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Enterprise Liability And Insider Trading

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ENTERPRISE LIABILITY AND INSIDER TRADING

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I. PREFACE

In an inconspicuous clause of the Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA),[1] the securities industry won for itself an immunity that will be the envy of other industries that are afflicted with statutory liabilities for pollution, unsafe products, and other harms. In private suits for violations of this Act, employers are *not* liable for offenses of their employees if the employers acted in good faith and did not induce the violations.[2] I will call this the rule of "rebuttable liability."

This novel provision rejected not only the rules of liability that most federal courts had applied under the principal Securities Acts,[3] but also a centuries-old tradition of the common law of torts.[4] It was, moreover, hard to reconcile with Congress' professed purpose in enacting ITSFEA—to provide "greater deterrence, detection and punishment of violations of insider trading."[5]

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1. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (1988) [hereinafter ITSFEA].

2. ITSFEA added a new section 20A to the Securities Exchange Act of 1934. 15 U.S.C.A. §§ 78a-78kk (West 1981) [hereinafter Exchange Act]. The new section authorized a new private right of suit but provided in § 20A(b)(3), 15 U.S.C.A. § 78t-1(b)(3) (West Supp. 1992), that employers should not be liable for offenses of employees in suits authorized by the Exchange Act except as provided by § 20(a), 15 U.S.C.A. § 78t(a), of the original Exchange Act. Section 78t(a) provided that a controlling person should be liable under the Exchange Act to the same extent as a controlled person "unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." Exchange Act § 78t(a).

For an interpretation of § 20A(b)(3) that is contrary to the statement in the text, see *infra* notes 187-93 and accompanying text. The interpretation stated above, however, has been accepted by most commentators on the Exchange Act. *See infra* note 174.

3. *See infra* text accompanying notes 59-79. By "Securities Acts," I mean here and elsewhere the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1988), and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1988). I will refer to these Acts separately as the Securities Act and the Exchange Act, respectively.

4. *See infra* text accompanying notes 14-19.

5. H.R. REP. No. 910, 100th Cong., 2d Sess. 7 (1988), *reprinted in* 1988 U.S.C.C.A.N. 6043, 6044. *See also* ITSFEA § 2, stating:

The Congress finds that—

Under traditional tort law, which most federal courts apply to liabilities under the Securities Acts, employers are liable for the frauds of their employees committed within the scope of their employment or authority without regard to the guilt or innocence of their employers.[6] Federal court decisions in the decades preceding adoption of the Securities Acts had imposed liability on employers for their agents' frauds, even in cases that a Restatement Reporter found extreme.[7] The governing principle has been called "vicarious liability,"[8] "respondeat superior,"[9] and most recently "enterprise liability."[10]

> (1) the rules and regulations . . . governing trading while in possession of material, nonpublic information are . . . necessary and appropriate . . .;
>
> . . . .
>
> (3) . . . additional methods are appropriate to deter and prosecute violations . . . .

There was no Senate Report on the bill that became ITSFEA, but an intention to increase deterrence of insider trading was avowed on the Senate floor, without dissent, by Senators William Proxmire, Alfonse D'Amato, John Heinz and Jake Garn. 134 CONG. REC. S17,218-20 (daily ed. Oct. 21, 1988).

6. *See* RESTATEMENT (SECOND) OF AGENCY §§ 257 (Misrepresentations; in General), 258 (Incidental Misrepresentation), 261 (Agent's Position Enables Him to Deceive), 262 (Agent Acts for His Own Purposes) (1958).

7. *See* Kean v. National City Bank, 294 F. 214 (6th Cir. 1923) (involving bank officer's role in selling stolen securities), *cert. dismissed,* 263 U.S. 729 (1924); National City Bank v. Carter, 14 F.2d 940 (6th Cir. 1926) (involving bank officer who cooperated with swindlers); Stewart v. Wright, 147 F. 321 (8th Cir.) (involving bank president and cashier aiding swindlers), *cert. denied,* 203 U.S. 590 (1906). The Restatement Reporter, Warren Seavey, found these results doubtful because of the remoteness of the connection between the bank officers' deceptions and their duties to their banks. RESTATEMENT (SECOND) OF AGENCY, app. at 422-23 (1958).

8. *See* THOMAS BATY, VICARIOUS LIABILITY (1916); William O. Douglas, *Vicarious Liability and the Administration of Risk I,* 38 YALE L.J. 584 (1929); Harold J. Laski, *The Basis of Vicarious Liability,* 26 YALE L.J. 105 (1916).

9. *See* Warren A. Seavey, *Speculations as to "Respondeat Superior," in* HARVARD LEGAL ESSAYS 433 (1934), *reprinted in* WARREN A. SEAVEY, STUDIES IN AGENCY 129 (1949).

10. "Enterprise liability" seems to have appeared first as a synonym for "vicarious liability" and "respondeat superior" in Albert A. Ehrenzweig, *Vicarious Liability in the Conflict of Laws—Toward A Theory of Enterprise Liability under "Foreseeable and Insurable Laws": III,* 69 YALE L.J. 978, 978 (1960), followed by C. Robert Morris, Jr., *Enterprise Liability and the Actuarial Process—The Insignificance of Foresight,* 70 YALE. L.J. 554, 554 (1961), and Lewis A. Kornhauser, *An Economic Analysis of the Choice Between Enterprise and Personal Liability for Accidents,* 70 CAL. L. REV. 1345, 1345 (1982). I embrace "enterprise liability" in preference to the older terms because it connotes the liability of a business organization of which the employee or agent is a part, rather than the liability of another distinct individual.

George L. Priest and some others have used "enterprise liability" to designate an extension of the concept to embrace product liability, which does not depend on the fault of an employee, but only on the imperfection of a product. *See* George L. Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law,* 14 J. LEGAL STUD. 461, 463 (1985); George L. Priest, *Punitive Damages and Enterprise Liability,* 56 S. CAL. L. REV. 123, 123-25 (1982); Jon D. Hanson & Kyle D. Logue, *The First-Party Insurance Externality: An Economic Justification for Enterprise Liability,* 76 CORNELL L. REV. 129, 133

ITSFEA's rejection of one of the axioms of tort law suggests a number of questions. Is the rebuttable liability principle more suitable than enterprise liability for insider trading offenses, or for securities frauds in general? If so, is it preferable for torts in general? Or is it, on the other hand, a gift to the securities industry that was slipped into ITSFEA without adequate consideration or justification?

In approaching these questions, I will start by reviewing the triumph of enterprise liability in Anglo-American tort law, and compare it with various forms of rebuttable liability that exist in foreign law (Part II). I will then review the rivalry between the two systems of liability in securities law that flourished in federal courts until 1990 (Part III). This review will be followed by an analysis of the commands and implications of ITSFEA (Part IV), after which I will speculate on the consequences of the choice between the two systems of liability (Part V). I will conclude with some guesses about the next steps in the rivalry between these principles (Part VI).

I will not, however, revisit the perennial dispute between defenders and denunciators of insider trading.[11] Rather, I will address the means of effectuating the policies against insider trading that have flourished in federal courts since 1946 and have been emphatically endorsed by Congress in the Insider Trading Sanctions Act of 1984 (ITSA)[12] and the Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA).[13]

II. Enterprise Liability in Other Contexts

A. *The Prevalence of Enterprise Liability*

The radical significance of excluding enterprise liability from suits on account of insider trading gains perspective when viewed in the light of the principle's conquest of other areas of tort law. Enterprise liability was unknown to the sophisticated legal system of ancient Rome and to the cruder system of medieval England. Under those regimes, employers were

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n.16 (1991).

Christopher Stone and Guido Calabresi appear to have used the term to embrace both kinds of liability. Christopher O. Stone, *The Place of Enterprise Liability in the Control of Corporate Conduct*, 90 YALE L.J. 1, 11-19 (1980); Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499, 500-01 (1961) [hereinafter Calabresi, *Thoughts*]; GUIDO CALABRESI, THE COSTS OF ACCIDENTS 50-58 (1970) [hereinafter CALABRESI, COSTS].

11. *See* James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School,"* 1986 DUKE L.J. 628 (reviewing insider trading dispute); Dennnis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 861 (1983) (favoring freedom to trade unless restricted by contract); Roy A. Schotland, *Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 VA. L. REV. 1425, 1425-30 (1967) (opposing insider trading); HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET (1966) (defending insider trading as contributor to market efficiency).

12. Pub. L. No. 98-376, 98 Stat. 1264 (1984).

13. 102 Stat. at 4677.

generally liable only for their personal misdeeds, as explained by Oliver Wendell Holmes, Jr., in his classic history of agency.[14] But the common law switched, about three centuries ago, to a principle that imposed liability on employers for the torts of their employees and agents committed in the course of their employment or authority, regardless of the employers' fault.[15] The principle was applied to frauds as well as to physical injuries.[16]

The principle of enterprise liability was adopted very casually, with no explanation beyond the aphorism or fiction that "the act of a servant is the act of his master."[17] When examined in the light of 19th century rationalism, the principle appeared to Holmes to be opposed to common sense,[18] while others denounced it in stronger terms.[19]

Enterprise liability awakened an intuitive hostility when the "employer" was visualized as an individual "master" employing a menial "servant," as suggested by the archaic terminology of the digest title, "Master and Servant,"[20] and the Restatement of Agency.[21] This perception is promoted also by the terms "vicarious liability"[22] and "respondeat superior,"[23] which imply that one individual is being assessed for the misdeeds of another, an obvious perversion of natural justice.

Holmes' attack on enterprise liability was immediately challenged on historical grounds[24] and later on grounds of social welfare and economic efficiency.[25] Some of the key criticisms were Harold Laski's observation that employers would generally suffer less from paying damages than injury victims would suffer from uncompensated injuries,[26] Young B. Smith's explanation that employers can pass the costs of compensating accidents on

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14. Oliver W. Holmes, Jr., *Agency*, 4 HARV. L. REV. 345 (1891); Oliver W. Holmes, Jr., *Agency*, 5 HARV. L. REV. 1 (1891), *reprinted in* 3 SELECTED ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY 368 (1909); *cf.* John H. Wigmore, *Responsibility for Tortious Acts: Its History—II*, 7 HARV. L. REV. 383 (1894), *reprinted in* SELECTED ESSAYS ON THE LAW OF TORTS 41 (1924).

15. *See* Holmes, *supra* note 14; Wigmore, *supra* note 14. The case most frequently cited for signaling the switch to enterprise liability is Jones v. Hart, Holt K.B. 642, 90 Eng. Rep. 1255 (1698).

16. Hern v. Nichols, 1 Salk. 289, 91 Eng. Rep. 256; Holt 462, 90 Eng. Rep. 1154 (1708).

17. *Jones*, 90 Eng. Rep. at 1255.

18. Holmes, *supra* note 14, at 14, *reprinted in* 3 SELECTED ESSAYS at 404.

19. *See* BATY, *supra* note 8, at 7; Frank W. Hackett, *Why is a Master Liable for the Tort of His Servant*, 7 HARV. L. REV. 107 (1893).

20. *See* 73 FPD 4th 455 (1992) (containing digest topic master and servant).

21. *See* RESTATEMENT (SECOND) OF AGENCY §§ 219-49 (1958).

22. *See* BATY, *supra* note 8.

23. *See* Seavey, *supra* note 9.

24. *See* Wigmore, *supra* note 14, at 404, *reprinted in* SELECTED ESSAYS at 62 n.

25. *See* Laski, *supra* note 8, at 121; Young B. Smith, *Frolic and Detour*, 23 COLUM. L. REV. 444, 716 (1923); Douglas, *supra* note 8.

26. Laski, *supra* note 8, at 115-22. Laski authored this article in 1916, when he was a lecturer at Harvard University. Later, he returned to England, where, among other activities, he became Chairman of the Executive Committee of the Labour Party.

to their customers,[27] and William O. Douglas' reasoning that liability will motivate employers to reduce and avoid injuries.[28]

In the second half of the twentieth century, scholars reinforced the defense of enterprise liability on grounds of economic efficiency.[29] Among other factors, they observed that employers can usually reduce accident causes more efficiently than potential victims can, and that putting the cost on employers tends to allocate resources away from accident-prone activities.[30]

Enterprise liability prevailed also in many other parts of the Western world, quite independently of the common law. The principle was adopted in France in the course of the 18th century[31] and enshrined in the Code Napoleon,[32] which was widely copied in other parts of the world.[33]

B. *Rebuttable Liability in Foreign Law*

The idea that employers should be subject only to a prima facie liability for their employees' torts, which would be rebuttable by proof of freedom from personal fault, seems to have been unknown in the United States before it was discovered as an interpretation of the Securities Acts. But it has interesting parallels in foreign countries.

Some contemporary legal systems offer a principle which burdens employers with prima facie liability, from which they can escape by proving that they exercised reasonable care to prevent the torts of their agents.[34]

27. Smith, *supra* note 25, at 458. Smith later became Dean of the Columbia University School of Law.

28. Douglas, *supra* note 8, at 587-88. Douglas, who published this article when he was a professor at Yale University Law School, was later Chairman of the Securities and Exchange Commission and a Justice of the United States Supreme Court.

29. *See* Calabresi, *Thoughts*, *supra* note 10; Kornhauser, *supra* note 10; Stone, *supra* note 10.

30. *See* ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 407-08 (1987); STEVEN SHAVELL, ECONOMIC ANALYSIS OF ACCIDENT LAW 170-77 (1987). Shavell adhered to the old term "vicarious liability" although justifying the principle by its effects on business organizations. *See also* WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF TORT LAW 120-21, 208-09 (1987) (adhering to "respondeat superior"); Hanson & Logue, *supra* note 10, at 160-61.

A novel attack on enterprise liability on the ground that it burdens the economy with the costs of punitive damages and "fails to reward effective compliance programs" was made in Harvey L. Pitt & Karl A. Groskaufmanis, *Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct*, 78 GEO. L.J. 1559, 1563-69, 1645 (1990).

31. M. Marcel Planiol, *Études sur la Responsabilité Civile*, 38 REV. CRIT. LEGIS. & JUR. 282 (1909).

32. (Fr.) C. CIV., art. 1384 (1804).

33. *See* KONRAD ZWEIGERT & HEIN KÖTZ, 2 INTRODUCTION TO COMPARATIVE LAW 337-39 (Tangweir trans., 2d rev. ed. 1987); Robert Neuner, *Respondeat Superior in the Light of Comparative Law*, 4 LA. L. REV. 1 (1941); E. Fabre Surveyer, *A Comparison of Delictual Responsibility in Law in the Countries Governed by a Code*, 8 TUL. L. REV. 53, 59-60, 63-66 (1933).

34. *See* ZWEIGERT & KÖTZ, *supra* note 33, at 324-30; Neuner, *supra* note 33, at 2-8.

