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### Recent Developments Concerning the 1933 Securities Act and 1934 Securities Exchange Act

Shep King

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# RECENT DEVELOPMENTS CONCERNING THE 1933 SECURITIES ACT AND 1934 SECURITIES EXCHANGE ACT

SHEP KING\*

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The field of securities law is governed by statutes, rules and regulations. These express provisions, so carefully set forth by Congress and the SEC, have oft been the tortured victim of a frustrated advocate attempting to serve his client. The purpose of this article is to present the results of these attempts as they relate to the Securities Act of 1933<sup>1</sup> and the Securities Exchange Act of 1934.<sup>2</sup> The cases considered are those decided between November 1964 and January 1966.

## I. DEFINITIONS

Section 2<sup>3</sup> of the Securities Act and section 3<sup>4</sup> of the Exchange Act define all of the important terms used in both pieces of legislation. "Security" as used in the Securities Act is perhaps the most widely litigated term<sup>5</sup> since a security must be found to exist before many of the provisions of either act may be utilized.

In *SEC v. Bill Willoughby Coin Exchange*,<sup>6</sup> the Commission sought to restrain and enjoin the defendant-partnership from engaging in prac-

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\* Assistant Editor, University of Miami Law Review; Student Instructor for Freshman Research and Writing.

1. 15 U.S.C. §§ 77a-aa (1964) [hereinafter referred to as the Securities Act].

2. 15 U.S.C. §§ 78a-jj (1964) [hereinafter referred to as the Exchange Act].

3. 15 U.S.C. § 77b (1964).

4. 15 U.S.C. § 78c (1964).

5. E.g., *Stevens v. Vowell*, 343 F.2d 374 (10th Cir. 1965); *United States v. Herr*, 338 F.2d 607 (7th Cir. 1964); *Nicewarner v. Bleavins*, 244 F. Supp. 261 (D. Colo. 1965); *Polikoff v. Levy*, 55 Ill. App. 2d 229, 204 N.E.2d 807 (1965).

6. CCH FED. SEC. L. REP. ¶ 91,355 (S.D. Cal. Apr. 4, 1964). *Accord*, *SEC v. Comstock Coin Co.*, CCH FED. SEC. L. REP. ¶ 91,414 (D. Nev. June 16, 1964).

tices constituting violations of section 5,<sup>7</sup> *i.e.*, sale of a security without a registration statement in effect. The partnership had solicited funds from the general public through magazines of national distribution; these funds were used to buy and sell coins for a profit. If a solicitee became an investor, he received a contract which entitled him to share in the partnership's anticipated earnings. The contract also provided that the investor agreed to give the partnership complete discretion in the purchase and sale of the coins, while the partnership agreed to use diligence in such transactions. Before determining whether the contract received by the investor was a security, the court repeated the familiar guideline that the term "security" is to be broadly construed to achieve the purposes for which the act was designed. The judge then quoted with approval the *Howey*<sup>8</sup> test:

[A security is] a contract, transaction or scheme whereby a person *invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party*, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.<sup>9</sup>

In deciding that the contract issued by the partnership was a security, the court declared that all the elements of a profit seeking business venture were present: "investors provide the capital and share in the profits while defendants manage, operate and control the business."<sup>10</sup>

The terms "purchase" and "sale" as used in the Exchange Act<sup>11</sup> are also words of art which have been the subject of much litigation. As will be seen later, many of the suits brought pursuant to section 16(b)<sup>12</sup> have turned upon the existence of a purchase or sale.<sup>13</sup> The issue also arises when the plaintiff sues under Rule 10b-5<sup>14</sup> since the fraud must take place "in connection with the purchase or sale of any security." In *Ruckle v. Roto Am. Corp.*,<sup>15</sup> the defendant urged that there could be no liability under Rule 10b-5 since there was no sale but only the mere *issuance* of stock by the corporation. The court found no difficulty in holding the issuance to be a sale, since the term is defined so broadly to include "any contract to sell or otherwise dispose of" a security. More-

7. 15 U.S.C. § 77e (1964).

8. SEC v. W. J. Howey Co., 328 U.S. 293 (1946).

9. *Supra* note 6, at ¶ 94,517. (Emphasis added.)

10. *Ibid.*

11. Purchase is defined in § 3(a)(13), 15 U.S.C. § 78c(a)(13) (1964). Sale is defined in § 3(a)(14), 15 U.S.C. § 78c(a)(14) (1964).

12. 15 U.S.C. § 78p(b) (1964). Section 16 was amended by 78 Stat. 565 (1964), which extended the section's application to certain over-the-counter securities.

13. *Infra* notes 69 *et seq.* and the accompanying text.

14. 17 C.F.R. § 240.10b-5 (1964).

15. 339 F.2d 24 (2d Cir. 1964).

over the court determined that the purpose of the Exchange Act would best be served by declaring such transaction to be a sale.<sup>16</sup>

## II. EXEMPT TRANSACTIONS<sup>17</sup>

A registration statement must be in effect before a security may be sold, unless the security or transaction is exempt under sections 3<sup>18</sup> or 4<sup>19</sup> of the Securities Act.

Section 3(a)(10)<sup>20</sup> provides for an exemption in certain types of re-organization issues which are supervised by a court or administrative agency. The exemption requires a hearing "at which all persons to whom it is proposed to issue securities . . . shall have a right to appear." In *SEC v. Granco Prods., Inc.*,<sup>21</sup> the insolvent defendant-corporation became subject to an arrangement proceeding under Chapter XI of the Bankruptcy Act.<sup>22</sup> Pursuant to this proceeding, a plan was devised whereby the corporation issued shares of stock to various underwriters, who, in turn, were to sell the shares for *the benefit of the creditors*. The corporation and underwriters unsuccessfully sought to be relieved from registration requirements by seeking to fall within the re-organization exemption. The court felt that the plan was nothing more than a scheme devised to induce an unwary public to pay for the losses sustained by the creditors of the corporation. The SEC established a prima facie case that a registration statement was required by showing that the securities were to be received by the public, and not creditors, and that the public "could not and did not participate in the Chapter XI proceedings upon which the asserted exemption from registration is based."<sup>23</sup>

A more commonly used exemption is contained in section 3(a)(11),<sup>24</sup> the *intrastate* offer or sale of a security. To fall within this exemption the following conditions must be met: (1) the issue must be offered and sold only to persons residing within a single state, *i.e.*, state A; (2) if the issuer is an individual, he must be a resident of state A, or if a corporation, it must be incorporated by state A; and (3) the issuer must be doing business within state A. Upon reviewing an order denying the

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16. *Accord*, *Kane v. Central Am. Mining & Oil, Inc.*, 235 F. Supp. 559 (S.D.N.Y. 1964).

