SECURITIES

The significant securities cases decided during the survey period by the Fifth Circuit addressed three important issues. First, the court had an opportunity to interpret the scope of the term "security" as used within the federal securities laws. Second, the court was called upon to determine whether in particular transactions there existed the requisite elements of a cause of action under section 10(b) of the 1934 Securities Exchange Act;[1] and third, the court addressed the availability of implied private remedies to persons injured in securities transactions.

I. THE SCOPE OF THE TERM "SECURITY"

Security as defined in both the Securities Act of 1933[2] (the Securities Act) and the Security Exchange Act of 1934[3] (the Exchange Act) has been construed to encompass a broad spectrum of investments including stocks, bonds, debentures, and investment contracts.[4] Although guidelines have been enumerated which assist the

1. 15 U.S.C. § 78j(b) (1982) (section 10(b)).

2. *Id.* §§ 77a-77aa. The term "security" is defined in the Securities Act as follows:

> The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Id. § 77b(1).

3. *Id.* §§ 77b-e, 77j, 77k, 77m, 77o, 77s, 78a-78o, 78p-78hh.

4. *See* National Bank of Commerce v. All Am. Assurance Co., 583 F.2d 1295, 1298 (5th Cir. 1978). "Although there are slight differences in wording between the 1933 Securities Act and the 1934 Securities Exchange Act," the definition of the term security is functionally equivalent under each of the two Acts and the Fifth Circuit will so treat them in most cases. *Id. See also* SEC v. Continental Commodities Corp., 497 F.2d 516, 520 (5th Cir. 1974) (holding that the definitional sections of the two Acts are substantially identical); McClure v. First Nat'l Bank, 497 F.2d 490, 492 (5th Cir. 1974) (holding that definition of security under each of two Acts is functionally equivalent), *cert. denied*, 420 U.S. 930 (1975).

courts in their efforts to properly determine whether a particular investment involves the sale of a security,[5] there still exists a number of transactions as to which the courts have not been able to concur. One such transaction arises when a purchaser acquires in a single transaction more than fifty percent of the stock ownership of a business.[6]

The courts developed two approaches for addressing this issue. Under one approach the courts treat the exchange as one involving a security, and thus within the purview of the securities laws.[7] However, another group of courts developed a theory known as the sale of business doctrine which holds that the sale of a controlling stock interest does not involve the sale of a security for purposes of the securities acts.[8] The sale of business doctrine was extrapolated from a series of cases beginning with *SEC v. W.J. Howey Co.*[9] In *Howey* the Supreme Court was confronted with a determination of whether a particular transaction involved an investment contract and thus a security, as defined within the Securities Acts.[10] The *Howey* court held that an investment contract is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of . . . a third party . . . ."[11] A number of circuit courts seized upon this language and language from *United Housing Foundation v. Forman*,[12] a Supreme Court decision involving a subsequent application of *Howey*, and concluded that the *Howey* investment contract test is

5. *See, e.g.*, SEC v. W.J. Howey Co., 328 U.S. 293, 297 (1946).

6. *See infra* notes 7-15 and accompanying text.

7. Daily v. Morgan, 701 F.2d 496, 497 (5th Cir. Mar. 1983); Golden v. Garafalo, 678 F.2d 1139, 1140 (2d Cir. 1982); Coffin v. Polishing Machines, Inc., 596 F.2d 1202, 1204 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979).

8. Sutter v. Groen, 687 F.2d 197, 199 (7th Cir. 1982); King v. Winkler, 673 F.2d 342, 346 (11th Cir. 1982); Frederiksen v. Poloway, 637 F.2d 1147, 1154 (7th Cir.), *cert. denied*, 451 U.S. 1017 (1981); Chandler v. Kew, Inc., 691 F.2d 443, 444 (10th Cir. 1977).

9. 328 U.S. 293 (1946).

10. *Id.* at 297. *See supra* note 2.

11. 328 U.S. at 298-99. After a tumultuous series of cases in the Fifth Circuit, the court's interpretation of the *Howey* test appears to be that an investment contract consists of (1) an investment of money (2) in a common enterprise (3) with profits to be derived solely from the efforts of others. *See Survey, Securities, Fifth Circuit Symposium*, 12 TEX. TECH L. REV. 319, 319-26 (1980).