Convenient examples may be found in the laws of Germany[35] and Puerto Rico.[36]

But these provisions impose much heavier burdens on employers than does ITSFEA. The employer does not escape liability merely by proving the good faith and noninducement that satisfy the Exchange Act.[37] In the German formulation, the employer must show that it observed the care required in the trade in providing contrivances and utensils and in directing performance of the activity.[38] The Puerto Rican version, typical of many derived from Spanish law, requires that the employer "employed all the diligence of a good father of a family to preclude the damage."[39]

Moreover, courts of the countries that adopted the German or Spanish formulation have tended to interpret the care requirements so rigorously that the results were similar to those under the enterprise liability principle

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35. (Ger.) BGB § 831, para. 1 (1896); (Ger.) CIV. CODE § 831, para. 1 (Walter Loewy trans., 1909). In the Loewy translation the section reads as follows:

> One who employs another to do an act, is bound to render indemnity for the injury which the employee in the performance of the act causes to a third person. The obligation for indemnity does not occur, if the employer in the selection of the employed person, and so far as he has to provide contrivances or utensils or has to direct the performance of the act, observes, in the providing or directing, the care required in trade or if the injury would also have occurred if such care had been observed.

36. P.R. CIV. CODE § 5142, P.R. LAWS ANN. tit. 31, § 5142 (1968). The text of the section reads as follows:

> The obligation imposed by the preceeding section [5141 of this title] is demandable, not only for personal acts and omissions, but also for those of the persons for whom they should be responsible.
>
> The father, and, in the event of his death or incapacitation, the mother, is liable for the damage caused by the minor children living with them.
>
> Guardians are liable for the damages caused by minors or incapacitated persons who are under their authority and live with them.
>
> Owners or directors of an establishment or enterprise are likewise liable for any damages caused by their employees in the service of the branches in which the latter are employed or on account of their duties.
>
> The Commonwealth is liable in this sense under the same circumstances and conditions as those under which a private citizen would be liable.
>
> Finally, masters or directors of arts and trades are liable for the damages caused by their pupils or apprentices while they are under their custody.
>
> The liability referred to in this section shall cease when the liable persons mentioned therein prove that they employed all the diligence of a good father of a family to preclude the damage.

Section 5141, referred to in the first paragraph of section 5142, is a general tort liability section, providing in its first sentence as follows:

> A person who by an act or omission causes damage to another through fault or negligence shall be obliged to repair the damage so done.

37. *See* 15 U.S.C. § 78t(a) (1988). Rebuttal of liability under the Securities Act, which is not involved in insider trading, requires proof that "the controlling person had no knowledge of or reason to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." Securities Act § 15, 15 U.S.C. § 78*o*.

38. *See supra* note 35.

39. *See supra* note 36.

of British, American, and French law.[40] In the 1980s, the German Ministry of Justice proposed a revision to the German Civil Code to replace rebuttable liability with enterprise liability.[41] Leading German scholars, after surveying laws of the Western world on the liability of employers, applauded the Ministry's proposal.[42]

In light of these comparisons, the conditions of employer exoneration authorized by ITSFEA appear to be more lenient than those of any modern legal system—foreign or domestic.

III. REBUTTABLE LIABILITY BEFORE ITSFEA

A. *The Words of Congress*

The conception of rebuttable liability was introduced in the Securities Acts of 1933 and 1934 by provisions that make persons who "control" others liable for violations of the Acts by controlled persons unless the controllers are innocent of specified elements of the violations. Under the Securities Act of 1933 (Securities Act), the controller was excused from liability if it had no knowlege or reason to know of the falsity that constituted the violation.[43] Under the Securities Exchange Act of 1934 (Exchange Act), the controller was exonerated if it acted in good faith and did not induce the controlee's violation.[44]

These provisions were not adopted in contemplation of the liability of employers, which was not even in the lawmakers' consciousness.[45] The liabilities of broker-dealers, which eventually became the principal subjects

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40. ZWEIGERT & KÖTZ, *supra* note 33, at 327-28.

41. *Id.* at 330.

42. *Id.* at 339.

43. *See* 15 U.S.C. § 78*o*. I use "controller" as an abbreviation of "controlling person," and "it" as a relative pronoun in lieu of "he, she, or it" because most of the controllers involved in this article are corporations rather than individuals.

44. *See* 15 U.S.C.A. §§ 78a-78kk (West 1981). I use "controlee" as an abbreviation of "controlled person."

45. This fact was noticed and documented in Kenneth I. Levin, Comment, *The Controlling Persons Provisions: Conduits of Secondary Liability Under Federal Securities Law*, 19 VILL. L. REV. 621 (1974). It was overlooked by most of the commentators on the conflict between enterprise and rebuttable liability, who consequently puzzled over the means of reconciling the common law principle with the control clauses. *See* William J. Fitzpatrick & Ronald T. Carman, *Respondeat Superior and the Federal Securities Laws: A Round Peg in a Square Hole*, 12 HOFSTRA L. REV. 1 (1983); Carol M. Lynch, Note, *Rule 10b-5—The Equivalent Scope of Liability Under Respondeat Superior and Section 20(a)—Imposing a Benefit Requirement on Apparent Authority*, 35 VAND. L. REV. 1383 (1982); Steven R. Reininger, *Exclusive or Concurrent—The Role of Control and Respondeat Superior in the Imposition of Vicarious Civil Liability on Broker-Dealers*, 9 SEC. REG. L.J. 226 (1981); Comment, *Secondary Liability of Controlling Persons Under the Securities Acts: Toward an Improved Analysis*, 126 U. PA. L. REV. 1345 (1978); Note, *The "Controlling Persons" Liability of Broker-Dealers for Their Employees' Federal Securities Violations*, 1974 DUKE L.J. 824; Note, *The Burden of Control: Derivative Liability Under Section 20(a) of the Securities Exchange Act of 1934*, 48 N.Y.U. L. REV. 1019 (1973).

of enterprise liability, were not addressed by Congress until 1936, when provisions for the registration of broker-dealers and their representatives were added to the Exchange Act.[46] The idea that the "controlling persons" affected by the rebuttable liability clauses embraced *employers* did not surface until more than three decades after the clauses' enactment.[47]

The "controlling persons" on whom the legislators intended to impose liability were not the corporations that might control employees, but the officers, financiers, or shareholders (including holding companies) that might control corporations. In the Securities Act, the persons specifically contemplated were those who controlled corporations through "dummy directors."[48] In the Exchange Act, the contemplated subjects were more broadly described as those who controlled corporations through "stock ownership, lease, contract, and agency."[49]

Under the common law that preceded the Securities Acts, these controlling persons bore no responsibility for the frauds of the corporations and the corporation agents that they controlled unless they participated personally in the frauds, or conducted their corporations' affairs with such

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46. *See* Act of May 27, 1936, § 3, 49 Stat. 1377 (1936) (adding subsections (b), (c), and (d) to § 15 (15 U.S.C. § 78*o*) of Exchange Act).

47. *See infra* text accompanying notes 59-69.

48. S. Rep. No. 47, 73d Cong., lst Sess. 5-6 (1933), *reprinted in* J. S. Ellenbarger & Ellen P. Mahar, 2 Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934, item 17 (1973); H.R. Rep. No. 152, 73d Cong., 1st Sess. (Conference Report) 27, 77 Cong. Rec. 3902 (1933), *reprinted in* 2 Legislative History, *supra*, item 19.

49. H.R. Rep. No. 1383, 73d Cong., 2d Sess. 26 (1934), *reprinted in* 5 Legislative History, *supra* note 48, item 18. The types of control contemplated are revealed by the following paragraph, contained in the section-by-section analysis of the section (then numbered 19) that became subsection 20(a) of the Exchange Act:

> It would be difficult if not impossible to enumerate or to anticipate the many ways in which actual control may be exerted. *See* Handy & Harmon v. Burnet, 284 U.S. 1336 (1931). A few examples of the methods used are stock ownership, lease, contract, and agency. It is well known that actual control sometimes may be exerted through ownership of much less than a majority of the stock of a corporation either by the ownership of such stock alone or through such ownership in combination with other factors.

The case of Handy & Harmon v. Burnet, 284 U.S. 1336 (1931), cited by the committee, involved control of a corporation in relation to an internal revenue regulation on consolidated tax returns.

Further evidence of the type of control that concerned legislators is contained in a 1934 report of a Senate investigation of abuses in the securities industry which observed:

> Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and offices, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others.

Senate Comm. on Banking and Currency, Stock Exchange Practices, S. Rep. No. 1455, 73d Cong., 2d Sess. 55 (1934), *reprinted in* Legislative History, *supra* note 48, item 21.

gross irregularity that courts would "pierce the veil" of corporate entity.[50] But irregularity in corporate procedures was easily avoided by well counseled managers, and evidence of personal participation was hard to uncover. In order to facilitate proof of participation by controllers in the frauds of their corporations, the legislators of 1933 and 1934 imposed liability on controllers for the frauds of controlees *unless* the controllers proved the existence of the exonerating elements listed in the Securities Acts.

But the liability of *employers*, unlike that of officers, directors, and shareholders, had long been established in both state and federal courts.[51] If legislators or their scriveners gave any thought to the liability of employers for securities frauds, they would naturally have expected courts to apply enterprise liability to securities frauds as courts had done in other fraud cases.[52] Their assumption would have been verified by the rulings of most federal courts in the first thirty-odd years of the Securities Acts, when courts routinely imposed enterprise liability on employers for employees' violations of securities laws.[53]

The words of Congress should, of course, be read not only with a view to legislators' specific intentions, but also to "avoid irrationality" and "promot[e] consistency and coherence"[54] or to achieve "comprehensive rationality."[55] In this vein, some of the judicial opinions that rejected enterprise liability argued that making employers liable would clash with a consistent pattern of fault-based liability.[56] But this observation ignored the Securities Acts' imposition of liability on an issuer when a registration statement was materially false, even if no one, not even an employee, was at fault.[57]

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50. For recent commentaries on disregarding the corporate entity, see Robert Charles Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505 (1977); Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 (1991); Christopher D. Stone, *The Place of Enterprise Liability in the Control of Corporate Conduct*, 90 YALE L.J. 1 (1980). For classic expositions, see ELVIN R. LATTY, SUBSIDIARIES AND AFFILIATED CORPORATIONS (1936); Adolf A. Berle, *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343 (1947); Elvin R. Latty, *The Corporate Entity as a Solvent of Legal Problems*, 34 MICH. L. REV. 597 (1936); I. Maurice Wormser, *Piercing the Veil of Corporate Entity*, 12 COLUM. L. REV. 496 (1912).

51. *See* sources cited *supra* note 6.

52. *See* sources cited *supra* note 7.

53. *See infra* text accompanying notes 58-64. The first departure from imposing enterprise liability was Kamen & Co. v. Paul H. Aschkar & Co., 382 F.2d 689 (9th Cir. 1967).

54. Cass R. Sunstein, *Interpreting Statutes in the Regulatory State*, 103 HARV. L. REV. 407, 464, 479, 482 (1989); *cf.* William N. Eskridge, Jr., *Overruling Supreme Court Statutory Interpretation Decisions*, 101 YALE L.J. 331, 373-74 (1991).

55. *See* Edward L. Rubin, *Beyond Public Choice: Comprehensive Rationality in the Writing and Reading of Statutes*, 66 N.Y.U. L. REV. 1, 5 (1991).

56. *See* Haynes v. Anderson & Strudwick, Inc., 508 F. Supp. 1303, 1307-14 (E.D. Va. 1981); Jackson v. Bache & Co., 381 F. Supp. 71, 95 (N.D. Cal. 1974).

57. Securities Act § 11(a)-(b), 15 U.S.C. § 77k(a)-(b) (1988). The due diligence defenses of subsection (b) do not apply to the issuer, which is made liable by subsection (a).

B. *Court Rulings Under the 1933 and 1934 Acts*

1. *The first wave: enterprise liability assumed*

For a quarter of a century after the courts discovered Rule 10b-5[58] as a basis of private suits for fraud, most of them casually imposed liabilities on firms for the frauds of agents without any reference to the presumptive liability clauses. This practice appeared in *Kardon v. National Gypsum Co.*,[59] which in 1946 launched the 10b-5 explosion, as well as in other early decisions.[60]

The courts in these cases were presumably applying common-law enterprise liability, since they made no mention of the rebuttable liability clauses. But they would probably have reached the same results in most of these cases if they had consciously applied the rules of rebuttable liability. The facts of the cases suggest that high executives of the defendant corporations induced the transactions. In *Speed v. Transamerica Corp.*,[61] for instance, the existence of fraud depended on the intentions of A. P. Gianinni, the chief executive of Transamerica; if he had guilty knowedge, so did Transamerica.[62]

In 1972, however, the Supreme Court clearly invoked the enterprise liability principle to impose liability on a defendant bank.[63] The opinion of the Tenth Circuit Court of Appeals, which the Supreme Court affirmed, had observed that "these employees as far as the plaintiffs were concerned were *apparently acting within their authority*. Thus the bank did become liable for any violation of the Regulation 10b-5."[64] Affirming on this point, the Supreme Court observed laconically, "The liability of the bank, of course, is coextensive with that of Gale and Haslem."[65] Neither counsel nor court seems to have considered the possibility that the Exchange Act's presumptive liability clause had any bearing on the case.[66]

Five years earlier, the assumption that enterprise liability applied to securities liabilities had been challenged by a Ninth Circuit Court of Appeals

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58. Rule 10b-5 under the Exchange Act, 17 C.F.R. § 240.10b-5 (1991).

59. 69 F. Supp. 512 (E.D. Pa. 1946).

60. *See* Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946); Hawkins v. Merrill, Lynch, Pierce, Fenner & Beane, 85 F. Supp. 104 (W.D. Ark. 1949); Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951); Speed v. Transamerica Corp., 235 F.2d 369 (3d Cir. 1956).

61. 99 F. Supp. 808 (D. Del. 1951).

62. *See* Speed v. Transamerica Corp., 99 F. Supp. 808, 821 (D. Del. 1951) (declaring that deception "must be based on the state of mind of Giannini").

63. *See* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972).

64. Reyos v. United States, 431 F.2d 1337, 1347 (10th Cir. 1970) (emphasis added), *aff'd in part, rev'd in part sub nom.* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972).

65. *Affiliated Ute Citizens*, 406 U.S. at 154.

