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Francis J. Lawler

John J. Madden

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PRIVATE RIGHTS AND REMEDIES UNDER THE S.E.C. PROXY RULES

Until 1933 the corporation was the ward of the individual states, amenable to state law and controlled by state agencies. With the catastrophic collapse of the securities markets in 1929, however, the woeful inadequacy of this guardianship proved a lesson dearly learned. It was out of this unprecedented economic maelstrom that federal regulation crystallized. The Securities Act of 1933¹ was part of President Franklin D. Roosevelt's prodigious "hundred days" legislation. One year later the Securities Exchange Act of 1934² established the Securities and Exchange Commission to administer federal securities laws. Further proliferation of federal regulation continued until the end of the decade with the passage of the Public Utility Holding Company Act of 1935,³ the Trust Indenture Act of 1939,⁴ the Investment Company Act of 1940⁵ and the Investment Advisers Act of 1940.⁶

It has been suggested that the history of the Securities and Exchange Commission reveals a decided and periodic shift in the emphasis accorded the multifarious facets of their work.⁷ The latest emphasis, according to the analysis, relates to the problem of enforcement, a problem which has commanded a large part of the Commission's energies during the third decade of its existence.⁸ In addition to enforcement by the Commission, the question of a private party's standing to complain of alleged violations of the various federal securities laws has been raised time and again. Of late, the sections relating to proxy regulation have come in for judicial interpretation, and it may now be said that there seems to be general agreement that, in appropriate cases, civil remedies are available to private parties complaining of proxy violations. With this in mind, an analysis of the state of the law with regard to rights of private litigants to enforce the proxy rules, and the extent of the relief available to them in the federal courts appears in order.

Regulation of proxy solicitation by the Commission is authorized by the Securities Exchange Act of 1934 with regard to securities listed on exchanges,⁹ by the Public Utility Holding Company Act of 1935 with regard to registered holding companies and their subsidiaries,¹⁰ and by the Invest-

¹ 48 Stat. 74 (1933), as amended, 15 U.S.C. §§ 77a-aa (1958).

² 48 Stat. 881 (1934), as amended, 15 U.S.C. §§ 78a-hh (1958).

³ 49 Stat. 803 (1935), as amended, 15 U.S.C. §§ 79-79z-6 (1958).

⁴ 53 Stat. 1149 (1939), as amended, 15 U.S.C. §§ 77aaa-bbbb (1958).

⁵ 54 Stat. 789 (1940), as amended, 15 U.S.C. §§ 80a-1-52 (1958).

⁶ 54 Stat. 847 (1940), as amended, 15 U.S.C. §§ 80b-1-21 (1958).

⁷ Gadsby, *Historical Development of the S.E.C.—The Government View*, 28 *Geo. Wash. L. Rev.* 6 (1959).

⁸ *Id.* at 13.

⁹ Securities Exchange Act § 14(a), 48 Stat. 895 (1934), 15 U.S.C. § 78n(a) (1958).

¹⁰ Holding Company Act § 12(e), 49 Stat. 824 (1935), 15 U.S.C. § 791(e) (1958).

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ment Company Act of 1940 with regard to registered investment companies.¹¹ The delegation of authority is substantially the same under the three statutes, each providing, in essence, that it shall be unlawful to solicit proxies in contravention of such rules and regulations promulgated by the Commission as necessary or appropriate in the public interest or for the protection of investors. Methods of enforcement are to some extent varied,¹² but the principal prescription, specifically enunciated in the three statutes, is a district court injunction order issued at the invocation of the Commission.¹³ There is nowhere expressed any right of a private party to institute such proceedings. However, with the development of implied private rights under section 10(b) of the Securities Exchange Act,¹⁴ such a claim of right was foreshadowed.

