The Law of Fogel v. Chestnutt: An Historical Analysis

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Introduction

One of the facts that identifies law as a profession is the phenomenon of the first year of law school. For the lay public, it must appear remarkable that law students—being trained to operate in worlds that are changing with increasing rapidity—should nevertheless spend their first year analyzing many of the same judicial decisions studied during their predecessors' first year.

It is because certain opinions attain a precedential value beyond the facts of the specific disputes they resolve that their study is not inconsistent with the learning of contemporary doctrine. Public acceptance of the profession, however, rests precisely on the ability to blur this distinction between the operational and precedential function of a judicial opinion: to explicate, for the lay public, the mysteries of precedent as though what was involved was a logically coherent series of clearly stated propositions embodied in the opinions in terms of which specific human controversies were resolved.

One of the authors recently analyzed a contemporary opinion, Fogel v. Chestnutt, as a demonstration of the fact that the difference between the work of a professional expert and a technician (the difference, for example, between things called judicial opinions as opposed to administrative rulings) is ultimately a matter of style. The profession, however, has interpreted that opinion as based on the fact that “the outside directors had not had the opportunity to make an informed business judgment” because “the management directors (who arguably had an interest in not pursuing recapture) had failed to make the independent directors adequately aware of the possible techniques for recapture and to point out the advantages and disadvantages of adopting them.”

Since the public function of the judicial opinion is to provide “the link between rationale and result that distinguishes law from fiat,” and since the value of the legal profession to the lay public is a function of the extent to which lawyers are perceived as possessed of a unique skill (the reading of judicial opinions), acceptance of this interpretation may well entail serious consequences in connection with the status and role of the profession—and thus the nature of law—in the contemporary world.

Moreover, even if the law is a matter of style, the crucial style for this nation is that of the Supreme Court of the United States, and we cannot understand the style of the Burger Court unless we understand the style of the Warren Court, how the two styles differ, and why.

The essential quality of the Warren Court approach to constitutional adjudication was to seek the right result. Faced with limitations on its time, that Court, as it moved away from the role of ruling that something was constitutional or not, and toward concern with affirmative results, began to establish rules, that is, positive assertions as to what would be constitutional.

The limitations on this approach are a consequence of the limitations inherent in the rule-making technique. The fundamental defect of proceeding by rules is that one selects a few features of an event and prescribes a result that is to follow if those features are present. A result reached under a rule will remain what is intended only if all the other facts turn out not to be relevant. If, however, the facts not specified in the rule turn out to be relevant and more important than the rule-specified facts, then the result reached under the rule will become unintended.

This dilemma can be illustrated from the history of the Miranda rules, which produced a procedure within the control of the police.

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4 Deutsch, note 2 supra, at 375.
5 See, e.g., Railway Clerks v. Allen, 373 U.S. 113 (1963), especially at 123 n.8, and App. at 124-129.
It proved to be no great challenge to comply with the rules and still obtain confessions. Worst of all for the accused, however, the jury trial on the basic issue of voluntariness had been lost.

As a result, one of the effects of the Miranda rules was to shift significant power to the lower federal judiciary, since judges unsympathetic to the rules could comply with their literal formulations while still sustaining confessions. In this sense, Miranda represents an implementation of formal rule-making power by the Supreme Court of the United States, at the cost of losing the substantive power to correct individual failures of justice on the part of the subordinate judiciary.

The Judicial Opinion as Political Document

A reading of Fogel v. Chestnutt consonant with this view of Miranda as a decision whose effects are the product of relationships among different levels of the judiciary would view the Fogel opinion as “a political document, whose focus is the activities of federal trial and appellate judges.” Such a reading is premised on a view of appellate tribunals as engaged in the process of delineating the ways in which trial courts should apply the law. It follows that the Burger Court, in implementing a shift in style from the Warren process that characterized reactions to the activities of the Warren Court. The extent to which such self-consciousness concerning process exists in the lower appellate judiciary is perhaps most clearly demonstrated in the Second Circuit’s denial of en banc rehearing in Green v. Santa Fe Industries, Inc., because “with four senior judges sitting . . . the law of the circuit might well be charted in such cases as Washington v. Davis and Buffalo Forge v. United Steel Workers, which contain “laundry lists” of lower court opinions that are disapproved.

