

political organizations are unable or are judicially prevented from manipulating alternative sources of rewards, the final result of *Elrod v. Burns* may be a major re-adjustment in American party politics. By removing the patronage dismissal from the hands of political bosses, however, the Court has reaffirmed its conviction that the health of the American polity is found more in the freedom of its members to speak and think as they choose than in the ability of politicians to grant favors in return for support.

RICHARD F. RINALDO

**Securities Law—Constitutional Law—Implied Waiver of Eleventh Amendment Immunity under the Securities Acts—*Green v. Utah*.**<sup>1</sup> In 1974 plaintiff Maxine Green brought suit<sup>2</sup> in federal district court against the State of Utah and its Commissioner of Financial Institutions (Commissioner) alleging violation of the antifraud provision of the Securities Exchange Act of 1934,<sup>3</sup> arising out of the state's regulation of one of its chartered financial institutions.<sup>4</sup> According to the complaint, Western States Thrift and Loan (WST) was an industrial loan corporation organized pursuant to Utah statutes,<sup>5</sup> which issued securities in the form of thrift certificates, passbook accounts, and debenture bonds.<sup>6</sup> Plaintiff alleged that due to a series of severe

<sup>1</sup> 539 F.2d 1266 (10th Cir. 1976).

<sup>2</sup> Plaintiff filed suit on behalf of herself and as a class action on behalf of all other persons similarly situated. *Id.* at 1268.

<sup>3</sup> Securities Exchange Act of 1934, § 10, 15 U.S.C. § 78j (1970) and rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1976). 15 U.S.C. § 78j (1970) provides in pertinent part:

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—

(b) To use or employ in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . .

Rule 10b-5 provides:

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.

<sup>4</sup> 539 F.2d at 1268.

<sup>5</sup> *Id.* at 1267-68. See UTAH CODE ANN. §§ 7-8-1 *et seq.* (1968 Replacement Volume).

<sup>6</sup> The court assumed *arguendo* that these were securities within the meaning of the Securities Acts. 539 F.2d at 1269. See 15 U.S.C. §§ 77b(1), 78c(a)(10) (1970).

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financial losses, WST had been operating in an insolvent condition during the years following 1965.<sup>7</sup> She further alleged that throughout the period of WST's insolvency, the state's Commissioner, who pursuant to state law<sup>8</sup> had annually examined WST, knew of the company's operating losses<sup>9</sup> but failed to inform the public.<sup>10</sup> Moreover, plaintiff alleged that even when the Commissioner had the opportunity to disclose this information in his biennial public report on the condition of the state's financial institutions, he intentionally concealed both these losses and WST's insolvency<sup>11</sup> through the use of a deceptive accounting device which made it appear that WST was not insolvent.<sup>12</sup> Although these and other acts of the Commissioner may have violated state law,<sup>13</sup> the other acts of the Commissioner may have violated state law,<sup>13</sup> the gravamen of Green's complaint was that the Commissioner had violated the federal securities laws prohibiting the use of deceptive devices in connection with the sale of securities<sup>14</sup> by knowingly permitting WST to operate in an insolvent condition, by issuing a misleading report, and by failing to inform the investing public of WST's poor financial condition.<sup>15</sup> On the basis of these alleged violations of federal law, plaintiff sought to recover approximately \$52,000 in actual losses from the state.<sup>16</sup> On behalf of itself and its

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<sup>7</sup> 539 F.2d at 1268.

<sup>8</sup> Under Utah state statutes, the Department of Financial Institutions is charged with responsibility for the regulation of state chartered financial institutions, including industrial loan companies. UTAH CODE ANN. § 7-1-1 (1) (1968 Replacement Volume). The chief officer, or Commissioner of the Department, is required to submit a biennial report to the governor "containing a copy of the last report furnished by each institution under the supervision of the . . . department and any other proceedings had or done by the department showing generally the condition of the businesses . . . and such other matters in connection with such business as may be of interest to the public . . ." *Id.* § 7-1-3. The statute provides for annual examination of "every loan and trust corporation" to determine its financial condition and compliance with the law. *Id.* § 7-1-8. In addition it is a criminal act for the Commissioner to "knowingly or willfully [permit] the violation of any of the provisions of law for a period of ninety days by any . . . institution under the supervision of the . . . department . . ." *Id.* § 7-1-29.

<sup>9</sup> Brief of appellant at 3 n.4. Since the district court dismissed the suit on eleventh amendment grounds, it made no findings of fact. See 539 F.2d at 1269.

<sup>10</sup> 539 F.2d at 1268.

<sup>11</sup> *Id.* at 1268, 1269.

<sup>12</sup> *Id.* Plaintiff alleged that contrary to accepted accounting practice, the Commissioner had reported a portion of WST's long term liabilities as assets. This accounting practice made it appear that WST was solvent when in fact it was not. *Id.*

<sup>13</sup> UTAH CODE ANN. § 7-1-29 (1968 Replacement Volume). See note 8 *supra*.

<sup>14</sup> 15 U.S.C. § 78j (1970) and rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1976). See note 3 *supra*.

<sup>15</sup> 539 F.2d at 1268-69. Plaintiff also alleged the Commissioner had violated the securities laws by failing to prevent WST from selling securities while insolvent; by failing to detect WST loans to companies in which WST officers had a financial interest; and by "instituting and maintaining an unauthorized and unlawful constructive credit to the capital accounts of WST which allowed it to make loans and advances in excess of its capability." *Id.*

<sup>16</sup> At the time suit was filed in 1974, WST had fallen into state receivership, thereby rendering plaintiff's securities virtually worthless. *Id.* at 1269.

Commissioner, the state moved for dismissal on the ground that the eleventh amendment barred jurisdiction.<sup>17</sup> The district court agreed and granted the motion to dismiss.<sup>18</sup> Plaintiff appealed to the Tenth Circuit, seeking reversal of the motion and claiming that the state had waived its eleventh amendment immunity to suit<sup>19</sup> by participating in an activity subject to federal regulation.<sup>20</sup> In affirming dismissal of the action the court HELD: the mere regulation by a state of its own financial institutions does not constitute an implied waiver of its eleventh amendment immunity to a private federal court suit under the federal securities laws.<sup>21</sup>

In reaching its decision, the court of appeals examined three Supreme Court opinions which form the basis for the doctrine of implied waiver,<sup>22</sup> and then compared three circuit opinions<sup>23</sup> which had applied the waiver doctrine to suits brought against states under the federal securities laws. On the basis of these opinions, the court of appeals first determined that Utah's regulation of its state chartered institutions was a governmental function.<sup>24</sup> Because of this fact, the court determined that in order to find an implied waiver of immunity it was necessary to first find an explicit indication in the federal securities acts that Congress intended to subject a state to private federal suit when a state exercises such a regulatory function. Applying this explicit intent test, the court concluded that the mere fact that one section of the securities laws defines "person" as including "a government or political subdivision thereof"<sup>25</sup> does not amount to the type of indication needed to show that Congress clearly intended to condition a state's participation in the regulation of securities upon a waiver of immunity.<sup>26</sup> Consequently, the court of appeals held that the ab-

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<sup>17</sup> *Id.* When a private party seeks to impose a liability which is to be paid out of a state's treasury, the suit will be considered to be one against the state, even though nominally it is against a state officer. *See* *Edelman v. Jordan*, 415 U.S. 651, 653 (1974); *Ford Motor Co. v. Department of Treasury*, 323 U.S. 459, 464 (1945). Thus, in *Green*, because the suit against the Commissioner sought to impose liability on the state, the suit was treated as one against the state and the eleventh amendment could be interposed to thwart it.

<sup>18</sup> 539 F.2d at 1269.

<sup>19</sup> *Id.* A second issue was whether the class action had been properly dismissed. *Id.* However, as the court found that the state's eleventh amendment immunity had not been waived, it did not reach this issue. *Id.* at 1274.

<sup>20</sup> Since the state had not expressly waived its immunity, see note 32 *infra*, the question facing the court was whether it had impliedly done so. 539 F.2d at 1270.

<sup>21</sup> 539 F.2d at 1274.

<sup>22</sup> *Edelman v. Jordan*, 415 U.S. 651 (1974); *Employees v. Department of Pub. Health and Welfare*, 411 U.S. 279 (1973); *Parden v. Terminal Ry.*, 377 U.S. 184 (1964).

<sup>23</sup> *Yeomans v. Kentucky*, 514 F.2d 993 (6th Cir. 1975); *Brown v. Kentucky*, 513 F.2d 333 (6th Cir. 1975); *Forman v. Community Servs., Inc.*, 500 F.2d 1246 (2nd Cir. 1974), *rev'd on other grounds*, 421 U.S. 837 (1975).

<sup>24</sup> 539 F.2d at 1274. Had the court found the state's activity to be proprietary instead of governmental, it might have applied a less stringent test in order to determine congressional intent. *See* 539 F.2d at 1271, 1273-74. *See* discussion in text at notes 71-76 *infra*.

<sup>25</sup> 15 U.S.C. § 77b(2) (1970).

<sup>26</sup> 539 F.2d at 1273-74.

sence of such congressional intent resolved the eleventh amendment question before it, and ruled that the state's eleventh amendment immunity barred Green's suit to recover her losses from the state.<sup>27</sup>

The principal significance of the *Green* decision lies in its clarification of the circumstances under which the Securities Acts may lift a state's immunity from private suit in federal court. The case adds its weight to the trend of recent circuit decisions ruling that a state does not waive its immunity merely by regulating securities-issuing institutions within its borders.<sup>28</sup> The decision also illustrates that a stricter test must be applied to measure congressional intent to subject states to private federal suit if the state's activity may be characterized as "governmental" rather than "proprietary."<sup>29</sup>

This note will first trace the development of the implied waiver doctrine in the context of suits by private parties against states in federal court. Three major Supreme Court decisions, which both define this doctrine in the context of eleventh amendment cases and create the basis for the use of the governmental/proprietary distinction, will be scrutinized. Because these Supreme Court decisions preclude an implied waiver of immunity by a state unless Congress intended to authorize private suits against states, the second section of the note will examine the Securities Acts and their legislative history to determine whether such congressional intent exists. The *Green* court's treatment of three recent circuit opinions applying the implied waiver doctrine to suits brought under the federal securities laws will then be analyzed. In the third section of the note, the significance of the governmental/proprietary distinction in eleventh amendment cases and some practical considerations relating to the application of the distinction will be examined.

## I. WAIVER OF ELEVENTH AMENDMENT IMMUNITY

The eleventh amendment provides that "[t]he judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."<sup>30</sup> Although on its face the amendment applies only to suits

<sup>27</sup> *Id.* at 1274.

<sup>28</sup> See *Yeomans v. Kentucky*, 514 F.2d 993, 995 (6th Cir. 1975); *Brown v. Kentucky*, 513 F.2d 333, 336 (6th Cir. 1975).

<sup>29</sup> See *Employees v. Department of Pub. Health and Welfare*, 411 U.S. 279, 284 (1973).

<sup>30</sup> U.S. CONST. amend. XI. It should be noted that a state possesses two kinds of immunity, which are often confused by the courts. First there is the common law doctrine of sovereign immunity, which bars a suit against a state by its own citizens absent its consent. See *Employees v. Department of Pub. Health and Welfare*, 411 U.S. 279, 288 (1973) (Marshall, J., concurring). In 1793, in *Chisholm v. Georgia*, 2 U.S. (2 Dall.) 419 (1793), the Supreme Court held that under article III of the Constitution ("The judicial power shall extend to . . . controversies . . . between a state and citizens of another state . . . and between a state . . . and foreign states, citizens or subjects." U.S.

brought against a state by out-of-staters, the Supreme Court has "consistently held that an unconsenting State is immune from suits brought in federal courts by her own citizens as well . . . ."<sup>31</sup> The amendment thus creates a constitutional immunity to private suit which may be invoked whenever a state is sued in federal court. However, as is the case with other constitutionally created rights, a state may waive its immunity to suit.<sup>32</sup> One of the ways a state may waive its eleventh amendment immunity is by engaging in an activity to which Congress has attached the condition of amenability to private federal suit.<sup>33</sup> In such a case the state will be held to have impliedly waived its immunity to suit.<sup>34</sup>

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CONST., art. III, § 2) a suit could be brought against a state in federal court by an out-of-stater. 2 U.S. (2 Dall.) at 450-51 (opinion of Blair, J.), 467 (opinion of Cushing, J.), 476-77, (opinion of Jay, C.J.) (1793). The decision in effect held that a state's common law immunity, which protected the state against suits brought in its own courts, was ineffective to insulate states from private suits brought in federal court. As a result an "outraged outcry of financially embarrassed debtor States fearful of suits in federal court greeted that decision and resulted in the immediate proposal, and fairly prompt adoption, of the Eleventh Amendment." *Employees*, 411 U.S. at 310 (Brennan, J., dissenting). This amendment created a second, constitutional source of immunity, applicable to suits brought against a state in federal court. See *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264, 406 (1821) (supporting the view that the financial shakiness of the states motivated the adoption of the amendment). See also *Employees*, 411 U.S. at 291 (Marshall, J., concurring); *Hans v. Louisiana*, 134 U.S. 1, 12-14 (1890); *Cullison, Interpretation of the Eleventh Amendment*, 5 HOUS. L. REV. 1, 6-9 (1967) (eleventh amendment introduced to clarify the original intent of the framers of the Constitution concerning the reach of the federal judicial power).

