University of Miami Law Review

Volume 23
Number 2 *Winter-Spring 1969*

Article 13

5-1-1969

Opening a Pandora's Box -- Disclosure Under the Florida Securities Act

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OPENING A PANDORA'S BOX—DISCLOSURE UNDER THE FLORIDA SECURITIES ACT

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I. INTRODUCTION

In recent years, the law reporters have been replete with cases discussing, exploring, expanding, and sometimes distorting section 10(b) of

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1. 15 U.S.C. § 78j (1964):

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

the Federal Securities Exchange Act of 1934[1] and Securities and Exchange Commission Rule 10B-5.[2] The provisions have been so liberally construed that the decisions employing them have become the classic examples of judicial law-making.

Few attorneys apparently realize that the Pandora's Box of Rule 10B-5 has a mirror image in the Florida Securities Act. Indeed, section 517.301 of the Florida Statutes is nearly identical in wording to its federal counterpart.[3] Yet no Florida cases have considered its construction; nor has it been used, like the federal Sword of Damocles, to achieve expanding remedial objectives.

Two alternative conclusions are possible from the dearth of litigation. Either lawyers are unaware of the existence or possibilities of section 517.301, or no fraudulent devices are currently being used in connection with the purchase or sale of securities in Florida corporations. While the former conclusion is perhaps reasonable, the latter hypothesis is, unfortunately, highly improbable and should be rejected as contrary to the normal state of affairs.[4]

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2. 17 C.F.R. § 240.10b-5 (1958):

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.

3. FLA. STATS. § 517.301 (1967): It is unlawful, and a violation of the provisions of this chapter, for any person:

(1) In the sale or purchase of any security in this state, including any security exempted under the provisions of § 517.05, and including any securities sold in any transaction exempted under the provisions of § 517.06, directly or indirectly:

(a) To employ any device, scheme, or artifice to defraud;

(b) 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;

(c) To engage in any transaction, 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.

(2) To publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, communication or broadcast which though not purporting to offer a security for sale, describes such security for a consideration received or to be received directly or indirectly from an issuer, underwriter, or dealer, or from an agent or employee of an issuer, underwriter or dealer, without fully disclosing the receipt whether past or prospective, of such consideration and the amount thereof.

(3) In any matter within the jurisdiction of the Florida securities commission to knowingly and willfully falsify, conceal or cover up by any trick, scheme, or device, a material fact, or make any false, fictitious or fraudulent statement or representation, or make or use any false writing or document, knowing the same to contain any false, fictitious or fraudulent statement or entry.

4. Another possible reason for the absence of litigation may be that actions which could be filed under FLA. STAT. § 517.301 (1967) are instead being filed in the federal courts under the federal statute. There are numerous instances, however, where the means of

Because of the absence of interpretation or application of section 517.301 and because of the lack of interpretation in other jurisdictions of similar statutes, it is clear to the authors that some guidelines might appropriately be drawn for the proper use of the statute. This necessarily requires analogy to the construction given SEC Rule 10B-5. While adoption by the Florida courts of the federal construction is not a legal imperative, it does appear to be highly probable in view of the identity of purposes of the two securities statutes.

Therefore, it shall be the purpose of this article to explore the possible contours of section 517.301 liability, to examine the possible application of this liability to recurrent corporate problems, and to suggest, in anticipation of some predictable difficulties, admendments to the statute.[5]

II. Comparative Survey of State Disclosure Statutes

A. *Other Jurisdictions*

The great majority of the states which have adopted fraud provisions and disclosure statutes have based the legislation on section 101 of the Uniform Securities Act, which provides:

> It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly—
> (1) to employ any device, scheme or artifice to defraud,
> (2) 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 light of the circumstances under which they were made, not misleading, or
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.[6]

Section 101 of the Uniform Securities Act is nearly identical in wording to Rule 10B-5 of the Securities and Exchange Commission,[7] which in turn was modeled after section 17(a) of the Federal Securities Act of 1933.[8] Unlike section 17(a), however, which requires disclosure by

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interstate commerce may not have been used. In these situations, the federal statute will be inapplicable and resort will have to be made to the state remedy.

5. For other recent articles dealing with this rapidly expanding area of securities law *see* Klein, *The Extension of a Private Remedy to Defrauded Securities Investors Under SEC Rule 10B-5*, 20 U. Miami L. Rev. 81 (1965); Manne, *Insider Trading and the Administrative Process*, 35 Geo. Wash. L. Rev. 473 (1967); Comment, *Fiduciary Suits Under Rule 10B-5*, 1968 Duke L.J. 791 (1968); Comment, *Rule 10B-5: Elements of a Private Right of Action*, 43 N.Y.U.L. Rev. 541 (1968).

6. Uniform Securities Act § 101.

7. *See* note 2 *supra*.

8. 15 U.S.C. § 77q(a) (1964):

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

sellers of securities, SEC Rule 10B-5 and section 101 of the Uniform Securities Act are designed to force disclosure by both *sellers* and *purchasers* of securities.

Twenty states and the Commonwealth of Puerto Rico have adopted section 101 of the Uniform Securities Act verbatim.[9] Five additional states, Alaska,[10] New Mexico,[11] Oregon,[12] Virginia,[13] and West Virgina,[14] have adopted section 101 with some important modifications or deletions. Arizona,[15] Mississippi,[16] North Dakota,[17] Tennessee,[18] and Vermont[19] have adopted disclosure provisions which are slightly similar to section 101. In all states which have enacted the disclosure provisions liability

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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.

9. ALA. CODE tit. 53, § 28, *as amended* (Supp. 1967); ARK. STAT. ANN. § 67-1235 (1966); COLO. REV. STAT. § 125-1-1 (1963); D.C. CODE ANN. § 2-2402 (1951); IDAHO GEN. LAWS ANN. § 30-1403 (1967); IND. STAT. ANN. § 25-866 (Burns, 1960), *as amended* (Supp. 1968); KAN. STAT. ANN. § 17-1253 (1963); KY. REV. STAT. § 292.320 (1963); MD. CODE ANN. art. 32A, § 14 (1957), *as amended* (1967); MICH. COMP. LAWS ANN. § 451.502 (1948), *as amended* (Supp. 1964); MO. REV. STAT. § 409.101 (1959); MONT. REV. CODE § 15-2005 (1947), *as amended* (Supp. 1961); NEB. REV. STAT. § 8-1102 (1943), *as amended* (Supp. 1965); NEV. REV. STAT. § 90.110 (1959), *as amended* (Supp. 1965); N.J. STAT. ANN. § 49:3-52 (1937), *as amended* (Supp. 1967); OKLA. STAT. tit. 71, § 101 (1951), *as amended* (Supp. 1965); P.R. LAWS ANN. tit. 10, ch. 37 § 851 (1963), *as amended* (Supp. 1963); S.C. CODE § 62-201 (1962); UTAH CODE ANN. § 61-1-1 (1953), *as amended* (Supp. 1963); WASH. REV. CODE ANN. § 21.20.010 (1951), *as amended* (Supp. 1959); WYO. STAT. § 17-117.1 (1957), *as amended* (Supp. 1965).

10. ALAS. STAT. 45.55.010 (1962). Alaska modified subsection (2) of the UNIFORM SECURITIES ACT § 101 as follows: "To make an untrue statement of a material fact or omit to state a material fact the omission of which makes a statement made misleading."

11. N. M. STAT. ANN. § 48-18-29 (1953). The New Mexico version makes violation of one of the subsections "fraudulent" as well as "unlawful."

12. ORE. REV. STAT. § 59.135 (1967) makes it unlawful to do one of the acts prohibited in UNIFORM SECURITIES ACT § 101 in connection with the purchase or sale of any security or

> the conduct of a securities business or for any person who receives any consideration from another person primarily for advising the other person as to the value of securities or their purchase or sale whether through the issuance of analyses or reports or otherwise.

13. VA. CODE § 13.1-502 (1950). The Virginia version adds the wording in subsection (2) "to obtain money or property by means" of any of the prohibited acts. The authors suggest that this creates a privity requirement. *See* note 28 *infra* and accompanying text.

14. W. VA. CODE § 32-1-17 (1966). This statute limits the scope of its provisions to injunction proceedings.

15. ARIZ. REV. STAT. § 44-199 (1956) includes transactions occurring "within or from" the state.

16. MISS. CODE ANN. § 5380 (1942), *as amended* (Supp. 1958) expressly limits the potential cause of action to fraudulent practices, thus eliminating a claim based upon a negligent act.

17. N.D. CENT. CODE ANN. § 10-04-15 (1960) contains all the substantive provisions of SEC Rule 10B-5.

18. TENN. CODE ANN. § 48-1644 (1964) excludes subsection (2) of the UNIFORM SECURITIES ACT § 101 and SEC Rule 10B-5.

19. VT. STAT. ANN. § 9-4224 (1959) restricts the operation of its disclosure statute to injunction proceedings.

is imposed, as under the federal acts, regardless of whether the prohibited act or omission occurs in connection with securities or transactions which are exempt from state registration requirements.[20]

B. *Florida*

In compiling section 517.301 of the Florida Statutes, the draftsmen followed the basic framework of section 17(a) of the Federal Securities Act of 1933 and SEC Rule 10B-5.[21] However, the Florida statute has excluded certain wording of both the Rule and the 1933 Act. The word "offer," for example, is conspicuously absent from the provisions of the Florida version.[22] This omission, however, may be covered by the definition of "sale" in section 517.02(3).[23] Subsection (b) contains the introductory phrase "to obtain money or property . . . ." by means of one or more of the prohibited acts.[24] While this phrase is included in section 17(a) of the 1933 Federal Securities Act,[25] it is not included in either the Uniform Securities Act[26] or SEC Rule 10B-5.[27] Moreover, the addition of this phrase may impose a requirement of privity of contract to sue which is not imposed under either the SEC rule or the Uniform Securities Act.[28]

Subsection (c) of the Florida provision has several important modifications. Under section 101 of the Uniform Securities Act, the fraud section applies to all "acts" in violation of its provisions.[29] However, under the Florida statute, subsection (c) applies only to prohibited "transactions."[30] Furthermore, while the Uniform Securities Act, the federal act, and the SEC rule make all the disclosure provisions applicable to the prohibited acts or omissions done "in connection with" the purchase or sale of a security,[31] the Florida statute applies this liberal wording only to subsection (c).[32]

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20. *See* notes 3, 9-19 *supra*.

