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Theodore R. Boehm
Baker & Daniels

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FEDERAL BUSINESS LAW AND THE INDIANA LAWYER: THE IMPACT OF THE SECURITIES LAW ON THE GENERAL PRACTITIONER

THEODORE R. BOEHM†

Recent years have seen the development of a substantial body of "federal corporation law" through the medium of the antifraud provisions of the federal securities laws. This law, of general application to commercial transactions, is neither wholly federal nor limited to corporations. Unfortunately, much of the publicity attending this phenomenon has been directed only at "securities lawyers" who are already familiar with the rapid growth of the law in this area. The purpose of this article is to alert the general bar to the very significant impact of securities laws on the many transactions and cases which are often undertaken without regard to this potentially dominant aspect. If anything is certain in the securities field, it is the rapidity of its current development. As a corollary, no one can predict with confidence the ultimate parameters of many of the causes of action that are now lurking around the legal countryside waiting to be uncovered. Thus, from time to time, theories are discussed that are at present only a gleam in the eye of some imaginative plaintiff's attorney and may not stand up under judicial scrutiny.

SOME ARTIFICIAL DEFINITIONS

At the outset the reader should have some notion of the sense in which the term "security" is used in this article. Although there are statutory definitions of "security" in most of the relevant laws, these are often less than precise and typically conclude with a catch-all, such as, "any interest or instrument commonly known as a 'security'."¹ Thus, it is hardly surprising that the courts and administrative authorities have produced some nonstatutory doctrines affording varying degrees of assistance in concluding whether a security is involved. The basic distinction is one of passive investment versus active and significant participation in the management of a business. The less active role a contributor has in a business the more likely he is to be classified as an investor in a security. Thus "security" includes the customary forms of stock, personal and corporate debt instruments, puts and calls, stock options, and interests in oil

† Partner: Baker & Daniels, Indianapolis. Member of the Indiana Bar.

1. Securities Act of 1933 § 2(1), 15 U.S.C. § 77b(1) (1970) [hereinafter referred to as the 1933 Act]; Indiana Securities Law § 101(k), IND. CODE § 23-2-1-1(u) (1971), IND. ANN. STAT. § 25-854(k) (1970).

and gas participations. It also may embrace interests in cattle herds,² voting trusts and investment partnerships,³ franchises,⁴ and even country club memberships.⁵

The term "material" omission or "material" misstatement appears throughout the civil liability sections of the securities laws.⁶ Unfortunately, it is far easier to define materiality than it is to determine whether a specific statement or omission is material in a given context. One generally accepted standard of "material omission" is whether the specific fact, if known, would have made a difference to the reasonable investor in determining to buy or sell.⁷ It is important to note that this formulation does not turn on whether the particular plaintiff would have acted differently. That is the issue of "reliance," discussed later in this article. In Indiana, a procedure exists for obtaining a ruling from the Securities Commissioner as to the materiality of statements or omissions in registration statements.⁸ Whether such a ruling insulates a prospectus from civil liability has not yet been judicially determined.

Most of the severe liabilities that may arise under the securities laws are generated by some form of transaction constituting an acquisition or disposition of a security. Section 10(b) of the Securities Exchange Act⁹ requires a "purchase or sale" of a security to precipitate civil liability.¹⁰ Transactions that may constitute a "purchase" or a "sale" within the meaning of that and other sections are far more varied than the normal stock purchase, however. At the outset, statutory definitions broaden the concepts somewhat. For example, any "contract to . . . acquire" is a "purchase" under § 3(a)(13) of the Securities Exchange Act.¹¹ Even this expansive definition does not suggest all of the transactions that might constitute a purchase or sale. These may include statutory mergers and

2. SEC Interpretive Letter, American Dairy Leasing Corp., 71-72 CCH FED. SEC. L. REP. ¶ 78, 584, at 81, 255 (Dec. 3, 1972).

3. SEC Securities Act Release No. 4877 (Aug. 8, 1967).

4. Tucker Corp., 26 S.E.C. 249 (1947). *See also* 49 OP. CAL. ATT'Y GEN. 124 (1967).

5. Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961); Annot., 87 A.L.R.2d 1135 (1961).

6. *See, e.g.*, Securities Act of 1933 §§ 11(a), 12(2), 15 U.S.C. §§ 77k(a), 77l(2) (1970); Securities Exchange Act of 1934 § 18(a), 15 U.S.C. § 78r(a) (1970).

7. List v. Fashion Park, Inc., 340 F.2d 457 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965). In SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969), this standard was elaborated considerably in the context of securities regularly traded in a market.

8. Ind. Sec. Reg. § 5.01 (1968), Burns Ind. Adm. Reg. § 25-859-4 (Supp. 1972).

9. 15 U.S.C. § 78j (1970).

10. Whether a § 10(b) claimant need be a party to the purchase or sale is problematic. *See* text accompanying notes 72-75 *infra*.

11. 15 U.S.C. § 78c(a)(13).

consolidations,¹² the formation of a close or publicly held corporation, a personal loan transaction,¹³ the making of a buy-sell agreement, restricting transfer of shares in a close corporation, stock redemptions, corporate dissolutions,¹⁴ formation of certain types of limited partnerships,¹⁵ pledges and security interests,¹⁶ and perhaps even amendments to a corporation's articles of incorporation if the terms of its securities are altered.¹⁷ In short, any transaction that involves the creation or exchange of a security for cash or another security may be viewed as a purchase or sale subject to the securities laws.

AN OVERVIEW OF THE SECURITIES LAWS

In order to understand the exposure of various transactions to attack under the securities laws, it is necessary to have a basic grasp of what those laws are and what they are designed to do. Unfortunately, as in all complex legal matters, some effort must be expended in understanding what these laws are likely to be in the future as well as grasping their present form.

There are six federal statutes that are generally referred to as "securities laws."¹⁸ In addition, every state except Delaware has some form of state securities law, collected under the title of "blue sky" statutes. Of the federal statutes, only two come into play in the context of the usual transaction contemplated by this article. These are the Securities Act of 1933¹⁹ and the Securities Exchange Act of 1934.²⁰

At least in form, the 1933 Act imposes no material substantive standards regarding the quality of securities registered under its provisions. It proceeds exclusively on a disclosure philosophy, assuming that if the

12. *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969). Apparently, this is not true under Indiana's blue sky law, which excludes transactions incident to class votes of shareholders from the definition of "sales." Indiana Securities Law § 101(i) (7), IND. CODE § 23-2-1-1(i) (7) (1971), IND. ANN. STAT. § 25-854(i) (7) (1970).

13. *See Anderson v. Francis I. duPont & Co.*, 291 F. Supp. 705 (D. Minn. 1968), in which the court elaborated some of the circumstances under which commercial paper and private notes are deemed "securities."

14. *Coffee v. Permian Corp.*, 434 F.2d 383 (5th Cir. 1970).

15. *United States v. Wernes*, 157 F.2d 797 (7th Cir. 1946).

16. *Investment Properties Int'l, Ltd. v. I.O.S., Ltd.*, 70-71 CCH SEC. L. REP. ¶ 93,011 (S.D.N.Y. Apr. 21, 1971).

17. *Western Air Lines, Inc. v. Sobieski*, 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (1961).

