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Securities Law - Rule 10b-5 - Oral Executory Contract to Purchase Securities Held to Provide Sufficient Basis for Standing to Bring Private 10b-5 Action, and Fraud Occuring during the Pendency fo the Executory Contract Held to Be in Connection with the Purchase of Securities

Lisa S. Hunter

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SECURITIES LAW—RULE 10b-5—ORAL EXECUTORY CONTRACT TO PURCHASE SECURITIES HELD TO PROVIDE SUFFICIENT BASIS FOR STANDING TO BRING PRIVATE 10b-5 ACTION, AND FRAUD OCCURRING DURING THE PENDENCY OF THE EXECUTORY CONTRACT HELD TO BE “IN CONNECTION WITH” THE PURCHASE OF SECURITIES. *Horst v. W.T. Cabe & Co.* (S.D.N.Y. 1977).

Plaintiffs, husband and wife, brought suit in the United States District Court, for the Southern District of New York, against a stock brokerage firm and one of its employees.¹ Plaintiffs alleged that in December of 1975 they orally instructed² defendants to purchase, for their account, 500 shares of Crane Company stock at the then current market price.³ Shortly thereafter, plaintiffs were allegedly informed by defendants that the stock had been purchased, when in fact the purchase order had never been executed.⁴ According to the complaint, defendants later informed plaintiffs that due to a clerical error the order had not been carried out, but that this would be done.⁵ Plaintiffs then sent defendants a check for \$1,700 and were again told that the stock had been purchased.⁶ The complaint, however, averred that this representation was false.⁷ It was alleged that the actions of the defendants “constituted ‘a manipulative and deceptive device and contrivance’ in violation of”⁸ section 10(b) of the Securities Exchange Act of 1934 (1934 Act)⁹ and rule 10b-5 of the Security and Exchange Commission (SEC).¹⁰ As a result of these actions, plaintiffs contended that they were

1. *Horst v. W.T. Cabe & Co.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213 (S.D.N.Y. Oct. 31, 1977).

2. *Id.* at 92,462-63. The instruction was apparently given over the telephone. *Id.* at 92,464.

3. *Id.* at 92,462. The market price of Crane Company stock at the time was 44¼ per share.

Id. As of the date of the purchase order, defendants were allegedly carrying a \$20,427.22 “free credit balance” on plaintiff’s account against which the cost of the purchase was to be charged. *Id.*

4. *Id.*

5. *Id.*

6. *Id.* This check raised plaintiffs’ free credit balance to \$22,127.22. *Id.*

7. *Id.* It was further alleged that, after defendants failed to send a written confirmation of the purchase, plaintiffs demanded that defendants remit the free credit balance, but that defendants “‘converted’ the sum ‘maliciously,’ in an effort to force plaintiffs to give defendants a release from any potential liability.” *Id.*

8. *Id.*

9. 15 U.S.C. § 78j(b) (1976). Section 10(b) provides in pertinent part:

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.

Id.

10. 17 C.F.R. § 240.10b-5 (1977). The SEC promulgated rule 10b-5 pursuant to the rulemaking authority conferred by § 10(b) of the 1934 Act. See Securities Exchange Act Release No. 3230 (May 21, 1942). The rule provides:

"lulled into believing that the . . . stock had been purchased . . . until the price of the stock had risen,"¹¹ which allegedly caused them damage.¹²

The defendants moved for summary judgment on the section 10(b) claim, asserting that plaintiffs lacked standing to sue under that provision as they "were neither 'purchasers' nor 'sellers' of securities."¹³ The district court refused to grant summary judgment on this ground, *holding* that an oral executory contract to purchase securities provides a sufficient basis for standing under section 10(b).¹⁴ Furthermore, although the defendants had not raised the issue, the court considered the question of whether the plaintiffs' complaint failed to state a claim under rule 10b-5 by not demonstrating that the alleged deceptive practice was "in connection with" the purchase or sale of a security, as required by the rule.¹⁵ The court found this requirement satisfied, *holding* that where deceptive practices occurred while a contract to purchase or sell securities was still executory, the deceptive practices could be considered "in connection with" the purchase or sale of the security.¹⁶ *Horst v. W.T. Cabe & Co.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96, 213 (S.D.N.Y. Oct. 31, 1977).

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.

17 C.F.R. § 240.10b-5 (1977).

11. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,462.

12. *Id.* The court noted that, "[a]lthough not explicitly alleged in the complaint, it was apparently plaintiffs' later purchase of the stock at 65½ which resulted in their claimed monetary damages" in the amount of \$10,625. *Id.* at 92,462, 92,464 n.2.

Plaintiffs alleged two other causes of action, one based on federal and the other on state law grounds. *Id.* at 92,462. It was alleged that by refusing to return plaintiffs' free credit balance upon request, defendants had violated § 15(c) of the 1934 Act. *Id.* at 92,466-67. *See* 15 U.S.C. §§ 780(c) (1976). Plaintiffs' pendent state law claim was for breach of contract, based upon the defendants' alleged failure to execute the order to purchase 500 shares of Crane Company stock. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,462.

13. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,462. The defendants argued that plaintiffs' standing could not be premised upon an oral contract "lacking documentary corroboration" as this would undermine the policy considerations which motivated the establishment of the purchaser-seller requirement. *Id.* at 92,463. For a discussion of the policy considerations underlying the purchaser-seller requirement of rule 10b-5, *see* note 31 *infra*.

Defendants accepted plaintiffs' factual allegations as true for the purpose of contesting plaintiffs' standing to sue under § 10(b). [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,463 n.1. Defendants' version of the facts surrounding the purchase order differed considerably from the version set out in plaintiffs' complaint. *Id.* at 92,468.

14. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,463-64.

15. *Id.* at 92,464-66.