Specifically with regard to implied private rights under the proxy rules, alternative arguments have been advanced. One theory is predicated upon a provision common to the three statutes, that contracts entered into in violation of the governing rules and regulations are void.¹⁵ Treating the proxy itself as a contract, the private litigant asserts standing, as a party to the contract, to compel a judicial determination that his proxy is of no effect. The much more common theory is grounded in the statutory tort doctrine that breach of a statutory duty normally gives rise to a right of action on behalf of injured persons for whose protection the statute was enacted.¹⁶ Recognition of implied rights under section 10(b) of the Securities Exchange Act has usually been justified by recourse to this approach, and attempts to counteract this argument with the contention that the recognition of additional implied remedies is unjustified under a statute contain-

¹¹ Investment Company Act § 20(a), 54 Stat. 822 (1940), 15 U.S.C. § 80a-20(a) (1958).

¹² The Commission may use its statutory power to "publish information concerning . . . violations." Also, it may initiate administrative proceedings of a disciplinary nature where the offender is a registered broker-dealer or an exchange member. It is even possible to use the violation as a basis for delisting the security. In addition, in appropriate cases, the Commission may request the Attorney General to prosecute willful violations. 2 Loss, Securities Regulation 931-32 (2d ed. 1961).

¹³ Securities Exchange Act §§ 21(e), (f), 48 Stat. 900-01 (1934), as amended, 15 U.S.C. §§ 78u(e), (f) (1958); Holding Company Act §§ 18(f), (g), 49 Stat. 832 (1935), 15 U.S.C. §§ 79(f), (g) (1958), Investment Company Act § 42(e), 54 Stat. 843 (1940), 15 U.S.C. § 80a-41(e) (1958).

¹⁴ 48 Stat. 891 (1934), 15 U.S.C. § 78j(b) (1958). For cases construing this section see *Matheson v. Armbrust*, 284 F.2d 670 (9th Cir. 1960); *Hooper v. Mountain States Securities Corp.*, 282 F.2d 195 (5th Cir. 1960); *Reed v. Riddle Airlines*, 266 F.2d 314 (5th Cir. 1959); *Errion v. Cornell*, 236 F.2d 447 (9th Cir. 1956); *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953); *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951); *Speed v. Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951); *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946).

¹⁵ Securities Exchange Act § 29(b), 48 Stat. 903 (1934), as amended, 15 U.S.C. § 78cc(b) (1958); Holding Company Act § 26b, 49 Stat. 835 (1935), 15 U.S.C. § 79z(b) (1958); Investment Company Act § 47(b), 54 Stat. 845 (1940), 15 U.S.C. § 80a-46(b) (1958).

¹⁶ Restatement, Torts § 286 (1934).

ing as elaborate a structure of express private remedies have proven largely unsuccessful.¹⁷

It was, then, a not unanticipated line of advocacy that two sets of private litigants adopted during recent months in asserting claims based on alleged violations of proxy rules. Plaintiff shareholders in *Dann v. Studebaker-Packard Corporation*¹⁸ and *Brown v. Bullock*¹⁹ brought sharply into focus important issues with which two federal courts dealt comprehensively. In *Dann*, plaintiffs, stockholders in Studebaker-Packard Corporation, sued in the federal court under section 27 of the Securities and Exchange Act²⁰ on a claim allegedly arising out of a violation of section 14(a) of the act relating to proxy regulation.²¹ The claim was denominated as both individual and derivative in nature. In substance, the complaint charged a fraud on the stockholders of Studebaker-Packard occasioned by certain "arrangements"²² with Curtiss-Wright Corporation, the effect of which constituted a waste and dissipation of the assets of Studebaker-Packard. The "arrangements" were alleged to have been consummated after an authorizing shareholder vote characterized by false and misleading proxy solicitation material. The relief sought was a voiding of improperly solicited proxies and a recount of the vote, and, if the recount disclosed that less than the required number of votes were in favor of the proposal, a rescission of the "arrangements" and a return to Studebaker-Packard's pre-arrangement status. The case came up to the Court of Appeals for the Sixth Circuit on plaintiff's appeal from the District Court's dismissal of the complaint.²³ In a lengthy opinion a unanimous court decided that the plaintiffs had standing to assert a violation of section 14(a) in a federal court, irrespective of lack of diversity of citizenship, and in spite of the fact that they were not deceived by the solicitation material or gave any proxies. The court then went on to hold, however, that it was without jurisdiction to grant the relief requested insofar as it sought to rescind corporate transactions already consummated.²⁴

¹⁷ Professor Loss has pointed out that although this argument has not prevailed it is by no means a frivolous one. His position is that it is, in fact, sufficiently important to the development of securities law to merit the attention of the Supreme Court. Loss, *Contemporary Problems in Securities Regulation—Forward*, 45 Va. L. Rev. 787, 792 (1959).