<sup>31</sup> *Edelman v. Jordan*, 415 U.S. 651, 662-63 (1974). Because much of the recent eleventh amendment law has developed in the context of suits brought against a state by its own citizens, this note will treat the amendment as applying to all private suits brought against a state in federal court. See, e.g., *id.* (holding the eleventh amendment barred a retroactive award against a state in a suit brought by the state's own citizens); *Employees v. Department of Pub. Health and Welfare*, 411 U.S. 279, 280 (1973).

<sup>32</sup> *Clark v. Barnard*, 108 U.S. 436, 447 (1883).

<sup>33</sup> See *Parden v. Terminal Ry.*, 377 U.S. 184, 195-96 (1964).

<sup>34</sup> *Id.* at 192. There are two additional ways in which a state may waive its eleventh amendment immunity to suit. The first is through an express waiver in the constitution or laws of the state. See *Petty v. Tennessee-Missouri Bridge Comm'n*, 359 U.S. 275, 276 (1959). Because the eleventh amendment confers a constitutional right, the courts have been reluctant to find an express waiver of this immunity unless it can be "shown to be clear and unequivocal." *Rothstein v. Wyman*, 467 F.2d 226, 238 (2nd Cir. 1972), *cert. denied*, 411 U.S. 921 (1973). See *Edelman v. Jordan*, 415 U.S. 651, 677 n.19 (1974). Therefore, if there is any indication in the laws of a state that it intended to limit consent to its own state courts, such as by providing a procedure or remedy anomalous to a federal court, a waiver of eleventh amendment immunity will not be found. *Chandler v. Dix*, 194 U.S. 590, 591-92 (1904); *Smith v. Reeves*, 178 U.S. 436, 438, 441 (1900); *Great Northern Life Ins. Co. v. Read*, 322 U.S. 47, 55 (1944). The final way a state may consent to private suit is by making a general appearance in federal court. Such appearance may be to defend on the merits, *Clark v. Barnard*, 108 U.S. 436, 447 (1883); *Gunter v. Atlantic Coast Line R.R. Co.*, 200 U.S. 273, 284 (1906), or to intervene to protect its own interests. *Clark v. Barnard*, 108 U.S. 436, 447 (1883). However, a limited appearance by a state in a federal suit will not be held to constitute a waiver of its immunity. *Missouri v. Fiske*, 290 U.S. 18, 25 (1933).

In contrast to an express waiver or waiver by appearance, which may occur in the context of any type of suit brought in federal court, the question of implied waiver

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### A. The Implicit Intent Test of Parden

The doctrine of implied consent under the eleventh amendment was first clearly enunciated in *Parden v. Terminal Ry.*,<sup>35</sup> where an individual sought to enforce the personal injury liability provisions of the Federal Employers Liability Act (FELA)<sup>36</sup> against a state-owned railroad engaged in interstate commerce.<sup>37</sup> The Court<sup>38</sup> first posed the question whether in enacting the FELA, Congress intended to subject a state to suit in these circumstances.<sup>39</sup> The Court found that it had, basing its conclusion both on language in the statute which referred to "every" common carrier by railroad in interstate commerce,<sup>40</sup> and on legislative history showing that the Act was intended to extend as far as the power of Congress to regulate interstate commerce would allow.<sup>41</sup> Furthermore, the Court reasoned that if Congress had intended to "exclude a particular group of workers from the benefits conferred by the Act" it would have done so.<sup>42</sup> The Court thus con-

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only arises in suits brought against a state under a federal regulatory statute. Furthermore, the issue only arises where it is doubtful that Congress could directly subject a state to suit. Compare *Parden v. Terminal Ry.*, 377 U.S. 184, 192 (1964) (Under the commerce power, Congress may condition the right to operate a railroad in interstate commerce upon amenability to private suit in federal court) with *Fitzpatrick v. Bitzer*, 427 U.S. 445, 456 (1976) (Under section 5 of the fourteenth amendment Congress may directly impose liability to private federal suits upon states in order to prevent discrimination on the basis of race, color, sex, etc.). See note 178 *infra*.

<sup>35</sup> 377 U.S. 184 (1964).

<sup>36</sup> 45 U.S.C. §§ 51 *et seq.* (1970). The FELA provides in part that "[e]very common carrier by railroad while engaging in commerce between any of the several States . . . shall be liable in damages to any person suffering injury while employed by such carrier in such commerce . . . ." *Id.* § 51.

<sup>37</sup> 377 U.S. at 184-85.

<sup>38</sup> Justice Brennan spoke for the majority in a 5-4 decision.

<sup>39</sup> 377 U.S. at 187.

<sup>40</sup> *Id.*, quoting 45 U.S.C. § 51 (1970).

<sup>41</sup> 377 U.S. at 187 n.5. To support its conclusion that Congress intended the liability provisions of the Act to apply to a state, the Court cited two earlier opinions in which similar broad language in other federal railway statutes had been held to embrace state owned railroads. *Id.* at 187-89. In *United States v. California*, 297 U.S. 175 (1936), a unanimous Supreme Court held that the words "any common carrier engaged in interstate commerce by railroad" in the Safety Appliance Act, 45 U.S.C. §§ 2, 6 (1970), included stated owned railroads within their scope. 297 U.S. at 185-87. As a result, the United States was allowed to recover a \$100 statutory penalty for permitting the use of substandard couplers. Later, in *California v. Taylor*, 353 U.S. 553 (1957), by virtue of similar language in the Railway Labor Act, 45 U.S.C. §§ 151 *et seq.* (1970) ("any . . . carrier by railroad subject to the Interstate Commerce Act," *id.* § 151), the Court held that the same state railroad was bound by the substantive provisions of that Act. 353 U.S. at 554. Neither case involved an attempt by a private party to sue the state, as in *Parden*, however, and the Court in *Taylor* specifically reserved consideration of whether the eleventh amendment would bar an employee of the railroad from enforcing an award of damages by the National Railway Adjustment Board against a state in federal court. *Id.* at 568 n.16. Thus these cases focused only upon whether Congress intended the substantive provisions of the acts to apply to states and not upon whether Congress intended to affect a state's immunity from private suit.

<sup>42</sup> 377 U.S. at 190.

cluded that Congress intended the liability for personal injury provisions of the FELA to apply to states.<sup>43</sup>

The Court also found sufficient indication that Congress intended to authorize private suits against states under the Act. "To read a 'sovereign immunity exception' into the Act," the Court argued, "would result in a right without a remedy,"<sup>44</sup> since employees who had been given a right under the FELA to be compensated by their employer would be left without a means of enforcing that right. The Court was "unwilling to conclude that Congress intended so pointless and frustrating a result."<sup>45</sup> Thus the Court found implicit in the FELA a congressional intent to subject states to private suit, even though the Act nowhere mentioned states, and even though Congress apparently never considered that the Act might infringe upon a state's eleventh amendment immunity from suit.<sup>46</sup>

After determining that Congress intended to authorize private suits against a state, the Court then addressed the question whether the national government possessed the power to subject a state to suit as against a state's claim of immunity. The Court first found that "by empowering Congress to regulate commerce [upon ratifying the Constitution] the States necessarily surrendered any portion of their sovereignty that would stand in the way of such regulation."<sup>47</sup> Therefore, the Court concluded, it was within Congress' power to create a cause of action against states pursuant to its plenary power to regulate interstate commerce.<sup>48</sup> However, instead of holding that this surrender of sovereign immunity gave Congress power to "directly strip a state of its sovereign immunity"<sup>49</sup> without the state's consent, the Court concluded that in enacting the FELA, "Congress conditioned the right to operate a railroad in interstate commerce upon amenability to suit in federal court"<sup>50</sup> and that Alabama, by thereafter operating an interstate railroad, *impliedly consented* to suit under the FELA.<sup>51</sup>

<sup>43</sup> *Id.* at 189-90.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.* at 199 (White, J., dissenting).

<sup>47</sup> *Id.* at 192. The Court continued: "Since imposition of the FELA right of action is within the congressional regulatory power, it must follow that application of the Act to such a railroad cannot be precluded by sovereign immunity." *Id.* The Court also quoted *New York v. United States*, 326 U.S. 572, 582 (1946): "[B]y engaging in the railroad business a State cannot withdraw the railroad from the power of the federal government to regulate commerce." 377 U.S. at 192 n.10.

<sup>48</sup> 377 U.S. at 191-92. See note 47 *supra*.

<sup>49</sup> *Id.* at 194 n.11.

<sup>50</sup> *Id.* at 192 (emphasis added).

<sup>51</sup> *Id.* The Court explained:

Recognition of the congressional power to render a State suable under the FELA does not mean that the immunity doctrine, as embodied in the Eleventh Amendment with respect to citizens of other States and as extended to the State's own citizens by [*Hans v. Louisiana*, 134 U.S. 1 (1890)] is here being overridden. It remains the law that a State may not be sued by an individual without its consent. Our conclusion is simply that

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The majority in *Parden* thus based its decision to allow the private suit for damages against the state upon four legal determinations: 1) that Congress intended to create a substantive right in employees of state owned railroads; 2) that Congress intended to allow private parties to enforce that remedy through a suit for damages against a state in federal court; 3) that Congress possessed the constitutional authority<sup>52</sup> to render a state amenable to suit by private parties in federal court; and 4) that the state consented to such suits. Assuming these four elements may be found, *Parden* stands for the proposition that when a state becomes involved in an activity already regulated by Congress under the commerce power, it will be deemed to have waived its immunity to suit brought under that regulation.

The four man dissent in *Parden* agreed with the majority that Congress could "condition a State's permit to engage in the interstate transportation business on a waiver of . . . immunity."<sup>53</sup> However, the dissenters would have required "that if Congress decides to . . . condition privileges within its control on the forfeiture of constitutional

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Alabama, when it began operation of an interstate railroad approximately 20 years after enactment of the FELA, necessarily consented to such suit as was authorized by that Act.

*Id.* (emphasis added). Thus, the fact that the federal regulation was in effect before the state began the operation of its railroad appeared to be necessary to the Court's finding of consent. The case has been so interpreted. See *Forman v. Community Servs., Inc.*, 500 F.2d 1246, 1256 n.13 (2d Cir. 1974), *rev'd on other grounds*, 421 U.S. 837 (1975); *Employees v. Department of Pub. Health and Welfare*, 411 U.S. 279, 296 (1973) (Marshall, J., concurring). Further support for this view may be found in a footnote in *Parden*, where Justice Brennan discussed the respondent's argument that Congress has no power to "directly strip a State of its sovereign immunity":

That Congress could not make a State suable upon all causes of action does not mean that it cannot do so with respect to this particular cause of action, where imposition of such liability is within its power to regulate commerce and where the State, by operating a railroad in interstate commerce, has voluntarily submitted itself to that power.

377 U.S. at 193-94 n.11 (emphasis added). See also *id.* at 195 n.13. Thus, despite his later disclaimers, see note 56 *infra*, Justice Brennan seemed to indicate that some voluntariness, such as that found when a state becomes involved in an activity already under federal regulation, was necessary to his finding that Alabama consented to suit. See note 76 *infra*.

Justice Brennan's mention of the eleventh amendment is inexplicable in light of his later analysis of the significance of *Parden*. See *Employees v. Department of Pub. Health and Welfare*, 411 U.S. 279, 300, 309 (1973) (Brennan, J., dissenting). In his dissent in *Employees*, Brennan claimed "*Parden* regarded the Eleventh Amendment to be inapplicable to suits against a State brought by its own citizens in federal court and held that whether the FELA suit was maintainable turned on the availability to Alabama of the protection of the ancient doctrine of sovereign immunity." *Id.* at 309. Brennan also maintained that "*Parden* held that the States had surrendered the protection of sovereign immunity in federal court suits authorized by Congress pursuant to the States' grant to Congress of the commerce power." *Id.* at 300. Thus, it is clear that Brennan really meant that Alabama consented to suit not when it operated a railroad after the FELA was enacted but when it operated a railroad after giving Congress power to regulate interstate commerce. See note 56 *infra*.

<sup>52</sup> In *Parden* the congressional authority stemmed from the commerce power. U.S. CONST. art. I, § 8, cl. 3.

<sup>53</sup> 377 U.S. at 198 (White, J., dissenting) (emphasis added).



rights, its intention to do so should appear with unmistakable clarity."<sup>54</sup> Finding no clear indication in the legislative history that Congress intended that a state which operated a railroad in interstate commerce would automatically be deemed to have waived its immunity,<sup>55</sup> the dissenters protested, "the majority in effect holds that . . . waiver of a constitutional privilege need be neither knowing nor intelligent."<sup>56</sup> Thus the dissenters would have required an affirmative showing of intent to subject a state to private federal suit before an implied waiver of immunity could be found. Additionally, they would have invoked a higher standard to determine whether the state consented to be sued—and would not have found a waiver of a state's immunity unless it was shown to be knowing and intelligent.

### B. The Explicit Intent Test of Employees

In the second Supreme Court case bearing on implied consent, *Employees v. Department of Public Health and Welfare*,<sup>57</sup> the view of the dissenters in *Parden* prevailed. At issue was whether employees of the Department of Public Health and Welfare of Missouri could sue the state in federal court for overtime compensation<sup>58</sup> due them under the Fair Labor Standards Act of 1937 (FLSA).<sup>59</sup> Originally, the FLSA specifically exempted state employees from the provisions of the Act,<sup>60</sup> but in 1966 Congress amended the Act specifically to include

<sup>54</sup> *Id.* at 199 (White, J., dissenting).

