1983

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RESPONDEAT SUPERIOR AND THE FEDERAL SECURITIES LAWS: A ROUND PEG IN A SQUARE HOLE

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The Supreme Court has had several opportunities in the last three years to resolve a split among the circuits involving the exclusivity of the vicarious liability sections of the federal securities laws and the applicability of the common law doctrine of respondeat superior.¹ This article contends that section 20(a) of the Securities Exchange Act of 1934,² imposing vicarious liability upon a corporation for the acts of its employees which allegedly violate the fraud section

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². 15 U.S.C. § 78t(a) (1976). For the text of this section, see infra note 6.
of the Exchange Act, precludes the application of the common law doctrine of respondeat superior. Where a firm, in a section 10(b) fraud claim, can demonstrate the good faith defense explicitly provided in section 20(a) of the Exchange Act, imposing liability under respondeat superior effectively nullifies the exculpatory provisions of section 20(a) as well as vitiates the scienter element of a section 10(b) claim.


4. Respondeat superior is a common law tort doctrine which allocates economic losses as between the parties based primarily upon policy considerations which reflect the greater ability of one party to compensate for realized losses. See W. Prosser, Handbook of the Law of Torts 459 (4th ed. 1971). For a further discussion of this doctrine, see infra notes 175-85 and accompanying text.


6. Securities Exchange Act of 1934 § 20(a), 15 U.S.C. § 78t(a) (1976), provides: Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

Similarly, § 15 of the Securities Act of 1933, 15 U.S.C. § 77o (1976), provides:

Every person who, by or through stock ownership, agency, or otherwise . . . controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

7. Section 10(b) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance 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.

A claim under § 10(b) is invariably accompanied by a claim under the statute's implementing regulation, rule 10b-5, 17 C.F.R. § 240.10b-5 (1983), which provides:

It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

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

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.
The civil issue has an administrative analogue—the propriety of and the rationale for the Securities and Exchange Commission\(^8\) bringing an administrative proceeding\(^9\) against a brokerage firm based upon an employee’s unlawful actions, notwithstanding the firm’s ability to demonstrate a vigorous, comprehensive, compliance system which, in a particular, isolated instance, did not prevent the violative acts in question.

This article summarizes and analyzes several recent cases. It then examines the reasoning of the courts in light of recent Supreme Court decisions and relevant legislative histories. After briefly analyzing the common law origins of respondeat superior, the discussion focuses on the Commission’s use of vicarious liability in its own administrative proceedings. Based upon these analyses, we conclude that respondeat superior should not be a liability theory available to hold a brokerage firm liable either civilly or administratively in cases premised upon violations of the federal securities laws.

I. BACKGROUND AND REVIEW OF CASE LAW

The federal securities laws do not expressly provide that a principal (e.g., a broker-dealer) should be civilly liable for the acts of its agent (e.g., a registered representative). The remedial nature of the securities laws, sections 20(a)\(^{10}\) and 28(a)\(^{11}\) of the Securities Exchange Act of 1934,\(^{12}\) and other theories have all been cited to support the application of common law agency principles to civil damage actions brought under the federal securities laws. Several recent cases have addressed the question of whether section 20(a) provides the exclusive means for holding a controlling party liable for violations of the federal securities laws by its agents. The Second, Third, Fifth, and Sixth Circuit Courts of Appeals have all answered this question in the negative, i.e., they have permitted plaintiffs to predicate liability on a respondeat superior theory in actions against broker-dealers and accounting firms alleging violations of section

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8. Hereinafter referred to as “the Commission.”
11. Securities Exchange Act of 1934 § 28(a), 15 U.S.C. § 78bb(a) (1976). This section provides, in part, that “[t]he rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity . . . .” See also 15 U.S.C. § 77p (1976) for the counterpart to this provision in the Securities Act of 1933.
10(b)

The Ninth and Fourth Circuit Courts of Appeals have responded to the query in the affirmative, holding that section 20(a) is the exclusive source of liability. An analysis of these two opposing views is instructive.

A. Majority View: Nonexclusivity of Section 20(a)

In *Marbury Management, Inc. v. Kohn*, the Second Circuit confronted the section 20(a)-respondeat superior problem. The plaintiffs had purchased securities through the defendant brokerage firm. They alleged that a registered trainee at the firm had, with the requisite scienter, misrepresented his status with the firm. Finding that the firm did not act with scienter, a necessary element in a civil liability action under section 10(b), the district court dismissed the action against the brokerage firm.

In reversing the district court’s decision and granting a new trial, the Second Circuit stated:

> Where respondeat superior principles are applied, the special good faith defense afforded by the last clause of Section 20(a) is unavailable. . . . [T]here is no warrant for believing that Section 20(a) was intended to narrow the remedies of the customers of brokerage houses or to create a novel defense in cases otherwise governed by traditional agency principles.

Citing section 28(a) of the Exchange Act, the court also found that agency principles could be applied to impose liability because “the rights and remedies provided by the ’34 Act shall be in addition to any and all rights and remedies that may exist at law or in equity. . . .”

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15. 629 F.2d 705 (2d Cir.), cert. denied, 449 U.S. 1011 (1980).
16. The causal relationship between the agent’s representations and the plaintiff’s losses—an issue in the case—is not important for the purposes of this discussion. The brokerage firm did not deny the actions of its trainee; it attempted, however, to establish its good faith defense under Exchange Act § 20(a). *Id.* at 711-12.
17. *Id.* at 707.
18. In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the Supreme Court held that scienter, an intent to defraud or deceive, is a necessary element of a civil suit based upon alleged violations of § 10(b) and rule 10b-5. *Id.* at 199.
20. 629 F.2d at 716. The Supreme Court has addressed the application of agency principles to the federal securities laws. See infra notes 91-96 and accompanying text.
21. 629 F.2d at 716. Section 28(a), however, does not justify the application of a common law doctrine (respondeat superior) to a case brought under the federal securities laws; it means, rather, that any state law or common law remedy which exists separately may provide
Paul F. Newton & Co. v. Texas Commerce Bank involved an alleged price manipulation of an over-the-counter stock. Paul F. Newton & Co. ("Newton"), a registered broker-dealer, executed orders which, unknown to Newton, were part of the alleged manipulative scheme. Pressman, Frohlic & Frost ("Pressman"), a broker-dealer which subsequently filed for bankruptcy and whose employee was involved in the manipulation, defaulted on payment for the shares it had ordered through Newton. Newton contended that Pressman's employee had violated section 10(b) of the Exchange Act and rule 10b-5 and that Pressman was liable under both Exchange Act section 20(a) and respondeat superior, thereby giving rise to the exclusivity issue. The Fifth Circuit considered the issue by examining the legislative history of section 20(a). After finding that it was "inconclusive," the court held that respondeat superior could be used to impose liability on a brokerage firm for violations of the antifraud provisions of the federal securities laws. The court cited commonly used reasons, such as common law agency principles, policy considerations, and the need to construe the "remedial" legislation flexibly to support its holding. The court reasoned that a contrary conclusion would enable the brokerage firm to escape liability merely by showing that it did not "culpably participate" in fraud committed by its employee. To allow a brokerage firm to avoid secondary liability simply by showing ignorance, purposeful or negligent, of the acts of its registered representative contravenes Congress's intent to

an additional cause of action in a securities matter. See, e.g., Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 738 n.9 (1975) (where the Court did not allow a plaintiff who had been offered, but had not purchased, a security to maintain a cause of action under rule 10b-5, but stated that under Exchange Act § 28(a), a non-purchaser may have a cause of action under state law). A district court in the Second Circuit recently rejected an attempt to hold a brokerage firm liable based on the acts of its employees. In Moss v. Morgan Stanley, 553 F. Supp. 1347 (S.D.N.Y.), aff'd, 719 F.2d 5 (2d Cir. 1983), the court did not hold a broker-dealer liable for its employee's violative acts, where the employee had "tipped" material non-public information relating to an impending tender offer, because such activities were outside the employee's scope of employment. Id. at 1357-58.

22. 630 F.2d 1111 (5th Cir. 1980).
23. Id. at 1112-14.
24. Id. at 1116.
25. Id. at 1118-19.
26. Id. at 1118; see infra text accompanying notes 82-149.
27. The Supreme Court, however, does not cite such reasons with approval. See infra text accompanying notes 82-149.
The court also held that the broker-dealer could be found liable under section 20(a) of the Exchange Act based upon a finding that Pressman had failed to establish, maintain, and enforce a system of supervision and control.\textsuperscript{29}

In \textit{Henricksen v. Henricksen},\textsuperscript{30} the Seventh Circuit found the broker-dealer defendant, Smith Barney, Harris Upham & Co. ("SBHU"), liable for the actions of one of its registered representatives under both section 20(a) and respondeat superior.\textsuperscript{31} The plaintiff had alleged that her former husband, a SBHU registered representative, was liable for various losses she sustained at SBHU as well as for the conversion of the proceeds from the sale of securities that had been deposited in the couple's joint bank account and were subsequently withdrawn by her husband.\textsuperscript{32}

The \textit{Henricksen} opinion illustrates many of the problems associated with controlling person-respondeat superior cases. The trial court held that SBHU had demonstrated its good faith defense under section 20(a) and limited the plaintiff's recovery to commissions generated from the account to assure that the firm was not unjustly enriched.\textsuperscript{33} In a loosely worded opinion couched in terms of fiduciary duty and respondeat superior, the Seventh Circuit held the brokerage firm liable for all losses sustained, including the money the plaintiff's husband had withdrawn from the couple's joint bank account, reasoning that the brokerage firm had contributed to the "ease" with which the plaintiff's husband withdrew and converted the customer's money from their joint account.\textsuperscript{34} Only an imaginative court could interpret such actions as a fraud recognizable in an action maintained under the federal securities laws.

