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Federal Securities Laws Should Protect Some Purchases of All or Substantially All of a Corporation's Stock

*Robert N. Rapp**

The federal securities laws were designed to protect purchasers of securities by ensuring adequate disclosure of material information regarding the security, issuer, and selling intermediaries. The author notes that a series of recent federal court decisions has formulated a virtual per se rule disallowing application of the federal securities law protections to transactions involving the purchase of all or substantially all the stock of a business. Although literally such "stock" would be subject to the securities law protections due to its inclusion in the statutory definition of "security," these recent decisions have held that acquisition of substantially all of the stock of a business conveys enough management control that disclosure and antifraud protection under the Acts is not warranted. The author examines the emergent trend created by these decisions as well as Golden v. Garofolo, *a Second Circuit decision which manifests a strong contrary reaction. He also examines the congressional intent behind federal securities law protections and the true economic reality of investment decisionmaking employed in the purchase of all or substantially all the stock of a business. The author concludes that the analysis employed in the recent trend of decisions and the emergence of a virtual per se rule contradict fundamental premises for federal securities law protections. He reasons that acquisition of management control, rather than being the determinative factor in denying securities law protections, is itself a critical factor in making an investment decision—one which is vulnerable to information failure and which consequently requires federal securities law protection.*

INTRODUCTION

FEW ISSUES of securities law have seen such rapid development as the issue of whether acquisitions in negotiated transactions of all or substantially all of the issuer's outstanding stock are

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covered by the antifraud provisions of the Securities Act of 1933 (1933 Act)[1] and Securities Exchange Act of 1934 (1934 Act).[2] In a series of recent decisions, some courts have refused to recognize securities law antifraud claims asserted by purchasers in such negotiated transactions, where, presumably, the acquisition represents the right to control the business enterprise. Shunning "literal" application of the securities laws[3] and relying instead on perceived "economic reality," these courts have decided that purchase of all or substantially all the stock of a corporation is really a purchase of the business for consumption and not a purchase of an investment "security" to which federal securities law applies. In the leading case of *Frederiksen v. Poloway*,[4] the Seventh Circuit succinctly articulated the "economic reality" perceived:

> [T]he transaction did not involve a sale of corporate stock to raise capital for profit-making purposes. The plaintiffs sought to acquire NSM's business in its entirety. The "stock" sale was a method used to vest ECC with ownership of that business. There was no offer of investment "securities." The stock of NSM merely was passed incidentally as an indicia of ownership of the business assets sold to ECC.[5]

Cases in the *Frederiksen* trend rest squarely on the premise that purchase of all or substantially all of the corporation's stock represents the antithesis of investment, because the presumed motivation is to "use or consume the item purchased."[6] Obtaining control gives the purchaser the power to translate his motivation into corporate policy. The *Frederiksen* court and later courts have supported this premise by applying the traditional "investment contract" analysis set forth in *SEC v. W.J. Howey Co.*,[7] updated to

1. 15 U.S.C. §§ 77a-77aa (1976 & Supp. IV 1980).

2. 15 U.S.C. §§ 78a-78kk (1976 & Supp. IV 1980). The focus of this Article will be limited to the investor protections provided by the general antifraud provisions of the 1933 and 1934 Acts. Although this Article does not analyze the federal securities law protections provided by the registration and reporting requirements of the Acts, many of the policies which compel the application of the antifraud provisions would also mandate compliance with the itemized disclosure requirements of the federal securities laws.

3. "The term 'security' means any . . . stock . . . ." Securities Act of 1933 § 2(1), 15 U.S.C. § 77b(1) (1976); Securities and Exchange Act of 1934, § 3(10), 15 U.S.C. § 78c(10) (1976).

4. 637 F.2d 1147 (7th Cir. 1981).

5. *Id.* at 1151-52.

6. *Id.* at 1150 (quoting United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852-53 (1975)). In *Forman* the Court contrasted such a motivation with that in which an "investor" is attracted solely by the prospects of a return on his investment. 421 U.S. at 853.

7. 328 U.S. 293 (1946).

reflect the "economic reality" theme of *United Housing Foundation, Inc. v. Forman*.[8] The resultant analysis is dangerously close to a per se rule denying federal securities law protection to acquisitions of all or substantially all the stock of a corporation.

The thesis of this Article is that cases in the *Frederiksen* trend which have left the impression of a per se rule are wrong. The antifraud protections of federal securities laws should be available in cases of acquisition of all or substantially all of a corporation's stock, where circumstances demonstrate the need for such protection by the presence of factors which the securities laws were intended to address. The advancement, moreover, of any per se rule of law based upon the reasoning and analysis offered in the current spate of decisions is actually antagonistic to most of the considerations heretofore justifying the availability of federal securities law protections. Such a rule is also at odds with a major premise underlying the creation of the liberalized antifraud protections in the first place. As demonstrated in the ensuing analysis, there are undoubtedly business acquisitions in which the facts and circumstances demand securities law protections. Indeed, the Second Circuit recently countered the *Frederiksen* trend and rejected the "sale of a business" doctrine which would have precluded securities law protections.[9] At the same time, however, it is equally clear that circumstances may demonstrate the absolute propriety of not affording such protections.

I. THE "ECONOMIC REALITY" CONUNDRUM

The literal language of the 1933 and 1934 Acts strongly supports the inclusion of purchase of all or substantially all of a corporation's stock within the statutory definiton of "security." The United States Supreme Court has said that the definition of "security"[10] includes two broad categories of items: traditional, stan-

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8. 421 U.S. 837 (1975).

9. Golden v. Garofolo, [current] FED. SEC. L. REP. (CCH) ¶ 98,656, at 93,275 (2d Cir. 1982). *See supra* text accompanying notes 94-96.

10. Section 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1) (1976), provides in part:

> When used in this subchapter, unless the context otherwise requires—
>
> (1) the term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest

dardized instruments like "stocks," "bonds," and "notes"; and instruments like "investment contracts" and "transferable shares."[11] While the substance of the transaction, not its form, will determine whether a particular item is a "security,"[12] the Supreme Court has in the past included instruments falling within the literal language of the statute.[13] Thus, the purely statutory ground for extending the protection of the federal securities laws to acquisitions of all or substantially all a corporation's stock, that is, literal coverage, is certain.

Reaffirming the commitment to maximizing the investor protections of the federal securities laws, the Court in *SEC v. W.J. Howey Co.*,[14] set in motion the expansion of the scope of securities law coverage characterizing the past four pre-*Frederiksen* decades. This expansion was accomplished through interpretation of the descriptive statutory definition of "investment contract" in light of the transaction's substance. The *Howey* Court stated:

> [A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by normal interests in the phys-

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> or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

11. In SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943), the Court said:

> In the Securities Act the term "security" was defined to include by name or description many documents in which there is common trading for speculation or investment. Some, such as notes, bonds and stocks, are pretty much standardized and the name alone carries well settled-meaning. Others are of more variable character and were necessarily designated by more descriptive forms, such as "transferable share," "investment contract," and "in general any interest or instrument commonly known as a security." We cannot read out of the statute these general descriptive designations merely because more specific ones have been used to reach some kinds of documents. . . . However, the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as a matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as "investment contracts," or as "any interest or instrument commonly known as a security."

12. The United States Supreme Court, in Tcherepnin v. Knight, 389 U.S. 332, 336 (1967) stated: "[I]n searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality."

13. The *Joiner Leasing Corp.* Court said: "Instruments may be included within any of these definitions, as a matter of law, if on their face they answer to the name or description." 320 U.S. at 351.

14. 328 U.S. 293 (1946).

ical assets employed in the enterprise.[15]

While the now familiar *Howey* rule assured application of federal securities law protections to the novel, uncommon, or irregular device, and achieved high visibility in the process, little substantive attention was ever focused upon reasons for the rule—the circumstances which justified specialized protection. Application of the *Howey* "test" became virtually mechanical.

The argument that the statutory meaning of "stock" required inclusion of substantial or total stock acquisitions within the term "security" seemed to have unassailable merit, particularly when buttressed analogically by the expansion of securities protections through the *Howey* definition of "investment contract." In 1975, however, the Supreme Court removed from the definition of "security" an instrument which on its face proclaimed to be "stock"—one of the specific instruments which the Supreme Court previously had noted were "pretty much standardized" with "the name alone carr[ying] well-settled meaning."[16]

In *United Housing Foundation, Inc. v. Forman*,[17] the Supreme Court decided that shares of "stock" in a state-sponsored housing cooperative were not "securities" entitled to federal protection, even though clearly within the literal language of the federal statute. The "stock" involved in *Forman* represented the right to reside in the project and had no traditional attributes of corporate stock.[18] The definitional provisions of both the 1933 and 1934 Acts provide that "security" includes the various enumerated in-

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15. *Id.* at 298-99. The *Howey* Court's definition of "investment contract" was expressly recognized by the Court to reflect *economic reality*. As the Court observed,

> [The term "investment contract"] was common in many state "blue sky" laws in existence prior to the adoption of the federal statute and, although the term was also undefined by the state laws, it had been broadly construed by state courts so as to afford the investing public a full measure of protection. *Form was disregarded for substance and emphasis was placed upon economic reality.*

Id. at 298 (emphasis added). Contrary to what later cases imply—particularly those denying the protections of federal securities laws to purchasers of all or substantially all a corporation's stock—the emphasis in *Forman* on "economic reality" represented no change of focus from *Howey*, only a change in result. The new aspect was to apply "economic reality" to defeat the existence of a security rather than find one. *See infra* notes 17-25 and accompanying text.

