1996

Mending the Weathered Jurisdictional Fences in the Supreme Court's Securities Fraud Decisions

Michael J. Kaufman

Follow this and additional works at: https://scholar.smu.edu/smulr

Recommended Citation

Michael J. Kaufman, Mending the Weathered Jurisdictional Fences in the Supreme Court's Securities Fraud Decisions, 49 SMU L. Rev. 159 (1996)

https://scholar.smu.edu/smulr/vol49/iss2/2

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit http://digitalrepository.smu.edu.
MENDING THE WEATHERED JURISDICTIONAL FENCES IN THE SUPREME COURT'S SECURITIES FRAUD DECISIONS

Michael J. Kaufman*

TABLE OF CONTENTS

I. INTRODUCTION ........................................ 159

II. THE COURT'S APPARENT "GUERRILLA WARFARE" ON IMPLIED RIGHTS OF ACTION ............ 162
A. THE SUPREME COURT'S HISTORY OF LIMITING JUDICIALLY CREATED SECURITIES FRAUD REMEDIES ... 162
B. MUSICK AND CENTRAL BANK: THE SUPREME COURT'S APPARENTLY IRRECONCILABLE APPROACH TO IMPLIED SECURITIES FRAUD REMEDIES ................. 167
1. Musick: The Supreme Court's Creation of an Implied Right to Contribution ....................... 167
   a. The Musick Decision ......................... 167
   b. Musick's Appearance of Result-Guided Reasoning ........................................... 171
2. Central Bank: The Supreme Court's Rejection of an Implied Right of Action for Aiding and Abetting ... 172
   a. The Central Bank Decision ............... 172
   b. Central Bank's Appearance of Result-Guided Reasoning ...................................... 173

III. ALLOYD AND PLAUT: THE COURT'S UNPRINCIPLED REJECTION OF EXPRESS REMEDIES FOR SECURITIES FRAUD ............. 175
A. Alloyd's Unprincipled Rejection of Express Remedies for Securities Fraud ...................... 175
   1. The Alloyd Decision .......................... 175
   2. Alloyd's Result-Guided Reasoning ............. 177
      a. The Court's Arguments Are Unpersuasive ...... 177

* Professor of Law, Loyola University of Chicago School of Law. A.B., Kenyon College (1980); J.D., University of Michigan (1983). I wish to thank Joel Seligman and Larry Marshall for their wisdom and critical insights.
b. The Court's Principles of Statutory Construction
   Are Consistent Only in Result .......................... 183

c. Alloyd Is Admittedly Result-Guided .................... 185

B. *Plaut's Unprincipled Rejection of Congress'*
   Express Grant of Jurisdiction over a Class of
   Section 10(b) Claims ........................................ 186

C. The Court's Express and Implied Securities
   Fraud Remedies Decisions Are Consistent Only in
   Result ...................................................... 189

IV. THE SUPREME COURT'S SECURITIES FRAUD
   POLICIES HAVE NO EMPIRICAL BASIS ................. 189

V. THE JURISDICTIONAL PRINCIPLE IN THE
   SUPREME COURT'S SECURITIES FRAUD
   DECISIONS .................................................. 192

A. Federal Courts May Adjudicate Private Rights
   of Action Only If There Is Subject-Matter
   Jurisdiction ................................................ 193

   1. Jurisdiction over Private Rights of Action ........ 193

   2. The Federal Judiciary Has No Power to Create
      Private Federal Remedies .............................. 194

   3. The Federal Courts Have No Arising Under
      Jurisdiction over Implied Rights of Action for
      Violations of Federal Securities Law ................ 196

   4. The Federal Courts May Imply Private Remedies for
      Securities Fraud in Diversity and Supplemental
      Jurisdiction Cases ...................................... 202

B. The Federal Courts Must Adjudicate Matters
   Within Their Jurisdiction .................................. 203

C. The Application of the Jurisdictional Principle
   to the Supreme Court's Securities Fraud Cases .. 204

VI. THE SUPREME COURT'S REJECTION OF THE
    JURISDICTIONAL PRINCIPLE IN ALLOYD AND
    PLAUT ....................................................... 213

A. Limiting the Court's Rejection of Jurisdiction in
   Alloyd: Section 12(2) Still Applies to Private
   Placement .................................................. 213

B. The Court's Rejection of Jurisdiction in *Plaut* .. 220

VII. CONCLUSION .............................................. 220
I. INTRODUCTION

AFTER surveying its most recent securities fraud opinions, the Supreme Court declared: "Separation of powers, a distinctively American political doctrine, profits from the advice authored by a distinctively American poet: Good fences make good neighbors." If only the Supreme Court had followed Robert Frost's advice.

Instead, in its securities fraud decisions, the Court has readily, and even expressly, crossed the fence that separates the legislative and judicial powers. In doing so, the Court has not been reticent about its political desire to protect defendants from exposure to securities fraud litigation and liability. It has created the perception that it is engaging in "preter-natural solicitousness for corporate well-being and...callousness toward the investing public."

This Article shows just how the Supreme Court's securities fraud decisions have created that perception. In particular, the Article demonstrates that the Court's most recent securities fraud opinions appear to be reconcilable only in their consistent protection of defendants from liability for securities fraud. Nonetheless, this Article finds, within the Court's apparently unprincipled and result-guided decisions, a unifying jurisdictional principle. That basic principle prevents the federal courts from accepting independent subject-matter jurisdiction over implied rights of action for securities fraud, but requires them to accept subject-matter jurisdiction over express rights of action for securities fraud. This jurisdictional principle reconciles the Supreme Court's apparently inconsistent, policy-driven implied right of action decisions. Ultimately, however, this Article concludes that the basic jurisdictional principle is disserved by the Court's most recent rejection of Congress' express remedies for securities fraud.

In Part II, this Article analyzes the Supreme Court's implied private right of action decisions. These opinions appear to be guided by the Court's desire to protect defendants from exposure to implied securities fraud remedies. In its most recent decisions, in fact, the Court has created an implied right of action for contribution on behalf of alleged participants in securities fraud, but has rejected an implied right of action against those same participants for aiding and abetting securities fraud. These latest decisions significantly enhance the appearance that the Court is guided by its political goal of protecting defendants from exposure to securities fraud liability.

---

Part III of this Article describes how the appearance of result-guided reasoning is reinforced by Alloyd\(^4\) and Plaut,\(^5\) the Court’s most recent decisions interpreting express securities fraud remedies. These decisions reject clear congressional language that expressly grants to the federal courts jurisdiction over express federal securities fraud remedies. The reasoning in these decisions is unpersuasive and inconsistent. Part III concludes with a chart graphically illustrating that all of the Supreme Court’s decisions interpreting express and implied remedies for securities fraud appear to be consistent only in their protection of defendants from the reach of those remedies. Moreover, as demonstrated in Part IV, the Court’s policy objective of protecting defendants from exposure to securities fraud liability itself has no legitimate empirical support.

In Part V, however, this Article discovers within the Court’s recent securities fraud decisions a jurisdictional principle that helps to reconcile these apparently result-guided and otherwise irreconcilable decisions. The jurisdictional principle is that the federal courts have the power to recognize implied private rights of action if, but only if, they have subject-matter jurisdiction by an express right of action. The principle’s corollary is that the federal courts have no power to decline to exercise subject-matter jurisdiction over rights of action expressly delegated to them by Congress. This jurisdictional principle justifies the Court’s restriction upon implied rights of action. It even reconciles the Court’s creation of an implied right of action for contribution with its rejection of an implied right of action for aiding and abetting. The principle’s corollary, however, shows that the Court’s rejection of express securities fraud remedies cannot be justified.

This Article concludes by calling for a return to fundamental jurisdictional principles. Such a return is particularly vital in an environment in which Congress has revisited the political issues surrounding the proper regulation of securities transactions.

II. THE COURT’S APPARENT “GUERRILLA WARFARE” ON IMPLIED RIGHTS OF ACTION

A. THE SUPREME COURT’S HISTORY OF LIMITING JUDICIA LLY CREATED SECURITIES FRAUD REMEDIES

The federal courts have recognized implied rights of action for fraud in connection with proxy solicitation under section 14(a) of the Securities Exchange Act of 1934 (the “1934 Act”),\(^6\) and for fraud in connection with

---

5. 115 S. Ct. at 1447.
6. 15 U.S.C. § 78n(a) (1994). Section 14(a) makes it “unlawful for any person ... in contravention of such rules and regulations as the Commission may prescribe ... to solicit or to permit the use of his name to solicit any proxy ... in respect of any security ... registered [on a national securities exchange]....” Id. SEC Rule 14a-9 prohibits material misstatements or omissions in connection with proxy solicitation. 17 C.F.R. § 240.14a-9 (1995).
securities transactions under section 10(b) of the 1934 Act.⁷ In *Borak*,⁸ the Supreme Court recognized an implied private right of action for proxy fraud, reasoning that the federal courts have the power to create remedies for violations of federal statutes, even when Congress has failed to do so.⁹ The Supreme Court has "repeatedly reaffirmed" the section

7. 15 U.S.C. § 78j(b) (1994). More civil actions have been filed under § 10(b) of the Securities Exchange Act of 1934 than under any other provision of the federal securities laws. See, e.g., Alfred F. Conrad et al., Enterprise Organization 991 (3d ed. 1982) ("Since the first civil action sired by Rule 10b-5 pecked its way out of the eggshell in 1947, its progeny have multiplied to become the most litigated segment of the SEC's jurisdiction.").


Section 10(b) itself is the subject of multi-volume treatises. See Alan R. Bromberg & Lewis D. Lowenfels, *Bromberg and Lowenfels on Securities Fraud & Commodities Fraud* (2d ed. 1994); Arnold S. Jacobs, *Litigation and Practice Under Rule 10b-5* (2d ed. 1981). Despite the quantity of this scholarship devoted to § 10(b) and the implied private right of action, none of it addresses the constitutional legitimacy of the judicial recognition of a private remedy based on federal court remedial power or legislative acquiescence.

Section 10 of the Securities Exchange Act of 1934 states:

> It shall be unlawful for any person . . . (b) [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance or any contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.


Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.


9. Id. at 433-35.

10(b)\(^{11}\) private remedy for securities fraud and declared its existence to be "well established"\(^{12}\) and "simply beyond peradventure."\(^{13}\) Yet the Supreme Court has never squarely held that a private right of action may be inferred from section 10(b). Instead, the Court has merely assumed the existence of the private remedy for purposes of erecting necessary elements for recovery, such as scienter,\(^{14}\) standing,\(^{15}\) deception,\(^{16}\) exclusivity,\(^{17}\) materiality,\(^{18}\) reliance,\(^{19}\) the statute of limitations,\(^{20}\) contribution,\(^{21}\) and aiding and abetting.\(^{22}\)

The Court's current dissatisfaction with the justifications for the judicial creation of private remedies, however, has led some of its members to insist that such remedies should never be created,\(^{23}\) while others hint that even the well-established section 10(b) and section 14(a) private remedies may be ripe for reconsideration.\(^{24}\) The Court has expressed its dissatisfaction with the existence of those remedies by narrowing their reach. In *Virginia Bankshares*, the Court confined the section 14(a) implied private right of action for proxy fraud to those plaintiffs who control votes required to authorize the corporate action subject to the challenged proxy solicitation.\(^{25}\) In that case, Justice Kennedy even observed that the Court had declared "guerrilla warfare"\(^{26}\) against private rights of action under the federal securities laws. He cautioned: "Congress and those charged with enforcement of the securities laws stand forewarned that unresolved questions concerning the scope of those causes of action are likely to be answered by the Court in favor of defendants."\(^{27}\)

Justice Kennedy's warning was justified. With limited exception, the Supreme Court has restricted the scope of the implied private remedies

\(^{11}\) Since its inception in 1946, the judicially created private remedy for violations of § 10(b) has become a significant supplement to the SEC's effort to enforce the federal securities laws, and has become an important source of compensation for defrauded securities investors. *Basic Inc. v. Levinson*, 485 U.S. 224, 230-31 (1988).

\(^{12}\) *Huddleston*, 459 U.S. at 380 n.70 (quoting *Hochfelder*, 425 U.S. at 196).

\(^{13}\) *Id.* at 380. See also *Basic*, 485 U.S. at 230-31.

\(^{14}\) *Hochfelder*, 425 U.S. at 197.

\(^{15}\) *Blue Chip Stamps*, 421 U.S. at 730.


\(^{17}\) *Huddleston*, 459 U.S. at 387.

\(^{18}\) *Basic*, 485 U.S. at 249-50.

\(^{19}\) *Id.*


\(^{24}\) *Musick*, 113 S. Ct. at 2092 (Thomas, J., dissenting, joined by Blackmun and O'Connor, JJ.) ("We again have no cause to reconsider whether the 10b-5 action should have been recognized at all."). See also *Virginia Bankshares*, Inc. v. Sandberg, 501 U.S. 1083, 1104 n.11 (1991) ("The object of our enquiry does not extend further to question the holding of [Borak] at this date ...") (emphasis supplied).

\(^{25}\) *Virginia Bankshares*, 501 U.S. at 1099-1108.

\(^{26}\) *Id.* at 1115 (Kennedy, J., dissenting in part and concurring in part, joined by Stevens, Blackmun, and Marshall, JJ.).

\(^{27}\) *Id.*
for securities fraud in each of its decisions interpreting those remedies. Those decisions have been expressly guided by the Court's distaste for implied remedies. In *Virginia Bankshares*, the Court began its restriction of the definition of "causation" in section 14(a) claims by announcing that "fundamental principles" of judicial power, which were not the "considered focus" of *Borak*, require the Court to reject an extension of judicially-created private remedies. Similarly, in *Blue Chip Stamps*, the Supreme Court based its decision to deny section 10(b) standing to mere offerees of securities upon the uncertain origins of the private remedy:

When we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn. . . . It is therefore proper that we consider . . . what may be described as policy considerations when we come to flesh out the portions of the law . . . .

The Court further decided that "[g]iven the peculiar blend of legislative, administrative and judicial history which now surrounds Rule 10b-5, practical factors . . . are entitled to a good deal of weight." The practical, policy reason for the Court's restriction of section 10(b) liability is the concern for the "danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b-5." The Court acknowledged that in fashioning its limitation on section 10(b) liability it did not dismiss as a "factor" that its result "makes it easier, rather than more difficult, for a defendant to obtain summary judgment." The justification for the Court's desire to protect defendants from liability is the uncertain judicial origin of the private remedy.

Similarly, in *Hochfelder*, the Court's transparent dissatisfaction with the existence of the section 10(b) private action drove its rejection of any such action based on allegations of mere negligence. The Court argued that because it is dealing with a "judicially implied liability," the statutory language, which seems to require intentional misconduct, could foreclose "further inquiry" in cases where proof of such intent is lacking. Whereas the Court in *Blue Chip Stamps* argued that the judicial origins of the section 10(b) private remedy justify its reliance on policy considera—

---

28. See, e.g., *Lampf*, 501 U.S. at 364 (finding no private right of action if filed more than three years after the challenged transaction or one year from discovery); *Santa Fe Indus.*, 430 U.S. at 479 (finding no private right of action for corporate mismanagement); *Hochfelder*, 425 U.S. at 193 (asserting that no private right of action will lie for negligence); *Blue Chip Stamps*, 421 U.S. at 730 (finding no private right of action for offerees of stock who neither purchased nor sold securities). *But see Basic*, 485 U.S. at 230-31; *Huddleston*, 459 U.S. at 384.


31. *Id.* at 749.

32. *Id.* at 740.

33. *Id.* at 742.

34. *Id.* at 762 (Blackmun, J., dissenting).


36. *Id.* at 200.

37. *Id.* at 201.
Nonetheless, the Hochfelder Court proceeded to argue that the unique role of the section 10(b) remedy within the federal securities laws also supports its denial of that remedy for negligent conduct. After observing that the express remedies created by the federal securities laws carry express procedural restrictions not present in the context of the implied section 10(b) remedy, the Court concluded: "We think those procedural limitations indicate that the judicially created private damages remedy under § 10(b)—which has no comparable restrictions—cannot be extended, consistently with the intent of Congress, to actions premised on negligent wrongdoing." The Court reasoned that because recovery under the express remedies of the securities laws is subject to express procedural requirements, recovery under the implied section 10(b) remedy should at least be subject to implied substantive limitations. This argument can be seen as the product of the Court's fundamental dislike for the section 10(b) implied remedy and its desire to limit its use. Indeed, Hochfelder cites Blue Chip Stamps with approval for its "concern that the inexorable broadening of the class of plaintiffs who may sue in this area of the law will ultimately result in more harm than good."

The Supreme Court also based its Lampf decision, which created a uniform, retroactive statute of limitations period for private section 10(b) actions, on the uncertain judicial origins of those actions. There, the Court itself complained that its task in defining the section 10(b) limitations period is made "awkward" and "complicated by the nontraditional origins of the § 10(b) cause of action." Justice Scalia agreed that the case presents a "distinctive difficulty because it involves one of those so-called 'implied' causes of action that, for several decades, this Court was prone to discover in—or, more accurately, create in reliance upon—federal legislation." Because, as Justice Scalia frankly acknowledged, the Court is "imagining," it conjures a retroactive limitations period that limits the section 10(b) remedy. Absent any such guidance, the Court

38. 421 U.S. at 737.
39. 425 U.S. at 201.
40. Id. at 208-12.
41. Id. at 210. Ironically, one of the procedural barriers not present in § 10(b) actions cited by the Court is the relatively short statute of limitations period governing the express rights of action. Id. at 210 n.29. The irony, of course, is that the Supreme Court in Lampf created a uniform statute of limitations period for § 10(b) actions based on the limitations periods for those express rights of action. 501 U.S. at 358-60.
42. Hochfelder, 425 U.S. at 210.
43. Id. at 214 n.33 (quoting Blue Chip Stamps, 421 U.S. at 747-48).
44. Lampf, 501 U.S. at 358.
45. Id. at 359.
46. Id. at 358.
47. Id. at 365 (Scalia, J., concurring).
48. Id. at 365-66.
blatantly acknowledges that it interprets the implied securities fraud remedies on its own, embarking on a “lawless” act of “imagining.”

B. Musick and Central Bank: The Supreme Court’s Apparently Irreconcilable Approach to Implied Securities Fraud Remedies

The Supreme Court’s recent Musick\(^{50}\) and Central Bank\(^{51}\) decisions appear to be reconcilable only in their consistent protection of defendants from exposure to securities fraud liability.

1. Musick: The Supreme Court’s Creation of an Implied Right to Contribution

a. The Musick Decision

In Musick, the Supreme Court created an implied right of action for contribution under section 10(b).\(^{52}\) In doing so, the Court acknowledged that the underlying section 10(b) private remedy derives from a “theory” of judicial power to “supplement federal statutory duties” rather than a theory of congressional intent.\(^{53}\) The Court further acknowledged that under its own precedent, the creation of rights of action “ought to be left to legislatures, not courts.”\(^{54}\) This is an implicit recognition by the Supreme Court that the “theory” of judicial power which gave birth to the section 10(b) private remedy is no longer sound.\(^{55}\) Rather than confront the constitutional propriety of the section 10(b) private remedy, however, the Court again assumed the remedy’s existence for purposes of interpreting its scope.

