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Bridging The Gap: Some Thoughts About Interstitial Lawmaking And The Federal Securities Laws

Kevin R. Johnson

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BRIDGING THE GAP: SOME THOUGHTS ABOUT INTERSTITIAL LAWMAKING AND THE FEDERAL SECURITIES LAWS

KEVIN R. JOHNSON*

True wisdom . . . is not certain of anything in this world of contradictions . . . .[1]

INTRODUCTION

Few would think that the esoteric field of federal securities regulation would raise some of the most fundamental questions of constitutional and jurisprudential theory. Last Term, however, the United States Supreme Court decided two federal securities law cases, *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*[2] and *Kamen v. Kemper Financial Services, Inc.*,[3] that raised precisely those types of questions.

Students of jurisprudence grapple with the question of defining the constraints, if any, on judges "making" law. Although not a politically palatable understanding of the judicial role,[4] mainstream legal thought generally accepts that, at least to some degree, judges legitimately, and indeed have the responsibility to, engage in lawmaking.[5] The search for

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* Acting Professor of Law, University of California at Davis. A.B. 1980, University of California at Berkeley; J.D. 1983, Harvard University. Special thanks are owed to Chris Cameron, who read and offered helpful comments on an earlier draft of this Article, and Lynne K. Zellhart, University of California, Davis, Class of 1993, whose invaluable research assistance and comments made this Article possible.

1. JOSEPH CONRAD, THE SECRET AGENT 81 (T. Nelson & Son ed. 1907).

2. 111 S. Ct. 2773 (1991).

3. 111 S. Ct. 1711 (1991).

4. *See, e.g.*, Boston Globe, July 1, 1991, at 3, col. 5 (reporting statement of rumored Supreme Court nominee, Emilio Garza, that it is Justice's "responsibility to . . . apply the law. We're not elected to be legislators."); Wash. Post, July 26, 1987, at A8, col. 1 (reporting statement of Court nominee Robert Bork that activist judiciary "engages in judicial legislation, and that seems to me inconsistent with the democratic form of government . . .").

5. *See, e.g.*, R. POSNER, THE PROBLEMS OF JURISPRUDENCE 457 (1990) (recognizing that "[j]udges make rather than find law, and they use as inputs both the rules laid down by legislatures and previous courts . . . and their own ethical and policy prefrences"); G. CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 92 (1982) (stating "[t]hat [judges make law] is by now an accepted fact . . .") (footnote omitted); J. ELY, DEMOCRACY AND DISTRUST 4 (1980) (positing that, "[o]f course courts make law all the time"). *See generally* B. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 113-41 (1921) (discussing "judge as a legislator"); L. JAFFE, ENGLISH AND AMERICAN JUDGES AS LAWMAKERS (1969) (same).

principles restricting judicial discretion in making law has given rise to an abundance of theories and volumes of writings.

Jurisprudential quandaries of this variety at first glance might not seem relevant to the federal system in the United States. In the unique form of government established by the Constitution, the fundamental institutional bedrock is the separation of powers.[6] The distribution of power in the federal system is simple in theory. Congress, elected by the voting public and thus politically accountable, passes the laws; the executive branch enforces the laws; the judiciary ensures that its coordinate branches faithfully comply with the laws passed by Congress as well as the Constitution.[7] In this constitutional system of checks and balances, it might appear that there is little, if any, room for federal judges to make law.

Adding a further layer of complexity, the Constitution creates a unique distribution of lawmaking power between the federal and state governments. Certain substantive areas are of such national concern—conducting foreign relations and regulating interstate commerce are two examples—that the Constitution provides the federal government with exclusive authority over those matters.[8] However, federal power is restricted and the national government is limited from treading unduly on state prerogative.[9] The states thus are the primary lawmaking authorities in the United States.[10] These are baseline principles of "Our Federalism."[11]

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6. *See generally* L. TRIBE, AMERICAN CONSTITUTIONAL LAW §§ 2-1 to 5-24, at 18-400 (2d ed. 1988).

7. *See, e.g.*, Tennessee Valley Auth. v. Hill, 437 U.S. 153, 194 (1978); *see also* THE FEDERALIST No. 47, at 324 (J. Madison) (J. Cooke ed. 1961) (stating that "[t]he accumulation of all powers, legislative, executive, and judiciary in the same hands, whether of one, a few or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny"); C. Pinckney, *Observations on the Plan of Government Submitted to the Federal Convention*, in III THE RECORDS OF THE FEDERAL CONVENTION OF 1787 108 (M. Farrand ed. 1937) ("In a government, where the liberties of the people are to be preserved, and the laws well administered, the executive, legislative and judicial, should ever be separate and distinct, and consist of parts, mutually forming a check upon each other").

8. *See, e.g.*, U.S. CONST. art. I, § 8, cl. 3 (commerce clause); *id.* art. II, § 2, cl. 2 (foreign relations power).

9. *See, e.g.*, Gregory v. Ashcroft, 111 S. Ct. 2395, 2401 (1991); *see also* THE FEDERALIST No. 45, at 313 (J. Madison) (J. Cooke ed. 1961) (stating that "[t]he powers delegated by the proposed Constitution to the Federal Government, are few and defined. Those which are to remain in the State Governments are numerous and indefinite").

10. *See* U.S. CONST. amend. X ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people"); Davis Warehouse Co. v. Bowles, 321 U.S. 144, 155 (1944) (stating that "[t]he great body of law in this country which controls acquisition, transmission, and transfer of property, and defines the rights of its owners in relation to the state or to private parties, is found in the statutes and decisions of the state"). The spirit of National League of Cities v. Usery, 426 U.S. 833, 851 (1976), *overruled* Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985), which prohibited federal regulation of certain types of state and local employees because such employment involved matters "essential to [the] separate and independent existence" of the states, represents a perhaps extreme view of federalist theory. *See* Merritt, *The Guarantee Clause and State Autonomy: Federalism for the Third Century*, 88 COLUM. L. REV. 1, 10-22 (1988).

11. Younger v. Harris, 401 U.S. 37, 44 (1971).

One type of federal law raises concern about judges making law as well as separation of powers and federalism questions.[12] In 1938, Justice Brandeis wrote in the venerable case of *Erie Railroad Co. v. Tompkins* that "[e]xcept in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state. There is *no* federal general common law."[13] The *Erie* doctrine, as elaborated upon in subsequent cases and commentary, often is ballyhooed as representing the essence of American federalism.[14]

On the same day that *Erie* was decided, however, Justice Brandeis wrote that "federal common law" governed a dispute over the apportionment of an interstate stream.[15] The existence of federal common law in a number of substantive areas, such as interstate disputes and admiralty matters, today is well-established.[16] The simultaneous development of *Erie* and the "new" federal common law reflects the tension between federal and state interests in the American constitutional order.

Although much discussed,[17] the precise scope of federal common law remains largely uncertain.[18] Specifically, despite few apparent differences between the statutes in question, the Supreme Court has vacillated between finding that some statutes passed by Congress delegate authority to the courts to make federal common law and others afford no such power.[19] Such discontinuity should not be surprising. When viewed in light of the Constitution, federal common law indeed is peculiar. The making of law through the common law method by the federal judiciary seems at odds

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12. When discussing federal common law, most commentators primarily focus on separation of powers and federalism concerns. *See, e.g.*, E. CHEMERINSKY, FEDERAL JURISDICTION § 6.1, at 296 (1989); Field, *Sources of Law: The Scope of Federal Common Law*, 99 HARV. L. REV. 881, 931 (1986); Merrill, *The Common Law Powers of Federal Courts*, 52 U. CHI. L. REV. 1, 1-2, 13-23 (1985); Mishkin, *Some Further Last Words of Erie—The Thread*, 87 HARV. L. REV. 1682, 1683 (1974).

13. 304 U.S. 64, 78 (1938) (emphasis added).

14. *See* Ely, *The Irrepressible Myth of Erie*, 87 HARV. L. REV. 693, 695 (1974).

15. *See* Hinderlinder v. La Plata River & Cherry Creek Ditch Co., 304 U.S. 92, 110 (1938).

16. *See infra* text accompanying notes 36-41; *see also* Meltzer, *State Court Forfeitures of Federal Rights*, 99 HARV. L. REV. 1130, 1167-76 (1986) (describing general contours of federal common law as it has developed).

17. *See, e.g.*, Field, *supra* note 12 (advocating broad view of federal common law); Merrill, *supra* note 12 (advocating narrow view of federal common law). For a debate about the constitutional and statutory legitimacy of federal common law, see the lively colloquy between Professors Redish and Weinberg in Redish, *Federal Common Law, Political Legitimacy, and the Interpretative Process: An "Institutionalist" Perspective*, 83 NW. U.L. REV. 761 (1989); Weinberg, *Federal Common Law*, 83 NW. U.L. REV. 805 (1989); Redish, *Federal Common Law and American Political Theory: A Response to Professor Weinberg*, 83 NW. U.L. REV. 853 (1989); Weinberg, *The Curious Notion That the Rules of Decision Act Blocks Supreme Federal Common Law*, 83 NW. U.L. REV. 860 (1989) [hereinafter Weinberg, *Curious Notion*].

18. *See* E. CHEMERINSKY, *supra* note 12, § 6.1, at 297; C. WRIGHT, LAW OF FEDERAL COURTS § 60, at 388-89 (4th ed. 1983).

19. *See infra* text accompanying notes 62-72.

with separation of powers principles and the idea that Congress has the exclusive constitutional authority to enact laws. The discretionary power of the federal courts to federalize certain substantive areas of law also creates the potential for displacement of state authority, thus undercutting federalism values.[20] Finally, federal common law implicates the age-old jurisprudential query whether limits exist that prevent lawmaking by judicial fiat.

When the judiciary is called upon to apply federal statutes, a species of federal common law frequently referred to as interstitial lawmaking[21] comes into play. Congress almost invariably leaves gaps in laws it enacts that the courts feel compelled to fill.[22] A prototypical example of interstitial lawmaking is adding a limitations period to a federal statute lacking one.[23] Rather than the ordinary task of interpreting the text of a statute, the court fills in the blanks left by Congress in the statutory language. Consequently, the task of interstitial lawmaking differs somewhat from traditional statutory interpretation.[24]

When making law at the interstices, the federal courts in many instances, though largely without analysis, traditionally "borrowed" or "absorbed" state law. Because a legislature of some sort, although not Congress, passed the law, such a practice arguably alleviates to some degree separation of powers concerns. At the same time, application of state law may seem to limit intrusions on state interests and restrict the scope of judicial lawmaking discretion.

The judicial function of "amending" statutes by supplementing their terms raises several questions that will be discussed here. Assuming that the federal judiciary legitimately may fill gaps in statutes, are the courts com-

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20. *See infra* text accompanying notes 33-73, 312-33.

21. *See generally* Mishkin, *The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision*, 105 U. PA. L. REV. 797 (1957).

22. *See* United States v. Little Lake Misere Land Co., 412 U.S. 580, 593 (1973) (emphasizing that "the inevitable incompleteness presented by all legislation means that interstitial federal lawmaking is a basic responsibility of the federal courts."); Southern Pacific Co. v. Jensen, 244 U.S. 205, 221 (Holmes, J., dissenting) (positing that "I recognize without hesitation that judges do and must legislate, but they can do so only interstitially; they are confined from molar to molecular motions"); Mishkin, *supra* note 21, at 800 (stating that, "[a]t the very least, effective Constitutionalism requires recognition of power in the federal courts to declare, as a matter of common law or 'judicial legislation,' rules which may be necessary to fill in interstitially or otherwise effectuate the statutory patterns enacted in the large by Congress").

23. *See infra* text accompanying notes 75-237.

24. Some, however, see federal common law as little different from statutory or constitutional construction. *See* Field, *supra* note 12, at 890-96; Westen & Lehman, *Is There Life for Erie After the Death of Diversity?*, 78 MICH. L. REV. 311, 332 (1980); *see also* Northwest Airlines, Inc. v. Transport Workers Union, 451 U.S. 77, 95 (1981) (observing that "[b]roadly worded constitutional and statutory provisions necessarily have been given concrete meaning and application by a process of case-by-case judicial decision in the common-law tradition"); Monaghan, *The Supreme Court, 1974 Term — Foreword: Constitutional Common Law*, 89 HARV. L. REV. 1, 13-14 (1975) (discussing constitutional common law).

pelled by principles of federalism, or the Rules of Decision Act,[25] to utilize state law to limit improper intrusion upon state prerogative? More fundamentally, from an institutional perspective, is it a proper function for the judiciary restrained by separation of powers principles in the federal system to supplement laws passed by Congress? Finally, regardless of constitutional or statutory concerns, should the federal courts be compelled to apply state law to restrict their power in making law?

In analyzing these questions, this Article articulates some thoughts about the Supreme Court's approach to interstitial lawmaking in the federal securities realm. Students of the federal securities laws are well aware of the many gaps in the regulatory scheme enacted by Congress. The courts frequently are called upon to remedy those deficiencies. Last Term, the Supreme Court attempted to fill some of those voids in two cases and reached what might appear to be incongruous results. In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,[26] the Court declined to "borrow" state law, but found that provisions from *federal* law should be utilized to fill a void in the statute. In *Kamen v. Kemper Financial Services, Inc.*,[27] the Court concluded that *state* law should be. Although both decisions may be correct as a matter of policy, the Court in both denied that it was engaged in policymaking.

To place these cases in perspective, Part I of the Article offers some background on federal common law. Part II discusses the problems addressed in *Lampf, Pleva* and *Kamen* and the implications of the Court's decisions. Part III suggests some of the forces at work in the Supreme Court's federal common law jurisprudence. First, the Court, by creating the presumption that federal courts should borrow state law when making federal common law, furthers deeply engrained federalism principles reflected in, if not required by, the Rules of Decision Act.[28] National interests compete for primacy with, and sometimes prevail over, state interests.[29] Second, the Court is influenced by separation of powers principles and the fear that the judiciary in certain instances is not constitutionally competent to fashion federal common law.[30] Finally, the Court's decisions reflect the longstanding jurisprudential concern with limitless lawmaking and the accompanying potential for judicial tyranny. To that end, compulsory incorporation of state law into deficient federal law may serve to restrain the

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25. The Rules of Decision Act, originally Section 34 of the Judiciary Act of 1789, 1 Stat. 92, is codified at 28 U.S.C. § 1652 (1988); *see infra* note 80 (quoting Act).

26. 111 S. Ct. 2773 (1991).

27. 111 S. Ct. 1711 (1991).

28. *See infra* text accompanying notes 312-33.

29. *See infra* text accompanying notes 312-33. *See generally* Fallon, *The Ideologies of Federal Courts Law*, 74 VA. L. REV. 1141 (1988) (describing competing "Federalist" and "Nationalist" models of judicial federalism and tracing theories in decisions in several areas of federal courts law).

30. *See infra* text accompanying notes 334-52.

lawmaking powers of the courts. Although these competing values cannot dictate results,[31] they assist in explaining the Court's decisions.

This Article suggests that, when engaged in interstitial lawmaking, the Supreme Court should simplify the inquiry. Neither the Constitution nor statute require the federal courts to resort to state law to fill gaps in a federal statute. To the contrary, in order to ensure effective implementation of a national program, the judiciary has the constitutional and statutory responsibility to fashion the best interstitial law possible. When filling the void in a *federal* law passed by Congress, there is no true federalism interest in need of protection. Nor does the borrowing of state law effectively limit judicial lawmaking in a meaningful way. Such borrowing leaves open a variety of options to the federal courts and thus fails to restrict significantly judicial discretion. More importantly, blind reliance on state law at times has undermined the effectiveness of laws passed by Congress.

For similar reasons, the courts are not bound to borrow from another federal statute. The courts instead should fashion the *best* law for the particular statute in light of its purposes. Passage by some legislature, federal or state, does not necessarily mean that a provision, borrowed from a different statute passed under different circumstances to address different problems, will effectively serve the goals of the deficient statute.

To fulfill Congressional intent, the Court should make the law—possibly but not necessarily from a state or federal source—that best fulfills the needs and purposes of the particular statute in question. This is particularly true with respect to the federal securities laws, enacted by Congress in an attempt to create a national regulatory scheme to cure deficiencies with state regulation of the interstate securities markets.[32] Because state law at times has proven to be a poor source for filling the gaps in the federal securities laws, the Supreme Court's frequent endorsement of state law as presumptively applicable has led to results that unnecessarily conflict with legitimate federal interests. In addition, borrowing provisions from the federal securities laws, while an improvement over state law borrowing in some circumstances, may lead to results not in keeping with the purposes of the particular statutory provision in question.

I. FEDERAL COMMON LAW: VACILLATION BETWEEN EXTREMES

Although the federal courts engaged in the making of common law long before 1938, a new chapter of federal common law commenced with *Erie*.[33] The parameters of the common law power of the federal courts, however, never have been clear. Although some have attempted to define

31. *See* E. CHEMERINSKY, *supra* note 12, § 6.1, at 297.

32. *See infra* text accompanying notes 121-56.

33. *See generally* Friendly, *In Praise of Erie—and of the New Federal Common Law*, 39 N.Y.U. L. REV. 383 (1964).

and circumscribe federal common law,[34] this Article modestly attempts to identify three influences—federalism, separation of powers, and jurisprudential concerns—in competition for primacy in the Supreme Court's decisions in this area.[35] Recognition of these influences will assist in explaining recent developments in the Court's attempts to fill the gaps of the federal securities laws and offer a prescription for the future.

Federal common law is well-established in a number of substantive areas, including interstate disputes,[36] admiralty and maritime matters,[37] international relations,[38] matters involving Indian tribes,[39] and liability of the United States government.[40] Because none of these areas of peculiarly national concern would seem appropriate for regulation by the various states, necessity almost compels that federal law govern.[41]

The substance of the federal common law in these areas, however, is a separate question from whether federal law should govern.[42] Congress in a few areas has expressly instructed the federal courts to incorporate state law as the federal rule of decision.[43] In addition, the courts sometimes borrow state law, not only as a matter of convenience, but also possibly because of federalism's strong influence.[44] Perhaps most common is for the

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34. *See* Field, *supra* note 12, at 890 (stating that "'federal common law' . . . refer[s] to any rule of federal law created by a court . . . when the substance of that rule is not clearly suggested by federal enactments—constitutional or congressional") (emphasis in original omitted); Merrill, *supra* note 12, at 5 ("'Federal common law' . . . means any federal rule of decision that is not mandated on the face of some authoritative federal text. . . .").

35. *See* Textile Workers Union v. Lincoln Mills, 353 U.S. 448, 465 (1957) (Frankfurter, J., dissenting) (criticizing potential for "judicial inventiveness" in making of federal common law); United States v. Standard Oil Co., 332 U.S. 301, 316-17 (1947) (refusing to create federal common law rule because judicial lawmaking "would be intruding within a field properly within Congress's control"); McCluny v. Sulliman, 28 U.S. (3 Pet.) 270, 277 (1830) (holding that Rules of Decision Act required "borrowing" of state limitations period for federal statute lacking one).

36. *See, e.g.*, Kansas v. Colorado, 206 U.S. 46, 97-98 (1907).

37. *See, e.g.*, Kossick v. United Fruit Co., 365 U.S. 731 (1961); *see also* M. REDISH, FEDERAL JURISDICTION: TENSIONS IN THE ALLOCATION OF JUDICIAL POWER 138-47 (2d ed. 1990) (arguing that federal common law should be limited to admiralty and maritime cases).

38. *See, e.g.*, Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 425 (1964).

39. *See, e.g.*, County of Oneida v. Oneida Indian Nation, 470 U.S. 226, 237 (1985).

40. *See infra* text accompanying notes 45-48.

41. *See* E. CHEMERINSKY, *supra* note 12, § 6.1, at 295; *see, e.g.*, County of Oneida v. Oneida Indian Nation, 470 U.S. 226, 237 (1985) (referring to federal common law as "'necessary expedient'") (quoting City of Milwaukee v. Illinois, 451 U.S. 304, 313-14 (1981)).

42. *See* Clearfield Trust Co. v. United States, 318 U.S. 363, 367 (1943) (noting that, when selecting federal common law rule, Court has "occasionally selected state law"); United States v. Kimbell Foods, Inc., 440 U.S. 715, 728-29 (1979) (observing that "state law may be incorporated as the federal rule of decision"). *But see* Field, *supra* note 12, at 885-90, 950-82 (criticizing this approach and arguing that, if state law is appropriate source, then federal common law is unnecessary).

43. *See, e.g.*, Federal Tort Claims Act, 28 U.S.C. §§ 1346(b), 2672 (1988); *see also* Mishkin, *supra* note 21, at 797 (noting that when federal statute requires reference to state law, "it would generally seem to conclude the matter") (footnote omitted).

44. *See Kimbell Foods*, 440 U.S. at 728 (considering, after finding federal common law

courts to fashion uniquely federal law from state and other sources.

Clearfield Trust Co. v. United States,[45] which indicates both the Court's limitation of *Erie* and the Court's willingness to fashion federal common law, is perhaps the most famous federal common law case. In *Clearfield Trust*, in an opinion by Justice Douglas, one of the leading architects of the new federal common law,[46] the Court held that the *Erie* doctrine was irrelevant and that federal common law, not state law, governed the ability of the United States to recover for fraud involving commercial paper issued by it.[47] In so holding, the Court emphasized that, because of the national scale of the federal government's issuance of commercial paper, the application of state law would result in "exceptional uncertainty" and "great diversity in results by making identical transactions subject to the vagaries of the laws of the several states. The desirability of a uniform rule is plain."[48]

The Court has vacillated about the propriety of federal common law in a number of areas. The odyssey of one dispute reflects that vacillation, or

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applicable, "[w]hether to adopt state law [as] a matter of judicial policy"); DeSylva v. Ballentine, 351 U.S. 570, 580-81 (1956) (following state definition of "children" for purposes of Copyright Act because state, unlike federal, law on definition was well-developed). *But cf.* Reves v. Ernst & Young, 494 U.S. 56 (1990) (declining to adopt state definition of "security" for purposes of Securities Exchange Act of 1934).