16. *Joiner Leasing Corp.*, 320 U.S. at 351. *But see* discussion concerning "notes" as securities in *infra* note 72 and accompanying text.

17. 421 U.S. 837 (1975).

18. The *Forman* Court listed what it believed were some of the traditional attributes of stock—the right to receive dividends contingent upon an apportionment of profits: negotiability, ability to be pledged or hypothecated, the right to vote in proportion to the number of shares owned, and the appreciation of stock value. *Id.* at 851. *See infra* text accompanying note 22.

struments "*unless the context otherwise requires.*"[19] To avoid the result so clearly commanded by the express statutory inclusion of "stock" in the definition of "security,"[20] the Court interpreted the "unless the context otherwise requires" statutory language to govern all the enumerated definitions of "security." Viewing "context" as subtending both the facts of the transaction and the later text of the statute, the *Forman* Court found the facts of the transaction to show that the purchasers of the "stock" were motivated to acquire only a place to live:

> Common sense suggests that people who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock. *These shares have none of the characteristics "that in our commercial world fall within the ordinary concept of a security."*[21]

Thus, the Court signalled economic reality in the commercial world as the test for a "security": "Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto."[22] The economic reality of *Forman* was consumption of housing for personal use rather than for investment. The shares in the cooperative lacked voting rights, cash dividend rights, rights to pledge or hypothecate, and the right to potential appreciation.[23] Therefore, the Court found the shares to lack the characteristics which in the commercial world fall within the concept of a "security."

As an alternative theory, the claimants in *Forman* asserted that an "investment contract" could be found in the circumstances by applying the *Howey* test. The Court disagreed, concluding that the situation offered no "expectation of profits" in the sense found

19. 15 U.S.C. §§ 77b(1) (1933 Act), 78a(c)(10) (1934 Act) (1976) (emphasis added).

20. *See supra* note 10.

21. 421 U.S. at 851 (emphasis added) (quoting H.R. REP. No. 85, 73d Cong., 1st Sess. 11 (1933)).

22. 421 U.S. at 849.

23. The undisputed purpose of the shares of "stock" involved in this case was the right to occupy an apartment in the housing project. The shares were nontransferable and upon termination of occupancy could only be reoffered to the cooperative, or to an eligible new tenant in the event repurchase was declined, at the initial price paid, making the initial purchase price, in actuality, merely a recoverable security deposit. Clearly, the claimants did not purchase the "stock" with an expectation of realizing an investment profit from the housing stock. The presence or absence of such an expectation is critical in the inquiry. *See* Rapp, *The Role of Promotional Characteristics in Determining the Existence of a Security*, 9 SEC. REG. L.J. 26 (1981).

necessary in *Howey* and, accordingly, involved no investment contract.[24]

While discarding wooden literalism in favor of transactional substance, the Court was, nevertheless, careful to point out:

> In holding that the name given to an instrument is not dispositive, we do not suggest that the name is wholly irrelevant to the decision whether it is a security. There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument.[25]

Later decisions, however, unfortunately have not followed *Forman's* clear warning. Using *Forman* as a talisman, later courts have denied federal securities law protections to purchases of all or substantially all stock of a corporation—even where "economic realities" compel quite the opposite result.

In searching for "economic reality," the test should be whether the facts of the transaction demonstrate that the purchaser's expectations were investment or consumption. While courts have no principled way to prefer the expectations of one of the parties over the other, Congress—in which both purchasers and sellers of securities are represented—has decreed that expectations of purchasers be preferred. The federal securities laws were adopted in response to demonstrated abuses. Of particular concern was purchasers' inability to obtain access to full information. The Supreme Court has construed the 1933 Act to prefer the expectations of purchasers:

> While a buyer and seller of securities, under some circumstances, may deal at arm's length on equal terms, it is clear that the Securities Act was drafted with an eye to the disadvantages under which buyers labor. Issuers of and dealers in securities have better opportunities to investigate and appraise the pro-

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24. The *Forman* Court described that expectation of profits:

> By profits, the Court has meant either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors' funds . . . . In such cases the investor is "attracted solely by the prospects of a return" on his investment. . . . By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—"to occupy the land or to develop it themselves," as the *Howey* court put it . . .—the securities laws do not apply. . . .
>
> In the present case there can be no doubt that investors were attracted solely by the prospect of acquiring a place to live, and not by financial returns on their investments.

421 U.S. at 852–53 (quoting *Howey*, 328 U.S. at 300).

25. 421 U.S. at 850–51.

> spective earnings and business plans affecting securities than buyers. It is therefore reasonable for Congress to put buyers of securities covered by that Act on a different basis from other purchasers.[26]

These concerns have not been limited to the public distribution of securities or to any particular setting. Indeed as the Supreme Court, in considering the scope of section 10(b) and Rule 10b-5 under the Securities Exchange Act of 1934,[27] later observed: "[W]e read § 10(b) to mean that Congress meant to bar deceptive devices and contrivances in the purchase or sale of securities whether conducted in the organized markets or face to face."[28] Furthermore, *Forman* teaches that an integral part of the factual assessment of the deal is the purchaser's legitimate expectation.[29] The decision to acquire a personal residence was not an investment decision protected by the securities laws because the buyers did not believe that "in reality" they were purchasing investment securities.[30] The purchase of all outstanding corporate stock, however—stock in the truest and most traditional sense—may involve entirely different investor expectations and may well occur in circumstances requiring federal securities law protections.

II. EMERGENT CASE LAW

No uniform interpretation of *Forman* has emerged from suc-

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26. Wilko v. Swan, 346 U.S. 427, 435 (1953). The precise issue in *Wilko* was whether an agreement to arbitrate claims could preclude assertion of securities law claims in Federal Court. Holding that such agreements could not extinguish the right to a federal adjudication as provided for in the Securities Act of 1933, the Court's analysis turned almost exclusively upon the special protections afforded the buyers of securities which was shown to be the intent of the Act.

27. 15 U.S.C. § 78j(b) (1976); 17 C.F.R. § 240.10b-5 (1982). Section 10(b) outlaws the use "in connection with the purchase or sale" of any security of "any manipulative or deceptive device or contrivance." Additionally, pursuant to its rulemaking authority under § 10(b), the Securities and Exchange Commission promulgated Rule 10b-5, which 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.

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

29. 421 U.S. at 848-51.

30. *Id.* at 851.

ceeding decisions. Some courts have merely failed to discuss the admonition in *Forman* that where the underlying transaction "embodies some of the significant characteristics typically associated with the named instrument,"[31] the securities laws may properly apply.

Other courts, however, have rejected the view that federal securities laws may be applied based *solely* on the characteristics of the instrument and have required "economic reality" analysis in all cases. Yet these courts have gone one step further and confined the economic reality analysis to the *Howey* factors, in effect blurring and blending the economic reality holding of *Forman* with its alternative holding that no *Howey* investment contract existed. In *Frederiksen v. Poloway*,[32] the Seventh Circuit offered this observation: "Our reading of *Forman* is that an "economic reality" assessment might be required by *Forman* even if the stocks involved do have some characteristics typically associated with investment securities."[33]

According to *Frederiksen*, the implication in *Forman* is that "the economic reality of a transaction is always a key issue."[34] In

31. *Id.*

32. 637 F.2d 1147 (7th Cir. 1981).

33. *Id.* at 1152 n.2.

34. *Id.* To hold otherwise, according to the court, would ignore the fundamental admonition of *Forman* that securities transactions are "economic in character" and that the intended applications of the securities laws turn upon the economic realities of a transaction. *Frederiksen* and its progeny emphasize that "stock" for purposes of securities law coverage means stock utilized in the traditional *capital formation* setting—"the sale of corporate stock to raise capital for profit-making purposes." *Id.* at 1151. *Forman* itself fueled that conclusion:

> The primary purpose of the Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors.

421 U.S. at 849.

The narrow focus upon capital formation activity, however, has never been, and surely could not be, the controlling principle in defining the ambit of securities law protections. Indeed the Supreme Court has itself emphasized after *Forman* that even within the 1933 Act the protective focus is much broader, and that the antifraud provisions, particularly section 17(a) of that Act, 15 U.S.C. § 77q (1976), represent a "major departure" from any such limitation in scope. United States v. Naftalin, 441 U.S. 768, 778 (1979). *See also* S. REP. No. 47, 73d Cong., 1st Sess. 4 (1933) (fraud or deception in the sale of securities may be prosecuted regardless of whether the security is old or new).