17. Though some of the exemptions considered may be contained in § 3, *Exempt Securities*, and not in § 4, *Exempted Transactions*, they are more similar to an exempt transaction. The exemptions are only good for the one transaction and may have to be registered in a subsequent sale. See SOWARDS, *BUSINESS ORGANIZATIONS—SECURITIES REGULATION—FEDERAL SECURITIES ACT* § 3.01(2) (1965).

18. 15 U.S.C. § 77c (1964).

19. 15 U.S.C. § 77d (1964).

20. 15 U.S.C. § 77c(a)(10) (1964).

21. 236 F. Supp. 968 (S.D.N.Y. 1964).

22. 11 U.S.C. §§ 701-799 (1964).

23. *Id.* at 971.

24. 15 U.S.C. § 77c(a)(11) (1964).

petitioner's application for registration as a broker-dealer, the Eighth Circuit Court of Appeals, in *Capital Funds, Inc. v. SEC*,<sup>25</sup> affirmed a prior Commission finding which had held that the petitioners had violated the Securities Act by not registering for the sale of an *interstate* issue. The Commission had held that, notwithstanding the fact that the stock was sold to a resident, if the resident purchased the security for someone living in another state, and did, in fact, transfer to the non-resident, the issue was not entitled to the intrastate exemption. Without saying so, the court appeared to have adopted the "come to rest" test. This test requires the court to ask the vague question of whether the security had "come to rest" in the resident state before being transferred to a subsequent holder across the state border. Because of this violation and others, the court affirmed the SEC's order which had denied the petitioner's application for registration as a broker-dealer.

Before leaving this section<sup>26</sup> it should be pointed out that the exemption afforded by sections 3 and 4 only extend to the registration requirements under section 5. Therefore, although a security may be exempt from registration as part of an intrastate issue, civil or criminal liability may attach if the securities are distributed by use of the mails.<sup>27</sup>

### III. CIVIL LIABILITY

#### A. *False Registration Statement*

Section 11<sup>28</sup> provides that, among others, the underwriters of an issue that is distributed under a false registration statement may be civilly liable to any person acquiring a security of that issue. In *Rudnick v. Franchard Corp.*,<sup>29</sup> the plaintiff brought suit against an underwriter pursuant to section 11. The facts revealed that two underwritings had occurred and that the defendant had underwritten only the first issue. The plaintiff purchased a portion of his stock under, and as a part of, the second underwriting. He purchased the remainder on the open market about fourteen months later. In deciding that defendant's motion for summary judgment should be granted, the court first turned its attention to the plaintiff's initial purchase which was made as a part of the second underwriting. The defendant was obviously not liable since he was not the "underwriter with respect to such security" purchased by the plaintiff as required in section 11(a)(5). Nor was the defendant liable for any

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25. 348 F.2d 582 (8th Cir. 1965).

26. For a discussion of the private offering exemption, see note 32 *infra* and accompanying text.

27. Section 4 expressly provides that the exemptions included therein apply only to § 5 registration requirements. Although § 3 contains no such provision, §§ 12(2) and 17, which are concerned with civil and criminal liability, both expressly provide that they apply to securities exempt by § 3.

28. 15 U.S.C. § 77k (1964).

29. 237 F. Supp. 871 (S.D.N.Y. 1965).

damages accruing to the plaintiff by virtue of his open market purchases. These purchases were transacted after the issuer had made generally available to its security holders an earnings statement covering a period of at least twelve months beginning after the effective date of the first registration statement. Under these conditions, the terms of section 11(a) require the plaintiff to prove that he relied upon the representation contained in the first registration statement. Reliance may be established without proof that the plaintiff actually read the statement; it may be proven by demonstrating that he engaged in conversations with persons who knew of the contents of the statements and that these persons based their opinions on its contents. Despite this apparent ease in proving reliance, the court found none to exist. Accordingly the motion for summary judgment was properly granted.

### B. *Violations of Section 5*

Section 12(1)<sup>30</sup> provides: "any person who offers or sells a security in violation of section 5 . . . shall be liable to the person purchasing such security from him . . . to recover the consideration paid for such security . . ." In *Fuller v. Dilbert*,<sup>31</sup> the guarantor of a stock purchase agreement sought a declaratory judgment that the agreement was void and unenforceable. The basis for the guarantor's suit was that the sale by the issuer was in violation of section 5. This would constitute a section 12(1) offense, and since the stock purchase agreement was still executory it could be declared void and unenforceable inasmuch as section 12 provides for the recovery of any consideration paid.

The facts of the case were that the guarantor's guarantee contracted with a controlling stockholder for the sale of stock, payments to be made in five annual installments. These payments were guaranteed by the guarantor. No registration statement was in effect for the shares being sold, because the guarantee-purchaser had agreed that the purchased shares were being acquired for investment thus causing the transaction to come within the section 4(2) private offering exemption.<sup>32</sup> However, the exemption was violated when the guarantee-purchaser decided not to hold the stock for investment, but instead sold to another who resold the shares to the public on the American Stock Exchange. Thus, the result was a sale of unregistered stock which did not fall within any exemption; hence a section 5 violation which would ordinarily result in section 12(1) liability.

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30. 15 U.S.C. § 771(1) (1964).

31. 244 F. Supp. 196 (S.D.N.Y. 1965).

32. The private offering exemption is very generally defined in § 4(2), 15 U.S.C. § 77d(2) (1964), to be "transactions by an issuer not involving any public offering." This has generally been interpreted to mean that the offerees be financially sophisticated, few in number and take for investment purposes only. For a complete discussion of the private offering exemption see SOWARDS, *supra* note 17, at § 4.02.

However, in the instant case, the guarantor was seeking a remedy under section 12(1) because of a section 5 violation *occasioned by his guarantee*. The court held that no public interest would be served by enabling the guarantee-purchaser who wrongfully caused the section 5 violation or his guarantor to be entitled to take advantage of section 12(1). On the contrary, to permit such parties to sue under 12(1) "would supply a built-in defense to a purchaser, who by the very violation of his agreement would at once effectively relieve himself of all his other obligations thereunder." If a remedy were afforded such purchaser, it would enable him to insure his investment against loss. If the price went up, he would adhere to his agreement; but if the price went down, he would sell a small portion of his purchase to the public and sue the seller for the consideration paid. For these reasons, and others not here relevant, the court correctly held that the guarantor and his guarantee were liable under the stock purchase agreement.

