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COMMENT

CIVIL LIABILITY FOR MARGIN VIOLATIONS—THE EFFECT OF SECTION 7(f) AND REGULATION X

I. INTRODUCTION

A substantial portion of "federal corporation law"[1] that has developed in the federal courts since the passage of the Securities Act of 1933[2] and the Securities Exchange Act of 1934[3] has involved the implication of private civil liability for the violation of sections of the 1934 Act and the rules adopted thereunder. These violations include, *inter alia*, the extension of credit in violation of the margin requirements established by the Federal Reserve Board pursuant to section 7[4] of the 1934 Act.

The recognition of such a cause of action has presented the courts with three difficult problems. First is the identification of the legal basis for implying a private cause of action for a violation of the margin requirements. Second is the extent to which an investor's participation in the transaction constituting a violation bars him from relief.[5] Third is the nature and extent of the remedy to which a successful plaintiff is entitled. The addition of section 7(f) in 1970,[6] and the promulgation by the Board of Regulation X[7] making unlawful the *obtaining* of credit in violation of the margin requirements, have given rise to questions regarding the continuing viability of the principles that underlie the implication of civil liability for violation of the margin requirements.

II. THE MARGIN REQUIREMENTS

Section 7 of the 1934 Act gives the Federal Reserve Board authority to regulate the amount of credit available in the securities market "[f]or the purpose

1. See Fleischer, "Federal Corporation Law": An Assessment, 78 Harv. L. Rev. 1146 (1965).

2. 15 U.S.C. §§ 77a et seq. (1970).

3. Id. §§ 78a et seq.

4. Id. § 78g.

5. Phrased differently, the question is to what extent can the lender who extended credit beyond the level permitted by the margin requirements rely upon the doctrine of pari delicto as a defense in an action by an investor? The common law doctrine of pari delicto holds that where two parties are equally blameworthy in an illegal transaction, neither will be permitted to recover from the other. Restatement of Contracts § 598 (1932). In the classic case, the defendant interposes the defense of illegality as a bar to enforcement of the contract. The plaintiff asserts that the illegality is immaterial since he is not in pari delicto with defendant. 6A A. Corbin, Contracts §§ 1534-40 (1962). In the margin rules context, the contract has usually been performed and it is the defendant who interposes pari delicto as a bar to restitution. See, e.g., Pearlstein v. Scudder & German, 429 F.2d 1136 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971).

6. Act of Oct. 26, 1970, Pub. L. No. 91-508, § 301, 84 Stat. 1124 (codified at 15 U.S.C. § 78g(f) (1970)).

7. 12 C.F.R. § 224 (1974).

of preventing the excessive use of credit for the purchase or carrying of securities."[8] Section 7(c) makes it unlawful for "any member of a national securities exchange or any broker or dealer" to extend, maintain, or arrange credit to or for any customer on any security, without collateral or with any collateral other than securities, except in compliance with the rules and regulations promulgated by the Federal Reserve Board.[9] In addition, section 7(d) makes it unlawful for any person not subject to subsection (c) to extend or maintain or to arrange the extension or maintenance of credit, for the purpose of purchasing or carrying securities, where the extension, maintenance, or arranging contravenes the rules and regulations of the Board.[10] Pursuant to the authority granted it by section 7, the Board has promulgated Regulations T,[11] G,[12] U,[13] and X,[14] each of which requires that for certain transactions to be lawful, the customer must present sufficient collateral within a specified period.[15]

Regulation T governs the extension of credit by brokers.[16] A purchase transaction carried out for a customer's special cash account[17] complies with Regulation T if there is sufficient cash in the account at the time of the transaction, or the broker makes the purchase relying in good faith on the customer's agreement promptly to pay in full and his representation that he intends not to sell the security prior to payment.[18] In addition, if payment is not made within seven business days after the purchase, the broker must "cancel or otherwise liquidate the transaction."[19] A sale is a valid cash transaction if the security is held in the account, or if the broker is informed by the customer that he owns the security, and the broker relies in good faith on the customer's agreement to deliver the security promptly.[20] Unlike the rule regarding a purchase, there is

8. 15 U.S.C. § 78g(a) (1970).

9. Id. § 78g(c).

10. Id. § 78g(d).

11. 12 C.F.R. § 220 (1974) (as amended, 39 Fed. Reg. 1006 (1974), and 39 Fed. Reg. 1974 (1974)).

12. Id. § 207 (as amended, 39 Fed. Reg. 1974 (1974)).

13. Id. § 221 (as amended, 39 Fed. Reg. 1006 (1974), and 39 Fed. Reg. 1974 (1974)).

14. Id. § 224.

15. The margin requirements thus regulate only the "initial margin." The rule of most stock exchanges (e.g. rule 431 of the New York Stock Exchange) require a "maintenance margin," which is the deposit of additional margin in the event that the market value of the collateral securities declines to such an extent that it is below margin. Solomon & Hart, Recent Developments in the Regulation of Securities Credit, 20 J. Pub. L. 167, 172 & n.31 (1971). It has been held that violation of a maintenance margin required by an exchange rule does not give rise to a private cause of action. Gordon v. duPont Glore Forgan Inc., 487 F.2d 1260 (5th Cir. 1973), cert. denied, 94 S. Ct. 3071 (1974).

16. 12 C.F.R. §§ 220.1 et seq. (1974).

17. Cash transactions are included in the special cash account. Id. § 220.4(c) (1974). All transactions not included in one of the special accounts, id. § 220.4, are recorded in the general account. Id. § 220.3.

18. Id. § 220.4(c)(1)(i).

19. Id. § 220.4(c)(2).

20. Id. § 220.4(c)(1)(ii). The actual language employed in the section is "in reliance

no specific time period within which delivery of the security must be made, a difference of some significance.[21]

In order to comply with Regulation T a margin transaction cannot involve the extension of credit beyond the "maximum loan value,"[22] the inverse of which is the required margin, *i.e.*, the amount of cash or other collateral that must be deposited with the broker in order for the transaction to be lawful.[23] If the customer's general account does not contain cash or other securities[24] in sufficient quantity to supply the required margin, the customer must deposit in the account within five business days *of the transaction* sufficient collateral to bring the margin up to the required level.[25]

Regulation U governs the lending of money by a bank where the borrower will use the loan proceeds for the purpose of purchasing or carrying securities, when the loan is secured directly or indirectly by securities.[26]

Regulation G[27] was adopted to close a loophole; lenders other than banks or brokers were unregulated in their activities and could legally extend credit for the purchase of securities far in excess of that obtainable from regulated sources.[28] Therefore, the Board extended the margin requirements to cover per-

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upon an agreement accepted by the [broker] in good faith that the security is to be promptly deposited in the account." Id. It is doubtful that there is a significant difference between good faith reliance on an agreement and "reliance on an agreement in good faith."

21. See Naftalin & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 469 F.2d 1166, 1173, 1176-80 (8th Cir. 1972); note 78 infra.

22. This value is set by the Supplement to Regulation T, 12 C.F.R. § 220.8(a) (1974), as amended, 39 Fed. Reg. 1974 (1974).

23. 12 C.F.R. § 220 (1974), as amended, 39 Fed. Reg. 1006 (1974), and 39 Fed. Reg. 1974 (1974). The maximum loan values for margin securities under Regulations T, U, and G are uniform. See 39 Fed. Reg. 1974 (1974).

24. The maximum loan value of these securities determines the extent to which they can serve as collateral for the purchase of other securities. 12 C.F.R. §§ 220.3(b)(1), (c) (1974).

25. Id. § 220.3(b)(1).

26. Id. § 221.1(a). Such loans are often referred to as "purpose loans" or "purpose credit." See Tartell v. Chelsea Nat'l Bank, 351 F. Supp. 1071, 1076 (S.D.N.Y.), aff'd mem., 470 F.2d 994 (2d Cir. 1972); Solomon & Hart, Recent Developments in the Regulation of Securities Credit, 20 J. Pub. L. 167, 174 (1971). Detailed rules for determining the purpose of credit are contained in section 3(b) of Regulation U. 12 C.F.R. § 221.3(b) (1974). The term "carrying securities" includes the use of the proceeds of the loan to repay a debt previously incurred for the purchase of securities. Id. § 221.3(b)(2).

27. 12 C.F.R. § 207 (1974), as amended, 39 Fed. Reg. 1974 (1974).

