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Application of Common Law Agency Principles to Actions under the Securities Acts: Strict Liability for Employers

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Application of Common Law Agency Principles to Actions under the Securities Acts: Strict Liability for Employers

In *Paul F. Newton & Co. v. Texas Commerce Bank*,[1] the U.S. Court of Appeals for the Fifth Circuit held that the provision of the Securities Exchange Act of 1934 that provides for secondary liability[2] does not exclude the application of common law agency principles in an action seeking to hold a brokerage firm liable for alleged violations of the Act committed by its employee. Significantly, the brokerage firm was held liable despite the lower court's finding that the fraudulent acts were committed without the participation or knowledge of the firm or any of its officers.[3]

It was alleged[4] that several individuals who controlled all the tradeable shares of stock of the Imperial Investment Company conspired to artificially inflate the price of the company's stock, which was traded in the over-the-counter market. Stanleigh Bader, a registered representative of the brokerage firm of Pressman, Frohlich & Frost, Inc., was hired by the conspirators to act as a market maker or middleman between the selling and buying brokers. The conspirators promised Bader a guaranteed profit, and in return, Bader was to increase with each transaction the price he quoted to persons seeking to trade in Imperial stock. Buyers hired by the conspirators placed purchase orders with various brokerage firms including Paul F. Newton & Company. The Newton Company agreed to purchase the ordered stock itself and then seek payment from the buyers. After paying over $515,000 to various market makers, Newton discovered that the buyers were not going to pay for most of the ordered stock. Newton, which had already paid Bader almost $220,000 for Imperial stock, refused to pay for an additional $170,000 of ordered stock. When the fraudulent scheme was discovered, the stock's price collapsed and Newton went into bankruptcy.[5]

Newton brought this action against Pressman and several other broker-

1. 630 F.2d 1111 (5th Cir. 1980).
2. 15 U.S.C. § 78t(a) (1976).
3. 630 F.2d at 1114.
4. The district court made no findings of fact. The factual summary was drawn by the court primarily from the allegations of the parties and the court's examination of the record. *Id.* at 1112 n.1.
5. *Id.* at 1114.

age firms and individuals allegedly involved in the conspiracy. The company contended that the conspirators had violated several provisions of the securities acts, and it sought to impose liability upon Pressman for the acts of its employee, Bader, under the doctrine of *respondeat superior* as well as section 20(a) of the Securities Exchange Act.[6] Pressman was the only party remaining in the action at the time of trial. Following the presentation of evidence to the jury, the district court granted a directed verdict to Pressman on the ground that *respondeat superior* could not be used as a basis of liability for a violation of the Securities Exchange Act. The court also found that Pressman was not "liable under section 20(a) because it had neither participated in, nor known of, the fraudulent acts committed by its employee."[7] Newton appealed this judgment.[8]

The coexistence of a statutory method of imposing secondary liability under the securities acts with common law theories of secondary liability has created a great deal of uncertainty regarding the relationship of the statutory and common law approaches. Section 20(a) of the Securities Exchange Act of 1934[9] provides for secondary liability by holding "controlling persons"[10] liable for violations of either the 1934 Act or regulations promulgated pursuant to the Act. Liability will not be imposed, however, if it can be demonstrated that the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation. A threshold issue in any action brought under section 20(a) is whether the relationship between the primary violator and the person sought to be held secondarily liable constitutes the type of control necessary to invoke this section. While there is no statutory definition of control, it is generally agreed that the concept is broader in scope than traditional doctrines of agency or conspiracy.[11] In fact, control has been

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6. Specifically, plaintiff contended that the conspirators had violated § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (1976); § 17 of the Securities Act, 15 U.S.C. § 77q (1976); rule 15c 2-7 of the Securities and Exchange Commission, 17 C.F.R. § 240.15c2-7 (1979); and the Texas common law doctrine of fraud. *Id.*

7. 630 F.2d at 1114.

