UNC SCHOOL OF LAW

NORTH CAROLINA LAW REVIEW

Volume 53 | Number 1 Article 9

11-1-1974

Securities Law -- Rule 10b-5 -- They Had So Many Plaintiffs They Didn't Know What To Do

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In surveying the development of "standing" criteria under section 10(b) of the Securities Exchange Act of 1934[1] and SEC rule 10b-5[2] it is hard not to think of Humpty Dumpty who told Alice, "When I use a word, . . . it means just what I choose it to mean—neither more nor less."[3] The history of standing criteria is one of constant redefinition. In early cases, only purchasers or sellers had standing to sue for fraud violations of 10b-5. Exceptions have developed through expansive interpretations of the words "purchaser" and "seller." Critics have suggested and one appellate court has switched to a "new" criterion[4] in which *investors* rather than purchasers and sellers have standing. Acceptance of this test reminds this writer of another of Alice's acquaintances, the Red Queen, who told Alice, "[I]t takes all the running you can do, to keep in the same place."[5] After more than two decades

1. 15 U.S.C. § 78j(b) (1970) 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—
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

2. 17 C.F.R. § 240.10b-5 (1973) 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,
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> (a) To employ any devise, scheme or artifice to defraud,
>
> (b) To make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statement made, in light of the circumstances under which they are 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.

3. L. CARROLL, THROUGH THE LOOKING GLASS (1871), *reprinted in* THE ANNOTATED ALICE 269 (M. Gardner ed. 1960) (emphasis omitted).

4. Eason v. General Motors Acceptance Corp., 490 F.2d 654 (7th Cir. 1973), *cert. denied*, 94 S. Ct. 1979 (1974); Bradford, *Rule 10b-5: The Search for a Limiting Doctrine*, 19 BUFFALO L. REV. 205 (1970) (advocates amendments by Congress and the SEC); Note, *The Purchaser-Seller Limitation to SEC Rule 10b-5*, 53 CORNELL L. REV. 684 (1968) (advocates standing for "any person"); Comment, *The Purchaser-Seller Rule: An Archaic Tool for Determining Standing Under Rule 10b-5*, 56 GEO. L.J. 1177 (1968) (advocates investor standing); Note, *10b-5 Standing Under Birnbaum: The Case of the Missing Remedy*, 24 HASTINGS L.J. 1007 (1973) (advocates "case or controversy" standing); Comment, *The Birnbaum Doctrine Revisited: Standing to Sue Under Rule 10b-5 Analyzed*, 37 MO. L. REV. 481 (1972) (advocates investor standing tied to a purchase or sale); 1967 DUKE L.J. 898 (advocates investor standing).

5. L. CARROLL, THROUGH THE LOOKING GLASS (1871), *reprinted in* THE ANNOTATED ALICE 210 (M. Gardner ed. 1960) (emphasis omitted).

of case by case adjudication, we start the process over again using different terminology.

The purchaser-seller rule originated with *Birnbaum v. Newport Steel Corp.*[6] in which the plaintiff brought an action on a statutory tort theory. Judge Augustus Hand writing for the Second Circuit held that section 10(b) and rule 10b-5 protected only purchasers and sellers; therefore, the plaintiff lacked standing.[7]

By the mid-sixties, however, exceptions had developed to the extent that the opponents of the purchaser-seller rule prepared to celebrate its final demise.[8] But the prophets of doom spoke too soon, for the *Birnbaum* doctrine survived, "[b]loody but unbowed."[9] In the early seventies, the courts were close to settling upon an expanded, yet functional, purchaser-seller rule. The Ninth Circuit decision in *Mount Clemens Industries, Inc. v. Bell*[10] typified the state of the law. The court decided that the flexibility required in the application of 10b-5 was possible within the purchaser-seller restriction. In addition to permitting standing for purchasers and sellers,[11] the court recognized exceptions giving standing to parties to an aborted contract for purchase or sale,[12] and to "forced sellers" in short form mergers.[13] An exception has also been recognized for plaintiffs seeking injunctive relief.[14]