16. *Id.* at 92,466. In addition, the court found that plaintiffs' allegation that defendants refused to return their free credit balance failed to state a claim under § 15(c) of the 1934 Act. *Id.* at 92,466-67. *See* note 12 *supra*. The court did note, however, that defendants' alleged conduct

Although neither section 10(b) nor rule 10b-5 expressly provides for a private cause of action,¹⁷ the courts have recognized the existence of an implied private right of action for violation of these fraud provisions.¹⁸ The courts have not, however, conclusively resolved the question of "the proper selection and definition of those elements necessary for recovery in a 10b-5 action."¹⁹

Concern with the rapid expansion of the scope of activities prohibited by section 10(b) and rule 10b-5²⁰ prompted the establishment of restrictions on the availability of private rights of action for violations of these provisions.²¹ The first major restriction arose from the Second Circuit's decision in *Birnbaum v. Newport Steel Corp.*,²² which involved the threshold question of standing to sue under rule 10b-5.²³ In *Birnbaum*, minority shareholders were denied the right to sue under rule 10b-5 for alleged breaches of fiduciary duties by a controlling shareholder and certain directors on the ground that the plaintiffs were neither purchasers nor sellers of securities.²⁴ The court viewed rule 10b-5 as designed to protect only pur-

might be the basis for a pendent state law claim for conversion. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,467. Finally, the court refused to grant summary judgment on the state law claim for breach of contract since there existed a factual dispute which rendered the granting of a motion for summary judgment inappropriate. *Id.* at 92,468-69. See notes 12 & 13 *supra*.

17. See 15 U.S.C. § 78j(b) (1976); 17 C.F.R. § 240.10b-5 (1977). For the pertinent text of § 10(b) and rule 10b-5, see notes 9 & 10 *supra*.

18. *Kardon v. National Gypsum Co.*, 73 F. Supp. 798, 800, 802-03 (E.D. Pa.), modified on other grounds, 83 F. Supp. 613 (E.D. Pa. 1947). The Supreme Court gave its imprimatur to this development in 1971 by stating: "It is now established that a private right of action is implied under § 10(b)." *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971). For a discussion of *Bankers Life*, see *The Supreme Court, 1971 Term*, 86 HARV. L. REV. 52, 260-67 (1972).

19. Campbell, *Elements of Recovery Under Rule 10b-5: Scienter, Reliance, and Plaintiff's Reasonable Conduct Requirement*, 26 S.C.L. REV. 653, 653 (1975). See A. JACOBS, *THE IMPACT OF RULE 10b-5* § 36, at 2-2 (rev. ed. 1977). It has been noted that the elements necessary to sustain a 10b-5 action may vary with the nature of the alleged fraudulent activity, and with the nature of the plaintiff and the particular remedy sought. *Id.* at 2-2 to 2-4.

20. Note, 49 TEMP. L.Q. 148, 148-49 (1975) (citations omitted). See *Manor Drug Stores v. Blue Chip Stamps*, 492 F.2d 136, 147 (9th Cir. 1973) (Hufstedler, J., dissenting), *rev'd*, 421 U.S. 723 (1975); *Landy v. FDIC*, 486 F.2d 139, 158 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); *Herpich v. Wallace*, 430 F.2d 792, 804 (5th Cir. 1970); *Iroquois Indus., Inc. v. Syracuse China Corp.*, 417 F.2d 963, 969 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970). See also Gallagher, *10b-5 After Blue Chip Stamps: How Stands the Judicial Oak?*, 80 DICK. L. REV. 1, 5 (1975).

21. See Gallagher, *supra* note 20, at 5.

22. 193 F.2d 461 (2d Cir. 1952).

23. See *id.* at 463-64; Allen, *Rule 10b-5 and The Burger Court—Time to Reexamine the Elements for a 10b-5 Action*, 82 COM. L.J. 118, 119 (1977).

24. *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 462-64 (2d Cir. 1952). The defendant Feldmann, acting in his official capacity as president of Newport, rejected an offer for merger with Follansbee Steel Corporation that would have been highly profitable to Newport, so that he could sell his own shares of Newport stock to the defendant Wilport Company at twice the then market value of the shares. *Id.* at 462. Feldmann subsequently resigned from his position and was replaced by defendant Gibson. *Id.* Feldmann and Gibson allegedly made misrepresentations to Newport's shareholders concerning the reasons for suspending negotiations for the

chasers or sellers of securities from fraud, "and as having no relation to breaches of fiduciary duty by corporate insiders resulting in fraud upon those who were not purchasers or sellers."²⁵ Although the *Birnbaum* doctrine was widely accepted by the federal courts,²⁶ certain exceptions to the strict purchaser-seller requirement did evolve,²⁷ including an exception for plaintiffs who are parties to an agreement to purchase or sell securities which is aborted as a result of a defendant's fraud.²⁸

Although the *Birnbaum* rule was frequently criticized as "an arbitrary restriction which unreasonably prevents some deserving plaintiffs from recovering damages"²⁹ under rule 10b-5,³⁰ the Supreme Court accepted the doctrine in 1975 in *Blue Chip Stamps v. Manor Drug Stores*.³¹ In addition, the *Blue Chip Stamps* court noted that an executory contract to purchase or

merger and the circumstances surrounding the sale of Feldmann's stock. *Id.* The plaintiffs claimed that these misrepresentations operated as a fraud upon Newport's shareholders in connection with the sale of Feldmann's shares, and constituted a violation of rule 10b-5. *Id.*

25. *Id.* at 463.

26. See, e.g., *Herpich v. Wallace*, 430 F.2d 792 (5th Cir. 1970); *Simmons v. Wolfson*, 428 F.2d 455 (6th Cir. 1970), *cert. denied*, 400 U.S. 999 (1971); *City Nat'l Bank of Fort Smith v. Vanderboom*, 422 F.2d 221 (8th Cir.), *cert. denied*, 399 U.S. 905 (1970); *Jensen v. Voyles*, 393 F.2d 131 (10th Cir. 1968); *Dasho v. Susquehanna Corp.*, 380 F.2d 262 (7th Cir.), *cert. denied*, 389 U.S. 977 (1967).