8. Newton contended that § 20(a) is not the exclusive method of imposing secondary liability under the Securities Exchange Act, that it was entitled to a directed verdict holding Pressman liable under the doctrine of *respondeat superior*, and that Pressman should not have been granted a directed verdict because material questions of fact existed. *Id.*

9. 15 U.S.C. § 78t(a). Section 20(a) provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

10. *Id.*

11. *See* Richardson v. MacArthur, 451 F.2d 35, 41 (10th Cir. 1971); Harriman v. E. I.

interpreted as "requiring only some indirect means of discipline or influence short of actual direction,"[12] and the legislative history of the provision indicates that Congress intended to allow the courts a broad and flexible application of the term.[13]

While there are numerous common law theories of agency,[14] the fundamental rule underlying these theories is that a master is liable for the acts of his servant committed within the scope of employment. When the master-servant relationship is shown to exist, the master is held strictly liable for the servant's acts committed within that scope.[15] The term "scope of employment"[16] never has been defined precisely but generally two factors must be present before it will be found in a given situation: "[F]irst, the activity of the servant, at least in part, must be motivated by an intent to serve the master's purposes rather than his own. Second, the manner, place and time in which the act is performed must not vary substantially from that authorized or that which is normal."[17] In addition, the master is usually liable only for those torts which would not have occurred except for the fact of the master-servant relationship.[18]

The courts that have considered the issue of secondary liability under the securities acts have reached differing conclusions regarding the relationship of the statutory provisions providing for secondary liability and common law agency principles.[19] For analytical purposes, the views adopted by the courts can be divided into two basic categories: exclusivity and nonexclusivity. The exclusivity view provides that the controlling persons provisions of the securities acts are the exclusive means of imposing secondary liability, thus excluding the use of common law theories.[20]

DuPont de Nemours & Co., 372 F. Supp. 101, 104 (D. Del. 1974); Hawkins v. Merrill, Lynch, Pierce, Fenner & Beane, 85 F. Supp. 104, 123 (W.D. Ark. 1949).

12. Myzel v. Fields, 386 F.2d 718, 738 (8th Cir. 1967). For a full discussion of the factors considered by courts in determining the existence of control, *see* 2 Loss, Securities Regulation 776-82 (2d ed. 1961).

13. "It was thought undesirable to attempt to define the term. It would be difficult if not impossible to enumerate or to anticipate the many ways in which actual control may be exerted. A few examples of the methods used are stock ownership, lease, contract, and agency." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 26 (1934).

14. These theories include the following: "A principal is subject to liability for loss caused to another by the other's reliance upon a tortious representation of a servant or other agent, if the representation is: (a) authorized; (b) apparently authorized; or (c) within the power of the agent to make for the principal." Restatement (Second) of Agency § 257 (1958).

15. W. Sell, Sell on Agency 84 (1975).

16. *Id.* at 88.

17. *Id.*

18. *Id. See* 3 Am. Jur. 2d *Agency* § 261 (1962).

19. *See* Annot., 38 A.L.R. Fed. 725, 730 (1978).

20. 630 F.2d at 1116.

The nonexclusivity view, on the other hand, allows the use of common law agency theories in addition to the statutory provisions.[21]

While the Supreme Court has never considered the applicability of agency principles to actions under the securities acts, the Court has discussed the congressional intent behind the acts in general. In *Ernst & Ernst v. Hochfelder*, [22] the Court considered the degree of culpability required for the imposition of liability under section 10(b) of the 1934 Act.[23] Customers of a brokerage house sought to hold the accounting firm that was responsible for auditing the brokerage house's books liable on the basis of negligence. After looking at the legislative history underlying the express civil liabilities in the 1934 Act, the Court said: "[T]here is no indication that Congress intended anyone to be made liable for such practices unless he acted other than in good faith."[24] The Court held that liability could not be imposed under section 10(b) based solely on the theory of negligence, but that an intent to deceive or defraud must be alleged. Thus, the Court rejected the argument that liability could be imposed on parties for nonintentional conduct under the securities acts, and it upheld the availability of the good faith defense.[25]

