Comments and Notes

THE INVESTMENT ADVISERS ACT OF 1940 AND THE SUPREME COURT: PRIVATE RIGHTS OF ACTION UNDER THE NEW *CORT* TEST

Transamerica Mortgage Advisors, Inc. v. Lewis

I. INTRODUCTION

On November 13, 1979, the Supreme Court in *Transamerica Mortgage Advisors, Inc. v. Lewis,*[1] squarely addressed the question of implied private rights of action under the Investment Advisers Act of 1940 (Advisers Act) and rejected in part the conclusions of three circuit courts of appeal.[2] The Supreme Court held that section 215[3] of the Act, which provides that contracts whose formation or performance would violate the Act "shall be void," *impliedly creates private causes of action for contract rescission, injunctive relief or restitution,* since these follow as "customary legal incidents of voidness."[4] But section 206[5] of the Advisers

1. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979).

2. Lewis v. Transamerica Corp., 575 F.2d 237 (9th Cir. 1978), *aff'd in part, rev'd in part,* 444 U.S. 11 (1979); Wilson v. First Houston Inv. Corp., 566 F.2d 1235 (5th Cir. 1978), *vacated and remanded,* 444 U.S. 959 (1979); Abrahamson v. Fleschner, 568 F.2d 862 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978).

3. Section 215, 15 U.S.C. § 80b-15 (1976), reads, in part, as follows:

Prohibited Transactions By Investment Advisers

(b) Every contract made in violation of any provision of this subchapter and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this subchapter, or any rule, regulation or order thereunder, shall be void . . . .

4. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 19.

5. Section 206, 15 U.S.C. § 80b-6 (1976), reads as follows:

Prohibited Transactions By Investment Advisers

It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly:

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

(2) to engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing . . . the capacity in which he is acting . . .;

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative.

Section 206(4) was added to the statute in 1960. 74 Stat. 887.

Act, which makes it unlawful for any investment adviser "to employ any device, scheme, or artifice to defraud" or to "engage in any practice that operates as fraud or deceit upon any client or prospective client" *does not impliedly create a private cause of action for damages.*[6] The Court's reasoning was that section 206 simply proscribes certain conduct and does not, in express terms, create or alter any civil liabilities.[7]

In denying a private action for damages under section 206, the Supreme Court has taken a new step in reaffirming its refusal to encroach upon legislative power.[8]

On the other hand, it has decreased the effectiveness of an Act already considered to be "the most inadequate"[9] of those administered by the SEC. In the process, it has placed into question the continued viability of the implication test outlined in *Cort v. Ash.*[10]

This note will examine the criteria influencing the implication of private rights of action under the Investment Advisers Act of 1940, and explore the Court's apparent analytical deviation from previous Supreme Court decisions by examining past litigation and recent trends in light of the *Cort v. Ash* four-pronged implication test.[11]

II. BACKGROUND

In the early 1900's the bulk of general securities issues was purchased by financial intermediaries and institutional investors, such as commercial banks, insurance companies, and trustees. The general public was only interested in a small number of securities. However, the post-World War I prosperity in industry investment sparked the birth of a new era. The public was no longer content with financial returns from savings accounts, savings bonds, and local investments.[12] These conservative investors sought to expand their investments by entering into the nationwide capital market. Lacking basic and accurate knowledge in this area, investors often turned to a reputable investment adviser or counselor for technical advice.[13]

In the 1920's, as the general investing public's interest in securities increased, so did certain problems and abuses in the securities industry. Some of the problems that existed were excessive use of credit by in-

6. *Id.*

7. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 19.

8. *See* Discussion, *infra* at p. 76.

9. *See* S. REP. No. 1760, 86th Cong., 2d Sess. 4 (1960), *reprinted in* [1960] U.S. CODE CONG. & AD. NEWS 3502-11.

10. 422 U.S. 66 (1975).

11. *E.g.*, Touche Ross & Co. v. Redington, 442 U.S. 560 (1979); Cannon v. University of Chicago, 441 U.S. 677 (1979).

12. Mallison, *The Investment Advisers Act of 1940*, 1 VAND. L. REV. 68-69 (1947).

13. *Id.*

vestors, manipulation of prices on the stock exchange by pools,[14] options,[15] and short-swing trading [16] by officers and directors in the stock of their own companies, frequently on the basis of inside information.[17] Many of these problems have been associated with the stock market crash of October, 1929, and the bitter depression that followed.[18] In 1939, it was not uncommon for the investment adviser to arrange for one client to sell a certain security and another client to buy that same security.[19] Thus, the investment adviser was in a "no lose" situation, since he operated on the then commonly accepted basis of receiving a portion of the profits earned by his clients on his investment advice.[20] These somewhat questionable practices by the investment adviser resulted in the passage of the Advisers Act.[21]

The Advisers Act [22] was enacted [23] with the prophylactic purpose of protecting the general investment community from investment advisers who engaged in fraudulent or deceitful practices.[24] The Advisers Act

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14. Pooling of interests or pool is an accounting method for combining the financial statements of firms that merge. The net result will affect the market price per share of stock and the price earnings ratio. J. WESTON & E. BRIGHAM, MANAGERIAL FINANCE 873 (6th ed. 1978).

15. Options are contracts which give the holder the right to buy (or sell) an asset at a predetermined price for a given period. Different option pricing models provide the investor with additional insights on the nature of debt or equity in a firm. Galai, *The Option Pricing Model and the Risk Factor of Stock*, 3 J. FINANCIAL ECON. 53, 81 (1976).

16. Short swing trading occurs when a purchase and sale or sale and purchase of a security occurs within six months. Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1273 (5th Cir. 1978).

17. Loomis, *The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940*, 28 GEO. WASH. L. REV. 214, 217 (1959).

18. The Senate Committee on Banking and Currency investigated the securities industry between March, 1932 and June, 1934, and exposed the problems and abuses of the industry. *Hearings on* S. REP. No. 1455 *Before the Senate Comm. on Banking and Currency, Stock Exchange Practices*, 73d Cong., 2d Sess. (1934).

19. Mallison, *The Investment Advisers Act of 1940*, 1 VAND. L. REV. 68, 70 (1947).

20. *Id.* The adviser's sole concern was to seek new clients to replace those whose assets were exhausted. Adviser custody of clients' funds was the basis of most deceptive practices. Instead of buying and selling in the interest of the client, there was frequently a shifting of high quality securities to the adviser's personal account and the placing of unwanted issues in the client's account.

21. The report of the Senate Banking Committee to the Congress and the record before the committee make it clear that the solution to the problems and abuses of the investment advisory service cannot be effected without federal legislation. S. REP. No. 1775, 76th Cong., 3d Sess. 1 (1940).

22. The Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to 80b-21 (1976) (originally enacted as Act of Aug. 22, 1940, ch. 686, Title II, § 201, 54 Stat. 847) is divided into three Titles. Title I regulates investment companies and is known as the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-52 (1976) (originally enacted as Act of Aug. 22, 1940, ch. 686, Title I, § 1, 54 Stat. 789). Title III amends § 8(a) of the Securities Act of 1933, 15 U.S.C. §§ 77a to 77aa (1976) (originally enacted as Act of May 27, 1933, ch. 38, Title I, § 1, 48 Stat. 74).

