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Recent Developments

RECENT DEVELOPMENTS

Antitrust—Extraterritorial Jurisdiction Under the Effects Doctrine—A Conflicts Approach.—In 1971 Timberlane Lumber Company, an Oregon partnership importing lumber into the United States, formed two new companies in Honduras in order to secure additional supplies of lumber for its United States operations. The Bank of America Corp., through its wholly owned subsidiary, Bank of America National Trust and Savings Association, had significant financial interests in three Honduran lumber mills, one of which, Lima Company, was in financial trouble. When Lima dissolved, its employees, according to Honduran law, had first claim to the company's assets for back wages and severance pay. Seeing an opportunity to acquire equipment for its second company, Timberlane purchased the Lima plant assets from the employees and reactivated the mill in competition with the other two lumber companies in which the Bank of America was interested. To quiet title, Timberlane attempted to settle the Bank's claim on Lima's assets, but the Bank refused and its agent, to whom the claim had been assigned, went to the Honduran court and obtained embargoes of the property of Timberlane's companies in Honduras, ostensibly to prevent the diminution in available assets from which the Bank's claim might be satisfied.[1] Thereafter, in an action in federal court, Timberlane alleged that this act and other acts of harassment constituted a conspiracy in restraint of trade in violation of sections 1 and 2 of the Sherman Act[2] and section 73 of the Wilson Tariff Act,[3] that the acts had a "direct and substantial effect on United States foreign commerce, and that defendants intended the results of the conspiracy, including the impact on United States commerce."[4] The district court dismissed the action for lack of subject matter jurisdiction and Timberlane appealed to the Ninth Circuit Court of Appeals. *Timberlane Lumber Company v. Bank of America, N.T. & S.A.*, 549 F.2d 597 (9th Cir. 1977).

The Sherman Act[5] condemns all contracts, combinations, and monopolies in restraint of trade both "among the several States" and "with foreign nations."[6] One of the most complex questions in the area of antitrust law is the practical application of the statutory grant of subject matter jurisdiction over activities involving foreign commerce. The extension of United States law to persons and activities beyond its own territorial boundaries must be carefully analyzed under the principles of international law to avoid conflicts

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1. Timberlane Lumber Co. v. Bank of America, N.T. & S.A., 549 F.2d 597, 604-05 (9th Cir. 1977).
2. 15 U.S.C. §§ 1 & 2 (Supp. V 1975).
3. 15 U.S.C. § 8 (1970).
4. 549 F.2d at 605.
5. 15 U.S.C. §§ 1-7 (Supp. V 1975).
6. *Id.* §§ 1 & 2.

with foreign sovereignties. To do this, one must distinguish "jurisdictional power" from "jurisdictional policy."[7]

I. TRADITIONAL THEORIES OF JURISDICTION

International law is comprised of basic principles that have evolved over the passage of time.[8] Under these principles there are four traditionally accepted theories by which one country may assert subject matter jurisdiction over activities occurring both within and without its borders. The most widely recognized theory of jurisdiction is based on territoriality.[9] Under this theory all acts must be governed by the law of the nation in which they occur, and each nation has jurisdiction over any acts which occur within its territory.[10] A second principle, recognized primarily by civil law countries, is that nations may assert jurisdiction over the acts of their own citizens, wherever they may be.[11] Two nations can, accordingly, have subject matter jurisdiction over the same activity. Nations may also assert jurisdiction under the "protective principle"[12] theory over activities that threaten the security of the nation, regardless of where they occur. The fourth and final traditional basis of jurisdiction is the "universality principle."[13] This principle permits the exercise of jurisdiction over acts of any nation's citizens which are universally condemned by the civilized world, such as acts of piracy. However, only nations which share the United States' advocacy of a competitive economic system will encourage the enforcement of laws prohibiting anticompetitive activities. These activities are therefore not universally condemned acts. Thus, the universality principle cannot serve as a basis for the extraterritorial application of the United States antitrust laws.[14]

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7. K. Brewster, Jr., Antitrust and American Business Abroad 286 (1958) [hereinafter cited as Brewster].

8. *See generally* J. Rahl, Common Market and American Antitrust 409-16 (1970) [hereinafter cited as Rahl].

9. Restatement (Second) of Foreign Relations Law § 17 (1965) [hereinafter cited as Restatement]; *see* W. Fugate, Foreign Commerce and the Antitrust Laws 34-35 (2d ed. 1958) [hereinafter cited as Fugate]; Haight, *International Law and Extraterritorial Application of the Antitrust Laws*, 63 Yale L.J. 639 (1954); Metzger, *The Restatement of the Foreign Relations Law of the United States: Bases and Conflicts of Jurisdiction*, 41 N.Y.U.L. Rev. 7, 11-18 (1966).

10. This theory is exemplified in the antitrust area by American Banana Co. v. United Fruit Co., 213 U.S. 347 (1909). The decision in *American Banana* restricted the assertion of jurisdiction to those activities which occurred in the United States. "[T]he general and almost universal rule is that the character of an act as lawful or unlawful must be determined wholly by the law of the country where the act is done." *Id.* at 356; *see* Rahl, *supra* note 8, at 373.

11. Branch v. FTC, 141 F.2d 31, 35 (7th Cir. 1944); Restatement, *supra* note 9, § 30; W. Bishop, Jr., International Law 343 (1953); *see* Rahl, *supra* note 8, at 394.

12. Restatement, *supra* note 9, § 33; *see* Rahl, *supra* note 8, at 398. *See also* Article 6, Principles of International Law, as adopted by the International Law Association, Report of the Fifty-fifth Conference of the International Law Association 139 (1974).

13. Restatement, *supra* note 9, § 34, Reporter's Note 2.

14. *See* Brewster, *supra* note 7, at 287; Haight, *International Law and Extraterritorial Application of the Antitrust Laws*, 63 Yale L.J. 639, 651-52 (1954).

II. THE EFFECTS DOCTRINE

In order to reach the activities of foreigners abroad, yet another basis of jurisdiction, the "effects doctrine,"[15] has evolved. The effects doctrine was first introduced in antitrust law by the opinion of Judge Learned Hand in *United States v. Aluminum Co. of America*[16] (*Alcoa*), in which it was stated that acts committed by aliens outside of the territorial United States are within the subject matter jurisdiction of the courts under the Sherman Act "if they were intended to affect [foreign commerce] and did affect [it]."[17]

Since it was first introduced, the effects doctrine has received a great deal of criticism for risking " 'conflicts with foreign laws and foreign economic interests . . . , conflicts that might better be resolved through diplomatic channels.' "[18] Indeed, several foreign nations have made formal complaints against its application.[19]

In spite of the possibility of conflict with foreign nations, the effects doctrine has been recognized as the law of the United States,[20] and its elements are outlined in section 18 of the Restatement of the Foreign Relations Law,[21] which requires

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15. *See* Fugate, *supra* note 9, at 37. For a review of the international antitrust cases, see Kintner & Hallgarten, *Application of United States Antitrust Laws to Foreign Trade and Commerce—Variations on American Banana Since 1909*, 15 B.C. Indus. & Com. L. Rev. 343 (1973); Simson, *The Return of American Banana: A Contemporary Perspective on American Antitrust Abroad*, 9 J. Int'l L. & Econ. 233 (1974). For applications of the effects doctrine in other areas of the law, see note 86 *infra*.

16. 148 F.2d 416 (2d Cir. 1945); *see* Brewster, *supra* note 7, at 72-73.

17. 148 F.2d at 444.

18. Fugate, *supra* note 9, at 72 (quoting from *Hearings on S. Res. 26 Before the Subcomm. on Antitrust and Monopoly of the Senate Judiciary Comm.*, 90th Cong., 1st Sess., 236 (1967)).

19. Objections from foreign governments have most often been made in connection with discovery proceedings in the United States directing production of documents held by corporations based in foreign nations. *See* ABA, Antitrust Law Developments 370-73 (1975); Fugate, *supra* note 9, at 50 n.28; A. Neale, The Antitrust Laws of the United States of America 365-72 (1970); Zwarensteyn, *The Foreign Reach of the American Antitrust Laws*, 3 Am. Bus. L.J. 163, 167-70 (1965).

20. The effects doctrine of jurisdiction has also been accepted by the European Economic Community and is used to assert jurisdiction over restrictive acts that have an effect within the Common Market. Dyestuffs, [1965-1969 Transfer Binder] Comm. Mkt. Rep. (CCH) ¶ 9314, at 8694 (Comm'n 1969).

21. "A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if either

(a) the conduct and its effect are generally recognized as constituent elements of a crime or tort under the law of states that have reasonably developed legal systems, or

(b)(i) the conduct and its effect are constituent elements of activity to which the rule applies; (ii) the effect within the territory is substantial; (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and (iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems." Restatement, *supra* note 9, § 18.

Comment g to § 18 states that it is not necessary that other nations with reasonably developed legal systems be found to have similar laws in order for it to be found that the United States antitrust laws are not inconsistent with the principles of justice mentioned in § 18(b)(iv). *See generally*

that the effect be "substantial" and that it occur as a "direct and foreseeable result of the conduct outside the territory." The alleged wrong must therefore be an act, the direct and foreseeable result of which is a substantial effect upon United States foreign commerce. There need be no actual intent, however, to violate the antitrust laws.[22] In fact, a foreigner might violate these laws without fully understanding them or, in an extreme case, without even knowing they exist.[23]

Since the decision in *Alcoa*,[24] many commentators have recommended that a "conflicts of laws" approach be taken in applying the effects test to eliminate possible friction with foreign nations.[25] With *Timberlane*, a court has finally adopted this approach. It is interesting to note that although there were acts within the territorial United States[26] which might have served as a basis for jurisdiction under the territorial theory, the court drew on the effects doctrine to obtain jurisdiction. Apparently the court had recognized the shortcomings of the effects doctrine as it had hitherto been applied and took advantage of this opportunity to clarify and restate it.

