In the

Supreme Court of the United States

TOUCHE ROSS & CO.,

Petitioner,

v. No. 78-309

EDWARD S. REDINGTON, ETC., ET AL.,

Respondents.

Washington, D. C.
March 26, 1979

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Washington, D. C.
Monday, March 26, 1979

The above-entitled matter came on for argument at 1:45 o'clock., p.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM BRENNAN, Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
WILLIAM H. REHNQUIST, Associate Justice
JOHN PAUL STEVENS, Associate Justice

APPEARANCES:

ARNOLD I. ROTH, ESQ., 575 Madison Avenue, New York, New York 10022, on behalf of the Petitioner.

PHILIP R. FORLENZA, ESQ., 67 Wall Street, New York, New York 10005, on behalf of the Respondent Securities Investor Protection Corporation.

JAMES B. KOBAK, JR., ESQ., One Wall Street, New York, New York 10005, on behalf of the Respondent Edward S. Redington.

C O N T E N T S

P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments next in 78-309, Ross & Company against Edward S. Redington, etcetera.

Mr. Roth, you may proceed whenever you are ready.

ORAL ARGUMENT OF ARNOLD I. ROTH, ESQ.,

ON BEHALF OF THE PETITIONER

MR. ROTH: Mr. Chief Justice, and may it please the Court:

Section 17(a) the the Securities and Exchange Act of 1934 requires broker-dealers to make such reports as the SEC may require. Section 18(a) provides an expressed damage remedy to purchasers and sellers of securities who relied upon misstatements in those Section 17(a) reports.

The primary issue here is whether, in light of the limited expressed damage remedy in Section 18(a), whether Section 17(a) itself also provides an additional implied private right of action in favor of customers of brokerage firms who are not purchasers and sellers against accountants who audit the Section 17(a) reports that contained the misstatements.

There are also two subsidiary issues here which the Court need reach only if it does find that Section 17(a) creates an implied private right of action. The first of those subsidiary questions is whether a trustee, liquidating the business of a defunct brokerage firm pursuant to the Securities Investors Protection Act of 1970, is entitled to assert the Section 17(a)

rights of action that belong to customers of the brokerage firm whose property he has been unable to return in the course of the liquidation.

The second subsidiary issue is whether customers of the brokerage firm who have been compensated with money obtained from the Securities Investor Protection Corporation retain any Section 17(a) rights, and if so is SIPC subrogated to those rights?

It is the position of Petitioner Touche Ross that there is no implied right of action under Section 17(a) in favor of brokerage firm customers or anyone else, and that such a right of action would be inconsistent with the statutory scheme, the evident legislative intent and the purposes of the statute.

It is also our position that even if you assume there to be such an implied right of action, that neither the trustee nor SIPC may assert that action.

Now, this case and those issues arise out of the failure in May of 1973 of a brokerage firm called Weis Securities and its subsequent liquidation under the Securities Investment Protection Act or SIPA, as I will refer to it.

Weis at that time was a member of the New York Stock Exchange and had approximately 35,000 customers. In April or May of 1973, the SEC and the New York Stock Exchange learned that officers of Weis had been falsifying the books and financial records of Weis, so as to conceal a deteriorating financial condition.

The officers' scheme had commenced in early 1972 and had continued on until the spring of 1973. Upon discovery of the scheme in May of '73, upon SIPC's application, the District Court in the Southern District of New York ordered the liquidation of Weis and appointed the trustee. The liquidation is on-going and SIPC is said to have advanced $14 million in that liquidation for the purpose of paying off customer claims.

Among the reports falsified by the Weis officers were the Weis financial reports for its fiscal year ending May 26, 1972, reports for a year ending about a year before the actual liquidation, reports which were filed with the SEC pursuant to Section 17(a) of the 1934 Act and the implementing regulation, Rule 17(a)(5).

Touche Ross, the Petitioner here, performed the annual audit with respect to those reports, but the audit failed to detect the misstatements in those reports.

According to the trustee in SIPC here in this case, Touche Ross failed to detect the misstatement because its audit was conducted in a negligent, reckless, careless, unskilled and grossly negligent manner.

It is also asserted that because the misstatements went undetected the Weis officers were enabled to continue until spring of '73 their scheme of concealing the ever-increasing losses that were the result of the mismanagement by those officers.

SIPC and the Trustee also allege that had Touche Ross

discovered the misstatements, effective remedial action could have been taken so that the forced liquidation could have been avoided or its consequences reduced.

On the basis of those assertions, SIPC and the Trustee commenced two separate lawsuits against Touche Ross.

QUESTION: At that point, Mr. Roth, did the Government appear below -- Did the United States Government appear below in any capacity at all?

MR. ROTH: Your Honor, the SEC appeared in the Second Circuit.

QUESTION: And they are not here, however?

MR. ROTH: They are not here, Your Honor.

QUESTION: Is there any significance in that?

MR. ROTH: I believe there is significance, Your Honor.

QUESTION: Mr. Roth, I didn't understand. What position did they take below, the SEC?

MR. ROTH: Your Honor, the District Court dismissed this action because -- on the ground that the Section 17(a) claims of the Trustee and SIPC failed to state a claim for relief because Section 17(a) does not imply remedy for anybody. It also dismissed the common law claims for accountants' malpractice, and so forth, that the Trustee and SIPC asserted, for lack of subject matter jurisdiction.

