HABERMAS, PROCEDURALISM AND THE PRIVATE CAUSE OF ACTION UNDER RULE 10b-5: THE IMPLICATIONS FOR DEMOCRACY

THOMAS F. MCINERNEY III†

I. INTRODUCTION

Since the United States Supreme Court gave its *imprimatur* to the notion of an implied cause of action under Section 10(b) ("Section 10(b)") of the Securities and Exchange Act of 1934 ("1934 Act") and Rule 10b-5 ("Rule 10b-5") promulgated thereunder, the Supreme Court, lower courts, and Congress have attempted to clarify the scope of this cause of action. The 10b-5 implied cause of action, as well as other implied causes of action, have received criticism from those persons viewing such implications as judicial legislation or, worse yet, anti-democratic. Others have argued that judicial decisions articulating the implied cause of action under Rule 10b-5 represent the necessary work of the courts, and that the exercise of such power by the courts was the explicit intent of the Congress in enacting Section 10(b). As such, these authors contend that no usurpation of legislative authority has occurred through the development of the implied cause of action under Section 10(b).

Both sides of the argument take an overly static view of the development of the legal architecture under Rule 10b-5. Specifically, both positions rest on the assumption that either Congress may act and then no additional work by the courts may be done to draw the implications of such congressional actions, or once Congress has acted, any additional work may be merely handed off to the courts to conclude the public policy-making process. This Article takes a different


   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 . . .

   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.

   *Id.*

stance. In contrast to the two schools of thought discussed above—broken down roughly along the lines of judicial activist versus judicial interpretivist schools—this author presents a view of this development of the law of Rule 10b-5 as a dynamic process, in which Congress, the courts, and the Securities and Exchange Commission ("SEC") take various actions, which subsequently receive the response from one or both of the other parties. This Article also shows the need to reexamine the Court's current rationale used to support the implication of a private right of action from the current one-dimensional congressional intent analysis to a multidimensional analysis necessary to comport with the actual evolution of law. This argument is based in large part on Jurgen Habermas' recent proceduralist moral and legal theories.

This Article will begin with a historical overview of cases involving the implied cause of action under Rule 10b-5 and an analysis of the Supreme Court's recognition of such causes of action and development of the jurisprudence of Rule 10b-5. After laying the appropriate historical background, this Article will turn to Habermas's proceduralist reconstructive approach to law to gain an appropriate theoretical background to analyze the democratic implications of the development of Rule 10b-5 jurisprudence. Finally, this author will develop an interpretation of Congress' and the Court's development of Rule 10b-5 jurisprudence in light of Habermas' proceduralist paradigm of law.

II. THE IMPLIED CAUSE OF ACTION UNDER RULE 10b-5

A. Historical Overview

Congress enacted the 1934 Act in response to the stock market crash of 1929. Congress' intent in enacting the 1934 Act was to protect investors from fraudulent or manipulative conduct in securities markets. The 1934 Act contains numerous explicit causes of action

3. See Lampf, Pleva, Lipkin, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364-66 (1991) (Scalia, J., concurring) (disputing Federal courts' creation of causes of action where the statute has not provided for them); Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1110 (1991) (Scalia, J., concurring) ("I think the federal cause of action [under Section 14(a) of the 1934 Act] was never enacted by Congress . . . and hence the more narrow we make it (within the bounds of rationality) the more faithful we are to our task."). See also Merrill Lynch v. Curran, 456 U.S. 353, 395-96 (1982) (Powell, J. dissenting) (viewing the implication of private causes of action under the Commodity Exchange Act as "incompatible with our constitutional separation of powers, and in my view . . . without logic or law").


5. Randall v. Loftsgaarden, 478 U.S. 647, 664 (1986) (stating that "Congress intended to deter fraud and manipulative practice in the securities markets and to ensure full disclosure of information material to investment decisions.").
under which investors may sue for such conduct. While this general legislative background engenders no fierce debates, when such proscriptions were enacted, greater debate ensued.

One of Congress' specific enactments advancing this general purpose was Section 10(b). Section 10(b) provides that it is unlawful for any person, directly or indirectly, to use or employ a manipulative device or contrivance in violation of rules established by the SEC. In response to Congress' specific grant of authority to the SEC to enact rules regarding manipulative or deceptive devices, the SEC enacted Rule 10b-5. Under Rule 10b-5, the SEC determined that it would be illegal to "employ any device, scheme, or artifice to defraud," "... make any untrue statement of a material fact or omit to state a material fact necessary" to render such statements not misleading, or engage in any practice which would constitute fraud. The stated purpose of the SEC in enacting Rule 10b-5 was to close the "loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase." It is generally agreed that the SEC did not leave a complete record of the process by which Rule 10b-5 was enacted such that later courts could significantly rely on such background in interpreting the provisions of the Rule. Neither Section

---

6. See, e.g., 17 C.F.R. § 240.14a-9 (1997) (prohibiting false or misleading statements when soliciting proxies); Section 16(b) of the 1934 Act, and Section 18 of the 1934 Act.


8. 17 C.F.R. § 240.10b-5.

9. Specifically, Rule 10b-5 states:

   Employment of Rule 10b-5 manipulative and deceptive devices. 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 in any facility of any national securities exchange, (a) To employ any device, scheme or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.


11. See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 729 (1975) (stating that: "no indication that Congress considered the problem of private suits under [10(b)] at the time of its passage"). See Edward A. Fallone, Section 10(b) and the Vagaries of Federal Common Law: The Merits of Codifying the Private Cause of Action Under a Structuralist Approach, 1997 U. ILL. L. Rev. 71, 96 (1997) (noting that: "because Congress—either intentionally or through oversight—included no express provision for a private cause of action under Section 10(b), courts hearing private lawsuits under the section have been forced to define for themselves just what constitutes deception in connection with the purchase or sale of a security.").
10(b) nor Rule 10-5 provides for an explicit civil remedy. Accordingly, the next step would come from the courts.

B. EARLY COURT DECISIONS

The United States Supreme Court's decision to recognize the 10b-5 cause of action had a solid basis in common law. The rationale for implying a cause of action based on a statute has its roots in the early common law. This standard had become best known in the case of per se liability in torts. Under that common law theory, the violation of a statute and the injury of a party entitled to the protection of such statute, constitutes a tort. Although the implication of a cause of action differs from the doctrine of negligence per se—the one concerns the existence of a remedy and the latter sets a standard of behavior—it does offer some additional support for judicial implications of private causes of action. One commentator noted that it is important that the creation of a right to be free from a certain harm be distinguished from an implied remedy. According to an analysis advanced by that commentator, federal courts have typically implied remedies where necessary to further the aims of a statute but have not implied rights entitling a claimant to a remedy.

A leading twentieth century case following such doctrine was the Supreme Court case of Texas & Pacific Railway Co. v. Rigsby. In that case, the Court found that a person employed as a rail yard switchman who was injured as a consequence of a violation of the Fed-

12. See William H. Painter, Inside Information: Growing Pains for the Development of Federal Corporation Law under Rule 10(b)-5, 65 COLUM. L. REV. 1361, 1366 (1965). See also Fallone, 1997 U. ILL. L. REV. at 95 (noting that the private cause of action under 10(b) or Rule 10b-5 was inferred by the courts despite any evidence that Congress intended such actions).


14. See generally Bruce A. Boyer & Howard V. Pierce, Implied Causes of Action and the Ongoing Vitality of Cort v. Ash, 80 NW. U. L. REV. 722 (1985) (discussing implied causes of action). Boyer found an early basis for judicially implied remedies in Marbury v. Madison, 5 U.S. (1 Cranch) 137, 163 (1803) ("It is a general and indisputable rule, that where there is a legal right, there is also a legal remedy by suit, or action at law, whenever that right is invaded.") (quoting 3 W. Blackstone Commentaries 23 (1768)). This doctrine was commonly referred to as the maxim ubi jus ibi remedium, literally, where there is law, there is a remedy. Boyer & Pierce, 80 NW. U. L. REV. at 733 & n.85.

15. BLACK'S LAW DICTIONARY 1035 (6th ed. 1990). Such was the doctrine of negligence per se. This doctrine finds the existence of a statute as establishing a standard of behavior. Accordingly, the statute defines the duty and the breach of the duty constitutes negligence.


17. Id.

eral Safety Appliance Act ("FSAA") and who was within the class of persons entitled to protection of such act, afforded the plaintiff a right to recover despite the lack of an express cause of action under the act. The FSAA required that all railway cars be equipped with secure "hand holds or grab irons . . . at the tops of [the] ladders." The Court noted that the FSAA contained no express language conferring a private right of action to an injured employee, but that "the safety of employees and travelers is [Congress'] principal object, and the right of private action by an injured employee, even without the Employer's Liability Act, has never been doubted." The Court reached back to the common law by noting that "[a] disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose special benefit the statute was enacted, the right to recover damages from the party in default is implied." The Court recognized that in two other places in the FSAA, Congress hinted at the use of the statute for suits in injury. The Court thus presaged the development of the 10b-5 cause of action by its affirmation of common law doctrines.

Against this backdrop, in 1946, four years after the SEC had promulgated Rule 10b-5, the United States District Court for the Eastern District of Pennsylvania decided in *Kardon v. National Gypsum Co.* that an implied cause of action existed under Section 10(b) and Rule 10b-5. The District Court in *Kardon* based its decision on traditional common law principles. Numerous lower courts followed the *Kardon* decision and in 1971, the Supreme Court finally acknowledged that a private right of action was implied by Section 10(b).

The recognition of the private cause of action under Rule 10b-5 sur-

---

22. Id. at 39 (emphasis added).
23. Id.
24. Id. at 39, 40. Specifically, Section 4 of the FSAA referred to "liability in any remedial action for the death or injury of any railroad employee." Section 8 stated: that an "employee injured by any car, etc., in use contrary to the act shall not be deemed to have assumed the risk." The Court held that these provisions made its conclusion 'irresistible.' Id. at 40.
vived, subject to the Court's subsequent pronouncements determining the existence of an implied cause of action as a general matter.29

Many years later, the Cort v. Ash30 decision played a strong role in the Court's subsequent treatment of the Rule 10b-5 cause of action. In Cort, the Court created a four part test for ascertaining the existence of an implied cause of action which differed substantially from the traditional understanding evidenced in Rigsby.31 The four parts are as follows. First, the court held that the plaintiff must be a member of the class intended to benefit from the statute.32 The Court cited to Rigsby for this leg of the test.33 Second, the Court examined whether there was an implicit or explicit indication of congressional intent to imply such a remedy.34 Third, the Court considered whether the implication of the cause of action was consistent with the underlying legislative scheme.35 Finally, the Court focused on whether the cause of action was one traditionally relegated to state law.36 In such a case, federalism concerns would suggest that the Court ought to leave the cause of action to the states.37

Of the four part test, the second prong, concern for legislative intent to imply a cause of action, most deeply influenced the Court's future direction.38 As to this congressional intent prong, the Court offered some examples of its understanding of this element.39 In a footnote, the Court identified Section 27 of the 1934 Act, considered in J.I. Case v. Borak,40 as providing for the enforcement of liability or duty created by the statute or rules thereunder.41 This language, the Court reasoned, evidenced congressional intent to furnish grounds for declaratory relief and also possibly supported derivative actions for rescission or damages.42 The Court also cited language in Rigsby which made sense only in the context of a private right of action.43 Both of

31. Cort, 422 U.S. at 78.
32. Id.
34. Cort, 422 U.S. at 78.
35. Id.
36. Id. See also Cannon, 441 U.S. at 689 (stating the four factors to consider).
37. Cort, 422 U.S. at 78.
38. Id. at 78-80.
39. Id. at 78-82.
41. Cort, 422 U.S. at 78 n.11.
42. Id.
43. Id.
these examples suggest that no congressional intent to imply a specific cause of action need be shown. These examples suggest that the second prong of the *Cort* test would be satisfied with a mere suggestion of private liability under a statute.

