1967

Robert I. Cohne, For and On Behalf of Himself and All Stockholders of Reliance National Life Insurance Company, Similarly Situated v. Frank B. Salisbury : Brief of Appellant

IN THE SUPREME COURT OF THE STATE OF UTAH

ROBERT I. COHNE, for and on behalf of himself and all stockholders of RELIANCE NATIONAL LIFE INSURANCE COMPANY, similarly situated,

Plaintiff and Appellant,

vs.

FRANK B. SALISBURY,

Defendant and Respondent.

ROBERT I. COHNE, for and on behalf of RELIANCE NATIONAL LIFE INSURANCE COMPANY,

Plaintiff and Appellant,

vs.

FRANK B. SALISBURY,

Defendant and Respondent.

Case No. 10814

BRIEF OF APPELLANT

Appeal from the Order Dismissing Complaint of the Third Judicial District Court for Salt Lake County, The Honorable Merrill C. Faux, Presiding

ADAM M. DUNCAN
319 Kearns Building
Salt Lake City, Utah
PAUL N. COTRO-MANES
430 Judge Building
Salt Lake City, Utah
ATTORNEYS FOR PLAINTIFF-APPELLANT

HANSON & BALDWIN
909 Kearns Building
Salt Lake City, Utah
ATTORNEYS FOR DEFENDANT-RESPONDENT

TABLE OF CONTENTS

Page

INDEX OF CASES AND AUTHORITIES

AUTHORITIES CITED

CASES CITED

STATUTES AND RULES CITED

IN THE SUPREME COURT OF THE STATE OF UTAH

ROBERT I. COHNE, for and on behalf of himself and all stockholders of RELIANCE NATIONAL LIFE INSURANCE COMPANY, similarly situated,

Plaintiff and Appellant,

vs.

FRANK B. SALISBURY,

Defendant and Respondent.

Case No. 10814

ROBERT I. COHNE, for and on behalf of RELIANCE NATIONAL LIFE INSURANCE COMPANY,

Plaintiff and Appellant,

vs.

FRANK B. SALISBURY,

Defendant and Respondent.

BRIEF OF APPELLANT

STATEMENT OF THE CASE

Plaintiff filed an action in the Third District Court in and for Salt Lake County for and on behalf of himself, and Reliance National Life Insurance Company

and for and on behalf of all stockholders of said Company pursuant to Rule 23, Utah Rules of Civil Procedure, to recover from defendant secret and unlawful profits realized by defendant in the sale by defendant of control of and over the said Reliance National Life Insurance Company in violation of defendant's fiduciary duties.

DISPOSITION OF THE CASE BY THE LOWER COURT

The lower court, Judge Faux, in his "Memorandum Decision" of December 22, 1966 (R. 41) and his "Judgment of Dismissal" on December 28 ,1966, (R. 42) granted defendant's "Motion to Dismiss or in the Alternative to Strike." Plaintiff is appealing herein from the said dismissal.

RELIEF SOUGHT ON APPEAL

It is submitted in this appeal that the rulings of the lower court granting defendant's Motion to Dismiss, should be reversed for error of law and the case remanded to the District Court with instructions to deny the Motion to Dismiss of defendant and require defendant to answer or otherwise plead.

STATEMENT OF FACTS

The facts underlying the appeal may be readily capsulized. Appellant filed an action in the United

States District Court for the District of Utah, Central Division on August 25, 1965, (Civil No. C-170 65), (R. 50-395). In that Action, four other defendants were named in addition to defendant Salisbury. Each defendant, including defendant Salisbury, was personally served by a United States Marshal outside of the State of Utah. Defendant Salisbury was served at Phoenix, Arizona (R. 82).

The action of plaintiff Cohne (Appellant herein) in the United States District Court was based on violation of federal securities statutes and regulations. After several hearings, the United States District Court granted plaintiff Cohne the right to amend his Complaint and the Amended Complaint was filed on December 30, 1965. (R. 144-158). On March 7, 1966, Judge Christensen struck from plaintiff's pleadings the phrase "or are pendent to claims arising under and based solely thereon." (R. 148). It was to the Amended Complaint in the United States District Court with the aforesaid language stricken by order of the Court, that defendants therein filed motions to dismiss. *At no time did any of the defendants in that action enter a general appearance and each defendant in every pleading carefully appeared specially solely to contest jurisdiction.* On July 6, 1966, Judge Christensen entered his "Memorandum Decision" dismissing plaintiff's Amended Complaint (R. 386-388) on the grounds of failure of jurisdiction in the said United States District Court action.