On appeal to the Second Circuit, SIPC and the Trustee sought reversal and the SEC came in in support of SIPC's position.

In addition to this action, the other action that was commenced by SIPC and the Trustee was a state court action that was commenced about ten months before this one in the New York state courts. Except for the few conclusory allegations in this action, which the Trustee and SIPC deemed necessary in order to assert claims under Section 17(a) of the '34 Act, the complaints are exactly identical, same parties, same facts, same allegations, same damages, everything.

QUESTION: The customers are not a party to either lawsuit -- no customer is a party to either lawsuit?

MR. ROTH: No customers are party to either lawsuit. The customers have their own lawsuits going.

QUESTION: Have they been paid by SIPC?

MR. ROTH: Your Honor, I think most of the customers have been paid off in the liquidation. $14 million of the amount that was necessary to pay them back was put in by SIPC, subject to its -- in accordance with its obligations under the Act SIPA.

QUESTION: The customers have been paid dollar for dollar, have they?

MR. ROTH: Your Honor, I don't know that every single customer has been paid dollar for dollar. There are, in fact -- I know that there are some who have not been. I believe that there are some customers who had property at Weis which is over the limits of the amounts for which SIPC is obligated to make

good. Those amounts subsequently have been raised, and I think if the new amounts had been in effect in 1972 there would have been even fewer that were not paid.

Your Honor, to finish up the question, the customers have suits primarily in the state court. Of course, about six days after the Second Circuit came down with its decision, saying for the first time in forty-five years that Section 17(a) does create an implied private right of action in favor of brokerage firm customers, they started an action in the Southern District. That action is presently being stayed pending this appeal.

QUESTION: Those customers who were paid off dollar for dollar hardly have been damaged, have they?

MR. ROTH: Your Honor, there is another lawsuit which Touche Ross is not a party to, but there is a decision in the Second Circuit saying that even customers who have been paid off in full by the Trustee still have causes of action that they can assert for the kinds of damages that are not compensated by SIPC, that is losses on the inability to get their shares back when they wanted them, certain tax consequences that flowed from having to --

QUESTION: Against whom? This action is against whom?

MR. ROTH: That action was commenced against the New York Stock Exchange and a brokerage firm that the Stock Exchange and the SEC tried to have Weis merge with in the last days of its existence.

In the Second Circuit, there was a reversal by a divided court of the District Court's dismissal of this action. The Second Circuit held, first, that there was an implied right of action, under Section 17(a), for the customers. It held that the Trustee and SIPC, who had been asserting that they could -- that they had a claim under Section 17(a) in their own right, did not have such a right.

However, the Second Circuit did say that the Trustee, as the bailee of customer property, could assert the Section 17 (a) rights of customers whose property the Trustee had been unable to return in the liquidation.

The Second Circuit also said that SIPC, having advanced money for the payment of certain customers' claims --

QUESTION: Mr. Roth, was there any cross-petition on the part of Redington or SIPC from the decision of the Court of Appeals?

MR. ROTH: Yes, sir. They both cross-petitioned. Those cross-petitions --

QUESTION: Are still pending?

MR. ROTH: As far as we know, yes.

QUESTION: The Court of Appeals held that the customers had a private right of action under 17(a), and that these two Respondents here had derivitive causes of action only, one as a bailee, the other as a subrogate.

MR. ROTH: Yes, sir.

Judge Mulligan in the Second Circuit filed a vigorous dissent, in which he dessented from all of the findings or the holdings of the majority, except that he agreed with them that neither SIPC nor the Trustee had any claims in their own right.

The crucial element in the statutory scheme here, of course, is the existence of Section 18(a), which already provides an expressed damage remedy to a certain class for misstatements in Section 17(a) reports.

Section 18 provides a remedy, like many other remedies in the 1934 Act, only to purchasers and sellers of securities who relied upon the misstatements. The presence of Section 18(a) in the statutory scheme reflects an apparent congressional intention that a damage remedy for such misstatements would be available only to purchasers and sellers as specified in Section 18(a), and would seem to require the conclusion that it would be improper to apply an additional and broader remedy under Section 17(a), itself, in favor of people who are not purchasers or sellers.

QUESTION: Of course, that's quite a different group of people for quite a different kind of damage, isn't it? In other words, these people here are customers of the brokerage firm.

MR. ROTH: Yes, sir.

QUESTION: And their problem is that the brokerage firm, through some chicanery, went busted. The other remedy

to which you refer has to do with purchasers and sellers of securities whose damage results from misinformation or wrongdoing on the part of the issuers of those securities which they purchase or sell, which is quite a different cause of action, quite a different group of protected people, quite a different kind of damage.

MR. ROTH: Your Honor, I think what you have done is to state the conclusion in a different way than I have just stated. Section 18(a) does not give to the customers a right of action. It only gives it to the purchasers themselves.

Now, they have lost property in this debacle of this brokerage firm.

QUESTION: Not because of anything they have purchased or sold on the Stock Exchange or elsewhere, but just because their broker went busted.

MR. ROTH: That's right.