21. Interview with Milton J. Wallace, General Counsel for the Florida Securities Commission, in Miami, Florida, Nov. 15, 1968.

22. *See, e.g.*, FLA. STAT. § 517.301 (1967) set forth at note 3 *supra*. It should be noted that while Florida had adopted the UNIFORM SECURITIES ACT, it has substantially modified § 101.

23. FLA. STAT. § 517.02(3) (1967) provides:

> "Sale" or "sell" includes every disposition or attempt to dispose of a security or interest in a security for value. Any security given or delivered with or as a bonus on account of any purchase of securities or any other thing shall be conclusively presumed to constitute a part of the subject of such purchase and to have been sold for value. "Sale" or "sell" also includes a contract to sell, an exchange, an attempt to sell, an option of sale, a solicitation of a sale, a subscription or an offer to sell, directly or by an agent, or a circular letter, advertisement or otherwise . . . .

24. FLA. STAT. § 517.301(b) (1967). *See* note 3 *supra*.

25. 15 U.S.C. § 77q(a) (1964). *See* note 8 *supra*.

26. *See* text at 595.

27. 17 C.F.R. § 240.10b-5 (1958). *See* note 2 *supra*.

28. *See* text at 606 *infra*.

29. *See* text at 595 *supra*.

30. FLA. STAT. § 517.301(c) (1967). *See* note 3 *supra*.

31. 15 U.S.C. § 78j(b) (1964), 17 C.F.R. § 240.10b-5 (1958); Uniform Securities Act § 101. *See* notes 1, 2, 6, and 8 *supra*.

32. FLA. STAT. § 517.301(c) (1967). *See* note 3 *supra*.

These modifications and deletions, as will be seen below, have a substantial impact on the construction given the statute. Where appropriate, the possible ramifications of the differences in wording will be discussed. Recognizing these changes, however, it is appropriate at this point to consider the history and development of section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10B-5.[33]

III. ORIGINS OF CIVIL LIABILITY

A. *Federal Development*

Section 10(b) was unceremoniously promulgated in 1934 in the following clear language:

> It shall be *unlawful* for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

In 1942, in order to adequately protect the "public interest," the Securities and Exchange Commission promulgated Rule 10B-5 announcing the following:

> the new rule closes a loophole in protections against fraud administered by the commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase . . . .[34]

Realizing the potential ramifications of this broad language, the commission one year later conducted an investigation into transactions connected with Ward La France Trade Corporation, "to call attention to Rule X-10B-5."[35]

If the use of 10(b) were limited to administrative and criminal actions, its application would be relatively unimportant. But in 1946, a federal district court in *Kardon v. The National Gypsum Co.*[36] ruled that the words "unlawful" in the statute also implied a right of civil remedy by the seller against a buyer of securities. This decision seemed to be

33. For an excellent review of the entire area of Rule 10B-5 *see* Klein, *The Extension of a Private Remedy to Defrauded Securities Investors Under SEC Rule 10B-5*, 20 U. MIAMI L. REV. 81 (1965).
34. SEC Exchange Act Release No. 3230 at 183-84 (May 21, 1942).
35. Ward La France Truck Corp., 13 SEC 373 (1943).
36. 73 F. Supp. 798 (E.D. Pa. 1947).

inconsistent with reasonable statutory construction. Indeed, Congress has expressly provided for civil liability in sections 11(a),[37] 12(1),[38] and 12(2)[39] of the 1933 Act. In the 1934 Act, sections 9,[40] 15,[41] 16[42] and 18[43] contain express civil remedy provisions. When Congress wanted to provide a civil remedy it had no reluctance to do so, nor was it clumsy in articulating its desires. When it did not expressly provide a remedy, an interpretation that Congress *really intended* to do so was obviously baseless.

Nevertheless, the *Kardon* decision was grounded in sound reasoning, if not in clear congressional intent.[44] First, Judge Kirkpatrick noted that under section 286 of the *Restatement of Torts*, when a statute is expressly intended to protect a person or a class of persons of which the plaintiff is a member and where the legislation provides a standard of conduct for the benefit of the class, a civil remedy would merely further promote that legislative purpose.[45] Section 10(b) was intended to promote full and fair disclosure for the benefit of investors, a class of persons which included the plaintiff in *Kardon*.[46]

Secondly, the court noted that under section 29(b) of the 1934 Federal Securities Exchange Act "every contract made in violation of any provision of this title or of any rule or regulation thereunder . . . shall be void . . . ."[47] If a contract in violation of a rule is to be void, the court reasoned, Congress "almost necessarily implied a [civil] remedy in respect of it."[48]

While the overwhelming number of federal district courts and courts of appeals support the *Kardon* construction of section 10(b), the Supreme Court of the United States has not as yet explicitly decided the question.[49] However, in 1964, the Court's decision in *J.I. Case Co. v. Borak*[50] seemed

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37. 15 U.S.C. § 77K(a) (1964).
38. 15 U.S.C. § 77L(1) (1964).
39. 15 U.S.C. § 77L(2) 1964).
40. 15 U.S.C. § 78i(a) (1964).
41. 15 U.S.C. § 78o(c)(1) (1964).
42. 15 U.S.C. § 78p(b) (1964).
43. 15 U.S.C. § 78r(a) (1964).
44. Practically every federal court of appeals has found an implied civil remedy. *See* Klein, *The Extension of a Private Remedy to Defrauded Securities Investors Under SEC Rule 10B-5*, 20 U. MIAMI L. REV. 81, 89 nn.40 & 41 (1965).
45. *See* Bell v. Hood, 327 U.S. 678 (1946); Texas & Pac. Ry. v. Rigsby, 241 U.S. 33 (1916).
46. In Texas & Pac. Ry. v. Rigsby, 241 U.S. 33 (1916) the Court stated that:

> a disregard of the command of the statute is a wrongful act, and where it results in damage to one of a class for whose special benefit the statute was enacted, the right to recover in damages . . . is implied . . . .

47. 15 U.S.C. § 78cc(a) (1964).
48. Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946).
49. Indeed, the Supreme Court of the United States recently accepted a 10B-5 case for the first time. SEC v. National Securities, Inc., 37 U.S.L.W. 4101 (U.S. Jan. 27, 1969). However, the court was not required to decide whether there is a private right of action. 37 U.S.L.W. 4101, at 4105 n.9.
50. 377 U.S. 426 (1964).

to settle the question temporarily. The Court was faced with a construction of section 14(a)[51] of the 1934 Act and SEC Rule 14A-9, which makes it "unlawful" for any person to solicit or permit the use of his name to solicit any proxy. The petitioner argued that there was no private implied civil remedy since Congress had made no special reference to a private remedy under section 14(a). The Court, however, looked to the purpose of the statute:

> While this language makes no special reference to a private right of action, among its chief purposes is the protection of investors, which certainly implies the availability of judicial relief where necessary to achieve that result.[52]

A few courts have determined that since similar policy surrounds section 10(b), the Court would apply an identical construction and imply a private civil remedy.[53] However, regardless of the arguable implications of *J.I. Case*,[54] it seems well-settled by the lower federal courts that civil liability may be pursued under section 10(b).[55]

B. *Florida Civil Liability*

The Florida statute is also drawn in terms that it shall be "unlawful" to engage in any of the prohibited acts or omissions.[56] Consequently, an express provision is made for severe criminal liability for a violation of the chapter.[57] A fine of five thousand dollars and a sentence of five years in the state penitentiary is possible. In addition, the Florida Securities Commission may secure an injunction to restrain violations of the chapter, including section 517.301.[58]

However, unlike SEC Rule 10B-5, the Florida law includes a number of different types of express civil remedies. First, at the option of the *purchaser*, every sale made in violation of section 517.301 may be voided.[59] Damages may be recovered up to the purchase price plus costs and attorney's fees, upon tender of the securities to the seller. Recovery may be made from any person in privity with the purchaser and every director, officer, or agent of the seller. In effect, this section provides a recission of the sale, but only by the purchaser. It should be pointed out,

51. 15 U.S.C. § 78n(a) (1964).
52. J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964).
53. Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, 543 (2d Cir. 1967). This conclusion seems well-founded. *See* The Treatment given in SEC v. National Securities, Inc., 37 U.S.L.W. 4101 (U.S. Jan. 27, 1969): "This case presents none of the complications which may arise in determining who, if anyone, may bring private actions under § 10(b) and Rule 10b-5. *Cf.* J.I. Case Co. v. Borak, 377 U.S. 426 (1964)." 37 U.S.L.W. 4101, at 4105 n.9.
54. *See* J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964).
55. *See* note 44 *supra*.
56. FLA. STAT. § 517.301 (1967).
57. FLA. STAT. § 517.302 (1967).
58. FLA. STAT. § 517.19 (1967).
59. FLA. STAT. § 517.21 (1967).

however, that section 517.301 declares it unlawful to violate the provisions of the section "in the sale or *purchase* of any security . . . ." Therefore, it is clear that the express liability provision under section 517.21 does not include private recovery for the full spectrum of prohibited activity under section 517.301.

The second major civil remedy provision is section 517.22, which prevents other statutory or common law remedies to be obviated by the express provisions in the securities act.[60] Conceivably, this section could be interpreted as not precluding implied remedies promulgated, as in the federal law, by judicial decision. However, the more reasonable interpretation of the section is simply to prevent preemption by the act of other causes of action.

Finally, the act provides that "the same civil remedies provided by laws of the United States now or hereafter in force for the *purchasers* of securities under any such laws . . . shall extend also under this chapter."[61] It is clear from the wording of the section, however, that only legislative promulgations are included in its purview. Thus, the contours of implied civil remedy as shaped to the recent federal decisions are presumably not within the penumbra of the section.