### C. Rule 10b-5

The once burning question of whether a civil suit may be maintained by a purchaser or seller under Rule 10b-5<sup>33</sup> is now but a fast flickering flame.<sup>34</sup> No less than sixteen cases have discussed Rule 10b-5 during the period covered by this survey.<sup>35</sup> Generally, the availability of a civil action under the Rule was usually never raised,<sup>36</sup> or, if raised,<sup>37</sup> quickly

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33. Rule 10b-5, 17 C.F.R. § 240.10b-5 (1949), was adopted to effectuate § 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) (1964). Rule 10b-5 reads as follows:

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,

(1) to employ any device, scheme or artifice to defraud,

(2) to make any untrue statement of 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 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.

34. For a complete discussion of this issue, see Klein, *The Extension of a Private Remedy to Defrauded Securities Investors under SEC Rule 10b-5*, 20 U. MIAMI L. REV. 81 (1966).

35. *Janigan v. Taylor*, 344 F.2d 781 (5th Cir. 1965); *Crist v. United Underwriters, Ltd.*, 343 F.2d 902 (10th Cir. 1965); *Stevens v. Vowell*, 343 F.2d 374 (10th Cir. 1965); *List v. Fashion Park, Inc.*, 340 F.2d 457 (2d Cir. 1965); *O'Neill v. Maytag*, 339 F.2d 764 (2d Cir. 1964); *Ruckle v. Roto Am. Corp.*, 339 F.2d 24 (2d Cir. 1964); *Parker v. Baltimore Paint & Chem. Corp.*, 244 F. Supp. 267 (D. Col. 1965); *Carliner v. Fair Lanes, Inc.*, 244 F. Supp. 25 (D. Md. 1965); *Glickman v. Schweichart & Co.*, 242 F. Supp. 670 (S.D.N.Y. 1965); *Weber v. C.M.P. Corp.*, 242 F. Supp. 321 (S.D.N.Y. 1965); *Voegel v. American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965); *Eagle v. Horvath*, 241 F. Supp. 341 (S.D.N.Y. 1965); *Hoover v. Allen*, 241 F. Supp. 213 (S.D.N.Y. 1965); *Barnett v. Anaconda Co.*, 238 F. Supp. 766 (S.D.N.Y. 1965); *Rogers v. Crown Stove Works*, 236 F. Supp. 572 (N.D. Ill. 1964); *Kane v. Central Am. Mining & Oil, Inc.*, 235 F. Supp. 559 (S.D.N.Y. 1964).

36. *E.g.*, *List v. Fashion Park, Inc.*, 340 F.2d 457 (2d Cir. 1965); *O'Neill v. Maytag*, 339 F.2d 764 (2d Cir. 1964); *Ruckle v. Roto Am. Corp.*, 339 F.2d 24 (2d Cir. 1964).

37. *E.g.*, *Crist v. United Underwriters, Ltd.*, 343 F.2d 902 (10th Cir. 1965); *Carliner v. Fair Lanes, Inc.*, 244 F. Supp. 25 (D. Md. 1965).

dispensed with by citing a long line of cases beginning with *Kardon v. National Gypsum Co.*<sup>38</sup> Contrary to the summary treatment given the question in these decisions, the court in *Weber v. C.M.P. Corp.*,<sup>39</sup> devoted much of its opinion to the problem. It first recognized that sections 11 and 12 of the Securities Act are subject to certain restrictions not imposed upon Rule 10b-5.<sup>40</sup> The court then reasoned that inasmuch as Rule 10b-5 did not expressly provide for civil liability as did sections 11 and 12, if the Rule were merely duplicative of sections 11 and 12 it would be unreasonable to assume that Congress meant to expressly impose certain restrictions in one instance and impliedly erase them in the next. Thereafter the court proceeded to interpret Rule 10b-5 as requiring the plaintiff to bear the burden of proving scienter, a requirement not imposed by sections 11 and 12. It was therefore quite reasonable to assume that Congress intended to grant a civil right of action free of the restrictions imposed under sections 11 and 12 to a purchaser or seller who could bear the added burden of proving scienter. Since the plaintiff had made no allegation of scienter in various counts of the complaint, these counts were dismissed with leave to amend.

Although *Weber* incorporated scienter into Rule 10b-5, the Tenth Circuit Court of Appeals in *Stevens v. Vowell*,<sup>41</sup> implied the contrary. The court stated that "it was not necessary to allege and prove common law fraud to make out a case under the . . . rule. It is only necessary to prove one of the prohibited actions such as the material misstatement of fact or omission to state a material fact."<sup>42</sup> A subsequent district court case<sup>43</sup> within the Tenth Circuit refused to follow the Court of Appeals apparent obliteration of the scienter requirement. It declared that, "Stevens does not specifically consider the question and the dicta which is the source of the plaintiff's contention does not . . . require the adoption of a ruling which is contrary to that . . . expressed in *Trussell*,"<sup>44</sup> [an earlier district court case].

The controversy regarding scienter appears to emanate from the three prohibitory clauses within the Rule.<sup>45</sup> Whereas clauses (1) and (3) speak in terms of fraud, which implies scienter, clause (2), which was referred to in *Stevens v. Vowell*,<sup>46</sup> resembles the language used in sections 11 and 12, which do not require scienter.<sup>47</sup> It would seem that the

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38. 73 F. Supp. 798 (E.D. Pa. 1947).

39. 242 F. Supp. 321 (S.D.N.Y. 1965).

40. The important restrictions which §§ 11 and 12 are subject to are privity, the short statute of limitations contained in § 13 and the obligation to furnish costs.

41. 343 F.2d 374 (10th Cir. 1965).

42. *Id.* at 379.

43. *Parker v. Baltimore Paint & Chem. Co.*, 244 F. Supp. 267 (D. Colo. 1965).

44. *Id.* at 270.

45. *Supra* note 33.

46. *Supra* note 41.

47. For further discussion on this thought see Klein, *supra* note 34.



courts, in their zeal to provide a logical rationale for granting civil redress under Rule 10b-5, have either overlooked clause (2) or decided not to grant a civil remedy to those plaintiffs proceeding under this clause since it would be duplicative of sections 11 and 12.

