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## I. Introduction

Since mid-1975, the Burger Court has handed down an unprecedented number of significant decisions[1] under the Securities Act of 1933[2] and the Securities Exchange Act of 1934.[3] All of these holdings favor defendants[4] and are the product of a Supreme Court that takes a restrictive view of the 1933 and 1934 Acts. This restrictive view is in sharp contrast to the Warren Court of 1964-1972.[5] Just as

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1. The quantity of decisions is staggering. In terms of *all* the federal securities laws, the Court's next most active period appears to be 1943-1947, when it decided the following nine cases, only three of which involved the Acts: Penfield Co. of California v. SEC, 330 U.S. 585 (1947) (section 20(a) of 1933 Act); American Power & Light Co. v. SEC, 329 U.S. 90 (1946) (section 11(b)(2) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79k (b)(20) (1976)); SEC v. W.J. Howey Co., 328 U.S. 293 (1946) (section 2(1) of the 1933 Act); North American Co. v. SEC, 327 U.S. 686 (1946) (section 11(b)(1) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79k (1976)); American Power & Light Co. v. SEC, 325 U.S. 385 (1945) (section 24(a) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79x (1976)); Otis & Co. v. SEC, 323 U.S. 624 (1945) (section 11(b)(2) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79k (1976)); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943) (section 2(1) of the 1933 Act); Jersey Central Power & Light Co. v. Federal Power Comm'n, 319 U.S. 61 (1943) (sections 201 and 203(a) of the Federal Power Act, *as amended by* Public Utility Act of 1935, 16 U.S.C. §§ 824 and 824(b) (1976)); SEC v. Chenery Corp., 318 U.S. 80 (1943) (section 24(a) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79x (1976)).

2. 15 U.S.C. § 77 (1976) [hereinafter cited as the 1933 Act].

3. 15 U.S.C. § 78 (1976) [hereinafter cited as the 1934 Act].

4. The only Supreme Court decision in plaintiff's favor, SEC v. Sloan, 98 S. Ct. 1702 (1978), was actually a victory for potential defendants, for it restricted the Securities and Exchange Commission's power summarily to suspend trading in a particular security. *See* notes 118-25 and accompanying text *infra*.

5. Strictly speaking, the Warren Court era ended in 1969 when Warren E. Burger replaced Earl Warren as Chief Justice. The Court's expansive approach to the Acts, however, a hallmark of Chief Justice Warren's tenure, continued through the 1972 decision of Affiliated

lower tribunals read the Warren Court as strongly encouraging broad rulings and interpreted the Acts accordingly, one can expect future judicial developments to mirror the Burger Court's recent, dramatic turnaround.

This article examines the Supreme Court's significant decisions under the Acts during both the Warren Court period of 1964-72 and the Burger Court period of 1975 to the present. Six Warren Court decisions and eight Burger Court decisions are analyzed as well as their effect on lower court rulings. The examination reveals that the approach of the Court to the federal securities laws is quite different during each period.

## II. The Warren Court

### *A. Significant Decisions*

An analysis of the 1964-1972[6] decisions produces two important observations. First, each case was decided in favor of plaintiff in a way that resulted in expanded coverage of the Acts. Second, the Court interpreted the Acts with a remedial philosophy that encouraged such expansion.

*1. Broad Holdings.*—Three decisions, two of which frame the eight-year period, bear witness to the Court's broad, plaintiff-oriented holdings. The earliest, *J.I. Case Co. v. Borak,*[7] concerned a plaintiff shareholder who instituted an action for damages and other relief[8] for alleged misrepresentations in proxy material used in connection with the merger of the shareholder's corporation.[9] Plaintiff based the suit partially upon section 14(a)[10] of the 1934 Act and

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Ute Citizens v. United States, 406 U.S. 128 (1972). It therefore seems appropriate to characterize the Supreme Court of 1964-72 as the Warren Court.

6. The author's view is that the six decisions examined in Part II are significant primarily for their role in shaping judicial developments under the Acts. In addition to these six decisions, the Court decided five cases during this period that directly involved the federal securities laws. Only two concerned issues under the Acts—Reliance Elec. Co. v. Emerson Elec. Co., 404 U.S. 418 (1972) (section 16(b) of the 1934 Act) and SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967) (section 3(a) of the 1933 Act). Neither *Reliance* nor two later Court decisions involving section 16(b) are examined in this article. *See* note 81 *infra.*

7. 377 U.S. 426 (1964).

8. The shareholder sought both rescission of the merger and damages. *Id.* at 429-30. Although the Court left the question of remedy for the trial court, it implied that a broad range should be available. *Id.* at 433-35.

9. *Id.* at 429.

10. 15 U.S.C. § 78n(a) (1976) provides,

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, 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, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78l of this title.

upon one of its implementing rules, 14a-9.[11] Although the statute clearly proscribed defendants' alleged misconduct, it did not establish private action for its violation. Nevertheless, a unanimous Court concluded that private parties have a right under Section 27 of the 1934 Act[12] to bring suit for violation of section 14(a) of that Act.[13] The Justices reasoned that implication of the private action accorded with the broad remedial purposes of section 14(a)[14] and that private enforcement of the proxy rules is a necessary supplement to SEC action[15] in processing proxy solicitation materials. *Borak,* which marked the Court's first recognition of an implied right of action under the federal securities laws, thus became the basis for subsequent lower court rulings in favor of implied private claims.[16]

After *Borak* it was inevitable that the Court would have to resolve disputes about the elements of a section 14(a) private action and the Court did so in *Mills v. Electric Auto-Lite Co.*[17] In *Mills,* minority shareholders of a merged corporation charged that management's proxy statement used to obtain shareholder approval of the merger was defective because it did not state that the board of directors, which supported the merger, was controlled by the acquiring entity.[18] At issue was the extent to which plaintiffs, as part of their section 14(a)[19] claim, must establish that the alleged violations actually caused the minority shareholders, some of whose votes were necessary to consummate the merger, to vote in favor of the transaction.[20] The circuit court, basing its decision on its perception of the

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11. Rule 14a-9, 17 C.F.R. § 240.14a-9 (1977), prohibits material misrepresentations and omissions in connection with a proxy solicitation subject to § 14(a). *See* note 10 *supra.*

12. Section 27 of the 1934 Act, 15 U.S.C. § 78aa (1976), grants the federal district courts jurisdiction over "all suits in equity and actions at law brought to enforce any liability or duty created" under the Act.

13. 377 U.S. at 430-31. The opinion's lack of analysis with regard to this conclusion has been highly criticized.

> With respect, the opinion does not say very much except that private rights of action will be implied when necessary to the achievement of the statutory objective. To consider it "clear" without discussion that a private action under the proxy rules is one "brought to enforce any liability or duty created by this title" within the meaning of § 27 . . . is to beg the question somewhat . . . . In short, the Court reached the right result not for the wrong reason but for no reason at all.

5 L. Loss, Securities Regulation 2882 (2d ed. Supp. 1969).

14. 377 U.S. at 431.

15. *Id.* at 432.

16. "At least since *[Borak,]* it has been accepted in securities law that when a statutory provision imposes a duty on someone in favor of a class of protected persons, those persons may sue for the 'statutory tort' committed when the duty is breached." Redington v. Touche Ross & Co., [1978 - Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,404, at 93,434 (2d Cir.), *cert. granted,* 47 U.S.L.W. 3368 (Nov. 28, 1978). A number of commentators, however, have recently taken the position that the Court has retreated from *Borak's* sweep. *See, e.g.,* the authorities cited in the dissenting opinion in *Redington, id.* at 98,439 n.2.

17. 396 U.S. 375 (1970).

18. *Id.* at 378.

19. Plaintiffs claimed violation of § 14(a) and rule 14a-9. *See* notes 10-11 *supra.*

20. The merger agreement required a 67% vote; the control group had 54%. 396 U.S. at 379.

impossibility of inquiring into the mental processes of the minority shareholders, held that causation would be presumed from the materiality of the nondisclosure.[21] Nevertheless, the court further ruled that defendants could rebut this presumption, and thus defeat the section 14(a) claim, by demonstrating the merger's fairness.[22]

On appeal, a unanimous Supreme Court reversed the lower court.[23] The Court reasoned that the fairness test used by the lower court added an extra barrier to small shareholders to challenge successfully a recommended proposal in a defective proxy statement.[24] Moreover, the Supreme Court's formulation of causation was less constrictive than that of the appellate court.

> Where there has been a finding of materiality a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress if . . . he proves that the proxy solicitation itself, rather than the particular defect in the solicitation, was an essential link in the accomplishment of the transaction.[25]

Thus, *Mills* relaxed the causation requirement by holding that causation "equals materiality plus essentiality of proxy solicitation."[26] Any lingering doubts about the Justices' bias toward easy access to the federal courts[27] for violations of section 14(a) and the proxy rules vanished with their statement that the test for causation "resolv[ed] doubts in favor of those the statute is designed to protect"[28]—that is,

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21. 403 F.2d 429 (7th Cir. 1968). The district court had entered an interlocutory summary judgment determining liability against defendants under one of plaintiffs' counts, 281 F. Supp. 826 (N.D. Ill. 1967), but the circuit court held that an issue of fact was presented with respect to the causal connection between the deficiency in the proxy statement and the merger of the corporations, 403 F.2d at 435.

22. Mills v. Electric Autolite Co., 403 F.2d 429, 435 (7th Cir. 1968), *vacated,* 396 U.S. 971 (1970). The discussion of causation by both the Seventh Circuit and the Supreme Court was in the context of a completed transaction for which prospective relief was no longer available.

23. 396 U.S. 375 (1970).

24. *Id.* at 382 n.5.

25. *Id.* at 385.

26. 1 A. BROMBERG, SECURITIES LAW: FRAUD § 4.17(554), at 86.12 (1977) [hereinafter cited as A. BROMBERG]. The Court in *Mills* expressly disclaimed that it was deciding the causation question in a situation in which management controls a number of shares sufficient to approve the transaction without any minority votes. 396 U.S. at 385 n.7. In a recent action involving such circumstances, defendants cited five of the Court's latest decisions to support their contention that the current Court would hold that causation is not present as a matter of law when management controls enough votes to carry the day. The trial court disagreed and ruled that causation is to be determined by the trier of fact. Evmar Oil Corp. v. Getty Oil Co., [1978 - Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,358, at 93,229-32 (C.D. Cal.). Professor Bromberg, quoted extensively by the *Evmar* court to support its holding, has collected lower court decisions that split on the issue. 1 A. BROMBERG *supra* § 4.7(552), at 86.7-86.9, and § 4.7(554), at 86.9 and 86.11.

27. The Court added an incentive for § 14(a) actions by sanctioning an interim award of attorneys' fees for the *Mills* plaintiffs, who had established a management violation of the federal proxy rules. 396 U.S. at 389-97. Justice Black dissented on this point. *Id.* at 397 (concurring and dissenting opinion). For a detailed discussion of awarding attorneys' fees, see Note, *Securities Regulation—Allowance of Attorney's Fees in 14(a) Derivative Suits,* 49 N.C. L. REV. 204 (1970) [hereinafter cited as Note, *Securities Regulations*].

28. 396 U.S. at 385. One commentator, in analyzing *Mills,* remarked, "The [federal] judicial system continues to protect a corporate shareholder through implementation of the rapidly

solicited shareholders.

The *Mills* Court's minimization of the importance of causation in section 14(a) actions was followed two years later by a similar relaxation for claims made under section 10(b) of the 1934 Act[29] and its anti-fraud cognate, rule 10b-5.[30] In *Affiliated Ute Citizens v. Utah*[31] plaintiffs claimed that certain defendants had failed to disclose material facts in connection with plaintiffs' sales of securities to these defendants and others.[32] The Court found a compensable violation and announced that the proscriptions of section 10(b) and rule 10b-5 are broad and obviously designed to be inclusive.[33] It therefore refused to read rule 10b-5 as restrictively[34] as did the court of appeals, which had required plaintiffs to establish reliance upon material misrepresentations to sustain their section 10(b) claim.[35] Instead, six Justices[36] ruled that

> under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in

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expanding anti-fraud provisions of the Securities Exchange Act of 1934." Note, *Securities Regulation—Shareholder Derivative Suits under Rule 14a-9*, 49 N. C. L. REV. 215 (1970).

29. 15 U.S.C. § 76j(b) (1976) 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—
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> . . . .
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> (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.

30. 17 C.F.R. § 240.10b-5 (1977) 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.

31. 406 U.S. 128 (1972).

32. *Affiliated Ute* involved two consolidated actions that originated in a series of federal statutes enacted during 1954-56 for the purpose of partitioning the assets of various American Indian tribes. In the action pertinent to this discussion, mixed-blood members of the Ute tribe had received shares of UDC, an incorporated association, in connection with the Ute partition and distribution. Defendant bank, which employed Gale and Haslem, two individual defendants, acted as both transfer agent and custodian for the UDC shares. Gale and Haslam created a secondary market for UDC shares and arranged for the sale of plaintiffs' shares at prices below the fair market value of the shares without disclosing to plaintiffs the disparity between selling price and market value. This conduct violated subparagraphs (1) and (3) of rule 10b-5. 406 U.S. at 152-53.

33. 406 U.S. at 152.

34. *Id.* at 152-53.