<sup>55</sup> *Id.*

<sup>56</sup> *Id.* at 200. That Justice Brennan did in fact mean that a state's waiver could be neither knowing nor intelligent is clear from his dissent in *Employees v. Department of Pub. Health and Welfare*, 411 U.S. 279, 298-324 (1973). There he maintained that *Parden* found the eleventh amendment not applicable to suits brought against a state in federal court by its own citizens. Therefore the only question to be decided was whether the state could invoke the common law and nonconstitutional doctrine of sovereign immunity. *Id.* at 309. In addition, according to Justice Brennan, *Parden* found that the states had surrendered their immunity to federal court suits in the commerce area when they adopted the Constitution. *Id.* at 299. Furthermore, he would continue the trend against finding governmental immunity except where absolutely required by a literal reading of the Constitution. *Id.* at 323.

However, as Justice Douglas pointed out, writing for the majority in *Employees*, if the question were so simple, then why in *Parden* did the Court even pursue the question of waiver? *Id.* at 280 n.1. If only a state's sovereign immunity and not its constitutional immunity were at stake in *Parden*, there would have been no need "to reach the question of waiver or consent, for Congress could subject the States to suit by their own citizens whenever it was deemed necessary or appropriate to the regulation of commerce." *Id.* Furthermore, as Justice Douglas noted, "there can be no doubt that the Court's holding in *Parden* was premised on the conclusion that Alabama, by operating the railroad, had consented to suit in the federal courts under FELA." *Id.* See note 51 *supra*.

<sup>57</sup> 411 U.S. 279 (1973).

<sup>58</sup> *Id.* at 281.

<sup>59</sup> 29 U.S.C. §§ 201 *et seq.* (1970). The FLSA provides for minimum wages, *id.* § 206, and minimum overtime compensation, *id.* § 207, for certain employees in enterprises affecting interstate commerce.

<sup>60</sup> Fair Labor Standards Act, ch. 676, § 3(d), 52 Stat. 1060 (1938).

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certain employees of state-run hospitals, institutions, and schools within its minimum wage and overtime compensation provisions.<sup>61</sup> As employees of state health facilities, plaintiffs were included by the 1966 amendments.<sup>62</sup>

Justice Douglas, writing for the Court, conceded that Congress intended the substantive provisions of the Act to apply to states.<sup>63</sup> However, he found that the legislation failed to evidence a clear congressional intent to authorize private suits against states in federal court,<sup>64</sup> since the jurisdictional section of the FLSA—undisturbed by the 1966 amendments—provided only that employers who violated the Act could be sued “in any court of competent jurisdiction.”<sup>65</sup> Because this jurisdictional section omitted reference either to state employers or to federal courts,<sup>66</sup> the Court concluded that Congress did not intend to “condition the operation of [the state facilities covered by the Act] on the forfeiture of immunity from suit in a federal forum.”<sup>67</sup> Therefore, since the statute did not condition the state’s

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<sup>61</sup> Fair Labor Standards Amendments of 1966, Pub. L. No. 89-601, § 102(b), 80 Stat. 830 (amending 29 U.S.C. § 203(d)). The Court had previously held that the 1966 amendments, as they applied to states, were a constitutional exercise of the congressional commerce power. *Maryland v. Wirtz*, 392 U.S. 183, 196-99 (1968), *overruled by National League of Cities v. Usery*, 426 U.S. 833, 855 (1976). The Court specifically reserved consideration of the eleventh amendment question for a future case. 392 U.S. at 200. The *Wirtz* decision was expressly overruled in *National League of Cities v. Usery*, 426 U.S. 833, 855 (1976), on the ground that the amendments unduly interfered with the states’ administration of essential governmental functions which had traditionally been carried on by states. *Id.* at 852. See discussion of *National League of Cities* in text at notes 169-80 *infra*.

<sup>62</sup> 411 U.S. at 279.

<sup>63</sup> *Id.* at 283. The majority of the Court in *Employees* did acknowledge, however, that under the power conferred by the commerce clause, U.S. CONST. art. I, § 8, cl. 3, Congress has the power to regulate the wages of employees of the state’s nonprofit facilities and consequently to place “new or even enormous fiscal burdens” on the states when it does so. 411 U.S. at 284. This dictum was based on the Court’s earlier decision in *Maryland v. Wirtz*, 392 U.S. 183, 195 (1968), which had declared the substantive provisions of the Act constitutional as they applied to states. There was thus no question that the Act was binding upon the states.

<sup>64</sup> 411 U.S. at 285.

<sup>65</sup> 29 U.S.C. § 216(b) (1970). This provision provided in part: Any employer who violates the provisions of [this Act] shall be liable to the . . . employees affected in the amount of their unpaid minimum wages or their unpaid overtime compensation as the case may be, and in an additional equal amount as liquidated damages. Action to recover such liability may be maintained in any court of competent jurisdiction . . .

<sup>66</sup> In *Parden*, the FELA specifically provided for suit in federal courts, although it omitted any reference to states: “Under this chapter an action may be brought in a district court of the United States . . . . The jurisdiction of the courts of the United States . . . shall be concurrent with that of the courts of the several States.” 45 U.S.C. § 56 (1970).

<sup>67</sup> 411 U.S. at 285. However, Justice Douglas cryptically suggested that the employees might arguably be able to sue Missouri for back wages in state court. *Id.* at 287. Justice Marshall argued that state courts have a constitutional obligation to entertain suits brought by employees under the FLSA, even if federal courts are barred from hearing such suits by the eleventh amendment. *Id.* at 298 (Marshall, J., concurring in result). To the extent state courts are obliged to entertain such a suit, *see id.*, this obser-

participation in a regulated activity upon amenability to private federal suit, there could be no finding that the state waived its immunity by operating its hospitals and schools.<sup>68</sup> Consequently, the eleventh amendment principle that a state may not be sued in federal court absent its consent,<sup>69</sup> barred the federal court from hearing the suit.<sup>70</sup>

The Court's narrow holding that an intent to subject states to suit had not been shown in this situation introduced a new standard into the implied waiver doctrine. The Court indicated that in order to lift a state's immunity when a state engages in an activity subject to congressional regulation, Congress must *explicitly* show its intention to do so.<sup>71</sup> Yet this result is in direct contrast with *Parden*, which had found a sufficient showing of congressional intent to authorize private federal suits against states *implicit* in a statute which nowhere mentioned states.<sup>72</sup> It was therefore incumbent upon the *Employees* Court to either overrule or distinguish *Parden*. Although the Court might have overruled *Parden* and held that an implied waiver of immunity will not be found unless Congress explicitly conditions state participation in an activity upon amenability to private federal suit,<sup>73</sup> the

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vation presumably applies equally well to the state employees in *Parden*, thereby invalidating the "right without a remedy" rationale used by the majority in that case. See text at notes 44-45 *supra*.

<sup>68</sup> See 411 U.S. at 284, 285. A close reading of the majority opinion reveals that Justice Douglas may have believed that under the commerce power Congress may directly lift the protection afforded states by the eleventh amendment, if it clearly shows its intent to do so. See *id.* at 283 ("The question is whether Congress has brought the States to heel, in the sense of lifting their immunity to suit in a federal court . . ."); *id.* at 285. This would explain his failure to acknowledge the voluntariness distinction noted by Justice Marshall in his concurring opinion. See note 76 *infra*. The possibility that under the commerce power Congress might directly lift a state's eleventh amendment immunity without the state's consent where the regulation concerns a state's essential governmental activities was clearly foreclosed by the Court in *National League of Cities v. Usery*, 426 U.S. 833, 852 (1976). See text at notes 169-80 *infra*.

<sup>69</sup> 411 U.S. at 284.

<sup>70</sup> *Id.* at 285. The Court's narrow holding that Congress had failed to show a sufficiently clear intent to lift a state's immunity from suit in federal court could easily be remedied by an amendment to the Act. *Id.* at 308-09 (Brennan, J., dissenting). In 1974, Congress amended the jurisdictional provision of the FLSA to provide: "Action to recover such liability may be maintained *against any employer (including a public agency) in any Federal or State court of competent jurisdiction . . .*" Fair Labor Standards Amendments of 1974, Pub. L. No. 93-259, § 6(d)(1), 88 Stat. 61 (codified at 29 U.S.C. § 216(b) (Supp. V, 1975)) (new language italicized). And to insure there could be no doubt, the legislative history reads: "This amendment is intended to overcome that part of the decision of the Supreme Court in [*Employees*] which stated that Congress had not explicitly provided in enacting the 1966 amendments that newly covered state and local employees could bring an action against their employer in a Federal court under section 16." H.R. REP. NO. 913, 93d Cong., 2d Sess. 45, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 2811, 2853.

This amendment and others were held unconstitutional in *National League of Cities v. Usery*, 426 U.S. 833, 855 (1976) on tenth amendment grounds. See note 61 *supra*.

<sup>71</sup> 411 U.S. at 285.

<sup>72</sup> See text at note 46 *supra*.

<sup>73</sup> The Court in *Parden* had found congressional intent to subject states to suit

*Employees* Court did not find it necessary to do so.

### C. The Governmental/Proprietary Distinction

Instead of overruling *Parden*, the *Employees* Court chose to distinguish the two cases on the basis of the nature of the state activity involved in each case. According to the Court, the profit-making operation of a "railroad business" by the state in *Parden* "was in the area where private persons and corporations normally ran the enterprise."<sup>74</sup> In *Employees* on the other hand, the non-profit operation of "[s]tate mental hospitals . . . and training schools for delinquent girls" was characterized as nonproprietary.<sup>75</sup> Thus the fact that the state's activity could be characterized as nonproprietary or governmental, apparently required the application of a stricter test to determine whether or not Congress intended to subject states to private federal suit.<sup>76</sup> Because the Court distinguished, rather than overruled,

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implicit in the statute. See text at note 46 *supra*.

<sup>74</sup> 411 U.S. at 284.

<sup>75</sup> *Id.* These activities, the Court emphasized, had been carried on by the states for over one hundred years. *Id.* at 284 & n.2.

The invocation of the proprietary/nonproprietary distinction seems peculiar here, in light of *Maryland v. Wirtz*, 392 U.S. 183 (1968), which had upheld the constitutionality of the substantive provisions of the FLSA governing the wages of certain state employees. *Wirtz*, although specifically reserving consideration of the eleventh amendment question, *id.* at 200, held that Congress, "when acting within a delegated power, may override countervailing state interests whether these be described as 'governmental' or 'proprietary' in character." *Id.* at 195. It would appear, then, that Justice Douglas, who had dissented vigorously in *Wirtz* on the grounds that the tenth amendment and principles of federalism protected states from such intrusions upon their sovereignty, *id.* at 201-05, was here trying to reintroduce considerations of federalism in an area where these considerations had been specifically rejected.

<sup>76</sup> The Court noted two other differences between *Parden* and *Employees*. The first was that under the FLSA the employee would be allowed to "recover double against a state," while in *Parden*, under the FELA, he or she would just be made whole. 411 U.S. at 286. See note 65 *supra*. Justice Douglas, writing for the majority in *Employees*, could not believe that "Congress in the pursuit of a harmonious federalism desired to treat the States so harshly." *Id.* at 286. Justice Brennan dissenting, however, pointed out that Congress had extended the coverage of the Act to state employees "with full awareness that it was imposing a financial burden." *Id.* at 307 (Brennan, J., dissenting). Furthermore, Brennan cited an earlier case which had held that the liquidated damages provision of the FLSA "is not penal in nature but constitutes compensation" for damages too difficult to prove. *Id.* at 307 (Brennan, J., dissenting), quoting *Brooklyn Savings Bank v. O'Neil*, 324 U.S. 697, 707 (1945). Thus, contrary to the view of the majority, the purpose of the statute was "as in *Parden* to make a state employee whole." 411 U.S. at 306 (Brennan, J., dissenting), quoting the majority opinion, *id.* at 286. For these reasons, the double/single recovery distinction seems insignificant.

The second additional distinguishing feature noted by the Court was the fact that in *Parden*, to preclude an injured employee from suing the state would result in a right without a remedy, while in *Employees*, to deny state workers the right to sue their employer in federal court would not make the coverage of the FLSA meaningless. *Id.* at 285-87. According to the provisions of the FLSA, the Secretary of Labor possesses authority to institute suit against nonconforming employers to obtain restitution on behalf of employees. *Id.* at 285-86. See 29 U.S.C. § 216(c) (1970). Justice Douglas concluded that the "policy of the Act so far as the States are concerned is wholly served by allow-

*Parden*, it would seem to follow that an explicit indication of congressional intent to authorize private federal suits against states will be required only where the state activity in question is a governmental function. In contrast, where a state engages in a proprietary activity, as in *Parden*, a sufficient intent to impose liability upon a state may be inferred from the purposes of the regulatory statute, even if not explicitly indicated.

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ing the delicate federal-state relationship to be managed through the Secretary of Labor." 411 U.S. at 286. However, as Justice Brennan pointed out in dissent, *id.* at 305, and as Justice Douglas himself seemed to acknowledge, *id.* at 287, the validity of this distinction is open to question. Due to a lack of staff and resources, the Secretary of Labor has the ability to investigate only a fraction of the claims that might otherwise be privately enforced. *Id.* at 305 n.5. Consequently, most state employees with valid claims for wages under the FLSA would be left with a right to wages but without a remedy to enforce that right. *Id.* at 305. Thus this distinction also seems insignificant.