In *List v. Fashion Park, Inc.*,<sup>48</sup> the element of reliance was considered. The plaintiff urged that abandoning the requirement of reliance would facilitate outsiders proving an insider's fraud and therefore advance the purposes of Rule 10b-5. Notwithstanding this possibility, the court felt that it was an inadequate reason for reading the basic tort principle of causation-in-fact out of the Rule. "The proper test is whether the plaintiff would have been influenced to act differently if the defendant had disclosed to him the undisclosed fact."<sup>49</sup> The court stated that the reason for the reliance requirement is to certify that the defendant's conduct actually caused the plaintiff's injury. But what of the situation where a defendant-director's failure to make public certain facts causes the price of the corporation's stock to fall, and shortly thereafter the plaintiff-stockholder sells his shares—a sale that would have occurred even if the defendant had fully disclosed? While it is true that the plaintiff did not rely upon the defendant's action, it is likewise true that were it not for the defendant, the plaintiff would be a wealthier man.<sup>50</sup>

Causation, or the lack of it, was the turning point in *Barnett v. Anaconda Co.*<sup>51</sup> The plaintiff alleged that the defendant-majority stockholder caused fraudulent proxy solicitations to be mailed in order to obtain stockholder approval for a pending merger. Under the applicable state law a two-thirds vote of the outstanding shares was required to approve a corporate dissolution. The defendant held seventy-three per cent of the outstanding shares. Thus, notwithstanding the fact the defendant may have caused the fraudulent proxy statements to issue, the court granted the defendant's motion to dismiss since there was no causal connection between the alleged fraud and the approval of the merger.<sup>52</sup> The defendant owned more than enough shares to approve the merger by himself; hence, even without the alleged fraud, the merger would have occurred. In a similar case<sup>53</sup> which also concerned the issuance of fraudulent proxy statements to gain approval of a merger, the defendant moved for a summary judgment and urged lack of causation. The de-

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48. 340 F.2d 457 (2d Cir. 1965).

49. *Id.* at 463.

50. See Painter, *Inside Information: Growing Pains for the Development of Federal Corporation Law Under Rule 10b-5*, 65 COLUM. L. REV. 1361, 1366 (1965). See also Hoover v. Allen, 241 F. Supp. 213, 229 (S.D.N.Y. 1965) (refuting the "but for" test). *But cf.*, Eagle v. Horvath, 241 F. Supp. 341, 343 (S.D.N.Y. 1965); Barnett v. Anaconda Co., 238 F. Supp. 766, 771 (S.D.N.Y. 1965).

51. *Supra* note 50.

52. The court also dismissed allegations under §§ 14 and 17(a) of the Exchange Act on the same grounds.

53. Eagle v. Horvath, *supra* note 50.

defendants asserted that they owned more than the amount of common stock necessary to approve the merger, and that through their control of the corporation they had the power to redeem all of the outstanding and issued preferred stock. The court denied the defendant's motion and held that the fraudulent proxy statements might have caused the approval, since the defendants merely had the power to redeem the preferred shares, but never did so. Thus, if the preferred shareholders had not been defrauded, they might have disapproved the merger.

As expected, the broad language of Rule 10b-5 has made it difficult to determine the extent of its applicability. Although the Rule is the most oft-used liability provision in either the 1933 or 1934 Act, a few recent cases have evinced a tendency towards limiting its application. In *Carliner v. Fair Lanes, Inc.*,<sup>54</sup> the plaintiff brought a derivative action against the defendant-directors for violations of Rule 10b-5. The plaintiff alleged that the defendant caused the corporation to purchase shares of stock from a director so as to provide the director with needed funds and maintain the defendant's control over the corporation. The purchase was made at a price equivalent to the market value. The court found that while the defendant-directors might have breached their common law duty to the corporation by diverting funds for noncorporate purposes, they had not engaged in the fraud or deception required under the Rule. Not every breach of a fiduciary duty will be cognizable under the Rule.<sup>55</sup>

The court in *Hoover v. Allen*,<sup>56</sup> went so far as to conclude "that control acquired as part of a fraudulent scheme, of itself, is not an injury to the corporation within the meaning of section 10(b) of the 1934 Act upon which a derivative action can be based."<sup>57</sup> This assumes that the control was acquired without causing the corporation to pay excessive sums for the purchased stock.

To conclude a discussion of Rule 10b-5 one should declare: "To be continued." It is obvious from the foregoing discussion that the Rule is presently in a state of flux. It appears to be expanding into areas specifically considered by other sections, such as sections 11 and 12, notwithstanding the *Weber* case<sup>58</sup> which attempted to differentiate these sections from Rule 10b-5. Furthermore, in *Barnett v. Anaconda Co.*,<sup>59</sup> the court stated that it was an open question whether fraud in a proxy statement, a section 14(a) violation, would constitute a Rule 10b-5 violation.

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54. 244 F. Supp. 25 (D. Md. 1965).

55. *Accord*, O'Neill v. Maytag, 339 F.2d 764 (2d Cir. 1964).

56. 241 F. Supp. 213 (S.D.N.Y. 1965).

57. *Id.* at 228. *But cf.*, Glickman v. Schweickart & Co., 242 F. Supp. 670 (S.D.N.Y. 1965).

58. See notes 39 and 40 *supra* and accompanying text.

59. *Supra* note 51.

In addition to the question of the scope of the Rule is the closely related question of what elements are required to generate the remedies thereunder. As previously discussed, the necessity for elements such as reliance, causation, and fraud is unsure as is the definition of these elements. For example, the courts repeatedly declare that something less than common law fraud is required, but how much less remains to be defined. It will be interesting to note how the Supreme Court treats these and other questions when it considers Rule 10b-5 for the first time.<sup>60</sup>

#### D. Statute of Limitations

Rule 10b-5 contains no statute of limitations, hence under the Rules of Decision Act<sup>61</sup> the applicable state statute of limitations governs.<sup>62</sup> In *Janigan v. Taylor*,<sup>63</sup> the defendant argued that pursuant to state law the statute of limitations should not be tolled unless the cause of action is affirmatively concealed. The court rejected that argument and held that it would first look to the more liberal federal law to determine whether the action was tolled, and then look to the state law to determine the period of limitation. Under federal law the cause of action is automatically concealed and does not arise until discovery.