66. Similarly, the Fifth Circuit Court of Appeals in Lewis v. Walston & Co., 487 F.2d 617, 623 (5th Cir. 1973), invoked the Restatement of Agency to impose liability on a brokerage house without discussing the relevance of the presumptive liability clause.

dictum that agency principles have no application to liabilities under the federal securities acts.[67] This conclusion was promptly repudiated by a district court and the Court of Appeals of the Fourth Circuit.[68] The argument against enterprise liability seems to have been overlooked by counsel in *Affiliated Ute Citizens v. United States*,[69] but was routinely raised by most corporate defendants in later years.[70]

2. *The triumph of enterprise liability*

The first judicial opinion to reexamine enterprise liability in light of the argument for rebuttability was delivered in 1968,[71] just one year after enterprise liability had been casually rejected by the Ninth Circuit.[72] On examining the legislative history of the Securities Acts, the district judge found no evidence of Congressional intention to limit liability and an apparent disposition to increase it.[73] Moreover, he doubted that the rebuttable liability clause was intended to apply to employers at all; it was probably directed at major shareholders and officers who control corporations.[74] On the level of social policy, the judge declared that excluding agency principles "would in effect give blessing to a hear-no-evil, see-no-evil approach by partners of a brokerage house which is hardly in keeping with the remedial purposes of the '33 Act . . . ."[75] The judge concluded by holding the brokerage firm liable on agency principles for the fraud of its agent. His opinion on this point was expressly approved by the Fourth Circuit Court of Appeals[76] and reaffirmed by it several years later.[77]

Later decisions in the First, Second, Fifth, Sixth, and Seventh Circuits reached the same conclusion as the Fourth,[78] usually after a briefer exami-

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67. *See* Kamen & Co. v. Paul H. Aschkar & Co., 382 F.2d 689, 696 (9th Cir. 1967).

68. Johns Hopkins Univ. v. Hutton, 297 F. Supp. 1165, 1210-12 (D. Md. 1968), *aff'd in part, rev'd in part*, 422 F.2d 1124 (4th Cir. 1970).

69. 406 U.S. 128 (1972). The *Affilated Ute Citizens* Court was focused on other issues, including the scope of the duty to disclose, which had not previously been addressed by the Court and the sovereign immunity of the United States. On the latter question, Justice Douglas dissented from the majority's view that the government had not waived its immunity. *Id.* at 157.

70. *See infra* notes 71-81, 91-100 and accompanying text; *see also* sources cited *supra* note 45.

71. *Johns Hopkins*, 297 F. Supp. at 1208-09.

72. *See* Kamen & Co. v. Paul H. Aschkar & Co., 382 F.2d 689, 696 (9th Cir. 1967) (rejecting enterprise liability).

73. Johns Hopkins Univ. v. Hutton, 297 F. Supp. 1165, 1211-12 (D. Md. 1968), *aff'd in part, rev'd in part*, 422 F.2d 1124 (4th Cir. 1970).

74. *Id.*

75. *Id.* at 1212.

76. Johns Hopkins Univ. v. Hutton, 422 F.2d 1124, 1128 (4th Cir. 1970).

77. Carras v. Burns, 516 F.2d 251 (4th Cir. 1975).

78. *In re* Atlantic Fin. Management, Inc., 784 F.2d 29 (1st Cir. 1986), *cert. denied*, 481 U.S. 1072 (1987); Paul F. Newton & Co. v. Texas Commerce Bank, 630 F.2d 1111 (5th Cir. 1980); Marbury Management, Inc. v. Kohn, 629 F.2d 705, 716 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980); Holloway v. Howerdd, 536 F.2d 690, 695 (6th Cir. 1976); Fey v. Walston & Co., 493 F.2d 1036, 1051-53 (7th Cir. 1974); SEC v. First Sec. Co., 463 F.2d 981, 986-87 (7th Cir.), *cert. denied*, 409 U.S. 880 (1972).

nation of authorities.[79] The argument most relied on was the absence of any indication of legislative intention to limit the liabilities that would normally be imposed by the law of torts. In 1990 the Ninth Circuit joined the majority,[80] but not before its rejection of enterprise liability had spread to other circuits.[81]

The Fourth Circuit, however, bypassed enterprise liability in a 1979 decision which mysteriously omitted any mention of it.[82] It examined liability only under the rebuttability clause, and found that the defendant brokerage firm had borne the burden of proving good faith and noninducement. This pretermission led a district judge of the same circuit to reexamine the relative merits of enterprise liability and rebuttable liability and to reject the ruling which his own Court of Appeals had approved nine years earlier.[83]

The opinions reviewed in the foregoing paragraphs involved private suits for damages. When the Securities and Exchange Commission (SEC) was the plaintiff in an enforcement proceeding, some of the courts that had applied enterprise liability to private suits declined to apply it to suits by the Commission. The Sixth Circuit refused to apply enterprise liability in an SEC enforcement proceeding on the ground that the common law principle of enterprise liability applied to private suits, not to governmental enforcement actions.[84]

An opposite view was adopted by one decision of the Second Circuit.[85] Its dominant consideration was evidence that the rebuttable liability clauses

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79. *Fey*, 443 F.2d at 1052-53. The *Fey* Court added the argument that the United States Supreme Court had affirmed the application of agency principles in *Affiliated Ute Citizens*, 406 U.S. 128, 154 (1972). The *Marbury Management* court reexamined the legislative history and other considerations and employed the same reasoning as the court in Johns Hopkins Univ. v. Hutton, 297 F. Supp. 1165 (D. Md. 1968), *aff'd in part, rev'd in part*, 422 F.2d 1124 (4th Cir. 1970).

80. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1621 (1991). The same principle that was applied by *Hollinger* to brokers and their reps was extended to nonbroker corporations and their employees in *In re* Network Equip. Technologies, Inc., 762 F. Supp. 1359 (N.D. Cal. 1991).

81. *See infra* text accompanying notes 100-03.

82. Carpenter v. Harris, Upham & Co., 594 F.2d 388 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979).

83. Haynes v. Anderson & Strudwick, 508 F. Supp. 1303, 1307-14 (E.D. Va. 1981) (repudiating *Johns Hopkins* decision). The repudiation may have been inspired not only by the appellate court's pretermission in *Carpenter* but also by the hostility toward broad applications of the securities laws which Supreme Court Justices had shown in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), and other cases. *See* Alfred F. Conard, *Securities Regulation in the Burger Court*, 56 U. COLO. L. REV. 193 (1985).

84. SEC v. Coffey, 493 F.2d 1304, 1318 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975).

85. SEC v. Management Dynamics, Inc., 515 F.2d 801 (2d Cir. 1975). Two earlier district court decisions in the same circuit had applied the presumptive liability rule to a corporation in an enforcement proceeding. One of them, SEC v. Micro-Moisture Controls, Inc., 148 F. Supp. 558 (S.D.N.Y. 1957), did not even discuss the applicability of enterprise liability. The other decision, SEC v. Lum's, Inc., 365 F. Supp. 1046 (S.D.N.Y. 1973), discussed enterprise liability, and concluded that it had been superseded by the rebuttable liability clauses.

were not intended to govern the liability of employers but the liability of the controllers of corporations. Consequently, these clauses could not have been intended to exclude common-law principles of agency.[86] The court did not discuss the question whether common-law agency principles apply in the same way to enforcement actions filed by government agencies, a question on which there is little, if any, common law. But a subsequent decision of the Second Circuit restricted the significance of agency principles in enforcement actions by holding that injunctions should issue only to restrain violations committed or approved by high executives; a firm should not be subjected to a sanction for the fault of a single employee.[87]

Common-law agency principles, including enterprise liability, arose in the context of private suits and are generally framed in that context.[88] Whether the rules that have grown up in civil suits should be applied without modification to criminal prosecutions is disputed. The federal courts appear to restrict derivative liability in criminal prosecutions to intentional acts of supervisory personnel who are vested with discretionary authority.[89] Whether

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Id. at 1061-63. The decision did not discuss any possible difference between the rules of liability applicable to enforcement proceedings and those applicable to private suits.

86. *Management Dynamics*, 515 F.2d at 812.

87. SEC v. Geon Indus., Inc., 531 F.2d 39, 54-56 (2d Cir. 1976).

88. *See* RESTATEMENT (SECOND) OF AGENCY (1958) (containing illustrative hypotheticals, all of which are in terms of private suits, distributed throughout). *See also* Holmes, *supra* note 14.

89. *See* United States v. Carter, 311 F.2d 934 (6th Cir. 1963); Continental Baking Co. v. United States, 281 F.2d 137 (6th Cir. 1960); New York Cent. and Hudson River R.R. v. United States, 212 U.S. 481 (1909). The *Continental* opinion, which was followed by *Carter*, stated the basic precondition of corporate liability in these terms: "There is an officer or agent of a corporation with broad express authority, generally holding a position of some responsibility, who performs a criminal act related to the corporate principal's business." 281 F.2d at 149. The Model Penal Code restated the principle as follows: "(c) the commission of the offense was authorized, requested, commanded, performed or recklessly tolerated by the board of directors or by a high managerial agent acting in behalf of the corporation within the scope of his office or employment." MODEL PENAL CODE & COMMENTARIES § 2.07(1)(c) (1985). The accompanying commentary declared, "The limitations on corporate liability imposed in cases falling within Subsection (1)(c) are generally consistent with the position of the English courts, the federal courts, and those of many American states." 1 PENAL CODE 340.

The Model Penal Code also imposed a prima facie liability on corporations for acts of employees at any level for violations of statutes that reveal "a legislative purpose to impose liability on corporations" *Id.* § 2.07(a)(1). This characterization seems to include the Securities Acts. This prima facie liability is subject to rebuttal under § 2.07(5), which provides,

> it shall be a defense if the defendant proves by a preponderance of evidence that the high managerial agent having supervisory responsibility over the subject matter of the offense employed due diligence to prevent its commission.

The commentary on this subsection characterized it as "an important contribution to the rationalization of corporate criminal responsibility," with parallels in a few state statutes, but does not indicate that it has any basis in state or federal case law. 1 PENAL CODE 346.

Courts sometimes state the principle without limiting it to acts of supervisory employees when the status of the guilty employee is not in question. *See* United States v. Gold, 743 F.2d 800, 822-23 (11th Cir. 1984) (involving case where level of employees involved does not appear); United States v. Beusch, 596 F.2d 871, 877-78 (9th Cir. 1979) (involving case where guilty enforcement proceedings pursued by the SEC, commonly called "civil actions," should employ the enterprise liability of private suits or the restricted derivative liability of criminal prosecutions remains debatable.

3. *The transitory rejection of enterprise liability*

a. *The exclusivity theory*

While most of the federal courts were applying enterprise liability to securities frauds, a small minority rejected it on the ground that the rebuttable liability clauses provided the exclusive bases on which employers could be held liable for their employees' violations of the Securities Acts.

The first judicial rejection of enterprise liability in a private suit appeared in an *obiter dictum* pronounced by the Ninth Circuit Court of Appeals without a word of analysis.[90] After the dictum had been contradicted by district and appellate judges of the Fourth Circuit[91] and ignored by the United States Supreme Court,[92] a district judge in the Ninth Circuit produced an elaborate rationalization.[93] Although the judge noted that rebuttability

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employee was senior corporate officer of branch at which violations occurred).

Some writers on corporate criminal liability have asserted that a majority of *state* courts apply respondeat superior to corporations in criminal cases by the same criteria as in private suits. *See* Kathleen F. Brickey, *Rethinking Corporate Liability Under the Model Penal Code*, 19 RUTGERS L.J. 593 (1988); *Developments in the Law—Corporate Crime: Regulating Corporate Behavior through Criminal Sanctions*, 92 HARV. L. REV. 1227 (1979). The number of cases cited is too small to indicate an imposing weight of authority. *See also* John C. Coffee, Jr., *Does "Unlawful" Mean "Criminal"?: Reflections on the Disappearing Tort/Crime Distinction in American Law*, 71 B.U. L. REV. 193, 213-15 (1991).

90. Kamen & Co. v. Paul H. Aschkar & Co., 382 F.2d 689 (9th Cir. 1967). The major portion of the opinion was devoted to liability for common-law fraud and rejected this liability because the individual malefactor had no apparent authority to commit the fraud. *Id.* at 696. On turning to liability under the Exchange Act, the court first found that the defendant had borne the burden of proving innocence, and then added that the defendant could not be liable under the Exchange Act on agency principles because these principles were inapplicable to Exchange Act liabilities. *Id.* at 697. But if the court had applied agency principles, it would have had to rule for the defendant under the Exchange Act as it had already done under common law fraud. This aspect of *Kamen* was noted in Johns Hopkins Univ. v. Hutton, 247 F. Supp. 1165, 1210-11 (D. Md. 1968), *aff'd in part, rev'd in part*, 422 F.2d 1124 (4th Cir. 1970), and in some other decisions affirming concurrent liability.

Another 1967 case that is sometimes cited for the rejection of enterprise liability is Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968). *See* Jackson v. Bache & Co., 381 F. Supp. 71, 94 (N.D. Cal. 1974). This, however, is a misreading. Although the *Myzel* court declared that the defendant's liability was not governed by agency principles, it did not even hint that agency principles were inapplicable under the Exchange Act, and even cited them as relevant to interpreting the presumptive liability clause. 386 F.2d at 738. The statement that the defendant's liability was not governed by agency principles was probably based on the view that the malefactor, although a controlled person, was not an agent.

91. *See Johns Hopkins*, 247 F. Supp. at 1210-12.

92. Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972).

93. *Jackson*, 381 F. Supp. at 94. This rationalization had appeared earlier in SEC v. Lum's, Inc., 365 F. Supp. 1046 (S.D.N.Y. 1973), an SEC enforcement proceeding, in which the court did not discuss any possible difference between liability in an enforcement proceeding and in a private suit.

had been rejected by the Fourth Circuit[94] and ignored by the Fifth,[95] he found wisps of support for it in earlier cases from other circuits as well as his own circuit,[96] but relied more heavily on policies articulated in the Exchange Act itself.

The judge reasoned that the rebuttable liability clause of the Exchange Act constituted a comprehensive scheme of secondary liability, which was broader than agency principles in basing liability on control alone without other elements of agency, but narrower in allowing the controller to escape liability by showing lack of complicity.[97] It was incompatible with enterprise liability, which was impliedly excluded. Furthermore, he argued that the Securities Act, which was *in pari materia* with the Exchange Act, rejected "insurer's liability" by its reasonable investigation and reasonable care clauses.[98]

A similar analysis was embraced in the following year by the Ninth Circuit in a case involving a newspaper's financial columnist,[99] and in 1982 by the Third Circuit in a case involving a corporation's liability for insider trading by the firm's president for his own account.[100] Several years later, a Fourth Circuit decision applied rebuttable liability to an employer[101] without even discussing its own contrary decisions,[102] and a district judge of the Fourth Circuit felt free to adopt the views of the Third and Ninth Circuits.[103]

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94. *Jackson*, 381 F. Supp. at 94 (citing Johns Hopkins Univ. v. Hutton, 422 F.2d 1124 (4th Cir. 1970)).

95. *Id.* (citing Lewis v. Walston & Co., 487 F.2d 617 (5th Cir. 1973)).

96. The court erroneously characterized Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968), as holding that agency principles are inapplicable. *See supra* note 90. The court also cited Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973), SEC v. Lum's, Inc., 365 F. Supp. 1046 (S.D.N.Y. 1973), and Kamen & Co. v. Paul H. Aschkar & Co., 382 F.2d 689 (9th Cir. 1967). *Lanza* did not involve the derivative liability of an employer, but the *primary* liability of a director for approving a merger without full disclosure. *Lum's* did not involve a private suit, but an SEC enforcement action. On *Kamen*, see *supra* note 90.

97. *Jackson*, 381 F. Supp. at 95.