45. 318 U.S. 363 (1943).

46. Justice Douglas' apparent enthusiasm for federal common law may have been fueled by his extensive experience in federal government during the New Deal, *see* W. DOUGLAS, GO EAST, YOUNG MAN 257-376 (1974), and his belief that many of the nation's financial ills were national in scope, *see generally* W. DOUGLAS, DEMOCRACY AND FINANCE (1940).

47. *See* Clearfield Trust Co. v. United States, 318 U.S. 363, 366-67 (1943); *see also* United States v. Little Lake Misere Land Co., 412 U.S. 580 (1973) (refusing to apply state law to dispute involving United States government). In so holding, the Court was succinct:

> *the rule of Erie R. Co. v. Tompkins does not apply to this action.* The rights and duties of the United States on commercial paper which it issues are governed by federal rather than local law . . . . The authority to issue the check had its origin in the Constitution and the statutes of the United States and was in no way dependent on the laws of Pennsylvania or of any other state. The duties imposed upon the United States and the rights acquired by it as a result of the issuance find their roots in the same federal sources. *In absence of an applicable Act of Congress it is for the federal courts to fashion the governing rule of law according to their own standards.*

Clearfield Trust, 318 U.S. at 366-67 (citations omitted) (emphasis added); *see* D'Oench, Duhme & Co. v. Federal Deposit Ins. Corp., 315 U.S. 447, 471-72 (1942) (Jackson, J., concurring); *see also* C. WRIGHT, *supra* note 18, § 60, at 394 (remarking that "[t]he Erie doctrine does not apply, and the federal court has much more freedom, where the state rule has merely been absorbed as the relevant federal rule").

48. *Clearfield Trust*, 318 U.S. at 367; *see also Kimbell Foods*, 440 U.S. at 728 (considering need for uniformity, or lack thereof, when deciding whether state law should serve as source of federal common law). In contrast to *Clearfield Trust*, when federal interests are simply implicated in disputes between private parties, the Court has been less likely to find that federal common law governed. *See, e.g.*, Miree v. DeKalb County, 433 U.S. 25, 31 (1977); Wallis v. Pan American Petroleum Corp., 384 U.S. 63, 67-68 (1966); Bank of Am. Nat'l Trust & Sav. Ass'n v. Parnell, 352 U.S. 29, 33 (1956).

perhaps the changing views, of the Court about federal common law. In *Illinois v. City of Milwaukee*,[49] Justice Douglas concluded for a unanimous Court that a cause of action for pollution of Lake Michigan was available under federal common law. Although recognizing that Congress did not create the claim,[50] the Court emphasized that Congressionally-created remedies "are not necessarily the only federal remedies available."[51]

That, however, was not the last word in that particular dispute. Congress subsequently passed a statute[52] which the Court, in an opinion by Justice Rehnquist, found to preclude federal common law remedies for pollution of the lake.[53] The opinion on the second go-round is considerably more deferential to a blend of separation of powers and federalism objections to federal common lawmaking:

> Federal courts, unlike state courts, are not general common-law courts and do not possess a general power to develop and apply their own rules of decision. . . . The enactment of a federal rule in an area of national concern, and the decision whether to displace state law in doing so, is generally made not by the federal judiciary, purposefully insulated from democratic pressures, but by the people through their elected representatives in Congress. . . . *Erie* recognized as much in ruling that a federal court could not generally apply a federal rule of decision, despite the existence of jurisdiction, in the absence of an applicable Act of Congress.[54]

Boyle v. United Technologies Corp.[55] is the Court's latest comprehensive word on federal common law and exemplifies the recurring debate. In that case, Justice Scalia wrote for a five-four majority holding that federal common law governed a products liability claim against a military contractor that manufactured a product for the federal government. The Court emphasized that federal common law governed a narrow category of cases implicating such "'uniquely federal interests'" that "state law is pre-empted and replaced."[56] Finding a uniquely federal interest implicated in the dispute and a potential conflict between state and federal law, the Court held that

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49. 406 U.S. 91 (1972).

50. *See id.* at 101-03.

51. *Id.* at 103 (citation omitted).

52. *See* Federal Water Pollution Control Act Amendments of 1972, Pub. L. No. 92-500, 86 Stat. 816 (1972).

53. *See* City of Milwaukee v. Illinois, 451 U.S. 304 (1981).

54. *Id.* at 312-13 (citations omitted).

55. 487 U.S. 500 (1988).

56. *Boyle*, 487 U.S. at 504 (citations omitted). A detailed historical analysis places in question the generally accepted view that the framers of the Constitution intended the scope of federal common law to be quite limited. *See* Jay, *Origins of Federal Common Law: Part Two*, 133 U. PA. L. REV. 1231 (1985); Jay, *Origins of Federal Common Law: Part One*, 133 U. PA. L. REV. 1003 (1985).

state law was "displaced."[57] The Court further concluded that, under federal law, the military contractor was immune from liability for products manufactured for the federal government.[58]

Objecting in separation of powers and federalism refrains ordinarily found in the opinions of more conservative Justices, Justice Brennan dissented.[59] Emphasizing that the Court lacked constitutional authority, as well as the expertise, to adopt the immunity rule, he "would leave that exercise of legislative power to Congress, where our Constitution places it."[60] Justice Brennan also articulated concern with "deeply rooted notions of federalism" implicated by the federal judiciary's displacement of state law.[61]

Consistent with the apparent inconsistency in the Court's decisions, the Court has exhibited ambivalent tendencies in the interpretation of federal statutes in determining whether the laws authorize the judiciary to make federal common law. In *Textile Workers Union v. Lincoln Mills*,[62] for example, the Court seemed eager to find broad delegations of federal

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57. *See Boyle*, 487 U.S. at 506-07, 511-12 (discussing possible conflict between state law and exception to Federal Tort Claims Act, 28 U.S.C. § 2680(a), which shields government employees from tort liability for exercise of discretionary functions); *see also* Zeppos, *Justice Scalia's Textualism: The "New" New Legal Process*, 12 CARDOZO L. REV. 1597, 1629 (1991) (finding Justice Scalia's reading of Federal Tort Claims Act as pre-empting state law in *Boyle* difficult to reconcile with his general technique of interpreting statutes by looking almost exclusively to statutory text).

58. *See Boyle*, 487 U.S. at 512. This judicially-created immunity has been criticized on policy grounds. *See, e.g.*, Cass & Gillette, *The Government Contractor Defense: Contractual Allocation of Public Risk*, 77 VA. L. REV. 257 (1991); Green & Matasar, *The Supreme Court and the Products Liability Crisis: Lessons from Boyle's Government Contractor Defense*, 63 S. CAL. L. REV. 637 (1990); *see also* Matasar, *Treatise Writing and Federal Jurisdiction Scholarship: Does Doctrine Matter When Law is Politics?* (Book Review), 89 MICH. L. REV. 1499, 1512 (1991) ("*Boyle* is inconsistent with federal courts doctrine. Its result makes sense only through an ideological lens."). Because the Court, not Congress, made the decision to immunize military contractors, Justice Scalia's approach in *Boyle* seems at odds with his strict separation of powers views. *See, e.g.*, Mistretta v. United States, 488 U.S. 361, 425-26 (1989) (Scalia, J., dissenting); Morrison v. Olson, 487 U.S. 654, 709 (1988) (Scalia, J., dissenting).

An example of broad federal common lawmaking from last Term is Chambers v. NASCO, Inc., 111 S. Ct. 2123 (1991), in which a five-four majority held that the federal courts possessed the "inherent power" to assess sanctions for a party's bad faith conduct in a diversity action even though such sanctions were not permitted under the law of the forum state. The majority seemed unfazed by separation of powers and federalism questions, including the *Erie* problem, *see id.* at 2137, which Justice Kennedy focused upon in dissent, *see id.* at 2148 (Kennedy, J., dissenting); *see also* Piper Aircraft Co. v. Reyno, 454 U.S. 235 (1981) (applying judicially made doctrine of forum non conveniens to dismiss action although constitutional and statutory jurisdictional and other requirements for suit in federal court had been satisfied).

59. *See Boyle*, 487 U.S. at 515-16 (Brennan, J., dissenting) (noting campaign of government contractors seeking protective legislation and accusing Court "unelected and unaccountable to the people" of "unabashedly step[ping] into the breach to legislate a rule denying . . . compensation that state law assures").

60. *Id.* at 516. Justice Stevens also voiced separation of powers objections to the making of federal common law in this instance. *See id.* at 531-32 (Stevens, J., dissenting).

61. *Id.* at 517 (Brennan, J., dissenting) (citation omitted); *see id.* at 517-18 (emphasizing similar concerns).

62. 353 U.S. 448 (1957).

lawmaking power resonating from a statute. The Court, in an opinion by Justice Douglas, held that the Labor Management Relations Act,[63] which provides for federal jurisdiction over disputes concerning collective bargaining agreements, permitted the courts to develop an entire body of federal common law of labor contracts.[64] The Court emphasized that "[i]t is not uncommon for federal courts to fashion federal law where federal rights are concerned."[65] Nor did the Court seem to fear, but in fact seemed to relish, the potential free-wheeling nature of judicial lawmaking: "[t]he range of judicial inventiveness will be determined by the nature of the problem."[66]

Voicing federalism and separation of power concerns, Justice Frankfurter dissented. In his eyes, the majority brought "into conflict state law and federal law, state courts and federal courts."[67] Concerned with judicial lawmaking, Justice Frankfurter criticized the

> casting upon the federal courts, with no guides except "judicial inventiveness," the task of applying a whole industrial code that is as yet in the bosom of the judiciary. There are severe limits on "judicial inventiveness" even for the most imaginative judges. The law is not a "brooding omnipresence in the sky," . . . and it cannot be drawn from there like nitrogen from air.[68]

In more recent years, the Court has adhered to the views of Justice Frankfurter more closely than those of Justice Douglas and has been hesitant to read a statute as authorizing federal common lawmaking. For example, in *Texas Industries, Inc. v. Radcliff Materials, Inc.*,[69] a unanimous Court, in an opinion by Chief Justice Burger, refused to fashion a right to contribution under the antitrust laws.[70] The Court found that, because uniquely federal interests were not at stake and because Congress did not

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63. Labor Management Relations Act § 301, ch. 120, 61 Stat. 156 (1947) (codified at 29 U.S.C. § 185 (1988)).

64. *See* Textile Workers Union v. Lincoln Mills, 353 U.S. 448, 456 (1957).

65. *Id.* at 457 (citing, inter alia, Clearfield Trust v. United States, 318 U.S. 363, 366-67 (1943)); *see* Friendly, *supra* note 33, at 413-21 (noting various areas that, under rationale of *Lincoln Mills*, might benefit from federal common lawmaking).

66. *Lincoln Mills*, 353 U.S. at 457 (citation omitted). For pointed criticism of *Lincoln Mills*, see Bickel & Wellington, *Legislative Purpose and the Judicial Process: The Lincoln Mills Case*, 71 HARV. L. REV. 1 (1957).

67. *Lincoln Mills*, 353 U.S. at 462 (Frankfurter, J., dissenting) (citation omitted).

68. *Id.* at 465 (citation omitted).

69. 451 U.S. 630 (1981).

70. *See also* Northwest Airlines, Inc. v. Transport Workers Union, 451 U.S. 77, 95-99 (1981) (refusing to fashion federal common law right to contribution under Equal Pay Act and Title VII of the Civil Rights Act of 1964).

Some commentators criticize *Texas Industries*. *See, e.g.*, Field, *supra* note 12, at 889-90 n.28, 892 n.39, 911-12 n.140, 940 n.244; Smith, *Courts, Creativity, and the Duty to Decide a Case*, 1985 U. ILL. L. REV. 573, 600, 614-15 (1985). The decision seems anomalous in light of the Court's previous holding that the Sherman Act's "legislative history makes it perfectly clear that [Congress] expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition." National Society of Professional Engineers v. United States, 435 U.S. 679, 688 (1978) (footnote omitted).

delegate the power, the federal courts could not fashion a federal common law of contribution under the statute.[71] Because of the perceived lack of judicial competence to resolve the complexities of the issue, the Court emphasized separation of powers concerns and that Congress, not the courts, is the lawmaker in the American constitutional order.[72]

In sum, the influence of federalism, separation of powers and fear of judicial lawmaking are evident in some, though not all, of the Supreme Court's federal common law decisions. The Court's differences in emphasis may be explained by the shifting views about whether national interests predominated over state interests, differing degrees of discomfort with the separation of powers implications of federal common lawmaking, and varying levels of concern with "judicial inventiveness."[73] The Court's determinations concerning whether Congressional enactments delegate federal common lawmaking authority to the courts also mirror these competing tendencies.

II. Filling the Gaps in the Federal Securities Laws

In the 1990 Term, the Supreme Court decided two cases in which the lower courts had filled gaps left by Congress in the federal securities laws.[74] In one case, the Court reversed the decision to fill the interstices with *state* law and held that the lower court should have applied *federal* law. In the other, the Court reversed a decision to fashion *federal* law and held that the lower court should have applied *state* law.

A. The Statute of Limitations Missing From Section 10(b)

Congress enacts many federal statutes that expressly or impliedly create rights of action but fail to provide an accompanying statute of limitations.[75] Despite the omission, the Supreme Court generally has been unwilling to permit a federal claim to go without a limitations period:

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71. *See Texas Industries*, 451 U.S. at 634-46; *see also id.* at 641 (stating that federal common law "exists only in . . . narrow areas").

72. *See id.* at 646-47.

73. Textile Workers Union v. Lincoln Mills, 353 U.S. 448, 457 (1957).

74. *See* Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 111 S. Ct. 2773 (1991); Kamen v. Kemper Fin. Serv., Inc., 111 S. Ct. 1711 (1991). In a similar fashion, the Court last Term elaborated on various requirements for actions under the federal securities laws with little help from the statutory text or legislative history. *See* Virginia Bankshares v. Sandberg, 111 S. Ct. 2749, 2763 (1991) (holding that shareholder failed to establish causation of damages necessary to establish an implied right of action under § 14(a) of Securities Exchange Act and Securities & Exchange Commission Rule 14a-9); Gollust v. Mendell, 111 S. Ct. 2173 (1991) (analyzing standing requirement for actions under § 16(b) of Securities Exchange Act).

75. *See* American Bar Association Committee on Federal Regulation of Securities, *Report of the Task Force on Statutes of Limitations for Implied Actions*, 41 Bus. Law. 645 (1986); Special Project, *Time Bars in Specialized Common Law: Federal Rights of Action and State Statutes of Limitations*, 65 Cornell L. Rev. 1011 (1980); *see also* Board of Regents v. Tomanio, 446 U.S. 478, 483 (1980) (noting that lack of limitations period is "void which is commonplace in federal statutory law").

> A federal cause of action "brought at any distance of time" would be "utterly repugnant to the genius of our laws." . . . Just determinations of fact cannot be made when, because of the passage of time, the memories of witnesses have faded or evidence is lost. In compelling circumstances, even wrongdoers are entitled to assume that their sins may be forgotten.[76]

To serve those purposes, firmly established rules are a necessity.[77] However, besides consuming inordinate amounts of time of the litigants and the judiciary, the efforts of the federal courts to articulate clear limitations rules instead have caused considerable uncertainty and confusion.[78]

Much of the difficulty comes in ascertaining *which* limitations period to incorporate into the deficient federal statute. Over 160 years ago, in *McCluny v. Sulliman*,[79] the Supreme Court held that the Rules of Decision Act[80] mandated federal courts to apply a state statute of limitations when a federal law lacked one. Since then, courts almost reflexively have "borrowed" or "absorbed" the limitations period applicable to the state cause of action "most analogous" to the federal claim.[81] At various times,

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76. Wilson v. Garcia, 471 U.S. 261, 271 (1985) (quoting Adams v. Woods, 6 U.S. (2 Cranch) 336, 341 (1805)); *see, e.g.*, Wood v. Carpenter, 101 U.S. 135, 139 (1879) (emphasizing that "[s]tatutes of limitation are vital to the welfare of society and they are favored in the law. They are found and approved in all systems of enlightened jurisprudence."); Bell v. Morrison, 26 U.S. (1 Pet.) 351, 360 (1828) (referring to statute of limitations as "wise and beneficial law . . . to afford security against stale demands, after the true state of the transaction may have been forgotten, or be incapable of explanation, by reason of the death or removal of witnesses"). *See generally* H. WOOD, A TREATISE ON THE LIMITATION OF ACTIONS AT LAW AND IN EQUITY §§ 1-5, at 1-7 (3d ed. J. Gould, 1901); Special Project, *supra* note 75, at 1016-18; *Developments in the Law—Statutes of Limitations*, 63 HARV. L. REV. 1177, 1185-86 (1950). *But see* Occidental Life Ins. Co. v. EEOC, 432 U.S. 355 (1977) (declining to apply state statute of limitations to federal claim and finding no limitations periods governing such claims).

77. *See* Chardon v. Fumero Soto, 462 U.S. 650, 667 (1983) (Rehnquist, J., dissenting) (remarking that "[f]ew areas of the law stand in greater need of firmly defined, easily applied rules than does the subject of period of limitations").

78. *See infra* text accompanying notes 79-237 & *supra* note 75 (citing authorities).

79. 28 U.S. (3 Pet.) 270, 277 (1830).

80. *See* 1 Stat. 92, 28 U.S.C. § 1652 (1988). The Act provides that

> [t]he laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as the rules of decisions in civil actions in the courts of the United States, in cases where they apply.

Id.

81. *See, e.g.*, International Union, United Auto., Aerospace & Agric. Implement Workers v. Hoosier Cardinal Corp., 383 U.S. 696, 704 (1966) (collecting authority); Campbell v. Haverhill, 155 U.S. 610, 613-18 (1895).

Critical of the practice of borrowing state limitations periods, the Federal Courts Study Committee recommended in 1990 that Congress adopt limitation periods for major federal claims that lack one and "fallback limitations periods" for claims implied by the courts. *See* FEDERAL COURTS STUDY COMMITTEE, REPORT OF THE FEDERAL COURTS STUDY COMMITTEE 93 (1990). Congress later partially implemented the recommendation. Section 313(a) of the Federal

however, the Court deviated from that course and looked to federal law to answer limitations questions when it determined that state law in some way conflicted with federal policy.[82] Such treatment is suggested by the preemption doctrine founded in the Supremacy Clause.[83]

Besides federalism concerns reflected in the Rules of Decision Act, the arbitrary nature of statutes of limitations might favor reliance on the law passed by a state legislature, a sentiment indicative of discomfort with judicial lawmaking.[84] Still, one might think it anomalous to worry about whether to apply a state statute of limitations when, in certain areas, the Supreme Court has given the lower courts carte blanche to displace state law and fashion entire bodies of substantive federal common law out of whole cloth.[85] Nevertheless, consistent with its federal common law decisions, the Supreme Court's decisions adding limitations periods to federal statutes reflect competition between federalism, separation of powers and jurisprudential concerns.

1. An Increased Willingness to "Federalize" Limitations Law?

Forced by legislative omission to divine limitations periods for increasing numbers of federal statutes, the Supreme Court in recent years repeatedly

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Courts Study Committee Implementation Act of 1990, which is part of the umbrella Judicial Improvements Act of 1990, Pub. L. No. 101-650, 104 Stat. 5114, provides that "[e]xcept as otherwise provided by law, a civil action arising under an Act of Congress after the date of the enactment of this section [December 1, 1990] may not be commenced later than 4 years after the cause of action accrues." *See* 28 U.S.C.A. § 1658 (West 1991). Congress apparently was reluctant to disturb well-established limitations provisions previously fashioned by the courts. *See* H. REP. No. 101-734, 101st Cong., 2d Sess. 24, *reprinted in* 1990 U.S. CODE CONG. & ADMIN. NEWS 6860, 6870.

82. *See* Occidental Life Ins. Co. v. EEOC, 432 U.S. 355 (1977) (declining to apply state statute of limitations to federal claim); McAllister v. Magnolia Petroleum Co., 357 U.S. 221, 224 (1958) (same); Holmberg v. Armbrecht, 327 U.S. 392, 395-97 (1946) (refusing to apply state statute of limitations to federal equitable claim); *see also* Hart, *The Relations Between State and Federal Law*, 54 COLUM. L. REV. 489, 534 (1954) (reporting that "growing body of federal decisions are finding in the interstices of federal legislation an authorization to develop uniform decisional rules governing many kinds of legal relations between private persons").

83. *See* U.S. CONST. art. VI, cl. 2; *see, e.g.*, Wisconsin Public Intervenor v. Mortier, 111 S. Ct. 2476, 2481 (1991) (stating that "[u]nder the Supremacy Clause . . ., state laws that 'interfere with, or are contrary to the laws of congress, made in pursuance of the constitution' are invalid") (quoting Gibbons v. Ogden, 9 Wheat. 1, 211 (1824) (Marshall, C.J.)). *See generally* L. TRIBE, *supra* note 6, §§ 6-26 to 6-29, at 481-511.

84. *See* International Union, United Auto., Aerospace & Agric. Implement Workers v. Hoosier Cardinal Corp., 383 U.S. 696, 703 (1966); Burbank, *Interjurisdictional Preclusion, Full Faith and Credit and Federal Common Law*, 71 CORNELL L. REV. 733, 769 (1986); Hill, *State Procedural Law in Federal Nondiversity Litigation*, 69 HARV. L. REV. 66, 94 (1955); *see also* Mishkin, *supra* note 21, at 803-04 (remarking that "there may be situations where state law is chosen only because of special difficulty in the judicial framing of a definite federal rule on a specific issue in an area otherwise totally national") (footnote omitted). For an interesting discussion of the view that judges should borrow state statutes of limitations to avoid the appearance of arbitrariness appropriate for legislatures but not the courts, see Judge Posner's concurring opinion in Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385, 1394 (7th Cir. 1990) (Posner, J., concurring), *cert. denied*, 111 S. Ct. 2887 (1991).