The district court, in applying the "direct and substantial" test of the Restatement,[27] which had been officially adopted by the International Law Association in 1974,[28] had simply held that "there [was] no direct and substantial effect on United States foreign commerce,"[29] and had dismissed the case for lack of subject matter jurisdiction.

Judge Choy, author of the court of appeals' opinion, however, reviewed the effects doctrine and the variety of standards utilized by different courts and writers to determine how great an effect is needed to support jurisdiction. In *United States v. General Electric Co.*,[30] for example, the court had required that

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Metzger, *The Restatement of the Foreign Relations Law of the United States: Bases and Conflicts of Jurisdiction*, 41 N.Y.U.L. Rev. 7, 12-18 (1966).

22. United States v. General Elec. Co., 82 F. Supp. 753, 891 (D.N.J. 1949); *see* E. Kintner & M. Joelson, An International Antitrust Primer 27-28 (1974).

23. This position seems to be suggested by E. Kintner & M. Joelson, An International Antitrust Primer 27-28 (1974), as well as by Fugate, *supra* note 9, at 48, although there has been no case on point. Generally, it may be assumed that any corporation so large that its practices would be found to have an effect on United States foreign commerce would be well aware of the antitrust laws.

24. 148 F.2d 416 (2d Cir. 1945).

25. *See, e.g.*, Brewster, *supra* note 7, at 445-56 (suggesting a "jurisdictional rule of reason"); Victor, *Multinational Corporations: Antitrust Extraterritoriality and the Prospect of Immunity*, 8 J. Int'l L. & Econ. 11, 28-29 & n.69 (1973). *See generally* Rahl, *supra* note 8. For a discussion of the implications of a conflicts approach, see Katzenbach, *Conflicts on an Unruly Horse: Reciprocal Claims and Tolerances in Interstate and International Law*, 65 Yale L.J. 1087 (1956).

26. The facts indicated that the conspiracy may have been directed from San Francisco. 549 F.2d at 615. If so, such activities would constitute acts sufficient to support a finding of jurisdiction under the territorial theory. *See* United States v. Sisal Sales Corp., 274 U.S. 268, 276 (1927).

27. Restatement, *supra* note 9, § 18(b)(ii) & (iii); *see* note 9 *supra*.

28. Report of the Fifty-fifth Conference of the International Law Association 139 (1974). The International Law Association is an association of lawyers with members from various countries who meet regularly to discuss areas of concern in the field of international law.

29. 549 F.2d at 601 (quoting from the opinion of the district court).

30. 82 F. Supp. 753 (D.N.J. 1949).

the effects be direct *and* substantial,[31] whereas a more recent case held that the effects were sufficient if they were either direct *or* substantial.[32] *Alcoa*, on the other hand, required a finding that the violators had intended to affect and had actually affected foreign commerce.[33] One commentator has even suggested that there need not be any effect on commerce as long as the act occurs in the course of foreign commerce.[34] In addition to this confusion over the proper test for effects, there was also the difficulty of defining "substantial."

The effects test was not, however, merely ill-defined. Judge Choy pointed out that the effects test, as hitherto applied by the courts, was "by itself . . . incomplete,"[35] and did not show the proper regard for the sovereignty of other nations:[36] "[I]t is evident," he wrote, "that at some point the interests of the United States are too weak and the foreign harmony incentive for restraint too strong to justify an extraterritorial assertion of jurisdiction."[37] Another approach was clearly called for.

III. The Tripartite Analysis

In place of the Restatement test, *Timberlane* has proposed the following tripartite analysis[38] for all cases involving the extraterritorial reach of the antitrust laws:

> [1] Does the alleged restraint affect, or was it intended to affect, the foreign commerce of the United States?
>
> [2] Is it of such a type and magnitude so as to be cognizable as a violation of the Sherman Act?
>
> [3] As a matter of international comity and fairness, should the extraterritorial jurisdiction of the United States be asserted to cover it?[39]

A major change in approach suggested by the first two questions of the analysis is separating the consideration of subject matter jurisdiction from the considera-

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31. *Id.* at 891. *See also* Fugate, *supra* note 9, at 30; E. Kintner & M. Joelson, An International Antitrust Primer 26 (1974); Article 5, Principles of International Law, as adopted by the International Law Association, Report of the Fifty-fifth Conference of the International Law Association 139 (1974).

32. Occidental Petroleum Corp. v. Buttes Gas & Oil Co., 331 F. Supp. 92, 102-03 (C.D. Cal. 1971), *aff'd on other grounds per curiam*, 461 F.2d 1261 (9th Cir.), *cert. denied*, 409 U.S. 950 (1972).

33. United States v. Aluminum Co. of America, 148 F.2d 416, 444 (2d Cir. 1945). *See also* ABA, Antitrust Law Developments 360 (1975).

34. Rahl, *Foreign Commerce Jurisdiction of the American Antitrust Laws*, 43 Antitrust L.J. 521, 523 (1974).

35. 549 F.2d at 611.

36. *Id.* at 612.

37. *Id.* at 609.

38. Mr. Fugate had earlier proposed a similar tripartite analysis of the general question of jurisdiction. The three considerations were: (1) whether the United States has the power to deal with acts outside its borders, (2) whether Congress has the power to make laws granting such jurisdiction under the Constitution, and (3) whether Congress intended that the antitrust laws apply to such acts. Fugate, *supra* note 9, at 31.

39. 549 F.2d at 615.

tion of the existence of a substantive violation of the antitrust laws.[40] These two issues involve two distinct types of "effects," which, as prior cases have emphasized, require individual treatment.[41] The type of effect which the first question is designed to pinpoint is an effect on commerce, the threshold requirement for subject matter jurisdiction. The second question addresses itself to an effect on competition, the essential substantive element of any antitrust violation.[42]

A. *Jurisdictional Requirement*

Judge Choy's first question—is there an effect on foreign commerce—is in his view the sole determinant of whether subject matter jurisdiction exists. The extent, however, to which this effect must be felt to support jurisdiction has rarely been discussed even in domestic antitrust cases.[43]

Jurisdiction under the Sherman Act[44] in domestic cases must be founded upon some restraint on the flow of interstate commerce;[45] or, where purely local transactions are involved, the restraint must be shown to substantially affect interstate commerce.[46] Under this latter theory, "the test of jurisdiction is not that the 'acts complained of affect a business engaged in interstate commerce, but that the conduct complained of affects the interstate commerce of such busi-

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40. That the court was consciously separating these two questions can be inferred from the changes made in the *Timberlane* opinion before it was published. In the slip opinion, the section dealing with the effects doctrine was entitled *Subject Matter Jurisdiction*, and there was no reference in the section to the tripartite analysis. In the amended opinion, this section is entitled the *Extraterritorial Reach of the United States Antitrust Laws* and encompasses not only subject matter jurisdiction, but also an examination of the effects needed to state a claim and a conflicts approach to be taken by courts to determine whether jurisdiction should be exercised. The primary purpose of the amended opinion was to clarify these three parts to the analysis of the case. The change in title from the slip opinion to the amended opinion emphasizes that the tripartite analysis is not limited to the issue of subject matter jurisdiction. If it were it would not have been necessary to change the name of the section. Question two is not relevant to the issue of whether jurisdiction exists; it is directed at the merits of the case. *Compare* 549 F.2d at 608, 612-13 *with* Timberlane Lumber Co. v. Bank of America, N.T. & S.A., Civ. No. 74-2142, at 15, 22-23 (9th Cir. Dec. 27, 1976).

41. *See, e.g.*, Rasmussen v. American Dairy Ass'n, 472 F.2d 517, 521-22 (9th Cir. 1972), *cert. denied*, 412 U.S. 950 (1973); Occidental Petroleum Corp. v. Buttes Gas & Oil Co., 331 F. Supp. 92 (C.D. Cal. 1971), *aff'd on other grounds per curiam*, 461 F.2d 1261 (9th Cir.), *cert. denied*, 409 U.S. 950 (1972). *See also* Comment, *The Confusing World of Interstate Commerce and Jurisdiction Under the Sherman Act*, 21 Vill. L. Rev. 721, 724-25 & n.28 (1976).

42. Occidental Petroleum Corp. v. Buttes Gas & Oil Co., 331 F. Supp. 92, 102 (C.D. Cal. 1971), *aff'd on other grounds per curiam*, 461 F.2d 1261 (9th Cir.), *cert. denied*, 409 U.S. 950 (1972).

43. ABA, Antitrust Law Developments 360 (1975).

44. It should be noted that jurisdiction under the Clayton Act is limited to acts in the course of commerce. It does not extend to those which have an effect on commerce. 15 U.S.C. § 12 (1970).

45. This is known as the qualitative test for jurisdiction. *See* J. Von Kalinowski, Antitrust Laws and Trade Regulation § 5.01[1], at 5-12 & n.15 (16 Business Organizations 1977) [hereinafter cited as Von Kalinowski]. *See also id.* at 5-22 to 63.

46. This is the quantitative test for jurisdiction. *See* Von Kalinowski, *supra* note 45, § 5.01[1], at 5-14 & n.16. *See also id.* at 5-66 to 93.

ness.' "[47] The long line of constitutional cases outlining the power of the federal government under the interstate commerce clause[48] has greatly eased the burden of proving that a local act affects interstate commerce.[49] Today almost any domestic activity can be found to affect interstate commerce with the result that the domestic jurisdictional requirement of "commerce among the several States" is rarely a problem.[50]

Judge Choy's approach to jurisdiction in foreign commerce cases requiring an effect on foreign commerce closely resembles that taken in domestic cases involving local acts requiring an effect on interstate commerce. It is therefore possible to assume that courts will begin to apply the tests for effects on interstate commerce to determine whether foreign commerce has been affected in a foreign case.[51] If the *Timberlane* approach to subject matter jurisdiction is followed it is difficult to envision a foreign act which will not be deemed to have some effect upon our foreign commerce. Taken by itself, the first part of *Timberlane*'s tripartite test asserts United States jurisdictional power to a greater extent than has ever before been suggested.