28. See, e.g., Junger v. Hertz, Neumark & Warner, 426 F.2d 805 (2d Cir.), cert. denied, 400 U.S. 880 (1970); Bronner v. Goldman, 361 F.2d 759 (1st Cir.), cert. denied, 385 U.S. 933 (1966), both involving the extension of credit by factors. But see Zatz v. Hertz, Neumark & Warner, 262 F. Supp. 928 (S.D.N.Y. 1966) (holding that a factor not subject to the margin regulations could be liable for conspiring with a broker to violate Regulation T). As examples of the problems that arose as a result of this loophole, see Glickman v. Schweickart & Co., 242 F. Supp. 670 (S.D.N.Y. 1965); Cooper v. North Jersey Trust Co., 226 F. Supp. 972 (S.D.N.Y. 1964); Meisel v. North Jersey Trust Co., 218 F. Supp. 274 (S.D.N.Y. 1963); Warshow v. H. Hentz & Co., 199 F. Supp. 581 (S.D.N.Y. 1961). These cases arose out of the

sons who, in the ordinary course of business,[29] extend or arrange "purpose credit"[30] secured by securities. The credit extended may no longer exceed the maximum loan value of the collateral.[31]

Section 7(f) of the 1934 Act and Regulation X extend to borrowers the prohibitions of the margin requirements. Section 7(f)(1) makes it unlawful to obtain or receive credit in violation of section 7 or the rules and regulations thereunder. Regulation X incorporates Regulations G, T, and U by reference and makes it a violation to obtain credit in a transaction which does not conform to those regulations.[32]

III. STATUS OF THE LAW PRIOR TO SECTION 7(f) AND REGULATION X

A. *Theoretical Basis for Implying a Private Cause of Action*

An examination of the cases recognizing a cause of action in favor of a recipient of credit in excess of that permitted reveals three different theories of liability.[33] The first is a tort theory developed in *Remar v. Clayton Securities Corp.*[34] and based on section 286 of the first Restatement of Torts:

> Broadly stated, the rule is that where defendant's violation of a prohibitory statute has caused injury to plaintiff the latter has a right of action if one of the purposes of the enactment was to protect individual interests like the plaintiff's.[35]

The court in *Remar* found language in the House Committee Report on section 7 to support the view that protection of the investor was a secondary purpose of the margin requirement.[36] It dismissed the argument that the plaintiff was barred

insolvency of a factor, First Discount Corp., which had engaged in the practice of making loans beyond the level permitted by the margin requirements, and which became insolvent after converting the securities of the various plaintiffs.

29. 12 C.F.R. § 207.1(c) (1974).

30. See note 26 supra and accompanying text.

31. 12 C.F.R. § 207.1(c) (1974); id. § 207.5, as amended, 39 Fed. Reg. 1974 (1974).

32. 12 C.F.R. § 224.2(a) (1974). The wording of section 2(a) of Regulation X is unfortunate in that it creates certain gaps in the coverage regarding borrowers. See notes 140-50 infra and accompanying text.

33. For a fuller discussion of these rationales, see Note, Federal Margin Requirements as a Basis for Civil Liability, 66 Colum. L. Rev. 1462 (1966) [hereinafter cited as Margin Requirements]; Note, Pearlstein v. Scudder & German: Implied Rights of Action for Violation of Federal Margin Requirements and the Demise of the In Pari Delicto Defense, 66 Nw. U.L. Rev. 372 (1971); 39 Fordham L. Rev. 782 (1971).

34. 81 F. Supp. 1014 (D. Mass. 1949).

35. Id. at 1017 (relying on Restatement of Torts § 286 (1934)).

36. Id. When put in context, the statement in which the court finds congressional purpose is less weighty authority for that proposition: "Nor is the main purpose even protection of the small speculator by making it impossible for him to spread himself too thinly—although such a result will be achieved as a byproduct of the main purpose." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 8 (1934), quoted in Margin Requirements 1468 n.44 (1966) (emphasis deleted). It has been argued that a fair analysis of the whole legislative history of the margin provisions leads to the conclusion that they were enacted solely to provide a means of regulating the aggregate amount of credit available in the securities market, and

from suing because of his participation in the transaction, considering that the Congress had regarded him as "incapable of protecting himself."[37]

The second rationale has developed by analogy to *J.I. Case Co. v. Borak*,[38] which recognized a cause of action for money damages resulting from misleading proxy statements. There, the Supreme Court considered it to be "the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose."[39] In *Borak*, however, protection of investors was "among [the] chief purposes" of section 14(a) of the 1934 Act,[40] whereas the protection of investors is at best a subsidiary purpose of the margin requirements.[41] On the other hand, if a private action for margin violations is viewed as aiding "the macro-economic policy of preventing wide fluctuations in security credit,"[42] as has been argued,[43] the conclusion that a private cause of action furthers this purpose is speculative at best.[44] Thus, it appears that the *Borak* rationale does not support a private damages action for violation of the margin requirements.

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that "[a]ny protection of the small speculator from individual loss was merely consequential . . . ." Id. at 1470-71.

The tort rationale has been used in later cases. See, e.g., Landry v. Hemphill, Noyes & Co., 473 F.2d 365 (1st Cir.), cert. denied, 414 U.S. 1002 (1973); Goldman v. Bank of the Commonwealth, 467 F.2d 439, 446 (6th Cir. 1972); Bronner v. Goldman, 361 F.2d 759 (1st Cir.), cert. denied, 385 U.S. 933 (1966); Goldenberg v. Bache & Co., 270 F.2d 675 (5th Cir. 1959); Aubin v. H. Hentz & Co., 303 F. Supp. 1119 (S.D. Fla. 1969); Cooper v. North Jersey Trust Co., 226 F. Supp. 972 (S.D.N.Y. 1964).

37. 81 F. Supp. at 1017. The court's emphasis on the plaintiff's inability to protect himself is an apparent attempt to avoid the stricture of Restatement § 286(d), which states as a prerequisite to a plaintiff's recovery that he "has not so conducted himself as to disable himself from maintaining an action." Restatement of Torts § 286(d), at 752 (1934). This refers to all of the common law defenses to a negligence action. Id. at 758. A comment to that section states: "If, however, the enactment is intended to protect persons from a danger, from which their immaturity or other inferiority renders them incapable of protecting themselves, the [defendant] is liable although the conduct . . . is such that but for the statute it would be regarded as contributory negligence . . . ." Id. at Comment j. The court discovered no "immaturity or other inferiority" on the part of the plaintiff, other than relative inexperience in the securities market. Would an experienced trader be barred from recovery? See Part III B infra.

38. 377 U.S. 426 (1964) (allowing civil damage action alleging misleading proxy statements under § 14(a) of the 1934 Act, 15 U.S.C. § 78n(a) (1970)).

39. Id. at 433.

40. Id. at 432.

41. See note 36 supra and accompanying text.

42. Margin Requirements 1475.

43. Id.; see Avery v. Merrill Lynch, Pierce, Fenner & Smith, 328 F. Supp. 677, 680 (D.D.C. 1971), where the court spoke of the private action as a means to achieve the congressional purpose, to "regulate excessive speculation on credit."

44. See Pearlstein v. Scudder & German, 429 F.2d 1136, 1148 (2d Cir. 1970) (Friendly, J., dissenting), cert. denied, 401 U.S. 1013 (1971); Serzysko v. Chase Manhattan Bank, 290 F. Supp. 74, 89-90 (S.D.N.Y. 1968), aff'd mem., 409 F.2d 1360 (2d Cir.), cert. denied, 396 U.S. 904 (1969).

In addition to the tort and *Borak* rationales, a third basis exists upon which an injured investor can bring an action against his creditor. Section 29(b) of the 1934 Act[45] voids any contract in violation of the Act or the rules and regulations thereunder,[46] and has been interpreted as making the contract or transaction voidable at the option of the "innocent party."[47] It gives to the borrower aggrieved by the overextension of credit a cause of action for rescission of the transaction.[48] It is probably more accurate to describe this cause of action as express rather than implied.[49] Courts have recognized section 29(b) as the basis of a cause of action for rescission under the margin rules;[50] others have recognized it as a defense when a broker seeks recovery of the price of securities purchased in a transaction violating the margin requirements.[51]

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45. 15 U.S.C. § 78cc(b) (1970).

46. "Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract . . . heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation . . . ." Id. As will be pointed out below, the language of the section requires a much closer examination for the proper determination of which rights should be deemed void. See notes 120-30 infra and accompanying text.

47. Mills v. Electric Auto-Lite Co., 396 U.S. 375, 386-87 (1970); Greater Iowa Corp. v. McLendon, 378 F.2d 783, 792 (8th Cir. 1967); Royal Air Properties, Inc. v. Smith, 312 F.2d 210, 213 (9th Cir. 1962).

48. A question of the utmost significance in actions for rescission, and in cases where § 29 is used defensively (see note 51 infra and accompanying text), is exactly what transaction did violate § 7. The significance will be made apparent below. See notes 116-24 infra and accompanying text.

49. 3 L. Loss, Securities Regulation 1759 (2d ed. 1961); Margin Requirements 1478.

50. Warshow v. H. Hentz & Co., 199 F. Supp. 581 (S.D.N.Y. 1961); cf. Appel v. Levine, 85 F. Supp. 240 (S.D.N.Y. 1948).

51. See Landry v. Hemphill, Noyes & Co., 473 F.2d 365 (1st Cir.), cert. denied, 414 U.S. 1002 (1973) (recognizing § 29(b) as a defense to defendant's counterclaim for the balance of the purchase price, although rejecting its applicability in that case to avoid double recovery); Cooper v. Union Bank, 354 F. Supp. 669 (C.D. Cal. 1973). But see E.F. Hutton & Co. v. Weinberg, [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,332 (N.Y. Sup. Ct. 1964); Irving Weis & Co. v. Offenberger, 31 Misc. 2d 628, 220 N.Y.S.2d 1001 (N.Y.C. Mun. Ct. 1961) (summary judgment granted plaintiff-broker despite allegation of Regulation T violation). These cases clearly were wrong when decided, and relied upon language from Nichols & Co. v. Columbus Credit Corp., 204 Misc. 848, 126 N.Y.S.2d 715 (Sup. Ct. 1953), aff'd mem., 284 App. Div. 870, 134 N.Y.S.2d 590 (1st Dep't 1954), a case involving violation of a margin requirement of the New York Cotton Exchange, and, therefore obviously distinguishable from the Regulation T cases.