12. 421 U.S. 837 (1975). The Court in *Forman* stated in dicta that the *Howey* test "embodies the essential attributes that run through all of the Court's decisions defining a security." *Id.* at 852. If this statement is taken at face value, then the argument presented by those courts which have adopted the approach is certainly plausible. *See* cases cited *supra* note 8.

the sole method for determining whether a particular transaction involves a security.[13] The courts that adopted this approach or which otherwise hold that the sale of a controlling interest in a business is not a transaction involving a security, generally rely upon the requirement in *Howey* that the investor must expect to derive profits solely from the managerial efforts of others in reaching their decision.[14] These courts argue that because the purchaser of a controlling interest in a business is apparently intending to manage the business himself and thus not intending to derive profits solely from the efforts of others, the transaction through which he obtained ownership of the instrument does not satisfy all of the elements of the *Howey* test and, therefore, does not involve the sale of a security.[15]

During the survey period the Fifth Circuit, in *Daily v. Morgan*,[16] confronted the question of whether the sale of one hundred percent of the stock in a corporation involved the sale of a security for purposes of section 10(b) of the Exchange Act.[17] The plaintiffs in *Daily* purchased one hundred percent of the stock in a Mississippi corporation from the defendants.[18] Subsequent to the purchase the plaintiffs assumed managerial control of the business.[19] Thereafter, they instituted suit under section 10(b) alleging that the defendants misled them as to the financial condition of the business at the time of sale.[20] In rebuttal of this contention, the defendants asserted that because the plaintiffs purchased a controlling interest in a business which they planned to manage themselves, the sale of business doctrine precluded liability for an alleged violation of section 10(b).[21]

The Fifth Circuit, in a four part analysis, held that "the sale of [one hundred percent of the] ordinary corporate stock in a business

13. *See* Chandler v. Kew, Inc., 691 F.2d 443, 443-44 (10th Cir. 1977); King v. Winkler, 473 F.2d 342, 345 (11th Cir. 1982).

14. *See* Sutter v. Groen, 687 F.2d 197, 202 (7th Cir. 1982); King v. Winkler, 673 F.2d 342, 346 (11th Cir. 1982); Frederiksen v. Poloway, 637 F.2d 1147, 1153 (7th Cir.), *cert. denied*, 451 U.S. 1017 (1981). Although the Court in *Howey* did not state that the profits which the investor intended to derive must come from the managerial efforts of others, it was clear in *Forman* that this is what the *Howey* court had intended. 421 U.S. at 852.

15. *See, e.g.*, King v. Winkler, 673 F.2d 342, 346 (11th Cir. 1982).

16. 701 F.2d 496 (5th Cir. Mar. 1983).

17. *Id.* at 497.

18. *Id.*

19. *Id.*

20. *Id.*

21. *See id.*

to a buyer who plans to manage and control it is covered by section 10(b) of the Securities Exchange Act . . . ."[22] The court began its analysis with an interpretation of the Supreme Court's decisions in *Howey* and *Forman*.[23] After a thorough discussion of these decisions the court concluded that the *Howey* test was not the sole method for determining whether an instrument is a security.[24] According to the court, *Howey* does not apply to those instruments having all of the typical characteristics of stock;[25] rather, it applies only to unusual instruments, the economic realities of which "trigger the operation of the formidable scheme of federal securities regulation."[26] Because the plaintiffs in *Daily* purchased instruments which contained all of the typical characteristics of stock, the *Howey* test was held inapplicable.[27] In the second portion of its opinion, the court noted that the congressional purpose in enacting section 10(b) was to protect the public from fraud in connection with the sale of securities and that "[i]f Congress had wanted to exempt the privately negotiated sale of a controlling interest of stock in a small business . . . it could have done so."[28] Because it did not, the court saw no indication that Congress intended the sale of a controlling stock interest in a business to be excluded from securities regulation.[29] The court's third position was that it would be unfair and illogical to hold that the sale of forty-nine percent of the stock in a

---

22. *Id.*

23. *Id.* at 498-500.

24. *Id.* at 499.

25. The typical characteristics of stock have been listed as including the right to receive dividends, the ability to negotiate, the right to pledge or hypothecate, the right to vote, and the possibility that the stock will appreciate in value. 421 U.S. at 851.