23. The Investment Advisers Act of 1940 became effective on November 1, 1940. 15 U.S.C. § 80b-21 (1976).

24. S. REP. No. 1760, 86th Cong., 2d Sess. 4 (1960), *reprinted in* [1960] U.S. CODE CONG. & AD. NEWS 3502, 3503. *See* Securities & Exch. Comm'n v. Myers, 285 F. Supp. 743, 745 (D.C. Md. 1968).

provided for the regulation of investment advisers by requiring them to register with the Securities and Exchange Commission and vesting that Commission with the power to monitor and discipline the adviser's behavior.[25] This statute reflected Congressional recognition of the delicate fiduciary relationship between investment advisers[26] and investors. In addition, there was a desire by Congress to eliminate or at least expose all conflicts of interest which might influence an investment adviser, whether intentional or unintentional, in distributing information or advice which was not disinterested.[27] In order to protect this fiduciary relationship there has been imposed upon the investment adviser an affirmative duty of utmost good faith; this duty includes full and fair disclosure of all material facts, as well as an obligation to employ reasonable care to avoid misleading a client.[28] Under the Advisers Act,[29] the investment adviser is required to keep various business records, both financial and those relating to communications sent and received from clients, and to make these business records available for inspection by the Securities and Exchange Commission.[30]

Section 206 of the Advisers Act[31] prohibits any registered adviser from using any device or transaction to defraud a client. However, section 206 fails to prescribe a standard or to state what the prohibition spe-

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25. Investment Advisers Act of 1940, §§ 203, 205, 208, 209, 211, 15 U.S.C. §§ 80b-3, b-5, b-8, b-9, b-11 (1976), *as amended by* 89 Stat. 166-69, 15 U.S.C.A. § 80b-3 (1976).

26. Investment Adviser means:

> any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include (A) a bank or any bank holding company . . . which is not an investment company; (B) any lawyer, accountant, engineer or teacher whose performance of such services is solely incidental to the practice of his profession; (C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore . . . .

15 U.S.C. § 80b-2(11) (1976).

27. *See, e.g.,* SEC v. Capital Gains Research Bureau, 375 U.S. 180, 192 (1963).

28. *Id.* at 189.

29. 15 U.S.C. §§ 80b-1 to 80b-21 (1976).

30. Reports by Investment Advisers.

> Every investment adviser who makes use of the mails or of any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser [other than those specifically exempted], shall make and keep for prescribed periods such records [as specifically defined], furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. All records (as so defined) of such investment advisers are subject at any time, or from time to time, to such reasonable periodic, special, or other examination by representatives of the Commission as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 80b-4 (1976).

31. *See supra* note 5.

cifically covers.[32] Section 206 also prohibits an investment adviser from buying securities from, or selling securities to, any client, either as principal or as agent for another person without notifying the client in writing as to the capacity in which he is acting and obtaining the client's consent thereto.[33] Under another section,[34] the United States District Courts are given the power to enjoin any practice on the part of the investment adviser which operates as a fraud or deceit upon the client. Section 206 does not, however, require proof of intent to injure or of actual injury to the client.[35]

The greatest question presented under section 206 is who may bring an action for a violation of that provision. Since there are no express provisions giving individual parties standing to sue, several courts have considered the issue of whether section 206 of the Advisers Act evidences a legislative inference to support an implied private right of action for damages.[36] The single most frustrating factor underlying this issue for prospective plaintiffs is the total silence on this matter in the legislative history of the Advisers Act. This silence has been previously interpreted by different courts as not preventing implication [37] or as precluding it.[38]

III. LEGISLATIVE HISTORY

A. *The Investment Advisers Act of 1940*

The Advisers Act,[39] the last of six regulatory statutes which were enacted during the period 1933 through 1940,[40] was designed to regulate

32. Mallison, *The Investment Advisers Act of 1940,* 1 VAND. L. REV. 68, 79 (1947).

33. *Id.*

34. 15 U.S.C. § 80b-14 (1976); *see also* SEC v. Capital Gains Research Bureau, 375 U.S. 180, 192 (1963).

35. SEC v. Capital Gains Research Bureau, 375 U.S. at 192, noting an issue which has been contested and debated on certain occasions. *See* Steadman v. SEC, 603 F.2d 1126, 1132 (5th Cir. 1979), scienter is required under 15 U.S.C. § 80b-6(1) but under 15 U.S.C. § 80b-6(2) scienter need not be shown. Carroll v. Bear, Stearns & Co., 416 F. Supp. 998, 1000 (S.D.N.Y. 1976) (court held it is necessary to show scienter in order to recover under 15 U.S.C. § 80b-6, and that negligence is not sufficient).

36. Wilson v. First Houston Inv. Corp., 566 F.2d 1235 (5th Cir. 1978), *vacated and remanded,* 444 U.S. 959 (1979), where the Fifth Circuit held a private right of action may be implied under 15 U.S.C. § 80b-6 (1970). In Abrahamson v. Fleschner, 568 F.2d 862 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978), the Second Circuit also held a private right of action may be implied. *See also* Bolger v. Laventhol, Krekstein, Horwath & Horwath, 381 F. Supp. 260 (S.D.N.Y. 1974), and Angelakis v. Churchill Management Corp., 1975 FED. SEC. L. REP. (CCH) ¶ 95,285 (N.D. Cal. 1975).

37. *Id.*

38. *See* Greenspan v. del Toro, No. 73-638 CIV JE (S.D. Fla. May 17, 1974), *appeal dismissed for want of prosecution,* No. 74-2943 (5th Cir. September 5, 1974), and Gammage v. Robert, Scott & Co., 1974 FED. SEC. L. REP. (CCH) ¶ 94,761 (S.D. Cal. 1974).

39. 15 U.S.C. §§ 80b-1 to 80b-21 (1976).

40. The Investment Advisers Act was preceded by (1) the Securities Act of 1933, 15 U.S.C. §§ 77a to 77aa (1976) (originally enacted as Act of May 27, 1933,

the marketing of investment securities. A fundamental purpose, common to all six statutes, was to substitute the philosophy of *caveat emptor* with the philosophy of full disclosure, thereby establishing a high standard of business ethics in the securities industry.[41] The legislative origin of both the Advisers Act[42] and the Investment Company Act of 1940[43] was a study made by the Securities and Exchange Commission at the direction of Congress.[44] The SEC Report pointed out the problems arising out of the delicate fiduciary relationship between investors and investment advisers and the potential for conflicts of interest.[45] The committee reports indicate a desire to preserve the personalized character of the investment service, while attempting to eliminate the conflicts.[46]

The House and Senate Committee Reports also made clear the general intent of Congress.[47] After the hearings on the bill in the Senate, representatives of the investment advisers industry met with members of the Securities and Exchange Commission to discuss the bill.[48] The subsequent version of the bill made no provisions for examination of advisers prior to registration, reduced the amount of information to be disclosed in registration applications and provided that investigations would be confidential.[49]

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ch. 38, Title I, § 1, 48 Stat. 74); (2) the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a to 78kk (1976) (originally enacted as Act of June 6, 1934, ch. 404, Title I, § 1, 48 Stat. 881); (3) the Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79a to 79z-6 (1976) (originally enacted as Act of Aug. 26, 1935, ch. 687, Title I, § 33, 49 Stat. 838); (4) the Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa to 77bbbb (1976) (originally enacted as Act of May 27, 1933, ch. 38, Title III, § 301, 53 Stat. 1149); and (5) the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-52 (1976) (originally enacted as Act of Aug. 22, 1940, ch. 686, Title I, § 52, 54 Stat. 847).

41. SEC v. Capital Gains Research Bureau, 375 U.S. 180, 186 (1963).

42. 15 U.S.C. §§ 80b-1 to 80b-21 (1976).

43. 15 U.S.C. §§ 80a-1 to 80a-52 (1976).

44. *Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on Investment Counsel, Investment Management, Investment Supervisory and Investment Advisory Services*, H.R. Doc. No. 477, 76th Cong., 2d Sess. 1 (1939) [hereinafter cited as SEC Report].

45. *Id.* at 28-30.

46. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. at 187.

47. The report of the Senate Committee on Banking and Currency declared that federal legislation was necessary, in that "protection of investors requires the regulation of investment advisers on a national scale," so as to solve "the problems and abuses of the investment advisory services . . . ." S. REP. No. 1775, 76th Cong., 3d Sess. 21 (1940).

The House Committee on Interstate and Foreign Commerce emphasized in its report the need "to protect the public from frauds and misrepresentations of dishonest advisers" and also "to protect honest investment advisers against unwarranted stigmatization by making fraudulent practices by investment advisers unlawful." H.R. REP. No. 2639, 76th Cong., 3d Sess. 28 (1940).

48. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. at 191.

49. *Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. 88, 93 (1940).

