BOOK REVIEWS

SECURITIES LAW—FRAUD—SEC RULE 10b-5. By Alan H. Bromberg.† New York: McGraw-Hill Book Co., 1967. Pp. xiii, 377. $24.50.

This book needed to be written. It is no news to attorneys engaged in the practice of corporation and securities law that there are literally hundreds of SEC rules and regulations. Yet here is an entire book on just one rule. But it is no news either that the rule in question has spawned, and will continue to spawn, more litigation than any part of the federal securities laws. For that reason alone, this book was well worth the writing.

Rule 10b-5 is perhaps the most controversial and least understood aspect of securities regulation. It is also one of the most important federal controls with respect to insider trading. Both the legitimacy of its birth and the future of its life have been called into question. In short, the argument has been advanced that the rule (or at least its extension to situations like *Cady, Roberts & Company*[1]), being a substantive rule rather than a procedural one, was not validly promulgated within the formalities of the Administrative Procedure Act.[2] But the rule rumbles on. Indeed, as the author so aptly puts it: "Today no business deal involving securities can safely be made without considering it."[3]

Broadly speaking, the following types of action may be brought under rule 10b-5: 1. Civil injunction. The Securities and Exchange Commission may apply to an appropriate United States district court for an order enjoining any person from violating the rule. 2. Administrative proceedings to discipline broker-dealers. Such proceedings may involve suspension or revocation of the broker-dealer's registration, suspension or expulsion from membership in a national securities dealers' association, and suspension or expulsion from membership in a stock exchange. 3. Criminal prosecution. Willful violation of rule 10b-5 may result in criminal prosecution

† Professor of Law, Southern Methodist University.

[1] 40 S.E.C. 907 (1961).

[2] *See* Manne, *Insider Trading and the Administrative Process*, 35 GEO. WASH. L. REV. 473 (1967).

[3] A. BROMBERG, SECURITIES LAW—FRAUD—SEC RULE 10b-5, at 5 (1967) [hereinafter cited as BROMBERG].

by a local United States attorney. 4. Private enforcement by defrauded buyers, sellers, and other persons. Professor Bromberg's book deals with these and related aspects of the rule and deals with them well. After tracing the origin of the rule and its place among existing fraud provisions, the author categorizes and exhaustively treats the situations that may arise under it as follows: direct personal dealing (face-to-face transactions, other than with broker-dealers); direct personal dealing (broker-dealers); direct-impersonal dealing (mergers, tender offers, etc.); indirect-impersonal dealing (stock exchange and open market trades); private actions; criminal actions; procedure and jurisdiction; and other aspects of the rule.

In recent years, the question with respect to rule 10b-5 that has excited most comment is whether it provides for implied civil liability, and, if so, to what extent. In most instances the courts have permitted private rights of action under rule 10b-5. The author apparently takes it for granted that the issue is, in effect, a closed one.[4] There is much to be said for this position, especially after *J. I. Case Company v. Borak*,[5] which permitted implied remedies under the proxy rules of the Securities Exchange Act of 1934. But a nagging doubt remains. Some recent cases have braked the rule's application.[6] Those who would deny a private right of action insist that Congress, in enacting sections 11 and 12 of the 1933 Act, provided *exclusive* civil remedies, and that if it had intended to make such a drastic change in this policy the following year it would have done so expressly. Further, it is argued that the words "It shall be unlawful" in the rule were directed solely to public enforcement by the SEC in administrative actions and the United States in criminal actions.

The answer given, of course, is that the remedies provided by sections 11 and 12 were merely *express* remedies, and that rule 10b-5 affords implied private rights of action. Professor Bromberg discusses four somewhat overlapping theories which have been advanced

[4] "There is an implied right of civil recovery (and correlative liability) for violation of 10b-5, although such a right is expressly granted for other fraud provisions and not for 10b-5." BROMBERG 27 n.47.