The Supreme Court has adopted several maxims of statutory interpretation in actions brought under other sections of the securities acts. At least two Supreme Court decisions have recognized the maxim that the federal securities laws are remedial in nature and must be construed in a broad manner, not technically nor restrictively.[26] Yet, in other decisions, the Court has rejected a broad construction in favor of a more restrictive approach. In *Blau v. Lehman*,[27] an action brought under section 16(b),[28] the Court refused to incorporate general partnership law into the statute, despite the obvious remedial purpose of the statute. The Court reasoned that since section 16(b) was a restrictive statute with clear limitations on liability, Congress must have intended it to be exclusive in its designation of those against whom an action may be maintained.[29]

The Third[30] and Ninth[31] Circuits have adopted the view that the con-

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21. *Id.* at 1117.

22. 425 U.S. 185 (1976).

23. 15 U.S.C. § 78j(b) (1976).

24. 425 U.S. at 206.

25. *Id.*

26. Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963).

27. 368 U.S. 403 (1962).

28. 15 U.S.C. § 78p(b) (1976).

29. 368 U.S. at 412-14. Other decisions that have taken a restrictive approach to the interpretation of the securities acts include: Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975); Gilbert v. Nixon, 429 F.2d 348 (10th Cir. 1970).

30. Gould v. American-Hawaiian S.S. Co., 535 F.2d 761 (3d Cir. 1976); Rochez Bros.,

trolling persons provisions of the securities acts are the exclusive means of imposing secondary liability, thus excluding the use of common law principles of agency. In *Rochez Brothers, Inc. v. Rhoades*,[32] a suit was brought by the executive vice president of a corporation seeking to hold the corporation secondarily liable for the fraudulent acts of the president under the theory of *respondeat superior*. In holding that principles of agency were inappropriate to impose liability on the corporation, the Third Circuit noted the existence of an inherent conflict between common law and securities law principles. The court reasoned that since the element of culpability is found throughout the federal securities laws, it should also be included in section 20(a). The good faith defense of section 20(a) allows those individuals who have not committed a culpable act to avoid liability. In contrast, if agency principles such as *respondeat superior* were applicable to actions brought under the securities acts, the good faith defense would be bypassed and persons who are in no meaningful sense culpable would be held liable. Thus, a principal would be held accountable for the acts of his agent regardless of the good faith or lack of knowledge of the principal. The court further argued that this result would be contrary to the legislative purpose of the 1934 Act and "in fact would also undermine the Congressional intent by emasculating [s]ection 20(a)."[33] Other courts that have adopted the exclusivity view have reasoned that the securities statutes are preemptive, maintaining that the express language of the controlling persons provisions precludes the use of common law agency standards of liability.[34]

The view that section 20(a) is not the exclusive means of imposing secondary liability under the securities acts has been adopted with varying degrees of enthusiasm by the Second,[35] Fourth,[36] Sixth,[37] and Sev-

Inc. v. Rhoades, 527 F.2d 880 (3d Cir. 1975); Thomas v. Duralite Co., 524 F.2d 577 (3d Cir. 1975).

31. Christoffel v. E. F. Hutton & Co., 588 F.2d 665 (9th Cir. 1978); Zweig v. Hearst Corp., 521 F.2d 1129 (9th Cir.) *cert. denied*, 423 U.S. 1025 (1975); Kamen & Co. v. Paul H. Aschkar & Co., 382 F.2d 689 (9th Cir. 1967), *cert. denied*, 390 U.S. 942 (1968).

32. 527 F.2d 880 (3d Cir. 1975).

33. *Id.* at 885. *See also* Jackson v. Bache & Co., Inc., 381 F. Supp. 71 (N.D. Cal. 1974); SEC v. Lum's, Inc., 365 F. Supp. 1046, 1063 (S.D.N.Y. 1973).