The Court based its decision to recognize a new implied right to contribution under section 10(b) on the very fact that the section 10(b) private remedy is a judicial creation. The Court suggested that but for the judicial origins of the section 10(b) private remedy, it would follow its recent precedents\(^{56}\) rejecting implied rights to contribution under comparable federal regulatory schemes.\(^{57}\) Despite the section 10(b) private action’s

\(^{49}\) Id.

\(^{50}\) Musick, Peeler & Garrett v. Employers Ins., 113 S. Ct. 2085 (1993).


\(^{52}\) Musick, 113 S. Ct. at 2091.

\(^{53}\) Id. at 2088 (asserting that the search for congressional intent to create the right would be futile) (citing Blue Chip Stamps, 421 U.S. at 730, 737).

\(^{54}\) Id. (citing Universities Research Ass’n v. Coutu, 450 U.S. 754, 770 (1981); Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 15-16 (1979); Touche Ross & Co. v. Redington, 442 U.S. 560, 575-77 (1979)).

\(^{55}\) See Touche Ross, 442 U.S. at 575-77; Lampf, 501 U.S. at 365-66 (Scalia, J., concurring).


\(^{57}\) Musick, 113 S. Ct. at 2088. The argument against the creation of a federal common law right to contribution from the Court’s recent cases “would have much force were the
inconsistency with the Court's decisions rejecting such actions absent congressional intent, the Court believed it "must confront the law in its current form," in the "present context," and in the "present state of the jurisprudence we consider here." According to the Court, it is the unique judicial origin of the private section 10(b) remedy that gives it the judicial power to define "the contours" of the remedy by creating a right to contribution.

The Court's stated reasoning, however, confounds logic and constitutional principles. The Court asserted that because the section 10(b) private right of action has questionable judicial origins, the federal courts may exercise more power than otherwise proper to create an additional right of action for contribution. The Court acknowledged that when the federal courts properly interpret and apply private remedies expressly created by Congress, they have no constitutional power to expand their jurisdiction by creating a federal common law right to contribution. The Court argued, however, that if the federal courts first have exceeded their constitutional power by creating an underlying cause of action for the violation of a federal statute, they may further exceed their constitutional power by creating an additional private right to contribution. This reasoning is nothing other than a sophisticated version of the argument that "two wrongs make a right." The initial constitutional error in creating a section 10(b) private remedy is used to justify a second constitutional error in creating a section 10(b) right to contribution.

Apparently recognizing the logical and constitutional flaws in this argument, the Supreme Court attempted to support its newly created section 10(b) right to contribution by appealing alternatively to legislative acquiescence. The Court contends that recent congressional references to the section 10(b) private right of action indicate not only congressional approval of that action, but also a broad delegation to the judiciary of power over its formulation.

The Court's reliance on legislative acquiescence, however, is unavailing. As the Supreme Court itself declared in Central Bank, legislative

---

58. Id. at 2087-89.
59. Id. at 2089.
60. Id. at 2088.
61. Id.
62. Id. at 2089 (quoting Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083 (1991)).
63. Musick, 113 S. Ct. at 2091-92.
64. Id. at 2087-88 (citing with approval Northwest Airlines, 451 U.S. at 91, 97; Texas Indus., 451 U.S. at 642).
65. Musick, 113 S. Ct. at 2088.
68. Id.
acquiescence is not a valid basis for the judicial creation of a private statutory remedy.\textsuperscript{69} Thus, the acquiescence doctrine is based on unfounded assumptions about congressional inaction.\textsuperscript{70} More significantly, the doctrine upsets the constitutionally-mandated separation of legislative and judicial powers. It permits the judiciary to treat congressional inaction as a legislative enactment and to knowingly maintain an erroneous interpretation of the intent of the enacting Congress.\textsuperscript{71} Even in the context of legislative responses to judicial interpretations of section 10(b), legislative acquiescence provides no legitimate constitutional basis for maintaining the private right of action in the face of the contrary intent of the enacting Congress.\textsuperscript{72}

When the Court in \textit{Musick} employed the legislative acquiescence doctrine to justify its power to create a right to contribution, it compounded these constitutional difficulties. The Court inferred from congressional “references” to section 10(b) not only congressional approval of a Court decision, but also a broad delegation from Congress of judicial power to continue to fashion the section 10(b) remedy, including the power to fashion additional rights of action such as those for contribution.

The Court’s interpretation of congressional “references” to section 10(b), however, lacks support. The Insider Trading and Securities Fraud Enforcement Act of 1988 preserves implied remedies; it does not expressly or implicitly delegate any judicial power to the federal courts.\textsuperscript{73} To the contrary, this statute expressly limits the traditional judicial power to construe statutory remedies in an exclusive manner.\textsuperscript{74} Similarly, section 27A vitiates the retroactive effect of the Supreme Court’s decision in \textit{Lampf} to create a uniform statute of limitations period for section 10(b) claims.\textsuperscript{75} It does so, however, by expressly granting to the federal courts jurisdiction over only one, unique category of section 10(b) claims.\textsuperscript{76} Contrary to the Court’s inference, this stop-gap provision does not “avoid[ ] entangling Congress” in the formulation of the statute of limitations issue.\textsuperscript{77} By limiting federal court jurisdiction to only one category of section 10(b) claims, this provision flatly rejects the Court’s prior work. Any inference that Congress has acquiesced to the Court’s power to formulate section 10(b), therefore, is contrary to fact.

In \textit{Musick}, the Court did not argue that legislative acquiescence supports the right to contribution, recognizing that there is no clear judicial

\textsuperscript{69} See \textit{Central Bank}, 114 S. Ct. at 1452-53.

\textsuperscript{70} \textit{Id.} See also Michael J. Kaufman, \textit{A Little “Right” Musick: The Unconstitutional Judicial Creation of Private Rights of Action under Section 10(b) of the Securities Exchange Act}, 72 \textit{WASH. U. L.Q.} 287, 324-29 (1994).

\textsuperscript{71} \textit{Id.}

\textsuperscript{72} \textit{Id.} at 329-35.

\textsuperscript{73} 15 U.S.C. § 78t-1(d) (1994).

\textsuperscript{74} \textit{Id.}


\textsuperscript{76} See \textit{discussion infra} Part V.

\textsuperscript{77} See \textit{Musick}, 113 S. Ct. at 2089.
authority or line of authority recognizing such an implied right.\textsuperscript{78} Instead, the Court asserted that Congress has acquiesced in its power to decide such matters as whether to create an implied right to contribution under section 10(b).\textsuperscript{79} The Court assumed that neither section 10(b) nor the general congressional grant of “arising under” subject matter jurisdiction\textsuperscript{80} expressly or impliedly confers this power to the federal courts.\textsuperscript{81} Nonetheless, because the federal courts have exercised that power and because Congress has not acted to remove that power, the Court inferred that Congress approves of the judicial use of that power.\textsuperscript{82} This argument improperly elevates the inaction of non-enacting Congresses over the intent of the enacting Congress.

Neither legislative acquiescence nor the unique judicial origins of the section 10(b) private remedy can authorize the Court to “define the contours” of that remedy by creating new rights of action.\textsuperscript{83} Even where the federal courts interpret and apply express statutory remedies, they undoubtedly have the power “to define the contours . . . and to flesh out those remedies.”\textsuperscript{84} But, as even the \textit{Musick} Court acknowledged,\textsuperscript{85} this power does not extend to the creation of new rights of action. When it determined whether a right to contribution is within the contours of the implied section 10(b) remedy, the Court expanded the notion of statutory contours beyond recognition. The Court concluded that the contours of section 10(b) are broad enough to encompass a contribution action.\textsuperscript{86} Yet the Court did not search for the right to contribution within the contours of section 10(b).\textsuperscript{87} The Court instead inferred from analogous express rights to contribution in the 1934 Act\textsuperscript{88} that Congress, had it created a section 10(b) private right of action, would have also created a corresponding right to contribution.\textsuperscript{89} At this point, however, the Court was no longer exercising its power to “round out” the scope of statutory language; instead, it was writing into the federal securities laws a private right of action for contribution that is not within the contours of section 10(b) itself and is not part of the congressional scheme.

\textsuperscript{78} Id. at 2087-88.  
\textsuperscript{79} Id. at 2089.  
\textsuperscript{81} \textit{Musick}, 113 S. Ct. at 2088-89.  
\textsuperscript{82} Id.  
\textsuperscript{83} Id. at 2089 (quoting Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1104 (1991)).  
\textsuperscript{84} Id. (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975)). \textit{See also} Cannon v. University of Chicago, 441 U.S. 677, 745 (1979) (Powell, J., dissenting) (“the federal judiciary necessarily exercises substantial powers to construe legislation, including, when appropriate, the power to prescribe substantive standards of conduct that supplement federal legislation”).  
\textsuperscript{85} \textit{Musick}, 113 S. Ct. at 2088 (citing \textit{Northwest Airlines}, 451 U.S. at 91, 97; \textit{Texas Indus.}, 451 U.S. at 642).  
\textsuperscript{86} 113 S. Ct. at 2090-91.  
\textsuperscript{87} Id.  
\textsuperscript{88} Id. at 2090 (citing 15 U.S.C. §§ 78i, 78r (1988)).  
\textsuperscript{89} See id.
The Court's reliance upon the presumed intent of Congress in enacting the 1934 Act to support its creation of an implied right to contribution was ironically misplaced. The Court initially justified its power to create the remedy by arguing that whether or not Congress in 1934 intended to create a section 10(b) private remedy, post-enactment Congresses have acquiesced in its power to create and continue to fill out the contours of the section 10(b) private action. When the Court filled out those contours, however, it suddenly returned to the intent of the enacting Congress. The irony is that the Court freely acknowledged that the enacting Congress did not intend to create the section 10(b) private right of action, did not intend to create any section 10(b) right to contribution, and did not expressly empower the federal courts to do so.

b. Musick's Appearance of Result-Guided Reasoning

By the light of the dubious Musick reasoning, the shadow of result-guided reasoning appeared. Unlike most of its prior decisions limiting the reach of the section 10(b) private action, the Supreme Court in Musick appeared to extend the scope of that private action. Ultimately, however, all of the Supreme Court's arguments in Musick hinge on its concern for defendants threatened with securities fraud liability: "Having implied the underlying liability in the first place, to now disavow any authority to allocate it on the theory that Congress has not addressed the issue would be most unfair to those against whom damages are assessed."

Hence, in the Supreme Court's previous decisions limiting the scope of section 10(b), the Court argued that the private remedy's unique judicial origins mandate a narrow construction. In Musick, however, the Court argued that these unique judicial origins justify the expanded use of judicial power to create a new private action for contribution. On the one hand, the Court used the judicial origins of section 10(b) to justify a contraction of federal judicial power. On the other hand, it used those origins to justify an expansion of federal judicial power.

This inconsistency is not irreconcilable. But the point of reconciliation in these Supreme Court section 10(b) decisions appears to be the Court's

90. *Musick*, 113 S. Ct. at 2088-89.
91. *Id.* at 2089-90 (citing *Lampf*, 501 U.S. at 359).
94. *Id.*
95. Most, if not all, of the Supreme Court's recent decisions interpreting § 10(b) limit rather than expand the scope of the private right of action. See supra Part II.
96. *Musick*, 113 S. Ct. at 2088. This is the same sort of fairness argument made by Justice Scalia in *Lampf*, 501 U.S. at 364 (Scalia, J., concurring). There, Justice Scalia asserted that absent a congressionally mandated statute of limitations period for § 10(b), "no limitations period exists." *Id.* at 364. Scalia declined to follow this principled result, however, because it would be "highly unjust to those who must litigate past inventions." *Id.* at 365.
97. See supra Part I.
98. See *Musick*, 113 S. Ct. at 2089.
almost unwavering protection of defendants threatened with securities fraud liability. The Court has limited the reach of the section 10(b) private remedy by arguing that the remedy's judicial origins give it no power to expand the congressional scheme. The Court also has created a contribution right by arguing that the remedy's judicial origins give the Court special power to do so.

2. Central Bank: The Supreme Court's Rejection of An Implied Right of Action for Aiding and Abetting

a. The Central Bank Decision

In Central Bank,99 the Supreme Court, in a 5-4 decision, held that a "private plaintiff may not maintain an aiding and abetting suit under § 10(b)."100 There, purchasers of public improvement bonds alleged that Central Bank had aided and abetted primary violations of section 10(b) committed by the issuer, the developers, the underwriters, and a member of the developer's board of directors.101 Central Bank allegedly accomplished this by agreeing to delay its independent review of an outdated appraisal of the property securing the bonds. Although the lower federal courts had recognized an implied right of action for aiding and abetting section 10(b) violations, the Supreme Court concluded that no such cause of action should exist.102

Writing for the Supreme Court's narrow majority, Justice Kennedy began his opinion by attempting to segregate two lines of Supreme Court section 10(b) cases: (1) those where the Court has "determined the scope of conduct prohibited by § 10(b)"103 and (2) those where the Court has decided questions about the "elements of the 10b-5 private liability scheme."104 In the latter category of cases, the absence of any express right of action for violations of section 10(b) has required the Court to "infer how the 1934 Congress would have addressed the issues" if that Congress had provided an express right of action.105 In the first category of cases, however, the Court suggested that the text of the statute alone has guided its prior decisions.106

Because, according to the Court, the issue of the existence of a private aiding and abetting claim involves the scope of the conduct prohibited by section 10(b), that question must be resolved by the text of the statute alone.107 After reaching the "uncontroversial conclusion"108 that the text

100. Id. at 1455.
101. Id. at 1443.
102. Id. at 1444.
103. Id. at 1445.
104. Id.
105. Id. at 1446 (quoting Musick, 113 S. Ct. at 2089).
106. Id.
107. Id. at 1448.
108. Id.
of the 1934 Act does not create a private aiding and abetting claim, the Court found that no such private remedy should exist.\footnote{109}

Although the Court declared that the absence of any textual support for the private aiding and abetting claim is dispositive,\footnote{110} it nonetheless proceeded to buttress its conclusion by noting that "none of the express causes of action in the 1934 Act further imposes liability on one who aids or abets a violation."\footnote{111} In addition, the Court flatly rejected the legislative acquiescence doctrine so prominent in \textit{Musick}.\footnote{112} The Court held that the congressional intent to create a private remedy for aiding and abetting section 10(b) violations cannot be inferred from the silence of the 1934 Congress or from subsequent congressional inaction.\footnote{113} The Court then offered that the statutory purposes of the 1934 Act may be disserved by aiding and abetting liability, which exacts "costs" on secondary participants in the securities industry.\footnote{114} Finally, the Court found that although 18 U.S.C. § 2 creates criminal liability for any person who aids and abets any violation of any federal statute, including section 10(b), this statutory provision should not be construed to create civil liability.\footnote{115}

\subsection*{b. \textit{Central Bank}'s Appearance of Result-Guided Reasoning}

Apparently aware that in some section 10(b) cases it appeared to embrace a strict textual approach, while in others it attempted to divine what the 1934 Congress might have written into the securities laws, the Court in \textit{Central Bank} purported to find a key distinction between its prior cases.\footnote{116} According to the Court, where the scope of prohibited conduct was at issue, the Court limited itself to the text of the 1934 Act.\footnote{117} By contrast, wherever the Court addressed the "elements" of "private liability," the Court inferred how the 1934 Congress would have addressed the issue had the section 10(b) private action been expressly included.\footnote{118} This distinction drove the Court's entire analysis in \textit{Central Bank}.

The cases cited by the Court do not support this distinction. The Court suggested that because \textit{Dirks},\footnote{119} \textit{Aaron},\footnote{120} \textit{Chiarella},\footnote{121} \textit{Santa Fe},\footnote{122} and \\textit{Hochfelder}\footnote{123} were all cases which involved the scope of conduct prohibited by section 10(b), as opposed to the elements of private liability, it

\begin{thebibliography}
  \bibitem{109} \textit{Central Bank}, 114 S. Ct. at 1455.
  \bibitem{110} \textit{Id.} at 1448.
  \bibitem{111} \textit{Id.} at 1449.
  \bibitem{112} \textit{Musick}, 113 S. Ct. at 2089.
  \bibitem{113} \textit{Central Bank}, 114 S. Ct. at 1452-53.
  \bibitem{114} \textit{Id.} at 1454.
  \bibitem{115} \textit{Id.} at 1455.
  \bibitem{116} \textit{Id.} at 1445-47.
  \bibitem{117} \textit{Id.} at 1446.
  \bibitem{118} \textit{Id.} at 1445-46 (citing \textit{Musick}, 113 S. Ct. 2085, 2090).
  \bibitem{120} \textit{Aaron} v. \textit{SEC}, 446 U.S. 680 (1980).
\end{thebibliography}
was constrained by the text of the statute.\textsuperscript{124} \textit{Santa Fe} and \textit{Hochfelder}, however, do not fit this mold. They were both actions in which the Court attempted to define the elements of civil liability under section 10(b).\textsuperscript{125} Furthermore, in \textit{Chiarella} and \textit{Dirks}, in which the Court addressed criminal and civil insider trading and tippee liability, the text of section 10(b) was not dispositive.\textsuperscript{126} Rather, the Court, particularly in \textit{Dirks}, fashioned its own rules of liability based on a balancing of competing policy objectives.\textsuperscript{127} Hence, the Court’s purported distinction is illusory.

The irreconcilability of \textit{Central Bank} with prior Supreme Court cases interpreting section 10(b) raises anew the appearance of result-guided reasoning. Indeed, the \textit{Central Bank} case appears to be dramatically inconsistent with \textit{Musick}. Ultimately, the \textit{Musick} Court created a new private right to contribution because to do otherwise “would be most unfair to those against whom damages are assessed.”\textsuperscript{128} In particular, the Court reasoned that although the “creation of new rights ought to be left to legislatures, not courts,”\textsuperscript{129} that rule of judicial restraint does not apply where the right to be created governs conduct already “subject to liability through private suit.”\textsuperscript{130} Furthermore, the \textit{Musick} Court found support for creating a right to contribution from congressional acquiescence in the Court’s power over the full “formulation” of the section 10(b) private remedy.\textsuperscript{131}

Each of these arguments regarding the power of the federal judiciary, however, was flatly rejected by the Supreme Court in \textit{Central Bank}. There, the Court argued that it has no power to create an additional private remedy despite the fact that the private right of action for aiding and abetting section 10(b) violations involves conduct already the subject of private suit. The Court also warned that, despite the universal judicial acceptance of the private right of action for aiding and abetting, and despite the fact that Congress had revisited section 10(b) on a number of occasions, any argument that Congress had acquiesced in the judicial creation of that right of action is erroneous.\textsuperscript{132} The Court in fact launched into a diatribe against theories of congressional re-enactment, amendment by silence, and legislative acquiescence: “It is impossible to assert with any degree of assurance that congressional failure to act represents affirmative congressional approval of the [Court’s] statutory interpret-
While the Court in *Musick* employed doctrines of legislative acquiescence and federal remedial power, the Court in *Central Bank* rejected these same theories. In its refusal to create an implied right of action for aiding and abetting, the Court completely rejected the very arguments it employed in *Musick* to justify creating the implied right of action for contribution.