35. Reyos v. United States, 431 F.2d 1337, 1348 (10th Cir. 1970), *rev'd*, 406 U.S. 128 (1972).

36. Justices Powell and Rehnquist took no part in the consideration or decision of the case.

> the sense that a reasonable investor might have considered them important in the making of this decision. This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact.[37]

The Court in *Affiliated Ute* thus expanded the availability of the Acts to plaintiffs[38] and held against defendants just as it did in every other significant decision that it rendered under the Acts between 1964 and 1972.[39]

*2. Remedial Philosophy.*—These Warren Court decisions are noteworthy not only for their expansive holdings, but also for the remedial philosophy underlying them. The Court's guiding interpretive canon[40] was illustrated in the unanimous opinion in *Tcherepenin v. Knight,*[41] in which plaintiffs brought a section 10(b) class action, claiming that they had been induced by fraudulent sales literature to purchase withdrawable capital shares in a savings and loan association that subsequently went into voluntary liquidation. Defendants contended that the shares were not securities subject to the 1934 Act.[42] Presented with its first opportunity to construe the term *security* under the 1934 Act,[43] the Court announced that it would be *"guided by the familiar canon of statutory construction that remedial legislation should be construed broadly to effectuate its purposes. The Securities Exchange Act quite clearly falls into the category of remedial legislation."*[44] The Court thus had little difficulty fitting capital shares into the broad concept of security[45] developed by its earlier 1933 Act decisions.[46]

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37. 406 U.S. at 153-54 (citations omitted). The terms "reliance" and "causation in fact" in *Affiliated Ute* apparently are used interchangeably, which is not an uncommon phenomenon. *See* 3 A. BROMBERG, *supra* note 16, at §§ 8.6(1) & 8.7(1), at 209, 213.

38. 1 A. BROMBERG, *supra* note 16, at § 4.7(554), at 86.11. "The Supreme Court's adoption of . . . [the] liberalized test indicates an especial willingness to depart from the formula of common law fraud in order to make rule 10b-5 a more effective deterrent of deceptive practices." *The Supreme Court, 1971 Term,* 86 HARV. L. REV. 50, 270 (1972).

*Affiliated Ute* involved a face-to-face transaction, see 1 A. BROMBERG, *supra* note 16, at § 4(1), at 68.11, and its causation test has been held inapplicable to the open market situation. Fridrich v. Bradford, 542 F.2d 307, 319-20 (6th Cir. 1976), *cert. denied,* 429 U.S. 1053 (1977). *Contra,* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, 495 F.2d 228, 240 (2d Cir. 1974).

39. *See* notes 40-64 and accompanying text *infra.*

40. This is not to say that the Warren Court ignored such interpretative tools as statutory language *see* SEC v. National Sec., Inc., 393 U.S. 453, 466-47 (1969)) or legislative intent *see* J.I. Case Co. v. Borak, 377 U.S. 426, 431-32 (1964)). The Court's use of such guideposts, however, is strongly colored by its remedial philosophy.

41. 389 U.S. 332 (1967).

42. Holders had the right under certain circumstances to withdraw the money paid for their capital shares. 389 U.S. at 337. This feature and other characteristics, *id.* at 343-44, distinguished the capital shares from traditional corporate stock that is indisputably a security.

43. The 1934 Act definition of a security is contained in § 3(a)(10) of that Act, 15 U.S.C. § 78c(a)(10) (1976). The 1933 Act definition is found in § 2(1) of that statute, 15 U.S.C. § 77(b)(1) (1976).

44. 398 U.S. at 336 (footnote omitted) (emphasis added).

45. *Id.* at 338. One commentator analyzed *Tcherpenin* as possibly reflecting a restrictive trend in the definition of a security, an analysis that seems unfounded. Note, *Licenses—Sales of Stock-Withdrawable Capital Shares,* 19 CASE W. RES. L. REV, 1123 (1968).

46. 389 U.S. at 336 n.9. The Court found that the capital shares resembled investment

Equally representative of this expansive philosophy is *SEC v. National Securities, Inc.*[47] In this case the Commission sought to unwind a merger of two insurance companies, charging material deficiency in the proxy materials sent to the minority shareholders of one company.[48] One issue before the Court was whether the minority shareholders' exchange of their old stock for the new company's shares constituted a purchase within the meaning of section 10(b) and rule 10b-5,[49] both of which require that the prohibited conduct be in connection with the purchase or sale of a security.[50] Although almost twenty years had passed since a federal judge had found a private damages action under section 10(b),[51] *National Securities* marked the Court's first venture into what it described as "virgin territory[,] . . . an area where glib generalizations and unthinking abstractions are major occupational hazards."[52] Finding no help in the 1934 Act's definitions of purchase and sale,[53] the majority asked whether defendants' alleged misconduct was the type of fraudulent behavior that the statute and rule were designed to forbid.[54] Without refering to legislative history, analyzing judicial precedent, or examining input from the Commission, the Court answered the question in the affirmative.

> Whatever the terms "purchase" and "sale" may mean in other contexts. . . . *[t]he broad anti-fraud purposes of the statute and the rule would clearly be furthered by their application to this type of situation.* Therefore we conclude that [the minority] shareholders "purchased" shares in the new company by exchanging them for their old stock.[55]

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contracts, *id.* at 338, a term occurring in both the 1933 and 1934 Acts' definitions of a security, *see* note 43 *supra,* that the Court had earlier focused upon in resolving the issue of a security *vel non* under the earlier statute, *see* note 97 *infra.*

47. 393 U.S. 453 (1969).

48. Defendants controlled Company *A* and purchased a controlling interest in Company *B.* The Commission claimed that the minority shareholders of Company *B* were not told in the proxy materials that the surviving entity would have to pay part of the cost of acquiring defendants' interest in Company *B. Id.* at 455.

49. Section 14(a) of the 1934 Act, *see* note 10 *supra*, did not apply to the solicitation, 393 U.S. at 468.

50. *See* notes 29-30 *supra.*

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

52. 393 U.S. at 465.

53. Sections 3(a)(13), 15 U.S.C. § 78c(a)(13) (1976) (purchase), and 3(a)(14), 15 U.S.C. § 78c(a)(14) (1976) (sale). The Court took two analytic steps before examining the statutory language. First, it dismissed defendants' contention that rule 133 (since repealed) of the 1933 Act, which excluded a merger from the definition of an offer or sale for purposes of § 5 of the 1933 Act, should be applied to a § 10(b) claim. Second, it stressed that the correct approach to statutory language was to examine its meaning in context, an approach to which the Court arguably did not adhere. 393 U.S. at 466.

54. 393 U.S. at 467.

55. *Id.* at 467 (footnote omitted) (emphasis added). Perhaps troubled by its haste, the majority felt constrained to add that its ruling did no violence to the language of the statute. *Id.* at 467-68.

The implications inherent in the majority's expansive approach to section 10(b) were not lost upon dissenting Justice Harlan. In prophetic fashion he observed that "the decision has far-reaching radiations, despite the fact that the precise issue presented is a narrow one." 393

Probably the most striking example of the Warren Court's remedial style is *Superintendant of Insurance v. Bankers Life & Casualty Co.*[56] This case, perhaps the Warren Court's most significant decision under the Acts,[57] involved the purchase of control of Manhattan Casualty Company. Proceeds from the sale of Manhattan's bonds had been fraudulently misappropriated to accomplish the acquisition, and plaintiff claimed that the fraud violated section 10(b) and rule 10b-5.[58] Because misappropriation of the bond sale proceeds did not affect the bonds' sale or threaten the securities markets, the Second Circuit found the nexus to section 10(b) and rule 10b-5 absent.[59]

Writing for a unanimous Supreme Court, however, Justice Douglas announced, "We do not read [section] 10(b) as narrowly as the Court of Appeals; it is not 'limited to preserving the integrity of the securities markets . . . . *Section 10(b) must be read flexibly, not technically and restrictively.*"[60] In language as loose[61] as it is broad[62]

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U.S. at 470 (dissenting opinion). Professor Bromberg includes *National Securities* in his list of judicial milestones in Section 10(b)'s "expansionary trend." 1 A. BROMBERG, *supra* note 26 at § 2.2(46), at 22.12. *See The Supreme Court, 1968 Term,* 83 HARV. L. REV. 60, 257 (1969).

56. 404 U.S. 6 (1971).

57. "Not since *Erie v. Tompkins* has a single case dominated an area of federal law the way *Bankers Life* has that of litigation under the Securities and Exchange Act of 1934." Ryan, *Bankers Life: Birnbaum Revisited,* 4 LOY. CHI. L. J. 47 (1973).

58. The complaint alleged that Bankers Life & Casualty Co. sold all Manhattan's stock to one of the individual defendants. He, along with other defendants, engineered a complex scheme that involved, in part, convincing Manhattan's directors to sell certain of Manhattan's treasury bonds. Defendants represented to Manhattan's directors that the bond sale proceeds would be exchanged for a certificate of deposit of equal value. Instead, they used the proceeds fraudulently to finance the purchase of Manhattan's stock from Bankers Life. Manhattan subsequently failed and its liquidator instituted an action against Bankers Life and others connected with the transaction, claiming violations of §§ 17(a) and 10(b) of the 1933 and the 1934 Acts. 404 U.S. at 7-9.

59. 430 F.2d 355, 360-61 (2d Cir. 1970), *rev'd,* 404 U.S. 6 (1971). In essence the Second Circuit "disconnected" the securities transaction from the misconduct that had led Manhattan's directors to believe it would actually receive the proceeds of sale.

60. 404 U.S. at 12 (emphasis added) (citations omitted).

61. [M]ost importantly, Bankers Life generally will offer little guidance to future courts faced with the task of interpreting the "in connection with" clause and thus the scope of rule 10b-5. This deficiency derives, in part, from the Court's selection of a case with such an unusual fact situation. *It also stems from the Court's failure in the course of its reasoning to articulate with precision how closely connected the fraud and the securities transaction must be.*

*The Supreme Court, 1971 Term,* 86 HARV. L. REV. 50, 263 (1972) (emphasis added).

*Bankers Life* did not determine the validity of what is perhaps the most significant judicial restraint imposed upon the implied right of action under § 10(b) and rule 10b-5; namely, that plaintiff be a purchaser or seller of securities. 404 U.S. at 13-14 n.10. *See* notes 66-74 and accompanying text *infra.* Although many commentators have discussed the impact of *Bankers Life* upon this limitation, the obscurity of the Court's opinion led them to contradictory conclusions. *See* Note, *Bankers Life: Paying for a Corporation by Selling Its Securities Violates 10b-5,* 1972 DUKE L.J. 465, 485 (purchaser-seller doctrine ill-defined and indefensible). *But cf.* Ryan, *supra* note 57, at 67 (purchaser-seller restriction ratified). *See also* Note, *Superintendent of Insurance v. Bankers Life and Casualty Co.: Supreme Court Expansion of Rule 10b-5,* 26 SW. L.J. 800, 807-08 (1972).

62. Professor Bromberg classifies judicial interpretation of § 10(b) and rule 10b-5 into two general modes, mechanical and jurisprudential. The latter focuses on perceived congressional purpose concerning the scope of the statute and rule on whether, as a matter of policy, a

the Court then held that the required connection was present because the claimed deceptive practices touched Manhattan's sale of securities as an investor.[63] The Court's response to the connection issue in *Bankers Life* had become a familiar one—interpret the Acts in a broad, remedial manner.

Perhaps more important, though, than either the wide ranging holdings of the six decisions or their remedial philosophy is the impression they cumulatively offer about the Warren Court's interpretation of the Acts. Four decisions reversed narrower lower court rulings[64] and none contained any significant thoughts of limitation. This expansive approach to the Acts was not lost upon the lower courts who followed the path that the Supreme Court paved for them.

### *B. Effect Upon Lower Courts*

More than a quarter of a century ago the second circuit imposed an important restriction on the judicially implied private action under section 10(b) and rule 10b-5 by limiting the class of plaintiffs to those who actually purchased or sold securities involved in the alleged fraud.[65] This restriction became known as the *Birnbaum* rule. Over a period of time, the lower courts developed exceptions[66] to this rule that permitted plaintiffs who were not literal purchasers or sellers to maintain actions under section 10(b) and rule 10b-5. Given the tenor of the Warren Court's decisions under the Acts, it was only a matter of time before gradual judicial erosion of the rule became

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particular transaction is within the scope of federal concern. At least until recently, this approach has probably led to expansive holdings on the connection issue. 1 A. BROMBERG, *supra* note 26 at § 4.7(572), at 88.21-.22.

63. 404 U.S. at 12-13.

64. Only *Borak* affirmed the appellate court's holding. 377 U.S. at 428. The court of appeals in *National Securities* did not reach the § 10(b) issues subsequently decided by the Supreme Court. SEC v. National Sec., Inc., 387 F.2d 25, 29 (9th Cir. 1967), *rev'd,* 393 U.S. 453 (1969).

65. Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952).

Actually, the purchaser/seller standing requirement was only one of three limitations imposed by the *Birnbaum* Court, which stated that § 10(b) "was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and . . . extended protection only to the defrauded purchaser or seller." *Id.* at 464.