Although the Investment Company Act[50] and the Advisers Act[51] were enacted together, they indicated a preference for separation and restatement of each previously-overlapping provision of the two Acts.[52] The language that was enacted as the jurisdictional section of the Investment Company Act,[53] appeared in both the initial[54] and the final[55] version as enacted into law. In addition, the SEC's initial draft of the Advisers Act[56] incorporated a provision of the Investment Company Act[57] conferring jurisdiction over "actions at law and in equity."[58] However, the final version, approved after the Senate hearings and negotiations with the SEC representatives, did not include the provision conferring jurisdiction over "actions at law."[59] Instead, section 214 of the Advisers Act was limited to "suits in equity."[60]

Another change from the initial to the final version is the omission of any express civil liability. This omission, combined with the fact that "actions at law" were not included in the final version, supports the construction that Congress did not intend to create a private right of action for damages under the Advisers Act.

B. *1960 Legislation*

Between 1956 and 1959, the Securities Exchange Commission (SEC) submitted several proposals to Congress relating to the federal securities laws. The SEC was attempting, by way of these amendments, to increase compliance with the Advisers Act.[61] The Senate Report explains that unlike the other federal securities statutes, the Advisers Act "has few substantive or regulatory provisions and, like the broker-dealer registration provisions of the 1934 Act, resembles a continuing census of the Nation's investment advisers."[62] None of the proposed amendments to the Advisers Act's limited grant of jurisdiction over "suits in equity" were added

50. 15 U.S.C. §§ 80a-1 to 80a-52 (1976).

51. 15 U.S.C. §§ 80b-1 to 80b-21 (1976).

52. *Hearings on S. 3580 Before a Subcomm. on Banking and Currency,* 76th Cong., 3d Sess. 745, 746 (1940).

53. 15 U.S.C. § 80a-43 (1976).

54. Confidential Committee Report, S. 3580, 76th Cong., 3d Sess. 213 (1940).

55. *Hearings on S. 4108 Before a Subcomm. on Banking and Currency,* 76th Cong., 3d Sess. 214 (1940).

56. 15 U.S.C. §§ 80b-1 to 80b-21 (1976).

57. 15 U.S.C. §§ 80a-1 to 80a-52 (1976).

58. *Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 2 (1940); H.R. REP. 8935, 76th Cong., 3d Sess. 30 (1940).

59. *Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce,* 76th Cong., 3d Sess. 88 (1940). Congress enacted this House bill.

60. *See* Abrahamson v. Fleschner, 568 F.2d 862, 881 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978) (Gurfein, J., concurring and dissenting).

61. S. REP. No. 1760, 86th Cong., 2d Sess. 4 (1960), *reprinted in* [1960] U.S. CODE CONG. & AD. NEWS 3502-11.

62. *Id.* at 3503.

to section 214.[63] The text and the legislative history of the 1960 amendments to the Advisers Act[64] indicated that the issue of implied private rights of action was not presented to or considered by Congress. However, Congress did refocus and strengthen the antifraud provision of the Advisers Act by amending section 206 to extend its coverage to unregistered investment advisers.[65] Congress also gave the SEC the power to establish rules and regulations describing and proscribing "fraudulent, manipulative and deceptive courses of conduct."[66]

C. *1970 Legislation*

In 1970, Congress amended both the Advisers Act and the Investment Company Act. One of the sections included a private right of action against certain investment advisers under the Investment Company Act, but no additional remedies under the Advisers Act.[67] Congress only referred to the Advisers Act generally, by stating:

> The Investment Advisers Act of 1940 is a companion statute to the Investment Company Act. It regulates the activities of those who receive compensation for advising others with respect to investments in securities or who are in the business of issuing analyses or reports concerning securities. Like other Federal securities statutes, the Advisers Act prohibits fraudulent practices and requires those subject to its provisions to register with the Commission and to keep books and records in accordance with Commission rules. It also empowers the Commission to make regular inspections and to take administrative remedial action against applicants for registration and registered advisers.[68]

Congress did not, however, amend the Advisers Act to allow for a private right of action or for any additional remedies.

D. *1976 Legislation*

The SEC submitted to Congress a proposed amendment to the Advisers Act that explicitly provided for a private right of action for damages.[69] In announcing its proposal, the SEC repeated its view that the

63. *Id.*

64. Investment Advisers Act—Amendments of Sept. 15, 1960, Pub. L. No. 86-750; 74 Stat. 885; S. REP. No. 1760, 86th Cong., 2d Sess. 4 (1960), *reprinted in* [1960] U.S. CODE CONG. & AD. NEWS 3502.

65. *Id.* at §§ 8 & 9, 74 Stat. 885 (1960).

66. *Id.* at § 9, 74 Stat. 885 (1960).

67. Investment Company Act of Aug. 22, 1940, Pub. L. No. 91-547, §§ 22-26, 84 Stat. 1413 (1971).

68. S. REP. No. 91-184, 91st Cong., 1st Sess. 43, 44 (1969), *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 4939.

69. S. 2849, 94th Cong., 2d Sess. § 5 (1976).

existing language was insufficient to imply a private right of action.[70] Although the proposal never came to a vote, there was some testimony concerning the amendment.[71] It was noted that this proposed amendment would not expressly create a private right of action, but would facilitate its implication by the courts.[72]

E. *1977 Legislation*

In order to clear up the controversy concerning implied private rights of action, the 1976 proposed amendments were reintroduced in 1977. The SEC amendment explicitly provided that the federal district courts would have jurisdiction of "all suits in equity and actions at law." [73] However, there has been no hearing or report on the proposed amendment.

As a result of these proposed amendments, Congress has now had five opportunities to rectify the confusion concerning private rights of action. Congress has apparently chosen not to act on the situation. The next question then becomes: How should this lack of affirmative action be interpreted? The remainder of this comment examines the different points of view and the Supreme Court's answer.

III. PRIOR LITIGATION

A. *General Background*

The Supreme Court has long recognized that private rights of action do not require express statutory authorization.[74] This recognition dates back to 1916 in *Texas & Pacific Railroad v. Rigsby*.[75] The plaintiff, an employee of the defendant railroad, was injured by a defective grab iron on a boxcar. A provision of the Safety Act stated: "All cars must be equipped with secure grab irons or handholds in the ends and sides of each car for the greater security of the men." [76] Thus, the existence of the defective grab iron constituted a violation of the Act under which the plaintiff brought suit. It was argued that the Act did not expressly confer a private right of action for damages. Nevertheless, the Court found that the principle object of the Act was the safety of employees and held:

> So, in every case, where a statute enacts or prohibits a thing for the benefit of a person, he shall have a remedy upon the same

70. S. REP. No. 910, 94th Cong., 2d Sess. 8-9, 15-17 (1976).

71. *Hearings on S. 2849 Before a Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 7-11, 17, 232, 233 (1976).

72. *Id.* at 233 (remarks of Prof. Louis Loss).

73. H.R. 2105, 95th Cong., 1st Sess. 37 (1977).

74. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 26 (White, J., dissenting).

75. 241 U.S. 33 (1916).

76. Section 4 of the Federal Safety Appliance Act of 1893, 45 U.S.C. § 4 (1976).

statute for the thing enacted for his advantage, or for the recompense of a wrong done to him contrary to said law.[77]

In *Steele v. Louisville & Nashville Railroad*,[78] the petitioner, a black railroad worker, brought suit in Alabama Circuit Court against his employer, the Louisville and Nashville Railroad Co. and the labor union, the Brotherhood of Locomotive Firemen and Enginemen. He charged discriminatory application of the collective bargaining agreement terms in favor of white persons. The contract called for the exclusion of blacks from certain jobs.