Despite the focus upon capital formation at the primary distribution stage, it is clear that the fundamental concern of the Securities Exchange Act of 1934, and its antifraud protections, is protection in the transactional setting as opposed to the distributional setting. *See* 1 L. LOSS, SECURITIES REGULATION 130–31 (2d ed. 1961). None of the cases after *Frederiksen* have considered the distinction in transactional focus. Yet, it necessarily bears

determining "economic reality," however, the *Frederiksen* court simply imported the *Howey* test for investment contracts focusing on profits from efforts of others. The elements for a "security" are (1) an investment in a common venture (2) premised on a reasonable expectation of profits (3) to be derived from the entrepreneurial or managerial efforts of others.[35] This test leads inescapably to the conclusion that the assumption of managerial control over the business enterprise and its future "profits" invariably defeats the contention that one has purchased a "security," because the expected profits would always be derived from the managerial efforts of the purchaser. Such a result occurs regardless of the particular facts of the deal, access of the parties to material information, and real expectations of the purchaser—regardless, in short, of economic reality. The analysis is simplistic and invites the emergence of a per se rule; it is fundamentally erroneous applied to the purchase of all or substantially all the outstanding stock of a corporation.

Forman itself is ambiguous as to whether stock possessing traditional or typical characteristics was intended to be exempted from economic reality analysis or whether *all* instruments are to be subjected to such analysis before securities laws may apply. On the one hand, the Court said that the federal securities laws would clearly apply "when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument."[36] But since the typical significant characteristics were missing in *Forman*, this statement by the Court is dictum. Further undercutting this dictum, the Court, discussing the alternative "investment contract" argument, said that the *Howey* test "embodies the essential attributes that run through *all* of the Court's decisions defining a security."[37] The Court also added:

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upon the policy analysis employed in the inquiry, and its absence is further evidence of the inadequate reasoning employed to achieve the current per se oriented results.

35. 637 F.2d at 1152. *See also Forman*, 421 U.S. at 852.

36. 421 U.S. at 851.

37. *Id.* at 852 (emphasis added). This observation, however, must be considered from the proper perspective. "All" of the Court's pre-*Forman* decisions defining a security relied upon the proposition that a particular set of circumstances gave rise to the existence of an *investment contract.* After *Joiner* and *Howey*, the Court in the next two decades decided SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959) (variable annuity contract held to be an investment contract); SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967) ("flexible fund" annuity contract held to be an investment contract); and Tcherepnin v. Knight, 389 U.S. 332 (1967) ("withdrawable capital shares" of a savings and loan association held to be investment contracts). The focus in all these cases was whether the essential attributes of an investment contract, as outlined in *Howey*, were presented. The Court

> The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors funds . . . . In such cases the investor is "attracted solely by the prospects of a return" on his investment . . . . By contrast, when a purchaser is motivated by a desire to use or consume the item purchased . . . the securities laws do not apply.[38]

Frederiksen and some later cases such as *Canfield v. Rapp & Son, Inc.*,[39] have simply concluded that since the *Howey* elements sum up and entrap the notion of economic reality, the *Howey* element of "expectation of profits from efforts of others" must exist—as a matter of economic reality—in *every* security transaction. That requirement is necessary in the emergent line of reasoning even if, as in *Canfield*, the stock involved possesses traditional attributes of corporate stock. As that court reasoned:

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answered affirmatively in each case. In each case policy analysis—the need for securities law protections in each set of circumstances—was prominent. It is also noteworthy that in *Tcherepnin*, the Court specifically noted that while all of the essential attributes of an investment contract were in evidence, the decision that a "security" was involved could also be based upon the *Joiner* principle that "[i]nstruments may be included within any of [the Act's] definitions, as a matter of law, if on their face they answer to the name or description." 389 U.S. at 339 (quoting *Joiner*, 320 U.S. at 351).

Thus, as pointed out in *Forman*, and now taken on faith in the emergent line, the "touchstone" test of *Howey* ran through all of the Court's prior decisions. The question of whether something which unquestionably answered to the name or description of a specifically identified category of security was never before the Court in any of those cases, however, and was not in the subsequent analysis. *See* International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979) (interest in a noncontributory, compulsory pension plan held not to constitute an investment contract). Moreover, in *Daniel*, the Court once again emphasized that "[t]he starting point in every case involving the construction of a statute is the language itself." *Id.* at 558. Acknowledging the omission of any reference to pension plan interests in either of the statutory definitions of "security," the Court went on in *Daniel* to consider the contention that the set of relationships involved gave rise to the existence of an investment contract.

Considering "all" of the decisions, the bifurcated analysis in *Forman*, and the considerable attention paid to what would "clearly" be the case when the instrument involved embodies significant characteristics typically associated with that instrument, is meaningful. The fact is that both parts of the *Forman* opinion are, independently, in accord with "all" prior decisions of the Court, and their unification in the emergent cases is neither undertaken in *Forman* nor logically compelled by anything contained in the opinion. None of the emergent lower court cases has demonstrated any sensitivity to this perspective on the words of *Forman*.

38. 421 U.S. at 852 (quoting *Howey*, 328 U.S. at 300).

39. 654 F.2d 459 (7th Cir. 1981). The author is unrelated to the defendant. *See also* King v. Winkler, 673 F.2d 342 (11th Cir. 1982).

> [W]hile the stock purchased by Rapp had the characteristics of ordinary stock, such as the right to receive dividends and voting rights, *in the hands of Rapp, this stock was not ordinary capital stock.*
>
> Unlike the ordinary investor in ordinary capital stock, Rapp acquired total control over those very characteristics—dividends and votes. When a purchaser acquires 100% of the stock of a corporation and, therefore, for example, can confer dividends on itself at will, the fact that dividends are a characteristic of ordinary capital stock does not give rise to a justifiable assumption that the federal securities laws apply.[40]

Other cases composing the emergent line, such as *Chandler v. Kew*,[41] *Bula v. Mansfield*,[42] and *Dueker v. Turner*,[43] have simply and erroneously equated bulk purchase of all assets of a business with the purchase of 100% of the capital stock of the business *entity*, which represents ownership of those assets along with the business (and, of course, its liabilities). Under this approach the stock represents a mere indicia of ownership of the business. As stated in *Chandler:*

> The economic realities of the case at bar show that the plaintiff was buying a liquor store and, incidentially as an indicia of ownership, was receiving 100% of the stock of the company which owned the store. There was no security transaction within the purview of the federal statutes.[44]

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40. 654 F.2d at 466 n.7 (emphasis added). The italicized language clearly stands for the proposition that in the hands of an "ordinary investor" the stock, with its traditional attributes, would trigger securities law protections. The basis for distinguishing between this particular purchaser and the "ordinary" investor is solely the amount of stock purchased and the degree of future control conferred. But, as this Article demonstrates, acquiring a right to future managerial control of an enterprise has no bearing upon the economic realities of the purchase transaction itself; the critical factor is an expectation of making that future control meaningful.

41. [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,966, at 96,053 (10th Cir. 1977).

42. [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,964, at 96,051 (D. Colo. 1977).

43. [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,386, at 97,535 (N.D. Ga. 1979).

44. [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,966, at 96,054 (10th Cir. 1977). The equation between an outright sale of assets and the purchase of 100% of the stock of a corporation was more readily made in these cases, which indeed were structured as asset purchases, with the transfer of the stock being a "mere incident" of the main transaction. In *Chandler*, for example, the Court emphasized that "plaintiff made a contract with the defendants for the purchase by him of 'described business and personal property . . . called K.E.W. Inc. dba Chambers Liquors. . . .' The contract says: 'PRICE TO INCLUDE: 100% of the outstanding issued stock of K.E.W., ...'" Yet this approach has recently been applied with equal force in situations such as *Canfield* in which the transaction involved only the sale of stock pursuant to a written stock purchase agreement. In the name of economic reality the *Canfield* Court reasoned:

Irrespective of where emphasis is placed, all of the cases necessarily adopt the view of *Forman* which conceives of economic reality simply in terms of the *Howey* test, thereby erroneously blurring and blending the alternative holdings in *Forman*.[45]

III. Case Law Application of the Economic Reality Test to Identify Investment Characteristics

The cases show the difficulty courts have in identifying the characteristics which separate an investment transaction from all others, thus creating the need for specialized protection of the federal securities laws. There is, however, one fundamental economic reality ignored by cases in the *Frederiksen* line which deny federal securities law protection to purchases of all stock in a corporation on the grounds that such purchase entails complete ownership and managerial control.

The decision to purchase the corporate stock is based upon an assessment of investment risk, which is determined by available information as to the reasonable expectation and ability of the purchaser to employ meaningfully its newly acquired management powers to maximize *post*-acquisition "profits." Cases in the *Frederiksen* line, however, have ignored the issue of whether such control could affect the near-term future success of the enterprise in any meaningful way. There is a vast difference between the right of future control over an enterprise and the ability to make that right mean anything. Furthermore, the significance of the

> Here the parties labeled their contract an "Agreement for Sale of Stock of Twigg Corporation." Pursuant to the Agreement, Rapp purchased 100% of the capital stock of Twigg, not Twigg's assets. But, despite the facial differences between the transaction here and in *Frederiksen*, an "economic reality" analysis of the transaction here indicates the sale of a business, not securities. Finding that a sale of 100% of the stock brings the transaction within the securities laws, while a sale of assets plus 100% of the stock does not, exalts form over substance. The economic reality test requires investigation beyond the parties' method of structuring the transaction. Undoubtedly, when Rapp purchased 100% of the Twigg stock, Rapp purchased the entire business. A separate sale of assets would have added nothing to the economic reality of the transaction.

