

# Sarbanes-Oxley Section 501(a): No Implied Private Right of Action, and a Call to Congress for an Express Private Right of Action to Enhance Analyst Disclosure

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*ABSTRACT: Section 501(a) of Sarbanes-Oxley and Regulation AC require securities analysts to disclose conflicts of interest associated with research reports. It is unlikely that courts will imply a private right of action in section 501(a) or Regulation AC; thus, investors will not be allowed to individually sue their analysts who have failed to disclose a conflict of interest. Yet, as professionals, securities analysts play an essential role in ensuring that their investor clients are not defrauded by misleading reports about the prospects of publicly traded companies. Investor confidence in the stock market rests heavily on the perception that analysts are either making fair recommendations free of external influence or allowing investors to view their recommendations in light of their disclosed interests. Congressional action creating an express private right of action for investors to sue analysts who fail to disclose a conflict would only strengthen enforcement of the current disclosure rules.*

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## I. INTRODUCTION

Crystal Ball is a securities analyst for Bulge Bracket, Inc., a large investment bank. Ball specializes in evaluating technology stocks. One company that Ball covers is ZipChip, a semiconductor company whose stock is publicly traded. In the course of her recent evaluation of ZipChip, Ball determines that the market for semiconductor business is becoming quite crowded; price competition is intensifying. While ZipChip was once a promising buy, the window for big profits and new clients has long since closed for the company. In short, ZipChip is a dog of a stock.

As a result, Ball is fully prepared to downgrade ZipChip from her current “hold” recommendation and issue a “sell” recommendation for the stock. But Ball pauses momentarily: if she were to issue this recommendation, would she be damaging Bulge Bracket’s attempts to win ZipChip’s business if ZipChip were to receive buyout offers in the future? What are Bulge Bracket’s current trading positions in ZipChip stock? Does she or a member of her family own stock in ZipChip? What are Ball’s chances of getting a return phone call from an officer or director of ZipChip in the future if the company’s fortunes change? What about her relationship with officers of the other companies who read her report?

This hypothetical situation demonstrates the different sources of pressure that a “sell-side” securities analyst faces, particularly when that analyst finds herself in the position of being the messenger of bad news about a stock.<sup>1</sup> Congress, the Securities and Exchange Commission (“SEC”), Self-Regulatory Organizations (“SROs”), and Bulge Bracket itself all require Ball to disclose any interest that she has in the outcome of her recommendations. This Note discusses the current state of those analyst disclosure requirements, and whether they effectively deter the analyst from misleading the investor. This Note proposes that Congress expressly include individual investors in the enforcement of those requirements.

Section 501(a) of the Public Accounting Reform and Investor Protection Act of 2002 (“Sarbanes-Oxley”) requires the SEC to enact rules to help prevent securities analysts from publishing false research reports.<sup>2</sup> Sarbanes-Oxley also encourages rulemaking designed to enhance analyst

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1. “Sell-side” analysts typically work for full-service broker-dealers and make recommendations on the securities they cover. Their research reports are often made available to the public. “Buy-side” analysts typically work for institutional money managers, such as mutual funds, hedge funds, or investment advisers that purchase securities for their own accounts. “Independent” analysts typically are not associated with firms that underwrite the securities they cover. They often sell their research reports by subscription or on another basis. U.S. Sec. & Exch. Comm’n, Investor Alert: Analyzing Analyst Recommendations, <http://www.sec.gov/investor/pubs/analysts.htm> (last visited Feb. 5, 2008). In this Note, “analysts” refers to “sell-side” analysts, unless otherwise indicated.

2. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 501(a), 116 Stat. 745, 791–93 (codified at 15 U.S.C. § 78o-6(b)).

disclosure by the two SROs—the New York Stock Exchange (“NYSE”) and the National Association of Securities Dealers (“NASD”).<sup>3</sup>

The SEC subsequently adopted Regulation Analyst Certification (“Regulation AC”).<sup>4</sup> Among other requirements, Regulation AC demands that a securities analyst like Ball certify that she did not receive any compensation linked to her recommendations in the research report.<sup>5</sup> Alternatively, if Ball is being paid to recommend a stock, Regulation AC requires her to document the details of that compensation in her report.<sup>6</sup> The SROs also made or amended rules of their own; for example, the NASD adopted Rule 2711, which included similar disclosure requirements for analysts.<sup>7</sup> The NASD also went a step further by preventing any member broker-dealer from paying “any bonus, salary or other form of compensation to a research analyst that is based upon a specific investment banking services transaction.”<sup>8</sup> Similarly, the NYSE amended its Rule 472 to require analysts to disclose the nature of their financial interest in their reports, “including whether the interest consists of any option, right, warrant, futures contract, or long or short position, etc.”<sup>9</sup>

How shall these rules be enforced? Section 501(a) of Sarbanes-Oxley is silent as to the question of whether investors can sue securities analysts for damages stemming from false certifications.<sup>10</sup> This congressional silence raises the question: Will courts imply a private right of action in section 501(a), allowing investors to institute class-action lawsuits against offending analysts and their employers? The lack of congressional intent in section 501(a) to create a separate, implied private right of action makes this unlikely. Additionally, courts have interpreted a separate section of

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3. *Id.* SROs have their own regime of rules to standardize the behavior among their member firms. The NYSE’s rules regime predated the federal securities laws and the SEC. Today, the NYSE and the NASD are the only two SROs. One advantage of the SROs’ private-enforcement mechanism is the SROs’ ability to tax the securities industry directly for its services, whereas the SEC must rely on the unpredictable funding decisions of Congress. Another is that the NYSE and the NASD can authorize rules that are more stringent than the baseline fraud protections given to investors by the federal securities laws and enforced by the SEC. *See* JOHN C. COFFEE, JR., JOEL SELIGMAN & HILLARY A. SALE, *SECURITIES REGULATION* 640–41 (10th ed. 2007).

4. Regulation Analyst Certification, Securities Act Release No. 8193, Exchange Act Release No. 47,384, [2002–2003 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,833 at 87,233–50 (Feb. 20, 2003).

5. 17 C.F.R. § 242.501(a)(2) (2007).

6. *Id.*

7. Notice of Filing and Immediate Effectiveness of Proposed Rule Changes Relating to NYSE Rule 472 and NASD Rule 2711, Exchange Act Release No. 54,616 (Oct. 17, 2006), <http://www.sec.gov/rules/sro/nyse/2006/34-54616.pdf>.

8. Order Approving NASD and NYSE Proposed Rule Changes Relating to Research Analyst Conflicts of Interest, Exchange Act Release No. 34-45908 (May 10, 2002), <http://www.sec.gov/rules/sro/34-45908.htm>.

9. NYSE, Inc., Listed Company Manual § 472(k)(1)(iii)(b) (2006).

10. 15 U.S.C. § 78o-6(b) (Supp. II 2002).

Sarbanes-Oxley as lacking an implied private right of action, thus making section 501(a) ripe for analogy.<sup>11</sup>

Like Sarbanes-Oxley, Regulation AC does not provide any new methods for sanctioning untruthful analysts.<sup>12</sup> Academics have criticized both Regulation AC and Sarbanes-Oxley for not effecting any meaningful reform, in spite of Sarbanes-Oxley's creation of the Public Company Accounting Oversight Board and provisions to increase funding for the SEC.<sup>13</sup> It seems that the only option available to private investors both before and after the enactment of Sarbanes-Oxley and its progeny is suing under the fraud provisions of the federal securities laws.<sup>14</sup> One prominent commentator has suggested, however, that fraud claims would be difficult to prove in this context.<sup>15</sup> The SEC also punishes fraudulent behavior by issuers and broker-dealers, just as it did before Sarbanes-Oxley.<sup>16</sup>

This set of rulemaking arose from a wave of public frustration toward analysts who covered stocks dishonestly.<sup>17</sup> But do these rules represent systemic changes that will persist beyond the sense of dissatisfaction that led to the creation of the rules? This Note argues that they do not, and in turn asks Congress to adopt an express private right of action for investor clients who are misled by an analyst's nondisclosure. This Note does not argue that the SEC should impose liability for substantive buy/sell recommendation errors,<sup>18</sup> nor does it argue that analysts cannot ever be interested in the

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11. See *Neer v. Pelino*, 389 F. Supp. 2d 648, 657 (E.D. Penn. 2005) (“[W]e are left with the core reality that Congress expressly granted a private right of action in Section 306 . . . yet elected not to do so in Section 304.”).

12. See discussion *infra* Part II.D.

13. See Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (and It Just Might Work)*, 35 CONN. L. REV. 915, 987 (2003) (characterizing Sarbanes-Oxley as a “restatement with the force of federal law”).

14. 15 U.S.C. § 78u-4(f)(1) (2000) (“Nothing in this subsection shall . . . modify, the standard for liability . . . under the securities laws.”).