In \textit{Holloway v. Howerdd},\textsuperscript{35} the Sixth Circuit held that the

\textsuperscript{28} 630 F.2d at 1118-19 (citations omitted). The court, however, misconstrues Exchange Act § 20(a) because ignorance, purposeful or inadvertent, of an employee's actions is not a defense. Rather, § 20(a) requires a controlling person to establish that it acted in good faith. \textit{See supra} note 6. It would be difficult for a court to find a firm which was purposefully ignorant of an employee's actions to be acting in good faith.

\textsuperscript{29} 630 F.2d at 1120.

\textsuperscript{30} 640 F.2d 880 (7th Cir.), \textit{cert. denied}, 454 U.S. 1097 (1981).

\textsuperscript{31} \textit{Id.} at 887-88. It is not clear from the court's opinion whether it was imposing liability based on common law fraud or § 10(b).

\textsuperscript{32} \textit{Id.} at 881-84.

\textsuperscript{33} \textit{Id.} at 884.

\textsuperscript{34} \textit{Id.} at 887.

\textsuperscript{35} 536 F.2d 690 (6th Cir. 1976).
plaintiffs could pursue an action against a broker-dealer based upon the actions of its registered agent under a respondeat superior theory despite the broker-dealer's established defense under section 15 of the 1933 Act. The court stated that the broker-dealer “had an affirmative obligation to prevent use of the prestige of its firm to defraud the investing public” and that the broker “must be clearly disassociated” from the illegal transactions to escape liability under respondeat superior.

Until its 1981 decision in Sharp v. Coopers & Lybrand, the Third Circuit was widely viewed as supporting section 20(a)'s exclusivity and rejecting respondeat superior as a basis for liability in a securities case. In an earlier decision, Rochez Brothers v. Rhoades, the court stated:

We are of the opinion that, after reviewing the legislative history of the 1934 Act and the pertinent cases, the principles of agency, i.e., respondeat superior, are inappropriate to impose secondary liability in a securities violation case.

... [Given section 20(a)'s good faith defense, if we were to apply respondeat superior, the availability of this good faith defense would be bypassed. ... To use respondeat superior for imposing secondary liability would not advance the legislative purpose of the 1934 Act and in fact would also undermine the Congressional intent by emasculating Section 20(a).]

In Sharp, the plaintiffs brought a claim under section 10(b) and rule 10b-5, alleging material misrepresentations and omissions in a tax opinion letter issued on behalf of the accounting firm, Coopers & Lybrand (“C&L”). C&L had initially issued an opinion letter in July of 1971 in response to an inquiry from one of its client’s investors. When C&L discovered that this letter was being utilized by the

36. Id. at 695. The trial court had found that “[the broker-dealer] ... had no knowledge of nor reasonable grounds to believe in the existence of [its registered agent’s] activity in publicly selling unregistered stock.” 377 F. Supp. 754, 766 (M.D. Tenn. 1973), aff’d in part and rev’d in part, 536 F.2d 690 (6th Cir. 1976).
38. 536 F.2d at 696. Of course, there is no way a broker-dealer could fulfill such an “affirmative obligation.” What the court is really talking about here is a strict, insurer’s liability. See infra text accompanying notes 64-81 (describing the strict liability doctrine of respondeat superior).
41. Id. at 884, 885 (emphasis added).
42. 649 F.2d at 179.
client as a part of its general sales program to all potential investors, the firm issued a second, allegedly more complete, opinion letter.\textsuperscript{43} The jury found that although the firm had not acted with scienter in causing the omissions and misrepresentations in the second letter, one of its employees had. The district court, therefore, held that, as a matter of law, C&L was liable under both the Exchange Act section 20(a) and the doctrine of respondeat superior.\textsuperscript{44} On appeal, the circuit court acknowledged C&L's lack of scienter, but retreated from its position in \textit{Rochez Brothers}. The court noted that although "the doctrine of respondeat superior . . . should not be widely expanded in the area of federal securities regulation,"\textsuperscript{45} it should be applied in situations where the controlling person is a brokerage firm, since it "owes a higher duty to its customers than do other employers."\textsuperscript{46} The court explained its reasoning:

When the firm's public representations are designed to influence the investing public, the firm should not be shielded from compensating persons who suffered from reckless or knowing acts by its employees. Otherwise, it could immunize itself from liability by constructing a "Chinese wall" between its employees and partners, allowing only the former to draft opinion letters. Partners . . . would have a strong incentive to avoid using their expertise to benefit the investors to whom opinion letters are directed. . . . This incentive can be reversed only by recognizing an absolute duty on the part of the firm . . . to supervise employees closely whenever its representations are designed to influence the investing public.\textsuperscript{47}

B. Minority View: The Exclusivity of Section 20(a)

A minority of the circuit courts of appeals take the position that Exchange Act section 20(a) is the exclusive means for establishing vicarious civil liability and expressly reject the application of respondeat superior to a securities fraud case.

\begin{footnotes}
\item[43] Id. at 178.
\item[45] 649 F.2d at 183.
\item[46] Id. at 182.
\item[47] Id. at 184 (emphasis added) (citations omitted). Of course, a firm with a "Chinese Wall" designed specifically to insulate the firm from liability could not demonstrate the affirmative defense provided by Exchange Act section 20(a)—it would not be acting in good faith. Practically speaking, partners or officers do not want law suits nor do they want their firm's reputation tarnished. For an analysis of the circuit court's decision, see infra text accompanying notes 68-73.
\end{footnotes}
The case of Zweig v. Hearst Corp.48 is generally cited for the proposition that Exchange Act section 20(a) is the exclusive means for holding an employer liable under the federal securities laws for the acts of its employee.49 In Zweig, a Hearst newspaper columnist published a favorable article about a company whose securities he had just purchased. The price of the company’s stock increased and then dropped. The plaintiffs alleged that the columnist’s conduct was actionable under section 10(b) and rule 10b-5.50 Relying upon an earlier decision in the same circuit, Kamen & Co. v. Paul H. Aschkar & Co.,51 the court affirmed the trial court’s holding that Hearst was not vicariously liable under respondeat superior,52 and that liability could only be established under Exchange Act section 20(a), wherein the dispositive issue would be the firm’s good faith.53

The Ninth Circuit subsequently confirmed its position that Exchange Act section 20(a) supplants common law vicarious liability theories in the case of Christoffel v. E.F. Hutton & Co.54 The plaintiff in that case was attempting to hold E.F. Hutton & Co., Inc. liable for the acts of its employee who, pursuant to court order, was acting as the guardian for an incompetent. The employee-guardian had effected a series of securities transactions which resulted in diminishing the value of the plaintiff’s estate by almost $400,000.55


49. E.g., Smith v. Christie, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,828, at 90,121 (N.D. Cal. Dec. 24, 1980) (citing Zweig for the proposition that § 20(a) “provides the exclusive means by which an employer may be held vicariously liable for the acts of its agent or employees. The doctrine of respondeat superior does not apply.”).

50. 521 F.2d at 1131.

51. 382 F.2d 689 (9th Cir. 1967), cert. granted, 390 U.S. 942, cert. dismissed, 393 U.S. 801 (1968). In Kamen, the plaintiff contended that a violation by a broker-dealer’s employee rendered the broker civilly liable. The Ninth Circuit rejected this and declined to hold the broker-dealer liable because it did not participate in the illegal actions and did not have reasonable grounds to believe that the activities were taking place. Id. at 694, 697. That is, the Ninth Circuit rejected the contention that respondeat superior remains an effective theory of vicarious liability in a § 10(b) claim, and expressly held that § 20(a) is to be applied to determine controlling person liability. See id. at 697; Zweig, 521 F.2d at 1132.

52. 521 F.2d at 1132-33.

53. Id. at 1135. The court took the precaution to point out that the “firm” here was a newspaper publisher, not a brokerage firm. Therefore, the court held Hearst to a “lesser standard amounting more nearly to culpability. . . .” Id.

54. 588 F.2d 665 (9th Cir. 1978).

55. Id. at 666-67.
Citing Zweig and Kamen, the court rejected the plaintiff’s attempt to hold the employer liable, stating: “[I]t is the established law of this circuit that section 20(a) supplants vicarious liability of an employer for the acts of an employee applying the respondeat superior doctrine.”

In Carpenter v. Harris, Upham & Co., the Fourth Circuit modified its earlier decision of Johns Hopkins University v. Hutton, where it had stated that the control person liability section of the 1933 Securities Act “was not intended to insulate a brokerage house from the misdeeds of its employees.” In Carpenter, the court stated:

While the standards of supervision may be stringent, this does not create absolute liability for every violation of the securities laws committed by a supervised individual. . . . It is required of the controlling person only that he maintain an adequate system of internal control, and that he maintain the system in a diligent manner.