¹⁸ 288 F.2d 201 (6th Cir. 1961).

¹⁹ 194 F. Supp. 207 (S.D.N.Y. 1961).

²⁰ 48 Stat. 902 (1934), as amended, 15 U.S.C. § 78aa (1958). This section gives exclusive jurisdiction to the district courts of the United States over suits brought to enforce any provisions of the act. Jurisdiction was also asserted under the more general provisions of 28 U.S.C. § 1331 (1958), giving district courts jurisdiction over actions arising under the laws of the United States. No claim of diversity of citizenship was urged as a ground for jurisdiction.

²¹ *Supra* note 9.

²² The opinion does not specify exactly what the "arrangements" were. There is no question, however, that shareholder approval was a necessary condition precedent.

²³ The judgment of dismissal was without comment.

²⁴ Judge Miller, in a concurring opinion, took the position that retroactive relief should not be denied because of lack of jurisdiction, but because the statute does not contemplate relief of that nature.

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In support of their recognition of implied private rights, the court emphasized initially the legislative history of section 14(a). Both the House and Senate Reports unquestionably reveal that the bill was intended to protect stockholders by ensuring complete and honest disclosure in corporate elections by proxy.²⁵ The court then relied on several district court cases recognizing that stockholders are entitled to their day in court to protect this right.²⁶ In professing their approval of such a conclusion, the court expressly declined to prefer the *expressio unius est exclusio alterius* rule of construction over the rule that breach of a statutory duty gives rise to a right of action in favor of individuals in the class for whose protection the statute was enacted. This preference is in keeping with the trend established in connection with the development of implied rights under section 10(b).²⁷

Having recognized the existence of a private right to enforce the proxy rules, the *Dann* court then had to decide whether this right was exclusively the stockholder's which he could assert only in an individual capacity, or whether it was also a right of the corporation which the stockholder could assert derivatively. An earlier case, *Howard v. Furst*,²⁸ decided by the Second Circuit Court of Appeals, had squarely held that violation of the proxy rules does not create a right of action in favor of the corporation, a holding which required dismissal of a stockholder's derivative suit. Explicitly left unanswered in that case was the propriety or impropriety of an individual suit. Noting this, the *Dann* court, relying on the fact that the

²⁵ "Fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange. Managements of properties owned by the investing public should not be permitted to perpetuate themselves by misuse of corporate proxies. Insiders, having little or no interest in the properties they manage often have retained their control without adequate explanation of the management policies they intend to pursue. . . . Inasmuch as only the exchanges make it possible for securities to be widely distributed among the investing public, it follows as a corollary that the use of the exchanges should involve a corresponding duty of according shareholders fair suffrage. For this reason, the proposed bill gives the . . . Commission power to control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which have frustrated the free exercise of the voting rights of stockholders." H.R. Rep. No. 1383, 73d Cong. 2d Sess. 13-14 (1934).

"In order that the stockholder may have adequate knowledge as to the manner in which his interests are being served, it is essential that he be enlightened, not only as to the financial condition of the corporation, but also as to the major questions of policy which are to be decided at the stockholders' meeting. Too often proxies are solicited without explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought." S. Rep. No. 792, 73d Cong. 2d Sess. 12 (1934).

²⁶ *Mack v. Mishkin*, 172 F. Supp. 885 (S.D.N.Y. 1959); *Central Foundry Co. v. Gondelman*, 166 F. Supp. 429 (S.D.N.Y. 1958); *Weeks v. Alpert*, 131 F. Supp. 608 (D. Mass. 1955); *Curtin v. American Tel. & Tel. Co.*, 124 F. Supp. 197 (S.D.N.Y. 1954); *Textron, Inc. v. American Woolen Co.*, 122 F. Supp. 305 (D. Mass. 1954); *Dunn v. Decca Record Co.*, 120 F. Supp. 1 (S.D.N.Y. 1954); *Horowitz v. Balabar*, 112 F. Supp. 99 (S.D.N.Y. 1949); *Doyle v. Milton*, 73 F. Supp. 281 (S.D.N.Y. 1947); *Tate v. Sonotone Corp.*, 5 S.E.C. Jud. Dec. 310 (S.D.N.Y. 1947).