18. Securities Act of 1933, 15 U.S.C. § 77a *et seq.* (1970); Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (1970); Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 *et seq.* (1970); Trust Indenture Act of 1939, 15 U.S.C. § 77aaa *et seq.* (1970); Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.* (1970); Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq.* (1970).

19. 15 U.S.C. § 77a *et seq.* (1970).

20. *Id.* § 78a *et seq.* [hereinafter referred to as the 1934 Act].

investor knows the facts, the decision to buy or not to buy is appropriately left to him. The fundamental concept of the 1933 Act is the requirement that offerings of securities be registered with the Securities and Exchange Commission unless exempt under some provision of that Act.²¹ Registration requires the distribution of a prospectus containing an elaborate and detailed description of the issuer and the offering.

The most commonly invoked exemptions from registration are the so-called private offering exemption afforded by § 4(2) of the Act²² and the intrastate offering exempted by § 3(a)(11).²³ Elaboration of the pitfalls inherent in each of these exemptions has been provided in several published sources and need not be repeated here. Suffice it to say that the nature of a private offering is determined by an extremely severe test of sophistication of the offerees combined with their access to virtually all of the information that would have been supplied if the offering had been registered and if an SEC approved prospectus had been delivered.²⁴ The test of sophistication, number, and access to information is not applied to buyers; it is applied to offerees. Thus, at least in the view of the SEC, a sale to only one purchaser could constitute a public offering if other offers are made to a large number of persons or if the one buyer has insufficient ability to fend for himself. As to what constitutes an offer for these purposes, one authority has only half jokingly responded "everything." In any event, it should be noted that the concept of offer as used in the securities field is much broader than traditional contract notions of the term. There is no doubt that the problems of proving offers to a sufficient number of sufficiently unsophisticated persons are significant, particularly in the absence of any documentation. Two final points: first, the rule of thumb that less than 25 offerees is safe as a private offering is merely that—a rule of thumb.²⁵ Any knowledgeable plaintiffs' securities lawyer would be happy to represent 24 widows and orphans on a contingent fee. Second, there is a chance that several distinct private offerings can be

21. *Id.* § 77e.

22. *Id.* § 77d(2).

23. *Id.* § 77c(a)(11).

24. The leading case on this matter is *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953). More recent decisions have caused concern about whether the exemption remains viable despite stiffer requirements of establishing access to pertinent matter. *SEC v. Continental Tobacco Co.*, 463 F.2d 137 (5th Cir. 1972).

25. This number evolved from an early advisory letter of the general counsel of the SEC. SEC Securities Act Release No. 285 (June 22, 1935). The present draft of the American Law Institute codification project proposes that a test of 35 buyers be adopted so that much of the anxiety of those relying on this exemption will be relieved. The SEC is also considering adoption of a new Rule 146, which focuses on buyers rather than offerees, and is designed to clarify the private placement exemption. See *BNA SEC. REG. L. REP.*, at A-3 (Aug. 16, 1972).

integrated to produce one large violation of the registration requirement.²⁶ The point is again a simple one: know the purchaser, the issuer and the means of sale before venturing into the tricky business of a private offering.

Reliance on the intrastate offering for exemption from federal registration is equally hazardous. This exemption requires that every offeree, not just every buyer, be a bona fide resident of the state within whose boundaries the offering is to take place.²⁷ A plaintiff's lawyer may find it difficult to prove an offer to a nonresident, but it must be remembered that only one such offer is necessary to void the entire exemption as to all offerees. It is no defense that the agent making the offer mistakenly thought the offeree was a resident; nor does rescission of the out-of-state offer rectify the violation, though it may mitigate damages. Once again the concept of "offer" is broader than the traditional common law contract concept. Finally, although use of the mails or facilities of interstate commerce is required to trigger the federal registration requirement,²⁸ few reported decisions have failed to find that requirement discharged,²⁹ however strained their reasoning may seem.

The 1934 Act is also based on the theory of full disclosure. It imposes no substantive requirements on issuers of securities—only reporting and disclosure requirements.³⁰ The key to most of the provisions of the 1934 Act is again registration, but, in this case, it is not the type of transaction which triggers application of the Act but rather the status of the company. Thus, the Act applies to issuers listed on a national exchange or those with 1,000,000 dollars in assets and 500 equity security

26. See, e.g., SEC Interpretive Letter, Presidential Realty Corp., 70-71 CCH FED. SEC. L. REP. ¶ 78, 066, at 80, 316 (Feb. 19, 1971).

27. Securities Exchange Act of 1934 § 202(11), 15 U.S.C. § 77c(a)(11) (1970); SEC Securities Act Release No. 4434 (Dec. 6, 1961).

28. Securities Act of 1933 § 5, 15 U.S.C. § 77e (1970).

29. The use of the mails or interstate transportation need only be in connection with the sale or offer, and any such use, whether or not by a particular defendant, is sufficient. See, e.g., *Little v. United States*, 331 F.2d 287 (8th Cir.), cert. denied, 379 U.S. 834 (1964) (jurisdiction sustained on the basis of mailings by the defendant's bank in the course of clearing checks obtained through fraud). In respect to local telephone use, compare *Burke v. Triple A Machine Shop, Inc.*, 438 F.2d 978 (9th Cir. 1971) (an intrastate call is not sufficient for federal jurisdiction), with *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968) (the telephone network is an integrated interstate facility and a local call is sufficient to establish federal jurisdiction).

30. Under §§ 16(a) and (b) of the 1934 Act, a corporation's directors, officers and ten per cent shareholders are liable to the issuer for profits from purchases and sales within any six-month period. This has given rise to a number of nice legal questions, but it applies only to companies that are registered under § 12(g), and is therefore beyond the scope of this comment.

holders.³¹ As usual, this requirement hinges on an army of definitions and a number of relatively exotic exemptions, but as a general proposition, if the issuer has met the 1,000,000 dollar/500 shareholder test, it is subject to the 1934 Act provisions governing reporting, proxy, insider trading and tender offers. Although these requirements were originally regarded as the heart of the 1934 Act, they have now been surpassed in significance by the antifraud provisions of § 10(b).³²

The remaining federal statutes have relatively limited application to transactions counseled by the general practitioner. It should be noted, however, that it is possible to inadvertently become an investment company subject to registration and substantive regulation, through mergers or consolidations in which one party receives cash or securities and becomes a holding company with over 100 shareholders.³³ Similarly, one may become an investment adviser subject to registration and regulation by the SEC without intending to do so through certain activities directed towards advising or counseling others, even other members of a limited partnership.³⁴

In addition to federal regulation, the general practitioner should be familiar with Indiana's securities laws. Virtually every state has a blue sky law similar to the 1933 Act requiring registration of certain offerings or sales of securities. The exemptions and definitions differ widely among the various states, and no effort is made here to enumerate or analyze the laws of states other than Indiana. The Indiana Securities Law³⁵ is patterned on the Uniform Securities Act, which is itself far from uniform among the states that have adopted it. Nonetheless, the basic format of the Indiana Act is reasonably similar to other versions of the uniform act, and decisions from other states are sometimes useful in interpreting the Indiana version.³⁶

Like the 1933 Act, Indiana requires registration of all transactions unless some exemption is available.³⁷ The state exemption most frequently relied upon is the analog to the federal private offering exemption.³⁸ Like the federal act, this exemption depends on the number of

31. Securities Exchange Act of 1934 §§ 12(a), 12(g), 15 U.S.C. §§ 781(a), 781(g) (1970).

32. 15 U.S.C. § 78j(b) (1970).

