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Regulation X: A Complexis

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I. Introduction

Until recently the margin prohibitions of the Securities Exchange Act of 1934 were addressed exclusively to those who extended credit in securities transactions. No responsibilities or restrictions were imposed upon the private borrower. Therefore, in any transaction in which credit for the purchase of securities was extended, the lender had the burden of observing margin requirements. Although the Securities Act provides only for publicly enforced sanctions, courts have found lenders liable in private actions for damages suffered by borrowers in illegal transactions.

In 1971, however, Congress passed legislation prohibiting the borrower from accepting illegal credit. This legislation was implemented through the Federal Reserve Board which promulgated Regulation X. Because both the borrower and lender now have the burden of observing margin regulations, private actions have changed drastically.

This note analyzes the private actions brought by borrowing investors against lenders for losses incurred in illegal transactions in light of the new legislation and regulation. This will be done by discussing the particular types of actions which could have been brought by borrowers before the issuance of Regulation X and the expected effect of the Regulation upon each. It is necessary initially to discuss the reasoning behind margin provisions generally and to define the transactions subject to regulation.

II. Purposes of Margin Control

Section 7 of the Securities Exchange Act first imposed Congressional control on securities credit. It directed that:

for the purpose of preventing the excessive use of credits for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall, . . . prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security (other than an exempted security).

It is important to note that the Act was promulgated in response to the stock market crash of 1929 and the Great Depression that followed. Regulation of margin transactions was one attempt to deal with these two events and also provide continuing control in three distinct areas.

National credit supply, and in a large sense overall monetary policy, was the foremost consideration in both the original legislation and today's provisions.
The Federal Reserve can control the economy's supply of money by regulating the amount of credit available. Margin buying, as a type of credit transaction, has an effect upon overall money availability and particularly upon the money available for businesses with widespread ownership. Regulation of margin also can be used to direct the use of credit into particular sectors of the economy. Loosening margin requirements directs more money towards business and tightening them frees money for other uses. More importantly, stock market fluctuations bring about abrupt changes in the amount of credit demanded by investors. Such changes, which have a volatile effect on the monetary system, can be reduced by limiting the amount of credit available. Furthermore, transactions involving a great amount of credit have been criticized as responsible for the explosive nature of stock market fluctuations.

Controls also serve to protect the financial community. The brokers able to secure the greatest financing attract many customers. However, high leverage financing in a fast-moving market frequently results in substantial difficulties for borrowers. As stock values fall, brokers make margin calls and those who have margined heavily often decide to do one of two things. They either sell the stock themselves, thus depressing the market even further to the detriment of the investment community, or they fail to meet the margin call and the broker sells out their accounts with debit balances remaining. Brokers are often unable to collect the balances and find themselves in financial difficulties. This problem is obviated not only by Federal Reserve Board requirements of sufficient margin upon initial purchase but also by "maintenance margins" which are demanded by the stock exchanges.6

Finally, protection of the borrower himself must be given consideration. The economically weak and those not sophisticated in securities trading are prevalent margin borrowers. They find it necessary to sell as soon as the market goes down and, in depressing the market, force their remaining collateral into jeopardy. Upon receiving a margin call that they cannot meet, they soon find themselves outside the securities market altogether and much poorer for the experience.7 By forcing all investors to be margined sufficiently to weather small storms, the regulations can save them from their own weaknesses.

III. Regulations on Securities Credit

The Board of Governors of the Federal Reserve System has promulgated several regulations in order to effectuate the considerations discussed above. Regulation T8 determines the initial minimum margin requirements that brokers and dealers9 may extend to their customers. Most of these credit transactions take place through either the customer's general account or special cash

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7 Congress recognized that "protection of the small speculator by making it impossible for him to spread himself too thin ... will be achieved as a by-product of the main purpose." H.R. REP. No. 1383, 73rd Cong., 2d Sess. (1934).
9 Regulation T applies to all brokers and dealers as defined in sections 3(a), (4) and (5) of the 1934 Act. 15 U.S.C. 78c(a) (4) and (5) (1971).
Section 3 of the Regulation prohibits a creditor from effecting for any customer with a general account any transaction which creates an excess of credit over the maximum value of the securities unless, within five business days following the transaction, the account is "brought up" to the current margin requirements. If the creditor fails to do so, the broker or dealer must immediately cancel the transaction by selling the securities which are undermargined or obtain an extension of time from the Securities and Exchange Commission (SEC) in which to qualify with the margin requirements. Cash transactions handled in a special cash account must be paid within seven business days after the transaction. However, if payment is to be made against the delivery of the security by the broker, he may extend the period to thirty-five days. In either case if the account is not paid within the required time, the broker must "promptly cancel or otherwise liquidate the transaction or the unsettled portion thereof." The broker's failure to comply with any of the provisions of this Regulation constitutes a violation of § 7 of the Act.

Regulation U applies to all banks. A loan comes within its proscriptions if it is for the purpose of purchasing or "carrying" specified types of equity securities and has as collateral some kind of stock. "Carrying" is defined as encompassing a loan made "for the purpose of reducing or retiring indebtedness incurred to purchase that stock." The Regulation provides: "No bank shall make any loan secured directly or indirectly by any stock for the purpose of purchasing or carrying any margin stock in an amount exceeding the maximum loan value of the collateral." Thus, banks are subject to controls similar to those of brokers under Regulation T. However, since a bank creditor must ordinarily obtain collateral for a loan before or at the time he makes the loan, no general liquidation provision applies to banks.

Regulation G was promulgated in 1969 to cover all other domestic lenders. Regulation G requires registration of every person who in the regular

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10 A customer who has a general account buys stock on credit. He pays only part of the purchase price in cash and receives an extension of credit for an indefinite period from the broker for the balance. A special cash account also involves credit, but is set up by a broker upon the reliance that the customer will make full cash payment for securities within a short time. See 2 L. Loss, Securities Regulation, 1248-56 (2d ed. 1961) [hereinafter cited as Loss].

11 12 C.F.R. § 220.3 (a) (1973):

"All financial relations between a creditor and a customer, . . . shall be included in and be deemed to be part of the customer's general account with the creditor, except that the relations which § 220.4 permits to be included in any special account provided for by that section may be included in the appropriate special account . . . ."

12 12 C.F.R. § 220.3(b) (1973).

13 12 C.F.R. § 220.3(c) (1973).