A district court in the Fourth Circuit recently interpreted the conflicting views of Johns Hopkins and Carpenter. In Haynes v. Anderson & Strudwick, Inc., the court found that Carpenter overruled Johns Hopkins sub silencio and stated:

Once it is determined that the controlling person provisions are applicable [the] broker-dealer . . . is entitled to the defenses provided therein. . . . [Congress’ intent] that controlling persons have certain defenses should not be thwarted by resort to common law agency principles that emasculate the controlling person defenses. . . . [T]he court concludes that the two theories of liability cannot sensibly or fairly operate concurrently [and finds] that

56. Id. at 667.
60. 595 F.2d at 394 (citations omitted). Interestingly, the Carpenter court did not once mention its earlier Johns Hopkins opinion.
62. Id. at 1312.
§ 20(a) is the exclusive standard of liability for a broker-dealer.83

II. JUDICIAL APPLICATION OF RESPONDEAT SUPERIOR: A CRITICAL ANALYSIS

The preceding case studies are representative of the positions taken by the various circuits. There are three major reasons supporting the view that respondeat superior should not be applied to alleged violations of the antifraud provisions of the federal securities laws: (1) an understanding of the doctrine of respondeat superior; (2) recent Supreme Court decisions which discuss the concepts of scienter, implied rights, and the application of common law principles to securities laws cases; and (3) the legislative history of section 20(a).

A. Understanding Respondeat Superior

A major problem associated with the application of respondeat superior by some circuit courts in actions brought under the antifraud provisions of the federal securities laws is their failure to comprehend the meaning and implications of the doctrine. The only relevant inquiry under the theory of respondeat superior is whether an individual's fraudulent act was committed within the scope of his employment.64 Any discussion of the good faith defense of section 20(a),65 negligence principles, or a duty to supervise becomes irrelevant when the common law theory is applied. The opinions in Sharp v. Coopers & Lybrand66 and Hollway v. Howerd67 illustrate a failure to comprehend the implications of respondeat superior. As discussed previously, the Third Circuit in Sharp held an accounting

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63. Id. at 1312. But see Frankel v. Wyllie & Thornhill, Inc., 537 F. Supp. 730 (W.D. Va. 1982). The Frankel court noted that Carpenter did not consider the question of respondeat superior, since it was never an issue before the court, but only focused on § 20(a) liability. As a result, the Frankel court determined that Carpenter did not affect earlier Fourth Circuit interpretations on respondeat superior. Id. at 93,864.

64. In the context of actions against broker-dealers, the scope of employment limitation is really no limit at all. Since actions are generally brought against brokers based upon misrepresentations in connection with the purchase and sale of securities, a broker-dealer would have a difficult time proving that such a representation was made outside an employee's scope of employment. See Holloway v. Howerd, 536 F.2d 690 (6th Cir. 1976); supra notes 35-38 and accompanying text.


66. 649 F.2d 175 (3d Cir. 1981), cert. denied, 455 U.S. 938 (1982); see supra notes 42-47 and accompanying text.

67. 536 F.2d 690 (6th Cir. 1976); see supra notes 35-38 and accompanying text.
firm liable under the common law doctrine of respondeat superior, specifically rejecting the idea, which it had expressly adopted in *Rochez Brothers v. Rhoades,* that section 20(a) provides the exclusive means for holding a party vicariously liable under the Exchange Act. The *Sharp* court held an accounting firm to a “high duty to supervise” and determined that respondeat superior provides the “incentive” for a firm to supervise its employees carefully. The court stated: “[A]n accounting firm owes a responsibility to the investing public to exercise stringent or high supervision of its employees, and failure to perform this duty will expose it to liability for their violations of rule 10b-5 under the doctrine of respondeat superior.” The court’s discussion of the duty owed by the firm is deficient because it fails to identify the source, statutory or otherwise, from which this “duty” is derived, or by which it is imposed.

In fact, while the Third Circuit was couching its opinion in terms of a stringent duty to supervise, its real focus was vicarious liability without fault. After deciding that section 20(a) was not the exclusive means for imposing vicarious liability and that respondeat superior could be applied to hold the accounting firm liable, any discussion of the internal control procedures utilized by C&L was irrelevant.

In summary, the *Sharp* opinion represents a complete misapplication of respondeat superior in the context of a claim brought under the federal securities laws. Phrases such as strict and high duty to supervise are misleading when respondeat superior is applied; the accounting firm was really held to an insurer’s liability.

The Sixth Circuit’s opinion in *Holloway* evidences a similar misapplication. In *Holloway,* the court held a brokerage firm liable for the acts of its “agent” under the doctrine of respondeat superior. The brokerage firm’s employee in *Holloway* had done many things to disassociate his firm from the unlawful sale of the unregis-

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68. 649 F.2d at 185.
69. 527 F.2d 880, 884-85 (3d Cir. 1975), cert. denied, 425 U.S. 993 (1976); see supra notes 40-41 and accompanying text.
70. 649 F.2d at 185.
71. Id. at 184.
72. Id. at 185. Just one year prior to the Third Circuit’s decision in *Sharp,* however, the Supreme Court warned that loosely worded claims of duties owed to the entire marketplace are not sufficient to sustain a cause of action under § 10(b). Chiarella v. United States, 445 U.S. 222, 233-35 (1980); see infra notes 128-31 and accompanying text.
73. Obviously, any discussion of a “high duty to supervise” is misplaced; the Third Circuit was really addressing an absolute and not a high duty when applying respondeat superior.
74. 536 F.2d at 695-96.
tered securities in question: He confirmed the allegedly illegal sales using his personal stationery,\textsuperscript{76} he never used the broker's stationery to communicate with investors,\textsuperscript{76} and word of the investment opportunity spread throughout the state "with a minimum of assistance from [the broker's employee]."\textsuperscript{77}

These facts led the trial court to conclude that the firm had met the statutory good faith defense.\textsuperscript{78} On appeal, the Sixth Circuit discounted these facts, holding that the securities laws were "not intended to preempt the operation of the doctrine of respondeat superior. . . ."\textsuperscript{79} and that the firm "had an affirmative obligation to prevent use of the prestige of its firm to defraud the investing public. . . . [The brokerage firm] must be clearly disassociated from [the unlawful transactions] as otherwise it will incur liability on the basis of respondeat superior. . . ."\textsuperscript{80}

As previously noted, the Sixth Circuit's discussion of an "affirmative obligation" is inappropriate. The court was, in reality, holding the firm vicariously liable through application of the respondeat superior doctrine. The brokerage firm in \textit{Holloway} had, to a reasonable extent, been disassociated from the illegal sales and had demonstrated the statutory good faith defense.\textsuperscript{81} The effect of the holding, therefore, was to place an insurer's liability on the brokerage firm.

Virtually all of the circuits which have applied the doctrine of respondeat superior in cases involving the antifraud provisions of the federal securities laws have done so in a misleading fashion. Discussion of a "high duty of supervision" which must be satisfied is inappropriate and unnecessary since such a duty, even if fulfilled, cannot constitute a defense under a strict liability doctrine such as respondeat superior. Once a court determines that liability may be found under respondeat superior, any discussion of a firm's duty to supervise or its negligent actions becomes irrelevant. Thus, those opinions which deal with such affirmative defenses in the context of respondeat superior lead to the conclusion that the court either does not understand or is reluctant to be limited by the cohesion and purposes of the federal securities laws.

\begin{itemize}
  \item 75. \textit{Id.} at 693.
  \item 76. \textit{Id.} at 694.
  \item 77. \textit{Id.} at 693.
  \item 79. 536 F.2d at 695.
  \item 80. \textit{Id.} at 696.
  \item 81. \textit{Id.} at 693-94.
\end{itemize}
The split in the circuits in addition to the underlying basic misconception and misapplication of respondeat superior creates substantial doubt as to the accuracy of the manner in which the circuit courts of appeals have treated this question.

B. Recent Supreme Court Decisions: Tort Principles, Implied Causes of Action, and Respondeat Superior

Although there have been no Supreme Court decisions analyzing the relationship of respondeat superior to section 20(a), an examination of several of the Court’s recent decisions interpreting the propriety of implying causes of action under various sections of the federal securities laws is instructive. These cases reveal that the Court will scrutinize carefully any claims which imply causes of actions (and, concomitantly, theories of recovery) based upon policy considerations. These cases also reveal the Court’s tendency to eschew finding such implied causes of action, indicating, instead, a clear preference for statutorily created causes of action.

In Transamerica Mortgage Advisors, Inc. v. Lewis ("TAMA"), the Supreme Court addressed the question of whether a private cause of action should be implied under section 206 of the Investment Advisers Act of 1940 ("IAA"). In TAMA, the plaintiffs alleged, inter alia, that an adviser had breached its fiduciary duty to a trust by causing it to purchase inferior securities and that the adviser had misappropriated profitable investment opportunities available to some of its affiliated companies. In analyzing whether an implied cause of action exists under section 206 of the IAA, the

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83. Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 (1976), provides, in part:
   It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—
   (1) to employ any device, scheme or artifice to defraud any client or prospective client;
   (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
   (3) acting as a principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting in obtaining the consent of the client to such transaction. . . .
   (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. . . .
84. 444 U.S. at 13-14.
Court stated that the determinative factor is the intent of Congress. The Court noted that in several of its previous decisions, considerable emphasis was placed upon the desirability of implying private causes of action to effectuate the purposes of a given statute. The Court, however, rejected such an effectuation of purposes test, holding, instead, that the determination to be made is "whether Congress intended to create the private remedy asserted." After analyzing the legislative history and language of the statute, the court stated that "the mere fact that the statute was designed to protect advisers' clients does not require the implication of a private cause of action for damages on their behalf" and held that, other than the express statutory remedy to void an adviser's contract under certain circumstances, the IAA did not confer a private remedy, equitable or otherwise.

