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SECURITIES REGULATION—Dumping *Birnbaum* To
Force Analysis Of The Standing Requirement
Under Rule 10b-5—*Eason v. General
Motors Acceptance Corporation*

The Court of Appeals for the Seventh Circuit has expressly declined to follow *Birnbaum v. Newport Steel Corp.*,¹ thereby renewing the 21 year old controversy concerning the validity of the so-called “*Birnbaum doctrine*.” In *Birnbaum*, the Court of Appeals for the Second Circuit held that a plaintiff must be either a purchaser or seller of securities to maintain an action under section 10b of the Securities Exchange Act of 1934 and rule 10b-5 of the Securities and Exchange Commission.² The standing requirement set forth in *Birnbaum* was never directly challenged by any circuit until the decision in *Eason v. General Motors Acceptance Corporation*.³ The Seventh Circuit in *Eason* held, “it is not part of the law of this circuit”⁴ that a plaintiff must be either a purchaser or seller of securities to obtain relief under section 10b of the 1934 Act and rule 10b-5, as promulgated thereunder.

1. 193 F.2d 461 (2d Cir. 1952).

2. Securities Exchange Act of 1934, § 10b, 15 U.S.C. § 78j(b) (1964) provides: 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.

Rule 10b-5, 17 C.F.R. § 240.10b-5 (1969) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

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

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

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

3. 490 F.2d 654 (7th Cir. 1973).

4. *Id.* at 661.

In *Eason*, the plaintiffs were shareholders of Bank Service Corporation (Bank Service) which purchased the assets of the leasing division of Dave Waite Pontiac, Inc. (Waite), a Pontiac dealership. Bank Service issued 7,000 shares of its stock to Waite in return for the leasing business, and assumed its liabilities. Among the liabilities assumed were notes payable to General Motors Acceptance Corporation (GMAC), the financier of the leased autos. GMAC required, as a condition to the transfer of the assets to Bank Service, that the shareholders of Bank Service personally guarantee payment of the existing obligations, and any future obligations that might arise. Thereafter, the leasing business became insolvent and Bank Service defaulted on the notes. GMAC brought an action in state court to recover on the guarantees.⁵ The plaintiffs counterclaimed for rescission of their guarantees, and brought an action in federal court seeking rescission and damages under section 10b and rule 10b-5. The complaint alleged misrepresentation of material facts in inducing the sale of the leasing business in exchange for the securities. The district court⁶ held that the corporation, not the shareholders, was the seller⁷ of the securities. The court dismissed the complaint on the grounds that the plaintiffs lacked standing to maintain the action, citing *Birnbaum*.⁸ On appeal, the Seventh Circuit substantiated its departure from *Birnbaum* by focusing on three areas of analysis: (1) the standing question; (2) the current status of the case law relating to the scope of the purchaser-seller definition; and (3) the policy arguments proffered as a basis for continuing *Birnbaum*'s longevity.

The court concluded that (1) the purchaser-seller requirement is not a valid limitation in resolving questions of standing; (2) the extension of the definition of purchasers and sellers to include persons who are not in fact purchasers or sellers is tantamount to an implied refusal to follow *Birnbaum*; and (3) the policy arguments presented for retaining *Birnbaum* are at best speculative and unpersuasive.⁹ The *Eason* decision, if followed by the Supreme Court¹⁰ will no doubt

5. The state action was subsequently stayed pending resolution of the federal question in the federal courts.

6. No. IP 71-C-613 (S.D. Ind. June 20, 1972).

7. *Hooper v. Mountain States Securities Corp.*, 282 F.2d 195 (5th Cir. 1960). This case was the first to hold that a corporation, in the issuance of its stock, is a seller of securities within the meaning of the *Birnbaum* limitation.

8. No. IP 71-C-613 (S.D. Ind. June 20, 1972).

9. 490 F.2d at 657-60.

10. The Supreme Court has denied certiorari, *GMAC v. Eason*, 94 S. Ct. 1979 (1974). However, the Court has recently decided to rule on the purchaser-seller issue by granting certiorari in *Blue Chip Stamps v. Manor Drugs Stores*, 43 U.S.L.W. 3273 (U.S. Nov. 12, 1974). The court of appeals decision appears at 492 F.2d 136 (9th Cir. 1974).

result in the disappearance of the *Birnbaum* doctrine with all its attendant difficulties. The importance of *Eason* must be viewed in the light of prior case law and commentary pertaining to the standing question, the *Birnbaum* doctrine, and *Birnbaum's* underlying rationale. Because the court's topical breakdown is a logical one, it is conveniently adopted.

STANDING

Two fundamental principles were expressed in *Birnbaum*: (1) a plaintiff must be a purchaser or seller of securities to have standing to sue under section 10b and rule 10b-5 (the procedural ruling);¹¹ and (2) rule 10b-5 will not support a cause of action where the fraud alleged is a breach of fiduciary duty or corporate mismanagement (the substantive ruling).¹² The *Superintendent of Insurance of New York v. Bankers Life and Casualty Co.*¹³ case substantially modified the substantive ruling by holding that some types of corporate mismanagement, notwithstanding the existence of an adequate state remedy, are within the scope of rule 10b-5, if the fraud alleged is more than tangential to the purchase or sale of securities.¹⁴ The controversy rekindled¹⁵ by *Eason*, however, concerns the standing issue resolved in *Birnbaum*—that a plaintiff must be a purchaser or seller of securities to bring an action under section 10b and rule 10b-5.

The *Birnbaum* court found support for the purchaser-seller limitation in the espoused purpose of the S.E.C. in promulgating the rule.¹⁶ The motivation for the adoption of rule 10b-5 was the fact that section 17(a) of the Securities Act of 1933 extended protection from fraud only to *purchasers* of securities.¹⁷ It was not illegal, under the 1933

11. 193 F.2d at 463.

12. *Id.* at 464.

13. 404 U.S. 6 (1971).

14. *Id.* at 12. For an excellent analysis of the vitality of the substantive ruling in light of *Bankers Life*, see Ryan, *Bankers Life: Birnbaum Reconsidered*, 4 Loyola U. CHI. L.J. 47 (1973).

15. The controversy generated by *Birnbaum* has precipitated voluminous commentary. See generally Whitaker, *The Birnbaum Doctrine: An Assessment*, 23 ALA. L. REV. 543 (1971); Macey, *Protection of Creditors' Rights through Use of Rule 10b-5*, 76 COM. L.J. 133 (1971); Kellogg, *The Inability to Obtain Analytical Precision Where Standing to Sue Under Rule 10b-5 is Involved*, 20 BUFF. L. REV. 93 (1970); Bloomenthal, *From Birnbaum to Schoenbaum: The Exchange Act and Self-Aggrandizement*, 15 N.Y.L.F. 332 (1969); Lowenfels, *Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268 (1968); Patrick, *Rule 10b-5 Equitable Fraud in Schoenbaum v. Firstbrook*, 21 ALA. L. REV. 457 (1969); Fleischer, *Federal Corporation Law: An Assessment*, 78 HARV. L. REV. 1146 (1965); Lowenfels, *Rule 10b-5 and the Stockholder's Derivative Action*, 18 VAND. L. REV. 893 (1965).

16. 193 F.2d at 463, citing SEC Securities Act Release No. 3230 (May 21, 1942).

