
Carlos L. Israels
Review


That famous literary lawyer, W. S. Gilbert, loved to poke fun at the establishment. No true Gilbertian will ever forget the Lord Chancellor in Iolanthe:

The law is the true embodiment
Of everything that’s excellent
It has no kind of fault or flaw
And I, my Lords, embody the law.

SEC Rule 10b-5 (the Rule) as interpreted by the Securities and Exchange Commission (the Commission) and the federal courts may (as some fear) or may not come to “embody the law” of fiduciary responsibility in respect of corporate “insiders.” It may or may not supersede long-standing state law doctrines, and preempt the field of federal securities regulation, at least in a wide area of litigation based on claim of “fraud.” It is certain, however, that the trend of decision under the Rule has produced deep schism between “liberal” and “conservative” elements of the corporate bar.° While Professor Bromberg’s title reflects a broader sweep, the book itself has a more modest scope. It is designed to provide a guide through the labyrinth of decision under the Rule,

1 17 C.F.R. § 240.10b-5 (1968). (The text of the Rule appears several times in this book). Employment of Manipulative and Deceptive Devices. 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 a 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.
2 Cf. Gilbert’s Private Willis, parliamentary sentry:
I often think it comical . . .
That ev’ry boy and ev’ry gal
That’s born into this world alive
Is either a little Liberal
Or else a little Conservative.

Iolanthe, Act II.

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both for lawyers and (perhaps in deference to the publisher of *Business Week*, who also published this book) for the executive.

There are indeed, as Professor Bromberg tells us, “anti-fraud” provisions other than the Rule in the federal securities laws. Notably, Section 17(a) of the Securities Act of 1933,\(^3\) (the 1933 Act) declares it to be “unlawful” for any person, “in the offer or sale of any securities,” by use of what have come to be termed “the jurisdictional means,”\(^4\)

1. to employ any device, scheme, or artifice to defraud, or
2. to obtain money or property by means of any untrue statement of a material fact or any omission 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 transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.\(^5\)

Breach of Clause 2 results in statutory civil liability under either Section 11(a) or Section 12(2) of the 1933 Act;\(^6\) and if securities are registered or in course of registration under that Act, there is an additional administrative sanction in the form of a “stop order” issuable by the Commission after notice and hearing.\(^7\) No specific statutory civil remedy is spelled out for violation of Clause 1 or Clause 3, nor for the protection of the defrauded seller of securities.

So the law remained until 1942, when the Commission suddenly confronted these lacunae and Rule 10b-5 was born. The history is brief. The draftsman of the Rule retold it recently:

It was one day in the year 1943 [sic], I believe. I was sitting in my office in the S.E.C. building in Philadelphia and I received a call from Jim Treanor who was then the Director of the Trading and Exchange Division. He said, “I have just been on the telephone with Paul Rowen,” who was then the S.E.C. Regional Administrator in Boston, “and he has told me about the president of some company in Boston who is going around buying up the stock of his company from his own shareholders at $4.00 a share, and he has been telling them that the company is doing very badly, whereas, in fact, the earnings are going to be quadrupled and will be $2.00 a share for this coming year. Is there anything we can do

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\(^3\) 15 U.S.C. § 77q(a) (1964).
\(^4\) These are: “any means or instruments of transportation or communication in interstate commerce or ... the mails.” *Id.*
\(^5\) The several “anti-fraud” provisions are diagrammed in A. Bromberg, SECURITIES LAW: FRAUD: SEC RULE 10b-5 (1967) [hereinafter cited as Bromberg], Bromberg § 2.1, at 16-17.
\(^6\) 15 U.S.C. §§ 77k(a) and 1(2) (1964).
\(^7\) 15 U.S.C. § 77h(b) (1964).
about it?" So he came upstairs and I called in my secretary and I looked at Section 10(b) and I look at Section 17, and I put them together, and the only discussion we had there was where "in connection with the purchase or sale" should be, and we decided it should be at the end.