14 12 C.F.R. § 220.4(c) (1973). Although a broker or dealer may set up other types of special accounts for customers, most margin transactions take place in the general and special cash accounts. See 2 Loss at 1248-49.

15 12 C.F.R. § 220.3(f) (1973).

16 12 C.F.R. § 220.4(c) (2) (1973).

17 12 C.F.R. § 221.1(a) (1973).

18 12 C.F.R. § 221.5(b) (1973).

19 12 C.F.R. § 221.1(a) (1973). The loan value is prescribed from time to time at 12 C.F.R. § 221.4 (1973).


21 A good summary of the history of securities credit regulation and its status as of 1971 is found in Soloman & Hart, Recent Developments in the Regulation of Securities Credit, 20 J. Pubs. L. 167 (1971) [hereinafter cited as Soloman & Hart].
course of business during any calendar quarter extends or arranges for extension of $50,000 or more in credit, or has outstanding at any time during the calendar quarter $100,000 or more, secured directly or indirectly, in whole or part, by collateral that includes margin securities. These registrants then become subject to general requirements similar to those provided by Regulation U. The Board intended through this measure to treat similarly all persons who extend credit for the purchase of securities in the ordinary course of their business.

Most recently Congress has become concerned with the control of the foreign lender. Section 7 of the 1934 Act is silent on the matter of credit extended by those outside the United States. Nevertheless, some past cases implied that if the effect of the transaction is felt in the United States, then the Act applied to the transaction. However, in a more recent case, Metro-Goldwin-Mayer, Inc. v. Transamerica Corporation, it was held that Regulations U and G did not apply to foreign lenders. In response to cases such as this, Congress passed Title III of the Bank Records and Foreign Transactions Act of 1970, amending § 7 of the Securities Act of 1934. The amendment forbids:

any United States person, or any foreign person, or any foreign person controlled by a United States person ... to obtain, receive, or enjoy the beneficial use of a loan ... from any lender for the purpose of (A) purchasing or carrying within the United States of any other securities, if, ... the loan ... is prohibited or would be prohibited if it had been made or the transaction had otherwise occurred in a lender's office or other place of business in a state.

In effect, Congress determined that the only way to control foreign lenders was to control the United States borrower. The legislation applies to all domestic transactions and holds the borrower equally responsible with the lender for any violation.

22 12 C.F.R. § 207.1(a) (1973).
23 See Soloman & Hart at 202-11.
25 See Roth v. Fund of Funds, Ltd., 279 F. Supp. 935 (S.D.N.Y. 1968), aff'd 405 F.2d 421 (2d Cir. 1968), cert. denied, 394 U.S. 975 (1969). A foreign-based mutual fund was held to be transacting business in securities in the United States and was found liable for violations of the 1934 Act. Id.
28 When foreign financial secrecy is imposed upon the natural complexity of some of these transactions, it is virtually impossible for the Securities and Exchange Commission to know whether any laws are being violated. Moreover, the Securities Exchange Act of 1934 is primarily a disclosure act and, with foreign financial secrecy, there can be no full disclosure. This legislation will remedy much of this problem by extending the applicability of margin requirements under section 7 of the Securities Exchange Act to the purchases of stock as well as to broker-dealers and financial institutions which lend money for that purpose. H.R. REP. No. 975, 91st Cong., 2d Sess. (1956).

The legislative history of this amendment has been reviewed by other writers. Soloman & Hart, supra note 21, state that the committee reports express concern about the potentially destabilizing effect of foreign credit on the domestic securities markets, and that the application of margin requirements to United States borrowers is to prevent this. Id. at 210.

In a note it was concluded that both the House and Senate committees were primarily concerned with secret foreign credit, its use in criminal activities, and its possible destabilizing effect on the securities market. Regulation X and Investor-Lender Margin Violation Disputes, 57 MINN. L. REV. 206, 219-20 (1972). Nothing significant has been found that shows congressional considerations of the effect of the amendment upon § 7 which deals with domestic policies.
As did § 7 of the 1934 Act, Title III of the Bank Records Act delegated to the Federal Reserve Board the responsibility of promulgating regulations to execute the legislation. Regulation X was issued for this purpose. Its stated purpose is to prevent the infusion into the securities markets of unregulated credit obtained either outside or within the United States by borrowers attempting to intentionally and wilfully circumvent the provisions of margin regulations. Although the legislation provides that the Federal Reserve Board may exempt any class of borrowers from the requirements, the Board declined to designate such a class. Therefore, the Regulation applies to all domestic borrowers as well as United States persons outside the United States. In essence it requires that the borrower of domestic credit from T, G, or U lenders conform to the respective regulations under which the lenders come and that the same requirements apply to credit received from outside the United States. However, the regulation provides that good-faith mistakes by borrowers in obtaining credit will not be deemed to be a violation in the event that reasonable remedial action is taken upon discovery of the violation.

IV. Public Enforcement of the Regulations

Although margin regulations are promulgated by the Federal Reserve Board, enforcement is delegated to the Securities and Exchange Commission. The SEC has chosen to do this through several alternative punitive actions which may be taken against violators. The Commission may transmit evidence of violations of margin regulations to the Attorney General's office where criminal prosecution may be instituted. Injunctions for violations may be issued as may be writs of mandamus. Under certain circumstances the SEC may also suspend or revoke the registration of any dealer or broker if it determines that doing so is in the public interest. Furthermore, the Act of 1934 provides that before they may be registered with the SEC, securities exchanges must have rules for disciplining members. The National Association of Securities Dealers, Inc. (NASD) has promulgated rules demanding minimum initial and maintenance margin requirements of its members. Members of NASD in violation of such rules may be penalized by censure, fine, expulsion, or suspension.

30 Id. § 224.2. It also applies to anyone who willfully aids or abets a violation by another.
31 Id. § 224.2.
32 Id. § 224.6.
35 Id. § 78u(f).
38 NASD Rules of Fair Practice, art. III, § 30.
39 Id. at art. V § 1.
The effectiveness of public sanctions may be questioned because of the problem of adequate enforcement. Margin violations are usually victimless crimes since they are not committed with the purpose of harming anyone. Therefore, few are reported by private interests for public action. Thus the agencies are dependent upon their own investigations to uncover violations. A lack of sufficient facilities and personnel prevents inspection of more than a fraction of the registered broker-dealers each year by the SEC. A study for the Special House Subcommittee on Investigations has found that the inability of the SEC to adequately inspect broker-dealers on a regular basis has accentuated the problems of the industry. The study reports that in May, 1970, the Commission's largest office had only ten inspectors for the 2,000 broker-dealers in its area. As a result, inspections often occur as much as three years apart. The report comments that even the inspections conducted are not comprehensive enough to be effective. This report concludes that the Commission is ill-equipped to initiate a sufficient number of thorough inspections each year.