Now, Your Honor, the question that we have to decide today is whether they ought to have a right of action. I think, though, that you have to start from the premise that if Congress were worried in 1934 about purchasers and sellers -- and we know they were because the '34 Act is filled with purchaser and seller remedies -- and if they were also concerned at that time, as my opponents say, with brokerage firm customers -- I am going to get to the legislative history that shows you this is just not so -- but the Second Circuit says brokerage firm customers are the

favored wards of Section 17. If that's so, then what you have is the situation where Congress, knowing about both of these groups, gives the purchasers and sellers an expressed remedy and doesn't give anything to the brokerage firm customers.

So you start almost logically from the proposition that they gave one something, they didn't give the other something and they must have intended not to give it.

Now, I think, Your Honor, that that does bring us to the cases that I say set forth the appropriate analysis for determining whether there ought to be or ought not be a private right of action for these customers.

Those cases are Amtrak, Barber, and Blue Chip Stamps, which deal specifically with the question of implying remedies from statutes that already have expressed remedies in them. And, of course, Amtrak and Barber hold that the congressional enactment of a limited expressed remedy for violation of a particular statutory provision is probative and compelling evidence of a legislative intent to preclude a broader implied remedy.

Now, the implied remedy that you would get from 17(a) is broader than the one in 18(a). It is a remedy for customers, not for purchasers and sellers, the typical people whom the 1934 Act was to protect.

QUESTION: But those cases, did they not -- maybe they didn't -- involved explicitly conferred statutory remedies. And the claim in each of those cases was that in addition to those

explicitly conferred statutory remedies there were other implied private causes of action as sanctions against the same category of wrongdoing.

Here, we have quite -- two different categories of wrongdoing, don't we? One would be wrongdoing on the part of issuers of securities that are bought and sold, purchased and sold by investors in the securities market, and the other, quite a different wrongdoing in this case which is alleged wrongdoing on the part of a brokerage firm vis-a-vis its own customers.

MR. ROTH: Yes, in a way, that is so, but I think, Your Honor, that I should take you to show you the substitute that Congress thought it was giving customers in place of the private remedy that was given to purchasers and sellers.

In the legislative history of the 1934 Act -- that's where I would like to start -- it makes no mention of a private right of action under Section 17(a). It talks only about the administrative enforcement by the SEC, about the SEC going in inspecting brokers and dealers. It does have one revealing thing to it, though, Your Honor. There is a statement in the legislative history that makes it clear that the SEC investigations were investigations so that they could go in and get evidence rapidly in any case where fluctuations in the price of a security indicate that manipulation may be in progress.

Now, that's the kind of thing that purchasers and sellers are concerned about. And so the only indicia as to who

was the special beneficiary of Section 17(a), in the legislative history of the '34 Act, is that it was purchasers and sellers and not so much the customers.

However, then you come to 1970, when Congress enacted SIPA. Now, that legislative history refers to certain protections for customers, although it did not refer to any implied right of action. Those protections that it was referring to were the preventive monitoring system that was in its infancy and then was made much broader by SIPA, itself, the investigative, injunctive and criminal powers of the SEC to enforce its own rights under Section 17(a) to enforce compliance by the brokerage industry with 17(a). And it was talking also about state law -- the right to go into the state courts and use traditional state law remedy.

In fact, the House report refers to some safeguards, however, on both the state and federal levels, as well as in industry imposed legislation. But the most significant thing is that the Senate report explicitly stated that brokerage firm customers, in this situation that Your Honor has referred to, have no remedy available to them under the 1933 and 1934 Acts.

The Senate report says "apart from the volunatary trust funds, there is no protection presently available under existing securities laws for the investor whose broker goes bankrupt." And it also said, "Neither statute prevents the investor from losing his entire investment if his broker fails,"

a recognition that there were some protections, but that the customer didn't have any protection, he didn't have an implied right of action. There was nowhere he could go sue for this thing.

And here, Your Honor -- and this is a most significant thing in this case -- what Congress did was to enact SIPA and to create SIPC, with the function, not only of being part of the early-warning regulatory preventive monitoring system, but with the function of paying off customers of failed brokerage firms.

QUESTION: Whether or not there was any fraud?

MR. ROTH: That's exactly right, Your Honor.

QUESTION: And, of course, those committee reports were a little mistaken, at least taking them on their statements, because customers did, in fact, have remedies. They had remedies under the Federal Bankruptcy Act and they undoubtedly had remedies at state law.

MR. ROTH: Well, Your Honor, I think that if you read those statements in the context that they occurred, I think it is perfectly clear that they were talking about they didn't have any '33 or '34 Act remedy. Senator Muskie says, "There still exists a serious gap in our securities laws." And he was talking about that gap. They then enact SIPA and create SIPC for that purpose. And, Your Honor --

QUESTION: But even if there is an implied remedy, you still would have needed SIPA -- Even if there is an implied

remedy for fraud, you still would have needed SIPA to take care of the non-fraud bankruptcy situation.

MR. ROTH: Well, Your Honor, that may be.

QUESTION: Well, it is, isn't it? That's exactly what you are talking about and what you read -- non-fraud situation.

MR. ROTH: But, Your Honor, I think there still is -- even when you take care of the non-fraud situation you are taking care of the fraud situation.

In other words, Your Honor, purchasers and sellers of securities don't have any agency they can go to and get money from if they lose money, having relied on misstatements --

QUESTION: Could you explain this to me. Could you give me an example of a violation of 17(a) by a broker that would give rise to litigation by a purchaser or seller, where he could recover.

MR. ROTH: Yes, sir. In fact, Your Honor, we have one in the Southern District arising out of this very same Weis situation, in which we are the Defendant.

