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UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 84-5401

LAURA ANGELASTRO, on behalf of herself
and all others similarly situated,

Plaintiff, Appellant,
Cross-Appellee,

v.

PRUDENTIAL-BACHE SECURITIES, INC.,
and BACHE HALSEY STUART SHIELDS, INC.,

Defendants, Appellees,
Cross-Appellants.

On Appeal from the United States District Court
for the District of New Jersey

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE
(on the Rule 10b-16 claim)

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(on the Rule 10b-16 claim)

QUESTIONS PRESENTED

1. Whether Rule 10b-16 of the Securities and Exchange Commission -- which requires a brokerage firm to disclose certain information to its customers when extending credit to them "in connection with any securities transaction" -- is a nullity, on the ground that, as a matter of law, the failure to provide the required information can never relate to a customer's decision to purchase securities.

2. Whether there is an implied private right of action for a violation of Rule 10b-16.

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION AND SUMMARY OF ITS POSITION

The Securities and Exchange Commission, the agency principally responsible for the administration of the federal securities laws, submits this brief as amicus curiae to address certain issues of importance to the Commission's administration of those laws and to the protection of investors. The plaintiff was a securities customer who had a margin account with the defendant brokerage firm. She has alleged that defendant violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Commission Rules 10b-5 and 10b-16 promulgated thereunder, 17 C.F.R. 240.10b-5 and 240.10b-16, by means of mispresentations and omissions concerning the terms under which defendant extended credit to plaintiff in connection with her purchase of securities on margin. The district court dismissed the Rule 10b-5 claim on the ground that the alleged misrepresentations were not made "in connection with the purchase or sale of any security," as required by Section 10(b) and Rule 10b-5. That holding is the subject of the appeal taken in this case by the plaintiff (No. 84-5427), and the Commission has filed an amicus curiae brief in that appeal urging that misrepresentations regarding margin interest rates are in connection with a customer's purchase of securities on margin.

With respect to the claim under Rule 10b-16, the district court denied defendant's motion to dismiss, holding that Congress intended to permit a customer of a brokerage firm to bring a private action for the firm's failure to make the rule's required disclosures concerning the credit terms applicable to margin accounts. That decision is the subject of the present cross-appeal by defendant.

Defendant asks this Court to reverse the district court's Rule 10b-16 decision on two grounds. First, defendant argues that margin disclosures relate only to the brokerage firm's extension of credit, not to the subsequent purchase of securities by the customer; in defendant's view, nondisclosures concerning margin interest rates thus can never be "in connection with" the purchase or sale of a security, as required by Section 10(b) and Rule 10b-16. This argument, which is identical to that made by defendant with respect to the Rule 10b-5 claim, would render Rule 10b-16 a nullity and should be rejected for the reasons stated in the Commission's amicus brief filed in the Rule 10b-5 appeal.

Second, defendant argues that, notwithstanding the implied private right of action that has long been recognized under Rule 10b-5, no private action can be brought under Rule 10b-16. Adoption of defendant's position would not only deny brokerage customers compensation for undisclosed excessive margin costs, but it would deprive the Commission of "a necessary supplement" to its own enforcement actions. See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975), quoting J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964). Moreover, it would contradict Congress' intent -- manifested when it exempted brokerage accounts from the Truth-in-Lending Act -- that brokerage customers would receive similar protections by Commission rule. Significantly, one of the main protections afforded under the Truth-in-Lending Act is an express private right of action. Indeed, Congress intended that that Act's disclosure requirements would be enforced primarily through private litigation, not government enforcement actions.

As amicus curiae, the Commission expresses no view on the merits of the factual allegations in the complaint, and will address only the legal issues presented by this appeal.

STATEMENT OF THE CASE

1. The Rule 10b-16 Charges

Plaintiff Laura Angelastro commenced this action in the United States District Court for the District of New Jersey, alleging that Prudential-Bache Securities, Inc. and its predecessor, Bache Halsey Stuart Shields, Inc., violated Section 10(b) of the Securities Exchange Act and Rule 10b-16 promulgated thereunder. Ms. Angelastro seeks to represent a class of plaintiffs consisting of all persons who purchased securities on margin through Bache from January 1, 1977 to December 31, 1982.