²⁷ *Supra* note 17.

²⁸ 238 F.2d 790 (2d Cir. 1956), cert. denied, 353 U.S. 937 (1957).

suit before it was both individual and derivative, chose to emphasize the right violated rather than the damage resultant, and accordingly affirmed the stockholder's right to sue *qua* individual.

The existence of the right established, next requiring consideration was the question of whether any conditions precedent have to be satisfied before the right can be asserted. In what appears to have been the first case dealing with the Commission's proxy rules which recognized implied rights, *Phillips v. United Corp.*,²⁹ there was a suggestion that this was so. In that case, a stockholder sought to enjoin a proposed corporate reorganization whereby the corporation was to convert from a public-utility holding company into an investment company. His complaint alleged that shareholder authorization was obtained by proxies, the solicitation of which violated certain rules of the Holding Company Act. The court, in denying defendant's motion for summary judgment, took the position that a private party has a qualified right to enforce the proxy rules. The qualification was actually twofold: first, any action initiated by the Commission would have precedence; second, the private party must have exhausted his administrative remedies by means of an appeal to the Commission to take action which proved unavailing. Later cases, *Dann* included, stressed not at all the qualified nature of the right. This abrogation of the qualification requirement seems sensible in view of the fact that none of the Commission's regulations make provision for any administrative remedy such as a formal hearing. In addition, time is usually of the essence in any proxy contest, and if an adverse decision by the Commission following a hearing is a necessary prerequisite to judicial enforcement, it may well be that by the time the condition is satisfied the action authorized by the vote will have been taken and the damage wrought.

Another ancillary problem to which the *Dann* case addressed itself was whether standing judicially to complain of proxy violations required that the plaintiff be one whose proxy was improperly solicited. This issue was virtually one of first impression, though two cases did dismiss out of court plaintiffs who had not been deceived and who submitted no proxies.³⁰ These cases have been criticized on the theory that the right asserted is not based so much on breach of the fiduciary duty inherent in an agency relationship as on the proposition that private parties on either side of a proxy contest may complain where the other side violates the governing rules.³¹ The *Dann* case is evidence this criticism did not fall on fallow ground. Very sensibly, the court had "no real difficulty in holding"³² that standing of the plaintiff in no way depended on his being personally deceived. In reaching this conclusion, the court reiterated that "the right sought to be protected by federal law is the right to full and fair disclosure in corporate elections . . .," and concluded that undeceived complaining shareholders "could suffer equally

²⁹ 5 S.E.C. Jud. Dec. 445 (S.D.N.Y. 1947).

³⁰ See *Textron, Inc. v. American Woolen Co.*, 122 F. Supp. 305 (D. Mass. 1954), and *Commonwealth ex rel. Laughlin v. Green*, 3 S.E.C. Jud. Dec. 221 (Pa. C.P. 1944), aff'd without mention of the proxy rules, 351 Pa. 170, 40 A.2d 492 (1945).

³¹ See 2 Loss, *Securities Regulation* 946-47 (2d ed. 1961).

³² *Supra* note 18, at 210.

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damaging injury to their corporate interests [where other shareholders] . . . were deceived in violation of federal law.³³ There is no quarreling with this rationale, and for their forthright treatment of the question the court deserves commendation.