15. See John C. Coffee, Jr., *Security Analyst Litigation*, N.Y. L.J., Sept. 20, 2001, at 5 (arguing that plaintiffs who would sue a research analyst employed by an investment bank “face[] an uphill battle”). But see Elizabeth A. Nowicki, *A Response to Professor John Coffee: Analyst Liability Under Section 10(b) of the Securities Exchange Act of 1934*, 72 U. CIN. L. REV. 1305, 1321 (2006) (listing three possible ways that a plaintiff could prove that an analyst had the intent to “deceive, manipulate, or defraud” (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976))).

16. For a compelling argument that investors can effectively sue securities analysts under the fraud provisions of the federal securities laws for failure to disclose conflicts of interest, see generally Jill I. Gross, *Securities Analysts' Undisclosed Conflicts of Interest: Unfair Dealing or Securities Fraud?*, 2002 COLUM. BUS. L. REV. 631.

17. See, e.g., BENJAMIN MARK COLE, *THE PIED PIPERS OF WALL STREET: HOW ANALYSTS SELL YOU DOWN THE RIVER* (2001); Charles Gasparino & Scot J. Paltrow, *SEC Joins Pack, Opens Inquiry into Analysts*, WALL ST. J., Apr. 26, 2002, at A1; Gretchen Morgenson, *See No Evil, Speak No Evil*, FORBES, Dec. 15, 1997, at 162; Randall Smith, *Next Big Target in Wall Street Probe: Bankers*, WALL ST. J., May 9, 2003, at C1.

18. See John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 353 (2004) (acknowledging that strict liability for substantive errors

outcome of their recommendations; rather, in keeping with the SEC's disclosure-focused approach,<sup>19</sup> analysts and their employers should be directly accountable to their investor clients for failing to disclose material interests in the outcome of their recommendations.

Admittedly, giving individual investors the right to sue analysts for nondisclosure is an aggressive solution. But congressional action to further incentivize analyst disclosure is proper because disclosure is far less difficult than defending a lawsuit, while the effect of nondisclosure can be extremely damaging to the firm's clients.

While many commentators place the securities analyst in a dispassionate role, others have suggested that rather than attempting to de-conflict every aspect of the analyst's job, it is sometimes better to view analyst research as sales material.<sup>20</sup> However, equity salespeople already perform the proper function of selling stocks to benefit the business of the firm; the role of the analyst is to be a professional market-watcher.<sup>21</sup> But unlike lawyers, who exist in an adversarial system and whose clients risk suffering a zero-sum loss if their counsel is conflicted, securities analysts square off against a market that can discount an analyst's recommendation to the extent that the analyst is conflicted.<sup>22</sup> One empirical study has shown this market-discounting effect.<sup>23</sup> Because markets function efficiently to discount for analyst conflicts, the most important enforcement mechanism to protect investors should be disclosure. Analysts and their employers, then, should be subjected to individual lawsuits for nondisclosure about where the analysts stand in relation to their recommendations.

Part II of this Note provides a brief background of the role of the securities analyst, Sarbanes-Oxley, and the implied private right of action doctrine. Part III tracks the history of the implied private right of action

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is not the proper regime for securities analysts, given that "the securities analyst is essentially a prognosticator whose predictions about the future are frequently wrong," and that imposing strict liability on the securities analyst for misinformation rooted in the errors of the company's statements "may amount to a virtual death sentence for the analyst").

19. Plain English Disclosure, Securities Act Release No. 7497, Exchange Act Release No. 39,593, 66 SEC Docket 777 (Jan. 28, 1998) ("Full and fair disclosure is one of the cornerstones of investor protection under the federal securities laws.").

20. See Coffee, *supra* note 18, at 316 (describing securities analysts as gatekeepers who serve as "reputational intermediaries" in spite of their historical bias in favor of "buy" recommendations). But see Robert P. Sieland, Note, *Caveat Emptor! After All the Regulatory Hoopla, Securities Analysts Remain Conflicted on Wall Street*, 2003 U. ILL. L. REV. 531, 568-69 (suggesting that, because a strict separation from investment banking and analyst functions is impracticable, the SEC should require broker-dealer analysts who are not certified as "independent analysts" to characterize their research reports as marketing material).

21. See *infra* Part II.A (discussing the role of the analyst).

22. See Anup Agrawal & Mark A. Chen, *Do Analyst Conflicts Matter? Evidence from Stock Recommendations* 7 (Univ. of Md. Robert H. Smith Sch. of Bus., Working Paper No. RHS-06-38, 2007), available at <http://ssrn.com/abstract=1005539> (examining the short-term stock-price impact of an analyst's conflicted recommendation).

23. *Id.*

doctrine in the “era of contraction.”<sup>24</sup> Part IV examines a recent decision denying an implied right of action in another section of Sarbanes-Oxley and concludes by analogy that courts likely will not imply a private right of action in section 501(a) of the Act. Lastly, Part V proposes that Congress should enact an express private right of action to incentivize analyst disclosure and to more effectively enforce the regulatory changes in Sarbanes-Oxley, Regulation AC, and the SRO rules.

## II. BACKGROUND

### A. THE ROLE OF THE ANALYST

For a student of the legal system, the securities analyst’s job is peculiar. Lawyers are trained to ensure that protected information from previous clients does not give them unfair advantages in the representation of current clients.<sup>25</sup> Conflicts of interest poison the system, and serve as the basis for malpractice lawsuits. Conversely, the securities analyst best serves his investor client by exploiting closely held information (to the extent he can legally obtain it) and maximizing conflicts of interest using, for example, information gleaned from previous employment in the semiconductor industry. Whether the information is obtained from prior experience or some other source, the analyst can best serve his client by using that unique information to predict a company’s future more accurately than his competitors. The challenge, then, is how to balance the need for analysts to achieve some sustainable competitive advantage with the need for investors to trust that security prices are not influenced by dishonesty or unfairness.

Analysts traditionally generate their reports by reviewing recent company filings with the SEC, studying economic indicators, and doing hands-on investigation. This type of investigation is conducted through personal meetings with the subject company’s managers.<sup>26</sup> In their article, *The Securities Analyst as Agent: Rethinking the Regulation of Analysts*, Professors Jill E. Fisch and Hillary A. Sale note that changes in analyst recommendations for stocks “typically trigger substantial price

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24. 1 ALAN R. BROMBERG & LEWIS D. LOWENFELS, BROMBERG AND LOWENFELS ON SECURITIES FRAUD AND COMMODITIES FRAUD § 2:31 (2d ed. 2003) (“The age of contraction, or retrenchment, for . . . implied liability . . . and securities law enforcement generally—can be dated from 1974–1975.”). This followed what Bromberg and Lowenfels dubbed the “expansion era,” which began with the enactment of the Securities Exchange Act of 1934. *Id.* § 2:30. Notably, Bromberg and Lowenfels identify a possible renaissance of the expansion era and include Sarbanes-Oxley in that category. *Id.* § 2:32.

25. MODEL RULES OF PROF’L CONDUCT R. 1.9 (2003) (“A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person’s interests are materially adverse to the interests of the former client unless the former client gives informed consent . . .”).

26. Jill E. Fisch & Hillary A. Sale, *The Securities Analyst as Agent: Rethinking the Regulation of Analysts*, 88 IOWA L. REV. 1035, 1042 (2003).

movements.”<sup>27</sup> This is because analysts announce their recommendations to the marketplace, and publishing services regularly poll analyst predictions. Thus, securities analysts influence a wider audience than the circle of clients for whom they publish their reports (and to whom they owe a fiduciary duty).

Fisch and Sale identify three types of conflicts of interest that analysts face in carrying out their responsibilities: ownership interests, business interests, and access interests.<sup>28</sup> Of these three, business interests are simultaneously the most dangerous and the most highly publicized. The primary reason for the danger lies with the increased influence of the investment-banking division within the analyst’s firm. Because investment banking has experienced a spike in profitability in recent years, investment bankers’ influence has grown proportionately within both their respective firms and the general investing community.<sup>29</sup>

Business interests can influence a securities analyst in the following way: say analyst Ball is ready to publish a report that includes her “sell” recommendation of ZipChip. That recommendation might cause the investment-banking division at Bulge Bracket to lose ZipChip’s merger-and-acquisition business when Ball’s recommendation frustrates senior ZipChip executives. So, instead of issuing a “sell” recommendation, Ball changes her recommendation for her investor clients to hold the stock if they already own it or, worse, to buy more shares.<sup>30</sup>

Another less prominent example of business interests is the firm’s ability to profit from increased trading in the subject company’s stock. Here, if Ball were to set off a buying frenzy by dishonestly issuing a “buy” recommendation for ZipChip, Bulge Bracket’s back office would then profit off of the increased commissions from the resulting increased trading volume.<sup>31</sup> The latter example is less significant due to the lower relative

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27. *Id.* at 1041.