Plaintiff alleges that defendant violated Section 10(b) and Rule 10b-16 by failing to provide her with a statement of the terms under which defendant extended credit in connection with her purchases of securities on margin, as required by the rule (App. 7). 1/ Plaintiff seeks judgment for damages and an order enjoining further violations.

2. Proceedings in the District Court

Defendant moved to dismiss the Rule 10b-16 claim on the grounds that the complaint failed to state a cause of action under the rule, and that a private right of action should not be implied under the rule (App. 13, 17). The district court granted defendant's motion to dismiss with respect to those portions of the complaint that alleged a failure to provide information

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1/ "App. __" refers to the Appendix filed by plaintiff.

which the court held was not required to be disclosed by the rule. 2/ The court then stated that the remaining portions of the complaint would state a claim if a private right of action could be implied under the rule. Concluding that Congress intended to create a private remedy under Rule 10b-16, the district court denied the motion to dismiss the other portions for failure to state a claim (App. 18).

Pursuant to a joint application of the parties, the question of whether there is an implied private right of action under Rule 10b-16 was certified for immediate appeal under 28 U.S.C. 1292(b) (App. 23).

ARGUMENT

I. RULE 10b-16 IS NOT A NULLITY; BECAUSE MARGIN DISCLOSURES BY A BROKERAGE FIRM WOULD BE RELIED UPON BY ITS CUSTOMERS IN PURCHASING SECURITIES, THOSE DISCLOSURES RELATE, NOT JUST TO EXTENSIONS OF CREDIT, BUT ALSO TO THE RESULTING SECURITIES PURCHASES.

Rule 10b-16 prohibits the extension of credit by a broker-dealer to a customer in connection with any securities transaction unless the broker-dealer has established procedures to ensure that the customer is given, at the time an account is opened, specified information with respect to the amount of and reasons for credit charges. Defendant argues that the complaint fails to allege a claim under Rule 10b-16, since margin disclosures

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2/ Plaintiff had alleged the failure to disclose information pertaining to interest rates on margin accounts before each purchase of securities (App. 17). The court reasoned that Rule 10b-16 requires disclosure only at the time an account is opened; disclosure of the relevant information prior to each purchase is not required (App. 17). The district court also dismissed the allegation that defendant failed to disclose alternate, lower available rates of interest; the court held that Rule 10b-16 requires the brokerage firm to disclose only its <u>own</u> interest rates (App. 17).

by a brokerage firm are not, in defendant's view, made in connection with any securities transaction as required by the terms of Section 10(b) of the Securities Exchange Act and Rule 10b-16.

Defendant's argument that a violation of the disclosure requirements of Rule 10b-16 does not take place in connection with the purchase of securities is grounded on its position, substantially incorporated from its argument with respect to the Rule 10b-5 claim, that there can never be a causal relationship between margin disclosures and the purchase of securities on margin. 3/ Since the only disclosures that Rule 10b-16 deals with relate to margin, defendant is, in effect, arguing that Rule 10b-16 is a nullity.

Defendant's position, as well as its disagreement with the position urged by the Commission in its amicus curiae brief on the Rule 10b-5 claim, turns on its contention that "statements relating to interest on margin are not and cannot be a 'direct cause', or indeed any cause at all, of any securities transaction" (Br. 13). As the Commission demonstrated in its earlier brief, however, defendant's contention defies common sense. If a margin customer does not know the interest rate applicable to his margin loan, he cannot assess the profitability of his investment. Thus, the applicable interest rate is a major factor affecting an investor's decision to purchase

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3/ To the extent defendant also suggests that no causal connection between the misrepresentation and the securities transaction has been alleged in the complaint in this case (see Br. 18-19), defendant overlooks plaintiff's allegation (App. 5; emphasis supplied) that