Two conclusions can be drawn from this analysis of the Florida law. First, express statutory civil remedies extend only to purchasers and only against those *directly* involved in the sale of the securities. Secondly, section 517.301 could be construed to provide a remedy against "any person" who "directly or indirectly" violates its provisions. It is, therefore, this second area of prohibited activity for which an implied or judicial civil remedy must be found.

If an implied remedy was a difficult task under the federal statute, that difficulty is magnified under the Florida legislation. It is clear that a civil remedy was expressly intended by the legislature for *purchasers* and not *sellers*. Under the ancient constructional maxim of *expressio unius est exclusio alterius*,[62] a remedy for sellers should be precluded. However, Judge Kirkpatrick's answer in *Kardon* seems to refute this:

> The argument is not without force. Were the whole question one of statutory interpretation it might be convincing, but the question is only partly such. It is whether an intention can be implied to deny a remedy and to wipe out a liability which, normally, by virtue of the basic principles of tort law accompanies the doing of the prohibited act. Where, as here, the whole statute discloses a broad purpose to regulate securities transactions of all kinds and, as a part of such regulation, the specific section in question

60. FLA. STAT. § 517.22 (1967) provides:
Nothing in this chapter shall limit any statutory or common law right of any person to bring any action in any court for any act involved in the sale of securities, or the right of the state to punish any person for any violation of any law.
61. FLA. STAT. § 517.23 (1967).
62. Literally translated, "The expression of one thing is the exclusion of another."

> provides for the elimination of all manipulative or deceptive methods in such transactions, the construction contended for by the defendants may not be adopted. In other words, in view of the general purpose of the Act, the mere omission of an express provision for civil liability is not sufficient to negative what the general law implies.[63]

Yet one could conceivably argue that the entire purpose of the act is the protection of investors, who might be defined as purchasers rather than sellers. Here again, the holding in *Kardon* is persuasive. An *investor* need not be synonymous with a purchaser. Indeed, a seller may have just as much stake in the full disclosure of material information as the purchaser. To the extent that the purpose of the statute is designed to include protection for all investors, a seller should be included. Clearly, the purpose of the federal enactment of section 10(b) was to extend the same protection to sellers that purchasers were afforded under section 17 of the 1933 Act.[64] The Florida legislature could reasonably be interpreted as having the same intent.

The ultimate question remaining, however, is whether other forms of remedy are precluded in view of the express remedy for purchasers, *i.e.*, recission. Here a better argument remains against an implied civil remedy for purchasers. Under the federal acts there are no all-inclusive remedy sections which expressly define what forms of action a potential litigant may bring. Thus where the statutes do not provide for a civil remedy *at all*, an implication of a remedy is entirely reasonable in view of the statutes' broad remedial purposes. On the other hand, where, as in Florida, an all-inclusive section expressly provides a remedy for "every sale made in violation of any of the provisions of this chapter,"[65] the clear intent of the legislature is seen.

Thus, if the question is one of statutory construction, the Pandora's Box of remedies potentially available to a purchaser by analogy to Rule 10B-5 is closed. If, however, as the authors believe, the question is rather one of judicial remedy, close analogy to the federal decisions is reasonable. In other words, where there is a legal injury there should be a legal remedy. The mere fact that the legislature has failed to expressly provide a particular form of remedy should not preclude a court from fashioning a remedy, as long as it is consistent with the traditional kinds of remedies known at the common law and is consistent with the legislative purpose. As the Supreme Court of the United States observed in *Deckert v. Independence Shares Corp.*:[66]

> The power to enforce implies the power to make effective the right of recovery afforded by the Act. And the power to make

63. Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946).
64. *Id.*
65. FLA. STAT. § 517.21 (1967).
66. 311 U.S. 282, 288 (1940).

> the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case.

Here, an implied civil remedy for a purchaser for damages is entirely consistent with the aims of the act. Moreover, inasmuch as one of the purposes of the statute is to force full disclosure, the remedy might well extend beyond the immediate seller and the participating officer, director or agent of the seller. The action could consistently be pursued against "any person" who contravenes the statute.

The extension of this logic to the seller is simpler. Although a seller is expressly included in section 517.301,[67] no remedy is provided. A court could well create a remedy without the fear of contravening express legislative action.

Thus, in the absence of an amendment to the statute providing for an expansive civil remedy to section 517.301, a Florida court would be well-founded in both reasoning and precedent to create a civil remedy for the section.

IV. The Elements of Liabilty

A. *Prohibited Acts or Omissions*

The terms of SEC Rule 10B-5 and Florida Statutes, section 517.301, superficially seem clear. Yet one of the most amazing legal phenomena of recent times is the seemingly endless expansion of the statutory language. The act's contours remain, therefore, undefined, and its furture undetermined. While specific examples of prohibited conduct will be advanced below, it can be accurately generalized here that liability is imposed for a device or scheme to defraud, an untrue statement, a half-truth, and non-disclosure. This conduct is prohibited notwithstanding the fact that the securities or transactions are exempt from registration under the respective securities acts.[68] Moreover, the plaintiff need not even allege and prove common-law fraud; he must merely prove a misstatement or omission. As one court stated:

> Section 10(b) speaks in terms of the use of "any manipulative device or contrivance" in contravention of rules and regulations as might be prescribed by the Commission. It would have been difficult to frame the authority to prescribe regulations in broader terms. Had Congress intended to limit this authority to regulations proscribing common-law fraud, it would have probably said so. We see no reason to go beyond the plain meaning of the word "any" indicating that the use of manipulative or deceptive devices or contrivances of whatever kind may be for-

67. Fla. Stat. § 517.301 (1967). *See* note 3 *supra*.
68. Fla. Stat. § 517.301 (1967). *See* note 3 *supra*.

bidden, to construe the statute as if it had read "any fraudulent" devices.[69]

The demonstrated intent of legislatures, both national and state, is to afford protection to the ordinary purchaser or seller of securities. Fraud in this liberal sense may be accomplished by false statements, a failure to correct a misleading impression left by statements already made, or by not stating anything at all when there is a responsibility to come forward. Thus *scienter*, which was a strict requirement at common law in cases of fraud,[70] is generally not required in Rule 10B-5 actions[71] and should not be required in section 517.301 actions.

It should be noted that the deliberately broad language of both the federal and state statutes allows a great amount of interpretation by the courts, an opportunity which has been fully exploited by the federal judiciary. Hence, new methods, plans and schemes may be effectively short-circuited. The only real guidelines for the buyer, seller, corporation and advising attorney is the avowed legislative purpose to equalize investment protection through full disclosure by all parties of material information. It is a policy of fundamental fairness.

B. *Statement or Nondisclosure of Material Fact*

Liability under SEC Rule 10B-5 and Florida Statutes, section 517.301, is imposed for the statement, misstatement, or non-statement of a material fact.[72] This is distinguished, as at the common law, from liability for the statement of a mere opinion.[73] For example, a person who falsely represents that *ABC Corporation* has acquired a number of assets in order to induce a purchase of securities in *ABC, Inc.* will be subject to liability under the Florida act. In addition, a person who represents that *ABC, Inc.* has acquired a number of assets, but fails to disclose that the assets are worthless in order to promote a sale of securities, should be held liable for rescission.

These situations, each involving a clearly discernable fact, must be distinguished from a mere opinion. A prediction, a theory, or an hypothesis need not be disclosed.[74] For example, assume that *X*, a director of *ABC, Inc.*, desires to sell a quantity of *ABC* stock. Assume further that research taking place in the laboratories of *ABC, Inc.*, if substantiated and developed, would skyrocket the value of *ABC, Inc.* stock. As long as the

69. Ellis v. Carter, 291 F.2d 270, 274 (9th Cir. 1961).

70. Derry v. Peek, (1889), 14 A.C. 337; W. PROSSER, THE LAW OF TORTS 715 (3d ed. 1964).

71. *See, e.g.*, Stevens v. Vowell, 343 F.2d 374 (10th Cir. 1965).

72. FLA. STAT. § 517.301 (1967). *See* note 3 *supra*.

73. *See* Cady, Roberts & Co., 40 S.E.C. 907 (1961); *Cf.* Nicewarner v. Bleavins, 244 F. Supp. 261, 264 (D. Colo. 1965). *See also* Painter, *Inside Information: Growing Pains for the Development of Federal Corporation Law Under Rule 10B-5*, 65 COLUM. L. REV. 1361, 1379 (1965).

74. *Id.*

research has not yet progressed beyond a mere theory, hypothesis or opinion, *X* is under no duty to disclose the information.

Between fact on the one hand and opinion on the other, lies a zone of legal uncertainty. When does a theory become a material fact? No objective test can, at the present, be established. However, one might presume that as the theory becomes verified, as the impact of the theory on the plans and development of the corporation becomes more substantial (and therefore material), liability will be imposed for non-disclosure.[75]

C. *Privity*

Cardozo's observation that "the assault upon the citadel of privity is proceeding in these days apace"[76] applies with as much force to securities disclosure actions today as it did to the accountant's plight in 1931. Section 517.301, like the federal section 10(b), imposes liability upon *any person* who contravenes its provisions "directly or indirectly" in connection with "the purchase or sale of any security."[77] From this clear wording, it appears that the reqiurement of privity of contract has been abandoned.

It should be noted that most problems with regard to Florida corporations will undoubtedly revolve around face to face transactions, and thus privity will be satisfied. Nevertheless, problems involving others not in privity (such as accountants) may be presented, where questions regarding the requirement of privity would appropriately be raised.