33. *Id.* § 80a-3(c)(1).

34. William M. Ryan, 70-71 CCH FED. SEC. L. REP. ¶ 78, 102, at 80, 393 (Mar. 2, 1971).

35. IND. CODE § 23-2-1-1 *et seq.* (1971), IND. ANN. STAT. § 25-854 *et seq.* (1970).

36. The statutes and decisional law of all states are reported in CCH Blue Sky Reporter.

37. Indiana Securities Law § 201, IND. CODE § 23-2-1-3 (1971), IND. ANN. STAT. § 25-856 (1970).

38. Indiana Securities Law § 102(b)(10), IND. CODE § 23-2-1-2 (1971), IND. ANN. STAT. § 25-855(b)(10) (1970).

offers rather than the number of sales. However, unlike the federal act, the state statute prescribes a specific number of offers—20 Indiana recipients in any twelve month period—which may be made without registration with the Indiana Securities Commissioner. The exemption also requires that (1) no commission be paid for the placement and (2) the buyer represents in writing his intention to hold for investment.³⁹ Several problems can be encountered in the computation of the number of offerees, and little help is found in either judicial or secondary authority. For example, there may be difficulties generated by offers to partnerships, trusts or even corporations and by offers made by persons other than the issuer. Fortunately, the Indiana Securities Commissioner is often willing to offer a prompt resolution of problems before they escalate into violations of the state securities laws.

The state securities laws also regulate broker-dealers,⁴⁰ provide antifraud penalties,⁴¹ and establish administrative procedures.⁴² However, unlike the federal acts, they also impose limitations on such matters as underwriters' compensation⁴³ and promoters' interests in the venture.⁴⁴

THE CONSEQUENCES OF AN ANTIFRAUD VIOLATION

Three basic results can issue from a securities violation: (1) an administrative agency can enter cease and desist orders; (2) the persons responsible can be imprisoned; and (3) civil liability can be imposed. The last of these three receives the most serious attention from the securities bar, since the potential liabilities are enormous, difficult to foresee, and confront virtually everyone involved in the offering. While most of these liabilities are expressly provided for by statute, they have often been ignored by the victims of securities law violations and their lawyers until it was too late.

Liability Under Federal Securities Laws

The first and most basic civil liability provision is § 11(a) of the

39. Indiana Securities Law § 102(b)(10), IND. CODE § 23-2-1-2 (1971), IND. ANN. STAT. § 25-855(b)(10) (1970). This section also authorizes the Securities Commissioner to waive conditions or increase the number of offerees with respect to a given transaction.

40. Indiana Securities Law § 301 *et seq.*, IND. CODE § 23-2-1-8 (1971), IND. ANN. STAT. § 25-862 *et seq.* (1970).

41. Indiana Securities Law § 401, IND. CODE § 23-2-1-12 (1971), IND. ANN. STAT. § 25-866 (1970).

42. Indiana Securities Law § 503, IND. CODE § 23-2-1-15 (1971), IND. ANN. STAT. § 25-869 (1970).

43. Sec. Div. Rule 8.01 (1969), Burns Ann. Rules & Reg. (25-859)-11 (Supp. 1972).

44. Sec. Div. Rule 8.04 (1969), Burns Ann. Rules & Reg. (25-859)-13 (Supp. 1972).

1933 Act which creates a liability for misstatements or material omissions in a federal registration statement.⁴⁵ Thus, if no registration is filed with the SEC, there can be no § 11(a) liability, despite the fact that a registration statement should have been filed. The magic language triggering § 11(a) liability is either the inclusion of: "an untrue statement of a material fact" or the omission of "a material fact . . . necessary to make the statements therein not misleading. . . ."⁴⁶ Though minor variants developed over the years, this language has remained as the keystone of civil liability under this and other antifraud provisions of the securities laws.

Certain limitations on this liability are provided by the statute: (1) the statute of limitations is one year from the discovery of the misstatement or omission;⁴⁷ (2) the purchaser must prove he relied on the omission or misstatement;⁴⁸ and (3) the defendant may avoid liability by proving both that he believed the statement to be complete and accurate and that this belief was reasonable based on a fair investigation to determine the facts.⁴⁹ However, since the statute merely defines reasonable belief or investigation as "that required of a prudent man in the management of his own property,"⁵⁰ the statutory defenses often prove to be soft footings in a litigation context and therefore cannot be relied on too heavily. The damages recoverable under this section are also provided by statute and award to the plaintiff, subject to certain qualifications, the difference between the price paid and the value at the time of sale or institution of the suit.⁵¹

Section 12(1) of the 1933 Act creates a cause of action for selling or offering unregistered securities which are required to be registered under § 5 of the Act. Therefore, unlike § 11(a), § 12(1) can impose liability even if no registration statement has been filed. Under this section, the person "purchasing the security from" the defendant has a cause of action for the difference between the price he paid and the price at which he later sold the security.⁵² In the event that the purchaser still owns the security, the statute provides him with an action for rescission.⁵³ The statute of limitations governing this section is one year from the unregistered offer or sale.⁵⁴

45. 15 U.S.C. § 77k(a) (1970).

46. *Id.*

47. *Id.* § 77m.

48. *Id.* § 77k(a).

49. *Id.* § 77k(b).

50. *Id.* § 77k(c).

51. *Id.* § 77k(e).

52. *Id.* § 77l.

53. *Id.*

54. *Id.* § 77m.

Section 12(2) allows the same measure of recovery to the same purchasers as § 12(1). Here, the basis for recovery is the offering or selling of a security "by means of a prospectus or oral communication" which either (1) includes an untrue statement of a material fact or (2) omits a material fact necessary to make the facts stated not misleading.⁵⁵ Again, there is a statutory defense if the defendant can establish that he did not know, and reasonably should not have known, of the misstatement or omission.⁵⁶ Since any communication which offers a security is a prospectus, this section covers any transaction in any security if the requisite use of the mails or interstate facilities is involved, as it usually is. This section has a one-year statute of limitations, running from the discovery of the omission or misstatement, but in no event extending to more than three years from the date of sale.⁵⁷

Section 17(a) of the 1933 Act is a general declaration that it is unlawful for any person "in the offer or sale" of securities, "directly or indirectly":

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

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.⁵⁸

While it has been commonly held that this section creates civil liability,⁵⁹ the parameters of that liability are still somewhat unclear. As just discussed, § 12(2) creates an express liability for the same basic wrong, but includes a relatively short limitations period, requires that the purchaser have purchased from the defendant and creates a defense based on the defendant's reasonable ignorance of the misstatement or omission. From this it has been argued that any liability implied from violation of § 17 must be similarly restricted. Unfortunately for those who deal in securities, and to the enormous benefit of many plaintiffs,

55. *Id.* § 771(2).

56. *Id.*

57. *Id.* § 77m.

58. *Id.* § 77q(a).