The first question would further extend jurisdiction over acts which were *intended* to affect our foreign commerce, even if they did not actually affect it. This represents an unprecedented extension of jurisdictional power of the United States and seemingly reflects a confusion between basic subject matter jurisdiction and the substantive elements of Sherman Act violations. For, in a domestic case, intent to enter into an agreement in restraint of trade, that is, intent to affect *competition*, may be a violation of the Sherman Act regardless of whether the restrictive act had any actual effect on trade or competition.[52] However, mere

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47. Von Kalinowski, *supra* note 45, § 5.01[1], at 5-3

48. U.S. Const. art. I, § 8, cl. 3.

49. *See, e.g.*, Wickard v. Filburn, 317 U.S. 111 (1942). *See also* Hospital Bldg. Co. v. Trustees of Rex Hosp., 425 U.S. 738, 743 n.2 (1976); Fugate, *supra* note 9, at 39; L. Sullivan, Handbook of the Law of Antitrust 709 (1977).

50. Fugate, *supra* note 9, at 71; *see, e.g.*, United States v. Employing Plasterers Ass'n, 347 U.S. 186 (1954); Lorain Journal Co. v. United States, 342 U.S. 143 (1951); United States v. Women's Sportswear Mfr. Ass'n, 336 U.S. 460 (1949); Marriott Hotels, Inc. v. Heart of Atlanta Motel, Inc., 232 F. Supp. 270 (N.D. Ga. 1964). Generally, if a corporation uses the mails, telegraph, or telephone or purchases raw materials out of state for synthesis in state, it will be found to have sufficient ties with interstate commerce to be within the jurisdiction of the Sherman Act. *See, e.g.*, United States v. Employing Plasterers Ass'n, 347 U.S. 186, 189 (1954); United States v. Employing Lathers Ass'n, 347 U.S. 198, 200 (1954); United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533, 542 (1944).

51. The Section of Antitrust Law of the American Bar Association asserts that "[t]he relevant antitrust statutes may . . . be interpreted as broadly in determining the scope and content of 'foreign commerce' as they have been in determining the scope and content of 'interstate commerce.' Thus, the American antitrust statutes regulating foreign commerce may reach all types of activities—industrial, commercial and business—covered by domestic antitrust laws, including export and import of commodities; direct investments and acquisitions abroad; transportation and communication services; financial activities; and transactions in industrial property rights, such as patents, know-how, trademarks, and copyrights." ABA, Antitrust Law Developments 359 (1975).

52. United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 224 n.59 (1940). *See also* Brewster, *supra* note 7, at 64.

intent to affect interstate *commerce* that does not approach the state of being an actual threat, does not satisfy the jurisdictional requirement of having a substantial effect on commerce.[53]

By suggesting that an intent to affect commerce is in itself a sufficient basis for jurisdiction, Judge Choy may be relying upon the protective principle[54] which allows a nation to exercise jurisdiction to protect its interests. Under that theory an intent to injure the United States could possibly support the assertion of jurisdiction although it seems unlikely that the United States would have to protect itself from a mere intent to injure commerce. This doctrine would seem more suited to situations involving actual threats of injury. A company may intend to affect United States commerce but never engage in sufficient acts to ever threaten the well-being of the United States to the point that the United States could justify the assertion of jurisdiction to "protect" itself. The International Law Association has suggested that the protective principle of jurisdiction in antitrust cases be used under only the most exceptional of circumstances.[55]

B. *Substantive Requirements*

The second question in Judge Choy's three-step analysis—whether there is a violation of the Sherman Act—is clearly directed toward the merits of the case.[56] It presupposes that the basic requirements of subject matter jurisdiction have been met and proceeds to ask whether the facts are sufficient to state a claim under the antitrust laws.[57] In order to state a sufficient claim one must show that the acts in question have a greater impact on commerce than is required for jurisdiction. They must be shown to have anticompetitive effects in restraint of foreign trade. Judge Choy has suggested that to be considered anticompetitive the acts must result in a "cognizable injury"[58] to the plaintiffs. That is, if the act has not had a sufficient impact on commerce so as to result in some noticeable injury, it has probably not adversely affected competition. However, he did not state that there must be actual proof of injury and presumably his suggestion would not limit the applicability to foreign commerce of the *per se* rules, which create an irrebutable presumption that certain activities will result in anticompetitive effects.[59]

The opinion itself did not give any guidance for future application of the first two tests. It merely noted the allegation that the activities of the Bank of America "were intended to, and did, affect . . . the flow of United States foreign commerce,"[60] and on that basis found the requisite federal jurisdiction. As to

53. *See* L. Sullivan, Handbook of the Law of Antitrust § 233, at 710 (1977); Von Kalinowski, *supra* note 45, § 5.01[4][a], at 5-93.

54. *See* note 12 *supra* and accompanying text.

55. Report of the Fifty-fifth Conference of the International Law Association 139 (1974). The Report does not indicate what such exceptional circumstances might encompass.

56. *See* note 40 *supra*.

57. *See* Fed. R. Civ. P. 12(b)(6).

58. 549 F.2d at 613.

59. *See* Fugate, *supra* note 9, at 14-15, 174-75; L. Sullivan, Handbook of the Law of Antitrust § 234(a), at 715-16 (1977).

60. 549 F.2d at 615.

question two, Judge Choy asserted that "the magnitude of the effect alleged . . . [was] sufficient to state a claim."[61] In a footnote, however, he did suggest that those domestic antitrust cases requiring a substantial effect on commerce could "offer some guidance for determining the degree of restraint necessary to support a claim for relief in the foreign commerce context as well."[62] In making this statement, Judge Choy pointed out that in domestic intrastate cases a " 'substantial' restraint [effect on competition] [was] in any event necessary for the establishment of jurisdiction itself,"[63] and cited *Hospital Building Co. v. Trustees of Rex Hospital.*[64] This statement reflects a misreading of the case. In *Hospital Building Company*, the Supreme Court stated that in order to find jurisdiction over wholly local businesses, one must show that "the restraint in question 'substantially and adversely affects interstate commerce.' "[65] It is the effect on commerce which must be substantial;[66] there is no jurisdictional requirement in domestic cases that the restraint [effect on competition] be substantial as Judge Choy has stated.[67]

Judge Choy asserts that the separation of the jurisdictional and substantive issues which he proposes in the foreign context is not duplicated in the domestic area.[68] It may be true that in domestic intrastate cases involving purely local activities, these issues are not separately analyzed[69] but that does not mean that they are not separate issues. Both the jurisdictional and substantive issues are incorporated in the domestic jurisdictional test of "substantially affecting commerce." "Affecting commerce" is the jurisdictional requirement similar to the first question in Judge Choy's tripartite analysis for foreign cases. "Substantially" defines the necessary impact on commerce and impliedly measures the degree of restraint or effect on competition. The greater the restraint, the more substantial the effect on interstate commerce. In *Hospital Building Company*, the Court measured substantiality in terms of the number of dollars and the quantity of merchandise moving through interstate commerce.[70] Any reduction in the amount of funds expended in interstate commerce would therefore be considered

61. *Id.*

62. *Id.* at 615 n.35.

63. *Id.*

64. 425 U.S. 738 (1976). The issue of this case was whether the actions allegedly taken by a local hospital and its officers to prevent the expansion of another local hospital constituted an anticompetitive restraint substantially affecting interstate commerce. The court held that, because an increase in purchases of supplies from out of state would result from any expansion, any activities restricting such an expansion would substantially affect interstate commerce. *Id.* at 744.

65. *Id.* at 743 (quoting Gulf Oil Corp. v. Copp Paving Co., 419 U.S. 186, 195 (1974)).

66. *Id.* at 739-40.

67. *See, e.g.*, Radovich v. National Football League, 352 U.S. 445, 453 (1957); United States v. Employing Plasterers Ass'n, 347 U.S. 186, 189 (1954).

68. 549 F.2d at 615 n.35.

69. *See, e.g.*, Hospital Bldg. Co. v. Trustees of Rex Hosp., 425 U.S. 738 (1976); United States v. Employing Plasterers Ass'n, 347 U.S. 186 (1954); United States v. Employing Lathers Ass'n, 347 U.S. 198 (1954).

70. 425 U.S. at 744. *See also* United States v. Employing Plasterers Ass'n, 347 U.S. 186, 187-88 (1954).

a direct result of the restraint imposed by the anticompetitive activity. Thus, effects on competition have a direct relationship to effects on commerce.

As a result of this close relationship, the domestic cases requiring a substantial effect on interstate commerce will be helpful in analyzing Judge Choy's second question aimed at identifying the restraint which would be sufficient to state a claim.

C. *The Conflicts Approach*

To summarize *Timberlane*'s tripartite plan, test one asks whether a court can assert jurisdiction; test two asks whether a sufficient claim exists. Given these two tests alone the actual limits of United States jurisdiction would be unpredictable. Test three attempts to remedy the possibility of overextension and the resultant conflict with foreign nations by examining whether jurisdiction should be asserted once it has been recognized.