26. 701 F.2d at 499. In referring to the economic realities of an instrument, the court was using language from the Supreme Court's decisions in *Howey* and *Forman*. *Id.* The Supreme Court used this language apparently as a justification for labeling an instrument a security notwithstanding the fact that it was not one of the types of transactions specifically enumerated by Congress in its definition thereof. 421 U.S. at 850. It is from this concept that the *Howey* investment contract test was promulgated. According to the Fifth Circuit in *Daily*, the economic realities or investment contract test applies only to those transactions involving unusual instruments, not those which traditionally come to mind when one speaks of a security. 701 F.2d at 499-500. It is at this point that the Fifth Circuit differs from those circuits which have adopted the sale of business exception to the securities laws. *See* cases cited *supra* note 8.

27. 701 F.2d at 499. The stock at issue in *Daily* was "governed by state corporation law, [carried] the right to be resold, [could] be used as collateral, [could] be voted proportionately, and [had] the potential to increase in value." *Id.*

28. *Id.* at 502.

29. *Id.*

business should be subject to regulation, but that the sale of fifty-one percent should not.[30] The court's final argument was that "by choosing to deal in stock, the parties may have created an expectation, deserving of some consideration, that the securities laws would apply."[31] In sum, the statutory and policy considerations behind section 10(b) caused the court to conclude that there is no reason to exempt the sale of a controlling stock interest in a business from the scope of the Exchange Act.[32]

The Fifth Circuit's decision in *Daily* is unique in several respects. Its interpretation and application of the *Howey* test has both clarified and limited an area of securities law which, prior to *Daily*, had been left open in the Fifth Circuit. Although its decision is at variance with that reached in other circuits,[33] there is currently no indication that either view will be preferred by the Supreme Court when the question arises.[34] The importance of the decision is obvious. It signifies that the Fifth Circuit has taken a literal approach toward the enforcement of the securities laws. The criteria it adopted are practical and easy to apply. Thus, the practicing attorney should be better able to predict the probable result in any proposed transaction. One seemingly inconsistent result of the court's decision is that it effectively opens the door to an area of securities litigation which other circuits have closed.

II. THE PURCHASE OR SALE REQUIREMENT UNDER SECTION 10(b)

For a plaintiff to have standing to maintain a private action under section 10(b) of the Exchange Act, two essential elements must exist.[35] First, the plaintiff must qualify as an actual purchaser

30. *Id.* at 503-04.

31. *Id.* at 503.

32. *See id.*

33. *See supra* text accompanying notes 7-15.

34. The court in *Daily* noted that there is language in *Forman* which supports both sides of the issue. 701 F.2d at 499. Although the *Forman* court did state that the *Howey* test embodied the "essential attributes that run through all of the Court's decisions defining a security," 421 U.S. at 852, it also stated that:

> There may be occasions when the use of a traditional name such as stocks or bonds will lead a purchaser justifiably to assume that the federal securities law apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument.

Id. at 850-51.

35. Although a plaintiff need only demonstrate that there has been a purchase or sale

or seller of securities,[36] and second, there must have been a purchase or sale of securities.[37] In *Rathborne v. Rathborne*,[38] a case decided during this survey period, the issues before the Fifth Circuit were whether a stock for assets exchange between affiliated corporations would qualify as a purchase or sale under section 10(b) and whether the recipient of stock distributed subsequent to a stock for assets exchange would qualify as a purchaser.[39]

The plaintiff in *Rathborne* was a shareholder in Rathborne Land Company (RLC), a closely held family owned corporation engaged in the real estate business.[40] A majority of RLC's shareholders agreed to create a new corporation and to distribute RLC property previously developed to the new corporation, Rathborne Properties Inc. (RPI), in exchange for stock from RPI.[41] After the exchange, RLC distributed the newly acquired RPI stock to its own shareholders, including the plaintiff, in a pro rata distribution.[42] Thereafter, the plaintiff instituted a section 10(b) claim alleging that there had been a fraud in connection with the purchase or sale of a security.[43] Facing the defendant's arguments that the transaction

---

of securities, *see infra* note 37, and that he is a purchaser or seller, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731 (1975), in order to have standing to assert a § 10(b) claim, a number of additional elements must be established to prove a violation of § 10(b). In order "[t]o violate Rule 10b-5 . . . , a person must (1) employ a device, scheme, or artifice to defraud or engage in a course of business that operates as a fraud (2) with scienter (3) on which the plaintiff relied (4) that proximately caused his/her injury." Chemetron Corp. v. Business Funds, Inc., 682 F.2d 1149, 1163 (5th Cir. Aug. 1982), *vacated and remanded*, 103 S. Ct. 1245, *rev'd in part on remand*, No. 80-1658 (5th Cir. Oct. 31, 1983).

36. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731 (1975).

37. Herpich v. Wallace, 430 F.2d 792, 805-06 (5th Cir. 1970). "Section 10(b) and Rule 10b-5 do not proscribe all fraudulent schemes concocted to take undue advantage of investors, but only those fraudulent schemes that are employed 'in connection with the purchase or sale of any security.' " *Id.* (quoting SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1983)).

38. 683 F.2d 914 (5th Cir. Aug. 1982).

39. *Id.* at 917.

40. *Id.* at 915. Prior to the transactions which led to this litigation, RLC was a corporation engaged in the real estate business which held both improved income producing and unimproved properties. *Id.* at 915-16.

41. *Id.* at 916. The shareholders of RLC wanted to develop the unimproved land held by RLC but did not want to encumber the income producing properties which the corporation owned. Therefore, a majority of the shareholders voted to distribute the income producing properties to RPI. Once this was done, the developed properties were effectively beyond the reach of RLC's creditors. *Id.* at 915 n.1.

42. *Id.* at 916.

43. The plaintiff based his contention on two different grounds. First, he alleged that because RPI was not, under the tax laws, classified as a personal holding company as was RLC, it would not be required to distribute its current income to its shareholders. Thus, the plaintiff was in fear that he would not receive dividend payments as he had with RLC. *Id.*

did not involve a purchase or sale and that the plaintiff was not a purchaser or seller, the plaintiff contended that the stock for assets exchange and the pro rata distribution of newly acquired RPI stock constituted purchases or sales.[44] Additionally, he alleged that as a recipient of the stock, he was a purchaser of securities.[45] The Fifth Circuit rejected all of these contentions and affirmed the trial court's dismissal of the plaintiff's complaint.[46]

The Fifth Circuit held that a stock for assets exchange between related corporations does not constitute a statutory purchase or sale transaction.[47] It noted that although "[a]n arm's-length stock-for-assets exchange between two distinct and independent corporations [would] constitute a purchase or sale," the transfer at issue "was a mere 'transfer between corporate pockets,' " and as such did not meet the statutory requirements.[48] The court then rejected the argument that the transfer of RPI stock from RLC to its shareholders was a purchase or sale.[49] It recognized that in some instances such a transfer would satisfy the statutory requirements, but noted that this result would ensue only when the transfer caused "a fundamental change in the nature of the plaintiff's investment."[50] Hence, if "the transaction has transformed the plaintiff into the functional equivalent of a purchaser or seller [that is, if] the plaintiff has been forced to exchange his stock for shares representing a participation in a substantially different enterprise," then the distribution of stock to the shareholders would constitute a qualifying transaction.[51] Because Rathborne "continued to possess the same proportionate interests in the same enterprises, with the same assets, and the same prospects," the transfer of RPI stock to him did not constitute a sale

at 916 n.2. His second argument was that a special bonus provision in RLC's management contracts would be prematurely triggered if RLC distributed property to RPI. The effect of this, he argued, was to enable one of RLC's management personnel who was near retirement to collect a sum he would not have otherwise received. *Id.* at 916 n.6.

44. *Id.* at 917-18.

45. *Id.*

46. *Id.* at 921. The district court had dismissed the plaintiff's § 10(b) claim on the ground that Rathborne was neither a purchaser nor seller of securities and consequently did not have standing to assert a claim. Rathborne v. Rathborne, 508 F. Supp. 515, 517 (E.D. La. 1980).

47. 683 F.2d at 918.

48. *Id.* at 919.

49. *Id.* at 918-19.

50. *Id.* at 920.