The first limitation was negated by Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 10-11 n.7 (1971). The second, undermined by *Bankers Life, (see* 1 A. BROMBERG, *supra* note 26, at § 4.7(522), at 84.31-32, has been revitalized to some degree by the Supreme Court's recent decision in Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977). *See* text accompanying notes 158-85 *infra.* The validity of the third, the so-called *Birnbaum* rule, was reaffirmed by the Court in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975). *See* notes 82-89 and accompanying text, *infra.*

66. For a complete discussion of these exceptions see GALLAGHER, *10b-5 After Blue Chip Stamps: How Stands the Judicial Oak?,* 80 DICK L. REV. 1, 8-22 (1975). *See also* 1 A. BROMBERG, *supra* note 26 at § 4.7(560-66), at 87-88.8.

outright rejection.[67] This result occurred in the seventh circuit in 1973 in *Eason v. General Motors Acceptance Corp.*[68]

Plaintiffs in *Eason*, shareholders of a failed corporation, had guaranteed their corporation's notes in a transaction that clearly made the corporation, but none of the plaintiffs, a seller of securities.[69] Rather than stretching the *Birnbaum* rule to accommodate plaintiffs, the seventh circuit repudiated it. Because no other appellate court had taken this course, the *Eason* court devoted considerable attention to explaining the basis for its holding.

> The language of Rule 10b-5 itself describes any act or practice which operates as a fraud or deceit "upon any person in connection with the purchase or sale of a security." The *Supreme Court has repeatedly stated that this language should be given a broad and flexible construction.* [A] formal purchaser-seller limitation is not consistent with the overriding requirement that, in construing the 1934 Act, "form should be disregarded for substance and the emphasis should be on economic reality."[70]

Focusing on a phrase from *Bankers Life*[71] and pointing to the role of rule 10b-5 in protecting investors, the circuit court decided that the coverage of the rule extends beyond purchasers and sellers.[72] Although the court acknowledged defendant's argument that abandoning *Birnbaum* might significantly increase the federal courts' work load,[73] it responded that "the volume of future litigation that was more clearly predictable as a consequence of the Supreme Court's holding in the *Bankers Life* case was not even mentioned in the Court's opinion as a possible objection to its broadened interpretation of Rule 10b-5 . . . ."[74]

The holding in *Eason* was exceptional in that it is the only ap-

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67. *See, e.g.,* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 768 n.3 (1975).

68. 490 F.2d 654 (7th Cir. 1973), *cert. denied,* 416 U.S. 960 (1974).

69. Plaintiffs were shareholders in the Bank Service Corporation, which purchased the leasing division of David Waite Pontiac, Inc. by issuing 7,000 Bank Service shares to Waite and assuming the liabilities of the leasing business, including notes payable to General Motors Acceptance Corporation (GMAC). Plaintiffs delivered to GMAC personal guarantees on the notes. After the leasing business failed and Bank Service defaulted on the notes, GMAC sued Bank Service's individual shareholders on the notes in state court. These shareholders in turn began a federal action for alleged fraud in Bank Service's acquisition of the leasing business in violation of § 10(b) and rule 10b-5. *Id.* at 655-66.

For a further discussion of the case see GALLAGHER, *supra* note 66 at 19-22.

70. 490 F.2d at 659 (footnote & citation omitted) (emphasis added).

71. The court considered the following phrase: "Manhattan suffered injury as a result of deceptive practices touching its sale of securities *as an investor.* " *Id.* at 659 (emphasis in original). *See* note 63 and accompanying text *supra.*

72. 490 F.2d at 659.

> Although no Supreme Court holding is inconsistent with the view that only purchasers or sellers of securities are protected by Rule 10b-5, *we think that the Court's opinions fairly imply that the rule was intended to protect a broader class of persons . . . who, in their capacity as investors* [not as purchasers or sellers,] suffer significant injury as a direct consequence of fraud in connection with a securities transaction . . . .

*Id.* (emphasis added).

73. *Id.* at 660. The court apparently believed that such an increase would not result.

74. *Id.* at 660-61.

pellate court decision to directly discard the *Birnbaum* rule.[75] Yet the decision was anything but exceptional in its willingness to forge an expansive holding. *Eason* clearly perceived the Court as an advocate of a remedial approach to issues arising under the Acts. Indeed, so strong was the remedial strain running through the Warren Court's decisions that the *Eason* panel was quite comfortable citing *Tcherpenin,* which dealt with the statutory definition of a security,[76] to support a broadening of an anti-fraud provision. Moreover, its perception of the Warren Court as a champion of a liberal approach to the Acts was certainly consistent with that of the other circuits. Whether the issue was interpretation of section 10(b) and rule 10b-5,[77] implication of a private damages action for violations of the Williams Act,[78] or the existence of a security,[79] the result from the lower courts was the same—a broad holding mandated, or at the very least blessed, by the Supreme Court.

## III. The Burger Court's Shift in Emphasis

### *A. Significant Decisions*

An analysis of eight significant Supreme Court decisions[80]

75. One other district court matched *Eason's* directness. Young v. Seaboard Corp., 360 F. Supp. 490, 494-95 (D. Utah 1973).

76. *See* notes 41-46 and accompanying text *supra.*

77. *See, e.g.,* Blackie v. Barrack, 524 F.2d 891 (9th Cir. 1975), *cert. denied,* 429 U.S. 816 (1976) (10b-5 action not defined by the limits of common-law fraud and must be adapted to the overriding purpose of enforcing the federal securities laws); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 235 (2d Cir. 1974) (open market purchasers of securities have a § 10(b) claim against those who trade on inside information and the non-trading tippers, despite a lack of privity).

78. *See* Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 356 (2d Cir.), *cert. denied,* 414 U.S. 910 (1973) (defeated tender-offeror has an implied private damages action against its successful rival and the target corporation for violation of § 14(e) of the 1934 Act). *But see* notes 142-56 and accompanying text *infra.*

79. We have found no case dealing with this particular language; but in view of the Supreme Court's policy of giving a broad reading to the definition of a security [citing *Tcherepnin*] and its generally expansive construction of the anti-fraud provisions of the Securities Exchange Act, [citing *National Securities*] we must read [§ 3(a)(10)] literally so as to include the [loan] participation . . . within the security category.

Lehigh Valley Trust Co. v. Central Nat'l Bank of Jacksonville, 409 F.2d 989, 992 (5th Cir. 1969); *see also* Forman v. Community Services, Inc., 500 F.2d 1246, 1253 n.9 (2d Cir. 1974), *rev'd sub nom.* United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975); SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 479 (5th Cir. 1974).

80. Supreme Court decisions since mid-1975 that directly relate to the federal securities laws but that are not discussed herein include the following: E.I. duPont de Nemours & Co. v. Collins, 434 U.S. 917 (1977); (SEC discretion in approving merger of investment company into an affiliate under § 17 of Investment Company Act of 1940, 15 U.S.C. § 80a-17 (1977), upheld); Radzanower v. Touche, Ross & Co., 426 U.S. 148 (1976) (venue in securities suit against national banking association governed by more limited provisions of § 94 of National Banking Act, 12 U.S.C. § 94 (1976), rather than those of § 27 of the 1934 Act); United States v. National Ass'n of Sec. Dealers, Inc., 422 U.S. 694 (1975) (SEC exercise of regulatory authority under Investment Company Act, 15 U.S.C. § 80a-1-80a-52 (1976), and Maloney Act, 15 U.S.C. § 78o-3 (1976), confers implied antitrust immunity for restrictions of secondary markets in mutual fund shares); Gordon v. New York Stock Exch., Inc., 422 U.S. 659 (1975) (SEC regulation of stock exchange fixed commission rates provides immunity from antitrust action challenging fixed rates).

handed down since mid-1975[81] discloses a transformation in the Court's approach to the coverage of the Acts. This transformation is especially evident in the Court's restriction of the Acts' coverage and in its replacement of the Warren Court's remedial philosophy with interpretative tools designed to shape narrow holdings.

*1. Narrow Holdings.*—Despite the Court's refusal in 1974 to review *Eason,* just one year later the Court, in *Blue Chip Stamps v. Manor Drug Stores,*[82] held that the *Birnbaum* rule is sound and should be followed.[83] The *Blue Chip* plaintiff claimed that a document offering securities emphasized various negative aspects of the issuer in a misleading manner and fraudulently induced plaintiff to refuse to purchase the securities.[84] A divided panel of the ninth circuit, faced with a plaintiff that was neither a purchaser nor seller of securities, added another exception to the *Birnbaum* rule and upheld plaintiff's standing to bring a section 10(b) claim.[85] In a 6-3 decision reversing the ninth circuit,[86] the Supreme Court reaffirmed

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The Court changed its mind about deciding whether one who accepts a pledge of stock is a "purchaser" and one who releases a pledge a "seller" of securities for purposes of § 10(b). Bankers Trust Co. v. Mallis, 568 F.2d 824 (2d Cir.), *cert. granted,* 431 U.S. 928 (1977), *cert. dismissed,* 435 U.S. 381 (1978).

81. Excluded from this article are those Supreme Court decisions involving § 16(b) of the 1934 Act, 15 U.S.C. § 78(p)(b) (1976), which imposes liability for so-called short-swing profits—those generated by purchases and sales of securities within a six-month period. Section 16(b) decisions, for the purposes of this article, are viewed as a distinct element in the Court's interpretation of the Acts, having limited precedential value for other areas. An extensive discussion of § 16(b) is found in Wentz, *Refining A Crude Rule: The Pragmatic Approach to Section 16(b) of the Securities Exchange Act of 1934,* 70 NW. L. REV. 221 (1975). For the latest Supreme Court pronouncement in this area see Foremost-McKesson, Inc. v. Provident Sec. Co., 423 U.S. 232 (1976).

82. 421 U.S. 723 (1975).

83. *Id.* at 749. One commentator found no compelling reason for the Court's grant of certiorari in *Blue Chip* because the ninth circuit's decision "was consistent with the previous pattern of limited exceptions to the *Birnbaum* doctrine." Lowenfels, *Recent Supreme Court Decisions Under the Federal Securities Laws: The Pendulum Swings,* 65 GEO. L.J. 891, 895 (1977). Lowenfels' view, however, may be at odds with the following statement from the *Blue Chip* opinion:

> While the *Birnbaum* rule has been flexibly interpreted by lower federal courts, we have been unable to locate a single decided case from any court in the 20-odd years of litigation since the Birnbaum decision which would support the right of persons who were in the position of respondent here to bring a private suit under Rule 10b-5.

421 U.S. at 751 (footnotes omitted).

84. Plaintiff and other members of the class plaintiff claimed to represent were offered common shares of a newly formed corporation pursuant to the terms of a consent decree settling an antitrust action brought by the United States. Plaintiff alleged that the prospectus offering the shares deliberately placed undue emphasis on the negative aspects of the status and future prospects of the new corporation to discourage the offerees from accepting that which amounted to a bargain offer so that the rejected shares could be offered subsequently to the public at a higher price. 421 U.S. at 725-27.

85. Manor Drug Stores v. Blue Chip Stamps, 492 F.2d 136 (9th Cir. 1973), *rev'd,* 421 U.S. 723 (1975). The majority would have found it difficult to imitate the seventh circuit's 1973 abrogation of Birnbaum, *see* notes 65-76 and accompanying text *supra,* for only one year earlier, in Mount Clemens Indus., Inc. v. Bell, 464 F.2d 339 (9th Cir. 1972), a different panel of the ninth circuit had refused to read the purchaser/seller requirement out of a § 10(b) action.

86. 421 U.S. at 731. Justice Rehnquist authored the Court's opinion, in which Chief Justice Burger and Justice White joined. Justices Marshall and Stewart joined in Justice Powell's concurring opinion.

*Birnbaum*[87] and declared that it took a dim view of the "endless case-by-case erosion" of the *Birnbaum* rule.[88] Justice Blackmun, filing a strong dissent that cited *Affiliated Ute, Bankers Life, National Securities,* and *Tcherpenin,* found the majority's ruling "quite out of keeping . . . with [the Court's] tradition and the intent of the securities laws."[89]

One week after *Blue Chip,* in *United Housing Foundation, Inc. v. Forman,*[90] the Court ruled narrowly on another recurring and important question that is often the subject of litigation; namely, whether a particular transaction involves a security. Prior to *Forman* the Court had consistently given the definition of "security" a broad interpretation, which brought many types of transactions within the reach of the Acts.[91] With *Forman*, the Court may have put an end to the plaintiff-oriented construction of the term "security."

The *Forman* plaintiffs purchased shares of stock in a non-profit state cooperative housing corporation as an incident of tenancy in the apartments.[92] Claiming material misrepresentations and omissions in the offering documents,[93] they filed a class action in federal court. The second circuit, in a decision clearly reflecting the broad perspective of the Warren Court, held that the cooperative shares were securities covered by the Acts.[94] The court reasoned that because the Acts' definitions of *security* include the term "stock,"[95] the shares must be securities.[96] Alternatively the court concluded that the cooperative shares were an "investment contract," another term

87. *Id.* at 749.

88. *Id.* at 755. It is uncertain whether this statement was a warning not to expand exceptions to the rule further, or a mandate to cut back the pre-*Blue Chip* exceptions already in existence. *See* note 62 *supra.*

89. 421 U.S. at 762 (dissenting opinion). Justice Blackmun also cited SEC v. Capital Gains Bureau, 375 U.S. 180, 195 (1963), which held that the SEC does not have to establish investment advisers' intent to injure and actual injury to clients as a condition of obtaining injunctive relief against investment advisers under the anti-fraud provisions of § 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 (1976). With its expansive holding and emphasis upon the remedial purposes of the securities laws, *Capital Gains* fits quite comfortably into the mold of Court decisions reviewed in Part II of this article. Two commentators have since questioned the soundness of *Capital Gains* in light of Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). *See* Berner & Franklin, *Scienter and Securities and Exchange Commission; Rule 10b-5 Actions: A Reappraisal in Light of Hochfelder,* 51 N.Y.U. L. REV. 769, 785-87 (1976).

