § 7 or the regulations, courts have applied the statute of the forum state. When two or more of the state's statutes of limitations might be applied, courts have chosen the statute that effectuates federal policy, but have looked to federal law to determine from what time the statute begins to run. Generally, the statute runs from the time of the wrongful act. See *Jennings v. Boenning & Co.*, 388 F. Supp. 1294, 1300-03 (E.D. Pa. 1975) (citing *Klein v. Bower*, 421 F.2d 338 (2d Cir. 1970), *Azalea Meats, Inc. v. Muscat*, 386 F.2d 5 (5th Cir. 1967), *Jannigan v. Taylor*, 344 F.2d 781 (1st Cir. 1965), *Moviecolor Ltd. v. Eastman Kodak Co.*, 288 F.2d 80 (2d Cir. 1961), *Shapiro v. Paramount Film Distrib. Corp.*, 274 F.2d 743 (3d Cir. 1960), *Goldenberg v. Bache & Co.*, 270 F.2d 675 (5th Cir. 1959), *Gammage v. Roberts, Scott & Co.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,760 (S.D. Cal. 1974), *Hornblower & Weeks-Hemphill, Noyes v. Burchfield*, 366 F. Supp. 1364 (S.D.N.Y. 1973), *McDonald v. Boslow*, 363 F. Supp. 493 (D. Md. 1973), *Maine v. Leonard*, 353 F. Supp. 968 (W.D. Va. 1973), and *Josef's of Palm Beach, Inc. v. Southern Investment Co.*, 349 F. Supp. 1057 (S.D. Fla. 1972)); *Merkens v. F.I. duPont, Gloré Forgan & Co.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,868, at 96,954 (S.D.N.Y. 1974); *Gammage v. Roberts, Scott & Co.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,760, at 96,498 (S.D. Cal. 1974); *Hornblower & Weeks-Hemphill, Noyes v. Burchfield*, 366 F. Supp. 1364, 1368 (S.D.N.Y. 1973).

101. 429 F.2d 1136 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971).

102. *Id.* at 1148 (Friendly, J., dissenting).

unscrupulous investor" might receive.¹⁰³ Furthermore, consonant with the enforcement rationale, courts have denied the defense of *in pari delicto* to creditors who violated the regulations because section 7's legislative history embraces the view that the investor has no duty of compliance, and, therefore, an investor cannot be at equal fault with the creditor.¹⁰⁴

C. *Consequences of Pre-Regulation X Cases*

Under the statute, regulation, and cases, an investor could receive

103. *Id.* at 1141.

104. *See, e.g.,* Spoon v. Walston & Co., 478 F.2d 246 (6th Cir. 1973); Naftalin & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 469 F.2d 1166 (8th Cir. 1972); Pearlstein v. Scudder & German, 429 F.2d 1136 (2d Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971); Avery v. Merrill Lynch, Pierce, Fenner & Smith, 328 F. Supp. 677 (D.D.C. 1971). The authority for this view comes from the denial of an *in pari delicto* defense under the antitrust laws. *See* Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134 (1968).

For other cases mapping out the boundaries of the private right of action under § 7, see Daley v. Capitol Bank & Trust Co., 506 F.2d 1375 (1st Cir. 1974) (bank's failure to segregate collateral held for Regulation U loans from other loans does not convert nonRegulation U loans into Regulation U loans); Kavitt v. A.L. Stamm & Co., 491 F.2d 1176, 1182 (2d Cir. 1974) (innocent mistake excused by Regulation T); Newman v. Pershing & Co., [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,060, at 97,713-14 (S.D.N.Y. 1975) ("performance of an otherwise legal contract, contrary to its terms, in a manner which violates Regulation T, will [not] render the contract itself void . . ."); UFITEC, S.A. v. Carter [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,841, at 96,832 (Super. Ct. Cal. 1974) (foreign corporation acting as statutory broker-dealer prohibited from collecting debt from defendant because transaction violated margin requirements); SEC Securities Exchange Act Release No. 11766, 8 S.E.C. Dock. 250 (1975) ("president of a broker-dealer firm has the responsibility for compliance with all applicable requirements").