28. *Id.* at 1042–56. In their article, the authors challenge the traditional view that analysts are “gatekeepers,” functioning as unbiased information-providers to the market. Instead, the authors assert that analysts should be treated as “quasi-agents” for regulatory purposes. Securities analysts are not totally beholden to clients and investors at the expense of the overall market, but, rather, behave as agents. Instead of viewing them as gatekeepers, this classification more accurately characterizes the pressures that analysts face. *Id.* at 1038–39.

29. *Id.* at 1046. Fisch and Sale note:

For example, in 1967, prior to the elimination of fixed commissions, commission revenue accounted for approximately 57% of Merrill Lynch’s revenues, and investment banking accounted for less than a tenth of that sum. In contrast, the Securities Industry Association reported in 1997 that commissions generated only 16% of industry revenues. Industry investment banking revenues, however, have increased fifty-fold in the last twenty-five years.

*Id.* (footnotes omitted).

30. *Id.* at 1047.

31. Fisch & Sale, *supra* note 26, at 1045.

returns that it would offer Bulge Bracket. It is, nevertheless, a conflicting interest.

At the risk of oversimplification, ownership interests represent the incentive for an analyst like Ball to misinform her clients about a stock to enhance the value of Ball's personal investment portfolio.<sup>32</sup> In other words, Ball decides to profit from her research by scalping the stock she is recommending. Scalping occurs when an analyst takes a position in a stock, widely recommends that stock, and sells (or buys) immediately after the market price reflects the positive (or negative) effects of her analysis.<sup>33</sup> Fisch and Sale cite an SEC investigation in which nearly one-third of the analysts investigated owned stocks in companies that they covered, suggesting that the potential for this practice to occur is widespread.<sup>34</sup>

Finally, analysts may be influenced by access interests. Fisch and Sale attribute access interests to the need for analysts to have positive ongoing relationships with their subject companies. These positive relationships ensure that analysts may continue to obtain good company information from them.<sup>35</sup> As an example, the authors mentioned that when securities analyst Anne Anderson issued a sell rating on her subject company Oxford, Inc., Oxford's response was to "disinvite" her from its analyst conference and refuse to return her calls.<sup>36</sup> Of the three interests, access interests appear to be the most difficult to identify as influencers of securities analysts. This is because access interests are so subjectively dependent on the relationship between the analyst and the target company. Thus, it is very difficult to prove that an analyst changed a stock recommendation in order to ensure continued cooperation from the subject company. The regulation of the relationship between the analyst and the subject company is beyond the scope of this Note.

Recent efforts by Congress, the SEC, and the SROs to address analyst conflicts of interest have focused on diminishing the effect of business interests. The next section describes those efforts.

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32. *Id.* at 1044.

33. For a description of scalping in the context of investment advisors, see Gross, *supra* note 16, at 647–51.

34. Fisch & Sale, *supra* note 26, at 1044. The authors cite Rachel Witmer McTague, *Unger Says Securities Firms Complied Poorly with Rules Relating to Analysts' Investments*, 33 Sec. Reg. & L. Rep. (BNA) No. 31, at 1136–37 (Aug. 6, 2001), and note that SRO regulations require the disclosure of analyst investments, but that the SRO monitoring and enforcement of those disclosures had been "virtually nonexistent." Fisch & Sale, *supra* note 26, at 1043–44 & n.34.

35. Fisch & Sale, *supra* note 26, at 1054.

36. *Id.* at 1055 (citing Morgenson, *supra* note 17, at 164). Other examples of "stonewalling" of disfavored analysts given by the authors include corporate officials' refusing to take analysts' phone calls, prohibiting company employees from speaking with them, and avoiding those analysts' questions on conference calls. *Id.* at 1055–56.

## B. SARBANES-OXLEY

Sarbanes-Oxley is a “securities regulation smorgasbord.”<sup>37</sup> Congress enacted Sarbanes-Oxley in 2002 following a “unique concentration of financial scandals . . . , all involving the common denominator of accounting irregularities.”<sup>38</sup> Among many other activities, Sarbanes-Oxley contains new procedures for companies to certify financial information in reports to the SEC and to the general public.<sup>39</sup> In the wake of the Enron and WorldCom scandals, these procedures are designed to place responsibility for the quality of company financial disclosures on senior managers.<sup>40</sup>

### 1. Express Private Rights of Action

To enforce the heightened standards for financial disclosures, two separate sections of Sarbanes-Oxley expressly provide for private causes of action that plaintiff-shareholders or employees can bring against offending directors or officers.<sup>41</sup> Whistleblower protection is one example of an express right of action in Sarbanes-Oxley.<sup>42</sup> If a company is found to have harassed a whistleblower employee in violation of the whistleblower-protection section of Sarbanes-Oxley, the injured party may sue his or her

37. HAROLD S. BLOOMENTHAL, *SARBANES-OXLEY ACT IN PERSPECTIVE* § 1:10 (2005–2006).

38. Coffee, *supra* note 18, at 302.

39. See BLOOMENTHAL, *supra* note 37. Bloomenthal notes:

From one perspective, it is an Act to create an independent board to regulate and provide supplementary oversight to SEC regulation of independent public accountants practicing before the Commission. . . . The Act includes a new certification regime that attempts to enhance the reliability and quality of financial and other information included in reports filed with the SEC and otherwise made available in the market . . . . The Act is also designed to enhance corporate disclosure and real-time reporting . . . . In order for enhanced disclosure to be effective, research analysts and the firms publishing their research reports must not be conflicted.

*Id.*

40. Lewis D. Lowenfels & Alan R. Bromberg, *Implied Private Actions Under Sarbanes-Oxley*, 34 SETON HALL L. REV. 775, 775 (2004).

41. See 15 U.S.C. § 7244(a)(2)(B) (Supp. II 2002) (establishing a private right of action for certain insider-trading violations); 18 U.S.C. § 1514A(b) (Supp. II 2002) (establishing a private right of action for whistleblowers). See generally Robert F. Serio & Matthew S. Kahn, *Private Rights of Action May Emerge from Sarbanes-Oxley Act*, CORP. COUNS. WKLY., Apr. 19, 2006, at 128 (discussing Sarbanes-Oxley’s private rights of action).

42. See 18 U.S.C. § 1514A. The Act states:

No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 . . . may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee . . . because of any lawful act done by the employee . . . to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of . . . any rule or regulation of the Securities and Exchange Commission . . . .

*Id.* § 1514A(a).

employer according to the procedure the Act lays out.<sup>43</sup> Sarbanes-Oxley allows these plaintiffs to sue for reinstatement and compensatory damages, but not for punitive damages.<sup>44</sup>

## 2. Implied Private Rights of Action

In addition to express private rights of action, commentators have suggested that it is possible for future courts to imply private causes of action in Sarbanes-Oxley.<sup>45</sup> The Act provides no express private right of action in some sections; in others, its provisions are silent as to the method of enforcement.<sup>46</sup> Because of the heightened requirements that must be met for a court to read a private right of action into any statute, it is unlikely that a court will find an implied private right of action for analyst nondisclosure under the provisions of Sarbanes-Oxley.

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43. *Id.* § 1514A(b). The procedure includes a requirement that the “person who alleges discharge or other discrimination by any person in violation of [the whistleblower-protection provision]” must first file a complaint with the Secretary of Labor, or, “if the Secretary has not issued a final decision within 180 days of the filing of the complaint and there is no showing that such delay is due to the bad faith of the claimant,” the Act allows for the alleged victim to bring an “action at law or equity for de novo review in the appropriate district court of the United States.” *Id.*

44. *Id.* § 1514A(c). The Act states:

Relief for any action under [the whistleblower-protection provision] shall include— (A) reinstatement with the same seniority status that the employee would have had, but for the discrimination; (B) the amount of back pay, with interest; and (C) compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.

*Id.*; see also Serio & Kahn, *supra* note 41, at 126 (noting that plaintiffs may also receive “special damages” such as litigation costs, expert fees, and attorney’s fees, but that it is unclear whether special damages include reputational injury).

45. See Serio & Kahn, *supra* note 41, at 126–27 (identifying several sections of Sarbanes-Oxley and other related sources as ripe for potential implied causes of action: section 304, which requires CEOs and CFOs to return monies in connection with financial restatements; section 807, which criminalizes securities fraud but does not explicitly prevent private causes of action; section 302(a) and Securities Act Release No. 8124, which establish rules for company officers regarding the certification of periodic financial reports; and section 401(b) and Regulation G, which implement rules regarding false pro forma financial information). See generally 1 BROMBERG & LOWENFELS, *supra* note 24 (discussing specific language in the Act that implies that private actions can be found under the Act).

46. 15 U.S.C. § 7243 (Supp. II 2002) (also known as section 304 of Sarbanes-Oxley, this provision requires CEOs and CFOs of companies to disgorge, among other things, bonuses received shortly before the company’s restatement of its accounts “due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws”); see also Serio & Kahn, *supra* note 41, at 126 (“Section 304 is silent as to how it is to be enforced and thus potentially ripe for implying a private cause of action.”). *But see, e.g., In re Digimarc Corp. Derivative Litig.*, No. 05-1324-HA, 2006 U.S. Dist. LEXIS 56134, at \*1 (D. Or. Aug. 11, 2006) (finding no private right of action); Kogan v. Robinson, 432 F. Supp. 2d 1075, 1075 (S.D. Cal. 2006) (same); Neer v. Pelino 389 F. Supp. 2d 648, 648 (E.D. Penn. 2005) (same).