Subsequent cases demonstrated that the test would not be employed to reach counterintuitive results. In *Cannon v. University of Chicago*, the Court refined the test to account for the likely absence of any manifest congressional intent, as such evidence would beg the question of the need to implicate the cause of action in the first place. Instead, the Court noted that where the statute grants to a certain class of persons certain rights, a plaintiff need not show an intent to create a private right of action. Inversely, an explicit purpose to deny such relief would control. The Court's holding in *Cannon* did not weaken the Court's application of the congressional intent prong in subsequent cases.

The addition of congressional intent into the analysis to determine the existence of implied causes of action ran contrary to the rationale underlying *Kardon* and the rationale underlying the common law. Under the common law, the justification for implying a cause of action was based on the legislature having created a right, which ought to logically imply a remedy. The new view of implied causes of action recognized such claims to the extent justified by consistency with congressional intent. Although evident as early as *Rigsby*, the congressional intent model has in recent years become the Supreme Court's dominant mode of construing the Rule 10b-5 cause of action.

---

44. 441 U.S. 677 (1979).
46. Canon, 441 U.S. at 694.
47. Id.
48. See Touche Ross & Co. v. Redington, 442 U.S. 560, 568-69 (1979) (noting that the Court's task was limited to "determining whether Congress intended to create a private right of action," the Court rejected an implied cause of action under section 17(a) of the 1934 Act for books and records violations by a broker-dealer). See also *Lewis*, 444 U.S. at 18-19 (holding that the Investment Advisors Act provides for a private cause of action for recision under Section 215). *But see Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982) (recognizing implied causes of action under the Commodity Exchange Act ("CEA") based on legislative intent inferred from Congress's amendments to the CEA in 1974 which preserved the remedy under the CEA previously developed by lower courts.).
in its attempts to define the contours and limitations of the claim. The four factor test developed by the Court in *Cort* was ultimately reduced to the congressional intent question. The following is an analysis of the Court’s recent pronouncements in this area whereby this new approach has become prevalent.

C. DEVELOPMENT OF RULE 10B-5 JURISPRUDENCE

The Supreme Court’s decisions, since its 1971 decision explicitly affirming the existence of the 10b-5 cause of action and the subsequent scale back represented by *Cort*, have created a well-defined body of law. The Court has indicated that the defining cases break down into roughly two categories. First, the Court has determined the scope of liability under Rule 10b-5. Second, the Court has determined the elements of the Rule 10b-5 liability scheme. This Article’s discussion will consider some of the more important cases, with attention to the Court’s explanation of the justification for the Rule 10b-5 cause of action.

An interesting feature of the evolution of the Rule 10b-5 cause of action has been that the initial cases recognizing the claim rarely discussed its broader justification. In a case where the Court limited the scope of liability under Rule 10b-5 to purchasers and sellers, the Court noted that no substantial discussion was given to its justification. In later cases, however, the court began to discuss the justification. For example, in *Blue Chip Stamps*, the Court noted that its conclusion to affirm the cause of action under Rule 10b-5 was consistent with *Borak*

---


54. *Stabile*, 71 *Notre Dame L. Rev.* at 868 (stating that “Although the *Cort* factors were applied flexibly by the Supreme Court and numerous lower courts in several subsequent cases, it was not long before courts began to move away from the four-factor approach toward an exclusive reliance on legislative intent.”). While this sentiment may not completely accurately assess the Court’s later decisions, it is right to regard the congressional intent analysis as the dominant one.

55. See infra notes 57-225 and accompanying text.

56. See *Superintendent of Ins. of New York*, 404 U.S. at 13 n.9 (citing secondary sources which state a private right of action has been implied under section 10(b)). See also *Cort*, 422 U.S. at 78 (citing numerous cases for an implied right of action).

57. See generally *Central Bank*, 511 U.S. at 170-78 (discussing the scheme of the 1933 and 1934 acts and the scope of civil liability). *But see Fallone*, 1997 *U. Ill. L. Rev.* at 88-89 (stating that the cases discuss either the elements of an action or the scope of liability).


59. *Id.*

60. See infra notes 62-225 and accompanying text.

in holding that private enforcement of SEC rules provides a necessary supplement to SEC actions. Having dispensed with the need to justify the cause of action, the Court turned to the case at hand.

In addressing the issue in *Blue Chip Stamps* of whether the Rule 10b-5 cause of action was limited to purchasers and sellers, the Court began by considering the analysis of the Second Circuit decision in *Birnbaum v. Newport Steel Corp.*, where the circuit court held that the Rule 10b-5 action was indeed limited to purchasers and sellers of securities. The court in *Birnbaum* determined that Rule 10b-5 applied only to fraud "in connection with the purchase or sale" of securities. Supporting the *Birnbaum* holding, the Court found that no congressional intent to extend "a private civil remedy" to persons other than defrauded purchasers and sellers could be shown, in contrast to Section 16(b) under the 1934 Act, which provides a right of action to all shareholders of a corporation. Indeed, the court noted, hundreds of lower courts had reaffirmed *Birnbaum*'s holding. Having found sufficient judicial authority on the subject as further support for the *Birnbaum* rule, the Court invoked two SEC proposals given to Congress. Proposals from both 1957 and 1959 requested that the language of the 10(b) statute be modified to cover attempted purchases or sales. The Court considered congressional rejection of the SEC proposal as evidence that the *Birnbaum* decision was correct.

The Court next considered congressional intent by looking to what Congress did in creating the securities laws in general, rather than focusing on what Congress chose not to do. The Court proceeded on a structural analysis of both the Securities Act of 1933 ("1933 Act") and the 1934 Act (for guidance as to how to construe the Rule 10b-5 cause of action as a means of following congressional intent). The Court indicated that the structure of the laws offered ar-

---

63. 193 F.2d 461 (2d Cir. 1952).
68. *Id.* at 732.
69. *Id.*
70. *Id.* at 733.
71. *Id.* at 733-34.
72. By structural analysis, I am referring to a means of interpreting the likely congressional or administrative intent for a specific statute or regulation where such statute or regulation is ambiguous. Such analysis looks to the structure of the broader statute or regulation in an attempt to determine the place of the specific statute or regulation in an overall legislative or regulatory scheme.
73. *See Blue Chip Stamps*, 421 U.S. at 733-36. The Court noted parallels to Section 17(a) under the 1933 Act, Section 28(a) under the 1934 Act, Section 29(b) under the
gumentative support for the Birnbaum decision, however, it could not infer anything like congressional intent through such a structural analysis. While later cases would provide a greater opportunity to employ such an analysis, the Court was not equipped to decide the case at hand by interpreting congressional intent.

To compensate for its inability to determine congressional intent, the Court engaged in an analysis of policy implications. In evaluating various policy considerations, the Court indicated that these considerations did not weigh entirely to one side. The primary concern motivating the Court's policy stance—concerns over vexatious litigation from an expanded class of plaintiffs—made the Court wary not to open the floodgates to strike suits. The Court noted that issues of proof and corroboration of damages based on oral testimony (due to the non-existence of proof of actual purchases and sales) justified restricting the class of potential plaintiffs. The Court determined that plaintiffs could merely prove the negative fact—that they lost an opportunity to purchase a given security based on a Rule 10b-5 violation. Accordingly, on that rule of law, a plaintiff's entire case could be based on uncorroborated oral testimony. Based on these concerns and a generalized concern about overly expanding the scope of Rule 10b-5, the Court concluded that policy reasons weighed in favor of the Birnbaum decision and that no clear indication of congressional intent regarding policy existed. After confronting an array of methodologies to resolve the case, the Court offered an explanation of Rule 10b-5 jurisprudence as an amalgamation of the inputs of various actors:

Given the peculiar blend of legislative, administrative, and judicial history which now surrounds Rule 10b-5, we believe that practical factors to which we have adverted, and to which other courts have referred, are entitled to a good deal of weight.

Thus[,] we conclude that what may be called considerations of policy, which we are free to weigh in this case, are by no means entirely on one side of the scale. Taken together with the precedential support for the Birnbaum rule over a period of more than 20 years, and the consistency of that rule with

1934 Act, Section 11(a) under the 1933 Act, Section 12 under the 1933 Act, Section 9 under the 1934 Act and Section 18 under the 1934 Act.

74. Blue Chip Stamps, 421 U.S. at 737.
75. Id.
76. Id. at 738-39.
77. Id. at 739-40.
78. Id. at 743.
79. Id. at 745-46.
80. Id. at 746.
81. Id.
what we can glean from the intent of Congress, they lead us to conclude that it is a sound rule and should be followed.82

The Court's view here comports with the dynamic nature of the evolutionary development of Rule 10b-5. Over the course of the next 20 years, the Court, in particular, Justice Rehnquist, would change direction to adopt a simpler, yet less realistic view of the development of the law.83

Subsequent to the Court's prophetic holding in Blue Chip Stamps, in Ernst & Ernst v. Hochfelder84 the Court established the rule that an investor suing under Rule 10b-5 must prove that the fraud alleged was accomplished with the requisite level of scienter.85 The holding in Ernst & Ernst relied on analysis of the meaning of the text of the statute and rule, congressional intent, and structure.86

The Court began its analysis by explaining the background preceding the development of the 1934 Act.87 The Court stated that in certain sections of the 1933 and 1934 Acts, Congress recognized the need, given its program of investor protection, to furnish the SEC with a flexible array of tools.88 While the Court cited broad congressional objectives in enacting the securities laws, it needed to search more widely for the hypothetical intent of Congress supporting the Rule 10b-5 private cause of action. The Court began its analysis of the implied right of action under Section 10(b) by acknowledging that no persuasive evidence existed that either Congress or the SEC intended to create such cause of action.89 The Court then cited Blue Chip Stamps to indicate that the cause of action was now firmly established.90 Finally, to further bolster its conclusion that the implied cause of action existed, the Court noted that a substantial body of case law and commentary supported the notion.91 Essentially, the Court's preface to its decision illustrates its continued methodology of acknowledging the nature of the implied cause of action under Rule 10b-5 as a result of stipulation by the judiciary.

The Court began its direct analysis of the scienter issue by focusing on the text of the statute itself.92 Justice Powell's opinion noted that the commonly accepted meaning of the terms "manipulative or

82. Id.
83. See infra notes 86-225 and accompanying text.
86. Ernst & Ernst, 425 U.S. at 194-214.
87. Id. at 195.
88. Id.
89. Id. at 196.
90. Id. at 197.
91. Id.
92. Id.
deceptive" used in the statute, "strongly suggest that Section 10(b) was intended to proscribe knowing or intentional misconduct."93 Despite the evidently clear textual basis for reading a scienter requirement into the law, the Court still invoked congressional intent.94 The use of such terminology in the statute itself should have afforded a basis for concluding the existence of an intent requirement.