17. Securities Act of 1933, § 17(a), 15 U.S.C. § 77q(a) (1964) provides:

It shall be unlawful for any person in the offer or sale of any securities by

Act at that time, for a purchaser to defraud a seller. The Commission adopted rule 10b-5 for the express purpose of closing this loophole and to extend protection from fraud to sellers as well as purchasers of securities.¹⁸ The Commission copied the language of section 17(a) of the 1933 Act in drafting rule 10b-5 with the substitution of "any person" in place of "the purchaser," and with the addition of "in connection with the purchase or sale of any security."¹⁹ The story of 10b-5's casual origin is best told by the recollection of Milton Freeman, an S.E.C. staff attorney at the time.

It was one day in the year 1943 [1942], I believe. I was sitting in my office in the S.E.C. building in Philadelphia and I received a call from Jim Treanor who was then the Director of the Trading and Exchange Division. He said, "I have just been on the telephone with Paul Rowen," who was then the S.E.C. Regional Administrator in Boston, "and he has told me about the president of some company in Boston who is going around buying up the stock of his company from his own shareholders at \$4.00 a share, and he has been telling them that the company is doing very badly, whereas, in fact, the earnings are going to be quadrupled and will be \$2.00 a share for this coming year. Is there anything we can do about it?" So he came upstairs and I called in my secretary and I looked at Section 10(b) and I looked at Section 17 [1933 Act], and I put them together, and the only discussion we had there was where "in connection with the purchase or sale" should be, and we decided it should be at the end.

We called the Commission and we got on the calendar, and I don't remember whether we got there that morning or after lunch.

the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, 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* (emphasis added).

18. SEC Securities Act Release No. 3230 (May 21, 1942), reads as follows:

The Securities and Exchange Commission today announced the adoption of a rule prohibiting fraud by any person in connection with the purchase of securities. The previously existing rules against fraud in the purchase of securities applied only to brokers and dealers. The new rule closes a loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities *if they engage in fraud in their purchase*. The text of the Commission's action follows:

The Securities and Exchange Commission, deeming it necessary for the exercise of the functions vested in it and necessary and appropriate in the public interest and for the protection of investors so to do, pursuant to authority conferred upon it by the Securities Exchange Act of 1934, particularly Sections 10(b) and 23(A) thereof, hereby adopts the following Rule X-10b-5 . . . (emphasis added). For the text of the rule, see note 2 *supra*.

19. *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 463 (2d Cir. 1952).

We passed a piece of paper around to all the commissioners. All the commissioners read the rule and they tossed it on the table, indicating approval. Nobody said anything except Sumner Pike who said, "Well," he said, "we are against fraud, aren't we?" That is how it happened.²⁰

The appellants in *Birnbaum* argued that the congressional history demonstrated that the broad purpose of the Act was to protect all investors from exploitation by corporate insiders, and that to limit standing to purchasers and sellers was too narrow an interpretation to effectuate that purpose. The court, nonetheless, felt that the S.E.C.'s enunciated purpose controlled, especially in view of the limited amount of congressional history available on point.²¹ This reasoning is fallacious since the purpose of the S.E.C. in promulgating a rule does not necessarily indicate the congressional intent for enacting the statute which gave rise to the rule. A reading of the plain language of section 10b reveals that the Commission was empowered to formulate rules and regulations under the section.²² However, where a rule conflicts with the broader congressional intent to protect all investors, the conflict must be resolved in favor of the congressional purpose, unless the restriction (here, the purchaser-seller limitation) is grounded in the statute itself. Section 10b does not present the ambiguity in its "purchase or sale" language that is present in the rule. Thus, section 10b lacks the foundation upon which a purchaser-seller limitation could be grafted; in fact its straight-forward wording demonstrates the broad purpose it was intended to encompass and protect. While the courts are the proper authority to interpret the rules and regulations of an agency promulgated under a congressional grant, it is inappropriate for the courts to claim that a limitation is congressionally mandated by interpreting an agency rule, rather than the enabling statute. Reliance upon an agency rule to determine the limits of a statute is particularly tenuous where the Commission did not exhaust its power under section 10b with the promulgation of 10b-5.²³ In fact, the agency is free to change its basis for, modify, or add to the rule at any time within the confines of congressional authority, and should not be forever bound by its original purpose in espousing the rule.²⁴ The S.E.C.'s opposition to the pur-

20. *Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 922 (1967).

21. *Birnbaum v. Newport Steel Corp.*, 193 F.2d at 464. The court noted that congressional intent was not manifest from the available history, and therefore concerned itself with the rule.

22. For the text of section 10b see note 2 *supra*.

23. L. LOSS, 3 SECURITIES REGULATION, ch. 9c, n.87 at 1469 (1961).

24. *Id.*

chaser-seller limitation is well-known to the courts through its amicus curiae briefs.²⁵ Sometimes, as in *Drachman v. Harvey*,²⁶ the S.E.C. gets only a one-line acknowledgment for their efforts:

The Commission urges us to take this opportunity to review and repudiate the purchaser-seller requirement for 10b-5 actions which we enunciated in *Birnbaum v. Newport Steel Corp.*²⁷

The court went on to decline the invitation. But with the S.E.C. interpretation of the rule clear, the only justification which the courts can have for retaining the limitation must be grounded in the statute itself. The cases decided subsequent to *Birnbaum* have not addressed themselves to the question of whether the limitation is premised on the statute or the rule.²⁸ This is apparently because the "in connection with the purchase or sale" phrase appears in both section 10b and rule 10b-5. But the *Birnbaum* court relied most heavily, if not exclusively, on the S.E.C.'s announced purpose in devising 10b-5.²⁹ It is this author's contention that the court's analysis of the purchaser-seller limitation should be based upon the section, rather than the agency's initial purpose in adopting the rule.

Little insight into Congress' intent in enacting section 10b can be garnered from the congressional history since the provision provoked a paucity of discussion.³⁰ One comment on the section's purpose was presented by Thomas G. Corcoran, a member of the Roosevelt Administration who helped draft the bill and undertook the responsibility of explaining it to the House committee. He summed up section 9c

25. See *Manor Drug Stores v. Blue Chip Stamps*, 492 F.2d 136 (9th Cir.), cert. granted, 43 U.S.L.W. 3273 (U.S. Nov. 12, 1974); *Supt. of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1970); *Mt. Clemens Industries, Inc. v. Bell*, 464 F.2d 339 (9th Cir. 1972); *Levine v. Seilon, Inc.*, 439 F.2d 328 (2d Cir. 1971); *Iroquois Industries Inc. v. Syracuse China Corp.*, 417 F.2d 963 (2d Cir. 1969); *Pappas v. Moss*, 393 F.2d 865 (3d Cir. 1968); *Dasho v. Susquehanna Corp.*, 380 F.2d 262 (7th Cir. 1967); *Vine v. Beneficial Finance Co.*, 374 F.2d 627 (2d Cir. 1967).

26. 453 F.2d 722, 738 (2d Cir. 1972).

27. *Id.* at 738. It would seem to be the obvious solution for the S.E.C. to modify or rewrite the rule so as to negate the *Birnbaum* controversy. But in all probability, the S.E.C. would not want to risk all that it has gained from the court interpretations of the rule. It is also unclear whether the S.E.C. ever accepted the *Birnbaum* rule and then changed its position, or whether, the S.E.C. merely failed to vocalize its opposition to the limitation in the early years which it is now attempting to make up for through the frequent use of amicus briefs.

28. See, e.g., *Sargent v. Genesco, Inc.*, 492 F.2d 750 (5th Cir. 1974); *James v. Gerber Products Co.*, 483 F.2d 944 (6th Cir. 1973); *Landy v. Federal Deposit Insurance Corp.*, 486 F.2d 139 (3d Cir. 1973); *Haberman v. Murchian*, 468 F.2d 1305 (2d Cir. 1972); *Mt. Clemens Industries, Inc. v. Bell*, 464 F.2d 339 (9th Cir. 1972); *Erling v. Powell*, 429 F.2d 795 (8th Cir. 1970); *Jensen v. Voyles*, 393 F.2d 131 (10th Cir. 1968).