A further limitation sometimes articulated by the courts on the implication of a private right of action for damages suffered through a margin violation is that

"in order to show that his loss on a particular transaction was caused by a broker-dealer's violation of Regulation T, the plaintiff must establish that defendant's liberal offer of credit induced him to purchase stock which he would not have otherwise acquired. . . ." Judge Tyler [in *Bell v. J.D. Winer & Co.*, 392 F. Supp. 646 (S.D.N.Y. 1975)] held that once initial margin requirements are met without objection, the violation can no longer be considered proximately connected with a later decrease in the market value.

Architectural League v. Bartos, 404 F. Supp. 304, 315 (S.D.N.Y. 1975), *quoting* *Landry v. Hemphill, Noyes & Co.*, 473 F.2d 365, 370 (1st Cir.), *cert. denied*, 414 U.S. 1002 (1973) (*citing* *Newman v. Pershing & Co.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,060 (S.D.N.Y. 1975) *and* *Bell v. J.D. Winer & Co.*, 392 F. Supp. 646, 652 (S.D.N.Y. 1975)). For other limitations on a § 7 private right of action, see *SEC v. Packer, Wilbur & Co.*, 498 F.2d 978, 984-85 (2d Cir. 1974); *Gammage v. Roberts, Scott & Co.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,760, at 96,501 (S.D. Cal. 1974).

illegal credit knowingly without fear of adverse consequences. If the value of his purchase dropped, he could bring suit against his creditor for rescission or damages.¹⁰⁵

If an investor's purchases in a "special cash account" climbed in value, he could earn a profit without any outlay of funds. He would have ordered the securities through his "special cash account" without making payment. Subsequently, the creditor would have neglected to call for payment while the securities climbed in value. Thereafter, the investor could either sell the securities at a profit before the creditor demanded payment or, if the creditor liquidated the securities, the investor could take the profit left in his account. Although the courts applying the enforcement rationale prefer to aid the enforcement of the Exchange Act despite the possibility of rewarding an investor who is aware of the violation, it is difficult to accept an approach that rewards a knowledgeable party to a violation simply because the burden of compliance has been placed upon the creditor. Judge Friendly, dissenting in *Pearlstein v. Scudder & German*,¹⁰⁶ described the situation well.

Even assuming that the purpose of § 7(c) would be served by a decree of private enforcement, I question whether the majority's free-wheeling approach will have the desired effect. As a result of it, speculators will be in a position to place all the risks of market fluctuations on their brokers, if only the customer's persuasion or the broker's negligence causes the latter to fail in carrying out Regulation T to the letter. Any deterrent effect of threatened liability on the broker may well be more than offset by the inducement to violations inherent in the prospect of a free ride for the customer who, under the majority's view, is placed in the enviable position of "heads-I-win tails-you-lose."¹⁰⁷

105. *Landry v. Hemphill, Noyes & Co.*, 473 F.2d 365, 370 (1st Cir.), *cert. denied*, 414 U.S. 1002 (1973).

106. 429 F.2d 1136, 1143 (2d Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971).

107. *Id.* at 1148, *citing* Comment, *Securities Act of 1934—Civil Remedies Based Upon Illegal Extension of Credit in Violation of Regulation T*, 64 MICH. L. REV. 940, 953-55 (1963).

Recently, a number of courts have questioned the validity of *Pearlstein*, and the propriety of implying a private right of action under § 7 of the Exchange Act on a secondary purpose of § 7 when using the tort rationale.

In *Gammage v. Roberts, Scott & Co.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,760 (S.D. Cal. 1974), the court faced a sophisticated investor who used his broker "as a mere purchasing agent." The court emphasized the negligible part investor protection played in the legislative history of § 7 and concluded that "whatever concern Congress had for the protection of the investor was with respect to innocent 'lambs.'" *Id.* at 96,501. Finding that the investor could not qualify as a member of the class for

V. THE 1970 DEVELOPMENT: REGULATION X

In 1970, section 7 was amended to include section 7(f)¹⁰⁸ which affected the position of investors purchasing on margin. Section 7(f) makes it unlawful for investors

to obtain, receive, or enjoy the beneficial use of a loan or other extension of credit from any lender . . . for the purpose of (A) purchasing or carrying United States securities, or (B) purchasing or carrying within the United States of any other securities, if, under this section or rules and regulations prescribed thereunder, the loan or other credit transaction is prohibited or would be prohibited if it had been made or the transaction had otherwise occurred in a lender's office or other place of business in a State.¹⁰⁹