Similarly, the Court in Touche Ross & Co. v. Redington held that section 17(a) of the Exchange Act does not create a private right of action. In Touche Ross, Redington, the trustee for the Securities Investor Protection Corporation ("SIPC") in the liquidation of Weis Securities, Inc., attempted to sue the accounting firm retained by the now bankrupt broker-dealer, alleging, inter alia, that the accounting firm breached a duty owed to SIPC, the trustee, and others under the common law and section 17(a) of the Exchange Act. The plaintiffs argued that the Court should imply a private remedy to effectuate the purpose of the statute. The Supreme

85. Id. at 15-16.
87. 444 U.S. at 15-16. The Court specifically rejected the Commission's argument as amicus that it must consider "the utility of a private remedy." Id. at 23.
88. Id. at 24.
90. 444 U.S. at 24.
93. 442 U.S. at 568-79. Section 17(a) provides, in part, that broker-dealers transacting business on a national securities exchange "shall make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise. . . ."
94. SIPC is a nonprofit organization of securities dealers established by the Securities Investors Protection Act of 1970 to protect the interests of broker-dealers' customers during the liquidation of broker-dealers. 15 U.S.C. § 78ccc (1982).
95. 442 U.S. at 562, 565-66.
Court, however, once again rejected such an argument and reiterated that the answer was to be found in the congressional intent.\textsuperscript{96}

One year after \textit{Touche Ross} was decided, the Fifth Circuit in \textit{Paul F. Newton & Co. v. Texas Commerce Bank}\textsuperscript{97} relied upon the "remedial purposes" of the federal securities laws to support the application of respondeat superior in securities fraud cases.\textsuperscript{98} Yet, in \textit{Touche Ross}, the Supreme Court expressly rejected such an argument when it stated: "The invocation of the 'remedial purposes' of the 1934 Act is . . . unavailing. Only last Term we emphasized that generalized references to the 'remedial purposes' of the 1934 Act will not justify reading a provision 'more broadly than its language and the statutory scheme reasonably permit.'\textsuperscript{99}

The Court in \textit{Touche Ross} also rejected the argument that the result reached "sanctions injustice."\textsuperscript{100} The Court stated that since it is "not at liberty to legislate,"\textsuperscript{101} this argument would be better made to Congress.\textsuperscript{102}

The Court's reasoning in \textit{TAMA} and \textit{Touche Ross} is relevant to an analysis of the respondeat superior-controlling person liability issue. As the Court stated in both cases, when Congress wished to create a cause of action, it knew how to do so.\textsuperscript{103} In section 20(a) of the Exchange Act, Congress expressly provided for vicarious liability, but also included within that statute a good faith defense to an action based on liability without fault.\textsuperscript{104} To paraphrase the Court, the mere fact that the federal securities laws were designed to protect investors should not require the application of a theory of liability based upon respondeat superior. The Supreme Court, in \textit{Touche Ross}, stated that reliance on tort principles to sustain a private cause of action under federal securities laws violations is "entirely misplaced,"\textsuperscript{105} and in determining whether a private cause of action exists, the focal point of the examination must be the language of the statute and the intent of Congress.\textsuperscript{106} Therefore, to apply respondeat

\textsuperscript{96} See id. at 575.
\textsuperscript{97} 630 F.2d 1111 (5th Cir. 1980).
\textsuperscript{98} Id. at 1119; see supra notes 22-29 and accompanying text.
\textsuperscript{99} 442 U.S. at 578 (quoting SEC v. Sloan, 436 U.S. 103, 116 (1978)).
\textsuperscript{100} Id. at 579.
\textsuperscript{101} Id.
\textsuperscript{102} Id.
\textsuperscript{103} \textit{TAMA}, 444 U.S. at 21; \textit{Touche Ross}, 442 U.S. at 572.
\textsuperscript{104} See supra note 6.
\textsuperscript{105} 442 U.S. at 568.
\textsuperscript{106} See id.
superior in federal securities laws claims by relying upon the remedial purposes of those laws is unavailing and improper.

In both TAMA and Touche Ross, the Supreme Court gave a clear message—when analyzing implied causes of action, courts must determine whether or not such application is mandated by the statutory scheme. In deciding whether or not to sustain a section 10(b) cause of action on a respondeat superior theory, courts should analyze whether the application of such a common law theory of recovery is mandated by the statutory scheme. Close attention should be paid to the Supreme Court’s analysis in Blue Chip Stamps v. Manor Drug Stores,108 where the Court refused to allow a section 10(b) cause of action by plaintiffs who were not actual purchasers or sellers,109 despite assertions that to do so “unreasonably prevents some deserving plaintiffs from recovering damages which have in fact been caused by violations of Rule 10b-5.”110 The court rejected this remedial purposes assertion, because of the fear of vexatious litigation111 and because the cause of action under rule 10b-5112 was “judicially found to exist, and [must therefore be] judicially delimited one way or another unless and until Congress addresses the question.”113 Likewise, allowing plaintiffs to sue under rule 10b-5 pursuant to the common law respondeat superior theory is extending the judicially created causes of action under section 10(b) and rule 10b-5 far beyond what the Supreme Court would allow.114

Application of respondeat superior in cases under the federal securities laws is not only inconsistent with the recent Supreme Court cases involving implied causes of action, but it is also inconsistent with the reasoning of Ernst & Ernst v. Hochfelder.115 In Hochfelder, the Court held that scienter is a necessary element in a private damage suit brought under Exchange Act section 10(b) and rule 10b-5. The Court based its decision on both the legislative history and the language of the statute which “clearly connotes inten-

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109. Id. at 730-31.
110. Id. at 738.
111. Id. at 739-44.
113. 421 U.S. at 749.
114. In Touche Ross, the Court stated that when it sustained a private cause of action under § 10(b) in Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6 (1971), it “simply . . . acquiesed” in the lower court’s acceptance of the cause of action. 442 U.S. at 577 n.19.
tional misconduct.”\textsuperscript{116} The Court defined scienter as “a mental state embracing intent to deceive, manipulate or defraud.”\textsuperscript{117} Application of respondeat superior circumvents and emasculates the Hochfelder holding by substituting an employee’s state of mind—be it a registered representative or a staff accountant in an accounting firm—for the entity which the plaintiff seeks to hold liable.

In Hochfelder, the respondents alleged that Ernst & Ernst had acted negligently in the performance of their auditing duties.\textsuperscript{118} Suppose, however, that one of Ernst & Ernst’s staff accountants had behaved in a reckless manner,\textsuperscript{119} failing to discover the unusual mail procedure utilized by the President of First Securities Co. of Chicago, which was the basis of the section 10(b) fraud claim.\textsuperscript{120} Under the reasoning of several of the circuit courts of appeals, the accounting firm could be held liable on the basis of one of its employee’s misdeeds, despite the existence of the good faith defense of section 20(a).\textsuperscript{121} Application of respondeat superior and the unavailability of section 20(a)’s good faith defense allows the imposition of section 10(b) and rule 10b-5 liability upon an employer who has done nothing more than “hire an employee or agent and assign him his legitimate duties.”\textsuperscript{122} It does not follow that the employer himself behaved recklessly. Permitting a civil action to lie against an employer

\textsuperscript{116} Id. at 201.

\textsuperscript{117} Id. at 194 n.12.

\textsuperscript{118} Id. at 190.

\textsuperscript{119} Several circuit courts of appeals permit the § 10(b) scienter requirement to be fulfilled by reckless conduct, which is defined by the Seventh Circuit as conduct which is limited to:

“highly unreasonable omission[s or misrepresentations] involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.”


\textsuperscript{120} 425 U.S. at 190.

\textsuperscript{121} \textit{See supra} text accompanying notes 15-47.

who acted in good faith and without the requisite mental state serves to nullify the scienter requirement imposed by the Court in Hochfelder.

The Supreme Court’s interpretation of the legislative history and the statutory language of section 10(b), as enunciated in Hochfelder, would be vitiated if a court sustained a cause of action based upon such a complaint. In reviewing the legislative history, the Court noted the absence of any indication on the part of “Congress [that it] intended anyone to be made liable for [violations of the express civil liability provisions of the 1934 Act] unless he acted other than in good faith.” Thus, the Court’s reasoning supports the view that section 20(a), with its express good faith defense, is the exclusive source of secondary liability for a violation of section 10(b).

Paraphrasing the Supreme Court’s language in Touche Ross, Congress intended to provide a means for vicarious liability, knew how to do so, and did so expressly in section 20(a). In the same section, however, Congress also established a good faith defense. It appears, therefore, that Congress specifically defined the parameters of vicarious liability in section 20 of the Exchange Act and its counterpart, section 15 of the Securities Act. Where Congress has expressly provided a cause of action against control persons based on vicarious liability principles, courts must, in the words of the Supreme Court, be “chary of reading others [into the statute]” and should—and must—look to Congress for guidance.