The Alabama Circuit Court of Appeals sustained the defendants' demurrer; the Supreme Court of Alabama affirmed.[79] The Supreme Court held that the Railway Labor Act provision "employees shall have the right to organize and bargain collectively through representatives" [80] imposed upon the union acting by authority of the statute as the exclusive bargaining representative, the duty to represent all employees, even those who are not members of the union.[81] Violation of that duty gave rise to an implied action for damages.[82]

Justice Powell noted in his reference to this case in *Cannon v. University of Chicago*,[83] that although "the Act did not refer expressly to an obligation not to discriminate, but in light of its *structure*, especially its vesting in an authorized union the power to exclude all others from representing employees, the Court felt compelled to imply this duty." [84]

B. *The Securities Framework*

Another decision, *J.I. Case Co. v. Borak*,[85] dealt specifically with the securities framework. A shareholder in the defendant company charged that a merger, effected through the circulation of false and misleading proxy statements, violated section 14A of the Securities Exchange

77. Texas & Pac. R.R. v. Rigsby, 241 U.S. at 39 (citing 1 Com. Dig., tit. Action upon Statute (F)).

78. 323 U.S. 192 (1944).

79. Louisville & Nashville R.R. v. Steele, 245 Ala. 113 (1943).

80. Section 2, Fourth of the Railway Labor Act, 48 Stat. 1185, 45 U.S.C. § 152 (1976).

81. Steele v. Louisville & Nashville R.R., 323 U.S. at 207.

82. We conclude that the duty which the statute imposes on a union representative of a craft to represent the interests of all its members stands on no different footing and that the statute contemplates resort to the usual judicial remedies of injunction and award of damages when appropriate for breach of that duty.

Id.

83. 441 U.S. 677 (1979).

84. *Id.* at 734, n.4 (Powell, J., dissenting) (emphasis added).

85. 377 U.S. 426 (1964).

Act of 1934,[86] thus depriving him and the other shareholders of their pre-emptive rights. Relief was sought under section 27 of the 1934 Act,[87] which conveys to the United States District Courts exclusive jurisdiction over "all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder." [88]

In holding that a private right of action was clearly implied for both derivative and direct causes of action,[89] the Court placed great emphasis on both the purpose of the 1934 Act [90] and section 27 which granted exclusive federal jurisdiction over securities exchange act violations.[91] "While this language makes no *specific* reference to a private right of action, among its chief purposes is 'the protection of investors,' which certainly implies the availability of judicial relief where necessary to achieve this result." [92]

Another decision concerning the implication of a private right of action for violation of a securities law was *Superintendent of Insurance v. Bankers Life & Casualty Co.*[93] This case involved the fraudulent sale of securities in violation of section 10(b) of the Securities and Exchange Act of 1934,[94] which makes unlawful the use of "any manipulative or deceptive device or contrivance" in connection with the purchase or sale of any security. The

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86. Act of June 6, 1934, c. 404, § 14, 48 Stat. 895; 15 U.S.C. § 78n(a).

> (a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce . . . or otherwise, in contravention of such rules and regulations as the Commission [SEC] may prescribe . . . , to solicit or to permit the use of his name to solicit any proxy . . . .

87. Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa (1976), provides, in part:

> The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.

88. *Id.*

89. 377 U.S. at 429-30.

90. *Id.* at 432.

91. The Supreme Court quoted from Deckert v. Independence Shares Corp., 311 U.S. 282, 288 (1940), for additional support:

> The power to enforce implies the power to make effective the right of recovery afforded by the [1933] Act. And the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case.

377 U.S. 426, 434 (1964).

92. J.I. Case Co. v. Borak, 377 U.S. at 432 (emphasis added).

93. 404 U.S. 6 (1971). *See also* Kardon v. National Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947).

94. 15 U.S.C. § 78j(b) (1976).

Supreme Court reversed the court of appeals,[95] holding that there was an implied private action under section 10(b) and rule 10b-5. The Court emphasized that section 10(b) must be read flexibly, not technically or restrictively, to protect investors.[96] Likewise, other decisions recognized implied private actions under the Public Utility Holding Company Act of 1935,[97] as well as the Investment Company Act.[98]

In sharp contrast to these decisions, in *Securities Investor Protection Corp. v. Barbour*[99] the Supreme Court refused to imply a private cause of action under section 7(b) of the Securities Investor Protection Act of 1970.[100] Thus, customers of failing broker-dealers were not allowed a private action to compel the Securities Investor Protection Corporation to act for their benefit. The Court stressed the existence of an administrative remedy as the basis for this decision.[101] However, the availability of an administrative remedy was not held to be controlling in *Steele v. Louisville & Nashville Railroad.*[102]

All of these Supreme Court decisions[103] stressed the importance of a benefited class, as illustrated in *J.I. Case Co. v. Borak,* but still left unclear precisely what factors were relevant to implication.[104] For example, legislative intent, legislative purpose, and administrative remedies were all considered important. But precisely how they should be balanced remained unclear until *Cort v. Ash.*[105]

In *Cort,* the plaintiff, a stockholder, brought an action for injunctive relief and damages, alleging that the petitioner corporate directors had

95. Bankers Life & Casualty Co. v. Superintendent of Ins., 430 F.2d 355 (2d Cir. 1970).

96. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. at 12.

97. Goldstein v. Groesbeck, 142 F.2d 422 (2d Cir. 1944), *cert. denied,* 323 U.S. 737 (1944) (15 U.S.C. §79y (1976)).

98. Esplin v. Hirschi, 402 F.2d 94, 103 (10th Cir. 1968), *cert. denied,* 394 U.S. 928 (1969) (15 U.S.C. §§80a-1 to 80a-52 (1976)).

99. 421 U.S. 412 (1975).

100. Securities Investor Protection Act of 1970, 84 Stat. 1636, 15 U.S.C. §§78aaa to 78lll (1976).

> (b) Enforcement of actions: In the event of the refusal of SIPC to commit its funds or otherwise to act for the protection of customers of any member of SIPC, *the commission* may apply to the District Court of the U.S. in which the principal office of SIPC is located for an order requiring SIPC to discharge its obligations under [the Act] and for other such relief as the court may deem appropriate to carry out the purposes of [the Act].

15 U.S.C. §78ggg(b) (1976) (emphasis added).

101. Securities Investor Protection Corp. v. Barbour, 421 U.S. at 416-20.

102. 323 U.S. 192 (1944) (admittedly, the administrative remedy in *Steele* was a poor one).

103. The decisions recognizing implied private rights of action under the Investment Company Act and the Public Utility Holding Company Act were not actual Supreme Court decisions, but petitions for certiorari were denied in those cases. *See supra* notes 97 & 98.

104. Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act,* 74 MICH. L. REV. 308, 314 (1975).

105. 422 U.S. 66 (1975).

made illegal Presidential campaign contributions.[106] The Court stated that the issue was "whether a private cause of action for damages against corporate directors is to be implied in favor of a corporate stockholder under 18 U.S.C. § 610, ..." [107] The Court outlined the following factors as relevant when determining whether a private remedy is implicit in a statute not expressly providing one.[108]

> First, is the plaintiff 'one of the class for whose *especial* benefit the statute was enacted', . . . that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? . . . Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? . . . And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the states, so that it would be inappropriate to infer a cause of action based solely on federal law? [109]

IV. DECISIONS BELOW

A. *Trial Court* [110]

In *Transamerica* the respondent, a shareholder of the petitioner (Trust),

> brought this suit in federal district court as a derivative action on behalf of the trust, and as a class action on behalf of the trust's shareholders. Named as defendants were the trust, several individual trustees, the trust's investment adviser, Transamerica Mortgage Advisors, Inc. (TAMA), and two corporations affiliated with TAMA.[111]

The complaint alleged that petitioners had been guilty of various frauds and breaches of fiduciary duty in violation of the Advisers Act.[112]

106. Cort v. Ash, 422 U.S. at 71.

107. *Id.* at 68.

108. *Id.*

109. *Id.* (citations omitted).

110. Lewis v. Transamerica Corp., No. C-73-2180 RHS (N.D. Cal. Nov. 21, 1974), *vacated,* 575 F.2d 237 (9th Cir. 1978), *aff'd in part, rev'd in part and remanded,* 444 U.S. 11 (1979) (order only, facts reported are those of the Supreme Court).

111. Transamerica Mortgage Advisors v. Lewis, 444 U.S. at 13.

112. Three causes of action were set out, each said to arise under the Advisers Act. The first alleged that the advisory contract between TAMA and the Trust was unlawful because TAMA and Transamerica were not registered under the Act and because the contract had provided for excessive compensation. The second alleged that defendants breached their fiduciary duty to the Trust by causing it to purchase securities of inferior quality from an affiliated corporation. The third alleged that defendants had misappropriated profitable investment opportunities to the respondent's detriment.

