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Another Demise of the Birnbaum Doctrine: "Tolls the Knell of Parting Day?"

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COMMENTS

ANOTHER DEMISE OF THE BIRNBAUM DOCTRINE: "TOLLS THE KNEEL OF PARTING DAY?"*

ALLEN FULLER**

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I. INTRODUCTION

The "purchase-seller requirement," which has been one of the most significant limitations placed upon the development of the implied liabilities of Rule 10b-5, arose in 1952 in the renowned decision of the Second Circuit, *Birnbaum v. Newport Steel Corp.*¹ Especially since 1967, this limitation on standing frequently called the Birnbaum Doctrine, has been the object of such extensive academic,² administrative,³ and judicial⁴ criticism, that its status in the law has remained uncertain. The purpose of this comment is to re-examine the Birnbaum Doctrine in the light, however opaque, of certain recent decisions.

* This article attempts to summarize the state of the law on the purchaser-seller requirement in actions brought under rule 10b-5 as of August 1, 1970. Since the law on this question is currently in a state of flux, the interested reader should be certain to consult the most current decisions. Some of the relevant cases decided subsequent to the completion of this comment appear below. See e.g., *Cooper v. Garza*, 431 F.2d 578 (5th Cir. 1970); *Erling v. Powell*, No. 19,780 (8th Cir. July 29, 1970); *Herpich v. Wallace*, No. 27,729, (5th Cir. July 14, 1970).

** Student Writing Editor, *University of Miami Law Review*; Student Instructor, Freshman Research and Writing.

1. 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 373 U.S. 956 (1952). The purchaser-seller requirement has been treated by many courts as an element of the plaintiff's *standing to sue*; a term the courts have apparently borrowed from the phraseology of constitutional law.

2. See Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for 10b-5*, 54 VA. L. REV. 268 (1968) [hereinafter cited as Lowenfels]. Comment, *The Purchaser-Seller Limitation to SEC Rule 10b-5*, 53 CORNELL L. REV. 684 (1968). See also, Leech, *Transactions in Corporate Control*, 104 U. PA. L. REV. 725, 832-35 (1956).

3. The SEC, as *amicus curiae* has argued that the Birnbaum doctrine was not required by the language of § 10(b). See *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 & n.3 (2d Cir. 1967); *Vine v. Beneficial Fin. Co.*, 374 F.2d 627, 633, 635 & n.6 (2d Cir. 1967).

4. See *Entel v. Allen*, 270 F. Supp. 60 (S.D.N.Y. 1967), *noted in* 42 N.Y.U. L. REV. 978 (1967).

II. HISTORY

Since 1946 courts have construed rule 10b-5⁵ as providing an implied private right of civil recovery for its violation.⁶ Private civil actions instituted under this rule have given birth to an important body of judge-made federal law of corporations.⁷ The extraordinary expansion of the subject matter coverage of rule 10b-5, coupled with the possibility of very substantial liability, has moved the courts to limit the class of persons who have standing to sue for violations of rule 10b-5.

In *Birnbaum v. Newport Steel Corp.*,⁸ certain minority stockholders, suing on behalf of the corporation and all stockholders similarly situated, alleged that the president and controlling stockholder had rejected a merger which would have been highly profitable for all the stockholders, in favor of a sale of only his controlling interest at a premium over market value. The plaintiffs contended that the sale, together with certain misrepresentations made to facilitate it, constituted fraudulent practices in connection with the purchase and sale of securities within the meaning of rule 10b-5. The district court dismissed the complaint.

5. Rule 10b-5, 17 C.F.R. § 240.10b-5 (1967), was promulgated under § 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891 (1964), 15 U.S.C. § 78j(b) (1964). Section 10 provides in part:

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

....

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 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 which would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

6. *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946) See also the discussion of the theories on which implied liability rests and the authorities collected in A. BROMBERG, *SECURITIES LAWS: FRAUD—SEC RULE 10B-5* (1969); 3 L. LOSS, *SECURITIES REGULATION* 1763 (1969 ed); Fleischer, *Federal Corporation Law: An Assessment*, 78 HARV. L. REV. 1146 (1965); Klein, *The Extension of a Private Remedy to Defrauded Securities Investors Under SEC Rule 10b-5*, 20 U. MIAMI L. REV. 81 (1965); Painter, *Inside Information: Growing Pains for the Development of Federal Corporation Law Under Rule 10b-5*, 65 COLUM. L. REV. 1361 (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); Comment, *The Prospects for Rule X-10b-5: An Emerging Remedy for Defrauded Investors*, 59 YALE L.J. 1120 (1950).

7. See Fleischer, *Federal Corporation Law: An Assessment*, 78 HARV. L. REV. 1146 (1965).

8. 193 F.2d 461 (2d Cir. 1952).