In professional terms, however, it is Hicks v. Miranda that is the most striking variation on these techniques. In that case, the Supreme Court declared that lower courts are bound by summary decisions of the Supreme Court dismissing appeals from state courts for want of a substantial federal question. The unprecedented nature of that holding was demonstrated when the Fourth Circuit refused to consider a constitutional attack upon a massage parlor ordinance because the Supreme Court had dismissed an appeal from the Virginia Supreme Court for want of a substantial federal question. Mr. Justice Clark, who was sitting as a member of the panel by designation, stated that “the Supreme Court’s statements in Hicks v. Miranda . . . to the effect that such dismissals are decisions on the merits, seem to me to fly in the face of the long-established practice of the Court at least during the eighteen Terms in which I sat.” It is a fact, however, that the Seventh Circuit and the Third Circuit have acted in accordance with the Fourth Circuit’s example.

Such Supreme Court holdings, insofar as they succeed in producing a shift in lower court decisional processes, will, of course, intensify the self-consciousness about the policies of the judicial process that characterized reactions to the activities of the Warren Court. The extent to which such self-consciousness concerning process exists in the lower appellate judiciary is perhaps most clearly demonstrated in the Second Circuit’s denial of en banc rehearing in Green v. Santa Fe Industries, Inc., because “with four senior judges sitting . . . the law of the circuit might well be charted

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4 Deutsch, note 2 supra, at 381.
7 96 S. Ct. 3037 (1976).
10 See also Alyeska Pipeline Co. v. Wilderness Soc’y, 421 U.S. 240, 270 (1975).
13 Sidle v. Majors, 536 F.2d 1156 (7th Cir. 1976).
with the concurrence of only a minority of the active judges," and because “[a] case in which Supreme Court resolution is inevitable should not be permitted to tarry . . . except when the views of this Court would be of real benefit to the Supreme Court.” \(^{15}\)

This self-consciousness has its roots in the work of Henry Hart, the scholar who taught a generation of lawyers and law students that the most fruitful way to analyze the law was as a process rather than by a focus on the substantive rules contained in the opinions resolving particular controversies. Hart’s vision is ultimately rooted in the fact that the political structure of our society is federal in nature, as evidenced in the penultimate exchange in “The Power of Congress to Limit the Jurisdiction of Federal Courts: An Exercise in Dialectic”:

“Q. But Congress can regulate the jurisdiction of state courts, too, in federal matters.

“A. Congress can’t do it constitutionally. The state courts always have a general jurisdiction to fall back on. And the Supremacy Clause binds them to exercise that jurisdiction in accordance with the Constitution.” \(^{16}\)

Given this view that the ultimate constitutional safeguard is provided by state law as opposed to the provision of a federal forum, it was perhaps to be expected that the Second Circuit’s certainty that its views on the question of whether:

“Section 10(b) and Rule 10b-5 authorize federal courts, in the absence of any allegation of misrepresentation or non-disclosure, to condemn, as breach of corporate fiduciary duty, conduct that is expressly sanctioned by the state that created the corporation, and to impose on the use of the state short-form merger statute requirements it is conceded the law of the state does not oppose” \(^{17}\)

“would [not] be of real benefit to the Supreme Court” \(^{18}\) would result from the latter’s decision in Blue Chip Stamps v. Manor Drug Stores, which held that “[W]e are of the opinion that Birnbaum v. Newport Steel Corp., 193 F. 2d 461 (C.A. 2, 1952) was rightly decided, and that it bars respondent from maintaining this suit under Rule 10b-5.” \(^{19}\)

Precisely what the meaning of that holding will be is, of course, a matter of prophecy, since, when Blue Chip was decided, the status of the Birnbaum ruling, even in the Second Circuit, was that “although some courts have held that a private party not a purchaser or seller, seeking injunctive relief, may have standing to assert a § 10(b) violation . . . and another has suggested the elimination of the purchaser-seller requirement . . . it is still the rule in this Circuit that the requirement be satisfied in a suit for damages.” \(^{20}\)

The basis for the Blue Chip holding, however, seems clearly to have been an attempt to bring to a halt a rule-making process that appeared relatively easy to arrest since it had been implemented largely by subordinate appellate tribunals.