Although the textualist argument made sense, the SEC advanced the claim that Congress, unaware that it had created a private right of action, would have intended an alternative result.95 In arguing for a less stringent level of intent, the SEC argued for a flexible reading of the purposes of the statute to further its remedial goals.96 Such an argument is implicitly premised on furthering Congress' goals. To refute this contention, the Court noted that Congress did not establish a uniform negligence standard even for express civil remedies.97 Because Congress did not intend to advance any unitary standard of liability under the securities laws, the Court reasoned that attention must be paid to the text of the statutes themselves.98 Apparently, broad proscriptions to further the remedial purposes of the securities laws could not override the statutory text. Upon rejecting the SEC's argument, the Court turned its attention to congressional intent.99

The Court's congressional intent analysis proceeded on two lines.100 First, the Court provided a brief history of the various bills which later became the final conference committee report, including the language of Section 10 of the 1934 Act.101 None of the examined history provided a basis for concluding that Section 10 was intended to deter unintentional conduct.102 The Court deemed it improbable that any lawyer or draftsman would have intended to proscribe non-intentional conduct by the use of the terms "manipulative or deceptive devices."103 The Court's conclusion appears as an attempt to divine congressional intent based merely upon a textual analysis.

The second element to the congressional intent analysis furthered a more persuasive basis for the Court's conclusion. For the second prong of the Court's congressional intent analysis, it employed a structural analysis of the 1933 and 1934 Acts as "interrelated components

---

93. Id. (emphasis added).
94. Id. at 200-01.
95. Id. at 200.
96. Id. at 200-01.
97. Id. at 200.
98. Id.
99. Id. at 201.
100. Id. at 201-11.
101. Id. at 201-05.
102. Id. at 202.
103. Id. at 203.
of the federal regulatory scheme governing transactions in securities."  

This type of analysis represents a more developed version of the analysis used in Blue Chip Stamps. As basis for its conclusion that the structure of the securities acts supported a scienter requirement, the Court focused on two points. First, in each instance that Congress intended to create an express cause of action for purchasers or sellers of securities, Congress specified the standard for liability. Second, the Court indicated that the explicit civil remedies under the 1933 Act, namely Section 11, Section 12(2), and Section 15, involve substantial procedural limitations not applicable to Section 10(b). Because Congress had significantly limited the express cause of action under sections 11, 12(2), and 15 under the 1933 Act, the Court concluded that to allow liability under Section 10(b) based upon negligence alone, would defeat Congress' intent. Under this undesirable interpretation, actions which could have been brought under the above mentioned limited sections would then be brought under Section 10(b). By expanding Rule 10b-5 to encompass claims which could have been brought under more limited sections, the Court's implied cause of action would frustrate congressional purposes.

The SEC finally indicated that Section 10(b) and Section 10(c), when viewed separately, "could encompass both intentional and negligent behavior." According to this view, Section 10(c), prohibited any person from engaging in any "act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. . . ." The Court rejected this claim, as it determined that the administrative history indicated that the SEC adopted the rule intending it to apply only to intentional conduct. Referring back to its analysis of "the language and history of Section 10(b) and related sections of the Acts," the Court concluded that the SEC's rule-making power would be limited by such facts.

The Court's analysis in Ernst & Ernst essentially turns on its interpretation of the words "manipulative and deceptive" as entailing a notion of intent. The Court was unable to provide any affirmative

---

104. Id. at 206 (citations omitted).
106. Ernst & Ernst, 425 U.S. at 206-11.
107. Id. at 207-08.
108. Id. at 208-09.
109. Id. at 210.
110. Id.
111. Id.
112. Id. at 212.
113. Id.
114. Id.
115. Id. at 214.
116. Id.
support for the proposition that Congress intended to include a scienter element in the statute, although its analysis of the structural components of the securities regulatory scheme adopted by Congress provides persuasive evidence that its conclusion was right. Ultimately, the Court's analysis indicates the shifting reality of its decision-making in this area, insofar as it appears that no unitary source for its decisions exists. Even where the text of Rule 10b-5 and Section 10(b) strongly suggest the correct answer, the Court's analysis in Blue Chip Stamps foreshadowed its subsequent shift to a pronounced reliance on congressional intent in considering Rule 10b-5 jurisprudence.

The next major decision, Herman & Maclean v. Huddleston, involved the question of whether the availability of an express cause of action under the 1933 Act precluded an implied cause of action under 10(b). To resolve this issue, the Court employed a modified structural analysis of the securities acts, but also invoked the theory that congressional inaction regarding Section 10(b) supported the law's then current development. The Court began by stating that the 1933 and 1934 Acts formed a "federal regulatory scheme." Noting that numerous implied causes of action under the 1933 and 1934 Acts have been developed by the federal courts, the Court declared that the existence of the Rule 10b-5 cause of action was "beyond peradventure." The Court took the view that the Section 11 cause of action—the express cause of action that would have been available to the plaintiffs had they not sued under Section 10(b)—and the Section 10(b) cause of action were part of this regulatory scheme, but were "intended to address different types of wrongdoing." Section 11, the Court explained, was open to any plaintiff who had purchased securities pursuant to a registration statement which contained a material misstatement or omission. Liability under Section 11 is virtually absolute.

Section 10(b), to the contrary, is a "catch-all" anti-fraud provision open to any "purchaser or seller of 'any security' against 'any person' who has used 'any manipulative or deceptive device or contrivance' in connection with the purchase or sale of security." An additional burden a plaintiff in a Section 10(b) action must prove is "intent to

119. See Huddleston, 459 U.S. at 380-91 (discussing the securities acts and Congressional amendments).
120. Id. at 380.
121. Id.
122. Id. at 381.
123. Id. at 381-82.
124. Id. at 382.
125. Id.
deceive, manipulate, or defraud.”¹²⁶ Because both causes of action apply to different types of fraud, the Court reasoned that although some of the same conduct may be prohibited by each, such result did not contravene congressional intent.¹²⁷ Indeed, the Court noted that Congress included “saving clauses” in both Section 16 of the 1933 Act and Section 28(a) of the 1934 Act.¹²⁸ This was a new basis articulated by the Court in support of the implied cause of action under Section 10(b) and seems to support the tendency to construe the securities laws broadly to effectuate their remedial purposes.

The Court next reaffirmed its holding in Ernst & Ernst noting that the various provisions of the securities laws, although part of one regulatory scheme, must be read as analytically distinct to prevent the Section 10(b) cause of action from becoming the exclusive vehicle for securities fraud actions.¹²⁹ While the Court was able to develop a structural analysis in favor of its holding, it appears that it was able to find support in congressional intent based on Congress' apparent understanding that it was developing numerous causes of action to cover various aspects of the same type of conduct and that its express cause of action would not limit any “other rights and remedies that may exist at law or in equity.”¹³⁰

The Court then employed a sort of negative congressional intent analysis¹³¹ by noting that Congress had revised the securities laws in 1975 leaving Section 10(b) untouched.¹³² When Congress revised the securities laws in 1975, it did so against the backdrop of numerous lower court cases permitting plaintiffs to sue under Section 10(b) despite the availability of express remedies under the securities laws.¹³³ The Court reasoned that because Congress left the law intact it intended to make the remedies under the securities laws cumulative and not exclusive.¹³⁴ In place of the Court's typical congressional intent analysis focusing on events of 1933 or 1934, in Ernst & Ernst the Court looked to recent congressional action for evidence that Congress had not changed its mind.¹³⁵ As the final arrow in its quiver, the Court concluded that the securities laws should be read flexibly to pro-

¹²⁶ Huddleston, 459 U.S. at 382.
¹²⁷ Id. at 382-83.
¹²⁸ Id. at 383.
¹²⁹ Id. at 383-84.
¹³⁰ Id. at 383.
¹³¹ This term is used to refer to a type of reasoning which became prevalent in the Court's treatment of 10b-5 and other areas of the law. On this analysis, the failure of Congress to act implied that Congress had tacitly affirmed the status quo.
¹³² Ernst & Ernst, 459 U.S. at 385-86.
¹³³ Id. at 384-86.
¹³⁴ Id. at 386.
¹³⁵ Id.
mote their remedial purposes. This final principle, as has been shown up to this point, can mean everything and nothing.

Employing a slightly different variation of its structural analysis, the Court in Lampf, Pleva, Lipkin, Prupis & Petigrow v. Gilbertson defined the applicable statute of limitations for a Rule 10b-5 action by referencing other sections of the 1933 and 1934 Acts, and analogizing such statutes of limitation to Section 10(b). Based on such sections of the statutes, the Court determined that one year from discovery of fraud or three years from the alleged occurrence of fraud would be the appropriate standard for the statute of limitations.

In Lampf, the Court considered an appeal from the dismissal of a securities fraud action under Rule 10b-5 based on failure to file the cause of action within the applicable limitations period. Because Rule 10b-5 contains no statute of limitations, following Ninth Circuit authority, the district court applied the forum state statutes most analogous to Rule 10b-5, the Oregon two year limitation period for fraud. The Court granted certiorari to determine whether a federal limitations period should apply. The parties to the litigation argued for adherence to the “borrowing” of analogous state statutes of limitations or, in the alternative, the one to three year structure under the explicit causes of action contained in Section 13 of the 1933 Act and similar provisions under the 1934 Act.

The Court initially noted that congressional inaction on statutes of limitations normally leads the courts to borrow the state time limitation. Where such enactments would frustrate the purposes of the federal enactment, the Court would look to suitable federal sources. In following congressional intent, the Court reasoned that it would be inappropriate to adopt state rules at odds with the objective of the statute. The Court then developed a three part test for determining when it would be appropriate to rely on a federal borrowing statute, as opposed to a state statute, when Congress did not specify the

---

136. Id. at 386-87.  
139. Lampf, 501 U.S. at 364.  
140. Id. at 354.  
141. Id. at 353.  
142. Id. at 354.  
143. Id. at 354-55.  
144. Id. at 355.  
145. Id. at 355-56.  
146. Id. at 366.
appropriate rule.\textsuperscript{147} This background would provide the basis for the Court's treatment of the Rule 10b-5 statute of limitations question.

In beginning its analysis of the Rule 10b-5 question, the Court noted that it had made "no pretense" that Congress intended the "remedy afforded."\textsuperscript{148} The Court indicated that the "statute of origin" should be the starting point for determining a limitation period where Congress has not provided one.\textsuperscript{149} Clearly adopting the congressional intent analysis, the Court held that there could be "no clearer indication of how Congress would have balanced the policy considerations implicit in any limitations provision than the balance struck by the same Congress in limiting similar and related protections."\textsuperscript{150}

This would present a rather simple analysis according to the Court, as both Section 13 under the 1933 Act and Sections 9 and 18 under the 1934 Act embody the one year from discovery, three year overall limitations period.\textsuperscript{151} Alternatively, Section 16 under the 1934 Act arguably concerned matters different than fraud and, thus, its two year limitations period ought not affect the analysis.\textsuperscript{152}

The Court rejected arguments from the SEC that with the passage of the Insider Trading and Securities Fraud Enforcement Act of 1988\textsuperscript{153} ("Insider Trading Act") Congress manifested an intent to extend the limitations period for Rule 10b-5 fraud cases to five years.\textsuperscript{154} The Court determined that Congress' action in this regard was designed to apply to insider trading only.\textsuperscript{155} Moreover, the Court noted that this enactment contained its own cause of action.\textsuperscript{156} The Court reasoned that congressional enactments "50 years after the original securities statutes" were enacted, should not be used to undermine the clear intent of Congress in 1933 and 1934.\textsuperscript{157} The SEC's weak argument and the Court's rejection of it are unsurprising. Neither adds much to the overall analysis of the Court's position.

\begin{itemize}
\item \textsuperscript{147} \textit{Id.} at 357-58. After Congress's clear intent in enacting the 1934 Act, changes to that original conception were wrought by the courts. Despite the existence of numerous explicit causes of action under the 1934 Act, the courts implied a cause of action under Rule 10b-5. \textit{Id.} at 358-59.
\item \textsuperscript{148} \textit{Id.} at 359. \textit{But See Blue Chip Stamps,} 421 U.S. at 730-32 (stating that the existence of the 10b-5 cause of action is simply "beyond peradventure.").
\item \textsuperscript{149} \textit{Lampf,} 501 U.S. at 359.
\item \textsuperscript{150} \textit{Id.}
\item \textsuperscript{151} \textit{Id.} at 360-62.
\item \textsuperscript{152} \textit{Id.} at 360 n.5.
\item \textsuperscript{153} Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 1, 102 Stat. 4877-84.
\item \textsuperscript{154} \textit{Lampf,} 501 U.S. at 361.
\item \textsuperscript{155} \textit{Id.}
\item \textsuperscript{156} \textit{Id.}
\item \textsuperscript{157} \textit{Id.}
\end{itemize}
Interestingly, Congress did specifically confront the issue of the proper statute of limitations for Rule 10b-5 cases after Lampf. The Court’s decision in Lampf did not resolve the question of whether the new statute of limitations would apply retroactively. Congress confronted the issue by undoing the retroactive effect of Lampf in a specific statute directed to it.\(^{158}\) Under this law, Congress directed that the limitation period under Section 10(b) of the 1934 Act should remain as before for any action commenced before June 19, 1991.\(^ {159}\) From Congress’s response to Lampf, it appears that Congress was paying attention to this decision, and presumably other Court decisions on Rule 10b-5. It is not likely that Congress sat by as a mere bystander watching passively as the Court asserted exclusive control over the securities regulatory scheme begun in 1933 and 1934.