[1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,227, at 91,534 (7th Cir. 1981).

Such analysis, of course, ignores fundamental economic reality that may be associated with liabilities and risk flowing from acquisition of the stock thereof. Both before and after *Forman*, such considerations for the chosen structure of a transaction—and the expectations associated with it—have been regarded as significant. *See* Occidental Life Ins. Co. v. Pat Ryan & Assocs., Inc., 496 F.2d 1255 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974); Bailey v. Meister Brau, Inc., 320 F. Supp. 539 (N.D. Ill. 1970). *See also* Mifflin Energy Sources, Inc. v. Brooks, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,734 (W.D. Pa. 1980); *see infra* text accompanying notes 47-60.

45. *But see supra* note 37.

control to be acquired is simply one more factor in the buyer's valuation process—albeit a very important factor. Yet the buyer is disadvantaged concerning the significance of control because the source of such information can only be the seller. Thus, the purchaser of all or most of the stock is in no different position from the disadvantaged buyer whom the Supreme Court long ago observed was on a "different basis from other purchasers"[46] in the commercial world. Such a buyer is precisely the buyer the securities laws were designed to protect. The right to exercise managerial control over an enterprise in the future is meaningless, in terms of economic reality, if the economic conditions of the enterprise have been misrepresented by the seller prior to the transaction.

The recent cases moving against the *Frederiksen* trend by permitting application of securities law protections to 100% stock acquisitions have demonstrated some sensitivity on this point, although they fail to articulate it. Thus these decisions are vulnerable to attacks of being impermissibly literal. In *Titsch Printing Co. v. Hastings*,[47] the United States District Court for Colorado allowed application of federal securities law protections in the case of a 100% stock acquisition. The *Titsch* Court refused to apply the *Howey* definition of investment contract in determining whether the plainly denominated stock was a security. Thus, the court rejected the notion that *Forman* imposed the *Howey* test across the board. The court further reasoned:

> Here we have the sale of two going concerns where the purchaser was buying not only the assets of the corporations, but also the liabilities. The balance sheet of a company is prime consideration that goes into the negotiating and eventual arrival at a purchase price. There is no question that in the event of a material misrepresentation the defrauded purchasers have an action for common law fraud. However, someone who purchases shares of stock, whether it be 1 per cent or 100 per cent, also has the reasonable expectation that he is a beneficiary of protection afforded by the federal securities laws. The policy behind the securities laws supports that expectation.[48]

46. Wilko v. Swan, 346 U.S. 427 (1953). *See also* Coffey, *The Economic Realities of A 'Security': Is There a More Meaningful Formula?*, 18 CASE W. RES. L. REV. 367, 396–98 (1967).

47. 456 F. Supp. 445 (D. Colo. 1978).

48. *Id.* at 449. Regarding the unified view of *Forman* the court stated:

> The Court did not utilize the *Howey* test in part "A" when it determined that the Co-Op City shares did not constitute "stock." Instead, the Court, in its analysis, addressed those characteristics normally associated with the purchase of "stock" in reaching its conclusion.

Thus, the purchase of merely all the assets as assets differs from the purchase of all the stock entailing an assessment of the corporation's debt structure in valuing the stock. Such an assessment is not relevant to the purchase of assets at break-up value for consumption as assets.

The Fourth Circuit Court of Appeals employed similar reasoning in refusing to apply the *Howey* test in a case where the purchaser only acquired veto power through purchase of 50% of the stock. In *Coffin v. Polishing Machines, Inc.*,[49] the Fourth Circuit based its holding entirely upon the rejection of the *Forman* view that requires analysis beyond notice that traditional corporate stock was involved. The court noted that the *Howey* test only "applies to interests not easily recognized as securities in the capital markets,"[50] and stated: "Absent some showing that ordinary corporate stocks are other than what they appear to be, we need not consider whether an investor will derive his profit from his own efforts."[51]

In *Coffin*, the purchaser's veto power as a 50% stockholder and position as executive vice president were meaningless rights in light of the information failure surrounding acquisition of those rights. The corporation was actually insolvent and there was a preexisting scheme for conversion of corporate assets. As a matter of economic reality, it made little difference that the purchaser of the stock would participate in the future management of the business upon discovering its insolvency.

Similarly, in *Mifflin Energy Sources, Inc. v. Brooks*,[52] the court found the application of the *Howey* "economic reality" test unnecessary in the context of a "stock purchase agreement" and the presence of corporate stock possessing all the traditional stock attributes. The court declared:

> In this case, the substance of the sale is 100% of stock in a business. This is clearly evidenced by the terms of the stock purchase agreement. Ownership of the business is a by-product of this transaction, but is not sufficient to remove what is clearly expressed in the terms of the purchase and sale of stock from the purview of the federal securities law.[53]

Id. This Article has done the same.

49. 596 F.2d 1202 (4th Cir. 1979).

50. *Id.* at 1204.

51. *Id.*

52. [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,734, at 98,851 (W.D. Pa. 1980).

53. *Id.* at 98,853.

The court clearly indicated that the purchase of stock differs substantively from the purchase of physical assets, not the least of which difference is the purchase of the debt structure of the business.

In *Bronstein v. Bronstein*,[54] the court recognized that despite the control acquired by a purchaser of all the stock, the protections of the securities laws nevertheless applied because the purchaser's expectations were of "acquiring an interest in a profit-making venture,"[55] not "with an eye towards personal use or consumption of the underlying asset,"[56] as in *Forman*. The court wrote: "[T]his case involves a [plaintiff] who clearly purchased his brother's stock in Penn Tower with the hope of realizing a return commensurate with the success of the business."[57] The need for securities law protections in *Bronstein* was further underscored because the plaintiff had purchased stock from his brother in reliance upon misrepresentations of internal facts concerning the financial position of the company.

Bronstein went further than *Titsch*, *Coffin*, or *Brooks* by holding that purchase of corporate stock could not "possess . . . dual characteristics"[58] of investment and consumption, but is an investment transaction by its very nature—the hope of realizing a return commensurate with the success of the business. The court's broad language, which would seem to cover a purchase of 100% of a business' stock pursuant to a preexisting plan of liquidation, must be read in its context: a rejection of the defense's trumpeting of the analogical value of promissory note cases which held notes not to be "securities" within the meaning of the Acts despite the literal statutory inclusion of "notes" in the definition of "securities."

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54. 407 F. Supp. 925 (E.D. Pa. 1976).

55. *Id.* at 930.

56. *Id.*

57. *Id.* at 931.

58. *Id.* The court observed:

> The reason courts have become involved in determining whether a note constitutes a security under the Acts is because instruments denominated notes can be either commercial or investment in nature. Shares of stock in a closely held family corporation do not possess such dual characteristics. Shareholders acquire these shares not with an eye towards personal use or consumption of the underlying interest . . . but rather for the purpose of acquiring an interest in a profit making venture. The *Bronstein* court also recognized that the scope of protections of the Securities Exchange Act of 1934 is not determined by a particular transactional setting, and that Section 10(b) and Rule 10b-5 should operate despite the fact that the shares of the corporation involved were closely held by members of a family and sold to another member of the family in a face-to-face transaction "outside the organized securities markets."

Id.

Bronstein took the position that due to the very character of corporate stock, a 100% stock acquisition done without an eye to liquidation was entitled to securities laws protections. Thus the court wrote that "[t]he federal securities laws are designed to protect investors, not persons engaged in ordinary consumer or commercial loan transactions."[59]

The *Bronstein* court and other courts bucking the *Frederiksen* trend reject a unified *Forman/Howey* "economic reality" analysis. These courts read *Forman* strictly and separate the "economic reality" analysis from the alternative holding applying *Howey* to an investment contract analysis. As *Bronstein* declared:

> While the *Howey* test, especially the language "solely from the efforts of others," has helped courts to identify the somewhat elusive investment contract, its *applicability to other less elusive types of securities is debatable.* In any event, since stock, one of the most common forms of securities, carried a traditional and accepted meaning, it is not necessary . . . for purposes of section 10(b) that Penn Tower stock meet the test used to identify an investment contract. Indeed, the *Forman* decision strongly suggests such a conclusion. The court in *Forman* applied the *Howey* test only in part "B" of its opinion, when it determined that the Co-Op City shares were not "investment contracts." By contrast, the Court did not utilize the *Howey* test in making its earlier finding that the Co-Op City shares did not constitute stock.[60]

The *Bronstein* Court's reading of *Forman* as embodying alternative holdings is correct. The "economic reality" of stock acquisition, whether 1% or 100%, cannot be defined exclusively in terms of the *Howey* profits-from-efforts-of-others criterion, but must be defined in terms of investment risk. In dicta, the Supreme Court has recognized this point. In *Rubin v. United States*,[61] the Court was confronted with a criminal prosecution for alleged violation of section 17(a) of the Securities Act of 1933[62] in connection with

59. *Id.* at 930.