The Supreme Court also limited the scope of section 10(b) in Chiarella v. United States. The Court stated that loosely worded claims of duties owed to the entire marketplace are not sufficient to sustain a section 10(b) cause of action. The Court reversed a financial printer’s conviction under section 10(b) because, inter alia, the printer did not owe a duty to the persons from whom he purchased the securities. The Court rejected the government’s broad interpretation of section 10(b) and held that imposing a duty on all purchasers and sellers of securities would depart “radically from the

123. 425 U.S. at 206 (emphasis added).
124. Touche Ross, 442 U.S. at 572.
126. TAMA, 444 U.S. at 19.
127. Id. at 15-16. See also Touche Ross, 442 U.S. at 568.
129. Id. at 233-35.
130. Id. at 232-33.
established doctrine that duty arises from a specific relationship between two parties, . . . [and should not be imposed] absent some explicit evidence of congressional intent.\footnote{Id. at 233.}

Although one of the Court's more recent decisions relevant to this study involving the federal securities laws appears, at first glance, to undercut the foregoing analysis, closer examination reveals that this case can be reconciled with the court's prior decisions. In \textit{Herman & MacLean v. Huddleston},\footnote{103 S. Ct. 683 (1983).} the Court held that the implied remedy under section 10(b) was available to defrauded purchasers of registered securities, notwithstanding the express remedy afforded by section 11 of the Securities Act\footnote{15 U.S.C. § 77k (1976).} for misrepresentations in a registration statement.\footnote{103 S. Ct. at 686.} The defendants had argued, inter alia, that section 11 provided the sole basis for recovery in actions based on an inaccurate registration statement.\footnote{See id.} Initially, the Court observed that the two sections are directed at different types of conduct—section 11 at any material misstatement or omission in a registration statement\footnote{136. Under § 11, liability against the issuer is "virtually absolute," \textit{Huddleston}, 103 S. Ct. at 687, while liability of experts, such as accountants, is predicated on a negligence standard. \textit{See} Ernst & Ernst v. Hochfelder, 425 U.S. 185, 208 (1976).} and section 10(b) at fraud perpetrated with scienter.\footnote{103 S. Ct. at 687-88.} Therefore, the Court found that its interpretation was sound under general rules of statutory construction since it would not nullify the procedural restrictions of section 11.\footnote{Id. at 688-89.} In contrast, section 20(a) of the Exchange Act specifically addressed the issue of vicarious liability. Application of the respondent superior doctrine, which also addressed vicarious liability, would render the statutory good faith defense of section 20(a) a nullity.

The Court in \textit{Huddleston} also utilized the "legislative reenact-
ment” analysis it had relied on in another recent case involving implied causes of action, *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran.* The Court reasoned that since Congress had comprehensively revised the securities laws in 1975 and had left section 10(b) “intact,” Congress implicitly ratified the cumulative remedies scheme “consistently and routinely” applied by the federal courts. This analysis, however, does not provide support for a plaintiff seeking to impose liability under the respondeat superior theory since the state of the law regarding the interaction of section 20(a) and the respondeat superior theory vis-a-vis violations of section 10(b) was unsettled at the time of these congressional revisions.

Lastly, in what at first appears to be a disregard for its own precedent, the Court refers to the “broad remedial purposes” of the federal securities laws as a third reason to support the nonexclusivity of section 10(b) and section 11. A closer examination, however, reveals the Court’s concern with the possibility of corporate officers not specified in section 11(a), and attorneys and accountants who are not acting as “experts,” avoiding all liability, “even if [they] en-

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139. 102 S. Ct. 1825 (1982). In *Curran,* the Court examined whether or not a private cause of action exists under the Commodity Exchange Act of 1936, ch. 545, §§ 1-13, 49 Stat. 1491 (codified as amended in scattered sections of 7 U.S.C.) (“CEA”). It noted that at the time of comprehensive amendments to the commodities laws, lower courts had already implied private causes of action under the CEA. It reasoned, therefore, that Congress implicitly affirmed the existence of a private cause of action because, when amending the commodities laws, it left intact these interpretations by lower federal courts. *Id.* at 1839-41. The Court reasoned:

[It] is abundantly clear that an implied cause of action under the CEA was a part of the ‘contemporary legal context’ in which Congress [amended the law]. . . . In that context, the fact that such a comprehensive reexamination and significant amendment of the CEA left intact the statutory provisions under which the federal courts had implied a cause of action is itself evidence that Congress affirmatively intended to preserve [the judicially implied] remedy. *Id.* at 1841 (citations and footnotes omitted).

140. 103 S. Ct. at 689. Prior to the Court’s decision in *Huddleston,* six of the seven courts of appeals faced with the exclusivity issue of § 10(b) and various express remedies of both the Securities Act and the Exchange Act had adopted the cumulative remedy view. *See,* e.g., *Berger v. Bishop Inv. Corp.*, 695 F.2d 302 (8th Cir. 1982); *Huddleston v. Herman & MacLean,* 640 F.2d 534 (5th Cir. 1981), *aff’d in part and rev’d in part,* 103 S. Ct. 683 (1983); *Wachovia Bank & Trust Co. v. National Student Mktg. Corp.*, 650 F.2d 342 (D.C. Cir. 1980), *cert. denied,* 452 U.S. 954 (1981); *Ross v. A. H. Robins, Co.***, 607 F.2d 545 (2d Cir. 1979), *cert. denied,* 446 U.S. 946 (1980); *Schaefer v. First Nat’l Bank of Lincolnwood,* 509 F.2d 1287 (7th Cir. 1975), *cert. denied,* 425 U.S. 943 (1976); *Ellis v. Carter,* 291 F.2d 270 (9th Cir. 1961). The Court of Appeals for the Tenth Circuit resolves conflicts between 10(b) and an express remedy in favor of the express remedy. *See* *Clegg v. Conk,* 507 F.2d 1351 (10th Cir. 1974); *Gilbert v. Nixon,* 429 F.2d 348 (10th Cir. 1970).

141. 103 S. Ct. at 689.

gaged in fraudulent conduct while participating in the [preparation
of the] registration statement."\textsuperscript{143} Hence, the Court's use of the
"broad remedial purposes" language does not effectively overrule its
prior decisions, which stated that: "generalized references to the 're-
medial purposes' " of the federal securities laws will not justify the
implication of a private cause of action.\textsuperscript{144}

In summary, the Supreme Court has specifically rejected several
of the rationales recently advanced by appellate courts in upholding
a plaintiff's right to hold the defendants liable under respondeat su-
perior. The Court has stated that general references to the remedial
sections of the federal securities laws are "unavailing."\textsuperscript{145} Similarly,
the Court has rejected references to agency principles as justifying
causes of action under the federal securities laws.\textsuperscript{146} The Court's po-
sition is clear: When Congress wants to create a cause of action or a
theory of recovery, it knows how to do so and drafts the statute ac-
ccordingly. As noted above, the argument of "need" has "little rele-
vancc\textsuperscript{147} if Congress, in the comprehensive remedial scheme of sec-
tion 10(b), section 20(a), and the other provisions of the federal
securities laws, chose not to authorize persons to recover on a respon-
deat superior basis.\textsuperscript{148} Lower courts should not ignore such legisla-
tive judgments\textsuperscript{149} and should heed the clear signals from the Su-
preme Court.

C. Legislative History

The legislative history of the control person liability sections
does not directly answer the question whether Congress intended re-
spendeat superior to be a supplement to the vicarious liability provi-
sions of the federal securities laws. One point, however, is significant.

\begin{itemize}
  \item 143. 103 S. Ct. at 690 n.22.
  \item 144. Touche Ross, 442 U.S. at 578; Hochfelder, 425 U.S. at 200.
  \item 145. Touche Ross, 442 U.S. at 578.
  \item 146. See id. at 568.
  \item 147. Id. at 575-76.
  \item 148. In Hochfelder, the Court addressed how Congress drafted the 1934 Securities Ex-
       change Act with respect to the specific level of culpability which a plaintiff must establish:
       Each of the provisions of the 1934 Act that expressly create civil liability . . . con-
       tains a state-of-mind condition requiring something more than negligence. . . .
       § 20, which imposes liability upon 'controlling person[s]' for violations of the Act by
       those they control, exculpates a defendant who 'acted in good faith and did not . . .
       induce the act . . . constituting the violation. . . .'
       425 U.S. at 209 n.28 (citations omitted).
  \item 149. See Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n, 453 U.S.
           1, 15-18 (1981); Touche Ross, 442 U.S. at 578.
\end{itemize}
As originally enacted, Securities Act section 15 did not have a "good faith defense" clause. Senator Fletcher, one of the draftsmen of the Securities Act, explained the insertion of the good faith defense into the text of § 15 when he stated:

The purpose of this amendment is to restrict the scope of the section so as more accurately to carry out its real purpose. The mere existence of control is not made a basis for liability unless that control is effectively exercised to bring about the action upon which liability is based.

While this excerpt from the legislative history refers specifically to the amending of section 15 of the 1933 Securities Act, it is equally relevant in interpreting the legislative intent underlying section 20 of the 1934 Exchange Act—which was based, to a large extent, on section 15 of the 1933 Act. The language quoted from the legislative history refutes the Fifth Circuit's view in Paul F. Newton & Co. v. Texas Commerce Bank that the legislative history "does not reflect any congressional intent to restrict secondary liability for violations of the acts to the controlled persons formula set out in [sections] 15 and 20(a)." Exchange Act section 28 is often cited as a rationale for applying respondeat superior in actions brought under the federal securities laws. The Fifth Circuit in Newton stated that this section "expressly make[s] the rights and liabilities imposed


151. 78 CONG. REC. 8185 (1934) (emphasis added). A subsequent conference report on the 1934 amendments to § 15 reiterates this point: Section 15 is proposed to be amended so as more accurately to carry out its real purpose. The mere existence of control is not made a basis for liability if it is shown that the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts upon which the liability of the controlled person is alleged to be based.