We called the Commission and we got on the calendar, and I don't remember whether we got there that morning or after lunch. We passed a piece of paper around to all the commissioners. All the commissioners read the rule and they tossed it on the table, indicating approval. Nobody said anything except Sumner Pike who said, "Well," he said, "we are against fraud aren't we?" That is how it happened. [Citation added.]

The Commission first publicly relied on the Rule in 1948 in reporting its investigation into the attempt of Ward La France Truck Corporation to purchase a substantial amount of its outstanding shares without making adequate disclosure to the prospective sellers of its current favorable financial condition and business prospects.

More recent decisions underscore the Commission’s imaginative use of the Rule since 1948. In 1961, disciplinary action was brought against the brokerage firm of Cady, Roberts & Co. for dealing in the market without disclosing unfavorable information which an associate acquired in his capacity as a director of the Company whose shares were sold. In 1966, the Commission appeared as plaintiff in SEC v. Texas Gulf Sulphur Co. seeking civil relief on behalf of sellers of Texas Gulf shares against the company and various of its officers, directors, and employees who, without adequately disclosing the discovery of a major ore body, either bought share themselves or suggested that others buy them.

8. This is § 10(b) of the Securities Exchange Act of 1934 (commonly known as the 1934 Act), 15 U.S.C. § 78j(b) (1964) which declares it unlawful

(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.


12. 258 F. Supp. 262 (S.D.N.Y. 1966). By stipulation, no decision was rendered as to the standing of the Commission as a proper party plaintiff. At this writing the case is pending on appeal, and the Court of Appeals has announced that it will consider it en banc. Doc. No. 30882 (2d Cir., May 2, 1968).

The essence of the legal standard which the Commission believes the insider is required to meet is probably best expressed in Chairman Cary's much quoted opinion in *Cady, Roberts & Co.:

We, and the courts have consistently held that insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment. . . . If, on the other hand, disclosure prior to effecting a purchase or sale would be improper or unrealistic under the circumstances, we believe the alternative is to forego the transaction.14

The statement seems simple and clear. But by the time Chairman Cary wrote it in 1961 there had been a thirteen-year history of civil litigation and judicial opinions defining the scope and purpose of the Rule.

Mr. Freeman, one of the Rule's draftsmen, "never thought that twenty-odd years later it would be the biggest thing that had ever happened."15 Just how "big" it is in terms of its significance in the entire scheme of federal securities regulation may be the subject of some argument. That litigation under the Rule continues to increase in volume and that its importance is still growing admits of no debate. Almost every weekly issue of the CCH Federal Securities Law Reporter bears this out. As Mr. Freeman puts it, the Rule

was intended to give the Commission power to deal with this problem [of the defendant seller]. It had no relation in the Commission's contemplation to private proceedings. How it got into private proceedings was by the ingenuity of members of the private Bar starting with the *Kardon* case.16 It has been developed by the private lawyers . . . with the assistance of, or if you don't like it, connivance of the federal judiciary, who thought this was a very fine fundamental idea and that it should be extended.17 [ Citation added. ]

Today, Professor Bromberg suggests that:

. . . 10b-5 is generating almost as much litigation as all the other general antifraud provisions together, and several times as much as the express liabilities. It is by now such a dominant factor in private securities litigation that one is surprised when it does not

turn up, and a court does not hesitate to introduce it as a major consideration if plaintiff fails to plead it.\textsuperscript{18}

Interestingly enough, the law is mainly based on district court decisions, supported by a few court of appeals opinions but without a word from the Supreme Court. Moreover the decisions are mainly on the pleadings. "Thus the typical 10b-5 'victory' is only a holding that a cause of action has been stated, good enough to withstand a motion to dismiss."\textsuperscript{20}

What Professor Bromberg does in his book is to take the text of the Rule and break it down into its three clauses (corresponding, as he points out, to those of Section 17 of the 1933 Act\textsuperscript{20}) and cast up the decisions against them in terms of the characteristics of the transaction in issue. These transactions he classifies as