60. *Id.* at 929-30 (emphasis added) (footnotes omitted). The court additionally observed that, carried to its logical extreme, the argument that stock is not a security where it carries a right of participation in managerial control would necessarily deny security status to any stock in the hands of one who is involved in management of a corporation—a result that cannot possibly be justified given the entire history of federal securities regulation. *See id.* at 931.

61. 449 U.S. 424 (1981).

62. 15 U.S.C. § 77q (1976). Section 17(a), a general antifraud provision, applicable to the offer and sale of securities, declares:

> 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 use of the mails, directly or indirectly—

the pledge of worthless securities as collateral for a loan. The precise question before the Court was whether a pledge of securities in a loan transaction constituted a "sale" of the securities for purposes of coverage under the antifraud provisions of the securities laws. The Court held that the antifraud provisions applied, and Chief Justice Burger's opinion observed:

> The economic considerations and realities present when a lender parts with value and accepts securities as collateral security for a loan are similar in important respects to the risk an investor undertakes when purchasing shares. *Both are relying on the value of the securities themselves, and both must be able to depend on the representations made by the transferor of the securities regardless of whether the transferor passes full title* or only a conditional and defeasible interest to secure repayment of a loan.[63]

The investment risk of purchasing any stock in a corporation is that the shares are misvalued before the transaction due to information failure, thus depriving the purchaser of a true picture. Assumption of management control, so critical to a *Howey* finding of nonsecurity status, is irrelevant to obtaining the knowledge *before the purchase* by which to evaluate the risk/return characteristics for the business's future. As Chief Justice Burger observed in *Rubin*, prior to the transaction the investor relies "on the value of

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> (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.

The expansive scope of protection accorded by section 17(a) was highlighted by the Supreme Court in United States v. Naftalin, 441 U.S. 768 (1979), where the Court rejected the respondent's argument that the criminal antifraud protections of section 17(a) are unavailable to brokers because they are not "traditional" investors. In extending the federal securities law protections to brokers as well as investors the Court seemed to rely upon the legislative history of the 1933 Act which stated, "[t]his legislation is designed to protect not only the investing public but at the same time to protect honest corporate business." 441 U.S. at 776 (quoting S. REP. No. 47, 73d Cong., 1st Sess. 1 (1933).

Most recently, in Marine Bank v. Weaver, 102 S. Ct. 1220 (1982), the Court reaffirmed its view that the definition of "security" for purposes of Exchange Act antifraud protection "is quite broad," and that the term ". . . was meant to include the many types of instruments that in our commercial world fall within the ordinary concept of a security," specifically including "ordinary stocks." *Id.* at 1223. Yet the Court went on to point out that the securities laws were not intended to provide a "broad federal remedy for all fraud," and refused to hold that a certificate of deposit issued by a federally regulated bank was a "security." *Id.* A critical factor in the determination was the scope of other regulation and the absence of investment risk.

63. 449 U.S. at 451 (emphasis added).

the securities themselves," and in that regard must be able to depend on the representations made by the seller-transferor. This is investment risk. It is also economic reality. The "unified *Forman/Howey* interpretation" is incorrect.

While the unified *Forman/Howey* interpretation is incorrect, so too is *Bronstein*'s dicta that "stock" by nature is investment and to be protected. Where parties to a transaction realistically bargain at arm's length, where access to material information and the opportunity to investigate are meaningful, and where the relative positions of the parties and the circumstances of the transaction demonstrate the self-protection ability of the purchaser, then concern for investor protections may be nonexistent. The justification for that conclusion is not that investors do not need protection because they have acquired a right to future control; rather, the purchaser may not be an "investor" in the sense of *being dependent upon the seller for disclosure of the material facts upon which risk will be evaluated and the investment decision made.*

The federal securities laws were intended to operate in certain instances in the myriad of transactions where special protection is needed over and above common law rights of fraud, contract, or breach of warranty. They will protect a buyer against one with superior knowledge of facts material to the exercise of investment judgment. Even some courts which adopt the *Howey* test as the general measure of "economic reality" of *Forman* (the unified *Forman/Howey* view), do not reject the notion that, under certain circumstances, acquisitions of 100% of the stock in a corporation *can be* an investment to be protected by the federal securities laws. *Golden v. Garofolo*,[64] a case solidly within the *Frederiksen* trend denying securities law protections to 100% stock acquisitions, said:

> Plainly the post-*Forman* decisions relied upon by the parties differ markedly over the proper interpretation to be given *Forman*. The issue is whether *Forman* adopts the *Howey* test as a general "economic reality" test to be applied to all purported securities, or whether *Forman* requires that instruments labelled or characterized as "stock" need only possess certain features commonly associated with stock instruments to come within the ambit of the Federal Acts.[65]

The *Golden* court aligned with the unified *Forman/Howey* in-

64. [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,277, at 91,767 (S.D.N.Y. 1981), *rev'd* [current] FED. SEC. L. REP. (CCH) ¶ 98,656, at 93,275 (2d Cir. 1982). *See supra* text accompanying notes 94-96.

65. [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,277, at 91,773.

terpretation, but clearly recognized that *Forman* did deem characteristics commonly associated with the term "stock" material, but only to the extent that the characteristics of an instrument "would lead a purchaser or seller reasonably to believe the securities laws would apply."[66] Thus, the *Golden* court relied heavily on the particular circumstances of the case:

> Here . . . despite the presence of the common features of stock in the transferred shares, there was manifestly no reasonable reliance by plaintiffs upon coverage by the Acts. The undisputed facts indicate that the concern of the parties was the transfer of a business, not the sale and purchase of stock. That the deal took the form of a stock transfer was merely a technicality dictated by a provision in a lease [which forbade assignment]. Plaintiffs were certainly not misled as to the reality of the transaction by the form which it took. Furthermore, plaintiffs were represented throughout by able counsel, and negotiated and executed the agreement after the Court's decision in *Forman* and after several lower federal courts had specifically ruled against plaintiff's position here. In short, this is not a case where the economic reality approach should be compromised

66. *Id.* The case law opposing the emergent line is, on this point, in complete agreement. The associated characteristics of "stock," in conjunction with the focus and structure of the transaction are, for these courts, conclusive as to the all important *expectation of protection*. In Mifflin Energy Sources, Inc. v. Brooks, [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,734 at 98,851, for example, the expectation of the plaintiff was found to be dictated by the following facts: the stock involved possessed all the traditional attributes, the substance of the transaction was that stock, and the parties structured the transaction in the form of a stock purchase agreement. That indicia, according to the *Mifflin* Court, mandated the conclusion that "[t]he purchaser is entitled to the protection of the securities laws, *as is expected in the purchase and sale of ordinary stock.*" *Id.* at 98,853 (emphasis added). Associated characteristics of an instrument continue to be important in the eyes of the Securities and Exchange Commission. In *Mutual Service Cooperative* [1981–1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 77,033, at 77,589 (SEC No Action Letter, July 27, 1981), the commission staff refused to issue "no action" advice in response to the proposition that shares of stock of a cooperative that acted as the fiscal agent for mutual insurance companies were not "securities" under the definitional provision of the Securities Act of 1933. In support of the proposition that the shares of stock were not "securities," the following points were noted: (1) no dividends are paid; (2) limitation existed on the number of shares that could be owned by a participant; (3) voting was not in proportion to share ownership; (4) the shares had a nominal purchase price; (5) there was "little" opportunity for gain; and (6) the issuer did not operate for profit. Nevertheless, the staff was unable to agree that securities within the contemplation of the Securities Act were not involved because, under the articles of incorporation and by-laws of the issuing organization, the payment of dividends was permitted, whether or not done or likely in the future; the shares could be transferred with approval of the issuer's board; and a "profit" potential did exist.

See also Amicus Brief of the SEC, *Golden*, [1981-82 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,277 (filed Feb. 11, 1982) (correct interpretation of *Forman* is that use of the "investment contract" test is appropriate in the case of shares of stock only where the stock does not possess characteristics typically associated with that type of instrument).

because of the reasonable expectations of the plaintiffs.[67]

Thus, given different circumstances, a contrary result could have been reached based on different expectations. Furthermore, the *Golden* court noted that the reasoning and results in *Tisch Printing, Inc. v. Hastings*[68] *and Miflin Energy Sources, Inc. v. Brooks*,[69] which upheld application of the federal securities laws, were "not necessarily inconsistent with either the decision here or with the general application of the economic reality test."[70] According to the *Golden* court, "the reality of [those] transactions was the purchase and sale of stock, *with the acquisition of a business being incidental* thereto."[71] While the *Golden* court's attempt to distinguish transactions in terms of what is "incidental thereto" is useless and impracticable, the court unmistakably recognized the existence of circumstances which demonstrate genuine "investment" characteristics despite the purchase being of 100% of a company's outstanding stock. Above all, this recognition supports a conclusion that no per se rule of law exists to deny securities law protections simply because a 100% stock purchase is involved.

The courts' difficulties with articulating a test to separate "investment" transactions (to which federal securities laws apply) from "commercial" transactions (to which they do not)[72] have tended towards analytical polarization: "literalism" on the one

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67. [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,277, at 91,773.

68. 456 F. Supp. 445 (D. Colo. 1978).

69. [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,734 (W.D. Pa. 1980).

70. [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,277, at 91,774.