6. 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

7. *Id.* at 464. Some courts and some commentators have failed to recognize that *Birnbaum* enunciated a rule of statutory standing. *E.g.*, Manor Drug Stores v. Blue Chip Stamps, 492 F.2d 136, 146 (9th Cir. 1973) (Hufstedler, J., dissenting); Mount Clemens Indus., Inc. v. Bell, 464 F.2d 339, 343 (9th Cir. 1972); Herpich v. Wallace, 430 F.2d 792, 805 (5th Cir. 1970); Whitaker, *The Birnbaum Doctrine: An Assessment*, 23 ALA. L. REV. 543, 549-50 (1971); Note, 24 HASTINGS L.J., *supra* note 4, at 1036; Comment, 37 MO. L. REV., *supra* note 4 (initially distinguished statutory and constitutional standing but confused them in conclusion); Comment, *The Purchaser-Seller Requirement of 10b-5 Reevaluated*, 44 U. COLO. L. REV. 151, 159 (1972). Their analyses of the purchaser-seller rule in terms of constitutional standing requirements is responsible for some of the imprecision in the analysis of 10b-5 standing problems. *See* text accompanying notes 43-53 *infra*.

8. Fleischer, *"Federal Corporation Law:" An Assessment*, 78 HARV. L. REV. 1146 (1965); Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for 10b-5*, 54 VA. L. REV. 268 (1968); Note, 53 CORNELL L. REV., *supra* note 4; Note, *Inroads on the Necessity for a Consummated Purchase or Sale Under Rule 10b-5*, 1969 DUKE L.J. 349; Comment, 56 GEO. L.J., *supra* note 4; Comment, *Another Demise of the Birnbaum Doctrine: "Tolls the Knell of Parting Day?"*, 25 U. MIAMI L. REV. 131 (1970); Comment, *The Decline of the Purchaser-Seller Requirement of Rule 10b-5*, 14 VILL. L. REV. 499 (1969).

9. Rekant v. Desser, 425 F.2d 872, 877 (5th Cir. 1970).

10. 464 F.2d 339 (9th Cir. 1972).

11. *Id.* at 345. The plaintiff could sue either individually or derivatively. *Id.* at 347 n.14.

12. *Id.* at 345-46.

13. *Id.* at 346.

14. Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967); *cf.* Mount Clemens Indus., Inc. v. Bell, 464 F.2d 339, 346 (9th Cir. 1972).

The recent decisions in *Manor Drug Stores v. Blue Chip Stamps*[15] and *Eason v. General Motors Acceptance Corp.*[16] must be considered against the background. The Ninth Circuit was confronted with a complex factual situation in *Manor Drug*. The defendants had been involved in an antitrust action that had resulted in a consent decree[17] providing for the reorganization of Blue Chip Stamp Company and an offering of the reorganized corporation's stock to the non-stockholding users of Blue Chip Stamps.[18] In connection with the required offering, the defendant allegedly prepared a prospectus " 'calculated to mislead and dissuade users not knowledgeable of the true value of [the] shares from purchasing [the] shares' "[19] and thereby violated rule 10b-5.

The court, purporting to apply the purchaser-seller rule as set out in *Mount Clemens*, identified two functions of the rule. First, the rule had to fulfill the intent of Congress to eliminate fraud in the investment process.[20] Secondly, the rule had to limit standing under 10b-5 to a plaintiff with a "provable" case;[21] the plaintiff had to allege a relationship indicating his ability to show " 'proof of loss and the causal connection with the alleged violation of the Rule.' "[22]

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15. 492 F.2d 136 (9th Cir. 1973), *petition for cert. filed*, 43 U.S.L.W. 3108 (U.S. Aug. 15, 1974) (No. 74-124), *noted in* 8 GA. L. REV. 487 (1974).

16. 490 F.2d 654 (7th Cir. 1973), *cert. denied*, 94 S. Ct. 1979 (1974). The reaction to *Eason* has been considerable. Note, *Standing to Sue in 10b-5 Actions: Eason v. GMAC and Its Impact on the Birnbaum Doctrine*, 49 NOTRE DAME LAW. 1131 (1974) is a complete discussion of the decision which favors the *Eason* approach over the purchaser-seller rule, but perceives problems which can best be solved by congressional action. *See* 42 FORDHAM L. REV. 688 (1974); 27 VAND. L. REV. 572 (1974) (applauding *Eason*).