The Tenth Circuit in *Green* considered a similar argument advanced by the plaintiff, namely that to uphold the state's eleventh amendment immunity would in effect deny her a forum in which to prosecute her claim. 539 F.2d at 1274. The court of appeals concluded, however, that "[t]he apparent hardships resulting from the adoption [of the immunity doctrine] have long been subordinated." 539 F.2d at 1274, quoting *MacKethan v. Virginia*, 370 F. Supp. 1 (E.D. Va. 1974), *aff'd*, 508 F.2d 838, *cert. denied*, 422 U.S. 1045 (1975). The court of appeals further opined that "this subordination of hardship seems acceptable when a governmental function is involved." 539 F.2d at 1274. By dismissing the "right without a remedy" argument in this fashion, the *Green* court, in effect, indicated its agreement with the view that the availability of an alternative remedy was not an important distinction between *Employees* and *Parden*. Because the double recovery and alternative remedy distinctions just discussed seem insignificant, the crucial distinction between *Employees* and *Parden* would seem to be the governmental/proprietary one. The Tenth Circuit's treatment of *Employees* and *Parden* in its opinion in *Green* supports this view.

Justice Marshall, in his concurring opinion in *Employees*, noted another difference between the two cases. In *Parden* it was possible to find a voluntary waiver since the FELA had been in effect for 20 years when Alabama started its railroad. 411 U.S. at 296 (Marshall, J., concurring). In *Employees*, on the other hand, the state was already operating the affected schools and hospitals at the time of the 1966 amendments and therefore could not have voluntarily chosen to subject itself to federal court suits. Marshall found this absence of free choice of crucial importance:

To suggest that the State had the choice of either ceasing operation of these vital public services or "consenting" to federal suit suffices, I believe, to demonstrate that the State had no true choice at all and thereby that the State did not voluntarily consent to the exercise of federal jurisdiction in this case.

*Id.* at 296 (Marshall, J., concurring). Since a state may not be sued in federal court absent its consent, and since there was no consent here, Marshall concurred in affirming the dismissal of the action. *Id.* at 296-97.

Although Justice Marshall agreed that the federal courts would be barred from entertaining the suit under the eleventh amendment, in his view the state courts would be able—and in fact, obligated—to entertain the suit. In his view, the eleventh amendment confers no absolute immunity from suit, just immunity from suit in federal court. When suit is brought against a state in state court the only immunity available to the state would be its nonconstitutional sovereign immunity, which the states surrendered to the national government insofar as they granted Congress power to regulate interstate commerce under the commerce clause. Therefore, a state court would be obligated to assess damages against the state, even though a federal court could not. *Id.* at 297-98 (Marshall, J., concurring):

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### D. Congressional Intent: A Prerequisite to Finding Waiver

The third Supreme Court decision providing the background for *Green's* holding on the issue of implied consent is *Edelman v. Jordan*.<sup>77</sup> In *Edelman*, recipients of Aid to the Aged, Blind and Disabled (AABD)<sup>78</sup> funds sued Illinois officials seeking a retroactive award of wrongfully withheld benefits.<sup>79</sup> The Court, in a 5-4 opinion, first noted the general rule that "a suit by private parties seeking to impose a liability which must be paid from public funds in the state treasury is barred by the Eleventh Amendment."<sup>80</sup> The Court then addressed the question whether the state had impliedly waived its eleventh amendment immunity by participating in a federal-state program subject to federal regulation. *Parden* and *Employees* were found inapplicable to the situation in *Edelman*.<sup>81</sup> In those cases, the Court observed, the question of waiver or implied consent turned "on whether Congress had intended to abrogate the immunity in question, and whether the State by its participation in the program authorized by Congress had in effect consented to the abrogation of that immunity."<sup>82</sup> In *Edelman*, however, "the threshold fact of congressional authorization to sue a class of defendants which literally includes States was wholly absent."<sup>83</sup> Congress simply had not created a cause of action against a state for a state's violation of federal AABD regulations.<sup>84</sup> The Court held that absent this threshold fact, the mere participation by a state in a federal-state public aid program is not sufficient to establish consent to suit in federal courts.<sup>85</sup> Consequently,

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<sup>77</sup> 415 U.S. 651 (1974).

<sup>78</sup> See 42 U.S.C. §§ 1381-1385 (1970) (amended 1972).

<sup>79</sup> 415 U.S. at 653, 656. Because of delays in processing applications and paying funds to eligible recipients, plaintiffs had been denied money to which they were entitled under federal regulations.

In addition to retroactive relief, the petitioners sought and obtained a permanent injunction requiring Illinois officials to comply with the federal regulations. The Supreme Court affirmed the validity of the prospective relief. *Id.* at 665. See note 86 *infra*.

<sup>80</sup> 415 U.S. at 663.

<sup>81</sup> *Id.* at 672.

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> *Id.* at 674. Even 42 U.S.C. § 1983 (1970), which provides for suits against persons acting under color of state law who deprive any person of rights secured by federal law, was held not to indicate congressional intent to lift a state's eleventh amendment immunity, since it was directed toward state officers rather than states. 415 U.S. at 674-77. See note 86 *infra*.

<sup>85</sup> In other words, where Congress had not conditioned participation in the AABD program upon amenability to suit, there could be no finding of implied waiver, and the mere fact of participation in the federal-state program did not amount to an express waiver of immunity. See note 34 *supra*. The Court also indicated that although it had in past cases authorized suits between private parties in order to effectuate a statutory purpose, it had never done so in the context of the eleventh amendment. 415 U.S. at 673-74.

the Court held that the eleventh amendment barred plaintiffs' suit for retroactive benefits.<sup>86</sup>

Thus *Edelman*, like *Employees*, focused on whether Congress intended to allow private suits against a state. Since Congress had created no private cause of action at all to enforce AABD regulations, there was no indication that Congress intended to condition a state's participation in the federal-state program upon a waiver of eleventh amendment immunity.

These three cases, *Parden*, *Employees*, and *Edelman*, provide the Supreme Court's guidance to the lower courts regarding the question of implied waiver under the eleventh amendment. *Edelman* made clear that implied consent may only be found where Congress provides a cause of action against a class of defendants which literally includes states. Once this threshold requirement is met, the other two cases taken together indicate that the nature of the state activity must be examined. In *Parden*, where a state was engaged in a proprietary activity, the Court found the requisite congressional intent implicit in the purposes of the FELA. Thus in order to find an implied waiver in *Parden*, it was unnecessary to show that Congress had even considered that the Act might abrogate a state's constitutional immunity to suit. In *Employees*, on the other hand, where historically governmental state activities were involved, the Court held that only a *clear* showing by Congress of intent to lift a state's immunity from suit would be sufficient to justify a finding of waiver. It was not enough in *Employees* to show that Congress clearly intended the Act to be binding upon the states; rather an explicit showing that Congress intended to subject states to private federal suit was required. Thus the Supreme Court apparently indicated that two different standards of review exist for determining whether an implied waiver of immunity may be found, depending

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<sup>86</sup> 415 U.S. at 678. The plaintiffs had been allowed, however, to seek injunctive relief to prevent the wrongful withholding of benefits in the future and the state did not challenge the validity of the prospective relief on appeal. *Id.* at 656-58.

The apparently inconsistent result that allowed a private party to sue for prospective relief but barred a suit for retroactive relief is the result of another fiction developed to avoid the harsh effect of the eleventh amendment. In a series of cases culminating in *Ex parte Young*, 209 U.S. 123, 159-60 (1908), the Court held that suits against state officers are not necessarily suits against the state itself. These cases established the principle that when a state officer acts contrary to the Constitution or laws of the United States, he is stripped of his representative capacity and becomes suable as an individual. *Id.* However, if the relief sought involves a monetary award to be paid from the state treasury, the suit will be considered as one against the state and thus barred by the eleventh amendment. *Ford v. Department of Treasury*, 323 U.S. 459, 464 (1945). In *Edelman* these two principles collided and the Court, in effect, held that the suit against the officer, who by violating federal law was "stripped of his representative capacity," was not a suit against the state when prospective relief was sought, but the same suit did constitute a suit against the state when the order was to be applied retroactively, because it would result in the award of moneys from the state treasury. Thus the suit for retroactive relief, being one against the state, was barred by the eleventh amendment.

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upon whether the state activity is considered governmental or proprietary.

### II. IMPLIED WAIVER UNDER THE SECURITIES ACTS

#### A. Legislative Intent

As the Supreme Court decisions in *Parden*, *Employees* and *Edelman* indicate, in order to find an implied waiver of immunity under federal regulatory statutes, a congressional intent to allow private federal suits against states must be shown. It is therefore necessary when analyzing *Green* to examine the securities laws in order to determine if this requisite congressional intent exists.

It is clear that the general antifraud provisions of the Securities Acts<sup>87</sup> apply to states when they issue securities. The definitional sections of both Acts define "person" to include "a government or political subdivision thereof."<sup>88</sup> The legislative history of the 1933 Act shows that this definition was meant to include "every form of commercial organization that might issue securities,"<sup>89</sup> including a "government or political subdivision."<sup>90</sup> Although state issued securities are exempt from the registration and disclosure requirements of the 1933 Act,<sup>91</sup> they are specifically not exempt from the antifraud section of that Act<sup>92</sup> and are also covered by the antifraud section of the 1934 Act.<sup>93</sup> Substantively, the antifraud provisions of both Acts make it unlawful for any person in connection with the offer or sale of any securities to engage in any act, "practice, or course of business which

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<sup>87</sup> 15 U.S.C. §§ 77q, 78j (1970).

<sup>88</sup> 15 U.S.C. § 77b(2) (1970); *id.* § 78c(a)(9) (Supp. V, 1975). Prior to June 4, 1975, the definition of person in the Exchange Act did not include governments or political subdivisions. *See* 15 U.S.C. § 78c(a)(9) (1970).

<sup>89</sup> H.R. REP. NO. 85, 73d Cong., 1st Sess. 11 (1933).

<sup>90</sup> *Id.* *See also* *Case v. Bowles*, 327 U.S. 92, 98-100 (1946) (construing a similar definition of person as showing clear congressional intent to include states).

<sup>91</sup> *See* 15 U.S.C. §§ 77c(a)(2), 77f, 77j (1970).

<sup>92</sup> *See* 15 U.S.C. § 77q(c) (1970).

<sup>93</sup> *See* 15 U.S.C. §§ 78c(9), (10), 78j (1970 & Supp. V, 1975). *See also* S. REP. NO. 75, 94th Cong., 1st Sess. 44-45, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 221-23 (legislative history of the 1975 amendments to the Exchange Act). The senate report stated in part: "The Committee is mindful of the historical relationship between the federal securities laws and issuers of municipal securities. Apart from the general anti-fraud provision, municipal securities are exempt from all substantive requirements." *Id.* at 44. The report went on to note:

[A]ll documents and materials utilized in connection with the sale [of municipal securities] would remain subject to the antifraud provisions of the Exchange Act. The [proposed amendments to the Exchange Act assure] that access of state and local governments to the capital markets will not be regulated in ways not now permitted under the fraud provisions of the federal securities laws."

*Id.* at 45. This would seem to indicate a congressional understanding that the antifraud provisions do apply to state issued securities.



operates or would operate as a fraud or deceit upon the purchaser."<sup>94</sup> It is therefore clear that states are to be bound by the substantive requirements of the Securities Acts' antifraud provisions.

However, it seems doubtful that Congress intended to condition a state's participation in the sale or distribution of securities upon amenability to private federal suit. Missing from the Acts is any indication that Congress intended to authorize private suits to be brought under the general antifraud sections.<sup>95</sup> While some sections of the 1933 Act specifically authorize private suits for damages in connection with a false registration statement,<sup>96</sup> or misleading prospectus,<sup>97</sup> the antifraud provisions do not expressly create a civil remedy.<sup>98</sup> Therefore it would seem that Congress did not contemplate a civil remedy for damages under the antifraud provisions of the Securities Acts.<sup>99</sup> Furthermore although the existence of an implied right to sue for damages under the antifraud sections has since been well established,<sup>100</sup> the absence of the "threshold fact of congressional au-

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<sup>94</sup> 15 U.S.C. § 77q (1970). The antifraud provision of the 1933 Act provides in part:

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —

- (1) to employ any device, scheme, or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission 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
- (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

*Id.* Compare this language with that of rule 10b-5, which is quoted at note 3 *supra*, promulgated pursuant to the antifraud section of the 1934 Act, 15 U.S.C. § 78j (1970).

<sup>95</sup> See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976) (there is no indication that Congress contemplated a civil remedy for violation of the antifraud provision of the Exchange Act); Note, *Implied Liabilities Under the Securities Exchange Act*, 61 HARV. L. REV. 858, 860 (1948).

<sup>96</sup> 15 U.S.C. § 77k (1970). States are not required to register their securities and therefore are exempt from this section. *Id.* §§ 77c(a)(2), 77f (1970).

<sup>97</sup> 15 U.S.C. § 77l (1970). State securities are also exempt from this section. *Id.* § 77l(2) (1970). Another section makes liable persons who control persons liable under sections 77k or 77l. 15 U.S.C. § 77o (1970). See notes 102, 135 *infra*.

<sup>98</sup> See 15 U.S.C. §§ 77q, 78j (1970).

<sup>99</sup> *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976); Note, *Implied Liabilities Under the Securities Exchange Act*, 61 HARV. L. REV. 858, 860-61 (1948).

<sup>100</sup> *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976). The Supreme Court has interpreted the scope of the remedy available under the antifraud provision of the Exchange Act, 15 U.S.C. § 78j (1970) in the light of other sections of the Act. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194-211 (1976) (in light of the purposes and language of other sections of the securities acts, the Court held that it is necessary to prove scienter in order to recover damages under § 10b); *Blue Chips Stamps v. Manor Drug Stores*, 421 U.S. 723, 731-36 (1975) (private damages under rule 10b-5 restricted to actual purchasers or sellers); *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153, 155 (1972) (the amount of damages obtainable under § 10b is governed by § 28, 15 U.S.C. § 78bb(a)).

thorization to sue a class of defendants which literally includes States" required by *Edelman*,<sup>101</sup> would seem to preclude a finding of implied waiver under these sections of the securities laws, when a state engages in the sale or distribution of securities.<sup>102</sup>

For a list of factors relevant to determining whether a private remedy is implicit in a federal statute not expressly providing one, see *Cort v. Ash*, 422 U.S. 66, 78 (1975).