The only difference between the Court's decisions in these cases appears to be the result. Ultimately, in *Central Bank*, the Court decided not to create a private right of action because it would be detrimental to the same type of defendants helped by the implied right to contribution. In *Central Bank*, the Court even expressly acknowledged its consistent policy of protecting defendants from exposure to securities fraud litigation when it stated: "[L]itigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general."
holders of Alloyd, Inc. ("Alloyd") sold substantially all of Alloyd's stock to a group of investors comprising Wind Point Partners, II, L.P. ("Wind Point"). Before the sale, Wind Point conducted an extensive investigation into the seller's business, relying partially on a review of Alloyd's financial statements performed by KPMG Peat Marwick ("KPMG"). The parties executed a sales contract which provided that Wind Point would pay $18,709,000 for the Alloyd shares, and an additional $2,122,219 that represented an estimated increase in Alloyd's net worth from the previous reported year. In the contract, the seller expressly warranted that the company's financial statements "present fairly . . . the Company's financial condition" and that "no material adverse change" in Alloyd's financial condition had occurred "between the date of the latest balance sheet and the date the agreement was executed."

The succeeding year-end audit of Alloyd, however, disclosed that its actual earnings were in fact lower than the estimates relied upon by the parties in negotiating the $2,122,219 adjustment. Accordingly, the buyers brought an action in federal court under section 12(2) seeking rescission of the sale of securities. The buyers claimed that because the contract for the sale of securities was a prospectus that contained material misstatements and omissions regarding the company's financial condition, they were entitled to rescind the contract without showing scienter, reliance, causation, or even actual damages.

The district court disagreed, and granted summary judgment for Alloyd. The court cited Ballay for the proposition that "section 12(2) claims can only arise out of the initial stock offerings." The district court further reasoned that the private sales contract could not be analogized to an initial offering because "the purchasers in this case had direct access to financial and other company documents, and had the opportunity to inspect the seller's property."

The Seventh Circuit, however, reversed the district court's grant of summary judgment. That court relied on its own intervening decision in Pacific Dunlop for the view that because the 1933 Act defines the term prospectus broadly to include any written communication, the contract of sale in this case was plainly within the scope of section 12(2). The Supreme Court granted certiorari to resolve whether section 12(2) "ex-
tends to a private, secondary transaction, on the theory that recitations in the purchase agreement are part of a 'prospectus.' "

2. Alloyd's Result-Guided Reasoning

That the Court's reasoning in Alloyd is result-guided is evidenced by the Court's: (1) lack of legitimate arguments supporting its result; (2) inconsistent use of principles of statutory construction; and (3) admission that its decision is guided by its policy objective of limiting defendants' exposure to private actions seeking the rescission of settled securities transactions.

a. The Court's Arguments Are Unpersuasive

In holding that section 12(2) does not extend to a private, secondary securities transaction, the Court, in a 5-4 decision written by Justice Kennedy, undertook a linguistic and structural analysis of the 1933 Act. The analysis yielded five basic arguments, each with significant flaws.

First, the Court contended that the term "prospectus" in section 12(2) must have the same meaning as "prospectus" in section 10 of the 1933 Act. The Court observed that section 10 of the 1933 Act provides that, subject to "explicit and well-defined exemptions for securities listed under § 3 [of the 1933 Act], a prospectus . . . shall contain the information contained in the registration statement." The Court reasoned that because the sales contract at issue in the case did not have to contain the information in a registration statement, it "follows that the contract is not a prospectus under § 10." The Court concluded that a "prospectus under § 10 is confined to documents related to public offerings by an issuer or its controlling shareholders."

Having defined the requirements for a prospectus under section 10, the Court contended that the "term 'prospectus' must have the same meaning under §§ 10 and 12" because "identical words used in different parts of the same act are intended to have the same meaning." The Court found no evidence to rebut its presumption that the term prospectus as used in section 10 should mean the same thing as when the term is used in section 12(2).

The Court's entire argument, however, is circular and incomplete. The argument is circular because it selects section 10 as the starting point for defining a prospectus and then proceeds on the assumption that all other uses of that term in the 1933 Act mean what that term means in section

---

150. Id. at 1064.
151. See discussion infra subsection III.A.2.a.
152. See discussion infra subsection III.A.2.b.
153. See discussion infra subsection III.A.2.c.
155. Id. at 1067. The Court also indicates that the meaning of § 10 is not in dispute. Id.
156. Id.
157. Id. (quoting Department of Revenue v. ACF Indus., 114 S. Ct. 843, 845 (1994)).
158. Id.
10. The circularity of this analysis can be seen by supposing that the Court had begun its analysis with section 2(10) of the 1933 Act instead of section 10. Section 2(10) defines "prospectus" as "any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television" that offers any security for sale or confirms its sale.\textsuperscript{159} If, as the Court asserted, the term prospectus must have the same meaning in every provision of the 1933 Act, then by its own reasoning this definition of prospectus in section 2(10) must be squared with the use of that same term in sections 10 and 12(2). That reconciliation is not difficult. Section 10, as the Court noted, describes the information that must be included in a "prospectus." Yet, a full reading of section 10 indicates that the information that must be included in a prospectus varies according to the circumstances.

As a rule, a prospectus must include the "information contained in the registration statement."\textsuperscript{160} But this rule presumes that there is a registration statement. When the issuer must file a registration statement, that issuer must include within "a" prospectus the information contained in "the" registration statement.\textsuperscript{161}

Yet, section 10(a) itself provides exceptions to the required content of a prospectus. For example, if a prospectus is used more than nine months after the registration statement's effective date, the information in the prospectus must, if practicable, be current (and perhaps different from the information in the registration statement) within sixteen months of its use.\textsuperscript{162} More significantly, section 10 gives the SEC power to promulgate rules or regulations which allow the omission from a prospectus of any information otherwise required by section 10.\textsuperscript{163} Moreover, the SEC is empowered to permit the use of a prospectus that omits or summarizes the information otherwise required in section 10 for the purpose of selling a security while waiting for the effective date.\textsuperscript{164} Section 10 also authorizes the SEC to require additional information in "[a]ny prospectus" and to "classify prospectuses."\textsuperscript{165} In addition, that section makes it clear that the information required in a prospectus need not be in writing,\textsuperscript{166} and may consist of radio or television broadcasts.\textsuperscript{167}

Section 10, fairly read, thus indicates what information must be included in various forms of prospectuses; yet, it does not define prospectus at all. Nor does section 10 genuinely limit a prospectus to documents that contain the information in a registration statement. The section provides

\textsuperscript{160} Id. § 77j(a)(1).
\textsuperscript{161} Id. (emphasis added).
\textsuperscript{162} Id. § 77j(a)(3).
\textsuperscript{163} Id. § 77j(a)(4).
\textsuperscript{164} Id. § 77j(b).
\textsuperscript{165} Id. §§ 77j(c)-77j(d).
\textsuperscript{166} See id. § 77j(e). That section provides that the information in a prospectus "when written," must be conspicuous. (emphasis added).
only that where a registration statement has been filed, "a" prospectus must generally include most of the information in that statement.\textsuperscript{168} If the Court had begun its analysis with section 2(10), which actually defines prospectus, it could have readily squared that definition with this fair reading of section 10. The 1933 Act defines prospectus broadly to include "any communication" precisely because Congress envisioned many different forms of selling documents. For offerings governed by the registration requirements in section 5 of the 1933 Act, Congress makes clear in section 10 that any prospectus must include most of the information in "the" registration statement that has been filed. Yet, in situations where such a registration statement need not be filed, section 10 makes equally clear that other prospectuses may not have to include such information. Section 10, in complete harmony with section 2(10), recognizes that many different types of prospectuses exist, each with its own content requirements.

Defining the term "prospectus" broadly in section 2(10), to include any selling instrument, is consistent with section 10's various content requirements for specific types of selling instruments. The meaning of "prospectus" in section 2(10), therefore, is identical to its meaning as used in section 10. Section 10 merely indicates the information requirements for various types of selling instruments.

Congress's use of the term "prospectus" in section 12(2) is consistent with both its definition of that term in section 2(10) and the informational requirements of section 10. Section 12(2) provides a cause of action for material misrepresentations or omissions in "a prospectus,"\textsuperscript{169} even if the security sold is fully exempt from the registration statement requirements of sections 5 or 10.\textsuperscript{170} A prospectus used in connection with the sale of securities that are exempt from the 1933 Act's registration statement requirements cannot, by definition, include information contained in the registration statement. Therefore, section 12(2) necessarily governs sales of securities using a prospectus that does not, and need not, include such registration statement information. Only by defining "prospectus" (as "any selling instrument" as Congress defines it in section 2(10)) may that term truly have a consistent meaning throughout the 1933 Act. If the Court had begun its analysis with section 2(10), it would have readily reached a consistent meaning for the term "prospectus" throughout the Act.

Instead, the Court fashioned an identical meaning to the term "prospectus" only by offering an admittedly incomplete view of section 10. In its interpretation of section 10, the Court first acknowledged the full range of meanings for the term "prospectus," and then disregarded the full meaning for the remainder of its opinion. Initially, the Court used

\textsuperscript{168} \textit{Id.}  
\textsuperscript{169} \textit{Id.} § 77l(2).  
\textsuperscript{170} \textit{Id.} § 77l(2) (1994).
the following phrases to qualify its view of a prospectus:171 "whatever else 'prospectus' may mean"; “[b]y and large”; and, “absent an overriding exemption.”172 This qualifying language is an admission that a prospectus does not always require the information contained in a registration statement. Still, the Court disregarded its own qualifying language when it concluded that, despite the variety of prospectuses recognized by Congress, “a prospectus under § 10 is confined to documents related to public offerings by an issuer or its controlling shareholders.”173

Second, and equally unsatisfying, the Court contended that the “structure” of the 1933 Act confirms its interpretation. According to the Court, section 12(2) liability flows from the obligation to distribute a prospectus, just like section 11 liability flows from the obligation to file a registration statement.174 The Court asserted that section 12(2)’s self-contained exemption for government-issued securities buttresses its self that the section does not apply to a private contract for the sale of securities.175 The Court reasoned that Congress intended to grant immunity to the government for government-issued securities, but not to subsequent private sellers of government-issued securities.176 The Court also asserted that section 12(2) should be interpreted as a method of enforcing the “new substantive obligations” created by the 1933 Act, which “for the most part” are limited to registration and disclosure requirements connected to public offerings.177

But the 1933 Act is not even “for the most part” limited to public offerings. Clearly the registration requirements of section 5 are limited to public offerings, but the liability provisions are not. As the Court itself conceded, section 17(a) of the 1933 Act regulates fraud in the sale of securities.178 However, there is no distinct disclosure obligation linked to section 17(a). In fact, if the 1933 Act is generally concerned with anything, it is selling securities. The disclosure obligations apply to selling stock.179 Each of the antifraud provisions governs the selling process: section 11 regulates material misstatements and omissions on a registration statement used to sell securities;180 section 12(2) regulates material misstatements and omissions in any selling document;181 and section 17(a) regulates all manipulative and deceptive devices used in the selling process.182 In light of the 1933 Act’s regulation of all materials used in the process of selling securities, the Court’s claim that the Act’s structure

172. Id.
173. Id.
174. Id.
175. Id. at 1067-68.
176. Id. at 1068.
177. Id.
178. Id. at 1070 (citing United States v. Naftalin, 441 U.S. 768, 777-78 (1979)).
180. Id. § 77k.
181. Id. § 77l(2).
182. Id. § 77q(a).
supports its view that section 12(2) must be limited to selling only in the public offering context cannot withstand scrutiny.

Third, the Court unpersuasively asserted that section 2(10) of the 1933 Act, which defines "prospectus," supports its result. That section provides: "the [t]erm 'prospectus' means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security." Although the word "communication" itself seems broad enough to include the private sales agreement at issue in the case, the Court asserted that two "sensible rules of statutory construction" preclude reading that word in isolation. An interpretation of "communication" that includes any written communication would improperly render the accompanying terms such as notice, circular, or letter "altogether redundant." Moreover, interpreting "communication" to include nonpublic communications ignores the principle that a word must be known by the company that it keeps, since the terms accompanying "communication" in section 2(10) together suggest methods of public solicitation to acquire securities. According to the Court, because the list of methods of communication in section 2(10) "refers to documents of wide dissemination," the inclusion of the term "communication" in that list refers to a widely disseminated (public) communication as well.

The Court's contention that the definition of prospectus in section 2(10) of the 1933 Act supports its view that a prospectus is limited to "documents of wide dissemination" borders on the disingenuous. The plain language of the Act defines "prospectus" to include not only "any prospectus," but also any "notice, circular, advertisement, letter, or communication." Interpreting the word "communication" to be its common meaning would not, as the Court suggests, render the accompanying terms within the definition "altogether redundant." While the term "communication" is broad enough to include prospectus, notice, circular, advertisement, and letter, it is actually broader than each of these accompanying terms. Congress provided examples of the different types of communications that are included within its definition of prospectus and also was careful to include the catch-all term "communication" within its definition. Congress's examples are forms of offering documents typically used when Congress enacted the 1933 Act. The additional catch-all term "communication" simply ensures that any new forms of offering documents will not escape the reach of the securities laws. The word

183. Alloyd, 115 S. Ct. at 1069 (citing 15 U.S.C. § 77b(10)).
184. Id.
185. Id. (citing United States v. Menasche, 348 U.S. 528, 538-39 (1955)).
186. Id. at 1069-70 (citing Jarecki v. G.D. Searle & Co., 367 U.S. 303, 307 (1961); Reves v. Ernst & Young, 494 U.S. 56, 63 (1990)).
187. Alloyd, 115 S. Ct. at 1070.
188. Id.
190. Alloyd, 115 S. Ct. at 1069 (citing Menasche, 348 U.S. at 538-39).
“communication,” therefore, is not redundant; it makes clear that the list of known offering documents is not exhaustive.

Nor does interpreting “communication” in light of the accompanying list of offering documents support the Court’s definition of prospectus. The terms “notice,” “circular,” and “advertisement” may suggest widely-disseminated documents. By no stretch of the imagination, however, does the word “letter” indicate a document of wide dissemination. To the contrary, Congress’s inclusion of “letter, or communication” within its definition of “prospectus” indicates that a “prospectus” includes offering material that is not widely disseminated.

It is the Court’s interpretation of section 2(10) that renders the congressional language meaningless. If, as the Court claimed, “prospectus” means only documents of wide dissemination, then the words “letter” and “communication” not only become mere surplusage, they become meaningless. Indeed, they are effectively eviscerated from the statute.

Fourth, the Court mistakenly tried to buttress its interpretation of the language in the 1933 Act with recognized definitions of “prospectus” at the time Congress drafted that statute. The Court suggested that the term prospectus was a “term of art” meaning a document of “wide dissemination” published by a company “inviting the public to subscribe to the issue.”191 In this context, Congress’s inclusion of “communication” in its definition of “prospectus” was meant to preclude an issuer from evading regulations merely by titling a widely-disseminated document inviting the public to purchase its shares something other than a “prospectus.”192

The Court’s argument that in 1933 “prospectus” was a “term of art” meaning documents of wide dissemination, however, actually further renders the congressional language defining “prospectus” meaningless. Congress defined “prospectus” to mean not only any “prospectus,” but also any “letter, or communication.” If, as the Court insists, “prospectus” was a “term of art” in 1933 meaning a public offering document, then it is clear that Congress intended to create a statutory definition of prospectus that was far broader than the recognized street meaning of that term. The statutory definition includes among its examples of the term “prospectus” the word “prospectus” itself. The inclusion of the word “prospectus” in a definition of prospectus would be not only bizarre, it would be redundant if the statutory definition of prospectus were limited to the recognized street definition of that term. If, on the other hand, the statutory definition of prospectus means something other than the street definition of prospectus, then Congress’s inclusion of “prospectus” within the definition makes perfect sense. Congress tries to make clear that its statutory definition not only includes the well-recognized forms of widely disseminated offering materials in use at the time, it also includes any letter or communication used to sell securities. The argument that “prospectus-

191. Id. at 1070 (citing BLACK’S LAW DICTIONARY 959 (2d ed. 1910); 15 U.S.C. § 77b(10); H.R. REP. NO. 85, 73d Cong., 1st Sess. 10 (1933)).
192. Id.
"JURISDICTION AND SECURITIES FRAUD"

... was a term of art when Congress drafted the 1933 Act, therefore, actually undercuts the Court's narrow reading of section 2(10).

Fifth, the Court argued that its prior Naftalin\(^{193}\) decision, interpreting section 17(a) of the 1933 Act\(^{194}\) to extend beyond public offerings, supports its restriction of section 12(2) to public offerings. Unlike section 12(2), the Court insisted, neither the language nor the legislative history of section 17(a) suggests that Congress intended to limit the latter provision to public offerings.\(^{195}\) According to the Court in Alloyd, in the absence of evidence limiting the scope of section 17(a), the Court in Naftalin correctly interpreted that section as an exceptional general antifraud provision. “[T]he presence of limiting language in § 12(2),” the Alloyd Court reasoned, requires a proportionately “narrow construction.”\(^{196}\)

The Court's effort to reconcile Naftalin with its Alloyd holding is unavailing. If, as the Court argued, section 12(2) had “limiting language,” then the holding in Naftalin regarding very different language in section 17(a) would be entirely consistent with the Court's holding in Alloyd. Yet, section 12(2) does not have any such limiting language. In addition, Naftalin's principles are inconsistent with Alloyd in two respects. Naftalin demonstrated that the 1933 Act extends its antifraud protections beyond documents of wide dissemination. It also demonstrated that those protections need not be rooted in a specific statutory disclosure obligation. Naftalin, therefore, at best is irrelevant to the Court's analysis of section 12(2), and at worst is inconsistent with that analysis. Nothing in Naftalin affirmatively supports the Court's Alloyd holding.

b. The Court's Principles of Statutory Construction Are Consistent Only in Result

The Court's method of statutory interpretation is driven by its desired result. The Supreme Court repeatedly has declared in its securities fraud opinions that the “starting point in every case involving construction of a statute is the language itself.”\(^{197}\) The Court adhered to that canon of statutory construction to limit the section 10(b) implied right of action to actual purchasers or sellers of securities,\(^{198}\) to limit the section 10(b) implied right of action to defendants who act with “scienter,”\(^{199}\) and to limit the section 10(b) implied right of action to primary participants in securities fraud.\(^{200}\) Yet, when interpreting the plain language of the definition of prospectus, which clearly favors an expansion of securities fraud liabil-

---


\(^{195}\) Alloyd, 115 S. Ct. at 1070.