> the purpose and effect of [defendant's conduct] were to induce plaintiff and other Class Members to purchase various securities through Bache and to make such purchases for excessive consideration * * *.

securities on margin. If, for example, an investor makes a margin purchase of debentures that pay a fixed rate of interest, the customer's net return will be the spread between the interest earned on the debentures and the margin costs. Any understatement of the margin costs by the broker will cause the customer to purchase on the assumption that he is getting a higher net return than is actually the case. The same is true with respect to equity securities, where the investor will balance the anticipated dividends and market performance against the represented margin costs. Since margin costs directly affect the profitability of an investment, it is unrealistic to assert, as defendant does, that there can be no causal connection between the broker's margin disclosures and the customer's decision to purchase securities. Thus, representations concerning margin interest rates are made "in connection with" the purchase of securities, since they "would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities." SEC v. Texas Gulf Sulphur, 401 F.2d 833, 860 (2d Cir. 1968), cert. denied, 394 U.S 976 (1969). 4/

4/ Contrary to defendant's contention (Br. 30), information concerning margin interest rates is material to an investor's decision to purchase securities, since an investor "would consider it important * * *" in deciding whether to purchase securities on margin. TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). See Flynn v. Bass Brothers Enterprises, Inc., [1984] Fed. Sec. L. Rep. (CCH) ¶91,674 at 99,400 (3d Cir. 1984).

Defendant takes issue with the Commission's position that the requirement in a Rule 10b-5 damage action that the fraud be the proximate cause of the plaintiff's loss is not at issue in this case, and urges that "[p]roximate causation is indeed precisely the issue that this

(footnote continued)

Defendant purports (Br. 26-27) not to take issue with the Commission's position, urged in its earlier amicus brief (pages 9-16), that misrepresentations need not relate to a particular security in order to satisfy the "in connection with" requirement. But defendant's reasoning that margin disclosures relate only to the extension of credit and not to the purchase of securities -- and are only material to an investor's decision as to which

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4/ (continued)

case presents to this Court" (Br. 30). Defendant misunderstands proximate causation -- the requirement that the type of loss suffered by the plaintiff be a reasonably foreseeable consequence of the defendant's misconduct. W. Prosser, Handbook of the Law of Torts, §110 at 732 (4th ed. 1971). That issue is not presented in this appeal.

Rather, this Court, in construing the "in connection with" phrase, has only required "a causal connection between the alleged fraud and the purchase or sale of stock." Tully v. Mott Supermarkets, Inc., 540 F.2d 187, 194 (3d Cir. 1976) (emphasis supplied). In Ketchum v. Green, 557 F.2d 1022, 1029 (3d Cir.), cert. denied, 434 U.S. 940 (1977), this Court applied the Tully standard, holding that

> the "connection" and "causation" principles speak to the degree of proximity required between a misrepresentation and a securities transaction [emphasis supplied].

In that case, which involved a plaintiff's sale of securities, the causation requirement was not met because there was "an independent and intervening cause of such transaction -- a force that serves to disrupt the connection between the challenged conduct on the part of the defendants and the relinquishment of plaintiffs' shares" (id.; emphasis supplied). This type of causation more closely resembles the concept of reliance, a form of causation in fact, which establishes a causal connection between the defendant's misconduct and the course of conduct undertaken by the plaintiff, which in turn results in the harm suffered by the plaintiff. See Prosser, supra, §108; List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), cert. denied, 382 U.S. 811 (1965). As demonstrated by the Texas Gulf Sulphur decision, it is the likelihood that an investor will rely upon the misstatements that satisfies the "in connection with" requirement.

brokerage firm to borrow from, not whether to purchase securities — would likewise apply to any misrepresentation concerning a broker's operations which does not relate directly to the particular securities purchased from the firm. For example, if defendant's reasoning were adopted, it would also follow that such well-established frauds as misrepresentations concerning the firm's solvency 5/ would not satisfy the "in connection with" requirement of Section 10(b); such a representation would be deemed of importance only to the customer's decision whether to open an account with that firm vis-a-vis another firm, not to the customer's decision to purchase securities through that account. Contrary to defendant's position, we submit that misrepresentations which cause an investor to open a margin account with a brokerage firm are properly considered to be made in connection with the subsequent purchase of securities through that account. 6/

5/ See the Commission's earlier amicus brief, at page 13.