Judge Choy suggests that the word "substantial" as used in the "direct and substantial" test proposed by the Restatement for foreign commerce cases[71] serves a somewhat different purpose than it does in the "substantially affecting commerce" test for domestic cases.[72] In the "interstate context [he views the substantial effects test as necessary] to separate the restraints which fall within the federal ambit under the interstate commerce clause from those which, as purely intrastate burdens, remain the province of the states."[73] Thus, in the interstate context, federal power is defined by constitutional limits designed to protect states rights. No such constitutional limitation is present in the foreign context. However, in the foreign context more complex questions of comity must be considered in order to protect the interests of other nations.[74] Judge Choy seems to suggest that in this area substantial effects are required to be certain that the United States is not asserting jurisdiction over foreign matters without just cause.[75]

The *Timberlane* opinion attempts to eliminate this problem by applying a conflicts approach to the question of whether jurisdiction should be exercised once it has been found. This is not a completely new idea. The direct and substantial effects test outlined in section 18 of the Restatement[76] was always subject to many of the rules of comity suggested by section 40 of the Restatement.[77] Indeed, the need for some resort to comity has been generally

71. *See* note 21 *supra* and accompanying text.

72. 549 F.2d at 612.

73. *Id.*

74. *Id.* at 611-12.

75. *Id.*

76. *See* note 21 *supra*.

77. "Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as

(a) vital national interests of each of the states,

(b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,

recognized.[78] In *Alcoa,* Judge Learned Hand wrote: "[I]t is quite true that we are not to read general words, such as those in this Act, without regard to the limitations customarily observed by nations upon the exercise of their powers; limitations which generally correspond to those fixed by the 'Conflict of Laws.' "[79]

Judge Choy suggests that these rules of comity may be overlooked in analyzing future cases unless they are clearly made a part of each decision.[80] By actually including a detailed examination of the interests of other nations among the criteria for the assertion of extraterritorial jurisdiction, *Timberlane* has taken a step to insure that these interests will be not disregarded. In attempting to balance the competing interests of nations, the opinion sets forth the following criteria:

[1] the degree of conflict with foreign law or policy,

[2] the nationality or allegiance of the parties and the locations or principal places of business of corporations,

[3] the extent to which enforcement by either state can be expected to achieve compliance,

[4] the relative significance of effects on the United States as compared with those elsewhere,

[5] the extent to which there is explicit purpose to harm or affect American commerce,

[6] the foreseeability of such effect, and

[7] the relative importance to the violations charged of conduct within the United States as compared with conduct abroad.[81]

These are not new standards. They have been recommended during the last two decades by Brewster and others[82] who have recognized that "taking all

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(c) the extent to which the required conduct is to take place in the territory of the other state,

(d) the nationality of the person, and

(e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state." Restatement, *supra* note 9, § 40.

This section does not cover all the possible situations which might result in conflict with foreign nations. It only directs that the five enumerated factors be considered when two countries have laws which *require* inconsistent conduct. However, there is no responsibility imposed upon a nation to review these factors where it requires certain conduct and the other nation merely *permits* inconsistent conduct. For this reason § 40 is insufficient to meet the needs of today's foreign commerce.

78. While the rules of comity may not have been reviewed as such, they were very often considered in some form. *See* Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690, 702-08 (1962), in which the Court weighed the interests of the Canadian Government before determining that the activities were subject to the United States antitrust laws; ABA, Antitrust Law Developments 369-71 (1975); Fugate, *supra* note 9, at 51. *See also* note 87 *infra* and accompanying text.

79. 148 F.2d at 443.

80. 549 F.2d at 612.

81. *Id.* at 614.

82. *See* Brewster, *supra* note 7, at 445-46; Rahl, *supra* note 8, at 409-16; Victor, *Multinational Corporations: Antitrust Extraterritoriality and the Prospect of Immunity,* 8 J. of Int'l L. & Econ. 11, 27-28 (1973); Zwarensteyn, *The Foreign Reach of the American Antitrust Laws,* 3 Am. Bus. L.J. 163, 170-71 (1965).

things into consideration [in applying the old effects doctrine] we were showing a politically unwise disrespect for the interests and prerogatives of other nations."[83] In fact, most of the court's criteria were borrowed word for word from those suggested by Brewster,[84] and the balance were adapted from section 40 of the Restatement.[85] The court's contribution lies in making these comity considerations a fundamental step in the analysis of whether jurisdiction should be asserted in an international antitrust case.[86]

The first criterion—assessing the degree of conflict with foreign law or policy—is designed to reduce conflicts by recognizing that the act complained of may be encouraged or even required by the laws of the foreign nation in which the act occurred, or that compliance with the United States antitrust laws would be directly contrary to the laws of the foreign nation. The idea implicit in this criterion is that businesses should not be forced to violate the laws of their place of business so as to comply with the laws of the United States.[87]

Criteria two and seven focus on the territory where the alleged violations were committed and the nationality of the violator. As noted earlier,[88] the presence of either conduct within the United States or acts of American nationals in foreign countries could be a sufficient basis in themselves for finding jurisdiction under the territorial and nationality approaches to jurisdiction. Judge Choy is suggesting, as did Brewster,[89] that these are factors to be considered before *exercising* jurisdiction based on effects. The mere fact that these factors are included among the criteria set forth in this third part of the tripartite analysis raises the question as to whether the presence of either of these in a given fact situation, although providing a basis for the finding of jurisdiction, is, by itself, sufficient to provide a justification for the *exercise* of the jurisdiction. Perhaps Judge Choy is suggesting that regardless of the basis on which jurisdiction is alleged, a conflicts approach with a full consideration of the rules of comity is in order before that

83. Brewster, *supra* note 7, at 286.

84. Brewster recommended that the following criteria be considered: "(a) the relative significance to the violations charged of conduct within the United States as compared with conduct abroad; (b) the extent to which there is explicit purpose to harm or affect American consumers or Americans' business opportunity; (c) the relative seriousness of effects on the United States as compared with those abroad; (d) the nationality or allegiance of the parties or in the case of business associations, their corporate location, and the fairness of applying our law to them; (e) the degree of conflict with foreign laws and policies; and (f) the extent to which conflict can be avoided without serious impairment of the interests of the United States or the foreign country." *Id.* at 446.

85. *See* note 77 *supra*.

86. Extraterritorial jurisdiction has also been asserted in the area of securities law. *See, e.g.*, Travis v. Anthes Imperial Ltd., 473 F.2d 515 (8th Cir. 1973). It has been suggested that a conflicts approach be applied in this area as well. *See* Note, *Extraterritorial Application of United States Laws: A Conflict of Laws Approach*, 28 Stan. L. Rev. 1005, 1011-14 (1976).

87. Generally, United States courts will not compel conduct which would violate a law of a foreign nation. ABA, Antitrust Law Developments 370 (1975). In fact, the opinion in one case was modified to exempt activities which were either required or prohibited by foreign law. United States v. Watchmakers of Switzerland Information Center, Inc., [1965] Trade Cas. (CCH) ¶ 71,352 (S.D.N.Y. 1965); *see* E. Kintner & M. Joelson, An International Antitrust Primer 29-32 (1974).

88. *See* notes 9 & 11 *supra* and accompanying text.

89. *See* note 84 *supra*.

jurisdiction is exercised. Perhaps the conflicts approach should not be limited to the assertion of jurisdiction under the effects doctrine.

Criteria five and six attempt to evaluate the intent to injure American commerce and the foreseeability of such injury. Under *Alcoa*[90] it was necessary to find actual intent to injure the foreign commerce of the United States before jurisdiction could be found.[91] *General Electric*[92] relaxed the intent requirement of *Alcoa* and held that the necessary intent was intent to commit the act, provided the effects of the act were reasonably foreseeable.[93] The difficulty with the rule expressed by *General Electric* was that aliens could conceivably be found to have violated laws that they did not even know were in existence, as long as the effects on the United States were a foreseeable result of the conduct.[94] Judge Choy has included an analysis of intent in these criteria as an important, but not determinative, part of a much more comprehensive analysis than either of those undertaken by *Alcoa* and *General Electric*.

Finally, the third criterion takes a practical approach to the problem of extraterritorial jurisdiction and recognizes that if there is little chance of enforcing a judgment, it would make little sense to risk a diplomatic conflict with a foreign nation over the issue of jurisdiction.

IV. CONCLUSION

In sum, *Timberlane*, with its tripartite approach, has spelled out the steps necessary to analyze questions of jurisdiction over extraterritorial antitrust violations in an attempt to rectify what was considered to be the ineffectiveness of prior approaches.[95] However, although *Timberlane* has set forth the steps to be taken in such an analysis, it has not made a definitive statement of when extraterritorial jurisdiction will be exercised. The exercise of that jurisdiction is still at the discretion[96] of the court and based upon its own analysis of the criteria in the third step of the test. By weighing the interests of other nations against our own, the court is attempting to show its deference to the sovereignty of other nations. However, it is still our courts that are deciding whether our laws should apply to acts in foreign nations. As Professor Rahl writes:

> The idea of balancing "vital national interests" of other nations by a national court is likely to seem somewhat presumptuous to the foreign state concerned, notwithstanding the qualifications of the judges. "Self-judging" is not likely to elicit enthusiasm from those who are judged to be wrong—especially since what is involved falls outside the area of generally accepted crimes and torts.[97]

As one possible alternative, Professor Rahl has suggested that the United

90. 148 F.2d 416 (2d Cir. 1945).

91. *See* note 17 *supra* and accompanying text.

92. United States v. General Elec. Co., 82 F. Supp. 753 (D.N.J. 1949).

93. *Id.* at 890-91.

94. *See* notes 21-23 *supra* and accompanying text.

95. *See* notes 30-36 *supra* and accompanying text.

96. *Timberlane* was a private damage action. It is not clear whether the conflicts of law approach would also apply to government suits. *See* Rahl, *supra* note 8, at 407-08.

97. *Id.* at 415-16.

