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Malcolm H. Neuwahl

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Obviously, the Supreme Court of Florida has attempted to clear the confusion surrounding the determination of bona fide forestry operations for the purposes of preferential tax treatment. The court's new reliance on the "operation" requirement seems logically sound and easy enough to apply. But the strong language indicating that the chancellor's finding should seldom be disturbed on appeal seems somewhat paradoxical in light of the companion decisions. In both *Conrad v. Sapp*⁴⁶ and *St. Joe Paper Co. v. Mickler*,⁴⁷ the trial court decisions were ultimately reversed. It is clear, therefore, that trial court determinations of factual questions are not as secure on appeal as the language of the supreme court in *Greenwood* seems to suggest.

PAUL J. LEVINE

INSIDER TRADING AND RULE 10b-5: A NEW REMEDY*

In the landmark case of *SEC v. Texas Gulf Sulphur Co.*,¹ the Court of Appeals for the Second Circuit held that the use of "inside information" to purchase stock in a corporation and the "tipping" of such information to third parties was a violation of section 10(b) of the Securities and Exchange Act of 1934² and rule 10b-5 thereunder.³ By

46. 252 So.2d 225 (Fla. 1971).

47. 252 So.2d 225 (Fla. 1971).

* In 1968, the Court of Appeals for the Second Circuit decided the landmark case of *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968). While the court set forth far-reaching principles of new law, many questions were left to be determined by the federal district court on remand since only the question of liability had been presented to the Second Circuit for review. Since the parties had stipulated that the question of possible remedies would be litigated after a determination of liability, many matters were left untended in the 1968 decision. This note is directed to the return visit of *Texas Gulf Sulphur* to the Second Circuit. Judge Waterman, who wrote the first opinion, has also authored this latest installment. The opinion is a rambling one which contains several sub-holdings within its principal holding and is a decision which must be read in conjunction with its predecessor. This note treats the primary and secondary holdings of this latest case and also places the case within its historical perspective as adequately as possible within its limited length.

1. 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

2. 15 U.S.C. § 78j(b) (1970) [hereinafter cited as section 10(b)].

To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commissioner may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.

3. 17 C.F.R. § 240.10b-5 (1971) [hereinafter cited as rule 10b-5].

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

stipulation of the parties, the question of what sanctions should be applied against the violators was to be determined separately by the federal district court. After a hearing on remand, the district court ordered the insiders who had violated section 10(b) and rule 10b-5 to pay the profits which had accrued to them and their tippees as of the date that the information was released to the public into an interest bearing fund which was to be held for five years for the purpose of satisfying civil judgments against the offending insiders with regard to these transactions.⁴ According to the court's ruling, any money remaining in the fund after the five year period would be passed on to the Texas Gulf Sulphur Company. On appeal to the Second Circuit, *held*, affirmed: Requiring corporate insider violators of the Securities and Exchange Act of 1934, who had used inside information to reap profits on stock purchases based on non-disclosed information, to refund all such profits is proper and does not constitute a penalty assessment since restitution merely deprives the insiders of the gains of their wrongful conduct. *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301 (2d Cir. 1971), *cert. denied*, 92 S. Ct. 561 (1971).

One of the prohibitions under rule 10b-5 is the use of deceptive or fraudulent practices in connection with the purchase or sale of any securities on a national exchange or through interstate commerce. In numerous cases, including the original *SEC v. Texas Gulf Sulphur Co.* case,⁵ rule 10b-5 has been applied to limit trading of securities by so-called "insiders."⁶ However, the SEC itself has brought few of these suits. In fact, *SEC v. Texas Gulf Sulphur Co.* is apparently the only reported case where the Securities and Exchange Commission (SEC) brought such an action—at least with regard to insider trading. The reason for this is twofold: first, once the SEC discovers a violation, the transaction ordinarily has already taken place, and the issuance of an injunction pursuant to section 21(e) of the Securities and Exchange Act of 1934⁷ would be futile; second, the violations cause injuries to specific individuals, rather than to the public in general.