A bank which made a subordinated loan to Weis was given the Weis Section 17(a) report in order to induce him to make that loan. He made the loan. And Judge Wyatt, the same judge that dismissed this action, upheld a Section 18(a) claim against Touche Ross, based on that.

QUESTION: They treated the bank as what, a purchaser of securities?

MR. ROTH: Yes, sir.

QUESTION: There wouldn't be a claim by a common ordinary person just buying and selling stock over the exchange, would there? That's a rather unusual --

MR. ROTH: Your Honor, that's hard to imagine because the purchasers and sellers -- and you know a customer is a purchaser and seller. I mean we are talking about almost the same person. But a purchaser and seller is dealing in stocks of General Motors, United States Steel. He is not going to buy and sell them in reliance on a Weis report.

QUESTION: That's right. That's why 18(a) primarily deals with misstatements that relate to the issuer of the security, doesn't it?

MR. ROTH: No, Your Honor. Section 18(a) deals with misstatements in any report that is filed. It is not called liability for purchasers and sellers or liability -- or remedy --

QUESTION: I find it difficult to imagine a case -- Say I am a customer of Weis and I get a false report about Weis' financial situation. I go out and buy General Motors stock. The two just don't fit.

MR. ROTH: That's exactly right, Your Honor. And that's part of the crux of this problem, Your Honor.

You see, when you talk about a prospectus or a proxy statement, that is something that goes primarily to the investor

and is primarily designed to induce him to act or not act. Those documents do go to the SEC, but the SEC is really exercising an oversight kind of function and it is important that your actions be made on accurate statement. And there is a congressional policy for that.

On the other hand, these Section 17(a) reports, particularly in 1972, were primarily for the purpose of going to the SEC and going to the regulatory agencies and were not designed for the basic purpose of inducing an investor to make a decision based thereon.

Now, it might be that one gets out into commerce somewhere and somebody does purchase or sell a security.

MR. CHIEF JUSTICE BURGER: I think you have completed your answer to the question, Mr. Roth, and your time has expired.

MR. ROTH: Thank you, Your Honor.

MR. CHIEF JUSTICE BURGER: Mr. Forlenza.

ORAL ARGUMENT OF PHILIP R. FORLENZA, ESQ.,

ON BEHALF OF RESPONDENT SIPC

MR. FORLENZA: Mr. Chief Justice, and may it please the Court:

I would like to go directly to the heart of Petitioner's case and pick up on the points raised by Mr. Justice Stewart and Mr. Justice Stevens.

The fact of the matter is that there is no situation where a customer has a claim under Section 18(a) for anything

that happened regarding violations of Section 17. The fact of the matter is that Section 17 and Section 18 may well travel separate roads that intersect at times, but they go beyond that to attain different goals, to protect different categories of investors.

QUESTION: Mr. Forlenza, is there any substantial difference between the position of your client, SIPC, and the position of Redington, the Trustee?

MR. FORLENZA: On the merits?

QUESTION: On the issues before this Court on Touche Ross' petition for certiorari.

MR. FORLENZA: No, sir.

The question, I think, that has been asked is --

QUESTION: Except you are here as a subrogate and there is the ultimate question of whether or not -- and your co-counsel represents an asserted bailee, and there is a question of whether or not he has standing in that capacity. So, to that extent, you are different cases. Because, basically, as I understand the Court of Appeals' judgment, neither you, your client, nor his client has a right of action on his own. Isn't that correct?

MR. FORLENZA: That's correct.

Actually, I don't think they raised --

QUESTION: But it's only a customer's right of action.

MR. FORLENZA: That's right.

I don't think the Court of Appeals made such a holding. I think in a footnote it suggested it wasn't particularly receptive to it. I think that's more accurate.

The fact of the matter is we are here in those capacities.

QUESTION: But the court held it is a customer's right of action.

MR. FORLENZA: That's correct.

QUESTION: And further held that you and he, for different reasons, have standing to assert that right of action.

MR. FORLENZA: That's right.

QUESTION: And was that the position of the Commission in the Court of Appeals?

MR. FORLENZA: That's correct, that customers do have standing under Section 17(a).

QUESTION: Do you know whether the Commission's brief filed in the Court of Appeals is part of the record here?

MR. FORLENZA: I am not sure it is part of the record.

QUESTION: But they haven't filed their own brief here now?

MR. FORLENZA: No. And I must say that I take issue with Mr. Roth's contention that their absence is significant. I think their record, their position in the cases, is as in the Second Circuit. They have not taken a different position in this Court. We don't know the reason for their non-participation at

this level.

If I may pick up again on the point about 18. I think the question that has to be asked is: Why should customers be denied a right of action against accountants who violate Section 17 and Rule 17(a)(5), not withstanding the egregiousness of the conduct of the broker or accountant, or the extent of the damage?

Now, Mr. Roth says two things. Number one, congressional silence back in 1974 as to a private right of action is some kind of evidence.

QUESTION: 1934?

MR. FORLENZA: 1934.

I think this Court has said time and again that congressional silence, particularly when there is no pending or proposed legislation, is evidence of very little.

QUESTION: You say the question is why should customers be denied this right of action? Certainly that isn't the way you would ordinarily phrase the question when you are in a federal court, is it?