Judicial reaction to *Eason* has been less favorable. The Fifth Circuit has expressly reaffirmed the purchaser-seller rule in Sargeant v. Genesco, Inc., 492 F.2d 750, 764 (5th Cir. 1974); *accord*, Smallwood v. Pearl Brewing Co., 489 F.2d 579 (5th Cir. 1974).

The Third Circuit, shortly before *Eason*, reaffirmed the validity of the *Birnbaum* doctrine. Landy v. FDIC, 486 F.2d 139, 158 (3d Cir. 1973), *cert. denied*, 94 S. Ct. 1979 (1974). Since *Eason*, the Third Circuit has had the opportunity to repudiate *Birnbaum*, but has instead reaffirmed in *dictum*. *In re* Penn Cent. Sec. Litigation, 494 F.2d 528, 533 n.5 (3d Cir. 1974).

The Supreme Court is not anxious to resolve this conflict between the circuits. Denials of certiorari in *Eason* and *Landy* came on April 22, 1974 with the Chief Justice and Justices White and Douglas favoring the granting of certiorari in both cases. 94 S. Ct. 1979 (1974).

17. United States v. Blue Chip Stamp Co., 272 F.2d 432 (C.D. Cal. 1967), *aff'd mem. sub nom.* Thrifty Shoppers Scrip Co. v. United States, 389 U.S. 580 (1968).

18. These were the direct victims of the antitrust violation and the 10b-5 plaintiffs.

19. 492 F.2d at 139.

20. *Id.* at 140.

21. *Id.* at 141. The court considered this second purpose as the basis for the various exceptions which developed under *Birnbaum*.

22. *Id., quoting* Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, 547 (2d Cir. 1967).

Under the traditional purchaser-seller rule, an actual sale or contract for sale provided the necessary proof of loss and causation. In *Manor Drug* the consent decree identified the potential purchasers and the number of shares and the prices of the securities to be offered. Therefore, the court viewed the consent decree as the functional equivalent of a contract in its effect on the plaintiff's ability to prove loss.[23] Since the plaintiff had satisfied the requirements of the purchaser-seller rule as defined by the Ninth Circuit, standing was allowed.

The problem with the "provable case" approach to standing is that the purchaser-seller rule becomes dependent on the merits of the plaintiff's case, rather than on some neutral principle discernible in the relationship of the plaintiff, the defendant, and the alleged fraud. Standing becomes in essence a function of the judge's perceptions of the equities involved.

In *Eason* the plaintiffs (Eason and Satrom) were shareholders in a corporation (Bank Service) which bought an automobile leasing business (from Dave Waite Pontiac) after the latter had been extended credit by GMAC. As part of the consideration, Bank Service issued 7,000 shares of its stock to Dave Waite Pontiac and assumed the debts of the leasing business. Eason and Satrom executed guarantees of the business' indebtedness to GMAC. When Bank Service defaulted, GMAC brought suit on the guarantees in Indiana state court.[24] Eason and Satrom countered with a 10b-5 action in federal court alleging fraud by GMAC and Dave Waite and seeking recission of the guarantees.[25] The court found a strict application of the *Birnbaum* rule to be inconsistent with the Supreme Court's admonition that 10b-5 be construed broadly and flexibly.[26] The court also rejected utilization of the liberalized purchaser-seller rule because constant redefinition of the words "purchaser" and "seller" had rendered the rule ineffective.[27] After holding that

> the protection of the rule [10b-5] extends to persons *who, in their capacity as investors,* suffered significant injury as a direct consequence of fraud in connection with a securities transaction, even though their participation in the transaction did not involve either the purchase or sale of a security, . . .[28]

23. 492 F.2d at 142. *See also* International Controls Corp. v. Vesco, 490 F.2d 1334 (2d Cir. 1974), *cert. denied,* 42 U.S.L.W. 3666 (U.S. May 31, 1974) (No. 73-1542), *discussed in* note 69 *infra.*

24. 490 F.2d at 656.