71. *Id.* (emphasis added). The court observed:

> [W]hile each of these opinions suggests a reading of *Forman* at odds with the interpetation of this court and of defendant's authorities, the specific results in these four [including *Bronstein* and *Coffin*] decisions are not necessarily inconsistent with either the decision here *or with the general application of the economic reality test. Id.* (emphasis added). This is to say, unequivocally, that the purchase of 100% of the outstanding stock of a corporation may, in total harmony with "economic reality" analysis, involve the purchase of a "security" for purposes of federal securities law protection. The dilemma rendered so apparent by this approach is that economic reality, like beauty, appears to lie in the eye of the beholder.

72. The commercial/investment dichotomy has figured prominently in the persistent question of whether a "note" or other debt instrument literally included within the definition of "security" are securities for purposes of securities law protections. Differing approaches have emerged in case law and, as underscored in Bronstein v. Bronstein, 407 F. Supp. 925 (E.D. Pa. 1976), the analyses offered can be instructive in the instant inquiry. The approaches have ranged from the unabashedly literal, Lehigh Valley Trust Co. v. Central Nat'l Bank of Jacksonville, 409 F.2d 989 (5th Cir. 1969), to the commercial/investment analysis, Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973), to the "risk capital" approach, Great Western Bank & Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976). These varying approaches led the Second Circuit to caution, in Exchange Nat'l Bank of Chicago v. Touche Ross & Co., 544 F.2d 1126, 1138 (2d Cir. 1976), that:

hand and per se "economic reality" on the other with nothing in the middle. This Article seeks to fill that middle. In *Somogyi v. Butler*,[73] for example, the plaintiff had purchased a Volkswagen dealership. After purchase, plaintiff incorporated the dealership and received over 90% of the stock pursuant to an alleged arrangement predating the transaction.[74] In connection with the exchange of stock for the dealership assets, plaintiff claimed violations of federal securities law antideception principles. The court rejected plaintiff's argument that his "stock" possessed all traditional attributes and thus, was a "security" covered by the securities laws. His argument was rejected because the court found the particular facts of the transaction contained no characteristics essential to coverage under the securities law.[75]

> So long as the statutes remain as they have been for over forty years, courts had better not depart from their words without strong support for the conviction that, under the authority vested in them by the "context" clause, they are doing what Congress wanted when they refuse to do what it said.

The inquiry in *Exchange National Bank* concerned unsecured subordinated notes "purchased" by a bank from a brokerage firm that subsequently became insolvent. Plaintiff invoked the antifraud provisions of the federal securities laws, seeking recovery on claims that statements of financial condition prepared for the maker of the note were false or misleading. Upon interlocutory appeal from an order denying defendant's motion to dismiss on the "security" question, the Second Circuit confronted the commercial/investment dichotomy and found "rather appealing" the analysis of the concurring judge in *Great Western Bank & Trust*, where the typical "investment situation" was described as one in which "*the issuer has superior access to and control of information material to the investment decision*." *See* 532 F.2d at 1262 (emphasis added). Just as importantly, in *Exchange National Bank* the Second Circuit, noting the frequent reference to the *Howey* test per *Forman*, rejected its application—characterizing it as being of "dubious value" to the particular inquiry. On the other hand, said the court, adoption of the "investment situation" principle set forth above "would afford the hope of bringing a modicum of certainty into one large section of a field in bad need of it." 544 F.2d at 1137. The Second Circuit's commentary on the real nature of an "investment situation" is particularly significant in its emphasis upon the disparate position vis-a-vis access to and control of material facts. As noted earlier, this is the fundamental concern of federal securities law protections and should in all cases determine the scope of their coverage.

73. [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,281 at 91,788 (D.N.J. 1981).

74. *Id.* at 91,793. The plaintiff purchasee contended the purchase agreement, together with other documents involved in the transaction "clearly reflects the fact that the Volkswagen dealership which I was purchasing from defendants Butler was to be organized as a corporation with not less than $148,000 in capital stock issued." *Id.*

75. Not only did the Court conclude that the acquisition of stock by the plaintiff did not fall within the ambit of securities law protections, "no other aspect of the commercial dealings" between the parties did either. The transaction represented the acquisition of a *franchise*, recognized to be outside the scope of securities laws except where the purchaser's role in management is only "nominal or insignificant." This was not the case in *Somogyi*. *Id.* at 91,800 n.16; *see also* Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973); Howard v. Chrysler Corp., [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,306, at 91,914 (D. Colo. 1977) ("stock" acquired in franchise transaction must be viewed as an

The court concluded, based on an investment contract analysis, that plaintiff's "assets purchase" and contemporaneous formation of a new corporation was not a "covered" securities transaction.[76] The court further opined:

> [T]he economic realities of plaintiff's "assets purchase" and incorporation lie at an even farther remove from the traditional concerns of the federal securities laws than the transactions involved in the "stock purchase" cases. Here, although plaintiff did acquire shares of stock, he did not acquire them from defendants. In effect he issued the shares to himself as a means of limiting his liability to creditors and to the public at large. Whether plaintiff had chosen to form a corporation or not, he clearly would have been required to invest the same amount of capital in the Volkswagen dealership as a condition of obtaining the franchise. By incorporating, plaintiff did not increase his risk by placing his money in the hands of others; rather he reduced his risk by limiting his liability. Hence, even though plaintiff may technically argue that he was a "purchaser" of statutorily defined "securities," he cannot, under *Forman's* "economic realities" test, be said to have engaged in the type of transaction to which Congress intended the securities laws to apply.[77]

Similarly, in *Reprosystem v. SCM Corp.*,[78] plaintiff attempted to invoke the antifraud provisions in connection with negotiation and preparation of a subsequently abandoned agreement to purchase the European photocopier business of the defendant. The court was prompted to declare:

> If the strict language of Section 10(b) . . . and Rule 10b-5 . . . were to be applied automatically because a sale of securities was contemplated, then virtually every sale of a business structured as was this transaction would call into play the panoply of rights and remedies under the securities law. An examination of the essential purpose of such laws is required whenever this outreach is sought.[79]

None of the putative "reality" cases, however, stands for the proposition that purchase of 100% of the stock of a corporation can never constitute purchase of a "covered" security. None of the putative "literal" cases propose that stock is stock without any further consideration. Whether articulated or not, both lines of

integral part of the management/investment "package" representing the dealership franchise).

76. [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) at 91,799.

77. *Id.* at 91,799-800 (footnotes omitted).

78. [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,207, at 91,436 (S.D.N.Y. 1981).

79. *Id.* at 91,449.

cases necessarily focus upon the expectations of the participants in a given set of circumstances which is undeniably the spirit, if not the command, of *Forman* however one reads the two-part opinion. Thus, the courts have clearly recognized, if not always fully articulated, that a purchaser of 100% of the stock of a corporation may indeed be an *investor* with respect to that stock.

Moreover, the *Frederickson v. Poloway*[80] line of cases denying securities law protections to purchasers of all or most of a corporation's stock poses the danger of producing future absurd results due to insensitive application of a unified *Forman/Howey* approach. For example, in *Oakhill Cemetery of Hammond, Inc. v. Tri-State Bank*,[81] the United States District Court for the Northern District of Illinois, applying *Frederiksen*, held that a purchase of 50% of the outstanding stock of a company, expressly accompanied by the right of control, did not constitute purchase of "stock" within the ambit of the federal securities laws. In the same opinion, however, the court held that the acquisition of a note secured by a pledge of the other 50% of the shares of that stock did constitute the purchase of a security. The purchase of the 50% interest accompanying the right of control could not, according to the court, be deemed the purchase of a security after *Frederiksen*. The court ruled, however, that the note secured by a pledge of the remaining 50% interest constituted the purchase of a security because:

> [W]hen one parts with value and accepts securities as collateral security for repayment, a "sale" of securities occurs within the meaning of the securities laws. *Rubin v. United States* . . . . Accordingly, one accepting such security has a remedy under the federal securities laws for false representation as to the value of that security.[82]

The court's focus on *Rubin v. United States*[83] is significant because there the Supreme Court equated the economic reality of a lender parting with value and accepting stock as collateral with the risk an investor takes when purchasing stock. The *Rubin* Court observed: "Both are relying on the value of the securities themselves, and both must be able to depend on the representations made by the transferor of the securities . . . ."[84] Equally important was that *Rubin* involved the fundamental question of whether

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80. 637 F.2d 1147 (7th Cir. 1981).
81. 513 F. Supp. 885 (N.D. Ill. 1981).
82. *Id.* at 892 (footnote omitted).
83. 449 U.S. 424 (1981).
84. 449 U.S. at 431.

the antifraud provisions of the federal securities laws were applicable under the particular facts of the case. Indeed, there was no jurisdictional challenge based upon the definition of "security." Rather, the issue concerned the scope of coverage through interpretation of the statutorily defined term "sale," a term covered by the same *context* qualifications as every other defined term.