\(^{196}\) Id. at 1071.


\(^{198}\) Blue Chip Stamps, 421 U.S. at 756.


\(^{200}\) Central Bank, 114 S. Ct. at 1445-47.
ity, the Court in Alloyd abandoned this primary canon of statutory construction. Instead, the Court interpreted the word prospectus by “turning to sources outside the four corners of the statute.”201

The Court's approach to statutory interpretation in Alloyd was markedly different from its approach in Central Bank. In Central Bank, the Court declared: “If . . . Congress intended to impose aiding and abetting liability, we presume it would have used the words ‘aid’ and ‘abet’ in the statutory text. But it did not.”202 In Alloyd, the Court presumed the reverse. It presumed that Congress intended to limit its broad definition of “prospectus” because it failed to use the words “private” or “secondary transaction” in that definition.203 Yet Congress clearly included the word “communication” in its definition of prospectus. Following the Central Bank presumption would have led the Court to conclude that if Congress did not intend section 12(2) to apply to “any communication,” it would not have used those words at all.

Similarly, in justifying its view that the term “prospectus” should have identical meanings in sections 12(2), 10, and 2(10) of the 1933 Act, the Court used a principle of statutory construction that it previously rejected in limiting the reach of securities fraud remedies. The Alloyd Court’s principle, that identical words used in different parts of the same statute are intended to have the same meaning,204 is based on its claim that acts of Congress “should not be read as a series of unrelated and isolated provisions.”205 Yet, the Court has used the opposite view of statutory construction in order to limit the reach of civil liability for securities fraud. In Hochfelder, both the private plaintiffs and the SEC argued that the “interdependence of the various sections of the securities laws” proves that section 10(b) does not itself require “scienter.”206 The Court rejected that argument as based upon a misconception of the significance of the separate provisions of the securities laws. Instead, the Court in Hochfelder felt compelled to discuss each of the separate liability provisions of the securities laws, contrasting each with section 10(b).207 The Court’s analysis was predicated on the presumption that the liability provisions of the securities laws are different from each other and must be interpreted as distinct, isolated statutory units. The Court again adopted the opposite presumption in Alloyd. There, the Court presumed that section 12(2) must be interpreted with, and virtually identical to, the very different registration provisions housed in section 10.

201. Alloyd, 115 S. Ct. at 1074 (Thomas, J., dissenting).
202. 114 S. Ct. at 1448.
203. 115 S. Ct. at 1069.
204. Id. at 1067 (citing Department of Revenue v. ACF Indus., 114 S. Ct. 843 (1994)).
205. Id.
207. Id.
In addition, as the Court's *Hochfelder* reasoning indicates, the fact that the 1933 Act creates obligations in section 5, which are enforced in section 11's liability provisions, should have had no bearing on its interpretation of the very different language in section 12(2). The fact that the other provisions of the 1933 Act are "for the most part" concerned with registration in a public offering is not a legitimate basis for limiting section 12(2) to public offerings.

Similarly, whereas the *Alloyd* Court relied heavily upon the maxim of *noscitur sociis* (a word is known by the company it keeps), the Court has rejected that maxim in previous securities fraud opinions. In *Reves*, for example, the Court refused to define the word "note" in Congress's definition of "security" in accordance with the accompanying broad term "investment contract." The Court declared: "To hold that a 'note' is not a 'security' unless it meets a test designed for an entirely different variety of instrument 'would make the Acts' enumeration of many types of instruments superfluous.' Although tenets of statutory construction are not inflexible, the Court's plainly inconsistent treatment of the same tenets in its recent securities fraud opinions yields the appearance that these decisions are consistent only in their protection of defendants from exposure to federal securities law liability.

c. *Alloyd* Is Admittedly Result-Guided

After engaging in its questionable analysis of the language and structure of the 1933 Act, the Court acknowledged that interpreting "prospectus" to include any communication would have detrimental policy implications. Any buyer could rescind a securities transaction upon a showing that the seller, in a "casual communication," omitted a material fact. Despite the fact that Congress drafted section 12(2) to provide that a rescission action could be maintained with no showing of fraud or detrimental reliance, the Court was concerned with the expansion of such a remedy. The Court asserted that the "stability of past transactions" would be threatened by any interpretation of "prospectus" that includes every communication used to sell any security.

The Court's candid statement of its own public policy conceded that its analysis of the express language of section 12(2) is guided by an ongoing policy concern that private actions for rescission or rescissory damages could threaten the "stability" of past transactions. In direct contrast, when the Court rejected private remedies for aiding and abetting securities fraud, it reiterated the familiar principle that policy considerations

---

211. *Alloyd*, 115 S. Ct. at 1071.
212. Id.
213. Id.
“cannot override the Court’s interpretation of [an] Act’s text and structure.”\textsuperscript{214}

In the context of its \textit{Alloyd} opinion, the Court’s professed concern for the “stability” of past transactions is itself anomalous. The Court’s opinion has done nothing to lend stability to securities transactions. The scope of that opinion, in fact, is so ambiguous that it has created little comfort for issuers of securities in private placements exempt from registration. While it is unclear from \textit{Alloyd} whether section 12(2) applies to offering materials distributed by an issuer in a private placement, there is a strong argument that such materials still are subject to section 12(2) liability. Although the Court cast its policy argument in \textit{Alloyd} in terms of stabilizing past transactions, the fact that its decision does not engender such stability suggests that the Court is less concerned with stability than with simply narrowing the reach of Congress’s express securities fraud remedies.

In their dissent from the Court’s \textit{Alloyd} decision, four Justices declared: “I doubt that the majority would read in so narrow and peculiar a fashion most other statutes, particularly one intended to restrict causes of action in securities cases.”\textsuperscript{215} As Justice Thomas declared, “[t]he majority does not permit Congress to implement its intent unless it does so exactly as the Court wants it to.”\textsuperscript{216}

\section*{B. \textit{Plaut’s} Unprincipled Rejection of Congress’s Express Grant of Jurisdiction over a Class of Section 10(b) Claims}

In \textit{Plaut},\textsuperscript{217} the Supreme Court addressed the constitutionality of section 27A(b) of the Exchange Act.\textsuperscript{218} Section 27A(b) is Congress’s direct response to the Supreme Court’s retroactive application of its opinion in \textit{Lampf} to create a uniform federal statute of limitations period for section 10(b) claims.\textsuperscript{219} The section provides that timely actions in jurisdictions where they were filed and dismissed as time-barred by retroactive application of \textit{Lampf} may be reinstated by a timely, properly supported motion.\textsuperscript{220}

\textsuperscript{214} \textit{Central Bank}, 114 S. Ct. at 1442 (citing Demarest v. Manspeaker, 498 U.S. 184, 191 (1991)).
\textsuperscript{215} \textit{Alloyd}, 115 S. Ct. at 1079 (Thomas, J., dissenting).
\textsuperscript{216} \textit{Id}.
\textsuperscript{218} \textit{Id}.
\textsuperscript{220} On the day that \textit{Lampf} was decided, the Court also decided \textit{James B. Beam Distilling Co. v. Georgia}, 501 U.S. 529 (1991), in which it held that a new rule of federal law applied by the Court to the parties before it must also be applied retroactively to all cases pending on direct review. The impact of \textit{Beam} was to require that the new 3-year/1-year federal statute of limitation rule created by the Supreme Court in \textit{Lampf} be applied retroactively to all pending cases.
In *Plaut*, the Court held that section 27A(b) represents a "clear violation" of the Constitution's separation of powers principles to the extent that it requires federal courts to re-open a final judgment reached before the statute's enactment.\(^{221}\) In his opinion for the Court, Justice Scalia offered no judicial precedent affirmatively supporting the result. Instead, the opinion relied entirely upon the "record of history," which showed that the Constitution's grant of federal judicial power in Article III was designed to give to the federal judicial "department" the exclusive power to render dispositive judgments in cases over which they have jurisdiction.\(^{222}\)

As the dissent points out, however, the Court's exclusive reliance upon the "record of history" to support its otherwise unprecedented decision was misplaced.\(^{223}\) First, the dissent produced a wealth of judicial and legislative precedent supporting the constitutionality of section 27A(b)'s remedial design.\(^{224}\) Second, the dissent showed that the separation of powers principle, which precludes Congress from engaging in any case-by-case review of the merits of individual trial court judgments, is not genuinely frustrated by section 27A(b).\(^{225}\) In fact, that section does not allow for a decision on the merits of an issue in any particular litigation. Instead, it creates a process by which a federal court may remove a barrier to the judicial resolution of section 10(b) claims on their merits, a barrier that was created by the Supreme Court itself in *Lampf*.*\(^{226}\) Section 27A(b) does not, however, require the judiciary to set aside any final judgment without condition. Instead, it merely permits a class of litigants to file a "motion to reinstate" which, like every other motion filed in court, must be resolved by the judiciary (not Congress) in accordance with governing law.\(^{227}\) The federal court is free to deny the motion if the motion is filed in an untimely manner or if the movant fails to demonstrate the conditions which entitle it to reinstatement under governing law.\(^{228}\) The decision whether to grant or to deny the motion, if filed at all, is not made by Congress, but is left to the federal court.\(^{229}\)

The acknowledged lack of precedent and settled separation of powers principles supporting the Court's *Plaut* decision raises again the appearance of result-guided reasoning. The decision effectively rids the federal courts of section 10(b) claims of tens of thousands of identified investors

\(^{221}\) *Plaut*, 115 S. Ct. at 1449.
\(^{222}\) *Id.* at 1453-56.
\(^{223}\) *Id.* at 1473.
\(^{224}\) *Id.*
\(^{225}\) *Id.*
\(^{226}\) *Id.* at 1466; see *Lampf*, 501 U.S. at 364.
\(^{227}\) *Plaut*, 115 S. Ct. at 1469.
\(^{228}\) *Id.*
\(^{229}\) *Id.*
who had sought the judicial resolution of the merits of their securities fraud claims for damages totalling billions of dollars.230

That result is obtained by the Court only by rejecting the same principles which it previously used to justify its limitation of securities fraud remedies. In *Lampf*, the Court rationalized its judicial creation and retroactive application of a relatively short statute of limitations period by arguing that the judicial creation of the section 10(b) right of action left it no choice but to embark upon a lawless act of judicial imagining.231 According to Justice Steven's dissent in *Lampf*, the fact that section 10(b) is a judicial creation has two negative results: (1) it allows the Court to change "four decades" of "established law" regarding the statute of limitations period; and (2) it allows the Court to require the federal courts to dismiss every pending and future section 10(b) claim not filed within one year of its discovery and within three years of the challenged transaction.232 Justice Stevens also strongly suggested in his dissent that Congress should accept its proper constitutional role and assert more legislative power in the securities arena.233

Following *Lampf*, Congress promptly enacted section 27A, creating a process for federal courts to remedy the harshest retroactive effects of *Lampf*. However, when the Court analyzed Congress's power to respond to the *Lampf* decision in *Plaut*, the Court declared: "*Lampf* as such is irrelevant to this case."234 The fact that the statute of limitations period to which Congress responded was the product of "judicial lawmaking," according to the Court, had no bearing on the separation of powers principles at issue in *Plaut*.235

The theoretical scope of Congress's legislative power may not hinge on these issues. However, there can be no doubt that the bizarre history of the judicial creation of a retroactive statute of limitations period for a judicially-created implied right of action has some bearing on separation of powers principles. The Supreme Court in *Lampf* had little difficulty arguing that the very existence of the uncertain judicial origins of implied rights of action for securities fraud gave it the "legislative" power to define those rights, and even to create additional supplemental rights of action.236 Yet, that same Court in *Plaut* was unwilling to assign any relevance to this history of unabashed judicial lawmaking in its interpretation of the scope of the congressional power to respond.237

When, in section 27A, Congress finally asserted its lawmaker power to create a remedial process for providing private remedies for thousands of

230. *Id.* at 1475 n.17. (Stevens, J., dissenting) (citing *Hearings on H.R. 3185 Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 102d Cong., 1st Sess. 1-4 (1991)).
232. *Id.* at 366-68 (Stevens, J., dissenting).
233. *Id.* at 366-67 (same).
235. *Id.*
alleged victims of securities fraud, the Court rebuked Congress for exceeding the Court's unprecedented view of the separation of powers. In \textit{Plaut}, the Court argued that the separation of powers doctrine in the Constitution is a "\textit{structural safeguard}," which establishes "high walls and clear distinctions" between congressional and judicial power. The \textit{Plaut} majority rejected the dissent's call for "[a]n appropriate regard for the interdependence of Congress and the judiciary" that can lead to "constructive legislative cooperation."

Yet, in prior cases, such as \textit{Lampf}, when the Court decided to narrow the scope of implied rights of action for securities fraud and to legislate contribution rights as well as federal statute of limitations periods, it expressly embraced a flexible, cooperative view of the separation of powers between Congress and the judiciary. Thus, the result of \textit{Plaut} is that when Congress legislates in favor of a class of private plaintiffs seeking relief for securities fraud, the Supreme Court ensures the wall of separation of powers remains "high." Yet, in cases such as \textit{Lampf}, when the Supreme Court rules in favor of defendants threatened with securities fraud liability, the wall inconsistently evaporates and a flexible, cooperative approach to lawmaking rules the day.

C. \textbf{The Court's Express and Implied Securities Fraud Remedies Decisions Are Consistent Only in Result}

As the preceding discussion and Figure 1 show, the only consistency in the Supreme Court's securities fraud decisions appears to be the Court's express policy of solicitousness of securities fraud defendants.

IV. \textbf{The Supreme Court's Securities Fraud Policies Have No Empirical Basis}

The Court's consistent protection of defendants from securities fraud exposure has been expressed in the form of two basic policy objectives. The Court has asserted the following: (1) securities fraud litigation poses a unique danger of vexatious, non-meritorious litigation; and (2) exposure to such litigation will destabilize settled securities transactions and otherwise increase their costs so as to chill meritorious securities offerings. Neither of these assertions has legitimate support.

First, there is no unique danger of vexatious litigation in the securities field. Contrary to the emotional claim that there has been an explosion of securities fraud litigation, the frequency of such litigation is relatively insignificant. Between 1989 and 1992, an average of 2,358.5 securities and commodities actions were filed in federal court each year. Of these

\begin{itemize}
  \item \textit{Id.} at 1453-56.
  \item \textit{Id.} at 1463.
  \item \textit{Id.} at 1476.
  \item See supra Figure 1.
  \item Private Litigation Under the Federal Securities Laws: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 103d
2,358.5 actions, 254 were class action suits.243 These actions include public enforcement actions, commodities law actions, and express private actions for securities fraud. They also include different suits brought against the same company for related fraud.244 Accordingly, only an average of 123.5 companies were named as defendants in commodities or securities fraud class actions in each of those years.245

The incidence of such suits is small when compared to the fact that approximately 17,400 companies file disclosure documents each year with the SEC.246 It is particularly small when compared with the fact that in those same years the total number of annual federal district court filings averaged 221,498.25.247 The total number of all securities and commodities actions, therefore, comprised about one percent of all actions filed in federal court.248 Securities or commodities class actions comprised about one-tenth of one percent of all actions filed in federal court.249 This is hardly an explosion.

Nor is there any genuine support for the contention that securities fraud claims create a unique danger of vexation because they are settled regardless of their merit, with a disproportionate share of the proceeds going to attorneys. As Professor Seligman persuasively has demonstrated, non-meritorious securities fraud suits are dismissed by defendants at the pleading stage based on motions to dismiss under frequently-employed existing federal rules and do not reach any type of settlement.250 Furthermore, the best current data available indicates that attorney's fees in cases producing settlements between 1991 and 1993 averaged between twenty-eight percent and twenty-nine percent of the total recovery to investors.251 The possibility of the recovery of such fees in meritorious securities fraud cases hardly presents a danger of vexatious litigation any different in degree or kind from other meritorious litigation.

Second, the purported explosion of such claims has not produced any discernable in terrorem effects on the capital markets. The supposed danger that enterprises will abandon high-risk ventures because of the threat of a securities fraud suit is simply not supported by the data.252 To
<table>
<thead>
<tr>
<th>A. PRINCIPLES</th>
<th>BLUE CHIP STAMPS (Standing Limited)</th>
<th>HOCHFELDER (Scienter)</th>
<th>VIRGINIA BANKSHARES § 14(a) Limited to Controlling Plaintiff</th>
<th>LAMPE (Statute of Limitations)</th>
<th>MUSICK (Contribution)</th>
<th>CENTRAL BANK (Aiding/Abetting)</th>
<th>ALLOYD (Limiting § 12(2))</th>
<th>PLAUT ($ 27A(b) Unconstitutional)</th>
<th>CONSISTENT OR INCONSISTENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Judicial Interpretation of Securities Fraud Remedies Requires Adherence to Plain Language</td>
<td>Rejected</td>
<td>Accepted</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Accepted</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Inconsistent</td>
</tr>
<tr>
<td>2. The Judicial Origins of Implied Securities Fraud Remedies Require Adherence to Plain Language of the Securities Laws and Foreclose Legislative Policy Considerations</td>
<td>Rejected</td>
<td>Accepted</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Accepted</td>
<td>Not Expressed</td>
<td>Rejected</td>
<td>Inconsistent</td>
</tr>
<tr>
<td>3. The Judicial Origins of Implied Securities Fraud Remedies Require Treating Those Remedies Differently from Express Remedies</td>
<td>Accepted</td>
<td>Accepted</td>
<td>Accepted</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Not Expressed</td>
<td>Rejected</td>
<td>Inconsistent</td>
</tr>
<tr>
<td>4. Legislative Acquiescence Justifies the Judicial Interpretation of Implied Remedies</td>
<td>Accepted</td>
<td>Not Expressed</td>
<td>Not Expressed</td>
<td>Not Expressed</td>
<td>Accepted</td>
<td>Rejected</td>
<td>Not Expressed</td>
<td>Not Expressed</td>
<td>Inconsistent</td>
</tr>
<tr>
<td>B. POLICIES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Securities Fraud Litigation Is Exclusively Vexatious</td>
<td>Expressed</td>
<td>Expressed</td>
<td>Expressed</td>
<td>Expressed</td>
<td>Expressed</td>
<td>Expressed</td>
<td>Expressed</td>
<td>Not Expressed</td>
<td>Consistent</td>
</tr>
<tr>
<td>2. Securities Fraud Litigation Exacts Costs Which Chill Securities Transactions</td>
<td>Not Expressed</td>
<td>Expressed</td>
<td>Not Expressed</td>
<td>Expressed</td>
<td>Expressed</td>
<td>Expressed</td>
<td>Expressed</td>
<td>Not Expressed</td>
<td>Consistent</td>
</tr>
<tr>
<td>C. RESULTS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. The Remedies Afforded Investors for Securities Fraud Are Expanded</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Rejected</td>
<td>Consistent</td>
</tr>
<tr>
<td>2. The Exposure of Defendants to Securities Fraud Liability Is Limited</td>
<td>Accepted</td>
<td>Accepted</td>
<td>Accepted</td>
<td>Accepted</td>
<td>Accepted</td>
<td>Accepted</td>
<td>Accepted</td>
<td>Accepted</td>
<td>Consistent</td>
</tr>
</tbody>
</table>
the contrary, the Securities Industry Association reports that the securities industry raised more than one trillion dollars for corporations through securities offerings in 1992 alone, more than double the amount raised in any offering prior to 1989.\textsuperscript{253} Similarly, the number of initial public offerings in the years 1989 through 1992 increased steadily from 254 issues raising over 13 billion dollars in 1989 to 603 new issues in 1992 raising nearly 40 billion dollars.\textsuperscript{254}

While no legitimate evidence supports the outcry over securities fraud litigation, there is legitimate evidence supporting the contrary position. The possibility of meritorious securities fraud litigation creates a perception of deterrence and compensation among investors which increases their willingness to participate in the capital markets. In 1929, before the federal securities laws were enacted, only 1.2\% of the American population owned corporate stock.\textsuperscript{255} As of 1990, 21.1\% of the American population (51 million citizens) owned corporate stock.\textsuperscript{256} Although this dramatic increase in stock ownership does not prove a causal relationship between the disclosure and antifraud provisions of the federal securities laws and investor confidence in the capital markets, it also does not support the position that the federal securities fraud regime chills participation in the capital markets. Enforcement of the mandatory disclosure provisions of the federal securities laws through private fraud actions may not fully deter and may not fully compensate defrauded investors. Nonetheless, the perception among the more than 50 million Americans interested in participating in the capital markets, in which such an enforcement mechanism exists, has done nothing to dampen that interest. The contrary perception, however, created by judicial or congressional removal of such enforcement mechanisms just may impede interest.