Pursuant to section 7(f), the FRB promulgated Regulation X for the purpose of . . . [preventing] the infusion of unregulated credit obtained both outside and within the United States into U.S. securities markets in circumvention of the provisions of the Board's margin regulations or by borrowers falsely certifying the purpose of a loan or otherwise wilfully and intentionally evading the provisions of those regulations.¹¹⁰

purchasing broker to deliver the 2,000 shares to his selling broker to cover the sale transaction, and expected his selling broker to pay his purchasing broker the proceeds of the sale, leaving a profit in the investor's account. The selling broker, however, experiencing financial difficulties, paid the purchasing broker with "bad" checks. The selling broker then went bankrupt. A trustee was appointed for Packer, Wilbur & Co., the selling broker, pursuant to the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa-77lll (1970), and the purchasing broker, Coggeshall & Hicks, Inc., brought a claim to the trustee in the amount of the "bad" checks. The court held that Coggeshall & Hicks, Inc. could not recover because the purpose of SIPA was to protect innocent customers other than broker-dealers and that any recovery by Coggeshall & Hicks, Inc. would be applied to its claim against the investor. The court explained:

It is one thing to allow . . . an investor who benefits from a margin violation to sue his broker for his part in that same violation. It is quite another thing, however, to allow an investor, who deliberately induces a margin violation, to be reimbursed from a quasi-public fund.

SEC v. Packer, Wilbur & Co., *supra* at 985 (footnote omitted).

108. Exchange Act § 7(f), 15 U.S.C. § 78g(f) (1970).

109. *Id.* § 7(f)(1), 15 U.S.C. § 78g(f)(1) (1970).

110. 12 C.F.R. § 224.1 (1976). The courts have noted the possibility of a § 7 violation rising to the level of a fraud or a violation of § 10(b) of the Exchange Act. See SEC v. Packer, Wilbur & Co., 498 F.2d 978, 983 n.7 (2d Cir. 1974), in which the court stated:

Of course an investor who unintentionally or inadvertently participated in a margin violation probably would stand on a different footing. It is doubtful whether he would possess the scienter essential to establish a violation of Rule 10b-5. Furthermore, he would not be guilty of a violation of Regulation

Regulation X requires that

[a] borrower shall not obtain any purpose credit from within the United States unless he does so in compliance with the following conditions¹¹¹

The conditions of Regulation X concerning the procurement of domestic credit incorporate Regulations T, G, and U. Under Regulation X, an investor procuring credit from a broker or dealer must now comply with Regulation T, whereas before the promulgation of Regulation X, such compliance was not required.¹¹²

Although it does not appear intentional, section 7(f) and Regulation X may have remedied some of the inequities under the credit regulations.¹¹³ By requiring compliance by both investors and creditors, section 7(f) and Regulation X have removed the knowledgeable recipient of illegally extended credit from the class of persons who would be

X, the purpose of which is to prevent investors from "willfully and intentionally evading the provisions of the [margin] regulations"
Id. at 985 n.13, quoting 12 C.F.R. § 224.1 (1973). See *Merkens v. F.I. duPont, Glore Forgan & Co.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,868, at 96,954 n.1 (S.D.N.Y. 1974).

111. 12 C.F.R. § 224.2 (1976). For the little judicial interpretation of Regulation X that exists, see *Pearlstein v. Scudder & German*, 527 F.2d 1141, 1145 n.3 (2d Cir. 1975) (appeal from damage award); *SEC v. Packer, Wilbur & Co.*, 498 F.2d 978, 983 n.7, 985 & n.13 (2d Cir. 1974); *Newman v. Pershing & Co.*, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,060, at 97,714-15 n.7 (S.D.N.Y. 1975); *Bell v. J.D. Winer & Co.*, 392 F. Supp. 646, 653 (S.D.N.Y. 1975). See generally Comment, *Civil Liability for Margin Violations—The Effect of Section 7(f) and Regulation X*, 43 *FORD. L. REV.* 93 (1974); Note, *Regulation X and Investor-Lender Margin Violation Disputes*, 57 *MINN. L. REV.* 208 (1972); Note, *In Pari Delicto As a Defense to Violations of Margin Legislation Under the Securities and Exchange Act of 1934*, *U. SAN. FRAN. L. REV.* 113 (1974).