27. See, e.g., *James v. Gerber Prods. Co.*, 483 F.2d 944, 945 (6th Cir. 1973) (beneficiaries of trust which sold stock have standing); *Kahan v. Rosenstiel*, 424 F.2d 161, 170-73 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970) (strict standing requirement relaxed where plaintiff seeks to enjoin deceptive practices which could lead to completed purchases or sales); *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 798 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970) (plaintiffs selling stock under threat of divestiture action under antitrust laws have standing); *Vine v. Beneficial Fin. Co.*, 374 F.2d 627, 633-35 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967) (plaintiffs required to buy or sell stock by statute regulating short form mergers are "purchasers" and "sellers"); *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 543-44 (2d Cir. 1967) (purchaser or seller requirement abandoned in private action for injunctive relief from corporate mismanagement); *Dasho v. Susquehanna Corp.*, 380 F.2d 262, 266 (7th Cir.), *cert. denied*, 389 U.S. 977 (1967) (standing allowed in derivative suit based on merger transaction). See also *Gallagher*, *supra* note 20, at 8-19; Note, *supra* note 20, at 150.

28. See, e.g., *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715, 718-19 (S.D.N.Y. 1968) (standing based on breach of agreement for sale of stock to plaintiffs); *Goodman v. H. Hentz & Co.*, 265 F. Supp. 440, 444-45 (N.D. Ill. 1967) (allowing standing where defendant fraudulently failed to carry out purchase order); *Opper v. Hancock Sec. Corp.*, 250 F. Supp. 668, 673-75 (S.D.N.Y.), *aff'd*, 367 F.2d 157 (2d Cir. 1966) (fraudulent failure to execute sell order as basis for standing). *But see Mount Clemens Indus., Inc. v. Bell*, 464 F.2d 339, 346 (9th Cir. 1972) (denying standing under aborted purchaser-seller exception where contractual relationship between plaintiff and defendant was lacking).

29. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 738 (1975).

30. See, e.g., Lowenfels, *The Demise of The Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268, 275-76 (1968); Whitaker, *The Birnbaum Doctrine: An Assessment*, 23 ALA. L. REV. 543, 585-86 (1971); Comment, *10b-5 Standing Under Birnbaum: The Case of the Missing Remedy*, 24 HASTING L.J. 1007, 1034-37 (1973) [hereinafter cited as *10b-5 Standing Under Birnbaum*]; Comment, *The Decline of the Purchaser-Seller Requirement of Rule 10b-5*, 14 VILL. L. REV. 499, 501-02 (1969). Some courts and commentators even predicted that the doctrine would be abandoned. See *Entel v. Allen*, 270 F. Supp. 60, 70 (S.D.N.Y. 1967); Lowenfels, *supra*, at 275-77; Comment, *supra*, at 515.

31. 421 U.S. 723, 731-55 (1975). The Court's principal reasons for accepting the *Birnbaum* doctrine were as follows: 1) the lower courts had been applying the doctrine for over 20 years, and the failure of Congress to broaden § 10(b) indicated its acquiescence in the interpretation of

sell securities is sufficient for purchaser-seller standing under the doctrine.³² The Court declined, however, to elaborate on the type of contract necessary to satisfy the doctrine or on the specific question of whether an *oral* contract to purchase or sell securities would provide standing.³³

While the question of whether an oral contract to purchase or sell securities is sufficient to establish purchaser-seller standing has rarely been addressed by the courts,³⁴ the Second Circuit has at least suggested that it would answer this question in the affirmative.³⁵ Moreover, in *Opper v. Hancock Securities Corp.*³⁶ and *Desser v. Ashton*,³⁷ the United States Dis-

10(b) embodied in the doctrine; 2) other provisions of the 1934 Act and the Securities Act of 1933, 15 U.S.C. §§77a-77aa (1976), which expressly provided remedies for nonpurchasers and nonsellers, indicated that Congress intended to limit the availability of remedies under the securities laws to purchasers and sellers unless it expressly provided otherwise; and 3) the *Birnbaum* rule would limit the number of vexatious "strike suits" that would likely result from a more expansive interpretation of rule 10b-5. 421 U.S. at 733-48.

In its discussion of this third consideration, the Court indicated that it was particularly concerned with the fact that proof of nonpurchasing and nonselling plaintiffs' claims would have to be made largely by uncorroborated oral evidence. *Id.* at 746. Such a plaintiff would be testifying "that he decided *not* to purchase or sell stock." *Id.* (emphasis supplied by the Court). In such a case, the Court noted that "[t]he jury would not even have the benefit of weighing the plaintiff's version against the defendant's version, since the elements to which the plaintiff would testify would be in many cases totally unknown and unknowable to the defendant." *Id.*

The majority further indicated that since Congress had not legislated with respect to a private cause of action under rule 10b-5, it was the responsibility of the courts to define the scope of the judicially created *Birnbaum* doctrine. *Id.* at 748-49.

32. 421 U.S. at 750-51. In reaching this conclusion, the Court relied primarily on § 3(a)(13) and (14) of the 1934 Act. *Id.* at 750-51 & n.13, citing 15 U.S.C. § 78c(a)(13), (14) (1976). Section 3(a)(13) provides: "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire." 15 U.S.C. § 78c(a)(13) (1976). Section 3(a)(14) provides: "The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of." 15 U.S.C. § 78c(a)(14) (1976).

The plaintiffs in *Blue Chips Stamps* were denied standing because they neither actually purchased or sold securities, nor had any "contractual right or duty to purchase . . . securities." 421 U.S. at 727, 751. Rather, the plaintiffs were merely offerees who declined to purchase the offered shares in reliance on a misleading prospectus. *Id.* at 726-27, 751.

33. See 421 U.S. at 749-51.

34. See Note, 28 U. FLA. L. REV. 858, 863 (1976).

35. See *Dopp v. Franklin Nat'l Bank*, 461 F.2d 873, 875 & n.3, 879-81 (2d Cir. 1972).

36. 250 F. Supp. 668 (S.D.N.Y.), *aff'd*, 357 F.2d 157 (2d Cir. 1966). In *Opper*, an investor sued a brokerage corporation for failing to sell securities owned by him pursuant to a verbal order to sell. 250 F. Supp. at 670-71. The defendant had falsely represented to the plaintiff that it was attempting to locate a purchaser for his stock, and at the time was selling shares of the same stock on its own account. *Id.* at 672-73. The court, without considering the question of the sufficiency of an oral contract as the basis for standing, held that the plaintiff could bring a rule 10b-5 action. *Id.* at 673.