V. Private Enforcement

Most authorities agreed that prior to the promulgation of Regulation X, a truly effective mechanism to enforce margin regulation was the private cause of action which the customer had against a violating lender. Beginning with Remar v. Clayton Securities Corp., where a United States district court found a broker who arranged financing in violation of Regulation U liable in tort to his customer, securities lenders have known of the severe risks they take when they violate margin regulations. In the typical case, a broker extended credit in violation of a regulation and when the stock fell in price he sold the stock. Then the customer sued to recover his loss. Even though recovery based upon tort was attacked from a common law point of view, it was accepted by the courts. Successful suits were also brought based upon common law contract as complemented by federal statutes and regulations. These two causes of action were

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40 STAFF OF SPECIAL HOUSE SUBCOMMITTEE ON INVESTIGATIONS, 92d Cong., 1st sess., Report on Review of SEC Records of the Demise of Selected Brokers Dealers, (Comm. Print 1971). The importance of the report becomes clear in this context when it is noted that one of the purposes of § 7 of the 1934 Act is protection of the industry. See text accompanying note 6 supra.

41 STAFF OF SPECIAL HOUSE SUBCOMMITTEE ON INVESTIGATIONS, note 40 supra. In fiscal 1959 when 1471 broker-dealers were inspected, 180 were found to be in financial difficulties and 170 were in violation of Regulation T. 2 Loss 1356. In 1967, of the 1019 broker-dealers inspected, 118 were having financial problems and 77 were in violation of Regulation T. 5 Loss (2d ed. Supp. 1969).


44 Pearlstein v. Scudder & German, 429 F.2d 1136, 1147 (2d Cir. 1970) (dissenting opinion); Note, Federal Margin Requirements as a Basis for Civil Liability, 66 COLUM. L. REV. 1462 (1966).

limited by the traditional defenses available in common law tort and contract.\textsuperscript{46} More recently, however, some courts upheld customer recovery based upon not only the broker's violation but also the importance of enforcement through private actions.\textsuperscript{47} One court, basing its decision on this rationale, held the customer's subjective knowledge not a factor for consideration absent misstatements on his part, and rejected ordinary defenses on the part of the lender.\textsuperscript{48} Under this view the broker was almost strictly liable in damages to a customer whenever he violated margin regulations promulgated under § 7 of the Act.

The vitality of these private actions following the promulgation of Regulation X is doubtful. When the customer accepts credit illegally he also violates § 7 and therefore may be precluded from recovery against his lender. Before Regulation X became effective, the courts were inconsistent not only in the theories of recovery for the customer but also in determining the situations in which recovery was warranted. Now that the customer is in a more perilous legal position, the issues are considerably less clear.\textsuperscript{49} Certainly, given the inefficiency of public enforcement and the important effect of the private action as an enforcement mechanism, a private sanction against the lender should still be available. However, analytical justification may be very difficult in light of the defenses available to brokers in contract and tort law.

Ultimately the issue could be resolved if it could be decided which customers ought to be able to recover damages. Equitably it would appear a division between "good faith" and "bad faith" investors would be rational. Unfortunately customers cannot be categorized as "good faith" or "bad faith" customers. They represent a continuum from the "lamb" type investor who would comply with margin regulations if he had knowledge of them to the very sophisticated customer who misrepresents himself to his broker. Courts have in the past been consistent in permitting the "lamb" to recover. Conversely, although there are exceptions,\textsuperscript{50} most courts do not permit the misrepresenter to recover. Assessment of the effect of the new amendment and Regulation X on the private cause of action by the customer may most easily be made by examining each theory of recovery separately.

A. Tort Actions

1. Prior to Regulation X

Most private actions have been brought in tort. The rationale has been based upon an application of the rule that where a defendant's violation of a

\textsuperscript{46} To recover in tort proximate cause resulting in damages must be shown. See Smith v. Bear, 237 F.2d 79, 87-88 (2d Cir. 1956) (dictum). In suit for breach of contract, if the plaintiff survives \textit{in pari delicto}, recovery is likely to be smaller than in tort. Privity is also a factor in contract actions.


\textsuperscript{48} Pearlstein v. Scudder & German, 429 F.2d 1136, 1141 (2d Cir. 1970).


\textsuperscript{50} See text accompanying notes 97-101, infra.
prohibitory statute has caused injury to the plaintiff, the latter has a right of action if one of the purposes of the enactment is to protect interests similar to those of the plaintiff's. In essence, it has been held that the lender is negligent in his actions toward the borrower. This rationale hangs from a fine thread. The protection of the small investor from the dangers of excessive trading was only a "by-product" and not an essential purpose of the 1934 Act. Nevertheless, courts have been consistent in recognizing negligence on the part of the violator.

Courts have not, however, been consistent in defining those parties who may recover. The Remar court held that the customer's participation as a borrower in the illegal transaction did not preclude recovery on his part. It was stated that since the legislature regarded the borrower as incapable of protecting himself, he was not prevented from suing for the injury he sustained. More recently, a United States district court stated that it would:

not entertain a cacophony of blame on the part of the brokers and customers—each blaming the other for not meeting the requirements—the ultimate responsibility must be placed somewhere and Congress has indicated that it is with the brokers or dealers.

This is perhaps the more widespread view. On the other hand, courts have stated that the broker's tort liability is not absolute but is subject to the traditional concepts of causation and contributory negligence. At first glance, the argument that the market fluctuations rather than the loan itself causes the customer's loss appears rather convincing. Nevertheless, courts apparently have not accepted the argument. Some courts have, however, required the plaintiff to show that he would not have bought the stock had it been margined at a higher rate. This argument is not meaningful in the context of Regulation T which requires the broker to sell the stock if not margined properly. If the customer loses money because the value of improperly margined stock falls after the date at which it was to be sold, the loss can be directly attributed to the lender's lack of action.