51. *Id.*

or purchase.[52] Finally, the court noted, because neither the stock for assets exchange nor the transfer of RPI stock from RLC to Rathborne qualified as a purchase or sale, Rathborne did not qualify as an actual purchaser or seller under section 10(b).[53]

Although the Fifth Circuit's opinion in *Rathborne* is well reasoned, there appears to exist an ambiguity in the manner in which the court reached its decision. To illustrate, the court cited the Second Circuit's decision in *International Controls Corp. v. Vesco*[54] as authority for holding that a transfer of stock from a subsidiary corporation to its parent did not constitute a statutory purchase or sale.[55] The Second Circuit in *Vesco* held that a stock for assets exchange between affiliated corporations did not constitute a purchase or sale transaction.[56] However, it also held that an in-kind distribution of stock in a wholly owned subsidiary from the parent corporation to the shareholder was a qualifying transaction.[57] Thus, under *Vesco* the distribution of RPI stock to Rathborne would have qualified as a purchase or sale. However, the Fifth Circuit disregarded *Vesco* on this issue and held that the transfer of stock from a corporation to its shareholders did not qualify.[58] As support for the holding that the transaction would qualify only if the distribution "[h]as wrought a fundamental change in the nature of the plaintiff's investment," the court cited two district court cases.[59]

If the Fifth Circuit desired to be consistent, it should have followed *Vesco* on both issues and held that the stock distribution was a qualifying transaction. Instead, it adopted the fundamental change test and established precedent for the classification of a transaction as a purchase or sale for purposes of section 10(b).[60] Because there is no apparent reason for this inconsistency, the court's decision may be explained in part by its realization that Rathborne was a minority shareholder in a closely held corporation.[61] The court, in strong language, stated that the "[Securities] Act does not

52. *Id.*
53. *Id.* at 921.
54. 490 F.2d 1334 (2d Cir. 1974).
55. 683 F.2d at 918-19.
56. 490 F.2d at 1343.
57. *Id.* at 1345.
58. 683 F.2d at 919-20.
59. *Id.* at 920 (citing Watts v. Des Moines Register & Tribune, 525 F. Supp. 1311, 1318 (S.D. Iowa 1981); McCloskey v. McCloskey, 450 F. Supp. 991, 995 (E.D. Pa. 1978)).
60. 683 F.2d at 919-20.
61. *See id.* at 921. The court stated, "[m]ajoritarian autocracy, even when exercised in

vest minority shareholders with the power to veto corporate decisions."[62] Thus, although the court has apparently excluded a category of transactions from the purview of section 10(b), in light of recent intimations by the Supreme Court to the effect that section 10(b) should be liberally applied in order to effectuate its broad remedial purposes,[63] it is possible that the fundamental change test will be used primarily as an avenue for detouring claims which the court may consider to be marginal.

III. Implied Private Remedies Under the Securities Acts

Although there are several express private remedies set forth in both the Securities Act and in the Exchange Act for persons injured in securities transactions,[64] a large number of the private actions instituted under the acts are based upon implied rights of action allowed by the courts in their interpretation and application of the securities laws.[65] During the survey period, the Fifth Circuit addressed two cases in which implied rights of action were involved. One case involved the availability of an implied private remedy under section 17(a) of the Securities Act.[66] In the second case the court was required to determine whether an implied private remedy was available under section 10(b) of the Exchange Act when there existed an express remedy applicable to the same conduct.[67]

A. *Implied Private Right of Action Under Section 17(a) of the Securities Act*

Heretofore, neither the Fifth Circuit nor the Supreme Court has firmly decided whether there exists an implied private right of

---

a maleficent manner, will not give rise to 10b-5 liability unless there has been wrongdoing in connection with the purchase or sale of a security." *Id.*

62. *Id.*

63. Herman & MacLean v. Huddleston, 103 S. Ct. 683 (1983).

64. In general, express civil liabilities are set forth in §§ 11, 12, and 15 of the Securities Act of 1933. 15 U.S.C. §§ 77k, 77l, 77o (1982). Express civil liabilities are set forth under §§ 9, 16, and 18 of the Exchange Act. 15 U.S.C. §§ 78i, 78p, 78r (1982).

65. *See* FEDERAL SECURITIES CODE (Proposed 1978). Although implied private remedies have been allowed under various sections of the securities acts, the most common provision under which such remedies have been allowed are §§ 10(b), 13, and 14(a) of the Exchange Act. 15 U.S.C. §§ 78j(b), 78m, 78n (1982).