B. *Pari Delicto*

Much controversy has been generated by the question whether the borrower's participation in the transaction bars his recovery in a private action under the margin rules. The position that it does has been stated in terms of both the contract doctrine of pari delicto[52] and the tort defense of contributory negligence.[53] Since the label applied has no apparent effect on the analysis, the term pari delicto will be used herein to refer to both defenses.

The early cases did not examine the applicability of pari delicto to private actions under the margin requirements.[54] The Supreme Court's decision in *Perma Life Mufflers, Inc. v. International Parts Corp.*[55] raised doubts regarding the availability of this defense in all areas where private suits are permitted to further public purposes under *Borak,* including actions under the margin requirements. However, *Serzysko v. Chase Manhattan Bank*[56] denied recovery against a bank on the grounds that the granting of relief would encourage the kind of fraudulent misrepresentation attributable to plaintiff customer.[57] In *Pearl-*

52. See, e.g., Pearlstein v. Scudder & German, 429 F.2d 1136 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971).

53. See, e.g., Aubin v. H. Hentz & Co., 303 F. Supp. 1119 (S.D. Fla. 1969).

54. Remar v. Clayton Sec. Corp., 81 F. Supp. 1014, 1017 (D. Mass. 1949). See also Smith v. Bear, 237 F.2d 79, 87-88 (2d Cir. 1956); Warshow v. H. Hentz & Co., 199 F. Supp. 581 (S.D.N.Y. 1961); Reader v. Hirsch & Co., 197 F. Supp. 111 (S.D.N.Y. 1961); Appel v. Levine, 85 F. Supp. 240 (S.D.N.Y. 1948).

Such holdings clearly are necessary if there is to be a private action for relief since most margin rules violations involve some measure of customer participation. Nonetheless, there is a great deal of conflict among the cases. Compare Avery v. Merrill Lynch, Pierce, Fenner & Smith, 328 F. Supp. 677, 680 (D.D.C. 1971) ("This Court does not intend to change this explicitly expressed legislative judgment by judicial fiat thereby imposing common law negligence and causation standards upon the regulations.") with Aubin v. H. Hentz & Co., 303 F. Supp. 1119, 1121 (S.D. Fla. 1969) ("However, a broker's liability for violation of this statute is not absolute. It is subject to traditional tort concepts of causation and contributory negligence.").

55. 392 U.S. 134 (1968) (plaintiff's participation in antitrust violations did not bar his recovery where defendant had coerced his participation).

56. 290 F. Supp. 74 (S.D.N.Y. 1968), aff'd mem., 409 F.2d 1360 (2d Cir.), cert. denied, 396 U.S. 904 (1969).

57. Id. at 89-90. The defendant with due diligence could have discovered plaintiff's fraud. Id. at 83-85. The most important effect of this finding was to deprive the defendant of the benefit of § 3(h) of Regulation U, 12 C.F.R. § 221.3(h) (1974), which provides that a "good faith" mistake will not be deemed a violation of the Regulation. But see § 29(c) of the 1934 Act, 15 U.S.C. § 78cc(c) (1970), which states: "Nothing in this chapter shall be construed . . . to affect the validity of any loan or extension of credit . . . made . . . prior or subsequent to the enactment of this chapter, unless at the time of the making of such loan or extension of credit . . . the person making such loan or extension of credit . . . shall have actual knowledge of facts by reason of which the making of such loan or extension of credit . . . is a violation of the provisions of this chapter or any rule or regulation thereunder . . . ." Compare Moscarelli v. Stamm, 288 F. Supp. 453 (E.D.N.Y. 1968) (no recovery, relying on statutory

stein v. Scudder & German,[58] the court concluded that the disadvantages of giving the "unscrupulous" plaintiff a windfall recovery were outweighed by the "salutary policing effect" a private cause of action would have upon broker-dealers.[59] The court distinguished *Serzysko* and *Moscarelli v. Stamm*[60] on the grounds that those cases, unlike *Pearlstein*, involved fraudulent deception of the defendants. Relying on *Perma Life*, the court concluded that the defense of pari delicto was not desirable in the margin rules context.[61] Judge Friendly dissented on the grounds that the holding would encourage customers to violate the margin rules.[62]

Cases subsequent to *Pearlstein* have ignored,[63] rejected,[64] and distinguished[65] that decision. None of those cases, however, are inconsistent with the *Pearlstein* holding. *Goldman v. Bank of the Commonwealth*[66] and *Tartell v. Chelsea National Bank*[67] involved plaintiffs who had actively misrepresented the purpose of the loan, thus coming within *Serzysko*, which had been left standing by *Pearlstein*. *Gordon v. duPont Glore Forgan, Inc.*,[68] which explicitly rejected *Pearlstein*,[69] concerned a violation of the New York Stock Exchange maintenance margin, rather than a violation of Regulation T and section 7(c). The customer was aware of the violation and the broker-dealer was not.[70]

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purpose (Borak) and traditional tort concepts where plaintiff and defendant's employee conspired to defraud defendant).

58. 429 F.2d 1136 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971), noted in 71 Colum. L. Rev. 1521 (1971) and 39 Fordham L. Rev. 782 (1971).

59. 429 F.2d at 1141.

60. 288 F. Supp. 453 (E.D.N.Y. 1968). See note 57 supra.

61. 429 F.2d at 1141-42 & n.10.

62. Id. at 1148 (Friendly, J., dissenting).

63. For example, Goldman v. Bank of the Commonwealth, 467 F.2d 439 (6th Cir. 1972), a case almost identical to Serzysko, relied on the doctrine of pari delicto to deny recovery to a plaintiff who gave a fraudulent non-purpose statement to a bank which, with reasonable diligence, could have discovered the true purpose. The court cited Moscarelli, Serzysko, and even the dissent in Pearlstein, but did not cite the majority opinion or attempt to distinguish the cases.

64. Gordon v. duPont Glore Forgan Inc., 487 F.2d 1260 (5th Cir. 1973), cert. denied, 94 S. Ct. 3071 (1974).

65. Tartell v. Chelsea Nat'l Bank, 351 F. Supp. 1071, 1077 n.2 (S.D.N.Y.), aff'd mem., 470 F.2d 994 (2d Cir. 1972), another case resembling Serzysko in its facts, viewed Pearlstein's refusal to "follow or to attack" Serzysko as leaving that decision standing as valid precedent.

66. 467 F.2d 439 (6th Cir. 1972).

67. 351 F. Supp. 1071 (S.D.N.Y.), aff'd mem., 470 F.2d 994 (2d Cir. 1972).

68. 487 F.2d 1260 (5th Cir. 1973), cert. denied, 94 S. Ct. 3071 (1974).

69. Id. at 1263.

70. The broker who was charged with overseeing the Gordons' account "inadvertently" allowed it to become undermargined. Id. at 1261. The availability of § 6(v) of Regulation T, 12 C.F.R. § 220.6(k) (1974) to excuse the broker's mistake in Gordon as an "innocent mechanical mistake" and therefore not a violation is made doubtful by Landry v. Hemphill, Noyes & Co., 473 F.2d 365, 371 (1st Cir.), cert. denied, 414 U.S. 1002 (1973) (construing the term mechanical to "exempt from liability only computational and similar errors").

On the other hand, *Pearlstein* has been followed in two cases that resemble it on their facts, since they involve broker-dealers who violated Regulation T but were not induced to do so by any fraud on the part of their customers.[71] It has also been followed in a case not involving a misrepresentation of the plaintiff's purpose to a lending bank.[72]

Notwithstanding the seemingly conflicting language of the decisions, analysis shows that the cases on the question of customer participation do not conflict. Thus, prior to section 7(f) and Regulation X, if the plaintiff had actively misrepresented the purpose for which he intended to use a bank loan and the bank was deceived, he would have been barred under *Serzysko*; if he had engaged in other *fraudulent* conduct with respect to the broker-dealer, *Moscarelli* would have barred recovery. If the customer were aware of the facts that gave rise to a violation, but failed to inform the broker-dealer or bank, which was unaware, it is possible (but not definite) that under *Gordon* his recovery was barred even absent misrepresentation. If, however, both the broker-dealer and customer (or bank and borrower) were aware, *Pearlstein* would control and the creditor would be liable, as he would be had the debtor been unaware. It also would seem that the broker-dealer would be liable even if neither he nor the customer were aware of the violation.[73]

C. *Remedial Problems*

Because of the procedural posture of the landmark cases in this area, the question of appropriate relief for an investor injured by margin violations has not received as careful consideration as have the previously discussed issues. Whether a case involves an action for damages under either the tort or the *Borak* rationale, a suit for rescission under section 29, or a defensive use of section 29 in an action to recover the purchase price for securities or on a defaulted note,[74] a court must determine the proper method of redressing the injury suffered by the aggrieved investor. As will be shown, this determination involves the resolution of some difficult theoretical problems.