Active and knowledgeable participation by the borrower has played an important role in some tort actions brought by customers. The rationale is that since violation of statute is actually negligence, the common law principle of contributory negligence should be applied where the customer takes an

51 Restatement (Second) of Torts § 288B (1965) states in part:
The unexcused violation of a legislative enactment or an administrative regulation which is adopted by the court as defining the standard of conduct of a reasonable man, is negligence in itself. See generally, W. Prosser, Law of Torts § 36 (4th ed. 1971) [hereinafter cited as Prosser].
53 81 F.Supp. at 1017.
56 See Note, Federal Margin Requirements as a Basis for Civil Liability, 66 Colum. L. Rev. 1462, 1471-72 (1966).
active part in the violation. In Bronner v. Goldman, a case in which the customer was unable to recover losses incurred, there was strong dicta in both the district court and court of appeals emphasizing that the plaintiff was thoroughly experienced in market trading and therefore aware of the margin regulations. The Sixth Circuit, in Goldman v. Bank of Commonwealth, denied tort recovery to a customer against a bank that violated Regulation U. Although in that case the court took notice of the fact that the customer represented to the bank that the loans in question were for purposes other than buying regulated securities, it concluded that "because... the customer knew that the loans violated Regulation U, he ought not to be permitted to recover damages occasioned by his wrongful acts."

2. Tort Actions After Regulation X

Before issuance of Regulation X, the diversity of views among courts when dealing with transactions in violation of margin laws was certainly significant to the investor. How courts will treat a tort action by the borrower now that he, too, may be in violation of a margin regulation is uncertain. The knowledgeable investor will be precluded from recovery because it is clear that where there are criminal penalties applied to a borrower who violates the regulations, he can no longer be said to be in the class protected by the statute. Viewed from a different perspective, it is also evident that the borrower who knowingly violates a margin regulation is contributorily negligent.

Nevertheless, the "lamb" borrower should still be successful in tort. A buyer who makes an "innocent mistake" in "good faith" and takes remedial action upon discovery is not in violation of Regulation X. It is clear that the Federal Reserve Board did not intend the naive investor to be criminally liable;
therefore, he stands in virtually the same position as he did before the issuance of Regulation X. Judicial definitions of good faith and innocent mistakes will vary. A reasonable measuring device would be to determine whether the borrower has scienter. In the antifraud area of securities law, scienter is deemed present when one has knowledge of the falsity of statements made. In this context, it would translate into an understanding of the violation. Thus, a rational rule for determining whether a borrower could recover in tort once a violation is discovered is to ask whether the borrower knew at the time of the transaction that he was in violation. If so he would be precluded from recovering.

The difficulty of maintaining an action under such a rule can be illustrated by the decision of the Sixth Circuit Court of Appeals in Gordon v. duPont Glor Forgan, Inc. Although the action was based upon a violation of New York Stock Exchange margin rules, the position of the court is most probably analogous to the view that will be taken by courts in similar actions under current Federal Reserve Board regulations. In this case the broker inadvertently permitted the customer's account to become undermargined. The customer was aware of the mistake but took no action. When the broker eventually realized he held the stock in violation of the rules, he sold the stock. The customer sued to recover the losses sustained as a result of the late sale. The court held that where the plaintiff knows his account is undermargined and does not take corrective action, he is precluded from recovering losses in a private civil remedy.

In all likelihood few tort actions will be brought successfully, for only the very imprudent broker will fail to inform his customer of margin requirements. Where, however, the customer is unaware of his violation and the broker liquidates the customer's account to his detriment without giving adequate opportunity to meet margin requirements, the law should provide the investor with a remedy in tort.

B. Contract Actions

1. Actions under Section 29(b)

a. Prior to Regulation X

Section 29(b) of the Securities Exchange Act of 1934 provides that an individual in violation of the statute or margin regulations thereunder cannot enforce a contract that violates, or the performance of which violates, such regulations. However, courts have chosen to hold contracts in violation of the Act as voidable, not merely void. In Mills v. Electric Auto-Lite, the Supreme Court held that the guilty party is precluded from enforcing the contract against an innocent party but that such reasoning does not compel the conclusion that the

69 Id. This is essentially the same as the holding in Goldman, 467 F.2d at 446.
contract is a nullity creating no enforceable rights in favor of the innocent party.\textsuperscript{72} One not in violation may rescind or enforce the contract at his option. Section 29(b) has not yet been authoritatively construed by a federal court and state courts have offered contradictory interpretations of a contract "the performance of which involves a violation of" the Act or any regulation thereunder. Section 29(b) interpretations are most often required in the context of Regulation T where the contract provides that the broker is to procure the stock and the investor to pay for it.\textsuperscript{73} If the investor fails to pay and the broker fails to liquidate the sale in the proper manner, it is evident that the broker is in violation of Regulation T. In such a case the violation is not evident on the face of the contract and courts are in dispute as to whether or not the violation occurs within the performance of the written contract.

The issue then is whether the customer can avoid the contract under § 29(b). Despite a strong dissent, a New York appellate court in Billings Associates, Inc. v. Bashaw\textsuperscript{74} held that the customer may not.\textsuperscript{75} The court held that § 29(b) applies only to contracts which by their terms violate the Act.\textsuperscript{76} Under this ruling, although the broker may be in violation of a regulation, the customer may not avoid his contractual obligation if the illegal action is not within the terms of the contract. In fact, this rationale seems to provide that the customer may be liable for breach of contract if he has not paid for the securities. In California, a court reached a similar result in Gregory-Massari, Inc. v. Purkitt.\textsuperscript{77} The case involved a violation of Regulation T by the broker and a refusal to pay for the stock on the part of the customer.\textsuperscript{78} In reversing the lower court decision to void the contract, the court held that the broker was in violation of Regulation T because he failed to liquidate the customer's account properly. Nevertheless, the court held that since the contract only required the broker to sell and the customer to pay, which had no illegal implication, the broker could recover from the customer for the customer's failure to pay for the stock.\textsuperscript{79} The court interpreted the provision voiding any contract "the performance of which involves the violation of . . . any provision" to encompass only action that is contemplated in the contract.\textsuperscript{80} The court maintained that even if the contract had encompassed liquidation and the broker did not liquidate, the contract would still be viable.\textsuperscript{81}

Another case directly on point takes the opposite view. In Staley v. Sal-
vesen, a Pennsylvania court found that the contract was merely to sell securities even though in the performance of the sale the broker granted an illegal extension. By granting the illegal extension, the broker violated Regulation T. Therefore, the contract was voidable at the election of the customer. Loss maintains in his treatise that this view appears more reasonable. The Billings and Purkitt interpretations leave a large loophole for evasion of margin regulations on the part of the broker while still affording him a contract remedy for damages. As stated by the dissenter in Billings, it would be a simple matter for a broker to let it be known that he would not abide by the margin regulations, but would permit customers to pay for securities in a variety of ways without entering such provisions in the contract. The obvious intent of § 29(b) is to render uncollectible those debts incurred in violation of margin regulations, thus acting as an added enforcement mechanism.