98. *Id.* at 95 (citing S. REP. No. 47, 73d Cong., 1st Sess. 5 and H.R. REP. No. 1383, 73d Cong., 2d Sess. 5). These Reports discussed provisions which eventually became Securities Act § 11(a) and (b). *See supra* note 57. The court passed over the fact that the law as eventually enacted imposed unconditional liability on the *issuer* even if the officers acted with due diligence. *See* Securities Act § 11(b) pmbl. (stating that defenses of due diligence applies to persons other than issuer).

99. Zweig v. Hearst Corp., 521 F.2d 1129 (9th Cir.), *cert. denied*, 423 U.S. 1025 (1975). The Ninth Circuit later affirmed a decision that the columnist was individually liable. Zweig v. Hearst Corp., 594 F.2d 1261 (9th Cir. 1979).

100. Rochez Bros. v. Rhoades, 527 F.2d 880 (3d Cir. 1975). The court ignored the possibility of exonerating the officers and directors on the ground that their trading in shares was outside the scope of their duties as officers and directors.

101. Carpenter v. Harris, Upham & Co., 594 F.2d 388 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979).

102. Johns Hopkins Univ. v. Hutton, 422 F.2d 1124 (4th Cir. 1970); Carras v. Burns, 516 F.2d 251 (4th Cir. 1975).

103. Haynes v. Anderson & Strudwick, Inc., 508 F. Supp. 1303 (E.D. Va. 1981) (relying

The recurrent rejection of traditional enterprise liability by some judges is not adequately explained by the faint indications of discordant legislative intentions. Like other judicial inclinations, the hostility toward enterprise liability is probably motivated by imperfectly articulated perceptions that something is vaguely wrong with imposing liability under the circumstances presented. Two probable sources of such intimations invite mention.

b. *The "injustice" of liability without fault*

One explanation of some judges' impulsive rejection of enterprise liability is probably a perception that it is unjust to impose liability on employers who are not personally at fault.[104] This perception underlay the classic attack on agency principles launched by Holmes a century ago.

Twentieth century critics attacked this analysis by arguing that the cost of liability is not borne by innocent "masters," as the attackers supposed, but is distributed among the consumers, investors, employees and others who are affected by the employing enterprise. Insofar as the cost is distributed to consumers, it makes them pay the full cost of the goods and services they consume and reduces their demands for harmful products and activities.[105]

This analysis rests on the assumption that the liabilities result from causes that are recurrent and can be reflected in later prices. Its validity is obvious in relation to the accidents of truck drivers. If, however, one thinks of torts that seem too outrageous to happen often, such as an employee's shooting a passer-by on the street, the analysis is less persuasive.

It seems likely that judges' rejection of enterprise liability in early cases under Rule 10b-5 was motivated in part by a perception of the newly discovered offense of insider trading as an outrageous deviation from the expectable that should not be figured into the cost of doing business. The very idea that trading on inside information is criminal was startling, because information from "inside" the company seems like the most reliable and legitimate kind of information. It was not until the enactment of the Insider Trading Sanctions Act of 1984 that Congress defined the offense as trading "while in possession of material, nonpublic information," which I abbreviate as "NPI trading."[106]

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on *Carpenter*). *Carpenter* had held, without mentioning agency principles, that a broker escaped liability by proving good faith under the presumptive liability clause. *Carpenter*, 599 F.2d at 394.

104. *See* Fitzpatrick & Carman, *supra* note 45. These coauthors were General Counsel and Associate General Counsel, respectively, of the Securities Industry Association, which consists largely of employers.

105. CALABRESI, COSTS, *supra* note 10, at 73; COOTER & ULEN, *supra* note 30, at 407-08; SHAVELL, *supra* note 30, at 170-72; LANDES & POSNER, *supra* note 30, at 120-21, 208-09.

106. The abuse of unpublished information is widely known as "insider trading," a term that gained its initial currency as a description of trading on information emanating from "inside" the issuer of the securities traded, like news of the lucky strike of ore in SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). Later

c. *The litigation explosion*

Another likely contributor to judges' hostility toward enterprise liability in securities cases was their revulsion from a flood of suits on unfamiliar principles based on the SEC's Rule 10b-5.[107] It is probably more than a coincidence that the exclusivity theory was elaborated after *SEC v. Texas Gulf Sulphur Co.*[108] had revealed the broad potential of liability under the rule, and *Affiliated Ute Citizens*[109] had confirmed the implication of a private right of suit.

One likely basis of judicial revulsion from liability for NPI trading was the boldness of the implication of a private right of suit from a statutory section which expressed only an intention to criminalize violations of SEC rules.[110] Even before *Texas Gulf Sulphur*, David Ruder, later an SEC Chairman, had protested against the implication.[111] Later, Justice Rehnquist referred to it caustically in *Blue Chip Stamps v. Manor Drugstores*.[112] In 1991, even after Congress had confirmed its approval of private rights of suit for insider trading,[113] Justice Scalia twice denounced the implication of private rights of suit under the Securities Acts.[114]

Although federal judges were bound by Supreme Court decisions to recognize the private right of suit, they could limit its consequences by refusing to apply in 10b-5 suits some of the principles of liability that are usually used in other tort cases. A disposition to do so was articulated by Justice Scalia, some years later, in these terms:

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cases extended the prohibition of the Rule to information emanating from *outside* the company, such as news of an impending takeover bid. *See, e.g.*, United States v. Newman, 664 F.2d 12 (2d Cir. 1981); Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544 (E.D.N.Y. 1971), *cert. denied*, 464 U.S. 863 (1983). For these cases, a new term is more appropriate. The Insider Trading Sanctions Act of 1984, 98 Stat. 1264, and ITSFEA, 102 Stat. 4077, gave official sanction to the term "nonpublic information," which I have abbreviated in the term "NPI trading."

The liabilities under ITSFEA are specifically applicable to persons who communicate unpublished information to traders. Exchange Act §§ 20A(c) and 21A(a), 15 U.S.C.A. §§ 78t-1(c), 78u-1(a) (West Supp. 1992). Although this practice is often distinguished as "tipping," in the interest of brevity I use the term "trading" to include "tipping."

107. 17 C.F.R. § 240.10b-5 (1991).

108. 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

109. Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972).

110. Rule 10b-5 was promulgated pursuant to Exchange Act § 10(b), 15 U.S.C. § 78j (1988), which made violations "unlawful," but said nothing about private suits.

111. *See* David S. Ruder, *Civil Liability under Rule 10b-5: Judicial Revision of the Legislative Intent?*, 57 Nw. U. L. Rev. 627 (1963).

112. 421 U.S. 723, 731-36 (1975).

113. *See* Exchange Act § 20A(a), 15 U.S.C.A. § 78t-1(a) (granting express private action); § 20A(d), 15 U.S.C. § 78t-1(d) (confirming existing implied rights of action).

114. Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 111 S. Ct. 2773, 2783 (1991) (Scalia, J., concurring); Virginia Bankshares Inc. v. Sandberg, 111 S. Ct. 2749, 2767 (1991) (Scalia, J., concurring).

In contrast to Justice Scalia's view of the intent of Exchange Act § 10(b), see Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 Stan. L. Rev. 385 (1990) (arguing that Congress intended to give SEC plenary power over stock markets).

> I recognize that the Court's disallowance . . . of an action for misrepresentation of belief is entirely contrary to the modern law of torts, as authorities cited by the Court make plain. . . . I have no problem with departing from modern tort law in this regard, because I think the federal cause of action at issue here 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.[115]

Conservative judges in early 10b-5 cases could well have been startled not only by myriads of investors to which brokerage firms might become liable by reason of imperfect disclosures by their agents but also by the immensity of the possible liabilities.[116] The Texas Gulf Sulphur executives who first concealed a lucky strike and then issued a misleading statement about it might conceivably be liable to thousands of investors who sold shares in ignorance of the company's bright prospects.[117] Merrill Lynch, one of whose representatives tipped a favored client, could imaginably be liable to thousands of other investors.[118] Class suits could impose immense costs of defense on issuers, dealers, and ultimately investors, with small returns to individual fraud victims. The Exchange Act contained no statutory cap on damages like the one that Congress attached to the new private right of suit created by ITSFEA.[119]

If the private right of suit against NPI traders was dubiously legitimate in the eyes of these judges, the liability of *employers* of NPI traders may have seemed even more questionable. In many of the cases that confronted these judges, the NPI traders were operating for the benefit of themselves or their confederates in flagrant conflict with the interests of their employers. This was true of the geologist and the lawyer of Texas Gulf Sulphur, who entered the market while their employer was witholding information pending a planned press release.[120]

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115. *Virginia Bankshares*, 111 S. Ct. at 27 (Scalia, J., concurring).

116. *See* Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 170 (2d Cir. 1980) (noting danger of "Draconian, exorbitant damages").

117. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 881-86 (2d Cir. 1968) (Moore, J., dissenting), *cert. denied*, 394 U.S. 976 (1969).

118. *See* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974).

119. *See* Exchange Act § 20A(b)(1)-(2), 15 U.S.C. § 78t-1(b)(1)-(2), added by ITSFEA, 102 Stat. 4677. The text of these paragraphs is the following:

> (1) The total amount of damages imposed under subsection (a) of this section shall not exceed the profit gained or loss avoided in the transaction or transactions that are the subject of the violation.
>
> (2) The total amount of damages imposed against any person under subsection (a) of this section shall be diminished by the amounts, if any, that such person may be required to disgorge, pursuant to a court order obtained at the instance of the Commission, in a proceeding brought under section 21u(d) [15 U.S.C. 78u(d)] of this title relating to the same transaction or transactions.

120. *See Texas Gulf Sulphur*, 401 F.2d at 840, 853.

In an overgeneralization from a case of this type, one federal judge observed that "a corporate insider necessarily exceeds the scope of his employment when he trades on the basis of material, nonpublic information."[121]

Although enterprise liability in cases of this sort could be defeated by proving that the employee was on a "frolic," there would be no need to put the employer to the test if, as the judge asserted, a corporate insider "necessarily exceeds the scope of his employment."[122]

d. *The retreat from rebuttability*

The negative reactions of some judges toward suits for NPI trading were belied by subsequent events. The apprehension that the implication of a private right of suit betrayed congressional intentions was laid to rest by decades of congressional acquiescence, capped by Congress' express preservation in ITSFEA of previously recognized private rights of suit.[123] The imagined danger of "[D]raconian, exorbitant damages"[124] was contained by conservative damage rules that were developed in the circuits that applied enterprise liability.[125]

The supposition that NPI traders necessarily exceed the scope of their employment was undermined by a series of cases in which broker-dealers' registered representatives (reps[126]) passed tips from the employer's under-

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121. O'Connor & Assoc. v. Dean Witter Reynolds, Inc., 529 F. Supp. 1179, 1194 (S.D.N.Y. 1981). In this case, the plaintiff alleged that officers and employees of the defendant corporation traded on nonpublic information about the company, but did not allege with specificity that they traded within the scope of their employment.

122. *Id.* A similar perception may have underlain an observation of the SEC staff in regard to enterprise liability, which declared:

> During the Committee's hearings, several witnesses expressed concern that an employer or controlling person could be exposed to litigation and potential liability under a respondeat superior theory, where an errant employee or agent engaged in insider trading for his own account and the principal did not benefit from or induce the violation. While the Committee does not believe that a principal would be found liable in such circumstances, under existing law, it believes that the possibility of such liability should be clearly eliminated. *Even if the principal would ultimately not be liable, it should not be required to defend meritless lawsuits in such circumstances.* (Emphasis supplied).

Insider Trading: Hearings before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 100th Cong., 2d Sess. 79-80 (1988) [hereinafter *Insider Trading*].

123. *See* Exchange Act § 20A(d), 15 U.S.C.A. § 78t-1(d) (West Supp. 1992); *infra* text accompanying notes 203-06.

124. Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 170 (2d Cir. 1980).

125. *See* Hackbart v. Holmes, 675 F.2d 1114 (10th Cir. 1982); Ohio Drill & Tool Co. v. Johnson, 498 F.2d 186 (6th Cir. 1974); Zeller v. Bogue Elec. Mfg. Corp., 476 F.2d 795 (2d Cir.), *cert. denied*, 414 U.S. 908 (1973).

126. The employees who take investors' orders to buy or sell securities, popularly known as "brokers," are designated in the language of the Securities Acts as "registered representatives" of "broker-dealers," sometimes abbreviated in trade lingo as "reps."

writing or acquisitions departments to a favored client.[127] These cases showed that broker-dealers, if not restrained by law, could make a very profitable business of gathering nonpublic information from some of their clients and passing it on as tips to others clients, or using it in their own market operations. Press reports of practices in Drexel Burnham Lambert indicated that a major investment bank engaged persistently in NPI trading and tipping in aid of its underwriting business.[128]

The impropriety of penalizing employers for their employees' "frolics" was contained by excluding liability for acts that are outside the scope of employment or authority under traditional agency principles.[129] This principle would have resolved the Ninth Circuit case that initiated the rejection of enterprise liability and another that reinforced it without erecting a conflict between the common law and the Securities Acts.[130]

Eventually, the two circuits that had rejected enterprise liability recanted.[131] Their reversals were probably influenced by amicus curiae briefs filed by the SEC, which argued that enterprise liability corresponded to the will of Congress.

In 1981, the Third Circuit held that enterprise liability was applicable to an accounting firm whose employee issued a misleading opinion. The court observed that its earlier decision in *Rochez Brothers v. Rhoades*[132] had recognized exceptions under which it could impose liability without overruling the prior case.[133] In 1990, the Ninth Circuit flatly renounced its former view, and affirmed the applicability of enterprise liability to suits

127. *See* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1979); Walton v. Morgan Stanley & Co., 623 F.2d 796 (2d Cir. 1980); Fridrich v. Bradford, 542 F.2d 307 (6th Cir. 1976).

128. *See* JAMES B. STEWART, DEN OF THIEVES 175-206 (1991); James B. Stewart, *Scenes from a Scandal*, WALL ST. J., Oct. 2, 1991, at B1, B6. Top executives' approval of illegal securities activites of a different type were disclosed in other firms. *See* William Power, *Da Puzzo Debacle is Least Likely Yet in Raft of Scandals*, WALL ST. J., Sept. 9, 1991, at C1; Kevin G. Salwen & Paulette Thomas, *Breeden Says "Distressingly Large" Number of Wall Street Firms Submitted False Orders*, WALL ST. J., Sept. 12, 1991, at C1; Michael Siconolfi et al., *Top Salomon Officials Knew About Illegal Bid*, WALL ST. J., Aug. 15, 1991, at C1.

129. *See* Sweasey v. A. G. Edwards & Son, Inc., 738 F. Supp. 1278 (W.D. Mo. 1990); Harrison v. Dean Witter Reynolds, Inc., 715 F. Supp. 1425 (N.D. Ill. 1989); Moss v. Morgan Stanley Inc., 553 F. Supp. 1347, 1356-57 (S.D.N.Y.), *aff'd*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984); Holloway v. Howerdd, 377 F. Supp. 754 (M.D. Tenn. 1973), *aff'd*, 536 F.2d 690 (6th Cir. 1976).