29. 193 F.2d at 463.

30. *Hearings on S. Res. 56, 84 & 97, Before Senate Committee on Banking and Currency*, 73d Cong., 1st and 2d Sess. 6624, 6899, 6910, 6936-38, 6988 (1933-34).

(later renumbered as 10b without substantial modification) of the first version (H.R. 7852) as follows:

Subsection (c) says "Thou shalt not devise any other cunning devices. . . ." Of course subsection (c) is a catch-all clause to prevent manipulative devices. I do not think there is any objection to that kind of clause. The Commission should have authority to deal with new manipulative devices.³¹

There were also several unsuccessful attempts to narrow the broad language of the section by the stock exchanges. Representative of those attacks are the comments of Eugene E. Thompson, President of the Associated Stock Exchanges, in his appearance before the House Hearing:

This section is so vague and inadequate for the purpose it evidently is intended to accomplish that it should be stricken out in its entirety. To allow it to remain leaves in the hands of the Commission a weapon with which that body might determine that anything or everything is detrimental to the public interest or to the proper protection of investors.³²

It appears that Congress addressed itself to a broad anti-fraud objective in order to arm the S.E.C. with the power to deal with varied manipulative schemes. This broad remedial purpose is frustrated by the imposition of the purchaser-seller limitation. If fraud and misrepresentation are the evils Congress sought to correct by enacting section 10b, would not this purpose be more fully effectuated by allowing all investors who are injured by such fraud to bring an action under 10b-5? Limitations upon access to the courts encourage the very activity Congress sought to suppress in promulgating the statute, since the danger exists that inventive potential defendants may seek to arrange the fraudulent transaction so that the potential plaintiffs will not be directly involved in a purchase or sale. Effective assistance in achieving Congress' stated purpose should not be lightly eliminated through the use of judicial restrictions upon standing.

Bankers Life

Another hurdle to the elimination of the purchaser-seller standing limitation is the unresolved question of whether or not *Bankers Life* ratified the purchaser-seller requirement of *Birnbaum*.³³ In *Bankers*

31. *Hearings on H.R. 7852 and H.R. 8720 Before House Committee on Interstate and Foreign Commerce on Stock Exchange Regulation*, 73d Cong., 2d Sess. 115 (1934).

32. *Id.* at 258.

33. Ryan, *Bankers Life: Birnbaum Reconsidered*, 4 LOYOLA U. CHI. L.J. 47, 59 (1973) [hereinafter cited as *Birnbaum Reconsidered*]. Mr. Ryan contends that the Su-

Life, various other defendants agreed with Bankers Life and Casualty Co. (Bankers Life) to purchase the Manhattan Casualty Co. (Manhattan) from it. The defendants obtained a short-term five million dollar loan without collateral from the Irving Trust Company. The loan was used to purchase all the stock of Manhattan. The defendants then caused Manhattan to sell its United States Treasury bonds for approximately five million dollars which was in turn used to repay Irving Trust. In brief, the defendants purchased the corporation with its own assets. The court held that Manhattan was injured as an investor in its sale of the Treasury bonds notwithstanding the fact that the fraud arose from insider activity for which an adequate state remedy existed.³⁴ Manhattan was held to have a remedy under 10b-5. The thrust of the decision was to significantly modify the substantive holding of *Birnbaum* which denied relief under 10b-5 for fraud perpetrated by insiders where a state remedy existed. Nonetheless, it has been argued that the Supreme Court, by making mention of the fact that Manhattan qualified as a seller of securities, has adopted the procedural holding of *Birnbaum*.³⁵ The argument is buttressed by the observation that the Supreme Court had never explicitly, prior to *Bankers Life*,³⁶ recognized a private right of action under section 10b. Yet, the Court has upheld private actions under the section without discussion of that particular point.³⁷ The implication is, that either by silence, or notation of the limitation's existence, the Court has adopted the purchaser-seller requirement. It is this writer's contention that the Supreme Court did not in fact acquiesce in the purchaser-seller limitation by its mere use of the word "seller" to describe Bankers Life. Acknowledgment that Bankers Life was a seller is not equivalent to an acceptance of the *Birnbaum* limitation because it was not necessary to the holding in the case.

Not only does *Bankers Life* fail to sanction the purchaser-seller requirement, it affirmatively supports its elimination. The *Eason* court noted that the standing limitation arose at a time when 10b-5 was

preme Court, in *Bankers Life*, impliedly ratified the purchaser-seller limitation of *Birnbaum* through its repeated use of the term "seller."

34. 404 U.S. at 13. *Birnbaum* did not specifically address itself to the existence of a state remedy or its adequacy, but it has been uniformly interpreted as foreclosing action against insiders for fraud because of the existence of the state remedy.

35. *Birnbaum Reconsidered*, *supra* note 33, at 59.

36. 404 U.S. at 14, n.9. While the Supreme Court did not formally recognize the existence of this right until 1972, it has been unquestioned by the courts since the decision of *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), the case in which the question was first presented.

37. *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363 (1966); *Tcherepnin v. Knight*, 389 U.S. 332 (1967).

thought to relate only to public sales of securities, when it would have been reasonable to assume that it provided protection only to the defrauded purchaser or seller.³⁸ According to *Eason*, the *Birnbaum* court considered section 10b and rule 10b-5 to be substantively limited to preserving the integrity of the securities markets.³⁹ A logical outgrowth of that premise would be *Birnbaum's* holding that 10b-5 would not support an action where the fraud alleged is a breach of fiduciary duty for which a state remedy exists. Because insider mismanagement or fraud does not directly relate to the preservation of the integrity of the securities markets, the *Birnbaum* court's opinion that 10b-5 did not apply logically followed. Consistent with the view that 10b-5 related only to the securities markets, the purchaser-seller limitation would then likely have been imposed as a logical means of effectuating the market integrity principle. With the Supreme Court in *Bankers Life* repudiating the substantive holding in *Birnbaum*, thereby destroying the premise that 10b-5 is limited to preserving the integrity of the securities markets, would not the *raison d'etre* of the purchaser-seller limitation, originally conceived to implement that policy, fall as well? The overruling of the substantive holding in *Birnbaum* clearly undercuts the continued existence of the procedural holding.

Constitutional Aspects of Standing

Whether or not a mandate for the purchaser-seller limitation derives from the language of section 10b itself must be considered even if the congressional history did not compel it, and the Supreme Court did not consider it:

It shall be unlawful for any person . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . for the protection of investors.⁴⁰

This section is directed at what the *defendant* may not do. Its only reference to plaintiffs is to state that the statute's general purpose is to protect investors. However, it is obvious that an investor can be de-

38. 490 F.2d at 658.

39. This conclusion comes from the Second Circuit's discussion of 10b-5's purpose in *Supt. of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 430 F.2d 355 (2d Cir. 1970), wherein the court stated at 361: "§ 10b is limited to preserving the integrity of the securities markets." Also pursuing this reasoning is *Landy v. Federal Deposit Insurance Corp.*, 486 F.2d 139 (3d Cir. 1973).

40. Securities Exchange Act of 1934, § 10b, 15 U.S.C. § 78j(b) (1964).

frauded without direct involvement in a purchase or sale. The facts of *Birnbaum* illustrate this fact. The minority shareholders of Newport Steel Corporation were defrauded when the controlling shareholder refused an attractive merger offer that would have benefited all shareholders, in favor of a collusive opportunity to sell only his own shares at a substantial premium. The buyer then used his controlling position to supply steel to himself at favorable prices, at a time when the demand for steel far exceeded its supply.⁴¹ The plaintiffs were denied standing to sue since the fraud did not occur in connection with the purchase or sale of securities even though the plaintiffs, as shareholders, incurred a monetary loss.