MR. FORLENZA: Mr. Justice Rehnquist, my point was addressed to the arguments that Mr. Roth was making. We contend that they have such a right. Under Section 17, they are the intended beneficiaries of that statute. They have been harmed by a violation of the statute. Under the Cort v. Ash, or any other test, be it Amtrak or Barber, there is no legislative intent to the contrary, and it is consistent with the legislative purpose.

QUESTION: But you are not contending it's an expressed cause of action?

MR. FORLENZA: Absolutely not.

So, the question is, should this Court imply a private right of action?

The Petitioner says it ought not to, not because of any --

QUESTION: Here again, we've implied it before from time to time, but we perhaps haven't always followed it. Congress knows how to state a cause of action.

You have to rest on the general contours of what we said in Cort v. Ash and some of the other cases.

MR. FORLENZA: Absolutely. And the fact of the matter is that I think in Cort v. Ash the Court recognized that there are times when Congress creates the duty, does not address the remedy, other than placing it in the hands of the Commission, for example, and it is the function of this Court, when the Cort v. Ash factors are met, to imply a remedy, as it did in Section 14(a) in Borak --

QUESTION: Then in the Piper case, which is more recent, it was indicated, certainly, that some necessity must be shown. It is necessary to do it, or else there is no remedy whatever.

MR. FORLENZA: Well, on the question of necessity, let me say this. I think as to the necessary supplement to

Commission action, which is the phraseology used by this Court on several occasions, there is no question that the Commission or the exchanges was ever intended to have the resources or ability to conduct the kinds of audits that are required to expose brokers' fraud in hiding net capital violation. The fact of the matter is it is common knowledge these kinds of audits take hundreds and hundreds of man-hours. The Commission hasn't got the ability or the resources to conduct those.

Number two, Mr. Roth talks about the fact there are customers in this case represented by the Trustee who have claims of losses in excess of $1 million, because they were over the limit of the SIPC fund. It is necessary to imply a private right of action to compensate those customers.

I'll get back to the Section 18 point. My adversary says that the reason for denying a private right of action to customers notwithstanding Section 17, the duty on the accountants set forth there and in the rule is not because of any clear legislative intent, but the maxim of expressio unius in this Court's decision in Amtrak.

But, as Mr. Justice Stewart pointed out, in Amtrak and Barber, there was a statute directly on point, giving to a certain party -- in that case, the Government and a very limited class of private parties -- a remedy for the very wrong question. Here, 18 deals with filed information which has an adverse effect on the price of a security, that is to say fraudulent statements.

Section 17 doesn't address that kind of situation. When Congress made the contours of a Section 18 claim, it made all the sense in the world, for the same reasons as Blue Chip, to require a purchaser-seller requirement as a limitation. No such limitation makes sense in a customer claim. Indeed, it's not a limitation on a remedy, it's a denial of a remedy to customers.

Turning to the intended beneficiaries. Mr. Roth takes issue with the fact that Section 17 has, as its intended beneficiaries, the customers.

I need only point to Sections 8(b) and 15(c)(3) of the '34 Act, which is the basis for the net capital rule, to point out that Congress was indeed interested in protecting customers against losses, by reason of insolvency of brokerage houses.

Section 17 is the only mechanism for finding out about such violations.

Secondly, for thirty-five years, the Commission has interpreted the rule as protecting customers in just these situations.

As recently as January of this year, the Daniels case, the Court pointed out that a consistent and longstanding interpretation by the Commission is entitled to great weight. In that case, the interpretation was neither longstanding nor consistent. That is certainly not the case here with Rule 17 (a)(5).

Now, as to this legislative intent in 1970, with the enactment of SIPA, if the Court will look closely at the Senate report, it talked about operational difficulty in the 1960s, the back office problem that gave rise to the demise of most of the brokerage houses at that time. They were not talking about situations where accountants had failed to pick up a fraud which exacerbated the situation with the brokerage house and resulted in its demise. Number one.

Number two, the void, unlike the Daniels case, was a lack of insurance. That is to say, investor confidence had badly been shaken. And implied lawsuits, of long duration, are hardly the kind of thing that would give investors the confidence they required at that time. SIPA was set up for that purpose.

The fact of the matter is, Mr. Roth overstates the congressional intent. There is nothing in the legislative history to suggest that Congress even addressed the question of implied rights against accountants.

QUESTION: That is in 1970?

MR. FORLENZA: In 1970, the enactment of SIPA.

QUESTION: The Section 18 remedy was part of the original '34 Act, was it?

MR. FORLENZA: That's correct.

In 1934, there was a Section 18 remedy, purchaser-seller requirement. There was 8(b) in 1934, which was the grandfather of the net capital rule. And there was Section 17,

clearly designed to protect customers.

The fact of the matter is Congress simply did not deal with the question of whether there should be an implied -- a private right of action under 17.

QUESTION: Any more than it did under Section 10.

MR. FORLENZA: 10(b). As this Court specifically pointed out, neither Congress nor the Commission considered the question. The same is true of 14(a), under Borak.

QUESTION: Mr. Forlenza, on the question whether 17(a) is directly intended to benefit customers, your opponent argues that, well, the real purpose of it is to help the SEC with its enforcement function, and the reports had to be filed with the SEC and they could look them over and maybe revoke a license, or something like that.

Is it your position, in your private cause of action, that the customers relied directly on the filed reports, or they, in effect, didn't get the benefit of enforcement action that would have taken place if correct reports had been filed?