6/ Chemical Bank v. Arthur Anderson & Co., 726 F.2d 930 (2d Cir.), cert. denied, 53 U.S.L.W. 3262 (U.S. Oct. 9, 1984), which defendant cites in support of its position (Br. 14, 15, 17, 18, 29, 31, 37), is distinguishable from the instant case. In Chemical Bank, a group of four commercial banks loaned $4 million to Elsters Corporation, a subsidiary of Frigitemp Corporation. The loan was secured by a pledge of 100% of the stock of Elsters, and was guaranteed by Frigitemp. The loan was allegedly induced by misrepresentations by the independent auditor pertaining to the financial condition of Frigitemp. After Frigitemp subsequently filed a petition in bankruptcy, the banks brought an action against the auditing firm under Rule 10b-5, alleging that the misrepresentations about Frigitemp were "in connection with" the pledge-sale of Elsters stock from Frigitemp to the banks. On appeal from the district court's denial of the firm's motion to dismiss, the Second Circuit held that the misrepresentations were not made "in connection with" the pledge-sale of Elsters stock. 726 F.2d at 945.

(footnote continued)

II. A PRIVATE RIGHT OF ACTION EXISTS IN FAVOR OF BROKERAGE CUSTOMERS UNDER COMMISSION RULE 10b-16.

Neither Section 10(b) nor Rule 10b-16 expressly provides a private right of action for violations of their provisions. But, a majority of the courts that have considered this issue have held that an implied cause of action exists under Rule 10b-16. Liang v. Dean Witter & Co., Inc., 540 F.2d 1107, 1113 n.25 (D.C. Cir. 1976); Slomiak v. Bear Stearns & Co., [Current] Fed. Sec. L. Rep. (CCH) ¶91,590, 99,062 (S.D.N.Y. 1984); Torn v. Rosen, [Current] Fed. Sec. L. Rep. (CCH) ¶91,603, 99,070 (S.D.N.Y. 1984); Haynes v. Anderson

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6/ (continued)

The court was strongly influenced by the fact that the pledging of the Elsters stock was "merely an incident" to the fraudulently induced loan transaction. 726 F.2d at 944 n.24. Because of this tenuous connection between the fraud and the securities transaction, the court stated that it would be "anomolous" to hold that the alleged mispresentations gave rise to Rule 10b-5 liability (726 F.2d at 944). Characterizing Rule 10b-5 as a tool "to protect persons who are deceived in securities transactions," the court declined to hold the auditing firm liable, since "the banks got exactly what they expected" from the securities pledged as collateral, where there were no misrepresentations about those securities. 726 F.2d at 943.

Unlike in Chemical Bank, a brokerage firm's misrepresentation concerning margin rates is inextricably related to the securities transaction; the broker-dealer makes the margin loan to enable the customer to trade in securities. Further, although a margin account is clearly not a prerequisite to purchasing securities through a broker-dealer, a margin account does permit the customer to purchase more securities than he would otherwise be able to purchase. See In re Catanella and E.F. Hutton & Co., Inc., Securities Litigation, [Current] Fed. Sec. L. Rep. (CCH) ¶ 91,497, 98,486 (E.D. Pa. 1984). For these reasons, the purchase of securities on margin is not, as the pledge of Elsters stock was characterized in Chemical Bank, "merely an incident" to the loan transaction. Rather, the purchase of securities is the very purpose for which the margin loan is made. Moreover, unlike the banks in Chemical Bank, a margin customer does not get exactly what he expected from the securities transaction; as we have seen, if the margin costs are understated by the broker, the margin customer will not get his full anticipated profit from the investment.