Very shortly after the decision in *Dann* was handed down, a New York District Court was confronted, in part, with substantially the same issues, this time arising under the Investment Company Act.³⁴ Plaintiffs in *Brown v. Bullock*³⁵ were stockholders of Dividend Shares, Inc., an investment company incorporated under Maryland law with its principal place of business in New York. Named as corporate defendants were Dividend Shares Inc., commonly known as the Fund, and Calvin Bullock, Ltd., the Management Company which served as investment adviser to the Fund. Both corporations had interlocking directors and officers who were joined as individual parties defendant. The Management Company had two contracts with the Fund, an underwriting contract and an investment advisory contract. The complaint stemmed from the annual extensions of the investment advisory contracts, allegedly effected by the defendant directors through their use of false and misleading proxy solicitation material in violation of sections 20(a) and 34(b).³⁶ This material, it was charged, induced the stockholders to bring about the election of the defendant directors responsible for the contract renewals, and prevented the stockholders from exercising their statutory right to terminate the contract or to seek its renegotiation on terms more favorable to the Fund.³⁷ Authorization to initiate the action in a federal court was not predicated on diversity of citizenship, but exclusively under the provisions of section 44 of the act,³⁸ giving the federal courts concurrent jurisdiction with the states to hear all suits brought to enforce any liability or duty created by the act, and to enjoin any violation.³⁹ Violation of provisions of the act other than those relating to proxy regulation were also alleged in the complaint,⁴⁰ and the relief requested was a voiding of both contracts with the Management Company, a repayment of investment advisory fees paid, and an accounting. In an exhaustive opinion the court held that the Investment Company Act imposes specific duties upon the parties

³³ Supra note 18, at 209.

³⁴ Supra note 5.

³⁵ Supra note 19.

³⁶ Investment Company Act § 20(a), 54 Stat. 822 (1940), 15 U.S.C. § 80a-20(a) (1958); Investment Company Act § 34(b), 54 Stat. 840 (1940), 15 U.S.C. § 80a-33(b) (1958).

³⁷ Investment Company Act § 15(a)(3), 54 Stat. 812 (1940); 15 U.S.C. § 80a-15(a)(3) (1958).

³⁸ Investment Company Act § 44, 54 Stat. 844 (1940), 15 U.S.C. § 80a-43 (1958).

³⁹ Compare with § 27 of the Securities Exchange Act, note 20, supra.

⁴⁰ The complaint also charged that the individual directors, owing to their effecting the continuation of the contracts were guilty of an unlawful and willful conversion of the Fund's moneys, property and assets in violation of § 37 of the act, and of gross abuse of trust, of gross misconduct, willful misfeasance, bad faith, gross negligence or reckless disregard of official and contractual duties in violation of §§ 1(b)(2), 10, 15, 17(h)(i), and 36.

in control of a registered company, and federal jurisdiction extends to a stockholder's suit brought to redress breaches of these duties. More specifically, the court decided that private civil remedies are available under the act, including, *inter alia*, the right of a private litigant to enforce the provisions relating to proxy regulation.

The recognition of implied private rights to enforce the Investment Company Act's proxy provisions was more easily come by than in the *Dann* case. Not only was *Dann* a compelling precedent, it is also a fact that the Investment Company Act is more comprehensive than the Exchange Act in its articulation of duties and prohibitions with respect to voting, boards of directors, conditions and terms of contracts, etc., thereby strengthening the statutory tort doctrine argument. Significantly though, the court did not feel constrained to limit the method of enforcement to suits in an individual capacity, and broke with the *Dann* holding insofar as it authorized derivative suits as well. In so doing the court distinguished *Howard v. Furst*⁴¹ on the basis of the different objectives and policy of the Exchange Act under which that case was decided. As for the Investment Company Act, the court felt that to say that it "was not intended in part to protect investment companies is to emasculate the statute."⁴²

Concerning the other issues dealt with in *Dann*—the question of whether the private party's right to sue is a qualified or unqualified one, and the question of whether the plaintiff's own proxy must have been improperly solicited—the *Brown* decision is silent. By implication it is clear the court did not regard the right as a qualified one requiring an appeal to the Commission before judicial enforcement could be had. That question now appears settled.⁴³ The second issue was not before the court since it appeared the proxy solicitation material was sent each and every stockholder. There is no reason at all to believe, however, that the *Brown* court would be disposed to come to a conclusion different from that reached in *Dann*.