25. *Id.*

26. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971).

27. 490 F.2d at 659.

28. *Id.* (emphasis added).

the court found that Eason and Satrom "were certainly 'investors' in the transaction which is allegedly tainted by fraud."[29] By failing to define "investors," the opinion skirted the central issue of standing.[30] The result in *Eason* indicates that the law on this issue may have run through twenty years of 10b-5 litigation without coming any closer to a satisfactory description of what constitutes standing for a 10b-5 private action.

The limits of the *Manor Drug* "provable case" approach to standing and the *Eason* "investor" approach may be determined by applying the holding of each case to the facts of the other. In applying the Ninth Circuit's reasoning in *Manor Drug* to the facts before the Seventh Circuit in *Eason*, it is clear that the plaintiffs in *Eason* had a "provable case." The history of the acquisition by Bank Service and the guarantees given by the plaintiffs provide the information necessary to prove loss and a causal connection. However, a problem arises in attempting to fit the *Eason* plaintiffs into the purchaser-seller rubric. The guarantees given to GMAC could have been viewed as securities sold by the plaintiffs, but this would have stretched the definition of "security."[31] An alternative would have been to view the events as a single transaction. The plaintiffs gave their guarantees inducing GMAC to permit the transfer of Dave Waite's company to Bank Service in return for 7,000 shares of stock (securities). However, with this approach it would have been necessary to treat the plaintiffs as sellers of securities issued by the corporation. This could not be done because the plaintiffs were suing in their individual capacities rather than on behalf of the corporation.[32]

Whether the Seventh Circuit's "investor" criterion would have afforded standing to the *Manor Drug* plaintiffs depends on the definition given to "investor." If the court meant to use the word in the layman's sense,[33] Manor Drug Stores would have lacked standing because it never invested in anything. In fact, had the plaintiffs invested, there would have been no injury; the fraud would have failed.[34] Judge Kirk-

29. *Id.*
30. *Id.* at 660 n.29.
31. *Id.* at 656.
32. Rekant v. Desser, 425 F.2d 872 (5th Cir. 1970) (standing allowed plaintiffs in derivative capacity, denied in individual capacity).
33. Investor is defined as "one who invests." Invest is defined as "To lay out (money or capital) in business with the view of obtaining an income or profit . . . ." WEBSTER'S NEW INTERNATIONAL DICTIONARY (2d ed. 1959).
34. 492 F.2d at 140.

patrick in *Kardon v. National Gypsum Co.*,[35] the first private action under 10b-5, described investors as persons "about to invest"[36] or already holding shares, while the Fifth Circuit has defined investors as persons "engaged in buying and selling and trading."[37] The *Birnbaum* rule was arguably an attempt to define "investor" on the basis of the type of transaction involved.[38]

The *Manor Drug* plaintiffs would not fit within any of these definitions easily. Use of the "about to invest" definition would either reduce "investor" to a meaningless standard permitting anyone to sue on a claimed intent to invest or require the plaintiff to allege an actual attempt to invest. Clearly, the plaintiffs did not meet the "buying and selling and trading" definition. Without the Ninth Circuit's stretching of the *Birnbaum* rule, the plaintiffs would not fit into the purchaser-seller definition of "investor."[39]

The search for a functional standing requirement must start with some basic propositions. First, accurate analysis requires identification of the type of standing involved. Secondly, standing is a function of the status of the plaintiff and should not depend upon the merits of the plaintiff's case.[40] Thirdly, congressional intent and purpose should be considered. Finally, it should be recognized that a conflict exists between the circuits, and the Supreme Court is not anxious to resolve the controversy.[41] A new standing criterion is most likely to be accepted by the "*Birnbaum* circuits" if that new criterion is responsive to the results of twenty years of litigation under the purchaser-seller rubric.