No federal court cases appear to address this problem directly. Nevertheless, some dicta are worth discussing. The court in Goldenberg v. Bache & Company discussed the application of § 29(b) in an offhand manner. The broker and customer had made a "Customer's Margin Agreement" which stipulated that all transactions "shall be subject to the constitution, rules, regulations... of the Exchange or Board of Market... [and] to the... provisions of the Securities Exchange Act of 1934." A violation of Regulation T transpired which was clearly not sanctioned on the face of the agreement. Yet the court stated:

Granted that violations of the Act or Regulation entered into the sales or purchases of which [the customer] complains, yet, before such contracts are "deemed to be void," Mrs. Goldenberg's action must have been brought [within the statute of limitations].

The court implied that had the action been timely, the customer might have been able to void the contracts. In Moscarelli v. Stamm, there was also a Regulation T violation in the performance of but not within the four corners of the contract. Although the court denied recovery to the customer in tort, it stated in dictum that, "[f]or similar reasons plaintiffs' instigation or willful participation in such violations would preclude their recovery by rescission under Section 29(b) of the Act." The implication is that one innocent of wrongdoing may be able to rescind a contract under § 29(b) where there is a violation which is not indicated on the face of the contract. Thus, considering these few instances, it would appear that when a federal court construes § 29(b), it is likely to do so broadly. Nevertheless, all federal court judges that have recognized

84 See Loss 3307 (Supp. 1969).
87 270 F.2d 675 (3th Cir. 1959). The case was decided on other grounds.
88 Id. at 677.
89 Id. at 680 (emphasis added).
91 Id. at 460.
the issue are not in agreement. Judge Friendly of the Second Circuit has stated that he favors the narrow interpretation.\footnote{Pearlstein v. Scudder & German, 429 F.2d 1136, 1149 (2d Cir. 1970) (dissenting opinion).}

b. Effect of § 29(b) on Actions Brought under Regulation X

The implications of this controversy are important in actions brought either in contract or under § 29(b) involving transactions covered by Regulation X.\footnote{Of course, these considerations are of importance only to those litigants who first hurdle the innocent party criterion required by some courts.} Those parties who sue in courts that construe § 29(b) narrowly will find that either party may sue for a violation of the contract as long as the violation is not provided for in the contract. Even though § 29(b) exists, the broker in violation of Regulation T would be able to sue the customer for any breach of contract. On the other hand, the customer who is in violation of a regulation for not satisfying margin requirements within the prescribed time could also sue for delivery of stock once he has rendered the requisite amount. Actually, any violation of a margin regulation which is not evident in the contract must be treated separately from the contract action. Only if the violation is provided for within the contract will a party be able to bring an action for rescission under § 29(b). Since Regulation X causes the customer to be equally guilty with the lender where the violation is knowing, neither party could claim innocence. Thus § 29(b) rescissions become an impossibility in most instances.

In those courts that interpret § 29(b) broadly, the contract will not be enforced for either party if both knowingly violate a margin regulation in performance of the contract. However, under the same rationale as that used in tort, an investor who is unaware of the margin requirement may not be in violation of Regulation X.\footnote{See text accompanying notes 66-67 supra.} If he is not, he would be in the same position as one before issuance of Regulation X and would be able to enforce or rescind the contract. Under the same rationale, if a lender has been duped into an unknowing violation by a fraudulent customer who is in violation of Regulation X, the lender may rescind the contract under § 29(b).

Where both parties are in violation, the courts will have little recourse but to determine the contract void. If the contract is viewed as void with respect to both parties, it would receive no legal sanction.\footnote{See J. Murray, Jr., Grismore on Contracts § 7 (rev. ed. 1965) [hereinafter cited as Murray].} Therefore neither party could enforce it and the courts will merely leave the parties as they are. Whatever contract may exist becomes a nullity and if there is a contractual obligation remaining on the part of either party, performance will not be enforced. If, after the sale of stock, there is a deficiency in the customer’s account, he will not be permitted to rescind or be reimbursed for what he has paid. Thus, in most situations where § 29(b) is read broadly, Regulation X will be available as a defense for either the broker or the customer, because any party who is in violation of a margin regulation cannot rescind a contract under § 29(b). Thus § 29(b) rescission provides an important new weapon for the broker which was
unavailable before the promulgation of Regulation X. However, rescission will no longer be available to the guilty customer for offensive use.

Given that the contract is void as to both parties, the court may still grant equitable relief in unusual situations. Although equity does not assume jurisdiction on the ground that a contract is in violation of a statute, under particular circumstances where equitable interference is necessary to give adequate protection to the interest of an innocent party which has been invaded, relief will be fashioned accordingly.96

c. Section 29(b) Actions in the Context of Regulation U

The controversy over the scope of § 29(b) has much less importance in the Regulation U area for two reasons. One is that the terms of the loan (X dollars are lent and Y securities are put up as collateral) make evident the duties of the parties and there is no provision that the securities will be delivered subsequently. The other involves the requirement of purpose statements which must be executed by the borrower and retained by the lender any time there is an extension of credit collateralized by regulated stock.97 These two factors effectively put most performance within the contract terms and therefore make the contract void if there is a violation of margin regulations. An issue of importance here, however, is the amount of reliance the lender may give to the truthfulness of the borrower's statements. In Serzysko v. Chase Manhattan Bank,98 it was held that Regulation U requires the lender to exercise reasonable diligence to inquire and investigate as to possible misconduct on the part of the borrower.99 Since this is mandatory under Regulation U, it stands to reason that even if the purpose statement causes the loan to appear proper, the contract still comes under § 29(b) if within the transaction the lender's performance does not meet regulation requirements.100 Under this reasoning the narrow reading of § 29(b) could sustain an action for rescission as well as the broader reading. Thus, the contract would be void for both parties. On the other hand, where the lender uses reasonable diligence to investigate the loan and only at a later date finds the true purpose, he would be able to rescind or enforce the contract at his option because the borrower would have been in violation of Regulation X and the contract would be voidable by the lender who would be an innocent party.101