112. 12 C.F.R. § 224.2 (1976). See, e.g., *Naftalin & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 469 F.2d 1166 (8th Cir. 1972); *Pearlstein v. Scudder & German*, 429 F.2d 1136 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971); *Avery v. Merrill Lynch, Pierce, Fenner & Smith*, 328 F. Supp. 677 (D.D.C. 1971).

113. In *Bell v. J.D. Winer & Co.*, 392 F. Supp. 646 (S.D.N.Y. 1975), the court stated that "[s]ection 7(f) was enacted primarily to promote the stability of our securities markets." *Id.* at 653, citing 2 U.S. CODE CONG. & AD. NEWS 4409-10 (1970). The court went on to state:

In any event, this court recognizes that § 7(f) was directed primarily at imposing responsibility for compliance with the margin requirements on investors in order to control the "infusion of unregulated foreign credit into American securities markets [which] can have a perniciously destabilizing affect on the market as a whole."

Id. at 653-54, quoting 2 U.S. CODE CONG. & AD. NEWS 4409 (1970). See note 116 *infra* and accompanying text.

able to use section 29(b). Investors receiving illegal credit, as violators of the Exchange Act, would have no recourse to section 29(b). Furthermore, under the tort rationale, it can no longer be maintained that section 7 was intended to protect investors who knowingly participated in illegal credit extensions since section 7(f) has made them violators. Moreover, section 7(f) weakens the enforcement rationale because it makes investors who knowingly participated in illegal credit extensions violators of the Exchange Act. Clearly, accommodating such investors in the courtroom would encourage a violation with every suit.

VI. ASH AND CREDIT REGULATION

The *Ash* and *Stewart* analyses are applicable to section 7(f) of the Exchange Act and Regulation X because the import of the section's legislative history does not deal with the question of implied private rights or with purposes that could be interpreted as an indication of congressional intent either to favor or discourage an implied private right of action.¹¹⁴ Furthermore, this congressional inattention necessitates a private right analysis that goes beyond the traditional rationales' dependence upon congressional intent.

Both the House¹¹⁵ and Senate¹¹⁶ Committees that reported out the amendment to the Bank Records and Foreign Transactions Act,¹¹⁷ which amended section 7 to include section 7(f), did not consider the regulation of domestic credit to be the primary purpose of the amendment.¹¹⁸ The regulation of securities credit was included in the amendment only as an afterthought to proscribe more efficiently foreign financial transactions that posed a serious threat to the stable and equitable operation of domestic finances. Congress saw the procurement of foreign credit, for the purpose of obviating compliance with the credit provisions, as an integral part of a scheme used by organized crime to evade taxes, to marshal the assets of black market trade, and to operate in domestic corporations and securities markets without comply-

114. See H.R. REP. NO. 975, 91st Cong., 2d Sess. 14 (1970); S. REP. NO. 1139, 91st Cong., 2d Sess. 9 (1970).

115. H.R. REP. NO. 975, 91st Cong., 2d Sess. 14 (1970).

116. S. REP. NO. 1139, 91st Cong., 2d Sess. 9 (1970).

117. Act of Oct. 26, 1970, Pub. L. No. 91-508, § 301(a), 84 Stat. 1124, *amending* 15 U.S.C. § 78g (1964) (codified at 15 U.S.C. § 78g) (1970).

118. See H.R. REP. NO. 975, 91st Cong., 2d Sess. 12-13, 24 (1970); S. REP. NO. 1139, 91st Cong., 2d Sess. 2-4 (1970).

ing with the law.¹¹⁹ Although the theme of the amendment was foreign credit, the Senate Committee briefly considered the amendment's impact upon the procurement of domestic credit. The Senate Committee viewed the domestic operation of the amendment as a prohibition against investor deceit in the procurement of credit. The prohibition against investor deceit, however, had been in effect before the amendment or promulgation of Regulation X.¹²⁰

The legislative history of section 7 is susceptible to several interpretations. First, it can be argued that the primary purpose of section 7(f) does not support an implied private right of action. Likewise, the secondary purpose of section 7(f) does not support an implied private right of action especially in light of the Supreme Court's holding in *Cort v. Ash* that an implied private right based upon a secondary purpose alone is inappropriate. Second, it can be argued that Congress was aware of the courts' activity in implying private rights at the time section 7(f) was added to section 7. Consequently, when Congress added section 7(f) without altering the courts' interpretations, these interpretations implicitly received legislative approval. Third, it has been suggested that since the prohibition against investor deceit had been in effect before the amendment of section 7 or promulgation of Regulation X, the addition of section 7(f) did not change the effect of illegal extensions of domestic credit, and there "is little evidence in . . . [section 7's] legislative history for requiring margin compliance by non-deceptive investors receiving domestic credit."¹²¹ Regardless of the interpretation, the legislative history fails to identify the circumstances under which a private right of action may be implied under section 7. The *Ash* and *Stewart* rationales provide the analysis for determining the propriety of a section 7 implied private right of action.