However well-established the right of a private litigant to enforce the proxy rules now appears, the extent of the relief rightfully available to such complainants presents a delicate question, and one which *Dann* and *Brown* resolved in a quite different fashion. The *Dann* court, after having arrived at such well-reasoned conclusions with respect to the existence of private rights under section 14(a), unfortunately proceeded to deprive itself of the ability to give the complete relief prayed for by plaintiffs. As indicated earlier,⁴⁴ the complaining shareholders in *Dann* had asked that if some of the proxies were invalidated and a recount revealed that the necessary approval of two thirds of the outstanding stock was not achieved, then the "arrangements" effectuated under the authority of such proxies should be rescinded and the corporation restored to its prior economic position. The court, how-

⁴¹ *Supra* note 28.

⁴² *Supra* note 19, at 233.

⁴³ No case since *Phillips v. United Corp.*, *supra* note 29, has as much as intimated that a complainant's right to sue is a qualified one.

⁴⁴ See text at page 60, *supra*.

ever, in considering the point at length, decided that, in the absence of diversity of citizenship, federal jurisdiction must end with a declaratory judgment as to the validity of the proxies in question and was not broad enough to permit a determination of the consequent effects of said proxies. The reasoning forwarded for such a result was that to grant rescission of already consummated corporate transactions would involve passing on so many matters of state law⁴⁵ that, in effect, the court would be federalizing large areas of Michigan corporation law.

This portion of the court's decision seems objectionable from a number of viewpoints. Section 27 of the Securities Exchange Act⁴⁶ reads in part:

Jurisdiction of offenses and suits. The district courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.

This express provision for exclusive federal jurisdiction has caused state courts, specifically New York⁴⁷ and Delaware,⁴⁸ to refuse access to their courts for alleged violations of the act. Thus, a defrauded shareholder finds himself in the dilemma of being forced into the federal courts by section 27 and then required by the *Dann* decision to move to a state tribunal if the relief he seeks is retroactive rather than prospective.⁴⁹ Such splitting of litigation is both an expensive inconvenience to the complainant and a bar to effective judicial administration.⁵⁰

Furthermore, such a holding does violence to the Supreme Court decision of *Bell v. Hood*,⁵¹ leading authority for the principle that where a right

⁴⁵ Specifically mentioned by the court as being just some of the myriad state law questions involved were: the quorum necessary to transact the business under consideration; the voting majority necessary to determine the issue voted upon; the scope and effect of the *de facto* doctrine as affecting proxies declared invalid under federal law and the eligibility of voters.

⁴⁶ *Supra* note 20.

⁴⁷ *American Distilling Company v. Brown*, 295 N.Y. 36, 64 N.E.2d 347 (1945).

⁴⁸ *Standard Power and Light Corporation v. Investment Associates*, 29 Del. Ch. 593, 51 A.2d 572 (1947).

⁴⁹ Prospective relief such as an injunction to prevent dissemination of misleading proxy material is authorized by the act itself. 48 Stat. 899 (1934), as amended, 15 U.S.C. § 78u(e) (1958). Also, the power of a court to enjoin the use of proxies already obtained through false and misleading solicitation seems well settled. *S.E.C. v. May*, 229 F.2d 123 (2d Cir. 1956). But these remedies are of no use in a case such as *Dann* where corporate action has already been taken pursuant to such proxies.

⁵⁰ For just some of the annoying problems of *res judicata* and collateral estoppel that would occur, see 2 Loss, *Securities Regulation* 1015-19 (2d ed. 1961).

In addition, a plaintiff forced into the state courts would be without the benefit of the broad venue and nationwide service provisions of section 27 of the Exchange Act. Thus, a complaining shareholder who might have been successful in the federal courts, may find it impossible to bring before a state court all the parties necessary for the complete relief sought.

⁵¹ 327 U.S. 678 (1946). See also *Texas & N.O.R. Co. v. Brotherhood of Ry. & S.S. Clerks*, 281 U.S. 548 (1930); *United States v. Kaufman*, 96 U.S. 567 (1877).

created by federal law has been invaded, the federal courts may use any available remedy to right the wrong done. In *Dann* the real wrong was not merely the unlawful solicitation of proxies but also the subsequent unauthorized action taken pursuant to said proxies. Such unauthorized action already having been consummated, the only truly efficacious relief would be rescission of the transactions and a return to the prior *status quo*.