The question raised before the Second Circuit was whether a plaintiff who neither sold nor purchased could assert a claim under rule 10b-5. In answering this question, the court explained that rule 10b-5 was adopted to make the prohibitions contained in section 17(a) of the 1933 Act⁹ applicable to purchasers as well as sellers and therefore the language "in connection with the purchase or sale of any security" should be construed as limiting standing to sue to buyers or sellers of securities.

This rigid purchaser-seller requirement, though adhered to by the courts,¹⁰ was criticized by the commentators¹¹ and the SEC as too strict a reading of the rule.¹²

III. "DEATH" AND RESURRECTION

A series of Circuit Court cases appeared in 1967 which expressly avoided deciding the contention that one need not be a purchaser or a seller to sue under rule 10b-5. These decisions did, however, weaken the impact of *Birnbaum* by expanding the definitions of "purchase" and "sale" so that persons not actually involved in a normal securities transaction were considered "buyers" or "sellers."¹³

In one of these decisions, *Vine v. Beneficial Finance Co.*,¹⁴ the plaintiffs were non-tendering stockholders of a target company which after a successful tender offer became a party to a short-form merger. The district court dismissed, relying on *Birnbaum* and the circuit court reversed, holding that the short-form merger constituted a "constructive sale" within the meaning of rule 10b-5.¹⁵

Three months later in *Dasho v. Susquehanna Corp.*,¹⁶ the Seventh Circuit held that a corporation which was fraudulently induced to issue its own shares in a merger, and which in turn received the shares of

9. 15 U.S.C. § 779 (1954).

10. *E.g.*, *Iroquois Indus., Inc. v. Syracuse China Corp.*, 417 F.2d 963 (2d Cir. 1969), *cert. denied*, 90 S. Ct. 2199 (1970); *Jensen v. Voyles*, 393 F.2d 131 (10th Cir. 1968); *Greater Iowa Corp. v. McLendon*, 378 F.2d 783 (8th Cir. 1967); *General Time Corp. v. American Investors Fund, Inc.*, 283 F. Supp. 400 (S.D.N.Y. 1968); *aff'd*, 403 F.2d 159 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969); *Farraioli v. Cantor*, 281 F. Supp. 354 (S.D.N.Y. 1968); *Hoover v. Allen*, 241 F. Supp. 213 (S.D.N.Y. 1965).

11. Leech, *Transactions in Corporate Control*, 104 U. PA. L. REV. 725 (1965); Comment, *Private Enforcement Under Rule 10b-5: An Injunction for a Corporate Insurer?*, 115 U. PA. L. REV. 618, 622-23 (1967); Comment, *The Decline of the Purchaser-Seller Requirement of Rule 10b-5*, 14 VILL. L. REV. 499, 501-02 (1969).

12. See references to amicus briefs of the SEC in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952); *Vine v. Beneficial Fin. Co.*, 374 F.2d 627, 634, 636 (2d Cir. 1967); *cert. denied*, 389 U.S. 970 (1967); *A.T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967). *Cf.* *J.I. Case Co. v. Borak*, 337 U.S. 426 (1964).

13. *Dasho v. Susquehanna Corp.*, 380 F.2d 262 (7th Cir. 1967); *A.T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967); *Vine v. Beneficial Fin. Co.*, 374 F.2d 627, 634, 636 (2d Cir. 1967), *cert. denied*, 389 U.S. 970 (1967). See also *Ruckle v. Roto Am. Corp.*, 339 F.2d 24 (2d Cir. 1964); *Hooper v. Mountain States Sec. Corp.*, 282 F.2d 195 (5th Cir. 1960), *cert. denied*, 365 U.S. 815 (1961).

14. 374 F.2d 627 (2d Cir. 1967).

15. *Vine v. Beneficial Fin. Corp.*, 374 F.2d 627 (2d Cir. 1967).

16. 380 F.2d 262 (7th Cir. 1967), *cert. denied*, 289 U.S. 977 (1967).

another corporation, was both a "seller" and a "purchaser" for the purposes of rule 10b-5.