For a plaintiff to prevail under the *Ash* and *Stewart* rationales, he must satisfy four requirements. First, the legislative history must fail to manifest a congressional intention either to withhold or grant an implied right.¹²² Second, the plaintiff must be within the class of persons

119. S. REP. NO. 1139, 91st Cong., 2d Sess. 9 (1970).

120. *Id.* See, e.g., *Goldman v. Bank of the Commonwealth*, 467 F.2d 439 (6th Cir. 1972); *Serzysko v. Chase Manhattan Bank*, 290 F. Supp. 74 (S.D.N.Y. 1968), *aff'd mem.*, 409 F.2d 1360 (2d Cir.), *cert. denied*, 396 U.S. 904 (1969); *Moscarella v. Stamm*, 288 F. Supp. 453 (E.D.N.Y. 1968).

121. Note, *Regulation X and Investor-Lender Margin Violation Disputes*, 57 MINN. L. REV. 208, 219 (1972).

122. See sources cited, notes 31, 33, 46 *supra* and accompanying text.

intended to be protected and the harm suffered must be of the type Congress intended to forestall.¹²³ Third, a private right must effectuate the underlying purposes of the statute.¹²⁴ Finally, there must be "collateral considerations" that either support the finding of a private right or do not counsel against such a finding.¹²⁵

The initial step of the *Ash* and *Stewart* rationales may be met by assuming *arguendo* that the legislative history of the amendment to section 7 evinces no clear congressional intent either to grant or withhold a private right of action. This assumption requires that two lines of argument be met to determine whether a plaintiff would fall within the class of persons intended to be protected and whether his injury was of the type Congress intended to forestall. At the very least, the underlying purpose of the amendment and Regulation X has rewritten the legislative intent found by the courts to support the proposition that section 7 was enacted with a secondary purpose to protect the investor. An investor who purchased securities knowing that the broker had illegally extended credit cannot say that he is within the class of persons to be protected by the statute because, under section 7(f) and Regulation X, the knowledgeable investor is now a violator. The only person in whose favor a private right might be found is the investor who innocently purchased securities with illegal credit since Regulation X expressly exempts such innocent violations.¹²⁶

If the effect of section 7(f) is to read out completely the "for the protection of the investor"¹²⁷ language that the courts developed, it is difficult to see how even an innocent investor could prevail. This result is supported by the legislative history of section 7(f), which barely touches on the domestic credit situation, much less the plight of an innocent investor.¹²⁸ It could be argued, however, that since the operation of the unamended statute¹²⁹ and the regulations thereunder¹³⁰ remained unchanged by the amendment, as evidenced by the portion of Regulation X that exempts innocent mistakes by investors, the previous-

123. See sources cited notes 31 & 47 *supra* and accompanying text.

124. See sources cited notes 32, 33, 48, 49 *supra* and accompanying text.

125. See sources cited notes 37-42 *supra* and accompanying text.

126. 12 C.F.R. § 224.6 (1976).

127. See, e.g., *Remar v. Clayton Sec. Corp.*, 81 F. Supp. 1014 (D. Mass. 1949).

128. See notes 108-20 *supra* and accompanying text. See also note 107 *supra* and accompanying text for discussion of secondary purpose of § 7 of the Exchange Act.

129. Exchange Act § 7, 15 U.S.C. § 78g (1970).

130. See sources cited notes 75-85 *supra* and accompanying text.

ly defined secondary purpose of the section would simply be changed to "for the protection of the innocent investor."¹³¹ Likewise, it could consistently be maintained that the harm suffered by the innocent investor was of a kind to be forestalled by the statute. This reading of the statute must be preserved if courts wish to imply a private right on behalf of innocent investors.