It is apparent that the purchaser-seller limitation arose from the language of the rule, not the statute. It has been maintained earlier that the court's reliance on the rule was error.⁴² Nonetheless, for purposes of analysis, it will be assumed that the rule was the proper place to seek congressional intent. The rule provides in pertinent part:

It shall be unlawful for any person . . . 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.⁴³

This language was impliedly construed by the *Birnbaum* court in such a fashion that the "in connection with the purchase or sale" language modified the latter reference to "any person." That construction, coupled with a strict interpretation of the phrase "in connection with" resulted in the court's finding that the potential plaintiff had to be either a purchaser or seller to sue under the rule. There are two significant errors in this interpretation. The first is that the Supreme Court in *Bankers Life* construed the "in connection with" language liberally, holding that the alleged fraud need only "touch" the purchase or sale.⁴⁴ Therefore, the purchase or sale need only touch the potential plaintiff, and that would seem to require something less than purchaser or seller status, *i.e.*, injury in fact to an investor. Second, the language of 10b-5 has not been held to require that the defendant engage in a purchase or sale in order to be found liable.⁴⁵ The fraud

41. *Birnbaum v. Newport Steel Corp.*, 193 F.2d at 462.

42. See text accompanying note 23 *supra*.

43. Rule 10b-5, 17 C.F.R. § 240.10b-5 (1969).

44. 404 U.S. at 13.

45. *Heit v. Weitzen*, 402 F.2d 909 (2d Cir. 1968). In *Heit*, the plaintiffs purchased debentures in reliance upon a false annual report. When sued, the insiders maintained that plaintiffs lacked standing under 10b-5 because the *defendants* had not engaged in the purchase or sale of any security. The court construed section 10b and rule 10b-5 broadly stating there was no necessity for contemporaneous trading in securities by

need only occur in connection with a purchase or sale, and the defendant himself need not be engaged in a purchase or sale. Thus, the "in connection with" language in 10b-5 has been construed broadly when the analysis is undertaken from the standpoint of the defendant's liability, but has been narrowly construed in connection with the plaintiff.

As discussed above, neither the congressional history, the statute, the rule, nor the Supreme Court decision compelled the application of the purchaser-seller requirement. If a standing limitation is deemed necessary by the courts to effectuate the purposes of the Act, the appropriate test of standing is imposed by the Constitution. The Constitution limits the jurisdiction of the federal courts to "cases" and "controversies."⁴⁶ This "standing" concept permits adjudication only when the dispute is in an adversary context and in a form historically viewed as capable of judicial resolution.⁴⁷

The gist of the question of standing . . . [is whether the party seeking relief has] alleged such a personal stake in the outcome of the controversy as to assure that concrete adverseness which sharpens the presentation of issues upon which the court so largely depends for illumination of difficult constitutional questions?⁴⁸

In other words, "the question is whether the person whose standing is challenged is a proper party to request an adjudication of a particular issue and not whether the issue itself is justiciable."⁴⁹ In 1970, the Supreme Court, in *Association of Data Processing Service Organizations, Inc. v. Camp*,⁵⁰ announced a two-pronged test for the determination of standing. The first element of the test requires the plaintiff to allege that the actions he complains of have caused him injury in fact, economic or otherwise.⁵¹ The second element requires that "the interest sought to be protected by the complainant is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question."⁵² In other words, to afford a plaintiff standing under the statute, the statute must be debatably designed to redress the particular injury which the plaintiff has incurred. In

insiders or the corporation itself, in order to be held liable under the rule. See also *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90 (10th Cir. 1971).

46. U.S. CONST. art. III, § 2.

47. *Flast v. Cohen*, 392 U.S. 83, 95 (1968).

48. *Baker v. Carr*, 369 U.S. 186, 204 (1962).

49. *Flast v. Cohen*, 392 U.S. at 99.

50. 397 U.S. 150 (1970).

51. *Id.* at 152.

52. *Id.* at 153. Dissenting Justices Brennan and White were of the opinion that the second element of the test was "wholly unnecessary and inappropriate," because a determination of standing, they felt, should not be predicated on the merits of the complaint. *Id.* at 169.

applying the first element of the test in *Eason*, Judge Stevens observed that either plaintiff or defendant would suffer a loss of three hundred thousand dollars as a result of the outcome of the litigation, and held that such a large monetary loss would sufficiently sharpen the issues in satisfaction of the constitutional requirement.⁵³ On the second element, the court cited *Kardon v. National Gypsum Co.*,⁵⁴ which was the first case to hold that a civil action could be maintained under section 10b and rule 10b-5. In *Kardon*, Judge Kirkpatrick held that an action could be brought by a member of the class "for whose special benefit the statute was enacted."⁵⁵ Judge Stevens, deciding that 10b was designed to protect all persons "who, in their capacity as investors, suffer significant injury as a direct consequence of fraud in connection with a securities transaction," ruled that *Eason*, as a guarantor, was within the class sought to be protected by the statute.⁵⁶

The two-element test espoused in the *Data Processing* case is broad enough to encompass the remedial purposes of the Act, yet narrow enough to require an examination of the merits of the plaintiff's claim to determine if the fraud touches the purchase or sale of securities. Moreover, the demise of the purchaser-seller limitation, coupled with the adoption of the constitutional approach to standing, is consistent with the Supreme Court's admonition relative to the perspective to be adopted in construing the 1934 Act: "form should be disregarded for substance and the emphasis should be on economic reality."⁵⁷

DIFFERENCE OR SEMANTICS?

The definition of what constitutes a purchaser or seller within the meaning of the *Birnbaum* doctrine is not what might conceptually be expected. The court in *Herpich v. Wallace*⁵⁸ stated its current status and rationale thusly:

We do not say that only those who are purchasers or sellers in the "strict comon law traditional sense" . . . may maintain an action for damages under Rule 10b-5. . . . In deciding whether a plaintiff has standing, we search for what will best establish the congressional purpose. . . . Thus we construe the "in connection

53. *Eason v. GMAC*, 490 F.2d at 657. Although the court apparently applied the two-pronged test enunciated in *Data Processing*, the case was not expressly mentioned.

54. 69 F. Supp. 512 (E.D. Pa. 1946).

55. *Id.* at 514.

56. 490 F.2d at 659.

57. *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

58. 430 F.2d 792 (5th Cir. 1970).

with the purchase or sale of any security" clause found in both the section and the rule broadly and flexibly to effectuate that purpose. . . . The "purchaser"- "seller" standing requirement is to be similarly construed . . . so that the broad design of the section and the rule is not frustrated by the use of novel or atypical transactions.⁵⁹

Those instances in which the courts have considered the plaintiff to be a purchaser or seller are indeed novel under the factual situations presented. The courts have continually eroded the limitation in determining what constitutes a purchaser or seller although purporting to follow *Birnbaum*. A review of the cases embracing distortions and expansions of the purchaser-seller concept follows, for the purpose of establishing the extent of erosion and circumvention of the rule.