In a subsequent case<sup>64</sup> arising in the Southern District of Florida, the court considered a similar argument. The defendant alleged that the statute of limitations should not be tolled unless the cause of action was concealed by trick or contrivance. Contrary to *Janigan*, the court agreed with the defendant and cited prior cases that had likewise looked to the state law to determine whether the statute of limitations had been tolled. These statements may only be referred to as dicta, since the holding of the court was that the plaintiff had sufficient information to have reasonably discovered the cause of action. The court also dwelled upon the fact that reasonable, rather than actual discovery, was all that was required.

Unlike Rule 10b-5, section 11 is governed by section 13<sup>65</sup> which limits the time in which an action may be brought. The plaintiff in *Escott v. Barchris Construction Corp.*,<sup>66</sup> brought a class action within the time specified in section 13. During the suit other members of the class sought to intervene and the defendant objected on the grounds that the time

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60. Perhaps the *Texas Gulf Sulphur Co.* litigation will supply this opportunity, but as of this date the federal trial court for the Southern District of New York has not delivered its opinion. For a complete discussion of this case up to the present time see Comment, 20 U. MIAMI L. REV. 939 (1965).

61. 28 U.S.C. § 1652 (1964).

62. *Azalea Meats, Inc. v. Muscat*, 246 F. Supp. 780 (S.D. Fla. 1965).

63. 344 F.2d 781 (1st Cir. 1965).

64. *Supra* note 62.

65. 15 U.S.C. § 77m (1964).

66. 340 F.2d 731 (2d Cir. 1965).

limitation had run. The court in holding for the interveners declared that the bringing of a class action tolled the time for all members of the class. In light of this decision an unanswered question arises as to whether the tolling of the time would enable other members of the class to bring a new action after the close of the tolling suit. The concurring opinion implied it would not.

### E. *Use of the Mails or Interstate Facilities*

To invoke the civil liability provisions under either the Securities Act or the Exchange Act, the plaintiff must successfully allege the use of any means or instrumentality of interstate commerce, or of the mails. Recent cases<sup>67</sup> have consistently held that it is not necessary for the interstate facility or the mail to carry or include the fraudulent statement. In *Stevens v. Vowell*,<sup>68</sup> the court declared that "all that is required is that such device or contrivance be used or employed in connection with the use of instruments of interstate commerce or the mails."<sup>69</sup> Similarly in *Kane v. Central Am. Mining and Oil, Inc.*,<sup>70</sup> the use of the mails to notify the stockholders about the meeting was held sufficient even though the actual fraud occurred at a stockholders' meeting.

Whereas the previous two cases dealt with Rule 10b-5, *Nicewarner v. Bleavins*,<sup>71</sup> concerned section 12(1) of the Securities Act. The entire sale of the unregistered stock was transacted in "one room" without any prior use of the mails. Shortly thereafter, the seller noticed an error in the sales contract and made an interstate telephone call to the purchaser. He advised him of the error and then wrote a letter explaining the proper manner in which to execute the correction. The purchaser then mailed the corrected instrument to the seller. Though subsequent to the sales transaction, these contacts were held adequate to invoke section 12(1).

### F. *Insider Short-Swing Profits—Section 16(b)*

Section 16(b)<sup>72</sup> of the Exchange Act provides that any profits realized by certain corporate insiders<sup>73</sup> "from any purchase and sale, or any sale and purchase, of any equity security of such issues . . . within any

67. In addition to the cases discussed in the text, see *McDaniel v. United States*, 343 F.2d 785 (5th Cir. 1965).

68. 343 F.2d 374 (10th Cir. 1965) (concerning Rule 10b-5).

69. *Id.* at 379.

70. 235 F. Supp. 559 (S.D.N.Y. 1964).

71. 244 F. Supp. 261 (D. Colo. 1965).

72. 15 U.S.C. § 78p(b) (1964). Section 16 was amended by 78 Stat. 565 (1964), which extended the section's application to certain over-the-counter securities.

73. An insider is defined in § 16(a) to be:

[E]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title, or who is a director or an officer of the issuer of such security. . . .

period of less than six months . . . shall inure to and be recoverable by the issuer . . .” Despite the fact that the first sentence of section 16(b) announces the purpose of the section to be that of preventing the unfair use of inside information, profits realized by an insider are recoverable even if he can absolutely establish that he did not make unfair use of inside information.

Inasmuch as no profits are recoverable unless there has been a purchase and sale, or sale and purchase within a six month period, many suits have been won or lost depending upon the parties' ability to prove the existence of a purchase or sale.<sup>74</sup> In *Heli-Coil Corp. v. Webster*,<sup>75</sup> the defendant-insider purchased convertible debentures in November; four months later he converted the debentures to common stock, and after another four months had elapsed he sold the common stock. In arriving at the conclusion that the *conversion* constituted a sale, the court analyzed three prior cases and found that two divergent roads had been taken in determining whether a transaction was a purchase or sale. The first case<sup>76</sup> used an objective test; the transaction was a purchase or sale depending upon whether it fell within the broad definitional language of sections 3(a)(13)<sup>77</sup> or 3(a)(14).<sup>78</sup>

The second view was presented in an opinion written by Judge, now Mr. Justice, Potter Stewart in which he favored a subjective test.<sup>79</sup> Justice Stewart stated that “every transaction which can reasonably be defined as a purchase will be so defined, if the transaction is of a kind which can possibly lend itself to the speculation encompassed by Section 16(b).”<sup>80</sup> He proceeded to scrutinize the conversion and concluded that it was not of a nature that would lend itself to the speculation encompassed by section 16(b). Thus the conversion did not amount to a sale for purposes of the section.<sup>81</sup> The third case<sup>82</sup> also used a subjective ap-

74. In addition to the cases discussed in the text, see *Blau v. Lamb*, 242 F. Supp. 151 (S.D.N.Y. 1965), which specifically considered whether a conversion might constitute a *sale*.

75. 352 F.2d 156 (3d Cir. 1965).

76. *Park & Tilford v. Schulte*, 160 F.2d 984 (2d Cir. 1947), *cert. denied*, 332 U.S. 761 (1947).

77. 15 U.S.C. § 78c(a)(13) (1964): “The terms ‘buy’ and ‘purchase’ each include any contract to buy, purchase, or otherwise acquire.”

78. 15 U.S.C. § 78c(a)(14) (1964): “The terms ‘sale’ and ‘sell’ each include any contract to sell or otherwise dispose of.”