34. Zweig v. Hearst Corp., 521 F.2d at 1132-33; SEC v. Lum's, Inc., 365 F. Supp. at 1061-63.

35. Marbury Management, Inc. v. Kohn, 629 F.2d 705 (2d Cir. 1980); SEC v. Management Dynamics, Inc., 515 F.2d 801 (2d Cir. 1975). *But see* SEC v. Geon Industries, 531 F.2d 39 (2d Cir. 1976).

36. Carras v. Burns, 516 F.2d 251 (4th Cir. 1975); Johns Hopkins University v. Hutton, 422 F.2d 1124 (4th Cir. 1970), *cert. denied*, 416 U.S. 916 (1974).

37. Holloway v. Howerdd, 536 F.2d 690 (6th Cir. 1976); Armstrong, Jones & Co. v. SEC, 421 F.2d 359 (6th Cir.), *cert. denied*, 398 U.S. 958 (1970).

enth[38] Circuits. In an opinion that is illustrative of the reasoning used by the courts adopting this view, the Second Circuit, in *SEC v. Management Dynamics, Inc.*,[39] rejected the claim of a brokerage firm that it should be exonerated under the good faith defense provided in section 20(a). The firm pointed to the record, which indicated no violation of the securities acts other than the trading activity of its vice president. The court adopted the position argued by the SEC that section 20(a) is not the sole measure of secondary liability in an employment context. Looking to the legislative history of section 20(a) and its analogue, section 15 of the Securities Act of 1933,[40] the court found no indication that Congress intended the statutes to govern employer liability.[41] In further support of its position, the court reasoned that given the pervasive application of agency principles in other areas of the law, clear evidence would be necessary to persuade the court that Congress intended to supplant those principles by enacting the controlling persons statutes.

Even those circuits that have adopted the nonexclusivity position have been careful to limit the scope of this view, resulting in apparently conflicting decisions. In particular, courts have been reluctant to extend agency principles to those controlling persons against whom no allegations of wrongdoing were made. A good example is the approach taken in the Second Circuit. In *Management Dynamics*, the court cautioned that it was not deciding whether "the entire corpus of agency law is to be imported into the securities acts for all purposes."[42] Specifically, the court said it was not expressing any view as to cases that may involve lesser employees or other agency principles since the policy considerations in those cases may be entirely different. The court did indeed find a different set of circumstances one year later in *SEC v. Geon Industries, Inc.*,[43] in which it held that an injunction should not be issued against a stock brokerage firm under the theory of *respondeat superior*. One of the

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38. Fey v. Walston & Co., 493 F.2d 1036 (7th Cir. 1974).

39. 515 F.2d 801, 812 (2d Cir. 1975).

40. 15 U.S.C. § 77o (1976). Section 15 provides:

> Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77*l* of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

41. 515 F.2d at 812 (construing S. REP. No. 47, 73d Cong., 1st Sess. 5 (1933) and H.R. CONF. REP. No. 152, 73d Cong., 1st Sess. 27 (1933)).

42. 515 F.2d at 813.

43. 531 F.2d 39 (2d Cir. 1976).

firms's registered representatives committed fraudulent acts in violation of the securities statutes without the encouragement or even knowledge of the firm. Plaintiff argued that the reasoning in *Management Dynamics* supported the imposition of liability on the basis of *respondeat superior* even though the firm did not fail to provide reasonable supervision nor did it in any way commit a culpable act. In the court's view, this argument was a "significant extension"[44] of *Management Dynamics*. The court distinguished *Management Dynamics* by pointing to the prominent position and apparent authority of the employee in that case. In contrast, the employee in *Geon* was only a registered representative of the firm who made no special use of his connection with the firm. Additionally, the firm made no profit beyond ordinary commissions. The court again limited its holding to the peculiar facts of the case, warning against a broad reading of the opinion.