The complaint sought injunctive relief, rescission of the investment advisers contract between the Trust and TAMA, restitution of fees and other considerations paid by the Trust, an accounting of illegal profits, and an award of damages.

On November 21, 1974, the district court entered an order dismissing the action with prejudice on the grounds that section 206 of the Advisers Act affords no private right of action and that, consequently, the court had no jurisdiction over plaintiff's claims.[113]

B. *Court of Appeals*

The United States Court of Appeals[114] vacated this order, holding that the implication of a private right of action for injunctive relief and damages under the Advisers Act in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation.[115] The Court alluded to the decisions of the Courts of Appeals for the Second and Fifth Circuits which had earlier considered this issue. "Without reiterating their able discussions, we adopt the rationale of the majorities in [the Second and the Fifth Circuits]."[116] Circuit Judge Wallace filed a dissenting opinion which endorsed the reasoning of the dissent in the Second Circuit.[117] An examination of these decisions will illuminate the Supreme Court's reasoning.

1. Second Circuit—*Abrahamson v. Fleschner*

The plaintiffs in *Abrahamson*,[118] who were limited partners of an investment partnership, brought an action against the general partners alleging that they had relied upon the general partners' representations that investments would be conservative. In fact, investments had been made in unregistered securities without the knowledge of the limited partners.[119] In deciding the question of whether to imply private rights of action under section 206 of the Advisers Act, the *Abrahamson* court applied the four-pronged *Cort* analysis.[120]

Looking to the legislative history, the court determined that the Advisers Act was enacted for the benefit of investors; the absence of

113. Lewis v. Transamerica Corp., No. C-73-2180 RHS (N.D. Cal. Nov. 21, 1974), *vacated*, 575 F.2d 237 (9th Cir. 1978), *aff'd in part, rev'd in part and remanded*, 444 U.S. 11 (1979).

114. Lewis v. Transamerica Corp., 575 F.2d 237 (9th Cir. 1978), *aff'd in part, rev'd in part and remanded*, 444 U.S. 11 (1979).

115. *Id.* at 240.

116. *Id.* at 239.

117. *Id.* at 239 (Wallace, J., dissenting).

118. Abrahamson v. Fleschner, 568 F.2d 862 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978).

119. *Id.* at 867.

120. *Id.* at 873; Cort v. Ash, 422 U.S. 66 (1975). *See* notes 106-09 *supra* and accompanying text.

any express evidence, which would have denied private rights of action to investors, did not preclude such a right. The first and second prongs were thereby satisfied. Recognizing that the regulation of investment advisers has traditionally been a federal concern, the court concluded that prong four was also satisfied. Only upon examining the third prong did the Second Circuit stress factors in addition to the *Cort* analysis.

The court looked to three factors in finding that a private right of action was consistent with the Advisers Act's underlying purpose. First, the court stressed the congressional intent to provide "effective federal regulation of this important segment of the securities industry." Since the SEC itself had confirmed that its resources were inadequate to effectively police the Act,[121] the court found that "[f]ailure to recognize a private right of action would effectively frustrate that purpose."[122] Second, the court stressed the similarities between sections 206 and 215(b) of the Advisers Act and sections in other securities acts which recognize implied private actions.[123] Although these other acts contained jurisdictional sections expressly authorizing "actions at law," the Second Circuit disagreed with the assertion that omission of these words in the Advisers Act's jurisdictional sections indicated congressional intent to deny private actions.[124]

> In our view, the reason for this omission is that each of the other Acts whose jurisdictional provisions refer to "actions at law," contains one or more sections expressly granting injured parties a private right of action for damages. There is no provision in the Advisers Act which expressly provides for private actions; since it is a less complex statute, containing no express grants of right of action to private parties, a reference to "actions at law" would be superfluous.[125]

The court cited House and Senate Reports[126] which stated that the enforcement provisions of the Advisers Act were "generally comparable" to the Investment Company Act. The court again emphasized that there was "not a shred of evidence" in the legislative history to support the assertion that Congress intended to preclude private actions.[127] Third, the court cited *SEC v. Capital Gains Research, Inc.* where the Supreme Court held that the Advisers Act should be construed like other securities

121. Investment Advisers Act Release No. 491, 8 SEC Docket 744 (December 15, 1975).

122. Abrahamson v. Fleschner, 568 F.2d at 874.

123. *Id.* at 874 n.19.

124. *Id.* at 874.

125. *Id.* at 874-75.

126. S. REP. No. 1775, 76th Cong., 3d Sess. 23 (1940); H.R. REP. No. 2639, 76th Cong., 3d Sess. 30 (1940).

127. Abrahamson v. Fleschner, 568 F.2d at 875.

legislation enacted for the purpose of avoiding frauds, *i.e.*, not technically and restrictively, but flexibly to effectuate its remedial purposes.[128]

Having passed the four-pronged *Cort* analysis, the court ruled favorably on implication, holding: "We believe that each of these factors point unmistakably toward recognition of an implied right of action under section 206 of the Advisers Act." [129]

The dissent in *Abrahamson* by Judge Gurfein presented a strong case that no private action for damages under the Advisers Act should be implied. Judge Gurfein found the Advisers Act differed "significantly from the securities statutes upon which the majority draws for support." [130] He disagreed with the majority with regard to the issue noting that instead of determining whether or not to imply a private right of action, the issue was whether a private action at law for "damages" should be implied.[131]

His review of early legislative history concerning the drafting of the Advisers Act revealed that "actions at law" was merely incorporated into the early draft of the Act by reference to section 40 of the Investment Company Act.[132] Subsequently, the SEC met with representatives of the industry to discuss changes to the bill. What resulted from these meetings was a new draft, incorporating a provision for suits in equity but omitting the phrase "actions at law." The dissent interpreted this part of the legislative history underlying the Advisers Act as merely displaying an intent to require a "compulsory census" of investment advisers and not for the especial benefit of investors.[133]

The key question in Judge Gurfein's mind was why the Advisers Act did not provide for "any" express civil liability in damages, as did every other securities act. Congress could have provided for an express damage remedy, as it had in other cases for misrepresentations. Rather, the absence of a damage remedy, together with indications that the Advisers Act was a compromise between the SEC and the investment advisers industry,[134] pointed toward a cautious approach to the regulation of investment advisers.[135] Absent more affirmative action by Congress, it was not the time to impose civil liability for damages.[136]

The dissent reversed the analysis of the majority. The majority urged a finding that the absence of a provision expressly denying an action for damages was evidence of legislative intent not to preclude pri-

128. *Id.* *See* SEC v. Capital Gains Research, Inc., 375 U.S. 180, 195 (1963).

129. Abrahamson v. Fleschner, 568 F.2d at 873.

130. *Id.* at 879 (Gurfein, J., concurring and dissenting).

131. *Id.*

132. *Id.* at 880 n.3 (Gurfein, J., concurring and dissenting).

133. *Id.* at 883.

134. *See* Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, 74 MICH. L. REV. 308, 319-30 & n.69 (1975).

135. 568 F.2d at 881 (Gurfein, J., concurring and dissenting).

136. *Id.* at 885.

vate damage actions. The dissent interpreted such absence as implying no "clear evidence" that Congress affirmatively intended private action for damages to be created for violations of section 206.[137]

Judge Gurfein interpreted the design of the Advisers Act as it was passed in 1940 not to be a regulatory scheme, but a compulsory census of investment advisers.[138] He then asserted that when Congress passed the amendments to the Advisers Acts in 1970,[139] it addressed itself to the civil liability of investment advisers and limited liability of investment advisers only as to those who advised investment companies and only to the extent of a breach of a fiduciary duty concerning payments for services. He argued that the implication was clear that Congress did direct specific attention to the extent of civil liability upon investment advisers and decided not to impose liability upon advisers except where advice had been given to investment companies.[140]

The majority's explanation for the omission of the words "actions at law" was that the lack of any substantive sections within the Advisers Act expressly granting injured parties a private right of action, made the jurisdiction unnecessary.[141] The dissent took exception to this analysis.[142] In the absence of legislative determination concerning the policy

137. *Id.* at 882 (Gurfein, J., concurring and dissenting).