Subsequent to the dismissal of the United States

District Court action, which said action was based solely on federal statutes and wherein extraterritorial service was sought under express federal statutory authorization, Mr. Cohne, Appellant herein, filed an action in the Third District Court in and for Salt Lake County, State of Utah, and obtained personal service upon Mr. Salisbury at Salt Lake City, Utah. (R. 9-11.) Defendant-Respondent filed a "Motion to Dismiss or in the Alternative to Strike" on September 26, 1966. (R. 38-39.) The sole argument of Defendant-Respondent herein in support of his motion to dismiss heard by the lower court on October 17, 1966, was that the dismissal of the federal court action somehow constituted a bar to any action thereafter against defendant Salisbury.

ARGUMENT

POINT I

THE CLAIM OF PLAINTIFF COHNE IN THE U.S. DISTRICT COURT ACTION (CIVIL NO. C-170-65) AROSE FROM CONDUCT OF DEFENDANTS THEREIN (INCLUDING DEFENDANT SALISBURY) VIOLATIVE OF FEDERAL LAW. THE ELEMENTS OF CIVIL LIABILITY UNDER FEDERAL RULE 10b-5 ARE NOT THE SAME AS COMMON LAW FRAUD OR DECEIT.

The action of Plaintiff Cohne (Appellant herein) in federal court was based solely on alleged violation of

Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78j)and Rule 10b-5 (17 C.F.R. 240.10b-5) promulgated by the United States Securities and Exchange Commission pursuant to authority of the Exchange Act.

Rule 10b-5 reads:

> "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, (1) to employ any device, scheme or artifice to defraud, (2) 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 (3) 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."

Each of the Circuit Courts which has considered 10b-5 civil liability has found that claims such as pleaded by plaintiff in the instant case, would lie. (See cases collected by Loss, *Securities Regulation* (2d Ed. 1961) Vol. III at page 1763). But no court has treated the matter more definitively than the Ninth Circuit in the case of *Ellis v. Carter,* 291 F. 2d 270 (1961). In the *Ellis* case the Court set forth at length the possible interpretations of the scope and requirements of 10b-5 civil liability. It acknowledges certain "anomalies" and then states (at page 274):

"(4) Appellees further argue that if we reaffirm *Matheson* [*Matheson v. Armbrust,* 284 F. 2d 670 (9th Cir. 1960)] we should at least hold that appellant must allege and ultimately prove genuine fraud, as distinct from 'a mere misstatement or omission', to paraphrase the language of subparagraph (2) of Rule 10b-5. This is in effect, a challenge to the validity of subparagraph (2) of the rule. It is predicated on the idea that a proscription of material misstatements and half-truths without using fraud or *scienter* language is not a permissible implementation of Section 10(b). We disagree. *Section 10(b) speaks in terms of the use of 'any manipulative device or contrivance' in contravention of rules and regulations as might be prescribed by the Commission.* It would have been difficult to frame the authority to prescribe regulations in broader terms. *Had Congress intended to limit this authority to regulations proscribing common-law fraud, it would probably have said so. We see no reason to go beyond the plain meaning of the word 'any', indicating that the use of manipulative or deceptive devices or contrivances of whatever kind may be forbidden,* to construe the statute as if it read 'any fraudulent devices'." (Emphasis added.)

Loss, *supra,* page 1435 says:

"The fact is that the courts have repeatedly said that the fraud provisions in the SEC acts, as well as the mail fraud statute, are not limited to circumstances which would give rise to a common law action for deceit. (Citing cases.)"

In *Texas Continental Life Ins. Co. v. Bankers*

Bond Co., 187 F. Supp. 14 (W.D. Ky. 1960) the Court said (at page 23):

> "I am of the opinion that it was the intention of the Congress by this legislation to give the purchaser of invalid bonds *a right to recover without the necessity of offering proof of deceit and intentional fraud. The statute contemplates a new right of action for the good faith purchaser to recover from the seller for constructive fraud which grows out of the failure to make a full and complete disclosure.*" (Emphasis added.)