Prior to its decision in *Texas Commerce Bank*, the Fifth Circuit had not decided whether the statutory provisions providing for secondary liability under the securities acts were exclusive,[45] although two previous opinions have been read by courts in other circuits as supporting the view of nonexclusivity.[46] In *Lewis v. Walston & Co.*,[47] buyers of unregistered securities brought an action against a brokerage firm and one of its registered agents to recover losses sustained on the purchase of the securities. The jury found the firm was liable for the acts of its employee, even though the firm did not deal in unregistered stock, the transactions were not executed through the firm, and the firm derived no benefit from the sales. There was evidence, however, that the firm had known of the employee's efforts to sell the unregistered securities but had failed to order the efforts stopped. The trial judge granted a judgment *n.o.v.* against the buyers, holding that the firm was not liable. On appeal, the issue was whether there was enough evidence to support the jury's conclusion that the employee was acting within the scope of employment. Since the actions of the employee were the types of acts commonly performed by brokers, *i.e.*, recommending the purchase of certain stocks and arranging the mechanics of a transaction, the court found the representative was acting within the scope of employment and reversed the lower court's decision.[48] In reaching this conclusion, the appellate court did not address the exclusivity-nonexclusivity issue, which apparently was not raised by the parties.

44. *Id.* at 54.

45. 630 F.2d at 1116.

46. *See, e.g.*, Marbury Management, Inc. v. Kohn, 629 F.2d at 714; Holloway v. Howerdd, 536 F.2d at 695; SEC v. Management Dynamics, Inc., 515 F.2d at 812-13.

47. 487 F.2d 617 (5th Cir. 1973).

48. *Id.* at 624.

Another Fifth Circuit decision that has been read as supportive of the application of common law agency principles in securities actions is *Woodward v. Metro Bank*.[49] A cosigner of a note brought suit against the party principally liable on the note as well as the bank that issued it, claiming fraud. In its discussion of the bank's possible liability, the court, in a footnote, alluded to what it characterized as the Second Circuit's view that section 20(a) is the exclusive method of imposing secondary liability.[50] While the court called this view an "unnecessarily restrictive approach to the securities acts,"[51] it also said that it is a question that need not be resolved in order to decide the case. The court dismissed the case, holding that the plaintiff had failed to state a claim within the ambit of the securities laws.

The court in *Texas Commerce Bank* began its analysis of the issue by looking to the legislative history of the controlling persons provisions, first to a portion of the history supportive of the exclusivity view. According to the court, the initial draft of the Securities Act prepared by the Senate included a proposal to provide an insurer's liability standard, under which any officer or director of a corporation would be liable for violations committed by the corporation regardless of personal fault.[52] This position, which is similar to imposition of liability under agency principles, was rejected by Congress and the version drafted in the House of Representatives, which imposed secondary liability only upon those controlling persons who breached a duty of care, was adopted.[53] The court also looked at evidence tending to support the nonexclusivity view. According to the court, Congress' specific purpose in enacting the controlling persons provisions was to prevent corporate directors from evading liability by utilizing "dummies" that would act in their place and under their control. The court found nothing in the legislative history to indicate that the provisions were intended to replace common law agency principles in an employer-employee situation. Thus, the court concluded that the legislative history of the acts is inconclusive and not supportive of either view.[54]

After finding no prior Fifth Circuit case on point,[55] the court in *Texas Commerce Bank* turned to the decisions of other circuits. The court noted the differing conclusions reached by the circuits that had consid-

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49. 522 F.2d 84 (5th Cir. 1975).
50. *Id.* at 94 n.22.
51. *Id.*
52. 630 F.2d at 1115. *See* S. Rep. No. 47, 73d Cong., 1st Sess. 5 (1933).
53. *See* 15 U.S.C. § 78t(a).
54. 630 F.2d at 1116.
55. *Id.* The court discussed both *Lewis* and *Woodward*, but found that neither decision had directly addressed the issue. *See* note 40-43 *supra*, and accompanying text.

ered the issue. In discussing the exclusivity view, the court acknowledged the position taken by the Third and Ninth Circuits but maintained that the Ninth Circuit had never directly addressed the issue.[56] The court discussed the conclusion reached in *Rhoades*[57] that Congress intended to restrict secondary liability to those controlling persons who were culpable participants. The court in *Rhoades* reasoned that this conclusion was consistent with the general tenor of the securities acts, which require a showing of culpability prior to the imposition of liability. Additionally, the court in *Rhoades* warned that the application of *respondeat superior* to violations of the securities laws would inflict strict liability upon employers for acts committed by their employees.