37. 408 F. Supp. 1174 (S.D.N.Y. 1975). The plaintiffs in *Desser* had alleged fraud in connection with an alleged oral agreement with the defendants for the supposed purchase of certain securities by the plaintiffs which never actually took place. *Id.* at 1175. The court specifically found that an oral contract satisfied the purchaser-seller requirement, and that it was not necessary that a contract satisfy the statute of frauds in order to support an action under rule 10b-5. *Id.* The court supported its holding by noting that no case had been located which supported the proposition that an oral or unenforceable contract could not be the basis for a 10b-5 action. *Id.* at 1175-77. In response to the contention that the Supreme Court opinion in *Blue Chip*

strict Court for the Southern District of New York permitted the plaintiffs to pursue their rule 10b-5 claims even though the actions were grounded upon oral contracts to purchase and sell securities.

Once standing to sue under rule 10b-5 has been established,³⁸ plaintiffs have traditionally been required to demonstrate that the alleged fraud or deceptive practice was causally related to the alleged injury.³⁹ The causation requirement was satisfied if the plaintiff met the test of reliance⁴⁰ (or

Stamps "contains strong language concerning the dangers of parol evidence in the proof of 10b-5 claims," the court distinguished the situation presented in *Desser*. *Id.* at 1176. The court reasoned:

There the Supreme Court was discussing the situation where a nonpurchaser of securities alleges not that he had an oral contract to purchase securities but simply that he himself refrained from purchasing due to reliance on an alleged misrepresentation or omission. . . . The hypothetical situation there is clearly distinguishable from the case at bar, at least because of the availability of the testimony of other witnesses to confirm or contradict the oral testimony of the plaintiffs.

Id. (citation omitted). See note 31 and accompanying text *supra*. For a discussion of *Desser*, see Note, *supra* note 34.

See also *Pepsico, Inc. v. W.R. Grace & Co.*, 307 F. Supp. 713 (S.D.N.Y. 1969), in which a cause of action under rule 10b-5 was denied, not because the plaintiff was relying upon an oral contract to purchase securities for standing, but rather because plaintiff had failed to factually support its claim, in opposition to the defendant's motion for summary judgment, that there was an oral agreement and fraud in connection with the purchase and sale of securities. *Id.* at 719-20.

38. See notes 17-37 and accompanying text *supra*.

39. See, e.g., *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380-81 & n.11 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975); *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 238-39 (2d Cir. 1974); *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 797 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970); *List v. Fashion Park, Inc.*, 340 F.2d 457, 462-63 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965); *Tucker v. Arthur Andersen & Co.*, 67 F.R.D. 468, 478-79 (S.D.N.Y. 1975); *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715, 719-20 (S.D.N.Y. 1968).

The causal relationship must be demonstrated in order for the fraud to be considered "in connection with" the purchase or sale as required by § 10(b) of the 1934 Act and rule 10b-5. See 15 U.S.C. § 78j(b) (1976); 17 C.F.R. § 240.10b-5 (1977). For the text of the these provisions, see notes 9 & 10 *supra*. For cases equating the "in connection with" requirement with the causation requirement, see, e.g., *Blackie v. Barrack*, 524 F.2d 891, 908 & n.23 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976); *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380-81 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975); *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 239 (2d Cir. 1974).

40. See *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965). The *List* court explained that abandonment of the reliance requirement would read the tort law principle of causation in fact out of rule 10b-5. 340 F.2d at 463. The court's analysis indicates the similarity between a 10b-5 action and the common law tort action for deceit, which requires damage to the plaintiff as a result of reliance on the defendant's misrepresentation. See W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* § 105, at 685-86 (4th ed. 1971). See also *Allen*, *supra* note 23, at 118 & n.5; Note, *The Reliance Requirement in Private Actions Under SEC Rule 10b-5*, 88 HARV. L. REV. 584, 584-86 & n.3 (1975). In *Titan Group, Inc. v. Faggen*, 513 F.2d 234 (2d Cir.), *cert. denied*, 423 U.S. 840 (1975), the court explained that the reason for the reliance requirement was "to restrict the potentially limitless thrust of Rule 10b-5 to those situations in which there exists a causation in fact between the act and injury." 513 F.2d at 238-39 (citations omitted). This suggests that the reliance requirement may be another manifestation of the concern over the rapid expansion of the private 10b-5 cause of action. See notes 20 & 21 and accompanying text *supra*. It should be noted that the requirement of reliance "is used interchangeably with the concept of 'causation.'" *Tucker v. Arthur Andersen & Co.*, 67 F.R.D. 468, 478 (S.D.N.Y. 1975) (citations omitted).

“transaction causation”⁴¹) set out in *List v. Fashion Park, Inc.*,⁴² under which the plaintiff must establish that the defendant’s “misrepresentation is a substantial factor in determining the course of conduct which results in [the recipient’s] loss.”⁴³

The general rule has been that the causation requirement can never be satisfied where the alleged fraudulent activity occurs after the completion of the purchase or sale transaction.⁴⁴ One district court has suggested, however, that there need only be “some temporal relationship” between the fraudulent practice and the securities transaction.⁴⁵ The precise question of whether causation can be established where the fraud occurs during the pendency of an executory contract has rarely arisen.⁴⁶ The Ninth Circuit

41. See *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380 & n.11 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975); *Tucker v. Arthur Andersen & Co.*, 67 F.R.D. 468, 478 (S.D.N.Y. 1975).

42. 340 F.2d 457 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965).

43. 340 F.2d at 462, quoting RESTATEMENT OF TORTS § 546 (1938). See *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 797 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970); *Tucker v. Arthur Andersen & Co.*, 67 F.R.D. 468, 478 (S.D.N.Y. 1975).