Subsequent to these events, the Court would have occasion to revisit its earlier analysis in Blue Chip Stamps in justifying the Rule 10b-5 right of action and Huddleston in adopting negative congressional intent. In Musick, Peeler & Garrett v. Employers Insurance of Wausau,\(^{160}\) the Supreme Court determined that the cause of action under Rule 10b-5 would permit an action for contribution against joint tortfeasors by a defendant to an action under Rule 10b-5.\(^ {161}\) The Court applied Cooper Stevedoring Co., Inc. v. Fritz Kopke, Inc.,\(^ {162}\) in part, in its decision in Musick.\(^ {163}\) In Cooper, the Court determined that a non-statutory right to contribution for joint tortfeasors responsible for injuring a longshoreman in contravention of a federal statute existed, but was careful to note that the case did not stand for the proposition that a right to contribution existed generally under Federal law.\(^ {164}\) The Court then turned to an analysis of the Texas Industries v. Radcliff Materials, Inc.\(^ {165}\) case, in which the Court determined that no right to contribution under Section 1 of the Sherman Antitrust Act existed.\(^ {166}\) In that case, the Court first asked the question of whether the Sherman Act implicated “uniquely federal interests of the kind that obliged courts to formulate federal common law.”\(^ {167}\) This would appear to represent a standard for determining when courts

\(^{159}\) Id.
\(^{163}\) Musick, 508 U.S. at 290.
\(^{167}\) Texas Indus., 451 U.S. at 642.
could imply a cause of action based solely on the nature of the question falling within the ambit of the Court's responsibilities. The alternative test, according to the Court's holding, is a secondary concern that the cause of action can be clearly implied from congressional intent.\textsuperscript{168} Rather than following an unequivocal direction of Congress for the courts to imply such cause of action, the \textit{Musick} Court acknowledged that in the Rule 10b-5 implied cause of action, the courts had implied such private remedies to supplement federal statutory duties.\textsuperscript{169} Such an analysis represents a recognition of the initial justification for implying a private right of action as \textit{ubi jus ibi remedium} or, where there is a right there is a remedy.\textsuperscript{170}

After reaffirming the justification for the Rule 10b-5 cause of action, the Court then defined the contours of the claim.\textsuperscript{171} The Court took a practical turn, deciding that because the architecture of Rule 10b-5 jurisprudence had already been laid down and because the Court was willing to give effect to the cause of action thereunder, it ought to treat the parties against whom damages are assessed fairly by continuing to allow the elaboration of the scope of the Rule 10b-5 claim.\textsuperscript{172} As noted in \textit{Virginia Bankshares, Inc. v. Sandberg},\textsuperscript{173} the Court was merely defining the boundaries of a legal structure of private statutory rights which Congress had not created.\textsuperscript{174}

Having gained its requisite authority for implying the claim in general, the Court now propounded a more specific justification.\textsuperscript{175} The Court turned to two federal statutes enacted in 1988 and 1991.\textsuperscript{176} The first such statute, the Insider Trading Act,\textsuperscript{177} added an insider trading prohibition to Section 20A of the 1934 Act.\textsuperscript{178} That statute contains a saving clause whereby nothing "shall be construed to limit or condition . . . the availability of any cause of action implied from a provision of this Title."\textsuperscript{179} Second, in an interesting return of the volley in the development of the congressional intent analysis, the Court considered Congress's response to the \textit{Lampf} decision in which it limited the retroactive application of the Court's decision.\textsuperscript{180} Based on these congressional enactments, the Court inferred that Congress had

\begin{itemize}
  \item \textsuperscript{168} \textit{Id.} at 643.
  \item \textsuperscript{169} \textit{Musick}, 508 U.S. at 288.
  \item \textsuperscript{170} \textit{Id.} at 286-98.
  \item \textsuperscript{171} \textit{Id.} at 294.
  \item \textsuperscript{172} \textit{Id.} at 294-95.
  \item \textsuperscript{173} 501 U.S. 1083 (1991).
  \item \textsuperscript{174} \textit{Musick}, 508 U.S. at 292-93.
  \item \textsuperscript{175} \textit{Id.}
  \item \textsuperscript{176} \textit{Id.} at 289-90.
  \item \textsuperscript{178} \textit{Musick}, 508 U.S. at 293.
  \item \textsuperscript{179} \textit{Id.}
  \item \textsuperscript{180} \textit{Id.}
\end{itemize}
acknowledged the Rule 10b-5 cause of action and that no further legislative intent was required to justify its existence.\textsuperscript{181} Congress, the Court reasoned, appeared to acknowledge and accept the Court's explication of the Rule 10b-5 action.\textsuperscript{182} The \textit{Musick} case would have appeared to have determined finally the question of the Court's role in resolving issues under Rule 10b-5, as well as the legitimacy of the private cause of action generally.

While the Court, over its history, remained somewhat consistent in its analysis and definition of Rule 10b-5 jurisprudence, some weaknesses in its use of a congressional intent analysis began to appear. In \textit{Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.},\textsuperscript{183} the Court limited the scope of liability under Rule 10b-5 by refusing to acknowledge the existence of a cause of action for aiding and abetting.\textsuperscript{184} The Court based its decision on the fact that the statute lacked any reference to aiding and abetting liability in its text.\textsuperscript{185} The Court employed an attenuated notion of congressional intent stating that "it is inconsistent with settled methodology in Section 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text."\textsuperscript{186} Further distancing itself from the basis in the doctrine of where there is a right there is a remedy, the Court noted that aiding and abetting ought to be actionable in certain instances.\textsuperscript{187} The Court cited to the \textit{Restatement (Second) of Torts} for general principles of aiding and abetting, but clarified that the issue was not whether imposing "civil liability on aiders and abettors is a good policy but whether aiding and abetting is covered by the statute."\textsuperscript{188}

This analysis would then appear textualist in nature. Although the discussion leading up to this point seemed to advocate a textualist approach to the question of congressional intent, the Court changed course by engaging in a hypothetical consideration of what the 1934 Congress would have done had the Section 10(b) action been an express provision under the 1934 Act. The Court noted that none of the express causes of action under the 1934 Act impose liability on one who aids and abets a violation of the 1934 Act.\textsuperscript{189} The Court disposed of arguments that Congress had implicitly intended to impose aiding and abetting liability under Section 10(b) based on background as-

\begin{itemize}
  \item \textsuperscript{181} Id. at 294.
  \item \textsuperscript{182} Id.
  \item \textsuperscript{183} 511 U.S. 164 (1994).
  \item \textsuperscript{185} Central Bank, 511 U.S. at 191.
  \item \textsuperscript{186} Id. at 177.
  \item \textsuperscript{187} Id.
  \item \textsuperscript{188} Id. at 177.
  \item \textsuperscript{189} Id. at 177.
\end{itemize}
sumptions relating to tort law in existence at the time the 1933 and 1934 Acts were enacted. The Court analyzed various Congressional enactments which contain express aiding and abetting causes of action, and thereby determined that if Congress had intended such a cause of action it would have provided for it explicitly. The Court rejected arguments that Congress interpreted Section 10(b) to cover aiding and abetting liability based upon references to such liability in committee reports in 1983 and 1988.

The Court also indicated that it could not be inferred that Congress had acquiesced in the lower courts’ inference of aiding and abetting liability, because it had reserved the issue of aiding and abetting liability in both *Huddleston* and *Ernst & Ernst*. Furthermore, the Court maintained, such argument was false on its face insofar as one could not infer with any degree of accuracy based on congressional inaction, Congress’s intent with respect to any particular matter. Indeed, the Court noted that Congress failed to enact bills introduced in 1957, 1959, and 1960 which would have amended the securities laws to make it unlawful . . . to aid, abet, counsel, command, induce, or procure the violation of any provision of the 1934 Act. Nonetheless, the Supreme Court cautioned that Congress’s failure to enact those provisions would not support the contrary inference that the Congress intended not to incorporate aiding and abetting liability. Accordingly, the Court rested its decision on the fact that the text of Section 10(b) did not impose aiding and abetting liability.

Against the backdrop of the *Central Bank* decision, Congress enacted major securities reform legislation with the *Private Securities Litigation Reform Act of 1995* ("PSLRA"). Here again, Congress clarified and, one could argue, undid the effect of a Supreme Court decision. In the PSLRA, Congress determined that the SEC could bring cases against violators of Section 10(b) based on aiding and abetting liability, a question left open by the *Central Bank* case. Prior

---

190. *Id.* at 181.
191. *Id.* at 179.
192. *Id.*
193. *Id.* at 186.
194. *Id.*
195. *Id.* at 186-87.
196. *Id.* at 187.
197. *Id.* at 191 (stating that "[b]ecause the text of Section 10(b) does not prevent aiding and abetting, we hold that a private plaintiff may not maintain an aiding and abetting suit under Section 10(b). ").
to Congress' action, the SEC had taken the position that it still could maintain suits premised on aiding and abetting liability.\textsuperscript{200} While the issue itself may not be overly significant, because private claims previously brought as aiding and abetting or secondary liability actions now allege primary violations as an alternative,\textsuperscript{201} it would appear that Congress' limited action in addressing the \textit{Central Bank} holding did not prevent private litigants from finding a way around the decision.