85. *See supra* text accompanying notes 62-68 (discussing *Lincoln Mills*).

addressed the question. With little hint of any overall direction, the Court has drifted back and forth between the borrowing of state or federal law.[86] Several generalizations, however, may be made. The Court in the 1980s appeared more willing than in the past to deviate from the traditional borrowing of state statutes and to borrow limitations periods from other federal laws. Nonetheless, in deference to federalism concerns, the Court repeatedly emphasized the continued vitality of the conventional wisdom about the presumptive borrowing of state limitations periods. Considering many federal as well as state alternatives, the Court always selected a limitations period passed by a state or federal legislature. The Court never endeavored to fashion a limitations period designed specifically for the particular federal statute in question.

In *DelCostello v. International Brotherhood of Teamsters*,[87] the Supreme Court in 1983 rejected rigid adherence to borrowing state limitations periods for federal statutes and instead applied a time limit from another federal statute.[88] Rejecting outright *McCluny v. Sulliman*'s conclusion that the Rules of Decision Act required application of a state limitations period,[89] the Court reasoned that Congress could not have intended the borrowing of state law inconsistent with federal law.[90] Consequently, the Court accepted the displacement of state law "when a rule from elsewhere in federal law clearly provides a closer analogy than available state statutes, and *when the policies at stake and the practicalities of litigation make that rule a significantly more appropriate vehicle for interstitial lawmaking.*"[91] The Court

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86. For a discussion of recent developments in the Court's statute of limitations jurisprudence concluding that the Court moved to minimize the costs of borrowing state limitations law, see Burbank, *Of Rules and Discretion: The Supreme Court, Federal Rules and Common Law*, 63 NOTRE DAME L. REV. 693 (1988).

87. 462 U.S. 151 (1983).

88. In a previous decision involving a similar claim, the Court, although reserving the question whether a federal limitations period should apply, had selected between two state statutes of limitations and analyzed which state claim was most analogous to the federal claim. *See* United Parcel Serv., Inc. v. Mitchell, 451 U.S. 56 (1981).

89. *See* DelCostello v. International Bhd. of Teamsters, 462 U.S. 151, 159 n.13 (1983). In so holding, the Court emphasized that the Act

> authorizes application of state law *only* when federal law does not "otherwise require or provide." . . . [T]he choice of a limitations period for a federal cause of action is itself a question of *federal* law. *If the answer to that question (based on the policies and requirements of the underlying cause of action) is that a timeliness rule drawn from elsewhere in federal law should be applied, then the Rules of Decision Act is inapplicable by its own terms.*

Id. (citations omitted) (emphasis added); *see also* Westen & Lehman, *supra* note 24, at 369-77 (characterizing argument that Rules of Decision Act prohibits federal common law contrary to state rules as "absurd"). The Court's conclusion has been criticized by some as contrary to the Rules of Decision Act. *See* Burbank, *supra* note 86, at 703-04 ; Burbank, *supra* note 84, at 759-62; Merrill, *supra* note 12, at 30-33; *see also* M. REDISH, *supra* note 37, at 119-25 (criticizing development of most federal common law as contrary to Rules of Decision Act and general principles of federalism).

90. *See DelCostello*, 462 U.S. at 161.

91. *Id.* at 172 (emphasis added).

concluded that, because a uniform limitations period from a related federal labor statute would further federal policies in a way that state law had not, the federal limitations period from that statute should apply to another federal labor statute.[92] Despite rejecting state law in this circumstance, the Court cautioned that "state law remains the norm for borrowing of limitations periods." Indeed, the Court stated that previous decisions "generally concluded that Congress intended that the courts apply the most analogous statute of limitations under state law."[93]

Despite the borrowing of federal rather than state law in *DelCostello*, the Court in 1989 in *Reed v. United Transportation Union*[94] applied a state limitations period to a claim that a union and various officers violated a member's free speech rights guaranteed by the Labor-Management Reporting and Disclosure Act.[95] It described *DelCostello* as "a closely circumscribed exception" to the general state law borrowing doctrine.[96] Finding the claim analogous to a state personal injury action and that state limitations periods would not frustrate national labor policy, the Court refused to borrow a limitations period from the same federal labor statute utilized in *DelCostello*[97] and instead applied a state personal injury statute of limitations.[98]

As *Reed* and other decisions make evident, the Court takes to heart *DelCostello*'s emphasis that state law normally is the source for a limitations period. In 1985 in *Wilson v. Garcia*,[99] the Court adhered to standard practice and held that courts should borrow the forum state's limitations period for personal injury actions for federal civil rights claims under Section 1983.[100] The Court found that state personal injury statutes would

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92. *See id.* at 165-69. The Court held that, rather than borrowing a limitations period from state law, the six-month limitations period for filing an unfair labor practice charge under the National Labor Relations Act, 29 U.S.C. § 10(b), should apply to claims against unions for breach of the duty of fair representation and against employers for breach of the collective bargaining agreement under § 301 of the Labor Management Relations Act. *See DelCostello*, 462 U.S. at 169.

93. *See id.* at 158 (footnote omitted). In a footnote, the Court admitted that Congress ordinarily failed in these circumstances to consider the limitations question but "that, absent some sound reason to do otherwise, Congress would *likely intend* that the courts follow their previous practice of borrowing state provisions." *Id.* at 158-59 n.12 (citation omitted) (emphasis added).

Justice Stevens dissented and claimed that, because federal law did not "otherwise require or provide," the Rules of Decision Act compelled application of state law. *See id.* at 172-73 (Stevens, J., dissenting). He emphasized that "[f]or the past century federal judges have 'borrowed' state statutes of limitations, not because they thought it was a sensible form of 'interstitial lawmaking,' but rather because they were directed to do so by the Congress of the United States." *Id.* at 172-73 (footnote omitted).

94. 488 U.S. 319 (1989).

95. *See id.* at 334.

96. *Id.* at 324.

97. *See id.* at 332-33.

98. *See id.* at 325-29.

99. 471 U.S. 261 (1985). Justice Stevens, who dissented in *DelCostello*, *see supra* note 93, wrote the opinion for the Court.

100. *See* 42 U.S.C. § 1983.

provide the necessary uniformity and that federal interests did not mandate national uniformity.[101] Rejecting other potential statutes of limitations for state law claims as inconsistent with federal law,[102] the Court held that a federal civil rights claim was most analogous to a state personal injury claim and thus that the personal injury limitations period was the "best alternative available."[103]

The Court soon learned that the solution of *Wilson v. Garcia* was more complicated than it may have at first seemed. Facing numerous statutes of limitations in the same state for different types of personal injury actions, the Court in *Owens v. Okure*[104] held that the courts should borrow the general or residual personal injury statute of limitations. The policy rationale offered by the Court for that selection was that the statute of limitations could be "readily ascertain[ed], with little risk of confusion or unpredictability."[105] Because of the wide variety of Section 1983 claims, the Court rejected a limitations period applicable to intentional personal injury claims.[106]

In contrast, the Court turned federal in adding a limitations period to another federal statute. In *Agency Holding Corp. v. Malley-Duff & Associates*,[107] the Court selected the proper limitations period for civil actions brought under the Racketeer Influenced and Corrupt Organizations Act (RICO).[108] The Court reiterated *DelCostello*'s holding that the Rules of Decision Act did not mandate application of state limitations periods.[109] Nonetheless, the Court still suggested that the Act ordinarily required application of state statutes of limitation and that borrowing federal law is a narrow exception to this general rule.[110] Moreover, presuming Congressional awareness of the application of state limitations periods, the Court reasoned, as it did in *DelCostello*, that to borrow state law ordinarily is consistent with the intent of Congress.[111]

The Court recognized the difficulties encountered in attempting to find a state claim analogous to a RICO claim, which may be predicated on offenses running the gamut from arson to securities fraud.[112] Finding a

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101. *See* Wilson v. Garcia, 471 U.S. 261, 275 (1985).

102. *See id.* at 278-79. The Court rejected catchall limitations periods and those governing claims based on misconduct by state officials. *See id.* at 276.

103. *Id.* at 276 (citation omitted); *see also* Goodman v. Lukens Steel Co., 482 U.S. 656, 660-64 (1987) (plurality opinion) (extending *Wilson v. Garcia* to discrimination claim under 42 U.S.C. § 1981 and holding that state personal injury statutes of limitations applied).

104. 488 U.S. 235, 243-48 (1989).

105. *Id.* at 248.

106. *See id.* at 249-50 & n.11.

107. 483 U.S. 143 (1987).

108. *See* Pub. L. No. 91-452, 84 Stat. 922 (1970) (codified at 18 U.S.C. §§ 1961-1968).

109. Agency Holding Corp. v. Malley-Duff & Assocs., 483 U.S. at 146.

110. *See id.* at 147-48.

111. *See id.* at 147. *But see infra* text accompanying notes 338-52 (discussing Congress's lack of knowledge of court decisions on issues lacking public controversy).

112. *See Agency Holding*, 483 U.S. at 149. The Court observed that

[s]ome courts have simply used the state limitations period most similar to the

"confused, inconsistent, and unpredictable" set of limitations rules,[113] the Court concluded that a uniform limitations period was necessary.[114] The need for uniformity was particularly acute because the multistate nature of the transactions giving rise to RICO liability created the potential for forum shopping if state limitations periods were borrowed.[115] The Court concluded that federal policies and the practicalities of litigation provided "compelling reasons for federal pre-emption" of state law.[116] Besides rejecting the application of state limitations periods, the Court refused to borrow a five year statute of limitations for criminal prosecutions under RICO[117] because in its view a federal antitrust statute, the Clayton Act, offered a "better federal law analogy."[118] Consequently, the Court adopted the four year statute of limitations from the Clayton Act.[119]

In light of the shift from state to federal and so on, it is difficult to discern a definite pattern to the Court's recent decisions concerning selection of a limitations period. However, as *DelCostello* and *Agency Holding*

> predicate offenses alleged in the particular RICO claim . . . . Others . . . have chosen a uniform statute of limitations applicable to all civil RICO actions brought within a given state . . . . The courts, however, have uniformly looked to state statutes of limitations rather than a federal uniform statute of limitations.

Id. at 148-49 (citations omitted).

113. *Id.* at 148 (citations omitted).

114. *See id.* at 149; *see also* International Union, United Auto., Aerospace & Agric. Implement Workers v. Hoosier Cardinal Corp., 383 U.S. 696, 712 (1966) (White, J., dissenting) (objecting to use of state statute of limitations for federal claim and arguing for uniform limitations period to avoid "unnecessary complexities and opportunities for vexatious litigation").

115. *See Agency Holding*, 483 U.S. at 154 (remarking that "[t]he multistate nature of RICO indicates the desirability of a uniform federal statute of limitations. With the possibility of multiple state limitations, the use of state statutes would present the danger of forum shopping . . .") (citations omitted). The Court distinguished Wilson v. Garcia, 471 U.S. 261 (1985), on the ground that "the typical § 1983 suit, in which there need not be any nexus to interstate commerce, . . . most commonly involves a dispute wholly in one State." *Agency Holding*, 483 U.S. at 154; *see supra* text accompanying notes 99-103 (discussing *Wilson v. Garcia*).

116. *Agency Holding*, 483 U.S. at 153.

117. *See* 18 U.S.C. § 3282 (requiring indictment within five years of commission of offense).

118. *Agency Holding*, 483 U.S. at 155-56. Because Congress apparently modelled RICO after the Clayton Act and intended to duplicate the Act's enforcement scheme in the new law, the Court intimated that Congress intended the Clayton Act's limitations period to apply to RICO claims. *See id.* at 150-51.

119. *See id.* at 156. Justice Scalia concurred in the judgment. *See id.* at 170 (Scalia, J., concurring in judgment). Claiming that the Court was taking a "giant leap into the realm of legislative judgments," *id.* at 157, *see id.* at 169, Justice Scalia stated that he would apply state limitations law unless inconsistent with the federal statute and in that event would apply no limitations period, *see id.* at 163-64. Justice Scalia accused the majority of "prowling hungrily through the Statutes at Large for an appetizing federal limitations period, and pouncing on the Clayton Act." *Id.* at 166; *see also* Reed v. United Transp. Union, 488 U.S. 319, 334 (1989) (Scalia, J., concurring in judgment) (reiterating "view that the Court should apply the appropriate state statute of limitations (if any at all) when a federal statute lacks an explicit limitations period").

suggest, the Court appeared more willing than in the past to select a limitations period from another federal statute enacted by Congress rather than a law passed by a state legislature. The Court unequivocally rejected the federalism concerns embodied in the Rules of Decision Act as mandating the "borrowing" of state law. It, however, repeated that the Act generally requires the application of state limitations periods. To address separation of powers concerns, the Court at times resorted to the fiction that, in light of the well-established rule mandating the borrowing of state limitations periods, Congress generally must have intended that state law apply.

In the end, the Court in each case had a range of alternative limitation, periods from which to choose. The test originally formulated in *DelCostello*, and applied in *Agency Holding*, expressly weighed the federal policies implicated as well as the practicalities of litigation under the particular federal statute. Such a vague test places minimal constraints on the Court's power to select a limitations period. Indeed, in borrowing a federal limitations period, the Court in *Agency Holding* refused to apply a limitations period applicable to another claim in the very same statute in question but instead looked to another federal law.[120] Nonetheless, concern with the outright appearance of judicial lawmaking may have deterred the Court from considering whether to fashion the best limitations period for the statute in question—that is, one separate and apart from a limitations period enacted by a state or federal legislature.

2. A Federal Limitations Period for Section 10(b)

A provision of a federal statute central to the national system of securities regulation, Section 10(b) of the Securities Exchange Act of 1934,[121] lacks a limitations period, as well as an express private right of action. Designed to deal with fraudulent, misleading and deceptive practices in the trading of securities on the national market,[122] the Act, along with the Securities Act of 1933,[123] sought to remedy the shortfalls of state laws

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120. Consequently, *Agency Holding* seems somewhat inconsistent with the Court's recent decision in *Lampf, Pleva* in which the Court found that a limitations period for an express claim under a federal statute also applied to a claim implied into that same statute. *See infra* text accompanying notes 157-237.

121. Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a-78ll (1988); 15 U.S.C.A. §§ 78a-78ll (West 1981 & Supp. 1990)). Section 10(b) of the Act, 15 U.S.C. § 78j(b) (1988), makes it unlawful for any person:

> [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

122. *See* Securities Exchange Act of 1934 § 2, 15 U.S.C. § 78b (1988) (stating that Act was designed to "perfect the mechanisms of a national market system for securities"); 1 L. Loss & J. SELIGMAN, SECURITIES REGULATION 148-52 (3d ed. 1989).

123. *See* Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a-77aa (1988)).

(without completely preempting state regulation of the field) and to create a minimum disclosure and anti-fraud scheme governing interstate securities transactions.[124] To enforce Section 10(b)'s provisions, the Securities and Exchange Commission (SEC) promulgated the now-famous Rule 10b-5.[125] "[J]udicial interpretation and application, legislative acquiescence, and the passage of time have removed any doubt that a private cause of action exists for a violation of § 10(b) and Rule 10b-5, and constitutes an essential tool for enforcement of the 1934 Act's requirements."[126]

When courts imply a right of action in a statute, many questions often arise concerning the parameters of the claim.[127] As an implied right of action, it is not surprising that Section 10(b) lacks a statute of limitations. Assuming that a limitations period must be supplied,[128] the next question is which is the appropriate limitations period, a subject of considerable litigation and commentary.[129]

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124. *See* Basic Inc. v. Levinson, 485 U.S. 224, 244 n.22 (1988); Herman & MacLean v. Huddleston, 459 U.S. 375, 389 (1983); 1 L. Loss & J. SELIGMAN, *supra* note 122, at 148-52, 221.

125. Rule 10b-5, 17 C.F.R. § 240.10b-5 (1990), in relevant part, provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national security exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with purchase or sale of any security.

126. Basic Inc. v. Levinson, 485 U.S. 224, 230-31 (1988) (citations omitted); *see, e.g.*, Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983). The Court adheres to that view even though over the last two decades it has exhibited considerable resistance to implying private rights of action into the federal securities laws. *See, e.g.*, Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979) (Investment Advisers Act of 1940); Touche Ross & Co. v. Redington, 442 U.S. 560 (1979) (§ 17(a) of Securities Exchange Act); *see also* Frankel, *Implied Rights of Action*, 67 VA. L. REV. 553 (1981) (discussing costs and benefits of implied rights of action under federal securities laws). *But see* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 374-82 (1982) (implying cause of action into Commodity Exchange Act).

127. *See generally* P. BATOR, D. MELTZER, P. MISHKIN, & D. SHAPIRO, HART & WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM 943-50 (3d ed. 1988). As in federal common law decisions generally, separation of powers issues arise frequently in implying rights of action into federal statutes. *Compare* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 374-82 (1982) (rejecting separation of powers arguments and implying cause of action into statute), *with* Cort v. Ash, 422 U.S. 66 (1975) (focusing on Congressional intent in deciding not to imply right of action into statute).

128. I assume here that the federal courts should supply a limitations period to a statute lacking one. *See supra* text accompanying notes 75-78 (reviewing reasons favoring adding statute of limitations to deficient federal statute). However, if one believes (as Justice Scalia seems to) that Congress may be forced to act if courts do not fill such statutory gaps, *see infra* text accompanying notes 334-52 (discussing separation of powers objections to interstitial lawmaking), then it may be unwise to add a limitations period.

129. *See, e.g.*, Guin & Donaldson, *The Insider Trading and Securities Fraud Enforcement*

With little analysis of the specific purposes of the federal securities laws, the lower courts until recent years generally followed the traditional rule and borrowed a state limitations period for Section 10(b) and Rule 10b-5 claims.[130] That is true even though the claims were by definition interstate[131] and the securities transactions at issue frequently involved conduct and actors in numerous states.[132] In borrowing state law, there was some disagreement among the lower courts about what the "most analogous" state law claim was to a cause of action under Section 10(b). Courts commonly found either state fraud or Blue Sky claims to be most analogous and therefore borrowed state limitations periods applicable to those state law causes of action.[133] The result was a considerable variety of limitations periods applied to the same type of claim and similar alleged misconduct. The limitations periods applied to Section 10(b) actions ranged at various times from one (Maryland) to ten years (Tennessee).[134]

Besides spawning an abundance of litigation, the variation of state statutes of limitation applied to Section 10(b) caused a significant lack of uniformity and certainty.[135] Commentators appeared to be near unanimous on the need for a uniform federal limitations period.[136] Numerous reasons

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Act of 1988: Has Congress Supplied a Limitations Period Appropriate for Use in Private 10b-5 Actions?, 47 WASH. & LEE L. REV. 541, 575-85 (1990); Bloomenthal, *The Statute of Limitations and Rule 10b-5 Claims: A Study in Judicial Lassitude*, 60 U. COLO. L. REV. 235 (1989); Garrett, *The Ramshackle Edifice: Limitations Periods for Private Actions Under Rule 10b-5*, 28 DUQ. L. REV. 1 (1989).

130. *See, e.g.*, Friedlander v. Troutman, Sanders, Lockerman, and Ashmore, 788 F.2d 1500, 1505 (11th Cir. 1986); Mosesian v. Peat, Marwick, Mitchell & Co., 727 F.2d 873, 876-77 & n.5 (9th Cir. 1984), *cert. denied*, 469 U.S. 932 (1985); Hackbart v. Holmes, 675 F.2d 1114, 1120 (10th Cir. 1982).

131. *See* Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b) (stating that "[i]t shall be unlawful for any person, directly or indirectly, *by the use of any means or instrumentality of interstate commerce* . . . .") (emphasis added); *id.* at § 2(1), 15 U.S.C. § 78b (stating need for regulation of interstate securities transactions).

132. *See, e.g.*, *infra* text accompanying notes 159-65 (discussing citizenship of various parties in *Lampf, Pleva*).

133. *See* A. JACOBS, LITIGATION & PRACTICE UNDER RULE 10B-5 § 235.02, at 10-21 to 10-30 (2d ed. 1988); American Bar Association Committee on Federal Regulation of Securities, *supra* note 75, at 659-66.

134. *See* A. JACOBS, *supra* note 133, at § 235.02, at 10-21 to 10-30. Although the Court of Appeals for the Sixth Circuit had not addressed the issue, the district courts borrowing Tennesee limitations periods before *Lampf, Pleva* were split on whether a ten year catch-all statute of limitations, a three year statute applicable to fraud, or the two year Blue Sky statute of limitations applied to a § 10(b) claim. *See* Nichols v. Merrill Lynch, Pierce, Fenner & Smith, 706 F. Supp. 1309, 1318-21 (M.D. Tenn. 1989) (describing development of case law on subject); Media General, Inc. v. Tanner, 625 F. Supp. 237, 245-47 (W.D. Tenn. 1985) (same).

135. *See supra* note 129 (citing authorities).