78 CONG. REC. 10,265 (1934) (emphasis added).

152. See Paul F. Newton & Co. v. Texas Commerce Bank, 630 F.2d 1111, 1116 (5th Cir. 1980) (citing Hearings on S. Res. 84 (72d Cong.), S. Res. 56 and 97 (73d Cong.) Before the Senate Comm. on Banking and Currency, 73d Cong., 1st Sess. 6571 (1934)).

153. 630 F.2d 1111 (5th Cir. 1980); see supra notes 22-29 and accompanying text.

154. 630 F.2d at 1118.

155. 15 U.S.C. § 78bb (1976). Section 28(a) provides:
The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; . . . Nothing in this chapter shall affect the jurisdiction of the securities commission . . . of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.
by the Act cumulative of any existing at law or in equity. . . .” 156 The House Committee which drafted the bill stated that section 28 (then section 27) "reserves rights and remedies existing outside of those provided in the act." 157 Section 28 simply does not support the proposition that the common law doctrine of respondeat superior can be mixed with federally created rights to impose vicarious liability on a brokerage firm for violations of section 10(b) by its employees. This section merely preserves the state or common law remedies in existence when the federal securities laws were enacted or which were created after its enactment. Congress' statement in section 28 is merely an indication to the states that the federal laws do not preempt the field. Section 28 does not, however, permit a court to ignore the language of the federal statutes which created specific remedies for violations of these statutes. Stated differently, an investor who alleges that he was injured by the misrepresentations of a registered representative could sue a broker-dealer in state court using state remedies which may include liability through respondeat superior. He should not, however, be permitted to utilize the common law doctrine of respondeat superior in a complaint alleging violations of section 10(b) and thereby completely nullify section 20(a) of the same act.

Perhaps, two reasons for the confusion in this area of the law is that the Commission itself claims: (1) that respondeat superior should be available in civil actions alleging violations of section 10(b), and (2) that respondeat superior liability is consistent with the statutory good faith defense provided in Exchange Act section 20(a). 158 In making such arguments, the Commission appears to be ignoring the Supreme Court's recent decisions in this area, 159 as well

156. 630 F.2d at 1118. The Second Circuit has expressed the same view. See Marbury Management, Inc. v. Kohn, 629 F.2d 705, 716 (2d Cir.), cert. denied, 449 U.S. 1011 (1980).
157. 78 CONG. REC. 7709 (1934) (emphasis added). Rather than supporting the premise that respondeat superior is available to hold a brokerage firm vicariously liable under § 10(b), § 28 instead permits a damaged investor to utilize state statutory or common law causes of action which existed prior to the passage of the federal securities laws in addition to those created by the federal securities laws. A court should not “piggyback” a common law liability doctrine on a cause of action created in the federal securities laws on the basis of § 28.
159. In the last nine years, the Supreme Court has consistently rejected the Commission's and plaintiffs' attempts to construe broadly the federal securities laws. See, e.g., Aaron v. SEC, 446 U.S. 680 (1980); Chiarella v. United States, 445 U.S. 222 (1980); Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979); Touche Ross & Co. v. Redington, 442
as exhibiting the same basic misunderstanding of the courts, with respect to the strict liability basis of the respondeat superior doctrine.

The Commission's first contention is one which the federal courts have relied on. The Commission claims that respondeat superior should be available in civil actions "when [fundamental common law] principles are necessary to effectuate the congressional purpose," and more specifically, "[t]hat agency principles are required to effectuate the congressional purpose embodied in Section 10(b)." Both arguments are inconsistent with the reasoning found in the recent Supreme Court cases analyzing implied rights and remedies under the federal securities laws. As previously discussed, the Supreme Court has specifically rejected such arguments because they result in an unnecessarily broad reading of the securities laws.

In support of the nonexclusivity of section 20(a), the Commission argues that under any other holding, "a broker-dealer could evade all responsibility to a customer for the fraud of the firm's salesman by demonstrating that it was merely negligent in failing to discover the wrong-doing." This argument, however, ignores the good faith defense requirement of section 20(a): A broker-dealer cannot establish the good faith defense under that section by demonstrating that it was merely negligent; rather, it must go on to demonstrate a system of controls effectively administered to establish the good faith defense. The argument also ignores the state or common law remedies which might exist, as well as the Supreme Court's statement that Congress had included a state-of-mind condition in each liability provision of the Exchange Act.

Further supporting its argument for section 20(a)'s nonexclusivity, the Commission cites remarks in the legislative history to the effect that the control provisions were designed "to prevent evasion


161. Id. at 5.
162. See supra notes 82-149 and accompanying text.
163. Id.
164. Smith Barney Brief, supra note 158, at 11.
165. See supra text accompanying note 60.
166. As previously discussed, the Supreme Court has stated that § 20(a) contains a state-of-mind requirement. See Hochfelder, 425 U.S. at 206-11; supra note 148.
of the provisions of the [laws] by organizing dummies who will un-
dertake the actual things forbidden by the section." Upon closer
examination it appears that these remarks were primarily addressed
to section 20(b), not 20(a). When referring to the two sections,
the report of the Committee on Interstate Commerce stated that section
20(a) makes "a person who controls a person . . . liable to the
same extent as the person controlled unless the controlling person
acted in good faith and did not induce the act in question," while
section 20(b) "makes it unlawful for any person to do, through any
other person, anything that he is forbidden to do himself." It
appears then that Exchange Act section 20(b), not 20(a), was specifically aimed at the "dummy" situation.

D. Summary

The two strongest reasons for not imposing vicarious liability on controlling persons under the common law doctrine are: (1) the language of recent Supreme Court decisions, and (2) the intent of Congress. The Supreme Court has specifically rejected the idea of expanding remedies under the federal securities laws because of the laws' general "remedial purposes," finding such arguments to be "unavailing."

The Court has also admonished against applying common law tort principles to cases involving the federal securities laws. Courts faced with cases attempting to impose vicarious liability on brokers based upon alleged violations of section 10(b) and rule 10b-5 by a broker's employee should heed the Supreme Court's statement in *Touche Ross & Co. v. Redington:* "The source of plaintiffs' rights must be found, if at all, in the substantive provisions of the 1934 Act which they seek to enforce . . . ." The source of such rights should not, and cannot, be found in either individual courts' notions of fairness or their views of common law tort principles. These may

167. *Hearings on S. Res. 84 (72d Cong.) S. Res. 56 and 97 (73d Cong.), before the Senate Comm. on Banking and Currency, 73d Cong., 1st Sess. 6571 (1934) (statement of Thomas Corcoran).*


It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this title or any rule or regulation thereunder through or by means of any other person.

169. 78 CONG. REC. 7709 (1934).


171. *Id. at 568.*

172. *442 U.S. 560 (1979).*

173. *Id. at 577.*
be valid concerns in the context of state and common law principles, but the federal statutory law should be administered as written by Congress. As stated previously, Congress' intent in drafting section 20(a) of the Exchange Act and section 15 of the Securities Act was to avoid strict vicarious liability for an agent's violation of these laws by providing controlling persons with a good faith defense. An examination of the historical foundation of respondeat superior, and the policies supporting its use, clearly illustrate that resort to the doctrine will frustrate, rather than further, Congress' intent in cases involving control person liability.

III. RESPOndeAT SUPERIOR—HISTORICAL FOUNDATION

Respondeat superior is primarily a doctrine of tort law—its underlying premise is that the master or principal will, in most circumstances, be civilly liable in a tort action for the misdeeds of its servant or agent. The origin of the doctrine of vicarious liability is uncertain; various rationales for the doctrine have been cited, including: (1) the principal's ability to bear the economic loss involved, (2) the principal's act of placing the agent in the position to commit the tortious act, and (3) the principal's ability to control the person or entity which committed the tortious act.

When vicarious liability is imposed upon an entity because of the acts of its agents, the entity's own actions become irrelevant. A leading treatise states:

Vicarious liability . . . is imposed . . . in cases where the master has taken all the steps that reasonable foresight would suggest, including those which involve the exercise of control. Indeed the court is not even interested in hearing whether the master exercised his right of control well and prudently . . . . [C]ases in which defendant[s having] no vicarious responsibility [are] held for failure to exercise a right of control over the conduct of another person present a marked contrast to the vicarious liability of a fault-free principal.

Therefore, when a court finds a broker-dealer or accounting firm civilly liable on a respondeat superior theory, due to the tortious acts of its employees, the only relevant inquiry should be whether the

174. See supra text accompanying notes 150-54.
176. Id.
177. Id. at 1367-68 (citations omitted). See also RESTATEMENT (SECOND) OF AGENCY § 219 (1957).
offending employee acted within the scope of his employment,\textsuperscript{178} not whether the employer fulfilled a duty to supervise.\textsuperscript{179}

As discussed previously, one problem with the doctrine is that courts have applied it in a misleading fashion.\textsuperscript{180} For instance, in its pristine form, the doctrine gives employers defending a cause of action based upon respondeat superior "all the defenses open to one defending an action of tort, including contributory negligence . . . ."\textsuperscript{181} In the cases examined previously, all of the courts have failed to recognize this concept. Certainly, in Henricksen v. Henricksen,\textsuperscript{182} the plaintiff negligently contributed to her own losses, and in fact, the district court found that it would have been easier for the plaintiff, than for the employer, to discover her husband's illegal conversion of the funds deposited in their joint savings account.\textsuperscript{183} Because the appellate court combined common law and statutory principles, it failed to consider the plaintiff's own negligence\textsuperscript{184} as a defense to the action, a consideration which would have been necessary under ordinary tort principles.