<sup>101</sup> 415 U.S. at 672. See text at notes 119-21 *supra*.

<sup>102</sup> In *Edelman*, the Court refused to imply a private right of action for wrongfully denied benefits in spite of the fact that Congress clearly intended states to comply with the federal regulations in connection with the administration of the AABD program. See note 79 *supra*. It would seem that the same approach is mandated under the securities laws, even though Congress probably intended that states not violate the antifraud provisions when they issue securities. Even if the issuing of securities by a state is considered to be a proprietary function, thereby causing the question of implied waiver to be determined by *Parden's* implicit intent test, the fact that Congress failed to provide a cause of action against those who violate the antifraud section would seem to prevent the courts from ever reaching the question of which test to apply. See note 85 *supra*. Of course, if the sale of securities by a state is considered to be governmental, see note 164 *infra*, the failure of the Securities Acts to provide explicitly for private federal suits against states would preclude a finding of implied waiver under the *Employees test*.

An argument may be made that the judicial recognition of an implied remedy under the antifraud provisions, see note 100 *supra* — a judicial recognition absent in *Edelman* — may provide a sufficient basis for distinguishing *Edelman*. Furthermore, to the extent Congress has tacitly endorsed implied liabilities under the antifraud provisions (Congress has not changed the antifraud provisions during the thirty years in which an implied remedy has been allowed by the courts. See Note, *Implied Liabilities Under the Securities Exchange Act*, 61 HARV. L. REV. 858, 859-60 (1948) (implied liability under the antifraud provisions first recognized in 1946)), it may be argued that the statutes do, in effect, create a cause of action against "a class of defendants which literally includes States." *Edelman*, 415 U.S. at 672. Furthermore, if the sale of securities by a state is considered to be a proprietary function, the extension of a well established implied remedy to cover state defendants would seem to be clearly analogous to the extension of an express right to sue under the FELA in *Parden*. The fact that the antifraud provisions do not create an express remedy may be balanced by the fact that, unlike the FELA in *Parden*, they specifically apply to states. See text at note 90 *supra*.

The potentially fatal weakness of this argument stems from the fact that the remedy is nevertheless an implied one. While the Court has "authorized suits by one private party against another in order to effectuate a statutory purpose, it has never done so in the context of the Eleventh Amendment and a state defendant." *Edelman*, 415 U.S. at 673-74. Although the Court did not preclude the availability of equitable relief in an eleventh amendment case, *id.* at 672 n.15, the likelihood that the Court would be willing to extend the implicit intent test of *Parden* to allow a private suit against a state under the antifraud provisions is not strong. But see note 184 and accompanying text *infra*.

A more in-depth analysis of the legislative history of the 1933 Act may be used to support either side of the question of congressional intent. On the one hand, support for the view that Congress could not have intended to allow private suits against states may be found in the legislative history indicating Congress first considered and then rejected an effort to make states liable under the express liability provisions. Under the House version of the bill, all persons who sold securities by means of a misleading prospectus—"whether or not [the securities were] exempted by section 3,"—were to be liable to the purchaser for damages. H.R. REP. NO. 85, 73d Cong., 1st Sess. 23 (1933). Under this version, states would have been expressly liable for deceptive language in an official prospectus. However, the conference committee added a proviso to exclude securities issued by states from the terms of the provision. H.R. REP. NO. 152, 73d Cong., 1st Sess. 26-27 (1933) (statement of the House Managers); Landis, *The Legislative History*

An even stronger argument can be made to show that in enacting the antifraud provisions of the securities laws, Congress did not intend to control a state's regulatory activities which affect the securities market. First, the legislative history of the Securities Act of 1933 indicates a desire by Congress to help states in their own regula-

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of the Securities Act, 28 GEO. WASH. L. REV. 29, 46 (1959); 1 LOSS, SECURITIES REGULATION 562 n.10 (1961). See 15 U.S.C. § 77l(2) (1970). Thus Congress excepted state issued securities from a provision creating express liability. Since in another context the Supreme Court has looked to legislative history to determine the reach of the implied liability sections of the Securities Acts, it would probably find this legislative history indicative of a congressional purpose not to subject states to suit. Cf. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201-06 (1976).

On the other hand, a court predisposed to find a state liable under the antifraud provisions could take a different view of the significance of this legislative history. First, it should be noted that theoretically, where a state controls a private corporation which violates section 11 or 12 of the 1933 Act, 15 U.S.C. §§ 77k, 77l (1970), the state will be jointly and severally liable for the violation under section 15, 15 U.S.C. § 77o (1970), unless the state "had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." *Id.* See note 135 *infra*. Thus it is not clear that Congress intended to immunize states from suit in all situations. Second, different sections of the Securities Acts carry with them different standards of care. By exempting state securities from § 12(2), 15 U.S.C. § 77l(2) (1970), wherein in order to avoid liability for a misleading prospectus the seller must show "that he did not know and in the exercise of reasonable care could not have known, of such untruth or omission, . . ." Congress may have only intended to avoid placing such a high standard of care upon states. Cf. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200 (1976). In contrast, under the controlling persons section mentioned above, it is only necessary to meet a more subjective test in order to avoid liability. 15 U.S.C. § 77o (1970). Therefore, where the antifraud provisions require a greater showing of negligence or intentional conduct on the part of the defendant than under section 12, see *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 191-92 n.7 (1976) ("intent to deceive, manipulate or defraud is required for civil liability under § 10b and Rule 10b-5 . . ."), Congress may not have intended to exempt states from liability. Under this approach where the court can find greater negligence or intent than is required under section 12, it could find a state liable under the antifraud provisions.

The Securities Acts also provide jurisdiction in the federal courts to hear suits brought under the Acts, 15 U.S.C. §§ 77v, 78aa (1970). Assuming that the antifraud provisions may be read as providing a cause of action against those who violate their terms (thus satisfying the *Edelman* requirement) it may be argued that because Congress clearly intended the antifraud provisions of the Acts to protect purchasers of securities issued by states as well as those issued by other commercial organizations, see H.R. REP. NO. 85, 73d Cong., 1st Sess. 11, 24 (1933), and because if denied the opportunity to sue the state, the victims of a state's misrepresentation in connection with the offer or sale of securities would have no other remedy, see note 76 *supra*, under the *Parden* test, any state which engaged in the sale or distribution of securities would impliedly waive its eleventh amendment immunity to a suit brought under the antifraud provisions. See discussion in text *supra* at notes 40-46.

The more puzzling question, however, is whether the test in *Parden* may be used in such a situation. The answer would probably depend upon which view of the distinctions between *Parden* and *Employees* is adopted. As discussed below, see note 136 *infra*, the Second Circuit in *Forman* relied upon the fact that the state voluntarily entered the field regulated by Congress in deciding that the *Parden* test should be applied. On the other hand, if the governmental/proprietary distinction is used, it is likely that a court would find that the *Employees* standard would be controlling. See note 164 and accompanying text *infra*.

## NOTES

tion of securities.<sup>103</sup> For example, the House report on the Act states:

This bill carefully preserves the jurisdiction of State security commissions to regulate transactions within their own borders. It goes further and makes that control more effective by preventing evasion of State security legislation by the device of selling in interstate or foreign commerce from outside the State.

The bill . . . also makes it unlawful to use the instruments of interstate or foreign commerce in an effort to evade protective state legislation.<sup>104</sup>

Thus Congress clearly indicated a desire to help states to enforce their own securities laws. Second, section 18 of the Act provides that "[n]othing in this subchapter shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State . . . over any security or any person."<sup>105</sup> This would seem to indicate a congressional purpose not to interfere with a state's ability to regulate securities within its borders. Finally, the antifraud sections address only misrepresentations made "in the offer or sale,"<sup>106</sup> or "in connection with the purchase or sale"<sup>107</sup> of any security and hence would not seem to embrace activities of a regulatory nature.<sup>108</sup> Due to the deference shown by Congress toward the ability of states to regulate securities and the conspicuous absence of any indication that Congress intended the antifraud provisions of the Acts to apply to a state's exercise of a regulatory function, it would seem to follow that Congress did not intend the antifraud sections of the securities laws to apply to a state's regulation of securities. Of course, if the substantive requirements of the antifraud provisions do not apply to state's regulatory activities, there can be no basis for finding an implied waiver of immunity when a state engages in regulatory activities.<sup>109</sup>

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<sup>103</sup> Until 1975, the 1934 Act did not include states within its definition of person. Thus the antifraud provision of that Act literally did not apply to states. See note 88 *supra*, 151 *infra*. 15 U.S.C. § 78c(a)(9) (1970) (amended by Securities Acts Amendments of 1975, Pub. L. 94-29, § 3(2), 89 Stat. 97).

<sup>104</sup> H.R. REP. NO. 85, 73d Cong., 1st Sess. 21 (1933).

<sup>105</sup> Securities Act of 1933, § 18, 15 U.S.C. § 77r (1970).

<sup>106</sup> 15 U.S.C. § 77q(a) (1970).

<sup>107</sup> 15 U.S.C. § 78j (1970).

<sup>108</sup> While an argument could be made that the phrase "in connection with the purchase or sale" in the antifraud section of the 1934 Act is broad enough to include a state's regulatory activities, the history of the statute indicates that this argument will not withstand scrutiny. First, as mentioned previously, see note 88 *supra*, as originally enacted the antifraud section of the 1934 Act did not apply to states at all. Secondly, there is no indication in the legislative history of the 1975 amendments to the Exchange Act that Congress contemplated the regulation of a state's regulatory activities under the antifraud section. See S. REP. NO. 75, 94th Cong., 1st Sess. 1, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 179. This history therefore would not support a finding of congressional intent in the antifraud section of the 1934 Act to regulate a state's regulatory activities. See *Brown v. Kentucky*, 513 F.2d 333, 336 (6th Cir. 1975).

<sup>109</sup> Since the regulation of a state's financial institutions is a governmental function, see text at note 157 *infra*, the explicit intent test of *Employees* would apply. See text at note 76 *supra*.

## B. Case Law Addressing the Waiver Question Under the Securities Acts

As the Court of Appeals in *Green* noted, three circuit court opinions have applied the implied waiver doctrine enumerated in *Parden*, *Employees* and *Edelman*, in the context of suits brought against states seeking damages under the securities laws.<sup>110</sup> Two of the decisions upheld the states' claims of immunity, but the remaining one, upon which the plaintiff in *Green* placed primary reliance, found an implied waiver of immunity by the state.

## 1. State Involvement in a Regulatory Capacity

In the first of these circuit court cases, *Brown v. Kentucky*,<sup>111</sup> the plaintiff brought suit against the state of Kentucky to recover money damages for alleged violations of the securities laws by the Commissioner of Banking and Securities and certain loan examiners.<sup>112</sup> The suit charged gross neglect by the state officials for failing to discover and report "many improper and illegal acts and omissions"<sup>113</sup> of a building and loan association. The Kentucky statutes, similar to ones in Utah,<sup>114</sup> required the Commissioner annually to "make a thorough examination into the condition, workings and affairs of the association,"<sup>115</sup> and to "report any violation of law or any unauthorized or unfit practices . . ."<sup>116</sup> of the company. The complaint further alleged that one of the examiners employed by the banking department had improperly received payments from the company in violation of a Kentucky statute.<sup>117</sup> The Sixth Circuit Court of Appeals, in a per curiam opinion, affirmed the lower court's dismissal of the action on eleventh amendment grounds. The court noted: "In this case, plaintiff has sought money damages from the Commonwealth itself. No injunctive or merely prospective relief has been sought. This, we think, is the clearest type of case in which the Eleventh Amendment bar . . . protects the state."<sup>118</sup> Therefore, the question to be decided was whether the state, through its involvement in an area already regulated by Congress, had thereby impliedly waived its immunity from suit.

In addressing the waiver issue, the court of appeals first observed that the question of waiver turns on whether Congress in-

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<sup>110</sup> 539 F.2d at 1272, 1273.

<sup>111</sup> 513 F.2d 333 (6th Cir.), *cert. denied*, 423 U.S. 839 (1975).

<sup>112</sup> *Id.* at 334-35. Plaintiff alleged violations of the antifraud provisions of the Securities Act of 1933, 15 U.S.C. § 77(q) (1970), the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1970), and rule 10b-5, 17 C.F.R. 240.10b-5 (1976). See notes 3, 93 *supra*.

<sup>113</sup> 513 F.2d at 335.

<sup>114</sup> See note 12 *supra*.

<sup>115</sup> KY. REV. STAT. § 289.710(1) (1970).

<sup>116</sup> KY. REV. STAT. § 289.710(2) (1970).

<sup>117</sup> 513 F.2d at 335. See KY. REV. STAT. § 289.690 (1970).