1. Direct-Personal Dealing
   (a) Face-To-Face Transactions, Other than With Broker-Dealers;
   (b) Broker-Dealers;
2. Direct-Impersonal Dealing (Mergers, Tender Offers, etc.);
3. Indirect-Impersonal Dealing (Stock Exchange and Open-Market Trades).\textsuperscript{21}

He then analyzes the same material in terms of the elements of cause of action and defense, such as materiality, \textit{scienter}, whether plaintiff is a buyer or seller, etc. It is in these areas that the Rule has been extrapolated so far that the decisions have created an entire structure of federal law dealing with the fiduciary responsibilities of corporate insiders. No experienced practitioner of federal securities law is without pronounced views on what should be the scope and impact of the Rule.\textsuperscript{22}

The questions are many. Let me select for brief discussion a few which to me seem both fundamental and controversial.

1. \textit{Civil Remedy}. Sections 11 and 12(2) of the 1933 Act\textsuperscript{23} provide civil remedies for the deceived buyer of securities sold by means of a "prospectus"\textsuperscript{24} which was "misleading," that is, inaccurate or incomplete...
in any material respect. If the prospectus is part of a registration statement which has become effective under the Act, the cause of action arises under Section 11; if not, it arises under Section 12(2). Does (or should) the buyer of a security, who would have a statutory and express civil remedy under either of these Sections of the 1933 Act, also have available a concurrent implied civil remedy under the Rule?

It cannot, of course, rationally be argued, that an implied right of civil recovery under the Rule is not available to buyers, just because, as we have seen, the Rule was formulated for the protection of sellers. Thus the market purchaser of common shares who suffers a loss by reason of reliance on a misleading prospectus as to preferred shares can allege a “fraud” and thus state a cause of action under the Rule. Judge Frank decided that such a buyer did have an implied civil remedy under the Rule and, incidentally, denied a claim for recovery under Section 11 of the 1933 Act. He stated, in dictum, that since establishment of the cause of action under the Rule required proof of “fraud” it was not duplicative of an action under Section 11 and could therefore exist concurrently. This dictum has been widely relied upon and cited for the proposition that a defrauded purchaser may have, on the same facts, both an express remedy under the 1933 Act and an implied remedy under the Rule, and as overruling two earlier district court decisions to the contrary. In Professor Bromberg’s view, these decisions “can no longer be regarded as valid.”

I respectfully demur, and point for support to a very recent decision, Jordon Building Corp. v. Doyle O’Connor & Co., Inc. The Jordon opinion can be interpreted as denying that the federal courts have any power to create an implied cause of action under the Rule in favor of a purchaser. It seems to me, however, that J. I. Case Co. v. Borak, which settled a conflict between circuits in favor of an implied civil remedy for breach of the Commission’s proxy rules, clearly negates such a broad interpretation. Certainly a cause of action under the Rule may properly be implied in favor of either seller or buyer but that does not mean that where Con-

now familiar booklet by which an issue of securities registered under the 1933 Act is offered for sale.

25. “... when, to conduct actionable under § 11 of the 1933 Act, there is added the ingredient of fraud, then that conduct becomes actionable under [the Rule].” Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 787 (2d Cir. 1951).


27. BROMBERG § 2.4(2) n.76, at 34.

28. Decided after the publication of Professor Bromberg’s book.


gress has created for the defaulted buyer an express civil remedy the federal courts can validly imply an additional remedy under the Rule on the same *substantive* facts (using the word “substantive” advisedly).

2. *Statute of Limitations.* Section 13 of the 1933 Act imposes a three year statute of limitations on actions under Sections 11 and 12 of the Act. All too many suits have been brought—and countenanced—under the Rule rather than under the 1933 Act in order to take advantage of the ingrown notion that, since no express statute of limitations is applicable, the court must look for analogous statutes of limitation and must find them in state law, where the periods are generally longer than three years. Professor Bromberg urges the application of a uniform three year statute. I agree. Indeed, I question the basis for the mechanical process generally found in the judicial exegesis, even on precedent. The first federal cases applying state statutes of limitation did so when it was the statutory duty of the federal courts, absent applicable federal statutes, to apply the law, both substantive and procedural, of the state wherein they sat. The court would characterize the action at bar, and, if Congress had not provided a specific period of limitation, or otherwise made the state statute inapplicable, to apply the most nearly analogous state statute.