In summary, application of respondeat superior to support a cause of action represents a policy decision regarding the distribution of certain losses. Taken alone, policy considerations might suggest that the doctrine should be applied in civil fraud actions brought under the federal securities laws. Policy considerations, however, must give way to the clear teachings of the Supreme Court and the relevant legislative histories.\textsuperscript{185}

IV. SEC INJUNCTIVE ACTIONS, ADMINISTRATIVE PROCEEDINGS, AND RESPONDEAT SUPERIOR

In contrast to the civil arena, respondeat superior should never be applied to an administrative proceeding against a broker-dealer.

\textsuperscript{178} F. Harper & F. James, Jr., supra note 175, at 1374. See also Restatement (Second) of Agency § 219 (1957).

\textsuperscript{179} See supra text accompanying notes 64-81.

\textsuperscript{180} Id.

\textsuperscript{181} Restatement (Second) of Agency § 219 comment c (1957).

\textsuperscript{182} 640 F.2d 880 (7th Cir.), cert. denied, 454 U.S. 1097 (1981); see supra notes 30-34 and accompanying text.

\textsuperscript{183} 640 F.2d at 887.

\textsuperscript{184} In addition to doing nothing to stop her ex-husband from withdrawing the proceeds from the sale of securities from their joint bank account, the plaintiff testified that she did not read any of the documents she signed when opening her trading account. Id. at 881. Clearly, the plaintiff was, as the district court found, id. at 887, in a better position than SBHU to detect and prevent her ex-husband's fraud, and thus, had contributed to her own losses.

\textsuperscript{185} See supra notes 115-69 and accompanying text.
The doctrine's modern day underpinning, the ability of a corporate entity to absorb losses caused by its agent through insurance, neither supports nor justifies the use of respondeat superior in an administrative proceeding.

The Commission has brought both injunctive actions and administrative proceedings based on the respondeat superior doctrine. This article briefly examines selected Commission injunctive actions and administrative proceedings brought under the respondeat superior liability theory.

A. Injunctive Actions

The Commission has utilized respondeat superior with varying degrees of success in injunctive actions as illustrated in two Second Circuit cases.

In *Securities Exchange Commission v. Management Dynamics, Inc.*, the Second Circuit upheld the lower court's issuance of an injunction against a brokerage firm based upon the violative acts of one of its vice-presidents. The court stated: "We agree with the Commission that with respect to SEC enforcement actions, § 20(a) was not intended as the sole measure of employer liability." The court relied on the agency principle of "apparent authority [of the vice president, thereby making] it appropriate to enjoin [the broker-dealer] from violation of the antifraud provisions" under the broad agency doctrine of respondeat superior.

In *Securities Exchange Commission v. Geon Industries*, the Second Circuit again examined the propriety of the Commission's issuance of an injunction based upon the actions of a firm's employees. The court, rejecting the Commission's position, refused to enjoin a brokerage firm based upon the violative acts of one of its registered representatives. The court distinguished *Management Dynamics* by focusing on the position of the employee. In *Geon*, the employee was a registered representative; in *Management Dynamics*, the employee was a vice-president. The *Geon* court held that *Management Dynamics* does not stand for the extension urged by the Commission, re-

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186. See W. Prosser, *supra* note 4, at 459.
187. 515 F.2d 801 (2d Cir. 1975).
188. *Id.* at 812. The brokerage firm maintained that its liability should be measured by § 20(a), and alleged that its good faith was demonstrated by the system it had instituted for overseeing the activity of its traders. The court, however, never reached the issue of good faith, as it held that ordinary principles of agency should apply. See *id.*
189. *Id.* at 813.
190. 531 F.2d 39 (2d Cir. 1976).
jecting the notion that Management Dynamics "points in the direction of imposing liability [on the broker-dealer] on the basis of . . . respondeat superior even though [the broker-dealer] did not fail reasonably to supervise."181

The Supreme Court's decision in Aaron v. Securities Exchange Commission192 should compel the Commission to consider a case carefully before bringing an injunctive action based on respondeat superior. The Court held that in injunctive actions, based upon violations of Exchange Act section 10(b)193 and Securities Act section 17(a)(1),194 scienter is a required element of proof.195 Chief Justice Burger, in a concurring opinion, stated that the issue may be "much ado about nothing"196 because in injunctive actions, the Commission is required to demonstrate a reasonable likelihood of future violations and those whose past actions have been in good faith are therefore not likely to be, nor should they be, enjoined.197

The Supreme Court's language does not necessarily mean that the decision in Management Dynamics was wrong. Rather, the proper view is that the Management Dynamics court unnecessarily articulated the respondeat superior doctrine—the basis of its decision198—in a situation where the defendant had, in fact, failed to act in good faith, and thereby failed to meet its section 20(a) good faith defense.199

B. Administrative Proceedings

1. Background.—Two parts of section 15 of the Exchange Act, which authorize the Commission to sanction broker-dealers, are relevant to this analysis. Section 15(b)(4)200 permits the Commission to censure, place limitations on, suspend for a period of up to twelve

191. 531 F.2d at 54. In SEC v. Lum's, Inc., 365 F. Supp. 1046 (S.D.N.Y. 1973), the court also rejected the Commission's attempt to enjoin a registered broker-dealer, Lehman Brothers, for the violations of one of its employees because, among other things, "[t]o hold Lehman liable on a theory of respondeat superior would . . . do violence to the legislative intent underlying the [1934] Act." Id. at 1063. See also Mathews, Litigation and Settlement of SEC Administrative Enforcement Proceedings, 29 CATH. U.L. REV. 215, 261-73 (1980).
195. 446 U.S. at 691, 697. For injunctive action under § 17(a)(2) or (3), however, the court held scienter is not required. Id. at 696-97. See 15 U.S.C. § 77q(a)(2)-(3) (1976).
196. 446 U.S. at 703 (Burger, C.J., concurring).
197. Id.
198. See supra text accompanying notes 188-89.
199. See 515 F.2d at 811-12; 15 U.S.C. § 78t(a) (1976); supra note 6.
months, or revoke the registration of a broker or dealer if, among other things, an associated person of the broker-dealer commits any of the offenses specified in subparagraphs (B), (C), or (D) of section 15(b)(4). Subparagraph (E) further permits the Commission to sanction a broker-dealer if the firm has failed to reasonably supervise persons subject to its supervision and is unable to demonstrate the good faith "defenses" of subparagraphs (i) and (ii) of that subsection.201 The first subsection seems to allow the Commission to proceed on a respondeat superior basis. The failure-to-supervise subsection, however, added to the Exchange Act by the 1964 amendments,202 reflects Congress' (and, at that time, Commission Chairman William Cary's) attempts to reduce the application of liability without regard to fault in administrative proceedings because it may be "unfair."203

Prior to the 1964 amendments to section 15 of the Exchange Act, the Commission could only proceed in a disciplinary proceeding against the entire brokerage firm, not against an individual.204 Commenting on this state of the law during congressional hearings, William Cary, then Commission Chairman, stated:

At the present time, if an individual connected with a securities firm violates the law without the approval—or the knowledge—of his employer, the Commission can take disciplinary action only by a proceeding against the entire firm. This approach,
possibly involving many persons wholly innocent of the violations in question, is awkward and may be unfair. . . . [The new section] would permit the Commission to act directly against offending individuals . . . in lieu of proceeding against the entire firm. . . . Of course, this section would not in any way reduce the responsibility of a firm to supervise its employees. . . .

It appears, therefore, that the 1964 Amendments were aimed, in part, at alleviating the onerous impact of the application of vicarious liability against brokerage firms in administrative proceedings—liability without fault—which Chairman Cary realized, “may be unfair.” Section 15(b)(4)(E) also provides statutory defenses to charges of failing to reasonably supervise employees. The major purpose of the primary liability provision is to enable the Commission to “reach more directly supervisory personnel who failed to discharge their responsibilities.” Supervisory personnel are not “absolute guarantors;” rather, if procedures and an appropriate system designed to prevent such problems are in place and the individual or firm does not have reasonable cause to believe the system was not working, there could be no liability.

2. Statutory Construction.—On several recent occasions, the Commission has censured national firms apparently on the basis of relatively isolated violations by a registered representative in a branch office, and not for breakdowns in their respective compliance systems.

In attempting to ascertain the proper reach of section 15, the starting point of our analysis is, as Justice Powell has stated, the language of the statute itself. The statute provides an affirmative defense for broker-dealers in failure to supervise cases. Section 15(b)(4)(E)(i) gives the firm an opportunity to show the existence of procedures and a system for applying such procedures that would reasonably be expected, insofar as practicable, to prevent and detect violations. The provision obviously does not require a failproof sys-

205. Id. at 62-63 (statement of William L. Cary, Chairman, SEC).
206. Id. at 363 (statement of SEC relating to S. 1642).
207. Id.
208. See, e.g., Exchange Act Release 34-18796, 25 SEC Docket 586 (June 8, 1982); Exchange Act Release 34-18623, 24 SEC Docket 1724 (April 6, 1982). Because the vast majority of such administrative proceedings end in settlements, it is difficult to ascertain which cases illustrate this problem. For monetary and other reasons, brokers may choose not to litigate administrative proceedings.
Section 15(b)(4)(E)(ii), the second prong of the affirmative defense, requires the firm to show "reasonable discharge" of the supervisor's duties, "without reasonable cause to believe that such procedures and system were not being complied with." The repeated use of the word "reasonable" in the text of the statute, combined with the legislative history—the testimony of Commission Chairman Cary in particular—leads to the conclusion that section 15(b)(4)(E) was designed to facilitate disciplinary proceedings against brokerage firms which either had an inadequate internal compliance system or had unreasonably failed to discharge duties and responsibilities under the system.