138. *Id.* at 883 (Gurfein, J., concurring and dissenting).

139. Amendment to Investment Company Act of Aug. 22, 1940, Pub. L. No. 91-547, §§ 22-26, 84 Stat. 1413 (1971).

140. Abrahamson v. Fleschner, 568 F.2d at 883 (Gurfein, J., concurring and dissenting).

141. *Id.* at 874, 875 (majority opinion).

142. The reason given by the majority is not persuasive, for it fails to note that in every single case in which an express civil liability is created in *any* of the Acts, the jurisdiction has *already* been stated in the very section creating the express liability. Thus, § 11 of the 1933 Act, 14 U.S.C. § 77k, *itself* provides that 'any person acquiring such security . . . may, either at law or in equity, in any court of competent jurisdiction, sue . . . .' Section 12 of the 1933 Act, 15 U.S.C. § 771, *itself* provides that the 'purchaser may sue either at law or in equity in any court of competent jurisdiction . . . .' To the same effect, *see* Section 9(e) of the 1934 Act, 15 U.S.C. § 78i(e); Section 16(b) of the 1934 Act, 15 U.S.C. § 78p(b); Section 18 of the 1934 Act, 15 U.S.C. § 78r; Section 16(b) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79p(b); Section 17(b) of that Act, 15 U.S.C. § 79q(b); Section 323(a) of the Trust Indentures Act, 15 U.S.C. § 77www(a); Section 30(f) of the Investment Companies Act, 15 U.S.C. § 80a-29(f). The better explanation, it seems to me, for the general jurisdictional provision in each Act—'the District Courts of the United States . . . shall have jurisdiction' etc.—is Congress' fear that general federal question jurisdiction under 28 U.S.C. § 1331 might not establish jurisdiction in the *federal* courts over securities law claims, particularly when the jurisdictional amount was lacking. The separate jurisdictional provisions associated with the several sections of the securities acts creating substantive liability referred only to 'any court of competent jurisdiction,' and hence left open the question of whether the federal courts were in fact courts of 'competent jurisdiction.' Thus, an independent jurisdiction was conferred on the federal courts by the general provision of each statute (and in the case of the Securities Exchange Act, exclusive jurisdiction). In short, the internal sections conferred general jurisdiction. The jurisdictional section was drawn as broadly as possible to confer clear *federal* jurisdiction.

The majority opinion seeks to draw support from the fact that the Senate and House Reports stated that the enforcement provisions of the

questions, Judge Gurfein found the court to be treading on dangerous ground in implying a private action under section 206. He felt it was a determination that should have been made by Congress. He argued that by creating a *de facto* extension of section 10(b) [143] without the requirement of fraud in connection with the purchase or sale of a security, section 206 liability would judicially create a new extension of rule 10b-5 [144] liability by resort to a different statute.[145]

2. Fifth Circuit

The Fifth Circuit, in *Wilson v. First Houston Investment Corp.*, also concluded that the four-pronged *Cort* analysis was satisfied.[146] It, too, found "additional support" in the language of the Supreme Court in *SEC v. Capital Gains Research, Inc.*: "Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation, 'enacted for the purpose of avoiding frauds,' not technically and restrictively, but flexibly to effectuate its remedial purposes." [147] By implying a private cause of action, the Fifth Circuit perceived neither a less stringent means to achieve the congressional goal nor a serious adverse impact on investors.[148]

Circuit Judge Hill, dissenting, found this implication inappropriate. "Suffice it to say that I am in complete agreement with Judge Gurfein's concurring and dissenting opinion in *Abrahamson v. Fleschner*." [149] In addition, the dissent warned against the impropriety of judicial legislation:

> It may be that the Act now created by our court is a better or more complete Act then [sic] the one actually passed by the Congress. Who knows? Its deficiency is that the judicially created section, establishing a private cause of action, was never submitted to the people's elected representatives and adopted by them.[150]

Advisers Act were 'generally comparable' to those of the Investment Companies Act. *Ante* at 875. Aside from the fact that this begs the crucial question—whether the Acts were comparable in this particular respect—it ignores what was in my view the more likely meaning of 'generally comparable' as applied to the enforcement provisions: that is, that the Advisers Act is 'generally comparable' to the Investment Company Act in that both provide for the concurrent jurisdiction of state and federal courts, as distinguished from the Exchange Act in which federal jurisdiction is made exclusive.

Id. at 881 n.6 (Gurfein, J., concurring and dissenting).

143. 15 U.S.C. § 78j(b) (1976).

144. 17 C.F.R. § 240.10b-5 (1979).

145. Abrahamson v. Fleschner, 568 F.2d at 885 (Gurfein, J., concurring and dissenting).

146. Wilson v. First Houston Inv. Corp., 566 F.2d 1235 (5th Cir. 1978), *vacated and remanded*, 444 U.S. 959 (1979).

147. SEC v. Capital Gains Research, Inc., 375 U.S. at 195.

148. Wilson v. First Houston Inv. Corp., 566 F.2d at 1243.

149. *Id.* (Hill, J., dissenting).

150. *Id.* at 1244 (Hill, J., dissenting).

V. THE SUPREME COURT DECISION

A. *The Opinion of the Court*

The Supreme Court, per Justice Stewart, emphasized from the beginning that the implication decision turns upon statutory construction and not the desirability of providing remedies thought to effectuate the purpose of a given statute.[151] "[W]hat must ultimately be determined is whether Congress intended to create the private remedy asserted. . . . We accept this as the appropriate inquiry to be made in resolving the issues presented by the case before us." [152] Accordingly, the reasoning of the Court started with the language of the statute.[153]

The Court conceded that both sections 215 and 206 were intended to benefit the clients of investment advisers,[154] but separated this particular expression of intent from the question of whether supplemental enforcement through private litigation was also intended.[155] The Court recognized that the legislative history of the Advisers Act is entirely silent on this matter. The Court, while admitting this alone did not "automatically undermine" the implication of a private action,[156] stated that such silence was "hardly helpful." [157] Evidently, silence, while not defeating implication of a private action, creates a strong presumption against it. To overcome this presumption the "language or structure of the statute" or the "circumstances of its enactment" must be examined to see if congressional intent is implicitly present.[158]

In the case of section 215 the Court concluded that the statutory language, by declaring certain contracts void, necessarily contemplated that the issue of voidness must be litigated somewhere.[159] "A person with the power to avoid a contract ordinarily may resort to a court to have the contract rescinded and to obtain restitution of consideration paid." [160] Previous recognition by the Court of the right to rescind a contract which was void under a comparable provision of the Securities Exchange Act of 1934,[161] as well as the fact that "federal courts in general have viewed such language as implying an equitable cause of action for rescission," [162] contributed to the Court's conclusion. Accordingly, the Court affirmed

151. Transamerica Mortgage Advisors, Inc. v. Lewis ,444 U.S. at 15.
152. *Id.* at 15, 16.
153. *Id.* at 16.
154. *Id.* at 17.
155. *Id.* at 18.
156. *Id.* *See also* Cannon v. University of Chicago, 441 U.S. 677, 694 (1979).
157. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 18.
158. *Id.*
159. *Id.*
160. *Id.* (citing Deckert v. Independence Corp., 311 U.S. 282, 289 (1940)).
161. *See* Mills v. Electric Auto-Lite Co., 396 U.S. 375, 388 (1970) (court held §29(b), 15 U.S.C. §78cc(b) (1970) conferred a right to rescind).
162. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 19 (citing Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946)).

the court of appeal's ruling that respondent could maintain an action on behalf of the Trust to void the investment advisers contract.