79. *Ferraiolo v. Newman*, 259 F.2d 342 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959).

80. *Supra* note 75, at 164.

81. The new security was the economic equivalent of the converted security, and the conversion was involuntary in the sense that if the owner had not converted he would have suffered a substantial economic loss.

82. *Blau v. Max Factor & Co.*, 342 F.2d 304 (9th Cir. 1965). In this case the corporation had two classes of stock outstanding, class A stock and convertible common stock. The public held class A and the initial family owners of the corporation held the convertible common. This was done to permit the corporation to pay dividends to the public and at the same time retain the family's income in the business; otherwise the shares were identical.

proach and found the conversion not to be a purchase within the meaning of section 16(b).

After this thorough analysis the court concluded that the proper procedure was to apply the objective test,<sup>83</sup> *i.e.*, did the transaction fall within sections 3(a)(13) or 3(a)(14).<sup>84</sup> In this writer's opinion this decision has only served to make an already rigid rule more rigid. It is submitted that this decision will necessitate numerous rulings to exempt those transactions which though a purchase or sale within sections 3(a)(13) or 3(a)(14) bear no relation to the evils sought to be prevented by section 16(b).<sup>85</sup> The subjective test proposed by Mr. Justice Stewart does not impose the difficult task of determining an insider's good or bad faith upon the courts; it merely obliges them to free from liability under section 16(b) an insider who engaged in a transaction which could not possibly lend itself to the evils sought to be prevented by the section.<sup>86</sup>

The *Heli-Coil* case is also worthy of note for its "unique" method of computing damages. It will be recalled that the defendant-insider converted the debentures to common stock within six months of the debenture purchase, and then sold the common stock within six months of the conversion. Inasmuch as the court held the conversion to be a sale, one would assume, as the trial court did,<sup>87</sup> that part of the profits inuring to the corporation would amount to the difference between the initial purchase price of the debentures and their value on the conversion date. The majority of the court held otherwise. It concluded that no sums were recoverable for the difference between the purchase price and sales (conversion) price of the debentures since according to the court no profits were realized upon conversion.

In determining that nothing was *realized* the court looked to Webster's International Dictionary<sup>88</sup> in which "to realize" is defined as: "To convert an intangible right or property into a real (tangible) property; hence to convert any kind of property into money." Since the insider received common stock for a debenture no real (tangible) property was received, and therefore nothing was realized. Though nothing was realized upon conversion, this did not diminish the fact that it still constituted a

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The family decided to sell a portion of their stock interest. To do so they had to convert their common stock to class A stock since the public only owned class A stock.

This conversion was held not to be a purchase of the class A stock inasmuch as it was merely a necessary step in the sale of the common stock. Moreover, it did not interrupt the continuity of the appellee's investment.

83. *Accord*, *Pettys v. Northwest Airlines, Inc.*, 246 F. Supp. 526 (D. Minn. 1965).

84. *Supra* notes 77-78.

85. Various rules have already been executed, *e.g.*, Rule 16b-9, and others are in the process. See the SEC's call for comments on a proposed rule governing conversions, SEC Securities Act Release No. 7750, CCH FED. SEC. L. REP. ¶ 77,305 (1965).

86. See *Heli-Coil Corp. v. Webster*, *supra* note 75 (Judge Hastie's dissent).

87. *Heli-Coil Corp. v. Webster*, 222 F. Supp. 831 (D.N.J. 1963).

88. (2d ed. 1948).

sale of the debentures and a purchase of the common stock. The common stock was sold four months after the conversion and seven months after the initial debenture purchase. Upon its sale the court held that the only profit recoverable under section 16(b) was the difference between the value of the common stock on the conversion date, and the price at which the stock was subsequently sold.

Judge McLaughlin in his dissent disagreed with the method used to compute damages and stated that it "is at odds with the conceded purpose of the statute, utterly unrealistic and, in ascribing lack of realized profit to the appellant on his debenture maneuver, is impossible to follow."<sup>89</sup> It is this writer's opinion that his statements are too kind. It is agreed by all that the purpose of section 16(b) is to prevent profits through short-swing speculation by insiders. The majority opinion agreed that speculative short-swing profits can arise through a conversion, but refused to include these profits as recoverable in a 16(b) action. A simple example will serve to illustrate the futility of their method of computation.

Assume a corporation has common and convertible preferred stock outstanding, and because of an anti-dilution clause they both vary directly in price. "I"-insider has some inside information which leads him to believe that the value of the corporation's stock will double in two weeks. "I" buys all the convertible preferred stock he can get. At the end of two weeks "I's" information proves correct, and he now wishes to sell the stock and take his profit. "I" realizes he cannot sell the preferred shares because this would be a purchase and sale of a security within six months to which section 16(b) applies. But "I"-insider once attended law school for a semester, and while pursuing his studies he happened upon *Heli-Coil Corp. v. Webster*.<sup>90</sup> Thus, he now recognizes that all he needs to do is convert his preferred shares into common (at which time no profits will be realized) and immediately thereafter sell the common stock. The net result is that he will have successfully engaged in short-swing speculations free of section 16(b).

Before leaving *Heli-Coil*, it should be pointed out that under the court's test for realization, *i.e.*, tangible property in exchange for intangible, an insider would never have to realize a profit within six months. Instead of selling the "I" security of the "I" Corporation in which he is an insider, all he need do is trade his "I" security for one of like value, "Q" security, and sell "Q" security. The trade will not give rise to a realized profit since he is receiving an intangible right, "Q" security, and the sale of the "Q" shares will not activate section 16(b) since the seller is not an insider in the "Q" Corporation.

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89. *Supra* note 75, at 170.

90. *Supra* note 75.