MR. FORLENZA: It is the latter, Mr. Justice Stevens. In addition, I am not sure that in this kind of case reliance, in the classic sense, is really an element here.

QUESTION: Well, reliance is an element of an 18(a) cause of action.

MR. FORLENZA: That's correct. If there is reliance, it is reliance on the system, if you will; but the fact of the

matter is they have been directly harmed by a breakdown in the system caused by the conduct of the Petitioner.

QUESTION: The failure of the accountants to catch it, and the failure of the SEC to catch it, too, of course.

MR. FORLENZA: Well -- But again the point is upon whom does the duty evolve?

QUESTION: And the failure of the Exchange to catch it.

MR. FORLENZA: Yes, but the fact of the matter is the mechanism set up by Congress initially and the Commission thereafter is that the Commission doesn't have the ability to pick up these kinds of deceptive practices. The fact of the matter is the 17(a) report certification is the key to the system picking up a net capital violation when the broker is trying to hide the fact. There are spot checks by the Exchange. There are monthly reports by the brokers to the Exchange. And if the Commission has any indication, whatsoever, that there is something wrong, it will send in a team of examiners. But audits of a nature that are designed to eliminate this kind of fraud, simply can't be done by the Exchange.

QUESTION: Because the Exchange doesn't have the personnel?

MR. FORLENZA: The personnel, the resources, the expertise, if you will, in terms of these kind of detailed audits.

QUESTION: How about the SEC?

MR. FORLENZA: I think the same, except for the expertise question. The fact of the matter, if I may, Mr. Justice Rehnquist, they could hardly be criticized if, in fact, the machinery set up by Congress is such that they were not intended to take on the function that the independent auditor voluntarily assumes. He is the linchpin to the --

QUESTION: I wasn't taking it as a criticism, but I was thinking that there are any number of criminal statutes in the country and many understaffed U.S. Attorneys' offices. I don't suppose some of them would come here making a claim that the fact that there aren't sufficient resources allocated to U.S. Attorneys gives them implied private right of action -- because the U.S. Attorneys are understaffed.

MR. FORLENZA: But that reason he has an implied right under the '34 Act and the Securities laws -- And, again, I point to 10(b), which is a criminal statute, 14(a), which is a criminal statute -- The fact of the matter is when they don't work, the issue before this Court is, is it appropriate, necessary to imply a private damage remedy to the persons hurt by the violations?

QUESTION: Do you rely on Borak for that?

MR. FORLENZA: We rely on Borak, Cort v. Ash, -- I don't think this Court has said otherwise.

QUESTION: You go way back to the Safety Appliance Act.

MR. FORLENZA: That's correct, in Rigeby.

And though there has been criticism by Petitioner of this line of reasoning, this Court has time and again approved that reasoning. In Piper, for example, the fact of the matter is the Court never reached the necessity question, because the issue before the Court was who were the intended beneficiaries? From the finding that the regulating parties were not the intended beneficiaries, I think everything else in Piper flowed.

QUESTION: Mr. Forlenza, may I ask one other question. If you are wrong, and there is no private cause of action against the accounting firm -- and you take the position the accounting firm is the key to the checking and catching these things -- what remedy is there against the accounting firm, other than state causes of action?

MR. FORLENZA: Other than state causes, which Mr. Kobak will address to, there are criminal --

QUESTION: What would their crime be? Is there a criminal remedy against them?

MR. FORLENZA: Yes. I believe Section 32 of the '34 Act makes it a crime to violate any of the filing statutes or regulations. So, actually, there would be a criminal --

QUESTION: Against the accounting firm?

MR. FORLENZA: Against the accounting firm.

But, as I've said before, the Court has noted that criminal sanctions just don't work often, and this is the reason

for implying a private right of action.

QUESTION: Might not the Trustee, as Trustee, have a private cause of action, under state law, against the accounting firm?

MR. FORLENZA: Mr. Justice Stewart, I am not sure of the answer. Mr. Kobak is going to address the state law question, if I may defer to him.

I would like to point out that there are only certain of the customers in this lawsuit that Mr. Roth has made reference to, and that has been stayed. And this Court if it decides in favor of affirmance, I believe in that case it probably would be dismissed because, between the two of us, we cover all the bases.

I think the suit that Mr. Roth referred to, as giving rise to an 18 claim, under Section 17, is worth commenting on just for a moment.

Exchange National Bank purchased subordinated notes from Weis of such a complicated nature that the District Court found it was more of the nature of a security than a commercial loan. The complications which are highly relevant are that they had provisions key to the Net Capital rule that were dictated by the SEC and it was agreed that they would be part of the company's net capital. So, of course, reliance by the Plaintiff on the Section 17 certification was relevant -- the most rarest of situations. Congress could not have intended that situation to

be a preclusive effect on Section 17 violations.

Thank you, very much.

MR. CHIEF JUSTICE BURGER: Mr. Kobak.

ORAL ARGUMENT OF JAMES B. KOBAK, JR., ESQ.

ON BEHALF OF RESPONDENT REDINGTON

MR. KOBAK: Mr. Chief Justice, and may it please the Court:

There are customers with unsatisfied claims in the Weis liquidation. There are hundreds of such customers and their claims total over $1 million. It is essential that these customers have a remedy when the scheme provided by Congress for regulating broker-dealers' financial condition for the benefit of customers does not work because of the wrongdoing of a third party.