A question that has led to inconsistent results in the cases is whether the creditor is entitled to any recovery when the illegality of the transaction is used defensively by the borrower under section 29(b). The problem can best be illustrated by reference to factual situations.

One such situation is where a broker has purchased securities for a customer's cash account, and the customer has failed to make payment on the seventh day, but the broker has failed to liquidate the account.[75] The broker should be al-

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71. Spoon v. Walston & Co., 345 F. Supp. 518 (E.D. Mich. 1972), aff'd, 478 F.2d 246 (6th Cir. 1973) (per curiam); Avery v. Merrill Lynch, Pierce, Fenner & Smith, 328 F. Supp. 677, 680 (D.D.C. 1971).

72. Cooper v. Union Bank, 354 F. Supp. 669, 674, 676 (C.D. Cal. 1973).

73. Landry v. Hemphill, Noyes & Co., 473 F.2d 365 (1st Cir.), cert. denied, 414 U.S. 1002 (1973).

74. See notes 33-51 supra and accompanying text.

75. Billings Associates, Inc. v. Bashaw, 27 App. Div. 2d 124, 276 N.Y.S.2d 446 (4th

lowed to recover the difference between the purchase price paid for the securities and their value on the seventh day, when full payment should have been received.[76] The subsequent illegality of the relationship should not void the transaction ab initio; the parties should be returned to their respective positions as of the seventh day. Similarly, where the customer brings an action for rescission, the transaction should be rescinded as of the seventh day.[77]

Dep't 1967). Many of the cases involving the defensive use of a margin violation are state court cases. This is so because the action is usually in contract for the purchase price of securities, as in Billings. See E.F. Hutton & Co. v. Weinberg, [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,332 (N.Y. Sup. Ct. 1964); Irving Weis & Co. v. Offenberger, 31 Misc. 2d 628, 220 N.Y.S.2d 1001 (N.Y.C. Mun. Ct. 1961), both discussed in note 51 supra. Other cases involve actions by the investor for the profit from a transaction, as in Surgil v. Kidder, Peabody & Co., 63 Misc. 2d 473, 311 N.Y.S.2d 157 (N.Y.C. Civ. Ct. 1970), rev'd, 69 Misc. 2d 213, 329 N.Y.S.2d 993 (App. T. 1971) (discussed in notes 136-39 infra and accompanying text), where federal questions are raised only in defense.

76. See note 19 supra and accompanying text. Cf. Billings Associates, Inc. v. Bashaw, 27 App. Div. 2d 124, 276 N.Y.S.2d 446 (4th Dep't 1967), in which the court allowed the plaintiff broker the difference between the purchase price and the highest value of the security between the seventh day and the day of liquidation. This was actually more generous to the customer than necessary, giving him the benefit of any rise and fall in value occurring subsequent to the seventh day. The court's award of damages has been criticized: "The rendering uncollectible of debts incurred in proscribed credit transaction, [the dissenters] thought, would be the best sanction for enforcing compliance with the credit provisions. The dissenting opinion . . . is the better reasoned." 2 L. Loss, Securities Regulation 3307 (Supp. V. 1969). The dissent's reasoning, however, begs the question. Is the "proscribed credit transaction" the initial purchase, or the holding after seven days; and if the latter, is not the debt incurred therein rendered uncollectible under the majority's damage measurement? In fact, the majority's award of damages is demonstrably correct. Section 29 declares void as regards the rights of any violator "[e]very contract made in violation of . . . this chapter or of any rule or regulation thereunder, and every contract . . . the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder . . . ." 15 U.S.C. § 78cc(b) (1970). The agreement in Billings was a simple cash purchase of securities by the broker for the customer and was, therefore, not "made in violation" of § 7 or the margin regulations; the performance of the contract, had it taken place, would not have involved a violation. Pearlstein v. Scudder & German, 429 F.2d 1136, 1149 (2d Cir. 1970), (Friendly, J., dissenting), cert. denied, 401 U.S. 1013 (1971). Section 29(b) is applicable only because plaintiff broker's holding of the securities for the defendant's benefit was the "continuance of a relationship" in violation of Regulation T. The rights to be voided by § 29 are only those accruing after the seventh day, when the relationship between plaintiff broker and defendant customer became unlawful, and plaintiff was properly permitted to enforce those rights which accrued prior to that time.

77. An interesting case in this respect is Spoon v. Walston & Co., 345 F. Supp. 518 (E.D. Mich. 1972), aff'd, 478 F.2d 246 (6th Cir. 1973) (per curiam). There, defendant broker executed what was to be a "day sale" for the plaintiff—that is, a purchase and sale at a profit on the same day. When the stock declined plaintiff customer held, on the registered representative's advice, in hopes of a later rise. On the settlement day the registered representative applied for and received an extension from the appropriate committee of the New York Stock Exchange on the basis of § 3(f) of Regulation T, 12 C.F.R. § 220.3(f) (1974), falsely stating that he was unable to contact his customer. Several more extensions were ob-

The problem arises in another context—that is, when a broker-dealer sells securities relying in good faith on the customer's representation that he owned the securities and would deliver them promptly. Such reliance protects the broker-dealer initially, but after a time it may become appropriate for the broker-dealer to purchase the securities on the open market and deliver them to the purchaser in the original transaction (*i.e.*, "buy in"). Failure to "buy in" after such time as would put the broker-dealer on notice that the customer's intentions are not as originally represented brings the broker-dealer into violation of Regulation T.[78] In a subsequent action by the broker-dealer to recover the excess of the price at which he "bought in" over the sale price, he should not be permitted to recover for any price rise that took place subsequent to the time when he should have liquidated but did not; he should be allowed to recover the loss resulting from the price rise until that time.[79]

Finally, the issue can present itself in the context of actions by the customer for damages. If the full purchase price has not been paid, the defendant's counterclaim for the balance should be allowed as a set-off against the plaintiff's claim, since to award the plaintiff damages, but not to require him to pay the balance due on the purchase price, would be to grant him double recovery.[80]

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tained on the basis of false applications and the stock finally was sold at a loss. The court granted the plaintiff rescission but, because of his participation, allowed him to recover only half his loss, stating that since rescission was an equitable remedy, the court should be guided by principles of equity. 345 F. Supp. at 522. The court viewed the failure to sell after the seventh day as the broker's violation, and apparently felt that fairness required that plaintiff customer not recover his full loss. The court's basis for allowing the plaintiff less than full recovery of his losses was not the measurement of damages from the date of violation, as would have been appropriate, but the arbitrary allocation to plaintiff of responsibility for one half of his losses, measured from the date of purchase. It should be pointed out, however, that since the parties contemplated a "day sale" the broker could not have relied in good faith on the customer's intention to pay before he sold, and the original transaction in fact violated § 4(c)(1)(i) of Regulation T, 12 C.F.R. § 220.4(c)(1)(i) (1974). But see Goldenberg v. Bache & Co., 270 F.2d 675, 681 (5th Cir. 1959), involving a failure to bring a general account up to the required margin within five days. The court did not allow the broker to recover on its counterclaim for decline in value occurring during the five day period. This might be viewed as the court doing "rough justice," since it denied the plaintiff rescission, deeming the broker's failure an "innocent mistake" of the type excused by § 6(v) of Regulation T prior to the addition of the requirement that the mistake be "mechanical." See 12 C.F.R. § 220.6(k) (1974).

78. "The good faith of a broker/dealer who has originally executed a sell order in compliance with Regulation T must gradually dissipate as time passes without delivery of the securities. The time comes when the good faith standard of section 4(c)(1)(ii) requires the broker/dealer to make inquiry concerning the reason for delay and to act accordingly." Naftalin & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 469 F.2d 1166, 1177 (8th Cir. 1972). There is no fixed time period within which delivery must be made, as there is for payment in a cash purchase, because of the mechanical difficulties often encountered in obtaining possession of the share certificate. Id.

79. Id. at 1182.

80. Landry v. Hemphill, Noyes & Co., 473 F.2d 365, 372 (1st Cir.), cert. denied, 414 U.S. 1002 (1973).

A parallel question is whether a bank that is sued for damages or rescission of a loan contract violative of Regulation U is entitled to return of the loan proceeds. Clearly, in a rescission case, the defendant bank is not entitled to interest on the loan, because this would amount to enforcement of the loan contract. As has been stated, however:

It is virtual hornbook law that rescission of a contract requires the parties to place each other as nearly as may be in *statu quo ante*.[81]

If in granting rescission the court permits the plaintiff borrower to retain the principal still due on the loan, the court is placing the plaintiff in a better position than he was prior to the transaction. There are cases, however, in which the bank has been denied even the principal of the loan.[82] The status quo can be established by awarding the plaintiff borrower the difference between the purchase price of the securities and the price received by the bank in the sale, plus the interest paid on the loan by the plaintiff, but less the balance of unpaid principal. The bank, counterclaiming for the unpaid principal, should succeed not in enforcement of the loan agreement voidable under section 29(b), but in a common law count for money had and received.[83]

IV. The Effect of Section 7(f) and Regulation X

The 1970 amendments to the Federal Deposit Insurance Act[84] are an attempt to deal, *inter alia*, with abuses of secret foreign bank accounts by United States citizens.[85] Title III added section 7(f)[86] to the Securities Exchange Act of 1934, raising unanticipated questions regarding private liability for violation of the margin requirements.[87]

A. *Effect of Section 7(f) Upon the Theoretical Basis for Implying a Private Cause of Action*

Under either the tort rationale or *Borak*, the basic assumption behind the implication of a cause of action in favor of an investor for violation of the margin requirements has been that a purpose of the margin requirements is to

81. Goldman v. Bank of the Commonwealth, 467 F.2d 439, 446 (6th Cir. 1972), quoting from the district court's opinion, 332 F. Supp. 699, 706-07 (E.D. Mich. 1971).