In *Campbell v. Haverhill,* a patent infringement case, the state statute of limitations was applied in an action based on a federally created right. The court stated that it believed it reasonable to presume that Congress intended the remedy to be enforced within the same period as similar actions within the state. But is any such argument fairly applicable in the field of federal securities regulation? If we are looking for the fair interpretation of congressional intent concerning the statute of limitations applicable to a cause of action established by federal law, and Congress has enacted a specific three-year statute covering an important area within the same field of regulation, does not that statute prima facie provide the most—if not the only—“reasonable” analogy? I suggest that what we see here is slavish devotion to stare decisis without critical appraisal of the historical reason for the prece-

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34. 155 U.S. 610 (1895).
dents. For some time Professor Loss has been citing in lecture a case in which the Supreme Court, absent a specifically applicable federal statute, found the most valuable analogy in another federal enactment.

In a recent labor relations case the Supreme Court again relied upon state law to determine the applicable statute of limitations. Mr. Justice White dissented, joined by Justices Douglas and Brennan, and urged that

Certain principles are undisputed in this case. The period of limitations for § 301 is to be determined by federal law; and, since Congress had made no express provision for any time limitation, this Court must fashion the governing rule. By adopting the statutes of the several States, the Court creates 50 or more different statutes of limitations rather than fashioning a uniform rule after consideration of relevant federal and state statutes. . . .

But here there is no dispute concerning whether a statute of limitations is to be fashioned—the choice is between one statute or 50. If the Court is to develop the substantive law of labor contracts, which it has undertaken to do with the blessing of Congress, it seems odd that the Court should balk at establishing a single limitations period, drawn from any of the sources available to it, including the relevant federal and state statutes. I undertake no such canvass here, but think the Court should do so.

Substitute the phrase “securities regulation” for “labor contracts” in Mr. Justice White’s final paragraph and you have the point in boldface. As I see it there is something more than incongruity in the present posture. In effect the implied cause of action for the enforcement of a federally created right, which under Section 27 of the 1934 Act can be enforced only in the federal courts, survives under state statutes of limitations for a longer period than an express cause of action under the 1933 Act as to which the state courts have concurrent jurisdiction.

3. Sciener. As Professor Bromberg points out there is decisional law supporting the proposition that at least under Clause 2 of the

37. See particularly the concurring opinion of Mr. Justice Brennan, id. at 229, where the point is clearly made that to find the period applicable to a maritime cause of action based on the unseaworthiness of a vessel, the “ready and logical source to draw upon” is that provided by Congress in the Jones Act, 48 U.S.C. § 688 (1964), not a shorter period derived by reference to state law as to limitation of actions based on negligence.
42. Bromberg § 2.6(1) n.135, at 59, and § 8.9 n.162, at 223.
Rule there is no requirement to prove intent to injure or even reckless disregard of the possibility or probability of injury; the Clause only requires proof of "a material misstatement of fact or the omission of a material fact." He suggests, however, that "[a] more balanced view, better reflective of the current [trend] of decision is that recovery requires, in addition, proof of an injury in some significant way connected with the violation." In other words, clear causal connection is a minimal requirement. Professor Bromberg's own view, with which I find myself again in agreement, is that there should be, if not scienter, at least "a negligence standard, including [reasonable] foreseeability of harm." Anything less would again create more than incongruity. Even under Section 11 of the 1933 Act only the issuer is an insurer of the accuracy of the registration statement. All other potential defendants (directors and other signers of the registration statement, experts and underwriters) are given various types of defenses, which in effect express for each a standard of care deemed by Congress fitting to his economic function. Under Section 12(2) of the same Act, even the issuer may "sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such error or omission."