In \textit{United States v. O'Hagan}\textsuperscript{202} the Supreme Court in 1997 approved the controversial "misappropriation theory" of liability developed by lower courts.\textsuperscript{203} The case involved the use of confidential information about a pending merger by a law firm partner in the firm representing the acquiring corporation.\textsuperscript{204} The partner who traded on the information had not been tipped to do so by the partner dealing with the acquisition and was not involved in the matter.\textsuperscript{205} The Court held that the partner's trade violated Section 10(b) and Rule 10b-5 based on the misappropriation theory.\textsuperscript{206}

The misappropriation theory stands for the proposition that "a person commits fraud in connection with a securities transaction," in violation of Section 10(b) by misappropriating "confidential information for securities trading purposes, in breach of a duty owed to the source of the information."\textsuperscript{207} This theory treats a "fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality," as conduct defrauding "the principal of the exclusive use of such information."\textsuperscript{208} Following the lead of \textit{Central Bank}, the Court based its decision on the text of the statute.\textsuperscript{209} The Court held that the misappropriation theory comports with Section 10(b)'s language insofar as the theory requires deception "in connection with the purchase or the

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{200} Id.
  \item \textsuperscript{201} See \textit{United States v. O'Hagen}, 117 S. Ct. 2199, 2213-14 (1997) (referring to \textit{Central Bank} as allowing suits for primary violations against secondary actors). Claims of aiding and abetting or secondary liability were routinely brought when the facts were insufficient to base a claim for a primary violation. Plaintiffs now routinely bring suits based on alleged primary violations of the law, which are made somewhat weaker given the quantum of proof the plaintiff can muster in support of the claim. See Ameena Y. Majid, Comment, \textit{Diminishing the Expected Impact of Central Bank of Denver v. First Interstate Bank of Denver: Secondary Liability Masquerading as Primary Liability Under Section 10(b)}, 28 Loy. U. Chic. L.J. 551, 551-64 (1997).
  \item \textsuperscript{202} 117 S. Ct. 2199 (1997).
  \item \textsuperscript{203} \textit{United States v. O'Hagan}, 117 S. Ct. 2199, 2207-14 (1997).
  \item \textsuperscript{204} \textit{O'Hagan}, 117 S. Ct. at 2205.
  \item \textsuperscript{205} Id. at 2206.
  \item \textsuperscript{206} Id.
  \item \textsuperscript{207} Id. at 2207.
  \item \textsuperscript{208} Id. at 2207.
  \item \textsuperscript{209} Id. at 2208.
\end{itemize}
\end{footnotesize}
sale of a security.\textsuperscript{210} Accordingly, \textit{O'Hagan} comports with the \textit{Central Bank} decision by emphasizing the inference to be drawn from the words "deceptive device" in the text of Section 10(b) and Rule 10b-5.\textsuperscript{211} This inference is analogous to the negative implication drawn from the lack of an explicit reference to aiding and abetting liability.

Although the Court's decision was not without textual basis, \textit{O'Hagan} shows that the text in this context can do only part of the work. The text of Section 10(b) prohibits the use or employment "in connection with the purchase or sale of any security ... [of] any manipulative or deceptive device or contrivance."\textsuperscript{212} The misappropriation theory requires the breach of a fiduciary duty, in this case by an agent's appropriation of confidential information of a principal, and trading on such information without disclosure.\textsuperscript{213} The misappropriator, in the Court's analysis, derives riskless profits by deceiving the principal and then trading on such information.\textsuperscript{214} This type of deception differs considerably from the case of an employee or agent who embezzles money and then uses such funds to purchase securities.\textsuperscript{215} In that case, the fraud would have occurred at the time of the theft, not in the securities transaction.\textsuperscript{216} The Court's decision thus rests in large part on the sense that the theft of information and use of such information to trade in securities, falls within the scope of Section 10(b).\textsuperscript{217}

The misappropriation theory illustrates the extent to which the application of Rule 10b-5 to actual situations requires explication and interpretation. Neither the statute nor the rule clearly answers the question entertained in \textit{O'Hagan}. That "deceptive device" can mean fraudulent appropriation of information from a principal by an agent is hardly tautological. To arrive at the Court's decision required a sense of the type of conduct involved, a review of prior case law, and weighing certain policy issues. An analysis of congressional intent alone would not suffice.

D. Analysis of Rule 10b-5 Jurisprudence

In all of the cases mentioned in the previous section, the Supreme Court grappled with the task of identifying the procedural and sub-

\begin{itemize}
  \item \textsuperscript{210} \textit{Id.}
  \item \textsuperscript{211} \textit{Id.} at 2208-09.
  \item \textsuperscript{212} 1934 Act, Section 10(b).
  \item \textsuperscript{213} \textit{O'Hagan}, 117 S. Ct. at 2205.
  \item \textsuperscript{214} \textit{Id.} at 2209.
  \item \textsuperscript{215} \textit{Id.}
  \item \textsuperscript{216} \textit{Id.}
  \item \textsuperscript{217} \textit{Id.}
\end{itemize}
stantive nature of the Rule 10b-5 cause of action. In Blue Chip Stamps, for instance, the Court directly determined an element of the cause of action. Later cases such as Lampf and Musick concerned more procedural matters. These cases directly turned on the Court’s implication of the cause of action. Because there is no text from which the Court may legitimately imply the 10b-5 cause of action, the Court was required to use its best judgment by referring to earlier decisions, analogous cases involving other statutes, and structural arguments based on an analysis of the securities laws. In Central Bank, the Court was able to reach the negative implication, based on the lack of statutory text, that no aiding and abetting liability could be inferred from the statute. It is difficult to distinguish this case from Lampf, wherein the Court inferred a statute of limitations for the 10b-5 cause of action. One can argue that Lampf concerned the application of remedies under Rule 10b-5 and Central Bank concerned the primary question of the scope of an element of the cause of action, but the justification for such distinction requires some argument. If this author’s reading of O’Hagan is correct, it appears that the Court has tried to stick with its analysis in Central Bank. This case illustrates the inadequacies of using a textualist approach to an implied remedy where no evident basis for assessing civil liability exists.

Part of the development of Rule 10b-5 jurisprudence can be seen in the array of judicial discussions interpreting the law and extending it over time. The court in Kardon, although a lower court, was the source for numerous cases following its holding. Both the Supreme Court and Congress have shown deference to the role of lower courts in this development by alternatively upholding lower court precedent and leaving ambiguity in the statute for judicial resolution. Accordingly, the institutional role of the lower courts in the process of defining the meaning of Rule 10b-5 should not be discounted. Lower courts thus form another level of discourse based on conferral of power from the Supreme Court and Congress.

218. See supra notes 5-174 and accompanying text.
219. See supra notes 47-68 and accompanying text.
220. See supra notes 121-30, 133-49 and accompanying text.
221. See supra notes 185-99 and accompanying text.
222. See David M. Gossett, Chevron, Take Two: Deference to Revised Agency Interpretations of Statutes, 64 U. Chi. L. Rev. 681, 689 n.41 (1997) (citing Smiley v. Citibank (South Dakota) N.A., 517 U.S. 735, 738 (1996)). This Congressional action is similar to the situation where Congress leaves ambiguous portions of the statute, which the Supreme Court has said shows Congress’ understanding that “the ambiguity would be resolved, first and foremost, by the agency, and desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows.” Alternatively, the lack of ambiguity in a statute may furnish grounds to infer the lack of congressional intent to leave a matter for agency interpretation. Id. at 689, 691.
These cases also illustrate the extent to which the Supreme Court is cognizant of Congress' action in refining the liability scheme of the securities laws. The Insider Trading Act in 1988; Congress' response to the Lampf decision in 1991; Congress' response to Central Bank; in the PSLRA in 1995; and the National Securities Markets Improvement Act of 1996 ("NSMIA"),\(^\text{223}\) in which Congress gave the SEC authority to determine which securities constitute "covered" securities,\(^\text{224}\) demonstrate the interplay between the judiciary, the SEC and the Congress. These cases along with Congress' continued consideration of Section 10(b) and the practical realities of litigation under Rule 10b-5, make the process of developing the Rule 10b-5 cause of action a dynamic one. This process began, not ended, in 1934. An analysis of Habermas' most recent explication of his theory of communicative action may provide an explanation, as well as a normative basis, for the development and evolution of Rule 10b-5.

### III. HABERMAS' THEORY OF LEGAL LEGITIMACY

In his recent work, *Between Facts And Norms*,\(^\text{225}\) Jurgen Habermas has united his theory of communicative action with a theory of law and democracy. Previous extensions of his work in developing a theory of communication involved the moral philosophical implications of such theory,\(^\text{226}\) but his latest work represents a new extension of post-metaphysical thinking\(^\text{227}\) to jurisprudential issues. In this work, he unites social theory with a philosophy of law and moral philosophy.\(^\text{228}\) Although his work, in its sociological moment, encompasses all aspects of society, due to the limitations imposed by the scope of this article, attention will be paid primarily to Habermas' understanding of the paradigmatic shift in the law which he believes has evolved in late Western democracies.


\(^{224}\) Under the NSMIA, Congress preempted state "blue sky" regulation of all "covered" securities. The actual determination of what securities would qualify for such preemption was left to Congress to determine.

\(^{225}\) JURGEN HABERMAS, BETWEEN FACTS AND NORMS (1996).


\(^{227}\) See generally JURGEN HABERMAS, POSTMETAPHYSICAL THINKING (1992). Habermas conceives of his theory as an attempt to step beyond the metaphysical tradition in social thought involving substantive commitments on questions of right, to one involving non-substantive normative commitments.

A. METHODOLOGICAL CONCERNS

Habermas presents an immensely complicated theory, due in part to the conceptual vocabulary he employs as well as the methodology of his approach. To understand Habermas's theory, as an initial matter, requires some attention to his methodology. As with many jurisprudential theorists, Habermas takes both descriptive and normative positions. Rather than reject the structure of contemporary systems of law and democracy wholesale, Habermas takes what he calls a reconstructive approach. First, Habermas undertakes an analysis of different paradigms of law. These paradigms are the liberal-bourgeois and the welfare bureaucratic models. According to Habermas, the liberal-bourgeois model is the legal order which emerges alongside the development of modern capitalist economies. In this sense, Habermas has in mind a paradigm of liberalism in the classical tradition. Legal formalism is perhaps the closest approximation to this notion. Ideals such as rights to property, freedom to contract, or in its most extreme moment, laissez faire capitalism, have their roots in this model. Traditionally such rights are referred to as negative rights. The stock market crash of 1929, the Great Depression, movements for civil rights, and changes in social thought in general brought about the demise of this liberal formalistic model. Whereas the notion of unfettered capitalism as the means of raising the standards of living of all persons had at one time been taken as self-evident, opposition to such order began to mount. Cracks in the edifice constructed by legal actors representative of this order, typified by such cases as the Supreme Court's Lochner decision, began to appear.

The welfare bureaucratic model was formed largely in response to such traditional liberal formalism. Proponents of welfare rights advanced the cause of positive freedoms, or freedoms designed to enable persons to participate in the economic and political system. Such rights have included pension rights, rights to government assistance, consumer rights, rights to education and the redistribution of

229. See Jurgen Habermas, supra note 226, at 82 (stating "I want to rationally reconstruct the self-understanding of these modern legal orders."). By such a rational reconstruction, Habermas intends to clarify the theoretical grounding for the developed legal order. In so doing, he looks to the normative presuppositions of actors in the legal system thereby gaining insight into the foundational principles, such as fundamental constitutional rights, accepted by participants in any given legal system.

230. See generally Habermas, supra note 226, at 388-446. Habermas does not explain the meaning he ascribes to the term "paradigms of law" but his use of the term descriptively provides an adequate contextual definition.

231. Habermas, supra note 226, at 388-90.

232. Id.
Such rights, largely the product of statute, have raised the standard of living of the lower and middle classes in an absolute sense so that radical responses to this economic order (e.g. Marxism) became unnecessary. To secure such positive liberties, a bureaucratic structure emerged. In the United States, this phenomenon manifested itself most dramatically in the rise of the federal government under the New Deal. While only a secondary effect of the welfarist program, this bureaucratization caused an increase in size and scope of government, resulting in the inability of government to change and a concomitant impotence of democracy.