Here, the wrongdoing is that of the accountant. We allege in our complaint that the accounts were not only negligent, but grossly negligent and reckless in failing to follow Rule 17(a)(5) and in failing to detect fraud, which infected the year-end financial statements filed by Weis with the regulatory authorities.

Now, it's true, as Mr. Roth points out in his brief, that many, many other documents -- financial documents -- are filed with the regulatory authorities by brokers in addition to these year-end audited statements. But there are over 5,000 brokerage firms in the United States. The SEC, which did appear

below, stated in its brief that it did not have time or the manpower to conduct its own audit of more than 5% of those 5,000 brokerage firms.

This other financial information that is furnished to the regulatory authority is of no value, except insofar as it is key to the audited statements that are filed annually by the brokerage house. As long as the monthly and other data filed by the broker is consistent with the year-end statements, the SEC or the stock exchanges would ordinarily have no reason to believe that anything was wrong. Therefore, if the audited financial statements, which are considered the barometer of the broker's financial condition -- if they are inaccurate, the entire monitoring scheme established by Congress for the benefit of investors, in their capacity as customers, cannot work and there is a risk that they will be lost to individual customers, as well as to SIPC, which is precisely what occurred in the Weis situation.

Now, Mr. Roth accuses us of trying to make accountants scapegoats for every brokerage house liquidation. And he suggests that if Congress had wanted there to be a private right of action against accountants it would have created one in the Act.

Well, no one contends that accountants are the cause of every brokerage house liquidation. The facts here are very unique. They involve, as our complaint alleges, gross negligence in failing to detect fraud.

The facts of the Weis liquidation are very unique.

QUESTION: You do have, do you not, a cause of action under the law of the State of New York, as Trustee?

MR. KOBAK: As Trustee, we have a derivative cause on behalf of Weis, as a corporate entity. That is not a cause of action on behalf of the hundred customers who have lost $1 million.

QUESTION: No. But it is on behalf of the corporation?

MR. KOBAK: That's correct.

QUESTION: If it is a corporation, or partnership.

MR. KOBAK: We have a negligence action, perhaps a breach of contract action, under state law.

However, in addition to the fact that that cause of action would not provide any protection for customers --

QUESTION: Except derivitively. If you recover, the corporation would have more money to pay them their claims.

MR. KOBAK: But that would be money that would be paid to general creditors and not necessarily the customers.

The other important limitation on our state court remedy is that, according to the accountants, we cannot rely, even in a state court negligence action, on the rules established by the SEC under Section 17 of the Exchange Act, because of Section 27 of the Exchange Act, which says that the jurisdiction of the federal courts over suits in equity and actions at law is exclusive of the jurisdiction of the state courts. In other

words, if our negligence case, in state law, is to depend -- it would have to depend in large part -- on violations of specific duties set forth in subparagraphs (g) through (i) of Rule 17(a)(5), as it existed in 1973, the accountants say we could not rely on that as a breach of duty under state law, and we would be left without a remedy.

QUESTION: I thought -- Wouldn't the effect of those provisions be that if you win this case you no longer have a state cause of action, because this would be your exclusive remedy?

MR. KOBAK: They said in the papers filed, both in our state court action and with the District Court when they made their motion to dismiss, that we had a cause of action based on negligence, per se, in the accountants breach and failure to follow the provisions of Rule 17(a)(5).

Touche Ross said in its papers, in both courts, that that did not state a cause of action, under Rule 17, because if there was any jurisdiction to enforce those provisions it was the jurisdiction of the Federal Court.

QUESTION: I take it, you don't finally accept your opponent's word in the lawsuit as to whether a cause of action exists, do you?

MR. KOBAK: No, I don't necessarily, Your Honor, but I think that is an issue that may exist in state court actions. In this case, there is no reason why this should even be an issue.

I think it is clear from the Borak case. I think it is clear from Justice Harlan's concurrence in the Bivens case, when he discusses the Borak case in a footnote, that one of the reasons Section 27 exists is to insure that there be remedies for the beneficiaries of Exchange Act provisions, and that those remedies be uniform across the United States.

Now, state court law on accountants' liability has developed in ways that are divergent, it has developed in ways that are tied to developments in professional malpractice actions, generally, but those developments have nothing in particular to do with the federal policy of regulating broker-dealers for the benefit of their customers.

Mr. Roth says that he is relying, primarily, on three cases, the Amtrak case, the Barber case and the Blue Chip Stamps case. In Amtrak and Barber, there was no equivalent of Section 27 of the Exchange Act. In addition, if a cause of action had been recognized on behalf of the private plaintiff in either of those cases, it would not only have been inconsistent with the congressional goals in legislating on behalf of a particular class of people, it would have been antagonistic to those goals.

For instance, in Amtrak, you could have had a person in one part of the country saying, "Don't cut off my railroad," and filing a suit. That might have been in his interest, but it would have been antagonistic to the interests of other railroad passengers, or would be railroad passengers, in other portions

of the United States.

Similarly, in the Barber case, where this Court recognized that a private citizen, a customer of a brokerage house, even though the beneficiary of the SIPA Act, should not have standing to invoke the remedies of SIPA, there was a clear antagonism among the interests of the class. One customer might have wanted his brokerage house liquidated immediately. Another would prefer that the SEC, or the stock exchange undertake the efforts that this Court pointed out those authorities commonly undertake to see if that brokerage house could not be saved and spare any possible loss to the customers.