82. E.g. Cooper v. Union Bank, 354 F. Supp. 669 (C.D. Cal. 1973); Serzysko v. Chase Manhattan Bank, 290 F. Supp. 74 (S.D.N.Y. 1968), aff'd mem., 409 F.2d 1360 (2d Cir.), cert. denied, 396 U.S. 904 (1969). The latter case is complicated by the fact that the plaintiff was not allowed to recover, as discussed in notes 56-57 supra and accompanying text. The court held that the bank had violated Regulation U through its negligence. The court may again have been doing "rough justice" by "leaving the parties as it found them."

83. Goldman v. Bank of the Commonwealth, 467 F.2d 439, 446-47 (6th Cir. 1972).

84. Act of Oct. 26, 1970, Pub. L. No. 91-508, 84 Stat. 1114.

85. H.R. Rep. No. 975, 91st Cong., 2d Sess. 12-13 (1970); S. Rep. No. 1139, 91st Cong., 2d Sess. 2-4 (1970).

86. 15 U.S.C. § 78g(f) (1970).

87. See notes 141-48 infra and accompanying text.

protect the individual investor.[88] This assumption, questionable when made,[89] is now even more so in light of section 7(f) and Regulation X. Congress and the Federal Reserve Board recognized that achievement of the main purpose —"to give a government credit agency an effective method of reducing . . . the nation's credit resources which can be directed by speculation into the stock market"[90]—was being frustrated by investors seeking credit in circumvention of the margin requirements. The extension of the strictures of the margin requirements to investors raises questions as to whether a purpose of these requirements remains protection of investors.

An examination of the legislative history of section 7(f) fails to reveal any consideration of the question of private liability.[91] The sponsors were primarily concerned with the "perniciously destabilizing effect" of "[t]he infusion of unregulated foreign credit"[92] on the domestic securities market. According to Representative Patman, chairman of the House Committee on Banking and Currency, which considered the bill,

> testimony before our committee indicated that Americans and foreigners were using the facade of secret foreign bank accounts to purchase in our markets in violation of the margin requirements . . . . Through a simple device of making the margin requirements applicable to the borrower as well as to the lender, we will be equipping the Securities and Exchange Commission . . . with sufficient legal and investigative weapons to require adequate disclosure of foreign financing.[93]

It has been suggested that since the legislative history of section 7(f) does not reveal any intention to overrule existing case law, that law remains intact.[94] Such a conclusion is not ineluctable. A body of law, such as the margin requirements, which has developed over a long period of time, obviously can have different purposes at different stages of development. Legislative history is not the only means of determining what a particular parcel of legislation, rules, and regulations seeks to achieve. A study of the legislation and the subject it covers is often equally revealing. The recent trend in the area of margin regulation has been to shut off alternative sources of unregulated credit[95] and to extend coverage to over-the-counter securities.[96] Even if it is accepted that one of the original

88. See notes 33-51 supra and accompanying text.

89. See note 36 supra and accompanying text.

90. Remar v. Clayton Sec. Corp., 81 F. Supp. 1014, 1017 (1949), quoting H.R. Rep. No. 1383, 73d Cong. 2d Sess. (1934).

91. See H.R. Rep. No. 975, 91st Cong., 2d Sess. 14, 24-25 (1970); S. Rep. No. 1139, 91st Cong., 2d Sess. 9-10 (1970); Hearings on H.R. 15073 Before the House Comm. on Banking and Currency, 91st Cong., 1st & 2d Sess. (1970); 116 Cong. Rec. 16951 et seq. (1970).

92. H.R. Rep. No. 975, 91st Cong., 2d Sess. 24 (1970).

93. 116 Cong. Rec. 16954 (1970).

94. Brodsky, Corporate and Securities Litigation: Margin Violation—Regulation X, 172 N.Y.L.J., July 3, 1974, at 1, col. 1. See Note, Regulation X and Investor-Lender Margin Violation Disputes, 57 Minn. L. Rev. 208, 220-22 (1972).

95. See notes 27-31 supra and accompanying text.

96. 15 U.S.C. § 78g (1970), and 34 Fed. Reg. 9196 (1969).

purposes of the margin requirements was to protect the individual investor, it can be argued persuasively that that purpose has shifted from protection of the investor to protection of the market from investors seeking to overextend themselves. With such a view of the present purpose of the margin requirements, it is submitted that the damages action based upon either the tort or *Borak* rationales should no longer be recognized.[97]

Most of the private actions subsequent to the promulgation of Regulation X have not discussed the effect of that provision on the basic assumptions leading to the implication of a cause of action,[98] because these cases deal with transactions that occurred prior to that regulation's effective date. It has twice been suggested that any effect Regulation X has will be on transactions occurring subsequent to its promulgation.[99] The one case[100] that has treated the question of the effect of Regulation X has done so in the context of the pari delicto defense.

B. *Effect Upon the Defense of Pari Delicto*

The effect of extending the margin requirements to include the investor upon the reasoning of those cases that have previously disallowed the defense of in pari delicto to the lender is clear. In *Pearlstein*[101] the court argued that while *Perma Life* would apparently preclude recovery by a plaintiff who had not been coerced into participating in the illegal scheme, "such a defense does not appear desirable in the securities area here involved."[102] This is so, said the court, because

> [u]nlike the antitrust laws which forbid both seller and buyer to enter into a proscribed transaction, the federally imposed margin requirements forbid a broker to extend undue credit but do not forbid customers from accepting such credit. This fact

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97. There exists a possibility that actions for rescission based on § 29(b) will be affected by the promulgation of Regulation X, but since the theory of liability and the remedy sought are so closely entwined, the potential effect of Regulation X on this type of action as a whole will be discussed in Part III C infra.

98. See, e.g., Landry v. Hemphill, Noyes & Co., 473 F.2d 365 (1st Cir.), cert. denied, 414 U.S. 1002 (1973); Bender v. New Zealand Bank & Trust (Bahamas) Ltd., [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,522 (S.D.N.Y. Apr. 19, 1974); Cooper v. Union Bank, 354 F. Supp. 669 (C.D. Cal. 1973).

99. Freeman v. Marine Midland Bank-New York, 494 F.2d 1334, 1337 n.4 (2d Cir. 1974); Spoon v. Walston & Co., 345 F. Supp. 518, 522 (E.D. Mich. 1972), aff'd, 478 F.2d 246 (6th Cir. 1973) (per curiam). It is unclear why this should be so since Regulation X causes questions regarding the continuing validity of the very basis for a private cause of action.

100. SEC v. Packer, Wilbur & Co., 362 F. Supp. 510 (S.D.N.Y. 1973), aff'd sub nom. SIPC v. Packer, Wilbur & Co., [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,583 (2d Cir. May 31, 1974).

101. Pearlstein v. Scudder & German, 429 F.2d 1136 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971).

102. Id. at 1141.

appears to indicate that Congress has placed the responsibility for observing margins on the broker . . . .[103]

This reasoning is obviously no longer valid. Regulation X makes clear that its purpose is to

> prevent the infusion of unregulated credit . . . into U.S. securities markets in circumvention of [the margin requirements] or by borrowers falsely certifying the purpose of a loan or otherwise wilfully and intentionally evading the provisions of those regulations.[104]

The responsibility for compliance with the margin requirements is now on the investor as well as the broker. The issue must be reexamined in light of the new circumstances created by Regulation X. Even if the courts do not accept the position that the entire basis for a damages action for violation of the margin requirements has been undermined,[105] there remains the question: To what extent does investor participation bar recovery?

It has been argued that Regulation X does not alter the result,[106] because even before its promulgation the investor who knowingly obtained credit in excess of that permitted under the margin requirements violated the law as an "aider and abettor or a co-conspirator with the lender."[107] Since the investor violated the law before Regulation X, the argument concludes, and the pari delicto defense was disallowed, there is no reason to reconsider the result on this issue merely because the legal prohibition of the investor's conduct has become clearer.[108]

The greatest weakness of this argument is that there is no judicial support for the proposition that the investor who obtained credit in excess of the permissible level was guilty of a violation prior to Regulation X.[109] Therefore, the investor is in a different position after Regulation X, and his new status requires a reevaluation of the applicability of the pari delicto defense.

The factors that determine whether one party should be granted a remedy against the other party to an illegal bargain include

> the degree of criminality or evil, the comparative innocence or guilt of the parties, the extent of public harm involved, the moral quality of the conduct of the parties, and the severity of the penalty or forfeiture that will result from refusal of relief.[110]

103. Id. See generally Avery v. Merrill Lynch, Pierce, Fenner & Smith, 328 F. Supp. 677, 680 (D.D.C. 1971).

104. 12 C.F.R. § 224.1 (1974).