To the extent beneficiaries of the welfare state receive the fruits it distributes, they become instrumental to the functioning of this system resulting in a loss of dignity and autonomy. As society came to be dominated by functional systems (such as the social welfare system) separate from and beyond the control of members of society, such persons were left with a sense of meaninglessness. The problems with such institutions, for Habermas, is that they have become unaccountable to the citizenry. Citizens conceive of such systems as monolithic and beyond control. The result is complete political paralysis in the face of such systems, causing the loss of meaning. The goals of the welfare bureaucratic system, while altruistic or progressive in origin, have not overcome the loss of meaning which all citizens, beneficiaries of this system or not, feel in its wake.

After mapping the earlier paradigms, Habermas makes the descriptive claim that a new paradigm has emerged to replace the traditional liberal-bourgeois paradigm and welfare-bureaucratic

233. Id. at 407.
235. See generally Jurgen Habermas, Legitimation Crisis (1975).
236. See Michel Rosenfeld, Can Rights, Democracy, and Justice be Reconciled Through Discourse Theory? Reflections on Habermas's Proceduralist Paradigm of Law, 17 Cardozo L. Rev. 791, 807 (1996) (stating that "in order to achieve factual equality, the dignity and autonomy of those who must be clients of the welfare state become substantially undermined").
237. Habermas conceives of such loss of meaning as the result of the dominance of functional systems,

We are confronted today not only by system theory's intellectual repression of the discursive structure of social life, but also by the real repression of processes of reactionary understanding in favor of systematic forms of integration such as the market or the bureaucratic state, which to a certain extent function behind the backs of the participants and achieve their ends by means of steering mechanisms.

This new paradigm attempted to overcome the inadequacy of the previous orders. It represents a departure from modernism and can be termed a post-modern paradigm. Unlike modernist ideologies, the post-modern paradigm arises from an intersubjective notion of rationality. No longer can political and legal decisions be considered the product of a singular will within this paradigm but, instead, must be viewed as a consensus-oriented process of decision-making involving communication by and among all concerned participants. Under this paradigm, law must be understood procedurally.

Herein lies the normative turn in Habermas' thought. He claims that not only has this new paradigm in law emerged, but also that such new understanding of law and politics must be guided by an understanding of the limits of human reason, of which an intersubjec-


239. An intersubjective approach may be distinguished from a subjective approach, which has historically dominated Western thought. In an intersubjective approach, persons reorient their perspective from a purely internal fixed point of reference to the external world to one in which the subjectivities of other individuals are appreciated. Charles Taylor provides a helpful understanding of this notion in the work of Habermas, he notes:

[R]eason is not understood monologically, but rather as a perfection of this process of reaching understanding in such a way that the ruptures in a commonly shared 'We' are repaired. By dint of the fact that we have to do here with ruptures in our common understanding, which are in turn bridged by more deeply rooted common properties, it makes sense to repair such ruptures in the commonly shared horizon. This, however, implies that we must search for 'reasons' within this horizon acceptable to all if we are to bring about a new consensus on the matter for dispute.

TAYLOR, supra note 238, at 28. Understanding in an intersubjective approach is not the result of an individual consciousness isolated from experience but the result of background understandings resulting from common experiences and beliefs. Rather than a latent background which the individual will access if so desired, such common understandings constitute the individual. By taking part in linguistic activity, the speaker must thereby relate to the other speaker. Such relation forms the individual subject:

a speaker can in a performative attitude address himself to a hearer only under the condition that he learns to see and understand himself—against the background of others who are potentially present—from the perspective of his opposite number, just as the addressee for his part adopts the speaker's perspective for himself.

HABERMAS, supra note 228, at 24. Or similarly,

[i]f namely, the self is part of a relation-to-self that is performatively established when the speaker takes up the second-person perspective of a hearer toward the speaker, then this self is not introduced as an object, as it is in relation of reflection, but as a subject that forms itself through participation in linguistic interaction and expresses itself in the capacity for speech and action.

Id. at 25. Once engaged in communicative action, an individual takes up the perspective of other participants, similar to the concept of the Kantian categorical imperative. Through such process, Habermas argues, the individual is formed.
Communicative, and hence intersubjective, rationality provides the means of reassessing modernist legal institutions in light of a proceduralist reconstruction of law and democracy. As such, his discourse theory provides a critical tool to evaluate existing political, legal, and social institutions. Such a critical program need not advocate the elimination of current institutions, but can build on the principles on which such institutions are based. It may thus be used to reinterpret existing traditions and institutions to realize a certain kinetic power for reinvigorating democracy. This rather thin normative argument requires only the critical reappraisal of legal and political institutions in accordance with the discourse principle in an attempt to implement the principle in existing practice.

This normative stance may at first appear inconsistent. On the one hand, Habermas asks that we accept his descriptive claims that a new post-modern paradigm has emerged. On the other hand, he claims that we must adopt a proceduralist view of law and an intersubjective notion of reason. Because our current political and legal systems are not to be abandoned completely, Habermas intends his communicative sense of rationality to be more completely realized in the existing legal order. Habermas does not conceive the possibility of realizing such changes in existing institutions as problematic. He

240. Lenoble, 17 CARDOZO L. REV. at 937. This argument stems from a broader reformulation of reason, from a Kantian pure theoretical understanding to a procedurally grounded notion:

The order of things that is found in the world itself, or that has been projected by the subject, or has grown out of the self-formative process of spirit, no longer counts as rational; instead, what counts as rational is solving problems successfully through procedurally suitable dealings with reality. Procedural rationality can no longer guarantee an antecedent unity in the manifold of appearances.

HABERMAS, supra note 226, at 35. Put simply, the basis for rational thought stems not from an individual consciousness capable of understanding reality solely through the processes of one's own faculties, but through the use of procedural devices employed in our attempts to understand the world. This understanding holds for discerning answers to problems within the natural sciences as well as "moral-practical problems for the community of citizens of a democratic state and for the system of law." Id.


242. In some earlier works, Habermas advocates a program of "democratization."

243. Put in critical theoretical terms,

The critical enterprise must now be a critique of the inherent potential for reaction within the existing power structure—i.e., the question is not one of dismantling the structure and replacing it by another, but rather one of buttressing the existing power structure against the threat looming from the right—whether the political, the economic, or the religious right.

244. Gabriel Motzkin, HABERMAS'S IDEAL PARADIGM OF LAW, 17 CARDOZO L. REV. 1431, 1431-32 (1996). While not a direct description of Habermas' intent, Motzkin has captured the essence of his project.
argues that through a process of reification, we have come to believe, incorrectly in his view, that existing social and political institutions are fixed entities which cannot undergo change.\textsuperscript{244} Rights, such as freedom of speech, although justified by appeal to modernist ideals when implemented originally, have taken on new meaning within this new paradigm. As such, these rights become essential to the more complete realization of intersubjective rationality and communicative decision-making.\textsuperscript{245} Having established the methodological basis upon which Habermas's theory is founded, attention may be given to more foundational aspects to the theory beginning with his understanding of communicative action.

B. Communicative Action

Habermas believes that the inherent limitations in human reason have led to the rejection of the possibility of a metaphysical ideal or unitary basis for political or legal judgment.\textsuperscript{246} Habermas has focused on the nature of communication as the grounds upon which rationality may be based under conditions of post-modernity. No arbiter of reason enables us to distinguish between claims of validity\textsuperscript{247} in this paradigm. Validity claims may be evaluated through a process of argumentation and debate among those persons effected by disputed norms. Habermas refers to such process as one of opinion and will formation by which the illocutionary\textsuperscript{248} binding force of language (or constraints created by the use of language itself) gives rise to certain background conditions and rules of argumentation directing us toward normative agreement.\textsuperscript{249} This process of putting forth a rea-

\textsuperscript{244} See generally Habermas, supra note 227, at 336-37. Habermas speaks of "the systemically induced reification of everyday practice" by which he means the tendency to view existing social and political institutions as things rather than social constructs which are continually reapproved by society. \textit{Id.} at 340. Such re-establishments of these institutions entail certain normative contents. Hence they are open to normative reappraisal.

\textsuperscript{245} Maus, 17 Cardozo L. REV. at 833-35.

\textsuperscript{246} Perhaps one of the best critiques of modernity is contained in Alasdair MacIntyre's \textit{AFTER VIRTUE}, although his neo-Thomist moral philosophy differs from Habermas considerably. \textit{See generally} ALASDAIR MACINTYRE, \textit{AFTER VIRTUE} (1987).

\textsuperscript{247} Habermas uses the notion of validity claims in referring to claims of normative justification.

\textsuperscript{248} This term is taken from John Austin's work in speech act theory. For a useful discussion, see John Searle, \textit{Austin on Locutionary and Illocutionary Acts}, LXXVII Phil. Rev. 405, 405-24 (1968). The term refers to non-linguistic meanings, such as forcefulness, present in discourse.

\textsuperscript{249} Habermas makes use of the notion of a "performative contradiction" as a means of justifying his rules of argumentation. By a performative contradiction, he refers to the implicit commitments which participants in a discourse make. Such commitments orient the participants to an understanding. An example of a skeptic involved in a discourse offers insight into this method. The skeptic states "using lies, I finally convinced
son, in itself, provides a foothold which serves to draw the participant into the debate. It also requires the person to accept a certain form of rationality, that is, the form of rationality inherent in meaningful discourse. Once the participant puts forth a reason or an argumentative position, then the deliberative process requires the participants to evaluate arguments and ultimately choose between better arguments. By looking to the pragmatic presuppositions of all speech, Habermas derives a discourse principle which is implicit in all such speech. Through this process, reason and will come together thereby leading the participants to “convincing positions to which all individuals can agree without coercion.”

In the legal context, this process of communication provides a criteria to distinguish between validity claims regarding a disputed norm. Norms are thus chosen through a discursive process whereby certain norms receive the approval of all those affected. Habermas’s succinct rendering of this ideal, as a principle of discourse, gathers numerous aspects of his theory: “[Only] those action norms are valid to which all possibly effected persons could agree as participants in rational discourses.” This formulation of his discourse principle serves a practical function. In the legal and political

---

This presupposition holds not only for particular instances but inevitably for every process of argumentation. I can prove this by making a proponent who defends the truth of [this] statement aware that he thereby gets himself into a performative contradiction. For as soon as he cites a reason for the truth of this statement, he enters a process of argumentation and has thereby accepted the presupposition, among others, that he can never convince an exponent of something by resorting to lies; at most, he can talk himself into believing something to be true. But the content of the assertions to be justified contradicts one of the presuppositions the proponent must operate with if his statement is to be regarded as a justification.

HABERMAS, supra note 226, at 103.

Maus, 17 Cardozo L. Rev. at 842.

251. HABERMAS, supra note 226, at 103.

252. Id. at 104.

253. Id. at 107. Rational discourse in this context differs from the conditions of the ideal speech situation under which Habermas developed a pure, theoretical construc-
context, rational discussion refers to a process whereby various "topics and contributions, information and reasons" are taken up in a bargaining context, so that participants in such discussion may reach agreement.254 Such discourse does not entail constraints on possible topics of discussion or permissible stances.255 The discourse process does permit compromise between the involved parties; however, such compromises must come about under fair bargaining conditions and be acceptable to all parties.256 The explicit assumption Habermas makes, and notes in his discussion of this discourse principle, is that "practical questions can be judged impartially and decided rationally."257 The process of decision making according to this method requires the adoption of certain rules of argumentation to answer different types of questions.258 Different rules must be adopted in resolving pragmatic, ethical, or moral questions.259 The discourse principle thus provides a flexible standard by which normative agreement may be achieved. Attention will now be directed toward the means by which Habermas suggests such discursive process may be realized in current democratic practice.