V. THE JURISDICTIONAL PRINCIPLE IN THE SUPREME COURT'S SECURITIES FRAUD DECISIONS

The fact that the Supreme Court's securities fraud policies have no empirical basis is not surprising. Whenever the Court leaves the familiar ground of legal principle and enters the realm of policy, it does so without reliable guidance. The Court's securities fraud decisions, which tread heavily upon legislative turf, appear to lack the legitimacy of either legal rules or political judgments. Nonetheless, those decisions do contain the germ of a reconciling principle.

In none of its recent decisions construing the implied and express rights of action for securities fraud has the Court expressly addressed the fundamental question of subject-matter jurisdiction of the federal courts to entertain such actions. Jurisdictional issues are, without doubt, implicit in

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{253} Id. at 413. See also Seligman, supra note 244, at 440.
\item \textsuperscript{254} Hearings, supra note 242, at 159.
\item \textsuperscript{255} Seligman, supra note 244, at 456 (citing S. REP. No. 1455, 73d Cong., 2d Sess. 9 (1934); WORLD ALMANAC AND BOOK OF FACTS 361 (1994)).
\item \textsuperscript{256} Seligman, supra note 244, at 456.
\end{itemize}
\end{footnotesize}
JURISDICTION AND SECURITIES FRAUD

the Court’s decisions. Lurking in the Court’s decisions, in fact, is a basic
jurisdictional principle: the federal courts may imply private rights of ac-
tion if, but only if, there is subject-matter jurisdiction over the action.257

This jurisdictional principle has three components. First, federal courts
have no power to create federal common law causes of action.258 Second,
federal courts have no “arising under” jurisdiction over judicially-implied
private rights of action for violations of federal law.259 Third, federal
courts have the power to recognize implied private rights of action for
violations of federal law if they have some alternative basis for jurisdic-
tion over the action.260 The jurisdictional principle provides a method of
reconciling the Supreme Court’s apparently irreconcilable decisions.

The principle also has a corollary. The federal courts have no power to
reject subject-matter jurisdiction over actions that expressly have been
granted to them by Congress.261 This corollary provides a basis for shap-
ing the Court’s recent attempt to revise express rights of action for securi-
ties fraud.

A. FEDERAL COURTS MAY ADJUDICATE PRIVATE RIGHTS OF
ACTION ONLY IF THERE IS SUBJECT-MATTER JURISDICTION

1. Jurisdiction Over Private Rights of Action

While state courts may retain the power to create private remedies,
federal courts have no power to create federal private remedies. When a
federal court creates a private right of action for the violation of a federal
statute, it engages in an unconstitutional expansion of its limited subject-
matter jurisdiction.262

257. See infra Section VI.A.
258. See infra subsection VI.A.2.
259. See infra subsection VI.A.3.
260. See infra subsection VI.A.4.
261. See infra subsection VI.B; Cohens v. Virginia, 19 U.S. (6 Wheat.) 264, 404 (1821).
262. As Justice Powell suggested in his dissent in Cannon v. University of Chicago, 441
U.S. 677, 746 n.17 (1979), the issues of private action implied from a federal statute and
federal jurisdiction are intertwined. The federal courts have no independent power to cre-
ate federal common law because the Constitution nowhere delegates it to the federal judi-
ciary. See Erie R.R. v. Tompkins, 304 U.S. 64, 78 (1938) (“[N]o clause in the Constitution
purports to confer such a power upon the federal courts.”). Absent a constitutional dele-
gation to the federal courts of the power to create common law, that power is reserved to
the states. U.S. CONST. amend. X.

The Constitution, however, does delegate to the United States Supreme Court judicial
power over cases “arising under” federal law, U.S. Const. art. III, § 2; as well as delegate
to Congress the power to create the lower federal courts, U.S. Const. art. I, § 8; id. art. III,
§ 1. Accordingly, Congress created the federal district courts and assigned to them juris-
cannot assign to the federal courts any greater power than the Constitution assigns to the
federal judiciary. Because the Constitution does not delegate to the federal judiciary the
power to create federal common law, Congress cannot grant jurisdiction to the lower fed-
eral courts to resolve cases arising under federal common law. See Erie, 304 U.S. at 78.
Instead, the jurisdiction of the federal courts is limited to cases arising under the Constitu-
tion, treaties, or congressional enactments. U.S. Const. art. III, § 2.

If, as Justice Powell recognized in Cannon, the “arising under” jurisdiction of the federal
courts is broad enough to accept a state law cause of action that includes as an element the
2. The Federal Judiciary Has No Power to Create Private Federal Remedies

Despite *Erie*'s oft-cited proclamation that "[t]here is no federal general common law," despite Erie's oft-cited proclamation that "[t]here is no federal general common law," federal courts have retained the power to create common law in two "restricted" circumstances: where "necessary to protect uniquely federal interests" such as those regarding the rights and obligations of the United States, interstate controversies, international boundary disputes and admiralty disputes; or where "Congress has vested jurisdiction in the federal courts and empowered them to create governing rules of law." Neither power, however, justifies the judicial creation of private securities fraud remedies.

Although the federal securities statutes embody a federal interest in eliminating harmful conduct, they do not present the kind of "uniquely federal interests" that empower the federal courts to fashion federal common law. If that power exists in the realm of securities law, it must derive from a specific congressional delegation to the federal courts of violation of a federal statute, then the implication of a private remedy expands the scope of federal jurisdiction. *Cannon*, 441 U.S. at 746 n.17. Justice Powell concluded that to the extent an expansive interpretation of "arising under" jurisdiction permits the federal courts to "assume control over disputes which Congress did not consign" to them, the interpretation is constitutionally defective. *Id.*

Ironically, after Justice Powell's dissent in *Cannon*, the Supreme Court, as discussed in this Section, rejected such an expansive interpretation of "arising under" jurisdiction. Accordingly, this Section contends that even if a cause of action can be implied from a violation of the federal securities laws, that action does not, and cannot consistently with the Constitution, "arise under" federal law.

263. *Erie*, 304 U.S. at 78.


268. *Banco Nacional*, 376 U.S. at 426-27; *Hinderlider v. La Plata River & Cherry Creek Ditch Co.*, 304 U.S. 92, 110 (1938) ("Jurisdiction over controversies concerning . . . boundaries . . . have been recognized as presenting federal questions.").


271. See *Musick, Peter & Garrett v. Employers Ins.*, 113 S. Ct. 2055, 2088 (1993). Supporting this contention is the following statement of the *Texas Industries* Court:

Admittedly, there is a federal interest in the sense that vindication of rights arising out of these congressional enactments supplements federal enforcement and fulfills the objects of the statutory scheme. Notwithstanding that nexus, contribution among antitrust wrongdoers does not involve the duties of the Federal Government, the distribution of powers in our federal system, or matters necessarily subject to federal control even in the absence of statutory authority.

*Texas Indus.*, 451 U.S. at 642.
both subject-matter jurisdiction and the authority to create governing rules of law.272

Congress, however, has provided no such grant of power to the federal courts. In the Securities Exchange Act of 1934,273 Congress gave the federal district courts “exclusive” subject-matter jurisdiction over all “suits in equity and actions at law brought to enforce any liability or duty created by [that Act] or the rules and regulations thereunder.”274 This grant of jurisdiction, however, is limited to actions based on liabilities or duties “created by” the federal statute.275 As the Supreme Court has declared, this language “creates no cause of action of its own force and effect; it imposes no liabilities.”276 Congress has expressly given to the federal courts jurisdiction over only those actions created by the “substantive provisions” of the 1934 Act.277 The mere grant of exclusive federal jurisdiction over actions expressly created by a federal statute does not, however, empower the federal courts to create additional federal common law actions which are not expressly created by that statute.278

Additionally, the sweeping antifraud provisions of the federal securities laws do not justify the creation of federal common law rights. There is no doubt that the federal securities laws represent a comprehensive congressional effort to regulate interstate securities transactions.279 The existence of that scheme alone, however, does not evidence a congressional intent to delegate to federal courts the power to fashion common law rights.280 To the contrary, the fact that Congress has created detailed and specific remedial provisions throughout the federal securities laws creates a presumption that Congress did not “intend [federal] courts to have the power to alter or supplement the remedies enacted.”281

272. See Wheeldin, 373 U.S. at 651.
274. Id.
275. Id.
276. Touche Ross & Co. v. Redington, 442 U.S. 560, 577 (1979) (holding that the grant of subject-matter jurisdiction in § 27A of the 1934 Act does not alone empower the federal courts to create private remedies for violations of the reporting requirements of § 17(a) of the Act).
277. Id.
278. See Merrell Dow Pharmaceuticals, Inc. v. Thompson, 478 U.S. 804, 808 (1986); Texas Indus., 451 U.S. at 643-46 (reasoning that congressional delegation to the federal courts of exclusive jurisdiction over unique remedies for antitrust law violations does not include a delegation to create an additional common law right to contribution).
279. The federal regulatory scheme is based upon the Securities Act of 1933, 15 U.S.C. §§ 77a-77bbbb (1994), the Securities Exchange Act of 1934, id. §§ 78a-78ll, and their amendments. See, e.g., The Williams Act, codified at id. §§ 78m(d), (e); n(d), (f). The 1933 Act regulates the offer and sale of securities by imposing civil liability for filing a materially false registration statement, id. § 77k, or prospectus, id. § 77l(2). The scope of the Securities Exchange Act of 1934 is broad in that it governs registration, distribution, sale, and resale of securities in interstate commerce. See, e.g., id. § 78(b) (unlawful for person to utilize interstate commerce to “use or employ ... any manipulative or deceptive device”). The 1934 Act criminalizes the fraudulent sale and purchase of securities, id. § 78(b), as well as manipulation insider trading, and misstatements in filed documents. Id. §§ 78l, 78(b), 78r(a).
280. See Texas Indus., 451 U.S. at 644-45.
281. Id. at 645.
Court recently concluded, "[t]he presumption that a remedy was deliberately omitted from a statute is strongest when Congress has enacted a comprehensive legislative scheme including an integrated system of procedures for enforcement." Even in the context of the antitrust laws where "the federal courts enjoy more flexibility and act more as common-law courts than in other areas governed by federal statute," the Supreme Court has held that congressional delegation of federal jurisdiction over a comprehensive remedial scheme does not include a delegation of power to create federal common law remedies.

Moreover, the necessity for federal courts to interpret and apply congressional statutes does not empower those courts to supplement the remedies provided in such statutes. The federal courts certainly have the authority to give "concrete meaning" to federal statutes through "a process of case-by-case judicial decision in the common-law tradition." Jurisdiction to resolve cases or controversies created by federal statutes naturally includes the power to interpret "ambiguous or incomplete provisions." The power to develop a federal common law through court decisions interpreting and applying federal statutes, however, does not extend to the creation of remedies not within the congressional statutes being interpreted or applied. The federal courts' inherent authority to interpret federal securities laws in the course of deciding the myriad actions expressly created by those laws, therefore, does not include the authority to create additional federal common law rights and remedies.


Even if the federal courts had the power to imply a private, common law cause of action for the violation of the federal securities laws, those courts nonetheless would lack subject-matter jurisdiction over that action.

In its decisions interpreting the elements of private rights of action for securities fraud, the Supreme Court has never reached the issue whether any such remedies arise under federal law for purposes of providing an independent basis for subject-matter jurisdiction in federal district.
courts. Significantly, in both of the cases in which the implied rights under sections 14(a) and 10(b) were first created, the federal courts had diversity jurisdiction over the actions. In *Borak*, the Supreme Court recognized an implied private right of action under section 14(a) for proxy fraud only after first making absolutely clear that the federal courts had diversity jurisdiction over the claims filed. Similarly, in *Kardon*, where the Court first created the implied section 10(b) claim, the Court expressly did not reach the question whether that claim arose under federal law because diversity jurisdiction existed in the case.

Nor, in any of its section 10(b) decisions, has the Supreme Court ever directly confronted a viable section 10(b) claim in which the violation of such was the only basis for jurisdiction in federal court. In some section 10(b) decisions the Supreme Court has held that no private right of action exists for the plaintiffs' claims at all. In all of the remaining cases, the plaintiffs asserted an independent basis for federal jurisdiction. In these cases, the federal courts had subject-matter jurisdiction over the securities fraud claims based upon the doctrine of supplemental jurisdiction.


*See Musick*, 113 S. Ct. at 2086 (initial claims brought under § 11 and § 12 of the 1933 Act afforded supplemental jurisdiction under 28 U.S.C. § 1367 (Supp. V 1993) for the related § 10(b) contribution claim); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 304-05, 309-10 (1985) (§ 10(b) claims are supplemental to other express federal claims, including those under the 1933 Act); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 387 (1983) (assuming the existence of cumulative remedies under § 11 of the 1933 Act, there will be supplemental jurisdiction for the related § 10(b) claims); *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 143 (1972) (jurisdiction asserted under 28 U.S.C. §§ 1399, 2409 (1988) as the United States was a party-defendant); *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 7 (1971) (because plaintiffs pled claims under the express liability provisions of the Securities Act of 1933, the federal court had supplemental jurisdiction over the related § 10(b) claims). But see *Basic Inc. v. Levinson*, 485 U.S. 224, 250 (1988) (only six Justices participated in a decision defining materiality as it appears in § 10(b) finding that it was not inappropriate for the lower court to certify a class based on a rebuttable presumption of reliance).

whether an implied private right of action for securities fraud is a claim "arising under" federal law which would afford independent "arising under" jurisdiction for that action.

The Securities Exchange Act of 1934's specific grant to the federal courts of exclusive jurisdiction over actions to enforce liabilities "created by" that Act does not alone provide for subject-matter jurisdiction over judicially created actions such as the private section 14(a) or section 10(b) remedies.296 Furthermore, although Congress has granted the federal district courts original jurisdiction over "all civil actions arising under the . . . laws . . . of the United States,"297 that grant of jurisdiction does not extend to judicially created private actions for the violation of a federal statute.

The Constitution provides that federal judicial power shall extend to "all Cases, in Law and Equity, arising under . . . the Laws of the United States."298 This constitutional grant of jurisdiction has been interpreted with "great breadth" to confer original jurisdiction upon the Supreme Court "whenever a federal question is an 'ingredient' of the action" or whenever a case involves "'potential federal questions.'"299 This broad constitutional grant of jurisdiction, however, has no independent application to the lower federal courts. Instead, the Constitution empowers Congress, and only Congress, to "ordain and establish . . . inferior Courts" to the Supreme Court and to define the jurisdiction of those inferior federal courts.300 The federal courts have no constitutional power to expand their own subject-matter jurisdiction.301 While Congress cannot assign to the lower federal courts any more power than the Constitution confers upon the Supreme Court, Congress can assign lower federal courts less power than allowed to the Supreme Court by the Constitution.302 Indeed, although Congress's statutory grant of jurisdiction to the lower federal courts virtually copies the Constitution's grant of federal

which are so related to joined federal claims that they are part of the same constitutional case. Id. at 214-15.


300. U.S. CONST. art. III, § 1. See also Merrell Dow, 478 U.S. at 807 (The constitutional grant of judicial power in "arising under" cases is not "self-executing.").


302. See U.S. CONST. art. III, § 2; id. amend X; Lampf, 501 U.S. at 365 (Scalia, J., concurring).
judicial power, the Supreme Court has interpreted the congressional delegation of lower court jurisdiction much more restrictively than the constitutional grant.

Under the Supreme Court's current view of the congressional grant of "arising under" jurisdiction to federal district courts, there is no doubt that those courts have the power to hear cases in which a federal statute actually "creates" the cause of action. In Moore, the Supreme Court concluded, however, that an implied right of action for the violation of a federal statute is created by state law rather than federal law. Moore filed two claims against the railroad, alleging he was injured as a result of a defective lever he used in attempting to uncouple freight cars. The Court concluded that the first claim brought under the Federal Employers' Liability Act, which provides for an express private right of action, clearly arose under federal law.

As to the second claim, however, the Supreme Court concluded that because the allegations in Moore's complaint relied upon the Federal Safety Appliance Act for the duty of care and not for the right to sue, that claim did not arise under federal law. Although the federal statute supplied the duty, "the right to recover damages ... sprang from the principle of the common law," and therefore supplied no basis for federal court "arising under" jurisdiction. The Moore Court reconciled its holding with Rigsby by recalling that the action in Rigsby was "brought in the state court and was removed to the federal court upon the ground that the defendant was a federal corporation."

In situations where federal provisions do not create a private cause of action, subject-matter jurisdiction for actions must be based on "the presence of a claimed violation of the statute as an element of a state cause of action." There is considerable doubt, however, as to whether the federal courts are empowered to hear claims that are not created by federal law, but rather merely hinge on a question of federal law.