105. See text accompanying note 125 infra.

106. Brodsky, Corporate and Securities Litigation: Margin Violation—Regulation X, 172 N.Y.L.J., July 3, 1974, at 3, cols. 3-4.

107. Id. at col. 4.

108. Id.

109. Indeed the attitude of the Pearlstein court indicates that plaintiff was deemed guilty of unscrupulous, but not unlawful, conduct. See note 59 supra and accompanying text.

110. 6A A. Corbin, Contracts § 1534 (1962). A consideration that has often led to a holding that the plaintiff in an action for restitution is not in pari delicto with the defendant is the unjust enrichment of the defendant. This is involved where the plaintiff has performed

There is common law support for the proposition that a party who enters an illegal bargain under duress, as in *Perma Life*, or who is not himself prohibited from entering the type of arrangement involved, as in *Pearlstein*, is not in pari delicto with the party who either coerces the illegal performance,[111] or is himself under a legal prohibition.[112] It is possible, then, to construe *Pearlstein* consistently with the view that pari delicto can be a defense in private actions for damages under the margin requirements, but not on the facts in that case.[113] The illegality of the investor's action subsequent to Regulation X simply becomes an additional factor to consider and to operate in favor of his being held in pari delicto with the lender.

This is especially sound where the plaintiff is an experienced investor. He should be presumed to be familiar with the margin requirements applicable to him. Although performance of an illegal bargain by one ignorant of the law should not always bar recovery for his consequent injury,[114] it is submitted that only excusable ignorance should permit the court to discount plaintiff's illegal conduct as a weight in the scales of pari delicto. The party asserting his own ignorance should have the burden of proving both his ignorance and its justifiability.[115] When, however, the investor is ignorant of the facts giving rise to the violation, it is likely that this would constitute an "innocent mistake" and he would not be guilty of violating Regulation X.[116]

It is submitted that the illegality of the investor's actions should tip the scales in favor of a finding that in the *Pearlstein* factual situation the investor is in pari delicto with the broker and therefore not entitled to recovery. The investor's active procurement of the broker's forbearance,[117] and the fact that he engaged

his side of the illegal bargain, but the defendant has not. The courts have been much more willing to grant restitution in such a case than they have been to grant specific enforcement where the contract remains executory, or to grant enforcement of the contract by means of a damages award that gives the plaintiff the value of the defaulted performance. Id. Such an unjust enrichment is absent in the margin violation cases since presumably both sides have performed and the investor is now dissatisfied with his bargain. The broker is enriched only to the extent of his commission.

111. Id. at § 1537.

112. Id. at § 1540.

113. In light of the court's noncommittal attitude towards Moscarelli and Serzysko, such an interpretation is reasonable. The court "decline[d] either to follow or to attack these holdings" as they "need not be read to contradict [the] view of the law" that it took. 429 F.2d at 1141-42. See notes 58-61 supra and accompanying text.

114. 6A A. Corbin, Contracts § 1539 (1962).

115. Such a rule would be consistent with the Serzysko court's position that an investor's sophistication should not bar him from bringing the action, but ought to be relevant in determining whether he is entitled to recover. See note 56 supra and accompanying text. It would also minimize the difficulty inherent in making inquiry into a party's subjective knowledge in that the investor must show not only that he was not familiar with the margin requirements, but that he also had no reason to know.

116. 12 C.F.R. § 224.6(a) (1974).

117. 429 F.2d at 1138, 1146. It should also be pointed out that the plaintiff originally purchased the securities in question, which were of a speculative nature, against strong advice of the defendant. Id. at 1145-46 (Friendly, J., dissenting).

in a number of such transactions,[118] indicates that the plaintiff in *Pearlstein* was hardly in need of protection. The court's alternative rationale—that the danger of giving windfall profit "to an unscrupulous investor is outweighed by the salutary policing effect"[119] upon brokers exerted by private damage actions —has lost whatever force it had before Regulation X. It can hardly be argued that private actions will have a "salutary policing effect" on investors who are intent upon evading the margin requirements, and who comprise the class of persons at whom section 7(f) and Regulation X were specifically aimed.[120] Permitting such an action would encourage such evasion by investors and frustrate the congressional purpose.

The only case which provides any guidance as to what effect Regulation X will be given by the courts is *SEC v. Packer, Wilbur & Co.*,[121] which involved the refusal by the court to recognize certain claims against an insolvent broker-dealer under the Securities Investors Protection Act of 1970.[122] Although the claim asserted was actually for the profit resulting from a transaction held to have violated Regulation T, the district court analyzed the case as though it were a suit for damages by the investor.[123] In disallowing the claim, the court declared that whatever the validity of the theory that damage actions against *brokers* for violation of Regulation T deter future violations, this was not the case where Securities Investor Protection Corp. is paying the debts of the broker.[124] The district court went on to hold that Regulation X also prevented the awarding of damages to an investor:

> The clear import of Regulation X is that Congress was determined not to limit the burden of compliance to brokers alone but rather extended it to customers as well.[125]

Although the court's reasoning is correct, the force of this case as precedent for the proposition that Regulation X undermined private damage actions for violation of the margin requirements is diminished by the fact that the case was in reality an action for recovery of profit.[126] In addition, on appeal, the court's

118. Id. at 1138.

119. Id. at 1141.

120. S. Rep. No. 1139, 91st Cong., 2d Sess. 9 (1970).

121. 362 F. Supp. 510 (S.D.N.Y. 1973), aff'd sub nom. SIPC v. Packer, Wilbur & Co., [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,583 (2d Cir. May 31, 1974).

122. 15 U.S.C. §§ 78aaa et seq. (1970).

123. This can be seen from the fact that the court relied upon Serzysko v. Chase Manhattan Bank, 290 F. Supp. 74 (S.D.N.Y. 1968), aff'd mem., 409 F.2d 1360 (2d Cir.), cert. denied, 396 U.S. 904 (1969), discussed in notes 56-57 supra and accompanying text; Moscarelli v. Stamm, 288 F. Supp. 453 (E.D.N.Y. 1968), discussed in note 57 supra; and Aubin v. H. Hentz & Co., 303 F. Supp. 1119 (S.D. Fla. 1969), note 54 supra, to distinguish Pearlstein, rather than pointing out the fact that a different type of action was involved in Packer Wilbur than in Pearlstein. The three cases cited involved actions for damages, as does Pearlstein.

124. 362 F. Supp. at 512-14.

125. Id. at 515.

126. See note 123 supra. Moreover, the court's holding on this point was alternative to a holding that SIPA protections are not available to a violator of the securities laws. 362 F. Supp. at 515-17.

finding of a Regulation T violation was rejected by the Second Circuit in dictum,[127] and it is possible to argue that there can be no violation of Regulation X without a violation of Regulation T.[128] The Second Circuit, however, was not faced with an appeal of the investor's claim, and expressed no opinion concerning the effect of Regulation X on the claim.[129] The district court's opinion is some indication, however slight, that section 7(f) and Regulation X will be given some weight in evaluating a plaintiff's conduct to determine whether he is entitled to relief.

The type of case most clearly affected by Regulation X is one involving an investor who sues the broker-dealer to recover the profit realized on a transaction that violates Regulation T. Such a case could involve a classical application of the pari delicto doctrine,[130] since the investor's cause of action is for breach of contract. It can also be considered as involving a defensive use of section 29(b), which would seem applicable in this situation. The transaction would now be void "as regards the rights of [the customer] who, in violation of such provision, rule, or regulation, shall have made or engaged in the performance of [a] contract" that violated the margin requirements.[131] Thus, the result in *Packer, Wilbur*[132] was correct if the finding of a violation of Regulation X was correct. Similarly, *Cohen v. G.F. Rothschild & Co.*[133] and *Klein v. D.R. Comenzo Co.*,[134] each of which on the basis of illegality refused to enforce a customer's contract (impliedly holding the customer in pari delicto with the broker-dealer), and each of which was arguably wrong when decided,[135] would

127. [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,583, at 96,042. The denial of the claim by the investor in question was not appealed; the Second Circuit indicated its doubt whether a broker other than Packer Wilbur, which was also involved in the transaction, had violated Regulation T (as the district court had held), but found it unnecessary to reach the issue since it affirmed the denial of the other broker's claim on an alternative ground. Id. See note 129 infra.

128. See notes 142-152 infra and accompanying text.

129. The court did suggest that it found the district court's first reason for denying the claim persuasive: "Any such challenge would fail, for the district court was correct in concluding that '[o]ne who engages in a fraudulent transaction cannot reap the benefits of the Act's intended protection.' We cannot believe that Congress intended that an active and sophisticated securities investor such as Arenstein, who deliberately engaged in a margin violation, should enjoy the benefits of SIPA." [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,583, at 96,043. This does not indicate that an investor who violates Regulation X will never be allowed recovery but rather only that he will not recover against SIPC. The court's assumption that Arenstein was guilty of a Regulation X violation is significant. See note 149 infra and accompanying text.

130. See note 5 supra.

131. The argument based upon § 29(b) is probably stronger than the common law illegality one because of the absolute language of the section. It appears to be less flexible, at least when used defensively. See note 155 infra and accompanying text.

132. See note 124 supra. But see 43 Fordham L. Rev. 136 (1974).

133. [1957-1961 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 90,849 (S.D.N.Y. 1958).