Standing is a function of the statute under which the suit is brought and of Article III of the Constitution.[42] Rule 10b-5 litigation has focused on statutory standing in situations in which the requirements for constitutional standing have been satisfied.[43] A number of commentators[44] have approached the statutory standing problem by re-

35. 69 F. Supp. 512 (E.D. Pa. 1946).
36. *Id.* at 514 (dictum).
37. Hooper v. Mountain States Sec. Corp., 282 F.2d 195, 201-02 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961).
38. 492 F.2d at 143 (Hufstedler, J., dissenting).
39. *Id.* at 143 n.1.
40. Flast v. Cohen, 392 U.S. 83 (1968).
41. *See* note 16 *supra.*
42. U.S. CONST. art. III, § 2.
43. *See* note 7 *supra.*
44. *E.g.*, Whitaker, *supra* note 7; Comment, 37 Mo. L. REV., *supra* note 4; Comment, 44 U. COLO. L. REV., *supra* note 7.

lying on a series of cases decided by the Supreme Court[45] in 1968 and 1970 that support a liberal approach, one favoring plaintiffs in standing questions.[46] In the most frequently cited case, *Association of Data Processing Service Organizations, Inc. v. Camp*,[47] Justice Douglas articulated two ingredients of standing: the Article III requirement of "injury in fact,"[48] and "whether the interest sought to be protected by the complainant is arguably within the zone of interests to be protected or regulated by the statute . . . in question."[49]

These cases are not applicable to the 10b-5 standing question. Since they involved private plaintiffs suing an agent or agency of the federal government,[50] the Justices' perceptions of the Court as a buffer protecting the citizen in the interface between government and governed influenced these decisions.[51] A correct analysis of 10b-5 standing must rely upon cases decided in the implied tort context[52] in which one private party sues another private party for damages occasioned by the defendant's violation of section 10(b) and rule 10b-5. The Restatement of Torts section 286 provides that a cause of action exists for a plaintiff, if the defendant violates a statute enacted for the plaintiff's protection.[53] The same requirement was enunciated in 1916 by the Court: "A disregard of the command of the statute is a wrongful

45. Barlow v. Collins, 397 U.S. 159 (1970); Association of Data Processing Serv. Organizations, Inc. v. Camp, 397 U.S. 150 (1970); Flast v. Cohen, 392 U.S. 83 (1968); Hardin v. Kentucky Util. Co., 390 U.S. 1 (1968).

46. Davis, *The Liberalized Law of Standing*, 37 U. CHI. L. REV. 450 (1970).

47. 397 U.S. 150 (1970); *see* Herpich v. Wallace, 430 F.2d 792, 805 (5th Cir. 1970); Note, 24 HASTINGS L.J., *supra* note 4, at 1036 n.105; Comment, 44 U. COLO. L. REV., *supra* note 7.

48. 397 U.S. at 152.

49. *Id.* at 153.

50. Barlow v. Collins, 397 U.S. 159 (1970) (suit by a tenant farmer challenging regulations promulgated by the Secretary of Agriculture); Association of Data Processing Serv. Organizations, Inc. v. Camp, 397 U.S. 150 (1970) (suit by a private corporation challenging a ruling of the Comptroller of the Currency); Flast v. Cohen, 392 U.S. 83 (1968) (taxpayer suit challenging the validity of HEW expenditures); Hardin v. Kentucky Util. Co., 390 U.S. 1 (1968) (suit by private corporation against the TVA).

Other recent decisions on standing are Sierra Club v. Morton, 405 U.S. 727 (1972) (injunction sought against the Secretary of the Interior); Investment Co. Institute v. Camp, 401 U.S. 617 (1971) (challenging regulations promulgated by the Comptroller of the Currency).

51. Flast v. Cohen, 392 U.S. 83, 109-14 (1968) (Douglas, J., concurring); *see* Note, NOTRE DAME LAW., *supra* note 16 (recognizing the distinction between the *Data Processing* type of litigation and private 10b-5 actions).

52. 1 A. BROMBERG, SECURITIES LAW: FRAUD § 2.4(1)-(2) (1973). The alternative to implied statutory tort as a theory was voidability under Securities Exchange Act § 29(b), 15 U.S.C. § 78cc(b) (1970); but this theory lost its hold with the decline of privity. A. BROMBERG, *supra*, § 2.4(1)(b).