<sup>118</sup> 513 F.2d at 336. See note 122 *infra*.

tended to abrogate a state's immunity from suit.<sup>119</sup> After examining the Securities Acts, the Sixth Circuit found no evidence that Congress intended "to divest the state of its power to regulate its state chartered institutions" or to condition such regulation upon consent to private federal suit.<sup>120</sup> The court of appeals emphasized that "the statutory duty imposed upon the [Commissioner] cannot in any way be construed as the exercise of a proprietary function, but is rather clearly the exercise of a regulatory function . . . which has been historically exercised as part of [the state's] governmental powers."<sup>121</sup> Apparently it was the fact that a governmental function was involved that led the court to apply the clear intent test of *Employees*.<sup>122</sup> The court found that the Securities Acts failed to evidence this requisite clarity of intent to subject a state's exercise of a regulatory function to private federal suit.<sup>123</sup> Thus, in a fact situation similar to that in *Green*, the Sixth Circuit held that the eleventh amendment barred the suit, despite plaintiff's contention that by "interposing itself completely in the affairs of [the company, the state] waived its immunity to suit."<sup>124</sup>

The Sixth Circuit subsequently confronted facts nearly identical to those in *Brown* in *Yeomans v. Kentucky*.<sup>125</sup> In *Yeomans*, plaintiffs charged that the states of Kentucky and Ohio "went beyond their regulatory functions and became aiders and abettors or participants in the fraudulent activities [of a consumer loan agency] which resulted in widespread losses to the investors."<sup>126</sup> The Sixth Circuit, again in a per curiam opinion and citing *Brown*, held that "[r]egardless of what the specific allegations may be, the complained of activities of the defendant states arose out of the immunity clothed function of governmental regulation of securities,"<sup>127</sup> and affirmed dismissal of the action.<sup>128</sup> Both *Brown* and *Yeomans*, then, indicate that in regard to the governmental function of regulating state chartered financial institu-

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<sup>119</sup> 513 F.2d at 336, quoting *Edelman*, 415 U.S. at 672.

<sup>120</sup> 513 F.2d at 336.

<sup>121</sup> *Id.*

<sup>122</sup> On the other hand, it is possible that the Sixth Circuit read *Employees* and *Edelman* as effectively replacing the standard set forth in *Parden*: i.e. under this view, in all future cases where an implied waiver is alleged—regardless of whether the state's activity is considered governmental or proprietary—a waiver will be found only where the language of the federal statute "leave[s] no room for any other reasonable construction" other than that Congress intended to lift a state's eleventh amendment immunity. See *id.*, quoting *Edelman*, 415 U.S. at 673, quoting *Murray v. Wilson Distilling Co.*, 213 U.S. 151, 171 (1909). The Sixth Circuit seemed to quote *Edelman* out of context, however, since in *Edelman* the Court was addressing the standard by which an express waiver of immunity by a state will be found, see note 34 *supra*, rather than the standard by which congressional intent to subject states to private suit will be measured. See *Edelman*, 415 U.S. at 673-74.

<sup>123</sup> 513 F.2d at 336.

<sup>124</sup> *Id.*

<sup>125</sup> 514 F.2d 993 (6th Cir.), cert. denied, 423 U.S. 983 (1975).

<sup>126</sup> *Id.* at 994.

<sup>127</sup> *Id.* at 995.

<sup>128</sup> *Id.*

tions, Congress failed to show clearly in the securities laws an intent to subject states to private suit.

## 2. State Involvement in a Commercial Capacity

These cases decided by the Sixth Circuit would have ended the Tenth Circuit's inquiry into the waiver issue had not plaintiff alleged that *Forman v. Community Services, Inc.*<sup>129</sup> was controlling. In *Forman*, a different situation than those in *Brown* and *Yeomans* faced the Second Circuit. In that case, tenants of a state financed housing project brought suit against the New York Housing Finance Agency (HFA) and the Commissioner of the New York State Division of Housing and Community Renewal (DHCR) for alleged violations of the anti-fraud provisions of the Securities Acts.<sup>130</sup> In contrast to *Brown* and *Yeomans*, the involvement of the state in *Forman* was not part of a state program to regulate securities. On the contrary, in *Forman* the state was directly involved in the corporation which issued the alleged securities<sup>131</sup> in both a financial and managerial capacity.<sup>132</sup> The state had provided significant financing for the housing project, and through the DHCR Commissioner, had provided "supervision of the development, construction, promotion and operation of the project."<sup>133</sup> The state was thus directly involved in the securities area in a commercial rather than a regulatory capacity.

In addressing the eleventh amendment issue, the Second Circuit found that the state had impliedly "waived its sovereign immunity with respect to federal securities laws violations by voluntarily entering a field under federal regulation."<sup>134</sup> The court of appeals also found that Congress had "conditioned the right to be involved in the sale

<sup>129</sup> 500 F.2d 1246 (2d Cir. 1974), *rev'd on other grounds, sub nom.* United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975).

<sup>130</sup> *Id.* at 1248-49. Plaintiff alleged violations of § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (1970), and of § 10b of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (b) (1970), and rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1976). The gravamen of the complaint concerned misrepresentations in an "Information Bulletin" distributed by the general contractor. One of the alleged misrepresentations was that the total cost would be \$258,678,000 with the risk of completing the project within that price on the contractors. However, it later turned out that the HFA agreed to a final bill nearly 30% higher or \$340,500,000, which increase substantially raised the cost to prospective tenants of both their shares of stock and their monthly rent. 500 F.2d at 1250.

<sup>131</sup> The primary question on appeal to the Supreme Court was whether the shares in the cooperative housing corporation purchased by all tenants of the project were securities within the meaning of the federal securities acts. The Second Circuit held they were, but the Supreme Court disagreed, 421 U.S. 837, 847 (1975). See Note, *Securities Regulation—Shares of Nonprofit Cooperative Housing Developments as Securities*, 17 B.C. IND. & COM. L. REV. 287 (1976). Because this disposition of the primary question settled the matter, the Supreme Court did not reach the eleventh amendment issues. 421 U.S. at 846 n.11. See note 137 *infra*.

<sup>132</sup> 500 F.2d at 1249.

<sup>133</sup> *Id.*

<sup>134</sup> *Id.* at 1256.

and distribution of securities upon amenability to suit in federal court . . . ."<sup>135</sup> Since the federal regulatory system was in effect at the time the state became involved in the securities field, the court held that the state waived its immunity by becoming so involved.<sup>136</sup> Thus where the state was involved in the securities area in a commercial capacity, the Second Circuit found that the state had impliedly waived its immunity under the securities laws on the basis of the implicit intent test in *Parden*.<sup>137</sup>

### 3. The *Green* Court's Analysis

Due to the proprietary nature of the state's activity in *Forman*, however, the Tenth Circuit found that case to be factually distin-

<sup>135</sup> *Id.* The problem with this approach lies in the fact that the antifraud provisions of the securities laws do not expressly create a cause of action against violators of their terms. See text at notes 95-102 *supra*. However, there is a theory, relying strictly upon the literal language of other provisions of the 1933 Act which might avoid the difficulties just mentioned. Under section 15 of the Act, 15 U.S.C. § 77o (1970), "[e]very person who . . . controls any person liable under sections [11 or 12 of the Act, 15 U.S.C. § 77k, 77l (1970)] shall also be liable . . . to any person to whom such controlled person is liable . . . ." Since §15 does not exempt states, it would seem that a state may be held liable where it controls someone liable under sections 11 or 12. Under the state statutory scheme in *Forman*, the state is responsible for the supervision of the development and construction of the housing project by the general contractors. *Forman*, 500 F.2d at 1249. Assuming the informational bulletin issued by the general contractor qualifies as a prospectus, see 15 U.S.C. § 77b(10) (1970), the general contractor could be held liable under the express terms of § 11 for misleading information in the prospectus. (It is important that the shares of stock are privately issued, as § 11 exempts securities issued by states from its terms.) Under this approach, the state would also be liable by virtue of § 15, and "the threshold fact of congressional authorization to sue a class of defendants which literally includes States" required in *Edelman* would be present.

<sup>136</sup> 500 F.2d at 1256 n.13. The Second Circuit relied solely on *Parden*, finding that the explicit intent test of *Employees* did not apply. *Id.* In its view, the crucial difference between *Parden* and *Employees* stemmed from the question of voluntariness. See note 76 *supra*. The Second Circuit explained that in *Employees*,

the state's activity came first, the federal regulation second. In this posture, the [Supreme] Court held, the state could not be found to have waived its immunity; rather Congress would be required explicitly to override it. Here and in *Parden*, however, the regulatory system was in effect before the state entered the field. That entry into the regulated field thus constituted a waiver of the state's immunity.

*Id.* Thus the Second Circuit relied on Justice Marshall's concurring opinion in *Employees* for this distinction, see note 76 *supra*, rather than on the governmental/proprietary distinction put forth by the majority.

An argument could be made however, that the construction of the housing projects in *Forman* and the issuance of the shares of stock in the projects to tenants were proprietary activities and that therefore the *Parden* test of congressional intent was appropriate. See also note 164 *infra*.

<sup>137</sup> 500 F.2d at 1256. After *Forman* was reversed by the Supreme Court on other grounds, 421 U.S. 837 (1975), see note 131 *supra*, the Second Circuit indicated its view that the implied waiver holding in that case remains unaffected by the Supreme Court's action. *Morrell v. Department of Social Servs.*, 532 F.2d 259, 263 (1976). Therefore, the Second Circuit's finding of an implied waiver under the Securities Laws when a state



guishable from the situation in *Green*.<sup>138</sup> In *Forman*, the court of appeals noted, where the "state of New York was not merely involved in a regulatory capacity"<sup>139</sup> but was directly involved in the development, construction, promotion and operation of the housing project,<sup>140</sup> the fact situation was indeed much closer to that in *Parden*.<sup>141</sup> In *Forman*, the state was directly involved in the actual sale and distribution of the alleged securities.<sup>142</sup> In contrast to the *Forman* situation, the states in *Green* and the Sixth Circuit cases, were not involved in the actual selling and distribution of securities, "except to the extent [their] laws allowed [certain companies] to issue securities."<sup>143</sup> Rather, these states were involved in the securities market solely in a regulatory capacity. Because of these factual differences, the *Green* court concluded that *Forman* was inapplicable to the present case."<sup>144</sup>

After disposing of *Forman*, the court of appeals announced that it preferred to follow the reasoning of the Sixth Circuit cases.<sup>145</sup> As the Sixth Circuit cases had indicated, because the regulation by a state of its own state chartered financial institutions is clearly a governmental function,<sup>146</sup> the explicit intent test of *Employees* governed the reso-

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participates in the actual sale and distribution of securities would seem to have strong precedential value. But the Second Circuit has still not dealt with the *Edelman* problem discussed *supra* in note 102 and accompanying text.

<sup>138</sup> The Tenth Circuit did not characterize New York's participation in the sale and distribution of securities as proprietary; it only asserted that *Forman* presented a situation closer to *Parden* than did *Green*, *Brown* or *Yeomans*. 539 F.2d at 1273. However, the court of appeals did distinguish *Green* from *Forman* on the grounds that *Green* involved a clearly governmental activity and hence was closer to the situation in *Employees*. Because the court appeared to base its findings of factual proximity to the situations in *Parden* or *Employees* upon the governmental nature of the activities involved in each case, it seems fair to say that the governmental/proprietary distinction formed the basis for the Tenth Circuit's distinction of *Forman*.

<sup>139</sup> 539 F.2d at 1273.

<sup>140</sup> *Id.*, quoting *Forman v. Community Servs., Inc.*, 366 F. Supp. 1117, 1120 (S.D.N.Y. 1973), *rev'd*, 500 F.2d 1246 (2d Cir.), *rev'd, sub nom.* United Housing Foundation, Inc. v. *Forman*, 421 U.S. 837 (1975). Involvement in the sale and distribution of securities is arguably analogous to the proprietary operation of a railroad. However, if the governmental/proprietary distinction is used as the basis of deciding whether to apply the test of *Employees* or *Parden*, it becomes harder to argue that the state's involvement in *Forman* is less governmental than Missouri's operation of mental hospitals and schools for the disabled in *Employees*. The state was not seeking a profit in either case. Would it be considered significant that New York was involved in the development of housing for only 20 years, while the historical operation by states of mental hospitals extended back over 60 years? Could one state's activities be considered more or less traditionally governmental than the other? Perhaps it was doubts about these questions which led the Second Circuit to rely on the voluntariness issue rather than the governmental/proprietary distinction. See note 136 *supra*. See also note 164 *infra*.

<sup>141</sup> 539 F.2d at 1273.

<sup>142</sup> See *id.* See note 131 *supra*.

<sup>143</sup> 539 F.2d at 1273.

<sup>144</sup> *Id.*

<sup>145</sup> *Id.*

<sup>146</sup> See text at note 157 *infra*.

lution of the eleventh amendment issue in *Green*.<sup>147</sup> Furthermore, as *Employees* had taught, in order to find an implied waiver where the state is engaged in a governmental activity, it is first necessary to show that Congress clearly intended to condition a state's participation in the activity upon amenability to suit in federal court.<sup>148</sup> Consequently, the Tenth Circuit sought but did not find a clear showing that Congress, in enacting the securities laws, intended to subject a state to private suit when it engages in a regulatory activity.<sup>149</sup> Applying the explicit intent test of *Employees*, the *Green* court declared that the mere fact that one section of the securities laws defines "person" as including a government or political subdivision "does not present the type of indication needed to establish a [clear] congressional intent to lift [a state's] Eleventh Amendment immunity."<sup>150</sup> Furthermore, the Tenth Circuit found nothing in any other applicable section of the Securities Acts that revealed "an intention on Congress' part to remove the state's immunity when it engages in regulating state chartered agencies or to condition Utah's operation of that function upon consent to suit in a federal forum when securities are involved in that regulatory function."<sup>151</sup> Accordingly, the Tenth Circuit concluded "the absence

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<sup>147</sup> 539 F.2d at 1274. The Tenth Circuit thus distinguished *Forman* from *Employees* on the basis of the governmental/proprietary distinction, rather than on the basis of the voluntariness distinction upon which the Second Circuit relied. See note 136 *supra*.