Although strict privity of contract was not a requirement of common law deceit,[78] the federal courts had, until recently, imposed it upon plaintiffs suing under section 10(b) and SEC Rule 10B-5. In *Joseph v. Farnsworth Radio and Television Corp.*,[79] the defendants sold shares of stock to unknown third persons contemporaneously with the assertion of false statements regarding the financial condition of the company. The plaintiffs, who did not buy directly from the defendants but purchased through a national exchange, sued under federal section 10(b), seeking to recover the loss they had suffered in selling their stock when the true facts were publicized. The Federal District Court for the Southern District of New York held that the plaintiffs failed to state a claim upon which relief could be granted for lack of an allegation of privity. The court reasoned, however, that the requirement of privity could be substituted by a demonstration of reliance. This, "coupled with the possibility that later sales by the individual defendants may form the basis of privity with these plaintiffs dictate that a fair opportunity to explore such prospects should be accorded . . . ."[80]

75. *See* A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10B-5 § 5.3, at 97 (1967).
76. Ultramares v. Touche, 255 N.Y. 170, 174 N.E. 441, 445 (1931).
77. FLA. STAT. § 517.301 (1967). *See* note 3 *supra*.
78. Palsey v. Freeman, 100 Eng. Rep. 450 (1789).
79. 99 F. Supp. 701 (S.D.N.Y. 1951).
80. *Id.* at 706-707.

However, in the absence of demonstrating reliance, the plaintiffs cause was non-actionable:

> A semblance of privity between the vendor and purchaser of the security in connection with which the improper act, practice or course of business was involved seems to be requisite and is entirely lacking here.[81]

On appeal, The Second Circuit affirmed per curiam.[82] Judge Frank dissented from the decision, recognizing that one purpose of the act is to extend common law liability for fraud to securities transactions. Since even at common law there was no requirement of privity of contract in an action for fraud, he reasoned that, a fortiori, privity should not be required under the statutes.[83]

The dissenting opinion was destined to prevail. In *Miller v. Bargain City, U.S.A., Inc.*,[84] for example, the court found difficulty with the concept of a "semblance of privity":

> [I]f "semblance of privity" means "privity" (like a little bit pregnant), I reject it. The pattern of legislation in the securities field following 1933 was designed to give the broadest protection to investors. . . .
> . . . In my judgment, it would be an unwarranted constriction of the broadest protection contemplated by the federal scheme of securities legislation to engraft upon that scheme a requirement that is neither a part of the statute nor a part of the governing common law tort principles.

Thus, it seems clear that based on common law principles and analogizing to the federal construction, privity is not a requirement for liability under section 517.301(1)(a) or (c). Subsection (1)(b), however, creates a distinct problem. As distinguished from SEC Rule 10B-5, section 517.301(1)(b) has the additional wording "to obtain money or property . . . ." by means of a prohibited act.[85] This provision has great ramifications upon the status of the potential defendant, since privity is apparently necessary in order to invoke this subsection. Moreover, the subsection is presumably aimed at face-to-face relationships. The wording of the Florida section, which has been construed by the federal courts as allowing an action for negligence,[86] apparently also imposes a requirement of gain. This element, thought unnecessary by the federal courts,[87]

81. *Id.* at 706.
82. Joseph v. Farnsworth Radio & Television Corp., 198 F.2d 883 (2d Cir. 1952).
83. *Id.*
84. 229 F. Supp. 33, 37 (E.D. Pa. 1964).
85. FLA. STAT. § 517.301 (1967). *See* note 3 *supra*.
86. *See* SEC v. Texas Gulf Sulphur, 401 F.2d 833, 867 (2d Cir. 1968); Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967); Stevens v. Vowell, 343 F.2d 374 (10th Cir. 1965); Royal Air Properties, Inc. v. Smith, 312 F.2d 210, 212 (9th Cir. 1962); Ellis v. Carter, 291 F.2d 270, 274 (9th Cir. 1961).
87. *See* Fischer v. Kletz, 266 F. Supp. 180 (S.D.N.Y. 1967).

significantly limits the potential liability which could be imposed under subsection (1)(b).

D. *Reliance and Causation*

At the common law, the causal connection between the defendant's wrongful conduct and the resulting damage to the plaintiff was demonstrated by the inducement of the plaintiff to act or to refrain from acting.[88] The defendant's statement or non-statement must have been so material and so substantial as to cause the plaintiff either to act or to refrain from acting.[89] If, however, the plaintiff made an investigation of the facts for himself and then acted upon his own determination, the causal connection was obviated.[90] Yet the representation need not have been the only cause; it is enough if it was a *substantial factor* in the plaintiff's decision.[91] Moreover, at common law, the complaining party who allegedly relied on the representation of non-disclosure must have been justified in his belief that the representation was true.[92] In addition, he must have also have been justified in taking action on the basis of the representation. This latter requirement was stated in terms of "materiality," and was tested from an objective viewpoint.[93] A demonstration of materiality was required to prevent unjustified rescission by the plaintiff and "some assurance that the representee was not merely using the misrepresentation as a pretext for escaping a bargain that he was dissatisfied with on other grounds."[94]

It is clear that with regard to common law liability for misrepresentation, concepts of reliance, causation, and materiality merged, with each taking on characteristics of the other. The main thrust of these requirements, however, was to insure that the wrongful act of the defendant was either a substantial cause or the sole cause of the plaintiff's damage.

With regard to liability under section 10(b), Rule 10B-5, and section 517.301 of the Florida Statutes, the same definitional problem is presented. However, the problem is not as great with regard to section 517.301 as it is with respect to the federal section 10(b). Most of the potential litigation under the Florida Statutes will come as a result of problems with close corporations and face-to-face dealings. A causal relationship between the defendant's act or omission and the plaintiff's damage will be relatively easy to prove. On the other hand, with the nationwide trading of securities of giant corporations, federal litigation under section 10(b) and Rule 10B-5 does not lend itself to simple proof of caus-

88. W. PROSSER, LAW OF TORTS 729 (3d ed. 1964).
89. *Id.*
90. *Id.* at 83.
91. *Id.* at 730. *See* Anderson v. Handley, 149 Cal. App. 2d 184, 308 P.2d 368 (1957).
92. W. PROSSER, LAW OF TORTS 731 (3d ed. 1964).
93. *Id.* at 734.
94. *Id.* at 734; Keeton, *Actionable Misrepresentation*, 2 OKLA. L. REV. 56, 59 (1949).

ation or reliance. As one commentator has noted, "Requiring reliance is likely to produce only a recital of pleading followed by 'I relied' testimony from the plaintiff."[95] Such testimony is difficult to substantiate in nation-wide trading. For example, how may one prove that a plaintiff actually relied on a false press release printed in the local newspaper to purchase shares in a corporation?

Furthermore, courts which have dealt with problems of reliance, causation, and materiality have frequently confused the terms.[96] Some form of reliance, however, has usually been thought of as necessary. In *Kohler v. Kohler Co.*,[97] for example, the plaintiffs brought an action to recover damages for the sale of stock allegedly induced by misrepresentations, half truths, and omissions of the defendants. The court stated:

> With regard to the element of reliance, although there is dicta to the contrary, this element appears to be indispensable to the cause of action . . . . Certainly it is reasonable to assume that reliance is inherent in the concept of a breach of duty to disclose material information. If a plaintiff does not rely upon the data he was furnished how can he say that the undisclosed data was material or that the data he was furnished was "in light of the circumstances misleading"? Absent proof of reliance, there is no liability.

It would be an oversimplification, however, to state that reliance has been required in all cases. Three categories may be distinguished: (1) civil cases involving affirmative misrepresentation, (2) civil cases involving non-disclosure, and (3) cases seeking prophylactic or injunctive relief.

In most cases involving affirmative misrepresentations, reliance is both required and reasonable to prove. Courts have presumed reliance from the type of transaction, materiality, or the relationship of the parties.[98] A difficult problem results, however, as the plaintiff is further removed from direct contract with the affirmative misrepresentation. Assume, for example, that *X*, an officer and director of *ABC, Inc.*, misrepresents a material fact. If the statement is released to the news media, it may drastically affect the price of *ABC* stock. The plaintiff, either a buyer or a seller, may have been damaged by the misstatement (through fluctuation of the market price) even though he did not directly rely on the statement and even if he was not aware of it. Here it would be unreasonable to impose reliance as a requirement.[99]

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95. A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10B-5 § 8.6(2), at 211 (1967).
96. *Id.*
97. 208 F. Supp. 808, 823 (E.D. Wis. 1962).
98. *See* A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10B-5 § 8.6(1), at 212 (1967); Janigan v. Taylor, 344 F.2d 781 (1st Cir. 1965), *cert. denied*, 382 U.S. 879 (1965).
99. *See* Comment, 74 YALE L.J. 658 at 672 (1969); *See also* A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10B-5 § 8.6(2), at 212 (1967): "If the misstatement does not come to plaintiff's attention, or can easily happen in open market trades, it would be meaningless to demand reliance."

With regard to non-disclosure cases, a requirement of reliance is unreasonable.[100] In *List v. Fashion Park, Inc.*,[101] for example, the Federal District Court for the Southern District of New York imposed a requirement of active reliance on the defendant's silence. On appeal, the Second Circuit reconstituted the concept of reliance, stating, "The proper test is whether the plaintiff would have been influenced to act differently than he did if the defendant had disclosed to him the undisclosed fact."[102]

It is submitted, however, that even in non-disclosure cases, affirmative reliance may be demonstrated directly or indirectly. For example, assume that the directors of *ABC Corporation,* amid wide-spread rumors of a new material development, fail to disclose the information while they buy additional shares in *ABC, Inc. Mr. P,* who knows nothing of the non-disclosure, sells his stock at $18 per share. Two days later, the rumors are substantiated by *ABC, Inc.*, and the value of the stock skyrockets to $76 per share. *Mr. P* has never *relied* on the non-disclosure, but has he not been injured? Had the material information been disclosed, he would not have sold. The injury to him was undoubtedly caused by the non-disclosure, but there has been no direct, affirmative reliance. One commentator has suggested that in cases of affirmative reliance involving market price fluctuation, resort may be had to a concept of indirect reliance.[103] Whether this concept could be applied to non-disclosure is open to question.