& Strudwick, Inc., 508 F. Supp. 1303, 1321 (E.D. Va. 1981); Abeles v. Oppenheimer Co., Inc., No. 83-C1468 (N.D. Ill. Nov. 7, 1983) (Available on Lexis, Fedsec. library, cases file). 7/ These decisions upholding a private right of action are fully consistent with the principles enunciated by the Supreme Court for implying private rights of action.

The Supreme Court has developed a four-prong test to assist the courts in determining whether an implied private right of action exists under a federal statute. In Cort v. Ash, 422 U.S. 66, 78 (1975), the Court articulated the test as follows (id. at 78, citations omitted, emphasis in original):

> First, is the plaintiff "one of the class for whose especial benefit the statute was enacted" -- that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purpose of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

Subsequent to its decision in Cort v. Ash, however, the Supreme Court has emphasized that the ultimate determination of whether an implied private right of action exists must turn on the intent of Congress:

> [I]n Cort v. Ash, * * * the Court did not decide that each of [the] factors is entitled to equal weight.

7/ Contra, Furer v. Paine, Webber, Jackson & Curtis, Inc., [1981-82] Fed. Sec. L. Rep. (CCH) ¶98,701, 93,495 (C.D. Cal. 1982); Establissement Tomis v. Shearson Hayden Stone, Inc., 459 F. Supp. 1355, 1361 (S.D.N.Y. 1978). Another district court held that an implied right of action exists under Rule 10b-16, but that decision was subsequently withdrawn when the parties settled the action. Saunders v. Oppenheimer Government Securities, Inc., [1981] Fed. Sec. L. Rep. ¶98,318 (D. Ore. 1981).

> The central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action.

Touche Ross & Co. v. Redington, 442 U.S. 560, 575 (1979). See also Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 102 S. Ct. 1825, 1845-46 (1982). Since the ultimate question is whether Congess intended that a private remedy exist, the Supreme Court has indicated that it is not necessary to examine each of the factors articulated in Cort v. Ash if congressional intent to grant or deny the private remedy is persuasively evidenced by some other means -- e.g., in the present case, by the congressional intent (reflected in the Truth-in-Lending Act) which led to Commission promulgation of Rule 10b-16 and by the contemporary legal context at the time that statute was enacted and the rule was adopted.

As we show infra at pages 13-16, the history behind the adoption of Rule 10b-16 shows congressional intent to create a private remedy under that rule. Furthermore, Congress directed the Commission to adopt Rule 10b-16 during a period of widespread acceptance of implied private actions under the federal securities laws, including recognition of an implied cause of action under Section 10(b) of the Securities Exchange Act pursuant to which Rule 10b-16 was promulgated (infra pages 14-15). In any event, a complete analysis of the four Cort v. Ash factors further supports the implication of a private remedy (infra pages 17-19).

A. The Congressional Intent (Reflected in the Truth-in-Lending Act) which Led to Commission Promulgation of Rule 10b-16, as well as the Contemporary Legal Context at that Time, Establish that Congress Intended an Implied Cause of Action under Rule 10b-16.

Rule 10b-16 was adopted as the analogue to the Truth-in-Lending Act (15 U.S.C. 1601 et seq.) for securities transactions. The legislative history behind enactment of the Truth-in-Lending Act demonstrates the existence of an implied private right of action under that rule. When Congress passed the Truth-in-Lending Act in 1968, it expressly exempted securities accounts from the Act's coverage (15 U.S.C. 1603(2)) but declared its intention that the Commission afford comparable protections by rule. The Senate Report stated:

> The Committee has been informed by the Securities and Exchange Commission that the Commission has adequate regulatory authority under the Securities Exchange Act of 1934 to require adequate disclosure of the costs of such credit. The Committee has also been informed in a letter from the SEC that "the Commission is prepared to adopt its own rules to whatever extent may be necessary."
>
> In recommending an exemption for stockbroker margin loans in the bill, <u>the Committee intends for the SEC to require substantially similar disclosure by regulation as soon as it is possible to issue such regulation</u>.