130. In Kamen & Co. v. Paul H. Aschkar & Co., 382 F.2d 689 (9th Cir. 1967), the court found the employer not liable on a common law fraud count because the agent lacked apparent authority. In Zweig v. Hearst Corp., 521 F.2d 1129 (9th Cir.), *cert. denied*, 423 U.S. 1025 (1975), the employee was a newspaper columnist, whose trading or tipping was no part of the agent's actual or apparent duties to the employer.

131. Sharp v. Coopers & Lybrand, 649 F.2d 175 (3d Cir. 1981); Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir.), *cert. denied*, 111 S. Ct. 1621 (1991).

132. 527 F.2d 880 (3d Cir. 1975).

133. *Coopers & Lybrand*, 649 F.2d at 181. In footnote 5, the court explained that as a mere panel of the circuit bench it was not at liberty to overrule Rochez Bros. v. Rhoades, 527 F.2d 880 (3d Cir. 1975).

under the Securities Acts.[134] Ironically, these decisions brought federal courts into convergence on enterprise liability during the same decade in which Congress excluded it from suits under ITSFEA.

4. Effects on results of suits

Regardless of whether a court applied enterprise liability or rebuttable liability, the consequence was often the same. In courts that applied enterprise liability, some employers escaped on the ground that the employee was acting outside the scope of employment or authority. In one recurrent type of case, a corporation's employee learned of an impending tender offer and tipped a confederate who bought before the tender offer was announced. In this type of case, the employee acted outside of his employment and authority, both actual and apparent.[135] With this type of case in mind, one federal judge observed, rather extravagantly, that "a corporate insider necessarily exceeds the scope of his employment when he trades on the basis of material, nonpublic information."[136] Similarly, reps who passed tips to noncustomers were held to have acted outside the scope of their employment.[137]

Other brokers whose reps deceived the brokers' own clients escaped liability on showing that the rep was not acting on the broker's behalf, and the customer knew it, or should have known it.[138] In one case, some of the plaintiff customers who dealt with a fraudulent agent knew that the agent was a registered representative of the defendant broker, but others did not; those who knew recovered judgment, but those who did not know were defeated because no appearance of authority was apparent to them.[139]

There were other NPI trading cases in which an employee passed nonpublic information to a customer of the employer, thereby acting, or appearing to act, within the scope of authority. In this type of case, a court that adhered to enterprise liability imposed it on the employer without a second thought.[140] Some of the leading opinions that rejected enterprise liability could have reached the same result on the ground that the employee's conduct was outside the agent's actual or apparent authority.[141] One of

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134. *Hollinger*, 914 F.2d at 1577-78.

135. *See* O'Connor & Assoc. v. Dean Witter Reynolds, Inc., 529 F. Supp. 1179 (S.D.N.Y. 1981).

136. *Id.* at 1194.

137. Moss v. Morgan Stanley, Inc., 553 F. Supp. 1347, 1356-57 (S.D.N.Y), *aff'd*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1005 (1984). The Second Circuit Court of Appeals affirmed the decision without passing on the secondary liability argument because it found that the rep had violated no duty to the plaintiff.

138. *See* Sweasey v. A. G. Edwards & Son, Inc., 738 F. Supp. 1278 (W.D. Mo. 1990); Harrison v. Dean Witter Reynolds, Inc., 715 F. Supp. 1425 (N.D. Ill. 1989).

139. Holloway v. Howerdd, 536 F.2d 690 (6th Cir. 1976).

140. *See* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974).

141. *See* Christoffel v. E. F. Hutton & Co., 588 F.2d 665, 668 (9th Cir. 1978) (involving broker's rep as simultaneously guardian of estate and committing frauds in his capacity as guardian).

these was the opinion that originated the rejection of enterprise liability.[142]

Although rebuttable liability is more lenient than enterprise liability, many of the employers who would incur liability under the latter may incur it also under the former. Brokers were held liable in a pair of cases in circuits that adhered to rebuttability; the opinions do not disclose what, if any, evidence of good faith and nonparticipation the brokers presented.[143] Decisions holding that the proof of innocence was sufficient are more numerous.[144] Almost any attention to the behavior of agents seemed to satisfy judicial scrutiny, including "spot checks" of which the method and frequency were unspecified.[145]

During the years when the circuits differed on enterprise liability, brokers' risks of liability for the fraudulent acts of their reps was substantially greater if they were sued in the First, Second, Sixth, Seventh, and Eighth Circuits, which adhered to enterprise liability, than if they were sued in the Third or Ninth Circuits, which adhered to rebuttability, or in the Fourth, where decisions were inconsistent. But most large brokerage firms could be sued in the Second Circuit because they had offices in New York; sophisticated plaintiffs' counsel could be expected to sue in that circuit. As a result, most broker-client relations were probably subject in practice to enterprise liability even before the Third and Ninth Circuits joined the majority.

III. Enterprise Liability after ITSFEA

While enterprise liability was establishing its supremacy under the Securities Acts of 1933 and 1934, it was routed from the new territory staked out by ITSFEA. This Act, adopted in 1988, authorized an explicit private right of suit[146] and an expansion of administrative remedies[147] for illegal use of unpublished information. The predicate conduct involved not only using unpublished information for buying and selling, but also communicating it

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142. *See supra* note 90.

143. Straub v. Vaisman & Co., 540 F.2d 591 (3d Cir. 1976); Hecht v. Harris, Upham & Co., 430 F.2d 1202 (9th Cir. 1970). The suits in both cases were based on churning the customer's account. In the *Hecht* case, the primary question was whether churning was actionable under the Securities Acts. In the *Straub* case, the court observed that the defendant broker defended chiefly on the ground of lack of reliance by the customer. *Straub*, 540 F.2d at 598. *See also* Marbury Management, Inc. v. Kohn, 629 F.2d 705, 716 (2d Cir.), *cert. denied*, 499 U.S. 1011 (1980) (holding broker-dealer liable both under presumptive liability and enterprise liability tests).

144. *See* Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1621 (1991); Carpenter v. Harris, Upham & Co., 594 F.2d 388 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979); *Christoffel*, 588 F.2d at 665; Haynes v. Anderson & Strudwick, Inc., 508 F. Supp. 1303 (E.D. Va. 1981); Barthe v. Rizzo, 384 F. Supp. 1063 (S.D.N.Y. 1974).

145. *Barthe*, 384 F. Supp. at 1063.

146. Exchange Act § 20A(a), 15 U.S.C.A. § 78t-1(a) (West Supp. 1992).

147. Exchange Act § 21A, 15 U.S.C.A. § 78u-1, added by ITSFEA, 102 Stat. 4677.

to others who might so use it, known as "tipping."[148] For brevity, I embrace both activities within "NPI trading."[149]

With respect to both private and administrative remedies, Congress excluded liability imposed "solely by reason of employing another person."[150] For private suits, ITSFEA preserved the prima facie but rebuttable liability of controllers,[151] but for suits by the SEC excluded even the prima facie liability.[152] ITSFEA disclaimed any intention to change the law with respect to remedies other than those newly authorized.[153]

The declared purposes of ITSFEA were to provide "additional methods . . . to deter and prosecute" insider trading[154] and to "augment enforcement."[155] The evil was seen as widespread among brokerage firms, which needed to take more rigorous measures to root out violations. The House Report declared,

> The wave of insider trading cases in recent years has demonstrated the potential for abuse in even the largest and most prestigious of Wall Street securities firms. In the view of the Committee, the scandal represents far more than the transgressions of a few indi-

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148. Exchange Act §§ 20A(c), 21A(a), 15 U.S.C.A. §§ 78t-1(c), 78u-1(a).

149. Tipping was included within "trading" by implication in the hearings on *Insider Trading*, *supra* note 122.

150. Exchange Act §§ 20A(b)(3), 21A(b)(2), 15 U.S.C.A. §§ 78t-1(b)(3), 78u-1(b)(2), as amended by ITSFEA, 102 Stat. 4677.

151. Exchange Act § 20A(b)(3), 15 U.S.C.A. § 78t-1(b)(3). The paragraph declared:

> No person shall be liable under this section solely by reason of employing another person who is liable under this section, but the liability of a controlling person under this section shall be subject to section 20(a) [15 U.S.C.A. § 78t-1(a)] of this title.

152. Exchange Act § 21A(b), 15 U.S.C.A. § 78u-1(b). The relevant provisions were:

> (1) *Liability of controlling persons*—No controlling person shall be subject to a penalty under subsection (a)(1)(B) of this section unless the Commission establishes that—
>
> (A) such controlling person knew or recklessly disregarded the fact that such controlled person was likely to engage in the act or acts constituting the violation and failed to take appropriate steps to prevent such act or acts before they occurred; or
>
> (B) such controlling person knowingly or recklessly failed to establish, maintain, or enforce any policy or procedure required under section 15(f) of this title [15 U.S.C.A. § 77oo(f)] or section 204A of the Investment Advisers Act of 1940 [15 U.S.C.A. § 80f-4a] and such failure substantially contributed to or permitted the occurrence of the act or acts constituting the violation.
>
> (2) *Additional restrictions on liability*—No person shall be subject to a penalty under subsection (a) of this section solely by reason of employing another person who is subject to a penalty under such subsection, unless such employing person is liable as a controlling person under paragraph (1) of this subsection. Section 20(a) of this title [15 U.S.C.A. § 78t(a)] shall not apply to actions under subsection (a) of this section.

153. Exchange Act §§ 20A(d)-(e), 21A(d)(3), 15 U.S.C. §§ 78t-1(d)-(e), 78u-1(d)(3) (1988).

154. ITSFEA § 2(3), 102 Stat. at 4677.

155. H.R. REP. No. 910, 100th Cong., 2d Sess. 7, *reprinted in* 1988 U.S.C.C.A.N. 6043, 6044.

> viduals. There is a clear need for an institutional, rather than merely individual, response to this problem. In the view of the Committee, *firms whose lifeblood is the continued public trust in our securities markets must do more to share in the responsibility for policing those markets* and should be subject to considerable penalties for a shirking of that responsibility.[156]

Senator John Heinz, explaining ITSFEA on the Senate floor, emphasized the role of the private suit as a reinforcement of administrative sanctions. He declared: "The SEC cannot fight this war alone. Consequently, Congress must give honest market participants a clear right to judicial action to take back illegal profits from insider traders."[157]

The provisions of ITSFEA with respect to private suits, however, ran counter to the expressed purposes. The amount of liability was capped,[158] and the firms that "must do more to share in the responsibility" were relieved of liability if they "acted in good faith" and "did not induce" the guilty act.[159]

The discordance between the legislators' professed purposes and what they did is highlighted by the House Report's declaration that ITSFEA was "specifically intended to overturn court cases which have precluded recovery for plaintiffs where the defendant's violation is premised upon the misappropriation theory."[160] The House Report cited *Moss v. Morgan Stanley* as an example.[161] *Moss* was a case in which an investor sued Morgan Stanley because a Morgan Stanley employee had tipped a confederate; recovery was denied because neither the employee nor the employer owed any duty to the plaintiff.[162] ITSFEA may have enhanced an investor's chances of winning a judgment against a broker-dealer's impecunious employee, but made it *less* likely that a judgment would have to be paid by an employer like Morgan Stanley.[163] Without enterprise liability, private suitors had little to gain from the new right of suit, even with an extended time limitation.[164]

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156. *Id.* at 14-15 (emphasis added).

157. 134 CONG. REC. S17,219 (daily ed. Oct. 21, 1988) (statement by Sen. Heinz).

158. *See* Exchange Act § 20A(b)(1)-(2), 15 U.S.C.A. § 78t-1(b)(1)-(2) (West Supp. 1992).

159. *See* Exchange Act § 20(a), 15 U.S.C. § 78t(2) (1988), incorporated by reference in Exchange Act § 20A(b)(3), 15 U.S.C.A. § 78t-1(b)(3).

160. H.R. REP. No. 910 at 26.

161. 553 F. Supp. 1347 (S.D.N.Y.), *aff'd*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984).

162. Moss v. Morgan Stanley, Inc., 553 F. Supp. 1347 (S.D.N.Y), *aff'd*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984). The employee, Courtois, had tipped Antoniu, who tipped Newman, who traded at a profit. *Id.* at 1352.

163. On the particular facts of *Moss*, Morgan Stanley would not have been liable even if the court had recognized a private right of action, because the employee's use of nonpublic information was outside of the actual and apparent scope of the employment in tipping a confederate who was not a customer of the employer. *See Moss*, 553 F. Supp. at 1356-57. But an employer would be liable in a case like Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1979), where the employee tipped a favored client of the employer.

164. *See* Exchange Act § 20A(b)(4), 15 U.S.C. § 78t-1(b)(4).

A. *The Express Private Right of Suit*

1. *Elements of the express right*

The new right of suit embraced a very minor fraction of NPI trading situations. Prior case law had recognized the right of investors to sue NPI traders who dealt directly or indirectly with the unenlightened investors.[165] Prior cases had also recognized the right of an investor to sue a trader with whom the investor had no prior dealings if the investor bought or sold on the open market while the defendant was trading on information emanating from the issuer.[166]

The new cause of action related to the special situation in which an investor sued an NPI trader with whom the investor had no existing relationship, and the trader used information emanating from *outside* the securities issuer, such as news of an impending takeover bid. In this kind of case, a decision which the Supreme Court declined to review had held that the investor had no private right to sue because neither the NPI trader nor the trader's informant had any duty to the investor. ITSFEA gave the investor a right to sue if the investor's purchase or sale was contemporaneous with the NPI trader's and complementary to it. That is, the suitor must have sold when the NPI trader bought, or bought when the NPI trader sold.[167]

ITSFEA also gave private suitors five years within which to sue,[168] which was more than they were likely to enjoy in other securities fraud suits. A few months before ITSFEA was enacted, the Third Circuit had ruled that suits under Rule 10b-5 must be brought within one year from discovery and three years from the event.[169] This limitation was destined to be adopted in 1992 by the Supreme Court.[170] Before that court ruled, most circuits had borrowed state limitations, which provided a bewildering variety of periods, some of which were longer than the one-and-three-year limits.[171]

While ITSFEA purported to enhance the rights of private suitors, it imposed new limits on damages and on the conditions of liability. With respect to damages, ITSFEA limited them to the gain made or the loss avoided by the NPI trader, from which the defendant could deduct any

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165. *See* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972).

166. *See Shapiro*, 495 F.2d at 228.

167. Exchange Act § 20A(a), 15 U.S.C. § 78t-1(a) (1988).

168. Exchange Act § 20A(b)(3), 15 U.S.C.A. § 78t-1(b)(3) (West Supp. 1992).

169. *In re* Data Access Sys. Sec., 843 F.2d 1537 (3d Cir.), *cert. denied*, 488 U.S. 849 (1988). The one-and-three-year periods were adopted by analogy to the express limitations in Securities Act § 13, 15 U.S.C. § 77m, and in Exchange Act §§ 9(e), 18(c), 15 U.S.C. §§ 78i(e), 77r(c).

170. Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 111 S. Ct. 2773 (1991).

171. *See* Robert B. Martin, Jr., *Statutes of Limitation in 10b-5 Actions: Which State Statute is Applicable?* 29 Bus. Law. 443 (1974). Beside the variety of time limits, there were differences in the degrees to which the limits were extended by concealment or nondiscovery of the offense.

amount payable pursuant to an SEC enforcement proceeding.[172] Even this amount was likely to be hard to collect from a mere employee.

2. *The exclusion of enterprise liability*

The clearest statement of the exclusion of enterprise liability appeared not in ITSFEA itself,[173] but in the House Report that accompanied the bill that became ITSFEA. The House report announced: "[T]he bill rules out the use of respondeat superior theory in private actions for insider trading by contemporaneous traders."[174]

The House Report offered no explanation of how the use of respondeat superior would impede ITSFEA's objectives of deterring insider trading and facilitating private suits, and no notice of the fact that excluding respondeat superior would be a radical departure from the case law of most Circuit Courts of Appeal[175] and from the common law of fraud and other torts.[176]

There was no Senate Report on the bill. Three of the four Senators who spoke on the Senate floor in support of the bill mentioned the grant of a private right of suit, but none of them revealed that this private right would be more limited than the rights of suit that had been previously

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172. Exchange Act § 20A(b)(1)-(2). *See* Barbara Bader Aldave, *The Insider Trading and Securities Fraud Enforcement Act of 1988: An Analysis and Appraisal*, 52 ALB. L. REV. 893, 919 (1988).

173. Section 20A(b)(3) declares that "No person shall be liable under this section *solely* by reason of employing another person . . ." Because of the word "solely," the clause is ambiguous. *See infra* text accompanying notes 195-201.

174. H.R. REP. No. 910 at 27. This interpretation was echoed by commentators on ITSFEA. *See* Aldave, *supra* note 172, at 914 n.16; Howard M. Friedman, *The Insider Trading and Securities Fraud Enforcement Act of 1988*, 68 N.C. L. REV. 465, 486 n.159; Stuart J. Kaswell, *An Insider's View of the Insider Trading and Securities Fraud Enforcement Act of 1988*, 45 BUS. LAW. 145, 167 (1989); Gary G. Lynch & James D. Herbert, *Enforcement and Compliance Under the Insider Trading and Securities Fraud Enforcement Act of 1988*, in ADVANCED SECURITIES LAW WORKSHOP 535, 546 (PLI) (1990); Bruce A. Teeters, Note, *Insider Trading and Securities Fraud Enforcement Act of 1988: Just How Much Are Employers Going to Pay?*, 59 U. CIN. L. REV. 587, 598 (1990).

For a critical comment on reliance on committee reports to establish meanings that do not appear in statutory texts, see Note, *Why Learned Hand Would Never Consult Legislative History Today*, 105 HARV. L. REV. 1005 (1992).

175. In 1988, the Ninth Circuit had not yet repudiated rebuttable liability. *See supra* text accompanying notes 90-99.

176. Equally silent is Kaswell, *supra* note 174. Kaswell was Minority Counsel of the Senate Committee involved in the drafting of ITSFEA. Aldave, *supra* note 172, and Friedman, *supra* note 174, mention the exclusion of respondeat superior only in footnotes. This feature of the Act was not even mentioned in two summaries of the new private right of suit in the Federal Securities Regulation and Law Report. 20 SEC. REG. & L. REP. 1393, 1623 (1988). *See also* Michael J. Chimel, Note, *The Insider Trading and Securities Fraud Enforcement Act of 1988: Codifying a Private Right of Action*, 1990 U. ILL. L. REV. 645 (1990) (passing over exclusion of respondeat superior); William K.S. Wang, *ITSFEA's Effect on Either an Implied Cause of Action For Damages by Contemporaneous Traders or an Action For Damages or Rescission by the Party in Privity with the Insider Trader*, 16 J. CORP. L. 445 (1991) (same).

recognized.[177] Their remarks indicated that the new private right of suit was simply an extension of existing rights to additional situations. Senator Jake Garn explained it this way:

> This legislation contains an express provision for private actions by all contemporaneous traders. It thus affirms those cases granting such actions in traditional insider cases, and rejects the holdings of others that imposed limitations on the class of plaintiffs or on other aspects of the remedy.[178]

In hearings on bills that led up to ITSFEA, sponsors of the bills indicated that the liability of employers would continue to be governed by the same principles as before, which comprised enterprise liability. In an early hearing, a Congressman raised the question of whether the liability of employers should be *increased*, and the Commission made the following written reply: "No, the Commission has not concluded that any change in the liability of broker-dealer firms for unlawful trading violations committed by their employees is necessary at this time."[179] Ensuing paragraphs indicated that the answer was directed primarily to liability in enforcement actions maintained by the the Commission, but concluded with an express reference to liablility in private suits.

Harvey L. Pitt and John F. Olson, explaining an earlier version of the "by reason of employment" clause, declared:

> Proposed subsection (d) of the Insider Trading Proscriptions Act would create a closely circumscribed "safe harbor" for persons who employ or control individuals who violate the prohibitions of the Act, by dictating that employers and controlling persons shall not be derivately liable for such violations of employees or controlled persons based *solely* upon their employment or control of the individual who has committed the violation.
>
> . . . Essentially, the new provision would protect employers from liability in the cases *when the employee is off on a frolic of his own* which is neither condoned by, nor of economic benefit to, the employer.[180]

The phrase "frolic of his own" obviously refers to the conception of scope of employment, which is a component of enterprise liability.[181] It

177. *See* 134 CONG. REC. S17,218 (daily ed. Oct. 21, 1988) (statement of Sen. Proxmire); 134 CONG. REC. S17,219 (daily ed. Oct. 21, 1988) (statement of Sen. Heinz); 134 CONG. REC. S17,219-20 (daily ed. Oct. 21, 1988) (statement of Sen. Garn).

178. *Id.* at S17,220.

179. *Securities Regulation Issues: Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 100th Cong., 1st Sess. 187, 190 (1987) [hereinafter *Securities Regulation*].

180. *Definition of Insider Trading: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 100th Cong., 1st Sess. 33 (1987) [hereinafter *Definition of Insider Trading*] (emphasis added).

181. *See* Smith, *supra* note 25.

would be irrelevant to a liability that is rebuttable by good faith and noninducement.

Charles Cox, Acting Chairman of the SEC, was asked, "What would be the liability of a brokerage firm . . . for the insider trading of one of its employees . . .?" He replied:

> It is essentially the same as current law. If we are talking about a multiservice firm where the person doing the trading did not know the information and the firm had reasonable and appropriate procedures to prevent a violation of law, there would be a defense. The same defense exists under current law. However, if you're talking about the situation where someone is off trading on his own, then that is the same as the current law, also, liability depends on the existing securities laws, controlling person provisions and *common law doctrines of respondeat superior.*[182]

The only passage in the legislative history that pointed to an exclusion of enterprise liability accompanied a bill submitted by the Commission which barred liability "solely by reason of employment" when the employer received no profit from the transaction. This passage appeared in a document entitled Proposed Language for Inclusion in Committee Report on Insider Trading. It declared:

> During the Committee's hearings, several witnesses expressed concern that an employer or controlling person could be exposed to litigation and potential liability under a respondeat superior theory, where an errant employee or agent engaged in insider trading for his own account and the principal did not benefit from or induce the violation [citing testimony in hearings]. While the Committee does not believe that a principal would be found liable in such circumstances under existing law [citing a federal court decision], it believes that the possibility of such liability should be clearly eliminated. Even if the principal would ultimately not be liable, it should not be required to defend meritless lawsuits in such circumstances.[183]

The Commission's willingness to accept an interpretation that made the presumptive liability principle exclusive may be explained partly by the fact that the grounds for rebutting presumptive liability under the SEC's bill were narrower than under the eventual section 20(a). The SEC's proposed clause was the following:

> Except as provided in Section 20(a) of this title, no person shall be liable under this section solely by reason of the fact that such person

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182. *Definition of Insider Trading, supra* note 180, at 15 (emphasis added). The provision in the bill on which Cox testified differed only slightly from the provision in the eventual ITSFEA. See § 16A(d) as proposed in S. 1680, *Definition of Insider Trading, supra,* at 50.

183. "Proposed Language for Inclusion in Committee Report on Insider Trading Definition," *in Insider Trading, supra* note 122, at 79-80.

> controls or employs a person who has violated this section, if such controlling person or employer *did not participate in, profit from,* or directly or indirectly induce the acts constituting the violation of this section.[184]

The effects of this provision would not have been very different from those of enterprise liability, since "participate" and "profit" would include most of the same cases covered by "scope of employment." In a case where a broker-dealer's rep tipped a favored client who then traded with the broker-dealer, the broker-dealer would be liable on grounds of both participation and profit.

But the final ITSFEA did not incorporate "participate" or "profit," and the House Committee did not incorporate in its report the Commission's suggested explanation of the "by reason of employing" clause. ITSFEA was left with neither a reason nor an explanation for excluding enterprise liability.

The idea of excluding enterprise liability from ITSFEA probably originated in the provisions on enforcement actions, in which the SEC could demand penalties up to three times the profit made or loss avoided by the NPI trader. These provisions were the subject of the amendment of Exchange Act section 21A, which legislators and commentators alike regarded as the principal focus of ITSFEA.[185]

Section 21A included the same language as 20A on liability "solely by reason of employing," but did not rely on this phrase to eliminate enterprise liability. It provided expressly that no one should be liable by virtue of controlling another unless the Commission could prove that the controller knowingly or recklessly neglected to take appropriate measures to prevent NPI trading by controlees.[186] The measures included "any policy or procedure required under section 15(f)" of the Exchange Act, which authorized the Commission to specify policies and procedures.[187]

In excluding the use of enterprise liability in enforcement actions prosecuted by the SEC, the ITSFEA conformed to the prevailing tendency of federal court decisions.[188] At the same time, it gave new definition to the duty of care owed by employers and other controllers.

The main support in the legislative history for excluding enterprise liability was the testimony of various witnesses for the Securities Industry

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184. Section 16A(e) of SEC bill, *Insider Trading, supra* note 122, at 57 (emphasis added); *Insider Trading Proscriptions Act of 1987: Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs,* 100th Cong., 1st Sess. 29 (1987) [hereinafter *Proscriptions Act*].

185. *See* Kaswell, *supra* note 174; Friedman, *supra* note 184; Lynch & Herbert, *supra* note 174; Pitt & Groskaufmanis, *supra* note 30, at 1590-93.

186. Exchange Act § 21A(b), 15 U.S.C.A. § 788u-1(b) (West Supp. 1992).

187. Exchange Act § 15(f), 15 U.S.C.A. § 78*o*(f).

188. *See supra* text accompanying notes 84-87.

Association.[189] To impose liability on employers would impede the flow of information to agents and clients, they said,[190] apparently on the supposition that firms would hesitate to disseminate information that might be regarded as nonpublic. One statement stressed the impossibility of "delving into the mind of an employee," insider trading being "a crime of the mind."[191] These remarks were apparently directed primarily at SEC suits, in which treble damages could be assessed.

While opposing enterprise liability, one industry representative professed "zeal for eliminating insider trading as well as for providing severe penalties for those who engage in such trading."[192] A brokerage officer averred that "the broker-dealer firms all need to be more rigorous in monitoring the Chinese Walls to assure they are not being breached."[193] But the increased sanctions were to be applied to the employ*ees*, not to the employ*ers*.

The rejection of enterprise liability was supported also by Rudoph W. Giuliani, U.S. Attorney for the Southern District of New York, who declared without further explanation: "There should be a defense available for the firm that it has in essence *done everything it reasonably could do to avoid the problem*, yet it has been victimized by an employee.[194] This was clearly a reference to the provisions of section 21A(b)(1) on enforcement proceedings, which called for broker-dealers to establish, maintain and enforce procedures required by SEC rules. It furnished no support for exoneration on the basis of mere good faith and noninducement.

The exclusion of enterprise liability appears to have spilled out of the provisions for SEC enforcement proceedings into provisions for private damage suits without any consideration of differences between these kinds of actions and without any definition of supervisory obligations like those that accompanied the exclusion from enforcement proceedings.

3. *Is enterprise liability really excluded?*

Notwithstanding the House Report's announcement that ITSFEA excludes respondeat superior, the language of ITSFEA does not reveal the exclusion to a careful reader. If any basis for the supposed exclusion can be found in the words of the statute, it is in the sentence that declares: "No person shall be liable under this section *solely* by reason of employing

189. *See Insider Trading, supra* note 122, at 108-14 (statement of the Securities Industry Association); *Proscriptions Act, supra* note 184, at 45 (testimony of Edward O'Brien, President of the Securities Industry Association).

190. *Insider Trading, supra* note 122, at 113-14, 146.

191. *Id.* at 112.

192. *Id.* at 105 (testimony of John W. Bachmann, Chairman of Securities Industry Association).

193. *Oversight of the Securities and Exchange Commission and the Securities Industry: Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 100th Cong., 1st Sess. 15, 17 (1987) [hereinafter *Oversight*] (statement of Donald B. Marron, Chairman of Paine Webber Group, Inc.).

194. *Insider Trading, supra* note 122, at 88 (emphasis added).

another person who is liable under this section, but the liability of a controlling person under this section shall be subject to section 20(a) of this title."[195]

An analytic examination shows that this exclusion effected no departure from the prior law of enterprise liability. Enterprise liability was never imposed "*solely* by reason of employing," but by reason of employing *plus* the employee's acting within the scope of employment or authority. This was not only the common law,[196] but also the rule applied in the federal circuits that used enterprise liability in NPI trading cases.[197] Scope of employment is not a matter of defense,[198] but something the third party must prove.[199] In order to find in these words an exclusion of enterprise liability, one must transpose "solely" from the first to the second clause, making the sentence read: "No person shall be liable under this section [. . .] by reason of employing another person who is liable under this section, but the liability of a controlling person under this section shall be subject [*solely*] to section 20(a) of this title."

A reading that is more literal, more consistent with legislative history, and more compatible with prior securities law would view the two clauses of the sentence as dealing with two different subjects. The first clause addresses the liability of employers; the second clause addresses the liability of controllers in general, including the officers, directors, major shareholders and financiers of corporations, who are not affected by the provision on "employing another."

This reading responds to two separate questions that had emerged from NPI trading cases in the 1980s. One question was whether an investment banker like Morgan Stanley was liable for the acts of an employee who leaked information to a confederate trader for purposes of his own.[200] By the first clause of the sentence, Congress assured that employers would continue to escape liability for the acts of employees on "frolics of their own." The clause assured this result by providing that the investment banker should not be liable "*solely* by reason of employing . . ."

A second question involved the extent to which major shareholders, officers, directors, and other controllers of corporations should be held

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195. Exchange Act § 20A(b)(3), 15 U.S.C. § 78t-1(b)(3) (1988) (emphasis added).