4. The Outer Limits? The Rule is not—indeed it cannot be—the underpinning for a complete and rounded structure of federal corporate law. The requirement of "connection with the purchase or sale of any security" excludes the possibility. Where the transaction is in

43. Quoted at p. 1586 supra.
44. Bromberg § 8.9, at 223, citing Stevens v. Vowell, 343 F.2d 374, 379 (10th Cir. 1965); Royal Air Properties Inc. v. Smith, 312 F.2d 210, 212 (9th Cir. 1962); and Ellis v. Carter, 291 F.2d 270 (9th Cir. 1961). The latter case, decided on the pleadings, was later dismissed for lack of proof of misrepresentation, 328 F.2d 379 (9th Cir. 1964).
45. "The connective may be expressed in terms of causation, privity, or reliance." Bromberg § 8.9, at 223.
46. Professor Bromberg finds this "implicit in the Rule's condition that the fraud be 'in connection with the purchase or sale of any security.'" He cites Royal Air Properties, Inc. v. Smith, 312 F.2d at 212, as "susceptible of this interpretation." Bromberg § 8.9 n.103, at 223.
47. Bromberg § 2.6(f) n.132, at 50, citing with apparent approval, Comment, 32 U. CHI. L. REV. 824 (1965). The word "[reasonable]" is my addition. Id. n.125, at 51.
48. 15 U.S.C. § 77k (1964). For an example of the potentially tough impact of that liability see Franchard Corp. [1964-1966 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,119 at 82,038 (SEC 1964), where no one but the president of the issuer and possibly one minor employee knew that the former was borrowing from the till. Following this opinion the issuer and others contributed to a substantial court-approved settlement of class actions brought under Section 11 and the Rule.
49. They are spelled out in § 11(b), 15 U.S.C. § 77k (1964). Meeting the requirements of the "due diligence" defenses afforded by the cited section is not easy of accomplishment. Reported decisions are few. Probably the most significant is that recently handed down by District Judge McLean in the Southern District of New York on March 29, 1968. Ezcott v. HarChris Constr. Corp., 4 CCH Fed. Sec. L. Rep. ¶ 77,179, at 96,827.
goods or services, or even cash or credits, for example, only state law standards will be applicable, and once conflict of interest has been shown, the result may well depend upon who bears the burden of proof to establish “fairness.” The salutary rule of Geddes v. Anaconda Copper Mining Co., which places that burden on the defending fiduciary, seems in danger of erosion both by statute and by decision. The burden, when it must be borne by the plaintiff, can be substantially more than a procedural roadblock. Litigation under the Rule usually does not present questions of conflict of interest, and there can be no doubt that a normal burden of proof rests upon the plaintiff; however, as the state courts appear to be narrowing the outer limits of the fiduciary duties of corporate insiders, the decisions under the Rule appear to be extending them.

Within the federal ambit some fascinating questions arise, mostly concerned with interpretation of the phrase “in connection with the purchase or sale of any security.” It seems that the plaintiff must be at least a potential buyer or seller of securities, but extension of protection to the potential as distinct from the actual buyer or seller is comparatively new.

Recent cases have granted injunctive relief, to prevent threatened corporate manipulation, and have presumed the existence of a buyer-

51. 254 U.S. 590 (1921), followed in Shlensky v. South Parkway Building Corp., 19 Ill. 2d 298, 280-81, 166 N.E.2d 793, 801 (1960) and, until comparatively recently (see note 53 infra) in most other jurisdictions.

52. CAL. CORP. CODE § 820 (West 1954) has been the model for later enactments in other states, e.g., N.Y. BUS. CORP. LAW § 713(a) (McKinney 1967 Supp.). Delaware only recently joined the parade. DEL. GEN. CORP. LAw § 144 (West 1967). For an interesting discussion of such statutes and their probable effectiveness, see Marsh, Are Directors Trustees?, 22 Bus. LAW. 35, 46-48 (1966).