66. Landry v. All Am. Assurance Co., 688 F.2d 381 (5th Cir. Oct. 1982).

67. Chemetron Corp. v. Business Funds, Inc., 682 F.2d 1149 (5th Cir. Aug. 1982), *vacated and remanded*, 103 S. Ct. 1245, *rev'd in part on remand*, No. 80-1658 (5th Cir. Oct. 31, 1983).

action for violations of section 17(a) of the Securities Act of 1933.[68] Although the Court has set forth a four part test for use in determining when an implied remedy is available to those injured by violations of the securities acts, it declined to apply the test in the context of section 17(a).[69] The test, as stated in *Cort v. Ash*,[70] involves a determination of congressional intent, but more specifically, it entails a determination of the following: Whether the plaintiff is one of the special class for whose benefit the statute was enacted, whether there is any indication of legislative intent to create or deny an implied remedy, whether it is consistent with the legislative scheme to imply such a remedy, and whether the cause of action is one traditionally relegated to state law.[71] Notwithstanding the fact that the Court has strictly applied this test,[72] it recently emphasized that implied private remedies are necessary in order to effectuate the broad remedial purposes of the securities acts, particularly in the area of fraud.[73]

During the survey period in *Landry v. All American Assurance Co.*,[74] the Fifth Circuit concluded that an implied private remedy was not available under section 17(a) of the Securities Act.[75] The plaintiffs in *Landry* invested approximately $270,000 in a bank and trust company in Saint Charles, Louisiana.[76] Within two years after the date of their initial investment, the value of the stock which they purchased had decreased to $18,000.[77] The plaintiffs, outraged by

68. *See* Landry v. All Am. Assurance Co., 688 F.2d 381, 384 & nn.8-9 (5th Cir. Oct. 1982); 15 U.S.C. § 77q(a) (1982). Section 17(a) of the Securities Act is worded very similarly to § 10(b) of the Exchange Act. It provides that:

> It shall be unlawful for any person in the offer or sale of securities by the use of any means or instruments of transportation or communication in interstate commerce or by the mails, directly or indirectly (1) to employ any device, scheme, or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon the purchaser.

Id.

69. *See* Landry v. All Am. Assurance Co., 688 F.2d 381, 384 n.8 (5th Cir. Oct. 1982).
70. 422 U.S. 66 (1975).
71. *Id.* at 78.
72. *See* Touche Ross & Co. v. Redington, 442 U.S. 560 (1979).
73. Herman & Maclean v. Huddleston, 103 S. Ct. 683, 689 (1983).
74. 688 F.2d 381 (5th Cir. Dec. 1982).
75. *Id.* at 391.
76. *Id.* at 382.
77. *Id.* at 383.

the results of their investment, filed suit on a number of theories including one claim under section 17(a).[78]

In denying the plaintiffs an implied private remedy, the Fifth Circuit applied the *Cort* test beginning with an examination of the statutory language itself, the first *Cort* factor.[79] It held that "[o]n its face, [section] 17(a) does not appear to . . . suggest a private cause of action. The statute merely represents a general censure of fraudulent practices . . . ."[80] With regard to the second factor, legislative history, the court determined that because the history makes no mention of civil liability, a private remedy was apparently not intended.[81] Using the third *Cort* factor, the court attempted to discern whether it was consistent with the legislative scheme to imply such a remedy.[82] It noted that sections 11 and 12(2) of the Securities Act[83] prohibited the same type of conduct as did section 17(a) and that both sections set forth express civil liabilities for their violation.[84] Accordingly, the court concluded, "[t]he creation of an implied cause of action [under section] 17(a) . . would effectively frustrate the carefully laid framework of the Act."[85] The only factor in the plaintiff's favor was that private remedies in this area were not matters traditionally relegated to state law.[86] However, it was determined that the importance of this factor was not sufficient to compel the implication of a private remedy.[87] Rather, if the language, the legislative history, and the legislative scheme indicate that Congress did not intend to imply a remedy, the "courts need not determine whether an implied private right is a cause of action traditionally

78. *Id.*

79. *Id.* at 389.