The question of a private action for damages under section 206 which "simply proscribes certain conduct, and does not in terms create or alter any civil liabilities" [163] was viewed quite differently by the Court. The Court found that an intent to create an implied action for damages must be found in the Advisers Act. "Yet, it is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be wary of reading others into it." [164]

The Court went on to list where the Advisers Act had expressly provided a particular remedy. Under section 217,[165] willful violations of the Advisers Act are criminal offenses which are punishable by fine, imprisonment, or both. Section 209 [166] authorizes the Commission to bring civil actions in federal courts to enforce compliance with the Advisers Act, and section 203 [167] authorizes the Securities and Exchange Commission to impose various administrative sanctions on persons who violate the Advisers Act, including section 206. In view of these express provisions for enforcing the duties imposed by section 206, the Court reasoned that it was "highly improbable that Congress absentmindedly forgot to mention an intended private action." [168] Provisions expressly authorizing private actions for damages under each of the other securities acts preceding the Advisers Act also suggested to the Court that Congress did not intend to create a private action.[169] "Obviously, then, when Congress wished to provide a private damages remedy, it knew how to do so, and did so expressly." [170]

The omission of the words "actions at law" from the jurisdictional section of the Advisers Act reinforced this argument.[171] All of the other acts expressly provided for jurisdiction over "all suits in equity and actions at law." The unexplained deletion of the words "actions at law" in the jurisdictional section was considered by the Court as "one more piece of evidence that Congress did not intend to authorize a cause of action for anything beyond limited equitable relief." [172]

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163. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 19.

164. *Id.* (citing Botany Mills v. United States, 278 U.S. 282, 289 (1929)).

165. 15 U.S.C. § 80b-17 (1976).

166. 15 U.S.C. § 80b-9 (1976).

167. 15 U.S.C. § 80b-5 (1976).

168. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 20 (citing Cannon v. University of Chicago, 441 U.S. at 742 (Powell, J., dissenting)).

169. Securities Act of 1933, §§ 11 and 12, 15 U.S.C. §§ 77k and 77l; Securities Exchange Act of 1934, §§ 9(e), 16(b), and 18, 15 U.S.C. §§ 78i(e), 78p(b), and 78r; Public Utility Holding Company Act of 1935, §§ 16(a) and 17(b), 15 U.S.C. §§ 79p(a) and 79q(b); Trust Indenture Act of 1939, § 323(a), 15 U.S.C. § 77www (a); Investment Company Act of 1940, § 30(f), 15 U.S.C. § 80a-29(f).

170. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 21 (quoting from Touche Ross & Co. v. Redington, 442 U.S. 560, 572 (1979)).

171. *Id.* at 21, 22 (15 U.S.C. § 80b-14 (1976)).

172. *Id.* at 22.

The Court once against stressed its rejection of the "utility of a private action" as a sole justification for implication.[173] "[T]he mere fact that the statute was designed to protect advisers' clients does not require the implication of a private cause of action for damages on their behalf." [174] Instead, the Court narrowed its focus. "The dispositive question remains whether Congress intended to create any such remedy." [175]

B. *The Dissent*

In his dissent, Mr. Justice White was unable to reconcile the majority's decision with previous Supreme Court decisions [176] which recognized implied actions for damages under securities laws with substantially the same language as the Advisers Act.[177] Paralleling much of the reasoning of the courts of appeals, the dissent stated that proper application of the *Cort* factors indicated that in addition to the limited private actions under section 215(b), an additional private right of action for damages under section 206 existed.[178] The dissent agreed that the implication of a private right of action "is limited solely to determining whether Congress intended to create the private right of action," [179] but maintained that full application of the four-pronged *Cort* analysis should still be the preferred criteria through which this intent could be discerned: [180]

> Each of the *Cort* factors points toward implication of a private cause of action in favor of clients defrauded by investment advisers in violation of the Act. The Act was enacted for the special benefit of clients of investment advisers, and there is no indication of any legislative intent to deny such a cause of action, which would be consistent with the legislative scheme governing an area not traditionally relegated to state law.[181]

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173. *Id.* at 23, 24. This is the third of the four *Cort* factors which apparently fell from the weighing scales in the case of Touche Ross & Co. v. Redington, 442 U.S. 560 (1979).

174. *Id.* at 24.

175. *Id.*

176. *See* Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 25 (White, J., dissenting) (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975) and Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971)).

177. Mr. Justice White noted that the provisions of § 206 of the Advisers Act, 15 U.S.C. § 80b-6 are substantially similar to § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and Rule 10(b)-5, 17 C.F.R. § 240.10(b)-5 (1979). Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 25, 26 (White, J., dissenting).

178. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 29 (White, J., dissenting).

179. *Id.* at 27 (quoting from Touche Ross & Co. v. Redington, 442 U.S. 560, 568 (1979)).

180. *Id.* (White, J., dissenting). *See* Davis v. Passman, 442 U.S. 228, 241 (1979).

181. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 36 (White, J., dissenting).

The dissent referred to prior case law [182] as well as the majority opinion [183] as proof that the first prong of *Cort* was satisfied.

In applying the second prong of *Cort*, the dissent reasoned that it was not necessary to show an express or implied intention to create a private right of action but that an explicit purpose to deny such a cause of action would control.[184] The dissent found no such intention to foreclose this right in the legislative history.[185] Instead, the dissent stressed the relationship between section 215(b), which authorized rescission, and section 206, which prohibited fraudulent actions. Justice White concluded that this relationship between substance and remedy created a practical necessity which suggested congressional intent to use private actions to redress violations of section 206.[186]

Justice White also took exception to the majority's focus on the omission of the words "actions at law" within the Advisers Act's jurisdictional section. The dissent reasoned that since jurisdictional provisions "create no cause of action of their own force and effect," [187] intent to preclude private rights of action must be found in the substantive sections of the Advisers Act.[188] Since the legislative history was silent on this matter, any omission of "actions at law" within the jurisdictional section was "delphic at best." [189]

Justice White found three factors under the third prong of *Cort* [190] favoring implication of private causes of action to be determinative. First, since the Securities and Exchange Commission has candidly admitted that it lacks the resources to effectively police the Advisers Act, permitting private litigation would provide a necessary supplement to SEC enforcement.[191] Second, allowing private litigation would allow investors to "activate and participate in the administrative process contemplated by the statute." [192] Finally, and perhaps most importantly, allowing private

182. *Id.* at 27 (White, J., dissenting) (citing Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977)); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963).

183. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 17.

184. *See* Cannon v. University of Chicago, 441 U.S. 677, 694 (1979).

185. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 28 n.5 (White, J., dissenting).

186. Last term in *Davis v. Passman*, we recognized that the question of whether a litigant has a 'cause of action' is analytically distinct and prior to the question of what relief, if any, a litigant may be entitled to receive. Once it is recognized that a statute creates an implied right of action, courts have wide discretion in fashioning available relief. (citations omitted).

Id. at 29 (White, J., dissenting).

187. *Id.* at 32 (White, J., dissenting) (quoting from Touche Ross & Co. v. Redington, 442 U.S. at 577).

188. *Id.* (White, J., dissenting).

189. *Id.* at 31 (White, J., dissenting).

190. The third prong requires asking whether implication would be consistent with the underlying purposes of the Act. *See supra* note 109 and accompanying text.

191. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 35 n.12 (White, J., dissenting).

192. *Id.* (quoting from Cannon v. University of Chicago, 441 U.S. at 707 n.41).

actions under section 206 would give victimized clients greater hope of obtaining redress for their injuries.[193]

The fourth prong of *Cort* is whether implication might interfere in an area of regulation traditionally delegated to the states. The dissent found that "[r]egulation of the activities of investment advisers has not been a traditional state concern." [194] Indeed, only six states had enacted legislation to regulate investment advisers before the Advisers Act was enacted and most states subsequently patterned such legislation after the federal legislation.[195]

VI. DISCUSSION

The Supreme Court, in *Transamerica,* gave only limited attention to the *Cort v. Ash* analysis. A careful reading of the opinion makes it clear that the majority did use the *Cort* test but considered its inquiry at an end when the second prong could not be satisfied.[196] The Court was willing to concede the Adviser's Act was enacted for the benefit of investors,[197] but in failing to find any intent on the part of Congress, in either the legislative history or the actual wording of the statute to provide for a private right of action, the Court took the analysis no further.[198] The respondent argued that the Court should have gone on and considered prongs three and four.[199] The majority was of the opinion, however, that those factors standing alone would not justify the implication of a private right of action.[200]

Three circuit courts of appeal and a strong dissent make a very persuasive argument using the *Cort v. Ash* test that an implied private right of action for damages should exist under section 206 of the Advisers Act.[201] The question now becomes: how viable is the *Cort v. Ash* stand-

193. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 35 (White, J., dissenting).