Meanwhile, in *A.T. Brod & Co. v. Perlow*,¹⁷ wherein the plaintiff was found to be a purchaser, the language of the court emphasized the connection which the scheme had with the securities market rather than the arbitrary rule limiting standing. Moreover, several district court decisions seemed to indicate that it is unnecessary to prove a consummated purchase or sale of securities as a condition precedent to the maintenance of a 10b-5 action.¹⁸

These and other similar decisions seem to have led at least one district judge¹⁹ and several commentators²⁰ to suggest that *Birnbaum* had been effectively emasculated. Their analysis neglected the fact that in fashioning mitigating doctrines granting standing to plaintiffs by artificially labelling them "purchasers" or "sellers" of securities, these courts were tacitly approving the purchaser-seller requirement. More recent decisions have clearly indicated that these suggestions that *Birnbaum* had been emasculated were, at best, premature.²¹ In *Iroquois Industries, Inc. v. Syracuse China Corp.*,²² the Second Circuit wrote:

Appellant Iroquois and the Commission (as a friend of the Court) in substance invite us to overrule *Birnbaum*; they assert that its reasoning has already been weakened by several decisions of this Court. We do not so read the decisions and we do not believe that "the purchaser-seller limitation" of *Birnbaum* "has been relaxed" by later decisions of this Court, as the Commission contends.²³

In *Rekant v. Desser*,²⁴ the Fifth Circuit chose more vivid language.

Birnbaum has been shot at by expert marksmen. The buyer-seller requirement for standing has been criticized as too strict a reading of the rule. Commentators have said the [sic] *Birnbaum* has been significantly eroded in a variety of later cases, even in the Second Circuit. . . . Bloody but unbowed, *Birnbaum* still stands. . . .²⁵

17. 375 F.2d 393 (2d Cir. 1967).

18. See, e.g., *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715 (S.D.N.Y. 1968); *Goodman v. H. Hentz & Co.*, 265 F. Supp. 440 (N.D. Ill. 1967). Cf. cases cited in A. BROMBERG, *SECURITIES LAW: FRAUD—SEC RULE 10B-5*, § 8.8, at 221-22 & n.98 (1968).

19. See *Entel v. Allen*, 270 F. Supp. 60 (S.D.N.Y. 1967).

20. See, e.g., Lowenfels, *supra* note 2; Comment, *The Purchaser-Seller Limitation to SEC Rule 10b-5*, 53 CORNELL L. REV. 684 (1968).

21. *Iroquois Indus., Inc. v. Syracuse China Corp.*, 417 F.2d 963 (2d Cir. 1969), *cert. denied*, 90 S. Ct. 2199 (1970); *City Nat'l Bank v. Vanderboom*, 422 F.2d 221 (8th Cir. 1970), *cert. denied*, 90 S. Ct. 2196 (1970); *Rekant v. Desser*, No. 25872 (5th Cir., Apr. 20, 1970) at 11; *Coffee v. Permian*, 306 F. Supp. 371 (N.D. Texas 1969) *rev'd* 434 F.2d 383 (5th Cir. 1970); *Greenstein v. Paul*, 400 F.2d 580 (2d Cir. 1968). See also *Vanderboom v. Sexton*, 422 F.2d 1233 (8th Cir. 1970).

22. 417 F.2d 963 (2d Cir. 1969), *cert. denied*, 90 S. Ct. 2199 (1970).

23. *Id.* at 967.

24. 425 F.2d 872 (5th Cir. 1970).

25. *Id.* at 877 (footnotes and citations omitted).

IV. THE SECOND DEMISE

This recent resurrection of *Birnbaum* may be more apparent than real. While the courts in *Iroquois* and *Rekant* were correct in minimizing the effect on *Birnbaum* of cases like *Vine*, *Brod*, and *Dasho*, they failed to pay sufficient attention to another series of cases directly challenging the language of the *Birnbaum* decision. At least since 1967, the Second Circuit has consistently maintained that the "purchaser-seller" requirement is not applicable in actions for injunctive relief.²⁶ In *Mutual Shares Corp. v. Genesco, Inc.*,²⁷ the Second Circuit evaluated the purchaser-seller requirement in the context of an action for damages and for an injunction. The plaintiffs, minority stockholders in S.H. Kress and Co., had purchased their stock shortly after Genesco, Inc. had obtained control of Kress through a successful tender offer. They claimed that the principals of Genesco had, during the tender offer, withheld information concerning Kress' undervalued real estate, and after obtaining control, had maintained a low dividend policy in order to purchase shares from minority stockholders at a depressed value. The plaintiffs sought damages for the misused assets, liquidation of Kress, and an injunction prohibiting further manipulation of the stock. The Court dismissed the damage claims but granted the injunction despite the fact that the plaintiffs were neither purchasers nor sellers.

The Court wrote:

[W]e do not regard the fact that plaintiffs have not sold their stock as controlling on the claim for injunctive relief. The complaint alleges a manipulative scheme which is still continuing. While doubtless the Commission could seek to halt such practices, present stockholders are also logical plaintiffs to play "an important role in enforcement" of the Act in this way. See *Studebaker Corp. v. Gittlin*, 360 F.2d 692, 698 (2d Cir. 1966). . . . Injunctive relief was considered proper in *Ruckle v. Roto American Corp.*, 339 F.2d 24 (2d Cir. 1964), to restrain the "sale" of treasury stock by a corporation on the theory that the corporation was a "seller" under Rule 10b-5 although the sale was not yet consummated. . . . Deceitful manipulation of the market price of publicly-owned stock is precisely one of the types of injury to investors at which the Act and the Rule were aimed. Since private parties have the right to sue for violation of the Rule, the broad remedial purposes of the Act suggest that the judicial relief available should not be limited to a particular type of remedy. See *J.I. Case Co. v. Borak*, 377 U.S. 426, 84 S. Ct.