3. Commission Actions.—The Commission has consistently utilized and cited the respondeat superior doctrine in disciplinary proceedings brought under Exchange Act section 15. A summary of some of the major proceedings is illustrative of the Commission's views in this area.

The leading case in support of the Commission's position is Armstrong, Jones & Co. v. Securities Exchange Commission. Armstrong, Jones & Co., a broker-dealer, appealed from a Commission order which permanently revoked its registration and barred its president from association with any broker-dealer for one year. The firm questioned the Commission's attribution of its employee's conduct to the firm. The Sixth Circuit affirmed the order and stated: "It has long been the position of the Commission that a broker-dealer may be sanctioned for the willful violations of its agents under the doctrine of respondeat superior." The court rejected petitioner's position that Exchange Act section 15(b)(5)(E) in any way limits the Commission's power to proceed under such a theory.

In Gotham Securities, the Commission brought an administrative proceeding against a firm based upon the violative acts of one of the firm's traders. Gotham's president knew that the trader had a

210. See supra note 201.
212. See supra text accompanying note 205.
214. Id. at 362 (citations omitted). The court failed to cite any statutory authority for this statement.
215. At the time of Armstrong, Jones, current § 15(b)(4)(E) was contained in § 15(b)(5)(E).
216. 421 F.2d at 362.
217. 10 SEC Docket 895 (Nov. 5, 1976).
history of securities laws violations prior to becoming associated with Gotham. The Commission's action was based on alleged violations involving trading in a public shell. In sanctioning the broker-dealer, the Commission stated, the "[r]egistrant's violations rest wholly on the doctrine of respondeat superior. But that is sufficient." In Gotham, the Commission, as did the Sixth Circuit in Armstrong, Jones, cited its earlier decision in In re Cady Roberts & Co., a landmark insider trading case. In Cady Roberts the Commission brought an action against both a partner of a firm and the firm itself. The Commission held that "actions of [a partner] . . . in the course of his employment are to be regarded as actions of [the] registrant itself." The Commission in Gotham also cited In re Sutro Brothers & Co. The Commission's Sutro opinion was framed in respondeat superior language—"willful violations of its employees in the course of their employment must be considered the willful violations of the firm" and that disciplinary proceedings against the firm may be based "on any willful violation by any employee of [the firm]."

Both Cady Roberts and Sutro preceded the 1964 Amendments which allowed the Commission to proceed directly against an individual. Although former Chairman Cary testified that one of the major reasons for the amendments to section 15 was to prevent liability without fault from being assessed, it appears, based on the

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218. A public shell corporation is an entity which has few or no assets, but whose securities are freely tradeable. See Securities Act Release No. 4982, [1969-1970 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 77,725 (July 2, 1969).

219. 10 SEC Docket at 898 n.19. As in the Armstrong, Jones case, the opinion did not cite any statutory support for this assertion.

220. 421 F.2d at 362; see supra text accompanying note 214.


222. See id. In Cady Roberts, a partner of a brokerage firm was held to have violated the antifraud provisions of the Exchange Act when he ordered shares of a corporation to be sold after learning of material adverse nonpublic information concerning the corporation. Id. at 908-13.

223. Id. at 911.


225. Id. at 479.

226. Id. The requirement that the Commission demonstrate that an employee has acted "willfully" is no obstacle at all. See, e.g., Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965), affg In re Sidney Tager, 42 SEC 132 (1964). A leading authority has noted, "[T]he Commission has practically read the 'willfulness' requirement out of the statute in administrative disciplinary proceedings." Mathews, supra note 191, at 238-39.

227. See supra notes 200-07 and accompanying text.
1976 decision in *Gotham*, that respondeat superior is, in the Commission’s view, a viable doctrine upon which to base a broker-dealer’s liability in an administrative proceeding.

C. Summary

There are several reasons why the Commission should abandon use of respondeat superior in administrative proceedings.

1. Policy Reasons.—Obviously, the primary function of the legal and compliance department in any brokerage firm is to ensure compliance with all relevant statutes, rules, and regulations so as to avoid civil, administrative, and other forms of liability. The law and compliance department generates no revenues; it serves primarily a prophylactic and advisory function. While these statements are self-evident, they should have important implications for the Commission’s policy orientation toward broker-dealers and administrative proceedings.

When asking for budget appropriations, the “trump card” of the legal and compliance department is the argument that the more money spent for compliance, the less likely it is that the firm will be sued—civilly or administratively. To the extent that brokerage firms are sued either civilly or administratively on a vicarious liability theory, the argument that increased compliance dollars lead to a lower likelihood that the firm will be sued is weakened. If firms, particularly large wire houses, are held vicariously liable for the acts of their employees without the opportunity to use the defense provided in sections 15(b)(4)(E)(i) and (ii), it becomes virtually impossible to justify increased compliance expenditures based on usefulness. No system can succeed at a 100% success ratio. The implications on the firm’s budgetary process are obvious—firms will not spend incremental dollars on compliance because their “good faith” and “reasonable systems” are irrelevant in an action based on respondeat superior.

Given these considerations, it is questionable whether the Commission’s recent posture in failure to supervise cases—seemingly placing an emphasis on relatively isolated compliance breakdowns—is in the public interest.\(^{228}\)

2. Statutory Reasons.—Application of respondeat superior in administrative proceedings nullifies the language of section 15(b)(4)(E) which provides broker-dealers with a good faith defense.

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\(^{228}\) This policy argument is clearly relevant to the civil liability issue also. Because, however, the Commission’s administrative proceedings must be in the “public interest,” its applicability is greater in the administrative area. See, e.g., 15 U.S.C. § 78o(4) (1976).
Congress passed this section partly in response to statements that administrative proceedings based on liability without fault may be "unfair." As a matter of policy the Commission should ensure a perception of fairness in its proceedings by affording brokers the opportunity to use the good faith defense Congress intended them to have.

3. Misuse of Respondeat Superior.—As previously discussed, respondeat superior is a civil tort remedy based on notions that a master should be held financially accountable for the misdeeds of its servants. It has only limited relevance outside of a civil damages case. The principal contemporary rationale for the doctrine—that it reflects a societal policy of allocating losses to those best able to absorb losses through insurance—is inapplicable to a Commission administrative proceeding.

V. CONCLUSION

A careful analysis of the relevant statutes, recent Supreme Court decisions, and the legislative history leads ineluctably to the conclusion that respondeat superior should not be available to either civil litigants or the Commission in actions which allege violations of the federal securities laws. The federal securities laws are a complex technical statutory framework carefully drafted by the Congress. The statutes provide specific rights and remedies as well as address the relationship between vicarious liability and causes of action which can be brought by aggrieved parties. When Congress sought to impose liability against entities which control other persons, it exculpated a defendant who acted in good faith and who did not induce the act constituting the violation.

The application of respondeat superior nullifies the clear language of these statutes. While the Supreme Court has specifically rejected the relevance of policy considerations and claims of the general "remedial" purposes of the Acts in the context of these cases, even such considerations suggest that respondeat superior should not be applied to administrative or civil actions brought under the federal securities laws. The policy considerations which the Commission should consider have been discussed previously.

The Supreme Court has expressed concern over expanding theories of liability and causes of action under the federal securities laws.

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229. Sections 217C and D of the RESTATEMENT (SECOND) OF AGENCY (1957) briefly discuss the application of vicarious liability to hold principals liable for punitive damages (§ 217C) and for penalties (§ 217D).

230. See supra text accompanying note 169.
In *Blue Chip Stamps v. Manor Drug Stores*, it expressed concern about "vexatious" litigation and cited Justice Cardozo’s admonition regarding the potential of opening the courts to a wide range of plaintiffs which might lead to "a liability in an indeterminate amount for an indeterminate time to an indeterminate class." Allowing plaintiffs to sue under section 10(b) using a respondeat superior theory will result in just such a problem for broker-dealers. It also represents poor public policy, is unsupported by the statute, and is inconsistent with recent Supreme Court decisions.

Finally, it should be remembered that following the statutes and allowing a broker a good faith defense in cases alleging a failure to supervise in no way diminishes the broker’s obligations under these laws. The broker is still accountable under the statutes—administratively to the Commission, and civilly to the public—for its misdeeds and failures to supervise reasonably. All that is eliminated by abolishing liability on a respondeat superior basis is insurer liability imposed on a firm for violations by its employees. The federal securities laws are unique and create many technical obligations unknown at common law. The public is well protected by state, federal, and common law without subjecting employers to unlimited exposure for acts they did not commit. The allowance of the good faith defense which Congress intended does not weaken the protection Congress created for the investing public.

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232. 421 U.S. at 748 (quoting Ultramares Corp. v. Touche Ross, 255 N.Y. 170, 179, 174 N.E. 441, 443 (1931)).