90. 421 U.S. 837 (1975).

91. *E.g.*, SEC v. W.H. Howey & Co., 328 U.S. 293, 299 (1946).

92. These shares were not transferable to a nontenant, descended only to a surviving spouse, and were subject to a right of first refusal in favor of the issuer at the original purchase price. The sole purpose of the shares was to allow the purchaser to occupy an apartment. Thus, in effect, their purchase was a recoverable deposit on that apartment. *Id.* at 842.

93. *Id.* at 845.

94. Forman v. Community Servs., Inc., 500 F.2d 1246 (1974), *rev'd sub nom,* United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975).

95. *See* note 43 *supra.*

96. 500 F.2d at 1252-53. This conclusion was supported by a statement from SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943), quoted approvingly in Tcherpenin v. Knight, 389 U.S. 332, 339 (1967).

used by the Acts to define a security and the traditional touchstone for testing the presence of a security in doubtful transactions.[97] An essential component of a transaction involving an investment contract is that the investor is offered an expectation of profits,[98] and the court found "profits" in three different forms, including reduction of tenant costs by income earned from leasing the apartment complex's commercial facilities.[99]

The Supreme Court disagreed with both of these rationales, however, and reversed. First, the Court rejected the literal approach[100] of the court of appeals in defining a security, concluding that the presence of a security should be determined not by semantics, but rather by economic realities.[101] Then, addressing the question of an investment contract, the majority again stressed the economic realities of the transaction,[102] finding the "income . . . far too speculative and insubstantial to bring the entire transaction within the Securities Acts."[103] Although the Court's unwillingness to embrace the Second Circuit's literalism and its refusal to adopt a broad concept of profits might be interpreted as nothing more than an exercise of reasonable restraint, when one compares *Forman* with the Court's earlier record concerning the existence of a security—not one decision in favor of a defendant—it is clear that *Forman* is the product of a changed Court.[104]

One day after deciding *United Housing,* the Supreme Court

97. In SEC v. W.H. Howey Co., 328 U.S. 293, 298-99 (1946), the Supreme Court defined investment contract as "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." Since this announcement, the term has usually been equated with all the other statutory phrases defining a security in §§ 2(1) and 3(a)(10) of the 1933 Act and 1934 Act. *See* note 43 *supra.* Therefore, whether a particular transaction involves a security generally turns upon the presence of an investment contract. Periodically, commentators have attempted, without much success, to refine or redefine the *Howey* formulation in their search for a single standard that can be productively applied to all questionable transactions. For a recent attempt see Newton, *What is a Security: A Critical Analysis,* 48 MISS. L.J. 167 (1977).

98. SEC v. W.H. Howey & Co., 328 U.S. 293, 298-99 (1946).

99. 500 F.2d at 1254-55. "Profits" were also found in plaintiffs' ability to deduct for tax purposes a certain portion of their monthly rental payments and in plaintiffs' ability to obtain apartments at a cost substantially below the going rental charge for comparable housing. *Id.* The Supreme Court summarily disposed of these two "supposed grounds" for finding profits. 421 U.S. at 855.

100. 421 U.S. at 848. Rejection of a "literal" approach seems consistent, however, with the Court's repeated emphasis on the triumph of substance over form, *see, e.g.,* SEC v. W.H. Howey Co., 328 U.S. 293, 298 (1946), even though that emphasis has usually resulted in inclusion of a transaction within the coverage of the Acts, *id.* Prior to *United Housing,* several lower courts had rejected the literal approach in cases involving promissory notes. *See* Newton, *supra* note 97 at 171-72.

101. 421 U.S. at 849.

102. *Id.* at 854.

103. *Id.* at 856.

104. *See* Note, *The Supreme Court's Trimming of the Section 10(b) Tree: The Cultivation of a New Securities Law Perspective,* 3 J. OF CORP. L. 112, 130 (1977). *But see* Castruccio & Tischler, *Developments in Federal Securities Regulation—* 1975, 31 BUS. LAW. 1855, 1858 (1976).

decided *Rondeau v. Mosinee Paper Corp.*,[105] its first foray into that part of the 1934 Act known as the Williams Act.[106] Rondeau had violated section 13(d)[107] of the 1934 Act by inadvertently failing to make a requisite filing upon his purchase of more than five percent of Mosinee Paper's common shares. In a 2-1 decision the Court of Appeals for the Seventh Circuit[108] held that Mosinee did not need to demonstrate irreparable harm as a prerequisite to obtaining permanent injunctive relief, which included a five year voting prohibition on a portion of Rondeau's shares, for a violation of section 13(d).[109] The Supreme Court, by a 6-3 vote, disagreed.[110] That Mosinee was suing under a statute generally recognized as serving the public interest provided no "basis for concluding that [Mosinee was] relieved of showing irreparable harm and other usual prerequisites for injunctive relief."[111]

One year later the Supreme Court decided *TSC Industries, Inc. v. Northway*[112] and followed the pattern established in 1975. Plaintiff in *TSC* claimed that a proxy statement furnished it in connection with a corporate take-over failed to disclose material information[113] and therefore violated both section 14(a)[114] of the 1934 Act and SEC

105. 422 U.S. 49 (1975).

106. Congress enacted the Williams Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454, 15 U.S.C. §§ 78m(d)-(e), n(d)-(f) (1976) *amending* 15 U.S.C. §§ 78m-n (1964) to subject tender offerors and others seeking corporate control to advance disclosure requirements for the protection of investors. *See* H.R. Rep. No. 1711, 90th Cong., 2d Sess. (1968).

107. 15 U.S.C. § 78m(d) (1976). In general, § 13(d) requires persons acquiring beneficial ownership of more than five percent of a class of equity security registered pursuant to section 12 of the 1934 Act to file with the SEC within ten days after the acquisition. The filing requires comprehensive disclosure about the persons purchasing the security, including their identities, background, financing, purposes, holdings, and recent transactions in the security. A copy must be sent to the issuer and to each exchange on which the security is traded.

108. Mosinee Paper Corp. v. Rondeau, 500 F.2d 1011 (7th Cir. 1974), *rev'd, sub nom.*, Rondeau v. Mosinee Paper Corp., 422 U.S. 49 (1975).

109. *Id.* at 1017. To "neutralize Rondeau's violation of the Act and to deny him the benefit of his wrongdoing," *id.* the seventh circuit instructed the district court to enter a decree that would have prevented 26,268 of Rondeau's shares from being voted on certain matters, such as a proxy contest, for five years.

110. 422 U.S. at (1975).

111. *Id.* at 65. Dictum in the majority opinion suggests that *Rondeau's* holding and rationale are not confined to actions involving permanent injunctions under §13(d). *"Mills* could not be plainer in holding that the questions of liability and relief are separate in private actions under the securities laws, and that the latter is to be determined according to traditional principles." *Id.* at 64.

For a discussion of the effect of *Rondeau* on cases dealing with *preliminary* injunctive relief, a frequently sought remedy for Williams Act violations, see E. ARANOW, H. EINHORN & G. BULSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 129-37 (1977). *See also* Porter & Hyland, *Rondeau v. Mosinee Paper Company and the Williams Act Injunction,* 59 MARQ. L. REV.743, 758-61 (1976).

112. 426 U.S. 438 (1976).

113. Plaintiff, Northway, a former shareholder of TSC Industries, claimed that the proxy statement furnished in connection with the sale of TSC's assets to National in exchange for the latter's securities omitted material facts relating to the degree of National's control over TSC and the favorability of the terms of the proposal to TSC shareholders. *Id.* at 442-43.

114. *See* note 10 *supra.*

rule 14a-9.[115] In evaluating plaintiff's summary judgment motion, the seventh circuit ruled that the standard for determining the materiality of facts omitted from a proxy statement was whether "a reasonable shareholder *might* consider [them] important."[116] In arriving at this broad formulation, the court of appeals relied on substantially identical statements concerning materiality in *Mills*[117] and *Affiliated Ute;*[118] certainly no reason existed to suspect that materiality should be tested otherwise.[119]

The seventh circuit, however, did not foresee that a unanimous Supreme Court would explain away those earlier statements[120] and rule that "[a]n omitted fact is material if there is a *substantial likelihood* that a reasonable shareholder *would* consider it important in deciding how to vote."[121] The Court rejected the seventh circuit's "might" standard as an unnecessarily low one that may cause a corporation's management to become litigation shy and "bury the shareholders in an avalanche of trivial information. . . ."[122]

*2. Restrictive Interpretative Patterns.*—Although every Burger Court holding under the Acts has been narrow, narrowness is not the only common denominator of the Court's decisions. The Warren Court's emphasis on the broad, remedial goals of the Acts as a basic analytic principle has been supplanted by traditional and more circumscribing interpretative patterns. Included among the patterns are an emphasis on precise statutory language, a requirement that interpretation of a particular statutory provision harmonizes with the overall statutory scheme, and an unwillingness to expand the Acts unless such an expansion is justified by specific legislative intent or purpose.[123]

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115. *See* note 11 *supra.*

116. Northway, Inc. v. TSC Indus., Inc., 512 F.2d 324, 330 (7th Cir. 1975), *rev'd,* 426 U.S. 438 (1976) (emphasis added).

117. 396 U.S. at 384-85.

118. 406 U.S. at 153-54.

119. Besides relying on *Mills* and *Affiliated Ute,* the seventh circuit reasoned that its test was "entirely consistent with the purposes of disclosure requirements and with the policy of 'resolving doubts in favor of those the statute is designed to protect.' " 512 F.2d at 332 (citations omitted).

120. The Supreme Court quite correctly characterized its earlier expressions of materiality as dicta. 426 U.S. at 446-47, 447 n.9. More than one lower court, however, had assumed that these "dicta" should control. *See, e.g.,* Gould v. American Hawaiian S.S. Co., 331 F. Supp. 981, 986 (D. Del. 1971).

121. 426 U.S. at 449 (emphasis added). A brief, but interesting, discussion of materiality with specific reference to both the seventh circuit and Supreme Court formulations in *TSC* is contained in R. JENNINGS & H. MARSH, JR., SECURITIES REGULATION 930-32 (4th ed. 1977).

122. 426 U.S. at 448. The Court paid lip service to the "recognition in *Borak* and *Mills* of the Rule's [14a-9] broad remedial purpose" and the importance of resolving doubts "in favor of those the statute [§ 14(a)] is designed to protect." *Id.* Nevertheless, the Court's holding and analysis undercut these remedial sentiments.

123. The decisions do not evidence a uniform approach to interpretation of the Acts. For example SEC v. Sloan, 436 U.S. 103 (1978), vividly displays all three patterns, while TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976) shows none. Yet the patterns are repeated in enough decisions to underscore their importance.

*a. Statutory language.*— A recent decision under the Acts, *SEC v. Sloan,*[124] is illustrative of the importance that the Justices now place on statutory language.[125] Section 12(k) of the 1934 Act permits the Commission "summarily to suspend trading in any security . . . for a period not exceeding ten days [if] in its opinion the public interest and the protection of investors so require."[126] Plaintiff, a shareholder of Canadian Javelin Ltd., claimed that the Commission had exceeded its statutory power when it issued a series of summary ten-day orders that continuously suspended trading in the stock for more than one year.[127] The second circuit agreed with plaintiff,[128] and the Commission appealed. In unanimously holding that "rollover" suspensions exceed the Commission's statutory authority,[129] the Supreme Court[130] found the statutory language compelling in and of itself.[131]

*b. Harmony with the statutory scheme.*— Another technique of statutory interpretation that is closely related to the *Sloan* Court's concentration upon the meaning of words or phrases is to construe a provision so that it harmonizes with the statutory scheme of which it is a part.[132] This latter approach was adopted in *Ernst & Ernst v.*

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124. 436 U.S. 103 (1978).

125. Besides SEC v. Sloan, *see* Santa Fe Indus. v. Green, 430 U.S. 462, 472-74 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197-201 (1976); United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 848-51 (1975); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring). *See also* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 24 (1977).

126. 15 U.S.C. § 78l(k) (1976). Section 12(k) was added to the 1934 Act in 1975. It consolidated a substantially identical grant of power previously contained in two separate provisions of the 1934 Act. *See* 436 U.S. at 105 n.1.

127. Trading in CJL was suspended twice. The first suspension lasted from November 29, 1973, until January 26, 1975. The second, which formed the basis for the action against the Commission, began on April 29, 1975, and ran through May 2, 1976. *Id.* at 106.

128. Sloan v. SEC, 547 F.2d 152, 157-58 (1976), *rev'd,* 436 U.S. 103 (1978).

129. *Id.* at 114. *Sloan* involved a provision of the 1934 Act that is not a common source of litigation. Moreover, neither the majority nor the two concurring opinions cited any of the Burger Court decisions discussed in this article. Nevertheless, the *Sloan* holding, which favors a narrow reading of the 1934 Act, together with the Court's emphasis on statutory language and the need to harmonize interpretation with the statutory scheme, *see* note 132 *infra*, places *Sloan* squarely within the mainstream of the Burger Court's decisions and may have precedential value in other areas.

130. All nine Justices joined in the Court's holding. Justices Brennan and Blackmun filed concurring opinions with Justice Marshall joining with the former.