26. *Crane Co. v. Westinghouse Air Brake Co.* 419 F.2d 787 (2d Cir. 1969); *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540 (2d Cir. 1967). See also *Greenstein v. Paul*, 400 F.2d 580, 581 (2d Cir. 1968); *Iroquois Indus., Inc. v. Syracuse China Corp.*, 417 F.2d 963 (2d Cir. 1969), cert. denied, 90 S. Ct. 2199 (1970); *Symington Wayne Corp. v. Dresser Indus. Inc.*, 383 F.2d 840 (2d Cir. 1967); *Ruckle v. Roto Am. Corp.*, 339 F.2d 24 (2d Cir. 1964).

27. 384 F.2d 540 (2d Cir. 1967).

1555, 12 L.Ed. 2d 423 (1964). . . . Moreover, as already indicated, the claim for damages on this theory founders both on proof of loss and the causal connection with the alleged violation of the Rule; on the other hand, the claim for injunctive relief largely avoids these issues, may cure harm suffered by continuing shareholders, and would afford complete relief against the Rule 10b-5 violation for the future. "It is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages." See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. at 193. . . . We, of course, do not know whether plaintiffs can prove their allegations. However, we hold that they have stated a claim under the Act and Rule 10b-5 for injunctive relief to prevent defendants from depressing the price of Kress stock by market manipulation or otherwise. . . .²⁸

In three recent decisions, the Second,²⁹ Third,³⁰ and to a lesser extent, the Fifth Circuit,³¹ have viewed the absence of "purchaser" or "seller" status, not as an absolute barrier to standing, but rather as an element in the problem of demonstrating that the alleged fraud caused the injury. This approach, which originated in *Genesco*, involves the first direct challenge to the *Birnbaum* doctrine by the circuit courts.³²

In *Crane v. Westinghouse Air Brake Co.*,³³ the plaintiff, Crane, a tender offeror, alleged that a third company, Standard, who had itself proposed a merger with the target company, Air Brake, had "painted the tape" in Air Brake stock so as to create a dramatic rise in market price and thereby deter Air Brake shareholders from tendering to Crane. The undisputed facts disclosed that on the day Crane's tender offer was to expire, Standard purchased 170,000 shares of Air Brake on the New York Stock Exchange at an average cost of \$49.50 per share, and secretly sold 100,000 shares off the market and 20,000 shares on the market at a negotiated price to third parties averaging \$44.50 per share. This resulted in an apparent loss of more than \$500,000 on its purchases and sales for the day. The Crane tender offer was defeated; the Standard-Air Brake merger was completed whereby Crane's shares of Air Brake were exchanged for shares of a new Standard convertible preferred; and Crane sold most of these shares under threat of a divestiture action to be brought by Standard under the antitrust laws. In reversing the court below,³⁴ a unanimous Second Circuit panel, including Chief Judge Lum-

28. *Id.* at 546-47 (footnotes omitted).

29. *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969).

30. *Kahan v. Rosenstiel*, 424 F.2d 161 (3d Cir. 1970), *cert. denied*, No. 1477 (U.S. June 8, 1970).

31. *Rekant v. Desser*, 425 F.2d 872 (5th Cir. 1970).

32. *Cf. Entel v. Allen*, 270 F. Supp. 60 (S.D.N.Y. 1967).

33. 419 F.2d 787 (2d Cir. 1969).

34. It should be noted that this case actually involved claims of deceptive proxy statement and illegal vote buying as well as forbidden manipulation and fraud in connection with the purchase and sale of securities. The main thrust of Crane's case in the lower court was

bard who had joined in the *Iroquois* decision, held that Standard, in concealing from the public, particularly the Air Brake stockholders, the true situation as to the market price, had violated sections 9(a)(2)⁸⁵ and 10(b) of the Exchange Act. The case was remanded for a further determination of the appropriate remedies which, the court noted, may include damages and prospective injunctive relief as well as retrospective relief.⁸⁶

The court discussed the problems of standing to sue under both § 9(a)(2) and § 10(b) and found that Crane was forced to sell by Standard's deception and therefore fell within the protection of § 9(a)(2).