The 1965 case of *Stevens v. Vowell*, 343 F. 2d 375 (10th Cir.) settled for this Circuit the question of whether a civil action arising under or based upon violation of the proscriptions of Rule 10b-5 required proof of the elements of common law fraud or deceit. *Stevens* originated in the United States District Court for the District of Utah, Central Division, and was tried to Chief Judge Willis W. Ritter. The appellant in that case argued that an action based on Rule 10b-5 was essentially the same as a common law fraud or deceit action, that the plaintiff had failed to prove certain elements of common law fraud and that, therefore, the judgment for plaintiff should be reversed. In affirming the trial court, the Circuit Court said (at page 379):

> "It is not necessary to allege or prove common law fraud to make out a case under the statute and rule. It is only necessary to prove one of the prohibited actions such as the material misstatement of fact or the omission to state a material fact (citing)."

Professor Loss, the acknowledged authority in the field says, concerning the elements of liability under Rule 10b-5:

> "Indeed, the plaintiff is not limited to proving an untrue statement or an omission but has recourse to the possibly broader 'fraud' language of the first and third clauses of the rule. (Citing.) The other elements of common law deceit — reliance, causation and scienter (citing) are not mentioned. . . . " Loss, *Securities Regulation*, (1961), Vol. III at page 1765.

In the case of *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 11 L. Ed. 2d 237, 84 S. Ct. 275 (1963), the Supreme Court said (at 11 L. Ed. 237, at 246, footnote 39):

> " . . . It is to be noted that it is not necessary that the person making the misrepresentations intend to cause loss to the other or gain a profit for himself; it is only necessary that he intend action in reliance on the truth of his misrepresentations. 1 Harper and James, the Law of Torts (1956), 531".

POINT II

THE UNITED STATES DISTRICT COURT DISMISSED PLAINTIFF'S COMPLAINT IN CIVIL NO. C-170-65, SOLELY ON THE GROUNDS OF FAILURE OF JURISDICTION.

Defendant Salisbury, Respondent herein, never entered a general appearance in the United States Dis-

trict Court action. In every stipulation to which defendant (Respondent) Salisbury was a party, he expressly provided that execution of the stipulation should not constitute a general appearance. See, for example, Stipulation dated September 23, 1965 (R. 89-90); Stipulation dated October 23, 1965, (R. 99-100); Stipulation dated November 18, 1965 (R. 127-128); Stipulation dated January 12, 1966, (R. 162-163): Stipulation dated February 3, 1966, (R. 204-205).

The sole and only question or issue raised by defendant (Respondent) Salisbury in the federal court action was alleged failure of jurisdiction. See, for example, "Motion to Dismiss for Lack of Jurisdiction", (R. 96-97) filed by defendant Salisbury on October 18, 1965, "Memorandum of Defendant Frank B. Salisbury in support of Motion to Dismiss for Lack of Jurisdiction" (R. 237-243) filed on April 1, 1966.

POINT III

THE UNITED STATES DISTRICT COURT DID NOT HAVE PERSONAL JURISDICTION OVER THE DEFENDANTS IN CIVIL NO. C-170-65 EXCEPT AS TO CLAIMS BASED SOLELY ON THE SECURITIES EXCHANGE ACT OF 1934.

In both the original Complaint (Paragraph 6, R. 60-61) and the Amended Complaint (Paragraph 4, R. 147-148), jurisdiction in the United States District Court action (Civil No. C-170-65) was based solely

upon Section 10(b) of the Securities Act of 1934 (Section 78j of Title 15, U.S.C.A.) and Rule 10b-5 (Title 17, C.F.R., Section 240.10b-5) promulgated by the Uinted States Securities and Exchange Commission thereunder.

All of the defendants in the federal Court action were served personally outside of the State of Utah. Defendant Salisbury was served by a U. S. Marshal at Phoenix, Arizona. (R. 82-84.) Section 27 of the Securities Exchange Act of 1934 (15 U.S. C.A. Section 78aa) permits service upon a defendant beyond the territorial limits of a United States District Court in actions based upon violation of the federal statute or regulations promulgated thereunder. The provision is a radical departure from traditional concepts of due process and jurisdiction and the Courts have tended to strictly construe its applicability.

In a recent case, as in the case at bar, based on Rule 10b-5, and wherein jurisdiction of the federal court as to common law claims asserted to be pendent to the federal statutory claims, Judge Doyle, United States District Court Judge for the District of Colorado wrote:

> "Englert's final argument challenges the jurisdiction of this Court over his person. He was served pursuant to the extraterritorial service of process provision contained in Section 27 of the Securities Exchange Act, and while he concedes that this service was sufficient to obtain jurisdiction over his person with respect to the federal claims, he maintains that it was insufficient to do so with respect to the claims based on the

Kansas statute, i.e., the third claims of each complaint, Englert acknowledges that these state claims, in accordance with Hurn v. Oursler (citing) are 'pendent' to the federal claims. However, he maintains that this doctrine applies only with respect to jurisdiction of the subject matter, and not jurisdiction of the person. The authorities on this point are in conflict. (Citing.)" *Trussell, et al. v. United Underwriters, Ltd., et al.*, 236 F. Supp. 801, 803 (1964).