States submit to the jurisdiction of the International Court of Justice for the resolution of such disputes.[98] This has never been done in an antitrust case.[99] However, as the number of multinational corporations[100] continues to grow and as foreign nations develop more extensive economic policies similar to those of the United States, such a practice might become a viable alternative.[101]

Elizabeth H. W. Fry

Securities Exchanges—Second Circuit Halts Expansion of Implied Private Rights of Action for Violation of Stock Exchange Rules.—The New York Stock Exchange, as well as other exchanges registered with the Securities and Exchange Commission (SEC), is required by section 6 of the Securities Exchange Act of 1934[1] (Act) to promulgate and enforce rules which will ensure that its members adhere to just and equitable principles of trade. Although the SEC has been given a supervisory function overseeing the registered exchanges' compliance with this section,[2] no private actions for violations of it are provided by the Act.

Pickard & Company (Pickard), formerly a member of the New York Stock Exchange, was a Delaware corporation which had registered with the SEC as a broker-dealer in 1962 and as an investment advisor in 1964. In September of 1967, an unannounced audit conducted by an independent public accoun-

98. *Id.* at 411-13. *See also* H. Zwarensteyn, Some Aspects of the Extraterritorial Reach of the American Antitrust Laws 127 (1970).

99. Rahl, *supra* note 8, at 412.

100. *See generally* L. Sullivan, Handbook of the Law of Antitrust § 234(b) (1977).

101. However, in the meantime, Mr. Fugate suggests that "other nations are considering the U.S. practice necessary and logical, for if no nation exercised such jurisdiction, there would be a vast area of unregulated restrictive practices in international trade." Fugate, *supra* note 9, at 50-51.

1. 15 U.S.C. § 78f(b) (Supp. V 1975). This section provides: "An exchange shall not be registered as a national securities exchange unless the Commission determines that—

. . . .

(5) The rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest . . . .

(6) The rules of the exchange provide that . . . its members and persons associated with its members shall be appropriately disciplined for violation of the provisions of this chapter, the rules or regulations thereunder, or the rules of the exchange, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction." *Id.*

2. The SEC is given authority under § 19(h) of the Act, 15 U.S.C. § 78s(h) (Supp. V 1975), to suspend or revoke the registration of an exchange which fails to comply with or enforce its rules. The SEC may also, under § 19(c), 15 U.S.C. § 78s(c) (Supp. V 1975), abrogate or amend the rules of an exchange.

tant, as required by a New York Stock Exchange rule,[3] revealed substantial deficiencies and inaccuracies in Pickard's books and records. As a result, the Exchange imposed restrictions on Pickard and attempted to put the faltering firm's books in order. The Exchange's endeavors, however, proved unsuccessful and Pickard was liquidated in early 1968. In the course of the liquidation proceeding, it was discovered that several of Pickard's officers and employees were involved in serious wrongdoings, including violations of securities laws and regulations as well as of several Exchange rules.

Aubrey Lank was appointed receiver for Pickard in April of 1969, and in that capacity he brought suit against the Exchange on December 17, 1971, in the United States District Court for the Southern District of New York. In that action he alleged, *inter alia*, that Pickard suffered substantial losses as a result of the Exchange's failure to enforce its net capital rule against Pickard, as it was required to do by section 6 of the Act [4] He alleged that as of October 1966 the Exchange knew or should have known of Pickard's violation of Exchange rules and that, if the Exchange had complied with its section 6 duty to enforce Pickard's compliance with those rules, many of the losses suffered could have been avoided. The Exchange moved to dismiss the complaint, arguing that the receiver lacked the capacity to assert a section 6 claim on behalf of Pickard against the Exchange. This motion was denied by the district court.[5]

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3. New York Stock Exchange Rule 418, at the times relevant to the case, provided that "[e]ach member organization doing any business with other than members and member organizations is required to have an annual audit of its affairs conducted, in accordance with the audit regulations of the Exchange by independent public accountants at a date to be selected by such accountants without prior notice to the member organizations, and to have such accountants prepare an answer to the financial questionnaire of the Exchange based upon such audit." New York Stock Exchange, Inc., Constitution and Rules (CCH) ¶ 2418 (1972). For the current rule 418, see 2 NYSE Guide (CCH) ¶ 2418 (1976).

4. At the time the action was brought, the former § 6, 15 U.S.C. § 78f (1970), read in pertinent part: "(a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section . . . .

. . . .

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the willful violation of any provisions of this chapter or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

. . . .

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this chapter and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange."

5. Lank v. New York Stock Exch., 405 F. Supp. 1031, 1036-39 (S.D.N.Y. 1975), *rev'd*, 548 F.2d 61 (2d Cir. 1977). The district court granted the Exchange's motion to dismiss those claims asserted by Lank on behalf of third parties, including creditors, subordinated lenders, and stockholders of Pickard. *Id.* at 1036. It denied the motion only with respect to those damages

On appeal, the United States Court of Appeals for the Second Circuit reversed, finding that a cause of action in favor of a member firm of an exchange against the exchange would not be implied under section 6 of the Act. *Lank v. New York Stock Exchange*, 548 F.2d 61 (2d Cir. 1977).

The Supreme Court has not considered whether an implied cause of action exists for a member's failure to comply with, or an exchange's failure to enforce, a federally mandated stock exchange rule. However, implication of private rights of action for violations of a given statutory scheme, where the statute is silent as to liabilities, is not a novel concept. In *J. I. Case Co. v. Borak*,[6] the Supreme Court considered whether a private cause of action should be implied in favor of a stockholder of a corporation when the corporation had violated section 14(a) of the Act.[7] That section regulates the solicitation of proxy material, and does not expressly grant a right of action. The Court found that the purpose of the section was to prevent authorization of corporate action by stockholders who were inadequately informed or deceived by proxy solicitation,[8] and that this specific purpose was part of the general scheme of the section to ensure the protection of investors.[9] It was further determined that private enforcement of the proxy rules would provide "a necessary supplement to [Securities and Exchange] Commission action"[10] and that, therefore, it was "the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose."[11] As a result, a private cause of action in favor of the plaintiffs was implied.

The same general question has been recently discussed by the Supreme Court in *Cort v. Ash*.[12] In that case the Supreme Court considered whether it was proper to imply a private cause of action in favor of a stockholder seeking damages in a derivative action for violation by corporate directors of a federal criminal statute regulating political campaign contributions.[13] Holding that

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claimed on behalf of the corporation, including the loss of the proceeds from the sale of Pickard's seat on the Exchange and the money paid by Pickard as reimbursement to the Special Trust Fund. *Id.*

6. 377 U.S. 426 (1964).

7. 15 U.S.C. § 78n(a) (1970). This section provides: "It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in 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, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title." *Id.*

8. 377 U.S. at 431.

9. *Id.* at 432.

10. *Id.*

11. *Id.* at 433.

12. 422 U.S. 66 (1975).

13. 18 U.S.C. § 610 (1970) (repealed 1976). While effective, the section made it unlawful "for any corporation whatever . . . to make a contribution or expenditure in connection with any election at which Presidential and Vice Presidential electors or a Senator or Representative in, or a Delegate or Resident Commissioner to Congress are to be voted for, or in connection with any

no private right of action should be implied under the statute in question,[14] the Supreme Court outlined the general criteria which govern such a determination. First, a court considering the question should look to whether or not the plaintiff was "one of the class for whose *especial* benefit the statute was enacted."[15] Second, it should consider whether there is "any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one."[16] Third, it should determine whether it is "consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff."[17] Finally, it should determine whether the cause of action would be "one traditionally relegated to state law, in an area basically the concern of the States."[18]

Therefore, although only lower federal courts have, to date, implied private causes of action for violations of stock exchange rules, the Supreme Court has formulated the basic principles for implying remedies under federal statutes in general. In *Baird v. Franklin*,[19] the first case to consider private rights of action under section 6 of the Act, the Second Circuit was faced with the question of whether a private right of action should be implied against a stock exchange in favor of a customer of a member of the exchange for the failure of the exchange to enforce its own rules against its members, as required by the section. In that case, plaintiffs sought to hold the New York Stock Exchange liable for losses incurred by reason of the hypothecation of their securities by their broker, Richard Whitney & Company (Whitney), a member firm of the New York Stock Exchange. The plaintiffs alleged that through a series of incidents prior to their actual loss, the Exchange had been put on notice that Whitney was guilty of unlawful acts and conduct which was inconsistent with just and equitable principles of trade in that the company had permitted its indebtedness to exceed the allowable percentage of net capital.[20] Section 6 requires a registered exchange to promulgate and enforce rules which will ensure that members conduct their businesses in a manner consistent with just and equitable principles of trade.[21] Therefore, according to the plaintiffs' theory, because the Exchange had failed to enforce its rules and take disciplinary action against Whitney for its alleged unlawful conduct, the Exchange should be liable to the plaintiffs for the losses suffered by them.

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primary election or political convention or caucus held to select candidates for any of the foregoing offices, or for any candidate, political committee, or other person to accept or receive any contribution prohibited by this section." *Id.* This section has been substantially reenacted as part of § 321 of the Federal Election Campaign Act of 1971, 2 U.S.C.A. § 441b (1971).

14. 422 U.S. at 77-78.

15. *Id.* at 78 (quoting Texas & Pac. Ry. v. Rigsby, 241 U.S. 33, 39 (1916) (emphasis in original)).

16. *Id.*

17. *Id.*

18. *Id.*

19. 141 F.2d 238 (2d Cir.), *cert. denied*, 323 U.S. 737 (1944).

20. *Id.* at 242 (Clark, J., dissenting in part).