131. 436 U.S. at 114. The Court reinforced its reading of § 12(k) by examining other provisions of the 1934 Act empowering the Commission to proceed summarily. These provisions permit long-term sanctions or continuations of summary restrictions only after notice and an opportunity for a hearing. *Id.* The importance of statutory language is underscored by the Court's response to arguments advanced in support of the Commission's interpretation of § 12(k), which included a contention that continuous 10-day suspensions further the 1934 Act's remedial purposes by giving the Commission in certain circumstances the only available effective weapon to maintain orderly and fair capital markets. *Id.* at 116. Conceding this point for the sake of argument, the Court nevertheless was not "inclined to read § 12 more broadly than its language . . . reasonably permit[s]." *Id.*

132. For another decision in which this method is used see Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 733-36 (1975).

*Hochfelder.*[133]

Plaintiffs in *Hochfelder* were victims of a fraudulent securities scheme engineered by the president of a failing brokerage firm. For a number of years, defendant, a national accounting firm, had audited the firm's financial statements. Plaintiffs brought an action for damages under section 10(b) and rule 10b-5, claiming that if the defendant's audits had not been negligent, the president's fraud would have been discovered earlier. Crucial to plaintiffs' claim was the following question that for years had occupied courts and commentators: may a private damages action under section 10(b) and rule 10b-5 be predicated upon negligence?[134]

A majority of the Court found the language of section 10(b), particularly the words *manipulative, device,* and *contrivance,*[135] to so clearly denote intentional misconduct that further inquiry would have been unnecessary.[136] Nevertheless, the Court also investigated whether a negligence standard for private damages actions under section 10(b) is consistent with the statutory scheme of the Acts, finding that the reduced standard would create disharmony by permitting such actions to continue unhampered by the restrictions of other provisions that expressly impose liability for negligence.[137] This conclusion supported both the majority's reading of the statutory language[138] and its holding,[139] by a 6-2 vote, that negligence will not support a private damages action under section 10(b).[140]

*c. Unwillingness to expand the Acts absent specific legislative in-*

133. 425 U.S. 185 (1976).

134. *See, e.g.,* the authorities cited in 425 U.S. at 193-94 n.12, 197 n.17.

135. *See* note 29 *supra.*

136. 425 U.S. at 201. This is consistent with the Court's reliance on strict statutory interpretation. *See* notes 124-31 and accompanying text *supra.*

137. 425 U.S. at 206-11. One commentator has stated that the "most portentous aspect of *Hochfelder* is the Court's unqualified policy of harmony within the legislative scheme which seems to run contrary to the continual expansion of the implied cause of action under § 10(b)." Cox, *Ernst & Ernst v. Hochfelder: A Critique and Evaluation of Its Impact Upon the Scheme of the Federal Securities Law,* 28 HASTINGS L.J. 569, 593 (1977).

138. The Court also found support from legislative and administrative history. 425 U.S. at 201-06. For an article critical of the Court's rationale see Cox, *supra* note 137, at 574-86.

139. The Court could have decided *Hochfelder* more narrowly. *See* Goldwasser, *Ernst & Ernst v. Hochfelder: An Anti-Landmark Decision,* 22 N.Y.U. L. REV. 29, 58-59 (1976).

140. At a minimum the majority ruled that negligence is insufficient to support a private damages action under § 10(b). 425 U.S. at 214. An investigation of the ambiguous trail left by the majority into precisely what state of mind will support a private damages action under § 10(b) is contained in Bucklo, *The Supreme Court Attempts to Define Scienter under Rule 10b-5; Ernst & Ernst v. Hochfelder,* 29 STAN. L. REV. 213, 218-27 (1977). Professor Bucklo forcefully argues that a majority of the current Court would hold recklessness sufficient. *Id.* at 227-40. A large number of the lower courts agree with her. *See* note 196 *infra*; *see also* Rolf v. Blyth, Eastman, Dillon & Co., 570 F.2d 38 (2d Cir. 1978), *cert. denied,* 47 U.S.L.W. 3383 (Dec. 5, 1978) (court held that if a broker owes a fiduciary duty to an investor, reckless conduct by the broker is the equivalent of scienter). *Contra,* Liggio, *The 'Ernst' Ruling—Expansion of a Trend* (pt. I), N.Y.L.J., Apr. 14, 1976 at 2, col. 5. Note, *The Supreme Court's Trimming of the Section 10(b) Tree: The Cultivation of a New Securities Law Perspective,* 3 J. OF CORP. L. 112 (1977).

*tent or purpose.*— Close attention to statutory language and regard for the overall statutory scheme reflect concern that statutory interpretation be consistent with legislative intent and purpose. The Warren Court broadened the scope of the Acts whenever expansion was consistent with their remedial purpose;[141] nothing required that Congress have contemplated judicial enlargement or that broadening by the Court fulfill some specific legislative purpose. That the present Supreme Court approaches matters quite differently, however, can be seen from its decision in *Piper v. Chris-Craft Industries, Inc.*[142]

The suit in *Piper* was an outgrowth of a hotly contested struggle for control of Piper Aircraft Corporation. After narrowly losing the prize to Bangor Punta Corporation, Chris-Craft sued Bangor Punta and others[143] for damages under section 14(e)[144] of the 1934 Act, a Williams Act anti-fraud provision covering tender offers.[145] Defendants contended that an unsuccessful tender offeror like Chris-Craft could not maintain a private damages action under section 14(e). Because the section, like its model, section 10(b), is silent on the issue of a private damages action for its violation,[146] the Court turned to legislative history to determine whether implication of a private action would be "*necessary* to effectuate Congress' goals"[147] in enacting section 14(e). The Court concluded that the legislative history

> shows that the sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer. . . . We find no hint in the legislative history, on which respondent so heavily relies, that Congress contemplated a private cause of action for damages by one of several contending offerors against a successful bidder or by a losing contender against the target corporation.[148]

Thus, unable to conclude either that implication would further the specific purpose for which section 14(e) was enacted or that Congress

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141. *See* notes 40-64 and accompanying text *supra.*

142. 430 U.S. 1 (1977).

143. Chris-Craft joined as defendants Piper, members of the Piper family, and the First Boston Corporation, which had acted as an underwriter for Bangor Punta and an investment adviser for Piper.

144. 5 U.S.C. § 78n(e) (1976) provides as follows:

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders or any solicitation of security holders in opposition to or in favor of any such offer, request or invitation.

145. *See* note 106 *supra.*

146. Such silence, of course, did not prevent the implication of a private damages action by the Warren Court under § 10(b). *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.19 (1971).

147. 430 U.S. at 26 (emphasis added).

148. *Id.* at 35. Despite its heavy reliance upon legislative history, the Court cautioned that the use of this tool in devining congressional intent is a step to be taken cautiously. *Id.*

intended a private damages remedy for defeated tender offerors, the majority, by a 7-2 vote, refused to read such a remedy into the statute.[149]

*Piper* astonished many lower court judges, for it "shattered the nearly universal holdings of lower courts that competing tender offerors had standing to sue each other for damages under the Williams Act."[150] Nevertheless, the *Piper* majority's reluctance to expand the coverage of the Acts absent specific legislative intent or purpose is consistent with other Burger Court decisions under the Acts.[151] Moreover, *Piper* is also consistent with the Burger Court's approach to implied private actions in general. The *Piper* majority supported its reading of legislative history by finding that Chris-Craft's section 14(e) claim failed to meet the implication standards formulated in *Cort v. Ash,*[152] in which the Justices used a four-factor approach[153] to reject a private damages claim under the Federal Election Campaign Act Amendments of 1974.[154] *Piper, Cort* and other recent restrictive activity in the implication area[155] reinforce the image of a Supreme Court reluctant to permit judicial expansion without fairly explicit legislative authorization.[156]

*3. Explanations for the Court's Transformation.*—The Burger Court's record under the Acts is remarkable. Seven of its eight deci-

149. *Id.* at 42.

150. Humana, Inc. v. American Medicorp., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,298, at 92,870 (S.D.N.Y. 1978).

151. SEC v. Sloan, 436 U.S. 103, 110-15 (1978); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 473, 477-78, 479 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 202, 206, 211, 214 (1976). *See* United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 859 n.26 (1975); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 732-33 (1975). *See also* Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 57-59 (1975).

152. 422 U.S. 66 (1975).

153. The four factors are as follows: (i) whether plaintiff is a member of the class for whose especial benefit the statute was enacted; (ii) whether any indication of legislative intent exists to create or deny an implied remedy; (iii) whether implication is consistent with the underlying purposes of the legislative scheme; and (iv) whether the claim is one traditionally reserved for state law. 422 U.S. at 78.

154. The *Piper* majority's analysis of *Cort* is set out at 430 U.S. at 37-41. *Piper* dissenters Justices Stevens and Brennan found *Borak,* not *Cort,* to be controlling. 430 U.S. at 66 (Stevens, J., dissenting). Support for the dissenters' position and a thorough analysis of *Piper* is contained in Note, *Chris Craft, Changing Perspectives on Contests for Corporate Control,* 6 HOFSTRA L. REV. 203, 214-31 (1977). *See also The Supreme Court, 1976 Term,* 91 HARV. L. REV. 70, 280-82 (1977).

155. *See* Securities Investor Protection Corp. v. Barbour, 421 U.S. 412 (1975) (SIPC) (no implied private right of action under Securities Investor Protection Act of 1970, 15 U.S.C. § 78aaa-78lll (1970), in favor of customers of failing broker dealer to compel Securities Investor Protection Corporation to act for their benefit); National R.R. Pass'r Corp. v. National Ass'n of R.R. Pass'rs, 414 U.S. 453 (1974) (Amtrak) (no implied private right of action under Rail Passenger Service Act of 1970, 45 U.S.C. §§ 501-644 (1970), in favor of private individuals seeking to enjoin discontinuation of rail service).

156. McMahon & Rodos, *Judicial Implication of Private Causes of Action: Reappraisal and Retrenchment,* 80 DICK. L. REV. 167, 187 (1976). The Supreme Court overturned the rulings of three courts of appeal in *Cort, SIPC,* and *Amtrak.* McMahon and Rodos analyze the appellate courts' opinions for all three decisions and conclude that they "reflected a judicial disposition to create remedies in support of perceived legislative objectives. They were a logical extension of the Supreme Court decisions of the previous ten years." *Id.* at 183.

sions replaced expansive lower court holdings[157] with narrow rulings. The Court abandoned the remedial philosophy of 1964-1972 and substituted a restrictive interpretative approach in its place. This dramatic turnaround raises a question about the Court's motivation. Although no answer is readily available, a portion of the majority opinion in *Santa Fe Industries, Inc. v. Green*[158] offers several possible explanations that have also surfaced in the Burger Court's other decisions under the Acts.

The corporate defendant, Santa Fe, which owned ninety-five percent of Kirby Lumber, a Delaware corporation,[159] decided to eliminate the minority shareholders. To accomplish this goal, known in contemporary parlance as "going private,"[160] Santa Fe used the Delaware short-form merger statute. This provision allowed Santa Fe to squeeze out Kirby's minority shareholders for cash without obtaining their consent or giving them advance notice of the merger.[161] Kirby's minority shareholders asserted violations of section 10(b) and rule 10b-5. In sustaining the sufficiency of plaintiffs' claim, the second circuit held that if plaintiffs allege a breach of fiduciary duty by a majority against minority shareholders, neither allegations nor proof of misrepresentation or nondisclosure is required.[162]

On appeal, a nearly unanimous Supreme Court reversed the court of appeals by finding that a section 10(b) violation must include deceptive or manipulative conduct.[163] The Court based its holding on a strict construction of the language of the section, specifically the terms "manipulative" and "deceptive."[164] Although in context this language is sufficiently clear to be dispositive,[165] the majority reinforced its ruling by setting forth four additional policy considerations.[166]

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157. Only SEC v. Sloan, 436 U.S. 103 (1978), affirmed the court of appeals.

158. 430 U.S. 462 (1977).

159. Santa Fe owned its interest in Kirby through a subsidiary. For a description of the various corporations involved in the transactions that formed the basis for the litigation, *see id.* at 466 n.3.

160. *See* R. JENNINGS & H. MARSH, *supra* note 121, at 999-1007.

161. DEL. CODE tit. viii, § 253 (1974). Under the Delaware scheme, minority shareholders' only remedy, upon notification of the merger, is to initiate judicial action to have a court-appointed appraiser determine whether the shareholders received fair value for their shares. If they have not, the surviving corporation will be ordered to remedy the situation. *Id.* §§ 253 and 262.

162. Santa Fe Indus., Inc. v. Green, 533 F.2d 1283, 1287 (2d Cir. 1976), *rev'd,* 430 U.S. 462 (1977).

163. 430 U.S. at 474. This holding has put an abrupt stop to the development of "new fraud," misconduct other than deception that lower courts during the past several years had held actionable under § 10(b). *See* Note, *The "New Fraud" Becomes No Fraud: Santa Fe Industries, Inc. v. Green,* 31 SW. L.J. 739 (1977).

164. 430 U.S. at 471-74.

165. *Id.* at 477, *citing* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201 (1976).

166. *Id.*

First, the Court expressed unwillingness to expand the coverage of the Acts absent evidence that expansion would fulfill some specific congressional purpose or was contemplated by the legislature.[167] This reluctance is consistent with both the interpretative approach taken by the Burger Court in several other decisions examined in this article[168] and the Court's restrictive attitude towards implied private actions.[169] In other words, the Burger Court's decisions under the Acts are a product of a judicial philosophy markedly more conservative than that of the Warren Court.