With regard to injunctive relief, a requirement of reliance is not appropriate. In such situations, it is not the injury to a particular investor which is litigated, but the potential danger to the entire public as a result of the prohibited conduct. No real causal relationship need be shown, therefore, and this requirement has not been implied by the courts or even discussed. The concept of reliance in injunctive relief cases is preempted by a requirement of materiality.[104]

It is submitted that reliance will be a necessary requirement in civil cases under section 517.301 of the Florida Statutes, at least in close corporation cases.

E. *Insider Trading*

1. DEFINITION OF "INSIDER"

Implied civil liability under section 10(b), SEC Rule 10B-5, and, hence, section 517.301 includes by its sweeping terms "any person" who

100. *See* A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10B-5 § 8.6(1), at 209 (1967): "In nondisclosure cases, reliance has little if any rational role." However, in direct-dealing nondisclosure cases, reliance has been required. Kohler v. Kohler Co., 208 F. Supp. 808, 828 (E.D. Wis. 1962), *aff'd*, 319 F.2d 634 (7th Cir. 1963).

101. 227 F. Supp. 906, 911-12 (S.D.N.Y. 1964).

102. List v. Fashion Park, Inc., 340 F.2d 457, 463 (2d Cir. 1965), *cert. denied*, 382 U.S. 811 (1965).

103. A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10B-5 § 8.6(2), at 212 (1967).

104. *See* SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 277-78 (S.D.N.Y. 1966). *See also* Manne, *Insider Trading and the Administrative Process*, 35 GEO. WASH. L. REV. 473 (1967).

engages in the prohibited conduct. Traditionally, this has included officers and directors.[105] Recently, the courts have indulged in extending the statute to include persons designated as "insiders."[106]

The status of insider is not predicated upon a particular corporate position, such as officer, director, or shareholder. Being an insider is rather a state of mind, or possession of knowledge of material information not generally disclosed:

> Anyone in possession of material inside information must either disclose it to the investing public or if he is disabled from disclosing in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.[107]

This rather unique pronouncement is a major conclusion of the now infamous case of *SEC v. Texas Gulf Sulphur*.[108] During the first week of November, 1963, the Texas Gulf Sulphur Company was involved in drilling test sites around Timmins, Ontario. On November 12th, the company discovered large ore deposits, one of the greatest mineral deposits in recent history. Although measures were taken to conceal the discovery, rumors began to spread about the find; and on April 12, 1964, Texas Gulf Sulphur issued a press release labeling the rumors unfounded and "premature."[19] Four days later, a decidedly contrary statement was made at a news conference where the company disclosed that the company had made a major find of approximately 25 million tons of ore.[110]

In the preliminary litigation, the SEC alleged that immediately following the preliminary find, company officials and others who were benefited with the information purchased a number of shares, "calls," and options to purchase at a low price.[111] At the time the strike was discovered, Texas Gulf Sulphur was selling for $17 per share. At the time of the final news release, the price had gone up to $58 a share. Finally, at the time the SEC instituted suit, Texas Gulf Sulphur was selling for $71 per share.[112]

The Federal District Court for the Southern District of New York

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105. *See* Cady, Roberts & Co., 40 S.E.C. 907 (1961).

106. *See* Jennings, *Insider Trading in Corporate Securities: A Survey of Hazards and Disclosure Obligations Under Rule 10B-5*, 62 NW. U.L. REV. 809 (1968); Wortsman, *The Insider: A Survey in Corporate Disclosure*, 25 FAC. L. REV. 55 (1967); Comment, *Insider Liabilities Examined*, 18 SYRACUSE L. REV. 808 (1967).

107. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968). *See* Fleischer, *Securities Trading and Corporation Information Practices: The Implications of the Texas Gulf Sulphur Proceeding*, 51 VA. L. REV. 1271, 1278-80 (1965).

108. 258 F. Supp. 262 (S.D.N.Y. 1966), *aff'd in part, rev'd in part*, 401 F.2d 833 (2d Cir. 1968).

109. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 845 (2d Cir. 1968).

110. *Id.* at 846.

111. *Id.* at 839, 840.

112. *Id.* at 847.

dismissed the complaint as to eleven of the thirteen defendants.[113] On appeal, the Second Circuit reversed the dismissal of the district court and remanded it for further proceedings consistent with its opinion.[114] It is the revolutionary impact of the court's opinion which has created such a stir in the legal and financial communities.

In one sweeping decision, the court eliminated a basic economic reality of major corporations:

> Our decision to expand the limited protection afforded outside investors by the trial court's narrow definition of materiality is not at all shaken by fears that the elimination of insider trading benefits will deplete the ranks of capable corporate managers by taking away an incentive to accept such employment. Such benefits, in essence, are forms of secret corporate compensation . . . .[115]

The benefits of insider trading, in the court's opinion, are derived at the expense of the uninformed investing public and not at the expense of the corporation.[116] The insiders with knowledge of the developments in Texas Gulf Sulphur were not trading on an equal basis with the outside investors. They alone were reasonably sure of the effect of the information they had received. "Such inequities based upon unequal access to knowledge should not be shrugged off as inevitable in our way of life, or, in view of the congressional concern in the area, remain uncorrected."[117] The legislative purpose, both at the state and national level, is to afford all investors the equal information necessary for participation in securities transactions. This purpose is not limited by the distance the insider is from the immediate transaction or from the original source of the information. Thus a person who is given information by an insider becomes, as a "tippee," an insider himself.[118] Although the court of appeals was not

113. *Id.* at 842, 258 F. Supp. 262 (S.D.N.Y. 1966).

114. 401 F.2d at 842, 843.

115. *Id.* at 851. *See* Cary, *Corporate Standards and Legal Rules*, 50 CALIF. L. REV. 408, 409-10 (1962).

116. 401 F.2d at 851. *See* SEC, TENTH ANNUAL REPORT 50 (1944). The court in Texas Gulf Sulphur observed that "Congress intended by the Exchange Act to eliminate the idea that the use of inside information for personal advantage was a normal emolument of corporate office." 401 F.2d at 848, n.9 (1968).

117. 401 F.2d at 852:

> It was the intent of Congress that all members of the investing public should be subject to identical market risks,—which market risks include, of course the risk that one's evaluative capacity or one's capital available to put at risk may exceed another's capacity or capital. The insiders here were not trading on an equal footing with the outside investors. They alone were in a position to evaluate the probability and magnitude of what seemed from the outset to be a major ore strike; they alone could invest safely, secure in the expectation that the price of TGS stock would rise substantially in the event such a major strike should materialize, but would decline little, if at all, in the event of failure, for the public, ignorant at the outset of the favorable probabilities would likewise be unaware of the unproductive exploration, and the additional exploration costs would not significantly affect TGS market prices.

118. *Id.*

required to discuss the problem, it noted that such trading by tippee insiders "certainly could be equally reprehensible."[119]

2. THE TEST OF MATERIALITY

An insider, the court stated, has a duty to disclose information in "those situations which are essentially extraordinary in nature and which are reasonably certain to have a substantial effect on the market price of the security if [the extraordinary situation is] disclosed."[120] The basic test of materiality is whether a reasonable man would attach importance in determining his choice of action in the transaction in question.[121] Analyzed from an objective viewpoint, the question is whether a fact in "reasonable and objective contemplation *might* affect the value of the corporation's securities."[122] The appellate court took issue with the trial court's application of the facts to the test of materiality. The district court had held that the results of the first drill core were too remote to have any material impact on the market price of Texas Gulf Sulphur stock.[123] The court of appeals, however, felt that knowledge of the results of the discovery would have been important to a reasonable investor and might have affected the price of the stock.[124] Knowledge of the great potentialities of the find were, in the court's opinion, more than marginal.[125]

Indeed, a major factor affecting the court's consideration was the

119. *Id.*

120. *Id.* at 848. *See* Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding*, 51 VA. L. REV. 1271, 1289 (1965).

121. 401 F.2d at 849; *see* List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir. 1965), RESTATEMENT, TORTS, § 538(2)(a); *accord*, W. PROSSER, THE LAW OF TORTS 554-55 (3d ed. 1964). Under Florida common law, a fact is material when it substantially affects the interests of the litigant. Generally, the test is whether, *but for* the perpetration of the fraud, the allegedly aggrieved party would have refused to enter into the transaction. *See* Morris v. Ingraffia, 154 Fla. 432, 18 So.2d 1 (1944); Hart v. Marbury, 82 Fla. 317, 90 So. 173 (1921).

122. 401 F.2d at 849; List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir. 1965).

123. 401 F.2d at 849 n.11:

> We are not, of course, bound by the trial court's determination as to materiality unless we find it "clearly erroneous" for that standard of appellate review is applicable only to issues of basic fact and not to issues of ultimate fact.

See Baranow v. Gibraltar Factors Corp., 366 F.2d 584, 587 (2d Cir. 1966); Mamiye Bros. v. Barber S.S. Lines, Inc., 360 F.2d 774, 776-78 (2d Cir. 1966), *cert. denied*, 385 U.S. 835 (1966); *see also* SEC v. R.A. Holman & Co., 366 F.2d 456, 457-58 (2d Cir. 1966) (by implication).

124. 401 F.2d at 850 n.12:

> We do not suggest that material facts must be disclosed immediately; the timing of disclosure is a matter for the business judgment of the corporate officers entrusted with the management of the corporation within the affirmative disclosure requirements promulgated by the exchanges and the SEC. Here, a valuable corporate purpose was served by delaying the publication of the K-55-1 discovery. We do intend to convey, however, that where a corporate purpose is thus served by withholding the news of a material fact, those persons who are thus quite properly true to their corporate trust must not during the period of non-disclosure deal personally in the corporation's securities or give to outsiders confidential information not generally available to all the corporations' stockholders and to the *public* at large. (Emphasis added.)