Since the mid-1970s, the Supreme Court has progressively limited the doctrine of implied private causes of action.<sup>47</sup> To understand why courts will not imply a private right of action for investors seeking to sue under section 501(a) of Sarbanes-Oxley, a preliminary discussion of that section is in order.

### C. SECTION 501(A)

Section 501(a) of Sarbanes-Oxley authorizes the SEC and SROs to adopt rules to address conflicts of interest that can arise when securities analysts recommend equity securities.<sup>48</sup> Members of the two SROs (the NYSE and the NASD) comprise practically all securities firms in the United States.<sup>49</sup> The SEC grants rulemaking authority to these entities to enforce industry standards for registered securities traders and brokers.<sup>50</sup> The SEC has the authority to enforce all SRO rules, and neither *res judicata* nor double jeopardy limits the SEC if the SRO already has acted to enforce its rule.<sup>51</sup>

Section 501(a) seeks to protect analysts from undue influences within their respective firms while also ensuring that analysts disclose their own conflicts of interest with their subject companies. To protect analysts, the statute asks the SEC to draft rules intended to “address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances.”<sup>52</sup> Further, the rules should be made “in order to improve the objectivity of research and provide investors with more useful and reliable information.”<sup>53</sup> Specifically, section 501(a) demands that the SEC promote the objectivity and independence of securities analysts in three ways. First, section 501(a)(1)(A) demands that the SEC limit the ability of investment bankers to approve analyst reports.<sup>54</sup> Second, section 501(a)(1)(B) demands that the SEC limit the ability of the firm’s investment banking division to influence the compensation of securities analysts.<sup>55</sup> Third, section 501(a)(1)(C) demands that the analyst’s

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47. 1 BROMBERG & LOWENFELS, *supra* note 24, § 2:31 (“The age of contraction, or retrenchment, for . . . implied liability . . . and securities law enforcement generally—can be dated from 1974-75.”). The age of contraction followed what Bromberg and Lowenfels dubbed the “expansion era,” which began with the enactment of the Securities Exchange Act of 1934. *Id.* § 2:30. Notably, Bromberg and Lowenfels identify a possible renaissance of the expansion era and include Sarbanes-Oxley in that category. *Id.* § 2:32.

48. 15 U.S.C. § 78o-6(a) (Supp. II 2002).

49. *See* 15 U.S.C. § 78o-3(a) (2000) (authorizing the creation of SROs).

50. *See* 15 U.S.C. § 78c(a)(26) (2000) (defining self-regulatory organizations); § 78(s)(b) (outlining the procedure for SRO rulemaking).

51. *Jones v. SEC*, 115 F.3d 1173, 1178, 1183 (4th Cir. 1997).

52. § 78o-6(a).

53. *Id.*

54. § 78o-6(a)(1)(A).

55. § 78o-6(a)(1)(B).

firm prevent internal retaliation by investment bankers against the analysts whose reports could harm investment banking business.<sup>56</sup> The three measures are clearly aimed at diminishing the effect that business interests may have on the truthfulness of the analyst's recommendations.

To ensure that analysts disclose their own conflicts of interest, the statute asks the SEC to draft rules that require analysts to disclose in each report "conflicts of interest that are known or should have been known by the securities analyst or the broker or dealer, to exist at the time of the appearance or the date of distribution of the report."<sup>57</sup> Specifically, the statute identifies five potential conflicts: (1) the extent to which the securities analyst has debt or equity investments in the subject company; (2) whether any compensation has been received by the analyst or the analyst's firm from the subject company; (3) whether the subject company is or has been in the year preceding the report a client of the analyst's firm, and if so, what types of services the firm provided to the subject company; (4) whether the analyst received compensation based on investment banking revenues in connection with the report; and (5) any other conflicts of interest that are material to investors, the analyst, or the analyst's firm.<sup>58</sup> By identifying these potential conflicts, Congress has remedied some of the ownership and access interests that could hinder the ability of an analyst to tell the truth.

#### D. THE SECURITIES AND EXCHANGE COMMISSION'S REGULATION AC

With the authority Congress granted to it in section 501(a), the SEC adopted Regulation AC.<sup>59</sup> Regulation AC adds a measure of specificity to the disclosures that the SEC requires analysts to include in their published reports and public appearances.<sup>60</sup> For example, Regulation AC explicitly

56. § 78o6(a)(1)(C).

57. § 78o6(b).

58. § 78o6(b)(1)–(5).

59. Regulation Analyst Certification, *supra* note 4. The regulation was formed out of concern "that many investors who rely on analysts' recommendations may not know . . . that favorable research coverage could be used to market the investment banking services provided by an analyst's firm, and that an analyst's compensation may be based significantly on generating investment banking business." *Id.* at 87,234.

60. *Id.* In connection with publishing research reports, Regulation AC requires that:

[Analysts] that publish . . . research reports include in those research reports:

(A) a statement by the research analyst (or analysts) certifying that the views expressed in the research report accurately reflect such research analyst's personal views about the subject securities and issuers; and

(B) a statement by the research analyst (or analysts) certifying either:

(1) that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report;

or

(2) that part or all of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report. If the analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the

requires analysts to include a statement that the views in their reports are the same as the views the analysts personally hold.<sup>61</sup> Further, analysts must state that they are not being compensated for the outcome of their report.<sup>62</sup> If the analyst is being compensated, the analyst must detail the nature of that compensation in her report.<sup>63</sup>

Notably, in defining the extent of liability for violations of Regulation AC, the SEC does not “alter any other existing obligation under the federal securities laws for research analysts or broker-dealers.”<sup>64</sup> In a recent commentary in BNA’s *Corporate Counsel Weekly Newsletter*, Robert F. Serio and Matthew S. Kahn suggest that “[d]espite invitation from commenters, the SEC declined to definitively state that Regulation AC does not create new liability for analysts or their firms.”<sup>65</sup> Instead, Serio and Kahn note that the SEC refused to be so direct, stating on one hand that Regulation AC “does not alter any other existing obligations under the federal securities laws,”

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research report, the statement must include the source, amount, and purpose of such compensation, and further disclose that it may influence the recommendation in the research report.

All certifications must be clear and prominent. . . .

*Id.* at 87,234–35.

61. *Id.*

62. *Id.*

63. *Id.*

64. Regulation Analyst Certification, *supra* note 4, at 87,242. The provision explaining fraud liability under federal securities laws states:

Several commenters requested that the Commission reiterate the position stated in the Proposing Release that Regulation AC does not impose new liability on analysts or their firms. Regulation AC formalizes and potentially adds rigor to analysts’ responsibilities to express their views truthfully and without guile. Regulation AC makes explicit the representations that are already implicit when an analyst publishes his or her views—that the analysis of a security published by the analyst reflects the analyst’s honestly held views. Regulation AC does not alter any other existing obligation under the federal securities laws for research analysts or broker-dealers. A research report contains an inherent representation that the views expressed in the report are not knowingly false and do not omit material facts necessary in order to make statements made not misleading. Thus, even without Regulation AC, analysts may be found to have violated the anti-fraud provisions of the federal securities laws if they make baseless recommendations or recommendations that they disbelieve.

*Id.* at 87,241–42 (footnotes omitted). Notably, Harvey Goldschmid, a former SEC Chairman, has criticized this regulation as woefully inadequate, stating that the Regulation AC is “little more than a ‘patch’ on a system that is ‘badly broken’ and . . . the SEC needs to go further and undertake comprehensive rule making in this area.” David J. Labhart, Note, *Securities Analysts: Why These Gatekeepers Abandoned Their Post*, 79 IND. L.J. 1037, 1054 (2004) (quoting Lynn Hume, *Regulation: SEC Narrows Scope of Final Rule Requiring Analysts To Certify Views*, BOND BUYER, Feb. 7, 2003, at 5). According to Commissioner Goldschmid, “certification ‘is not a seal of approval’ and . . . investors would still benefit from doing their own analysis.” *Id.* (quoting Deborah Solomon, *SEC Requires Analysts Certify Their Research*, WALL ST. J., Feb. 7, 2003, at A2).