2. Application of Common Law Principles to Contract Actions

In some cases common law contract principles have played an important

96 See 27 Am. Jur. 2d Equity § 57 (1966). Injunctive relief is unlikely. Generally for an injunction to issue a right must be violated and no rights are usually recognized under an illegal contract. 43 C.J.S. Injunctions § 19 (1945).
97 12 C.F.R. § 221.3 (1973). See Serzysko v. Chase Manhattan Bank, 290 F.Supp. at 80-81. Note also that the borrower must prepare and retain records of loans received from foreign creditors. 12 C.F.R. § 224.2(b) (1973).
99 290 F.Supp. at 90.
100 This is substantially different from the Regulation T controversy. See text accompanying notes 70-96 supra. Here the loan itself is illegal.
101 The lender would also be able to recover damages for fraud.
role in private suits arising under violations of margin regulations. In Goldenberg v. Bache & Company, the court stated that such an “action could be looked on as an action ex contractu, based on the contract between the stockbroker and the customer as affected by the federal statute and regulations. . . .” In effect, past cases have held that the borrower, as an innocent party who is protected by statute, is able to rescind a contract made voidable by the illegal action of the lender. Actually, the threshold considerations in contract actions are similar to the factors considered in actions brought under § 29(b).

It has been held in such cases that even though one is innocent in a criminal sense, he is not necessarily able to rescind. In Moscarelli v. Stamm, an action to rescind under § 29(b), the court stated that a customer’s instigation or willful participation in violations would preclude recovery by rescission. In Naftalin & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., the customer perpetrated on many brokers an elaborate scheme for short-selling stock. It was brought to a costly halt when the market price of the stock in which he was dealing rose unexpectedly. The court made it clear that the customer who was not an “unwilling innocent party” would not be permitted to invoke § 29(b). These courts have followed the rationale espoused by the Supreme Court in Mills v. Electric Auto-Lite where it was held that § 29(b) rescissions were possible only at the instigation of “an unwilling innocent party.” The criteria used to define “an unwilling innocent party” have not yet been measured exactly. In Moscarelli the plaintiffs conspired with the defendant to violate the Act and gambled with the defendant’s funds with the expectation of reaping profits. In Naftalin the customer successfully deceived his brokers for a long period.

In other cases not involving rescission under § 29(b), the courts have not applied the Mills rationale but rather have looked to the common law and asked if the parties were in pari delicto. In Serzysko v. Chase Manhattan Bank, the court appears to equate the two concepts. Whether the courts claim to be applying Mills or in pari delicto, it is evident that until now the criteria are similar. It is generally recognized that where parties stand equally at fault in the context of an illegal contract, the law will leave them where it finds them. They are essentially in pari delicto. It is also recognized that a party to an illegal agreement who is clearly not at fault will not be denied relief. There can be no question that this concept was applied in Naftalin. The use of “unwilling innocent party” or, in actuality, the use of in pari delicto in these cases was an
attempt to remedy a significant inadequacy of § 29(b): that one not in violation of securities regulations could rescind the contract. Simply because the customer is not criminally liable does not necessarily mean that he should not be responsible for his losses.\textsuperscript{116} Today the inadequacy no longer exists because the customer under Regulation X is virtually precluded from bringing an action to rescind.\textsuperscript{117} Furthermore, it may be agreed that Regulation X is a mandate to view both parties as \textit{in pari delicto} in the context of a contract action.

\section*{C. Alternative Causes of Action}

There are alternative actions that can be brought even if the contract is determined a nullity under § 29(b). In \textit{Goldman v. Bank of Commonwealth}, the court noted that the lender may have a cause of action at law for money lent,\textsuperscript{118} based on an allegation that there was a payment of money by the plaintiff to the defendant in the form of a loan.\textsuperscript{119} It is generally recognized that in this action all that must be pleaded is that money was lent.\textsuperscript{120} Nevertheless, some courts have held that it is necessary to have a statement of facts upon which an implied contract could be constructed;\textsuperscript{121} at least one court appears to hold that the suit must be based upon a contractual obligation.\textsuperscript{122} This action would permit the lender to recover the money owed on or advanced for the purchase of regulated securities. Furthermore, all the equitable defenses are available to the borrower.\textsuperscript{123}

The \textit{Goldman} court also recognized that there could be an action for misrepresentation on the part of the lender.\textsuperscript{124} Actually, the court was referring to the tort of deceit, a subcategory of misrepresentation. Deceit lies in cases where the defendant knowingly makes a false representation with the intention to induce the plaintiff to justifiably rely on it to his detriment.\textsuperscript{125} This cause of action could be used most effectively by Regulation U lenders where the borrower misrepresents himself on the "purpose statement" for the loan. However, it must be noted that the lender may find he is under a stricter standard here because under Regulation U he is charged with investigating the truthfulness of the borrower's statement.\textsuperscript{126} Courts may hold that unless he has fulfilled this obligation, he may not recover for deceit, because his reliance would not be justified. On the other hand, the court may hold that Regulation U has no

\begin{footnotes}
\footnotetext[116]{Id. at § 1537; \textit{Restatement of Contracts} § 604 (1932).}
\footnotetext[117]{Note there may be a circumstance in which the customer is not in violation of Regulation X and will be able to rescind the contract even though his stock is not margined correctly. \textit{See} text accompanying note 66 \textit{supra}.}
\footnotetext[118]{467 F.2d at 447.}
\footnotetext[119]{\textit{See} 58 C.J.S. \textit{Money Lent} § 2a (1948).}
\footnotetext[121]{\textit{E.g.}, Foley-Carter Ins. Co. v. Commonwealth Life Ins. Co., 128 F.2d 718 (5th Cir. 1942).}
\footnotetext[122]{Hester & Wise v. Chinn, 162 S.W.2d 450 (Tex. Civ. App. 1942).}
\footnotetext[123]{58 C.J.S. \textit{Money Lent} § 4 (1948).}
\footnotetext[124]{467 F.2d at 447.}
\footnotetext[125]{\textit{See} Prosser 685-86.}
\footnotetext[126]{290 F.Supp. at 90.}
\end{footnotes}
effect on the tort since both parties are at fault and hold the lender to the care of a reasonably prudent man, rather than the stricter standard.