The traditional causation requirement has been modified in cases involving nondisclosure rather than affirmative misrepresentation. See *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 152-54 (1972), where the Supreme Court held that, under circumstances “involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in [the decision to sell securities].” *Id.*, citing *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 384 (1970); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied sub nom.*, *Coates v. SEC*, 394 U.S. 976 (1969); A. BROMBERG, *SECURITIES LAW, FRAUD—SEC RULE 10b-5* §§ 2.6, 8.6 (1967). 6 L. LOSS, *SECURITIES REGULATION* 3876-80 (2d ed. Supp. 1969). The Court further noted that the “obligation to disclose and th[e] withholding of a material fact establish the requisite element of causation in fact.” 406 U.S. at 154, citing *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1172 (2d Cir. 1970). *Accord*, *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 239 (2d Cir. 1974); *List v. Fashion Park, Inc.*, 340 F.2d 457, 463 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965); *Tucker v. Arthur Andersen & Co.*, 67 F.R.D. 468, 479 (S.D.N.Y. 1975) (“in a nondisclosure case ‘reliance’ has little if any rational rule”). See also Note, *supra* note 40, at 590-92. It should be noted that, in connection with the question of relaxing the reliance requirement, the Second Circuit has indicated that “[b]efore there may be a violation of the securities acts there need not be present all of the same elements essential to a common law fraud.” *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 239 (2d Cir. 1974), quoting *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1291 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970).

44. See, e.g., *Raschio v. Sinclair*, 486 F.2d 1029, 1030 (9th Cir. 1973) (no causation where plaintiffs purchased securities two months prior to issuance of prospectus which allegedly violated rule 10b-5); *Clinton Hudson & Sons v. Lehigh Valley Coop. Farms, Inc.*, 73 F.R.D. 420 425 (E.D. Pa. 1977) (no causation where fraudulent activity allegedly occurred five years after purchase of stock as the fraud could not have “touched” the acquisition of stock); *Pepsico, Inc. v. W.R. Grace & Co.*, 307 F. Supp. 713, 720 (S.D.N.Y. 1969) (fraud practiced after a purchase or sale is not “in connection with” purchase or sale of a security).

45. See *Clinton Hudson & Sons v. Lehigh Valley Coop. Farms, Inc.*, 73 F.R.D. 420 (E.D. Pa. 1977), where the court stated that “[o]rdinarily, specific dates of circumstances giving rise to or constituting fraud are not significant, so long as there is some temporal relationship between the events and the purchase of stock.” *Id.* at 425. The court did not define the limits of the term “some temporal relationship,” but merely held that fraud occurring five years after a completed purchase was not causally related to that purchase. *Id.*

46. *But see Ohashi v. Verit Indus.*, 536 F.2d 849, 853 (9th Cir.), *cert. denied*, 429 U.S. 1004 (1976); *Davis v. Davis*, 526 F.2d 1286, 1290 (5th Cir. 1976).

dealt with that issue in *Ohashi v. Verit Industries*,⁴⁷ and held that if the contract by which the plaintiff acquired stock of the corporate defendant “was still executory when the fraudulent activities occurred and if those acts affected the unperformed part of the bargain, the fraud may be ‘in connection with the sale or exchange of any securities.’”⁴⁸ Similarly, the Fifth Circuit, in *Davis v. Davis*,⁴⁹ recognized a plaintiff’s right to injunctive relief under rule 10b-5 where the fraud occurred during the pendency of an executory contract to sell stock,⁵⁰ and found that the fraud sufficiently “touched” the contract to be “in connection” with a sale of securities.⁵¹

The *Horst* court’s analysis of the issues raised by the defendants’ motion for summary judgment initially focused upon the question of the plaintiffs’ standing to sue based upon the oral purchase order.⁵² The court noted that plaintiffs predicated their standing on section 3(a)(13) of the 1934 Act, “which defines the terms ‘buy’ and ‘purchase’ to include ‘any contract to buy, purchase, or otherwise acquire.’”⁵³ Since the defendants had argued that standing based upon an *oral* contract “would undermine the policy consider-

47. 536 F.2d 849 (9th Cir.), *cert. denied*, 429 U.S. 1004 (1976). *Ohashi* involved an exchange of plaintiff’s stock for stock in the defendant corporation. *Id.* at 851. As part of the exchange, the plaintiff agreed not to transfer his stock until certain restrictions upon its transfer were removed. *Id.* at 851-52. After the actual exchange of the stock, the defendant made false representations to the plaintiff that steps were being taken to remove the restrictions, allegedly as part of a deceptive plan to keep the plaintiff’s stock off the market. *Id.* at 852. The court recognized that, had the fraud occurred after the exchange was completely executed, causation could not have been established. *Id.* at 853. For examples of cases holding that the causation requirement cannot be met where the fraud occurs after the completion of the purchase or sale, *see note 44 supra*. The *Ohashi* court found, however, that under state law Verit had an implied contractual duty to use good faith in attempting to remove the restrictions, and the contract remained executory until it performed this duty. 536 F.2d at 853 (citations omitted). The court thus concluded that at least some of the misrepresentations had been made while the contract had not yet been fully performed. *Id.* at 853-54.

48. 536 F.2d at 853. The *Ohashi* court found that the plaintiff had satisfied this test of causation. *Id.* at 854. The court did note, however, that not every breach of contract constitutes actionable fraud within the meaning of rule 10b-5. *Id.*, *citing* A.T. Brod. & Co. v. Perlow, 375 F.2d 393, 398 (2d Cir. 1967).

49. 526 F.2d 1286 (5th Cir. 1976).

50. *Id.* at 1287-89.

51. *Id.*, *citing* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971).

52. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,463. Before dealing with the issues raised by the defendants, the court considered whether there was a sufficient allegation of scienter in the plaintiffs’ complaint, an issue which the defendants had *not* raised. *Id.* at 92,462. It was noted that proof of the defendant’s “mental state embracing intent to deceive, manipulate, or defraud” is a necessary element of a 10b-5 action. *Id.* at 92,462-63, *quoting* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193-94 n.12 (1976). Noting that plaintiffs had *not* alleged that defendants had acted with any of the “states of mind indicative of fraud,” the court concluded “that plaintiffs ha[d] failed to state a claim under § 10(b) in the complaint as [then] drafted.” [1977-1978 Transfer Binder] FED. SEC. L. REP. ¶ 96,213, at 92,463. However, since it appeared to the court that it may have been plaintiffs’ intention to assert a cause of action in fraud, they were granted leave to amend the complaint to include the proper allegation of scienter. *Id.* The court proceeded with its analysis on the assumption that an adequate amended complaint would be filed. *Id.*

53. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,463, *quoting* 15 U.S.C. § 78c(a)(13) (1976) (emphasis supplied by the court).