65. Serio & Kahn, *supra* note 41, at 127 (“This ambiguity could turn Regulation AC into a basis for Section 10(b) or Rule 10b-5 actions.”).

but, on the other hand, “suggesting that violation of Regulation AC might constitute securities fraud.”<sup>66</sup> The SEC’s ambiguous response suggested that the possibility exists for implying private causes of action under the regulation.<sup>67</sup>

Alternatively, Alan R. Bromberg and Lewis D. Lowenfels have noted that SROs have issued rules of their own that govern research analysts’ certifications.<sup>68</sup> These rules, the authors assert, are “inextricably intertwined” with the text of section 501(a) and Regulation AC.<sup>69</sup> While not taking a particular position, Bromberg and Lowenfels point out that private actions may be implied from violations of SRO rules.<sup>70</sup> Again, because Congress did not expressly imply a private right of action in section 501(a) of Sarbanes-Oxley, advocates will face similar hurdles in their attempt to establish such a cause of action within the SEC and SRO rules enacted pursuant to section 501(a).

Bromberg and Lowenfels also note that Regulation G, another SEC regulation enacted pursuant to Sarbanes-Oxley, contains language that is more likely to include an implied private right of action than Regulation AC.<sup>71</sup> Regulation G contains language similar to section 10(b) of the Securities Exchange Act.<sup>72</sup> The SEC enacted Regulation G pursuant to section 401(b) of Sarbanes-Oxley, which authorizes rules for the proper presentation of pro-forma financial statements by officers and executives.<sup>73</sup> Section 10(b) of the Securities Exchange Act lays out the elements necessary for a prima facie securities fraud claim. The Supreme Court has interpreted section 10(b) to include an implied private right of action.<sup>74</sup> Thus, among the provisions of Sarbanes-Oxley that have the potential to contain an

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66. *Id.* (quoting Regulation Analyst Certification, *supra* note 4). “[E]ven without Regulation AC, analysts may be found to have violated the anti-fraud provisions of the federal securities laws if they make baseless recommendations that they disbelieve.” *Id.* (quoting Regulation Analyst Certification, *supra* note 4).

67. *Id.*

68. Lowenfels & Bromberg, *supra* note 40, at 799.

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. Section 401(a) requires the SEC to issue rules ensuring that all periodic financial reports filed with the SEC “disclose all material off-balance sheet transactions” that could have a “material current or future effect on financial condition.” See 15 U.S.C. § 78m(j) (Supp. II 2002). Regulation G prevents the public disclosure of financial information that is not calculated in accordance with Generally Accepted Accounting Procedures (“GAAP”) that results in an “untrue statement of a material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading.” 17 C.F.R. § 244.100 (1993).

74. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 13, 13 n.9 (1971) (“It is now established that a private right of action is implied under § 10(b).”).

implied private right of action, Regulation AC is not the strongest contender.

Nevertheless, could either section 501(a) or Regulation AC serve as the basis for an implied private right of action? To fully understand the *Neer* court's denial of this possibility and the need for congressional action, it is important to first understand the evolution of the implied private right of action doctrine.

### III. THE IMPLIED PRIVATE RIGHT OF ACTION DOCTRINE

The Supreme Court has, in rare cases, found a federal statute to allow individuals to use that statute as a basis for a lawsuit, even when the statute does not expressly include that possibility.<sup>75</sup> This practice, however, has fallen out of favor, particularly in the area of securities law—perhaps because Congress has been willing to take stronger remedial action.<sup>76</sup> This section traces the recent history of the implied private right of action doctrine and demonstrates that the so-called “era of contraction” that has progressively limited implied private rights of action will likely continue. Thus, courts acting under instruction from the Supreme Court will be very hesitant to imply private rights of action in the future, including in section 501(a) of Sarbanes-Oxley.

#### A. *CORT V. ASH: ESTABLISHING A FOUR-PART TEST*

In August and September of 1972, an advertisement containing statements made by Stewart S. Cort, Chairman of the Board of Directors of Bethlehem Steel Corp., appeared in *Time*, *Newsweek*, and other national publications, as well as in local newspapers near Bethlehem plants.<sup>77</sup> The advertisement asked voters to form “truth squads” to refute the claim of an unnamed “political candidate” who argued that big business was not paying

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75. See, e.g., *Cannon v. Univ. of Chi.*, 441 U.S. 677 (1979) (holding that Title IX of the Education Amendments of 1972 provides a private cause of action for persons claiming discrimination); *I. Case Co. v. Borak*, 377 U.S. 426 (1964) (holding that the Securities Exchange Act provides a private cause of action for corporate stockholders).

76. In a recent case, Chief Justice Roberts stated:

[M]y suggestion is not that we should go back and say that there is no private right of action. My suggestion is that we should get out of the business of expanding it, because Congress has taken over and is legislating in the area in the way they weren't back when we implied the right of action under 10(b).

Transcript of Oral Argument at 7, *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008) (No. 06-43).

77. *Cort v. Ash*, 422 U.S. 66, 70 (1975).

its fair share of taxes.<sup>78</sup> Bethlehem also reprinted the ads and sent them to stockholders with the company's third-quarter dividend checks.<sup>79</sup>

Richard Ash owned fifty shares of Bethlehem stock.<sup>80</sup> Ash filed a civil suit against Cort in the U.S. District Court for the Eastern District of Pennsylvania.<sup>81</sup> Ash sought private relief under 18 U.S.C. § 610, a criminal statute.<sup>82</sup> Section 610 prohibited corporations from making “a contribution or expenditure in connection with any election at which Presidential and Vice Presidential electors . . . are to be voted for.”<sup>83</sup> The statute did not contain language preventing or sanctioning private remedies for violations of the statute, but it did establish an administrative procedure for submitting complaints of § 610 violations to the Federal Election Commission.<sup>84</sup> Justice Brennan, writing for a unanimous court, held that a private remedy was not implicit in § 610.<sup>85</sup> In reaching his holding, Justice Brennan established four relevant factors for courts to consider in determining whether a statute warrants a private right of action: (1) whether the plaintiff is “one of the class for whose *especial* benefit the statute was enacted”; (2) whether there is evidence of explicit or implicit legislative intent to create a remedy; (3) whether implying a right of action would be “consistent with the underlying purposes of the legislative scheme”; and (4) whether the cause of action is one “traditionally relegated to state law . . . so that it would be inappropriate to infer a right of action based solely on federal law.”<sup>86</sup> Finding that the statute did not fulfill factors two, three, or four, Justice Brennan held that § 610 did not contain an implied private right of action.<sup>87</sup> Justice Brennan established the Supreme Court's initial test for determining the basis for an

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78. *Id.* at 70–71. The advertisement never named a specific candidate or party, but the “complaint in this case alleged that the ‘candidate’ referred to was quite clearly the Democratic candidate for President at the time (George McGovern).” *Id.* at 71 n.2.

79. *Id.*

80. *Id.* at 71.

81. *Id.*

82. *Cort*, 422 U.S. at 71.

83. *Id.* at 68 (quoting 18 U.S.C. § 610 (1970 & Supp. III 1970)).

84. *Id.* at 74–75 (citing 2 U.S.C. § 437g (Supp. IV 1970)).

85. *Id.* at 68–69.

86. *Id.* at 78 (emphasis added) (quoting *Tex. & Pac. R. Co. v. Rigsby*, 241 U.S. 33, 39 (1916) (citations omitted)).

87. *Cort*, 422 U.S. at 79–85. In his opinion, Justice Brennan acknowledged that part of the legislative intent behind § 610 was to protect ordinary stockholders from having their invested funds appropriated for political purposes. But, Justice Brennan wrote, an investigation of the legislative history of the Act:

[D]emonstrates that the protection of ordinary stockholders was at best a secondary concern. Rather, the primary purpose of the . . . Act . . . was to assure that federal elections are “free from the power of money,” to eliminate “the apparent hold on political parties which business interests . . . seek and sometimes obtain by liberal campaign contributions.

*Id.* at 80–82 (quoting *United States v. Auto Workers*, 352 U.S. 567, 574, 576 (1957)).

implied private right of action.<sup>88</sup> It did not take long for the Court to narrow the four factors to one.

B. *NARROWING THE TEST: TOUCHE ROSS, CENTRAL BANK,  
ALEXANDER V. SANDOVAL, AND STONERIDGE*

In determining whether a statute contains an implied private right of action, the Supreme Court in *Touche Ross & Co. v. Redington* collapsed *Cort's* four-part test down to one dispositive question: “whether Congress intended to create, either expressly or by implication, a private cause of action.”<sup>89</sup> The Court applied this modified analysis again in *Central Bank of Denver v. First Interstate Bank of Denver*.<sup>90</sup> Then in *Alexander v. Sandoval*, the Court completely eliminated any potential for analyzing anything other than whether Congress intended to imply a private right of action.<sup>91</sup> Recently, in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*,<sup>92</sup> the Court reaffirmed *Sandoval's* narrow approach by refusing to expand an existing implied private right of action in the area of private securities litigation.