125. *Id.* at 849-50.

importance attached to the drilling results by those who had insider information. The purchase of short-terms calls, in some cases by persons who had never before purchased Texas Gulf Sulphur stock, helped the court infer that these persons were definitely influenced by the drilling results.[126] Outside investors with the same inside information would, in objective contemplation, have been just as influenced.[127]

3. TIMING OF DISCLOSURE

Assuming that the information is objectively material, the matter of timing of disclosure is left to the reasonable judgment of the corporate officers. Thus, if there is a reasonable and valuable corporate purpose which can be served by withholding the material information, this alone does not constitute a breach of the statutes.[128] This is distinct from the prohibition that material information may not be used by insiders to deal personally in the corporation's securities or be given to "tippees" to indulge in trading.[129]

An individual possessing material inside information will become liable under Rule 10B-5 and Florida Statutes section 517.301 at the time that he places an order to trade in the corporate securities in advance of general public or outsider knowledge. This was distinguished by the *Texas Gulf Sulphur* court from the time of ultimate execution of an order.[130] Insiders are thus discouraged from "beating the news" by requesting that their orders be executed immediately after a news release is distributed, but before outsiders can act on the disclosed information.[131]

Apparently, the test considered by the court most consistent with the congressional purpose is the "Dow-Jones" test. That is, an insider must wait until "the news could reasonably have been expected to appear over the media of widest circulation, the Dow-Jones broad tape."[132] Of course, this test applies solely to those securities which might appear on the Dow-Jones tape. It will require another case to determine the test for securities of a smaller corporation. It is relatively clear, however, that

126. *Id.* at 851.
127. *Id.*
128. *Id.* at 850 n.12.
129. *Id.*
130. *Id.* at 853 n.17:

The effective protection of the public from insider exploitation of advance notice of material information requires that the time that an insider places an order rather than the time of its ultimate execution, be determinative for Rule 10B-5 purposes. Otherwise, insiders would be able to "beat the news" by requesting in advance that their orders be executed immediately after the dissemination of a major news release but before outsiders could act on the release.

131. *Id.* at 854:

Before insiders may act upon material information, such information must have been effectively disclosed in a manner sufficient to insure its availability to the investing public. Particularly here, where a formal announcement to the entire financial news media had been promised in a prior official release known to the media, all insider activity must await dissemination of the promised official announcement.

132. *Id.*

the courts are concerned with dissemination of the information to the public. Therefore, regardless of the media, insiders desiring to trade will have to wait until the information could reasonably be expected to reach the general investing public. In the case of a close corporation, insiders apparently will have to disclose material information to the shareholders before attempting to enter into the purchase or sale of corporate securities.

Questions naturally arise as to the application of such a test. For example, if an insider may act as soon as the information is transmitted or published does he nevertheless have an advantage? Most investors will need varying amounts of time to assimilate and analyze the information disclosed. An insider who already realizes the potential ramifications of some development will be able to act more quickly than outsiders, even though he does not literally "beat the news." On the other hand, if an arbitrary time limit for assimilation is set, the insider will be put at a decided disadvantage. A speculator will be able to act on the development faster than the insider. No clear ideal test seems possible which is fair to all parties concerned. It is submitted, nevertheless, that the test adopted by the court in *Texas Gulf Sulphur* is unclear and impractical.

4. PURCHASE OR SALE UNNECESSARY

Broadly construing the legislative purpose underlying section 10(b) and Rule 10B-5, the court of appeals in *Texas Gulf Sulphur* held that when Congress used the phrase "in connection with the purchase or sale of any security" it

> intended only that the device employed, whatever it might be, be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities.[133]

Thus, whether an insider has a wrongful motive is irrelevant to his liability. Moreover, the fact that an insider does not engage in a securities transaction does not negate the possibility of wrongful purpose:

> We do not believe that Congress intended that the proscriptions of the Act would not be violated unless the makers of a misleading statement also participated in pertinent securities transactions in connection therewith, or unless it could be shown that the issuance of the statement was motivated by a plan to benefit the corporation or themselves at the expense of a duped investing public.[134]

Rule 10B-5 and, therefore, Florida Statutes section 517.301 are violated whenever assertions are made in a manner reasonably calculated

133. *Id.* at 860.
134. *Id.*

to influence the investing public if such assertions are false or misleading or are so incomplete as to mislead irrespective of whether the statement, half truth, or omission was motivated by corporate officials for ulterior purposes. However, "if corporate management demonstrates that it was diligent in ascertaining that the information it published was the whole truth and that such diligently obtained information was disseminated in good faith, Rule 10B-5 would not have been violated."[135]

5. NEGLIGENCE

Noting that proof of a specific intent to defraud is unnecessary in both SEC enforcement and private actions, the court in *Texas Gulf Sulphur* extended this to include an action for negligent misstatements. The court observed that just as the standard for deceptive conduct has been modified in enforcement proceedings, such as injunction petitions,[136] it has likewise been modified in private litigation. Thus, negligent insider conduct has become both unlawful and actionable.[137]

The opinion implied that there was no congressional intention to require specific fraudulent intent. Indeed, the court observed that the securities laws should be interpreted as an expansion rather than a constriction of the common law, in order to effectuate the broad remedial purposes of the legislation:

> Moreover, a review of other sections of the act from which Rule 10B-5 seems to have been drawn suggests that the implementation of a standard of conduct that encompasses negligence as well as active fraud comports with the administrative and the legislative purpose underlying the Rule.[138]

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135. *Id.* at 862.

136. *See* Berko v. SEC, 316 F.2d 137, 141-42 (2d Cir. 1963); SEC v. Capital Gains Bureau, 375 U.S. 180 (1963).

137. *See, e.g.*, Stevens v. Vowell, 343 F.2d 374 (10th Cir. 1965); Royal Air Properties, Inc. v. Smith, 312 F.2d 210 (9th Cir. 1962); Ellis v. Carter, 291 F.2d 270 (9th Cir. 1961); Dack v. Shanman, 227 F. Supp. 26 (S.D.N.Y. 1964). *But see* Weber v. C.M.P. Corp., 242 F. Supp. 321 (S.D.N.Y. 1965); Thiele v. Shields, 131 F. Supp. 416 (S.D.N.Y. 1955).

138. 401 F.2d at 855 n.22:

> Liability under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2), the language of which is strikingly similar to that of 10B-5 (2), attaches from the mere fact of misrepresentation or misleading omission unless defendant proves that 'he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.' The provisions of Sections 17(a)(2) and (3) of the Securities Act of 1933, 15 U.S.C. § 77q(a)(2) and (3), which are virtually identical to the provisions of Rule 10B-5(2) and (3) and were, in fact, the model therefor, see Birnbaum v. Newport Steel Corp., 193 F.2d 461, 463 (2d Cir.), cert. denied, 343 U.S. 956, 72 S. Ct. 1051, 96 L.Ed. 1356 (1952); Hooper v. Mountain States Sec. Corp., 282 F.2d 195, 201 n.4 (5th Cir. 1960), cert. denied, 365 U.S. 814, 81 S. Ct. 695, 5 L. Ed. 2d 693 (1961), apply criminal penalties to sellers only (Rule 10B-5 was promulgated to fill this gap in enforcement, SEC Ann. Rep. 10 (1942)), and have been read, upon close scrutiny of their legislative history, as not requiring specific fraudulent intent, SEC v. Van Horn, 371 F.2d 181, at 184-186 (7th Cir. 1966); United States v. Schaefer, 299 F.2d 625, 629 (7th Cir. 1962) (lack of diligence is all that is required for conviction in a criminal prosecution for violation of § 17(a) of the 1933 Act.)

The court recognized that even constructive fraud has been expanded from recklessness to include non-reckless negligent misrepresentation. Utilizing a rather questionable distinction, the court attempted to reconcile its decision in *Texas Gulf Sulphur* with its 1967 decision in *Barnes v. Osofsky*.[139] In *Barnes* "some form of the traditional scienter requirement" was held necessary.[140] Twisting somewhat the definition of "scienter," the court equated it with "lack of dilligence, constructive fraud, or unreasonable or negligent conduct . . . ."[141] The dominant consideration in the court's reasoning is the congressional purpose of investor protection; "the investing public may be injured as much by one's misleading statement containing inaccuracies caused by negligence as by a misleading statement published intentionally to further a wrongful purpose."[142]

The decision and authority in this area are not clear. First, the language and intent of the statute seems to require a showing of some specific fraudulent intent. Secondly, the requirement of scienter, while modified somewhat in the common law, is still equated with some element of the knowledge of the falsity.[143] Thirdly, the position of the court that imposition of liability for negligence is consistent with congressional design seems equally unfounded.[144] Were negligence to be imposed with a duty owed to a particular person or a clearly defineable class, negligent misstatements or omissions would be actionable. However, when the class of persons may be unlimited and when the plaintiffs are, in effect, "unforeseeable," liability for negligence would be unrealistic.

The problem with a cause of action for negligence in this area is not so much the negligent act as it is the limitation of liability. A person may not be negligent to the world. Thus, the court's implication in *Texas Gulf Sulphur* is revolutionary. An insider in a large corporation could be liable to several hundreds of thousands of investors, and damages could be millions of dollars, simply for a negligent misstatement.

Judge Cardozo in *Ultramares v. Touche*[145] was concerned with this

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139. 373 F.2d 269 (2d Cir. 1967).

140. *Id.* at 272.

141. 401 F.2d at 855. *See* Note, 63 MICH. L. REV. 1070, 1075, 1076 n.29 (1965); Note, 32 U. CHI. L. REV. 824, 832 n.36 (1965). *See also* Heit v. Weitzen, 402 F.2d 909, 913 (2d Cir. 1968):

> If some form of scienter test is to be applied, as Judge Friendly seems to suggest in his concurring opinion in Texas Gulf Sulphur, we think the alternative allegation of actual knowledge of falsity is amply sufficient as a matter of pleading. And this would seem to be so whether the scienter test ultimately applied be strict or liberal. See Fed. R. Civ. P. 8(e)(2); Pettit v. American Stock Exchange, 217 F. Supp. 21, 28-29 (S.D.N.Y. 1963); Michael v. Clark Equipment Co. et al, 380 F.2d 351, 352 (2d Cir. 1967).

142. 401 F.2d at 860.