ations which motivated the Supreme Court's decision in *Blue Chip Stamps*," the court found it necessary to examine that decision.⁵⁴

The court found that the primary concern of the *Blue Chip Stamps* Court was that granting standing to nonpurchasers and nonsellers of securities "would render the 10b-5 cause of action both unmanageable and susceptible of abuse."⁵⁵ Moreover, the court noted the *Blue Chip Stamps* Court's specific holding that holders of contractual rights to purchase or sell securities had standing as purchasers or sellers under rule 10b-5 by operation of sections 3(a)(13) and (14) of the 1934 Act.⁵⁶ Those sections, it was observed, did not distinguish between oral and written contracts, which led the *Horst* court to conclude that "[t]he standing of a contractual purchaser or seller . . . derives from the express wording of [the] statute, whether the underlying arrangement be verbal or written."⁵⁷

Despite its conclusion that the policy considerations expressed in *Blue Chip Stamps*⁵⁸ had "little or no applicability" to a plaintiff within the "statutorily defined class of purchasers and sellers,"⁵⁹ the court nonetheless considered the defendants' policy argument.⁶⁰ It was determined that the policy considerations had no merit in a situation such as that presented in *Horst* because where a plaintiff has alleged some contractual relationship with the defendant, even if oral, the trier of fact can weigh that version of the facts with the version presented by the defendant.⁶¹ Such an opportunity is not available where no contractual relationship is alleged.⁶²

It was further noted in the *Horst* decision that the granting of standing based upon an oral contract to purchase or sell securities was not entirely without precedent.⁶³ Finally, the court stated that it "would be loath, in

54. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,463. See note 13 and accompanying text *supra*.

55. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,463. The Court, reiterating the concerns expressed in *Blue Chip Stamps*, noted that "[l]awsuits involving such plaintiffs would present serious difficulties in terms of assessing damages; would necessarily require resort to uncorroborated oral testimony as the means—perhaps the sole means—to demonstrate plaintiffs' reliance upon alleged fraudulent representations; and would provide fertile ground for the extortion of settlements of unmeritorious claims." *Id.* For a discussion of the treatment of these issues by the *Blue Chip Stamps* Court, see note 31 *supra*.

56. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,463, citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 750-51 (1975); 15 U.S.C. § 78c(a)(13), (14) (1976). See note 32 and accompanying text *supra*.

57. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,463.

58. See notes 31 & 54-56 and accompanying text *supra*.

59. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,463-64.

60. *Id.* at 92,464.

61. *Id.*

62. *Id.*, citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 746 (1975). The court also cited the *Desser* decision, in which a similar determination was made two years earlier by the district court. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,464, citing *Desser v. Ashton*, 408 F. Supp. 1174, 1176 (S.D.N.Y. 1975). For a discussion of *Desser*, see note 37 *supra*.

63. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213 at 92,464, citing *Desser v. Ashton*, 408 F. Supp. 1174 (S.D.N.Y. 1975). The *Horst* court, quoting *Desser*, expressed the

view of the broad, remedial purposes of the Act, to deny plaintiff standing"⁶⁴ where a defendant with the status of plaintiffs' agent⁶⁵ and broker had allegedly engaged in a fraudulent practice.⁶⁶

After establishing that the plaintiffs did have standing, the court considered whether the complaint demonstrated a sufficient causal connection between the defendants' conduct and plaintiffs' alleged injury.⁶⁷ According to the court, the complaint indicated that the fraud did not induce the formation of the contract, but instead "occurred during the course of the parties' contractual relationship."⁶⁸ Recognizing that the traditional reliance, or "transaction causation," test could not be satisfied under such circumstances,⁶⁹ the court considered the essential inquiry to be whether the lack of transaction causation "in its normally understood sense" was "fatal to the 10b-5 claim."⁷⁰

view that "the anti-fraud provisions of Rule 10b-5 are to be liberally and flexibly construed so as to further the aim of Congress to protect investors from fraud and maintain a free and open securities market" . . . and, further, that "[i]t has been specifically held that this admonition should apply to the term "contract" as defined in the 1934 Exchange Act . . . and to the "purchaser-seller" requirement." [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,464, quoting *Desser v. Ashton*, 408 F. Supp. 1174, 1176 (S.D.N.Y. 1975) (citations omitted). For a discussion of *Desser*, see note 37 *supra*.

64. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,464.

65. *Id.* The court's characterization of defendants' status apparently was based upon the Practice Commentary to § 8-319 of the New York Uniform Commercial Code, N.Y. U.C.C. § 8-319 (62-½ McKinney 1964). The Practice Commentary provides in part:

The vast majority of transactions in securities take place on the organized markets and are carried on through brokers acting as agents for sellers and buyers respectively.

.....

.....

Where the broker acts as agent the contract between broker and customer is not "for the sale of securities." It is a contract of employment. . . .

Practice Commentary to N.Y. U.C.C. § 8-319 (62-½ McKinney 1964). As plaintiffs' agent, the defendants were found to have been under an obligation to obtain the best possible market price in purchasing the ordered stock. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,464 (citations omitted).

66. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,464. The court considered "[d]efendants', or any broker's, misfeasance in the execution of his customer's verbal order" to be "an act intrinsic to the post-distribution trading process and thus of central concern under the 1934 Act." *Id.*

67. *Id.* The court, rather than the defendants, raised the causation issue. *Id.*

68. *Id.* at 92,464-65.

69. *Id.* at 92,465. The test of reliance was stated in the *Horst* opinion as "whether the misrepresentations were a substantial factor in determining the course of conduct which resulted in the plaintiff's loss." *Id.*, citing *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 797 (2d Cir.), *cert. denied*, 400 U.S. 822 (1970); *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965); *Tucker v. Arthur Andersen & Co.*, 67 F.R.D. 468, 478 (S.D.N.Y. 1975). For a discussion of the traditional reliance test, see notes 41-43 and accompanying text *supra*.

70. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,465. The court noted that the reason for requiring a showing of reliance is to insure that the defendant's fraud actually caused the alleged injury. *Id.*, citing *Titan Group, Inc. v. Faggen*, 513 F.2d 234, 238-39 (2d Cir.), *cert. denied*, 423 U.S. 840 (1975); *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 797 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970); *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (3d Cir.), *cert. denied*, 382 U.S. 811 (1965). See note 40 and accompanying text *supra*.