55. Colonial Realty Corp. v. Curtis Publishing Co., [1965-1967 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,105, at 95,522 (S.D.N.Y. 1957) (deciding in the publication of Bromberg) denied to holders of the Series A Debentures of Curtis the right to sue under the Rule to restrain the offer of Series B Debentures to Curtis's preferred shareholders which, plaintiff alleged, due to the substantial deterioration in Curtis' financial position over the years since the offering of Series A, would seriously impair the "security" of the older Series. The court deemed plaintiff not properly a buyer or seller for purposes of maintaining an action under the Rule. The offer was subsequently withdrawn.


seller relationship and reliance on the part of the plaintiff shareholder in a merger transaction. These broad interpretations of the scope of the Rule highlight the recent amendment of the Delaware General Corporation Law eliminating dissenters’ rights of appraisal in a merger or consolidation situation where there is a public market for the securities. In general, the Delaware decisions not only require the minority shareholder attacking a merger, consolidation or recapitalization to allege and prove “fraud or illegality,” but also define the terms narrowly. In merger or consolidation cases the opinions have often pointed out that the plaintiff has an alternative, and presumably adequate, remedy through the appraisal procedure. As Professor Bromberg points out, “fraud” under the Rule as interpreted by the federal courts speaks basically in terms of “equalization of bargaining position” and “is closer to unfairness than to what either lawyers or laymen usually think of as fraud.” This suggests, to me at least, that the Rule may soon be invoked in a merger or consolidation proceeding in Delaware to attack the fairness of the plan under Clause 1 or Clause 3 of the Rule, or under Clause 2 combined with an attack on the accuracy of proxy material under Borak. There can be no doubt that any merger or consolidation involves a defined “sale” of securities, and the Commission’s Rule exempts mergers or consolidations from being considered a “sale” only for purposes of the registration and prospectus requirements of the 1933 Act and not for any other purpose. Certainly the transaction involves a “purchase” of the securities of the surviving corporation by those of the constituents, assuming that their rights and interests are at all affected. If the insiders try to impose an unfair plan, for example, by the weight of their own two-thirds voting power, where the remain-

59. Del. Gen. Corp. L. § 262(k) (2 P-H Corp. (July 3, 1967)). Unless the certificate of incorporation provides otherwise, appraisal rights are denied when the issue is listed on a national securities exchange, or is held of record by at least 2,000 holders. At this writing it appears that Pennsylvania, at least, is gestating a similar enactment.
62. Bromberg § 1.1, at 5.
64. The definition appears in § 2(5) of the 1933 Act, 15 U.S.C. § 77b(3) (1964). It includes any disposition for value.
ing one-third of the shares are listed on an exchange or held by more than 2,000 holders, the Rule may well offer succor, although under the earlier Delaware cases there would be no hope.

Does a plaintiff have a good cause of action under the Rule if he purchases securities after a defendant issuer has filed misleading data with the Commission or published it to its security holders or to the public generally, causing a rise in market price? The decisions—there are three—seem to deny the plaintiff standing to sue. All were decided in the Southern District of New York; at least one is pending on appeal in the Second Circuit.66 Professor Bromberg appears to anticipate reversal. Indeed he characterizes the decisions in the two cases decided before publication of this book as having “naively disregarded any possible market impact as incidental.”67 Whether remedies under other Sections of the 1934 Act are available in such cases is another matter. Where reports are “filed” with the Commission as required by Section 13 of the 1934 Act68 Professor Bromberg suggests an implied cause of action, citing Miller v. Bargain City USA.69 But Section 18 of the same Act70 creates an express civil remedy based on misleading statements in reports filed with the Commission. Thus as to Form 10-K (the Annual Report required under the 1934 Act), for example, there is no need for implication. But annual reports to shareholders, reports to stock exchanges, publicity releases to the general or the financial press, advice to the statistical services all may contain material which substantially affects markets and which will be widely disseminated and relied upon. None of this type of material is required to be “filed” with the Commission. Although copies of the annual report to shareholders are required to be mailed to the Commission, such transmission is “solely for [the Commission’s] information.”71 This does not constitute a “filing” and Section 18 is inapplicable.72 Therefore, the Rule provides the only available remedy for misleading statement—if remedy there is to be.