In several cases, the courts have determined that a corporation has standing as a purchaser and/or seller where a corporate sale, acquisition or merger occurs. In *Hooper v. Mountain States Securities Corp.*,⁶⁰ a corporation was defrauded into issuing 700,000 dollars worth of stock for assets of negligible value. The court held that a corporation's issuance of securities in return for assets or money is not unlike a sale of securities, and held that such a transaction satisfied the *Birnbaum* requirement. In *SEC v. National Securities Inc.*,⁶¹ National made a successful tender offer to the shareholders of the target corporation. However, the offeror corporation failed to advise the shareholders of the offeree corporation that assets of the offeree corporation were to be used to assist in payment of the acquisition. The court held that it was as though the shareholders of the offeree corporation had sold their shares for cash and then used the money from the sale to purchase shares in the offeror corporation. The exchange of shares was found to be equivalent to a purchase within the meaning of section 10b and rule 10b-5. The Seventh Circuit, in *Dasho v. Susquehanna Corp.*,⁶² extended the *National* holding by determining that the surviving corporation in a merger is both a purchaser and a seller of securities within the rule, and noted the result is the same where a sale of assets for securities takes place followed by a liquidation of the selling corporation. The factual situation in *Dasho* is almost the converse of *National*. Here, the merger occurred when insiders in the offeror corporation, overvalued the offeree corporation to secure profit for themselves arising out of their ownership interests in the offeree cor-

59. *Id.* at 806-07 (citations omitted).

60. 282 F.2d 195 (5th Cir. 1960).

61. 393 U.S. 453 (1969).

62. 380 F.2d 262 (7th Cir. 1967).

poration. The offeror corporation, as a result of its bargain, purchased 435,000 shares of its own stock held by the offeree corporation for almost two million dollars in excess of its fair market value. Again, the court found that the plaintiff had achieved the status of purchaser and seller.

The Court of Appeals for the Second Circuit, in *Vine v. Beneficial Finance Co.*,⁶³ conceived the "forced-seller" doctrine as another method to avoid the *Birnbaum* doctrine. In *Vine*, the plaintiff was characterized as a seller of securities even though no actual sale took place. Through misrepresentation, insiders of the offeror corporation obtained 95 per cent of the stock of the offeree corporation in a tender offer. Under Delaware law, holding stock in that percentage permits the holder to effectuate a short-form merger.⁶⁴ The plaintiff in *Vine* was one of the squeezed-out shareholders whose only recourse in such a merger is the right to the appraisal value of his stock from the surviving corporation. The court found a constructive sale, with the plaintiff a constructive or forced seller. The court stated that where a shareholder's investment is changed from an interest in a going enterprise to a right solely to the payment of money, he should be treated as a seller and permitted standing to complain of the fraud that resulted in the sale.

Two cases decided by the Second Circuit in 1969 demonstrate how the application of the forced-seller doctrine, with its ambiguities and uncertainties, can achieve incongruous results through its inconsistent application by the courts. In *Iroquois Industries, Inc. v. Syracuse China Corp.*,⁶⁵ a tender offer was frustrated by insiders of the target corporation who misrepresented facts to their shareholders in order to discourage them from tendering their shares. Consequently, the tender offer failed. Although the offeror obtained a substantial number of shares, it did not obtain working control, which it desired. The plaintiff sought to meet the *Birnbaum* standard by reason of the purchase of the shares it had acquired in the tender offer. The court held that the plaintiff was not defrauded in the shares it purchased, but rather was defrauded in the shares it was unable to purchase. Hence there was no fraud in connection with a purchase and no resultant standing to sue. The facts in *Crane Co. v. Westinghouse Air Brake Co.*⁶⁶ are

63. 374 F.2d 627 (2d Cir. 1967).

64. A short form merger permits the corporation holding the stock to merge the corporation whose stock is held into the holding corporation without the consent of the remaining shareholders.

65. 417 F.2d 763 (2d Cir. 1969).

66. 419 F.2d 787 (2d Cir. 1969).

substantially similar to *Iroquois* with these variations: First, instead of the target corporation, Westinghouse, engaging in the misrepresentation, it sought and obtained a friendly merger partner, Standard, who engaged in the alleged fraud. Second, the stock which the offeror gained in its unsuccessful tender offer, was the subject of a forced sale (divestiture) under threat of an antitrust suit, as both Crane and Standard were engaged in the manufacture of plumbing fixtures. The Second Circuit held that Crane had standing to sue because of its later forced sale, even though the later sale was not the sale touched by fraud. In fact, a profit of several million dollars was made. The fraud occurred in both *Iroquois* and *Crane* when the purchaser was unable to obtain shares that it desired because of the alleged misrepresentations. Consistency would require that *Crane* be denied standing under the logic of *Iroquois*, since in *Crane* the subsequent forced sale was not touched by the fraud. The Second Circuit supported its rationale in *Crane* by focusing on the *Vine* test, later summarized by the Fifth Circuit in *Dudley v. Southeastern Factor and Finance Corp.*⁶⁷

Vine's informing principle, carried forward in *Crane*, is that a shareholder should be treated as a seller when the nature of his investment has been fundamentally changed from an interest in a going enterprise into a right solely to a payment of money for his shares.⁶⁸

The *Iroquois* and *Crane* cases highlight the type of problems which courts may encounter when attempting to analyze fact situations through the ambiguities of the purchaser-seller rule. The Second Circuit, in its adherence to *Vine*, undercut its own logic in *Iroquois* when it decided *Crane*.⁶⁹ If the cases had been approached from the standpoint of the constitutional requirements for standing to sue, the forced seller doctrine would never have been developed. The court would have recognized that the plaintiff in *Iroquois* and *Crane* had suffered injury in fact in its attempted securities purchases which section 10b was enacted to protect. As previously noted, the facts of the *Crane* case were identical to *Iroquois* with the exception of the antitrust implications. Thus, the standing requirement would be met under the constitutional analysis in both cases.

A further extension of the purchaser-seller definition was enunciated in *A. T. Brod & Co. v. Perlow*,⁷⁰ which conceived the aborted pur-

67. 446 F.2d 303 (5th Cir. 1971).

68. *Id.* at 307.

69. Kellogg, *The Inability to Obtain Analytical Precision Where Standing to Sue Under Rule 10b-5 is Involved*, 20 BUFF. L. REV. 93 (1971).

70. 375 F.2d 393 (2d Cir. 1967).

chaser-seller doctrine. In that case, a customer ordered his broker to purchase stock for him with the intent to pay for it only if the value of the stock increased by the time the time payment was due. The court held that the customer's order to his broker was a contract of purchase by the customer, consequently the broker was a seller within the meaning of the *Birnbaum* rule and had standing to sue under 10b-5.

The Sixth Circuit, in *James v. Gerber Products Co.*,⁷¹ purported to follow *Birnbaum* and merely add another extension to the purchaser-seller definition. In fact, the court's analysis refutes *Birnbaum* and supports the *Eason* approach. In *Gerber*, a bank was the trustee of a testamentary trust, that happened to have officers of the Gerber Products Co. (Gerber) on its board. The plaintiff's trust contained substantial holdings of Gerber stock. A sale was arranged to Gerber of 15,000 shares of the stock from the trust at the closing price on the New York Stock Exchange on the day of the sale. At the time, the market price of Gerber was depressed well below its actual value, a fact then unknown to the market at large. The plaintiff alleged that inside information on the part of the Gerber representatives instigated the sale. The court held that the beneficiary, as the real party in interest, should be considered the seller and given standing to sue, stating:

As beneficiary, she was the person who was to be benefited by the sale and thus she had the interests of a de facto seller. . . . [S]eparating the legal and beneficial incidents of ownership in the property is a mere technical argument since there is only one interest at stake and that is the beneficiary's.⁷²

The court also observed that rule 10b-5 was designed to protect against a wide variety of deceptive activities in securities transactions without regard to the limitations of a common law action for fraud.