*Western Auto Supply Co. v. Gamble-Skogmo, Inc.*<sup>91</sup> considered another aspect of computing damages under section 16(b). The damages recoverable under this section have repeatedly been characterized as non-penal, remedial compensation to protect the corporation and its investors. To determine the amount of profits recoverable the courts have applied a rule described as the lowest-price-in and highest-price-out (LIHO) within six months. As the rule commands, the lowest price purchases are matched against the highest price sales to determine the profits recoverable. This rule was created to prevent the insider from matching his sales with high price purchases, or even purchases made over six months previously, and thereby relieve himself of any liability. The trial court in *Western Auto*<sup>92</sup> examined the previous cases which had applied LIHO. In those cases the defendant attempted to match the sales with purchases dating back further than six months. The courts refused to permit this obvious abuse of section 16(b) and disgorged all possible profits by LIHO. In the instant case the defendant did not seek to match its sales with old purchases, on the contrary it persuaded the court to adopt the last-in first-out (LIFO) rule. Under this system the sales are matched with the most recent purchases. This prevents a defendant-insider from matching purchases and sales in order to avoid liability, and at the same time greatly diminishes the gross inequities that might arise under LIHO.<sup>93</sup> LIFO also adheres to the announced purpose of remedial compensation rather than penal impositions. Unfortunately, the Court of Appeals of the Eighth Circuit<sup>94</sup> reversed the trial court without refuting its well-reasoned opinion. The appellate court merely mechanically repeated the LIHO rule and the trite phrases about scuttling the effectiveness of section 16(b) by arbitrary matching which is inapplicable to the LIFO system.

*Western Auto* also held that the right to sue under section 16(b) survived the issuer in a merger and inured to the successor corporation. Section 16(b) was defined as a tort action which safeguarded *property* rights, and at common law this type of action survived the injured party. Moreover, the court held the right to sue was assignable.

91. 348 F.2d 736 (8th Cir. 1965).

92. 231 F. Supp. 456 (D. Minn. 1964).

93. It is mathematically possible to compel an insider who has suffered a net financial loss to pay back his "profits" under the LIHO method of computation. Furthermore, § 16(b) is designed to prevent only short-swing profits. In the factual situation presented below, the only opportunity for short-swing profits occurred on 1/1/66, but under LIHO the insider would be required to pay \$5 profit for a sale that afforded no opportunity for short-swing profits. This would not occur under LIFO.

"I" purchased 10 shares at \$10 in 1959.

Purchases		Sales
1/1/66	1 share at \$15	1 share at \$15
5/1/66		1 share at \$20

94. *Supra* note 91.



Section 16(b) will continue to generate litigation since the results achieved by its application often materially differ from its announced purpose; namely to prevent "the unfair use of inside information. . . ." However, because the section applies notwithstanding the unfair use of inside information, many innocent insiders suffer along with the guilty. This possibility was well known to Congress, but it was felt that the hardship would have to be borne to effectively reduce short-swing speculation by insiders.<sup>95</sup> This decision was reached because of the enormous difficulty encountered when attempting to prove bad faith or the unfair use of inside information.

While cognizant of the possible hardships that must be borne, the courts should remain alert to those cases which present no possible opportunity for short-swing speculation. Though it is often easier to mechanically look for a "purchase" and "sale," a thorough analysis of the transaction to determine whether it is within the scope of section 16(b) will result in the more just decision.

The same holds true when assessing damages. Although a conversion may not meet "Mr. Webster's" definition of realization, if such a conversion provides the opportunity to acquire short-swing profits, these profits should be recoverable under section 16(b).

#### IV. MISCELLANEOUS

##### A. *Revocation of Broker-Dealer Licenses*

In *Tager v. SEC*,<sup>96</sup> the petitioner sought to review an order of the SEC which revoked his registration as a broker and dealer and expelled him from membership in the National Association of Securities Dealers (NASD). The authority for the action by the SEC was contained in section 15(b)<sup>97</sup> of the 1934 Act which provided for such action if a broker or dealer "has willfully violated any provisions of the Securities Act of 1933, or of this chapter, or of any rule or regulation thereunder." The petitioner argued that he had not acted *willfully* since he did not understand his acts to be manipulative. The court rejected this argument declaring: "It has been uniformly held that 'willfully' in this context means intentionally committing the act which constitutes the violation."<sup>98</sup>

##### B. *Constitutionality of an NASD Tribunal*

In a proceeding<sup>99</sup> to review an order of the SEC which dismissed an application to review a disciplinary action against the petitioner by the

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95. *Heli-Coil Corp. v. Webster*, 352 F.2d 156, 166 n.13 (3d Cir. 1965).

96. 344 F.2d 5 (2d Cir. 1965).

97. 15 U.S.C. § 780(b) (1964).

98. *Supra* note 96, at 8. *Accord*, *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798 (D.C. Cir. 1965).

99. *Nassau Sec. Serv. v. SEC*, 348 F.2d 133 (2d Cir. 1965).

NASD, the petitioner challenged the constitutionality of a NASD tribunal. The attack was grounded upon the fact that he was tried by his competitors. While the court "admitted to a certain uneasiness about their [the competitors'] possible lack of disinterestedness," it rejected the challenge because NASD rules and disciplinary actions are subject to full review by the SEC. These tribunals are analogous to those which act in disbarment proceedings in the legal community.

### C. *The SEC As The Defendant*

In *Holmes v. Eddy*,<sup>100</sup> the plaintiff sued the SEC and members of its staff. The plaintiff alleged that the defendants had conspired to circulate, and had circulated publicly, untruths about the plaintiff. The decision of the court was that the defendants were acting within the scope of their employment in performing investigatory tasks, and were therefore not liable to the plaintiff.

## V. PROCEDURAL PROBLEMS

### A. *Extraterritorial Service*

Section 27<sup>101</sup> of the Exchange Act provides that in "any suit or action to enforce any liability or duty created by this title . . . process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found." The provision relieves a plaintiff of the standard territorial service of process limitation. Standing alone this nationwide or extraterritorial service appears clear enough, but when coupled with the theory of "pendent jurisdiction" the area becomes hazy.

Under the theory of "pendent jurisdiction" a federal court may have subject matter jurisdiction over a claim that does not raise a federal question if it is closely related to a claim brought in the same suit that does raise a federal question.<sup>102</sup> The perplexing question is whether a

100. 341 F.2d 477 (4th Cir. 1965).

101. 15 U.S.C. § 78aa (1964).

102. The vague and difficult determination of whether a claim is pendent or not was considered in *Glickman v. Schweickart & Co.*, 242 F. Supp. 670 (S.D.N.Y. 1965) and *United Industrial Corp. v. Nuclear Corp.*, 237 F. Supp. 971 (D. Del. 1964). In *Glickman*, the court employed a very subjective test: would there be a substantial commitment of federal judicial resources to the nonfederal claim at the time the nonfederal claim is decided so that remittance of the nonfederal claim to a state court would occasion a senseless duplication of judicial and litigant effort. The court in *United Industrial Corp.*, applied the test used in the leading case of *Hurn v. Oursler*, 289 U.S. 238, 246 (1933). The test requires the court to distinguish

between a case where two distinct grounds in support of a single cause of action are alleged, only one of which presents a federal question, and a case where two separate and distinct causes of action are alleged, only one of which is federal in character. In the former . . . the federal court . . . may . . . dispose of the case upon the non-federal ground; in the latter it may not do so upon the nonfederal cause of action.