---

303. 28 U.S.C. § 1331 (1988) provides: "The district courts shall have original jurisdiction of all civil actions arising under the ... laws ... of the United States."
304. Merrell Dow, 478 U.S. at 807.
305. Id. at 808 (quoting American Well Works Co. v. Layne & Bowler Co., 241 U.S. 257, 260 (1916)).
308. Moore, 291 U.S. at 211.
310. Id. at 211-15.
311. Id. at 215-16 (citing Texas & Pac. Ry. v. Rigsby, 241 U.S. 33, 39-40 (1916)).
312. Id. at 215 n.6.
313. See Merrell Dow, 478 U.S. at 814.
314. See id. at 813-14. See also id. at 821 n.1 (Brennan, J. dissenting). Compare Moore, 291 U.S. at 214-15 (no arising under jurisdiction over state law claim that necessarily depends on the interpretation of a federal statute) with Smith v. Kansas City Title & Trust Co., 255 U.S. 180, 199-200 (1921) (arising under jurisdiction exists over state law claim that necessarily depends on the interpretation of the U.S. Constitution).
In Franchise Tax,315 the Supreme Court declared that a case may arise under “federal law where the vindication of a right under state law necessarily turned on some construction of federal law.”316 As the Supreme Court itself later cautioned in Merrell Dow, however, its “actual holding” in Franchise Tax rejects that basis for federal jurisdiction.317 The Supreme Court acknowledged that the plaintiffs’ state law claims in Franchise Tax hinged on a substantial question of federal law, yet the Court denied the existence of “arising under” jurisdiction.318

In Merrell Dow, the Supreme Court made explicit that the federal district courts have no jurisdiction over causes of action created by state law, even where they necessarily depend upon the judicial construction of a federal statute.319 The plaintiffs there sought damages for injuries allegedly caused by Merrell Dow’s failure to satisfy the branding requirements of the Federal Food, Drug, and Cosmetic Act (FDCA).320 The Supreme Court assumed that the FDCA did not itself create a private right of action for monetary relief.321 This assumption led the Court to assume further that “some combination” of the then-controlling Cort v. Ash322 implication factors was not present.323

Accordingly, the Court reasoned that “careful scrutiny of legislative intent” would reveal the absence of any congressional desire to provide for a private right of action.324 Finally, the Court concluded that “the congressional determination that there should be no federal remedy for the violation of this federal statute [was] tantamount to a congressional conclusion that the presence of a claimed violation of the statute as an element of a state cause of action [was] insufficiently ‘substantial’ to confer federal-question jurisdiction.”325 The Court found that the federal statutory issue was not sufficiently substantial despite the fact that Congress had created a comprehensive scheme for enforcing federal food, drug and cosmetic standards326 and had vested jurisdiction exclusively in the fed-

316. Id. at 9; see also Merrell Dow, 478 U.S. at 808-09.
317. Merrell Dow, 478 U.S. at 809.
318. Id. at 801.
319. Id. at 817.
321. Merrell Dow, 478 U.S. at 810. Both parties agreed that the FDCA contains no private right of action. Id. But that concurrence is hardly based on the merits of the arguments rejecting the private remedy. Rather, the defendants despite their desire to litigate in federal court, did not wish to acknowledge the existence of any private FDCA remedy which could be used against them. The plaintiffs’, despite their desire for a remedy, denied the existence of a federal cause of action, so that they could remain in state court.
324. Id. at 811-12 (citing Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 377 (1982)).
325. Id. at 814.
326. 21 U.S.C. §§ 301-395 (1994). The dissent, however, noted that:
   The enforcement scheme established by the FDCA is typical of other, similarly broad regulatory schemes. Primary responsibility for overseeing implementation of the Act has been conferred upon a specialized administrative agency, here the Food and Drug Administration (FDA). Congress has pro-
eral district courts for all claims brought under the statute.\(^\text{327}\) Whatever doubt remains regarding federal jurisdiction over state law claims that depend on the construction of a “substantial question” of federal law,\(^\text{328}\) there is no doubt that the federal courts have no jurisdiction over claims created by state law that depend on the construction of a federal statute.\(^\text{329}\)

Provided the FDA with a wide-ranging arsenal of weapons to combat violations of the FDCA, including authority to obtain an ex parte court order for the seizure of goods subject to the Act, see 21 U.S.C. § 334, authority to initiate proceedings in a federal district court to enjoin continuing violations of the FDCA, see § 332, and authority to request a United States Attorney to bring criminal proceedings against violators, see § 333. \(\text{Merrell Dow, 478 U.S. at 830 (Brennan, J., dissenting).}\)

\(^{327}\) 21 U.S.C. §§ 332(a), 333, 334(a)(1) (1994). “Congress structured the FDCA so that all express remedies are provided by the federal courts . . . .” \(\text{Merrell Dow, 478 U.S. at 831 (Brennan, J., dissenting).}\) The FDCA, in this respect, is indistinguishable from the Securities Exchange Act of 1934. Both create exclusive jurisdiction in the federal courts for express remedies and both create a specialized administrative agency responsible for overseeing implementation and enforcement of the statutory standards. \(\text{See 15 U.S.C. § 78aa (1994).}\)

\(^{328}\) The \(\text{Merrell Dow}\) majority did not eliminate federal jurisdiction for state law claims which turn on a substantial question of federal law. \(\text{Merrell Dow, 478 U.S. at 814.}\) The Court concluded that the presence of a federal statutory standard as an element of a state law cause of action did not rise to the level of a substantial federal question. \(\text{Id.}\)

\(^{329}\) The \(\text{Merrell Dow}\) majority reconciled its holding with \(\text{Smith v. Kansas City Title & Trust Co., 255 U.S. 180 (1921) by suggesting that Smith involved a question of the “constitutionality of an important federal statute” rather than merely the construction of an important federal statute. 478 U.S. at 814-15 n.12. The “nature” of the constitutional issue at stake in Smith was different from the “nature” of the federal statutory issue at stake in Merrell Dow. Martin H. Redish, \text{Federal Jurisdiction: Tensions in the Allocation of Judicial Power} 67 (1st ed. 1980). See also William Cohen, \text{The Broken Compass: The Requirement That a Case Arise “Directly” Under Federal Law, 115 U. Pa. L. Rev. 890, 916 (1967); David L. Shapiro, Jurisdiction and Discretion, 60 N.Y.U. L. Rev. 543, 569 (1985). The dissent takes issue with the majority’s effort to reconcile Smith, asserting that Smith is a vital and influential case which cannot be reconciled on a clearly-defined, principled basis with cases like Moore and Merrell Dow. 478 U.S. at 821-24 n.1 (Brennan, J., dissenting).}

Yet, there can be no dispute that the Supreme Court has made a clear distinction between the constitutional question at stake in cases such as Smith and the federal statutory questions at stake in cases such as Moore. In Smith, the Supreme Court affirmed federal jurisdiction over a shareholder’s suit to enjoin a corporation from issuing bonds on the grounds that the federal statute, which authorized the issuance, was unconstitutional. Smith, 255 U.S. at 199-202. The Court announced the “general rule” that federal jurisdiction exists where the plaintiff’s “right to relief depends on the construction or application of the Constitution or laws of the United States, and that such federal claim is not merely colorable, and rests upon a reasonable foundation.” \(\text{Id. at 199. Yet, in Smith, the Court argued that it was “the constitutional validity of an act of Congress which is directly drawn in question” that supported the exercise of federal jurisdiction. Id. at 201.}\)

In Moore, by contrast, the federal question derived from a federal statute (the Federal Safety and Appliance Acts) that created a duty, the breach of which gave rise to a state law tort action. Moore, 291 U.S. at 216-17 (quoting Minneapolis, St. Paul & Sault Ste. Marie Ry. v. Poplar, 237 U.S. 369, 372 (1915)) (“The federal statute, in the present case, touched the duty of the master at a single point and, save as provided in the statute, the right of the plaintiff to recover was left to be determined by the law of the state.”). Similarly, in Merrell Dow, the FDCA touched on the duty of drug manufacturers such as Merrell Dow at a single point, and the right of the plaintiff to recover was left to be determined by state law. \(\text{See supra note 328.}\)

The jurisdictional distinction between claims that depend upon a construction of a federal statute and those which depend upon a construction of the Constitution has also been
Under the reasoning of *Merrell Dow*, *Franchise Tax*, and *Moore*, therefore, a claimed violation of the federal securities laws as an element of a state law action for damages is “insufficiently 'substantial' to confer federal-question jurisdiction.”330 The original congressional determination that there should be no private remedy for the violation of a provision of the federal securities laws is “tantamount” to a congressional conclusion that the necessity of construing that standard in resolving a state law claim for its violation does not present a “substantial” federal question.331

The federal courts, therefore, have no independent “arising under” jurisdiction over implied private rights of action under the federal securities laws.332 The continued recognition of independent federal subject-matter jurisdiction over such implied private securities fraud actions is an unconstitutional exercise of federal judicial power.

4. The Federal Courts May Imply Private Remedies for Securities Fraud in Diversity and Supplemental Jurisdiction Cases

In *Moore*, the Supreme Court made clear that any private right of action for the violation of a federal statute that a court creates without congressional intent must have its origin in state tort law.333 To the extent that the judicial creation of an implied right of action for violations of section 10(b) and section 14(a) is based on a theory of judicial power which permits the creation of private remedies absent an expressed congressional intent to the contrary,334 therefore, those rights of action must be a creation of state law.335

That the federal courts have no “arising under” jurisdiction over implied private actions for securities fraud, however, does not necessarily deprive those courts of jurisdiction to adjudicate such actions. In its grants of diversity jurisdiction336 and supplemental jurisdiction,337 Congress has given the federal courts the power to adjudicate claims created


331. *Id.*


333. *Moore*, 291 U.S. at 215 (“The Safety Appliance Acts having prescribed the duty in this fashion, the right to recover damages sustained by the injured employee through the breach of duty sprang from the principle of the common law. . . .”).


335. Indeed, there is no genuine dispute that Congress, in enacting the 1934 Act, did not create private remedies for the violation of § 10(b). See, e.g., Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 359 (1991) (“We have made no pretense that it was Congress' design to provide the remedy afforded.”).


by state law. When a federal court is called upon to adjudicate such state law claims, it acts as a court of the state whose law provides the rules of decision in the case. In its role as a surrogate state court, the federal court in such instances becomes a common law court of the state. It obtains the power to recognize common law causes of action. As state common law courts, therefore, the federal courts have the power to recognize private rights of action which have been implied under state common law and, additionally, to create private rights of action under implication principles prevalent in the state.

If the federal courts were to recognize a private right of action created by state law, they would simply be applying familiar principles of the common law of torts. There is no genuine doubt that federal courts have the constitutional power to recognize implied rights of action created by tort law in the state which supplies the rules of decision for the action. Moreover, none of the Supreme Court's decisions rejecting or limiting the judicial implication of federal private rights of action for securities fraud address this very different issue of whether the federal courts have the power in diversity or supplemental jurisdiction cases to recognize a state law cause of action for the violation of the federal securities laws. Clearly, the federal courts have such power.

The components of the jurisdictional principle dictate that the federal courts have no power to imply a federal private right of action for securities fraud and no “arising under” subject-matter jurisdiction over any such action. If, however, the federal courts have an independent basis for subject-matter jurisdiction by virtue of diversity or supplemental jurisdiction, they may recognize, and even create, a state law implied private right of action for the violation of the federal securities laws.

The jurisdictional principle indicates that the federal courts have no “arising under” jurisdiction over any implied right of action for securities fraud. Accordingly, in the absence of any independent subject-matter jurisdiction, the federal courts have no power to adjudicate any implied securities fraud rights of action, including the implied section 14(a) action, the implied section 10(b) action, the implied section 10(b) contribution action, and the implied section 10(b) secondary liability action. If, however, the federal courts have independent subject-matter jurisdiction over an action based on diversity or supplemental jurisdiction, they may entertain state-law-created private rights of action for securities fraud violations.

B. The Federal Courts Must Adjudicate Matters Within Their Jurisdiction

The jurisdictional principle just examined has a necessary corollary. As the Supreme Court has declared: “It is most true that this Court will not

339. *See supra* notes 337-38 and accompanying text.
take jurisdiction if it should not: but it is equally true, that it must take jurisdiction if it should.

Similarly, the Court has made clear that the federal judiciary has "no more right to decline the exercise of jurisdiction which is given, than to usurp that which is not given. The one or the other would be treason to the constitution." 

The Supreme Court has "steadily held" that the federal courts may not decline to exercise jurisdiction over cases or controversies properly before them. A federal court may decline to exercise jurisdiction over a particular action only in situations involving the doctrines of abstention or forum non conveniens. Each of those doctrines, however, permits the federal courts to decline jurisdiction only in specific instances. They do not afford the federal courts a basis for rejecting jurisdiction in cases where the "special circumstances" required by the doctrines are absent. In the absence of these circumstances, the federal courts have a "duty" to adjudicate matters entrusted to their subject-matter jurisdiction.

The federal courts, therefore, must exercise the jurisdiction which Congress expressly has granted to them to adjudicate cases arising under federal law. The Supreme Court has no power to permit the federal courts to reject cases within the jurisdiction because Congress has the "sole power" to create lower federal courts and to assign to them jurisdiction within constitutional limits.

C. The Application of the Jurisdictional Principle to the Supreme Court's Securities Fraud Cases

This jurisdictional principle can be used to reconcile the Supreme Court's implied right of action decisions, even—to some extent—its recent decisions in Central Bank and Musick.

341. Id.
343. Abstention in its various forms is required in a case in which "the exercise of jurisdiction would create an unwarranted friction between federal and state sovereigns." Weiner v. Shearson, Hammel & Co., 521 F.2d 817, 820 (9th Cir. 1975). See, e.g., Railroad Comm'n v. Pullman Co., 312 U.S. 496, 500-01 (1941). The doctrine of forum non conveniens gives the federal court discretion to dismiss an action if the chosen forum is grossly inconvenient and if another forum exists. See Gulf Oil Corp. v. Gilbert, 330 U.S. 501 (1947).
345. See Propper, 337 U.S. at 491-92; Chicot County, 148 U.S. at 534 ("[T]he courts of the United States are bound to proceed to judgment and to afford redress to suitors before them in every case to which their jurisdiction extends. They cannot abdicate their authority or duty . . . .")
First, the jurisdictional principle justifies the Supreme Court's decisions which consistently limit the scope of implied securities fraud remedies. The Supreme Court has suggested two theoretical bases for the judicial creation of private remedies for securities fraud: (1) federal judicial power to create remedies, absent congressional intent, and (2) congressional acquiescence in the federal judicial power to create remedies for statutory violations. As the Court itself has recognized, however, neither of these theories can survive constitutional analysis.

The Court has rejected as "entirely misplaced" the judicial implication of private remedies based on the principles of federal court remedial power followed in earlier cases such as Borak. At the same time, the Court has acknowledged that the judicial implication of the section 10(b) private remedy is based on the flawed reasoning of those outmoded cases. Even in the rare instances in which the Court has tolerated the judicial implication of private rights of action, the Court has made it

---

347. The Supreme Court first characterized its own acceptance of the private remedy by declaring that it had "explicitly acquiesced" in the lower federal court recognition of the private remedy. In *Musick*, the Court recently suggested that the § 10(b) private right of action was created by the lower federal courts on the theory that they are empowered to create remedies for violations of federal statutes, even absent congressional intent. 113 S. Ct. at 2088.

As an alternative to this theory of federal court remedial power, the Supreme Court has indicated that the § 10(b) private remedy also can be justified by congressional acquiescence to the judicial creation of that remedy. The *Musick* Court finds evidence of congressional acquiescence in the federal courts' creation and interpretation of implied rights of action under § 10(b). *Musick*, 113 S. Ct. at 2089. In *Basic*, the Supreme Court included "legislative acquiescence" as a foundation for the judicial implication of the private § 10(b) remedy. *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988). Similarly, in *Huddleston*, the Court based its cumulative construction of the remedies provided by the federal securities laws on congressional acquiescence. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 384-85 (1983).

In *Huddleston*, the Court supported the cumulative use of the implied § 10(b) remedy with express securities laws remedies by arguing that "when Congress comprehensively revised the securities laws in 1975, a consistent line of judicial decisions had permitted plaintiffs to sue under § 10(b) regardless of the availability of express remedies . . . . Congress' decision to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action." *Id.* at 384-86.

348. *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575 (1979) ("The central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action.").


350. See *Musick*, 113 S. Ct. at 2088 (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730, 737 (1975)).

clear that the implication must be based on evidence of congressional intent. Yet, the Court also has concluded that the implication of a private right of action under section 10(b) cannot be supported by any evidence of congressional intent. The Court acknowledged and recent scholarship has confirmed that when Congress enacted section 10(b) in 1934 it did not intend to create or to have the courts create a private right of action for damages.

Nor can courts rely on the theory of legislative acquiescence to justify the creation of private remedies. In its purest form, the theory of legislative acquiescence is that congressional silence in the wake of the judicial construction of a statute indicates congressional approval of that judicial construction. The legislative acquiescence theory gains additional strength when Congress has either reenacted a statute without altering the judicially-construed portion or has altered other provisions of the statute, leaving intact the judicially construed provision. As the Supreme Court recently declared, that theory is flawed because it permits courts to assign unjustifiable and unconstitutional significance to the inaction of post-enactment Congresses. The doctrine of legislative acquiescence is discredited by the Supreme Court's repeated reaffirmation of its rejection of judicially-induced concepts of congressional intent.

---


352. Cannon, 441 U.S. at 688. See also Touche Ross & Co., 442 U.S. at 568.

353. Lampf, 501 U.S. at 359 (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976)) ("[W]e have made no pretense that it was Congress' design to provide the remedy afforded"). See also Hochfelder, 425 U.S. at 196 ("[T]here is no indication that Congress, or the Commission when adopting Rule 10b-5, contemplated such a remedy . . . .").

354. See, e.g., Musick, 113 S. Ct. at 2088; Lampf, 501 U.S. at 359; Blue Chip Stamps, 421 U.S. at 730, 737.


356. The Supreme Court has explained this principle in these terms: "When a court says to a legislature: 'you (or your predecessor) meant X,' it almost invites the legislature to answer: 'We did not.' " Johnson v. Transportation Agency, 480 U.S. 616, 630 n.7 (1987) (quoting GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 31-32 (1982)).


Compare Girouard v. United States, 328 U.S. 61, 69 (1946) ("It is at best treach[ere]ous [sic] to find in Congressional silence alone the adoption of a controlling rule of law.") with Apex Hosiery Co. v. Leader, 310 U.S. 469, 488 (1940) ("The long time failure of Congress to alter the Act after it had been judicially construed . . . is persuasive of legislative recognition that the judicial construction is the correct one.").

cense is contrary to the realities of congressional conduct, and it is contrary to the constitutional roles assigned to the legislature and to the judiciary. Nor does the actual legislative experience with the federal

360. First, there is no evidence that a majority of the members of Congress typically is aware of Court decisions interpreting statutes. What evidence there is suggests that “most Supreme Court decisions never come to the attention of Congress.” Marshall, supra note 359, at 186 (quoting Abner J. Mikva, How Well Does Congress Support and Defend the Constitution? 61 N.C. L. Rev. 587, 609 (1983)). Even if some members of Congress, by virtue of their leadership or subcommittee roles, follow judicial interpretations of legislation, their knowledge rarely spreads to a majority of the Senate and the House of Representatives. Marshall, supra at 187-88.

Second, even if Congress is fully aware of the judicial construction of its legislation and even if a majority of Congress disagrees with that construction, there is no guarantee that Congress will take corrective action. Congressional inaction is often the product not of approval, but of “inertia” or even “paralysis.” Id. at 190-91.