59. *Osborne v. Mallory*, 86 F. Supp. 869 (S.D.N.Y. 1949).

most courts either have not found these contentions persuasive or have simply ignored them.⁶⁰ This is largely a result of the fact that § 17(a) claims are usually bolstered by allegations of violations of § 10(b) of the 1934 Act. However, there are some potentially significant distinctions between § 17(a) and § 10(b). For example, since § 17(a) governs statements and omissions "in the sale of securities," it is unclear whether the section applies to persons other than the seller, whereas § 10(b) applies to all communications "in connection with" a purchase or sale.⁶¹ As a practical matter though, as the courts expanded § 10(b), they also expanded § 17(a), apparently without any attention to possible distinctions. Dicta appears in several cases implying, if not stating, that § 17(a) doctrines are identical to those of § 10(b).⁶²

Section 10(b) of the 1934 Act is the greenhouse in which most federal securities litigation has flourished. This provision prohibits employing "any manipulative or deceptive device or contrivance"⁶³ in connection with the purchase or sale of a security, in violation of any SEC rule. In 1942, the Commission promulgated Rule 10b-5⁶⁴ which was generally assumed to protect sellers in the same way that § 17(a) protected buyers. The language of Rule 10b-5 is substantially identical to § 17(a) except for this shift in focus. It has been commonly held that Rule 10b-5 creates a cause of action for those injured by violations of the rule,⁶⁵ but the precise elements of this cause of action remain somewhat unclear. A Rule 10b-5 claim may arise "in connection with" any "purchase" or "sale" of any "security" as long as there is some use of the mails or interstate transportation. There is no statute of limitations and no express requirement of privity; nor does the Rule indicate who the plaintiff must be or in what relationship to the defendant he must stand. Finally, there is no express defense based on good faith or absence of knowledge of the misstatement or omission. Because of this absence of restrictions on 10b-5 liability, the practical consequence of the Rule is to eliminate or weaken the various statutory defenses to civil liability

60. *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123 (7th Cir. 1972) (statute of limitations); *Dorfman v. First Boston Corp.*, 336 F. Supp. 1089 (E.D. Pa. 1972) (§ 12 limits apply to § 17(a) (2) but not to §§ 17(a) (1) or (a) (3)).

61. 15 U.S.C. § 77q(a) (1970).

62. *See, e.g., Schaefer v. First Nat'l Bank*, 326 F. Supp. 1186, 1193 (N.D. Ill. 1970).

63. 15 U.S.C. § 78j(b) (1970).

64. 17 C.F.R. § 240.10b-5 (1972).

65. *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946). Since the 1934 Act was principally directed to problems of large publicly owned companies and their securities, it is ironic that the first case to find that Rule 10b-5 created civil liability involved a corporation with only four shareholders.

under the 1933 Act. As a result 10b-5 has largely swallowed up the express causes of action under the federal laws.

Blue Sky Civil Liability

Section 507 of the Indiana blue sky law contains a civil liability provision derived from the uniform securities law and common to many states.⁶⁶ It states:

(a) Any person who

(1) offers or sells a security in violation of sections 201 [requiring registration of security offerings unless exempt], 204(d) [requiring delivery of an "adequate" prospectus], 301(a) [requiring registration of broker-dealers and agents] or 502(b) [prohibiting representing that the Commission has approved the merits of the registered issue]; or

(2) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission, is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six per cent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security and any income received on it, or for damages if he no longer owns the security. Damages are the amount that would be recoverable upon a tender less the value of the security when the buyer disposed of it and interest at six per cent per year from the date of disposition.⁶⁷

It should be noted that subsection (2) looks remarkably like § 12(2) of the 1933 Act, except that it requires no use of the mails and it includes an award of attorneys' fees. Like § 12(2), it is limited to suits

66. IND. CODE § 23-2-1-19 (1971), IND. ANN. STAT. § 25-873 (1970). *See also* ABA-ALI MODEL BUS. CORP. ACT § 410 (1959) [hereinafter cited as MODEL ACT].

67. IND. CODE § 23-2-1-19 (1971), IND. ANN. STAT. § 25-873 (1970).

by buyers and creates a cause of action only against the seller. The statute of limitations is two years from discovery.

The attorneys' fees in securities litigation often run into six digits. Unlike the state statutes, no provision of federal securities laws awards attorneys' fees for the successful claimant. The lesson is fairly clear: one should accompany any § 12(2) claim with a claim under § 507(a)(2) of the Indiana Act in either federal or state court. Federal pendent jurisdiction over the state claim is at least arguable if a § 12(2) claim is asserted, and state and federal courts have concurrent jurisdiction over a § 12(2) claim. If the plaintiff must rely on § 17(a) or Rule 10b-5, the elements of the state and federal claims are somewhat different, and federal jurisdiction over the § 507(a)(2) claim may be challenged in the absence of diversity of citizenship.

Section 507(a)(1) does not create a cause of action for violation of § 401, which is a substantially verbatim reproduction of Rule 10b-5 except that no use of the mails is required. Prior to 1967, it was clear that the express causes of action under § 507(a)(1) for violation of the listed sections were the sole remedy for private plaintiffs under the Indiana Act. This certainty was expressed by paragraph (h) of § 507 which read:

(h) The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or in equity *but this act does not create a cause of action not sponsored in this section 302 (b)*.⁶⁸

The emphasized language was deleted when § 507 was re-enacted in 1967, giving rise to the presently untested contention that an implied cause of action has been created under Indiana law for what would be Rule 10b-5 violations under federal law, whether or not use of mails is involved.⁶⁹

WHO CAN SUE

Obviously the individual most likely to bring suit for a securities law violation is the buyer who purchased from a defective prospectus or in direct reliance on some material misstatement or omission. If a registration statement has been filed, the plaintiff has claims under § 11

68. Ch. 333, § 507(h), [1961] Ind. Acts 1864 (emphasis added).

69. The states that have adopted § 410 of the uniform act, MODEL ACT, *supra* note 68, without the phrase that has been deleted from § 507(h) have not had frequent opportunity to consider the question. See *Shermer v. Baker*, 2 Wash. App. 845, 472 P.2d 589 (1970), finding such an implied cause of action. The Uniform Act was drafted to prevent the implication of causes of action. See L. LOSS & E. COWETT, *BLUE SKY LAW* 395 (1958).

of the 1933 Act and § 507(a)(1) of the Indiana securities laws.⁷⁰ Whether or not the offering has been registered, the plaintiff still has claims under §§ 12(2) and 17(a) of the 1933 Act, § 10(b) of the 1934 Act and § 507(a)(2) of the Indiana Act. While there may be an implied claim for violation of § 401 of the Indiana Act, the remedy may be available only to a seller. For reasons of largely historical interest, a defrauded seller has no claim under § 12(2) or § 507 (a)(2) and must resort to §§ 10(b), 17(a)⁷¹ or 401 for relief.

Relief for parties other than buyers or sellers remains unclear. Until relatively recently, *Birnbaum v. Newport Steel Corp.*⁷² was thought to establish a requirement that only buyers or sellers may invoke Rule 10b-5.⁷³ However, in *Superintendent of Ins. v. Bankers Life & Cas. Co.*,⁷⁴ the Supreme Court apparently abolished this requirement. In that case, the plaintiff's Treasury bonds were sold for it by the defendant to a third party. Although there was no misrepresentation or fraud in the sale, the Court held that this sale was an essential part of an alleged plot to defraud the plaintiff, and thus the fraud was "in connection with" that sale in violation of Rule 10b-5.⁷⁵ As a practical matter, it would seem that some form of sale can be found or created in most transactions to trigger 10b-5 application if the fraud need not occur "in" a sale but rather only "in connection with" that sale.