See also WRIGHT, FEDERAL COURTS § 19 (1963).

court is granted personal jurisdiction over the defendant for purposes of the pendent claim where he has been served in a district other than that of the forum. In *Trussell v. United Underwriters, Ltd.*,<sup>103</sup> the court held that it did not have jurisdiction over the defendant with respect to the pendent claim.<sup>104</sup> Section 27 of the Exchange Act expressly provided for nationwide service for federal claims but was silent as to pendent claims. The court stated that since the limits of service of process have been meticulously guarded extensions by way of extraterritorial service should not be implied. The court further declared that their ruling would not create judicial waste by having to relitigate the same issues when seeking recovery under the pendent claim in another court since the doctrine of collateral estoppel could be used in the second suit.

Contrary to the *Trussell* decision, the court in *Kane v. Central Am. Mining & Oil, Inc.*<sup>105</sup> felt that the dual considerations of judicial economy and convenience of the parties required that extraterritorial service be sustained as to non-federal pendent claims.

The cases illustrate the present split of authority.<sup>106</sup> It is submitted that in light of the present trend toward nationwide service as evidenced by nonresident motorist, nonresident business, and unauthorized insurer statutes, the authorities will finally resolve the question in favor of permitting the extraterritorial service for pendent claims.

The *Kane* case<sup>107</sup> demonstrated still another aspect of extraterritorial service. One of the defendants was a corporation which was incorporated in Panama and which owned mines in Honduras. Section 27 provides that a defendant may be served wherever it may be "found." The court held that this provision was to be liberally construed, and notwithstanding the fact that the corporation may not have been "doing business" within New York, it was held to be "found" there. The significant corporate contacts with New York were that the entire Board of Directors resided there, and that special meetings of both stockholders and directors had been held in New York. The court interpreted the Exchange Act to have a broad remedial purpose and felt that to restrict its application would do violence to the spirit in which it was passed.

### B. Venue

Section 27 of the Exchange Act, discussed previously relative to extraterritorial service, also contains the venue provision. It provides

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103. 236 F. Supp. 801 (D. Colo. 1964).

104. *Accord*, *Parker v. Baltimore Paint & Chem. Corp.*, 244 F. Supp. 267 (D. Colo. 1965).

105. 235 F. Supp. 559 (S.D.N.Y. 1964).

106. For a list of other cases illustrating the present split of authority, see note 97, *supra* at 803-4.

107. *Supra* note 99.

that any suit or action to enforce any liability or duty under the Act must be brought in a district where: (1) the act or transaction constituting the violation occurred, (2) a defendant is found, (3) a defendant is an inhabitant, or (4) a defendant transacts business.

Considering the first possibility, namely, where the violation occurred, the court in *Blau v. Lamb*<sup>108</sup> held that the plaintiff could recover for damages on all sales constituting a violation whether made *within* or *without* the forum's district. This was true notwithstanding the fact that the only basis for venue were the sales made *within* the forum's district. *Kane v. Central Am. Mining & Oil, Inc.*<sup>109</sup> also discussed the first possibility. The problem in the case was to ascertain *where* the violation occurred. The court determined that despite the fact that certain mailed letters contained no fraudulent statements, the letters did constitute a step in the fraudulent scheme,<sup>110</sup> and therefore a violation had occurred at the place where the letters were deposited in the mail.

The second and fourth opportunities for venue were analyzed in *United Industrial Corp. v. Nuclear Corp. of America*.<sup>111</sup> As to the first defendant, the plaintiff maintained that he had served him where he was "found." Although the defendant was not personally within the district, the plaintiff urged that the defendant was "found" there because he owned property in the district. The court rejected this argument and pointed out that the plaintiff had previously signed an affidavit to procure the issuance of a writ of attachment which stated that the defendant was a nonresident and "could not be found." Next the court considered the plaintiff's claim of proper venue for the second defendant. This claim was based on the contention that the defendant was "transacting business" in the district. Inasmuch as the court had no cases discussing this phrase under the Exchange Act, it looked to cases interpreting the same phrase within the Securities and Clayton Acts. Although the determination is always a question of fact, the court deduced the following set of standards: the activities must constitute a substantial part of the defendant's ordinary business, be continuous, and exist at the time of suit and at least for some duration. In the instant case the plaintiff failed to bear his burden of proof and the action against the defendant was dismissed.

At the beginning of this article the various sections of the Securities Act and the Exchange Act were said to be the tortured victim of a frustrated advocate. The following case<sup>112</sup> conclusively illustrates this point and to even the most cursory reader the section cries out in pain.

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108. 242 F. Supp. 151 (S.D.N.Y. 1965).

109. *Supra* note 99.

110. The letters requested the stockholders to attend a meeting which was designed to give the defendants control of the corporation.

111. 237 F. Supp. 971 (D. Del. 1964).

112. *United States v. Kane*, 243 F. Supp. 746 (S.D.N.Y. 1965).

The defendant was charged with the crime of having violated section 5(a)(2) of the Securities Act. The section provides:

5(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(2) *to carry or cause to be carried* through the mails . . . any such security for the purpose of sale or for delivery after sale. (Emphasis added.)

The defendant moved to dismiss one of the counts for lack of venue based upon the contention that the violation did not occur in the forum. The count charged that the defendant "caused" the delivery of a sight draft to be made in the forum's district. The defendant maintained that section 5(a)(2) couched two separate crimes; one "to carry," and the other "to cause to be carried." "[T]he crime of 'carriage' is a continuing one which commences at the place of deposit and continues along the route to the mail's final destination, whereas the crime of 'causation' is static, being complete at the time and place where the mailed matter is deposited."<sup>113</sup> Thus, since the defendant was charged with "causation" and since he mailed the letter from outside the forum, there was no violation within the forum upon which venue could rest. As expected the court rejected this strained interpretation of section 5(a)(2) in what appeared to this writer to be an all too patient opinion.

It is essential that the bench remain constantly alert, so as to distinguish between those innovations which seek to evade the purpose of the law, and those which seek to promote it.

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113. *Id.* at 749.