Second, affirmance of the Second Circuit's ruling would have increased the federal judiciary's involvement with additional types of fiduciary self-dealing, a form of misconduct for which the states have traditionally provided remedies.[170] In light of this tradition, the majority was loathe to enlarge the federal courts' role in this area.[171] This resistance to expansion, especially important for private actions,[172] has surfaced in other areas. For example, the *United Housing* majority pointed out that extension of the federal securities laws to real estate transactions is an issue involving "important questions as to the appropriate balance between state and federal responsibility,"[173] resolution of which is more appropriate for the legislature than the judiciary.[174]

Third, the Court questioned the soundness of a ruling that would have interfered with the corporate laws of many states.[175]

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167. *Id.* at 477-79. The majority viewed the fundamental purpose of the 1934 Act—and § 10b—to be the full disclosure of a particular transaction rather than insuring the fairness of its terms. *Id.* at 478.

168. *See* notes 142-50 and accompanying text *supra* and note 151 *supra.*

169. In a recent decision denying a private remedy under § 7 of the 1934 Act, a district court commented upon the development of "a recent trend away from the wholesale implication of private rights of action" under the securities laws, citing *Cort, Piper,* and *Santa Fe.* Stern v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1978-Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,528 at 94,089 (D.C. Md.). Two commentators have drawn the same conclusion: "Under the judicially active Warren Court the absence of express legislative intent was interpreted to permit the judiciary to fashion remedies to further social and statutory policies. Under the Burger Court, however, the absence of express legislative intent militates against implication." McMahon & Rodos, *supra* note 156, at 191.

170. 430 U.S. at 478.

171. *Id.* Indeed, since *Santa Fe* the Delaware Supreme Court has imposed substantive fairness requirements on freeze-out mergers, ruling that such mergers should not be allowed absent a valid business purpose and that a merger "made for the sole purpose of freezing out minority stockholders is an abuse of the corporate process. . . ." Singer v. Magnavox Co., 380 A.2d 969, 980 (Del. 1977). Although it is too soon to conclude that *Singer* will become the majority rule, *Singer* evidences a trend towards greater state regulation of freeze-out mergers. For a discussion of freeze-out mergers in light of *Singer, see* Note, *Singer v. Magnavox Co.. Minority Rights and Freeze-Out Mergers,* 83 DICK. L. REV. 159 (1978).

172. *See* Piper v. Chris-Craft Indus., 430 U.S. 1, 40 (1977).

173. 421 U.S. at 859 n.26.

174. *Id.*

175. 430 U.S. at 479. Apparently, the second circuit's ruling would have overridden the short-form merger provisions of not only Delaware, but also of thirty-seven other states. Green v. Santa Fe, Indus., Inc., 533 F.2d 1283, 1299 (2d Cir. 1976) (dissenting opinion), *rev'd,* 430 U.S. 462 (1977).

Perhaps many of the Burger Court's decisions are the result of its reaction to what it perceives as an impractical expansion of the federal securities laws by the lower courts.[176] For example, the *Piper* majority noted that agreement with the court of appeals would have sanctioned the imposition of a multi-million dollar damages award against Bangor Punta, the successful bidder for *Piper.* But the *Piper* shareholders, who acquired Bangor Punta stock and who are members of the class to be protected by the Williams Act, would have borne a large part of the burden of the judgment.[177] Similarly, in *TSC* the Supreme Court expressed a fear that a low standard of materiality for actions involving proxy rule violations could produce less meaningful disclosure for the very shareholders that section 14(a) of the 1934 Act was designed to serve.[178]

Last, the Court pointed to the danger of vexatious litigation that an expanded plaintiff class could produce.[179] This concern, amplified in detail in *Blue Chip,*[180] has found expression in the Burger Court's three section 10(b) decisions.[181] While it is possible that the Court's primary concern is the ability of unscrupulous plaintiffs to use section 10(b) to harass defendants, it is more likely that the Court was really apprehensive about the growing number of plaintiffs who are encouraged by the Warren Court rulings to seek redress through the federal courts. Although no Supreme Court decision has directly acknowledged this concern, evidence exists that at least some of the justices are troubled by crowded federal dockets.[182] In two recent non-section 10(b) decisions, for example, the Court appears to be thinking about the increased number of federal actions that the lower courts' holdings would produce.[183] Moreover, recent rulings of

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176. *See* note 180 *infra (Blue Chip)*; note 109 and accompanying text *supra* (*Rondeau*); and note 103 and accompanying text *supra* (*United Housing*).

In 1970 Phillip Kurland wrote that "the Supreme Court has been using federal statutes as an excuse for absorbing corporation law into the national domain" and that "the lower federal courts have anticipated the Supreme Court's direction." P. KURLAND, POLITICS THE CONSTITUTION AND THE WARREN COURT 61 (1970). He also noted that the Warren Court greatly expanded federal control over securities law. *Id.*

177. 430 U.S. at 39.

178. *See* note 122 and accompanying text *supra.*

179. 430 U.S. at 479.

180. *Blue Chip* stated that "there has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." 421 U.S. at 739. The opinion then devoted considerable attention and space to identifying this "vexatiousness" at both the pre-trial and trial stages. *Id.* at 739-49. Justice Blackmun in dissent criticized the Court on this point for becoming "mire[d] . . . in speculation and conjecture not usually seen in its opinions." *Id.* at 769-70.

181. *See* notes 179-80 and accompanying text *supra,* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 n.33 (1976).

182. Various commentators support this proposition. *See, e.g.,* Liggio, *The 'Ernst' Ruling—Expansion of a Trend,* N.Y.L.J., April 15, 1976 at 4, col. 5; McMahon and G. Rodos, *supra* note 150, at 191; Note, *Chris-Craft: Changing Perspectives On Contests For Corporate Control,* 6 HOFSTRA L. REV. 203, 242 (1977).

183. In *TSC* the Court discussed the probability that management would be subjected to liability for insignificant omissions or statements in proxy materials if the seventh circuit's

the Burger Court on issues other than those involving the Acts should reduce the number of plaintiffs able to look to the federal courts for relief, an effect that was certainly not lost on the Court.[184] Finally, Justice Burger has publicly proclaimed his views about the need to pare back the amount of litigation in the federal system.[185]

### *B. Reaction by the Lower Courts*

Whatever the Court's motivation, one point seems clear: the Court's shift since mid-1975 in its approach to the Acts is so striking that it cannot go unnoticed by the lower courts. While it is too soon to predict the precise imprint that the Court's recent decisions will make on the federal securities laws,[186] lower court holdings already evidence the changes that the Court has wrought.

*1. Narrow Holdings.*— Although the recent Supreme Court decisions have not ended the proclivity of all lower courts for plaintiff-oriented interpretations of the Acts,[187] recent holdings have been narrower.[188] One example is *SEC v. Bausch & Lomb, Inc.*,[189] in which the Securities and Exchange Commission sought a permanent injunction against a corporate executive who inadvertently tipped material inside information to a securities analyst in violation of section 10(b).[190] While *Hochfelder* ruled out a private damages action grounded only upon negligence,[191] it left unresolved the nature of a

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standard for materiality (see note 122 and accompanying text *supra*) were to prevail. 426 U.S. at 448. In other words, a less severe test of materiality would encourage increased litigation in the federal courts, which, under § 27 of the 1934 Act, 15 U.S.C. § 78aa (1970), have exclusive jurisdiction over all claims under that Act. *See also* notes 163-64 and accompanying text *supra*.

184. *See, e.g.*, notes 152-56 and accompanying text *supra*; Cooper & Lybrand v. Livesay, 46 U.S.L.W. 4757 (June 20, 1978) (rejection of "death knell" doctrine that permitted appeal of prejudgment order denying class certification); Alyeska Pipeline Serv. Co. v. The Wilderness Soc'y, 421 U.S. 240 (1975) (rejection of private attorney general exception to prevailing American rule that each party to litigation is responsible for own attorneys' fees).

185. Chief Justice Burger's *1977 Report to the American Bar Association,* 63 A.B.A.J. 504 (1977); *Chief Justice Burger Issues Year-End Report,* 62 A.B.A.J. 189 (1976).

186. One commentator has remarked that the Supreme Court's recent decisions under the Acts have "enumerated principles that may circumscribe the rights of plaintiffs under the federal securities laws for many years to come." Lowenfels, *supra* note 83, at 892.

187. *See* note 250 *infra*.

188. For other decisions not discussed in this article, *see, e.g.*, Grenader v. Spitz, 537 F.2d 612 (2d Cir.), *cert. denied,* 97 S. Ct. 941 (1976) (*United Housing* applicable to shares of stock in a privately sponsored housing cooperative); Gunther v. Hutcheson, 433 F. Supp. 42 (N.D. Ga. 1977) (*Hochfelder, Piper,* and *Santa Fe* support rejection of implied private action under section 17(a)); Berkowitz v. Baron, 428 F. Supp. 1190 (S.D.N.Y. 1977) (traditional, and apparently broader, test for materiality in section 10(b) actions questioned after *TSC*); Bio-Medical Sciences, Inc. v. Weinstein, 407 F. Supp. 970 (S.D.N.Y. 1976) (*Blue Chip* supports narrow construction of connection requirement of rule 10b-5 action); Copperweld Corp. v. Imetal, 403 F. Supp. 579 (W.D. Pa. 1975) (*Rondeau* irreparable harm requirement may apply to preliminary injunctive relief under the Williams Act). *See also* notes 193-94 *infra*.

189. 420 F. Supp. 1226 (S.D.N.Y. 1976), *aff'd,* 565 F.2d 8 (2d Cir. 1977).

190. For a discussion of § 10(b) liability for tipping, *see* 2 A. BROMBERG, *supra* note 26, at § 7.5, at 190.11-190.20.

191. *See* note 140 *supra*.

defendant's state of mind that the Commission has to establish as a prerequisite to injunctive relief.[192] After reviewing *Hochfelder*[193] the district court judge found himself unable to distinguish an injunctive action from a private damages claim and, therefore, concluded, contrary to prevailing pre-*Hochfelder* authority,[194] that "*scienter* must be pleaded and proved whether suit is brought by the SEC or by a private litigant."[195] Hence, the executive's inadvertent violation could not be the basis for an injunction.[196]

Another illustration of the narrowing impact of the Supreme Court's recent decisions is *Browning Debenture Holders' Committee v. DASA Corp.*[197] Plaintiffs, holders of a small percentage of DASA's convertible debentures, claimed that the corporation's directors had violated section 14(a)[198] of the 1934 Act by breaching a fiduciary duty to deal fairly with the debenture holders.[199] Until recently, this type of claim had been at least colorable and had provided a fair basis for litigation.[200] A Second Circuit panel, however, rejected the claim because *"it is clear since the Supreme Court's recent decision in Green v. Santa Fe Industries, Inc.* . . . that no such duties are im-

192. 425 U.S. at 194 n.12.

193. A number of recent decisions show the influence of *Hochfelder. E.g.,* Collins Sec. Corp. v. SEC, 562 F.2d 820, 827 (D.C. Cir. 1977) (SEC directed to consider applicability of *Hochfelder* scienter requirement to broker-dealer enforcement proceedings); Utah State Univ. v. Bear, Sterns & Co., 549 F.2d 164, 168 (10th Cir. 1977) (something more than mistake or negligence necessary for violations of stock exchange and NASD rules); Vacca v. Intra Management Corp., 415 F. Supp. 248, 250 (E.D. Pa. 1976) (*Hochfelder* applies equally to both equitable actions for rescission and actions at law for money damages). *See* Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977) (reckless behavior sufficiently culpable state for § 10(b) but definition of *reckless behavior* should not be a liberal one); Applied Digital Data Sys. Inc. v. Milgo Electronic Corp., 425 F. Supp. 1145, 1157 n.41 (S.D.N.Y. 1977) (dictum) (*Hochfelder* scienter requirement applicable to § 14(e) private damages actions).

194. The principal pre-*Hochfelder* authorities, most of which concluded that the Commission need only establish a negligent violation, are discussed in Berner & Franklin, *Scienter and Securities and Exchange Commission Rule 10b-5 Injunctive Action: A Reappraisal in Light of Hochfelder,* 51 N.Y.U. L. REV. 769, 787-92 (1976). Under § 21(a) of the 1934 Act, 15 U.S.C. § 78u(d) (1976), the Commission must establish both that a violation has occurred and that the violator is engaged, or is about to engage, in a prohibited act or practice.

195. 420 F. Supp. at 1241. *See* Justice Black's dissent in *Hochfelder,* 425 U.S. at 217-18; Berner and Franklin, *supra* note 194, at 781-87; Cox, *supra* note 137, at 589-92. The second circuit subsequently affirmed, on other grounds, the district court's refusal to grant the injunction, SEC v. Bausch & Lomb, Inc., 565 F.2d 8, 18-19 (1977), which affirmance made it unnecessary to decide "whether *Hochfelder* mandates abandonment of our long-standing rule that proof of past negligence will suffice to sustain an SEC injunction action," *id.* at 14. The second circuit still has not resolved this issue. *See* SEC v. Commonwealth Chemical Sec., Inc., 574 F.2d 90, 101-02 (1978).

196. 420 F. Supp. at 1242. Many courts do not interpret the scienter requirement so narrowly. *See* the authorities cited in Berdahl v. SEC, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,359, at 93,238 n.6 (8th Cir. 1978).

197. 560 F.2d 1078 (2d Cir. 1977).