80. *Id.* The plaintiffs asserted that the defendants had prepared financial statements which "were inaccurate and grossly misrepresented [the bank's] financial condition. Furthermore, it was asserted that representations made by the various defendants at advisory board meetings and elsewhere were affirmatively misleading, inaccurate and omitted material information." *Id.* at 383. The lower court denied them relief upon these allegations. *Id.*

81. *Id.* at 389-90.

82. *Id.* at 390.

83. 15 U.S.C. §§ 77l, 77m (1982).

84. 688 F.2d at 390.

85. *Id.* In support of this statement, the court noted that Congress had set forth strict procedural requirements for actions under §§ 11 and 12(2) and that these restrictions would not be applicable to a private remedy implied under § 17(a). Because all of these sections prohibited basically the same type of conduct, the court saw no reason to imply a private remedy under § 17(a). *Id.* at 390 & n.37.

86. *Id.* at 390-91.

87. *See id.*

relegated to state law."[88]

Prior to *Landry* it was an open question in the Fifth Circuit whether an implied private remedy was available under section 17(a) of the Securities Act. Because section 17(a) prohibits essentially the same conduct as does section 10(b) of the Exchange Act for which the courts have long recognized an implied remedy,[89] there would appear to be little need to imply a remedy under section 17(a) as well. However, a plaintiff under section 10(b) must prove scienter on the part of the defendant before a private action will be successful.[90] Although scienter is required under section 17(a)(1), it is not required under sections 17(a)(2) or (a)(3).[91] Therefore, had an implied private remedy been allowed under section 17(a), the scienter requirement of section 10(b) would have effectively been nullified. As a result of *Landry*, private plaintiffs hereafter must proceed under section 10(b) of the Exchange Act and continue to face the scienter requirement in order to recover for injuries sustained as a result of material misstatements or omissions in purchase or sale transactions.

B. *Implied Private Remedies Under Section 10(b) of the Exchange Act*

It is no longer doubted that there exists under section 10(b) and rule 10b-5 of the Exchange Act (collectively section 10(b)) an implied private remedy for fraud perpetrated in connection with the purchase or sale of a security.[92] However, it has often been questioned whether an implied remedy is available under section 10(b) when there also exists an express remedy under some other provision of the securities acts.[93] The Supreme Court recently addressed this concern in *Herman & MacLean v. Huddleston*.[94] The specific issue in *Huddleston* was whether a private remedy would be implied under section 10(b) when there existed under section 11 of the Se-

88. *Id.* at 388.

89. *See* 442 U.S. at 577 n.19.

90. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194-214 (1976).

91. Aaron v. SEC, 446 U.S. 680, 697 (1980).

92. *See* Herman & MacLean v. Huddleston, 103 S. Ct. 683, 689 (1983).

93. *See id.* at 686; Chemetron Corp. v. Business Funds, Inc., 682 F.2d 1149, 1157-58 (5th Cir. Aug. 1982), *vacated and remanded*, 103 S. Ct. 1245, rev'd in part on remand, No. 80-1658 (5th Cir. Oct. 31, 1983).

94. 103 S. Ct. 683 (1983).

curities Act[95] an express private remedy for the conduct which was the subject of the plaintiff's complaint.[96] The Court held that, notwithstanding the fact that the plaintiff's burden was lighter under section 11 and that an implied private remedy under section 10(b) would cause some overlap, it could "see no reason to carve out an exception to [s]ection 10(b) . . . just because the same conduct may also be actionable under [s]ection 11."[97]

In *Chemetron Corp. v. Business Funds, Inc.*,[98] a case of first impression in the Fifth Circuit, the court was called upon to determine whether a private right of action under section 10(b) was available when there existed an express private right of action under section 9 of the Exchange Act.[99] The defendants in *Chemetron*, Business Funds, Inc. (BFI), were in the business of loaning venture capital to companies in exchange for stock warrants in those companies.[100] Westec, a company listed on the American Stock Exchange, was one of the companies to which BFI loaned money.[101] In an attempt to raise the market value of the Westec stock, BFI masterminded a stock manipulation scheme in which BFI insiders and subsidiaries purchased or committed to purchase large amounts of Westec stock.[102] While this stock manipulation was occurring, Chemetron Corporation (Chemetron) became involved in negotiations with Westec which led to the acquisition by Westec of a Chemetron subsidiary.[103] Chemetron received shares of Westec stock in exchange for its interest in the subsidiary.[104] Shortly thereafter, one of the Westec stock purchases which the BFI insiders had arranged fell through.[105] Chemetron learned of the stock manipulation scheme and reported this information to the Securities and Exchange Commission.[106] Westec was forced into reorganization.[107] Chemetron