A different cause of action was used successfully by the borrower in Billings: conversion. Courts have reasoned that where the broker sells the securities of a customer carried on margin, the broker must give reasonable notice of the time and place of the sale. Failing to do this leaves him liable for conversion of the securities. The plaintiff's position as a violator of Regulation X should have no effect on the action except to give him notice of the sale at the prescribed time. Beyond this, the same rules that apply to a defendant who has violated a statute apply to a plaintiff. Certainly § 7 of the Securities Exchange Act and regulations issued thereunder requiring sale of undermargined stocks were not promulgated for the purpose of providing notice of forced sales. Where the broker sells at a later time without notifying the customer, he has effectively converted the customer's stock.

D. Lender Liability Under the "Enforcement Doctrine"

Although the whole concept of private liability for violation of margin regulations rests upon public policy and acts as an enforcement mechanism, most courts maintain that the suit by the borrower is bounded by common law concepts. A few courts, however, have permitted the customer to recover without regard to any of the concepts discussed above and look at the customer's action purely as an unencumbered method of enforcement. They appear to permit customer recovery in any situation where the lender has violated a margin provision. Regulation X may force a rethinking of these cases.

1. Enforcement Doctrine in the Absence of Regulation X

Pearlstein v. Scudder & German, decided by the Second Circuit, is the principal case in this area. It was held in Pearlstein that a customer has a private right of action against his broker for violation of federal margin regulations, regardless of his sophistication or knowing participation in the transaction. The ultimate result is that the broker becomes almost strictly liable for damages occasioned by the customer in any transaction where he breaches an applicable regulation. The court held that:

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127 See Prosser 715-17.
128 27 App. Div. 2d at 127. The court took the narrow view on voidability of a contract to buy securities and permitted recovery in conversion to prevent the broker from reaping benefit from an unlawful act.
129 Mayer v. Monzo, 221 N.Y. 442 (1917); Content v. Banner, 184 N.Y. 121 (1906).
130 It could be argued that presumption of knowledge of the forced sale provision of Regulation X could not be used by the broker in this manner because the purpose of the regulation is not to give notice to the customer that his stock will be sold at a specific time if he has not paid for it.
131 Damages are computed by the highest value of the securities prevailing during a reasonable period following the date of notice of the conversion. 27 App. Div. 2d at 127.
133 Id. at 1140-41.
the danger of permitting a windfall to an unscrupulous investor is outweighed by the salutary policing effect which the threat of private suits for compensatory damages can have upon brokers and dealers above and beyond the threats of government action by the Securities and Exchange Commission.\textsuperscript{134}

The court refused to recognize the defense of \textit{in pari delicto}. This defense was dismissed rather tersely by a citation to \textit{Perma Life Mufflers, Inc. v. International Parts Corp.},\textsuperscript{135} an antitrust case, for the proposition that \textit{in pari delicto} was undermined in securities law.\textsuperscript{136}

The court in \textit{Pearstein} broke rather significantly from the tort rationale of \textit{Remar} and its progeny, probably in an effort to avoid the strong arguments against recovery based upon tort.\textsuperscript{137} Instead, it used the same rationale as that espoused by the Supreme Court in \textit{J. I. Case Co. v. Borak}.\textsuperscript{138} There it was decided that an implied private right of action exists for a violation of §14(a) of the Securities Exchange Act of 1934,\textsuperscript{139} which deals with regulation of proxy statements. The \textit{Borak} Court based its decision on the principle that private enforcement of the proxy rules provides a necessary supplement to SEC action and compared it to the antitrust situation where treble damages serve as an effective weapon for enforcement.\textsuperscript{140} It is important to realize that this type of suit is not based upon a mandate from Congress or necessarily upon a reading of the statute implying a private action; it is based upon a judicial recognition that an additional enforcement mechanism is needed. The \textit{Pearstein} court wisely qualified this rationale somewhat by stating that an investor who misrepresents himself is not entitled to recover.\textsuperscript{141}

Judge Friendly addressed the enforcement doctrine in his dissent in \textit{Pearstein}. He argued that the private suit in margin enforcement was not furthering the purpose of the statute because Congress intended only to prevent widespread margin violations and that the SEC could do that effectively.\textsuperscript{142} He also stated that the ultimate effect of the ruling would be to induce the customer to engage in margin violations since he would be in a "heads-I-win, tails-you-lose" situation.\textsuperscript{143}

Some courts appear to have followed the \textit{Pearstein} reasoning,\textsuperscript{144} but most still apply the common law tort and contract defenses.\textsuperscript{145} However, one case,
Spoon v. Walston & Co., Inc., relied upon Perma Life to support its holding that there would be no application of common law barriers to the customer's action and indicated responsibility must be placed upon the broker. It was held that the customer could rescind, even though each party was at fault in an equitable sense. Thus the court fashioned an equitable remedy: the customer's loss was shared equally. In affirming the decision, the Sixth Circuit Court of Appeals expressly adopted the Pearlstein view.

2. Regulation X and the Enforcement Doctrine

Decisions as to the enforcement doctrine for actions brought under Regulation X appear slight. It is likely to be held that since the Federal Reserve Board provided that the borrower is liable for violation of margin regulations, it would be unjust to reward him for his wrongdoing. Many courts will add that even if the action aids enforcement, it certainly encourages violation by the customer. Nevertheless, those courts that have adopted the Pearlstein viewpoint may very well continue to follow the enforcement rationale analogizing to the antitrust situation established by Perma Life. Regardless of the fact that both of those courts refused to accept the defense of in pari delicto, it remains to be seen whether that defense will be rejected entirely in securities actions.

It must be noted that not all of those who concurred in the result of Perma Life agreed with the opinion. Justice White stated that he would deny recovery where the plaintiff and defendant bear substantially equal responsibility for the resulting injury. Only where one party was responsible for originating, negotiating, or implementing the scheme would he permit recovery. Justice Fortas' view was similar. He stated that if the fault of the parties is reasonably within the same scale then in pari delicto would bar recovery. Justices Marshall and Harlan with whom Justice Stewart concurred shared similar views. They would deny recovery where the parties show active participation in the formation of an illegal scheme and stand equally at fault by cooperating with each other. It is likely that if the equities of Perma Life had not been so clearly in favor of the plaintiffs, the defense of in pari delicto would not have been rejected. Essentially, these Justices were not primarily concerned with whether the plaintiff was in a legal or illegal position but rather the extent to which he participated in the illegal enterprise.