136. *See, e.g.*, *supra* note 129 (citing authorities); L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 992-1003 (2d ed. 1988); 2 T. HAZEN, THE LAW OF SECURITIES REGULATION § 13.8, at 128 n.6 (practitioner's ed., 2d ed. 1990) (collecting commentary); American Bar Association Committee on Federal Regulation of Securities, *supra* note 75, at 646-47, 656-57; *see also* Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385, 1389 (7th Cir. 1990) (Easterbrook, J.) ("With a unanimity unmatched in any other corner of securities law, everyone wants a simpler

were offered in support of that view, including that Congress intended for national regulation, that ready limitations periods are available in the federal securities laws, that the confused state of the law wasted judicial resources and was unfair to litigants, and that the borrowing of state law encouraged forum shopping.[137] As Professor Loss put it, "[w]ould it not be eminently more consistent with the overall statutory scheme to look to what Congress itself did when it was thinking specifically of private actions in securities cases than to a grab-bag of more or less analogous state statutes?"[138]

Once it is decided to look to other than state law, there are many federal limitations periods from which to choose. The Securities Exchange Act of 1934 sets forth express limitations periods for actions brought under Section 9[139] (prohibiting manipulation of securities prices) and Section 18[140] (prohibiting the filing of misleading documents with the Securities & Exchange Commission). For both, Congress created limitations periods that vary somewhat in specific language but generally limit the filing of suit to one year from actual or constructive discovery, or at the most three years from the date of the alleged misconduct.[141] The Securities Act of 1933, which, *inter alia*, prohibits omissions and misrepresentations in registration statements,[142]

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way—and to everyone that means a uniform federal statute of limitations."), *cert. denied*, 111 S. Ct. 2887 (1991).

137. *See* Guin & Donaldson, *supra* note 129, at 542; Bloomenthal, *supra* note 129, at 271-72; Garrett, *supra* note 129, at 18-24. Besides the fact that numerous actors from many states often are involved in significant securities transactions, forum shopping is a distinct possibility in light of the broad venue and service provisions of the Securities Exchange Act. *See* Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (1988).

138. L. Loss, *supra* note 136, at 995.

139. *See* Securities Exchange Act § 9, 15 U.S.C. § 78i (1988). Section 9(e), 15 U.S.C. § 78i(e), provides that "No action shall be maintained to enforce any liability created under this section, unless brought within one year after discovery of the facts constituting the violation and within three years after such violation." Section 9, which generally prohibits deception or manipulation of securities prices, includes a number of elements making it difficult for plaintiffs to establish a violation of the section and, therefore, is rarely used. *See* L. Loss, *supra* note 136, at 919-21; *see also infra* note 219 (stating Justice Kennedy's questioning in *Lampf, Pleva* of Court's application of § 9(e) limitations language to § 10(b) claims).

140. *See* Securities Exchange Act § 18, 15 U.S.C. § 78r (1988). Section 18(c), 15 U.S.C. § 78r(c), provides that "No action shall be maintained to enforce any liability under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued." Section 18 generally imposes liability on any person who makes, or causes to be made, any material misrepresentation or omission in a document filed with the SEC pursuant to the Securities Exchange Act or rule thereunder. *See* L. Loss, *supra* note 136, at 922-23. Because of various prerequisites to liability, it is difficult to establish a violation of that section. *See id.*

141. In addition, § 29(b) of the Securities Exchange Act, 15 U.S.C. § 78cc(b), which allows for rescission of certain contracts that violate the Act, has a similar one/three year limitations scheme, which was added by amendment in 1938. *See* Act of June 25, 1938, ch. 677, § 3, 52 Stat. 1076.

142. Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k(a) (1988), allows purchasers to bring suit against persons involved in the issuance of a registration statement containing a material misrepresentation or omission of a material fact. *See generally* Folk, *Civil Liabilities Under the Federal Securities Acts: The BarChris Case*, 55 VA. L. REV. 1 (1969); Landis, *The*

also includes a similar, though not identical, one/three year limitations scheme.[143]

However, there is some variation in the limitations periods found in the federal securities laws. Actions brought under the short-swing profit provision of Section 16(b) of the 1934 Act restricting trading of securities by corporate insiders are subject to a maximum two-year limitations period.[144] A longer alternative is the five year statute of limitations provided in the Insider Trading and Securities Fraud Enforcement Act of 1988, which amended the Securities Exchange Act to expressly prohibit insider trading, a potent form of securities fraud.[145] Thus, the 1934 Act, as amended, includes at least three different limitations periods ranging from one to five years.

Relying on *DelCostello* and *Agency Holding*, some courts of appeals beginning in 1988 started to borrow a federal limitations period applicable to some claims expressly created by the Securities Exchange Act.[146] Other circuits, however, refused to do so.[147] Until the Supreme Court's recent edict on the

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Legislative History of the Securities Acts of 1933, 28 GEO. WASH. L. REV. 29 (1959); Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171 (1933).

143. Section 13 of the 1933 Act, 15 U.S.C. § 77m (1988), provides in pertinent part that

> No action shall be maintained to enforce any liability created . . . unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence . . . . In no event shall any such action be brought to enforce a liability created . . . more than three years after the security was bona fide offered to the public, or . . . more than three years after the sale.

Id. Section 13's one/three year limitations period applies to claims under § 11, *supra* note 142, and § 12(2) of the 1933 Act, 15 U.S.C. § 77l (1988), which provides a remedy for a purchaser of securities damaged by false statements made by the seller.

144. *See* Securities Exchange Act § 16(b), 15 U.S.C. § 78p(b) (1988). Section 16(b), which requires the disgorgement of unlawful profits from trading in securities by corporate insiders, sets a two year period of repose. It specifically provides that "no . . . suit [to enforce its provisions] shall be brought more than two years after the date [the] profit [in dispute] was realized." *See id.* Congress may have selected this shorter limitations period because violation of § 16(b) is a strict liability offense. *See generally* L. Loss, *supra* note 136, at 541-82.

145. *See* Pub. L. No. 100-704, § 5(b)(4), 102 Stat. 4680, 4681, 15 U.S.C. § 78t-1(b)(4) (1988) (stating that "[n]o action may be brought under this section more than 5 years after the date of the last transaction that is the subject of the violation"). Similarly, the limitations period for securities fraud under the *American Law Institute's Federal Securities Code* requires suit within one year of discovery and a maximum of five years from the fraud. *See* AMERICAN LAW INSTITUTE, FEDERAL SECURITIES CODE § 1727(b), § 1727 comment 1 (1988). The commentary suggests that the one/three year scheme found in the Securities Exchange Act is too short. *See id.*

146. *See, e.g.*, Ceres Partners v. GEL Assoc. 918 F.2d 349 (2d Cir. 1990); Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385, 1387-90 (7th Cir. 1990), *cert. denied*, 111 S. Ct. 2887 (1991); *In re* Data Access Sys. Sec. Litig., 843 F.2d 1537, 1542-51 (3d Cir.) (en banc), *cert. denied*, 488 U.S. 849 (1988); *see also* Norris v. Wirtz, 818 F.2d 1329, 1331-33 (7th Cir.) (questioning practice of borrowing state statutes of limitations for § 10(b) claims before *Agency Holding*), *cert. denied*, 484 U.S. 943 (1987).

147. *See, e.g.*, Bath v. Bushkin, Gaims, Gaines & Jonas, 913 F.2d 817, 818-19 (10th Cir. 1990) (per curiam); Nesbit v. McNeil, 896 F.2d 380, 384-85 (9th Cir. 1990); Smith v. Duff & Phelps, Inc., 891 F.2d 1567, 1569-70 (11th Cir. 1990); Roney & Co. v. Goren, 875 F.2d 1218 (6th Cir. 1989).

question, In re *Data Access Systems Securities Litigation* was the leading decision borrowing a federal statute of limitations.[148] In that case, the Court of Appeals for the Third Circuit sitting *en banc* held that the Securities Exchange Act of 1934 provided a closer analogy than any state statute, and that federal policy and the practicalities of Section 10(b) litigation favored application of limitations periods from the Act.[149] Borrowing the most prevalent limitations period in the Securities Exchange Act, the court held that Section 10(b) claims were time-barred unless brought within one year after the plaintiff discovered, or should have discovered, the facts constituting the violation, and in no event more than three years after the violation.[150]

Data Access was received favorably in some quarters[151] and was followed by two circuits.[152] The commentary remained unanimous on one point—that the courts should select a limitations period for Section 10(b) claims from the federal securities laws, not state law.[153] However, the commentators differed on *which* limitations period was the most appropriate. Some argued that Congress, if it had considered the question, would have intended a one/three year statute of limitations to apply to Section 10(b) claims.[154] Others suggested the need for the longer five year statute of limitations added to the 1934 Act by the Insider Trading and Securities Fraud Enforcement Act.[155] The proposals focused primarily on the question of which, as a policy matter, was the best limitations period. None analyzed in detail the difficult questions concerning whether the judiciary was compelled by constitutional or statutory dictate to apply a state limitations period, or whether the courts could independently fashion a statute of limitations tailored for Section 10(b) even

148. 843 F.2d 1537 (3d Cir.) (en banc), *cert. denied*, 488 U.S. 849 (1988). Judge Aldisert, who wrote the *en banc* opinion, expressed similar views earlier in a separate opinion in Davis v. Birr, Wilson & Co., 839 F.2d 1369, 1370-76 (9th Cir. 1988) (per curiam) (Aldisert, J., sitting by designation, concurring).

149. *See In re* Data Access Sys. Sec. Litig., 843 F.2d 1537, 1545 (3d Cir.) (en banc), *cert. denied*, 488 U.S. 849 (1988).

150. *See id.* at 1550.

151. *See, e.g.*, Note, *The Proper Statute of Limitations on a Rule 10b-5 Action*, 23 IND. L. REV. 731 (1990); Note, *Statutes of Limitation for Section 10(b) and Rule 10b-5: A New Proposal for Uniformity*, 46 WASH. & LEE L. REV. 665 (1989). *But see* Guin & Donaldson, *supra* note 129, at 563-75 (criticizing *Data Access*).

152. *See* Ceres Partners v. GEL Assocs., 918 F.2d 349 (2d Cir. 1990); Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385 (7th Cir. 1990), *cert. denied*, 111 S. Ct. 2887 (1991). A conflict had existed about whether the federal limitations period adopted in *Data Access* and its progeny should be applied retroactively. *Compare* Hill v. Equitable Trust, 851 F.2d 691 (3d Cir. 1988) (applying *Data Access* retroactively), *cert. denied*, 488 U.S. 1008 (1989), *with* Levine v. NL Indus., 926 F.2d 199 (2d Cir. 1991) (declining to apply new rule retroactively) *and* Welch v. Cadre, 923 F.2d 989 (2d Cir. 1990) (same), *vacated and remanded in light of* James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991), and Lampf, Pleva, Prupis, & Petigrow v. Gilbertson, 111 S. Ct. 2773 (1991). *See also infra* note 216 (discussing Justice O'Connor's objection to retroactive application of Court's decision in *Lampf, Pleva*).

153. *See supra* text accompanying notes 135-38.

154. *See* Bloomenthal, *supra* note 129, at 257-62.

155. *See* Guin & Donaldson, *supra* note 129, at 575-85.

if some limitations period for another type of claim could be located in some other state or federal statute. Frustrated by years of avoidance of, or at least inattention to, the question, the commentators challenged the Supreme Court to resolve it.[156]

3. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*

Last Term, the Court squarely decided the question of the proper limitations period to apply to Section 10(b) and Rule 10b-5 actions. In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,[157] the Court, in a five-four decision, rejected the borrowing of state statutes of limitations for Section 10(b) claims. Presented with numerous federal options, including several from the Securities Exchange Act of 1934, the Court selected the one year from actual or constructive discovery, with a maximum of three years from the alleged misconduct,[158] found in certain provisions of the Securities Exchange Act as well as the Securities Act of 1933. The five opinions constitute a microcosm of the recurring debate about federalism, separation of powers and jurisprudential questions with respect to federal common lawmaking.

The dispute in *Lampf, Pleva* arose from the sale of Connecticut limited partnerships formed to purchase and lease computer hardware and software.[159] Lampf, Pleva, Lipkind, Prupis & Petigrow, a New Jersey law firm, provided legal services and rendered an opinion on the tax consequences of investing in the partnerships.[160] Investors purchased units in the partnerships from 1979 to 1981.[161] The partnerships failed. By early 1983, plaintiffs received notice from the Internal Revenue Service (IRS) of an investigation.[162] The IRS disallowed the tax benefits in 1985.[163]

In November 1986 and June 1987 in the federal district court for the District of Oregon, John Gilbertson and other plaintiffs, residents of Oregon, California and Washington,[164] sued Lampf, Pleva and a number of other defendants from a variety of different states involved in the preparation of the offering memoranda for the partnerships.[165] Plaintiffs allegedly first

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156. *See* Bloomenthal, *supra* note 129, at 296-97; Garrett, *supra* note 129, at 34-40.

157. 111 S. Ct. 2773 (1991).

158. *See supra* text accompanying notes 139-45 (outlining various limitations periods in Securities Exchange Act and Securities Act).

159. *See* Lampf, Pleva, Lipkind, Prupis, Petigrow v. Gilbertson, 111 S. Ct. 2773, 2776 (1991).

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.* at 2776-77.

164. Brief for Respondents at 2-3, Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 111 S. Ct. 2773 (1991) (No. 90-333).

165. *See* 111 S. Ct. at 2776. The other defendants were New York and New Jersey parties who sold equipment to the partnerships, New York and Texas equipment appraisers identified in the offering memoranda, New York and New Jersey residents who appraised the software, equipment lessees from Delaware, Illinois, New York and North Carolina, and software marketing companies from New York, New Jersey and Pennsylvania. *See* Brief for Petitioner, Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 111 S. Ct. 2773 (1991) (No. 90-333).

became aware of misrepresentations made by the defendants in 1985 when the IRS disallowed the tax benefits.[166]

Following the well-established Ninth Circuit practice of "borrowing" analogous state statutes of limitations,[167] the district court applied Oregon's two-year statute of limitations applicable to fraud claims to the Section 10(b) claims.[168] Finding that the declining financial condition of the partnerships placed the plaintiffs on inquiry notice of the fraud as early as October 1982,[169] the district court ruled that the claims were time barred and granted summary judgment for defendants.[170] Although agreeing that Oregon law supplied the proper limitations period, the Court of Appeals for the Ninth Circuit reversed.[171] The court held that disputed factual issues about when plaintiffs should have discovered the alleged fraud precluded summary judgment.[172]

In an opinion by Justice Blackmun, the Supreme Court reversed. In a part of the opinion joined by only a plurality of the Court, Justice Blackmun reviewed the Court's previous decisions in this murky area.[173] At the outset, Justice Blackmun emphasized that the "usual rule" is to borrow the state limitations period for the cause of action most analogous to the federal claim; that "practice, derived from the Rules of Decision Act . . . has enjoyed sufficient longevity that we may assume that . . . Congress ordinarily 'intends by its silence that we borrow state law.'"[174] The plurality acknowledged the equally well-established exception to the "usual rule" that, because Congress could not have intended to select a state rule at odds with federal law, the courts should not blindly borrow a state limitations period that would frustrate federal policies.[175] Emphasizing that the borrowing doctrine may not be "lightly abandoned" and that the analysis is a "delicate one," Justice Blackmun offered a "hierarchical inquiry" for selecting a limitations period for a federal claim lacking one.[176]

The three-part hierarchy attempts to distill, if not reconcile, the Court's recent decisions on borrowing limitations periods. The first inquiry is whether there is a need for a uniform statute of limitations. Acknowledging that one

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166. *See* 111 S. Ct. at 2777.

167. *See, e.g.*, Robuck v. Dean Witter & Co., 649 F.2d 641, 644 (9th Cir. 1980).

168. *See* ORE. REV. STAT. § 12.110(1) (1989).

169. 111 S. Ct. at 2777.

170. *Id.*

171. *See* Reitz v. Leasing Consultants Associates, 895 F.2d 1418 (9th Cir. 1990) (memorandum disposition) (reporting reversal of district court decision).

172. *Lampf, Pleva*, 111 S. Ct. at 2777.

173. Chief Justice Rehnquist and Justices White and Marshall joined Justice Blackmun's opinion in its entirety. Justice Scalia also joined the opinion, except for Part IIA. *Id.* at 2783 (Scalia, J., concurring in part, concurring in judgment). Part IIA is Justice Blackmun's restatement of the law in the area. *See infra* text accompanying notes 174-80.

174. 111 S. Ct. at 2778 (quoting Agency Holding Corp. v. Malley Duff & Associates, 483 U.S. 143, 147 (1987)).

175. *See* 111 S. Ct. at 2778 (citing DelCostello v. Teamsters, 462 U.S. 151 (1983); *Agency Holding Corp., supra*; McAllister v. Magnolia Petroleum Co., 357 U.S. 221, 224 (1958)).

176. *See* 111 S. Ct. at 2778.

class of state statutes of limitations sometimes might provide the necessary uniformity, Justice Blackmun attempted to reconcile the approaches of *Wilson v. Garcia* in which the Court adopted one type of state statute in each of the states and *Agency Holding* in which the Court borrowed the limitations period from another federal statute.[177] If uniformity is deemed necessary, the next inquiry is whether the source of the uniform limitations period should be state or federal law.[178] As in *Agency Holding*, Justice Blackmun reiterated that the multistate character of a federal claim militates in favor of a uniform federal statute of limitations.[179] Finally, because of "the *presumption* of state borrowing," the court must ascertain "that an analogous federal source truly affords a 'closer fit' with the cause of action at issue than does any available state-law source."[180]

The remainder of Justice Blackmun's opinion represented the views of a majority of the Court. Observing that it had "repeatedly recognized" the implied private right of action under Section 10(b) and Rule 10b-5,[181] the Court understood that it was "faced with the awkward task of discerning the limitations period that Congress intended courts to apply to a cause of action it really never knew existed."[182] To accomplish that difficult task, the Court established a new rule for selecting statutes of limitations for causes of action implied into federal statutes:

> [W]here . . . the claim asserted is one implied under a statute that also contains an express cause of action with its own time limitation, a court should look *first* to the statute of origin to ascertain the proper limitations period. We can imagine no clearer indication of how Congress would have balanced the policy considerations implicit in any limitations provision than the balance struck by the same Congress in limiting similar and related protections. . . . *When the statute of origin contains comparable express remedial provisions, the inquiry usually should be at an end. Only where no analogous counterpart is available should a court then proceed to apply state-borrowing principles.*[183]

The Court therefore rejected the state law presumption when the right of action is implied in a statute that includes a limitations period for express actions. This represents a significant departure from the Court's past pron-

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177. *See id.* at 2779; *supra* text accompanying notes 99-103, 107-19 (discussing *Wilson v. Garcia* and *Agency Holding*).

178. *See* 111 S. Ct. at 2779.

179. *See id.*

180. *Id.* (emphasis added). In that regard, Justice Blackmun wrote that "commonality of purpose" and the "similarity of elements" between competing state and federal statutes are relevant. *Id.*

181. *Id.* at 2779-80 (citations omitted); *see supra* text accompanying notes 121-29 (discussing implied right of action under Section 10(b)).

182. 111 S. Ct. at 2780.

183. *Id.* (citations omitted) (emphasis added).

ouncements on the question and ultimately may erode to some degree the state law borrowing doctrine. Frequently, it would seem, a comprehensive statute includes a limitations period for some express claim "comparable" to the implied right in question. In those instances, *Lampf, Pleva* ordinarily would seem to require application of that limitations period, not that of any state.

Applying the new test, the Court looked to the Securities Exchange Act of 1934, which contains several express causes of action with explicit limitations periods, and did not consider state law alternatives.[184] The Court selected a variation of the one year from discovery with a three year "period of repose" found in the 1934 Act and the Securities Act of 1933.[185] The Court concluded that Section 9 of the 1934 Act,[186] barring willful manipulation of security prices, and Section 18,[187] prohibiting misleading filings, "target the precise dangers that are the focus of § 10(b)" and "facilitate a central goal: 'to protect investors against manipulation of stock prices . . . .'"[188] Because the various one-and-three year periods differ in terminology,[189] the Court sought to avoid any uncertainty and without explanation decreed that the specific limitations language of Section 9(e) would apply to all future Section 10(b) claims.[190]

The Court had before it many alternative federal and state limitations periods. The Court summarily rejected the shorter two year limitations period for claims brought under Section 16(b).[191] It also found unpersuasive the SEC's argument for adoption of the five year period set forth in the Insider Trading and Securities Fraud Enforcement Act's amendment to the Securities Exchange Act.[192] The Court emphasized that the recently enacted law focuses exclusively on insider trading[193] and that there was no suggestion that Congress intended "the enhanced protection" of a five year limitations period to apply to other provisions of the Securities Exchange Act.[194] The Court reached that

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184. *See id.*

185. *See supra* notes 139, 140, & 143 (quoting Securities Exchange Act §§ 9(e) and 18(c) and Securities Act § 13).

186. *See* 15 U.S.C. § 78i (1988).

187. *See* 15 U.S.C. § 78r (1988).

188. 111 S. Ct. at 2781 (citations omitted).

189. *See supra* notes 139, 140, & 143 (quoting provisions).

190. *See* 111 S. Ct. at 2782 n.9. The Court failed to mention, much less explain, its two previous suggestions that state law supplied the proper limitations period for § 10(b) claims. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 384 n.18 (1983); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 210 n.29 (1976).

191. *See supra* note 144 (quoting § 16(b)). The Court concluded that § 16(b) "differs in focus from § 10(b)" and therefore is not "an appropriate source from which to borrow a limitations period. . . ." 111 S. Ct. at 2780 n.5.

192. 111 S. Ct. at 2781.

193. *See* Insider Trading and Securities Fraud Enforcement Act § 5(a), 15 U.S.C. § 78t-1(a) (1988) (defining insider trading as "purchasing or selling a security while in possession of material, nonpublic information").