S. Rep. No. 392, 90th Cong., 1st Sess. 9 (1967) (emphasis supplied). The House Report likewise relied upon Commission assurances that it would address the issue by rulemaking. H. Rep. No. 1040, 90th Cong, 1st Sess. 28 (1967). Pursuant to this congressional mandate, Rule 10b-16 was adopted under the general authority of Section 10(b) of the Securities Exchange Act. Securities Exchange Act Release No. 8773 (Dec. 8, 1969).

Since Rule 10b-16 was promulgated as the analogue to the Truth-in-Lending Act with respect to credit furnished by broker-dealers, the congressional purposes underlying that Act should also carry over to the rule. Congress created in that Act an express cause of action for borrowers where there has been noncompliance with the Act's requirements. 15 U.S.C. 1640(a). Congress thus intended that persons who were harmed by failure to comply with the statute could recover damages. In fact, Congress intended that the Act be "self-enforcing," and that the "main[ ]" method of enforcement would be civil actions brought by private parties rather than law enforcement actions brought by the government. Hearings before the Senate Subcommittee on Financial Institutions of the Committee on Banking and Currency, 90th Cong., 1st Sess. 18 (synopsis of Senate Bill), 682 (statement of Senator Proxmire, sponsor of Senate bill) (1967).

The fact that Congress directed the Commission to provide substantially similar protection to brokerage firm customers by regulation weighs heavily in favor of an implied cause of action for noncompliance with the rule subsequently adopted. The Truth-in-Lending Act covers a wide range of credit transactions. It is inconceivable that Congress would have singled out securities customers by denying them the benefit of a private right of action. Thus, to be consistent with the congressional mandate, the rule must be read to provide the same remedy for securities customers. See Haynes v. Anderson & Strudwick, Inc., 508 F. Supp. at 1320.

Moreover, the contemporary legal context, at the time of enactment of the Truth-in-Lending Act and subsequent promulgation of Rule 10b-16, supports the existence of an implied right of action under the rule. As Judge Friendly stated in Leist v. Simplot, 638 F.2d 283, 296 (2d Cir. 1980), aff'd sub nom., Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353 (1982), the late 1960's and early 1970's, which encompass the period in which the Truth-in-Lending Act was considered and adopted, were years of a "widespread, indeed almost general, recognition of implied causes of action" under the Securities Exchange Act. The Supreme Court in Cannon v. University of Chicago, 441 U.S. 677, 698-99 (1979), likewise noted that during the period between

1964 and 1972 the Supreme Court had consistently found implied remedies, and that when reviewing congressional action taken during this time, it was "not only appropriate but also realistic to presume that Congress was thoroughly familiar with these unusually important precedents * * * and that it expected its enactments to be interpreted in conformity with them." Id. at 699. 8/ Congress therefore must have intended in 1968, when it directed the Commission to use its rulemaking power under the Exchange Act to adopt margin disclosure requirements, that any rules adopted by the Commission would also be enforceable through a private right of action.

Indeed, Rule 10b-16 was specifically adopted under a provision which the courts had universally recognized as giving rise to a private right of action -- Section 10(b) of the Securities Exchange Act. The Supreme Court, in Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983), recently stated that "a private right of action under Section 10(b) of the 1934 Act and Rule 10b-5 has been consistently recognized for more than 35 years. The existence of this implied remedy is simply beyond peradventure." The Court noted that such an implied private right of action was first recognized in 1946 and that by 1969 ten of the eleven courts of appeals had recognized such a right. Id. at 380-81 n.10. The Supreme Court first confirmed the existence of an implied private right of action under Section 10(b) in Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 13 n.9

8/ See also, Cannon, 441 U.S. at 718 (Rehnquist, J., concurring) (during this period Congress "tended to rely to a large extent on the courts to decide whether there should be a private right of action * * *," and Supreme Court and other federal court decisions "gave Congress good reason to think that the federal judiciary would undertake this task" (emphasis in original).