Where the alleged fraud occurs after a completed purchase or sale transaction “which is itself the occasion for the plaintiff’s economic loss,” the court conceded that the traditional causal relationship could not possibly be established.⁷¹ The court was particularly influenced, however, by the Ninth Circuit’s decision in *Ohashi v. Verit Industries*,⁷² which it considered to be “persuasive authority for the proposition that where the underlying transaction is a contract for purchase or sale, the fraud need not precede the formation of the contract, or constitute its inducement, for the requisite transactional nexus to be present.”⁷³ The *Horst* court also relied on *Davis v. Davis*,⁷⁴ in which the Fifth Circuit found causation where the deceptive practice followed the formation of the contract,⁷⁵ as support for its conclusion that the causation requirement was satisfied in the instant case.⁷⁶ It was noted that in both *Ohashi* and *Davis* the plaintiff’s loss resulted from the defendant’s fraudulent breach of contract, rather than from the formation of the contractual relationship itself.⁷⁷ The court extracted from these two cases the principle that where the defendant’s fraudulent practices, even though not the inducement for the contract, are “intrinsic” to the stock transaction in question and are the direct cause of the plaintiff’s damages,⁷⁸ the policy underlying the transaction causation requirement⁷⁹ would appear to be fully satisfied.⁸⁰ The court concluded that “[o]n the basis of the authorities cited, plaintiffs have alleged a sufficient causal nexus between defendants’ fraud and their own injury to withstand the dismissal of the complaint.”⁸¹

71. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,465, citing *Raschio v. Sinclair*, 486 F.2d 1029 (9th Cir. 1973); *Clinton Hudson & Sons v. Lehigh Valley Coop. Farms*, 73 F.R.D. 420 (E.D. Pa. 1977).

72. 536 F.2d 849 (9th Cir.), cert. denied, 429 U.S. 1004 (1976). For a discussion of *Ohashi*, see notes 47 & 48 and accompanying text *supra*.

73. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,466. The court engaged in an extensive analysis of the factual situation in *Ohashi*, noting that the fraud neither induced the formation of the agreement to exchange stock, nor occurred contemporaneously with its formation. *Id.* at 92,465-66. See note 47 *supra*. It observed that the Ninth Circuit had nevertheless found that the causation requirement was satisfied, since “the contract by which [the plaintiff] acquired [his] stock was still executory when the fraudulent activities occurred . . . [and] . . . those acts affected the unperformed part of the bargain.” [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,466, quoting *Ohashi v. Verit Indus.*, 536 F.2d 849, 853 (9th Cir.), cert. denied, 429 U.S. 1004 (1976).

74. 526 F.2d 1286 (5th Cir. 1976).

75. *Id.* at 1287-89. See text accompanying notes 50 & 51 *supra*.

76. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,466, citing *Davis v. Davis*, 526 F.2d 1286 (5th Cir. 1976). The *Horst* court did recognize that the plaintiff in *Davis*, unlike plaintiffs in *Horst*, sought only injunctive relief and not damages. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,466. It nonetheless considered the *Davis* decision to be “instructive in the present context.” *Id.*

77. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,466.

78. *Id.* Only in *Ohashi* did the court consider it to be clear that the defendant’s fraudulent conduct was the direct cause of the alleged damages. *Id.*

79. The *Horst* opinion again noted that the reason for requiring transaction causation was to insure a causal relationship between the fraudulent act and the injury. *Id.* See note 70 *supra*.

80. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,466.

81. *Id.* The court reached this conclusion after finding that *Horst*, like *Ohashi* and *Davis*, involved fraud which occurred “during the pendency of an executory contract between the

It is submitted that the *Horst* court has taken a well reasoned approach to the issue of standing to sue under rule 10b-5 based upon an oral contract to purchase or sell securities. Support for the court's position can be found in the Supreme Court's admonition to read rule 10b-5 liberally and flexibly,⁸² which has been applied to the purchaser-seller requirement.⁸³ There is no doubt that standing may be based upon an executory contract to purchase or sell stock,⁸⁴ and there is authority for the position that a plaintiff has standing where that contract is an oral one.⁸⁵ The *Horst* court's determination that sections 3(a)(13) and (14) of the 1934 Act do not distinguish between oral and written contracts⁸⁶ is, it is submitted, a strong basis for the decision on the issue of standing.⁸⁷ Finally, it is suggested that the court's distinction as to the dangers of oral evidence in the factual situation presented in *Horst* as compared to cases in which no contractual relationship is alleged⁸⁸ is indeed a valid one.

parties for the purchase or sale of securities," and that plaintiffs had alleged that defendants' fraudulent breach of contract and misrepresentations were the direct cause of their damages. *Id.* For a discussion of the court's disposition of plaintiffs' other federal and state law claims, see note 16 *supra*.

82. See *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971), in which the Supreme Court stated that "[s]ection 10(b) must be read flexibly, not technically and restrictively." *Id.* See also *Lanza v. Drexel & Co.* 479 F.2d 1277, 1299 (2d Cir. 1973); *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715, 718 (S.D.N.Y. 1968); A. JACOBS, *supra* note 19, § 38, at 2-25.

83. See, e.g., *Mount Clemens Indus., Inc. v. Bell*, 464 F.2d 339, 346 n.12 (9th Cir. 1972); *Herpich v. Wallace*, 430 F.2d 792, 806-07 (5th Cir. 1970); *Desser v. Ashton*, 408 F. Supp. 1174, 1176 (S.D.N.Y. 1975).

84. See, e.g., *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 750-51 (1975); *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715, 718-19 (S.D.N.Y. 1968); *Goodman v. H. Hentz & Co.*, 265 F. Supp. 440, 444-45 (N.D. Ill. 1967); *Opper v. Hancock Sec. Corp.*, 250 F. Supp. 668, 673-75 (S.D.N.Y.), *aff'd*, 367 F.2d 157 (2d Cir. 1966). See also notes 28 & 32 and accompanying text *supra*.