194. 111 S. Ct. at 2781. To the contrary, the Court read the Act, 15 U.S.C. § 78t-1(d), as suggesting the opposite conclusion. *See* 111 S. Ct. at 2781. That section provides that

conclusion even though Section 10(b) previously had been interpreted to prohibit insider trading.[195]

The Court rejected out of hand a new catch-all four year statute of limitations passed by Congress in 1990 to apply to future federal legislation lacking limitations periods.[196] The Court failed to address plaintiffs' contention that the Interstate Land Sales Full Disclosure Act,[197] which includes language nearly identical to Rule 10b-5, offered a more appropriate limitations period of three years from discovery.[198] Finally, the Court declined Justice Kennedy's invitation to borrow the one year from discovery but not the three year statute of repose from the Securities Exchange Act.[199] Characterizing the one-three year scheme as Congress's "indivisible determination" on the appropriate limitations period,[200] the Court condemned Justice Kennedy's proposal as "the type of judicial policymaking that our borrowing doctrine was intended to avoid."[201] The Court further reasoned that the three year period of repose would not frustrate the policies underlying Section 10(b).[202]

Although recognizing that equitable tolling of a statute of limitations ordinarily is permitted, the Court held that Congress barred such tolling in the case of Section 10(b) by enacting the one/three year scheme in the Securities Exchange Act.[203] Because the plaintiffs sued more than three years after the alleged misrepresentations, the Supreme Court reversed.[204]

"[n]othing 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 chapter or *the availability of any cause of action implied from a provision of this chapter.*" 15 U.S.C. § 78t-1(d) (emphasis added).

195. *See, e.g.*, Affiliated Ute Citizens v. United States, 406 U.S. 128, 150-54 (1972); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 847-57 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969). Although some § 10(b) cases might be based on insider trading and thus two limitations periods might apply to different claims based on the same alleged misconduct, the Court downplayed the significance of that possibility. *See* 111 S. Ct. at 2781.

196. 111 S. Ct. at 2782-83 n.10; *supra* note 81 (quoting statute).

197. *See* Pub. L. No. 90-448 § 1412, 15 U.S.C. § 1711(a)(2) (1988) (as amended by Pub. L. No. 96-153 § 406, 93 Stat. 1131 (1979)).

198. *See* Brief for Respondents, Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 111 S. Ct. 2773 (1991) (No. 90-333).

199. 111 S. Ct. at 2782 n.8.

200. *Id.*

201. *Id.*

202. *Id.* at 2782.

203. *Id.* The Court's finding is consistent with the lower court's refusal to permit equitable tolling under § 13 of the Securities Exchange Act, *see, e.g.*, Admiralty Fund v. Hugh Johnson & Co., 677 F.2d 1301, 1308 (9th Cir. 1982), and § 9(e) of the Securities Exchange Act, *see, e.g.*, Walck v. American Stock Exchange, Inc., 687 F.2d 778, 792 (3d Cir. 1982), *cert. denied*, 461 U.S. 942 (1983). Some commentators before *Lampf, Pleva* also concluded that equitable tolling was inappropriate when borrowing the one/three year limitations scheme for § 10(b) claims. *See* Bloomenthal, *supra* note 129, at 278-87; American Bar Association Committee on Federal Regulation of Securities, *supra* note 75, at 655; *see also* Norris v. Wirtz, 818 F.2d 1329, 1332 (7th Cir.) (remarking that "[t]he legislative history . . . makes it pellucid that Congress included statutes of repose [in the 1934 Act] because of fear that lingering liabilities would disrupt normal business and facilitate false claims. It was understood that the three year rule was to be absolute"), *cert. denied*, 484 U.S. 943 (1987).

204. *Lampf, Pleva*, 111 S. Ct. at 2782-83.

Voicing a blend of federalism, separation of powers and jurisprudential concerns, Justice Scalia concurred in part and concurred in the judgment.[205] Disagreeing with Justice Blackmun's hierarchy, he reiterated a previously stated view that, when a federal statute lacks a limitations period, state periods govern, and "if they are inconsistent with the purposes of the federal act, no limitations period exists."[206] Chiding the Court for implying rights of action into statutes,[207] Justice Scalia stated that such a practice "may be a proper function for common-law courts, but not for federal tribunals."[208] He suggested that, while the "irrational results" caused by the borrowing of state statutes of limitations in implied actions might have the beneficial effect of deterring future "judicial invention" of claims, it would be unfair to those forced to litigate.[209] In an apparent response to Justice Kennedy's dissent, Justice Scalia suggested that to imply a statute of limitations not expressly adopted by a legislature is "lawless."[210] By applying a limitations period from another section of the same statute, the majority in his view took the "most responsible," albeit artificial, course.[211]

Objecting on federalism and separation of powers grounds, Justice Stevens dissented.[212] He restated the view that, when a federal statute is silent on the subject, the Rules of Decision Act requires application of a state limitations period.[213] Justice Stevens further observed that "the Court has undertaken a lawmaking task that should properly be performed by Congress."[214] Although agreeing that a uniform limitations period is preferable to the chaos caused by the application of state law, Justice Stevens emphasized that "Congress, rather than the federal judiciary, has the responsibility for making the policy

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205. *Id.* at 2783 (Scalia, J., concurring in part, concurring in judgment).

206. *Id.* at 2783 (citing Agency Holding Corp. v. Malley-Duff & Assocs., 483 U.S. 143, 157-70 (Scalia, J., concurring in judgment)) and Reed v. United Transportation Union, 488 U.S. 319, 334 (1989) (Scalia, J., concurring in judgment); *see supra* note 119 (describing Justice Scalia's concurrence in *Agency Holding*).

207. 111 S. Ct. at 2783 (stating that "[t]he present case presents a distinctive difficulty because it involves one of those so-called 'implied' causes of action that, for several decades, this Court was prone to discover in—or, more accurately, create in reliance upon—federal legislation") (citation omitted). In other cases, Justice Scalia also has expressed distaste for implied private rights of action under the federal securities laws. *See* Virginia Bankshares v. Sandberg, 111 S. Ct. 2749, 2767 (1991) (Scalia, J., concurring in part, concurring in judgment) (agreeing that, although element supplied by Court to implied claim was "entirely contrary to the modern law of torts," it was correct because implied rights should be "narrow"); *cf.* Thompson v. Thompson, 484 U.S. 174, 192 (1988) (Scalia, J., concurring in judgment) (suggesting under another type of statute that courts "should get out of the business of implied rights of action altogether").

208. 111 S. Ct. at 2783 (citations omitted).

209. *Id.*

210. *Id.*

211. *Id.*

212. *Id.* (Stevens, J., dissenting). Justice Souter joined the dissent. *See id.*

213. *Id.* at 2784 n.2 (citing, inter alia, his dissent in *DelCostello*, *see supra* note 93).

214. *Id.* at 2783.

determinations . . . and choosing a new limitations period and its associated tolling rules."[215]

Articulating an approach that constitutes the clearest form of judicial lawmaking, Justice Kennedy dissented.[216] He agreed with the majority on the need for a uniform federal statute of limitations but disagreed with the adoption of the three year statute of repose.[217] That part of the statute of limitations, to Justice Kennedy, is simply bad policy:

> This absolute time-bar on private § 10(b) suits conflicts with traditional limitations periods for fraud-based actions, frustrates the usefulness of § 10(b) in protecting defrauded investors, and imposes severe practical limitations on a federal implied cause of action that has become an essential component of the protection the law gives to investors who have been injured by unlawful practices.[218]

Noting the Court's failure to identify reasons for arbitrarily borrowing the specific limitations language of Section 9(e), Justice Kennedy suggested that the Court had the competence to fashion one slightly different from any other found in the Securities Exchange Act.[219] His justification was that other actions under those laws lacked Section 10(b)'s "scope and coverage."[220] Fearing that victims of securities fraud may be unable to bear the heavy burden of discovering the fraud in time to bring suit,[221] Justice Kennedy bluntly stressed that the three year statute of repose "makes a § 10(b) action all but a dead letter for injured investors."[222]

The divisive debate among the five-four Court in *Lampf, Pleva* mirrors the tensions in the Supreme Court's federal common law jurisprudence. As

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215. *Id.* at 2784 (footnote omitted). Justice Stevens pointed out that, by adding a four year limitations period to the Clayton Act in 1955, Congress, not the federal courts, in the past created uniformity that it concluded was necessary. *Id.* at 2784 n.3 (citing 69 Stat. 283, 15 U.S.C. § 15b).

216. 111 S. Ct. at 2788 (Kennedy, J., dissenting). Justice O'Connor joined Justice Kennedy's dissent. She also wrote a separate dissent, joined by Justice Kennedy, objecting to the retroactive application of the new limitations period to this case on the ground that it was contrary to precedent. *See id.* at 2785 (O'Connor, J., dissenting). In a case decided the same day as *Lampf, Pleva*, a sharply divided Court, with no one opinion representing a majority, retroactively applied a previous decision invalidating a state statute on constitutional grounds. *See* James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991). Since *Lampf, Pleva* and *James B. Beam*, the lower courts have tended to apply the new Section 10(b) limitations rule retroactively. *See, e.g.*, Boudreau v. Deloitte, Haskins & Sells, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,194, at 91,024 (8th Cir. Aug. 16, 1991) (per curiam).

217. 111 S. Ct. at 2788 (Kennedy, J., dissenting).

218. *Id.*

219. *Id.* at 2788-89. Justice Kennedy suggested that it is odd to utilize the limitations period for the "rarely used remedy" of § 9 of the Securities Exchange Act. *Id.* at 2789; *see also* L. Loss, *supra* note 136, at 920 (referring to § 9(e) as "a dead letter"); *supra* note 139 (noting difficulties of establishing § 9 violation).

220. 111 S. Ct. at 2789 (Kennedy, J., dissenting).

221. *Id.* (remarking that "[t]he most extensive and corrupt schemes may not be discovered within the time allowed for bringing an express cause of action under the 1934 Act").

222. *Id.* at 2790.

in *DelCostello* and *Agency Holding*, the majority opts for a federal approach to the question and purports to discern Congressional intent, thus alleviating to some degree separation of powers concerns. National prevail over state interests in the federalism calculus. Though ostensibly paying deference to federalism concerns by labelling the borrowing of state law as a "presumption," the Court rejects state law, selects a federal statute of limitations, and endorses a test that in many circumstances may avoid the need to consider state law at all. Finally, as jurisprudential concerns might suggest, the Court discarded the "judicial policymaking" proposed by Justice Kennedy.

By giving short-shrift to the many other limitations periods in the federal securities laws, the Court made its own policy judgments about the proper statute of limitations applicable to Section 10(b) claims. The process by which the Court ultimately selected a limitations period is instructive in that regard. By selecting one of a myriad of possible limitations periods, including a number of different ones from the same statute on which the claim was based, the Court weighed "federal policy" and the "practicalities of litigation" under Section 10(b). The Court therefore necessarily made a policy choice in choosing the one/three year statute.

Although rejecting the fashioning of a unique limitations period as "lawless," Justice Scalia accepts a federal solution to the problem. Justice Stevens, besides believing that the Rules of Decision Act compels application of state law, staunchly advocates the separation of powers principle that Congress should be making the arbitrary judgments inherent in the creation of a statute of limitations. In an approach starkly different from that articulated by any other Justice, Justice Kennedy proposes the tailoring of a unique limitations period representing a refined version of a limitations period found in the Securities Exchange Act to reflect the practicalities of securities fraud litigation.

In the end, a difficult question is whether the majority's policy choice is reasonable. Besides the need for certainty and avoidance of judicial waste,[223] the national scope of regulation and the interstate nature of securities transactions—which, as *Lampf, Pleva* illustrates, may include actors (corporations, officers and directors, investment bankers, accounting and law firms, and purchasers and sellers of securities) in many states—suggests that a uniform national limitations period, as adopted for similar reasons in *Agency Holding*, is preferable.[224] There is a particular need for uniformity in Section 10(b) class actions premised on the fraud-on-the-market theory.[225] In the typical

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223. *See supra* text accompanying notes 75-78 (discussing need to imply limitations period in statute lacking one).

224. *See supra* text accompanying notes 107-19 (discussing *Agency Holding*).

225. The Supreme Court in Basic Inc. v. Levinson, 485 U.S. 224, 241-49 (1988), approved the fraud-on-the-market theory in § 10(b) and Rule 10b-5 actions. That

> theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business . . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the

fraud-on-the-market action involving a publicly traded company, a purchaser or seller of a security (and potential Section 10(b) class representative)[226] frequently exists in every state of the Union. Consequently, if the courts resort to state law, the limitations periods of 50 different states might apply to identical conduct.[227] The borrowing doctrine took root in an era of simpler litigation in cases in which a single plaintiff and a single defendant per lawsuit was the norm.[228] Its application is problematic in cases with hundreds, if not thousands, of class members and numerous defendants located throughout the country.[229] Under those circumstances, borrowing state law in effect sanctions forum shopping and allows plaintiffs to avoid suit in states with limitations periods that have expired and to file in states in which they have not.[230]

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misstatements . . . . The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.

Peil v. Speiser, 806 F.2d 1154, 1160-61 (3d Cir. 1986) (quoted in Basic Inc. v. Levinson, 485 U.S. at 241-42). Though accepting the theory generally, the Court emphasized that the presumption of reliance is rebuttable by evidence "that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price." *Id.* at 248. For recent commentary on *Basic Inc. v. Levinson* and the fraud-on-the-market theory, see Ayres, *Back to Basics: Regulating How Corporations Speak to the Market*, 77 VA. L. REV. 945 (1991); Macey & Miller, *The Fraud-on-the-Market Theory Revisited*, 77 VA. L. REV. 1001 (1991); Macey, Miller, Mitchell & Netter, *Lessons From Financial Economics: Materiality, Reliance, and Extending the Reach of Basic v. Levinson*, 77 VA. L. REV. 1017 (1991); Macey & Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059 (1990).

226. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

227. *See* L. Loss, *supra* note 136, at 994 (observing that, because of diversity in state analogies selected by courts and number of jurisdictions, at least 500 possible limitations periods might apply).

228. *See supra* text accompanying notes 79-81 (citing cases utilizing borrowing doctrine).

229. *See, e.g.*, Pinney v. Edward D. Jones & Co., 735 F. Supp. 915 (W.D. Ark. 1990) (discussing five options available to court attempting to determine applicable limitations period); Kronfeld v. Advest, Inc., 675 F. Supp. 1449, 1457-58 & n.21 (S.D.N.Y. 1987) (following traditional rule and borrowing 26 state statutes of limitation); *In re* National Student Marketing Litig., [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,926, at 90,709 (D.D.C. 1981) (noting possible application of 34 different state statutes of limitations); *In re* Clinton Oil Co. Sec. Litig., [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,015, at 91,557, 91,566-91,573 (D. Kan. 1977) (borrowing limitations periods from eight different states and eight different statutes of limitations to same misconduct).

230. *See Agency Holding*, 483 U.S. at 154; Note, *Federal Statutes Without Limitations Provisions*, 53 COLUM. L. REV. 68, 77 (1953) (discussing federal statutes lacking limitations periods and emphasizing that "forum shopping is clearly undesirable, because it disserves the dominant policy in this area—uniformity throughout the federal system").

Although one might think that conflicts of laws principles might prevent forum shopping, conflicts has long been in disarray when it comes to discerning the statute of limitations applicable to a claim touching on more than one state. *See* Vernon, *Statutes of Limitation in the Conflict of Laws: Borrowing Statutes*, 32 ROCKY MTN. L. REV. 287 (1960). Conflicts principles failed to prevent forum shopping in § 10(b) cases when the lower courts employed the state borrowing doctrine. *See* Bloomenthal, *supra* note 129, at 275-78; Guin & Donaldson, *supra* note 129, at 542 n.5; *see, e.g.*, Hill v. Equitable Trust Co., 562 F. Supp. 1324, 1333-

If a uniform national limitations period is deemed necessary, the next question is whether the one/three year statute was the appropriate one. It obviously is next to impossible to divine the intent of Congress concerning the proper statute of limitations for a claim that it never expressly created. It therefore is problematic to claim, as the Court did in *Lampf, Pleva*, that Congress intended the one/three year statute to apply to implied private rights of action under Section 10(b).[231] At least if given the opportunity to consider the question today, Congress might be persuaded, as it was in two other recent instances,[232] to provide a longer statute of limitations for a fraud-based claim such as Section 10(b).

Similarly, the Court for good reason generally has recognized equitable tolling of limitations periods, particularly if a person stands to benefit from effective concealment of a fraudulent scheme.[233] Because a carefully designed securities fraud scheme may be difficult to detect, an absolute three year bar, as Justice Kennedy contended, may indeed be too short for defrauded investors to uncover the fraud.[234] By premising its adherence to the three year maximum

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39 (D. Del. 1983) (analyzing complex conflicts questions raised in § 10(b) action involving parties from several states), *rev'd on other grounds*, 851 F.2d 691 (3d Cir. 1988), *cert. denied*, 488 U.S. 1008 (1989). Indeed, the conflicts rules in an ordinary tort case may lend themselves to forum shopping. *See, e.g.*, Kaczmarek v. Allied Chemical Corp., 836 F.2d 1055, 1057 (7th Cir. 1987) (Posner, J.) (positing that "[t]he new, flexible standards, such as 'interest analysis,' have caused pervasive uncertainty, higher cost of litigation, more forum shopping . . ., and an uncritical drift in favor of plaintiffs") (citations omitted). I owe this conflicts of law point to my colleague Friedrich K. Juenger.

231. *See Lampf, Pleva*, 111 S. Ct. at 2783 (Scalia, J., concurring in part, concurring in judgment) (admitting that Court was "imagining" what Congress would have done if it addressed limitations question and if it had provided for express right of action under § 10(b)).

232. *See* Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677, 15 U.S.C. §§ 78t-1a to 78t-1e (1988); Interstate Land Sales Full Disclosure Act, Pub. L. No. 90-448, 82 Stat. 590 (1968), 15 U.S.C. §§ 1701-1720 (1988) (as amended by Pub. L. No. 96-153, 93 Stat. 1131 (1979)).

233. *See, e.g.*, Irwin v. Veterans Administration, 111 S. Ct. 453, 457-58 (1990); Hallstrom v. Tillamook County, 110 S. Ct. 304, 309 (1989); Bailey v. Glover, 88 U.S. (21 Wall.) 342, 348 (1874); *see also* Holmberg v. Armbrecht, 327 U.S. 392, 397 (1946) (stating in dictum that equitable tolling doctrine "is read into *every* federal statute of limitation") (emphasis added). Lower courts borrowing state statutes of limitation before *Lampf, Pleva* generally applied federal equitable tolling principles in the event of fraud or deception. *See, e.g.*, Suslick v. Rothschild Sec. Corp., 741 F.2d 1000 (7th Cir. 1984); Mosesian v. Peat, Marwick, Mitchell & Co., 727 F.2d 873, 877 (9th Cir.), *cert. denied*, 469 U.S. 932 (1984).

234. *See, e.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185, 189 (1976) (describing elaborate fraud scheme extending in time from 1942 through 1966, with most of fraudulent transactions in 1950s, which did not come to light until 1968 when perpetrator of fraud described scheme in suicide note); Anixter v. Home-Stake Production Co., [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,128, at 90,713 (10th Cir. July 22, 1991) (finding after *Lampf, Pleva* that one-three year limitations scheme barred § 10(b) action in which alleged multi-million dollar Ponzi scheme extending from 1964 until 1972 injured thousands of investors); *see also* Guin & Donaldson, *supra* note 129, at 568-71 (discussing difficulties in discovering Ponzi schemes or fraud in municipal bond offerings within three years of fraud); Akst, *How Minkow Fooled the Auditors*, FORBES, Oct. 2, 1989, at 126 (describing elaborate fraud by Barry Minkow of ZZZZ Best extending over number of years).

on a weak theory of deference to a legislative judgment, the Court avoided discussing, much less justifying, the impact of the three year cap on Section 10(b) private enforcement actions.

Nor is Justice Kennedy's proposal all that different in terms of judicial lawmaking from the technique employed by the Court in borrowing limitations periods. Even under traditional borrowing principles, courts enjoy much discretion in determining the state claim most analogous to the federal one and thus which state limitations period apply.[235] There also is considerable leeway when determining whether federal policy and the practicalities of litigation required departure from state borrowing and application of a limitations period from an analogous federal statute.[236] There clearly was significant room for maneuvering when the Court in *Lampf, Pleva* arbitrarily selected one out of several limitations periods from the Securities Exchange Act. In short, the courts *always* have enjoyed great discretion in the ultimate selection of the appropriate limitations period for a deficient federal statute.

It is not a significant departure from settled doctrine to suggest that the judiciary, as Justice Kennedy proposed, should formulate the limitations period that is best tailored to the federal claim in question. As the equitable doctrine of laches illustrates,[237] that tack would not be unprecedented. In that light, the Court in *Lampf, Pleva* at least should have considered more seriously the benefits of fashioning a unique limitations period specifically designed for the practicalities of Section 10(b) litigation.

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235. *See supra* text accompanying notes 86-120, 133-34. *Cf.* Chauffeurs, Teamsters & Helpers, Local No. 391 v. Terry, 494 U.S. 558 (1990) (noting that Court could not decide whether union's breach of duty of fair representation of member was legal or equitable in nature by looking to analogous claims for purposes of determining right to jury trial under Seventh Amendment).

236. *See supra* text accompanying notes 86-120.

237. *See* Harwood v. Railroad Co., 84 U.S. 78, 81 (1872) (stating that "[w]ithout reference to any statute of limitations, the courts have adopted the principle that the delay which will defeat a recovery must depend upon the particular circumstances of each case"); *see, e.g.*, Holmberg v. Armbrecht, 327 U.S. 392, 396 (1946); Patterson v. Hewitt, 195 U.S. 309, 317-18 (1904); Russell v. Todd, 309 U.S. 280, 287-89 (1940). *See generally* 2 J. STORY, COMMENTARIES ON EQUITY JURISPRUDENCE 842-53 (M. Bigelow 13th ed. 1886). In International Union, United Auto., Aerospace & Agric. Implement Workers v. Hoosier Cardinal Corp., 383 U.S. 696, 713 (1966) (White, J., dissenting), Justice White suggested such an approach in dissenting from the Court's adoption of state statutes of limitation for a federal labor statute:

> The case for the Court's decision thus ultimately comes down to the proposition that fashioning a uniform federal statute would involve too bald an exercise of judicial innovation. This is an argument I have difficulty in fathoming. Courts have not always been reluctant to "create" statutes of limitations, the common-law doctrine of prescription by which judgments are presumed to have been paid after the lapse of 20 years, . . . being just one example. In equity they have applied the doctrine of laches . . . . But here there is no dispute concerning whether a statute of limitations is to be fashioned—the choice is between one statute or 50.