67. Bromberg § 7.2(2) n.41, at 151.
71. SEC Rule 14a-3(c) under the 1934 Act, 17 C.F.R. § 240.14a-3(c) (1968).
72. The Instructions for Form 10-K make the distinction by reference at the end of the official form to “Supplemental Information to be Furnished,” 17 C.F.R. § 249.310 (1968). Its utility, for example, in allowing considerably wider latitude, as in appraisals of earnings prospects and general discussion of the company’s plans for the future, is reasonably obvious.
What about the defendants? Must they also be parties to a purchase or sale of securities? Surely not, so long as there is clear causal connection between the defendants' action (or inaction as the case may be) and an actual or potential sale or purchase by the plaintiff. Thus, a claim against directors for causing their corporation (plaintiff in a derivative action) to make a sale of shares to a third party at an inadequate price for the purpose of solidifying the defendants' control states a cause of action under the Rule.\(^3\)

Must the defendants be "insiders"? Certainly not in the sense that limits the category to the issuer itself, its officers, directors or controlling persons. Defendants may be liable under the Rule if they have access to confidential information and misuse it. In *Cady, Roberts & Co.*,\(^4\) liability was extended to an employer and in *Texas Gulf Sulphur*\(^5\) to employees fairly well down the line. It has also been suggested that the Rule may furnish a basis for imposing liability on accountants who are careless in their auditing procedures or in the manner of presentation of financial statements—at least on an " aider and abettor" theory—and thus broaden the narrow doctrine of *Ultramares Corp. v. Touche, Niven & Co.*,\(^7\) generally followed in the state courts.\(^7\)

Finally, when does an "outsider" become an "insider"? Take the case of individuals (or even corporations) who, for whatever purpose, seek control of another enterprise. Usually the first step is quiet market purchases of shares. Public "tender offers" often follow. In either context the investment judgment of the potential seller may well be affected by knowledge of the identity of his purchaser and the purpose of his purchase. Pending legislation in Congress suggests that disclosure is properly required when ten per cent of the outstanding issue has been acquired or contracted to be acquired,\(^7\) in effect casting the

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\(^3\) Ruckle v. Roto American Corp., 339 F.2d 24 (2d Cir. 1964); cf. O'Neill v. Maytag, 339 F.2d 764 (2d Cir. 1964), where recovery was denied because all the directors knew all the facts of the corporate purchase (again from a third party); thus, said a majority of the court, the corporation could not have been "deceived." The decision can be seriously criticized and may well not stand up in the future. See, e.g., Israels, *Corporate Purchase of Its Own Shares—Are There New Overtones?* 50 Cornell L. Q. 620 (1965).

\(^4\) 40 S.E.C. 907 (1961). The director was a registered representative of the respondent firm.

\(^5\) S.E.C. v. Texas Gulf Sulphur Co., 258 F. Supp. 262 (S.D.N.Y. 1966). All defendant directors and officers were exonerated because their purchases had been made before, in the court's judgment, the information had become sufficiently "hard" to warrant the imposition of liability. This is, of course, a major issue on the pending appeal.

\(^6\) 255 N.Y. 170, 174 N.E. 441 (1931).

\(^7\) *Note, Accountants' Liabilities for False and Misleading Financial Statements, 67* Colum. L. Rev. 1427 (1967).
"outsider" as the "insider." The Commission has supported the legislation, but it raises many fascinating questions which, if not determined legislatively, will sooner or later reach the courts.79

5. The Way Out? As Professor Bromberg states, "Few people are content with 10b-5 as it is. Some would like to see it sharply curbed. . . . Still others seek expansion. . . . My own position is in between. . . ."80 So, I think, is that of most experienced practitioners in the field, no matter what their client orientation.