196. RESTATEMENT (SECOND) OF AGENCY §§ 228, 265 (1958).

197. *See supra* text accompanying notes 135-39.

198. *See* W. EDWARD SELL, AGENCY 88-91, 105 (1975) (discussing scope of employment as element of liability and not under matters of defense). In the Restatement, scope of employment or authority are integral parts of the liability principle. *See* RESTATEMENT (SECOND) OF AGENCY §§ 219, 257 (1958).

199. *See* Energy Factors, Inc. v. Nuevo Energy Co., FED. SEC. L. REP. (CCH) ¶96,446, 91,946 (dismissing suit against employer for lack of specific allegation that offending employee was not "on a frolic"). For routine assertions of the principle that a plaintiff must prove that employee's tort was within scope of employment in order to sustain a claim against the employer, see Gumm v. National Homes Acceptance Corp., 339 F.2d 993 (7th Cir. 1965); 57 C.J.S. *Master & Servant* § 615 (1948 & Supp. 1991).

200. *See* Moss v. Morgan Stanley Inc., 553 F. Supp. 1347 (S.D.N.Y.), *aff'd*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984).

liable for the NPI trading of corporation employees.[201] The second clause of the quoted sentence assured that these "controlling persons" would continue to be governed by the rebuttable liability of section 20(a) and would not be confused with "employers," who are liable regardless of their own good faith and lack of inducement.

Analyzed in this way the ITSFEA carried forward to the new private right of suit the same principles of derivative liability that a majority of federal courts had applied to NPI trading in preceding years. The House Report's assertion that respondeat superior had been excluded would be regarded either as a careless carryover of a statement that had accompanied the abandoned SEC bill, or a bald attempt at legislation by Committee Report. The House Report's assertion is likely, however, to prevail in the courts, which often find the explanations in committee reports more illuminating than the Delphic utterances of statutes.

B. *Surviving Implied Rights of Suit*

Most varieties of suits against NPI traders may escape the enterprise liability exclusion because they can be prosecuted without invoking ITSFEA. Suitors who can frame a complaint without invoking ITSFEA will normally prefer to do so since they may thereby escape the arguable exclusion of enterprise liability and the subordination of their damages to prior claims of the SEC.[202] For them, the question will be whether the exclusion of enterprise liability affects suits that fall within the terms of ITSFEA, but are equally authorized by earlier case law.

This question will be relevant to virtually all kinds of "insider trading" cases, since they all involve the use of nonpublic information contemporaneously with some transaction of the complainant.

1. *Negative implications?*

Congress rejected as emphatically as it could any implication that the grant of an express right of suit for NPI trading implied the exclusion of preexisting implied rights. ITSFEA declared: "Nothing in this section shall be construed to limit or condition the right of any person to bring an action to enforce a requirement of this title or the availability of any cause of action implied from a provision of this title."[203]

This clause was no routine disclaimer, but a deliberate rejection of an express exclusivity clause that had appeared in one of the bills that led up

201. *See* Durham v. Kelly, 810 F.2d 1500 (9th Cir. 1987).

202. *See* Wang, *supra* note 176; T. Rowe Price New Horizons Fund, Inc. v. Preletz, 749 F. Supp. 705 (D. Md. 1990). In *Horizons*, an investor sought in vain to recover on the basis of contemporaneous trading without the limitations imposed on private suits by Exchange Act § 20A, 15 U.S.C.A. § 78t-1 (West Supp. 1992).

203. Exchange Act § 20A(d), 15 U.S.C. § 78t-1(d). "This title" refers to the Exchange Act. To the same effect, see H.R. REP. No. 910 at 27.

to ITSFEA.[204] On its face, that clause appeared to exclude only other *definitions* of insider trading, but some language of the SEC chairman suggested that it was also intended to exclude rights of action for insider trading other than those expressed in ITSFEA.[205] Chairman Ruder's letter accompanying the proposal contained this paragraph:

> *The scope of the bill's exclusivity*—The compromise bill contains a legislative finding on exclusivity. The legislative history should clarify two important points. First, the statute is only exclusive with respect to the federal securities laws; actions brought under state law, or the federal mail and wire fraud or other statutes, are unaffected.[206]

In rejecting Chairman Ruder's proposal, Congress emphasized its decision to preserve the rights of suit that had been recognized before ITSFEA was adopted.

2. *Compatibility with the whole Securities Acts*

Although legislators did not intend by enacting ITSFEA to restrict preexisting rights of suit, they could not help changing the statutory matrix within which the presumptive liability clauses must be applied to rights that predated ITSFEA. For judges who rejected enterprise liability before 1988, the apparent decision of Congress to exclude it from ITSFEA will presumably confirm their preexisting view that rejection fits the comprehensive rationality of the Securities Acts.

For judges who were previously favorable to enterprise liability, the solution is less obvious. If they accept the view that ITSFEA excludes enterprise liability from suits brought under it, they may infer that the same policy would further the objectives of other provisions of the Securities Acts. On the other hand, these judges may find in ITSFEA additional reasons for retaining enterprise liability in other contexts. ITSFEA itself contained a finding that "additional methods are appropriate to deter and prosecute violations" of insider trading rules.[207] The House Report empha-

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204. Proposed § 16A(a)(5) of Exchange Act, in SEC's Proposed Insider Trading Bill, Nov. 18, 1987; *Proscriptions Act*, *supra* note 184, at 28-29; *Insider Trading*, *supra* note 122, at 55. The text of the paragraph was:

> It is appropriate to, and this section does, establish *exclusive* statutory prohibitions that clarify the conduct that constitutes the wrongful trading of securities while in possession of material, nonpublic information, and the wrongful communication of such information, under the federal securities laws, thereby reducing uncertainties in the state of the law without otherwise affecting existing statutory prohibitions against manipulative, deceptive or fraudulent conduct. (Emphasis supplied).

Id.

205. *Proscriptions Act*, *supra* note 184, at 26-27 (letter of David S. Ruder, Chairman of SEC to Senators Donald Riegle and Alfonse D'Amato); *Insider Trading*, *supra* note 122, at 52-53.

206. *Insider Trading*, *supra* note 122, at 52-53; *Proscriptions Act*, *supra* note 184, at 27.

207. ITSFEA § 2(3), 102 Stat. at 4677.

sized the need for brokerage firms to "do more to share in the responsibility for policing these markets."[208] Besides, Congress emphasized in the clearest terms its intention to preserve all the private remedies for insider trading that existed before ITSFEA was adopted.[209]

In view of these factors, judges may concede that even if ITSFEA excludes enterprise liabilility from suits brought under it, the exclusion is one of those anomalies that are insinuated into legislative drafts and committee reports without reflecting any consensus on policy. This appraisal would be supported by the absence of any disclosure in the House Report of a major shift of legal principle and the lack of any explanation for such a shift. So viewed, the exclusion does not call for any effort to interpret other provisions of the Securities Acts to make them compatible with the anomaly.

At the least, ITSFEA will provide lawyers with grounds for renewing the debate about enterprise liability under other sections of the Securities Acts.

IV. The Consequences of Rebuttable Liability

The choice of rebuttable liability instead of enterprise liability is likely to have consequences that are economically and socially significant, even if difficult to observe and measure. I will consider first the consequences of the particular form of rebuttable liability that was chosen by Congress or, more realistically, chosen by the staffers who wrote the House Report. I will then speculate briefly on the consequences of a form of rebuttable liability that might better serve the purposes of Congress.

Although the literature of tort law is rich with favorable evaluations of enterprise liability,[210] the evaluators do not answer directly some of the questions suggested by ITSFEA'S remarkable proscription. Most of the evaluators have addressed a choice between enterprise liability and *personal* liablility. Between these two poles, there is no room for argument in the modern world.

ITSFEA presents a subtler choice between enterprise liability and a prima facie liability that is rebuttable by proving the absence of specified elements of fault. Under ITSFEA, these elements are good faith and noninducement. Other varieties of rebuttable liability also merit consideration. Liability might be rebutted by proof of freedom from reckless disregard of precautions, as suggested by the enforcement action section of ITSFEA, or by proof of diligence in supervision of employees, as suggested by the laws of Germany and Puerto Rico.

ITSFEA also invites the question whether NPI trading in particular, and securities frauds in general, are less suitable subjects than other torts for the invocation of enterprise liability.

208. H.R. Rep. No. 910 at 14-15.
209. *See supra* text accompanying notes 203-04.
210. *See supra* notes 25-30.

A. Deterrence

ITSFEA's exclusion of enterprise liability surrenders the most powerful weapon for the deterrence of NPI trading, which is the motivation of employers to prevent their employees from committing it. Employers are far more able than are their customers, unrelated investors, or the SEC to discover what their employees are doing. The deterrent power of laws against NPI trading depends primarily on how these laws motivate employers to police the activities of their employees.

Under ITSFEA's rule of rebuttable liability, as under enterprise liability, an employer may be expected to announce a passel of rules about trading and tipping and to lecture employees about them. The rules will include "Chinese walls" dividing underwriting and merger-acquisition departments from trading departments. A securities industry executive at a congressional hearing described in detail practices of these kinds that were already employed by major financial service firms.[211]

However, a profit-maximizing employer would be primarily concerned not with eliminating NPI trading, but with eliminating *liability* for such trading. Some NPI trading and tipping, done on behalf of the employer or the employer's clients, would, in the absence of liability, enhance the employer's profits. Consequently, the employer's behavior, so far as it responds to the threat of liability, would be directed against being sued or prosecuted rather than against NPI trading itself.

Under enterprise liability, a profit-maximizing employer would want to prevent employees from engaging in any detectable NPI trading. Under the rebuttable liability rule, the employer would want, rather, to save itself from being detected in any *tolerance or inducement* of NPI trading, but would have no interest in preventing NPI trading that would benefit the employer or its customers if the employer could not be shown to have tolerated or induced it. As the Maryland District Court observed in *Johns Hopkins University v. Hutton*[212], rebuttable liability would "give blessing to a hear-no-evil, see-no-evil approach by partners of a brokerage house."[213]

Under either rule, an employer would have to decide what level of expenditure is worthwhile in view of the risk of liability. Because the risk of liability would be greater under enterprise liability than under rebuttable liability, employers would naturally devote less effort under the latter rule than under the former.[214]

These considerations in favor of enterprise liability are similar to those that have been invoked to support enterprise liability for all kinds of torts,

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211. *See, e.g.*, *Securities Regulations*, *supra* note 179, at 123-36 (statement of Stephen L. Hammerman, Executive Vice President of Merrill Lynch, Pierce, Fenner & Smith).

212. 297 F. Supp. 1165 (D. Md. 1968), *aff'd in part, rev'd in part*, 422 F.2d 1124 (4th Cir. 1970).

213. Johns Hopkins Univ. v. Hutton, 297 F. Supp. 1165 (D. Md. 1968), *aff'd in part, rev'd in part*, 422 F.2d 1124 (4th Cir. 1970).

214. *Cf.* COOTER & ULEN, *supra* note 30, at 367-69 (comparing negligence liability with strict liability with respect to level of expenditure on prevention).

with special emphasis on personal injuries.[215] They apply with even greater force to NPI trading in particular and to securities frauds in general because employers and employees alike in the securities industry have economic incentives to commit the offenses. A vigorous desire of employers to eliminate violations is essential to deterrence.

Some might argue that enterprise liability in private suits is not important because the new treble damage remedy granted to the SEC[216] supplies deterrent enough. This contention assumes that the Commission is immune to bureaucratic apathy, is safe from capture by special interests, and never lacks the resources or the zeal that are needed to uncover and prosecute offenses. If the SEC is less divinely endowed, securities regulation needs the reinforcement of effective private rights of suit. Congress created the private right of suit precisely because, in the words of Senator Heinz, "The SEC cannot fight this war alone."[217] But this "clear right" would not be worth much without the support of enterprise liability.

B. *Loss distribution*

A second objective of enterprise liability that has been viewed as desirable by most of the tort theorists of the twentieth century is the shifting of losses away from tort victims.[218] This was one of the merits of ITSFEA's private right of suit, as viewed by Senator Garn, who observed in support of the bill that "private investors should have a right to recover when they have been victimized by insider trading."[219] Enterprise liability relieves the distress of tort victims and spreads their losses among consumers through small and painless increases in the prices they pay for the product or service that occasions the losses.[220]

In securities law, enterprise liability achieves loss distribution in some of the same ways as in other tort law. Like other tortfeasors, purveyors of false or nonpublic information are likely to be mere employees, who cannot be forced to pay the costs of their offenses. If losses are to be distributed, the employers must be the instruments of distribution. Moreover, employers

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215. *See* LANDES & POSNER, *supra* note 30, at 121; SHAVELL, *supra* note 30, at 170-71.

216. Exchange Act § 21A, 15 U.S.C.A. § 78u-1 (West Supp. 1992).

217. 134 CONG. REC. S17,219 (daily ed. Oct. 21, 1988). *See also supra* text accompanying note 157.

218. *See* CALABRESI, COSTS, *supra* note 10; LANDES & POSNER, *supra* note 30; SHAVELL, *supra* note 30; Smith, *supra* note 25.

219. 134 CONG. REC. S17,220 (daily ed. Oct. 21, 1988). In his introductory summary of the merits of ITSFEA, Senator Garn declared,

> This legislation would address these issues in several ways. It would expand the civil and criminal penalties for insider trading. It would increase the responsibilities of securities firms to monitor and supervise the actions of their employees. And it would enable investors who have been adversely affected by insider trading to seek redress against those who engage in the practice.

Id.

220. CALABRESI, COST, *supra* note 10, at 68-77; LANDES & POSNER, *supra* note 30; SHAVELL, *supra* note 30.

in the securities industry are likely to have the necessary resources to compensate losses and a continuity of activities that enables them to spread the costs across a large number of transactions.

There are, however, important peculiarities of the securities industry that make loss distribution operate differently than in other settings. One peculiarity is the unavailability of insurance to assist in the spreading of losses.[221] Investors cannot insure themselves against being defrauded. Issuers, broker-dealers, and their employees cannot insure themselves against liability for fraud.

The unavailability of insurance for investors accentuates the importance of enterprise liability in relieving the losses of fraud victims. If potential victims could insure themselves, there might be advantages in leaving victims to insure themselves against loss, rather than imposing enterprise liability on the employers of tortfeasors.[222] Concluding that automobilists could insure themselves against their own injuries more cheaply than they could insure themselves against liability for the injuries of others, Keeton and O'Connell substituted compulsory first-party insurance for liability insurance in their no-fault insurance plan.[223] But enterprise liability for securities frauds cannot be rejected on this ground, since insurance is unavailable for securities fraud losses.