The limits of this expansion of Rule 10b-5 protection are presently not discernible. It is noteworthy, however, that the *Bankers Life & Casualty* opinion was unanimous in expressly rejecting the notion that Rule 10b-5 is limited to frauds that relate to "the integrity of the securities markets,"⁷⁶ concluding that:

Section 10(b) must be read flexibly, not technically and re-

70. Section 507(a)(1) covers violations of § 204(a), which requires that an "adequate" prospectus be delivered to offerees in a registered offering. A material misstatement or omission presumably renders a prospectus inadequate. IND. CODE § 23-2-1-5 (1971), IND. ANN. STAT. § 25-859(d) (1970).

71. It has been held that only purchasers may invoke § 17(a) on the theory that it relates to fraud "in the sale" of securities. Support for this view lies in the fact that subparagraph (3) of § 17(a) speaks of fraud "on the purchaser." See, e.g., *Simmons v. Wolfson*, 428 F.2d 455 (6th Cir. 1970), cert. denied, 400 U.S. 999 (1971); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 430 F.2d 355 (2d Cir. 1970), rev'd on other grounds, 404 U.S. 6 (1971).

72. 193 F.2d 461 (2d Cir.), cert. denied, 343 U.S. 956 (1952).

73. *Birnbaum* involved a suit by a shareholder of Newport Steel alleging fraud in the sale of control of Newport at the expense of the plaintiff and other minority shareholders. This claim was rejected under 10b-5 because *Birnbaum* had neither purchased nor sold. 193 F.2d at 463.

74. 404 U.S. 6 (1971).

75. *Id.* at 12.

76. *Id.*

strictively. Since there was a "sale" of a security, and since fraud was used "in connection with" it, there is redress under § 10(b) whatever might be available as a remedy under state law.⁷⁷

Until the Supreme Court clarifies this issue, Rule 10b-5 claims may be anticipated wherever a security is sold or bought at a loss caused by some misleading or deceptive scheme whether or not the security was itself misleadingly described.

Section 12(2) and § 507(a)(2) require that the plaintiff "not know of" the untruth or omissions.⁷⁸ Presumably, materiality of the omitted or misstated facts added to the purchaser's ignorance amounts to reliance, except in the case of the incompetent plaintiff or the expert who may not have acted differently even if the material fact were disclosed. Some form of "reliance" has long been contended to be essential to a § 17(a) or a § 10(b) claim. This theory is based on two premises: (1) these statutory fraud provisions carry over some elements of common law fraud, one of which is the requirement of reliance; and (2) since these sections only imply, rather than expressly provide, a cause of action for their violation, they should not be so free of statutory defenses that they swallow up causes of action which are expressly stated.

The obvious form of reliance occurs in the case of a buyer or seller who acts while conscious of the facts as stated and who would, if apprised of the whole story, have acted otherwise. This type of reliance is clearly sufficient under existing decisions to sustain a plaintiff under both § 17(a) and Rule 10b-5. One problem area revolves around the plaintiff who is dragged into his purchase or sale by the actions of others, even though he himself is not misled. A common example is a statutory merger requiring only a simple majority vote of shareholders to become effective under Indiana corporate law. The consequence of the merger is to effect a "sale" of the acquiring corporation's shares to the shareholders of the acquired corporation. Notwithstanding his knowledge of the misstatement, an outvoted minority shareholder may invoke Rule 10b-5 and presumably § 17(a) if the affirmative vote of the majority was based on a violation of Rule 10b-5.⁷⁹ A different form of reliance may be found in the plaintiff's right to "rely" on a correct market place evaluation of his

77. *Id.* Despite the language quoted in the text, the Court expressly reserved what it called the "standing" issue of *Birnbaum, id.* at 13 n.10, and some lower courts continue to follow *Birnbaum*. See, e.g., *Mount Clemens Indus., Inc. v. Bell*, 464 F.2d 339 (9th Cir. 1972).

78. 15 U.S.C. § 771(2) (1970); IND. CODE § 23-2-1-19 (1971), IND. ANN. STAT. § 25-873 (1970).

79. See *Kohn v. American Metal Climax, Inc.*, 458 F.2d 255 (3d Cir. 1972).

securities. Thus, if nondisclosure produces a different market price than if full disclosure had been made, the reliance requirement might be satisfied. No reported case has expressly adopted such a theory, but one recent case suggests that a plaintiff may establish such reliance to show the extent of damages but not the fact of liability.⁸⁰ In substance, it seems that the courts are presently settling on the concept of causation as a substitute for reliance, although this focus is still unclear.

The plaintiffs' most potent weapon under the securities laws is Rule 23 of the federal and Indiana rules of procedure, which permits any member of a class to assert the claims of all other members as well as his own. Such class actions may aggregate numerous minor claims to reach often staggering totals.⁸¹ In class action litigation, the successful plaintiffs' attorney is entitled to compensation from the entire class. Some courts have taken the view that the amount of the attorney's fees depends upon the size of the recovered fund, furnishing plaintiffs' lawyers with a considerable incentive to vindicate the rights of the plaintiff's co-victims.⁸² The point is simply that securities transactions by their nature often involve dealings with groups of persons, no one of whom may find it economic to sue but who, when aggregated, are more than adequately spurred to litigation.

WHO CAN BE SUED

Sections 11, 12(2) and 507(a)(1) and (2) provide for a cause of action by the buyer only against the seller. Rule 10b-5 has no such limitation, however, since the *Bankers Life & Casualty* case erased any privity requirements. A plaintiff who can establish loss from his purchase or sale and the defendant's violation of Rule 10b-5 "in connection with" that sale no longer needs to establish that he bought from or sold to the defendant.

Whether § 17(a) is free from a privity requirement is not entirely clear. Some courts have discussed § 17(a) claims and § 10(b) claims as though they were interchangeable.⁸³ There are cases, however, in which it may be of critical significance whether the claim is maintained under

80. *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90 (10th Cir. 1971).

81. A recent example is the assertion of a seventy dollar claim for alleged violations of the 1934 Act in odd lot transactions on the national exchanges. The plaintiff claimed to represent 3,750,000 other plaintiffs with claims of similar size. The District Court found that a class action of this size was feasible, and ordered that notice be sent to 5,000 random members of the class and be published in the Wall Street Journal and New York, San Francisco and Los Angeles newspapers. *Eisen v. Carlisle & Jacquelin*, 52 F.R.D. 253 (S.D.N.Y. 1971).

82. See generally Annot., 38 A.L.R.3d 1384 (1971).

83. *E.g.*, *Schaefer v. First Nat'l Bank*, 326 F. Supp. 1186, 1193 (N.D. Ill. 1970).

17(a) or § 10(b), and in such a case the defense of absence of privity under § 17(a) should be asserted.