“We quite agree that if Congress had legislated the elements of a private cause of action for damages, the duty of the Judicial Branch would be to administer the law which Congress enacted; the judiciary may not circumscribe a right which Congress has conferred because of any disagreement it might have with Congress about the wisdom of creating so expansive a liability. But as we have pointed out, we are not dealing here with any private right created by the express language of § 10(b) or of Rule 10b-5. No language in either of those provisions speaks at all to the contours of a private cause of action for their violation. However flexibly we may construe the language of both provisions, nothing in such construction militates against the Birnbaum rule. We are dealing with a private cause of action which has been judicially found to exist, and which will have to be judicially delimited one way or another unless and until Congress addresses the question. Given the peculiar blend of legislative, administrative, and judicial history which now surrounds Rule

\(^{15}\) 533 F.2d 1310 (2d Cir. 1976).

\(^{16}\) 66 Harv. L. Rev. 1362, 1001 (1953).

\(^{17}\) Petition for Certiorari in Santa Fe Indus., Inc. v. Green, No. 75-1753.

\(^{18}\) Text at note 15 supra.

\(^{19}\) 95 S. Ct. 1917, 1923 (1975).

10b-5, we believe that practical factors to which we have adverted, and to which other courts have referred, are entitled to a good deal of weight.” 21

The Definition of an Expert

Social Meaning of Expertise

The rationale that justified the expansion of federal jurisdiction resulting from the erosion of the Birnbaum precedent was the need to police the operations of those in control of corporations. Thus, because of such procedural advantages as nationwide service of process, federal securities legislation was perceived as a necessary adjunct to the shareholder's derivative suit developed by the common law to perform that function. The dangers inherent in an overly broad reading of the statutory provisions governing federal securities law was perhaps most succinctly put by Second Circuit Judge Medina in a dissent from an en banc reversal of the dismissal of a 10(b)5 complaint:

"The essence of the claim is that, whenever a corporation through action of its directors sells a block of its own stock, a stockholder can maintain an action in the federal courts under Section 10(b) and Rule 10(b)5 by merely alleging that the price was too low or too high, that the directors 'knew or should have known' it was too low or too high, sealed with the characterization or opinion of the claimant that this was a 'fraud' perpetrated against the corporation. This does indeed open the floodgates. For the result is to transform a simple cause of action against directors for waste or the use of bad judgment in the sale of corporate assets into a federal securities fraud case by judicial fiat.” 22

"What this amounts to is giving carte blanche to every holder of a few shares in any corporation whose stock is traded on the New York or American stock exchanges to give his imagination full rein in the making of any sort of extravagant charges, no matter how ill founded in fact they may be, and then, when faced with a summary judgment motion based upon personal knowledge and documentary proof, say simply 'I know nothing whatever about the matter but hope my lawyer will find something if we conduct extensive discovery proceedings and compel the defendants to produce their complete files.' This, while doubtless not so intended, is in my judgment nothing short of a standing invitation to blackmail and extortion.” 23

Even if one grants that the departure from Birnbaum was excessive in that the course of decision in the Second Circuit overestimated the benefits and underestimated the dangers involved in the expansion of federal jurisdiction, the question remains whether any retreat will strike the proper balance rather than representing simply a countervailing excess or an inadequate correction. To determine whether or not Fogel v. Chestnutt has struck such a balance, it is necessary to define the precedential significance of that decision, and it is our contention that the profession's interpretation of that significance24 ignores the role necessarily played by expertise, not only generally but also in the particular business situation that was being subjected to judicial review in that case.