On the other hand, the unavailability of insurance might be cited as a disadvantage of enterprise liability for securities frauds on the ground that employers cannot spread losses through the medium of liability insurance, as the employers of taxi-drivers are expected to do. But most employers in the securities industry are likely to be able to self-insure against the liabilities to which they may be exposed. Since damages for securities frauds are limited by the magnitude of the transactions out of which the frauds arise, employers are likely to have assets commensurate with the magnitude of their liabilities. They are not liable for pain and suffering, and they run little danger of incurring a disparity like that between a million-dollar negligence verdict and a five-dollar taxi fare.

A second peculiarity of the securities industry is the capacity of a large proportion of potential fraud victims to bear their losses without distress and to spread their losses over a very large number of transactions just as easily as the employers of offenders can. Institutions such as pension funds and insurance companies can typically distribute their losses just as widely as broker-dealers can, and can do so more efficiently because they have no need to investigate a stranger's claim of loss.

221. This assertion is based partly on responses from lawyers in securities practice who say they have no knowledge of such insurance and on the obvious moral risk that would attend the writing of such insurance.

222. *See* Richard A. Epstein, *Products Liability as an Insurance Market*, 14 J. LEGAL STUD. 645 (1985).

223. ROBERT E. KEETON & JEFFREY O'CONNELL, BASIC PROTECTION FOR THE TRAFFIC VICTIM; A BLUEPRINT FOR REFORMING AUTOMOBILE INSURANCE 343-51 (1965).

Individual investors normally lack the loss-distribution capacities of institutions, but some of them also present a weak appeal for loss distribution. In *Basic, Inc. v. Levinson*,[224] the dissenting judges regarded the complainants as mere speculators whose "losses" were part of the expected risks of their investments.[225]

Alongside these diversified investors, there are others whose losses are once-in-a-lifetime events that they cannot possibly spread over a series of transactions. The Kardons, who received far less than the value of their shares in a two-family concern, may have lost a substantial fraction of their family fortune.[226] The retiring employee who accepted the current market value of his shares in his corporate employer in ignorance of an impending merger may have lost a significant proportion of his life savings.[227]

Compensation in cases of this kind is appealing not only because the loss may be large in relation to the victim's total resources, but also because it appeals to popular conceptions of justice. The gainer is an easily identified person, whose enrichment is resented not only by the loser but by disinterested observers. Moreover, the gainer's conduct seems more merciless because the gainer knows the identity of the loser who is hurt. The failure of the law to compensate in such cases would disturb all but the most calloused market economists. But cases of this kind are rare, and they are hardly imaginable in the context of open market transactions among strangers.

The fact that investors' losses from NPI trading are seldom tragic does not differentiate their claims from those that arise today from other torts. Various forms of health insurance, disability compensation, and public assistance also await personal injury victims. In both situations, the law seeks to protect citizens from losses caused by the faults of others. But in both, loss distribution today must be viewed as subsidiary to deterrence. The private right of suit for insider trading arose by implication from a penal command[228] rather than any program designed to compensate investors. The right conferred by ITSFEA was obviously designed more for deterrence than for compensation, since the possibility of compensation was undermined by giving priority to penalties demanded in enforcement actions.[229]

C. *Resource allocation*

Loss distribution not only relieves the losses of tort victims at a minor cost to consumers, but also reduces the level of activities in which injuries

224. 485 U.S. 224 (1988).

225. *See* Basic, Inc. v. Levinson, 485 U.S. 224, 255-56, 262 (1988) (White, J., joining O'Connor, J., concurring in part, dissenting in part).

226. *See* Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).

227. *See* Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976).

228. Exchange Act § 10(b). *See supra* note 110.

229. *See supra* text accompanying note 172.

are likely to occur by raising their costs and thereby diverting consumer demand for them.[230] This effect is variously characterized as "resource allocation" or "general deterrence."[231] In a graphic illustration of this conception, Guido Calabresi imagined automobilists switching to safer rail travel as automobile insurance is made more expensive by imposing liability on owners.[232]

Under a regime of enterprise liability, brokerage firms would presumably raise their prices to cover the increased costs of policing their employees and of paying their liabilities when employees are detected in violations. This might lead investors to reduce the frequency with which they trade in the expectation of very small gains and divert their efforts to longer term gains. This diversion seems unlikely to be large enough to affect the economic utility of securities markets.

However, different kinds of brokerages would be affected differently. Brokerages that offer cut-rate services without investment advice and do not engage in underwriting or in mergers and acquisitions would rarely incur liabilities and would not need to raise their prices. Some investors would switch to cut-rate brokers from whom they would obtain order executions at lower cost. Investors who stayed with full-service brokerages would pay the full costs of such services. This development seems desirable, forcing investors to pay the true costs of brokers' advice if they want it, while allowing them to avoid the costs if they do not.

The brokers who continue to supply advice to clients might, however, reduce their level of activity in producing and disseminating information because of the difficulty of separating the nonpublic information which should not be disseminated from the public information that should be. This possible consequence of enterprise liability was cited by a securities industry representative who opposed enterprise liability because it would impede the flow of information to agents and clients of securities firms.[233]

Impeding the flow of *nonpublic* information was, of course, the very purpose of ITSFEA. The enhanced penalties for NPI trading were intended by Congress to induce the securities industry to expend the effort necessary to separate public from nonpublic information, whatever the cost might be. Enterprise liability in private suits could only reinforce the congressional purpose.

D. *Incentives for loss avoidance*

Enterprise liability has its vices. One of them, noted in relation to product liability, is that it reduces the incentives of potential victims to

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230. This is a recurrent theme of the law-and-economics school, whose adherents stress the power of market forces to make prices reflect costs and human behavior to reflect prices. *See* STEVEN SHAVELL, ECONOMIC ANALYSIS OF ACCIDENT LAW 26-32 (1987); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 160-65 (3d ed. 1986).

231. *See* CALABRESI, COSTS, *supra* note 10, at 68-94.

232. *Id.* at 70-71.

233. *See supra* text accompanying notes 189-90.

avoid losses by avoiding exposure to products to which they may be abnormally vulnerable.[234]

This vice, however, seems irrelevant to securities frauds in general and to NPI trading in particular. These offenses consist of giving information that the communicator knows to be false, and using information that is not available to the public. Affected investors cannot, even by diligence, protect themselves against these risks except by doing less investing. The power to reduce the losses that result from NPI trading does not lie in the hands of the potential victims, but in the hands of the traders, the tippers, and the tippers' employers.

E. Costs of litigation

The most attractive advantage that might flow from excluding enterprise liability in NPI trading suits is a reduction of expenditures on litigation. If fewer employers are liable, the number of suits filed will probably diminish. While litigation expenses fall, deterrence will also diminish, and the frequency of violations and resulting losses will increase. Whether the deterrence of NPI trading by private suits is worth the costs that the suits engender is a question that I will not attempt to answer here. It is, however, a question that Congress answered affirmatively by ITSFEA's grant of an express private right of suit and confirmation of preexisting rights of suit. Enterprise liability is essential to the effectiveness of the rights of suit that ITSFEA granted and confirmed.

Although rebuttable liability may reduce the number of suits, it seems likely to increase litigation costs in the suits that persist. Under enterprise liability the crucial question is whether the employee was acting within the scope of employment or authority. This question calls for evidence of the communications between the offender and the persons with whom the offender dealt, which should be readily obtainable. Under rebuttable liability, the question is whether the employer acted in good faith or induced the violation. This query involves an inquiry into the minds of the employer's executives and the whole train of communications and acquiescences within the enterprise. Trials will involve volumes of evidence that will be as voluminous and as inconclusive as the evidence of hypothetical transactions that Justice Rehnquist decried in *Blue Chip Stamps v. Manor Drugstores*.[235]

At one point in the hearings, an SEC communication suggested that enterprise liability would lead to "meritless suits" against employers.[236] Although this comment accompanied a draft law that would have made employers liable in many more instances than does ITSFEA,[237] it deserves some consideration in relation to the eventual Act. The suggestion evidently

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234. *See* William M. Landes & Richard A. Posner, *A Positive Economic Analysis of Products Liability*, 14 J. LEGAL STUD. 535, 560-63 (1985).

235. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 743 (1975).

236. *See supra* note 122.

237. *See supra* note 184.

referred to cases like that of *Moss v. Morgan Stanley* in the district court.[238] There, Morgan's rep had used nonpublic information to tip a confederate who was not a Morgan client. Morgan was subjected to a "meritless" suit, which it defeated on the ground that Antoniou was acting outside the scope of his employment and authority.

But not all suits against employers on account of NPI trading will be meritless. In *Shapiro v. Merrill Lynch*,[239] Merrill's rep had tipped a favored client. Since the rep's nonpublic information had emanated from the security issuer, Merrill and its rep were liable even before ITSFEA. But if in 1992 another rep, using nonpublic information of a takeover bid, tips a client of Morgan, a different question will be presented. Under the SEC's bill, Morgan would have been liable because it would have received a profit by way of commission for tipping the client. But under ITSFEA Morgan will not be liable if it can show good faith and noninducement. The inquiry into Morgan's good faith and noninducment promises to be more complex and expensive than an inquiry into the tipper's scope of employment. The more unpredictable the outcome, the more the parties will spend on litigation.

F. Other forms of rebuttability

ITSFEA's exclusion of liability for employers who acted in good faith and did not actually induce violations seems irreconcilable with any plausible conception of the purposes of ITSFEA or of the Exchange Act, which ITSFEA amended. One can hardly believe that legislators who voted for ITSFEA were conscious of the significance of the exclusion.

But legislators, or at least some of them, may well have thought that enterprise liability was too rigid a rule. The observation of the prosecutor Giuliano, that "There should be a defense available for the firm that it has . . . done everything it reasonably can do to avoid the problem,"[240] is plausible in relation to private suits, although it was probably directed by its author to governmental enforcement actions. This formulation makes a strong appeal to a sense of justice that is repelled by penalizing innocent employers through enterprise liability.

A form of liability that comes close to Giuliano's prescription is observable in the German law, which excuses the employer who "observes the care required in the trade," and saddles the employer with proving the defense.[241] This standard is far more exacting than ITSFEA's provision for private suits.[242] It is also more demanding than ITSFEA's provision for enforcement actions, which not only excuses an employer who is not

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238. *See supra* note 129.
239. *See supra* note 118.
240. *Insider Trading, supra* note 122, at 88.
241. *See supra* note 34.
242. Exchange Act § 20(a), incorporated by reference in Exchange Act § 20A(b)(3).

intentional or reckless, but also relieves the employer of the burden of proof.[243]

If Congress were determined to exonerate the employer that has done everything it can, it should consider adopting a formula like that of the German law. But legislators should also ask whether litigation over the vigor of the employer's efforts is likely to cost more in litigation expense and in defeats of deserving plaintiffs than it saves by exonerating the truly innocent. They should also consider the fact that leading German jurists have recommended abandoning their rebuttability rule in favor of enterprise liability.[244]

VI. The Future of Enterprise Liability

The conflict that existed before 1988 with regard to enterprise liability was revived in new forms by ITSFEA. When suits for NPI trading are filed, there will be disputes as to whether they can be sustained without recourse to ITSFEA, where claimants can assert enterprise liability, or only under ITSFEA, where they cannot.

More importantly, the disparity between liability under ITSFEA and under other provisions of the Securities Acts may provoke a congressional reexamination of the role of enterprise liability. On one hand, legislators may not be satisfied to see brokerage firms defeating private suits on grounds of mere good faith and noninducement, when they have failed to maintain the procedures required by the Exchange Act. On the other hand, a reversion to enterprise liability may be successfully resisted by the securities industry, and alternative forms of rebuttable liability may replace the lax rule of ITSFEA.

If the securities industry succeeds in excluding enterprise liability, other regulated industries may contend for similar exoneration. The widely shared revulsion against the rising tide of tort litigation[245] may produce a critical reexamination of enterprise liability. A return to the ancient rule of personal fault liability for employers is hardly conceivable in the modern world, but a switch to some form of rebuttable liability for employers is conceivable.[246]

Liability for harmful products is under attack, although the most visible trend of current law is to expand it.[247] But the antiliability movement has

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243. *Supra* note 152.

244. *See supra* text accompanying notes 40-42.

245. *See* Committee for Economic Development, Who Should be Liable? A Guide to Policy Dealing with Risk (1989); Peter W. Huber, Liability: The Legal Revolution and Its Consequences (1988).

246. *See* Pitt & Kaufmanis, *supra* note 30, at 1647-52 (proposing to relieve employers of liability when they prove that they have exercised due diligence in supervisions of employees).

247. *See* Symposium, *Critical Issues in Tort Law Reform: A Search for Principles*, 14 J. Legal Stud. 459-818 (1985). Of particular interest are Priest, *Enterprise Liability*, *supra* note 10, and Epstein, *supra* note 222. Priest traced the development of product liability in a critical tone. Epstein contended that product liability often displaces first-party loss insurance, which would bear losses more efficiently.

displayed little interest in attacking enterprise liability for wrongful acts of employees.[248] Recent recommendations of industrial and governmental agencies have included a raft of constrictions on liability, but eliminating employers' liability for the torts of employees is not one of them. The Committee for Economic Development recommended, among other things, limitations of amounts of awards, making damages proportionate to share of fault, and restricting liability for health and safety hazards to violations of regulatory standards.[249] The President's Council on Competitiveness recommended, among other steps, taking punitive damage awards away from juries and assessing costs of suits against losing parties.[250] Peter Huber, in his widely read *Liability*, complained of liability in unlimited amounts for unforeseeable injuries,[251] but not of making the employer compensate the losses actually caused by employees' negligence.

If securities fraud is subject to the same dynamics as other torts, eliminating enterprise liability is not a promising means of restraining excesses. ITSFEA's limitation of damages to the offender's profit or loss[252] is compatible with the recommendations made for other areas of compensation, but eliminating enterprise liability from private suits would be a bold step in a new direction.

In the absence of any significant economic or social analyses attacking enterprise liability, Congress would be wise to delete from ITSFEA the ambiguous clause that denies liability "solely by reason of employing." Absent congressional action, federal courts would promote consistency in securities law and consistency with other areas of tort law by adhering to enterprise liability under the Securities Acts, and by disregarding the House Committee's questionable announcement that ITSFEA excludes the principle of respondeat superior.

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248. *See* Robert D. Cooter, *Economic Theories of Legal Liability*, 5 J. ECON. PERSP. 11 (1991); George L. Priest, *The Modern Expansion of Tort Liability: Its Sources, Its Effects, and Its Reform*, 5 J. ECON. PERSP. 31, 48-49 (1991). The proposal of Pitt and Kaufmanis, *supra* note 30, is a rare exception.

249. COMMITTEE FOR ECONOMIC DEVELOPMENT, *supra* note 245, at 148-49.

250. *Agenda for Civil Justice Reform in America* (1991, President's Council on Competitiveness); David Margolick, *Address by Quayle on Justice Proposals Irks Bar Association*, N.Y. TIMES, Aug. 14, 1991, at A-1.

251. HUBER, *supra* note 245, at 3-18.

252. Exchange Act § 20A(b)(1)-(2), 15 U.S.C.A. § 78t-1(b)(1)-(2) (West Supp. 1992).