Third, even if congressional inaction does indicate approval of the judicial construction of a statute, it is often difficult to determine which precise aspect of that construction Congress approves. Id. at 193. Congressional silence may indicate approval of the Court’s actual result in a case, or it could indicate approval of the Court’s exercise of power in interpreting the statute. Id. at 192. In addition, Congress could approve of the Court’s disposition of the case on a substantive point wholly unrelated to the legislation, or on a procedural point unrelated to the substance of the legislation itself. Indeed, the ambiguity present in virtually every Court decision naturally renders congressional inaction in the wake of a Court decision also ambiguous. Professor Marshall has thoroughly attacked this premise in the context of statutory stare decisis. He shows that ignorance, inertia, interpretational ambiguity, and irrelevance make it difficult to infer congressional approval from congressional inaction. Id. at 184-96.

361. The Constitution, with rare clarity, requires that before a law can be enacted, it must be “passed” by both houses of Congress and “presented” to the President. U.S. Const. art. I, § 7, cl. 2 (“Every bill which shall have passed the House of Representatives and the Senate, shall, before it becomes a law, be presented to the President of the United States . . . .”). See also INS v. Chadha, 462 U.S. 919, 946 (1983) (The presentment clause and bicameral enactment are “integral part[s] of the constitutional design for the separation of powers.”). This requirement alone ensures a multifaceted balance of power: (1) a law cannot be enacted without approval of both the House and the Senate, giving to each veto power; (2) a law cannot be enacted without first being presented to the President, giving to the President modified veto power (Congress retains the power to override a presidential veto by a two-thirds vote. U.S. Const. art. I, § 7, cl. 3) and (3) because a law can only be enacted if approved by both houses of Congress and presented to the President, it cannot be enacted by the judiciary.

The equation of congressional inaction with congressional approval of the judicial interpretation of a statute threatens each of these balances. The equation effectively gives to each house of Congress not the power to veto legislation, but the power to pass legislation. For, so long as one house fails to pass legislation disapproving the judicial interpretation of a statute, Congress as a whole is deemed to approve that interpretation. While a minority of the most powerful members within each house of Congress does not have the power to pass legislation (RULES OF THE HOUSE OF REPRESENTATIVES, H.R. DOC. NO. 279, 99th Cong., 2d Sess. § 508 (1985)), that minority may well have the power to block legislation. See Marshall, supra note 359, at 188 (“The power of congressional leaders is largely a negative power; they often can control the agenda in a manner that effectively kills certain proposed legislation.”). Under the theory of legislative acquiescence, if a strong minority of one house of Congress blocks legislation which would negate the judicial interpretation of a statute, that minority is treated as having the affirmative power to fashion legislation approving the interpretation. See id. (“A great many provisions of the Constitution (including bicameralism, the executive veto, and judicial review) present impediments to the passage of legislation, reflecting the essentially conservative bias of our system of government.”) (citing Jesse H. Choper, Judicial Review and the National Political Process 26 (1980)).

Similarly, the doctrine of legislative acquiescence usurps the presidential veto power. The constitutional requirement that legislation be presented to the President for a poten-
is not germane to the issue of the intent of the enacting Congress. The Congress or Con-

vention into "Speculative Unrealities", 186; "Inaction enables Congress to effectuate its will without ever risking presidential veto (not to mention public scrutiny or pressure"). The judicial treatment of congressional inaction as the equivalent of congressional legislation, therefore, disrupts the constitutional roles assigned to the President and the Congress in the lawmaking process.

The doctrine of legislative acquiescence also upsets the roles that the Constitution assigns to the legislative and judicial branches of government. The Constitution requires that "[a]ll legislative Powers" shall be vested in Congress. U.S. Const. art. I, § 1. This apparently clear assignment of legislative power has been interpreted in two different ways. The delegation of power to Congress could mean that Congress has the exclusive power to make law and therefore that the judiciary is constitutionally prohibited from doing so. (For a particularly stark example of this view, see Thomas W. Merrill, The Common Law Powers of Federal Courts, 52 U. Chi. L. Rev. 1 (1985) (finding that the Constitution prohibits the courts from making law and that the courts must therefore adhere strictly to congressional intent in construing a statute).

On the other hand, the Constitution's delegation of "legislative powers" to the Congress has been interpreted as an exclusive delegation to Congress only of the power to enact statutes, leaving to the federal courts the power to create common law. See William N. Eskridge, Jr., Dynamic Statutory Interpretation, 135 U. Pa. L. Rev. 1479, 1499 (1987). Eskridge argues that this power to make common law is consistent with the Framers' view of separation of powers, a view which tolerated shared lawmaking power, but not concentrated lawmaking power. Id. at 1501.

But even the most strident advocates of federal judicial power accept the qualification that the Court's task in applying a statute should be to attempt to interpret the will of the legislature and not to create its own law. See id. at 1501 n.88 (quoting The Federalist No. 78, at 469 (Alexander Hamilton) (Clinton Rossiter ed., 1961) ("The courts must decide the sense of the law; and if they should be disposed to exercise will instead of judgment, the consequences would equally be the substitution of their pleasure to that of the legislative body.").

When the courts presume congressional approval from congressional silence, they not only fail to administer the will of the legislature which enacted the legislation, they express and knowingly interpret the statute in a manner contrary to the will of that legislature. Legislative acquiescence is a doctrine that presumes congressional intent from the silence of the legislature in the wake of a court decision interpreting a statute. In its first interpretation of the statute, the Court endeavors to divine the legislative intent of the Congress which enacted the legislation. See, e.g., Oscar Mayer & Co. v. Evans, 441 U.S. 750, 758 (1979); International Bhd. of Teamsters v. United States, 431 U.S. 324, 354 n.39 (1977). This initial act of judicial power is consistent with the role assigned to the judiciary in the Constitution. See, e.g., Frank H. Easterbrook, Statutes' Domains, 50 U. Chi. L. Rev. 533 (1983). See also Oscar Mayer, 441 U.S. at 758. After that first interpretation, however, the Court revisits its prior construction of a statute and discovers that its initial interpretation of the intent of the enacting legislature was incorrect. See Marshall, supra note 359, at 186; see also John C. Grabow, Congressional Silence and the Search for Legislative Intent: A Venture Into "Speculative Unrealities", 64 B.U. L. Rev. 731, 741 (1984). The Court nevertheless is unwilling to correct that interpretation because Congress has not acted in the wake of the Court's erroneous decision. Id.

When it "interprets" the inaction of post-enactment Congresses, the Court exceeds the legitimate exercise of its constitutional power. The conduct of post-enactment Congresses is not germane to the issue of the intent of the enacting Congress. The Congress or Con-
securities laws support the application of the doctrine. The Court has

gresses which do not act to correct a court decision are not the same Congress which enacted the statute. See, e.g., Runyon v. McCrary, 427 U.S. 160, 174 n.11 (1976). The Supreme Court is not even willing to accept the comments of legislators after the enactment of a statute as evidence of the enacting Congress's intent. See, e.g., Grove City College v. Bell, 465 U.S. 555, 566-68 (1984); Regional Rail Reorganization Act Cases, 419 U.S. 102, 132 (1974). The Court has found that "the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." Andrus v. Shell Oil Co., 446 U.S. 657, 666 n.8 (1980); see also United States v. Price, 361 U.S. 304, 313 (1960).

Indeed, while it is easy to identify the Congress that enacted the initial legislation, and even easier to identify expressed post-enactment statements, it is virtually impossible to identify the Congress, Congresses, or legislators which have not passed corrective legislation. The Court purports to administer the intent of a series of diffuse Congresses which apparently have expressed their intent through their silence after the enactment. When the Court presumes congressional intent from congressional inaction, therefore, it fails to interpret the intent of the Congress which enacted the statute.

Moreover, under the doctrine of legislative acquiescence, the Court purposefully gives more power to the inaction of post-enactment Congresses than it does to the intent of the enacting Congress. The doctrine presumes that the Court has discovered that its prior interpretation of a statute is incorrect. Yet, the Court is willing to maintain that knowingly wrong interpretation of the intent of the enacting Congress merely because post-enactment Congresses have failed to act. Professor Marshall writes: "It is downright silly for a court that takes this stand with respect to rather contemporaneous and explicit post-enactment history to afford extraordinary significance to far removed and ambiguous inaction." Marshall, supra note 359, 193-94.

Judges and scholars long have disagreed about the proper balance of power between the legislature and the judiciary. See, e.g., Choper, supra; Martin H. Redish, Federal Common Law, Political Legitimacy, and the Interpretive Process: An "Institutionalist" Perspective, 83 Nw. U. L. Rev. 761 (1989); Steven D. Smith, Why Should Courts Obey the Law?, 77 Geo. L.J. 113 (1988). No matter where one strikes that balance, there can be no legitimate dispute that the Constitution does not empower the federal courts to apply a congressional statute in a manner that is knowingly contrary to the intent of the legislature which enacted the statute. That is precisely the effect of the doctrine of legislative acquiescence.

The evidence of congressional approval of the private remedy seems particularly strong because Congress has revisited the federal securities laws on many occasions without "correcting" the judicial creation of the private remedy. During the years in which private recovery has been recognized under § 10(b), Congress has considered and passed ten major legislative amendments to the 1934 Act. The major revisions of the Securities Exchange Act of 1934 during the period from 1968 to the present, are:


stated that it would have “trouble inferring” congressional acquiescence in the federal courts’ creation of private securities law remedies.  

Even if Congress had acquiesced by its silence to an expansion of federal judicial power beyond that contemplated in section 14(a) or section 10(b), or in the general grants of federal subject-matter jurisdiction, however, the federal courts could not constitutionally accept that power. The

§§ 78c, 78o, 78u, 78ff, 78kk) it preserved even all “implied” remedies under the 1934 Act. Id. § 78tt-1. Most recently, in 1991, when Congress enacted § 27A of the 1934 Act reinstating statute of limitations periods for § 10(b), it specifically referred to the § 10(b) private remedy. Id. § 78aa-1 (1994).

By the time Congress amended the securities laws in 1988 and certainly by the time it added § 27A to the 1934 Act in 1991, the “consensus” in the lower federal courts concerning § 10(b)’s private remedy was “old” and “overwhelming.” See Curran, 456 U.S. at 380. The Supreme Court in Curran suggests that the consensus regarding the private remedy under the Commodities Exchange Act was not so “old” or so “overwhelming” as that under § 10(b). That the Court was willing to infer the congressional intent to create the private Commodities Exchange Act remedy suggests that a fortiori it would do so in the context of § 10(b). According to the Supreme Court, “the fact that a comprehensive reexamination and significant amendment of [a statute] left intact the statutory provisions under which the federal courts had implied a cause of action is itself evidence that Congress affirmatively intended to preserve that remedy.” Curran, 456 U.S. at 381-82 (holding that the congressional revisitation of the Commodity Exchange Act without altering the provision from which the courts had implied a private remedy indicates the congressional intent to maintain that remedy).  

Additional evidence that Congress factored Supreme Court decisions into its lawmaking process, contrary to suggestions otherwise, is found in the legislative history of both the 1988 Act and § 27A, which indicates a congressional preoccupation with these decisions. The legislative history of the 1988 Act is replete with references to Supreme Court decisions limiting the reach of congressional legislation designed to prevent insider trading. Pub. L. No. 100-704, 102 Stat. 6043 (1988). The history indicates that Congress intended to codify a theory of liability for misappropriating material non-public information, a theory which the Supreme Court had touched upon, but had never approved. The legislative history mentions Carpenter v. United States, 484 U.S. 19 (1987), in which the Supreme Court divided 4-4 on the merits of the misappropriation theory. Id. at 28. Similarly, when Congress enacted § 27A of the 1934 Act, it plainly was aware of the Supreme Court’s decision in Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350 (1991), which created a uniform, retroactive statute of limitations period for § 10(b) actions. Section 27A was not only enacted in direct response to the Court’s Lampf decision, it actually incorporates that decision and the date on which it was rendered as terms in the legislation itself. See 15 U.S.C. § 78aa-1 (1994). That section provides:

Special provision relating to statute of limitations on private causes of action
(a) Effect on pending causes of action
The limitation period for any private civil action implied under Section 78(j)(b) of this title that was commenced on or before June 19, 1991, shall be the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991.

(b) Effect on dismissed causes of action
Any private civil action implied under Section 78(j)(b) of this title that was commenced on or before June 19, 1991—

(1) which was discussed as time barred subsequent to June 19, 1991, and

(2) which would have been timely filed under the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991, shall be reinstated on motion by the plaintiff not later than 60 days after Dec. 19, 1991.


Constitution grants to Congress the sole authority to create the lower federal courts and to assign to them subject-matter jurisdiction. Congress can only create the lower federal courts and assign to them subject-matter jurisdiction through the legislative process. Congress cannot, by its inaction, delegate judicial power to the lower federal courts. The Constitution prohibits the federal courts from accepting judicial power not delegated by an act of Congress. Accordingly, the Supreme Court cannot permit the federal courts to accept judicial power absent such a delegation. Congress, therefore, cannot by its acquiescence delegate federal judicial power.

In its reliance upon the uncertain origins of implied rights of action for securities fraud to guide its statutory interpretations, the Court engages in a form of result-guided reasoning. Its decisions are overtly legislative, yet they are not without principle. The Court’s apparent effort to contract the reach of section 10(b) can be seen as an effort to curtail the original judicial transgression, which resulted in the creation of the section 10(b) implied right of action.

The Supreme Court never has reached the question whether the implied rights of action of under sections 14(a) and 10(b) arise under federal law for jurisdictional purposes. Instead, the Court has interpreted the elements of liability in cases in which the section 10(b) or section 14(a) claim had some independent jurisdictional basis, such as supplemental jurisdiction. In these cases, the Court’s effort to restrict the implied claim can be viewed as a principled effort to prevent an unwarranted expansion of the federal court’s limited jurisdiction.

These narrowing interpretations of private remedies make clear that the subject-matter jurisdiction of the federal courts is limited and will not be expanded by the judiciary. Until the Supreme Court squarely reaches the issue of the jurisdictional basis for implied securities fraud remedies, its decisions limiting the scope of those remedies are at least consistent with its obligation to circumscribe the federal courts’ limited subject-matter jurisdiction.

Further, the Court’s decision to recognize an implied right of action for contribution in *Musick* is consistent with this jurisdictional principle. A right of action for contribution under the federal securities laws assumes as its predicate that a claim already has been filed in federal court for securities fraud liability. Because claims created by section 10(b)

---

364. See U.S. Const. art. III, § 1; id. art. I, § 8.
366. Id.
367. See U.S. Const. art. III, §§ 1, 2; see also American Fire & Casualty Co. v. Finn, 341 U.S. 6, 17-18 (1951).
368. Finn, 341 U.S. at 18.
370. See, e.g., Fed. R. Civ. P. 14(a). The Rule authorizes a defendant sued in federal court to file a third-party claim against any person “not a party to the action who is or may be liable to the third-party plaintiff for all or part of the plaintiff’s claim against the third-party plaintiff.” Id.
are exclusively vested in federal court.\textsuperscript{371} any implied right of contribution for section 10(b) liability necessarily follows a claim filed in federal court for securities fraud.\textsuperscript{372} Without determining whether the federal courts have subject-matter jurisdiction over the initial claim for securities fraud, the Supreme Court could still create an implied right of contribution within the federal courts’ jurisdiction.

In the typical case where a plaintiff sues a defendant for securities fraud, the defendant may assert an action for contribution even in the absence of any independent subject-matter jurisdiction over the contribution action. This is because Congress has granted the federal courts “supplemental jurisdiction” to resolve non-federal and non-diverse claims which are so related to a federal or a diverse claim that they are part of the same case.\textsuperscript{373} A claim for contribution, which necessarily asserts that a third-party defendant may be liable to the third-party plaintiff for all or part of that third-party plaintiff’s securities fraud liability to the original plaintiff, will invariably be within Congress’s grant of supplemental jurisdiction.\textsuperscript{374} In fact, Congress even gave federal courts the power to hear such contribution claims where the only basis for jurisdiction in federal court is diversity.\textsuperscript{375} Thus, even if the Supreme Court properly concluded that an implied right of action for a violation of the federal securities laws has no independent “arising under” subject-matter jurisdiction in federal court, it could still consistently conclude that the federal courts have supplemental jurisdiction over any implied right to contribution.

Third, in light of the jurisdictional principle, the Musick opinion is even consistent with Central Bank.\textsuperscript{376} Unlike the contribution claims at issue in Musick, the aiding and abetting claims at issue in Central Bank were not necessarily within the supplemental jurisdiction of the federal courts. The perpetuation of a federal, implied right of action for aiding and abetting securities fraud would have represented an unconstitutional expansion of federal judicial power which no amount of lower court precedent could justify.\textsuperscript{377} Accordingly, the Central Bank Court was justified in rejecting the widely-held lower court view accepting the cause of action.\textsuperscript{378} The Court simply refused to tolerate an unconstitutional expansion of federal subject-matter jurisdiction.

Its holding, however, should be limited to the rejection of a federal judicial power to create a federal cause of action which would afford the federal courts “arising under” jurisdiction over that action. The Central Bank holding does not specifically address the different question whether

\begin{itemize}
\item \textsuperscript{371} 15 U.S.C. § 78aa (1994).
\item \textsuperscript{372} FED. R. CIV. P. 14(a); see also 6 CHARLES A. WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 1446 (2d ed. 1990).
\item \textsuperscript{374} Id.
\item \textsuperscript{375} 28 U.S.C. § 1332 (1988).
\item \textsuperscript{376} Central Bank v. First Interstate Bank, 114 S. Ct. 1439 (1994).
\item \textsuperscript{377} See discussion supra Section V.A.
\item \textsuperscript{378} Central Bank, 114 S. Ct. at 1439.
\end{itemize}
the federal courts have the power to adjudicate state law claims for aiding and abetting securities fraud violations, where federal subject-matter jurisdiction otherwise exists. For example, the Court has the power to recognize state law aiding and abetting claims in diversity cases.\(^{379}\) It may also recognize such claims in an action in which the SEC or private investors bring claims against primary violators of section 10(b) or other remedial provisions of the federal securities laws together with related claims against secondary violators of section 10(b).\(^{380}\) In such actions, the federal courts generally will have supplemental jurisdiction over the claims against the secondary violators.\(^{381}\) Even if, as the Supreme Court held in *Central Bank*, the claims against the secondary violators are not created by federal law,\(^{382}\) Congress has given the federal courts jurisdiction to hear those claims if they are so related to the claims against the primary violators as to be part of the same case.\(^{383}\)

From this jurisdictional perspective, however, an aiding and abetting claim is fundamentally different from a contribution claim. An aiding and abetting claim does not necessarily depend on the filing of a primary securities fraud claim. In direct contrast, a federal contribution claim must follow a securities fraud claim already filed in federal court.\(^{384}\) The federal courts invariably will have supplemental jurisdiction over the contribution claim. They will not invariably have supplemental jurisdiction over an aiding and abetting claim.