As Professor Bromberg suggests, there are three routes to reform: legislation, amendment of the Rule, and judicial decision. Each has its limitations. The legislative route is almost surely futile. One can all too easily imagine the controversy certain to prevent attainment of the substantial consensus between the Commission, the bar, and the securities industry which seems a prerequisite for Congressional action.81

Amendment of the Rule is another matter. Here the Commission's power is substantive. It could easily impose a standard of scienter or due care.82 It could limit the application of the Rule to defined classes of "insiders."83 Perhaps the Commission could deal with the problem of overlapping causes of action by means of a provision that a state of facts upon which a cause of action in favor of a buyer of securities could be spelled out under Section 11(a) or Section 12(2) of the 1933 Act,84 or in favor of either buyer or seller under Section 18 of the 1934 Act85 shall not be deemed a violation of the Rule.

As to period of limitations, I suspect that the Commission is powerless to legislate by rule. It cannot command the courts to create a cause of action, nor can it negate one,86 or deal in any effective manner with

79. See Brudney, A Note On Chilling Tender Solicitations, 21 Rutgers L. Rev. 609 (1967).
81. That consensus was conspicuously present in 1964, and made possible the adoption in that year of the so-called 1964 amendments, most importantly § 12(g) of the 1934 Act, 15 U.S.C. § 78l(g) (1964), including in the registration requirements of that Act a large number of "over-the-counter" companies. The amendments also subjected the companies to the Commission's proxy rules, and their officers, directors, and ten per cent shareholders to reporting requirements and accountability for short-swing profits under § 16, 15 U.S.C. § 78p (1964).
82. Compare the phrase "with knowledge" in Rule 15cl-2 under the 1934 Act, 17 C.F.R. § 240.15cl-2 (1968), reprinted in Bromberg App. C, at 304.
83. This is really a "many splendored word." It is not necessarily equivalent or limited to the issuer itself (described by Professor Bromberg as "the most inside of insiders," Bromberg § 6.4(1), at 125), nor to an officer, director, 10 per cent shareholder or "controlling person" (as defined in Rule 405 under the 1933 Act, 17 C.F.R. § 230.405(f) (1968).
84. 15 U.S.C. §§ 77k(a) and 1(2) (1964).
86. The attempt of the Comptroller of the Currency to do this in his proxy rules for
purely procedural aspects. But the decisional route remains wide open, and I suggest that the Commission as amicus curiae should mount a powerful argument along the lines of Mr. Justice White's dissent in *UAW v. Hoosier Cardinal Corp.*

I would be sanguine as to the eventual result.

How well this book performs its intended function will depend largely on which door the reader came in by. If he is a lawyer sophisticated in the field, he will find much of interest, and something to question, particularly when Professor Bromberg gets beyond encyclopedic summary and analysis and into the area of judgment of policy and trend. This is not to denigrate the utility of the encyclopedic aspect of the book. It does assemble in one place "all the law there is." The practitioner must then check through every issue of the CCH Federal Securities Law Reporter subsequent to the last looseleaf supplement. Then, depending on the correspondence between the facts before him and those of one or more decided cases (which, as this book indicates, may go both ways on the same point), he must reach the mature judgment necessary for an opinion to be expressed to his client. How far this can be safely done by the lawyer lacking years of experience and "feel" for the likely attitudes of the Commission and the Courts will depend on the clarity of the facts and applicable precedents. In my view the suggestion that this book will have any genuine usefulness for the business executive is pure publisher's propaganda. At most it waves a red flag that warns: "Don't move without consulting counsel."

The general practitioner seeking education in the intricacies of the Rule and the decisions under it will find help in this book. He will have to read it from cover to cover and try to absorb a working knowledge of the broad spectrum before he can safely advise a client in any except the simplest of fact patterns—the equivalent of *Kardon* or the like, however, such phenomena cannot be classified as "non-recurring."

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