[5] 377 U.S. 426 (1963). *See also* Surowitz v. Hilton Hotels Corp., 383 U.S. 363, 371 (1966) (dictum recognizing the need for protection of small investors by this sort of remedy).

[6] *See, e.g.*, Jordan Bldg. Corp. v. Doyle, O'Connor & Co., [1966-1967 Transfer Binder] CCH FED. SEC. L. REP. ¶ 91,996 (N.D. Ill. June 28, 1967).

in support of implied civil liability:[7] (1) the statutory tort theory, "that a person injured by violation of a statute enacted for the benefit of persons in his position is entitled to recover his damages;"[8] (2) the theory that since section 29(b) of the 1934 Act makes all contracts violative of the Act or rules promulgated under it voidable, any transaction violating rule 10b-5 must be voidable by the injured party in a civil action; (3) the arguable implication that section 27 of the 1934 Act gives district courts jurisdiction over any action brought to enforce a liability or duty created by the Act or the rules and regulations thereunder; and (4) the theory that since the policy of the Act was to protect the investing public, Congress must have intended any violation of its rules to give rise to a private remedy. Much is at stake when this question is argued. Sections 11 and 12 of the 1933 Act, in certain situations at least, contain limiting requirements such as privity and reliance. Moreover, section 10 and rule 10b-5 have no statute of limitations except the governing state statute of limitations,[9] while section 13 of the 1933 Act provides for short statutes of limitations for actions brought under sections 11 and 12. If the attorney and his client can make an end run around sections 11 and 12 to rule 10b-5, they may move forward free of the limitations contained in sections 11 and 12.

There is a middle ground: permit private rights of action under rule 10b-5 but with the same limitations which attach to actions brought under sections 11 and 12. These important questions have not yet been resolved by the United States Supreme Court. Professor Bromberg proposes a legislative amendment to resolve some of these problems. He advocates congressional ratification of the doctrine of implied civil liability in order to end the controversy on this question.[10] To eliminate the present inconsistencies among the antifraud provisions, he suggests abolition of the present trans-

[7] BROMBERG 29-34.

[8] *Id.* at 29.

[9] As the book points out, it is not always clear if the 10b-5 action must be brought within the period of the state's statute of limitations for fraud, or whether the period of some other state statute, such as the "catch-all" statute of limitations, applies. The question appears to turn on the court's view of how the *state* would characterize a 10b-5 action, but Professor Bromberg suggests that a federal characterization would be more appropriate. *Id.* at 41, 42 n.105.

[10] *Id.* at 283. But the author expresses doubt as to the political feasibility of this solution, suggesting that Congress may be more conservative than the courts, especially in times of economic prosperity. *Id.* at 286.

actional classifications and consolidation of all these provisions. Short of this, he proposes the enactment of a federal statute of limitations for 10b-5, but argues that a three-year period, rather than one year, is more appropriate.[11]

Another area of securities regulation that has attracted considerable attention in recent years is that of tender offers. It has been suggested that rule 10b-5 may not be applicable to many such offers because it is not activated unless there is a duty to disclose, and, despite the rule's reference to "any person," there is arguably no duty of disclosure unless there is a fiduciary or special relationship between the parties to the transaction of purchase and sale.[12] In his discussion of this question,[13] the author distinguishes between tender offers by insiders, outsiders, and issuers. Insiders are probably subject to a disclosure duty equal in scope to that imposed when they offer to buy directly from an individual shareholder. Plans for disposition or change in the operation of the enterprise, information as to material recent developments in the company, and perhaps the insider's analysis of observed trends in the business, must be disclosed to avoid 10b-5 liability. The outsider, although subject to 10b-5 liability for misrepresentation and misleading omissions, is not presently under any affirmative obligations to make disclosures.[14] But Professor Bromberg points out that any information gleaned from an insider probably must be disclosed. Moreover, he predicts an extension of the 10b-5 disclosure requirement to the outsider who has material information about the issuer or its management within his peculiar knowledge. The author believes that insiders and outsiders will probably be required to disclose their identity. But in neither case should a court consider inadequacy of the price offered shareholders in a tender offer a 10b-5 violation. Where the tender offer is by the issuer, however, the possibility of unfair dilution or change in control make it likely that price will have more legal significance. Because the issuer has complete access to insider in-

[11] *Id.* at 284.