The court in *Texas Commerce Bank* rejected the reasoning of the opinion in *Rhoades*, finding the arguments advanced by the courts supporting the nonexclusivity view to be more persuasive.[58] In response to the Third Circuit's claim that the use of common law agency principles would result in strict liability for corporations and other employers, the court pointed to the requirements of agency that an agent must act within the course and scope of his employment and within his actual or apparent authority as restrictions on the scope of an employer's liability. The court in *Texas Commerce Bank* also rejected the argument in *Rhoades* that the congressional intent behind the securities acts was to restrict liability to culpable parties. Rather than restricting liability, the court found the controlling persons provisions to be congressional extensions of secondary liability to parties that could not be reached under traditional agency principles. The court noted that the federal securities statutes are remedial legislation and that the long-standing rule of construction for this type of legislation mandates a broad reading.[59]

For additional arguments in support of the application of agency principles, the court in *Texas Commerce Bank* turned to two Second Circuit opinions. In *Management Dynamics*, the court observed that the inclusion of corporations within the meaning of "person" in the definitional sections of the acts[60] indicated that Congress intended the use of agency

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56. The court found those opinions in the Ninth Circuit that support the exclusivity position relied primarily on an earlier decision that did not decide the question. 630 F.2d at 1117 n.5. The earlier decision mentioned by the court was *Kamen*, in which the court decided that the defendant's employee acted without actual or apparent authority and thus could not be held liable under agency principles.

57. 527 F.2d at 884-86.

58. 630 F.2d at 1118-1119.

59. *Id.*

60. 15 U.S.C. § 77b (1976); Securities Exchange Act of 1934, ch. 404, § 3, 48 Stat. 883 (1934) (This section was amended to eliminate "corporation" from the definition of "person" subsequent to the court's decision. See Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97 (1975)).

principles, since the only way to hold a corporation liable is through the acts of its agents.[61] In *Marbury Management, Inc. v. Kohn*,[62] the Second Circuit found additional support in section 28(a) of the Securities Exchange Act,[63] which provides that the rights and remedies created by the Act did not displace previously existing rights and remedies. Under this line of reasoning, the previously existing agency principles are still applicable to actions brought under the Act.

Policy considerations also favor the nonexclusivity view, according to the court in *Texas Commerce Bank*. Again relying on the reasoning in *Management Dynamics*, the court said that the exclusivity view would allow a brokerage firm to "avoid secondary liability simply by showing ignorance, purposeful or negligent, of the acts of its registered representatives."[64] According to the court, the intent of Congress was to protect the public, particularly unsophisticated investors, from fraudulent practices. Since most investors choose a broker on the basis of the reputation of the brokerage firm rather than its individual employees, the firm itself should be held liable. A brokerage firm that provides an employee with the means to perpetrate fraud, the court reasoned, should also bear the burden of paying damages to a victim of that fraud when the employee has acted within the scope of his employment.[65]

The underlying reason for the court's imposition of liability upon the brokerage firm is because such a distribution of loss is both commercially and socially feasible.[66] Under allocation of risk theory, losses caused by the acts of an employee are taken into account as a cost of doing business.[67] While it can be argued that allocation of liability to an employer rather than an innocent party is equitable, it seems less equitable to hold the employer liable when the broker has made every attempt to prevent the wrongful conduct. Yet, under traditional agency principles, the conduct or good faith of the employer is irrelevant to the issue of liability. Since civil actions under the securities acts carry the potential for enormous judgments,[68] an innocent principal may be saddled with enormous liability due solely to the acts of an employee.[69]