Construing the participation rationale espoused by five members of the Supreme Court in the margin regulation context would indicate a denial of

147 Id. at 521.
148 Id. at 522-23.
150 Title III of the Bank Records Act leaves the loophole that the SEC could exclude any class from regulation. The SEC specifically applied Regulation X to domestic borrowers.
151 392 U.S. at 145.
152 Id. at 147.
153 Id. at 149-53.
154 The defendant granted franchises to the plaintiffs only under terms that were restrictive of trade. The plaintiffs had no bargaining power, and were in a "take it-or leave it" situation. Id. at 137.
recovery to a great number of cases. Most often the lender and borrower each participate equally in the illegal transactions; both are aware of their actions and neither forces an illegal scheme on the other. In such a case they would be in pari delicto. Certainly, in those violations in which the customer deceives the bank or where the broker takes advantage of a “lamb” investor, recovery would be permitted. However, in the majority of transactions there would be no private enforcement.

Nevertheless, in at least one case both parties were found to be in active violation of securities regulations, and yet the court rejected an in pari delicto defense and permitted recovery based upon the enforcement doctrine. Both parties in Nathansan v. Weis, Voisin, Cannon, Inc. 156 were in violation of Rule 10b-5 which prohibits fraudulent activities in the sale of securities. 157 The defendants were insiders who gave “privileged” inside information to the plaintiffs who then bought stock from others believing they would reap huge profits in subsequent sales. The buyers found to their dismay that the tips they received did not produce the results they expected. The buyers sued for their losses. The defendants were in violation for releasing inside information and the plaintiffs were in violation for not disclosing what they knew to the sellers from whom they bought the stock. The defendants pleaded in pari delicto, maintaining that the plaintiffs were in active violation of 10b-5. The court denied the defense, maintaining that the overriding public policy considerations to secure effective enforcement of the antifraud provisions of the Securities Act must be given effect. 158 It was decided that the most important party, the public, could be protected best by discouraging insiders from making disclosures. The circumstances here are very similar to those found in the margin violation area with Regulation X in effect. Both parties actively engage in transactions that may cause harm to the public. Ultimately, the use of the enforcement doctrine becomes a matter of weighing personal rights and long-standing tradition against the good of the public.

VI. An Argument for the Enforcement Doctrine

By following the enforcement doctrine strictly without recognition of an in pari delicto defense on the part of the broker, the courts can best effectuate the purposes of margin regulation. The objective of the Securities Act of 1934 and Title III of the Bank Records Act of 1970 was regulation of credit in such a way as to protect the public, the securities community, and finally, as a by-product, the customer. The best way to achieve protection of these people is to minimize the appeal of an illegal credit arrangement.

If no private actions are permitted, there will be little deterrent to violate margin regulations. The lender would feel relatively secure in making illegal transactions knowing the customer could not charge any losses to him in private actions. Considering the past record of inefficiency of the SEC in monitoring

157 325 F.Supp. at 53.
the activities of security lenders, Judge Friendly's argument, that widespread violations would be stopped by public sanctions, loses its persuasiveness. The parties could simply agree to violate the regulations knowing there is little likelihood of public discovery. Under such conditions, it appears that high-leverage credit could become rather commonplace.

If private actions are recognized but common law defenses permitted, only those who have been defrauded, such as the "lamb" investor or the lender who has been deceived, will be able to recover. The vast majority of transactions take place between parties who fall within these two extremes. Therefore, most of those in the securities field could simply agree to violate knowing that an *in pari delicto* or contributory negligence defense would prevent either of them from suing the other successfully. Another consideration is the rather unsophisticated borrower who does not understand margin requirements and the process of liquidation and who therefore needs protection. Although he may not be truly blameworthy, he will be unable to gain redress as long as he has been informed. Even he would be in violation of Regulation X. Permitting the private action based upon the enforcement doctrine, but also recognizing the defense of *in pari delicto*, will solve this issue only at the expense of much litigation.

By establishing a clear policy of customer recovery under the enforcement doctrine, all these problems will be solved. Permitting the customer to recover may induce customers to attempt to violate margin regulations as stated by Judge Friendly, but the deterrent effect upon the lender would be much greater. No creditor would provide the customer with illegal credit knowing that the blameworthy borrower might prevail in a subsequent law suit. Creditors would not be tempted to lend illegally. Moreover, as between the institutional creditor and the borrower, the lender who is in the stock market every day presents the greater potential threat to undermining protection intended for the public. It appears that anything less grants to the lender the privilege of gambling. By making the creditor strictly liable to the borrower, the public purpose of complete credit management can best be achieved while at the same time protecting all borrowers from their own ignorance.

Finally, the most significant criticism of the enforcement doctrine, protection of the guilty borrower at the expense of the lender, is overcome in two ways. First of all, it should be recognized that the lender is in control; the borrower cannot force him to extend credit. Only the creditor can decide whether he should violate the regulations and subject himself to liability. Secondly, in a very short time the issue would become moot because there would be much less illegal credit and the institutional lender would not be exposed to possible suit. Moreover, as has been shown above, in the antitrust context and in at least one area of securities regulation, courts have determined that private interests must yield to protection of the public as a whole. If credit regulation is genuinely economically important to the public, then margin regulation deserves the same consideration.

VII. Conclusion

The future of private actions under Regulation X can largely be forecast
by the past. Courts were in little agreement then and it is unlikely there will be much uniformity in the future unless the Supreme Court makes a definitive ruling. Nevertheless, some generalities can be made. Regulation X does not condemn all private actions. Where one of the parties to a margin transaction is undeniably taking advantage of the other, legal and equitable principles will provide remedies. Under § 29(b) actions, the "lamb" investor as well as the lender who has been deceived will be able to rescind. Even though recovery in tort will be very rare, other causes of action may lie.

Nevertheless, Regulation X has created a twofold problem. It appears likely that most courts will not permit recovery where the parties are in pari delicto, which will preclude private actions for the overwhelming majority of illegal transactions. The second part of the problem concerns protection of the unsophisticated borrower who, though not really blameworthy, has been informed of his margin obligation. If the enforcement doctrine is accepted, but limited by an in pari delicto defense, this problem may be solved. Nevertheless, the enforcement problem remains.

Those courts that follow the lead of the Pearlstein and Nathansan decisions which recognize the unencumbered enforcement doctrine, will best effectuate the policies of margin regulation. However, at this point it appears that most courts will not permit such unfettered recovery on the part of the borrower. Nevertheless, it is clear that by consistently finding the creditor liable, the courts would maximize compliance with margin regulations, a goal which ought to be their foremost concern.

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