1. *Touche Ross & Co. v. Redington*

Touche Ross & Co., an accounting firm, audited the books of Weis Securities, Inc. (“Weis”) from 1969 to 1973.<sup>93</sup> In May 1973, the SEC and the NYSE learned that Weis was on the brink of insolvency.<sup>94</sup> The U.S. District Court for the Southern District of New York granted a decree for the Securities Investor Protection Corporation (“SIPC”), declaring that Weis’s investors were eligible for protection under the Securities Investor Protection Act (“SIPA”).<sup>95</sup> The district court appointed Edward S. Redington to act as trustee to liquidate Weis pursuant to SIPA.<sup>96</sup>

Weis’s liquidated assets could not meet the obligations of the customers who had remained with the company.<sup>97</sup> “Despite a \$14 million advance from SIPC” to satisfy a limited number of customer and creditor claims, several

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88. *See id.* at 78 (outlining the relevant factors in determining whether an implied right of action exists).

89. *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575 (1978).

90. *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 174–76 (1994).

91. *Alexander v. Sandoval*, 532 U.S. 275, 287 (2001) (“Having sworn off the habit of venturing beyond Congress’s intent [in determining whether to imply a private right of action], we will not accept respondents’ invitation to have one last drink.”).

92. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008).

93. *Touche Ross*, 442 U.S. at 563.

94. *Id.* at 564.

95. *Id.* The court explained: “SIPC is a nonprofit organization of securities dealers established by Congress in 1970 in the Securities Investor Protection Act. . . . SIPA also provides procedures for the liquidation of brokerage firms when required.” *Id.* at 565 n.5 (citing 15 U.S.C. §§ 78ccc, 78fff).

96. *Id.* at 565.

97. *Id.* at 564.

million dollars of unmet obligations to customers remained.<sup>98</sup> As a result, SIPC and Redington filed a civil action for \$51 million under section 17(a) of the Securities Exchange Act against Touche Ross.<sup>99</sup> The complaint alleged that Weis officers falsified financial reports to conceal substantial financial losses.<sup>100</sup> The complaint further alleged that, due to Touche Ross's improper audit, customers could not know the true financial condition of the company until it was too late to "lessen the adverse financial consequences of such a liquidation to the Weis customers."<sup>101</sup>

Writing for the majority, Chief Justice Rehnquist narrowed the four-factor *Cort* test to three factors: the "language and focus of the statute, its legislative history, and its purpose."<sup>102</sup> Of the three factors, Justice Rehnquist held that the "central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action."<sup>103</sup> After making that inquiry, the Court determined that there was no implied private right of action in section 17(a).<sup>104</sup> Further, the Court rejected Redington's argument that the Court should infer a private right of action based on the lack of congressional intent to deny one.<sup>105</sup> Commentators have suggested that this holding strengthened the Supreme Court's focus on legislative intent in examining federal securities laws for implied private rights of action.<sup>106</sup>

## 2. *Central Bank of Denver v. First Interstate Bank of Denver*

In *Central Bank*, the Supreme Court again denied that an implied private right of action existed in federal securities law.<sup>107</sup> The rationale for the holding reaffirmed the Court's emphasis on legislative intent in *Touche Ross*, albeit to a lesser extent.<sup>108</sup> In *Central Bank*, the Colorado Springs–

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98. *Touche Ross*, 442 U.S. at 565 & n.6 ("The Weis customer accounts were protected by SIPA up to a maximum of \$50,000 for each customer, except that cash claims were limited to \$20,000.").

99. *Id.* at 565–66.

100. *Id.* at 565.

101. *Id.* at 566.

102. *Id.* at 575–76.

103. *Touche Ross*, 442 U.S. at 575.

104. *Id.* at 569. The Court found that the "[legislative] intent of § 17(a) is evident from its face," concluding that the language of the statute is like "countless other statutes that simply require certain regulated businesses to keep records and file periodic reports to enable the government authorities to perform their regulatory functions." Specifically, the Court noted that "[t]he information contained in the § 17(a) [required company] reports is intended to provide the [SEC], the [NYSE], and other authorities with a sufficiently early warning to enable them to take appropriate action to protect investors before the financial collapse of the particular broker-dealer involved," and that "there is no basis in the language of § 17(a) for inferring that a civil cause of action for damages lay in favor of anyone." *Id.* at 569–71.

105. *Id.* ("[I]mplying a private right of action on the basis of congressional silence is a hazardous enterprise, at best.") (citing *Santa Clara Pueblo v. Martinez*, 436 U.S. 49, 64 (1978)).

106. Lowenfels & Bromberg, *supra* note 40, at 778.

107. *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 185 (1994).

108. *Id.* at 184, 190.

Stetson Hills Public Building Authority (“Authority”) made a multi-million dollar bond issue to finance public improvements in a local residential and commercial real-estate development.<sup>109</sup> Central Bank of Denver served as the indenture trustee for the bond issues.<sup>110</sup> Believing that real-estate prices had dropped, Central Bank sought an outside appraiser to review the value of the land to ensure that Central Bank would meet the 160% threshold value of the bonds’ outstanding principal and interest.<sup>111</sup> After communicating with real-estate developer AmWest, Central Bank agreed to delay scheduling the outside appraisal until six months after the closing of the bond issue.<sup>112</sup> Before the appraisal was complete, however, the Authority defaulted on the bonds.<sup>113</sup>

First Interstate Bank of Denver, a major purchaser of the bond issue, sued Central Bank under section 10(b) of the Securities Exchange Act for “aiding and abetting the fraud.”<sup>114</sup> Looking to the legislative history of the Act, the Court acknowledged that the express provisions of the Act enable private plaintiffs to sue alleged perpetrators of securities fraud.<sup>115</sup> However, concentrating on the text of the statute, the Court refused to find a basis for an implied private right of action for aiding and abetting under section 10(b):

Adherence to the text in defining the conduct covered by § 10(b) is consistent with our decisions interpreting other provisions of the securities Acts. In *Pinter v. Dahl*, for example, we interpreted the word “seller” in § 12(1) of the 1933 Act by “look[ing] first at the language of § 12(1).” . . . We found “no support in the statutory language or legislative history for expansion of § 12(1),” and stated that “[t]he ascertainment of congressional intent with respect to the scope of liability created by a particular section of the Securities

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109. *Id.* at 167.

110. *Id.*

111. *Id.*

112. *Cent. Bank*, 511 U.S. at 168.

113. *Id.*

114. *Id.* (citing App. 26).

115. *Id.* at 171–72. The Court cited 17 C.F.R. § 240.10b-5 (1993):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

*Id.*

Act must rest primarily on the language of that section.” . . . Our consideration of statutory duties, especially in cases interpreting § 10(b), establishes that the statutory text controls the definition of conduct covered by § 10(b).<sup>116</sup>

Having reaffirmed the importance of statutory language in discerning the existence of an implied private right of action in *Central Bank*, the Court took its analysis a step further in *Alexander v. Sandoval*.<sup>117</sup>

### 3. *Alexander v. Sandoval*

In a five to four decision, the Court in *Alexander v. Sandoval* held that the discriminatory-impact provision of Title VI of the Civil Rights Act of 1964 contained no implied private right of action.<sup>118</sup> In that case, the plaintiff alleged that Alabama’s policy of administering drivers’ license exams only in English had a discriminatory impact on non-English speakers based on their national origin.<sup>119</sup> As a recipient of financial assistance from both the U.S. Departments of Justice and Transportation, Title VI applied to the Alabama Department of Public Safety.<sup>120</sup> Writing for the Court, Justice Scalia asserted that “[w]ithout [statutory intent], a right of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute.”<sup>121</sup> Finding no statutory intent in the text or structure of section 602 of Title VI, and holding that no further inquiry was necessary,<sup>122</sup> the Court refused to imply a private right of action.<sup>123</sup>

By focusing Justice Brennan’s original four-part test in *Cort* on the question of whether Congress intended for a statute to serve as a basis for an implied private right of action, the Court narrowed the possibilities for that doctrine’s application.

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116. Lowenfels & Bromberg, *supra* note 40, at 778 (internal citations omitted) (citing *Cent. Bank*, 511 U.S. at 174–76). For a critical commentary of the Court’s opinion in *Central Bank*, see Joseph F. Morrissey, *Catching the Culprits: Is Sarbanes-Oxley Enough?*, 2003 COLUM. BUS. L. REV. 801, 815–20 (2003) (arguing that the Court’s primary rationale that the plain language of the Securities Exchange Act of 1934 did not authorize aiding-and-abetting causes of action is unpersuasive given that courts find implied private causes of action for section 10(b) absent explicit textual authority).

117. *Alexander v. Sandoval*, 532 U.S. 275 (2001).

118. *Id.* at 289 (“So far as we can tell, this authorizing portion of § 602 reveals no congressional intent to create a private right of action.”).

119. *Id.* at 279.

120. *Id.* at 278.

121. *Id.* at 286–87.

122. *Alexander*, 532 U.S. at 288 (“We therefore begin (and find that we can end) our search for Congress’s intent with the text and structure of Title VI.”).

123. *Id.* at 288–91.