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61. 515 F.2d at 812.
62. 629 F.2d 705, 716 (2d Cir. 1980).
63. 15 U.S.C. § 78bb (1976).
64. 630 F.2d 1118-1119.
65. *Id.* at 1119.
66. *See* Comment, *Apparent Agency— An Extension of the Deep Pocket Theory*, 23 S.C.L. REV. 826 (1971).
67. W. PROSSER, LAW OF TORTS 459 (4th ed. 1971).
68. *See* Comment, *Vicarious Liability of Controlling Persons Under the Securities Acts*, 11 LOYOLA OF L.A. L. REV. 151, 178 (1977).
69. Indeed, the present case is an apt illustration. Despite the lower court's finding that the defendant had no knowledge of the acts committed by its employee, it was held liable.

In rejecting the argument that the application of agency principles would result in strict liability for employers, the court pointed to the requirements of agency that must be met before liability can be imposed.[70] While the court is correct in stating that liability is not imposed on a principal unless the requirements of agency are satisfied, it failed to recognize that once the relationship between principal and agent is established, liability becomes absolute for all acts committed within the scope of employment. The result is the imposition of a strict liability standard on those controlling persons who also happen to meet the agency requirement. This type of standard was specifically rejected by Congress when section 20(a) was adopted.[71] One justification for a strict liability approach is that this standard would have a deterrent effect on fraudulent conduct.[72] This argument fails to recognize the existing strict standards to which brokerage firms are already subjected. Since these regulations require high standards in the hiring and supervision of employees,[73] it seems unlikely that strict liability would have any additional deterrent effect.

In its analysis of the legislative history of section 20(a), the court focused on the intent of Congress to extend the coverage of the acts to include persons not within the scope of common law agency principles.[74] Since congressional intent was to expand liability, the court reasoned, section 20(a) should not be construed to restrict secondary liability. The intent of Congress in creating section 20, however, was apparently twofold: to increase the coverage of the 1934 Act to include controlling persons; yet, at the same time, to introduce the element of culpability (lack of good faith). Moreover, the Supreme Court recently indicated that liability without culpability is inappropriate under the securities acts.[75] The court's reliance on the often quoted maxim that the federal securities statutes are remedial in nature and must be given a broad construction ignored the Supreme Court's refusal in several previous cases to incorporate common law principles into the securities acts.[76]

While the court discussed the exclusivity view, it did not directly deal with much of the reasoning that supports the view. In particular, the court failed to consider the effect of strict liability on brokerage firms and

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630 F.2d at 1114.

70. *Id.* at 1119.

71. Compare the Senate's proposed standard of "insurer's liability," S. REP. 47, 73d Cong., 1st Sess. 5 (1933) with the position of the House which was finally adopted, H.R. REP. No. 1383, 73d Cong., 2d Sess. 5 (1933).

72. PROSSER, note 64 *supra*, at 459.

73. *See* LOYOLA OF L.A.L. REV., *supra* note 65, at 180.

74. 630 F.2d at 1118.

75. *See* note 22 *supra*, and accompanying text.

76. *See* notes 25-27 *supra*, and accompanying text.

other employers in the securities field. By denying that the application of agency principles to actions under the securities acts would create a strict liability standard for many employers, the court failed to address the primary problem with the view of nonexclusivity; namely, holding nonculpable parties liable for the actions of others. Allowing controlling persons the use of a good faith defense would not, as the court suggested, allow brokerage firms to avoid liability simply by showing ignorance, but would place the considerable burden of demonstrating the existence of good faith and lack of inducement, direct or indirect, on the controlling person. The good faith defense would permit a firm to avoid liability when it has done everything possible to prevent wrongful acts by its employees as well as encourage a firm to take steps to prevent those acts.

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