It is clear that Crane was one of the class of persons intended to be protected by the statute against Standard's violation. Standard acted for the "purpose of inducing" sale by Crane. Standard's actions had the intended and inevitable effect of inducing Crane to become a seller within the meaning of section 9(a)(2), for if successful in defeating Crane's tender offer and consummating the Standard merger, antitrust considerations would require sale by Crane of the shares held by Crane or those received in exchange. This placed Crane in a situation comparable to that of the dissenting shareholders in *Vine v. Beneficial Finance Co.*, 374 F.2d 627 (2d Cir. 1967), *cert. denied*, 389 U.S. 970, 88 S. Ct. 463, 19 L.Ed. 2d 460 (1968) for here as there, plaintiff was forced to become "a seller under the Act."⁸⁷

Based upon the foregoing and other language, it has been argued that the court allowed Crane standing to sue under rule 10b-5 because he was a "forced seller."⁸⁸ Although portions of the opinion, if taken out of context, support that argument,⁸⁹ this writer cannot agree for the following statements seem to indicate a contrary view.

in support of the former and as to these claims the lower court's decision was affirmed. That aspect of the case, however, is not germane to this discussion.

35. 15 U.S.C. § 78i(a)(2) (1954) makes it unlawful:

To effect, alone or with one or more other persons, 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.

Liability for a violation of section 9(a)(2) is provided by section 9(e):

Any person who wilfully participates in any act or transaction in violation of subsections (a), (b), or (c) of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such act or transaction.

36. *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 803 (2d Cir. 1969).

37. *Id.* at 794.

38. This was argued by the unsuccessful appellee in *Kahan v. Rosenstiel*, 424 F.2d 161, 171 (3d Cir. 1970). See also *Hirsch v. Merrill Lynch, Pierce, Fenner & Smith*, 311 F. Supp. 1283 (S.D.N.Y. 1970).

39. The present case falls within the rationale of *Vine*, where we held that a minority shareholder in a short form merger is a 'seller' since he is entitled only to cash for his shares. . . . The success of Standard's maneuver made Crane a

Standard's failure to disclose its manipulation operated as a fraud and deceit on Crane in connection with the purchase and sale of securities, creating a right to relief in Crane quite apart from Crane's rights as a forced seller under section 9(a)(2).⁴⁰

Other language which tends to confirm this writer's position, that the court found that Crane could sue under 10b-5, not because he was a "forced seller" but because as a tender offeror, he was in a position to demonstrate that the alleged violations caused injury, appears below.

When securities are subject to trading dominated by an insider such as Standard, there is an obligation to disclose material information to the investing public, and this duty gives rise to liability under 10b-5 to third persons who, as a result of the deception practiced upon the public, are prevented from entering into securities transactions with members of the public. When Crane entered, the securities market with its tender offer, it was entitled to the Act's protection not only against being deceived itself but also against deception of the investing public designed to prevent the public from entering into securities transactions. See *SEC v. Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 279 (S.D.N.Y. 1966) and *supra*, at 401 F.2d 848.⁴¹

Furthermore, the court specifically discussed questions of standing under 10b-5. First, it considered whether Crane was a proper party to complain of non-disclosure of the trading scheme since it did not rely on the non-disclosure. The court held, quoting from *Vine*: "What must be shown is that there was deception which misled [other] stockholders and that this was in fact the cause of plaintiff's claimed injury"⁴² and then proceeded to discuss the purchaser-seller limitation:

Although this court adhered to a fairly strict construction of the purchaser-seller requirement in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), cert. denied 343 U.S. 956, 72 S. Ct. 1051, 96 L. Ed. 1356 (1952), and in *Iroquois Industries*,

forced seller of the newly issued Standard convertible preferred under threat of a divestiture action to be brought by Standard under the antitrust laws.

Crane Company v. Westinghouse Air Brake Company, 419 F.2d 787,798 (1969).

But the court continues:

Thus, we have here in Crane one induced to sell by Standard's deception and manipulation and so within the protection of section 9(a)(2). Moreover, even if a narrower view were taken of section 9(a)(2), it would seem that Standard's conduct would still be actionable under Rule 10b-5(c), condemning conduct which operates as a fraud or deceit "upon any person."

The purchase-sale requirement must be interpreted so that the broad design of the Exchange Act, to prevent inequitable and unfair practices on securities exchanges and over-the-counter markets, is not frustrated by the use of novel or atypical transactions. *A.T. Brod & Co. v. Perlow*, *supra*, 375 F.2d at 397 (footnotes omitted).

Crane at 798.

40. *Crane Co. v. Westinghouse Air Brake Company*, 419 F.2d 787,795-96 (1969).

41. *Id.* at 796.

42. *Id.* at 797.