As a result, the bulk of the actions brought under rule 10b-5 have been prosecuted by private parties who seek rescission, restitution, or damages.⁸ *Kardon v. National Gypsum Co.*⁹ was the first case to allow a

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.

4. *SEC v. Texas Gulf Sulphur Co.*, 312 F. Supp. 77 (S.D.N.Y. 1970).

5. 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969) [hereinafter cited as *SEC v. Texas Gulf Sulphur Co.*].

6. See generally A. BROMBERG, *SECURITIES LAW: FRAUD—SEC RULE 10B-5* (1967).

7. 15 U.S.C. § 78u (1970) [hereinafter cited as section 21(e)]. This section provides, *inter alia*, that the SEC may enjoin acts being performed which would constitute violations of any provision of the Securities and Exchange Act of 1934.

8. See, e.g., *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967). In *Myzel*, an insider purchased stock with knowledge that there had been an increase in corporate earnings, but

private party rescission or money damages under these provisions despite the fact that neither section 10(b) nor rule 10b-5 expressly provided for relief to private parties. The court, in *Kardon*, reasoned that since the objective of the Securities and Exchange Act is to regulate securities and section 10(b) attempts to eliminate manipulation and deceptive practices with regard to purchases and sales of securities, civil remedies against the violators would be a logical means of effecting these objectives. Subsequent to *Kardon*, a number of cases have allowed similar remedies for such violations.¹⁰

In certain instances, however, the SEC has sought injunctive relief in the courts pursuant to the provisions of section 21(e) in connection with violations of other provisions of the Securities and Exchange Act. In one such case,¹¹ the SEC sustained an action in which an injunction was issued to prevent a company from continuing to violate the reporting requirements of the Act.¹²

Despite the admitted access of the SEC to seek the exercise of the injunctive powers of the courts under section 21(e), the appellants in the instant case argued that the remedy granted was improper because it was not expressly provided for in section 21(e).¹³ In refuting appellants' arguments, the court looked to three other areas where remedies not expressly provided for under the securities acts have been fashioned:¹⁴ first, a number of cases have allowed the appointment of a receiver when provisions of the securities acts have been violated, even though there was no express provision for such appointment in the acts;¹⁵ second, in actions brought by the government under other federal statutes, the courts have allowed restitution, even though the particular statutes did not specifically grant such a remedy;¹⁶ and third, one leading

before this information had been publicly announced. The court held that the injured seller could recover "out of pocket" damages if rescission was not adequate. *See also* Braumel v. Rosen, 412 F.2d 571 (4th Cir. 1969), where damages were allowed in a similar situation even though rescission had been waived by delay.

9. 69 F. Supp. 512 (E.D. Pa. 1946) [hereinafter cited as *Kardon*].

10. *See* note 8 *supra* and the authorities cited therein.

11. *SEC v. Atlas Tack Corp.*, 93 F. Supp. 111 (D. Mass. 1950).

12. *See also* *SEC v. Computronic Industries Corp.*, 294 F. Supp. 1136 (N.D. Tex. 1968), where a C.P.A. was enjoined from practicing before the SEC under a provision of the Securities Act of 1933 because he prepared inadequate and inaccurate work papers for use in the compilation of a registration statement.

13. *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1307 (2d Cir. 1971), *cert. denied*, 92 S. Ct. 561 (1971).

14. *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1307-08 (2d Cir. 1971), *cert. denied*, 92 S. Ct. 561 (1971).

15. *See, e.g.*, *SEC v. Bowler*, 427 F.2d 190 (4th Cir. 1970), in which there had been violations of the registration provisions of the Securities Act of 1933, and the corporation whose securities were sold had been mismanaged. In addition to the issuance of an injunction against the further sale of unregistered securities and in view of the foregoing circumstances, the appointment of a receiver to manage the business affairs of the corporation was held necessary to protect the public.