C. HABERMAS ON DEMOCRACY.

Habermas does not begin his direct analysis of law and democracy from a blank slate. Instead, he takes a reconstructive sociological approach to democracy by which he attempts to recover "fragments of existing reason" latent in the practices of Western democracies. Accordingly, Habermas is not of the view that legal systems have been unable to implement any of the ideals he advocates, but rather, that many of such ideals are already realized.260 In keeping with his focus on communicative agreement as the means of determining normative questions, Habermas looks to the deliberative processes inherent in

254. HABERMAS, supra note 226, at 108.
255. HABERMAS, supra note 226, at 108.
256. HABERMAS, supra note 226, at 108.
257. Id. at 109.
258. Id. at 109.
259. Id. at 109. For an instructive discussion of the questionable nature of this assumption by Habermas see Lenoble, 17 CARDOZO L. REV. at 951. In that piece, the author adopts a Quinean critique of the undecidability of every speech act.
260. See Mark Gould, Law and Philosophy: Some Consequences for the Law Deriving from Sociological Reconstruction of Philosophical Theory, 17 CARDOZO L. REV. 1239, 1240 (1996). Habermas contends that the ideal communicative system "is actually, if only implicitly, present even before it is realized, even if it is never to be realized." Id. As part social theory, Habermas has chosen to go back to an earlier understanding of Kant and Hegel that "the conditions of a society can only be explained in the framework of a theory of law." MAUS, 17 CARDOZO L. REV. at 825.
current democratic structures to root his theory in current practice. Accordingly, while he adheres to the notion of communicative action as the basis for normative decision-making, his formulation of the discourse principle discussed earlier becomes an ideal theoretical construct, rather than a concrete proposal. Using this theoretical construct as a metronome, Habermas can examine the structure of existing democracies (which already contain much of the institutional structure necessary to implement his ideals) for consistency and coherence with this ideal.\textsuperscript{261}

By analyzing existing institutions and practices, Habermas ties his theory to current legal practice. Because Habermas believes that normative justification under his discourse principle consists of following procedures to produce normative consensus, it follows that laws resulting from such processes are legitimate. Legitimate law can be created only through discursive processes, which comport with the discourse principle. Just as universal acceptability of norms provides the basis for justifying such norms in the moral context, political agreement constitutes the basis for justifying law. A deliberative politics conceived along the lines of the discourse ideal provides a problem solving procedure which uses knowledge as a means of collective decision-making which produces legitimate law as the outcome of such procedure.\textsuperscript{262}

For such structures that facilitate the process of collective decision-making to survive, the legal system itself must recognize certain rights. Rights are necessary to create the structures within which such opinion and will formation through deliberation may occur. Within the legal system, Habermas’s philosophical proceduralist leanings are redefined as concrete legal rights. Law secures freedoms of speech in the public sphere and regulates the manner of speech within public institutions.\textsuperscript{263} Moreover, law secures private rights of autonomy which allow individual members of society to exercise their participatory rights in the public sphere.\textsuperscript{264} Public autonomy is thus secured by private autonomy and vice versa.\textsuperscript{265} Rights understood as preserving the communicative process are universal claims based on the pragmatic assumptions which all speech acts involve. This deriva-

\begin{itemize}
\item \textsuperscript{261} The critical use of the ideal speech situation provides a tie between this most recent work and Habermas’s firm roots in the tradition of critical theory. See Gould, 17 CARDOZO L. REV. at 1240.
\item \textsuperscript{262} What is most striking in Habermas’ theory is not his claim that the discourse principle represents a valid means of determining normative questions but his claim that existing democratic structures provide a basis for such process to occur.
\item \textsuperscript{263} See Gould, 17 CARDOZO L. REV. at 1244. This aspect of the theory can be seen as akin to American process theorists like John Hart Ely.
\item \textsuperscript{264} HABERMAS, supra note 226, at 408.
\item \textsuperscript{265} Id.
\end{itemize}
tion of rights does not conflict with his belief in the breakdown of modernist rationality.

In this way, Habermas relies on the aspects of current democracies arising from the modernist tradition. Rights such as freedom of speech, while the product of enlightenment philosophies, furnish a basis for the implementation of Habermas' post-modern program. In the United States, the legacy of modernism subdures most clearly in the Constitution. The accomplishments of modernity ought not be discarded. Rather the rights and institutions to emerge from this tradition ought to be reoriented toward the new paradigm. No longer should such rights be conceived as "inalienable rights" justified by pure reason, but as rights derived from pragmatic presuppositions of speech necessary to implement fair procedures through which we may create valid law. The structure of legislation and public policy-making, thus, does not entail any substantive political or moral ideals. Substantive normative decisions can be rendered by the operation of the institutions oriented towards consensus which are established by such rights.

D. Circulation of Power

Once the requisite structures are established, legitimate law-making can occur within the confines of such institutions. Legitimate law is produced through a circular process. "[L]egitimate law reproduces itself only in the forms of a constitutionally regulated circulation of power, which should be nourished by the communications of an unsubverted public sphere rooted in the core private spheres of an undisturbed life world via the networks of civil society." No longer should we conceive of the process of democratic decision-making as a zero sum game between competing actors, public and private or legis-

266. Habermas's position considers both the basic rights necessary to ensure a fair procedure and the laws to emerge from such procedure as derived under conditions of communication leading to a consensus. The initial participants in discourse designed to produce basic rights, such as those supporting freedom of speech, must have already in place some basic rules of argumentation prior to the discussion occurring. Such rules present a sort of "thin" set of guidelines for an initial debate, such as might occur in a constitutional convention. Presumably, for Habermas, such initial discourse derives its rules based on the undeniable form of rules of argumentation arising from the sense of the performative contradiction in his ideal speech model. It may be that the notion of the performative contradiction cannot do all of the work required to generate sufficient rules for argumentation for this constitutional convention. Accordingly, he may need to revert to a Rawlsian justification for such rules. See John Rawls, Political Liberalism 372-434 (1992) (Habermas debate). The discourse arising later involving actual democratic practice of legislation and adjudication will involve "thick" rules, namely the rules adopted as the basic structures of the political system. But see Gould, 17 Cardozo L. Rev. at 1272-73.

267. Habermas, supra note 226, at 408.
lative, judicial, and administrative. Instead, we should conceive of all such actors as participants in the deliberative process, which is continually evolving.

Legitimate law derives its status from multiple sources. In a system such as the current U.S. legal system, one cannot point to a single entity from which all legitimate law issues. While the Constitution may function as a rule of recognition under which laws made in accordance with the process supported by the Constitution are legitimate, such an understanding fails to account for the accumulation of law throughout 200 years of democratic practice, including statutory, administrative, common, and constitutional law. Habermas' understanding of this phenomena views the courts and legislature as co-participants in a process of legislation. This form of a dynamic process, therefore, acts as a continual reaffirmation of the legitimate order by the separate institutions.

If the discursive process involves all concerned persons and takes into account all points of view as Habermas envisions, the process of law-making becomes diffuse. Administrative agencies, the courts, and legislative bodies feed and are fed by each other in a deliberative process of democracy. Legitimacy becomes circular and the preconditions justifying state action become justified themselves ex post facto by the results of such procedures themselves. Such institutions are similarly fed by public opinion which furnishes background conditions for democratic decision-making, and through informal and formal channels communication feed the institutionalized democratic organs. Such public opinion becomes “converted into political power only if it passes through the sluices of democratic procedure and penetrates the constitutionally organized political system in general.”

---


269. “Because judicial decision making is bound to law and legal statutes, the rationality of adjudication depends on the legitimacy of existing law. This legitimacy hinges in turn on the rationality of a legislative process that under the conditions of the constitutional separation of powers is not at the disposal of agencies responsible for the administration of justice.” HABERMAS, supra note 226, at 238.

270. See generally Maus, 17 CARDOZO L. REV. at 864 (discussing the process of legitimation). Claus Gunther characterizes the structure of this circular process as “quasdialectical,” leading him to argue that “the fact that in Habermas's work subjective liberties are presented as both the result of and the prerequisite for democratic lawmaking is not a contradiction, but rather the ‘whole point of the argument.’” Id. at 838.

271. Maus, 17 CARDOZO L. REV. at 874. “Habermas transforms popular sovereignty into fluid communicative power while insisting on the intrinsic logic of the administrative system.” Id.

272. HABERMAS, supra note 226, at 327.
IV. ANALYSIS OF 10b-5 JURISPRUDENCE FROM A HABERMASIAN PERSPECTIVE

The development of Rule 10b-5 jurisprudence affords a strong example of the process of law-making Habermas envisions. Beginning with congressional enactments of statutes, followed by administrative regulation, and apparently concluding with judicial amplification and extension, the dynamic nature of law emerges. Once this cycle is completed, it turns back on itself. The following will illustrate the extent to which this process constitutes legitimate law under Habermas' theory. This discussion is an attempt to reconstruct generally the history of the development of Rule 10b-5 jurisprudence bearing in mind the Habermasian perspective.

A. DISCOURSE OF ALL CONCERNED PARTICIPANTS

Habermas envisions legitimate law-making as a process of debate and discussion of all concerned participants. The development of Rule 10b-5 jurisprudence suggests an ongoing debate from its inception. At each stage in the evolution of the law, parties engaged in active argumentation and produced a workable outcome. The process ought not be seen as a closed circle of legislators engaged in parliamentary type debates, but as one involving actors in various public and private spheres.

The breadth of influences giving rise to Section 10(b) traces back to the conditions leading to the passage of the securities laws. In 1933, Congress enacted the Securities Act which regulated the public offering of securities in response to the 1929 stock market crash.\(^\text{273}\) The events occurring subsequent to the market crash created widespread public interest in remedying abuses in the securities business. The Great Depression stirred tensions in the public, forcing the Congress and the President to respond to the prior inadequate legal scheme.

To complement the 1933 Act, Congress enacted the 1934 Act to regulate the trading and distribution of securities.\(^\text{274}\) One of the apparent rationales for enacting this statute was to remedy perceived fraudulent and manipulative practices in the securities markets.\(^\text{275}\) Public opinion of both investors and those affected by the market crash directly, or indirectly as a result of the Great Depression, supported such legislation. Public opinion in this analysis fed the legislative process, if only in a general sense, becoming rationalized through

\(^{274}\) See supra note 5 and accompanying text.
\(^{275}\) Ernst & Ernst, 425 U.S. at 195.
its enactment into law. Out of this process, statutes, as well as an administrative agency, were created to further the goals of the regulatory program.

The main institution charged with enforcing the securities laws was the SEC. Once in place, the SEC took Congress' explicit grant of authority to create regulations supporting the statute. Through this process, the SEC promulgated Rule 10b-5, consistent with the power conferred by Congress. The SEC prohibited "manipulative and deceptive devices," as had Section 10(b), but gave no indication of its desire to confer a private right of action. While not a public debate as in congressional enactments, the SEC internally weighed the pros and cons of the rule on the staff and at the Commission level. The rule can thus be viewed as the product of congressional intent and administrative prerogative.

B. LEGISLATIVE AND JUDICIAL DEVELOPMENT AS DISCOURSE

The SEC's rule-making received subsequent judicial input. The court in Kardon read the rule as affording a private right of action. This was but one of numerous courts which subsequently gave voice to the private right to action. The justification advanced by such courts in the doctrine of "where there is a right there is a remedy" fused legislative and regulatory enactments with a prior, well-worn legal principle. This circle of public policy making was thus fed by rationalized input from the sphere of common law. In other words, the common law doctrine when applied to a statute and regulation, dictated slightly different consequences than those the original legislative and administrative actors envisioned.