The Court said further (at page 804):

"Undoubtedly, the issues underlying pendent subject matter jurisdiction and pendent personal jurisdiction are different. The fundamental issue decided in Hurn v. Oursler, supra, was that pendent subject matter jurisdiction was embraced within the scope of subject matter jurisdiction permitted by Article 3 of the United States Constitution; it was there recognized that Congress has conferred this jurisdiction upon the federal courts. The question was whether Congress had the power to do so . . . In any event, after Hurn v. Oursler, there can be little doubt that Congress has the power to allow extraterritorial service of process with respect to pendent state claims. The sole question is whether Congress has provided for such service.

Congress has not provided explicitly for such service, neither by the statute here in question, Title 15, U.S.C. Section 78aa, nor has it done so by rule. See Mississippi Publishing Corp. v. Murphree, 326 U.S. 438, 66 S. Ct. 242, 90 L. Ed. 185 (1946). The question remains whether it should be here implied. Sanction of extraterritorial service has been implied, at least once, from the terms of a federal statute, United

States v. Congress Construction Co., 222 U.S. 199, 32 S. Ct. 44, 56 L. Ed. 163 (1911), Limerick v. T. F. Scholes, Inc., 10 Cir., 292 F. 2d 195 (1961). But the explicit limits of service of process historically have been meticulously guarded. Robertson v. Railroad Labor Board, 268 U.S. 619, 45 S. Ct. 621, 69 L. Ed. 1119 (1925), United States v. Rhoades, D.C. 14 F.R.D. 373 (1953). These limits have been set by the Congress. Most recently, Federal Rules of Civil Procedure, Rule 4(f) has been amended to permit service of process extraterritorially, not to exceed one hundred miles from the place of trial. See the comment on this amendment contained in the article by Kaplan (the reporter to the Advisory Committee), Federal Rules Amendments, 77 Harv. L. Rev. 601, 631 (1964). It would appear that the statutory approach to service of process has been such as to discourage implied extensions."

POINT IV

A DEFENDANT MAY BE LIABLE FOR RECOVERY OF A PREMIUM REALIZED IN THE SALE OF CONTROL OF A CORPORATION, BUT SUCH A CLAIM MAY NOT BE BASED ON RULE 10b-5.

This matter was settled by the United States Circuit Court of Appeals for the Second Circuit in the companion cases of ***Birnbaum v. United States Steel***, 193 F. 2d 461 (2d Cir., 1952) and *Perlman v. Feldmann*, 219 F. 2d 173 (2d Cir.) cert. denied, 349 U.S. 952 (1955). In the *Birnbaum* case, the Court of Ap-

peals for the Second Circuit held that recovery for sale of corporate control was not actionable under Rule 10b-5 and the same Court held in *Perlman* that the same facts did constitute a common law cause of action. (See 78 Harv. L. Rev. 505, Jan. 1965).

The argument of Plaintiff (Appellant herein) Cohne in the federal court action urged the Court to distinguish the *Birnbaum* case and hold jurisdiction was proper as to the recovery of the premium realized by Mr. Salisbury. (R. 229-236). The federal Court did not so hold, and granted the defendants' motions directed to—and solely to—jurisdiction.

CONCLUSION

The question of the liability of defendant Salisbury, Respondent herein, for selling control of Reliance National Life Insurance Company has never been litigated and the Plaintiff-Appellant and the persons for whom he brought this action, have never had their "day in court". The United States District Court in Civil No. C-170-65, first struck references to pendent claims from the amended complaint and then determined that jusidiction over the person of the defendant was not present. The claims of plaintiff Cohne in the federal action were based *solely* on federal statutes and the ruling of the federal Court in no sense should be deemed res judicata as to a state court common law action.

Accordingly, the order of the lower court dismiss-

ing the Complaint of Plaintiff-Appellant should be reversed for error of law and the case remanded to the District Court for trial.

Respectfuly submitted,

Adam M. Duncan
319 Kearns Building
Salt Lake City, Utah

Paul N. Cotro-Manes
430 Judge Building
Salt Lake City, Utah

Attorneys for Appellant.