53. RESTATEMENT OF TORTS, § 286 (1934) provides:

act, and where it results in damage to one of the class for whose especial [sic] benefit the statute was enacted, the right to recover the damages from the party in default is implied. . . ."[54] The cases dealing with standing to challenge government action do not necessitate the abandonment of the judicial self-restraint that has characterized decisions on standing in implied tort. If the courts substitute their judgment concerning who ought to be protected from securities fraud for that of Congress, they would be usurping the legislative function.[55]

Statutory standing under 10b-5 depends on whether a plaintiff is within the class of persons that Congress intended to protect when it enacted section 10(b) of the Exchange Act.[56] A reading of the legislative history[57] of the Securities Act and the Exchange Act reveals that Congress intended to establish market conditions in which investment decisions could be made in a free and honest atmosphere.[58] The problem of uncertainty, inherent in investment decision-making, can be minimized by the diversification of holdings that offsets the risk of unexpected loss with the potential of unexpected gain, or by the collection of more accurate information with which to make decisions.[59] Congress in the Securities and Exchange Acts attempted to reduce uncertainty through the second approach. With an assurance of accurate information, the investor can reduce the impact of the risks inherent in investment decision-making and thereby add stability to the securities market.[60]

The violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if:

(a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and

(b) the interest invaded is one which the enactment is intended to protect; and

(c) where the enactment is intended to protect an interest from a particular hazard, the invasion of the interest results from that hazard; and

(d) the violation is a legal cause of the invasion, and the other has not so conducted himself as to disable himself from maintaining an action.

54. Texas & Pac. Ry. v. Rigsby, 241 U.S. 33, 39 (1916); *accord,* Jacobson v. New York, N.H. & H.R.R., 206 F.2d 153 (1st Cir. 1953), *aff'd mem.*, 347 U.S. 909 (1954).

55. Flast v. Cohen, 392 U.S. 83, 92-97 (1968).

56. Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b) (1970).

57. The legislative history of the Securities Act and the Exchange Act has been compiled in an eleven volume work; J. ELLENBERGER & E. MAHAR, LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934 (1973).

58. *See* H.R. REP. No. 1383, 73d Cong., 2d Sess. 10 (1934); S. REP. No. 1455, 73d Cong., 2d Sess. 55 (1934) (Fletcher Report).

59. Hirshleifer, *Investment: Investment Decision,* in 8 INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL SCIENCES 194, 199-202 (1968).

60. This may have been the logic behind an SEC proposal to use "decision making groups" in analyzing standing under 10b-5. The proposal is suggested as a solution to 10b-5 standing in Comment, 56 GEO. L.J., *supra* note 4, at 1186.

Congress intended to protect the integrity of investment decision-making rather than to protect the investor per se. This concern for minimizing risk can be translated into a definition of "investor" by introducing a "transaction" requirement.[61] In order to obtain investor status, the plaintiff should be required to allege that the defendants' actions had an adverse impact upon the integrity of the plaintiff's investment decision-making.

A transaction requirement is not new to 10b-5 litigation.[62] The purchaser-seller rule required the plaintiff to allege that fraud touched a completed transaction.[63] The exceptions to the *Birnbaum* rule also adapt themselves to transaction analysis.[64] The Seventh Circuit apparently recognized a transaction requirement in *Eason* when it referred to the plaintiff's position as an " 'investor' in the transaction . . . tainted by fraud,"[65] and as a "[principal] in the transaction."[66]

The corporate mismanagement cases also reflect the influence of the transaction concept.[67] In *Rekant v. Desser*[68] the plaintiff-shareholders sued the management of the corporation for fraud (*i.e.* mismanagement) that involved securities transactions. Standing was allowed in the derivative action and denied in the individual actions. Under the transaction test the results would be the same. The fraud did not impair the decision-making of the individuals because they were not involved in the transaction; however, the corporation was involved and its decision-making was affected.

The consideration of six possible situations will serve to illustrate that the transaction test is responsive to the *Birnbaum* experience. First, the plaintiff could make and act upon an investment decision. This is the *Eason* situation and the situation covered by a strict pur-

61. This requirement looks at the status of the plaintiff in the abstract and does not imply use of reliance or materiality criteria.