Although *Gerber* purported to apply the *Birnbaum* doctrine, it presented a cogent argument for abandoning *Birnbaum's* rationale. First, although a state remedy existed, the court permitted the plaintiff-beneficiary standing to sue. Second, and most important, the court held that the plaintiff was the real party in interest, and as such, should have standing to sue. In short, labels should not control the determination of standing.⁷³ The court's logic is equally applicable to share-

71. 483 F.2d 944 (6th Cir. 1973).

72. *Id.* at 948-49.

73. See also *Drachman v. Harvey*, 453 F.2d 722 (2d Cir. 1972) (beneficial shareholders in debenture redemption plan); *Bailes v. Colonial Press, Inc.*, 444 F.2d 1241 (5th Cir. 1971) (trustee-in-bankruptcy).

holders of a corporation, who as a result of the *Birnbaum* rule, do not have standing to sue in their own right if the sale giving rise to the fraud is transacted by the corporation. Although shareholders do have the right to sue derivatively on behalf of their corporation,⁷⁴ many times, such as in *Eason*, that right is of no value when the misrepresentation results in an action directly against the shareholder so that he is unable to interpose the corporation to obtain standing derivatively.⁷⁵ The courts permit a corporation to bring an action for fraud under 10b-5 when it participates in a purchase or sale. The result should not be different when the real party in interest, the shareholder, seeks to bring an action in his own behalf when the fraud has been perpetrated upon the corporation, and has caused injury in fact to the shareholder in his capacity as an investor.

The final line of cases illustrate the exception to, rather than an extension of, the purchaser-seller limitation. In these cases, the courts permit injunctive relief to plaintiffs who are not purchasers or sellers by stressing the dissimilarity between damage and injunctive actions. In *Mutual Shares Corp. v. Genesco, Inc.*,⁷⁶ the defendant, after obtaining control of the Kress Company, depressed the dividends of the corporation to facilitate purchase of the remaining outstanding stock at reduced prices. The court held that since the plaintiff had not yet sold his stock, he lacked standing to sue for damages because he was not yet a seller. However, the court held that the plaintiff could sue for injunctive relief because the complaint alleged a manipulative scheme that still continued. The court stated:

[T]he claim for damages . . . founders both on proof of loss and the causal connection with the alleged violation of the Rule; on the other hand, the claim for injunctive relief largely avoids these issues⁷⁷

This remark by the Second Circuit may give some insight into a possible purpose of the courts in sustaining the *Birnbaum* limitation. It suggests that the purchaser-seller limitation is continually reaffirmed not because of a statutory mandate, but rather as a device to avoid problems of proof. Another leading case which permits injunctive relief to one not a purchaser or seller is *Kahan v. Rosenstiel*.⁷⁸ The de-

74. *Shell v. Hensley*, 430 F.2d 819, 824 (5th Cir. 1970).

75. In *Eason*, GMAC was able to avoid action against the corporation by suing the shareholders directly on their personal guarantees.

76. 384 F.2d 540 (2d Cir. 1967).

77. *Id.* at 547.

78. 424 F.2d 161 (3d Cir. 1970); *see, e.g.*, *Britt v. The Cyril Bath Co.*, 417 F.2d 433 (6th Cir. 1969); *Erling v. Powell*, 429 F.2d 795 (8th Cir. 1970); *Vincent v. Moench*, 473 F.2d 430 (10th Cir. 1973).

defendant was the controlling stockholder of the Schenley Corporation, who sold his stock at a premium to the Glen-Alden Corporation. Glen-Alden then made a tender offer for the remaining outstanding shares of Schenley, representing that the tender was equal in value to the amount per share paid to Rosenstiel. Plaintiff was a non-tendering shareholder who alleged that the offer of Glen-Alden did not approximate the Rosenstiel bargain, and charged misrepresentation and fraud. The court said, in granting equitable relief:

Neither the language of § 10b and Rule 10b-5 nor the policy they were designed to effectuate mandate adherence to a strict purchaser-seller requirement so as to preclude suits for relief if a plaintiff can establish a causal connection between the violations alleged and plaintiff's loss.⁷⁹

The courts in the injunction-plaintiff cases, in pursuing a causation approach, look to the relation of the plaintiff to the defendant, not the title of either party, as their primary analytical tool.⁸⁰ In other words, these decisions permit the real party in interest to bring suit for equitable relief if such party can demonstrate a causal connection between the fraud alleged and the injury suffered. This analysis is applicable to damage actions as well as injunctive suits. In permitting the injunctive remedy, the courts are acknowledging that the plaintiff is being damaged by the defendant. It seems incongruous to permit a plaintiff to prevent future damage, yet deny him recovery for damage already suffered.

The trend of the decisions which deviated from the *Birnbaum* rationale was summarized by the Ninth Circuit in *Mount Clemens Industries, Inc. v. Bell*:⁸¹

These allegations clearly reveal that appellants never actually purchased or sold the Missile stock. Yet that circumstance does not end our inquiry, for under the liberal interpretation that has sometimes attended the application of the *Birnbaum* doctrine, there have been cases in which standing has been afforded to persons who, even though not actual purchasers or sellers, have been deemed to have the required status.⁸²

Echoing the Ninth Circuit, Judge Stevens remarked in *Eason* that, "[T]he course of judicial decision since 1952, when *Birnbaum* was decided, has actually recognized that the class of protected persons is

79. 424 F.2d at 173.

80. Brief for Respondents in Opposition to Certiorari, at 11, *GMAC v. Eason*, 416 U.S. 960 (1974).

81. 464 F.2d 339 (9th Cir. 1972).

82. *Id.* at 345.

broader than merely purchasers and sellers."⁸³ The brief for respondents in opposition to certiorari in *Eason* stated:

Some circuits, like the Second, Third, and Fifth, purport to accept the *Birnbaum* purchaser-seller limitation, but then extend 10b-5 protection by treating persons as purchasers and sellers even though they are not. . . . Other circuits, like the Eighth, Ninth and Tenth are moving toward a causational approach. The recent decisions of the Sixth and Seventh circuits look more to the purpose of Rule 10b-5 and the class of persons to be protected by the Rule. *To a circuit*, however, the answer to the question . . . is the same. Persons who are neither purchasers nor sellers of securities are allowed to maintain 10b-5 actions.⁸⁴

It has been demonstrated that the broad remedial purpose of the Act can prevail when the court so desires. Any difference between the cases reviewed and *Eason* is in the semantics of the rationale, not in the result. *Eason*, unlike its predecessors, in refusing to accept the purchaser-seller requirement, adopts an analysis which does not look to who the plaintiff is in providing a remedy for fraud under 10b-5.

POLICY CONSIDERATIONS

The respondents in *Eason* raised two policy arguments before the Seventh Circuit in their unsuccessful quest to have the *Birnbaum* limitation upheld. The first contention was that removal of the purchaser-seller limitation would unleash an unmanageable flood of litigation.⁸⁵ The second objection was that the court, if it refused to follow *Birnbaum*, would not be preserving national consistency in the interpretation of federal securities legislation.⁸⁶

On the first point, the petitioner's brief for certiorari quotes Judge Stevens supposition in *Eason* that even if "complete abandonment of *Birnbaum* will significantly increase our workload" it is not sufficient justification to reject what the court believes to be "a correct interpretation of the statute."⁸⁷ The brief goes on to argue:

Without question, the practical impact of any particular interpretation of a statute is *not a relevant consideration* in the process of statutory interpretation, the exclusive purpose of which is to de-

83. 490 F.2d at 659.