By statute certain persons other than the issuer or seller may be liable for misstatements in a registration statement. As a general proposition these include management, controlling shareholders, and experts, notably accountants, named in the registration statement.⁸⁴ Persons controlling the seller are also expressly liable by statute for violations of §§ 11 and 12 and § 507(a).⁸⁵ The question of who constitutes a control person is a favorite topic of securities lawyers and often leads to some surprising results, such as the inclusion of public accountants in this category.⁸⁶

Additionally, officers or employees of issuing corporations occasionally have been known to act as "agents" in effecting sales of stock. Unless these persons are themselves registered as agents or exempt under § 101(b),⁸⁷ they may be acting in violation of § 301(a) of the Indiana securities law and therefore liable under § 507(a)(1).

In addition to the statutory liability imposed on accountants, engineers, appraisers and other experts named in a prospectus, accountants have been subjected to litigation for various misstatements or omissions in their client's public reports. Rule 10b-5 provides the broadest base for potential recovery, and has in fact resulted in civil recovery from accountants not only for participation in the preparation of false financial statements⁸⁸ but also for failure to take corrective action when errors are subsequently discovered.⁸⁹ These liabilities have been imposed without regard to whether the accountant had utilized the misinformation or inside correct information to his own advantage, and at least one court precluded accountants from asserting any indemnification rights against their client.⁹⁰

The lawyers' constitutional immunity from otherwise broadly applicable regulatory statutes is in some peril in the securities field. It has been clear for some time that a lawyer may participate in a securities violation

84. The categories of persons statutorily liable, as well as the circumstances of their liability and the defenses available to them, are set forth in §§ 11 and 15 of the 1933 Act, 15 U.S.C. §§ 77k, 77o (1970), § 20 of the 1934 Act, 15 U.S.C. § 78t (1970), and § 507(b) of the Indiana Securities Law, IND. CODE § 23-2-1-19 (1971), IND. ANN. STAT. § 25-873 (1970).

85. 15 U.S.C. § 77o (1970); IND. CODE § 23-2-1-19(b) (1971), IND. ANN. STAT. § 25-873(b) (1970).

86. *Kohler v. Kohler Co.*, 208 F. Supp. 808 (E.D. Wis. 1962), *aff'd*, 317 F.2d 637 (7th Cir. 1963).

87. IND. CODE § 23-2-1-1(b) (1971), IND. ANN. STAT. § 25-854(b) (1970).

88. *Drake v. Thor Power Tool Co.*, 282 F. Supp. 94 (N.D. Ill. 1967).

89. *Fischer v. Kletz*, 266 F. Supp. 180 (S.D.N.Y. 1967).

90. *State Mut. Life Assurance Co. v. Peat, Marwick, Mitchell & Co.*, 49 F.R.D. 202 (S.D.N.Y. 1969).

in a manner that may subject him to administrative sanction and perhaps civil liability if his role in the violation is "beyond the lawyer's normal one."⁹¹ More recently, a lawyer who prepared the papers involved in alleged violations of state blue sky law and Rule 10b-5 was held subject to the jurisdiction of the federal court as a "participant" in the violation on the ground that the transaction would not have proceeded without him. The failure of the lawyer to advise the buyer that the shares were not registered under the state statute was spoken of as a basis for the lawyer's liability under Rule 10b-5.⁹²

The SEC has recently instituted litigation against two well known New York and Chicago law firms, asserting that they violated Rule 10b-5 by their failure to resign from representation of their client or to disclose to the SEC alleged misstatements in a pending proxy statement.⁹³ The statement was not alleged to have been misleading when prepared; the only contention was that it was subsequently found to be defective prior to its public dissemination. Needless to say the consequences of the SEC's theory should be of enormous significance to the bar. The contention is that the lawyer not only must abstain from assisting in a violation of the law but must resign or report to the SEC if he discovers a violation that is about to take place. Several problems arise related to the attorney-client privilege. The resolution of these problems is not easy in the face of the propositions that (a) the lawyer is obliged to disclose to the other party or the appropriate tribunal if his client is about to commit a fraud,⁹⁴ (b) the lawyer is obliged to hold in confidence the secrets of his client,⁹⁵ and (c) violations of the securities laws can be crimes as well as giving rise to civil liability. The result may be that professional insurance will become unavailable and knowledgeable attorneys will simply refuse to undertake such assignments. The lawyer's economic stake in the transaction—his fee—is presently substantially out of proportion to his exposure.

Another area of developing liability exposure involves the use of confidential information to one's advantage in public or private transactions. The classic case arose from the purchase of Texas Gulf Sulphur shares on

91. SEC v. Frank, 388 F.2d 486, 489 (2d Cir. 1968).

92. Black & Co. v. Nova-Tech, Inc., 333 F. Supp. 468 (D. Ore. 1971).

93. SEC v. National Student Marketing Corp., Civil No. 225-72 (D.D.C., filed Feb. 3, 1972).

94. AMERICAN BAR ASSOCIATION, ABA CODE OF PROFESSIONAL RESPONSIBILITY, DISCIPLINARY RULE 7-102(b). Whether the SEC or a state commission is an appropriate "tribunal" and whether violations of Rule 10b-5 constitute "fraud" are debatable and unresolved issues.

95. AMERICAN BAR ASSOCIATION, ABA CODE OF PROFESSIONAL RESPONSIBILITY, CANON 4.

the national securities markets prior to a news release of a major ore strike. The purchases involved in that case were by directors, officers and employees who received the information by virtue of their employment positions and were therefore "insiders" whose purchases, without disclosing the information, violated Rule 10b-5.⁹⁶ This violation subsequently formed the basis for civil actions on behalf of those who sold during the period the information was withheld. The company whose shares were being traded was held liable on the basis of its public statements about the ore strike, even though it neither bought nor sold its stock nor participated in any way in the open market transactions in its shares.⁹⁷ It also appears that an outsider who is the beneficiary of inside information is likely to be held equally subject to Rule 10b-5, at least if he comes into his information as the result of a conscious decision by an insider.⁹⁸ Since "insider" cases typically involve purchase rather than sales by the malefactor, and since the seller would often be anonymous on an Exchange, Rule 10b-5 has provided virtually the sole basis for liability in the area of "insider" trading.

Persons other than the seller who "aid and abet" the violation of Rule 10b-5 may be held liable, but this concept, imported from the criminal law, remains rather nebulous. The leading case, *Brennan v. Midwestern United Life Ins. Co.*,⁹⁹ sustained a claim by a class of customers of the then insolvent Dobich Securities Corporation who had purchased shares of the defendant's common stock in the open market through Dobich. The court based Midwestern's liability on its failure to report certain of Dobich's illegal activities to the Indiana Securities Commissioner. After *Brennan*, some form of affirmative assistance to the principal violator appears to be necessary along with some knowledge of the violation. Whether benefit to the aider and abettor is required remains unclear.

There is some basis for concluding that any of the myriad regulations governing securities transactions can be transformed into a claim under Rule 10b-5 under the proper circumstances. In *Buttrey v. Merrill, Lynch, Pierce, Fenner & Smith*,¹⁰⁰ the complaint alleged violations of Rule 10b-5 claiming the defendant aided the same Dobich Securities Corporation involved in *Brennan*. The court suggested that a knowing breach of a rule of the New York Stock Exchange could constitute a fraud and

96. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

97. *See Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90 (10th Cir. 1971), *cert. denied*, 404 U.S. 1004 (1972).