Thus, despite the fact that “there were . . . business reasons against seeking recapture, at least for the period when reciprocals or give-ups to brokers in return for sales efforts were in vogue,” 25 the Fogel Court held, “in remanding to the district court for the determination of damages” 26 that “the considerations against allowing defendants to attempt to prove that, after independent investigation by the disinterested directors, the board might reasonably have concluded not to recapture . . . similarly foreclose defendants with respect to damages.” 27 The imposition of this remedy of damages upon the defendants is thus justifiable only if the information at issue concerning recapture was material for the consideration of the entire board of directors rather than a matter

23 Id. at 221.
24 See text at note 3 supra.
26 Id. at 755.
27 Id. at 756.
of purely technical expertise properly entrusted to those members of the board regarded by that body as competent to deal with it.

The basis on which this possibility of trusting a smaller group is suggested is the rationale for reliance upon any form of expertise: the fact that the limited amount of time at the disposal of any given human being renders both necessary and efficient the specialization made possible by a division of labor. Division of labor, however, is often far more efficient than necessary, and the latter quality increasingly comes into play to the extent that the activity in question cannot accurately be reduced to a set of techniques, a regular pattern, or formula. In any given conflict, for example (whether political, economic, or military), such concepts as momentum, morale, or strategic advantage are applicable to the war as a whole rather than to an individual battle, precisely because, if enough factors are taken into account, single occurrences can be analyzed so completely as to empty concepts such as morale of content. The fact remains, however, that few wars consist of one battle alone, and that any subsequent battles are fought in the context of all that has gone before, thus rendering the prior analysis of a set of instances necessarily incomplete. Given the premium placed on novelty by the inadequacy of historical analysis in ensuring future success, perhaps the critical test applied by history in determining whether the designation of expert has been earned is the value of the changes introduced into the field of expertise by the person claiming the designation, and the durability of those changes.

The value of expertise is that it provides a basis on which to judge the validity of competing claims within its area, and the danger constantly confronting the expert is the temptation to claim expertise for judgments concerning situations that involve crucial factors located outside that area. What makes innovations so critical a test, then, is that they represent attempts to expand the scope of expertise by persuading the public that such new situations can be encompassed. The recent history of the United States Presidency provides concrete examples of these general propositions, if the question addressed is the implementation of political expertise.

In particular, what an exploration of the recent history of the presidential form of political expertise demonstrates are two closely related characteristics of expertise: First, the extent to which maintenance of any system affecting a lay public not only requires the implementation of expertise, but also constrains the expert; and second, the fact that the expert controls innovation more successfully than a technician confined to implementing a given set of techniques in a logically coherent manner, because of the expert's demonstrated awareness that symbols incapable of complete analysis are crucially important in permitting the lay public to participate in the exercise of expertise. Thus, in contrast to President Eisenhower, whose expertise—developed as the commander of a multinational armed force—consisted of successful orchestration of the work of a variety of experts autonomous within individual substantive fields, President Kennedy attempted to limit that autonomy not only by setting up parallel institutions within the White House, but also by seeking substantive information from junior officers in the various administrative hierarchies. The Nixon Presidency illustrates the extent to which such an attempt to expand the scope of a given form of expertise may result in destruction of the system in terms of which that expertise is exercised. Perhaps even more important, however, is the extent to which such attempts may well change the relationship between any such system and the consumers of its products: "Ask not what your country can do for you; ask what you can do for your country."

That this analysis may be applicable to mutual funds can be illustrated by analogy with insurance. Because of the relatively stringent limits on substantive differences among policies imposed by regulatory authorities, the art of selling a given policy consists largely of convincing prospects that they should prefer one sort of program over another, despite the fact that variations in such things as access to capital and required cash payments are, at least in the long run, to a significant extent mathematical equivalents. Similarly, in the case of mutual funds, the competition for customers must largely take the form of demonstrating to prospects that the particular configuration of capital appreciation, risk, and cash payments historically characteristic of a given fund's performance fulfills the needs created by their particular lifestyle more closely than any competing fund.

Assuming the correctness of this analysis of the basis on which
mutual funds are substituted for individual investment programs, it is presumably the task of the “disinterested” directors, as representatives of the holders of fund shares, to ensure that the particular configuration of elements on the basis of which the fund was sold continues to be maintained. On that assumption, furthermore, the question presented to the Court in Fogel v. Chestnutt can be restated as whether the issue of “recapture” relates to the task of defining the proper configuration of the fund or solely to that body of expertise properly regarded as technical, in that it is concerned solely with the techniques to be utilized in achieving that configuration. It is because of this fact, finally, that that decision surfaces for examination the distinction between technician and expert in terms of the responsibilities necessarily assumed by each in terms of their relationship to the lay public.