62. *See* 2 A. BROMBERG, *supra* note 52, § 8.8. There seems to be a natural tendency to group 10b-5 standing cases into groups based upon the type of underlying transaction. *See* Boone & McGowan, *Standing to Sue Under SEC Rule 10b-5*, 49 TEXAS L. REV. 617 (1971); Kellogg, *The Inability to Obtain Analytical Precision Where Standing to Sue Under 10b-5 is Involved*, 20 BUFFALO L. REV. 93 (1970); Whitaker, *supra* note 7; Note, 24 HASTINGS L.J., *supra* note 4; Comment, 14 VILL. L. REV., *supra* note 8.

63. *E.g.*, Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

64. *See* note 62 *supra*; text accompanying notes 70-72 *infra*.

65. 490 F.2d at 659.

66. *Id.* at 659-60.

67. For an excellent discussion of issues other than standing in corporate mismanagement cases see Note, *The Controlling Influence Standard in Rule 10b-5 Corporate Mismanagement Cases*, 86 HARV. L. REV. 1007 (1973).

68. 425 F.2d 872 (5th Cir. 1970).

chaser-seller rule. The defendant sets out to influence an investment decision, the decision is made and acted upon. Standing should not be denied; the transaction is complete.[69]

Alternatively, interference by the defendant could frustrate the intention of the plaintiff.[70] These transactions are the frustrated offers or aborted contracts for purchase or sale. Since the fraud affects the plaintiff's investment decision-making, standing should be allowed.

Thirdly, the defendant could force the plaintiff into a decision.[71] This is the short form merger in which the plaintiff's decisional freedom is limited. Standing should be allowed.

Fourthly, manipulation of the market by the defendant could hinder a plaintiff who desires to make an investment decision.[72] This is the suit for injunctive relief. Standing should be allowed so that the plaintiff's future investment decision may have full and effective protection consistent with the intent of Congress.

Fifthly, the plaintiff could be the recipient of a specific and individually directed offer, and the actions of the defendant made the offer less attractive.[73] If the plaintiff does nothing, the situation does not indicate that the plaintiff made an investment decision, but only that the defendant intended to interfere with any decision-making that the plaintiff might make. Standing should be denied because there is no transaction in which decision-making can be found.

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69. In International Controls Corp. v. Vesco, 490 F.2d 1334 (2d Cir. 1974), *cert. denied*, 42 U.S.L.W. 3666 (U.S. May 31, 1974) (No. 73-1542), the court stretched the definition of "sale" in order to give standing to the plaintiff under the purchaser-seller rule. The plaintiff corporation was induced by a violation of 10b-5 to dispose of portfolio securities through a dividend in kind to its shareholders. Although no consideration was given by the shareholders, the court held, over the sharp dissent of Judge Mulligan, that the spin-off was a sale. The court admitted that the decision was without precedential support, *id.* at 1344, and arguably contrary to an earlier second circuit case, *id.* at 1344-45, 1358.

Under a transaction-investor criterion, the plaintiff would have obtained standing because it made what the court recognized as an important decision concerning its investment holdings. *Id.* at 1346.

70. *E.g.*, Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970); Iroquois Indus., Inc. v. Syracuse China Corp., 417 F.2d 963 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970); A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967).

71. *E.g.*, Dasho v. Susquehanna Corp., 461 F.2d 11 (7th Cir.), *cert. denied*, 408 U.S. 925 (1972); Coffee v. Permian Corp., 434 F.2d 383 (5th Cir. 1970); Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967).

72. Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970); Britt v. Cyril Bath Co., 417 F.2d 433, 436 (6th Cir. 1969); Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, 546 (2d Cir. 1967).

73. This is the situation presented in *Manor Drug*; *see* text accompanying notes 17-19 *supra*.

The final situation is virtually identical to the immediately preceding one except that the offer was not directed to any particular individuals.[74] If the class of offerees is not defined, it is difficult to identify the persons who could have reasonably made any investment decision vis-a-vis the offer; therefore, the logic of denying standing becomes stronger.