84. Brief for Respondents in Opposition to Certiorari, at 14, *GMAC v. Eason*, 416 U.S. 960 (1974).

85. 490 F.2d at 660.

86. *Id.* The continuing validity of this argument may be laid to rest in *Manor Drug Stores v. Blue Chip Stamps*, 492 F.2d 136, *cert. granted*, 43 U.S.L.W. 3273 (U.S. Nov. 12, 1974).

87. Petitioner's Brief for Certiorari, at 17, *GMAC v. Eason*, 416 U.S. 960 (1974), citing *Eason v. GMAC*, 490 F.2d at 660.

termine the intent of Congress in enacting the statute in question. Nevertheless, the practical impact of the interpretation adopted . . . is certainly a highly relevant consideration in assessing the importance of the decision below.⁸⁸

If the practical impact of a decision is irrelevant to a court construing a statute, then such considerations should not be relevant to a reviewing court, simply because the reviewing court is in fact interpreting the statute anew. Arguably, the practical impact of the statute may be relevant, but only to the extent Congress considered it when enacting the statute. The anticipation of Congress in evaluating the statute's consequences is pertinent to its intent in promulgating the statute. However, where the congressional history is devoid of any comment on the anticipated effect, the court should defer to the purpose conveyed by the statute in its determination regardless of the number of persons enfranchised. The *Eason* court, however, utilized a different approach:

The extent to which a refusal to adhere to *Birnbaum* will affect that volume is really a matter of speculation. . . . The number of parties who may invoke Rule 10b-5 without the purchaser-seller limitation may not differ materially from the number who would recover by persuading a court to interpret the purchaser-seller concept flexibly.⁸⁹

The second policy consideration presented in *Eason* also lacks persuasive force. The argument is made that the purchaser-seller standing limitation should not be overruled in order to preserve national consistency in the interpretation of federal securities legislation. The petitioner's brief quotes *Blau v. Leheman*:⁹⁰

Congress can and might amend [the Act] if the Commission would present to it the policy arguments it has presented to us, but we think that Congress is the proper agency to change an interpretation of the Act unbroken since its passage, if the change is to be made.⁹¹

The argument might have force if there was a substantial difference in the outcome of cases involving the purchaser-seller question as a consequence of the Seventh Circuit decision. The difference between *Eason* and the cases purporting to follow *Birnbaum* is primarily semantic, reflecting the fact that the exceptions and extensions to the standing limitation largely envelop the rule. In addition, it was only

88. *Id.* at 18 (emphasis added).

89. 490 F.2d at 660.

90. Petitioner's Brief for Certiorari, at 10, *GMAC v. Eason*, 416 U.S. 960 (1974), citing *Blau v. Leheman*, 368 U.S. 403, 413 (1962).

91. 368 U.S. at 413.

2 years earlier that the Supreme Court substantially modified the substantive ruling of the *Birnbaum* decision in *Bankers Life* without directing the proponents of change to seek their remedy in Congress. That interpretation of the Act had also been unbroken for 20 years prior to the Supreme Court's decision to modify it. Since the Court was able to change the substantive ruling of *Birnbaum*, there is little reason why it is unable to change the procedural ruling as well. Finally, Judge Stevens concluded in the *Eason* opinion that the controversy surrounding consistency of interpretation of securities legislation is exaggerated:

We are inclined to think that the extent of the consistency in applying *Birnbaum* is overstated and is less important than an independent appraisal of an important issue arising in an area of the law which, despite the age of the statute, is still in an embryonic stage of development.⁹²

Another policy consideration of considerable importance is the fact that the dramatic growth of securities law coverage of the past two decades, primarily under rule 10b-5, has created a burgeoning federal corporation law. In commenting upon the court construction of section 10b of the 1934 Act, the court in *McClure v. Borne Chemical Co., Inc.*⁹³ said:

That Act deals with the protection of investors, primarily stockholders. It creates many managerial duties and liabilities unknown at common law. It expresses Federal interest in management-stockholder relationships which theretofore had been almost exclusively the concern of the states. Section 10(b) imposes broad fiduciary duties on management viz-à-viz the corporation and its individual stockholders. As implemented by Rule 10b-5 . . . Section 10(b) provides stockholders with a potent weapon for enforcement of many fiduciary duties. It can be fairly said that the Exchange Act of which Section 10(b) [is a part] . . . constitutes far reaching federal substantive corporation law.⁹⁴

The growth of federal corporate law has evolved as a result of the failure of state corporate statutes to provide adequate protection for the needs and interests of stockholders and other investors. Judge Learned Hand recognized the basis for the growth of federal corporation law when he observed that the undesirable and conceptualistic state law construction of fiduciary principles as applied to corporate insiders in securities transactions creates "a grave omission in our cor-

92. 490 F.2d at 661.

93. 292 F.2d 824 (3d Cir. 1961).

94. *Id.* at 834.

porate law."⁹⁵ Professor Stanley A. Kaplan pointed to the state's failure to curb the wide latitude given to corporations—a practice detrimental to the shareholder's well-being:

In states such as Illinois, Delaware and New York, and states which have adopted the Model Business Corporation Act, the basic theory of the statutes, in effect, is to set up enabling provisions to permit a corporation to act with considerable freedom, to forbid only certain egregious improprieties and to require only certain specified shareholder protection.⁹⁶

Again, the states have not yet learned their lesson, that abdication of their responsibility to the public, either as a result of the efforts of special interest groups or otherwise, will encourage the osmotic entry of the federal government to fill the void which the absence of state action creates, whether judicially or legislatively.

Commentators have disagreed with respect to the desirability of the expansion of federal interests in corporate activities.⁹⁷ It seems undeniable that the states have a vested interest in providing liberal corporation laws in order to compete for the corporate franchise taxes. This interest conflicts with interests of shareholder protection.⁹⁸ As the states have utilized such an approach, adequate protection of the shareholders' interests has defaulted to the federal government resulting in the expansion of the existing federal securities law.

Elimination of the purchaser-seller requirement will remove perhaps the last major barrier to shareholder redress in the federal courts for fraud perpetrated upon shareholders and corporations by other corporations and insiders. The Supreme Court in *Bankers Life* removed from corporate insiders, the cloak of privilege from federal action that *Birnbaum* had draped about them on the grounds that an adequate state remedy existed.⁹⁹ While *Bankers Life* did not address itself to the adequacy of the state remedy, it would be fair to infer that had an adequate state remedy been in fact available, there would have been no need for the Supreme Court to provide a federal remedy. Removal of the purchaser-seller limitation will perfect the availability of a fed-

95. *Gratz v. Claughton*, 187 F.2d 46, 49 (2d Cir. 1951).

96. Kaplan, *Corporation Law and Securities Regulation*, 18 BUS. LAW. 868, 869 (1963).

97. Bahlman, *Rule 10b-5: The Case for Its Full Acceptance as Federal Corporation Law*, 37 U. CIN. L. REV. 727 (1968); Hankel, *Codification—Civil Liability Under the Federal Securities Laws*, 22 BUS. LAW. 866 (1967); Painter, *Inside Information: Growing Pains in the Development of Federal Corporate Law Under Rule 10b-5*, 65 COLUM. L. REV. 1361 (1965); Ruder, *Pitfalls in the Development of a Federal Law of Corporations by Implication Through Rule 10b-5*, 59 NW. U.L. REV. 185 (1964).

98. H. HENN, *LAW OF CORPORATIONS*, §§ 92-95, at 131 (2d ed. 1970).

99. See note 34 *supra*.

eral remedy for corporate shareholders whose current state remedy is still far from satisfactory.