The Supreme Court in *Rubin* held that a pledge of stock constituted a sale of that stock within the ambit of the statute, specifically the antifraud provisions.[85] Applying a decidedly literal approach, the Court noted: "When we find the terms of a statute unambiguous, judicial inquiry is complete, except 'in rare and exceptional circumstances.'"[86] The Court concluded that: "No such circumstances are present here, for our reading of the statute is wholly consistent with the history and purpose of the Securities Act of 1933."[87]

Against the backdrop of *Rubin*, so aptly highlighted in *Oakhill*, a fundamental "economic reality" analysis is discernable. The processes by which prospective purchasers of stock plus control determine the proper price of the stock by coming to know the risk and return attributes of the corporation's business are just as vulnerable to falsehoods and misinformation as are the processes by which prospective holders of notes secured by stock determine the proper value of their collateral. The reason for such equal vulnerability of the two processes of information gathering is that the seller is the source of the information in both cases.

Viewed in this light, acquisition of management control is irrelevant to whether protections of the securities laws should be accorded. The value of the stock in either case is determined by the ability of the enterprise to succeed in the future. The acquisition of future control is merely an element involved in making the investment decision. As a mere element, it must be assessed through information gathering like any other element bearing on the valuation of the business. The prospect of future control does not stand outside the potential purchaser's decision whether to purchase and does not reduce vulnerability to falsehoods and misleading statements. The prospect of future control is merely an element within the process.

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85. The Court ruled that the sale qualified as a statutory "sale" under section 23(3) of the Securities Act of 1933, and specifically under an antifraud provision of the Act, § 17(a). *See* 449 U.S. at 431.

86. *Id.* at 638 (citing TVA v. Hill, 437 U.S. 153, 187 n.33 (1978)).

87. *Id.* at 430 (citations omitted).

The *Oakhill* court's attempt to distinguish purchase of stock from purchase of a note secured by stock is unpersuasive because it fails to recognize the basic identity of the processes of purchaser decisionmaking. In *Oakhill*, the court attempted to distinguish the "economic realities" of the two transactions by saying that the pledge was not "intended to confer ownership and responsibility for the day-to-day operations" of the issuer.[88] Such ownership and responsibility, said the court, could not arise in the pledge situation until the event of a default on the terms of the note. Moreover, the court found that by reason of an acceleration provision in the note which was keyed to the earnings of the issuer, the transaction demonstrated "investment" characeristics.[89] As argued above, such distinctions are unfounded. The investment character of a transaction is a function of risk, and is not determined by the presence or absence of a right to own and control an enterprise. Furthermore, as *Rubin* pointed out, an investor assumes risk relying on the underlying value of the stock itself, and depending upon information disclosed or available during the information gathering period.[90]

Thus, access to pre-decision information is the critical basis for defense of application of the antifraud provisions of the federal securities laws to purchases of all or substantially all of the stock of a company. The fatal defect in any per se rule that would hold otherwise is the failure to recognize the necessity for such access. In valuing the stock, the purchaser must take into account the control entailed by the acquisition. The purchaser must assess the degree to which the control is meaningful in terms of hiring and firing, changing lines of business, financing, revamping products

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88. *See* 513 F. Supp. at 892.

89. *Id.* The court observed:

> There is no evidence in the record that this [pledge] transaction was intended to confer ownership and responsibility for the day day-to-day operations of Oakhill upon Roark. Presumably, Roark did not obtain ownership of Oakhill and responsibility for its operation until he exercised his option to demand title and ownership of the securities after the Hannons defaulted upon their note. Moreover, the terms of repayment on the note—providing for accelerated payment in the event Oakhill achieved a certain operating success—are indicia that the transaction was of an investment as opposed to a commercial character.

It is also interesting to note in *Oakhill* that the court went on, fully embracing *Rubin*, to observe that one accepting securities as collateral in a pledge transaction has a remedy under federal securities law "for false representations as to the value of that security." *Id.* These are the same securities which have been held not to support a federal claim in the other aspects of the transaction—the only difference being the present conveyance of a right to future control of the enterprise. One must ask, however, if the misrepresented *value* of the security is any different because of that right.

90. *See supra* text accompanying notes 83-84.

and plants—in short, in changing the risk/return characteristics of the business. The source of the information necessary to assess the degree to which control is meaningful, however, is the seller. Alternative sources of information may be lacking. Thus, the process of assessing the meaningfulness of control may be vulnerable to information failure depending on the facts of the particular deal. The particular circumstances critical to the issue are those demonstrating disparity of access to material information affecting value and reasonable reliance upon the seller to disclose material facts. Where such circumstances exist, the transaction embodies all the essential attributes of an investment, notwithstanding the purchaser's ownership and managerial control *after* the transaction. The economic reality of the transaction is determined by evaluation of the investment risk existing prior to, and simultaneous with, the point at which the investment decision is made, and not by analysis of whether future profits will accrue from the managerial control of the purchaser. If the purchaser's stock valuation calculus, taking future managerial control into account, is hampered because the evaluation is based upon information supplied by the seller or publicly available to any investor but without the advantage of equal access to all material information, the transaction is indistinguishable from any purchase of stock protected by the antifraud provisions of the securities laws. Therefore, as a matter of sound policy and commmon sense, *those protections should be available*, and it is reasonable for purchasers in those circumstances to expect such protections.[91]

This is not to say that every transaction involving the purchase of all or substantially all the stock of a corporation can or should fall within the ambit of federal securities law protection. Considerations that preclude a prohibitory per se rule similarly preclude an all-encompassing rule. The circumstances of a transaction must be the determining factor, and the acquisition of the right to future managerial control should be but one factor to be considered in the totality of circumstances. Across the board application

91. While reasonable expectations of protection under the securities laws have been considered by some courts confronting the issue of coverage as a factor of some degree of weight in the assessment of "economic reality," the recent decision in Seagrave Corp. v. Vista Resources, Inc., [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,469, at 92,748 (S.D.N.Y. 1982), firmly rejected any role for purchaser expectation in the process. Holding that the transaction of issue only "involved a sale of a business in which stocks were transferred as an indicia of ownership," the court addressed purchaser expectations thus: "[T]he expectations, subjective intentions and motivations of the parties do not determine whether the federal securities laws apply . . . ." *Id.* at 92,751.

of the *Howey* "test" has demonstrated results focusing solely upon some future right of control—all in the name of economic reality—which contradict the premise offered, and which largely ignore what a right of, or participation in, future control actually represents. The issue of whether the purchase of all or substantially all of the stock of a corporation involves the purchase of a "security" can be determined by neither literalism nor the *Howey* "test." Stock is, in reality, stock for purposes of security transactions; and as to these characteristics neither literal coverage nor glorification of future "control" can, or should, produce a conclusion.

IV. *Golden v. Garofolo*: The Second Circuit Reacts

The effective emergence of a per se rule of law—the "sale of business doctrine"—following *Frederiksen v. Poloway* led to inevitable confrontation and reaction. Even in the Seventh Circuit the breadth of the doctrine was challenged in *McGrath v. Zenith Radio Corp.*,[92] where the same court that championed the doctrine distingushed *Frederiksen* so as to uphold antifraud claims asserted by the *sellers* of 100% of outstanding stock who claimed to have been defrauded by the control-purchaser. The court explained that *Frederiksen* was meant only to apply to the control-buying part of a transaction, and that sellers should not be deprived of the protections of the federal securities laws.[93] Couching *Frederiksen* in terms of strict buy side application the *McGrath* court left the doctrine intact, but clearly undermined its per se character by emphasizing the importance of circumstances. Further reaction to the

92. 651 F.2d 458 (7th Cir. 1981).

93. The court approached *Frederiksen* as follows:

> The dispositive factor in *Frederiksen* was that "[t]he stock . . . merely was passed incidentally as an indicia of ownership of the business assets sold . . . ." Neither in the hands of the sole shareholder/seller, nor in the hands of the purchaser . . . did the purchase meet the requirements of the "economic reality" test . . . . In *McGrath*, in contrast, the Basford shares were investments on the part of the individual employees who held those shares. The Basford shares constituted "securities" in the hands of plaintiff as well as the other sellers and they did not lose that status merely by reason of the fact that all of the Basford shares were sold at the same time. To conclude otherwise would be to hold that a purchaser of corporate shares may deprive investor/sellers of the protections of the securities laws if it can arrange that all of the corporation's shares are purchased at one time. Whatever the beadth of language, clearly *Frederiksen* does not require such a result.

651 F.2d at 468 n.5 (citations omitted). *See also* Stacy v. Rogers, [Current] Fed. Sec. L. Rep. (CCH) ¶ 98,735, at 93,710 (E.D. Mich. 1982) (sale of business doctrine would not require dismissal of claims by defrauded sellers of all or substantially all stock in a corporation against buyer of those shares).

doctrine came in *Golden v. Garololo*,[94] in which a divided Second Circuit panel flatly rejected the doctrine.