Id. (citations omitted); *see* Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385, 1394 (7th Cir. 1990) (Posner, J., concurring), *cert. denied*, 111 S. Ct. 2887 (1991); Comment, *A Functional Approach to Borrowing Limitations Periods for Federal Statutes*, 77 CALIF. L. REV. 133, 159-69 (1989).

This discussion should not be understood to suggest that the Court's rejection of the state borrowing doctrine when the federal statute includes a limitations period for an express right of action, is entirely in error. That new rule represents movement in the right direction. The same federal statute is more likely to approximate the policies implicated by a claim implied into that same statute than those addressed by some other state or federal statute passed at a different time to address different concerns. Nonetheless, for the reasons outlined here, the Court could have done better.

B. The Demand Requirement in Shareholder Derivative Suits Brought Under the Federal Securities Laws

Corporations, of course, are organized under the laws of the various states.[238] Still, as the federal securities laws attest, Congress, particularly in the aftermath of the crash of 1929, has regulated corporate activity in a variety of ways.[239] Those laws are riddled with questions that the statutory language fails to answer, questions that have increased greatly because of rights of action implied into those statutes.

Based on such extensive regulation, Judge Friendly suggested the possibility of a federal common law of corporations.[240] The development of such law, however, has not come to fruition. To the contrary, even when simply filling the interstices of federal securities laws concerning matters implicating the allocation of authority within a corporation, the Supreme Court generally has found compelling reasons to resort to state law.

1. *Burks v. Lasker*

The 1979 case of *Burks v. Lasker*[241] is a significant example of the Court's incorporation of state law when application of the federal securities laws implicates issues of internal corporate authority. In *Burks*, the investment company's disinterested directors concluded that litigation was not in the best interests of the corporation and sought to dismiss a shareholder derivative suit against some of the company's directors and the investment adviser

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238. *See* H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS § 1, at 7 (3d ed. 1983) (observing that "[t]he American laws of business enterprises, in the sense of the legal principles controlling the formation and ordinary operations of most business enterprises, have traditionally been almost entirely state laws . . ."). This need not have been the case. James Madison unsuccessfully proposed a constitutional provision that would have given the federal government the power "to grant charters of incorporation where the interest of the U.S. might require & the legislative provisions of individual States may be incompetent." J. MADISON, NOTES OF DEBATE IN THE FEDERAL CONVENTION OF 1787 638 (Ohio Univ. Press ed. 1966).

239. *See generally* H. HENN & J. ALEXANDER, *supra* note 238, §§ 291-317, at 784-867.

240. *See* Friendly, *supra* note 33, at 413. Some commentators have advocated that Congress should act to establish minimum corporate law standards. *See, e.g.*, Seligman, *The Case for Federal Minimum Corporate Law Standards*, 49 MD. L. REV. 947, 971-74 (1990); Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 696-705 (1974).

241. 441 U.S. 471 (1979).

brought under the Investment Company Act[242] and the Investment Advisers Act.[243] Because the claims were implied rights of action, the statutes were silent on the rules governing derivative actions brought to enforce their provisions.[244] In deference to the business judgment of the disinterested directors, the district court granted summary judgment for the defendants.[245] Concluding that the disinterested directors could not foreclose a derivative suit to enforce federal law, the Court of Appeals for the Second Circuit reversed.[246]

In reversing, the Supreme Court held that state law governed whether disinterested directors of an investment company could terminate a derivative suit brought against other directors under the federal securities statutes in question. Although finding the *Erie* doctrine inapplicable to the enforcement of a federal statute, the Court in *Burks* still concluded that state, not federal, law filled the statutory gap.[247] The Court made the standard acknowledgement that, when inconsistent with federal policy, state law cannot be applied.[248] The Court, however, emphasized that Congress has not authorized the judicial creation of a federal common law of corporations.[249] Nor did Congress suggest an intent to displace state law regulating the power of corporate directors in derivative actions brought under the two federal securities statutes in question.[250] The Court held that, so long as consistent with federal law—without suggesting when that might be the case, state law governed the authority of independent directors to discontinue derivative suits brought to enforce the federal securities laws.[251] It praised the compulsory incorporation

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242. 15 U.S.C. § 80a-1 to 80a-64 (1988). The Investment Company Act sought to remedy the potential conflict of interest between mutual funds and the fund's investment advisers by, among other things, requiring that at least 40% of the directors of an investment company not be affiliated with the adviser. *See* Investment Company Act § 15(c), 15 U.S.C. § 80a-15(c); S. REP. No. 184, 91st Cong., 1st Sess. 5, *reprinted in* 1970 U.S. CODE CONG. & ADMIN. NEWS 4897, 4901. *See generally* 2 T. HAZEN, *supra* note 136, §§ 17.1-17.10, at 300-68; T. FRANKEL, THE REGULATION OF MONEY MANAGERS: THE INVESTMENT COMPANY ACT AND THE INVESTMENT ADVISERS ACT (1978).

243. *See* 15 U.S.C. § 80b-1 to 80b-21 (1988). The Investment Advisers Act generally regulates non-broker dealers in the business of rendering investment advice. *See* 2 T. HAZEN, *supra* note 136, §§ 18.1-18.4, at 369-86; T. FRANKEL, *supra* note 242. In essence, "Congress intended the Investment Advisers Act to establish federal fiduciary standards for investment advisers." Sante Fe Indus., Inc. v. Green, 430 U.S. 462, 471 n.11 (1977).

244. The Supreme Court assumed without deciding that an implied right of action existed under the statutes. *See* Burks v. Lasker, 441 U.S. 471, 475-76 (1979).

245. *See* Lasker v. Burks, 426 F. Supp. 844, 853 (S.D.N.Y. 1977).

246. *See* Lasker v. Burks, 567 F.2d 1208, 1212 (2d Cir. 1978). The Second Circuit found that "[i]t is asking too much of human nature to expect that the disinterested directors will view with the necessary objectivity the actions of their colleagues in a situation where an adverse decision would be likely to result in considerable expense and liability for the individuals concerned." *Id.* at 1212 (footnote omitted); *see infra* text accompanying notes 254-56 (discussing criticism of Supreme Court decision in *Burks*).

247. *Burks*, 441 U.S. at 476-77.

248. *Id.* at 479.

249. *Id.* at 477.

250. *Id.* at 479 & n.6.

251. *Id.* at 486.

of state law for "reliev[ing] federal courts of the necessity to fashion an entire body of federal corporate law out of whole cloth."[252] The Court remanded the case to the court of appeals for consideration of state law.[253]

As is true for federal common law generally, the Court in *Burks* appeared influenced by federalism, separation of powers, and jurisprudential concerns. In opting for state law, *Burks*, however, failed to consider whether state law in the long run would ensure effective enforcement of the Investment Company Act and the Investment Advisers Act. Indeed, the Court's suggestion that a so-called disinterested board, if permitted by state law, might silence a derivative suit brought to enforce a federal securities statute in some circumstances might undermine shareholders' ability to enforce the will of Congress.[254] Reminiscent of the previously discussed defects of *Lampf, Pleva*[255] and foreshadowing those of *Kamen*, the Court would have done better to consider that possibility. After *Burks*, lower courts followed its broad language and rarely found that federal policies precluded termination of a derivative suit under state law.[256]

2. *Kamen v. Kemper Financial Services, Inc.*

Last Term, the Court re-visited questions similar to those addressed in *Burks v. Lasker* in *Kamen v. Kemper Financial Services, Inc.*[257] The facts are

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252. *Id.* at 480.

253. *Id.* at 486. Justice Stewart, joined by Justice Powell, concurred in the judgment and emphasized the absolute proposition, with little explanation but presumably based on federalism principles embodied in the Rules of Decision Act, that state law must apply. *Id.* at 487 (Stewart, J., concurring in judgment).

254. *See* Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261 (1981). *But see* Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 597 (1991) (stating that "[s]ome evidence seems to show that derivative actions tend to be resolved for structural or cosmetic changes with no tangible economic benefit to the corporation, plus large attorneys' fees") (footnote omitted); Fischel & Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 277-83 (1986) (stating conclusion of empirical study that shareholder derivative suits did not benefit corporations). Besides criticizing the holding of *Burks v. Lasker* on policy grounds, Professors Coffee and Schwartz also fault the Court for failing to suggest precisely when state law will frustrate federal policy. *See* Coffee & Schwartz, *supra*, at 287-300.

For commentary suggesting that "disinterested" directors may not be truly impartial, see Cox & Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 LAW & CONTEMP. PROB. 83 (1985); Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 611-16 (1982); Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U.L. REV. 96, 121-22 (1980); Note, *The Propriety of Judicial Deference to Corporate Boards of Directors*, 96 HARV. L. REV. 1894 (1983).

255. *See supra* text accompanying notes 157-237.

256. *See* Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L.J. 545, 580-81 (1984); *see, e.g.*, RCM Securities Fund, Inc. v. Stanton, 928 F.2d 1318, 1325-30 (2d Cir. 1991); Joy v. North, 692 F.2d 880 (2d Cir. 1982), *cert. denied*, 460 U.S. 1051 (1983).

257. 111 S. Ct. 1711 (1991). After *Burks v. Lasker*, in Daily Income Fund, Inc. v. Fox, 464 U.S. 523 (1984), the Court avoided a question similar to the one later posed in *Kamen*

not extraordinary. Jill Kamen brought a shareholder derivative action on behalf of Cash Equivalent Fund, Inc., a registered investment company managing a money market mutual fund, under Section 20(a) of the Investment Company Act (ICA)[258] against Kemper Financial Services, Inc. (KFS), the Fund's investment adviser.[259] Although Section 20(a) fails to expressly create a private right of action, the lower courts have implied one.[260]

Kamen averred that, by causing the Fund to issue a proxy statement that materially misrepresented the fees of the investment adviser, KFS improperly obtained shareholder approval of the investment adviser contract.[261] Claiming that under the circumstances the making of a demand on the board of directors to bring suit would be futile and that demand therefore should be excused, she did not make one.[262] To support the futility claim, Kamen alleged that the board unanimously approved the fraudulent proxy statement and moved to dismiss the derivative action.[263] Finding that Kamen failed to plead the facts excusing demand with the requisite particularity, the district court dismissed the action.[264]

The Court of Appeals for the Seventh Circuit, in an opinion by Judge Frank Easterbrook, affirmed the dismissal for entirely different reasons—namely, that Kamen failed to make a demand on the board of directors to file the action.[265] Deciding that federal common law governed the derivative

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by holding that a shareholder action under § 36(b) of the Investment Company Act, 15 U.S.C. § 80a-35(b), to recover allegedly excessive fees paid by an investment company to its investment adviser was not a derivative action, that is, not one on behalf of the corporation. *See Daily Income Fund*, 464 U.S. at 542; *see also id.* at 545-46 (Stevens, J., concurring in judgment) (stating that demand requirement was inconsistent with text and legislative history of statute and "would serve no meaningful purpose and would undermine the efficacy of the statute"). The Court therefore affirmed the lower court decision reversing dismissal of the action based on the shareholder's failure to make a demand on the board of directors to bring the action. *See id.* at 542.

258. 15 U.S.C. § 80a-20(a) (1988). Section 20(a), 15 U.S.C. § 80a-20(a), makes it unlawful to issue a proxy statement contrary to Securities & Exchange Commission regulations, which prohibit the issuance of materially misleading statements by registered investment companies, *see* 17 C.F.R. § 270.20a-1(a) (1990); *id.* § 240.14a-9.

259. *See Kamen*, 111 S. Ct. at 1714.

260. *See* Kamen v. Kemper Financial Services, Inc., 659 F. Supp. 1153, 1157 & nn.8-9 (N.D. Ill. 1987) (collecting authority). The district court implied a private right of action into the statute. *Id.* at 1156-60. Because the Seventh Circuit did not address the question and because the question was not raised in the petition for certiorari, the Supreme Court declined to decide the issue. *See Kamen*, 111 S. Ct. at 1715 n.3; *see also supra* note 126 and accompanying text (noting Court's refusal to expressly decide question whether implied right of action exists under § 10(b) of Securities Exchange Act and Rule 10b-5).

261. *Kamen*, 111 S. Ct. at 1715.

262. *Id.*

263. *Id.*

264. *Kamen*, 659 F. Supp. at 1160-63 (N.D. Ill. 1987). Federal Rule of Civil Procedure 23.1 requires plaintiffs in shareholder derivative suits, if required by the applicable law, to plead the facts excusing demand with particularity.

265. 908 F.2d 1338 (7th Cir. 1990). For a general description of the demand requirement, see Macey & Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation:*

rules under a federal statute, the Seventh Circuit adopted a new rule different from that in many states.[266] Because the futility exception generated "gobs" of wasteful litigation,[267] the court embraced a universal demand rule proposed in a tentative draft of the American Law Institute's *Principles of Corporate Governance*, which virtually abolishes the futility exception.[268]

Though recognizing that *Burks v. Lasker* held that state law should ordinarily be utilized when engaged in this type of interstitial lawmaking under the federal securities laws, the Seventh Circuit held that Kamen waived that argument.[269] The court further relied on the 1881 Supreme Court decision of *Hawes v. Oakland*[270] to conclude that federal common law contains a demand rule.[271] Judge Easterbrook found that the demand requirement "allows directors to make a business decision about . . . whether to invest the

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Economic Analysis and Recommendations for Reform, 58 U. CHI. L. REV. 1, 34-38 (1991) and Comment, *The Demand and Standing Requirements in Stockholder Derivative Suits*, 44 U. CHI. L. REV. 168 (1976).

266. *See* 908 F.2d at 1344.

267. *Id.*

268. *See id.* (relying upon American Law Institute's PRINCIPLES OF CORPORATE GOVERNANCE §§ 7.03(a)-(b) and comment a (Tent. Draft No. 8, Apr. 15, 1988)). The American Law Institute's tentative draft would excuse demand "only when the plaintiff makes a specific showing that irreparable injury to the corporation would otherwise result." Principles of Corporate Governance § 7.03(b). To avoid the costs and time of litigating whether demand was required, the American Bar Association advanced a similar proposal. *See* American Bar Association Committee on Corporate Laws, *Changes in the Model Business Corporation Act—Amendments Pertaining to Derivative Proceedings*, 45 BUS. LAW. 1241, 1244-46 (1990).

Judge Easterbrook, a member of the American Law Institute, *see* 2 ALMANAC OF THE FEDERAL JUDICIARY 7th Cir-15 (1991), previously expressed views similar to those in *Kamen* about the futility exception to the demand requirement. *See* Starrels v. First Nat'l Bank, 870 F.2d 1168, 1174-76 (7th Cir. 1989) (Easterbrook, J., concurring) (reviewing Delaware law on excuse of demand in derivative actions and concluding that universal demand rule tentatively proposed by American Law Institute was preferable). The near abolition of the futility exception arguably will limit shareholders' ability to bring derivative actions, a view in harmony with Judge Easterbrook's opinions limiting recovery under § 10(b) of the Securities Exchange Act. *See* Sontag, *Harder to Sue*, NAT'L L.J., June 17, 1991, at 1, col. 1 (discussing Judge Easterbrook's § 10(b) opinions); *cf.* Patterson, *A Fable from the Seventh Circuit: Frank Easterbrook on Good Faith*, 76 IOWA L. REV. 503, 505 (1991) (claiming that Judge Easterbrook's opinion in lender liablity case of Kham & Nate's Shoe's No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351 (7th Cir. 1990), "demonstrates the degree to which untethered ideology distorts the judicial process and the community of discourse that is the law").

In greatly limiting the futility exception, the Seventh Circuit overruled a prior decision. *See Kamen*, 908 F.2d at 1347.

269. *See Kamen*, 908 F.2d at 1342. Under the conflicts of law principle known as the internal affairs rule, the law of the state of incorporation generally governs internal arrangements of corporations. *See generally* Reese & Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 COLUM. L. REV. 1118 (1958). The court, however, concluded that, because Kamen failed to mention until her reply brief that the law of the state in which the Fund is incorporated, Maryland, recognized the futility exception, she had waived the argument that Maryland law applied. *See Kamen*, 908 F.2d at 1342.

270. 104 U.S. 450 (1881).

271. *Kamen*, 908 F.2d at 1342.

time and resources of the corporation in litigation."[272] Finally, despite the deferential review standard applied by many states in reviewing such a decision,[273] the Seventh Circuit held that, as the American Law Institute's tentative draft provided, "the making of a demand does not affect the standard with which the court will assess the board's decision not to sue."[274]

The Supreme Court, in an opinion by Justice Marshall, unanimously reversed.[275] The Court held that, because the demand question in shareholder derivative actions "embodies the incorporating State's allocation of governing powers within the corporation," and because a futility exception was not inconsistent with federal law, state law determines whether the representative shareholder in a derivative action under Section 20(a) of the Investment Company Act must make a demand on the board of directors.[276]

Despite mandating the application of *state* law, the Court emphasized that any rule governing a claim under a federal statute necessarily was a *federal* question.[277] Federal courts, however, should incorporate state law into a deficient federal statute unless to do so " 'would frustrate specific objectives of the federal programs.' "[278] In language remarkably similar to that found in the Court's federal common law cases, the Court emphasized that

> a court should endeavor to fill the interstices of federal remedial schemes with uniform federal rules only when the scheme in question evidences a distinct need for nationwide legal standards, . . . or when express provisions in analogous statutory schemes embody congressional policy choices readily applicable to the matter at hand . . . .[279]

To buttress that conclusion, the Court read *Burks v. Lasker* as creating a "*presumption* that state law should be incorporated into federal common

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272. *Id.* (citations omitted).

273. *See infra* text accompanying note 290.

274. *Kamen*, 908 F.2d at 1344. In its short life span, the Seventh Circuit's approach in *Kamen* did not seem to attract many followers. *See* RCM Securities Fund, Inc. v. Stanton, 928 F.2d 1318, 1325-30 (2d Cir. 1991) (declining to follow Seventh Circuit's approach in *Kamen*); Johnson v. Hui, 752 F. Supp. 909, 914 (N.D. Cal. 1990) (same).

275. *See Kamen*, 111 S. Ct. at 1723. Contrary to the position it asserted in *Lampf, Pleva*, *see supra* text accompanying note 192, the Securities and Exchange Commission supported application of state law in *Kamen*. *See* Brief for the Securities & Exchange Commission as Amicus Curiae in Kamen v. Kemper Financial Services, Inc., 111 S. Ct. 1711 (1991) (No. 90-516). In many ways, the Court's opinion tracks the SEC's *amicus curiae* brief.

276. *Kamen*, 111 S. Ct. at 1714 (citation omitted).

277. *Id.* at 1717 (citing, *inter alia*, Burks v. Lasker, 441 U.S. at 476-477). The Court quickly disposed of the argument that Federal Rule of Civil Procedure 23.1, which governs the specific procedures governing shareholder derivative actions in federal court, *see supra* note 264, imposed a demand requirement on shareholders. The Court held that, consistent with the Rules Enabling Act, 28 U.S.C. § 2072(b) (1988), the rule only provides a vehicle for execution of a demand if required by the applicable law. *See Kamen*, 111 S. Ct. at 1716.

278. *Id.* at 1717 (quoting United States v. Kimbell Foods, Inc., 440 U.S. 715, 728 (1979)).

279. *Kamen*, 111 S. Ct. at 1717 (citing Clearfield Trust Co. v. United States, 318 U.S. 363, 366-367 (1943); Boyle v. United Technologies Corp., 487 U.S. 500, 511-512 (1988); DelCostello v. Teamsters, 462 U.S. 151, 169-172 (1983)).

law" when allocation of power between shareholders and the board of directors is at issue.[280] State law therefore ordinarily controls whether disinterested directors possess the power to terminate a shareholder derivative action under the federal securities laws.[281] The Court had "little trouble" concluding that the demand requirement and futility exception fell within the scope of the state law presumption.[282] According to the Court, the demand requirement affords the board of directors the opportunity to exercise its reasonable business judgment and waive a legal right vested in the corporation if it concludes that to do so would promote the corporation's best interests.[283] Because the shareholder ordinarily cannot sue if the board of directors declines to do so, the demand requirement protects the prerogative of the board to sue or not to sue.[284] On the other hand, the Court reasoned that the futility exception to the demand requirement restricts the board of director's power to control the initiation of corporate litigation.[285]

The Court in a footnote rejected the Seventh Circuit's conclusion that *Hawes v. Oakland*[286] created a federal common law demand requirement. It concluded that, because *Hawes* sought to fashion federal common law in a diversity case, the decision failed to survive *Erie* and in any event "has been eclipsed by the philosophy of *Burks*."[287] In addition, because the entire dispute centered on the source of the law to be applied, the Court rejected the Seventh Circuit's conclusion that Kamen waived the argument that state law applied.[288] The Court hinted at disapproval of the lower court's decision to fashion a new federal rule "even though *neither* party addressed whether the futility exception should be abolished as a matter of federal common law."[289]

The deferential business judgment rule is the standard by which a court in some states, including Delaware, generally reviews the board of directors' decision not to litigate the corporate claim raised by the shareholder in a derivative suit.[290] To avoid the apparent inequities of the application of so deferential a standard to the litigation decision of the board of directors and thus possibly the easy derailment of a federal securities claim, KFS contended,

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280. *Kamen*, 111 S. Ct. at 1717 (citations omitted) (emphasis added).

281. *Id.* at 1719.

282. *Id.*

283. *Id.*

284. *Id.* (emphasizing that "demand requirement implements 'the basic principle of corporate governance that the decision of a corporation—including the decision to initiate litigation—should be made by the board of directors or the majority of shareholders'") (citation omitted).

285. *Id.* at 1717.

286. 104 U.S. 450 (1881).