16. In *United States v. Moore*, 340 U.S. 616 (1951), restitution of overceiling rent was allowed, even though section 206(b) of the Housing and Rent Act of 1947 did not provide

case, *Fleischmann Distilling Corp. v. Maier Brewing Co.*,¹⁷ specifically limited the remedies available to the ones expressly provided for by a particular applicable statute.¹⁸ Unlike the limited availability of remedies found in *Fleischmann*, the remedies under section 21(e) were found not to be as restrictive since that statute broadly provides that the SEC shall have the power to seek the injunction of practices or acts which would constitute violations of the Securities and Exchange Act of 1934.

Submitted to close scrutiny, the court's reasoning has several weaknesses. In two cases,¹⁹ the statutes held to provide restitution without express provisions in the enactment contained language which is somewhat broader than the wording contained in section 21(e). For example, in *United States v. Moore*,²⁰ section 206(b) of the Housing and Rent Act of 1947 provided that the district court had the power to issue "other orders" which it deemed appropriate under the circumstances. Section 21(e), however, does not expressly give the courts such discretion. Also, setting up a fund for payment of possible judgments against persons violating the Securities and Exchange Act of 1934 is sharply distinguishable from merely ordering the wrongdoers to make restitution to the injured parties.

On the other hand, there is a great deal of authority to support this decision. Section 10(b) has been recognized as remedial legislation, and the United States Supreme Court has encouraged that it be broadly construed.²¹ This rule of liberal construction has been applied by courts on numerous occasions in interpreting section 10(b), and the remedies it allows.²² As noted previously, private parties have been allowed to bring civil actions under section 10(b) and rule 10b-5 despite the fact that neither section 10(b) nor rule 10b-5 contain any express provisions for private civil actions. However, private suits have been permitted on the

for any remedies other than injunctive relief. Act of June 30, 1947, ch. 163, § 206(b), 61 Stat. 193 (1947).

17. 386 U.S. 714 (1967) [hereinafter cited as *Fleischmann*]. The statute in question there was section 35 of the Lanham Trademark Act, 15 U.S.C. § 1117 (1964). In *Fleischmann*, the Court held that attorneys fees would not be allowed as part of costs because they were not specifically provided for in the Act. "When a cause of action has been created by a statute which expressly provides the remedies for vindication of the cause, other remedies should not be readily applied." *Fleischmann*, 386 U.S. 714, 720 (1967) (emphasis added).

18. In *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970), the Court distinguished *Fleischmann* by holding that the remedies available under section 14 of Securities and Exchange Act of 1934, 15 U.S.C. § 78n(a) (1970) [hereinafter cited as section 14(a)] were not so detailed as to "circumscribe the courts' power to grant appropriate remedies." *Id.* at 391.

19. *U.S. v. Moore*, 340 U.S. 616 (1951) and *Mitchell v. Robert DeMario Jewelry, Inc.*, 361 U.S. 288 (1960).

20. 340 U.S. 616 (1951). See note 16 *supra* and accompanying text.

21. See *Tcherepnin v. Knight*, 389 U.S. 332 (1967).

22. See, e.g., *Kuehnert v. Texstar Corp.*, 412 F.2d 700 (5th Cir. 1969), where a tippee failed to disclose material inside information to the seller of securities. He was held to have violated section 10(b) and rule 10b-5, even though he had never met the seller face-to-face but had only dealt with him through a broker.

theory that they effect the purpose of eliminating deceptive practices and manipulation in the purchase and sale of securities. The remedy granted in the instant case can certainly be justified on the same basis.

In addition, the general equity powers conferred upon the federal district courts by section 27 of the Securities and Exchange Act of 1934²³ with regard to actions brought under the Act provides substantial authority to allow the remedy. The history of equity indicates that one of its primary purposes is to secure "general justice not specially provided for in the ordinary way. . . ."²⁴ In recent times, the courts have indicated their willingness to permit great flexibility in granting equitable decrees where the interests of justice will be served.²⁵ It appears, therefore, that the equitable powers granted the district courts under section 27 would enable them to grant any reasonable remedy which would further the goals of the Act.

The appellants, in the instant case, had argued that the restitution required was punitive in nature since the parties actually injured were not directly compensated by payment of profits into an escrow fund.²⁶ The courts have generally held, as appellants contended, that the civil remedies provided for in the securities acts were intended to protect the public and compensate it for any injuries resulting from violations of these acts.²⁷ For this reason, continued the appellants, remedies or orders which operate as penalties are opposed to the letter and spirit of the civil liability provisions of federal securities laws.