Remedies

If the above analysis of the social meaning of expertise has been convincing, the test of judicial expertise would occur in the field known as remedies, since the way in which a judgment is executed defines the extent to which the conclusion arrived at in the judicial decision is attempted to be implemented. In addition, if the above analysis constitutes an accurate description, what is happening to law would represent a reaction to the results of prior judicial innovations.

In connection with the question of the significance to be attributed to the availability of information under federal securities legislation, it seems noteworthy that on the basis of the historical fact that “the derivation of Rule 10b-5 is peculiar,” 28 the author of Fogel v. Chestnutt (in an earlier circuit court decision) concluded that “the consequences of holding that negligence in the drafting of a press release . . . may impose civil liability on the corporation are frightening.” 29 even though he had joined the majority in the earlier opinion in holding insider trading activity “the only truly objective evidence of the materiality of [a mineral] discovery” and

thus disapproving the action of the district court, which had “disregarded” that evidence “in favor of the defendants' expert witnesses, all of whom agreed that one drill core does not established an ore body, much less a mine.” 30

In more general terms, the remedies in terms of which judicial expertise is most seriously at issue today are those involved in school desegregation decrees. Perhaps the most explicit judicial recognition of the factors that resulted in this situation occurred in Hobson v. Hansen, in which Judge Skelly Wright noted that

“It is regrettable, of course, that in deciding this case this court must act in an area so alien to its expertise. It would be far better indeed for these great social and political problems to be resolved in the political area by other branches of government. But these are social and political problems which seem at times to defy such resolution. In such situations, under our system, the judiciary must bear a hand and accept its responsibility to assist in the solution where constitutional rights hang in the balance.” 31

The purpose of the Hobson litigation was to ensure for the poor and black a right to equal educational opportunity with the white middle class. To achieve that result—and it is important to stress that that result has not in fact been achieved—Judge Wright ordered a massive intervention into the administrative operations of the District of Columbia school system to ensure equalization of expenditures, which, in a later opinion, 32 was defined as requiring that per-pupil expenditures on the salaries and benefits of teachers in any elementary school should not differ more than 5 percent from the mean expenditure in all such schools. That history appears to have demonstrated the impossibility—or perhaps the irrelevance—of implementing so rigid a formula, seems to us less significant than that history may also provide a satisfactory answer to the query as to why the attempt was undertaken.

Acts 3 and 5 of the Second Extraordinary Session of 1961 rep-

29 Id. at 866.
30 Id. at 851.
resented responses by the Louisiana Legislature to *Bush v. Orleans Parish School Board*, in which a three-judge court (on which Judge Wright sat) successfully issued restraining orders and injunctions running directly against the Legislature. These acts, passed as a result of the attempt on the part of the School Board of Orleans Parish to comply with a court order to desegregate, created two new crimes: the giving to or acceptance by any parent of anything of apparent value as an inducement to sending a child to a school operated in violation of Louisiana law; and the doing of any act to a parent or child to influence that person to do any act in violation of that law.

The Louisiana Attorney General's defense of the Acts consisted of the arguments that the Acts were so vague that the state courts would hold them illegal, and that they were irrelevant to the subject matter of the *Bush* litigation on the ground that the phrase "in violation of any law of this state" could not refer to desegregated schools because all of the state laws that required school desegregation had been held unconstitutional by the federal courts. What the *Bush* court relied on in justifying the use of federal judicial power to void state legislative acts in the field of criminal law was the historical fact that all contemporary Louisiana legislation designed to prevent desegregation had used that phrase and that the context of those statutes had made it clear that the phrase "in violation of" meant desegregated schools. What the *Hobson* court overlooked was the historical fact that the meanings of contexts change, and that history itself is one of the forces producing such transformations.

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34 Id. at 182-187.