At no time during this period of judicial development of the private right of action did Congress attempt to illuminate it. While the Court's aversion to such analysis as evidence of congressional intent offers a useful prudential rule, in practice, it seems counter-intuitive. Had the courts been usurping congressional or administrative authority at this point, Congress or the SEC could have acted. Instead, Congress danced around the issue in its legislative efforts and the SEC viewed it as supporting the notion of private attorneys general policing the enforcement of the securities laws. Consequently, rather

276. Id.
277. Id. at 195-96.
278. Id.
279. Id. at 195.
281. For the Court's recognition of this notion, see J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964) (noting that private enforcement of SEC rules may provide "a necessary supplement to Commission action").
than looking at the legal developments as separate and exclusive of Congress, Congress must instead be viewed as a continued participant in the debate.

After almost 30 years of congressional inaction and consistent judicial treatment of Rule 10b-5, the Supreme Court gave its *imprimatur* to the rule in 1971.282 A new voice in the debate, the Court weighed in its interpretations of congressional intent, textual analyses, and policy in a melange supportive of the Rule 10b-5 cause of action. The Supreme Court in *Blue Chips Stamps*, presented the clearest explanation of the unclear source of this law.283 It showed the extent to which the evolution of the law in this context grew out of collective decision-making of all involved parties.284 This idea also received the Supreme Court's approval in decisions involving separation of power questions.285 It also sounds vaguely similar to Habermas' analysis of the circulation of power. The *Blue Chip Stamps* Court, perhaps unwittingly, acknowledged the multiple sources for the Rule 10b-5 cause of action, a representative example of Habermas' postmodern paradigm of law.286

Subsequent legislative developments began this cycle anew. The various congressional responses to the Court's decisions left intact the private cause of action, but attended to particular aspects to the claim. Congress made numerous revisions to the securities laws, but first weighed the existence of the civil liability scheme in considering an amendment to Section 10(b) in 1957 and 1959.287 At that time, Congress considered changing the wording from "in connection with the purchase or sale of any security" to "in connection with the purchase or sale of or, any attempt to purchase or sell any security."288 Congress did not approve the amendment.289 Part of its decision apparently rested on a desire not to extend the cause of action further.290

282. See supra note 23 and accompanying text.
283. See supra notes 53-68 and accompanying text.
284. Id.
285. See Buckley v. Valeo, 424 U.S. 1, 121 (1976) (acknowledging the interdependence of the three branches of government). See also Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 635 (1952); Susan J. Stabile, *The Role of Congressional Intent in Determining the Existence of Implied Private Rights of Action*, 71 Notre Dame L. Rev. 861, 879 1996 (noting that we as a people have "long since abandoned a literal application of separation of powers, which would require a strict and absolute separation between the functions of the branches of the federal government. Instead, courts have applied an analysis that recognizes the interdependence of the three branches and a mixture of powers to the extent necessary to carry out the main function of each branch.").
286. Compare supra notes 53-68 and accompanying text, with supra notes 177-224.
287. See *Blue Chip Stamps*, 421 U.S. at 732.
288. Id.
289. Id.
290. Id.
Congress next approached the validity of the Rule 10b-5 implied cause of action when it enacted the Securities Acts Amendments of 1975, which were considered "the most searching reexamination of the competitive, statutory and economic issues facing the securities markets, the securities industry, and, of course, public investors, since the 1930's." In evaluating and amending the securities laws, Congress must have been aware of the existence of the implied cause of action under Rule 10b-5 and the general nature of litigation under the Rule. The failure of Congress to amend Section 10(b) to alter the jurisprudence involving securities actions at this time can reasonably be seen as a conscious effort to preserve the existing order. Interpreting it as otherwise would make Congress's "searching re-examination" of the securities laws illusory.

Interpreting Congress' choice not to amend Section 10(b) as intentional is buttressed by Congress's response to the Lampf decision. In Lampf, decided in 1991, the Court defined the statute of limitations for a Rule 10b-5 action by referring to other sections of the 1933 and 1934 Acts. One year later, Congress amended the 1934 Act to explicitly determine that the Court's decision would not apply retroactively. Applying a Habermasian perspective, Congress's action represents the recirculation of power back to the body originating the law. Congress' response was simply reactive. It did not undo the Court's action, but rather filled in the gaps the decision left. The two branches, thus, played mutually supportive roles.

Congress' reaction to Lampf shows that members of Congress were well aware of the development of the Rule 10b-5 private right of

---


292. 15 U.S.C. § 78aa-1 (1994). The law was added to the comprehensive FDIC Improvement Act of 1991 and the committee reports on the bill are uninformative concerning the amendment to the 1934 Act. The amendment provides:

Special provision relating to statute of limitations on private causes of action.

Sec. 27A. (a) Effect on pending cause of action-The limitation period for any private civil action implied under section 78j(b) of this title that was commenced on or before June 19, 1991, shall be the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991. (b) Effect on dismissed causes of action-Any private civil action implied under section 10(b) of this Act that was commenced on or before June 19, 1991-78j(b).

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

(2) which would have been timely filed under the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991,

shall be reinstated on motion by the plaintiff not later than 60 days after December 19, 1991.

Id.

The clear import of this amendment is its conscious acknowledgment of the Rule 10b-5 implied cause of action. Congress preserved the claim and refined its procedural application in response to the Court's earlier interpretation.
action and had affirmed its use. How far one may take this analysis is another question. Principles of statutory interpretation rightly impute some knowledge of existing law to members of Congress. The implication by the Court in Curran of an implied cause of action based on congressional inaction places too great a burden on Congress to survey the entire legal landscape prior to acting lest it be seen as giving its tacit approval to current legal developments. Yet at some point Congress did accede to the Court's development of the law. When this happened is a threshold question. With greater certainty, however, one can reasonably argue that Congress sees itself as a participant in the development of Rule 10b-5 jurisprudence.

Similar congressional gap-filling was evident in the PSLRA. In that case, Congress responded to the Central Bank case by explicitly allowing the SEC to bring enforcement actions for aiding and abetting. The SEC had responded to the Court's Central Bank holding that aiding and abetting was not available for private actions under Rule 10b-5 by refusing to accept the Rule's application to SEC enforcement actions. Congress and the SEC worked together in crafting the PSLRA—despite the SEC's apparent lack of jurisdiction over the matter—and presumably Congress's decision was in part due to the SEC's push for codification of its administrative interpretation of Central Bank. Accordingly, power in this instance must be seen as effectively shared by the parties: Congress, the SEC, and the source for the policy question, the Supreme Court.

C. THE CONSENSUS JUSTIFYING RULE 10B-5 ADJUDICATION

The common denominator to these situations is the diffusion of power against a background of general agreement on the legitimacy of the law. The Supreme Court's attempt to find textual or congressional intent to support the various questions under Rule 10b-5 must be seen as a search for a non-existent holy grail. Even assuming, for the sake of argument, that Congress did not intend to create a private cause of action and that each successive piece of legislation under Section 10(b) could not support a claim that Congress tacitly supported the reigning order, does not the PSLRA alone once and for all end the discussion? The greater question is whether the congressional intent principles

293. The specific holding of the Court was that "the text of § 10(b) does not prohibit aiding and abetting, we hold that a private plaintiff may not maintain an aiding and abetting suit under § 10(b)." Central Bank, 511 U.S. at 191 (emphasis added). The SEC interpreted this reference to leave open the possibility of enforcement actions premised on aiding and abetting liability.

announced in *Cort* any longer make sense. That is, if we cannot identify any congressional intent to create a private cause of action under Section 10(b), and find Congress' subsequently endorsed the legal regime created without such conscious authorization, when does the congressional intent principle announced in *Cort* come into play? Within the conventional framework, this question would appear unanswerable.

When viewed through the Habermasian perspective, this result no longer seems undesirable or illegitimate. We can come to see the development of this law as a particularly well-defined instance of a developed administrative, judicial, and legislative system. Private litigants, lobbying groups representing corporate groups, pension funds for unions and corporations, consumer groups, the press, academics, and lawyers form a source of public opinion which infuses the evolution of the law through institutions. Even in a fairly esoteric subject such as securities law, public opinion still plays a role. The institutional bodies rationalize such discursive input and provide a forum for debate and discussion both between these private parties and between the institutions themselves. Within the bounds of the procedures established by the Constitution and the institutions, policy emerges as both the cause of and the result of the debate. Such is Habermas's point on legitimacy: it cannot be traced to one unitary source. The affirmation and reaffirmation of law, incrementally over time, results in legitimate law.

When put through the formal structures of an administrative system, we lose sight of these discursive and dynamic elements of the law. This element is always present and, with the rise of the administrative state, has perhaps increased within formal structures. The evolution of law in the Rule 10b-5 context can thus be seen as one of point and counterpoint by each of the institutional actors. Although a subject not usually engendering strong public opinion, the law has gone through a discursive process in an institutional forum.

What this interpretation of the development of Rule 10b-5 jurisprudence—one implied cause of action among many possible actions—means for such other existing causes of action and causes of action to be implied in the future is unclear. It does illustrate the dynamism of the public policy making process and the interdependence of institutional actors in creating public policy. While no unitary source for the law exists, prudential considerations and principles of comity counsel limitations for ventures of judicial expansionism. Moreover, principles of *stare decisis* may be offended if courts implied causes of action as test balloons awaiting legislative accession.
Yet in the case of Rule 10b-5 jurisprudence, we see what most regard as legitimate law which was apparently not envisioned by Congress when enacted. Clear indication of legislative intent emerged only years later. Indeed, Congress could have intended to do nothing, only to wait to see how a private liability scheme might evolve. Such a hypothetical would permit Congress to intercede at any time to eliminate the cause of action. Alternatively, Congress could look at the legal development only some time later to evaluate its strengths and weaknesses. This approach would represent a form of shared power, which, even without Congress's intent to create such legal regime, would not disturb the separation of powers or constitute undemocratic or illegitimate law making. Indeed, the question of illegitimate law would appear more likely to arise in cases in which either the Court renders a decision which Congress fails to accept or Congress fails to respond to Supreme Court decisions directed toward it. Fortunately, due to our country's adherence to the rule of law, fidelity to institutional boundaries, prudential considerations or a simple fear of potential consequences, we see that the actors discussed in this article manifest striking restraint in obeying the proscriptions and directions of the other parties. Concern with the undemocratic affects of implying causes of action based on statutes may, thus, be misplaced or premature. Although courts ought to exercise caution in this regard, when such efforts are made within the contours of a strong democratic, administrative, and legal system, any negative effects can be readily addressed and the legal framework to support such laws can develop so as to achieve a functionally workable and legitimate legal order.

V. CONCLUSION

Our legal and political system has changed significantly over time. In the age of televised presidential debates, regulatory agencies wielding immense power, and voter apathy, one must question the source of political power. As the evolution of the Rule 10b-5 cause of action shows, once Congress and the President have acted, the system takes on a life of its own. One response to these developments is to condemn them as anti-democratic. Such condemnation might strike a harder blow were we living in an Athenian democracy. In a modern

295. Discussions of this question often forget that the enactment of the statute itself supplies strong evidence of congressional intent to prohibit or encourage certain behavior.
296. For an instructive discussion of the related question of executive adherence to Court rulings and the exclusivity of the Court's interpretive power over constitutional questions, see generally Larry Alexander & Frederick Schauer, On Extrajudicial Constitutional Interpretation, 110 Harvard L. Rev. 1359 (1997).
regulatory state with a well developed legal system, power—while emanating from the people—also issues from other sources. Habermas helps illustrate the extent to which this new system requires us to reimagine the aspirations of law. Indeed, rather than a diffusion of power implying an impotent democratic system, perhaps we should view the current system as the natural evolution of the separation of powers doctrine originating in an earlier age.