At the third stage of the *Ash* and *Stewart* analyses, if the secondary purpose analysis is maintained, providing a remedy to an innocent investor would both allow him a means for redress and help effectuate the secondary purpose of the section. Furthermore, unassisted agency enforcement could be difficult and inadequate. No one need know of a margin violation if such an illegal extension is made to an innocent investor and the illegality is skillfully buried in the creditor's books. Even the financial reporting required of brokers might prove to be insufficient as an aid in discovering such violations. Moreover, a late liquidation and a drop in the value of the investor's securities would cause financial loss that neither the Securities and Exchange Commission's criminal prosecution nor an injunction could rectify.

Finally, under the "collateral considerations" inquiry, it must be determined whether a private right would result in a multiplicity of suits,¹³² whether speedy enforcement is required,¹³³ whether violations are simple,¹³⁴ and whether a private right would interfere with the Securities and Exchange Commission's administration of the Exchange Act.¹³⁵

Credit violations hardly seem to be an area that would generate a multiplicity of suits. There are approximately 630,000 margin accounts with member firms of the New York Stock Exchange.¹³⁶ It is likely that only a small fraction of the transactions effected through these accounts result in violations. Furthermore, the number of suits brought before Regulation X do not seem to have placed too great a burden on the courts. In fact, prior to the promulgation of Regulation X, courts tended to encourage private actions under section 7.¹³⁷

131. See note 107 *supra* and accompanying text.

132. See source cited note 38 *supra* and accompanying text.

133. See source cited note 40 *supra* and accompanying text.

134. See note 43 *supra* and accompanying text.

135. See sources cited notes 42, 52, 53 *supra* and accompanying text.

136. The Wall Street Journal, March 17, 1975 at 2, col. 3.

137. See notes 101-106 *supra* and accompanying text.

The need for speedy enforcement under section 7 seems to be a neutral factor counselling neither for nor against an implied private right. Whether an action is maintained by a private party or the Securities and Exchange Commission, a violation cannot be prevented before it occurs. The most that can be desired is that suits, whether by investors or the Securities and Exchange Commission, will deter future violations. Although speed of enforcement does not seem crucial, at the very least it would not present an argument against finding a private right.

The *Stewart* court's concern about the complexity of the Act and the difficulty of discovering violations may cause the innocent investor some problems. Violations may not be simple. A violation in the form of an overextension of credit may be complex; the regulations are highly technical.¹³⁸ On the other hand, a broker's failure to liquidate on the date required can be established without special knowledge. The securities either were liquidated on the proper day or they were not. Moreover, regardless of the issues' complexities and the need for special knowledge to deal effectively with the issues, the courts have not been reluctant to hear these cases in the past.¹³⁹ The most crucial determination at this stage of analysis is whether allowing private litigants to enforce the provisions of section 7 would interfere with the fair and efficient administration of the Exchange Act.

Does the need for the preservation of prosecutorial discretion outweigh the need for a private right to aid the maximum enforcement of the Exchange Act? The Securities and Exchange Commission is charged with administering a complex statutory scheme that requires sophistication on the part of persons working in the area. Consistency in administration is an important goal so that those who are regulated will be able to plan their activities accordingly. Prosecutorial discretion allows the Securities and Exchange Commission to administer the Exchange Act flexibly to meet the needs of enforcement. It also fosters both maximum enforcement and compliance by enabling the Securities and Exchange Commission to gain the cooperation and confidence of the securities community. To the extent that the Securities and Exchange Commission foregoes prosecutions to conserve manpower, how-

138. See 12 C.F.R. § 220 to 224 (1976).

139. See note 101-106 *supra* and accompanying text.

ever, the implication of a private right of action would assist rather than interfere with the Securities and Exchange Commission's administration.

VII. CONCLUSION

The courts will be faced with the task of determining the importance of the investor's position within the context of the statute's operation and its underlying policy. Presumably, an *Ash* or *Stewart* analysis would never proceed far on the assumption that the underlying policy of the section was to regulate the flow of credit into the securities markets and to control its destabilizing effect on the economy. The value of using these approaches to find implied private rights of action lies in their fine tuning of the crucial criteria used to determine the propriety of implying a private right. The *Ash* or *Stewart* courts struck a balance that exposes the pitfalls of granting or withholding a private right. This careful and measured approach gives guidance that was previously lacking.