134. 207 N.Y.S.2d 739 (N.Y.C. Mun. Ct. 1960).

135. Since the customers were not bound by the margin requirements, the rights they

be correct today. On the other hand, *Surgil v. Kidder, Peabody & Co.*,[136] in which the trial court permitted recovery by a customer of the profit from a sale of securities that took place when it became apparent that she would not be able to pay for them within seven days, would arguably be decided differently today.[137] The case deserves closer analysis, however, since it discloses a possible gap in the coverage of Regulation X.

The plaintiff in *Surgil* opened a special cash account with the defendant and ordered securities worth approximately $36,000. When it became apparent that the plaintiff would be unable to make payment within the seven days allowed by Regulation T, the broker sold out the account and a $4,000 profit resulted. Although the confirmation stated that the sale had been made as agent for the plaintiff, defendant refused to pay the profit to her, whereupon plaintiff sued. The court rejected the defendant's claim that Regulation T had been violated and that therefore plaintiff could not recover, pointing out that the sale had occurred prior to the expiration of the seven day period, and that the broker-dealer had not "cancel[led] or otherwise liquidate[d]" the original transaction because it sold as agent, not as principal.[138]

Neither the trial court nor the appellate term discussed the possibility that the transaction violated Regulation T from the beginning. This, of course would depend on whether the broker-dealer had a good faith belief that the customer intended both to make prompt payment and to hold the shares. The relevant findings of fact were that the plaintiff, at the time of purchase, expected a

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acquired in the transaction that involved the extension of credit beyond the permissible limits were not voided by § 29(b). See Margin Requirements 1481-83. It is also arguable that the plaintiffs were not in pari delicto with the broker-dealer defendants. 6A A. Corbin, Contracts § 1540 (1962); see note 112 supra and accompanying text. On the other hand, it is possible to argue that the Rothschild and Comenzo courts were correct in refusing to enforce executory illegal contracts since doing so would force the broker to complete a transaction in violation of the margin requirements. As was pointed out earlier, the courts have been reluctant to grant enforcement of illegal bargains that remain executory. See note 110 supra. This reasoning is especially forceful where the customer has not made any payment toward the purchase price.

136. 63 Misc. 2d 473, 311 N.Y.S.2d 157 (N.Y.C. Civ. Ct. 1970), rev'd, 69 Misc. 2d 213, 329 N.Y.S.2d 993 (App. T. 1971).

137. The appellate term reversed the decision, holding that the plaintiff had implicitly misrepresented her ability to make payment within the required time and, therefore, violated the "implicit" requirement in Regulation T, "that customers as well as brokers have responsibilities to take part only in bona fide transactions." 69 Misc. 2d at 215, 329 N.Y.S.2d at 994-95. This court apparently adopted the reasonings of Cohen v. G.F. Rothschild & Co., [1957-1961 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 90,849 (S.D.N.Y. 1958), and Klein v. D.R. Comenzo Co., 207 N.Y.S.2d 739 (N.Y.C. Mun. Ct. 1960), although neither case was cited.

138. 63 Misc. 2d at 475, 311 N.Y.S.2d at 160. The court could have held that even had Regulation T been violated the rights of the plaintiff did not become void under the law as it then stood. See note 135 supra. The appellate term, on the other hand, held that the broker had in fact "liquidated" the transaction pursuant to Regulation T. 69 Misc. 2d at 214, 329 N.Y.S.2d at 994.

"wealthy friend" to provide the funds for the securities, and also that the broker was negligent in its investigation of plaintiff's financial background.[139]

Some interesting problems are brought to light by the *Surgil* case. It would seem that if a broker did not have a good faith belief that the customer intended to pay, but the customer in fact intended to pay, the broker has violated Regulation T.[140] Would the customer have violated Regulation X by obtaining credit in a transaction that was a violation of Regulation T?[141] If the customer had a reasonable basis for believing that he could pay within the time limit, he should be protected by the "innocent mistake" provision of Regulation X,[142] and he should not be barred from recovering either a profit or a loss resulting from the transaction. Suppose, on the other hand, that the broker-dealer in good faith believes that the customer's intentions are proper, but in fact the customer either intends to sell before he pays or not to make "prompt" payment. Unless a duty to make a reasonable investigation is read into Regulation T,[143] the broker-dealer has not violated Regulation T. A literal reading of Regulation X seems to compel the conclusion that the customer has not violated that provision.[144] Such a reading would leave a gap in the coverage of Regulation X to the benefit of a customer who succeeds in deceiving his broker.[145] Suppose further that in this situation the broker becomes aware of the customer's intentions. Is he obligated to liquidate the transaction immediately, even if seven days have not passed since the purchase? The reasoning of *Naftalin & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[146] in connection with cash sales indicates that he is; if he fails to do so he is violating Regulation T and the customer is violating Regulation X.[147] This would lead to the anomalous result

139. 63 Misc. 2d at 476-77, 311 N.Y.S.2d at 161-62. The appellate term deemed the broker's actions "imprudent," but not a violation of Regulation T. 69 Misc. 2d at 214, 329 N.Y.S.2d at 994.

140. See note 18 and accompanying text.

141. Regulation X provides that "[c]redit obtained from a broker/dealer shall conform to the provisions of [Regulation T] which is hereby incorporated in this part," and if the credit does not so conform the customer violates Regulation X. 12 C.F.R. § 224.2(a)(2) (1974).

142. 12 C.F.R. § 224.6(a) (1974).

143. It is possible to argue that a broker-dealer who fails to make a reasonable investigation into the financial background of his customer cannot in good faith accept that person's promise to pay. Contra, Surgil v. Kidder, Peabody & Co., 69 Misc. 2d 213, 214, 329 N.Y.S.2d 993, 994 (App. T. 1971). A better view is that a failure to make a reasonable investigation is merely evidence that the broker-dealer did not rely in good faith on the promise.

144. See text accompanying note 128 supra.

145. If the broker suffered a loss on the transaction he would have a cause of action under rule 10b-5. A.T. Brod & Co. v. Perlow, 375 F.2d 393, 398 (2d Cir. 1967).

146. 469 F.2d 1166 (8th Cir. 1972). See note 78 supra and accompanying text.

147. This apparently was the district court's interpretation of the situation in Packer, Wilbur. SEC v. Packer, Wilbur & Co., 362 F. Supp. 510 (S.D.N.Y. 1973), aff'd sub nom. Securities Inv. Protection Corp. v. Packer, Wilbur & Co., [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,583 (2d Cir. May 31, 1974). The facts do not seem to comport with this interpretation however. The investor claimant gave a cash buy order to Coggeshall

that under Regulation X the customer who successfully deceives his broker-dealer about his intention to pay might recover the profit from the transaction, whereas the investor who either does not succeed in his deception or is frank about his intentions cannot recover. A partial solution to the problem is to interpret Regulation X to mean that an investor violates the provision if he obtains credit that would violate Regulation T *if* the facts were known to the broker-dealer.[148]

There is some indication in *Packer Wilbur* that such a reading might be given to Regulation X. Despite the dictum to the effect that there had been no violation of Regulation T, the court of appeals in *Packer Wilbur* considered the customer's actions to be a violation of Regulation X.[149] This indicates that the court either did not perceive the gap in Regulation X, or gave Regulation X the interpretation set forth above. In either event, the dictum is useful authority for the proposition that the successfully deceitful investor is guilty of a violation of Regulation X. Under such a rule an investor would be denied profit from a margin rules violation regardless of the broker-dealer's knowledge, and the broker-dealer would be unable to recover a deficiency resulting from the liquidation of a transaction that had violated Regulation T.[150] This would remove the "heads-I-win tails-you-lose" aspect to which Judge Friendly objected.[151]

C. *Effect Upon Remedial Issues*

If it is determined that a cause of action still exists in favor of an investor who has violated Regulation X, and that under the specific circumstances the investor is not in pari delicto with the defendant in the case, there still remains

& Hicks, Inc., which executed it. Four days later the customer had Coggeshall deliver the securities to Packer, Wilbur, who gave a check to Coggeshall for the purchase price. The district court held that this should have given Coggeshall notice that Arenstein, the customer, intended to sell before he paid and that Coggeshall therefore violated Regulation T. This is difficult to accept, since the check from Packer, Wilbur would seem to constitute at least conditional payment. Nor did Packer, Wilbur seem to violate Regulation T since it received the securities promptly. The Second Circuit stated in dictum that it did not consider Coggeshall's action a violation of Regulation T. [1973-1974 Transfer Binder] Fed. Sec. L. Rep. at 96,041-42; see text accompanying note 127 supra.

148. Cf. Surgil v. Kidder, Peabody & Co., 69 Misc. 2d 213, 214, 329 N.Y.S.2d 993, 994 (App. T. 1971).

149. After explaining where its interpretation of Regulation T differed from the district court's, the Second Circuit said in a footnote: "None of this is to exonerate in any way a customer who deliberately misrepresents his intention of prompt payment. If the bona fide intent of a customer should change after the broker had purchased the stock for him, the customer could legitimately direct his broker to sell . . . . The case of a customer who initially misrepresents his intention to his broker is different. He violates Regulation X . . . and Rule 10b-5 by making this misrepresentation." [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. at 96,041 n.7 (citation omitted). (The significance of the reference to rule 10b-5 is explained in note 145 supra.)