4. *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*

On January 15, 2008, the Supreme Court handed down its opinion in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.* In that case, the plaintiff, Stoneridge Investment Partners, sued on behalf of purchasers of defendant Charter Communications, Inc. stock under the fraud provisions of section 10(b) of the Securities Exchange Act and SEC Rule 10b-5.<sup>124</sup> The Supreme Court has previously implied a private right of action in the fraud provision of Securities Exchange Act section 10(b).<sup>125</sup> The *Central Bank* decision subsequently truncated that right of action.<sup>126</sup> Prior to the opinion, scholars had labeled *Stoneridge* “the most important securities [] case . . . in a decade”<sup>127</sup> because of its potential for expanding the scope of the section 10(b) fraud provision—allowing investors to sue not only a fraudulent actor, but also those entities who knowingly aided and abetted the fraud. Importantly for the conclusion of this Note, the *Stoneridge* opinion also pushed the implied private right of action doctrine further into the era of contraction.<sup>128</sup>

In *Stoneridge*, the plaintiffs alleged that between late 1999 and mid-2002, Charter defrauded investors to boost the company’s profitability through three activities: (1) delaying the disconnecting of customers no longer paying their bills; (2) manipulating labor costs; and (3) entering into sham transactions with two equipment vendors of Charter.<sup>129</sup> With regard to sham-vendor transactions, the district court threw out Stoneridge’s claims against the two vendors (Scientific-Atlanta, Inc. and Motorola, Inc.) because the vendors did not make any misstatements to the market and were merely a part of the fraudulent scheme.<sup>130</sup> The Eighth Circuit affirmed, and the Supreme Court granted certiorari to determine whether the vendors could be liable to Charter investors for transactions with Charter that ultimately led to Charter’s fraudulent behavior, because the vendors knew or should have known that Charter would use the transaction to engage in such fraud.<sup>131</sup>

The Supreme Court, in a five to three decision, determined that section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 did not imply a

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124. *In re Charter Commc’ns, Inc., Sec. Litig.*, 443 F.3d 987, 991 (8th Cir. 2006).

125. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 & n.9 (1971) (citing *Shell v. Hensley*, 430 F.2d 819, 827 (5th Cir. 1970)).

126. *See supra* Part III.B.2 (discussing the *Central Bank* holding).

127. Barbara Black, *Stoneridge Investment Partners v. Scientific-Atlanta (8th Cir. 2006) What Makes It the Most Important Securities Case in a Decade?* 1 (Univ. of Cincinnati Coll. of Law, Working Paper No. 07-21, 2007), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1020102](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1020102).

128. *See id.* (explaining that the plaintiff’s theory would expand the liability of “outside actors”).

129. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 766 (2008).

130. *Id.* at 767.

131. *Id.*

private right of action against Charter's vendors because Charter's investors did not rely on the vendors' actions in purchasing Charter stock.<sup>132</sup> Importantly for this Note, the Court stated in dicta that "it is settled that there is an implied cause of action only if the underlying statute can be interpreted to disclose the intent to create one."<sup>133</sup> In refusing to expand section 10(b)'s implied private right of action, the Court reaffirmed its reluctance to imply private rights of action in general. While not a further constriction of the doctrine of implied private rights of action, *Stoneridge* represents a continuation of the era of contraction and an affirmation of *Sandoval*. In the wake of *Stoneridge*, it is unlikely that courts will imply a private right of action in section 501(a) of Sarbanes-Oxley.

#### IV. AN IMPLIED PRIVATE RIGHT OF ACTION DOES NOT EXIST IN SECTION 501(A) OF SARBANES-OXLEY

##### A. NEER V. PELINO: NO IMPLIED RIGHT OF ACTION EXISTS IN SECTION 304 OF SARBANES-OXLEY

*Neer v. Pelino*, a case from the U.S. District Court for the Eastern district of Pennsylvania, severely weakened the argument for finding a private right of action in Section 501(a) of Sarbanes-Oxley.<sup>134</sup> By analogizing section 304 of Sarbanes-Oxley to section 501(a), courts will likely apply the same reasoning that the court applied in *Neer* and deny plaintiffs the opportunity to use section 501(a) as a basis for claiming an implied private right of action.

As the *Neer* court noted in its opinion, section 304 of Sarbanes-Oxley "provides for forfeiture of certain bonuses and profits by CEOs and CFOs when a restatement is required due to [a securities] issuer's noncompliance with any financial reporting requirements of the securities law, if the noncompliance arises from misconduct."<sup>135</sup> Like section 501(a), section 304 does not expressly provide for a private right of action.<sup>136</sup>

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132. *Id.*

133. *Id.* at 772.

134. *Neer v. Pelino*, 389 F. Supp. 2d 648 (E.D. Pa. 2005). In *Neer*, the plaintiff sued defendants Pelino and Crain for violating section 304 of Sarbanes-Oxley. *Id.* The defendants were the former CEO and CFO, respectively, of Stonepath Corporation. *Id.* at 651 n.6. Stonepath issued financial restatements that revealed significant decreases in net income for the preceding quarters. *Id.* at 650. *Neer* has subsequently been cited with approval by two Ninth Circuit district courts. *In re Digimarc Corp. Derivative Litig.*, No. 05-1324-HA, 2006 U.S. Dist. LEXIS 56134, at \*5-6 (D. Or. Aug. 11, 2006); *Kogan v. Robinson*, 432 F. Supp. 2d 1075, 1078 (S.D. Cal. 2006).

135. *Neer*, 389 F. Supp. 2d at 651-52. Section 304 reads in full:

Forfeiture of certain bonuses and profits

(a) Additional compensation prior to noncompliance with commission financial reporting requirements. If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of

In reaching its holding, the court in *Neer* first reasoned that because Congress chose to treat enforcement rights differently throughout Sarbanes-Oxley, the Act's general enforcement provision was not dispositive in determining what Congress intended regarding section 304's enforcement, or that of other individual sections in the Act.<sup>137</sup> Next, the court turned to the *Cort* test and concluded that the Supreme Court limited *Cort* to a question of congressional intent when looking to imply a private right of action.<sup>138</sup> Following the Supreme Court's direction in *Alexander*, the *Neer* court ascertained congressional intent by first looking at the text and structure of Sarbanes-Oxley.<sup>139</sup>

The court addressed two textual arguments. First, the plaintiff contended that because section 304 created a reimbursement benefit for issuers to indemnify for wrongly obtained officers' proceeds, that benefit must have created a right that Congress intended for private plaintiffs to enforce in court.<sup>140</sup> The court acknowledged that Congress had created a remedy that would indirectly benefit wronged shareholders.<sup>141</sup> However, the court concluded that because Congress did not include a private remedy to accompany the benefit to injured parties for indirect recovery, congressional

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misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer for—

(1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement; and

(2) any profits realized from the sale of securities of the issuer during that 12-month period.

(b) Commission exemption authority. The Commission may exempt any person from the application of subsection (a), as it deems necessary and appropriate.

15 U.S.C. § 7243 (Supp. II 2002).

136. *Neer*, 389 F. Supp. 2d at 652.

137. *Id.* at 652 n.7. The general enforcement provision of Sarbanes-Oxley states:

“A violation by any person of this Act, any rule or regulation of the Commission issued under this Act, or any rule of the Board shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or the rules and regulations issued thereunder, consistent with the provisions of this Act, and any such person shall be subject to the same penalties, and to the same extent, as for a violation of that Act or such rules or regulations.”

*Id.* (quoting 15 U.S.C. § 7202(b)(1) (2002)).

138. *Id.* at 653 (citing *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575 (1979)).

139. *Id.* at 653–55.

140. *Id.*

141. *Neer*, 389 F. Supp. 2d at 653–54.

intent to create an implied private right of action was not evident in the text of section 304.<sup>142</sup>

The plaintiff's next argument rested on the part of section 304 that allowed the SEC to exempt a CEO or CFO from repaying wrongly obtained payouts when appropriate.<sup>143</sup> The plaintiff argued that the text of this section would be unnecessary unless Congress had contemplated someone other than the SEC initiating the action.<sup>144</sup> In other words, Congress must have contemplated a scenario where, after a private party brought a suit against the offending officers, the SEC would make a determination about whether the officers would be exempt.<sup>145</sup>

The court disagreed and found two plausible explanations for the provision. First, the court reasoned that because Congress did not give guidance as to how the exemption determinations would be made or whether they would be mandatory, congressional intent to create an implied private right of action was not clear.<sup>146</sup> Second, because one could interpret the provision as merely giving the SEC discretion to consider factors when deciding on an exemption, the section should not be read as implying a private right of action.<sup>147</sup>

Turning next to the Act as a whole, the court noted that Congress explicitly created a private right of action in section 306 of Sarbanes-Oxley.<sup>148</sup> Section 306 prohibits insider trading by officers or directors of shares acquired in connection with their employment during "fund blackout periods."<sup>149</sup> Pension-fund blackout periods often occur when a company retirement-plan fund changes its management, or when the fund itself is involved in a merger.<sup>150</sup> The court noted that both sections 304 and 306 involve the wrongdoings of officers, and both provide for the issuer's

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142. *Id.* (citing *Gonzaga Univ. v. Doe*, 536 U.S. 273, 284 (2002)).