98. *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

99. 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

100. 410 F.2d 135 (7th Cir. 1969).

hence a Rule 10b-5 violation.¹⁰¹ Similarly, breach of the National Association of Securities Dealers "Rules of Fair Practice" may create a 10b-5 cause of action against a NASD member-broker.¹⁰²

Section 11 of the 1933 Act imposes liability on issuers for misstatements in the registration regardless of their innocence, negligence or wilfulness.¹⁰³ As to all other defendants, §§ 11, 12(2) and Indiana § 507(a)(2) each provide a relatively narrow defense described as lack of "scienter" based on the defendant's reasonable ignorance of the misstatement or omission. This defense may also be available under § 17(a) or Rule 10b-5, since it is arguable, as discussed before, that an implied remedy may not eliminate the statutory defenses of the express remedy. Further, § 10(b) is couched in terms of "deceptive" or "manipulative" acts and "contrivances," each of which seems to bear a connotation of a significant mental element or intent. Thus, the conclusion seems to be that some form of knowledge, recklessness or negligence as to the misleading nature of the statement or omission is necessary under Rule 10b-5. As in the case of materiality, however, the critical point is not what in fact was in the defendant's mind, but what a jury will conclude was there. In the case of complex financial transactions this defense is often difficult to establish in the face of a sympathetic claimant's losses. Finally, as to the often critical question of burden of proof on this issue, the majority rule places that burden on the plaintiff as an element of his case under Rule 10b-5.¹⁰⁴

Lastly, indemnification agreements between defendants have been held invalid as contravening the policy of the securities laws if they seek to reimburse for liabilities imposed by statute¹⁰⁵ or if they are thought to contravene public policy, specifically the desirability of public reliance on accountant's certificates.¹⁰⁶ However, while indemnification provisions may be unenforceable, § 11(b) and § 507(a)(2) do provide for contribution between defendants jointly liable.¹⁰⁷

101. *Id.* at 141-43. The Rule involved was Rule 405, which mandated a member firm of the Exchange to "know your customer" and his circumstances.

102. *Avern Trust v. Clarke*, 415 F.2d 1238 (7th Cir. 1969).

103. 15 U.S.C. § 77k(a)(1) (1970).

104. *See, e.g., Heit v. Weitzen*, 402 F.2d 909, 914 (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969).

105. *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970).

106. *State Mut. Life Assurance Co. v. Peat, Marwick, Mitchell & Co.*, 49 F.R.D. 202 (S.D.N.Y. 1969).

107. 15 U.S.C. § 77k(f) (1970); IND. CODE § 25-2-1-19(b) (1971), IND. ANN. STAT. § 25-873(b) (1970). *See also* *Globus, Inc. v. Law Research Serv., Inc.*, 318 F. Supp. 955 (S.D.N.Y. 1970), *aff'd*, 442 F.2d 1346 (2d Cir. 1971).

PROCEDURAL ADVANTAGES OF THE SECURITIES LAWS

It is plain that the civil liability sections of the securities laws may be invoked to afford redress for any number of wrongs that are also subject to vindication under state common law principles; notably fraud or breach of corporate fiduciary relationships. It is also clear that no federal pre-emption of state law is effected by the federal acts.¹⁰⁸ Even where a state cause of action may be asserted, however, there are often significant advantages or disadvantages to the plaintiff asserting a security claim as well.

Generally, there are jurisdictional advantages to a plaintiff in bringing a securities claim. First, federal court jurisdiction is available under the 1933 and 1934 Acts¹⁰⁹ without regard to the amount in controversy, permitting aggregation of smaller claims otherwise unavailable in federal court.¹¹⁰ Second, while 10b-5 claims may only be initiated in federal court,¹¹¹ actions under §§ 11, 12(2) or 17(a) may be brought in "any court of competent jurisdiction," federal or state.¹¹² Moreover, actions under the 1933 Act, if brought in a state court, are not removable.¹¹³ Thus, by proper selection of the statutory basis of his claim, the plaintiff may insure trial in a forum of his choice.

Personal jurisdiction over the defendant is readily available since both the 1933 and 1934 Acts include a provision for service of process wherever the defendant is an "inhabitant" or is "found."¹¹⁴ As a practical matter, these provisions permit consolidation of actions against several defendants in various parts of the country as well as giving wide choice of locale for suits against one or few defendants.

Federal venue can usually be found at the site of plaintiff's choice. In federal court venue is proper for any 1933 Act claim in any district in which the defendant "is found or is an inhabitant or transacts

108. Securities Act of 1933 § 18, 15 U.S.C. § 77r (1970); *Crosby v. Weil*, 382 Ill. 538, 48 N.E.2d 386 (1943); Securities Exchange Act of 1934 § 28, 15 U.S.C. § 78bb (1970).

109. Securities Act of 1933 § 22, 15 U.S.C. § 77v (1970); Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (1970).

110. *See Snyder v. Harris*, 394 U.S. 332 (1969), holding that multiple claims could not be accumulated to reach the 10,000 dollar jurisdictional amount required for suits "arising under" federal law or based on diversity of citizenship.

111. *Aetna State Bank v. Alheimer*, 430 F.2d 750 (7th Cir. 1970).

112. 15 U.S.C. §§ 77k(a), 77l (1970).

113. Securities Act of 1933 § 22, 15 U.S.C. § 77v(a) (1970).

114. Securities Act of 1933 § 22, 15 U.S.C. § 77(a) (1970); Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (1970). The nationwide service provisions do not apply to suits brought in state courts; thus, the state court litigant must resort to the standard grounds for jurisdiction over out-of-state defendants. *Negin v. Cico Oil & Gas Co.*, 46 Misc. 2d 367, 257 N.Y.S.2d 434 (S. Ct. 1965).

business" or in which the offer or sale took place, if the defendant participated in it.¹¹⁵ A 1934 Act claim may be asserted wherever "any act constituting the violation occurred."¹¹⁶ These broad provisions have not been narrowly construed. For example, a law firm has been held a "participant" in a sale by virtue of the inclusion of its name as counsel in reports containing allegedly misleading information.¹¹⁷ In the view of some authorities, the omission of a material fact which constitutes a violation of Rule 10b-5 takes place where the plaintiff happens to be, instead of where the defendant is.¹¹⁸ Finally, as mentioned previously, attorney's fees are easy to recover if a claim can be sustained under Indiana § 507(a)(2).

Express statutes of limitations are provided for causes of action under § 11(a) and § 12(2) (one year from discovery),¹¹⁹ § 12(1) (one year from sale),¹²⁰ and § 507(a)(1) and (2) (two years from discovery).¹²¹ No statute expressly purports to govern claims under § 17(a), Rule 10b-5 or Indiana § 401. It is now reasonably clear that the appropriate state statute of limitations applies to the federal claims.¹²² Two problems remain: (1) identifying which state's law applies; (2) specifying which of the available statutes within a state are applicable. The selection of the state has received little attention usually because the forum state is both the place of the violation and the most familiar to the court. With the expansion of claims to aiders and abettors and others the issue may become more important. The statute of the forum state has on occasion, and perhaps without reflection, been said to be the settled choice.¹²³ If confronted with such a case, the courts should at least consider looking to the conflicts of laws doctrines of the forum state.

Once the proper state is chosen, the question of the appropriate statute remains. In most states there are several choices. In Indiana these include the two-year statute applicable to "injuries to property" and to actions "for forfeiture of penalty given by statute,"¹²⁴ the two-year blue sky statute,¹²⁵ the six-year fraud statute,¹²⁶ and the fifteen-year catch-

115. Securities Act of 1933 § 22, 15 U.S.C. § 77v(a) (1970).

116. Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (1970).