(1971) and has repeatedly reaffirmed this holding. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975); Affiliated Ute Citizens v. United States, 406 U.S. 128, 150-54 (1972). Since Congress designed Section 10(b) to be implemented by rules, and Rule 10b-16 implements the antifraud provisions of Section 10(b), it follows that a cause of action should be implied under Rule 10b-16 as well. See Liang v. Dean Witter & Co., Inc., 540 F.2d at 1113 n.25; Haynes v. Anderson & Strudwick, Inc., 508 F. Supp. at 1320-21; Slomiak v. Bear Stearns, [Current] Fed. Sec. L. Rep. (CCH) ¶91,590, 99,026 (S.D.N.Y. 1984).

Defendant argues, however, that the Commission acted contrary to congressional intent in deciding that Rule 10b-16 should be adopted under Section 10(b) (Br. 38-40). Asserting that Rule 10b-16 should have been promulgated under Section 15 or Section 7 of the Securities Exchange Act, under which courts have not uniformally implied a private right, 9/ defendant maintains that promulgation of Rule 10b-16 under Section 10(b) is inconsistent with the asserted limited purpose of the margin disclosure requirements — to inform a potential investor about the terms of a credit transaction which, in defendant's view, is "entirely collateral to his participation in the securities markets * * *" (Br. 38).

Defendant's contention fails for two reasons. First, given the clear intention of Congress in enacting the Truth-in-Lending Act that the credit

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9/ Compare Admiralty Fund v. Hugh Johnson & Co., Inc., 677 F.2d 1301, 1313-14 (9th Cir. 1982), with Opper v. Hancock Securities Corp., 367 F.2d 157, 158 (2d Cir. 1966) (dealing with private right of action under Section 15). See also Walck v. American Stock Exchange, Inc., 687 F.2d 778, 788-89 (3d Cir. 1982) (no implied right of action for damages under Section 7).

disclosure rules be enforced through private litigation, it would not have mattered what section of the securities laws the Commission adopted its rule under; congressional intent would nevertheless have required recognition of a private right of action. Second, defendant's argument that Rule 10b-16 has no relation to Section 10(b) on the ground that it does not address fraudulent securities practices is plainly incorrect. This contention is, of course, simply a reiteration of its erroneous position that margin disclosures are not made in connection with the purchase or sale of a security, but instead relate only to the extension of credit.

In Slomiak v. Bear Stearns & Co., [Current] Fed. Sec. L. Rep. (CCH) ¶91,590 (S.D.N.Y. 1984), the court read the legislative history of the Truth-in-Lending Act to indicate that Congress, in exempting margin disclosures by broker-dealers from the coverage of the Truth-in-Lending Act, intended that the Commission adopt analogous disclosure rules under Section 10(b). Id. at 99,026, citing S. Rep. No. 392, 90th Cong., 1st Sess. 9 (1967). Accord, Torn v. Rosen, [Current] Fed. Sec. L. Rep. (CCH) ¶ 91,603, 99,070 (S.D.N.Y. 1984). The Slomiak court based this conclusion on the fact that Rule 10b-16 serves to implement the purposes of the antifraud provisions of Section 10(b):

> "Rule 10b-16, like Rule 10b-5, directly advances the purpose of Section 10(b). It makes unlawful a particular 'manipulative or deceptive device' — the extension of credit with undisclosed terms and conditions.

Id. at 99,026, quoting Abeles v. Oppenheimer Co., Inc., No. 83-C1468 (N.D. Ill. Nov. 7, 1983). Thus, the purpose of Rule 10b-16 should not be restrictively viewed as relating only to the terms of a credit transaction; rather, the rule was designed to protect the integrity of the securities markets by providing full disclosure concerning the material terms of a securities transaction.

B. The Traditional Cort v. Ash Analysis Further Demonstrates the Existence of an Implied Right of Action under Rule 10b-16.

As we have just demonstrated, the congressional intent behind the enactment of the Truth-in-Lending Act, as well as the contemporary legal context at that time, establish that Congress intended the implication of a private right of action under Rule 10b-16. While that analysis provides an independent basis for implication of a private right of action, it also satisfies the second factor of the four-prong Cort v. Ash test. The other factors in the Cort v. Ash test also support the implication of such a private remedy.