21. See note 1 *supra* for the current version of this requirement.

The court, speaking through Judge Clark,[22] concluded that section 6 placed a duty on the Stock Exchange to enforce the rules and regulations prescribed by that section. Furthermore, the court concluded that under the section, a private right of action would exist against the Exchange for its failure to enforce those rules which it knew or had reasonable cause to suspect were being violated.[23] This conclusion was based on the well-established principle that "members of a class for whose protection a statutory duty is created may sue for injuries resulting from its breach and . . . the common law will supply a remedy if the statute gives none."[24] Therefore, because it was found that one of the primary purposes of the Act was to protect the general investing public, members of the general investing public would be given an implied cause of action against an exchange when the exchange neglected its section 6 duty.[25]

The decision in *Baird* remained the authoritative decision in the Second Circuit for many years and withstood at least one attempt to expand it. For instance, in *O'Neill v. Maytag*,[26] the Second Circuit acknowledged that *Baird* granted a private right of action in favor of a customer of a member firm against an exchange for the exchange's failure to enforce its rules, but refused to hold that a stockholder's derivative suit against a listed company based on violation of an exchange rule by the listed company would also be available.[27]

Some twenty-two years after *Baird*, however, the Second Circuit in one way expanded *Baird*'s private right of action and in another way restricted it. In *Colonial Realty Corp. v. Bache & Co.*,[28] the Second Circuit considered whether a private right of action in favor of a customer of a member firm would exist against the member firm for the firm's violation of an exchange's rules promulgated pursuant to section 6. Although the court was willing to extend the private right of action found to exist in *Baird* to include an action against a member for violation of the exchange rules,[29] the court nevertheless restricted its *Baird* opinion and held that, at least in actions against member firms, only violations of certain rules would give rise to such a private right of action.[30]

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22. Judge Clark dissented only on the issue of proximate cause of damages. 141 F.2d at 245-47 (Clark, J., dissenting in part).

23. *Id.* at 244 (Clark, J., dissenting in part). This is a standard of care which has subsequently been regarded as essentially one of negligence. In Evans v. Kerbs & Co., 411 F. Supp. 616 (S.D.N.Y. 1976), Judge Cannella stated that "[a]lthough courts should be careful not to hold an exchange to too exacting a duty of supervision, claims [under § 6] are to be measured by what is essentially a negligence standard." *Id.* at 625. *See also* Rich v. New York Stock Exch., 522 F.2d 153, 155 n.4 (2d Cir. 1975); Marbury Management, Inc. v. Kohn, 373 F. Supp. 140, 142 (S.D.N.Y. 1974).

24. 141 F.2d at 245 (Clark, J., dissenting in part).

25. *Id.* at 244-45 (Clark, J., dissenting in part).

26. 339 F.2d 764 (2d Cir. 1964).

27. *Id.* at 770.

28. 358 F.2d 178 (2d Cir.), *cert. denied*, 385 U.S. 817 (1966).

29. *Id.* at 182.

30. *Id.* at 182-83.

The plaintiffs had alleged simply that certain actions on the part of the defendant had not been consistent with just and equitable principles of trade.[31] Although exchanges are required by section 6 to promulgate rules which will ensure that such principles are followed, the plaintiffs' allegation was found to be overbroad. According to the court, Congress could not have intended to create civil causes of action for violations of all rules adopted pursuant to the section.[32] A contrary ruling would be at odds with one Congressional purpose apparent in Section 6—self-regulation of the exchanges for basic and significant protection of the investing public.[33] The court also noted the fact that the grant of jurisdiction to the federal courts under section 27 of the Act[34] did not include any explicit reference to exchange rules but granted jurisdiction to the courts solely for "suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder."[35] On the other hand, in spite of a lack of an explicit grant of jurisdiction for rule violations, the court cautioned against denial of a private right of action for violation of a rule "which provides what amounts to a substitute for regulation by the SEC itself."[36] Therefore, according to *Colonial*, before implying a private right of action for violation of a particular rule by a member firm "the court must look to the nature of the particular rule and its place in the regulatory scheme, with the party urging the implication of a federal liability carrying a considerably heavier burden of persuasion than when the violation is of the statute or an SEC regulation."[37]

The *Colonial* court added that the case for an implied private right of action would be strongest when the particular rule in question imposed a duty which did not exist at common law.[38] Because of the broad and indefinite scope of the terms "fair and equitable principles of trade," the court was concerned with the possibility of a virtually limitless cause of action.[39] Such a broad cause of action would have the undesirable consequence of stripping the states of virtually all jurisdiction over claims alleging violations of exchange rules since section 27 of the Act gives the federal courts exclusive jurisdiction over all actions brought to enforce any liability or duty created by the Act.[40]

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31. *Id.* at 180-81.

32. *Id.* at 181.

33. *Id.* Here the court relied on Silver v. New York Stock Exch., 373 U.S. 341 (1963), in which the Supreme Court recognized the importance of self-regulation by the exchanges. *Id.* at 352-57.

34. 15 U.S.C. § 78aa (1970) provides that "[t]he district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder."

35. 358 F.2d at 181-82 (quoting § 27 of the Act, 15 U.S.C. § 78aa (1970)).

36. 358 F.2d at 182.

37. *Id.*

38. *Id.*

39. *Id.* at 183.

40. *Id.*

There is considerable difference in the approaches taken by the various circuits in implying private rights of actions for violations of stock exchange rules. In *Butterman v. Walston & Co.*,[41] a suit by a customer of a member firm against an exchange, the Seventh Circuit accepted *Baird*'s conclusions of law virtually without comment.[42] However, two years later, in *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[43] a suit by a customer against a broker, it adopted the more restrictive test fashioned by the Second Circuit in *Colonial*, while at the same time adding a test which significantly eased *Colonial*'s restrictions. In *Buttrey*, the plaintiff was the trustee in bankruptcy for Dobich Securities Corporation, a corporation which had engaged in the sale of securities as a dealer. The complaint alleged that the defendent broker had granted the bankrupt's request to open a cash account for the purpose of trading securities as a customer of the defendant, that the defendant knew that the bankrupt, in its transactions with defendants, was using fraudulently converted property of various customers of the bankrupt, and that the defendant thereby violated the "Know Your Customer Rule"[44] of the New York Stock Exchange, adopted by the Exchange pursuant to section 6.[45] The trustee of the bankrupt was found to have authority to bring suit by virtue of section 70e of the Bankruptcy Act,[46] which allows a trustee in bankruptcy to avoid transfers which are fraudulent or voidable by any creditor of the debtor under any federal or state law.[47] Nevertheless, in determining whether or not the defendant could be held liable to its customers for a violation of the "Know Your Customer Rule," the court stated that the plaintiff would first have to establish that the rule in question provided a substitute for SEC regulation.[48] The court added, however, that "[t]he touchstone for determining whether or not the violation of a particular rule is actionable should properly depend upon its design 'for the direct protection of investors.' "[49]

Applying these tests, the court held that a violation of the "Know Your Customer Rule" was not automatically actionable, but it did find that

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41. 387 F.2d 822 (7th Cir. 1967), *cert. denied*, 391 U.S. 913 (1968).

42. *Id.* at 825.

43. 410 F.2d 135 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969).

44. *Id.* at 136-37. The "Know Your Customer Rule" of the New York Stock Exchange has been amended slightly since the court's decision. However, it is substantially the same and provides: "Every member organization is required through a general partner, [or] a principal executive officer . . . to

(1) Use due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization and every person holding power of attorney over any account accepted or carried by such organization.

(2) Supervise diligently all accounts handled by registered representatives of the organization.

(3) Specifically approve the opening of an account prior to or promptly after the completion of any transaction for the account of or with a customer . . . ." 2 NYSE Guide (CCH) ¶ 2405 (1970).

45. 410 F.2d at 137.

46. 11 U.S.C. § 110e (1970).

47. 410 F.2d at 137-40.

48. *Id.* at 142.

49. *Id.* (quoting Lowenfels, *Implied Liabilities Based upon Stock Exchange Rules*, 66 Colum. L. Rev. 12, 29 (1966)).

plaintiff's allegations stated a claim of fraud on the investor's customers and therefore supported a private right of action.[50] Although the Seventh Circuit appeared to adopt the restrictive *Colonial* test, the addition of the broader investor protection test significantly weakened the *Colonial* test's restrictive rationale.[51]

The Court of Appeals for the Tenth Circuit has also taken a different approach. In *Utah State University v. Bear, Stearns & Co.*,[52] the state university alleged that it had suffered investment losses due to the defendant member firm's violation of, among other rules, the New York Stock Exchange's "Know Your Customer Rule."[53] The court cited with approval both the *Colonial* substitution test and the *Buttrey* investor protection test as well as a dictum in a prior Tenth Circuit decision that "in an appropriate case, violations of exchange rules designed for customer protection might give rise to a private cause of action . . . ."[54] The court limited, however, the scope of a broker's potential liability for rule violations. It was concerned with the advantages of self-regulation of the exchanges over the alternative of "more massive governmental bureaucracy and a detailed and rigid regulation of the entire securities field."[55] In the court's opinion, the automatic imposition of liability for violations of rules meeting only the *Colonial* and *Buttrey* tests would impair the system of self-regulation by discouraging the exchanges from promulgating new regulations, for every new rule would have the potential of creating extensive liability for the exchange and its members.[56] Adopting the rule of *Ernst & Ernst v. Hochfelder*,[57] the court concluded that "something more than mistake or negligence must be shown" before liability

50. 410 F.2d at 143. At least one case, Nelson v. Hench, 428 F. Supp. 411 (D. Minn. 1977), has determined that a private right of action would not exist in favor of a customer and against a broker-dealer for the dealer's violation of the "Know Your Customer Rule." In this case, the court was convinced that "the rules requiring broker-dealers to closely supervise their accounts and know the background of their customers must have been enacted primarily for the protection of the dealers. While a broker-dealer should be concerned for the welfare of the customers as a matter of ethics, the firm as a matter of economics is concerned first with discouraging actions by individual representatives that might give rise to legal liability. It also is interested in the ability of its customers to meet their financial obligations." *Id.* at 419. Therefore, of course, the court denied the plaintiffs a private right of action. *Id.* at 420.