287. *Kamen*, 111 S. Ct. at 1718-19 n.6.

288. *Id.* at 1718.

289. *Id.* (emphasis in original); *see also* Macey & Miller, *supra* note 265, at 38 (stating that present state of law raises potential for courts to "sometimes manipulate the demand rules to dismiss cases they want to dispose of for other reasons").

290. *See, e.g.*, Zapata Corp. v. Maldonado, 430 A.2d 779, 784 & n.10 (Del. 1981).

as suggested by the American Law Institute's tentative draft and accepted by the Seventh Circuit, that the demand requirement should not be tied to the standard used to review the board's decision.[291] In familiar tones of condemnation of judicial lawmaking, the Court rejected that argument without equivocation or much elaboration: "Whatever its merits as a matter of legal reform, we believe that KFS' proposal to detach the demand standard from the standard for reviewing board action would require a quantum of federal common lawmaking that exceeds federal courts' interstitial mandate."[292]

The Court observed that the American Law Institute "developed an elaborate set of standards that calibrates the deference afforded the decision of the directors to the character of the claim being asserted by the derivative plaintiff."[293] In the Court's view, any attempt to fashion such standards would require the federal courts to create a federal common law of corporations, a task it declined to assume in *Burks v. Lasker*.[294] The Court further reasoned that, rather than reducing litigation, a universal demand rule in this circumstance would only shift the focal point of litigation from the futility exception to the deference due the board's decision under federal law.[295]

The Court recognized that the law of the various states differs widely concerning when the directors have the power to terminate derivative litigation and when a demand may be excused.[296] Refusing to intrude on that diversity and unwilling to mandate the national uniformity promoted by the Seventh Circuit, the Court declined to "[s]uperimpos[e] a rule of universal-demand over the corporate doctrine of [the] States [that] would clearly upset the balance that they have struck between the power of the individual shareholder and the power of the directors to control corporate litigation."[297]

Finally, seemingly as an afterthought, the Court found that the application of state derivative rules was not inconsistent with the Investment Company Act.[298] It rejected KFS' argument that, by permitting shareholders to sue without a demand, state law undermined the Act's intent that the 40% of the board of directors independent of the investment adviser would serve as

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291. *Kamen*, 111 S. Ct. at 1720.

292. *Id.*

293. *Id.* (citing AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE § 7.08 & § 7.08 comment c (Tent. Draft No. 8, Apr. 1988)).

294. *See Kamen*, 111 S. Ct. at 1717 (quoting Burks v. Lasker, 441 U.S. 471, 480 (1979)). The Court also concluded that such lawmaking would create excessive uncertainty for corporations with respect to the deference properly accorded to decisions of the board of directors and would unduly complicate the analysis when a shareholder brought state as well as federal claims. *Kamen*, 111 S. Ct. at 1721.

295. *Id.* at 1721.

296. *Id.* at 1719 (citing D. DEMOTT, SHAREHOLDER DERIVATIVE ACTIONS § 5.03, at 35 (1987)). *See generally* D. DEMOTT, *supra*, § 5.03, at 23-43 (discussing variation in demand requirements in the law of various states). An example of one variation in the law is that some states, including Delaware, prevent a shareholder who makes a demand to later declare that the demand was futile. *See* Spiegel v. Buntrock, 571 A.2d 767, 775 (Del. 1990) (citing Stotland v. GAF Corp., 469 A.2d 421, 422 (Del. 1983)).

297. *Kamen*, 111 S. Ct. at 1720.

298. *Id.* at 1722.

a "watchdog."[299] Finding that state law generally governed the managerial authority of the directors,[300] the Court decided that it would be anomalous to afford the board of directors "*greater* power to block shareholder derivative litigation than these actors possess under the law of the State of incorporation."[301]

In short, the Court in *Kamen* reaffirmed the holding of *Burks v. Lasker* that, unless inconsistent with federal policies, gaps in the federal securities laws bearing on the allocation of governing powers within the corporation must be filled with state law.[302] On that basis, the Court held that the Seventh Circuit erred in adopting a uniform rule abolishing the futility exception to the demand requirement for shareholder derivative suits under Section 20(a) of the Investment Company Act.[303]

Although perhaps less starkly than *Lampf, Pleva, Kamen* raises familiar issues of federalism, separation of powers and jurisprudence in interstitial lawmaking. Elaborating on *Burks v. Lasker*, the Court opts to make state law the norm—indeed refers to the state law "presumption"—in interstitial lawmaking under the federal securities laws when the statutory gap implicates the relative distribution of corporate power between the board of directors and shareholders. Federalism concerns partially explain the reluctance to interfere with entities that exist only by virtue of state law.[304] To the extent that state law limits the federal courts' lawmaking powers, it would seem to make the interstitial lawmaking less of an intrusion on separation of powers principles. The state law presumption, at least in theory, transfers lawmaking to a legislative, albeit not federal, branch. Indeed, assuming that Congress

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299. *Id.*; *see supra* note 242 (discussing purpose of Investment Company Act).

300. *Kamen*, 111 S. Ct. at 1722.

301. *Id.* (emphasis in original). Moreover, the Court emphasized that, after concluding that the board of directors alone could not be relied upon to ensure that the fees of the investment adviser were reasonable, Congress added § 36(b) to the Investment Company Act, 15 U.S.C. § 80a-35(b) (1988), which expressly permits a shareholder to sue on behalf of the investment company for breach of the investment adviser's fiduciary duty. *Kamen*, 111 S. Ct. at 1722; *see supra* note 257 (discussing interpretation of § 36(b) in Daily Income Fund, Inc. v. Fox, 464 U.S. 523 (1984)). In the Court's eyes, § 36(b) suggests that Congress did not consider shareholder litigation as displacing the authority of the independent directors. *Kamen*, 111 S. Ct. at 1722.

302. *See Kamen*, 111 S. Ct. at 1722.

303. *Id.* at 1714, 1723. The Court remanded the case for further proceedings consistent with the opinion. *See id.* at 1723 & n.10. On remand, the Seventh Circuit held that Kamen's failure to make a demand on the board was not justified by the futility exception—which was discussed in one Maryland Court of Appeals decision nearly 25 years old, Parish v. Maryland & Virginia Milk Producers Ass'n, 250 Md. 24, 81-84, 242 A.2d 512, 544-45 (1968)—under Maryland law. *See* Kamen v. Kemper Fin. Serv., Inc. v. Cash Equivalent Fund, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,183, at 90,988 (7th Cir. Aug. 7, 1991) (Easterbrook, J.).

304. *See supra* text accompanying note 238. Because corporations are created by state law but are regulated extensively under the federal securities laws, federalism concerns frequently come into play in this area. *See, e.g.*, Anderson, *The Meaning of Federalism: Interpreting the Securities Exchange Act of 1934*, 70 VA. L. REV. 813 (1984); Kitch, *A Federal Vision of the Securities Laws*, 70 VA. L. REV. 857 (1984); Schwartz, *supra* note 256; Cary, *supra* note 240.

was aware of the presumption when passing the law, incorporation of state law arguably is consistent with Congressional intent.[305]

Perhaps most importantly, the familiar jurisprudential concern with judges fashioning large bodies of law out of whole cloth also influenced the Court. Judicial lawmaking might appear more problematic the greater the body of law being made. At least intuitively, it appears more troublesome for the judiciary to create an entire body of law governing shareholder derivative actions (*Kamen*) than it is for judges to simply add a missing term to a statute, such as a limitations period (*Lampf, Pleva*).[306]

The specter of potential judicial mischief is at its zenith when a court, with minimal guidance, is permitted to construct an entire corpus of law with all the intricacies ordinarily found in a comprehensive statutory scheme passed by Congress with hearings, reports, and debate. Although *Lincoln Mills* demonstrates that such an occurrence is not unprecedented, the Supreme Court, as *Kamen* suggests, has tended in the intervening years to exhibit more caution in concluding that a particular substantive area falls within the common lawmaking power of the federal courts.[307] The Court in *Kamen* clearly refused to do in 1991 for corporate regulation what it had done in 1957 for collective bargaining disputes in *Lincoln Mills*. It flatly—and unanimously—rejected Judge Easterbrook's attempt to fashion a body of federal corporations law. At least when the judicially made rule would bar a derivative claim from the courts, the Court acted in a manner suggesting fear of an activist judiciary.

A troublesome aspect of *Kamen* is that, as it did in *Lampf, Pleva*, the Court avoided analyzing the policy implications of its call for presumptive incorporation of state law. In a case in which it indeed appeared fruitless to make a demand on the board of directors, the Court opted for state law, which recognized a futility exception to the demand requirement. By so doing, the Court created the possibility that the claim might be decided on the merits.[308] The ultimate question that *Kamen*'s state law presumption leaves is whether state law in future cases generally will best fulfill the purposes of the Investment Company Act. At least some members of the prestigious American Law Institute ("ALI") might think otherwise. Indeed, if ever presented with the various arguments, the policy justifications in support of the ALI proposal might persuade Congress. Still, the Court never expressly addressed the merits of the ALI's proposal, but rather seemed to belittle its

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305. *See supra* text accompanying notes 111, 174 (discussing similar inferences made by Court in *Agency Holding* and *Lampf, Pleva*).

306. *See supra* text accompanying notes 157-237. In addition, by federalizing labor law, *Lincoln Mills, see supra* text accompanying notes 62-68, created difficult problems of federal pre-emption of state laws—problems that continue to plague the Court. *See, e.g.*, Lingle v. Norge Div. of Magic Chef, Inc., 486 U.S. 399 (1988). The Court's refusal in *Kamen* to federalize shareholder derivative actions may avoid such thorny questions.

307. *See supra* text accompanying notes 52-54, 69-72.

308. That possibility, however, did not come to pass. *See supra* note 303 (discussing dismissal of case by Seventh Circuit on remand).

"legal reform" efforts. Nor did it discuss whether, as Judge Easterbrook concluded, the futility exception led to excessive unproductive litigation.

In addition, and perhaps more importantly, the Supreme Court's strong endorsement of the state law presumption and failure to suggest when federal policies may dictate otherwise, may hamstring the lower courts in future attempts to faithfully apply the federal securities laws. What would happen if a state did not recognize a futility exception to the demand requirement or allowed interested directors to decide whether to pursue a shareholder derivative suit? Suppose a state abolished derivative actions? Although these extreme hypotheticals may be so egregious as to be preempted by federal law, the laws of some states may disfavor in less extreme fashion shareholder derivative actions,[309] disfavor that now will be engrafted on the federal securities laws. There seems to be no legitimate policy reason for that result. Similar to the impact of *McCluny v. Sulliman* on the subsequent development of federal limitations law, the side effects of the Court's unequivocal endorsement of the state law presumption in shareholder derivative suits under federal statutes may remain for years to come and hinder a potentially important method of enforcing the federal securities laws.[310] Moreover, though the breadth of its language suggests that such an occurrence will be rare, the Court made no suggestion when federal policy might preempt state law with respect to derivative suits.[311]

Put simply, the Court in *Kamen* once again left unaddressed the policy questions that it failed to analyze in *Burks v. Lasker*. Influenced by federalism, separation of powers and jurisprudential concerns, the Court refused even to attempt to discern the law that would best fulfill the purposes of the Investment Company Act. Thus, at least superficially, form prevailed over substance.

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309. *See, e.g.*, R. CLARK, CORPORATE LAW § 15.5, at 652-55 (1966) (discussing variation among states in security for expense statutes in derivative litigation); *see also* L. SOLOMON, D. SCHWARTZ & J. BAUMAN, CORPORATIONS LAW AND POLICY 816-17 (2d ed. 1988) (remarking that "[a]lthough nuisance suits are not peculiar to the corporate setting, the fact remains that the law has singled out derivative suits for the imposition of special procedural restrictions and judicial oversight to discourage abuses of the process because of the large costs that may be imposed on corporations by people purporting to act on its behalf"); Coffee & Schwartz, *supra* note 254 (discussing developing caselaw allowing board to reject derivative actions and suggesting need for legislative reform). Professor DeMott, for example, observes an increasing tendency for states not to excuse shareholder demand on the board. *See* D. DEMOTT, *supra* note 296, § 5.03, at 31-36; *see, e.g.*, Aronson v. Lewis, 473 A.2d 805, 808 (Del. 1984) (holding that shareholder must allege with particularity facts that "create a reasonable doubt that the directors' action was entitled to the protections of the business judgment rule").

310. *See* Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 548 (1949) (referring to shareholder derivative suit as "the chief regulator of corporate management"); Dykstra, *The Revival of the Derivative Suit*, 116 U. PA. L. REV. 74 (1967) (arguing that barriers to derivative actions hinder ability of such suits to police corporate officers and directors).

311. *See supra* text accompanying notes 254-56 (discussing similar criticism of *Burks v. Lasker*).

III. The Federal Judiciary's Constitutional Responsibility

As we have seen, the Court's decisions in *Lampf, Pleva* and *Kamen* implicate constitutional, as well as jurisprudential, questions about the legitimacy of certain types of interstitial lawmaking. For different reasons, the divergent paths taken in those cases are unappealing. The courts should not be confined in interstitial lawmaking options to the law passed by a legislature governing some analogous state or federal claim, but should do their best to ensure fidelity to Congressional intent. Despite persistent suggestions to the contrary, federal courts are constitutionally and statutorily competent to fill the gaps of a federal statute with the best law regardless of whether it originated in a law enacted by a state or federal legislature. Importantly, such lawmaking would not differ significantly from that presently done by federal judges but obscured by the "borrowing" terminology.

The need for the fashioning of the best law, as opposed to simply relying on some possibly ill-fitting alternative found elsewhere, is particularly true with respect to federal securities regulation. The adherence to outdated notions of "borrowing" or "absorbing" state law has tended to undermine Congress's regulation of the national securities market. Nor does it make sense to extrapolate that Congress intended the incorporation of state law that it found deficient enough to require passage of a comprehensive package of federal laws.

A. Federalism Concerns

Federalism concerns have been expressed about the federal judiciary's constitutional and statutory competence to fashion federal common law without regard to state law.[312] Let us consider the relevance of those concerns to interstitial lawmaking in the federal securities laws.

When filling gaps in federal statutes, the law that the courts are making undisputedly is federal.[313] The fortuity that Congress failed to perform the near impossible task of drafting a statute without any omissions should make no difference in the constitutional sense. Assuming that Congress legitimately exercised its constitutional powers in enacting the law in the first place, Congress surely could constitutionally fill the voids in its work. Interstitial lawmaking therefore should not be viewed as raising the issues of raw federalism that the Supreme Court saw in *Erie*.[314] To the contrary, the competence in the federal judiciary to declare federal law "is essential to the effective implementation of the legislative powers committed to the national government by the Constitution."[315]

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312. *See* Merrill, *supra* note 12, at 33-34; Smith, *supra* note 70, at 597, 608-11; *see also supra* note 89 (citing authorities rejecting *DelCostello* on the ground that it is contrary to Rules of Decision Act).

313. *See supra* text accompanying notes 33-73, 75-85.

314. *See* Mishkin, *supra* note 21, at 799.

315. *Id.* at 799-800. *But cf.* Merrill, *supra* note 12, at 21 (stating that "[n]either the text of the Constitution nor the federal history of the Federal Convention gives any indication that the federal courts are to partake of an advisory, amendatory, or supplementary role in the formulation of legislation") (footnote omitted).

Nor can it seriously be disputed that courts must decline to employ state law to fill the interstices of a federal statute when to do so would defeat federal policies.[316] Unless one is willing to implausibly claim that states may act to nullify federal legislation simply because Congress may have been sloppy, that conclusion seems inevitable. For example, suppose a state had a two week limitations period governing common law fraud actions. Before *Lampf, Pleva*, few would disagree that courts should not allow such a short limitations period to bar a Section 10(b) claim. However, if federalism principles were truly at stake, state law might not be so cavalierly dismissed. After *Erie*, for example, federal courts generally have not concluded that, if contrary to federal policies, a court need not apply state substantive law in a diversity action.[317]

Besides constitutionally-based federalism concerns, some argue that the Rules of Decision Act compels looking to state law as the exclusive interstitial lawmaking source.[318] Rejecting a literal interpretation of the Act, the Supreme Court has held that it does not.[319] That reading of the Rules of Decision Act is consistent with the long history of federal common law, even before the "new" federal common law spurred on by *Erie*.[320] It also is consistent with the vast expansion of federal power sanctioned by the Court since passage of the Act in 1789.[321] Even since 1938 and the new spin on federalism offered by *Erie*, Congress has engaged in an "orgy of statute making."[322] In a parallel and related development during that same time period, the Court has concluded that Congress has extensive powers under the commerce clause to regulate matters that only tangentially affect interstate commerce.[323]

Congress enacted the Rules of Decision Act in a very different time, an era with few federal statutes and a narrowly circumscribed notion of federal

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316. *See supra* text accompanying notes 75-120. Even critics of the Court's current jurisprudence on the subject make this admission. *See* Burbank, *supra* note 84, at 770; Merrill, *supra* note 12, at 34.

317. *But cf.* Byrd v. Blue Ridge Rural Elec. Coop., Inc. 356 U.S. 525 (1958) (holding in diversity action that, because federal interests outweighed state interests, federal court could provide jury trial even though issue would be resolved by judge under state law).

318. *See supra* note 89 (citing authority criticizing *DelCostello* on grounds that it is contrary to Rules of Decision Act).

319. *See supra* text accompanying notes 86-120 (discussing Court's recent cases on supplying limitations periods for federal statutes).

320. *See* E. CHEMERINSKY, *supra* note 12, § 6.1, at 296 n.19 (positing that "[f]ederal courts have fashioned common law for almost 200 years, notwithstanding the literal dictate of the Rules of Decision Act. The statute must be read in light of this history in the absence of congressional modification or objection.").

321. *See* Eskridge, *Dynamic Statutory Interpretation*, 135 U. PA. L. REV. 1479 (1987) (advocating theory of statutory interpretation that allows interpretation of statute to evolve dynamically with changing developments in society).

322. G. GILMORE, THE AGES OF AMERICAN LAW 95 (1977).

323. *See, e.g.*, Katzenbach v. McClung, 379 U.S. 294 (1964) (holding that Congressional power to regulate interstate commerce under Constitution authorized application of Civil Rights Act of 1964 to family-owned restaurant, Ollie's Barbecue, in Birmingham, Alabama). *See generally* L. TRIBE, *supra* note 6, §§ 5-4 to 5-8, at 305-17.

power. The Act should be interpreted in light of the intervening developments.[324] The Court's current interpretation mirrors the changing views of national power. On the other hand, a formalist interpretation of the Rules of Decision Act historically has lead to anomalous results. The inconsistency and lack of uniformity in the statute of limitations law alone exhibits the need to shed the restraints of a rigid interpretation of the Act.[325]

Proponents of the literalist interpretation of the Rules of Decision Act point out that a safety valve exists to protect valid federal interests. The Act provides that state law does not apply when federal law "otherwise require[s] or provide[s]."[326] In an example of circular logic, when state law is inconsistent with federal policies (which usually are not defined with any degree of particularity in the statute), federal law has been treated as "otherwise requir[ing] or provid[ing]."[327] That understanding tends to make the application of state law appear to be simply a function of judicially defined federal policies. That, in turn, suggests that the Act makes the borrowing of state law optional when filling gaps in federal statutes. Those claiming that the Act restricts the power of the courts to make federal common law, however, generally view its dictates as mandatory.[328] The literalist argument therefore in reality amounts to little more than a narrow, discretionary restraint on the federal courts: the Rules of Decision Act requires state law to apply unless federal law, through policies unstated in the statute, suggests otherwise. In the end, the literalist argument is nothing more than an unexplained preference for state rather than federal law. Indeed, the federal policy exception properly read provides for the displacement of state law in many circumstances when courts engage in interstitial lawmaking.

Federalism concerns are particularly misplaced when it comes to the federal securities laws. True, as *Burks* and *Kamen* suggest,[329] caution may be justified to avoid undue interference with state regulation of corporations created by state law.[330] Nonetheless, the overall goals and purposes of the federal securities laws should not be forgotten. Congress passed those laws to cure deficiencies in state law.[331] At the same time, Congress sought to provide a comprehensive uniform scheme to regulate the national securities market and avoid a repeat of the Crash of 1929.[332] To put it gently, it seems

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324. *See* G. CALABRESI, *supra* note 5; Eskridge, *supra* note 321; *see also* Weinberg, *Curious Notion*, *supra* note 17, at 866 (stating that "[i]t is time to face up to the fact that the Act comes down to us as a relic of a prepositivist, prerealist time, with scant relevance for us today").

325. *See supra* text accompanying notes 75-156.

326. *See supra* note 80 (quoting Rules of Decision Act).

327. *See, e.g.*, Agency Holding Corp. v. Malley-Duff & Assocs., 483 U.S. 143, 147-48 (1987); DelCostello v. International Bhd. of Teamsters, 462 U.S. 151, 159-60 n.13 (1983).

328. *See supra* note 89 (citing authorities criticizing *DelCostello*).

329. *See* Kamen v. Kemper Fin. Serv., Inc., 111 S. Ct. 1711, 1717 (1991); Burks v. Lasker, 441 U.S. 471, 478 (1979).

330. *See* Sante Fe Indus., Inc. v. Green, 430 U.S. 462, 479 (1977); Cort v. Ash, 422 U.S. 66, 84 (1975).

331. *See supra* text accompanying notes 121-24.

332. *See supra* text accompanying notes 121-24.

anomalous to borrow what Congress concluded to be deficient state law to fill gaps in federal statutes designed to cure that deficiency. In light of the purposes of the federal securities laws, compulsory, or even presumptive, incorporation of state law to fill the federal interstices is at best curious and at worst contrary to Congressional intent.