Similarly, in the Piper case, where the necessity language was underscored three times on page 25. The question there was a different question. The question was not whether any private right of action was consistent with congressional goals. The question was whether it was necessary that the particular plaintiff involved there be given a right of action in order to effectuate those goals. In that case, the plaintiff was not a member of the protected class, and again there was a possible antagonism between his interests and the interests of the class, as a whole. That was pointed out by Chief Justice Burger on behalf of the Court at page 39 of the opinion.

The principles that are applicable here are those of the Borak case, they are those of Bivens v. Six Unknown Narcotics Agents. They are also the principles that have been applied in

a well-established line of cases in the lower courts, under Section 6 of the Securities Exchange Act. Section 6 creates no private right of action, expressly. That provision, like Section 17, was designed by Congress for the protection of investors.

QUESTION: Suppose you are right, there is a private right of action. What are the elements that your client would have to prove?

MR. KOBAK: In our case, we would have to prove duty on behalf of Touche Ross, a breach of that duty, and causation, the elements of any lawsuit.

QUESTION: Causation would amount to what?

MR. KOBAK: Well, in our view, our prima facie showing of causation would require us to show that Touche Ross, through its negligence or gross negligence or recklessness, failed to detect fraud, which,had it discovered in a timely fashion, it would have had to alert regulatory authorities to the existence of. At that point, the regulatory authorities could have taken action to prevent or reduce the amount of damage that has been suffered in the Weis liquidation.

QUESTION: But in no event, does either the regulatory agency or your clients, or anybody else, have specifically to rely on the accuracy of the statements that were filed?

MR. KOBAK: Well, the regulatory authorities do rely -- -- our customers --

QUESTION: Well, you don't rely -- they don't rely --

You wouldn't have to prove, for example, that they examined these statements and relied on them?

MR. KOBAK: No, that's correct. They rely on them to the --

QUESTION: So your answer is, nobody has to rely on them?

MR. KOBAK: No, they don't have to rely. The regulatory authorities rely on the fact that the auditor has been there, has supposedly performed the minimally acceptable steps required in a Rule 17(a)(5) audit, and has discovered no irregularity.

QUESTION: To that extent, they were there. And for all anybody knows, they did go through some steps, but they filed some wrong statements, I take it.

Your clients don't need to rely on anything?

MR. KOBAK: My clients are the customers.

QUESTION: I understand. But you don't have to rely on anything with respect to these statements?

MR. KOBAK: No. In fact, at the time in question there was no congressional requirements or regulatory requirements of the SEC. The customers even received these statements.

QUESTION: Would a purchaser of securities have to rely on them?

MR. KOBAK: A purchaser of licensed securities would. The case that Mr. Roth talks about is that of a subordinated

lender. That subordinated lender claimed he received a copy of false financial --

QUESTION: Customers are in a better shape than buyers --

MR. KOBAK: They are in better shape than buyers --

QUESTION: -- insofar as being able to impose any liability on the accountants?

MR. KOBAK: In those rare cases, when they suffer a loss because of a brokerage house failure. The reason that they are in a better position is that Congress legislated in the Exchange Act that they be the beneficiaries of a very extensive scheme of monitoring and regulating broker-dealers. When the accountant fails to act, that scheme cannot --

QUESTION: But the buyer can recover from the accountant, but he is going to have to prove some reliance on the statements.

MR. KOBAK: He is going to have to prove reliance, that is correct, because he is in a different category. He is a purchaser-seller. He is probably going to have to --

QUESTION: I know he is a different -- So, your answer is yes, the customer is in a better position with respect to reliance than the buyer?

MR. KOBAK: When there has been a brokerage house failure, the customer, through the Trustee, has to show that the system could not work because the accountants failed to alert the regulatory authorities to the existence of fraud and false financial statements.

QUESTION: But if he is both a customer and a buyer and sues in both capacities, he has to prove reliance on one and not the other?

MR. KOBAK: Well, I don't think -- He can't sue in both those capacities at the same time. As a customer, he is buying through --

QUESTION: You mean about the same thing. He could certainly be a buyer, couldn't he?

MR. KOBAK: Well, you could conceivably have someone who was both a Weis customer and a Weis shareholder, yes. He would be dealing in two different capacities. He would have different burdens of proof under both statutes.

QUESTION: But tell me -- What you are really saying is that there is an implied cause of action, that the Act provides a cause of action for you. Why would Congress think -- I am sure you know and can tell me why Congress would make it easier for the customer than the buyer to recover from the accountant?

MR. KOBAK: Congress wanted these customers -- Congress wanted the innocent -- the ignorant man in the street, the most naive person imaginable, to deal in the nation's capital markets.

QUESTION: There are an awful lot of ignorant buyers around, aren't there?

MR. KOBAK: That may be, Your Honor. But I suggest

those ignorant buyers are unable to sustain their causes of action because they are unable to prove reliance and fraud.

QUESTION: I am just asking you, why shouldn't customers have to prove something?

MR. KOBAK: Because Congress wanted the customer to be able to rely on the regulatory authorities to do that for him, and not have to make his own sophisticated analyses of a broker's financial statements.

Thank you.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen.

The case is submitted.

(Whereupon, at 2:47 o'clock, p.m., the case was submitted.)