51. The investor protection test, because of its breadth and vagueness, would enable a court to imply a cause of action for violation of almost all stock exchange rules. However, under the substitute for SEC regulation test, very few rules would be found to provide regulation not already provided by SEC regulations. Therefore, under this test, violations of relatively few stock exchange rules would give rise to an implied cause of action.

52. 549 F.2d 164 (10th Cir. 1977).

53. *Id.* at 166; *see* note 44 *supra*.

54. 549 F.2d at 168 (quoting Ocrant v. Dean Witter & Co., 502 F.2d 854, 858 (10th Cir. 1974)).

55. *Id.*

56. *Id.*

57. 425 U.S. 185 (1976). In *Hochfelder*, the Supreme Court held that a plaintiff must show scienter, or intent to deceive, on the part of the defendant in order to recover for securities fraud under § 10b of the Act, 15 U.S.C. § 78j(b) (1970), and rule 10b-5, 17 C.F.R. § 240.10b-5 (1977), promulgated thereunder.

for violation of an exchange rule will be imposed,[58] and upheld the district court's dismissal of the plaintiffs' complaints.[59]

In *Van Gemert v. Boeing Co.*,[60] the Second Circuit appeared to move toward the less restrictive *Buttrey* public investor test while at the same time utilizing its *Colonial* analysis. The *Van Gemert* plaintiffs were holders of convertible debentures issued by defendant Boeing. The debentures were listed on the New York Stock Exchange pursuant to a listing agreement between Boeing and the Exchange.[61] The plaintiffs alleged that Boeing had given inadequate notice of its intention to redeem the convertible debentures, and that such inadequate notice was in violation of the requirements of the New York Stock Exchange rules promulgated pursuant to section 6 of the Act.[62] The plaintiffs claimed to have suffered loss by reason of their inability to exercise their conversion rights prior to the deadline for the redemption.[63] In deciding whether or not a violation of the exchange notice requirements would give rise to a colorable claim, the court first cited the *Colonial* "substitution for SEC regulation" test,[64] but foremost among its reasons for granting a private cause of action was its view that the rules were designed for the protection of the investing public.[65] It specifically stated that

> to the American investing public listing on the New York Stock Exchange carries with it implicit guarantees of trustworthiness. The public generally understands that a company must meet certain qualifications of financial stability, prestige, and fair disclosure, in order to be accepted for that listing, which is in turn so helpful to the sale of the company's securities. Similarly it is held out to the investing public that by dealing in securities listed on the New York Stock Exchange the investor will be dealt with fairly and pursuant to law.[66]

Finding that a private right of action was available, the Second Circuit not only expanded its restrictive substitution test devised in *Colonial*, but also extended the private right of action to include an action by a member of the investing public against a listed company which failed to follow exchange rules. This would appear to be contrary to its decision in *O'Neill v. Maytag*,[67] discussed above.[68] The *O'Neill* decision can be distinguished, however, because the cause of action therein was in the nature of a stockholder's derivative suit against a listed company.[69]

The implied causes of action for violation of section 6 were expanded again

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58. 549 F.2d at 168.
59. *Id.* at 169.
60. 520 F.2d 1373 (2d Cir. 1975).
61. *Id.* at 1374-75.
62. *Id.* at 1374-75, 1380.
63. *Id.* at 1374.
64. *Id.* at 1380.
65. *Id.* at 1381.
66. *Id.*
67. 339 F.2d 764 (2d Cir. 1964).
68. *See* notes 26-27 *supra* and accompanying text.
69. 520 F.2d at 1380.

in *New York Stock Exchange, Inc. v. Sloan*.[70] There the District Court for the Southern District of New York implied an action in favor of subordinated lenders and limited partners of a member firm against the New York Stock Exchange for the Exchange's failure to enforce compliance with its rules by the member firm. In *Sloan* the limited partners and subordinated lenders of a liquidated member firm sought recovery of their lost investment in the member firm by way of counterclaim against the Exchange.[71] They alleged that the Exchange knew or should have known of the member firm's failure to meet Exchange net capital requirements and that the Exchange had adopted a policy of not enforcing its rules with regard to the liquidated member firm.[72] Although the court agreed with the proposition set forth by the defendant Exchange that a primary purpose of the Act was to protect public customers, it refused, nonetheless, to accept the further proposition that the public customers were Congress' exclusive concern[73] and, therefore, extended protection to limited partners and subordinated lenders.[74]

The court relied on the preamble of the Exchange Act[75] and the language of section 6[76] to demonstrate that the Act was designed for the larger purpose of ensuring the secure operation of the market in general,[77] and found therein a sufficient congressional intention to protect interstate commerce and national

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70. 394 F. Supp. 1303 (S.D.N.Y. 1975).

71. *Id.* at 1305.

72. *Id.*

73. *Id.* at 1308-09.

74. At least one case, Weinberger v. New York Stock Exch., 335 F. Supp. 139 (S.D.N.Y. 1971), has found a right of action in favor of a limited partner of a member firm against the Exchange for the Exchange's failure to enforce its rules based upon the contract formerly required by § 6(a) of the Act as a prerequisite to registration. *Id.* at 140. The court in this case applied the congressional intent of § 6, as interpreted in *Baird*, to the contract to find that the contract was intended for the benefit of investors and that therefore an investor was a third party beneficiary of the contract and was entitled to an independent claim for relief upon its breach. *Id.* at 144. Former § 6(a)(1), 15 U.S.C. § 78f(a)(1) (1970), had required an exchange to file, as part of its registration with the SEC "[a]n agreement . . . to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this chapter, and any amendment thereto and any rule or regulation made or to be made thereunder . . . ." This requirement was dropped by the amendments to the section enacted by Act of June 4, 1975, Pub. L. No. 94-29, § 4, 89 Stat. 104, 15 U.S.C. § 78f(a) (Supp. V 1975).

75. 15 U.S.C. § 78b (1970) provides, as a reason for regulating transactions in securities, that such transactions "are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto . . . and to impose requirements necessary to make such regulations and control reasonably complete and effective, in order to protect interstate commerce, the national credit . . . and to insure the maintenance of fair and honest markets in such transactions."

76. The court pointed out the broad language contained in former § 6(a)(2), 15 U.S.C. § 78f(a)(2) (1970), which expressed an intent to protect the "public interest" in general as well as "investors." Similar language is now found in 15 U.S.C. § 78f(a) (Supp. V 1975). The court also pointed to language in former § 6(d), 15 U.S.C. § 78f(d) (1970), which evidenced a congressional intent to "insure fair dealing." 394 F. Supp. at 1309.

77. 394 F. Supp. at 1309.

credit, as well as to maintain generally a fair and honest securities market.[78] Also relied on was *Silver v. New York Stock Exchange*,[79] an antitrust case in which the Supreme Court had allowed the petitioners, who were neither public customers nor New York Stock Exchange members, to challenge the manner in which the Exchange had applied its rules to them. The court was further influenced by *Bright v. Philadelphia-Baltimore-Washington Stock Exchange*,[80] wherein the District Court for the Eastern District of Pennsylvania implied a private right of action in favor of a member against an exchange for the exchange's failure to comply with its own rules regulating the conduct of an election for membership on the exchange's board of governors.[81] As a result, the *Sloan* court concluded that a private right of action should be accorded to those persons who were intended to be benefited by the particular rule in question. It determined that

> [r]ules made pursuant to §6 are intended not merely to protect public investors (as in *Baird*) but to effect the comprehensive scheme of self-regulation envisioned by Congress. Accordingly, members of the Exchange community who are intended to be benefited by such rules (as in *Bright*) or who are "swept into the currents of self-regulation" (as in *Silver*) have standing to complain of the manner of their enforcement.[82]

Applying these criteria to the facts of the case, the *Sloan* court found that the net capital rules of the Exchange "which relate to the financial soundness of member firms, are manifestly intended to protect those who entrust their funds or securities to broker-dealers, and who stand in the kind of relationship to the firm which requires them to rely on its compliance with the rules."[83] On the other hand, the court was unwilling to extend the same private right of action to general partners of the member firm.[84] The general partners were not viewed as intended beneficiaries of section 6 of the Act since they were charged with the individual responsibility of complying with the Exchange rules.[85] The rationale of the *Sloan* decision was subsequently adopted by the Ninth Circuit in *Hughes v. Dempsey-Tegeler & Co.*,[86] which also held that both subordinated lenders and limited partners would be entitled to bring actions against an exchange for violations of section 6.