95. 15 U.S.C. § 77k (1982).
96. 103 S. Ct. at 685.
97. *Id.* at 688.
98. 682 F.2d 1149 (5th Cir. Aug. 1982), *vacated and remanded*, 103 S. Ct. 1245, *rev'd in part on remand*, No. 80-1658 (5th Cir. Oct. 31, 1983).
99. 682 F.2d at 1157. *See* 15 U.S.C. § 78i (1982).
100. 682 F.2d at 1154.
101. *Id.*
102. *Id.*
103. *Id.* at 1154-55.
104. *Id.* at 1155.
105. *Id.*
106. *Id.*
107. *Id.*

then instituted this suit under sections 9 and 10(b) of the Exchange Act alleging that BFI illegally manipulated stock prices and also failed to disclose this fact or made misleading statements concerning the scheme.[108] In the lower court the express remedy under section 9 for stock manipulation was denied by the jury.[109] However, judgment was entered for Chemetron on its section 10(b) claim.[110]

On appeal, the Fifth Circuit held that an implied private remedy under section 10(b) was not available when an express remedy existed under section 9 for the same conduct.[111] The court held that because the section 9 requirements were much stricter than the requirements for successfully maintaining an action under section 10(b),[112] allowing an implied remedy under section 10(b) would "impermissibly broaden the section 9 remedy by nullifying its restrictions in defiance of . . . congressional mandate."[113] Consequently, to imply a remedy under section 10(b) in the face of a restrictive section 9 remedy would clearly be to go beyond Congress' intent in creating such an express remedy.

Although the court's decision in *Chemetron* clearly indicates that it will examine with scrutiny the attempts of securities claimants to impose liability upon defendants in litigation arising under the securities laws, the decision itself is of no precedential value. Subsequent to the circuit's decision, the Supreme Court vacated and remanded *Chemetron* for reconsideration in light of *Huddleston*.[114] On remand, the Fifth Circuit reversed that portion of its opinion in which it had denied the availability of an implied private action under section 10(b).[115] Consequently, *Chemetron* can only be used as a guide for estimating the probable course the Fifth Circuit will take in securities claims hereafter.

---

108. *Id.*

109. *See id.* at 1157. "[T]he jury found that Chemetron had not proven that the stock scheme 'affected' the price it paid for Westec stock, a necessary element of a section 9 claim, *see* section 9(e), 15 U.S.C. §78i(e)." *Id.*

110. *See id.*

111. *Id.* at 1169-70.

112. According to the court, causation is easier to prove under § 10(b); the scienter requirement is lighter; there exists a presumption of reliance under § 10(b) which does not exist under § 9; and § 9 requires a finding of intent to induce which is not required under § 10(b). *Id.* at 1165.

113. *Id.* at 1159.

114. 103 S. Ct. 1245 (1983).

115. Chemetron Corp. v. Business Funds, Inc. No. 80-1658 (5th Cir. Oct. 31, 1983).

IV. CONCLUSION

It is apparent from the Fifth Circuit's decisions during the survey period that the court took a conservative approach towards interpretation and application of the federal securities laws. Although in *Daily* the court did appear to open the door to one area of securities litigation by holding inapplicable the sale of business doctrine, it is clear from the court's other decisions that it will show little reluctance to deny standing to securities claimants hereafter. To illustrate, the court in *Rathborne* denied section 10(b) standing to an individual whose investment underwent a series of changes which clearly could have been fraudulent as to him and worthy of compensation. In *Landry* the court held that implied private remedies were not available under section 17(a) of the Securities Act. In *Chemetron*, although remanded by the Supreme Court and subsequently reversed in part by the Fifth Circuit, the court denied the existence of an implied private remedy under section 10(b) for conduct which also provided a plaintiff with a more restrictive express remedy under some other provision of the Act. If the court continues to follow the trend in these decisions, a foreboding future for securities claimants is likely.

David M. Tatum