198. *See* note 10 *supra.*

199. Two-thirds of the debenture holders agreed to debenture modifications permitting the sale of certain DASA assets and reducing the debentures' conversion price. Plaintiffs claimed that the solicitation seeking consent to the modifications failed to disclose to the debenture holders certain conflicts of interest and the unfairness of the conversion price modification. 560 F.2d at 1080-82.

200. *Id.* at 1088.

posed by federal law upon corporate directors and that violation of any such state law fiduciary duties . . . will not support a claim of constructive fraud under [section] 14(a). . . ."[201] This pronouncement probably extends *Santa Fe* to limits that other courts would find unacceptable.[202] Nevertheless, the use of *Santa Fe* to block claims sounding principally in breach of corporate fiduciary duties is not unusual.[203]

A final example of a defendant-oriented result attesting to the effect of a recent Supreme Court decision is *Davis v. Rio Rancho Estates, Inc.*[204] Plaintiff claimed to be the victim of a land promotion scheme actionable under the anti-fraud provisions of the 1934 Act.[205] A threshold question was whether the scheme was a security under that Act. A clause in plaintiff's purchase agreement reserved the seller mineral rights to the land purchased, but granted plaintiff one-half of any mineral production royalties that the seller might realize.[206] Plaintiff contended that this arrangement brought the sale within section 3(1), which defines a security to include a "certificate of interest or participation in any profit sharing agreement or in any oil, gas or other mineral royalty or lease."[207] The *Davis* court thought otherwise, noting that mechanical application of the Acts to anything literally fitting the definition of a security has been specifically rejected by *United Housing*.[208] Echoing the majority opinion in

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201. *Id.* at 1084 (footnotes omitted) (emphasis added).

202. A district court judge has noted that in three recent opinions the second circuit "appears to have taken somewhat different positions concerning the breadth of *Santa Fe*." Biesenbach v. Guenther, [1978-Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,363 at 93,248 (E.D. Pa.). He compared the statement from *Browning Debenture Holders' Committee* with Goldberg v. Meridor, 567 F.2d 209, 217-18 (1977), *cert. denied,* 434 U.S. 1069 (1978) and Cole v. Schenley Indus., Inc., [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,166 at 92,288 (1978).

203. *See* Berman v. Gerber Prods. Co., [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,506 (W.D. Mich. 1978) (*Santa Fe's* deception requirement applicable to claim under § 14(e) of 1934 Act); Lavin v. Data Sys. Analysts, Inc., 443 F. Supp. 104 (E.D. Pa. 1977) (failure to disclose to shareholders that employee bonus plan was adopted solely for benefit of corporation's officers and directors not manipulation or deception violative of § 10(b)); O'Brien v. Continental Ill. Nat'l Bank & Trust Co., 431 F. Supp. 292 (N.D. Ill. 1977) (breach of fiduciary duty by purchase of high-risk securities for discretionary trust and agency account not manipulation or deception violative of § 10(b)); Voege v. The Magnavox Co., 439 F. Supp. 935 (D.C. Del. 1977) (false statement in merger proxy statement based upon opinion of properly qualified counsel regarding validity of merger under state law not manipulative or deceptive device violative of § 10(b)).

204. 401 F. Supp. 1045 (S.D.N.Y. 1975).

205. *Id.* at 1047.

206. *Id.* at 1050.

207. 15 U.S.C. § 78c(10) (1976).

208. 401 F. Supp. at 1050. *United Housing* supported the district court's rejection of another argument advanced by plaintiff. She apparently claimed that representations that the developer would build, or encourage other purchasers to build, roads and other improvements—which would of course increase the value of plaintiff's property—constituted the type of promoter efforts that are the hallmark of a security. *Davis* ruled that "this is not the type of managerial service contemplated in . . . , *United Housing.* Defendants did not promise to run the development and distribute profits to the plaintiff. . . . There was no management contract between plaintiff and defendants, nor were defendants obligated to perform any such

*United Housing,*[209] the district court reasoned that the " 'economic reality of this transaction is the simple installment sale of a parcel of real property. The mere possibility of future discovery of minerals . . . is too speculative, and too insubstantial, to bring the transaction within the securities laws."[210]

*2. Statutory Language.*— Evidence of the Court's handiwork can also be found in the lower courts' use of statutory language to forge narrow holdings.[211] In *Gunther v. Hutcheson,*[212] plaintiffs asserted a claim under section 17(a)[213] of the 1933 Act, an anti-fraud provision that, like section 10(b), is silent on the existence of a private action. The district court focused upon the language of section 17(a), stating, "[I]t is readily apparent, and undisputed, that there is no express private right of action in Section 17(a)."[214] Finding no evidence in the legislative scheme or history to support implication, *Gunther* rejected plaintiffs' section 17(a) claim.[215]

*3. Harmony With the Statutory Scheme.*— Close attention to statutory language is not the only interpretative tool that produces narrow holdings. As the district court decision of *Redington v. Touche Ross & Co.*[216] demonstrates, concern about harmonizing a particular statutory provision with the statutory scheme can also produce this result. In this suit, which followed the collapse of Weis Securities, Inc., a large brokerage house, plaintiffs were obviously reaching for a "deep pocket" from which to recover their losses. Sec-

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services." *Id.* at 1050. This portion of the *Davis* opinion was recently quoted with approval by the tenth circuit in Woodward v. Terracor, 574 F.2d 1023, 1026 (10th Cir. 1978).

209. *See* note 103 and accompanying text *supra.*

210. 401 F. Supp. at 1051. In a different case at the district court level involving the same land scheme, defendants' motion for summary judgment was denied. The trial judge reasoned that plaintiffs' affidavits raised a factual question whether the land promotion involved the sale of a security. "To the extent that *Davis*. . . suggests a different result, I [the trial judge] must respectfully disagree . . . . */Davis/* take[s] a narrow view inconsistent with the flexible and realistic approach mandated by the Supreme Court. *See generally* United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975)." Jenne v. Amrep Corp., [1978-Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,343 at 93,166 (D.C.N.J.). Compare *Jenne's* reading of *United Housing* with that of Robinson v. United Mine Workers of America Health & Retirement Funds, 435 F. Supp. 245, 246 (D.D.C. 1977).

211. For decisions not discussed in the text, see Holdsworth v. Strong, 545 F.2d 687, 694 (10th Cir. 1976); SEC v. Southwest Coal & Energy Co., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH)¶ 96,257 at 92,695 (W.D. La. 1977); SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226, 1240 (S.D.N.Y. 1976), *aff'd,* SEC v. Bausch & Lomb, Inc., 565 F.2d 8 (2d Cir. 1977); Copperweld Corp. v. Imetal, 403 F. Supp. 579, 597 n.45 (W.D. Pa. 1975). *Cf.* Abrahamson v. Fleschner, 568 F.2d 862, 880-81 (2d Cir. 1977) (Gurfein, J., concurring and dissenting) (no implied cause of action under § 206 of Investment Advisers Act, 15 U.S.C. § 80b-6 (1977)), *cert. denied,* 98 S. Ct. 2253 (1978).

212. 433 F. Supp. 42 (N.D. Ga. 1977).

213. 15 U.S.C. § 77q(a) (1976).

214. 433 F. Supp. at 45. *Gunther* quoted from the majority opinion in *Hochfelder,* which repeated the advice from Justice Powell's *Blue Chip* concurrence that "[t]he starting point in every case involving construction of a statute is the language itself [421 U.S. at 756]." *Id.* at 45.

215. *Id.* at 47.

216. 428 F. Supp. 483 (S.D.N.Y. 1977), *rev'd,* [1977-1978 Transfer Binder] [Current] FED. SEC. L. REP. (CCH) ¶ 96,404 (2d Cir.), *cert. granted,* 47 U.S.L.W. 3368 (Nov. 28, 1978).

tion 17 of the 1934 Act required Weis to make various filings with the Securities and Exchange Commission.[217] Included in those filings were Weis's financial statements that had been audited by defendant accounting firm. Plaintiffs asserted that defendants violated section 17(a) by improperly auditing the financial statements, so that as filed they presented an overly optimistic picture of Weis's financial condition and delayed corrective action that presumably would have prevented the collapse.[218]

The difficulty with plaintiffs' claim was that section 17 says nothing about a private damages action for its violation.[219] Moreover, section 18 of the 1934 Act expressly creates private liability for the very wrongdoing that plaintiffs charged.[220] Unfortunately for plaintiffs, they fell outside the protected class to whom section 18 affords relief. Thus, the district court rejected the section 17 claim.[221] Central to this rejection was the judge's refusal to rule contrary to the statutory scheme: "The subject matter of the two sections [sections 17 and 18], their titles, and their juxtaposition would strongly suggest a legislative intent that the *only* private claim for a violation of Section 17 was the claim created in Section 18."[222]

On appeal the second circuit could find no evidence of legislative intent to create a private remedy under section 17.[223] By broadly interpreting the language and purpose of the provision, however, a split panel decided that plaintiff's claim met the criteria for implication set out by the Supreme Court in *Cort v. Ash*[224] and became the first court of appeals to rule on a private damages action under section 17 of the 1934 Act. Nevertheless the dissent found the majority opinion flawed by its failure to consider the gloss *Piper* added to *Cort* —whether implication is a *'necessary* adjunct . . . to accomplish the primary congressional goal embodied by the legislation."[225] This issue the dissent resolved against the plaintiffs.[226]

In view of the current Court's approach to the securities laws,

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217. Section 17, 15 U.S.C. § 78q (1976).

218. 428 F. Supp. at 487.

219. *See id.* at 488-89.

220. Section 18, 15 U.S.C. § 78r (1976) creates a private cause of action for misleading statements in any application, report, or document filed pursuant to the 1934 Act in favor of any person who purchased or sold a security at a price affected by the misleading statements. Being neither purchasers nor sellers, plaintiffs could not state a claim under § 18. *See* Note, *Section 18 of the Securities Exchange Act of 1934: Putting the Bite Back into the Toothless Tiger.* 47 Fordham L. Rev. 115 (1978).

221. 428 F. Supp. at 491.

222. *Id.* at 489 (emphasis in original). The district court cited *Blue Chip* as authority.

223. [1978-Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,404 at 96,434 (2d Cir.). Nor did anything indicate congressional intent to *deny* such a remedy.

224. *Id.* at 93,433-93,435. *See* notes 152-54 *supra* and accompanying text.

225. [1978-Transfer Binder] FED. SEC. L. REP. (CCH)¶ 96,404 at 93,441 (2d Cir.) (Mulligan, J., dissenting).

226. *Id.* at 93,443.

particularly in the implication area,[227] the Second Circuit ruling seems clearly wrong. It indeed would be suprising if the Court, which recently granted certiorari from the court of appeals ruling,[228] did not side with the dissent.[229]

*4. Unwillingness to Expand the Acts Absent Specific Legislative Intent or Purpose.*—Two recent decisions from the Southern District of New York illustrate a third interpretative pattern woven through several of the Burger Court's decisions, namely, unwillingness to expand judicially the coverage of the Acts, absent a clear indication that expansion is consistent with specific legislative intent or purpose.

*Superintendent of Insurance v. Freedman*[230] involved a suit by the New York Superintendent of Insurance as the liquidator of the bankrupt Knickerbocker Insurance Company. The action grew out of a sham stock transaction by which a substantial sum of money was diverted from Knickerbocker to Universal, its parent and sole shareholder. Rejecting the Superintendent's section 10(b) claim, the court noted the absence of deception by Knickerbocker, its management, or its sole shareholder/parent for whose benefit the stock transaction had been engineered.[231] The court explained its reluctance to extend section 10(b) protection to Knickerbocker policy holders and creditors who had clearly been deceived thus:

> It should be remembered, however, that the private cause of action under the Rule [10b-5] is a judicial creation that was implied notwithstanding the existence of private actions explicitly provided by other sections of the 1933 and 1934 Acts. *The Rule should not be applied automatically to every allegedly fraudulent transaction arguably involving securities . . . . [It] should not be extended to include within its proscription frauds which do not injure any public investors nor any purchasers or sellers of securities. Such extensions are not justified by the legislative purpose of federal securities regulation.*[232]

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227. *See* notes 150-156 and accompanying text *supra*.

228. 47 U.S.L.W. 3368 (Nov. 18, 1978).

229. Other lower courts have respected the statutory scheme. *See* Sanders v. John Nuveen & Co., Inc. 554 F.2d 790, 795 (7th Cir. 1977); Utah State Univ. v. Bear, Sterns & Co., 549 F.2d 164, 168 (10th Cir.), *cert. denied*, 98 S. Ct. 264 (1977). *See* Gunther v. Hutcheson, 433 F. Supp. 42, 45-46 (N.D. Ga. 1977); Braun v. Northern Ohio Bank, 430 F. Supp. 367, 373-75 (N.D. Ohio 1977).

230. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH)¶ 96,262 at 92,714 (1977).

231. *Id.* at 92,718. In derivative actions grounded upon a claim that the corporation has been involved in a fraudulent securities transaction, courts employ various theories to find the deception element required for the § 10(b) claim. *See* the discussion in *id.* at 92,717-78 and 1 A. BROMBERG, *supra* note 26, at § 4.7(541)-(547), at 84.51-71.