In the first four situations, the plaintiff transacts business, attempts to transact business, or wishes to transact business in securities. The transactions involve the investment decision-making process that Congress sought to protect. The plaintiff is the decision-maker; therefore the plaintiff should be protected by 10b-5 and standing should be allowed.

The last two situations will be the battle field of controversy under the investor criterion. Those who favor a virtually limitless reach for 10b-5 will argue that these last two situations should result in standing for the plaintiff. In substance, their argument will be first that the Supreme Court requires a broad and flexible interpretation of section 10(b) and 10b-5[75] and that cases like *Association of Data Processing Service Organizations, Inc. v. Camp*[76] have liberalized standing requirements. However, *Data Processing* and the related standing cases do not apply to the 10b-5 situations.[77] The broad and flexible construction concept must be balanced against the traditional requirements of judicial self-restraint.[78] While the Supreme Court wishes the lower courts to adhere to congressional purpose by giving the benefit of the doubt to a victim rather than a defrauder, it does not follow that the lower courts should ignore the congressional decision to protect *only* investors.

CONCLUSION

This note developed a functional interpretation of the statutory standing criteria for litigation between private parties under 10b-5. Standing will be given to *investors* — persons who make, attempt to make, or wish to make investment decisions in a securities *transaction.* This interpretation leaves to the states their traditional powers to regulate corporate management[79] and preserves the tradition of judicial

74. This is the situation presented in Mount Clemens Indus., Inc. v. Bell, 464 F.2d 339 (9th Cir. 1972).

75. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971).

76. 397 U.S. 150 (1970).

77. *See* notes 50-51 and accompanying text *supra.*

78. *See* note 55 and accompanying text *supra.*

79. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971). "We

self-restraint in the determination of standing questions.[80]

A transaction-investor standard of standing determines standing not on the merits of the plaintiff's case, but on the neutral principles discernible from the position of the plaintiff vis-a-vis the investment decision-making process.[81] At the same time, the standard tends to eliminate plaintiffs with unprovable claims.[82] The transaction concept provides an element of flexibility,[83] and the decision-making approach provides some certainty. Finally, the lessons of the *Birnbaum* experience are not ignored.

C. CLINTON STRETCH

Tax—Only God Knows For Sure But the I.R.S. Makes a Good Guess—Use of the Treasury Department's Actuarial Tables

An individual's life expectancy determines, in many tax situations, the number of tax dollars the federal government will receive. Consequently, the method used to measure this expectancy is extremely important to both the Internal Revenue Service and the taxpayer. However, the courts disagree[1] on whether this valuation should be based upon actual expectancy or actuarial expectancy.[2]

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agree that Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement." *Id.* at 12.

80. *See* notes 55 & 78 and accompanying text *supra.*

81. *See* note 4 *supra.*

82. This was the concern of the court in *Manor Drug*; *see* note 21 *supra.*

83. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971).

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1. *Compare* Miami Beach First Nat'l Bank v. United States, 443 F.2d 116 (5th Cir. 1971), *with* Continental Ill. Nat'l Bank & Trust Co. v. United States, 32 Am. Fed. Tax R.2d 6235 (N.D. Ill. 1973).

2. "Actual expectancy" involves consideration of all facts pertinent to an individual's state of health. "Actuarial expectancy" is determined by extensive averaging of the population as a whole and does not consider the state of health of the specific individual in question.

The statutory foundation for the actuarial tables is INT. REV. CODE OF 1954, § 7805(a), which authorizes the issuance of "all needful rules and regulations" for the enforcement of the Internal Revenue Code. These tables are used by the Internal Revenue Service for a variety of tax purposes in valuing annuities, life estates, remainders and reversions. Some of these purposes are: (a) Valuation of general life estates with remainer interests to others; (b) Valuation of life annuities [*But see* ABA, Memorandum of Feb. 11, 1974 (Proposal C) concerning changes in section 72(b) of the Internal Revenue Code]; (c) Valuation of income interests in funds for terms for years; (d) Valuation of annuity interests for terms for years; (e) Valuation in corporation-stockholder