The Court's decisions in *Lampf, Pleva* and *Kamen* illustrate the difficulties with the view that interstitial lawmaking under the federal securities laws is controlled by state law. Because of reliance on the vagaries of the statutes of limitations of fifty states, the limitations law governing Section 10(b) and Rule 10b-5 actions was in serious disarray for decades before the Court adopted a federal statute of limitations. If federal concerns had not been under-emphasized and the Rules of Decision Act had not been literally, and perhaps thoughtlessly, applied, much of the litigation and accompanying judicial waste might have been avoided.

Similarly, although *Kamen* is defensible as the best approach to limit the excesses of judicial lawmaking, there was no need to create a presumption of state law incorporation into federal law. By wedding the judiciary to state law, that presumption may unduly inhibit the courts from seeking to ensure that shareholder derivative actions serve as effective vehicles for the enforcement of the federal securities laws. In so doing, *Kamen* unfortunately failed, as *Burks* did, to offer a hint at when federal policy might displace state derivative rules.

Nor is there a legitimate justification to indulge in the fiction, as a plurality of the Court did in *Lampf, Pleva*, that Congress by its silence intends for state law to supply a limitations period to a claim that it never expressly created.[333] Rather, because federal law is at issue, the court is not bound to apply state law but should endeavor to fashion the federal law that best fulfills the purpose of the statute in question. If state law makes the best federal law, it should be used. Still, the unnecessarily broad presumption of *Kamen* and the fictitious attribution of congressional intent in *Lampf, Pleva* may unreasonably inhibit the lower courts from striving to make the federal securities laws work in the most effective fashion.

B. Separation of Powers Concerns

A strict separation of powers perspective might suggest that, if gaps exist in statutes, the judiciary should not fill them. Rather, so the argument goes, that task should be left for the institution, Congress, with the constitutional power to legislate.[334] The logic, of course, is far stricter than any separation of powers position yet accepted by the Supreme Court. Applying that theory, virtually all federal common law would be rendered invalid, a position

333. *See supra* text accompanying note 174.

334. *See* Agency Holding Corp. v. Malley-Duff & Assocs., 483 U.S. 143, 170 (1987) (Scalia, J., concurring in judgment); Cannon v. University of Chicago, 441 U.S. 677, 743 (1979) (Powell, J., dissenting).

obviously incompatible with the Court's pronouncements.[335] The extreme separation of powers objection, for a variety of reasons, is particularly inappropriate when analyzing the problem of filling in the gaps in laws duly passed by the legislative branch, particularly the federal securities laws.

Interstitial lawmaking in effect is judicial lawmaking by necessity.[336] As Professor Mishkin so aptly and succinctly summarized:

> *[T]he separation of powers cannot be water-tight*; exclusive reliance upon statutory provision for the solution of all problems is futile. Beyond the political realities which will at times compel congressional by-passing of any issue—thus leaving it open until pending litigation forces court resolution—lie such simpler pressures as shortness of time and, perhaps most important, the severe limits of human foresight. Together, these factors combine to make the concept of statutory enactment as a totally self-sufficient and exclusive legislative process entirely unreal. At the very least, effective Constitutionalism requires recognition of power in the federal courts to declare, as a matter of common law or "judicial legislation," rules which may be necessary to fill in interstitially or otherwise effectuate the statutory patterns enacted in the large by Congress. In other words, it must mean recognition of federal judicial competence to declare the governing law in an area comprising issues substantially related to an established program of government operation.[337]

Congress, despite clear flaws in the laws it passes, frequently fails to correct them for long periods, if ever.[338] As legal academicians are well aware, the realities of modern politics, not simple legal rationality, come into play in the legislative process. Unless pressured politically, legislators may not correct the most obvious errors or fill basic gaps in existing statutes.[339]

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335. *See supra* text accompanying notes 33-73 (discussing Supreme Court's federal common law decisions).

336. *See supra* text accompanying note 41 (discussing similar rationale for federal common law).

337. Mishkin, *supra* note 21, at 800 (emphasis added) (footnotes omitted).

338. *See* Friendly, *The Gap in Lawmaking—Judges Who Can't and Legislators Who Won't*, 63 COLUM. L. REV. 787, 792-93 (1963).

339. *See* G. GILMORE, *supra* note 322, at 95-96 (remarking that "[o]n the federal level it is difficult to the point of impossibility to draw the attention of a crisis-ridden Congress to any area of law reform which, although it may be urgent, has not erupted in political controversy"); Friendly, *supra* note 338, at 791-92 (noting that legislatures are better lawmakers than courts but lamenting that they fail to fully legislate); Coffin, *Grace Under Pressure: A Call for Judicial Self-Help*, 50 OHIO ST. L.J. 399, 403 (1989) (judge voicing problems of legislation including "maladroitness, inconsistencies, and gaps in enacted statutes"); Mikva, *Reading and Writing Statutes*, 48 U. PITT. L. REV. 627 (1987) (judge, formerly member of Congress, expressing lack of attention paid by members of Congress to law and legal developments); *see also* L. JAFFE, *supra* note 5, at 16 (noting that lawmaking role of judiciary is function of many variables including staffing of legislature and matters of public concern at the time); *Proceedings of the Forty-Ninth Judicial Conference of the District of Columbia Circuit*, 124 F.R.D. 241, 323-24 (1988) (Remarks of Robert Katzmann) (reporting on study of

Although many have made concrete suggestions to remedy this problem for decades, none of the proposals has borne fruit.[340]

Despite the Court's repeated statements to the contrary, there is little suggestion that, through inaction, Congress intended the courts to borrow state law.[341] Nor ordinarily is there evidence suggesting that Congress intended a gap in one federal statute to be filled with a provision of another federal statute. If the other federal provision would be counterproductive when applied to a different federal statute, a logical (though still fictitious) deduction is that, rather than borrowing from elsewhere in the law, Congress would have wanted the courts to formulate the law that best fulfills its purpose. The question is slightly more complicated when, as in *Lampf, Pleva*, the federal statute for other express claims provides analogous provisions that the court might easily apply to remedies implied into the same law. Although the incorporation of related federal provisions may effectively fill the interstices of a deficient federal claim, a court should not be precluded from looking elsewhere if the provisions do not.

Moreover, judicial lawmaking in this realm most definitely is limited. Interstitial lawmaking is narrower than constitutional interpretation in which elaborate doctrines have evolved from sparse text.[342] In contrast, the outer limits of interstitial lawmaking are defined by the gaps left in the statute. Consequently, interstitial lawmaking is in many ways similar to the ordinary task of statutory interpretation performed daily by the federal courts.[343]

There is a potential check on judicial abuse of the lawmaking power as well. If a majority of Congress strongly objects to the interstitial law made by the courts, it may act to effectively overrule the judiciary.[344] Consequently, even if we distrust the undemocratic judiciary,[345] the democratically elected Congress has the opportunity to remedy any judicial excesses. Although such

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random sample of D.C. Circuit cases and finding that staff of congressional committees with jurisdiction over the legislation interpreted by the court were generally aware only of major decisions).

340. *See* Cardozo, *A Ministry of Justice*, 35 HARV. L. REV. 113 (1921); Friendly, *supra* note 338, at 802; Ginsburg & Huber, *The Intercircuit Committee*, 100 HARV. L. REV. 1417, 1429-34 (1987); *see also* Abrahamson & Hughes, *Shall We Dance? Steps for Legislators and Judges in Statutory Interpretation*, 75 MINN. L. REV. 1045 (1991) (discussing interface between courts and legislatures and reviewing various possibilities for remedying deficient statutes).

341. *See supra* note 339 (citing authorities showing difficulty in convincing Congress to act).

342. *See supra* note 24 (citing authorities contending that federal common law is similar to constitutional and statutory interpretation); *cf.* Barnes v. Glen Theatre, Inc., 111 S. Ct. 2456 (1991) (holding that nude dancing is not "speech" for First Amendment purposes).

343. *See supra* note 24.

344. *See* G. CALABRESI, *supra* note 5, at 92-93. *But see* Merrill, *supra* note 12, at 22-23 (criticizing that justification for federal common lawmaking power on grounds that it fails to remedy Constitutional violation and is unrealistic). At least in politically controversial areas, such an occurrence is not extraordinary. *See* Mikva & Bleich, *When Congress Overrules the Court*, 79 CALIF. L. REV. 729, 734-44 (1991) (discussing instances of Congress overruling Court during New Deal and recent years).

345. *See generally* A. BICKEL, THE LEAST DANGEROUS BRANCH (2d ed. 1986).

Congressional action might seem unlikely, it seems equally improbable that the judiciary frequently will run amok in filling gaps in a statute. To fulfill Congressional intent, it is most practical to allow courts leeway rather than to guarantee that an obviously deficient statute remains deficient in perpetuity.

Observations about Congressional inaction are particularly apt when discussing the federal securities laws. With the stroke of the pen, Congress easily could have resolved the questions percolating for years in the lower courts that the Supreme Court ultimately decided in *Lampf, Pleva* and *Kamen*. The questions, especially the appropriate statute of limitations for implied rights of action under Section 10(b) and Rule 10b-5, had long been recognized.[346] Congress never acted. Why? The federal securities laws understandably fail to generate the public controversy spawned by issues such as flag burning,[347] civil rights,[348] and abortion[349] necessary to provoke quick, or perhaps any, Congressional action.[350] Needless to say, elections generally are not won and lost depending on whether a federal securities claim has a statute of limitations or whether there is a futility exception to the demand requirement in a shareholder derivative suit brought under a federal law regulating investment companies.

In the end, if the courts wait patiently for Congress to remedy the shortfalls in the federal securities laws, the wait would be quite lengthy, if not interminable. Section 10(b) and Rule 10b-5 claims remain *implied* private rights of action, not ones expressly created by Congress, even though courts have recognized the rights for nearly half a century.[351] The right to a Section 10(b) or Rule 10b-5 claim now is the well-recognized centerpiece of federal law designed to combat securities fraud. More generally, as the discussion in this Article illustrates, the rights of action implied into other provisions of the federal securities laws suggest the consistent lack of attention paid by Congress to fine-tuning them. This is true even though, by enacting the American Law Institute's *Federal Securities Code*, Congress immediately could

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346. *See* Schulman, *Statutes of Limitation in 10b-5 Actions: Complication Added to Confusion*, 13 WAYNE L. REV. 635 (1967).

347. For example, in response to Texas v. Johnson, 491 U.S. 397 (1989), Congress quickly passed the Flag Protection Act of 1989, Pub. L. No. 101-131, 103 Stat. 777 (codified at 18 U.S.C. § 700 (West Supp. 1990)), which the Supreme Court just as promptly declared unconstitutional, *see* United States v. Eichman, 110 S. Ct. 1463 (1990).

348. *See* Mikva & Bleich, *supra* note 344, at 740-43 (chronicling Congressional response to decisions of Supreme Court in proposed Civil Rights Act of 1990).

349. In response to Rust v. Sullivan, 111 S. Ct. 1759 (1991), in which the Court upheld the constitutionality of regulations barring federally funded clinics from counseling women on abortion, the House Appropriations Committee moved within one month to halt enforcement of the regulation. *See Hill Panel Votes to Block Abortion Counseling Ban; Unusual House Coalition Backs Amendment*, Wash. Post, June 21, 1991, at A4, col. 1.

350. *See* Ginsburg, *A Plea for Legislative Review*, 60 S. CAL. L. REV. 995, 1013 (1987) (noting that statutes most in need of repair often have little political significance).

351. Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946), is the first reported decision that implied a private right of action for damages into § 10(b) and Rule 10b-5. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, at 380-81 n.10 (1983) (tracing history of implied right of action under § 10(b) and Rule 10b-5).

remedy many of the deficiencies present in the current versions of the federal securities laws.[352] In light of the electorally insignificant nature of the federal securities laws, interstitial lawmaking in a manner that best fulfills the statutory mandate—whether or not a similar provision has been passed by a federal or state legislature—makes eminent sense for the effective administration of a national regulatory scheme.

C. *Jurisprudential Concerns*

As voiced by Justice Frankfurter's derision of "judicial inventiveness" in his dissent in *Lincoln Mills*,[353] another frequent objection to interstitial lawmaking is that judges should not be acting as lawmakers without electoral constraints. Even if federalism and separation of powers hurdles are surmounted, one might argue that, in order to limit the power of judges to make law, they should be bound by state law unless clearly contrary to the mandate of the federal statute. State law might serve to curb the potential for much-feared judicial abuse. This may be the only viable theory for requiring state law to fill the interstices of a federal law.

The concern with restrictions on judges' lawmaking power traditionally has been at the core of debate in jurisprudential circles and at the root of positivist thought.[354] Fearful of judicial discretion, various commentators have strived for theories to constrain the discretion of judges and offer some degree of certainty to the law.[355] The quest for absolute certainty, of course, is unattainable.[356] Legal Realism long ago undermined the idea that lines

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352. *See* AMERICAN LAW INSTITUTE, FEDERAL SECURITIES CODE (1980).

353. *See supra* text accompanying notes 67-68.

354. "Positivists" generally consider law to be a rational system of rules influenced by social life but independent from morality, natural justice, and politics. *See, e.g.*, H.L.A. HART, THE CONCEPT OF LAW (1961).

355. *See, e.g.*, M. EISENBERG, THE NATURE OF THE COMMON LAW (1988) (articulating theory of common law adjudication in which judicial power is circumscribed by social propositions).

356. As described by Cardozo:

> As the years have gone by, and as I have reflected more and more upon the nature of the judicial process, I have become reconciled to the uncertainty, because I have grown to see it as inevitable. I have grown to see that the process in its highest reaches is not discovery, but creation; and that the doubts and misgivings, the hopes and fears, are part of the travail of mind, the pangs of death and the pangs of birth, in which principles that have served their day expire, and new principles are born.

B. CARDOZO, *supra* note 5, at 166-67; *see also* R. POSNER, CARDOZO: A STUDY IN REPUTATION 20-32 (1990) (discussing Cardozo's theory of law articulated in THE NATURE OF THE JUDICIAL PROCESS).

The abstract desire for certainty is not unique to federal common law. It persists in theories of those who claim that the Constitution should be interpreted according to the intent of the framers, *see, e.g.*, R. BORK, THE TEMPTING OF AMERICA: THE POLITICAL SEDUCTION OF THE LAW 1-265 (1990), and that statutes should be constructed as plain language dictates, *see, e.g.*, Easterbrook, *The Role of Original Intent in Statutory Construction*, 11 HARV. J.L. & PUB. POL'Y 59 (1988).

could be drawn neatly to circumscribe judicial discretion.[357] That observation is evident from the limited ability of precedent to bind a court, a fundamental principle of the American legal system.[358] Nonetheless, "our quest for certitude is so ardent that we pay an irrational reverence to a technique which uses symbols of certainty, even though experience again and again warns us that they are delusive."[359]

Most—particularly liberals fearful of an increasingly conservative federal judiciary—might agree that there must be *some* constraints on the power of the courts to fashion law. Though legal doctrine may be unable to dictate results, it may narrow the range of permissible options for judges.[360] By requiring judges to borrow state law, the presumption of *Burks v. Lasker* and the traditional wisdom of borrowing state limitations periods in theory narrowed the options and limited the discretion of judges to make law when filling the voids in the federal securities laws. However, as the developments culminating in *Lampf, Pleva* illustrate, that theory in practice suffers from serious flaws. Besides lengthy indeterminate litigation accompanied by uncertainty and waste, blind incorporation of state law may result in undesirable results, if not results that undermine the effective implementation of the federal securities laws.

Moreover, consistent with previous line-drawing attempts, the state law presumption engrafted on interstitial lawmaking never truly limited the discretion of judges. For example, before *Lampf, Pleva*, the lower courts selected from a variety of different types of state limitation periods for causes of action deemed "analogous," an amorphous benchmark at best.[361] The determination of what claims are analogous necessarily offers a wide range of options and considerable room for argument.

The borrowing from federal sources is marked by similar discretion. In *Lampf, Pleva*, the Court considered federal policies and the practicalities of litigation and selected one—with no explanation for the particular selection—from numerous alternative statutes of limitations from federal sources.[362] Though masking that selection with an attenuated theory of Congressional intent, the Court implicitly made a policy judgment about the proper limitations period for Section 10(b) actions.

Similarly, Judge Easterbrook's ability in *Kamen* to find the room to fashion uniquely federal law in the face of the Court's contrary holding in *Burks v. Lasker*, exemplifies the leeway in the law.[363] In reversing, the Court

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357. *See, e.g.*, K. LLEWELLYN, THE COMMON LAW TRADITION (1960).

358. *See* K. LLEWELLYN, *supra* note 357, at 62-120.

359. Federal Power Comm'n v. Hope Gas Co., 320 U.S. 591, 644 n.40 (1944) (Jackson, J., dissenting).

360. *See* Schauer, *Formalism*, 97 YALE L.J. 509 (1988); *see also* Chemerinsky, *The Supreme Court, 1988 Term—Foreword: The Vanishing Constitution*, 103 HARV. L. REV. 43, 101 n.236 (1989) (recognizing similar phenomenon in constitutional adjudication).

361. *See supra* text accompanying notes 130-34.

362. *See supra* text accompanying notes 157-237.

363. *See supra* text accompanying notes 265-74.

made a policy judgment, at least in the individual case, that Kamen's shareholder derivative suit should not be thrown out of court based on a brand new federal common law rule. The Court, however, did not appear to consider the impact of its decision on future cases and the policy implications of compulsory application of the law of the states with a less favorable tilt toward shareholder derivative actions than the law before it.

The Court's decisions in *Lampf, Pleva* and *Kamen* in tandem once again demonstrate that federal courts enjoy significant discretion when engaging in interstitial lawmaking under the federal securities laws. In the end, as in virtually every substantive area, judges to some degree and in some respects have discretion to make law within certain constraints.

It is a small step in logic to conclude that, rather than simply borrowing federal or state law, judges filling in the interstices of the federal securities laws should fashion the *best* law by considering the policies underlying those laws and the practicalities of enforcement litigation.[364] In light of the difficulties of divining Congressional intent, the Court admittedly resorts to "policy considerations . . . to flesh out the portions of the [federal securities laws] with respect to which . . . the congressional enactment . . . offer[s] [no] conclusive guidance."[365] The same technique would be equally effective in filling voids in the federal securities laws to ensure that interstitial law is consistent with the purposes of the comprehensive scheme of securities regulation.

Such an approach also applies to the fashioning of statutes of limitations. The equitable doctrine of laches represents judicially-made, yet flexible limitations periods.[366] Although laches might seem to constitute legislation by "judicial fiat,"[367] the same accusation could be made with respect to the selection of a statute of limitations in *Lampf, Pleva* as well as the selection of virtually any limitations period. Except for reasons of artificial certainty, why should the courts blindly adopt a state or federal limitations period applicable to another claim—if deficient in some significant way—simply because it has the imprimatur of some legislature? If we admit that interstitial lawmaking most definitely *is* judicial legislation, courts, it would seem, should strive to "pass" the best law.

Although the Supreme Court in *Kamen* rejected Judge Easterbrook's activist attempt at law reform, it might have done better to determine whether state law indeed made the best federal law in a broad range of shareholder derivative actions. The Court instead endorsed an across-the-board presumption of state law incorporation into federal law when, as the development in the statute of limitations cases suggests, that presumption may prevent the lower courts from fashioning the federal law that best implements the hopes

364. *See generally* R. DWORKIN, LAW'S EMPIRE (1986).

365. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975); *see* Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749, 2764 (1991).

366. *See supra* note 237 and accompanying text.

367. *Cf.* Guin & Donaldson, *supra* note 129, at 563 (criticizing Third Circuit's decision in *Data Access* in that regard).

and goals of the federal securities laws. Insistent on restraining the lawmaking power of the federal courts, the Court did not truly investigate the question whether, as a matter of policy, the substantive state law made sense when incorporated into the particular federal securities statute in question.

CONCLUSION

The Supreme Court's decisions last Term in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*[368] and *Kamen v. Kemper Financial Services, Inc.*[369] reflect the recurring tension in the Court's federal common law and interstitial lawmaking decisions between constitutional principles of federalism and separation of powers, as well as the general concerns with imposing limits on judicial lawmaking. This Article attempts to outline some ideas supporting the position that, when filling gaps in federal statutes, courts should strive to make the best federal law possible. Neither federalism nor separation of powers principles suggest that this task is constitutionally infirm and that the federal courts are obligated to borrow state law. Although restrictions on the ability of judges to make law are necessary, the quest for absolute limits should not lead to the creation of federal law that undermines the purposes for which Congress passed the legislation.

For similar reasons, the idea that, if not forced to borrow state law, courts engaged in interstitial lawmaking must borrow from an analogous federal statute is flawed as well. Simply because a law was passed by Congress does not by itself suggest that its provisions will work effectively when plugged into an entirely different statute. Put simply, the judiciary should not be limited in its options between statutes passed by a state or federal legislature. The courts instead, when necessary, should tailor the missing provisions to most effectively implement the statutory program in question.

These arguments carry particular weight when applied to the federal securities laws. Congress designed these laws to remedy shortfalls in state regulation of the interstate securities markets and offer a uniform system of national regulation. The interstices of the regulatory scheme created by these laws are vast. Congress cannot be expected to be pressured politically to fill them. By necessity, the judiciary must fulfill its constitutional responsibility. The statutes themselves, as well as their purposes, serve as the constraints on judicial lawmaking. Although not failsafe, such constraints are the best available and not much different in character from those limiting lawmaking under traditional borrowing doctrines.

For those wedded to federalism, separation of powers, and jurisprudential objections to interstitial lawmaking, the logical course would seem to be the abolition of federal common law. Because opponents of federal common law claim that such lawmaking creates laxity in the legislature, its abolition theoretically would pressure Congress to act. In light of the history of federal

368. 111 S. Ct. 2773 (1991).
369. 111 S. Ct. 1711 (1991).

common law and interstitial lawmaking, that approach, however, is not a pragmatic alternative. It would undermine the effectiveness of federal laws passed by Congress and would leave the federal securities laws unsettled indefinitely.