Three other policy considerations emerge in the cases and commentary which should, so it is maintained, bar the abandonment of the *Birnbaum* limitation: (1) the difficulty of determining causation between the plaintiff's injury and the fraud alleged;¹⁰⁰ (2) the difficulty of determining damages where no purchase or sale takes place by the plaintiff;¹⁰¹ and (3) the potential for unlimited liability when many persons are adversely affected by the fraud alleged.¹⁰² The difficulty with the first two arguments is that there are established areas of the law that deal with these particular problems. The law of torts has innumerable cases on the subject of causation and proximate cause.¹⁰³ Similarly, the law of damages has established methods for the determination of damages, even where assessment is difficult.¹⁰⁴ The complexity of determining causation and damages should not be the rationale employed to deny an injured party access to the courts. On the question of liability, if section 10b's purpose is to prevent manipulation and fraud, then overwhelming liability imposed upon those who persist in utilizing fraudulent methods, will go farther than criminal sanctions in correcting the abuses the Act was designed to remedy. Further, either liability exists or it does not in a specific case. The determination of the existence of such liability should not be based upon the possibility that the liability may be extensive.

In sum, Lewis Lowenfels perhaps best articulates the policy reasons for the elimination of *Birnbaum*:

The infinite variety of problems which the courts are called upon to consider, the many varieties and complexities of fraud which are possible in contemporary securities markets, the ingenuity of potential wrongdoers—all argue strongly against having any rigid, inflexible judicial requirement other than the presence of the fraud itself as a *sine qua non* of the right to sue. If such a rigid doctrine is permitted to exist, clever men will always find ways to perpetrate their wrongdoings without incurring liability.¹⁰⁵

CONCLUSION

It is evident that the purchaser-seller limitation was engrafted on

100. *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 547 (2d Cir. 1967).

101. *Id.*

102. *Herpich v. Wallace*, 430 F.2d 792, 804 (5th Cir. 1970), citing R. JENNINGS & H. MARSH, *SECURITIES REGULATION* 961 (2d ed. 1968).

103. W. PROSSER, *LAW OF TORTS* § 41, at 236 (4th ed. 1971).

104. J. SUTHERLAND, *LAW OF DAMAGES* § 1171 at 4388 *et seq.* (4th ed. 1916).

105. Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268 (1968).

section 10b via rule 10b-5. As a result, a statutory standing requirement was created where it had not previously existed. The restriction excluded from remedy many plaintiffs who were victims of misrepresentation and manipulation in connection with the purchase or sale of securities, merely because they failed to be directly involved in the fraudulent purchase or sale. Authority for the standing qualification could not be found in the scant congressional history available on section 10b. Although there was no evidence of any intended restriction upon plaintiffs, the congressional hearings indicated a broad anti-fraud purpose which eventually manifested itself in the language of section 10b. However, the *Birnbaum* court imposed the restriction in its construction of the rule, pointing to the S.E.C.'s announced purpose at the time of the rule's inception. If a permanent obstacle is to be placed in the path of potential plaintiffs seeking remedy from fraud pursuant to the securities acts, then the limitation should be predicated upon the statute, not in the rule.

Even if the limitation is properly founded in the agency's rule, then the well delineated position of the S.E.C. over the past decade in opposition to the limitation, should be granted a degree of deference by the courts. The agency's current position should control to the extent that its interpretation does not exceed the parameters of statutory authority. The sole standing requirement should be dictated by the Constitution: an injury in fact which the statute proposes to remedy. Such an approach would further Congress' intent by protecting investors from fraud rather than scrutinizing the investor to ascertain if he qualifies under a contrived standing requirement not relevant to the fraud alleged. Injury to the plaintiff, not his position in the transaction, should control access to the courts.

All of the circuits subscribe to one or more of three basic viewpoints in their ostensibly unanimous opposition to the Seventh Circuit's stance in *Eason*. These viewpoints can be roughly categorized as the (1) constructive, (2) causation, and (3) purpose approaches to standing. The constructive approach adopts a solution in avoidance of *Birnbaum's* import by construing the plaintiff to be a purchaser or seller within the meaning of that concept. The causation approach, found primarily in suits for equitable relief, permits standing to sue where the plaintiff demonstrates a causal connection between the fraudulent sale of a security and injury to himself. The purpose approach looks to the interests sought to be protected by the enactment of the statute and the promulgation of the rule. Regardless of the

approach adopted, all share a common result: every circuit which has considered the question has, at one time or another, managed to find standing for a plaintiff that would otherwise have been without a federal remedy under a strict interpretation of the *Birnbaum* rule. This very achievement is the strongest argument of all for the semantically straightforward approach of *Eason v. GMAC*.

The policy considerations proffered in support of retention of the *Birnbaum* limitation do not withstand careful analysis. The contention that removal of the purchaser-seller limitation would cause a flood of litigation is speculative. The number of plaintiffs may not materially differ from those now litigating in the hope of persuading the courts to construe the limitation broadly. Also, if Congress' purpose was to provide investors who suffer from fraud with a remedy, then the fears of the courts as to the number of potential litigants should not be permitted to thwart that congressional intent.

The argument that *Birnbaum* should be retained to preserve consistency in interpretation of securities legislation is illusory. The courts have shown a willingness to alter their views on other similar securities matters. In addition, the change sought here would not produce a drastic difference of result from what currently exists, but primarily a difference of rationale.

The policy contention that overruling *Birnbaum* would promote the further expansion of federal corporate law, assumes that such expansion is undesirable. The failure of the states to provide an adequate remedy for defrauded shareholders where, under our system of justice, an adequate remedy should lie, provides an open invitation to the federal government to fill the void. Where a remedy is needed, its provision is more important to society in general, than the particular jurisdiction providing it. If state governments decide that the federal tentacles spread too far, the states, through legislation, can provide a competing forum. Thus, from a policy standpoint, the *Eason* approach appears to be a valid one if the Supreme Court is willing to utilize it.

The initial reaction of the circuits deciding cases subsequent to *Eason*, has been to reaffirm the *Birnbaum* limitation without discussion of *Eason*.¹⁰⁶ However, with the Supreme Court granting certiorari in *Blue Chip Stamps v. Manor Drug Stores*,¹⁰⁷ where the validity of

106. *Manor Drug Stores v. Blue Chip Stamps*, 492 F.2d 136 (9th Cir. 1974); *Sargent v. Genesco, Inc.*, 492 F.2d 750 (5th Cir. 1974); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579 (5th Cir. 1974).

107. 43 U.S.L.W. 3273 (U.S. Nov. 12, 1974).

the purchaser-seller requirement is directly in issue, a conclusive resolution appears finally to be at hand. *Manor Drugs* affords the Supreme Court the opportunity to establish a remedy for defrauded investors against corporate manipulation which adversely affects their interests, regardless of whether or not they are purchasers or sellers.

Compelling reasons for overruling the *Birnbaum* doctrine are found in *Young v. The Seaboard Corporation*.¹⁰⁸

There is no reasoned basis for concluding that a plaintiff's . . . standing . . . depends upon whether retrospective injunctive relief rather than damages is necessary to cure his injury. Such a distinction is impractical and would soon be eroded [Limitations of damage claims] are better resolved through an application of the law of damages, as the *Vincent* court's causality approach suggests, rather than through the erection of standing barriers supposedly anchored in the statute itself but which are frequently elbowed aside. In the opinion of this court, the *Vincent* decision suggests that *any person, not just one seeking equitable relief*, who shows a causal connection between the fraudulent sale of a security and injury to himself may sue under Rule 10b-5.¹⁰⁹

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108. 360 F. Supp. 490 (D. Utah 1973).

109. *Id.* at 494 (emphasis added).