150. As pointed out below, the investor is still entitled to use section 29(b) defensively. See note 155 infra and accompanying text.

151. See note 62 supra and accompanying text.

to be determined whether Regulation X affects the remedy to which the plaintiff is entitled.

The argument has been advanced that since Regulation X and section 7(f) put the investor in violation of the 1934 Act, he is no longer entitled to an award of damages since this would amount to enforcement of a contract which is void under section 29(b).[152] It is submitted that this argument misconstrues the nature of a damage action for margin violations and equates it with an action for breach of contract. The award of damages in a breach of contract action "seeks to place the aggrieved party in the same economic position he would have had if the contract had been performed."[153] In so doing, a court enforces the contract and awards the plaintiff the value of the defendant's performance. The award of damages in the margin violation case does not enforce the illegal contract, which has already been performed.[154] The plaintiff seeks not the "value" of the defendant's performance, but restoration to the economic position he enjoyed before the contract was performed. The remedy is necessarily a restitutionary one, and not one for enforcement of any right that accrued under the illegal contract. Thus, it seems that the combination of section 7(f), Regulation X, and section 29(b) does not affect the plaintiff's right to damages as a remedy.

It is possible that Regulation X will have an effect on actions by investors for rescission under section 29(b). Even prior to Regulation X, Judge Friendly in his *Pearlstein*[155] dissent and Judge Murrah for the court in *Naftalin*[156] argued that a conscious wrongdoer is not entitled to rescission under section 29(b). That relief, the argument proceeds, is equitable and should be granted only to parties who can be characterized as "innocent."

> It may be that in the context of this case Naftalin, as the customer, cannot be the violator since, as we have seen, the onus of complying with section 7 and Regulation T is entirely upon the broker/dealers. Nevertheless, we cannot perceive how, under any stretch of the imagination, Naftalin can qualify as an "unwilling innocent party" entitled to invoke section 29(b). To absolve Naftalin of all contractual obligations after it had instigated and perpetuated these illegal schemes would be an inequitable and gratuitous result.[157]

152. Note, Regulation X and Investor-Lender Margin Violation Disputes, 57 Minn. L. Rev. 208, 220 (1972).

153. J. Calamari & J. Perillo, Contracts § 205 (1970).

154. An exception to this statement must be made for the case where the investor seeks to recover profit retained by the broker-dealer, which is an action seeking to enforce the contract. See note 110 and text accompanying note 130 supra. As pointed out earlier, such a cause of action is undermined by Regulation X. See notes 130-37 supra and accompanying text.

155. See note 62 supra and accompanying text. Judge Friendly pointed out that the majority did not reach this question. 429 F.2d at 1149. He implies that his attitude might be different if called upon to enforce a contract that violated the margin requirements. He seems to indicate that section 29(b) would be applied more rigidly when raised defensively, and that the parties should be left as the law found them.

156. 469 F.2d at 1181-82. It should be noted, however, that the Naftalin court did in effect grant rescission of the illegal portion of the transaction.

157. Id. at 1182.

These authorities seem to be applying the maxim that a plaintiff must come before the court of equity with "clean hands" in order to be granted relief. It is possible to argue that the rescission action is not equitable in nature since it is legislatively granted. However, Judge Friendly answers that

> [d]espite the Draconian language, § 29(b) does not provide a pat legislative formula for solving every case in which a contract and violation concur. Rather it was a legislative direction to apply common-law principles of illegal bargain . . . .[158]

Since the "unclean hands" maxim is the equitable corollary of the doctrine of pari delicto,[159] a "common-law principle of illegal bargain," it can be assumed that section 29(b) directs its application as well. A clear indication that a court will apply principles of equity when faced with the decision of whether to grant rescission pursuant to section 29(b) is found in *Mills v. Electric Auto-Lite Co.*[160] There, in the context of a merger achieved by misleading proxy statements in violation of section 14(a)[161] of the 1934 Act, the Supreme Court said:

> [Section] 29(b) leaves the matter of relief where it would be under *Borak* without specific statutory language—the merger should be set aside only if a court of equity concludes, from all the circumstances, that it would be equitable to do so.[162]

Mills may not be authority for the proposition that a "non-innocent" party to a transaction can be refused rescission against the other party whose rights are "void" within the literal language of section 29(b) because he has clearly violated the 1934 Act. The language from *Mills* quoted in *Naftalin*[163] seems to presume that there is one "innocent" party and one "guilty" party to the transaction, and that the "innocent" party has the option of avoiding the contract or holding the "guilty" party to it.[164] It does not suggest a solution for the case with two "guilty" parties.[165]

The other case upon which *Naftalin* relied provides better support for its argument that one "guilty" party cannot have rescission from another. *Royal Air Properties, Inc. v. Smith*[166] involved an action for rescission based upon rule 10b-5[167] and section 29(b). It was held that the defendant could raise the defenses of waiver and estoppel because the plaintiff failed to take action—

158. 429 F.2d at 1149.

159. Morrissey v. Bologna, 240 Miss. 284, 297, 123 So. 2d 537, 543 (1960), cert. denied, 366 U.S. 212 (1961); 27 Am. Jur. 2d Equity § 141 (1966); 30 C.J.S. Equity § 94 (1965).

160. 396 U.S. 375 (1970).

161. 15 U.S.C. § 78n(a) (1970).

162. 396 U.S. at 388.

163. 469 F.2d at 1182.

164. 396 U.S. at 387.

165. Id. at 388. In addition, the Court indicated that the parties seeking rescission, individual shareholders in the merged corporation, did not have a statutory right to rescission in their own right since they were not parties to the merger agreement. Whether rescission should be granted in the corporation's name by virtue of the derivative status of plaintiffs depended upon whether that would be fair to the rest of the shareholders. Id.

166. 312 F.2d 210 (9th Cir. 1962).

167. 17 C.F.R. § 240.10b-5 (1974).

indeed he continued as a director—after learning the facts.[168] According to the opinion:

The purpose of the Securities Exchange Act is to protect the innocent investor, not one who loses his innocence and then waits to see how his investment turns out before he decides to invoke the provisions of the Act.[169]

This reasoning seems especially applicable to the margin violation cases.[170]

What emerges from this discussion is both clear Supreme Court authority in *Mills* that rescission under section 29(b) is to be granted according to equitable principles, and some indication in the cases that, even prior to Regulation X, an investor who had intentionally obtained excess credit would be deemed to have "unclean hands" and therefore not entitled to rescission. Possibly section 7(f) and Regulation X will influence more courts to accept this latter view, for such an investor would violate these provisions. It can hardly be contested that an investor whose acts are both unscrupulous *and unlawful* has hands which are less clean than one whose acts are merely unscrupulous.[171]

Aside from the theoretical effects of section 7(f) and Regulation X on the availability of certain remedies, it is possible that these provisions will, as a practical matter, have some impact on the measure of recovery. It may be assumed from the frequency with which courts point out that only the broker-dealer or bank was in violation of the law[172] that they are influenced by that fact in fashioning remedies, that is in not allowing broker-dealers to recover the balance of purchase price due on securities[173] or banks to recover the interest on loans.[174] Section 7(f) and Regulation X may lead courts to analyze more precisely the rights of these defendants since both they *and their customers* will now be in violation of the law.

168. 312 F.2d at 212-13.

169. Id. at 213-14. Curiously, the defense of estoppel appears never to have been raised in the context of a margin violation. It would seem that the broker-dealer relied to his detriment upon the investor's representations, and the argument could be made that the investor is therefore estopped from rescinding.

170. The investor who knowingly obtains credit beyond the level permitted by the margin requirements has "lost his innocence," and he then "waits to see how his investment turns out." If it is successful, he takes his profit; if it fails, he sues his broker for damages or rescission.

171. The question occurs whether an action for rescission is necessary if one for damages is possible, since the recovery in either would be virtually identical. Since, however, it is unclear that a damage action would be able to withstand a pari delicto defense, the question of the availability of restitution is an important one.

172. E.g., Pearlstein v. Scudder & German, 429 F.2d 1136, 1141 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971); Cooper v. Union Bank, 354 F. Supp. 669, 676, 681-83 (C.D. Cal. 1973); Avery v. Merrill Lynch, Pierce, Fenner & Smith, 328 F. Supp. 677, 680-81 (D.D.C. 1971); cf. Serzysko v. Chase Manhattan Bank, 290 F. Supp. 74, 90 (S.D.N.Y. 1968), aff'd, 409 F.2d 1360 (2d Cir.) (per curiam), cert. denied, 396 U.S. 904 (1969).

173. See notes 79-80 supra and accompanying text.

174. See notes 81-83 supra and accompanying text.

V. Conclusion

The law regarding private causes of action was in a state of uncertainty even prior to the adoption of section 7(f) and Regulation X. Perhaps Regulation X does not diminish this uncertainty. Nevertheless, Regulation X will have a significant impact on civil actions for margin violations. First, it may undercut, in part, the theoretical basis for implying a private cause of action in this area of securities law. Second, it should make the courts more willing to employ the doctrine of pari delicto to deny recovery. Given the propensity of courts to imply a private right of action under the securities laws, Regulation X probably will have its greatest effect in the application of the pari delicto defense.

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