VI. THE SUPREME COURT'S REJECTION OF THE JURISDICTIONAL PRINCIPLE IN *ALLOYD* AND *PLAUT*

Although this jurisdictional principle can justify the Supreme Court's implied right of action decisions, that principle cannot explain the Court's *Alloyd*\(^{385}\) and *Plaut*\(^{386}\) decisions. It can only serve to minimize the extent of the Court's improper rejection of jurisdiction.

A. LIMITING THE COURT'S REJECTION OF JURISDICTION IN *ALLOYD*: SECTION 12(2) STILL APPLIES TO PRIVATE PLACEMENT

Congress has given the federal courts "concurrent" jurisdiction over section 12(2) claims.\(^{387}\) Section 12(2) expressly creates a private right of

---


\(^{380}\) 28 U.S.C. § 1367 (1988 & Supp. V 1994) (authorizing the federal courts to adjudicate any state law claim which is "so related" to a joined claim that arises under federal law as to be part of the same constitutional case).

\(^{381}\) Id.

\(^{382}\) 114 S. Ct. at 1455.


\(^{384}\) See Fed. R. Civ. P. 14(a) (a contribution claim must allege that the contributing defendant may be liable for "part" of any liability running to the original plaintiff).


action. Even under the most restrictive view of the federal courts' "arising under" jurisdiction, there is no doubt that Congress has empowered the federal courts to resolve such claims. Nonetheless, in Alloyd, the Court refused to accept the grant of power which Congress has given to the federal courts by discarding the plain language of the federal securities laws. The jurisdictional principle demands that the holding in Alloyd be narrowly construed. While the language in the opinion is ambiguous, the jurisdictional principle requires limiting Alloyd's rejection of jurisdiction to only those section 12(2) claims which allege misstatements in a stock purchase agreement in a secondary securities transaction not involving an issuer.

The Supreme Court's decision holds only that section 12(2) is inapplicable to misstatements in a stock purchase agreement in a secondary transaction, i.e., a purchase of securities not from the issuer. Properly read, Alloyd does not address the applicability of section 12(2) to an offering memorandum provided to prospective purchasers in an initial or "primary" distribution of securities, i.e., from the issuer in a transaction exempt from registration as a private placement under section 4(2) of the Securities Act.

The question presented in Alloyd was "whether [the] right of rescission extends to a private, secondary transaction, on the theory that recitations in the purchase agreement are part of a 'prospectus.'" The plaintiffs in Alloyd purchased the stock not from the issuer but from stockholders, and sought to base their claim for rescission upon representations and warranties contained in their stock purchase agreement—not on any offering memorandum provided in connection with the sale. The district court rejected the claim, relying on the Third Circuit's decision in Ballay v. Legg Mason Wood Walter Inc., and held that section 12(2) claims "can only arise out of the initial stock offerings." The Court of Appeals for the Seventh Circuit vacated that judgment in light of its intervening decision in Pacific Dunlop Holdings, Inc. v. Allen & Co., which reasoned that the term "communication" in the Securities Act's definition of "prospectus" meant that the term prospectus was defined "very broadly" to include all written communications that offered a sale of securities, "including the stock purchase agreement in the present case." The Supreme Court in Alloyd granted certiorari "to resolve this Circuit conflict." Alloyd thus considered the applicability of section 12(2) to misstatements made by selling shareholders in a stock purchase agreement or in a secondary transaction.

388. See discussion supra Section V.A.
389. Alloyd, 115 S. Ct. at 1064.
390. Id. at 1064-65.
392. Alloyd, 115 S. Ct. at 1065.
393. 993 F.2d 578 (7th Cir. 1993), cert. denied, 114 S. Ct. 907, and cert. dism'd, 114 S. Ct. 1146 (1994).
394. Id. at 595, quoted in Alloyd, 115 S. Ct. at 1065.
The majority opinion's analysis in *Alloyd* focused on "[t]he determinative question [of] whether the contract between Alloyd and Gustafson [was] a 'prospectus' as the term [was] used in the 1933 Act."\(^{396}\) The Court began its analysis with section 10 of the Act.\(^{397}\) Because section 10 requires a "prospectus" to contain the same information required in a registration statement, unless there is an "overriding exemption,"\(^{398}\) the Court reasoned that a stock purchase contract is not a prospectus:

There is no dispute that the contract in this case was not required to contain the information contained in a registration statement and that no statutory exemption was required to take the document out of § 10's coverage. It follows that the contract is not a prospectus under § 10. That does not mean that a document ceases to be a prospectus whenever it omits a required piece of information. It does mean that a document is not a prospectus within the meaning of that section if, absent an exemption, it need not comply with § 10's requirements in the first place.

An examination of § 10 reveals that, whatever else "prospectus" may mean, the term is confined to a document that, absent an overriding exemption, must include the "information contained in the registration statement."\(^{399}\)

The Court added:

By and large, only public offerings by an issuer of a security, or by controlling shareholders of an issuer, require the preparation and filing of registration statements. It follows, we conclude, that a prospectus under § 10 is confined to documents related to public offerings by an issuer or its controlling shareholders.\(^{400}\)

Noting that the circuit split on section 12(2) had turned on whether the term prospectus was required to be read consistently in both sections 10 and 12—as the Third Circuit in *Ballay*\(^{401}\) held—the Court then concluded that the term "must have the same meaning under §§ 10 and 12."\(^{402}\) Thus: "If the contract before us is not a prospectus for purposes of § 10—as all must and do concede—it is not a prospectus for purposes of § 12 either."\(^{403}\) The Court then synthesized the scope of section 12(2) as follows: "[T]he liability imposed by § 12(2), cannot attach unless there is an obligation to distribute the prospectus in the first place (or unless there is an exemption)."\(^{404}\)

\(^{396}\) Id. at 1066. The opinion noted that the parties and the Courts of Appeals had all agreed that the "oral communication" referred to in § 12(2) was "restricted to oral communications that relate to a prospectus." Id.


\(^{398}\) *Alloyd*, 115 S. Ct. at 1067.

\(^{399}\) Id. (citation omitted).

\(^{400}\) Id. (citation omitted).


\(^{402}\) *Alloyd*, 115 S. Ct. at 1067.

\(^{403}\) Id.

\(^{404}\) Id.
The stock purchase contract at issue in *Alloyd* was thus held not to be a prospectus because there was no dispute that (1) the contract between the seller and the purchaser was not a required disclosure of any kind under the 1933 Act; and (2) "no statutory exemption was required to take the document out of § 10's coverage."\(^{405}\) The same reasoning demonstrates the applicability of section 12(2) to situations in which sellers have an obligation under the 1933 Act to provide information,\(^{406}\) and in which their offering memoranda would have to comply with the registration statements requirement of section 10 but for the existence of a statutory exemption under section 4(2) of the Act.\(^{407}\)

Nowhere does the Court state that an initial distribution in the form of a private placement falls outside section 12(2), or that an offering memorandum used in such an initial distribution is immunized from section 12(2).\(^{408}\) When the Court first introduced the "public offering" language into its opinion, it did so using expressly qualified terminology: "By and large, only public offerings by an issuer of a security, or by controlling stockholders of an issuer, require the preparation and filing of registration statements," from which the Court concluded that "a prospectus under § 10 is confined to documents related to public offerings by an issuer or its controlling shareholders."\(^{409}\) To read into this and related language, which was not necessary to resolution of the circuit conflict or question presented on certiorari, the conclusion that *Alloyd* forecloses section 12(2) liability in private initial distributions, would be an unwar-
ranted extension of the Court's narrow rejection of federal subject-matter
jurisdiction.

Indeed, the Court suggested that it employed the "public offering" phraseology simply to distinguish initial offerings from secondary transactions, and not to exclude all initial but privately placed offerings by distinguishing offerings available to the general public from everything else. In describing the "primary innovation" of the 1933 Act as the creation of federal duties "in connection with public offerings," the Court relied on a statement from a prior opinion that described the Act's concern as "initial distributions of newly issued stock from corporate issuers."\(^{410}\) A private placement by the issuer is an initial distribution of newly issued stock.

Similarly, in supporting its holding by reference to the Court's earlier section 17(a) decision in Naftalin,\(^ {411}\) the Alloyd opinion, while referring to the term "prospectus" as relating "to public offerings by issuers," relied on Naftalin's statement that section 17(a) was "intended to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading."\(^ {412}\) The Court noted that Naftalin had identified the 1933 Act's primary concern with the regulation of new offerings," and that Naftalin extended section 17(a) to an "initial distribution" as well as "ordinary market trading" in "a major departure from th[e] limitation [of the 1933 Act for new offerings]."\(^ {413}\)

That the Court's "public" terminology was not intended to remove all private placements from coverage is further suggested by the opinion's discussion of section 2(10) of the Act, the definition of "prospectus." The opinion rejected reading that definition's inclusion of "communication" to mean that "prospectus" includes all communications (such as a private stock purchase agreement). The Court reasoned from the various terms included in the definition, "prospectus, notice, circular, advertisement . . . letter . . . [or] communication," that "it is apparent that the list refers to documents of wide dissemination."\(^ {414}\) Unlike the individualized stock purchase agreement claimed to be a prospectus in Alloyd, private offerings may require the wide dissemination of communications with investors. Likewise, the Court's desire that section 12(2) not extend to "every casual communication between buyer and seller in the secondary market," but rather be limited to "misstatements contained in a document prepared with care, following well established procedures relating to investigations with due diligence,"\(^ {415}\) would not be contravened by section

---

\(^{410}\) See id. (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 752 (1975)).


\(^{412}\) Alloyd, 115 S. Ct. at 1070 (quoting Naftalin, 441 U.S. at 777-78).

\(^{413}\) Id. (bracketed language in original). See also Ballay, 925 F.2d at 690-91 & n.10 (noting that the 1933 Act addressed "initial" as opposed to "secondary" distributions).

\(^{414}\) Alloyd, 115 S. Ct. at 1070.

\(^{415}\) Id. at 1071.
12(2)'s application in initial private distributions. Offerors engaged in a private offering certainly treat the preparation and dissemination of offering memoranda as a major exercise of their due diligence. Attachment of section 12(2) liability to such offering memoranda would not in any sense extend liability to "every casual conversation between buyer and seller in the secondary market."[416]

The use of the phrase "public offering" merely as shorthand to exclude secondary market transactions can also be seen in the Court's legislative history discussion. The opinion argued that Congress intended section 12(2) to apply "only to public offerings by an issuer (or a controlling shareholder)" by quoting the House Report's statement that "[t]he bill affects only new offering of securities.... It does not affect the ordinary redistribution of securities unless such redistribution takes on the characteristics of a new offering."[417] An initial distribution from the issuer is a "new offering of securities" whether it takes the form of a private placement or a public issuance. So, too, the majority opinion's emphasis on the indications in the legislative history that liability attaches to the "origi-nators of securities" is perfectly compatible with section 12(2) liability as to all types of initial distributions, public or privately placed, while excluding all types of secondary transactions.[418] Reading Alloyd to exclude from section 12(2) all initial offerings that take the form of private placements thus, is not compelled by the opinion itself.

Reading Alloyd broadly also would be irreconcilable with the Supreme Court's own recent decision recognizing that Congress has given the federal courts jurisdiction over section 12(2) claims involving a privately placed initial offering of securities. In Randall v. Loftsgaarden,[419] the Court was presented with a question regarding the scope of rescissory damages available to a purchaser under section 12(2). The Court held that tax benefits received by the investor through the purchase of the securities did not constitute "income received," or a return of "consideration" within the language of section 12(2), and thus need not be subtracted from the purchase price in calculating damages.[420] In Randall, the Court applied section 12(2) to private placement of limited partnership units conducted through an offering memorandum in a transaction that was exempt from the registration requirements of the 1933 Act as a private offering.[421] If Alloyd intended to limit section 12(2) to a public distribution by the issuer to the exclusion of private initial distributions, then the Supreme Court would have mentioned that it was limiting its prior decision in Randall. But Alloyd nowhere mentions Randall, and

[416] Id.
[417] Id. at 1072 (quoting H.R. REP. No. 85, 73d Cong., 1st Sess. 5 (1933)).
[420] Id. at 648.
lower courts should not lightly assume that a Supreme Court decision is overruled sub silentio.\textsuperscript{422}

Similarly, the Court has held that "although § 4(2) of the 1933 Act ... exempts transactions not involving any public offering from the Act's registration provisions, there is no comparable exemption from the antifraud provisions."\textsuperscript{423} If Alloyd truly intended to exclude the section 4(2) exempted transactions from the antifraud provision of section 12(2), then it would have at least mentioned that it was departing from the prominent view and practice to the contrary.

Moreover, lower federal courts, applying the Third Circuit's holding in \textit{Ballay} that the term prospectus "describes the transmittal of information concerning the sale of a security in an initial distribution,"—a decision specifically upheld in \textit{Alloyd}\textsuperscript{424}—have held that a purchaser of stock pursuant to a private placement stated a claim under section 12(2) of the Securities Act "with respect to all initial purchases of ... stock."\textsuperscript{425} The courts also have held that because \textit{Ballay}'s holding that section 12(2) applies "only to initial distributions and not to secondary transactions," section 12(2) liability does not extend to securities purchased in the secondary market.\textsuperscript{426}

Like \textit{Ballay}, other courts, holding that section 12(2) does not apply to secondary market transactions, have nevertheless held that initial purchases from the issuer in private placements are within the scope of section 12(2).\textsuperscript{427} Indeed, "every Court of Appeals to consider the issue has ruled that private placements are subject to § 12(2)."\textsuperscript{428} Any suggestion that section 12(2) does not cover private placements, in light of \textit{Alloyd}, must be rejected. For if the Supreme Court intended to overturn every circuit precedent regarding private placements, it would have done

\textsuperscript{422} See \textit{Amato v. Wilentz}, 952 F.2d 742, 749 (3d Cir. 1991); \textit{In re School Asbestos Litigation}, 921 F.2d 1310, 1318 (3d Cir. 1990), \textit{cert. denied}, 499 U.S. 976 (1991) ("The [Supreme] Court knows how to state explicitly that a previous decision is no longer to be followed; ... it also knows how to send signals that it will be reconsidering a previous ruling.").

\textsuperscript{423} \textit{Landreth Timber Co. v. Landreth}, 471 U.S. 681, 692 (1985). See also \textit{Nor-Tex Agencies, Inc. v. Jones}, 482 F.2d 1093, 1099 (5th Cir. 1973), \textit{cert. denied}, 415 U.S. 977 (1974) ("The so-called private offer exemption of section 4(2) of the Securities Act of 1933 ... only exempts a transaction from the registration requirements of [§ 5], and does not exempt a transaction from the anti-fraud provisions of sections 12(2) of the '33 act or Rule 10b-5 under the '34 act.").

\textsuperscript{424} The circuit conflict that the Supreme Court granted certiorari to resolve in \textit{Alloyd} was between the Third Circuit's holding in \textit{Ballay} and the Seventh Circuit's decision in \textit{Pacific Dunlop}. The Supreme Court resolved the conflict in favor of \textit{Ballay}.


\textsuperscript{428} \textit{Alloyd}, 115 S. Ct. at 1082 (Ginsberg, J., dissenting) (collecting cases).
so explicitly. Nowhere in the opinion did the Court do so. Such a massive sub silentio overruling should not be inferred, particularly where doing so would further extend the Court’s rejection of the express congressional grant of jurisdiction over section 12(2) claims.429

B. The Court’s Rejection of Jurisdiction in *Plaut*

In its prior implied right of action decisions, the Court narrowly defined the parameters of those actions without reaching the fundamental question of the limits of federal court jurisdiction. In *Plaut*,430 by contrast, the Court quickly reached the question of the limits of congressional power. Yet, the statute which it addresses is arguably the only hint that Congress ever has granted the federal courts jurisdiction over a class of cases arising under section 10(b). Section 27A(b) is an express grant of subject-matter jurisdiction to the federal courts over some implied private rights of action under section 10(b). It is the only grant of subject-matter jurisdiction over such actions. It is a limited grant. The federal courts have the power, upon a proper and timely filed motion, to reinstate and to resolve on its merits a private civil action for the violation of section 10(b) that was: (1) commenced on or before June 19, 1991; (2) dismissed as time barred after June 19, 1991; and (3) timely filed under the limitations period applicable in the jurisdiction in existence on or before June 19, 1991.431

This is an express grant of subject-matter jurisdiction. It is a grant of power to the federal courts, not a usurpation of power. In light of the fact that section 27A(b) is the only express delegation of jurisdiction which Congress has ever given the federal courts over section 10(b) claims and in light of the judicial history of accepting and interpreting such claims in the absence of any such grant of jurisdiction, the Court’s determination that this express grant of power to the federal judiciary exceeds Congress’s power is truly anomalous.

VII. CONCLUSION

While the jurisdictional principle may serve to reconcile the Supreme Court’s apparently inconsistent implied right of action securities fraud decisions, that principle cannot explain the Court’s rejection of jurisdiction over express rights of action for section 10(b) and section 12(2) liability. Nor can that principle justify the Court’s perpetuation of any independent jurisdictional basis for a federal implied right of action for securities fraud.

429. See *Linn v. Andover Newton Theological Sch., Inc.*, 874 F.2d 1, 8 n.9 (1st Cir. 1989) ("We will not lightly presume that the [Supreme] Court intended to overrule, sub silentio, a view held by virtually every circuit to have considered the issue."); *Bartlett v. Bowen*, 816 F.2d 695, 719 (D.C. Cir. 1987) (Bork, J., dissenting), cert. denied, 485 U.S. 940 (1988).


Viewed as a whole, the Supreme Court's securities fraud cases actually have flaunted the will of Congress. The Court initially permitted an expansion of its jurisdiction to entertain judicially-created private remedies where Congress had refused to do so. Now the Court has eviscerated the private remedies which Congress has expressly created. It is no wonder in *Alloyd* that Justice Thomas warned Congress that the Court's methodology is "frustrating Congress' will." 432 If, as the dissent in *Alloyd* suggests, all the "key words" in a securities fraud statute will be defined by the Court in light of the Court's own policy objectives, "there should be no need for Congress to attempt to define them." 433

Indeed, if the Court is prepared to expand its own jurisdiction where Congress has refused to do so, and to deny private remedies where Congress has expressly decided to create them, there would be no need for Congress to act at all.

Such an interplay between Congress and the Supreme Court regarding private remedies under the federal securities laws represents a startling judicial rejection of the constitutionally mandated separation of powers. As Congress revisits its securities fraud legislation, it stands forewarned that its language may be subject to judicial revision. All that Congress can do is to attempt to make its securities fraud legislation so clear and so comprehensive that not even a result-guided judiciary can justify its intrusions upon the legislative branch of government. A truly clear and comprehensive legislative scheme should include a definitive expression of the precise power which Congress intends to delegate to the federal judiciary.

---

432. *Alloyd*, 115 S. Ct. at 1079 (Thomas, J., dissenting).
433. *Id.*