117. Black & Co. v. Nova-Tech, Inc., 333 F. Supp. 468 (D. Ore. 1971).

118. *Id.*

119. 15 U.S.C. § 77m (1970).

120. *Id.*

121. IND. CODE § 23-2-1-19 (1971), IND. ANN. STAT. § 25-873(e) (1970).

122. Parrent v. Midwest Rug Mills, Inc., 455 F.2d 123 (7th Cir. 1972); Turner v. Lundquist, 377 F.2d 44 (9th Cir. 1967).

123. See, e.g., Vanderboom v. Sexton, 422 F.2d 1233 (8th Cir. 1970).

124. IND. CODE § 34-1-2-2 (1971), IND. ANN. STAT. § 2-602 (1967).

125. Indiana Securities Law § 507(e), IND. CODE § 23-2-1-19 (1971), IND. ANN. STAT. § 25-873(e) (1970).

all.¹²⁷ Decisions from other jurisdictions support each of the choices available under Indiana law.¹²⁸ However, the Seventh Circuit, probably the final arbiter for Indiana, has recently given some help to those attempting to assess their contingent liabilities under Rule 10b-5. In *Morgan v. Koch*¹²⁹ the Seventh Circuit accepted the parties agreement that the Indiana fraud statute applied to a Rule 10b-5 action. However, here even the six-year statute had run, leaving no incentive for the defendant to contend for the two-year statute. More recently, in *Parrent v. Midwest Rug Mills*,¹³⁰ the Seventh Circuit has adopted the Illinois three-year blue sky statute as applicable to a Rule 10b-5 claim, expressly noting that in the *Morgan* decision neither party contested the district court's adoption of the Indiana fraud statute. Since the Illinois statute is basically similar to Indiana's, a plaintiff should assume that § 507(e) of the Indiana blue sky law governs § 17(a) and Rule 10b-5 claims brought in Indiana. The matter may not be fully resolved, however, as one judge concurred in *Parrent* in a somewhat cryptic manner suggesting possible disagreement with the holding insofar as it related to the statute of limitations, and certain technical distinctions may be drawn between the Indiana and Illinois statutes for this purpose.¹³¹

Another possible disadvantage to a plaintiff in bringing a claim for violation of the securities laws is the possible unavailability of punitive damages. There is a split of authority on the question whether punitive damages may be awarded in a civil suit under the securities laws. One line of cases adopts the view that since § 28(a) of the 1934 Act limits recovery under the Act to "actual damage,"¹³² punitive damages are un-

126. IND. CODE § 34-1-2-1 (1971), IND. ANN. STAT. § 2-601 (1967).

127. IND. CODE § 34-1-2-3 (1971), IND. ANN. STAT. § 2-603 (1967).

128. Compare *Vanderboom v. Sexton*, 422 F.2d 1233 (8th Cir. 1970) (blue sky statute similar to Indiana's), with *Charney v. Thomas*, 372 F.2d 97 (6th Cir. 1967) (fraud statute), and *Azalea Meats, Inc. v. Muscat*, 246 F. Supp. 780 (S.D. Fla. 1965) (action for statutory violation).

129. 419 F.2d 993 (7th Cir. 1969).

130. 455 F.2d 123 (7th Cir. 1972).

131. Under ILL. ANN. STAT. ch. 121-1/2, § 137.12 (Smith-Hurd Supp. 1972), it is illegal to engage in certain activities: the use of any "device, scheme or artifice to defraud in connection with the sale or purchase of any security;" transactions "in the sale" of a security which "tend to work a fraud;" and "obtaining money through the sale" by means of misleading omissions or misstatements. These activities are broader in scope than those which are expressly subject to civil liability under the Indiana statute. However, the Illinois act is similar to Indiana's in that the sole civil remedy provided for injury resulting from the proscribed activities is rescission. More importantly, the *Parrent* court found the absence of a scienter defense significant in drawing the parallel between the Illinois Act and Rule 10b-5. Indiana's act does provide a scienter defense. It should be noted, however, that *Parrent* expressly approved of the result in *Vanderboom v. Sexton*, 422 F.2d 1233 (8th Cir. 1970), where the court found that the statute of limitations in Arkansas' blue sky law, which is virtually identical to Indiana's, did apply to § 17(a) and Rule 10b-5 claims.

132. 15 U.S.C. § 78bb (a) (1970).

available even under the implied remedy afforded by Rule 10b-5.¹³³ However, punitive damages have been awarded in Rule 10b-5 cases on the ground that any tort sustains such an award under the appropriate circumstances. In any event punitive damages may still be available under § 17(a) or § 401 since the 1933 Act, and the Indiana statutes, contain no comparable reference to "actual" damages.¹³⁵

THE MORAL

There are a few steps, short of withdrawing from the practice to return to law school for a year's course in securities regulation, that may be taken in the face of these unresolved and sometimes surprising contentions. It should be reasonably clear that Rule 10b-5 has subsumed virtually all other provisions of the securities laws as far as their impact on normal transactions at the planning stage is concerned. Thus, for the planner, the task is that of accurately transmitting all *material* facts in connection with any *purchase* or *sale* of a *security*. The problems involved in making adequate disclosure are often enormous and their resolution can be expensive and time consuming, but the failure to do so can incur severe risks. Anyone planning the acquisition of a corporation with significant value should resort to the preparation of a document substantially similar to the requirements for an SEC cleared proxy statement for the transactions. At the other extreme, the cost of such a document for the formation of a two-man corporation is ordinarily out of proportion to the benefit, even though that transaction is equally subject to Rule 10b-5. But even in simple cases, recall that unless a written investment representation is given, the "sale" of "securities" violates § 507(a)(1) of the Indiana securities laws regardless of the number of offerees.

In sum, at the planning level start with the presumption that there is a securities aspect to a transaction and figure out why no registration is required and why disclosure is adequate; at the litigation stage, consider the relative merits of addition of or sole reliance upon a securities claim to virtually any commercial suit. Finally, check the advance sheets, since much of the foregoing will undoubtedly become obsolete in a relatively short period.

133. See, e.g., *deHaas v. Empire Petroleum Co.*, 435 F.2d 1223 (10th Cir. 1970); *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970).

134. E.g., *Hecht v. Harris, Upham & Co.*, 283 F. Supp. 417 (N.D. Cal. 1968).

135. See *Nagel v. Prescott & Co.*, 36 F.R.D. 445 n.2 (N.D. Ohio 1964). *But see* *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276 (2d Cir. 1969), in which it was held that symmetry of the 1933 and 1934 Acts and the lack of any need for punitive damages as a deterrent preclude their award under § 17(a).

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CONTRIBUTORS TO THIS ISSUE

PATRICK L. BAUDE: A.B. 1964, J.D. 1966, University of Kansas; Associate Professor of Law, Indiana University School of Law, Bloomington.

THEODORE R. BOEHM: A.B. 1960, Brown University, J.D. 1963, Harvard University.

MICHAEL J. ZIMMER: A.B. 1964, J.D. 1967, Marquette University; Assistant Professor of Law, University of South Carolina.

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