232. Superintendent of Ins. v. Freedman, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,269, at 92,719 (emphasis added) (citations omitted). The fifth circuit has held that promoters' issuance of a corporation's shares for inadequate consideration can give rise to a derivative action in favor of the corporation under § 10(b) even though all contemporaneous directors and shareholders of the corporation are privy to the wrongdoing, if the participants in the fraud intended to defraud future shareholders or creditors. Miller v. San Sebastian Gold Mines, Inc., 540 F.2d 807 (1976); Bailes v. Colonial Press, Inc., 444 F.2d 1241 (1971). *Freedman* distinguished these cases on the ground that the fraud involved investors who later

Refusal to extend the Acts past the parameters marked off by Congress also figured prominently in *Nussbacher v. The Chase Manhattan Bank.*[233] A stockholder instituted a derivative damages action against a number of defendants, including Chase. She claimed that the bank financed her corporation's acquisition of an insurance company in violation of the credit limitations imposed by section 7 of the 1934 Act and Regulation U.[234] Neither the statute nor the regulation mentions a private action for its violation.

In moving for dismissal, Chase asked the court to reconsider, in light of *Cort, Piper,* and *Santa Fe,*[235] a 1970 second circuit decision[236] that had inferred a damages action under section 7 in favor of a private investor. In essence the bank argued that protection of private investors was not one of Congress' primary purposes in enacting section 7 and that a private damages action in favor of that class should not be judicially created. The district court judge agreed with Chase and dismissed the section 7 claim.[237] In support of his ruling, the judge read *Piper* and *Santa Fe* as barring recognition of a private action that does not fulfill some fairly explicit congressional goal.[238] Other lower courts have exercised similar restraint.[239]

*5. Lower Courts' Perception of the Burger Court.*— Perhaps the most telling indication of the Supreme Court's recent shift in its attitude toward coverage of the Acts is the express recognition accorded the turnaround by some lower courts. One of the strongest statements appears in *Crane Co. v. American Standard, Inc.*[240] This action was born out of an intense take-over battle for Westinghouse Air Brake, Inc. that Crane lost to American Standard. In 1969 the second

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buy shares in the corporation, are members of the investing public, and therefore are arguably within § 10(b)'s scope. *Id.* at 92,718.

233. 444 F. Supp. 973 (S.D.N.Y. 1977).

234. *Id.* at 974-75. Section 7 of the 1934 Act, 15 U.S.C. § 78q (1976), gives the Federal Reserve Board authority to fix margin requirements and makes it unlawful for any broker, dealer or banker to extend credit in violation of those requirements. Regulation U, 12 C.F.R. § 221.1-221.123 (1978), governs loans by banks and prescribes minimum margin requirements in accordance with § 7.

235. 444 F. Supp. at 978.

236. Pearlstein v. Scudder & German, 429 F.2d 1136 (2d Cir. 1970).

237. The court concluded that § 7 was directed at bolstering the national economy, not at protecting any private party. 444 F. Supp. at 979. *See also,* Stern v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1978-Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,528 (D.C. Md.).

238. 444 F. Supp. at 979-80. *See* note 237 *supra.*

239. *See* Schy v. FDIC, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,242 (E.D.N.Y. 1977); Gluck v. Frankel, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,238 (S.D.N.Y. 1977); Gunter v. Hutcheson, 433 F. Supp. 42 (N.D. Ga. 1977). *See* O'Brien v. Continental Ill. Nat'l Bank & Trust Co. of Chicago, 431 F. Supp. 292 (N.D. Ill. 1977); Redington v. Touche Ross & Co., [1978-Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,404 at 93,438 (S.D.N.Y.) (Mulligan, J.) (dissenting opinion), *cert. granted,* 47 U.S.L.W. 3368 (Nov. 28, 1978). *Cf.* Abrahamson v. Fleschner, 568 F.2d 862, 879-87 (2d Cir. 1977) (no implied cause of action under section 206 of Investment Advisers Act, 15 U.S.C. § 80b-6 (1976)) (Gurfein, J., dissenting in part), *cert. denied,* 98 S. Ct. 2253 (1978).

240. 439 F. Supp. 945 (S.D.N.Y. 1977).

circuit[241] found that Crane had standing to bring a damages action against American Standard for violation of sections 9(a)(2)[242] and 10(b)[243] of the 1934 Act. The action was tried in 1976, but *Piper* was handed down before the district court reached a decision. The trial judge then ruled that the second circuit's holding could not survive, even though *Piper* was not squarely on point.[244] The judge also analyzed the significance of *Piper* and the Court's other recent decisions.

> *[Piper]* does not stand alone. It is not *sui generis,* distinguishable from all other cases because of unusual facts or esoteric points of law. Instead, it is one of several recent Supreme Court decisions which indicate that the Court is taking a hard, new look at federal jurisdiction under the securities laws. Included in this trend are *[Santa Fe, TSC, Hochfelder and Blue Chip.]*
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> . . . .
>
> The reasoning of *[Piper]* implies that Crane lacks standing to recover in this action. This conclusion is buttressed by the trend toward a restrictive interpretation of the federal securities laws evidenced by the Supreme Court's recent decisions.[245]

Comparable statements appear in *Robinson v. United Mine Workers of American Health & Retirement Funds.*[246] In granting defendants' motion for partial summary judgment, *Robinson* rejected plaintiffs' argument that an interest in a noncontributory health and retirement plan is a security under the Acts.[247] *United Housing,* which supported the district court's reluctance to expand the scope of the concept of security,[248] was characterized as "but one of a series of

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241. Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969), *cert. denied,* 400 U.S. 822 (1970). A second appellate duel resulted in Crane Co. v. American Standard, Inc., 490 F.2d 332 (2d Cir. 1973).

242. 15 U.S.C. § 78i(a)(2) (1976). Section 9(a)(2) makes it illegal to effect "a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others."

243. The violation centered on American Standard's purchase of 82,400 Air Brake shares on the last day of Crane's tender offer for Air Brake shares. American Standard concurrently made undisclosed sales of 120,000 Air Brake shares to two friendly institutions at a per share price more than $4.00 below the average price of $49.08 American Standard paid for the shares. 439 F. Supp. at 947.

The second circuit found that American Standard had "painted the tape," by driving up the price of Air Brake shares to a level that would make Crane's tender offer, with a $50.00 per share value, appear less favorable. Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 792 (2d Cir. 1969), *cert. denied,* 400 U.S. 822 (1970).

244. "Although the *[Piper]* case is not directly analogous, the reasoning of *[Piper]* appears to preclude suit by Crane." 439 F. Supp. at 951. The district court opinion then reasoned that allowing a defeated tender offeror to sue the winner for damages under §§ 10(b) and 9(a)(2) would contravene *Piper's* refusal to permit such a result under § 14(e). *Id.* at 951-53. The decision is analyzed in Note, *Securities Regulations—Limiting Private Rights under the Antifraud Provisions of the Securities Exchange Act of 1934,* 56 N. C. L. REV. 765 (1978) [hereinafter referred to as *Securities Regulations—Limiting Private Rights*].

245. 439 F. Supp. at 953-54, 958.

246. 435 F. Supp. 245 (D.D.C. 1977).

247. The presence *vel non* of a security depended on whether the plan involved an "investment contract." *Id.* at 246. *See* note 97 *supra.*

248. 435 F. Supp. at 246.

recent Supreme Court decisions indicating a pronounced disfavor with attempts to stretch the securities laws beyond their traditional scope. *E.g., Santa Fe* [and] *Blue Chip.*"[249]

## IV. Conclusion

The Warren Court of 1964-1972 ruled consistently in favor of plaintiffs invoking the protection of the Acts by approaching statutory interpretation with a pronounced emphasis on the remedial goals of the legislation. In the face of uncertainty about the coverage of the Acts, the Court resolved doubts in favor of expansion and of those plaintiffs that it determined Congress generally sought to protect. Lower courts, understandably perceiving the Warren Court as the champion of an expansive attitude toward the Acts, adopted the Warren Court's remedial philosophy and produced equally broad holdings that continually enlarged the coverage of the Acts.

Since mid-1975 the Burger Court has uniformly issued narrow rulings favoring defendants. Accompanying this decisional turnaround is a pronounced shift in the Court's approach to interpretation of the Acts. The remedial philosophy of 1964-1972 has yielded to an emphasis upon statutory language and statutory scheme and to a marked distaste for judicial expansion of the Acts without clear legislative mandate.

Probably the most striking aspect of the Burger Court's recent activity is in the field of implied private actions. Three decisions, *Blue Chip, Hochfelder* and *Santa Fe,* have sharply cut back the potential range of section 10(b), and a fourth decision, *Piper*, has

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249. *Id.* at 247. Robinson and Crane are not alone in their views. In Reliance Ins. Co. v. Barron's, 442 F. Supp. 1341 (S.D.N.Y. 1977), plaintiff corporation sued Barron's and the author of an article defamatory of plaintiff that appeared in the weekly financial magazine. To circumvent the difficulties of proof of a libel claim, plaintiff alleged violation of § 10(b) and rule 10b-5. Dismissing the securities law claim, the court stated, "As we have seen recently, the heyday of the *unfettered extension of the federal securities laws to recompense all those damages has ended* [citing *Santa Fe, Hochfelder* and *Blue Chip*]." *Id.* at 1353 (emphasis added).

A recent district court decision dismissing § 10(b) and rule 10b-5 claims stated,

> These decisions [*Blue Chip, Santa Fe, Piper, Hochfelder* and *TSC*] place a new gloss on section 10(b) and rule 10b-5 actions requiring the courts to scrutinize with great care the appropriateness of a federal securities law remedy for certain conduct by defendants. The Supreme Court in recent decisions has adopted a more limited approach to § 10(b) and rule 10b-5 . . . .

O'Brien v. Continental Ill. Nat'l Bank & Trust Co. of Chicago, 431 F. Supp. 292, 295 (N.D. Ill. 1977) (footnote omitted). *See* Bio-Medical Sciences, Inc. v. Weinstein, 407 F. Supp. 970, 973 (S.D.N.Y. 1976). *See also* St. Louis Union Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 562 F.2d 1040, 1052-53 (8th Cir. 1977), *cert. denied,* 98 S. Ct. 1490 (1978); Maldonado v. Flynn, 448 F. Supp. 1032, 1038-39 (S.D.N.Y. 1978); Schy v. FDIC, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,242 at 92,629 (E.D.N.Y. 1977); Voege v. The Magnavox Co., 439 F. Supp. 935, 942 (D. Del. 1977); Gunter v. Hutcheson, 433 F. Supp. 42, 45, 47 (N.D. Ga. 1977); SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226, 1240 (S.D.N.Y. 1976), *aff'd,* 565 F.2d 8 (2d Cir. 1977).

Many commentators have noted the restrictive trend of the Court. *E.g.,* Castruccio & Hentrich, *Developments in Federal Securities Regulations—1970,* 33 BUS. LAW 1645, 1647, 1662 (1978); Note, *Securities Regulation, Limiting Private Rights, supra* note 244, at 779.

knocked out entirely a private damages claim under section 14(e) of the 1934 Act. This curtailment was accomplished in a manner that must be disquieting to those who have viewed the implied private action as one of the most potent weapons in a plaintiff's arsenal under the Acts.

The precise reason for the Court's transformation since mid-1975 remains unclear. The decisions themselves suggest several explanations, including a high court now primarily staffed by conservatives, at least some of whom have decided to limit judicially the number of plaintiffs able to bring their grievances to a federal forum. Whatever the explanation, the Court's about-face will have a significant impact upon future developments under the Acts. Although some lower courts continue to opt for an expansive approach to the Acts,[250] many are reaching narrow holdings by wielding the interpretative tools with which the Burger Court forged its restrictive rulings. Particularly noteworthy are those lower court expressions signifying a perception of the Burger Court as an advocate of a restrictive approach to the Acts.[251]

As this article was going to press, the Burger Court decided in *International Brotherhood of Teamsters v. Daniel* [252] the significant issue of whether an interest in a noncontributory, compulsory pension plan is a security. The Court's ruling, which refused to consider the pension plan as constituting an investment contract[253] and thus a security, is of interest for at least two reasons. First, the seventh circuit's determination that the interests were securities expanded coverage of the Acts and ran counter to the flow of the Burger Court's decisions. Second, the appellate court's opinion, which is exhaustive, used an approach to statutory interpretation extrapolated from the Burger Court's opinions. Nevertheless, the Burger Court has issued too many narrow rulings and too obviously changed its approach to the Acts to reverse its direction. It is clear, for the present at least, that the Burger Court is not going to revert to the remedial ways of the Warren Court.

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250. *See* text following notes 251 *infra,* 216-28 *supra* and *e.g.,* Bosse v. Growell, Collier & MacMillan, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,295 at 92,864 (9th Cir. 1977) (2-1 decision) (expansive reading of § 10(b) connection requirement); SEC v. World Radio Mission Inc., 544 F.2d 535, 541 n.10 (1st Cir. 1976) (negligent violation of § 10(b) sufficient basis for SEC injunctive action) (dictum); Green v. Hamilton Int'l. Corp., 437 F. Supp. 723, 727-28 (S.D.N.Y. 1977) (affirmation of breadth of *Bankers Life* and narrow reading of *Blue Chip*).

251. A survey published in April 1978 summed up lower court activity under the federal securities laws during the previous year as follows: "With the marked exception of . . . Daniel v. International Brotherhood of Teamsters, 561 F.2d 1223 (7th Cir. 1977), . . . the past year has also witnessed a generally consistent response by the lower courts in following the Supreme Court's current restrictive trend." Castruccio & Hentrich, *supra* note 249, at 1647.

252. 47 U.S.L.W. 4135 (1979).

253. *See* note 97 *supra.*