Inc. v. Syracuse China Corp., 417 F.2d 963 (2d Cir., Nov. 3, 1969), there was in *Birnbaum* no indication of a causal connection between the alleged violation of Rule 10b-5 and the injury to the corporation and its shareholders. The requirement has been interpreted fairly broadly in cases since *Birnbaum*. In *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540 (2d Cir. 1967), we held that shareholders of a corporation had standing under Rule 10b-5 to obtain injunctive relief to prevent controlling persons from depressing the price of the corporation's stock by market manipulation, even though the complaining shareholders had purchased their shares prior to the manipulation and had not yet sold them. The damage claim was dismissed for lack of a causal connection, *id.* at 547. . . . In damage action, this court in *Symington Wayne Corp. v. Dresser Industries, Inc.*, 383 F.2d 840, 842 (2d Cir. 1967), referred to the decisions in *A.T. Brod & Co. v. Perlow*, *supra*, and *Vine v. Beneficial Finance Co.*, *supra*, as having "expressly left undecided the question whether one who is neither a purchaser nor a seller can attack a transaction under Rule 10b-5." *Iroquois* declined to allow relief in a tender offer situation where plaintiff was neither a purchaser nor a seller.⁴³

To be sure, the court viewed the absence of "purchaser" or "seller" status as an aspect of the problem of demonstrating causation. Moreover, it seems that the court allowed a claim for damages or rescission by a plaintiff who was neither a "purchaser" nor a "seller." Furthermore, the court never designated whether this right to damages arose under rule 10b-5 and not solely under § 9(a).⁴⁴ However, the court noted that Crane's rights under rule 10b-5 existed even if § 9(a)(2) were narrowly construed.⁴⁵ In any case, his rights under 10b-5 should not be construed to include only prospective injunctive relief as such relief would have been practically futile since at the time of the suit, Crane's tender offer had been defeated; the Standard-Air Brake merger consummated; and Crane had already disposed of all but 1,000 of its 740,311 shares of Standard convertible preferred.

The possible ramifications of *Crane* were vividly expressed by the Third Circuit in *Kahan v. Rosenstiel*,⁴⁶ wherein the court stated that "*Crane Co. v. Westinghouse Air Brake Company* . . . makes it clear that there is no longer a *per se* requirement that plaintiff's in a 10(b) suit be defrauded purchasers or sellers. . . ."⁴⁷ *Kahan* involved a petition for legal fees arising out of a prior 10b-5 suit. In the suit giving rise to the legal fees, the plaintiff, a non-tendering shareholder of Schenley claimed that Rosenstiel, the controlling stockholder, sold his interest to Glen

43. *Id.* at 797-98 (footnotes omitted).

44. See note 35 *supra*.

45. See note 39 *supra*.

46. 424 F.2d 161 (3d Cir. 1970), *cert. denied*, 398 U.S. 950 (1970).

47. *Id.* at 171.

Alden for a premium only after he terminated merger negotiations with P. Lorillard on terms more favorable to the minority stockholders because they refused to pay him a premium. The plaintiff also alleged that when Glen Alden made a tender offer to the minority stockholders of Schenley, they both omitted to disclose this lost opportunity and falsely represented that the offer to the stockholders was equal or comparable to the price per share paid to Rosenstiel.

In the action for legal fees, the plaintiff alleged that as a result of his legal action, Glen Alden increased its offer creating a fund of approximately \$83,000,000 for the class he represented, based upon the difference between the value of the original offer and the final tender offer. The district court dismissed plaintiff's petition on the grounds that: the plaintiff had not filed a meritorious damage action which could survive a motion to dismiss, because he was not a purchaser or seller and because he failed to allege reliance on the deception; the plaintiff failed to establish a proper class action, or benefit to the class; and the plaintiff sought counsel fees from the defendants rather than from a fund created by his efforts.⁴⁸ Upon each of these grounds, the Third Circuit reversed and the Supreme Court denied certiorari.⁴⁹ In finding that the plaintiff had standing to sue under rule 10b-5 despite the fact that he did not tender his stock, the court relied primarily on *Crane* and the emphasis on causation enunciated therein. Moreover, the court specifically rejected the defendants' contention that *Crane* was decided on the "forced seller theory" developed in *Vine v. Beneficial Finance Co.*⁵⁰ In addition, the *Kahan* case quoted with approval from *Butler Aviation International, Inc. v. Comprehensive Designers, Inc.*,⁵¹ wherein Judge Cannella of the Southern District of New York stated:

[I]t is not required under Rule 10b-5 that plaintiff be a buyer or seller of stock as those terms are normally understood. The phrase "in connection with the purchase or sale of any security" was intended by Congress to mean only "that the device employed, whatever it might be, be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities. [SEC v. Texas Gulf Sulfur Co., 401 F.2d 833 at 860 (2d Cir. 1968)]. See *Crane Co. v. Westinghouse Air Brake Co.*⁵²

While *Kahan* undoubtedly rejects a strict purchaser-seller requirement in cases involving injunctive relief, it does not resolve the question of whether the fact that a plaintiff is neither a "purchaser" nor "seller" precludes him, as a matter of law, from demonstrating sufficient causal

48. *Kahan v. Rosenstiel*, 300 F. Supp. 447 (D. Del. 1969).