143. At least in private actions. *See* Weber v. C.M.P. Corp., 242 F. Supp. 321 (S.D.N.Y. 1965); Parker v. Baltimore Paint and Chemical Corp., 244 F. Supp. 267 (D. Colo. 1965). Bromberg quite correctly points out that the trend is against requiring scienter. A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10B-5 § 2.6(1), at 50 (1967).

144. Indeed, the Congressional design, to protect investors from overreaching by insiders, is inconsistent with merely negligent omissions. Nor does the court point to any Congressional intent in favor of liability for negligence.

145. 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931). *See also* Investment Corporation of

problem when he refused to hold an accountant liable for a negligent misrepresentation. To do so, he reasoned, would in effect make the accountant liable to an unforeseeable class of persons:

> If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class.

More recently, in *Hedley Byrne & Co., Ltd. v. Heller & Partners, Ltd.*,[146] *A* bank inquired of *B* bank concerning the financial position of a customer of bank *B*. Bank *B* negligently replied that the customer was in a sound financial position. Later, the customer went bankrupt, and bank *A* was injured by the statement. The court held that a cause of action for negligence against bank *B* was stated. This situation, however, is distinguishable from that of a large corporation. In *Hedley Byrne,* not only were the plaintiffs forseeable, they were also quite limited. In a large corporation, the plaintiffs are both unforseeable and unlimited.

In a close corporation, imposition of liability for negligence under section 517.301(1)(b) would not be as unreasonable as the same liability in a large public corporation. Generally, the class of persons to whom the insiders owe a duty in a close corporation are both forseeable and limited. Thus, under section 517.301 of the Florida Statutes and section 10(b) of the 1934 Federal Securities Exchange Act, liability for negligence could be judicially constructed. However, it is submitted that the common law tests which exist with respect to the limitation of the scope of liability will have to be applied. Thus, the question for the court will not be whether the insider was in fact negligent, but rather the extent of his liability.

It should be made clear, however, that in the authors' opinion imposition of liability for negligence should not be a matter of judicial statutory construction. There is no indication that either Congress or the Florida Legislature intended an insider to be liable for a negligent act. Until such time as the legislative bodies reach a clear decision on the subject, the courts should not venture into such an uncharted area. The results could be not only inconsistent with the purpose of the legislation, but devastating to the financial community.

V. Damages

The obvious available remedy for purchasers is rescission under section 517.21 of the Florida Statutes.[147] Under section 517.301, however, the defrauded buyer will undoubtedly be able to secure the purchase

Florida v. Buchman, 208 So.2d 291 (Fla. 2d Dist. 1968); Note, 23 U. Miami L. Rev. 256 (1968).

146. [1964] A.C. 465 (1963), 2 All E.R. 575.

147. *See* note 59 *supra* and accompanying text.

price, even though he does not rely on section 517.21. Alternatively, a defrauded buyer could keep the securities and recover the difference between the price paid and the actual value when purchased.[148]

A question may arise as to the conflict between sections 517.21 and 517.301. Section 517.21 provides, in part, that:

> No purchaser otherwise entitled shall claim or have the benefit of this section who shall have refused or failed within thirty days from the date thereof to accept an offer in writing of the seller to take back the security in question.

Assume that the purchaser learns of the misrepresentation after thirty days and after the seller has tendered the purchase price. May he now bring an action under 517.301 seeking, not a formal recission under section 517.21, but the difference between the purchase price and the real value? Such a question should be resolved, the authors submit, in favor of the maintenance of the action after fraud has been discovered, regardless of the exhaustion of the thirty-day period.

The defrauded seller is in a better position under the federal decisions. The courts have implied a constructive trust giving the seller whatever profits have been made by the buyer on resale.[149] In several cases, however, the measure employed has been the difference between the price at sale and the real value at the time of the sale.[150]

In the case of both the defrauded seller and the defrauded buyer, allegations and proof of the scienter may not provide the basis for punitive damages.[151]

Substantial difficulties may be encountered in measuring damages in a case involving a Florida close corporation. The reference point for damages is not as reliable as the market value in actively traded publicly held securities.[152] The question, of course, will be one for a jury; and from an evidentiary viewpoint, proof of real value will be exceedingly difficult.[153]

VI. STATUTE OF LIMITATIONS

A. *Federal*

An action brought under the federal section 10(b) of the Securities Exchange Act of 1934 is governed by the state statute of limitations.[154]

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148. Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir. 1965), *cert. denied*, 382 U.S. 879 (1965); Pfeffer v. Cressaty, 223 F. Supp. 756 (S.D.N.Y. 1963).

149. Kardon v. National Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947).

150. *See, e.g.*, Pappas v. Moss, 257 F. Supp. 345, 364-65 (D.N.J. 1966).

151. Green v. Wolf Corporation, CCH FED. SEC. REP. ¶ 92,321, p. 97, 497, at 97, 505 (2d Cir. 1968): "Punitive damages are not authorized in private actions under § 10(b) and Rule 10b-5."

152. *See* A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10B-5 § 9.1, at 228 (1967).

153. For an article dealing with the measure of damages under Rule 10B-5 *see* Comment, *Measurement of Damages in Private Actions Under Rule* 10B-5, 1968 WASH. U.L.Q. 165.

154. *See* Dack v. Shanman, 227 F. Supp. 26 (S.D.N.Y. 1964); A. BROMBERG, SECURITIES

However, when the state has a number of limitations statutes which might be applicable, the federal court may decide which statute applies. Thus, in *Charney v. Thomas*,[155] the court indicated that if a state statute contained a provision similar to section 10(b) with a limitations period, it would apply that state limitation to the federal action. This was based on the reasoning that the decision as to limitations should fall upon the state statute that best effectuates the federal policy.

In *Azalea Meats, Inc. v. Muscat*,[156] a complaint was filed in the Federal District Court for the Southern District of Florida under section 10(b) and SEC Rule 10B-5. A motion for summary judgment by the defendant on the grounds that the action was barred by the statute of limitations was granted. In so holding, the court said that either Florida statutes, section 95.11(5)(a),[157] relating to liabilities created by statute, or section 95.11(5)(d),[158] relating to fraudulent acts, could apply to bar a federal action not brought within three years.

B. *Florida*

There are a number of potential state limitations which could apply to actions growing out of a violation of Florida Statutes section 517.301. Section 517.21, which provides for a rescission of every sale made in violation of chapter 517, provides that "no action shall be brought for the recovery of the purchase price after two years from the date of such sale . . . ."

For criminal liability, the limitation on prosecution of offenses committed in violation of the chapter is five years.[159]

Under subsection (1)(a) and (1)(c) of 517.301, which imposes liability for some form of fraud, analogy may be made to section 95.11 (5)(d) of the Florida Statutes. That section limits actions for relief on the ground of fraud to three years.[160] Additionally, the cause of action is not deemed to have accrued until the discovery by the aggrieved party of the facts constituting the fraud.[161]

Finally, section 95.11(5)(a) provides for a three-year limitation

LAW: FRAUD—SEC RULE 10B-5 § 2.5, at 41 n.105 (1967); Schulman, *Statutes of Limitation in 10B-5 Actions*, 13 WAYNE L. REV. 635 (1967).

155. 372 F.2d 97, 99-100 (6th Cir. 1967).

156. 246 F. Supp. 780, 781-84 (S.D. Fla. 1965).

157. Actions other than those for the recovery of real property can only be commenced as follows:

. . . .

(5) Within three years.—

(a) An action upon a liability created by statute other than a penalty or forfeiture . . . .

158. (5) Within three years.—

(d) an action for relief on the ground of fraud, the cause of action in such case not to be deemed to have accrued until the discovery by the aggrieved party of the facts constituting the fraud . . . .

159. FLA. STAT. § 517.302 (1967).

160. FLA. STAT. § 95.11(5)(d) (1967). *See* note 158 *supra*.

161. FLA. STAT. § 95.11(5)(d) (1967). *See* note 158 *supra*.

upon an action for "liability created by statute, other than penalty or forfeiture." This limitation seems appropriate for section 517.301(1)(b), which may provide liability for negligence. However, strict observance of the words "liability created by statute" may cause confusion for the courts, since liability for negligence is probably not created by statute but rather by judicial decision. If the courts do imply a cause of action for negligence under section 517.301(1)(b), then section 95.11(4) will operate to limit the action. This three-year limitation applies to "any action not specifically provided for in this chapter."

The statute of limitation for an action of rescission (two years) preempts the general statute of limitations (three years). In *Fowler v. Matheny*,[162] the plaintiffs filed a suit for rescission claiming that bonds were fraudulently sold to them in violation of the Florida securities laws. Notwithstanding this allegation, the court held that Florida Statutes section 95.11(5)(d) is not applicable to an action for rescission even though fraud is involved.

The question of the tolling of the statute of limitations seems clear. In *Azalea Meats, Inc. v. Muscat*,[163] the court construed section 95.11(5)(d), which provides that the statute is not tolled until "discovery by the aggrieved party" of the facts constituting the fraud. The plaintiff contended that this should be construed to mean *actual* discovery, measured by a subjective standard. The defendant contended that the court should adopt an objective standard, namely, whether the litigant, in the exercise of due diligence, could have discovered the facts. Holding for the defendant, the court drew on both Florida state decisions and federal decisions and concluded:

> The word discovery as used in the statute must be determined by an objective, not subjective standard. It has been uniformly interpreted as measuring knowledge of acts which could have been discovered in the exercise of due diligence.[164]

Limitation-hunting may afford one a welcome diversion, but it does not make for cohesive enforcement. It is submitted here, and will be suggested again below, that a statute of limitations should be added to section 517.301. In addition, the tolling of the statute should take place as of the time of the discovery of the material misstatements, or when such act or omission should reasonably have been discovered.

VII. DEFENSES

If there is one non-complex area in potential section 517.301 liability, it is in the area of defenses. Beyond a few paltry shields, there are none. Although counsel may argue for a judicial interpretation requiring an

162. 184 So.2d 676 (Fla. 4th Dist. 1966).
163. 246 F. Supp. 780 (S.D. Fla. 1965).
164. *Id.* at 783.

element of scienter, privity, or reliance, litigants will probably be successful only in the area of reliance. A good defense to any claim of misrepresentation, either fraudulent or negligent, is undoubtedly unjustified reliance. In the area of liability for negligence, counsel may also wish to argue the proximity of the cause to the injury, and in the present status of the law counsel may effectively argue that the implied civil remedy is inappropriate.