Employing rationale similar to that set out in *Bell v. Hood*, federal courts have traditionally made determinations of state law when necessary to decide the federal question before it.⁵² Thus, in *Osborn v. Bank of the United States*,⁵³ where it was contended that the action did not arise under a law of the United States because several questions might have involved local law, Chief Justice Marshall replied:

If this were sufficient to withdraw a case from the jurisdiction of the federal courts, almost every case, although involving the construction of a law, would be withdrawn; and a clause in the Constitution, relating to a subject of vital importance to the government and expressed in the most comprehensive terms, would be construed to mean almost nothing.⁵⁴

The fact that rescission of completed corporate transactions, such as a merger, may involve determination of state law has not deterred federal courts from affording such relief in suits based on violations of the anti-trust laws. In *Schine Chain Theatres, Inc. v. United States*,⁵⁵ the Supreme Court approved a decree that would order divestiture of theatres found to have been acquired in violation of the Sherman Anti-Trust Act.⁵⁶ A similar inclination was evident in *Sola Electric Co. v. Jefferson Electric Co.*,⁵⁷ where the Court announced:

When a federal statute condemns an act as unlawful, the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted.⁵⁸

Furthermore, at least one court has even indicated that retroactive relief would be available in an action under section 14(a) of the Securities Exchange Act. In *Mack v. Mishkin*,⁵⁹ a preliminary injunction to restrain the use of proxies was denied for failure to show irreparable harm, but in denying the requested relief the court noted that if it was later found

⁵² *United Fuel Gas Company v. Railroad Commission of Kentucky*, 278 U.S. 300 (1929); *Risty v. Chicago, Rock Island and Pacific Ry. Co.*, 270 U.S. 378 (1926).

⁵³ 22 U.S. (9 Wheat.) 738 (1824).

⁵⁴ *Id.* at 818.

⁵⁵ 334 U.S. 110 (1948).

⁵⁶ And cf. *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590 (1921), where the Court set aside a sale of assets of one corporation to another because a common director who dominated both boards did not sustain the burden of showing fairness.

⁵⁷ 317 U.S. 173 (1942).

⁵⁸ *Id.* at 176.

⁵⁹ 172 F. Supp. 885 (S.D.N.Y. 1959).

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that the proxies were unlawfully obtained and utilized, the election of directors by the use of said proxies could be set aside.⁶⁰

In holding that federal jurisdiction extended no further than a consideration of the validity of the disputed proxies, the *Dann* court declared that it was relying on the precedent of *Gully v. First Nat'l Bank*.⁶¹ Such reliance would appear to be misplaced. The *Gully* case involved a suit brought in a state court by a state tax collector to collect taxes from a national bank pursuant to the provisions of a state statute. The bank attempted to have the case removed to the federal docket solely on the ground that state taxation of national banks must be consistent with a federal statute permitting such taxation. There was no evidence of inconsistency. In holding that the case was not removable as one arising under the laws of the United States, Mr. Justice Cardozo pointed out that "the most one can say is that a question of federal law is lurking in the background."⁶² It is submitted that this situation is quite distinguishable from *Dann* where the complaint involved a violation of a specific section of the Securities Exchange Act and was instituted under a section of that act vesting the federal courts with exclusive jurisdiction. It is submitted further that the broad language of *Gully* adverted to by the *Dann* opinion must be read in the light of the remoteness of the federal question in *Gully*.