143. *Id.* at 654.

144. *Id.*

145. *Id.*

146. *Neer*, 389 F. Supp. 2d at 654.

147. *Id.*

148. *Id.*

149. *Id.* (citing 15 U.S.C. § 7244(a) (2002)).

150. Defined in 17 C.F.R. § 245.100, blackout periods are:

[A]ny period of more than three consecutive business days during which the ability to purchase, sell or otherwise acquire or transfer an interest in any equity security of such issuer held in an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan with respect to not fewer than 50% of the participants or beneficiaries located in the United States and its territories and possessions under all individual account plans . . . maintained by the issuer that permit participants or beneficiaries to acquire or hold equity securities of the issuer.

17 C.F.R. § 245.100(b)(1) (2007).

reimbursement.<sup>151</sup> Because Congress expressly provided for a private damages remedy in section 306 but elected not to in section 304, the court held that Congress did not intend for courts to imply a private right of action for violations stemming from section 304.<sup>152</sup>

Finally, the *Neer* court tentatively commenced to examine the legislative history of section 304 for evidence of congressional intent.<sup>153</sup> The court summarily dismissed any evidence of legislative intent to create a private right of action in the legislative history of section 304, stating that “one point is clear: neither supporters nor opponents of the House draft wanted to give private parties the right to seek disgorgement under this provision. The House Report thus reflects a consensus that the SEC alone would have the right to seek disgorgement.”<sup>154</sup>

Section 501(a) is unlike section 304 in that it is not directly preceded or followed by a provision that expressly provides for a private right of action (thus providing direct relief for its lack of a private remedy). However, based on the stringent requirements for a court to imply a private right of action, section 501(a) will likely not be found to contain one.<sup>155</sup>

*B. APPLYING NEER: NO IMPLIED PRIVATE RIGHT OF ACTION IN SECTION 501(A)*

Following the *Neer* court’s analysis, an initial look at the text of section 501(a) demonstrates that Congress did not specifically create a remedy for violations of that section. Thus, a plaintiff could not argue (as the plaintiff in *Neer* unsuccessfully argued) that a remedy exists for private parties. In fact,

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151. *Neer*, 389 F. Supp. 2d at 655.

152. *Id.*

153. *Id.* at 655 & n.10 (agreeing generally with Justice Scalia’s skepticism about inquiring into the legislative history of an act). The court goes on to quote Justice Scalia’s description of using legislative history as “the equivalent of entering a crowded cocktail party and looking over the heads of the guests for one’s friends.” *Id.* (quoting *Conroy v. Aniskoff*, 507 U.S. 511, 519 (1993) (Scalia, J., concurring)).

154. *Id.* at 657. The court reviewed H.R. REP. NO. 107-414 (2002), which required the SEC to analyze whether any officer or director should be required to disgorge funds during the six months preceding the filing of a restatement, and compared it with the minority view in the same report. *Id.* at 656 & n.11. The minority asked the majority to “act quickly to provide the SEC with the power to require disgorgement of compensation in an administrative proceeding.” *Id.* at 656–57.

155. *Cf.* N. Henry Simpson et al., *After the Fall: The Sarbanes-Oxley Act of 2002, Part Two*, TEX. B.J., Apr. 2003, at 316, 322 (arguing that because section 804(c) of Sarbanes-Oxley provides that “[n]othing in this section shall create a new, private right of action,” not only does that language acknowledge a private right of action for violation of the securities laws, but the phrase “nothing in this section” could mean that the language denying the creation of a new private right of action applies *only to the provisions that expressly include that language*). However, the article acknowledges that “Rule 205.7(a) states that nothing contained in Section 307 ‘is intended to . . . create a private right of action,’” and that Congress consistently included provisions entitled “Enforcement,” two facts which point to congressional intent for SEC enforcement and not actions by plaintiffs’ attorneys. *Id.*

section 501(a) does not include any language indicating Congress's intent for the SEC or the courts to imply a private right of action.

Looking to the structure of the Act as a whole, a court would likely conclude that because Congress expressly denied an implied private right of action in other sections of the Act, and explicitly created a private right of action in sections 306 and 806(a) (the whistleblower provision), congressional silence about private enforcement of section 501(a) and Regulation AC effectively precludes the possibility of using section 501(a) as the basis for an implied private right of action.<sup>156</sup>

Because there is likely no implied private right of action for investors to sue analysts who fail to disclose their own conflicts of interest in Sarbanes-Oxley, Congress should instead create an express private right of action that would hold analysts and their employers liable for failing to disclose conflicts of interest.

#### V. CONGRESS SHOULD CREATE AN EXPRESS PRIVATE RIGHT OF ACTION FOR INVESTORS HARMED BY MATERIAL ANALYST NONDISCLOSURE

Analysts face pressure from their employers, their clients, and their own self-interests. Section 501(a) of Sarbanes-Oxley and Regulation AC do not completely eliminate the pressures that analysts face. Shunting investment banker influence on securities analysts may help to remedy the business interests identified by Fisch and Sale.<sup>157</sup> Yet, these enhanced requirements only have a limited effect, if any, on ownership and access interests that analysts face.

The creation of an express private right of action for investors to sue for a material nondisclosure will not completely eliminate the pervasive pressure felt by analysts from business and access interests. Yet, an express cause of action would be a great deterrent because of the potentially high cost to the analyst relative to the potential gain from nondisclosure.<sup>158</sup> This action would also encourage analysts to be highly diligent in their search to disclose even the appearance of a conflict of interest—whether or not the analyst was aware of the potential conflict when writing the research report.<sup>159</sup>

An express cause of action for analyst nondisclosure would work well in tandem with the Securities Exchange Commission Analyst Website

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156. See *supra* note 152 and accompanying text.

157. See *supra* notes 27–33 and accompanying text.

158. James D. Cox, *Private Litigation and the Deterrence of Corporate Misconduct*, 60 LAW & CONTEMP. PROBS. 1, Autumn 1997, at 2 (“Assuming the entity and its agents are rational economic actors, misbehavior will occur only when its expected utility exceeds the disutility of its accompanying punishment. Central variables to this equation are the size of the fine and the joint probabilities of detection, prosecution, and conviction for the violation.”).

159. See Coffee, *supra* note 18, at 318 (offering “general undeterrence” as a partial explanation for why gatekeepers such as securities analysts and auditors failed to detect Enron’s desperate financial situation).

(“SECAW”) that Fisch has recently proposed.<sup>160</sup> In her Article, Fisch proposes an alternative regulatory regime in which the SEC requires analysts to register and publish their conflicts of interest in an online database.<sup>161</sup> This, she argues, would enhance disclosure and allow for increased funding for analyst research.<sup>162</sup> By disclosing the conflicts of interest, the market could efficiently respond to an analyst’s recommendation, and firms would increase funding for analyst research to benefit the public.<sup>163</sup> Analysts could then be given a safe harbor from private litigation based on their conflicts of interest.<sup>164</sup>

Emphasizing disclosure backed by the heavy stick of private litigation for fraud addresses two important market realities. First, markets are efficient in discounting a recommendation that has been colored by interested funding or other conflicts. Second, while this Note has focused on shareholders defrauded by nondisclosure, those shareholders are not harmed in a vacuum. When an analyst influences the market perception about one stock, that perception feeds back into the prices of competitor stocks, the sector, and the market as a whole. Thus, maximizing the availability of information through disclosure promotes efficient pricing for more than just the subject company’s stock.

## VI. CONCLUSION

Section 501(a) does not expressly provide a means of enforcing its terms, nor does Regulation AC. The era of contraction in the doctrine of implied private rights of action has resulted in a set of stringent requirements necessary for a court to imply one. It is unlikely that courts will imply a private right of action in section 501(a), especially given the lack of clear legislative intent. Yet, securities analysts play an essential role in ensuring that investors are not defrauded by misleading information about the prospects of their subject companies. The proper safeguard to promote investor confidence is for analysts to maximize disclosure of their potential conflicts of interest. Analysts are paid by individual employers who rationally seek to protect their own interests, but investor confidence in the stock market rests heavily on understanding whether an analyst has a conflict of interest regarding his or her recommendations. Pressures on analysts create a moral hazard that they will help their employers (or themselves) at the

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160. Jill Fisch, *Does Analyst Independence Sell Investors Short?*, 55 UCLA L. REV. 39, 88–89 (2007).

161. *Id.*

162. *Id.* at 90–91.

163. *See id.* at 72–83 (describing how recent reforms have limited available research for many market segments).

164. *See id.* at 96 (suggesting that one way to “increase analyst incentives for candor on SECAW would be to establish a safe harbor from fraud liability for information that is properly disclosed”).

expense of individual investors. The current rules that require analysts to disclose conflicts of interest would have a greater effect if Congress created an express private right of action for investors to seek redress against analysts who fail to disclose a conflict.