<sup>148</sup> Under the *Employees* explicit intent test, the mere showing that Utah had entered a field subject to federal regulation was insufficient to support a finding of implied waiver. See note 102 *supra*.

<sup>149</sup> 539 F.2d at 1273-74.

<sup>150</sup> *Id.*

<sup>151</sup> *Id.* at 1274. As previously noted, the antifraud provisions would seem only to apply to states when they engage in the purchase or sale of securities. See text at notes 91-94 *supra*. Plaintiff's theory that the antifraud provisions apply where a state acts in a regulatory capacity is supported by neither the language of the statutes, nor their legislative history. See text at notes 103-109 *supra*. After suit was filed but before the Tenth Circuit rendered its opinion in *Green*, Congress amended the definition of person in the 1934 Act so that it now includes governments and political subdivisions thereof. 15 U.S.C. § 77c(a)(9) (Supp. V, 1975). Neither the parties nor the Tenth Circuit acknowledged this development. However, even if the Tenth Circuit had considered the new amendments to the Securities Exchange Act of 1934, it surely would have reached the same result. The change in the definition of person was one small part of a comprehensive amendment to the Act designed to facilitate the creation of a national market system for securities. See 15 U.S.C. § 78b (Supp. V, 1975). There is no indication in the legislative history of the 1975 amendments that Congress intended to subject a state to private federal suit for activities arising out of the state's regulation of securities. See S. REP. NO. 75, 94th Cong., 1st Sess. 1, reprinted in [1975] U.S. CODE CONG. & AD. NEWS 179. Since the original act clearly exempted states from the antifraud provisions of the 1934 Act, see note 88 *supra*, and since there is no indication in the legislative history that Congress intended to change the status of the states' immunity from suit when they regulate securities, congressional intent to subject states to private suit for regulatory activities would seem to be lacking. Consequently, under the *Employees* test the mere fact that the definition of person in the 1934 Act now includes governments and political subdivisions would not constitute a sufficient indication of congressional intent to lift a state's immunity from suit when it engages in the regulation of securities.

of that congressional intent resolves the Eleventh Amendment question at an early stage and prevents inquiry into conduct by the state which might constitute consent."<sup>152</sup> Hence, the Tenth Circuit held that the eleventh amendment afforded Utah and its Commissioner of Financial Institutions immunity from the plaintiff's private federal suit for monetary compensation under the securities laws.

In light of the examination of the securities law undertaken previously,<sup>153</sup> it seems that the court of appeals in *Green* correctly perceived that under the strict *Employees* test, the requisite threshold fact of Congressional intent to allow private federal suit against a state for acts arising out of its regulation of securities was lacking. Unfortunately for the plaintiff, under this test, the mere showing that the state had entered a field subject to considerable federal regulation, was insufficient to support a finding of implied waiver.

### III. THE FUTURE OF THE GOVERNMENTAL/PROPRIETARY DISTINCTION

Still to be determined is which state activities are "governmental" and which "proprietary." Because the availability of monetary relief under protective federal statutes may turn upon the classification of the state's activity in a given case,<sup>154</sup> it is important to know what factors are important in determining whether the activity will be deemed governmental or proprietary. This section of the note will examine the governmental/proprietary distinction more closely, and focus upon potential difficulties in applying the distinction. In addition, the future role of the distinction in eleventh amendment cases will be explored in the light of the Supreme Court's recent decision in *National League of Cities v. Usery*,<sup>155</sup> which invalidated the extension of the minimum wage and overtime provisions of the FLSA to state employees on grounds that it impermissibly infringed upon traditional state functions.

#### A. Practical Considerations—Problems of Classification

In the cases considered thus far which utilized the

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The legislative history of the 1975 amendments to the Exchange Act do make it clear that materials issued by states in connection with the sale of government issued securities "would remain subject to the antifraud provisions of the Exchange Act." S. REP. NO. 75, 94th Cong., 1st Sess. 45, reprinted in [1975] U.S. CODE CONG. & AD. NEWS 223.

<sup>152</sup> 539 F.2d at 1274.

<sup>153</sup> See text at notes 87-109 *supra*.

<sup>154</sup> This would be true for all federal statutes authorizing suit for monetary damages passed pursuant to the commerce power, such as the FELA in *Parde*. However, the question whether the state's activity is governmental or proprietary would not be significant where the statute authorizing monetary compensation was adopted under Congress' spending power or pursuant to section 5 of the fourteenth amendment. See note 178 *infra*.

<sup>155</sup> 426 U.S. 833 (1976).

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governmental/proprietary distinction, the task of classifying a state's activity as governmental or proprietary was not difficult. In *Employees*, two factors were found relevant in classifying the operation of schools and hospitals as nonproprietary. First, the institutions were not operated for profit; second, they did not represent activities normally engaged in by private persons and corporations.<sup>156</sup> Similarly, since the regulatory activities of the states in *Green*, *Brown* and *Yeomans* had historically been exercised by the states<sup>157</sup>—presumably on a non-profit basis—they too could be classified as governmental. On the other hand, the operation of the railroad in *Parden* which was both profit-making and an activity normally engaged in by private persons, was considered by the Court to be proprietary.<sup>158</sup>

In future cases, however, it will not always be clear which state-run activities are governmental and which are proprietary. If both the profit/nonprofit distinction and the question whether private persons normally engage in the activity are to be considered in any given situation, problems of classification will inevitably arise when a state activity, such as operating a railroad, is normally carried on by private persons, but is not operated for profit by the state; or contrarily, when a state runs a uniquely governmental enterprise, such as a toll highway, but for profit.

The problem of classification may be conceptually simplified by eliminating the profit/nonprofit distinction. First, it seems quite clear that the result in *Parden* would have been the same even if Alabama had operated its railroad on a nonprofit basis. Indeed, in *United States v. California*,<sup>159</sup> cited with approval in *Parden*, the argument that a federal act should not apply to a state run railroad on the grounds that it was not operated for profit was rejected by the Supreme Court.<sup>160</sup> Furthermore, the Court in *Parden* was influenced by the purpose of the FELA to provide compensation for all railway workers injured in the course of their employment.<sup>161</sup> Since the Court was unwilling to conclude that Congress intended to exclude a group of employees from the coverage of the Act merely because their employer "happen[ed] to be state owned,"<sup>162</sup> it is unlikely the Court would have denied the protection of the Act to employees whose employer happened to be state owned and nonprofit. Thus it seems clear that *Parden* would have held the FELA applicable to non-profit state-run railroads. Secondly, in *Employees*, where the crucial factor was held to

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<sup>156</sup> 411 U.S. at 284.

<sup>157</sup> See *Brown v. Kentucky*, 513 F.2d at 336.

<sup>158</sup> See *Employees*, 411 U.S. at 284.

<sup>159</sup> 297 U.S. 175 (1936).

<sup>160</sup> *Id.* at 183, 185. For a discussion of the probable future significance of *United States v. California*, see *Fry v. United States*, 421 U.S. 542, 549-58 (1975) (Rehnquist, J., dissenting). See also *National League of Cities v. Usery*, 426 U.S. 833, 854 n.18 (1976) (majority opinion of Rehnquist, J.).

<sup>161</sup> 377 U.S. at 189-90.

<sup>162</sup> *Id.* at 190.

be absence of clear congressional intent, Congress had clearly shown its intent to include state hospitals and schools within the provisions of the FLSA even where operated for profit.<sup>163</sup> It seems highly unlikely that the Court in *Employees* would have decided the case differently if all or some of the schools had been operated for profit. Therefore it is submitted that the profit/not-for-profit distinction is of little weight in determining whether a state's activity is governmental or proprietary.

The criterion of whether or not private individuals normally run the enterprise also poses difficulties. First, classification problems would arise where both governments and private persons normally engage in the activity. Selling securities<sup>164</sup> or operating colleges, libraries or recreational facilities are examples of such activities, all of which Congress may regulate under the commerce power. Secondly, times change: activities once normally engaged in by private parties may now be run by the government and vice-versa. Gambling operations,<sup>165</sup> and the construction of low cost housing,<sup>166</sup> are such examples. The Court's opinion in *Employees* constitutes inadequate guidance for the judicial resolution of these classification problems in the future. Hence classification of states' activities in these gray areas

<sup>163</sup> See 29 U.S.C. § 203(r)(1) (1970).

<sup>164</sup> The problem of classifying the activity of selling securities by a state illustrates the inadequacy of the governmental/proprietary distinction. Other considerations suggest, however, that the sale of securities by a state should be classified as a governmental activity. For example, in *Parden* the operation of the Terminal Railway was a "rather isolated activity." *Employees*, 411 U.S. at 285. Furthermore, the history of litigation under federal railroad statutes had indicated that state owned railroads stand on the same footing as private railroads. See note 41 *supra*. On the other hand the issuance of securities by states is not an isolated state activity, but is an activity traditionally engaged in by states and political subdivisions thereof. Furthermore, implicit in the notion that some state activities should be considered proprietary is the conviction that these activities merit the same treatment when engaged in by states or private persons. It is clear from a reading of the Securities Acts, that Congress believed that states and state issued securities deserve special treatment, see text at note 91 *supra*, and the mere fact that Congress has recognized that state issuers of securities merit different treatment than private issuers may justify the application of *Employees* stricter test. That is, once Congress has recognized that an activity deserves different treatment when engaged in by a state, it would seem to be appropriate to require Congress to explicitly show its intent to lift a state's eleventh amendment immunity. For these reasons, the offer and sale of securities by a state should be considered a governmental function.

<sup>165</sup> New Hampshire established the twentieth century's first state operated lottery in 1964. 1963 N.H. Laws 52:1 (current version at N.H. REV. STAT. ANN. § 284:21-a - 21-n (1966 Replacement Volume)). As of 1975, twelve other states had followed suit. COMMISSION ON THE REVIEW OF THE NATIONAL POLICY TOWARD GAMBLING, FIRST INTERIM REPORT 13, 20 (1975).

<sup>166</sup> In 1960, New York created the first state housing finance agency to provide supervision and financing for the development of low cost housing. 1960 N.Y. Laws ch. 671, current version at N.Y. PRIV. HOUSING FIN. LAW, art. 3, § 41 (McKinney 1962). As of 1973 at least twenty nine other states had created similar agencies. *Development of State Housing Finance Agencies*, 9 REAL PROP., PROB. & TR. J. 471, 471 (1974); Pearlman, *State Housing Finance Agencies and the Myth of Low Income Housing*, 7 CLEARINGHOUSE REV. 649, 649 (1974).

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will have to be "marked out on a case by case basis."<sup>167</sup>

### B. *Significance of the Distinction after National League of Cities*

A 1976 Supreme Court decision, which addressed the governmental/proprietary distinction in a case involving the doctrine of federalism embodied in the tenth amendment,<sup>168</sup> may reduce the number of cases presenting the problems of classification outlined above. In *National League of Cities v. Usery*<sup>169</sup> several states challenged the 1974 amendments to the Fair Labor Standards Act<sup>170</sup> which extended the Act's minimum wage and overtime requirements to virtually all state employees.<sup>171</sup> The Court, bringing to an abrupt halt the trend of decisions finding the congressional power under the commerce clause *vis-a-vis* the states practically limitless,<sup>172</sup> found that by virtue of the policy of constitutional federalism embodied in the tenth amendment, the Act impermissibly interfered with the states' ability to make choices in areas essential to the administration of public law and the furnishing of public services.<sup>173</sup> The Court held that under the commerce power, Congress may not significantly interfere with "States' abilities to structure employer-employee relationships" in activities traditionally engaged in by state and local governments.<sup>174</sup>

In so holding, the *National League of Cities* Court expressly rejected the reasoning in *Maryland v. Wirtz*,<sup>175</sup> which upheld as constitutional the 1966 amendments to the FLSA<sup>176</sup> on the grounds that

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<sup>167</sup> *Fry v. United States*, 421 U.S. 542, 558 (1975) (Rehnquist, J., dissenting).

<sup>168</sup> "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. CONST. amend. X.

<sup>169</sup> 426 U.S. 833 (1976). See Note, *The Reaffirmation of State Sovereignty as a Fundamental Tenet of Constitutional Federalism*, 18 B.C. IND. & COM. L. REV. 736 (1977).

<sup>170</sup> Fair Labor Standards Amendments of 1974, Pub. L. No. 93-259, 88 Stat. 58-60 (amending 29 U.S.C. § 203 (1970)).

<sup>171</sup> 426 U.S. at 836.

<sup>172</sup> *Maryland v. Wirtz*, 392 U.S. 183, 195 (1968). ("[T]he Federal Government, when acting within a delegated power, may override countervailing state interests whether these be described as 'governmental' or 'proprietary' in character."), *overruled by National League of Cities*, 426 U.S. at 855.

The *National League of Cities* Court also disapproved the following dicta from *United States v. California*, 297 U.S. 175, 185 (1936):

[We] look to the activities in which the states have traditionally engaged as marking the boundary of the restriction upon the federal taxing power. But there is no such limitation upon the plenary power to regulate commerce. The state can no more deny the power if its exercise has been authorized by Congress than can an individual.

426 U.S. at 854-55.

<sup>173</sup> 426 U.S. at 851.

<sup>174</sup> *Id.* The majority termed this ability the "States' power to determine the wages which shall be paid to those whom they employ . . ." *Id.* at 845. Justice Stevens in dissent found no such "inherent right to pay a substandard wage . . ." *Id.* at 880 (Stevens, J., dissenting).

<sup>175</sup> 392 U.S. 183, 195 (1968); *overruled by National League of Cities*, 426 U.S. at 855.