With respect to first Cort factor, it is clear that a customer harmed by a broker's failure to comply with Rule 10b-16 is a member of the class for whose "especial benefit" the pertinent statutes and the rule were adopted. Margin customers, as purchasers of securities, are the intended beneficiaries of Section 10(b) under which the rule was adopted. Rule 10b-16 was intended to prevent harm caused to customers who purchase securities without adequate disclosure of the terms of a margin account.

Likewise, margin customers, as borrowers, are the intended beneficiaries of the Truth-in-Lending Act. Indeed, Congress explicitly granted borrowers a private right of action to recover damages caused by failure to comply with that Act, thus identifying them as the direct beneficiaries of the Act. 15 U.S.C. 1640. Finally, the courts have recognized that customers of a broker-dealer are members of the class for whose "especial benefit" Rule 10b-16 itself was promulgated. See, e.g., Liang v. Dean Witter & Co., Inc., 540 F.2d at 1112-13; Haynes v. Anderson & Strudwick, Inc., 508 F. Supp. at 1321.

The third factor in the Cort v. Ash test is also met, since implying a private remedy under Rule 10b-16 would be consistent with the underlying purposes of the legislative scheme — to protect investors from fraud in connection with the purchase and sale of securities. See Ernst & Ernst v. Hochfelder, 425 U.S. at 195. Although Congress provided the Commission with a flexible arsenal of enforcement powers, the Commission does not have sufficient resources adequately to police all possible violations of the securities laws. It has long been recognized that private actions to enforce the securities laws are a necessary supplement to the Commission's own enforcement program. See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975), quoting J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964). See also Cannon v. University of Chicago, 441 U.S. at 706-07.

Customers of broker-dealers are generally in a better position than the Commission to detect inadequate or incorrect disclosure pertaining to their margin accounts. Adequate enforcement of the disclosure requirements by the Commission would require not only the examination of customer account agreements and periodic notices to ascertain that the required information was supplied, but would require policing of the entire broker-customer relationship to assure that the information was timely submitted and provided in the form stipulated by the rule. Given the scarcity of Commission resources, this sort of supervision could not be thoroughly undertaken, creating the potential for serious abuses to go unnoticed. Moreover, recognition of a private right of action is essential to fulfill Congress' intent that private litigation would provide compensation to customers who paid undisclosed excessive interest charges, and that such litigation would be the primary means of enforcing the credit disclosure provisions.

Finally, with respect to the fourth Cort factor, the private cause of action here is not one traditionally relegated to state law. Congress enacted comprehensive federal regulation -- the Truth-in-Lending Act -- requiring disclosure of information in connection with the extension of credit. In addition, Rule 10b-16 advances the purposes of Section 10(b) of the Securities Exchange Act by prohibiting certain deception in connection with the sale of securities. Congress, of course, intended that victims of securities fraud be protected by federal law.

CONCLUSION

For the foregoing reasons, this Court should hold (1) that a failure to provide information required by Rule 10b-16 occurs "in connection with" the purchase or sale of securities within the meaning of Section 10(b) of the Securities Exchange Act and (2) that a private right of action exists under Rule 10b-16 in favor of brokerage customers.

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UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

LAURA ANGELASTRO, on behalf of herself and all others similarly situated, Plaintiff, Appellant, Cross-Appellee, v. PRUDENTIAL-BACHE SECURITIES, INC., and BACHE HALSEY STUART SHIELDS, INC., Defendant, Appellees, Cross-Appellants.	:	No. 84-5401

CERTIFICATE OF SERVICE

I hereby certify that I have today caused two (2) copies of the Brief of the Securities and Exchange Commission, Amicus Curiae, to be served by mail, first class, government frank, on counsel for the parties as follows:

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CERTIFICATE OF BAR MEMBERSHIP PURSUANT TO LOCAL RULE 21(1)

The undersigned hereby certifies that he is a member of the bar of the United States Court of Appeals for the Third Circuit.

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