Using the foregoing criteria, the relief granted in the instant case may be clearly categorized as non-punitive. Although persons injured are not directly benefited by the restitution, they certainly receive an indirect material benefit by being assured, at least to the extent of the escrow fund, that their judgments against the wrongdoers will be satisfied. The accrual of the residual amounts of the fund to the corporation after five years is also compensatory, as opposed to punitive, since the corporate name and reputation may be damaged when its officers and directors abuse their official positions.²⁸ Moreover, "[i]t would severely defeat the purpose of the Act [*i.e.*, to prevent manipulation and the use of deceptive practices in securities transactions] if a violator of Rule 10b-5 were

23. 15 U.S.C. § 78aa (1970) [hereinafter cited as section 27].

24. Adams, *The Origin of English Equity*, 16 COLUM L. REV. 87, 97 (1916).

25. *See, e.g.*, Georgia v. Tennessee Copper Co., 237 U.S. 474 (1915), where an action was brought to enjoin certain businesses from emitting fumes from their factories. Instead of merely issuing an injunction, the Court ordered the defendants to comply with certain conditions which were designed to eliminate the nuisance.

26. SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971), *cert. denied*, 92 S. Ct. 561 (1971).

27. *See, e.g.*, Beck v. SEC, 430 F.2d 673 (6th Cir. 1970). Here, the court found that "[t]he purpose of the Securities Acts is to protect the investing public [citations omitted] and the orders issued by the Commission are intended to be remedial and not punitive." *Id.* at 674.

28. *See* Diamon v. Oreamuno, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969).

allowed to retain the profits from his violation."²⁹ Also worthy of note is the fact that the decision only requires insiders to make restitution to the extent of the sum represented by the difference between the price of the stock when purchased as a result of the "inside information" and the value of the stock at the time of public disclosure of that information. This reflects the purely compensatory nature of the remedy since it merely places the insider in the same position as the general public.

Perhaps, the most novel aspect of the decision is the requirement that one of the appellants make restitution for the profits of tippees from which he himself *theoretically* derived no benefit. In light of the fact that such tipping was expressly held to violate section 10(b) and rule 10b-5,³⁰ this requirement seems appropriate. Additionally, the argument that a person receives no benefit from profits derived by his tippees from use of inside information cannot withstand careful scrutiny. If there were no provision for restitution for such gains, the insider could make reciprocal tipping arrangements or simply have a friend or relative purchase the stock with the understanding that any profits would accrue to the insider.

At this point, it is difficult to predict the ultimate effect of this decision. From a purely legal standpoint, the case has several weaknesses which were discussed previously. However, few, if any, leading cases have been decided solely on the basis of a simple precedent or statutory provision. Considering the dearth of cases dealing with actions by the SEC against private parties under section 10(b) and rule 10-5, the decision is extremely well reasoned.

On the social and economic side, the decision certainly promotes the purpose of the Securities and Exchange Act of 1934 in general and of section 10(b) and rule 10b-5 in particular since it substitutes a policy of full and fair disclosure for the doctrine of caveat emptor in the purchase and sale of securities.³¹ The new remedy granted by the case discourages corporate insiders from using "inside information" by effectively preventing them from reaping any benefit from such use. By the same token, the parties injured by the use of such information are afforded a practical means of satisfying their judgments. Hopefully, other federal courts as well as the state courts which must rule on similar Blue Sky provisions³² will follow the decision in the instant case, despite the fact that the court's reasoning is somewhat strained at times, since the rationale of the opinion is supported by substantial legal authority and has the effect of furthering the statutory purpose of investor protection.

MALCOLM H. NEUWAHL

29. SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971), *cert. denied*, 92 S. Ct. 561 (1971).

30. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 852 (2d Cir. 1968).

31. See *Herpich v. Wallace*, 430 F.2d 792 (5th Cir. 1970).

32. See, e.g., FLA. STAT. § 517.301 (1969).