Considerable authority has aligned itself contrary to the *Dann* case on the issue of the ability of the federal courts to give complete relief to shareholders so defrauded. The Securities and Exchange Commission in two recent cases⁶³ has filed briefs as amicus curiae deprecating the *Dann* holding on the jurisdictional issue while endorsing that court's recognition of private rights under section 14(a). The Commission has taken the position that now that the doors of the federal court have been opened to defrauded stockholders they should be entitled to remain in that court for their full relief, notwithstanding a lack of diversity of citizenship. This same position has been adopted by Professor Loss in his recent work on securities regulation.⁶⁴ He has argued that the difference between the prospective relief of enjoining the use of improperly solicited proxies, and the retroactive relief of rescission

⁶⁰ The court in *Dann* was more persuaded by the judge in *Howard v. Furst*, 140 F. Supp. 507 (S.D.N.Y. 1956), who, in construing this same section 14(a), stated:

There is no basis in the statute or its legislative history for an implication that Congress intended to give an individual stockholder, as an incident of his protection by proxy statement regulations, the right to rescind completed corporate transactions whenever based upon votes solicited by such statements, or the right to enforce the corporation's claim for waste. The drastic nature of such relief and the ease with which it could have been expressly authorized if Congress had so intended all argue against such implication.

140 F. Supp. at 513.

⁶¹ 299 U.S. 109 (1936).

⁶² *Id.* at 117.

⁶³ *Brown v. Bullock*, supra note 19; *Sawyer v. Pioneer Mill Co.*, # 17223. The latter case is still pending in the U.S. Court of Appeals for the 9th Circuit. If the court goes to the merits of the jurisdictional issue and decides it contra to the 6th Circuit, then hopefully the Supreme Court may have a chance to review the conflict.

⁶⁴ 2 Loss, Securities Regulation 960-71 (2d ed. 1961).

of completed corporate transactions based upon the use of such invalid proxies, is merely a difference of degree rather than kind.⁶⁵ Similarly, the concurring judge in *Dann* disagreed with the majority opinion insofar as it cast in jurisdictional terms its refusal to permit rescission of consummated corporate dealings allegedly effectuated through violations of section 14(a) and rules thereunder. He contended that the question of jurisdiction must be decided as of the time the action is filed and that if jurisdiction does exist it is not contingent or partial but continues in the court to enable it to dispose of all issues raised by the pleadings.⁶⁶

As it happened, the problem of federal jurisdiction to give complete relief, including retroactive relief, was not nearly so acute in *Brown v. Bullock*. The court in *Brown* decided that where proxies solicited in violation of the proxy provision of the Investment Company Act of 1940 caused shareholders to forego the exercise of their statutory right to terminate at will an investment advisory contract, then appropriate relief would include a voiding of said contract. Unlike the *Dann* court which, at this juncture, became overwhelmed by what it conceived to be the numerous matters of state law involved,⁶⁷ the *Brown* opinion stressed the fact that the complaint set forth a "substantial federal claim";⁶⁸ that the rights protected and the relief sought are "creatures of the 1940 act; they do not originate out of the State-law."⁶⁹ In developing this distinction the court emphasized the difference between the 1940 act and the Securities Exchange Act of 1934 involved in *Dann*. Whereas the 1934 act regulated merely the purchase and sale of corporate securities, the 1940 act regulates in depth a particular industry. Whereas the 1934 act has been construed not to vest rights in the corporation⁷⁰ but merely in the individual shareholders,⁷¹ one of the primary objectives of the 1940 act is the protection of investment companies as well as investors. Such protection having been bestowed upon the corporation, it could be enforced in the usual manner by a derivative suit brought by a shareholder. It was on this basis that the court in *Brown* permitted the complete relief that was ultimately denied in *Dann*. Since, however, the suit in *Brown* was brought in an individual as well as a derivative capacity, the same relief could have been granted for the reasons set forth earlier in criticizing the *Dann* result. In fact, retroactive relief should be available irrespective of the particular federal securities statute sued under and irrespective of whether derivative relief might also be had. Only in this way will proxy rights effectively be protected, will piecemeal litigation be avoided, and will the procedural nature of the suit properly be deemphasized.

FRANCIS J. LAWLER
JOHN J. MADDEN

⁶⁵ *Id.* at 960.

⁶⁶ *Supra* note 18, at 218. See note 24.

⁶⁷ *Supra* note 45.

⁶⁸ *Supra* note 19, at 233.

⁶⁹ *Ibid.*

⁷⁰ *Howard v. Furst*, *supra* note 28.

⁷¹ *Dann v. Studebaker-Packard Corporation*, *supra* note 18.