49. *Kahan v. Rosenstiel*, 424 F.2d 161 (3d Cir. 1970), cert. denied, 398 U.S. 950 (1970).

50. *Id.* at 172.

51. 307 F. Supp. 910 (S.D.N.Y. 1969), *aff'd*, (without passing on the question of standing rule 10b-5) 425 F.2d 842, n.1 (2d Cir. 1970).

52. *Kahan v. Rosenstiel*, 424 F.2d 161, 172 (3d Cir. 1970).

connection between his injury and the alleged violation. This follows since the court chose to distinguish *Birnbaum* and *Iroquois* on the ground that they involved damage suits.⁵³

Another interesting facet of *Kahan* involves the fact that the plaintiff's complaint in the 10b-5 suit did not specifically ask for injunctive relief; it contained only the general request for "further relief as may be just." Nevertheless, the court found that the plaintiff had standing to bring the suit because a federal court empowered to award any relief appropriate under the circumstances⁵⁴ would not have dismissed so long as a cause of action for injunctive relief were inherent in the complaint.⁵⁵ While this position allows standing to those who neglect or fail to recognize their right to equitable relief, it also implies that absent a claim for injunctive or, in any case, equitable relief, one who is not a "purchaser" or "seller" cannot, as a matter of law, demonstrate the necessary connection between the violation and the injury to sue under rule 10b-5.

This compulsion to uphold the *Birnbaum* requirement in damage actions is evident in the recent decision of the Fifth Circuit, *Rekant v. Desser*.⁵⁶ In *Rekant*, the court upheld a derivative action upon finding that the corporation was a "seller" for the purposes of rule 10b-5.⁵⁷ The court disposed of the individual and class actions without reaching the question of whether the decision to hold, rather than to buy or sell, is sufficient to give rise to a cause of action under rule 10b-5.⁵⁸ Nonetheless, the court added by way of vigorous dictum that "*Birnbaum* still stands."⁵⁹

Yet even the *Rekant* court recognized that the purchaser-seller requirement was not absolute and that the distinguishing factor in damage suits denying standing to "non-purchasers" or "non-sellers" was the inability of the plaintiffs to show a causal connection between the loss and the violation.

The cases professedly disallowing a federal action under § 10(b) and Rule 10b-5 for corporate mismanagement may perhaps be distinguished on the issue of causation. In *Birnbaum*, the corporation was not a direct party to the allegedly fraudulent transaction; the president of Newport Steel, in his official capacity, rejected a merger proposal from Follansbee Steel, and instead personally sold his control block of Newport stock to Follansbee at a substantial profit. Similarly in the private-damage cases,

53. *Id.* at 171.

54. FED. R. CIV. P. 54(c).

55. *Kahan v. Rosenstiel*, 424 F.2d 161, 174 (3d Cir. 1970).

56. 425 F.2d 872 (5th Cir. 1970).

57. *Id.* at 877.

58. *Id.* It is interesting that this court, which so vigorously defended *Birnbaum*, appeared extremely reluctant to decide whether the decision to hold, *i.e.*, a decision not to sell, could give rise to a cause of action under rule 10b-5. The court, quite properly, avoided this issue, but only after withholding ruling on the case for over one year after receiving briefs and hearing oral arguments during which period it called upon the Securities and Exchange Commission to file an amicus brief on this very question.

59. The dictum referred to is quoted on p. 134 *supra*.

such as *Mutual Shares Corp. v. Genesco, Inc.*, 2 Cir. 1967, 384 F.2d 540, there was no direct-dealing between the plaintiff and the perpetrator of the alleged fraudulent stock transaction. The hesitancy of courts to grant a cause of action under Rule 10b-5 when the causal connection between the fraud and the injury is not readily apparent, as when there is no direct-dealing between the parties, may explain in part, at least, the diverse results. See *Commerce Reporting Co. v. Puretec, Inc.*, S.D.N.Y. 1968, 290 F. Supp. 715.⁶⁰

V. CONCLUSION

By treating the absence of purchaser or seller status as only an element in the problem of demonstrating causation between the alleged fraud and the injury, the three cases, *Crane*, *Kahan* and *Rekant*, should impliedly reverse *Birnbaum*.

The *Birnbaum* court concluded that § 10(b) was added to the securities laws merely to provide a remedy for defrauded sellers comparable to that provided for defrauded buyers by § 17 of the 1933 Act and that despite the use of the words "any person . . . in connection with the purchase or sale of securities," Congress intended to afford protection only to "purchasers" or "sellers."