Since *Baird*, then, in which a private right of action was granted to a customer of a member firm against an exchange for the exchange's failure to enforce its own rules,[87] similar rights of action have been granted in the following situations where the relevant substitution or investor protection

78. *Id.*
79. 373 U.S. 341 (1963).
80. 327 F. Supp. 495 (E.D. Pa. 1971).
81. *Id.* at 500-02.
82. 394 F. Supp. at 1310.
83. *Id.*
84. *Id.* at 1311.
85. *Id.* at 1314-15.
86. 534 F.2d 156 (9th Cir.), *cert. denied*, 429 U.S. 896 (1976).
87. *See* notes 19-25 *supra* and accompanying text.

tests have been met: to a customer of a member firm against the member firm for its failure to follow the exchange rules, as in *Colonial*;[88] to an investing member of the public against a company listed on an exchange for the company's failure to follow the exchange rules, as in *Van Gemert*;[89] and, most recently, to subordinated lenders and limited partners of a member firm against an exchange for the exchange's failure to enforce compliance with its rules by the member firm, as in *Sloan* and *Hughes*.[90] However, when the Second Circuit subsequently reviewed the related question in *Lank v. New York Stock Exchange*,[91] of whether or not the member firm itself could have a cause of action against an exchange for its failure to enforce its rules, the court backed away from the recent initiatives taken by the *Sloan* and *Hughes* courts. The *Lank* opinion effectively held that section 6 of the Act was intended to protect only public investors.[92] It expressly held that a member firm would never have an action against an exchange for the exchange's failure to enforce its rules against the member firm.[93]

The district court,[94] which had found that a cause of action in favor of the member existed, had relied to a great extent on its prior decision in *Sloan*, where it had rejected the general proposition that an exchange's duties under section 6 ran only to public customers.[95] As discussed above,[96] that decision had determined that the self-regulatory scheme of section 6 of the Act required that a private right of action should be granted to those persons who were intended to be protected by the particular rule in question. In *Lank*, the district court found that the same reasoning should control in an action brought on behalf of a member corporation.[97] Using the *Sloan* reasoning, found to be applicable where the action is asserted by a receiver in liquidation of a member firm,[98] the lower court in *Lank* held that "[a] corporation, like the customers, subordinated lenders and limited partners of a brokerage firm, is required by its status to rely on those responsible for the management of the firm to comply with the net capital rule and is therefore entitled to the Exchange's diligent enforcement."[99]

The lower court's characterization of the liquidated member firm as the corporation, which was entitled to bring an action against the exchange, was developed by that court in order to distinguish *Lank* from the holding in *Sloan*. In *Sloan*, the general partners of the member firm, who would necessarily share personal responsibility for the firm's acts, were not entitled

88. *See* notes 28-29 *supra* and accompanying text.
89. *See* notes 60-69 *supra* and accompanying text.
90. *See* notes 70-86 *supra* and accompanying text.
91. 548 F.2d 61 (2d Cir. 1977).
92. Arneil v. Ramsey, 550 F.2d 774, 783 (2d Cir. 1977).
93. 548 F.2d at 66.
94. Lank v. New York Stock Exch., 405 F. Supp. 1031 (S.D.N.Y. 1975).
95. *Id.* at 1036.
96. *See* notes 70-85 *supra* and accompanying text.
97. 405 F. Supp. at 1037.
98. *Id.*
99. *Id.*

to a claim under the Act. Here, however, where the corporation was required as an entity to rely on its management, the corporation itself was found not to be culpable.[100] As the court noted, the corporation is an entity with "characteristics distinct from those of the general partners in *Sloan*."[101] Moreover, the ultimate beneficiaries of a recovery by Lank would be "third parties who share[d] no culpability for Pickard's wrongdoing and ultimate demise."[102]

The court of appeals, however, rejected the district court's reasoning, and found nothing in the legislative history of the Act to indicate that a cause of action should be extended to all those persons who were in a position to rely on an exchange's enforcement or who stood to suffer injury as a result of a lack of such enforcement.[103] The Second Circuit stated simply that "[t]he beneficiary of the 1934 legislation was intended to be the public investor."[104] For this proposition it relied on excerpts from the legislative history of the Act which expressed the congressional intention to ensure that the general public was protected in its investments.[105] The court could find no indication whatsoever that "members of the exchanges [could be] considered to be within the class of public investors Section 6 of the Act was designed to protect."[106]

Also influencing the court's decision was its view that the interests of the members of the exchange were often antagonistic to the interests of the public investors.[107] Therefore, to require an exchange to enforce its rules with a view toward protecting the member firms could have the undesirable result, obviously contrary to the congressional intention in enacting the Act, of

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100. *Id.* at 1039.

101. *Id.*

102. *Id.* For a case following the holding of the district court in *Lank*, see Collins v. PBW Stock Exch., Inc., 408 F. Supp. 1344 (E.D. Pa. 1976).

103. 548 F.2d at 66.

104. *Id.* at 65.

105. *Id.* Specifically, the court relied on a statement made by Senator Fletcher, Chairman of the Senate Committee on Banking and Currency, who introduced an earlier version of the bill which eventually became the Exchange Act by stating: "The bill just introduced for the regulation of securities exchanges is one of the series of steps taken and to be taken for the purpose of bringing safety to the general public in the field of investment and finance . . . .

"It is in the light of the interests of the general public that the bill was drawn . . . .

. . . .

"The purpose of the bill is to insure to the public that the securities exchanges will be fair and open markets. The bill seeks to protect the American people by requiring brokers on these exchanges, members of these exchanges, to be wholly disinterested in performing their services . . . ." *Id.* (quoting 78 Cong. Rec. 2264, 2270-71 (1934)).

The court also quoted from the report of the House Committee on Interstate and Foreign Commerce accompanying the Securities Exchange Bill of 1934 as follows: "The bill proceeds on the theory that the exchanges are public institutions which the public is invited to use . . . , and are not private clubs to be conducted only in accordance with the interests of their members. The great exchanges of this country upon which millions of dollars of securities are sold are affected with a public interest in the same degree as any other great utility." *Id.* at 65 (quoting H.R. Rep. No. 1383, 73d Cong., 2d Sess. 15 (1934)).

106. *Id.* at 65.

107. *Id.* at 66.

inducing the exchanges to disregard the interests of the public investors. Accordingly, the Second Circuit concluded that it was Congress' intention to draw a clear distinction between members of an exchange, whose conduct was to be regulated for the protection of the investing public, and the investing public itself.[108] The investing public was entitled to assert claims against an exchange for damages arising out of violations of section 6 while the members of the exchange were not.[109]

Although the *Lank* decision did not require the court to overrule *New York Stock Exchange, Inc. v. Sloan*,[110] which had merely extended a cause of action to limited partners and subordinated lenders, the decision made clear the Second Circuit's view that private actions under section 6 of the Act were available exclusively to public investors. And, indeed, in a subsequent decision, *Arneil v. Ramsey*,[111] the Second Circuit succinctly confirmed its *Lank* holding "that Section 6 was intended to protect only public investors . . . ."[112] The *Arneil* court overruled *Sloan* without mention of that case. It stated that "those who invest in a member of a securities exchange, whether as limited partners, subordinated lenders or purchasers of other than its publicly traded securities, have no claim under Section 6 against the exchange for damages suffered as a result of the exchange's violation of that section."[113]

In *Lank* and *Arneil*, the Second Circuit has drawn a line against expansion of private rights of action for violations of stock exchange rules. In so doing, however, it has created a conflict among the circuit and district courts on the issue of whether a private right of action for violation of exchange rules can ever be granted to other than public investors. In the Ninth Circuit, the court of appeals has indicated in *Hughes v. Dempsey-Tegeler & Co.*,[114] as discussed above,[115] that subordinated lenders and limited partners may bring private actions for rule violations against an exchange. In the Third Circuit the District Court for the Eastern District of Pennsylvania, in *Collins v. PBW Stock Exchange, Inc.*,[116] adopted the opinion of the lower court in *Lank* and held that a receiver in liquidation of a member firm may bring a private action for rule violations against an exchange.[117]

In view of this conflict, it would be appropriate for the Supreme Court to avail itself of its next opportunity to address the question and resolve the dispute. Until that time, no one other than a public investor can be certain of

108. *Id.*

109. *Id.*

110. 394 F. Supp. 1303 (S.D.N.Y. 1975); *see* notes 70-85 *supra* and accompanying text.

111. 550 F.2d 774 (2d Cir. 1977).

112. *Id.* at 783.

113. *Id.* The holdings in *Lank* and *Arneil* have since led the District Court of the Eastern District of New York to conclude that "if a member of a firm cannot sue the Exchange for a violation of Exchange Rules, a member cannot sue another member of the same firm [for similar violations]." Halperin v. Edwards, 430 F. Supp. 121, 126 (E.D.N.Y. 1977).

114. 534 F.2d 156, 165 n.4 (9th Cir.), *cert. denied*, 429 U.S. 896 (1976).

115. *See* note 86 *supra* and accompanying text.

116. 408 F. Supp. 1344 (E.D. Pa. 1976).

117. *Id.* at 1350-51; *see* notes 97-102 *supra* and accompanying text.

his right to recover for losses suffered by reason of rule violations. However, in view of the Supreme Court's recent trend to restrict private rights of action for violation of federal securities statutes,[118] it is not unreasonable to suggest that the Supreme Court will agree with the Second Circuit and conclude that only public investors are entitled to bring private actions for rule violations.

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118. This trend has been set by several recent Supreme Court cases. First, the Court held in Piper v. Chris-Craft Indus., Inc., 97 S. Ct. 926 (1977), that a defeated tender offeror has no implied cause of action for damages under § 14(e), 15 U.S.C. § 78n(e) (1970).

A related line of cases also indicates the restrictive trend. In Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), the Court held that under § 10(b) of the Act, 15 U.S.C. § 78j(b) (1970), and rule 10b-5, 17 C.F.R. § 240.10b-5 (1977), promulgated thereunder, which prohibit the use of manipulative and deceptive devices in connection with the purchase or sale of securities, private damage actions would be limited to plaintiffs who had actually purchased or sold securities. Subsequently, in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), similar actions were further limited to plaintiffs who could show scienter, or intent to deceive, on the part of the defendant. In TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976), the Supreme Court defined "materiality" of omissions under § 14(a) of the Act, 15 U.S.C. § 78n(a) (1970). Under the announced standard, "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder *would* consider it important . . . ." *Id.* at 449 (emphasis added). Although the case was concerned with § 14, the Supreme Court subsequently remanded, for reconsideration in light of *TSC*, a case which was concerned with the materiality of nondisclosed information in the context of a 10b-5 action. *See* Woolf v. S.D. Cohn & Co., 515 F 2d 591 (5th Cir 1975), *remanded*, 426 U.S. 944 (1976) (*mem.*). And, most recently, in Sante Fe Indus., Inc. v Green, 97 S. Ct. 1292 (1977), the Court held that private damage actions for fraud under § 10(b) would not include actions for breach of fiduciary duty. Thus, the word manipulation, as used in § 10(b), does not encompass unfair treatment of shareholders by a fiduciary. It only refers "generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity . . . ." *Id.* at 1302.