Plaintiffs in *Golden* purchased 100% of the outstanding stock of a corporation engaged in the ticket brokerage business. They intended to manage the business directly. Plaintiffs alleged that the defendant-seller made material misrepresentations to them as to the value of the business and the value of the stock purchased, and asserted claims under the antifraud provisions of the federal securities laws. The district court dismissed their claims under the sale of business doctrine.[95]

The Second Circuit reversed, holding quite simply that "conventional stock in business corporations is a security within the meaning of the '33 and '34 Acts whether or not the underlying transaction involves the sale of a business to one who intends to manage it."[96]

As previously discussed,[97] the fundamental fault of the sale of business doctrine is the premise that the right of future control or management is determinative of whether securities law protections should be available in transactions involving the acquisition of that right. Concern over that faulty premise is apparent in the *Golden* analysis:

> So far as the antifraud policies of the Acts are concerned, the possibilities of fraud and the ability to protect oneself through contract are the same as to a "passive" investor buying 30% of a corporation's shares from a sole shareholder or an "active" purchaser taking 100% and expecting to manage it directly.[98]

The court was critical of distinctions between transactions on the basis of commercial versus investment characteristics in sale of business situations, pointing out that transfers of corporate control frequently are motivated by a hope of capital appreciation and

94. [Current] FED. SEC. L. REP. (CCH), ¶ 98,656, at 93,275 (2d Cir. 1982).

95. 521 F. Supp. 350 (S.D.N.Y. 1981).

96. [Current] FED. SEC. L. REP. (CCH) at 93,276.

97. *See supra* text accompanying note 46.

98. [Current] FED. SEC. L. REP. (CCH), at 93,281. *See also* King v. Winkler, 673 F.2d 342 (11th Cir. 1982). In *King* the court applied the sale of business doctrine to affirm dismissal of securities law antifraud claims, but nevertheless offered this observation quite consistent with the *Golden* view as to necessary protection:

> It is apparent that the approach used here is not a function of numbers. A sale of less than 100% of the stock might not be covered by the Acts. A sale of 100% of the stock can be covered by the Acts. The number of sellers and purchasers will not necessarily control the outcome.

Id. at 346.

future value.[99] In the end, according to the court, it is the statutory language that must control, and the statutory definition of "security" construed to include all instruments having commonly agreed upon characteristics, such as "stock," should control. Contrary to *Frederiksen*, the *Golden* court viewed *Forman* as compelling that result.

A prominent and essential predicate for the sale of business doctrine is the proposition that the *Forman* view of "economic reality" requires application of *Howey* investment contract analysis to every situation, even if the instrument involved possesses traditional corporate stock attributes.[100] This view presumes no separate significance to the two parts of the *Forman* opinon. *Golden*, however, emphasized the separate, alternative, analysis of the *Forman* court to support its conclusion:

> We think the term "stock" in this definition of "security" in the '33 and '34 Acts should be read to include instruments, such as these, which have the characteristics associated with ordinary, conventional shares of stock. There was little reason for the drafters to use words such as "stock," "treasury stock" or "voting-trust certificate", unless their intention was to include all such instruments as commonly defined. If an "economic reality" test were intended, reference to such specific types of instruments, and common variations of them, would have been inappropriate because a substantial portion of each class of instrument would, in fact, not be within the definition. We believe that Congress intended to draft an expansive definition and to include with specificity all instruments with characteristics agreed upon in the commercial world, such as "debentures," "stock," "treasury stock" or "voting-trust certificates." Catch-all phrases such as "investment contract," were then included to cover unique instruments not easily classified. If the "economic reality" test were to be the core of the definition, only general catch-all terms would have been used.[101]

Golden's rejection of the sale of business doctrine came over the strong dissent of Judge Lumbard who urged that the *Forman* test was not two-part and that economic reality compelled application of the doctrine. Most prominent among the points offered in dissent, however, was the observation that the particular plaintiffs did not need the protections of the securities laws. The absence of need, according to Judge Lumbard, was a function of the plaintiffs' ability and position to inspect the business, to obtain

99. *Id.*

100. *See supra* text accompanying notes 31–45.

101. [Current] FED. SEC. L. REP. (CCH), ¶ 98,656, at 93,279–80.

specific contractural warranties and representations regarding the business' tangible and intangible assets, and the fact that they obtained "full operational control from the moment they signed the purchase agreement."[102] This is to say that the plaintiffs were in a position to affect significantly the risk associated with their investment decision.

Though *Golden* bespeaks of the literal school, its message is more substantive: the protections of the federal securities laws are not to be limited by vague notions of post-transaction control. That fundamental proposition is as much a reflection of economic reality as it is of literal application of the statutory definitions. It is in actuality the sale of business doctrine that has emerged a wooden and literal approach, and the reaction evidenced in *Golden* was inevitable. The Seventh Circuit offered its rejoinder in *Sutter v. Groen*,[103] in which this Article's thesis emerges prominently.

In *Sutter*, the court reexamined its pronouncement in *Frederiksen* in light of the Second Circuit's rejection of the sale of business doctrine in *Golden*. Although it reaffirmed the *Frederiksen* principle, the court vacated a summary judgment dismissing the federal securities law claims and remanded the case to allow the presumption of control to be rebutted by a showing that the main purpose of the transaction was investment.

At issue in *Sutter* was the claim by a 70% stockholder of a corporation, Happy Radio, that he purchased stock concurrently with and only because Happy Radio was itself purchasing 100% of the stock of Bret Broadcasting from the defendant. Plaintiff alleged that his stock purchase was made in reliance upon misrepresentations by the defendant concerning the value of Bret Broadcasting stock. Defendant asserted the sale of business doctrine, and the Seventh Circuit framed the essential inquiry as whether the plaintiff was an entrepreneur or an investor in the transactions.

Though the court undertook a scholarly analysis of the distinction between entrepreneur and investor status based on active managerial control versus passive stock ownership, it conceded that the allegations were consistent with either conclusion. Indeed, Judge Posner offered: "This would be that exquisitely mixed case that the Second Circuit despaired of being able to de-

102. *Id.* at 93,283–84.

103. [Current] FED. SEC. L. REP. (CCH) ¶ 98,783 at 94,015 (7th Cir. 1982).

cide."[104] Concluding that despair was premature, the court remanded the case for reconsideration by the district court under the following presumption:

> If, as in this case (the complaint alleges that Sutter owns 70 percent of the common stock of Happy Radio), the purchaser already has, or by the purchase in question acquires, more than 50 percent of the common stock of the corporation, his purpose in purchasing the stock will be presumed to have been entrepreneurship rather than investment.[105]

Thus the per se rule has come full circle. The *Sutter* court has directed factual inquiry into each transaction using the presumption saying, "[i]t makes the 'economic reality' test of *Frederiksen* . . . a little more concrete and thereby meets the Second Circuit's concern with the difficulty of drawing lines."[106] The progenitor of the per se rule has effectively conceded its shortcomings and directed the precise inquiry that must be made in any set of circumstances.

V. CONCLUSION

The securities laws protect investment decisions by assuring the availability of adequate information for investment decision-making and by providing liberalized antifraud remedies in the event of deception. The disparity of access to material information and the vulnerability of investor valuation processes to misinformation are sound bases for application of the federal securities laws. The number of shares purchased is not determinative. The purchase of one share or 100% of the shares of a corporation does not affect the need for protection in these circumstances.[107]

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104. *Id.* at 94,019.

105. *Id.*

106. *Id.* The court specifically declined to consider the question of the sale of business doctrine as applied to purchases of 50% of less of a corporation's stock which was, of course, the subject of a constitutent district court decision. *See* Oakhill Cemetery of Hammond, Inc. v. Tri-State Bank, 513 F. Supp. 885 (N.D. Ill. 1981). See *supra* text accompanying notes 81-82 for a discussion of *Oakhill*.

107. Although a pre-*Forman* analysis, the observation in Occidental Life Ins. Co. v. Pat Ryan & Associates, Inc., 496 F.2d 1255, 1263 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974), retains vitality on this point:

> The application of Section 10(b) cannot depend on whether the purchaser of stock buys a small interest, a controlling interest, or all of the stock, of a corporation. Such a standard would be difficult to apply and create a capricious basis for dispensing the protection of Section 10(b). The Court finds no reason for reading the Securities Exchange Act in a manner that provides coverage of the small investor, but not the large one. Such a construction would fly in the face of the remedial purposes of the Act. In one sense the large investor has a more pressing need for protection to the extent that he has expended a greater amount of his

The bevy of cases to confront this issue have produced conclusions on both sides but have demonstrated little reasoned analysis of the genuine "realities" of the situations put before them. The absence of factual analysis is acute, and the perceived desirability of a pervasive rule apparent. Neither is appropriate, and it is *Forman* above all that compels that conclusion. While a settled rule of law may be desirable, the history of application of the federal securities laws is rife with fluid analyses undertaken to effectuate congressional purposes. *Frederiksen*, *Golden* and all of the cases confronting the issue have sought to do likewise, and the polarity of their respective approaches now literally mandates ultimate resolution. That resolution should not come as an adoption of one perceived school of thought over the other, for there are really no separate schools. What is needed instead is a fundamental restatement of application and purpose. In *Golden*, the court called upon Congress to act if it is dissatisfied with the present scope of the Acts. Others will undoubtedly call upon the Supreme Court to address the issue. The result, however accomplished, must be based upon recognition of the fundamental elements of a "security" and the undisputed focus for over four decades on the object of protection: an investment decision.

> resources. It is entirely irrelevant that the parties *could* have conducted their business transaction without the use of stock. The plain fact is that they *did* not choose to use the stock.

496 F.2d at 1263.