194. *Id.* (White, J., dissenting).

195. *Id. See, e.g., Hearing on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 996-1,017 (1940); Note, *Private Causes of Action Under Section 206 of the Investment Advisors Act,* 74 MICH. L. REV. 308, 324 (1975).

196. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 22, 23.

197. *Id.* at 17.

198. *Id.* at 23.

> It is true that in *Cort v. Ash,* the Court set forth four factors that it considered 'relevant' in determining whether a private remedy is implicit in a statute not expressly providing one. But the Court did not decide that each of these factors is entitled to equal weight. *The central inquiry remains whether Congress intended to create,* either expressly or by implication, a private cause of action. Indeed, the first three factors discussed in *Cort*—the language and focus of the statute, its legislative history, and its purpose, see 422 U.S. at 78—are ones traditionally relied upon in determining legislative intent.

Touche Ross & Co. v. Redington, 442 U.S. at 575-76 (emphasis added).

199. *Id.*

200. *Id.* (citing Touche Ross & Co. v. Redington, 442 U.S. 560 (1979)).

201. The argument is strong because (1) there was no unambiguous expression of intent by Congress and (2) because the Court has repeatedly stated that the

ard in light of *Transamerica* and the Court's recent decision in *Cannon v. University of Chicago*?[202]

The *Cannon* decision indicates that the Supreme Court still considers the *Cort v. Ash* analysis to be a viable method for determining whether or not to imply a private cause of action. The Court in *Cannon* held there was an implied private right of action under section 901(a) of Title IX of the Education Amendments to the 1964 Civil Rights Act.[203] In reaching their decision to imply a private right of action, the Supreme Court explicitly cited the four prongs of *Cort v. Ash*. The Court summarized their findings by stating:

> In sum, there is no need in this case to weigh the four *Cort* factors; all of them support the same result. Not only the words and history of Title IX, but also its subject matter and underlying purposes, counsel implication of a cause of action in favor of private victims of discrimination.[204]

What distinguished the *Cannon* case for the Court was the finding that the second prong was more than amply satisfied by legislative history and judicial decisions that were handed down before the decision in *Cort*. Title IX was written in the likeness of Title VI of the Civil Rights Act; the statutes used identical language to identify the benefited class, with the exception of the word "sex" used in Title IX. The drafters of Title IX had presumed that during its making, it would be given the same treatment and applied in the same manner as Title VI[205] and would pre-

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federal securities laws should be applied liberally to effectuate its remedial purposes. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963). When weighing prongs two and three together, one would believe that the effectuation of known congressional purpose would outweigh unknown specific legislative intent.

202. 441 U.S. 677 (1979). This question becomes extremely important when considering the volume of litigation in other areas where an implied private right of action is alleged under other federal laws. *See* Fischer v. Rosenthal & Co., 481 F. Supp. 53 (N.D. Tex. 1979), where the district court held that the Commodities Exchange Act, 7 U.S.C. §§ 1-22 (1970) did not imply a private right of action. *See* Stone v. Saxon & Windsor Group, 485 F. Supp. 1212 (N.D. Ill. 1980), *but see* Alken v. Lerner, 485 F. Supp. 871 (D.N.J. 1980); Gonzalez v. Paine, 493 F. Supp. 499 (S.D.N.Y. 1980) and Navigator Group Funds v. Shearson Hayden Stone, Inc., 487 F. Supp. 416 (S.D.N.Y. 1980).

In another area, § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a), the precursor of rule 10b-5, the same problem of implication has arisen. The Supreme Court expressly noted this problem in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 734 n.6 (1975). *See also* Aaron v. SEC, 100 S. Ct. 1945, 1951 (1980). The lower courts are wrestling with this particular problem now. *See, e.g.*, McFarland v. Memorex Corp., 493 F. Supp. 631 (N.D. Cal. 1980); Freeman v. McCormack, 490 F. Supp. 767 (W.D. Okla. 1980); Martin v. Howard, Weil, Labouisse, Friedricks, Inc., 487 F. Supp. 503 (E.D. La. 1980); and Gunter v. Hutcheson, 433 F. Supp. 42 (N.D. Ga. 1977). There are many cases cited in Gunter which have held that a private cause of action is to be implied. *See* Gunter, 433 F. Supp. at 44.

203. Section 901(a), 86 Stat. 373, *as amended*, is set forth in 20 U.S.C. § 1681 (1976).

204. Cannon v. University of Chicago, 441 U.S. at 709.

205. Title VI of the Civil Rights Act of 1906, 78 Stat. 252, 42 U.S.C. § 2000d (1976).

vent discrimination on the basis of sex as Title VI had prevented discrimination on the basis of race, color, or national origin.

The decision reached in *Cannon* must stand on its facts and its peculiar legislative history. Unfortunately, the transition to securities law can not easily be made. The *Cannon* analysis has shown here that more than a fair implication or ambiguity is needed to satisfy prong two.[206] Despite the fact that a statute may exist for the special benefit of a stated class, failure to find explicit legislative intent to permit private parties to bring an action for relief apparently renders the remainder of the *Cort* analysis unnecessary. Using the four prongs of *Cort,* the *Cannon* Court emphasized that Title IX would assist in achieving the statutory purpose of providing individual citizens effective protection against discriminatory practices. Under the same test, the Court in *Transamerica* found that the goal of effective protection of investment advisers' clients was insufficient to warrant a judicial approval of a private cause of action for damages under section 206 in addition to the traditional equitable relief *fairly implied* in section 215 of the Advisers Act.[207]

Considering *Transamerica* and *Cannon* together, the *Cort* test is not abandoned, although its focus is narrowed. The Court's primary concern is in satisfying the second prong of *Cort,* now requiring a positive finding of legislative intent. The other "relevant factors" while important are not strong enough on their own to support the implication of a private right of action.

The Court's decision represents an apparent shift to a more pure form of the separation of powers. This is well illustrated by the following quote from *Transamerica*: "The dispositive question remains whether Congress intended to create any such remedy. Having answered that question in the negative, our inquiry is at an end." [208]

VII. CONCLUSION

The significance of the Court's decision in *Transamerica Mortgage Advisors, Inc. v. Lewis* extends well beyond the issue of private rights of action for damages under the Advisers Act. It represents a determination by the Court not to encroach upon legislative power. This is a

206. "Far from evidencing any purpose to *deny* a private cause of action, the history of Title IX rather plainly indicates that Congress intended to create such a remedy." Cannon v. University of Chicago, 441 U.S. at 694.

207. This separation of legal and equitable *remedies* as opposed to the more basic question of the existence of a *right* or *standing* to sue *ab initio* appears anomalous as Mr. Justice White recognized in his dissent, 444 U.S. at 30. This theoretical conflict may well arise in other areas of federal securities law in the near future, to say nothing of the confusion the Court has created in this already troubled area. *See* Zeffiro v. First Pa. Banking & Trust Co., 623 F.2d 290 (3rd Cir. 1980) (court held §§ 322(b) and 323 of the Trust Indenture Act of 1939, 15 U.S.C. §§ 77vvv(b), 77www, created a private cause of action in federal court for aggrieved plaintiffs citing Transamerica and 15 U.S.C. § 80b-15 as supporting authority).

208. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 24.

trend away from past Supreme Court decisions that emphasized remedial legislative purposes over inadequate or ambiguous draftsmanship by Congress. In the process, the Court has severely weakened the continued reliability of *Cort v. Ash*'s implication standard as an analytical tool for the federal plaintiff seeking relief under a broad legislative prohibition protecting his specific interests. The practicing lawyer as well must be wary of the Court's more restrictive view of its judicial powers of legislation where federal remedial purposes would be served. The Court has given another signal to Congress to act.

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