85. See *Dopp v. Franklin Nat'l Bank*, 461 F.2d 873, 875 & n.3, 879-81 (2d Cir. 1972); *Desser v. Ashton*, 408 F. Supp. 1174, 1175 (S.D.N.Y. 1975); *Opper v. Hancock Sec. Corp.*, 250 F. Supp. 668, 673 (S.D.N.Y.), *aff'd*, 357 F.2d 157 (2d Cir. 1966). See also notes 34-37 and accompanying text *supra*. One commentator has adopted the position that an enforceable contract should not be required for 10b-5 standing:

If X resorts to a fraudulent device to escape a contractual obligation to buy Y's securities, the device would seem no less unlawful under Rule 10b-5 because the contract later turned out to be unenforceable on account of some illegality on the part of Y. Just as not every breach of contract violates the rule . . . , it is equally true that there can be a violation of the rule, which is subject to the usual public sanctions, without an enforceable contract.

3 L. LOSS, *SECURITIES REGULATION* 1473 n.102 (2d ed. 1961). But see Note, *supra* note 34, at 866-67 (rule 10b-5 would not be "eviscerated" if standing based on oral contracts were disallowed).

86. See text accompanying note 57 *supra*.

87. Justice Powell noted in *Blue Chip Stamps* that "[t]he starting point in every case involving construction of a statute is the language itself." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring). It is submitted that had the *Horst* court concluded that standing could not be based upon an oral contract, it would have effectively added the term "written" to the term "contract" in the statutory language of §§ 3(a)(13) and (14) of the 1934 Act. For the text of §§ 3(a)(13) and (14), see note 32 *supra*.

88. See notes 54 & 60-62 and accompanying text *supra*.

To support its conclusion on the issue of causation, the *Horst* court relied primarily on the Fifth Circuit's decision in *Davis* and the Ninth Circuit's decision in *Ohashi*.⁸⁹ It is suggested that *Davis* does not provide firm ground upon which to base the court's holding as to causation as that case involved a claim for injunctive relief.⁹⁰ Since the purchaser-seller requirement has been relaxed in private rule 10b-5 suits in which only an injunction was sought,⁹¹ it is reasonable to assume that rule 10b-5 actions involving injunctions may generally have less stringent requirements than those in which damages are sought, and, therefore, that the two classes of cases should not be analogized.⁹²

Rather than expressly adopting either of the tests of causation employed in *Ohashi*⁹³ and *Davis*,⁹⁴ it is submitted that the *Horst* court formulated a test of its own. The court stated that the causation requirement would be satisfied where it could be established that defendant's fraudulent breach of the contractual terms caused the plaintiff's economic loss, and was thus "intrinsic" to the securities transaction and the direct cause of the plaintiff's damages.⁹⁵ This test is susceptible to two criticisms. First, the court failed to elaborate on the meaning of the word "intrinsic" as used in the causation test.⁹⁶ It is unclear from the language employed by the court whether fraud is to be considered "intrinsic" to a securities transaction *whenever* a plaintiff suffers a loss as the result of the defendant's fraudulent breach of the contractual terms, or whether some *additional* standard is embodied in the word "intrinsic." Second, it is submitted that the *Horst* court's causation test does not squarely confront the causation issue. Stripped to its elements, the test, it is suggested, requires a plaintiff to allege that while the contract to purchase or sell securities was still executory, the defendant's fraudulent breach of the contract directly caused the plaintiff's injury.⁹⁷ If the function

89. See notes 72-81 and accompanying text *supra*.

90. See text accompanying notes 49 & 50 *supra*.

91. See, e.g., *Kahan v. Rosenstiel*, 424 F.2d 161 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970) (plaintiff who was neither purchaser nor seller held to have standing to seek injunctive relief, although he had not requested such relief); *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540 (2d Cir. 1967) (plaintiff need not be purchaser or seller in private suit for injunctive relief from corporate mismanagement). For examples of other cases in which the purchaser-seller requirement has been relaxed, see note 27 *supra*.

92. The *Horst* court did recognize the fact that *Davis* involved a claim only for injunctive relief, but nevertheless considered the case to be "instructive" on the issue of causation in the context of the instant case. See note 76 *supra*.

93. The *Ohashi* court required the plaintiff to show that the contract to purchase or sell securities was still executory when the fraud occurred, and that the fraud "affected the unperformed part of the bargain." *Ohashi v. Verit Indus.*, 536 F.2d 849, 853, *cert. denied*, 429 U.S. 1004 (1976). See notes 47 & 48 and accompanying text *supra*. The *Horst* court did not expressly adopt the language of the latter part of this test. See notes 78-81 and accompanying text *supra*. See also text accompanying note 95 *infra*.

94. The test employed in *Davis* was whether or not the allegedly fraudulent scheme sufficiently "touched" the executory contract to purchase or sell securities as to be in connection with a purchase or sale. See text accompanying notes 49-51 *supra*.

95. See notes 78-81 and accompanying text *supra*.

96. See [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,466.

97. See notes 78-81 & 95 and accompanying text *supra*.

of the test is to prove the existence of causation,⁹⁸ it is submitted that the test is not serving its intended purpose if it merely asks whether the defendant's conduct was the cause of the plaintiff's damage.

It is suggested that the *Horst* court's well reasoned position on the issue of standing to sue under rule 10b-5 based upon an oral contract to purchase or sell securities could be persuasive authority for other courts presented with the same issue.⁹⁹

It is not clear, however, what impact the court's decision on the causation issue will have, even within the Southern District of New York. This view is founded upon the fact that the *Horst* opinion did not expressly indicate whether its new formulation of the causation requirement is to be applied solely to situations in which the plaintiff alleges that a deceptive practice occurred during the pendency of an executory contract to purchase or sell stock, or whether it is to have broader applicability.¹⁰⁰

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98. While the Second Circuit has stated that all of the elements of common law fraud need not be required for a 10b-5 cause of action, *see* note 43 *supra*, the *Horst* court nevertheless indicated that its test was intended to satisfy the policy underlying the traditional reliance test—insuring a causal relationship between the defendant's act and the plaintiff's injury. *See* notes 78-80 and accompanying text *supra*.

99. *See* notes 82-88 and accompanying text *supra*.

100. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,466.