These three cases, properly read, express the view that Congress intended to provide a remedy to anyone connected with a securities transaction who could demonstrate that the alleged fraud *caused* him injury. However, to say that they have reversed *Birnbaum* is at best premature.⁶¹ While their reasoning should not be reconciled with *Birnbaum*, they consistently express continued admiration for that decision.⁶² Perhaps these expressions of admiration should be considered more as a monument to the ability of lawyers to hypnotize themselves with their own creations

60. *Rekant v. Desser*, 425 F.2d 872 (5th Cir. 1970).

61. The treatment of *Birnbaum* varies both among and within the circuits. See *Rekant v. Desser*, 425 F.2d 872 (5th Cir. 1970); *Kahan v. Rosenstiel*, 424 F.2d 161 (3d Cir. 1970); *City Nat'l Bank v. Vanderboom*, 422 F.2d 221 (8th Cir. 1970); *Iroquois Indus., Inc. v. Syracuse China Corp.*, 417 F.2d 963 (2d Cir. 1969); *Britt v. Cyril Bath Co.*, 417 F.2d 433 (6th Cir. 1969); *Greenstein v. Paul*, 400 F.2d 580 (2d Cir. 1968); *Dasho v. Susquehanna Corp.*, 380 F.2d 262 (7th Cir. 1967); *Greater Iowa Corp. v. McLendon*, 378 F.2d 783 (8th Cir. 1967); *Norsul Oil & Mining, Ltd. v. Texaco, Inc.*, 309 F. Supp. 1242 (S.D.N.Y. 1970); *Stedman v. Storer*, 308 F. Supp. 881 (S.D.N.Y. 1969); *Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc.*, 307 F. Supp. 910 (S.D.N.Y. 1969), *aff'd*, 425 F.2d 842 (2d Cir. 1970); *Coffee v. Permian*, 306 F. Supp. 1371 (N.D. Tex. 1969) *rev'd* 434 F.2d 383 (5th Cir. 1970). *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715 (S.D.N.Y. 1968). Moreover, the Supreme Court has consistently avoided questions involving the purchaser-seller requirement. See, e.g., *Nat'l Sec., Inc. v. Sec. & Exch. Comm'n*, 393 U.S. 453, 467 & n.9 (1969). In this past session the Court has denied certiorari in the following cases: *Iroquois Indus., Inc. v. Syracuse China Corp.*, 90 S. Ct. 2199 (1970); *Vanderboom v. City Nat'l Bank*, 90 S. Ct. 2196 (1970); *Glen Alden Corp. v. Kahan*, 90 S. Ct. 1870 (1970).

62. See e.g., *Rekant v. Desser*, 425 F.2d 872, 877 (5th Cir. 1970): "Bloody but unbowed, *Birnbaum* still stands. . . ."

than as an agreement with the *Birnbaum* interpretation of Congressional intent. In any case, they cannot be disregarded.⁶³

To be sure, there is no longer a strict purchaser-seller requirement in cases involving injunctive relief. However, this may be viewed as merely an exception to *Birnbaum* required by the fact that injunctive relief is generally sought before the purchase or sale is consummated. So long as Congress intended to allow private suits for injunctions, it could not have intended to provide this remedy only to the "purchaser" or "seller." Whether this is an exception to *Birnbaum* or evidence of the fallacy of *Birnbaum* is the question these cases fail to resolve. *Kahan* and *Rekant* attempt to walk the tightrope. Both these courts apparently reject the idea that Congress intended to afford a remedy only to the purchaser or seller but achieve the result in *Birnbaum* by treating the absence of purchaser-seller status as an absolute bar, as a matter of law, to establishing the necessary correlation between the alleged violation and the loss in actions seeking other than injunctive relief. To date, only the *Crane* court has allowed a claim for rescission and damages when the plaintiff was neither a "purchaser" nor a "seller."⁶⁴

While the reasoning employed by each of these decisions supports the elimination of a per se purchaser-seller requirement, the courts seem reluctant to abandon *Birnbaum*, especially in damage actions. The best the opponents of *Birnbaum* can say is that in these cases *Birnbaum* has been reversed and reversed.

63. Though not raised in any cases involving the "Birnbaum rule," a strong argument can be made for the proposition that courts should not, absent exceptional circumstances, re-examine, after the passage of time, decisions resolving Congressional intent. See *Boys Mrkts., Inc. v. Retail Clerk's Union, Local 770*, 90 S. Ct. 1583 (1970) (dissenting opinion, Black, J.) wherein Justice Black argues that when courts alter important provisions of statutes years later simply because the judges have changed, they usurp a proper function of the legislature.

64. See discussion of *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), p. 138 *supra*.