<sup>176</sup> These were the very amendments at issue in *Employees*. See text at notes 59-61, *supra*.

under the commerce clause Congress "may override countervailing state interests whether these be described as 'governmental' or 'proprietary' . . . ."<sup>177</sup> Since it is now clear after *National League of Cities*, that congressional regulation of wages and hours of employees of state hospitals and schools is impermissible, it is equally clear that no cause of action may be created against a state under the FLSA where the state engages in a traditionally governmental activity. Thus, where the tenth amendment prohibits the regulation, no cause of action may be created under which eleventh amendment issues would arise.<sup>178</sup>

<sup>177</sup> 392 U.S. at 195.

<sup>178</sup> It should be noted that the Court in *National League of Cities* directed its holding to the limitation of congressional power to interfere with states' governmental functions under the commerce clause. The Court specifically suggested, however, that under either the spending power, U.S. CONST. art. 1, § 8, cl. 1, or § 5 of the fourteenth amendment, Congress might interfere with states' traditional governmental functions. See 426 U.S. at 852 n.17. Thus, for example, under the spending power Congress could condition a state's participation in a federally subsidized project, such as the Aid to the Aged, Blind and Disabled program in *Edelman*, upon a waiver of immunity to suit without exceeding the limitation imposed by the tenth amendment. See *Edelman*, 415 U.S. at 672-74 (implying that if Congress had shown a clear intent to create a private federal cause of action against a state in connection with the federally subsidized AABD program, an implied waiver of immunity might have been found). It is submitted that the underlying rationale for such a result is that a state's participation in a federally funded program would be voluntary and therefore the state would have impliedly consented to conditions attached to participation. Similarly, and as the Court held in *Fitzpatrick v. Bitzer*, 427 U.S. 445, 456 (1976), one month after *National League of Cities*, under section 5 of the fourteenth amendment, Congress may regulate a state's governmental activities to the extent the state unconstitutionally discriminates on the basis of race, color, religion, sex or national origin, and even provide private federal suits for damages against a state when it does so. At issue in *Fitzpatrick*, were recent amendments to Title VII of the Civil Rights Act of 1964, authorizing private federal suits for monetary damages against a state found to have discriminated on the basis of race, color, religion, sex or national origin in its employment practices. Equal Employment Opportunity Act of 1972, Pub. L. No. 92-261, 86 Stat. 103, 107 (amending 42 U.S.C. § 2000e (1970)). The Court found that in this case, "the 'threshold fact of congressional authorization' . . . to sue the State" which was absent in *Edelman*, was here clearly present. 427 U.S. at 452, quoting *Edelman*, 415 U.S. at 672. Because the fourteenth amendment is specifically directed toward states, the Court held that "the Eleventh Amendment, and the principle of state sovereignty which it embodies . . . are necessarily limited by the enforcement provisions of § 5 of [that] amendment." 427 U.S. at 456.

Thus, under the fourteenth amendment Congress may directly lift a state's eleventh amendment immunity, even where the state is already engaged in the activity at the time of the federal legislation. In *Fitzpatrick*, Congress provided for private federal suit against a state for discrimination in connection with employment, even where the state could not have voluntarily chosen to withdraw from the activity. However this does not mean that an exception has been created to the rule that a state may be sued without its consent. Strictly speaking, although the fourteenth amendment does not specifically so provide, it is fair to construe the adoption of the fourteenth amendment by the states as a waiver of immunity to suits authorized by Congress to facilitate the enforcement of the amendment's substantive provisions against the states. Because the fourteenth amendment was adopted after the eleventh amendment, and because its provisions are directed specifically toward state conduct, the power given to enforce its provisions differ from the other powers of congress *vis-a-vis* the eleventh amendment. Due to the time factor, the eleventh amendment clearly limits congressional power stemming from earlier provisions, such as the commerce clause, but does not necessarily

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Therefore, when Congress acts under the commerce power and provides for private federal suit against a state, the threshold question will be whether the congressional regulation "curtail[s] in any substantial manner the exercise of [the state's] powers,"<sup>179</sup> or substantially "interfere[s] with traditional aspects of state sovereignty . . ."<sup>180</sup> Where the federal regulation is found to be invalid under this threshold test, the case will be disposed of before reaching the implied waiver issue under eleventh amendment. Thus the *National League of Cities* test will effectively weed out a substantial number of cases which otherwise would have been decided upon the basis of the governmental/proprietary distinction as set forth in *Employees* and *Parden*. Where, however, the federal regulation was not passed pursuant to the commerce clause, or does not impermissibly interfere with a state's decision-making abilities, or affects an area not traditionally considered essential to the state's governmental function, the policies of federalism embodied in the tenth amendment would not invalidate the regulation and the eleventh amendment issues discussed above will be reached.

### C. Considerations of Federalism and the Securities Laws.

It is apparent that under this approach, in those cases where an individual sues a state pursuant to federal regulation, and where the state is engaging in a traditionally governmental activity, the regulation may be held invalid under the tenth amendment policy announced in *National League of Cities*, even if it is clear that Congress intended the state to be bound by the federal regulatory statute.<sup>181</sup> Under the test applied in *National League of Cities*, the crucial question concerns the impact of the legislation upon a state's ability to determine priorities in a traditionally governmental area.<sup>182</sup> Assuming for

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limit powers conferred later, such as those granted under § 5 of the fourteenth amendment which are specifically directed to state action. See *Fitzpatrick*, 427 U.S. at 456. Thus the states consented such suits as Congress would authorize to enforce the terms of the fourteenth amendment, by adopting the enforcement provision, section 5 of that amendment.

To summarize, it is the probable meaning of *National League of Cities* and *Fitzpatrick* for future cases under the commerce clause, that Congress may condition a state's participation in a proprietary activity upon amenability to federal court suit, but may not substantially interfere with a state's governmental prerogatives. Under the spending power, Congress may condition receipt of federal funds upon waiver of eleventh amendment immunity to causes of action arising out of the use of those funds. Finally, under the fourteenth amendment, Congress may unilaterally provide for private federal actions against states, since the protection afforded by the eleventh amendment is necessarily limited by the fourteenth.

<sup>179</sup> 426 U.S. at 844, quoting *Metcalf & Eddy v. Mitchell*, 269 U.S. 514, 523 (1926).

<sup>180</sup> 426 U.S. at 849.

<sup>181</sup> This generalization is valid where the congressional regulation at issue was adopted pursuant to Congress' power under the commerce clause, but would not apply where the authority supporting the regulation stems from the spending power or from section 5 of the fourteenth amendment. See note 178 *supra*.

<sup>182</sup> 426 U.S. at 852.



the moment that a congressional intent to allow private suits against state issuers of securities could be shown, it seems clear that imposing the implied remedies under the antifraud provisions of the Securities Acts upon states would have minimal impact upon a state's decision to issue securities. Unlike the minimum wage and overtime provisions of the FLSA which forced states either to increase revenues or to curtail essential services,<sup>183</sup> the imposition of the antifraud requirements upon states when they issue securities would create no comparable dilemma.<sup>184</sup> The antifraud provisions require only that information provided in connection with the sale of securities not be misleading. Where the state issues securities, it presumably has access to—and may verify the accuracy of—information concerning the security in question. Moreover, since in order to obtain damages under the antifraud provisions it is necessary to show an intent to deceive, manipulate or defraud on the defendant's part,<sup>185</sup> imposition of a right to sue states under the antifraud section is unlikely to interfere with a state's decision to issue securities.

In addition, in order to find a federal statute invalid under the policy of federalism set forth in *National League of Cities*, the interference with a state's ability to carry on "functions essential to [its] separate and independent existence"<sup>186</sup> must be substantial.<sup>187</sup> The *National League of Cities* Court opinion makes it clear that some federal regulations which only minimally disrupt a state's prerogatives are permissible.<sup>188</sup> Therefore, because the imposition of the antifraud requirement of the Securities Acts upon states would not impair a state's "ability to function effectively [with]in a federal system,"<sup>189</sup> it would seem that the policy of federalism embodied in the tenth amendment would not preclude the application of this congressional regulation to the states. Assuming this analysis is correct, if a state sold securi-

<sup>183</sup> *Id.* at 846-47.

<sup>184</sup> It could be argued that the threat of private federal suit for damages—not the antifraud requirements themselves—would constitute an impermissible interference with a state's prerogatives. If issuers were held strictly liable under the general antifraud provisions for misrepresentations made, this argument would be compelling. But the Supreme Court recently held that merely negligent conduct was insufficient to ground an action for damages under the antifraud provision of the 1934 Act and indicated that a showing of an intent to deceive, manipulate or defraud on the defendant's part would be required. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 (1976) (The Court left open whether reckless conduct might be sufficient to support civil liability in some circumstances. *Id.* at 193 n.12). It is submitted that imposing this standard of care upon states would not deter them from exercising their prerogative to issue securities and therefore would not "impair the States' 'ability to function effectively [with]in a federal system.'" *National League of Cities*, 426 U.S. at 852, quoting *Fry v. United States*, 421 U.S. 542, 547 (1975).

<sup>185</sup> See note 184 *supra*.

<sup>186</sup> 426 U.S. at 845, quoting *Coyle v. Smith*, 221 U.S. 559, 580 (1911).

<sup>187</sup> See 426 U.S. at 847, 849.

<sup>188</sup> See *id.* at 853; S. REP. NO. 75, 94th Cong., 1st Sess. 44-45, reprinted in [1975] U.S. CODE CONG. & AD. NEWS 221-23 (implying that the imposition of the antifraud provisions on states is not an impermissible incursion upon states' prerogatives).

<sup>189</sup> 426 U.S. at 852, quoting *Fry v. United States*, 421 U.S. 542, 547 (1975).

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ties after the effective date of the regulation, it would be held to have impliedly consented to the terms of the regulation, and the eleventh amendment would not bar a private suit against a state as provided by the act.<sup>190</sup>

In contrast, a congressional enactment imposing liability upon states arising out of their regulation of their securities-issuing institutions would probably greatly affect states' decisions in a traditionally governmental area.<sup>191</sup> It is one thing to require a state not to misrepresent facts when it sells or distributes its own securities; it is quite another to render a state liable for the veracity of all information supplied by corporations operating within the state. If in *Green*, the state could be held liable for the accuracy of the information made public in its annual report, the state might be forced to decide not to issue such reports, with the consequence that the state could no longer provide any information for the protection of its citizens. To impose upon a state the burden of guaranteeing the accuracy of information made public, especially when the information is based on data submitted by private corporations, would force the state either to increase greatly its ability to police the accuracy of such information or to forego issuing such information altogether. This interference with a state's ability to make choices would probably be found to impermissibly "displace state policies regarding the manner in which [it] will structure delivery of those governmental services which [its] citizens require,"<sup>192</sup> and therefore would be unconstitutional under the doctrine of federalism elucidated in *National League of Cities*.<sup>193</sup> Thus even if in *Green* the court had found a clear congressional intent to provide for such suits, the application of the statute to states would likely have been found unconstitutional by virtue of the tenth amendment.<sup>194</sup>

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<sup>190</sup> But see note 102 *supra*. If the sale of securities by a state is considered governmental rather than proprietary, see note 164 *supra*, the *Employees* explicit intent test must be used to determine if Congress intended to lift a state's eleventh amendment immunity to suit. Since the jurisdictional sections of both Acts fail to explicitly provide that a state may be sued, the eleventh amendment would bar suit. Furthermore, the fact that the cause of action under the antifraud sections is implied, may prevent a court from reaching the implied waiver question. See text at note 102 *supra*.

<sup>191</sup> A state's regulation of its state chartered financial institutions would clearly seem to be a traditionally governmental activity. See *Brown v. Kentucky*, 513 F.2d 333, 336 (6th Cir. 1975). See text at note 157 *supra*.

<sup>192</sup> 426 U.S. at 847.

<sup>193</sup> A question yet to be confronted is whether the tenth amendment would preclude federal regulation of a clearly governmental activity under the commerce clause, but an activity in which a particular state had not yet engaged. That is, whether the fact that a state could "voluntarily" submit to the regulation would be more important than the characterization of the activity as governmental.

<sup>194</sup> The *National League of Cities* decision was handed down on June 24, 1976, only a month before the Tenth Circuit announced its decision in *Green*.

## CONCLUSION

It appears that the *Green* court was correct in affirming dismissal of a private claim brought against the state of Utah under the securities laws on the grounds that Utah had not waived its eleventh amendment immunity to private federal suit. First, on the authority of three Supreme Court decisions, it is clear that in order to find an implied waiver of immunity under the securities laws, it must be shown that Congress intended to subject states to private federal suit. Furthermore, where the state's activity—in this case the regulation of state chartered institutions—is a governmental function, a stricter test must be applied to determine the existence of this congressional intent. A close examination of the securities laws reveals no intent to lift a state's eleventh amendment immunity when it regulates securities issuing institutions. Since this threshold congressional intent to subject a state's regulatory activities to private federal suit is lacking in the Securities Acts, it is clear that there can be no basis for finding an implied waiver of immunity by the state of Utah.

The governmental/proprietary distinction developed in *Parden* and *Employees*, and relied upon by the Tenth Circuit in *Green*, will continue to be utilized in eleventh amendment cases where suit is brought against a state pursuant to a federal regulatory statute. Where the federally regulated state activity is a proprietary function, congressional intent to authorize private suits against a state will be found where it may reasonably be inferred from the purposes of the legislation. On the other hand, where the regulated activity is historically governmental, Congress must explicitly provide in the statute that a state will be liable to private federal suits; otherwise the state will not be held to have waived its immunity to suit by engaging in the activity. In some cases, however, it will not be apparent whether to classify a state's activity as governmental or proprietary. These problems of classification in gray areas will have to be solved on a case by case basis.

DAVID C. LUCAL