[12] Mills v. Sarjem Corp., 133 F. Supp. 753, 764 (D.N.J. 1955); Speed v. Transamerica Corp., 99 F. Supp. 808, 828-29 (D. Del. 1951) (dictum); *see* Cohen, *A Note on Takeover Bids and Corporate Purchases of Stock*, 22 BUS. LAWYER 149 (1966); Sowards & Mofsky, *Corporate Take-Over Bids: Gap in Federal Securities Regulation*, 41 ST. JOHN'S L. REV. 499 (1967).

[13] BROMBERG 115-32.

[14] Mills v. Sarjem Corp., 133 F. Supp. 753 (D.N.J. 1955); BROMBERG 119.

formation and special influence on shareholders, its duty to disclose "should, if anything, be greater than an insider's . . . ."[15]

It is fortunate that this book was published in loose-leaf form and can be frequently updated, for much has occurred even in the short time since its publication. Activity has been particularly intense in the area of derivative suits charging acts resembling mismanagement or fiduciary breach rather than fraud.[16] For several reasons the courts, especially the Second Circuit, have been reluctant to extend the federal law of corporations[17] which has developed under rule 10b-5 into this area. As the author points out, this reluctance stems from a desire to avoid conflict with state policies, both procedural and substantive, in this traditionally state-dominated field, as well as from a difficulty in distinguishing between the knowledge of the insiders and that of the corporation in order to find some deception. Recent district court cases, however, bear out Professor Bromberg's observation that "10b-5 has become a powerful, if slightly erratic, tool in the enforcement of fiduciary duties."[18]

This review has touched on only a part of the wealth of material contained in Professor Bromberg's book. But there is a full and clear treatment of all relevant material in the book. The topic is one with which lawyers will have to deal for years to come. It is a must on the bookshelf.

HUGH L. SOWARDS*

[15] BROMBERG 130.

[16] *See id.* at 83-88.

[17] *Id.* at 83 & n.65.

[18] *Id.* at 88; *see* Entel v. Allen, 270 F. Supp. 60 (S.D.N.Y. 1967); Weitzen & Epstein v. Kearns, [1966-1967 Tranfer Binder] CCH FED. SEC. L. REP. ¶ 91,973 (S.D.N.Y. July 20, 1967). In the latter case the existence of a 10b-5 action for breach of corporate fiduciary duties was openly recognized. The *Entel* court relied upon the rationale of A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967), and Vine v. Beneficial Finance Co., 374 F.2d 627 (2d Cir. 1967), for the proposition that an undisclosed breach of fiduciary duty constituted a 10b-5 violation. 270 F. Supp. at 70. The *Weitzen & Epstein* court, on the other hand, relied upon the non-imputation of director knowledge rationale expressed in Ruckle v. Roto American Corp., 339 F.2d 24 (2d Cir. 1964), to find the requisite 10b-5 deception of the corporation. *But see* Schoenbaum v. Firstbrook, 268 F. Supp. 385 (S.D.N.Y. 1967). *See also* Delaware Management Co. [1966-1967 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,458 (SEC Exchange Act Release No. 8128, July 19, 1967), *noted in* 1967 DUKE L.J. 1059; Fleischer, *"Federal Corporation Law": An Assessment,* 78 HARV. L. REV. 1146 (1965); Ruder, *Pitfalls in the Development of a Federal Law of Corporation by Implication through Rule 10b-5,* 59 NW. U.L. REV. 185 (1964).

* B.S. 1941, Trinity College; LL.B. 1946, Yale University; Professor of Law, University of Miami (Florida).