Of course, the usual dilatory tactics may be invoked, as well as laches, unclean hands, waiver, estoppel and limitations.[165]

IX. ECONOMIC IMPACT OF 517.301 LIABILITY

Civil liability under section 517.301 has drastic economic ramifications. Undoubtedly, the greatest effect will be in the area of liability insurance for officers, directors, and accountants. Federal actions against insiders and others connected with the unlawful purchase or sale of securities have already resulted in untold millions of dollars in damages.[166] The recovery sought in *Fischer v. Kletz*[167] against a national accounting firm well exceeded the amount demanded in any other case of its kind. Thus, as potential liability for accountants increases, the fees for auditing and certifying financial statements will, in all likelihood, increase proportionately.

The strict disclosure requirements construed as necessary under Rule 10B-5 and therefore also under section 517.301 will obviously be expensive to Florida corporations. This will naturally affect the cost of proposed business transactions and therefore impinge greatly upon the flexibility which small corporations have heretofore enjoyed.

Corporations which have been operating without the benefit of counsel will now be well-advised to seek the guidance of an attorney in this specialized and rapidly developing field. Moreover, general practitioners will be forced to rely upon their more knowledgeable brethren as Rule 10B-5 and section 517.301 liability expands further.

Finally, the *Texas Gulf Sulphur* case demonstrates that at least one area of secret corporate compensation is foreclosed.[168] Officers and directors no longer will be able to act and trade on developments and transactions not otherwise available to other investors or shareholders.

When weighed against the benefits to be obtained, *i.e.*, full and fair disclosure for all investors, civil liability under section 517.301 is not unreasonable. This is not to say, however, that the Florida courts should

165. *See* A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10B-5 § 11.5, at 253 (1967).

166. *See* Ruder, *Corporate Disclosure Required by the Federal Securities Laws: The Codification Implications of Texas Gulf Sulphur*, 61 NW. U.L. REV. 872 (1967).

167. 266 F. Supp. 180 (S.D.N.Y. 1967). *See* Note, *Common Law Deceit: Accountants' Liability Under Section 11 of the Securities Act of 1933; Implied Civil Liability Under Rule 10B-5*, 22 U. MIAMI L. REV. 181 (1967).

168. *See* note 107 *supra* and accompanying text.

adopt the construction of Rule 10B-5 by the federal courts in total. Some of the decisions are both unreasonable and dangerous to a dynamic financial structure; while, on the other hand, some of the decisions have been long overdue. The Florida courts have a unique opportunity to make reasoned choices based on the hindsight and experience of another judicial system.

IX. PROPOSED AMENDMENTS

It should be clear from the preceding discussion that a considerable amount of judicial "construction" of SEC Rule 10B-5 has expanded the original scope of the statute beyond the realm of reasonableness. It could also be fairly observed that, despite judicial protestations to the contrary, Rule 10B-5 does not conform to original intent. The statute, therefore, is basically a product of legislation by both the judiciary and the administrative body. The authors submit that such activity is not only dangerous to the basic tripartite form of government we presently enjoy, but is also dangerous to the realities of economics in a basically capitalistic structure.

Legislation by legislative bodies is a function of deliberation by representative factions of all the necessary data, argumentation, and policy considerations which combine to make sound political judgments. These decisions are, for the most part, not made in a chamber, isolated from the practicalities and realistic application of law to the economy. They take into account the impact of liability upon the financial community. They are not merely responsive to a single litigant seeking a remedy.

The judiciary, which has neither the tools, nor the expertise, nor the economic sensitivity to balance conflicting public interests, has intruded into an arena for which it is embarrassingly unprepared. It is one thing to devise a test for the "materiality" of a particular event. It is quite another to devise an action for negligence when there is none, and when none was intended. Such judicial contortions not only add confusion but also detract reason from clear legislative mandate.

The judicial creations in the guise of Rule 10B-5 has had an unprecedented negative impact on the financial community at the federal level. Section 517.301 of the Florida Statutes need not meet the same fate. While analogy to the federal construction is certainly warranted at the present time, the authors submit that a number of amendments might restrict judicial expansion where there is an absence of clear legislative intent.

A. *Civil Liability*

It is submitted that a provision should be included in section 517.301 granting a private civil remedy for a violation of any of its provisions. Legislative sanction of such a remedy must be clear to be effective. Thus, if the opinion of the Florida Legislature is that section 517.301 should be limited merely to criminal or administrative sanctions, it should be more clearly articulated. On the other hand, if, as the authors urge, a private remedy is justified, the provision should be included.

B. *Privity*

The provision "to obtain money or property . . . ." in subsection (1)(b) of section 517.301 should be deleted. The clause is not a part of the Uniform Securities Act and was taken from section 17(a) of the Federal Securities Act of 1933. However, section 17(a) is limited solely to recovery by purchasers. Since section 517.301 is not limited to purchasers, the above-mentioned provision is contradictory and confusing. Moreover, subsection (1)(b) as it is presently drafted adds an inappropriate requirement of privity. Since privity is not required in common-law fraud or deceit actions, it is, in view of the statutory purpose, out of place in section 517.301.

C. *Offer*

The Uniform Securities Act, the Federal Securities Act of 1933, and the Federal Securities Exchange Act of 1934 each include in their respective fraud provisions a prohibition, not only of a fraudulent purchase or sale, but also of a fraudulent offer. The Florida Securities Act, of course, includes "offer" in the general definition of "sale." However, to avoid confusion, the Legislature would be well advised to include the term "offer" in the introductory paragraph of section 517.301.

D. *Act*

Rule 10B-5 prohibits any "*act*, practice, or course of business . . . ." which involves a material misstatement. The Florida counterpart, like section 17(a) of the Federal Securities Act of 1933, merely prohibits a "*transaction*, practice, or course of business . . . ." The difference in wording may be crucial. Under Rule 10B-5, a fraudulent *act*, regardless of whether there is privity or an actual business transaction, is prohibited. Thus, under the federal rule, a fraudulent act by an accountant is prohibited, although he does not engage in a business transaction with a purchaser or seller. It is questionable whether, under the present Florida statute, the same construction would be obtained. While some lexicographers may define "transaction" to include any single act, it could be easily misconstrued to mean a business series of acts. It is, therefore, urged that the word "act" be substituted for "transaction."

E. *Silence*

Section 517.301(1)(b), like SEC Rule 10B-5, is not clear in its proscription of fraudulent silence. The clause which prohibits the "omission to state a material fact necessary in order to make the statements made not misleading . . . ." could be construed to prohibit half-truths, but not fraudulent silence. Therefore, the subsection should be amended to read "to make any untrue statement of a material fact or to omit to state a material fact."

F. *Fraud*

It is the opinion of the authors that the remedial purpose of the Florida Securities Act is the maintenance of full and fair disclosure of all material facts to all investors. This remedial purpose does not, and should not, include a cause of action for simple negligence. In a business which is replete with technicalities, where errors in mathematics are made even by automatic data processing systems, it seems patently unreasonable to subject individuals to enormous liability for simple mistakes. The purpose of the securities laws will not be furthered by such liability. Indeed, the tremendous economic ramifications outweigh any real advantage that might possibly be gained.

The authors urge that section 517.301(1)(b) be amended to read "to make any untrue statement of a material fact, which statement or omission is made with knowledge or with reasonable grounds to believe that it is unture or misleading or which statement is made without knowledge or reasonable grounds to believe that it is true."

G. *In Connection with Purchase or Sale*

SEC Rule 10B-5 applies the clause "in connection with the purchase or sale of any security" to the entire rule. Section 517.301 applies that clause only to subsection (1)(b). Since this obviously leads to a different result, it is urged that the phrase be applied to the entire section.

H. *Statutes of Limitation*

As stated above, section 517.301 should have its own statute of limitations. The authors suggest that the action be required to be brought within one year after the discovery of the prohibited act. However, the statute should also have a maximum limitation of three years after the purchase or sale.

X. PROPOSED STATUTE

The following statute is proposed by the authors to clearly effectuate the policy of the Florida Securities Act:

> Section 517. 301. FRAUDULENT TRANSACTIONS; FALSIFICATION OR CONCEALMENT OF FACTS.
>
> (1) *It shall be unlawful, and a violation of the provisions of this chapter, for any person in connection with the pur-*

chase or sale of any security in this state, including any security exempted under the provisions of section 517.05, and including any securities sold in any transaction exempted under the provisions of section 517.06, directly or indirectly—

(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, which statement or omission is made with knowledge or with reasonable grounds to believe that it is untrue or misleading, or which statement is made without knowledge or reasonable grounds to believe that it is true,*

(c) *To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,*

(d) *To knowingly and willfully falsify, conceal or cover up any trick, scheme, or device, a material fact, or make any false, fictitious, or fraudulent statement or representation, knowing the same to contain any false, fictitious, or fraudulent statement or entry.*

(2) *Any person who participates in any act or transaction in violation of (a), (b), (c), or (d) of subsection (1) shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue in any court of competent jurisdiction to recover damages sustained as a result of any such act or transaction. In any such suit, the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorney's fees, against either party litigant. Every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person, who, if joined in the original suit, would have been liable to the same payment.*

(3) *No action shall be maintained to enforce any liability created under (a), (b), (c), or (d) of subsection (1) unless brought within one year after the discovery of the untrue statement or omission, or after such discovery should have been made by the exercise of reasonable diligence. In no event shall any such action be brought to enforce a civil liability created under this section more than three years after the purchase or sale.*

(4) *It is unlawful in any matter within the jurisdiction of the Florida securities commission to knowingly and willfully falsify, conceal or cover up by any trick, scheme, or device, a material fact, or make any false writing or document, knowing the same to contain any false, fictitious or fraudulent statement or entry.*