

SECURITIES REGULATION: RULE 10b-5 PURCHASER/
SELLER REQUIREMENT SATISFIED EVEN WITHOUT
ACTUAL SALE IN SHORT-FORM MERGER SITUATION

THE Second Circuit, in *Vine v. Beneficial Finance Co.*,¹ has allowed a civil liability action under section 10 (b) of the Securities Exchange Act² and rule 10b-5³ even though the plaintiff had not actually sold his stock. When Beneficial Finance, a major small-loan company, became interested in acquiring Crown Finance, Beneficial arranged with the officers and directors of Crown to buy at a premium their Class B stock which held voting control. Beneficial then made a public tender to Class A holders, whose stock had sizable dividend and liquidation advantages. Having thereby acquired 95% of all shares, Beneficial executed a short-form merger.⁴ This purchase scheme resulted in an 800,000 dollar saving for Beneficial and a 900,000 dollar gain for the B shareholders, all at the expense of the A holders. However, Vine, one of the A holders, refused the tender. Thus, when he sued, the district court dismissed, reasoning that the plaintiff had to qualify as a seller in order to bring a 10b-5 action.⁵ In reversing, the Second Circuit attributed the requisite status to Vine since the short-form merger gave him no alternative but sale. Moreover, it held that a plaintiff's reliance on the fraud need not be shown in the case of a forced sale.⁶

Although section 10 (b) of the Securities Exchange Act and its implementing rule 10b-5 broadly proscribe fraud "in connection with the purchase or sale" of securities, the private actions subsequently allowed⁷ under those provisions have been subject to some limitations. For example, the plaintiff must prove a causal connection between the fraud and the harm which he suffered⁸ as well as some

¹ 374 F.2d 627 (2d Cir. 1967).

² 48 Stat. 891 (1934), 15 U.S.C. § 78j (b) (1964).

³ 17 C.F.R. § 240.10b-5 (1964, Supp. 1966).

⁴ 374 F.2d at 630-31; See N.Y. BUS. CORP. LAW § 905.

⁵ 252 F. Supp. 212 (S.D.N.Y. 1966).

⁶ 374 F.2d at 634-35.

⁷ See, e.g., *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946); cf. notes 9-10, 13-24 *infra* and accompanying text.

⁸ See *Barnett v. Anaconda Co.*, 238 F. Supp. 766, 773 (S.D.N.Y. 1965); *Kremer v. Selheimer*, 215 F. Supp. 549 (E.D. Pa. 1963).

degree of reliance upon the deceptive statements of his defendant.⁹ Moreover, while courts have abandoned any privity requirement¹⁰ and given an expansive interpretation to the "in connection with" clause of section 10 (b),¹¹ a restrictive "buyer/seller" test, first enunciated in *Birnbaum v. Newport Steel Corp.*,¹² still remains. In that action, the court reasoned that rule 10b-5 was promulgated only to perfect the securities law which had not previously proscribed fraudulent *buying* of securities and that, therefore, persons who were neither sellers nor buyers were not to be included in the protected class.¹³

Although the *Birnbaum* test has yet to be rejected expressly, its seemingly rigid classifications have been expanded to accommodate varied transactions. Hence, both the initial issuance of securities¹⁴ and the exchange of stock for stock in a corporate merger¹⁵ have been recognized as involving a purchase or sale under 10b-5. An underwriter's unexecuted agreement to distribute an issue¹⁶ and an investor's unfilled promise to purchase stock from a broker¹⁷ have also been deemed to satisfy the *Birnbaum* rule. Likewise, one who secures a stock purchase loan with a portion of the acquired shares is given "buyer" status in an action against a collateral holder who unlawfully disposes of the securities.¹⁸

⁹ See *Rogen v. Ilikon Corp.*, 361 F.2d 260, 266-68 (1st Cir. 1966); *List v. Fashion Park, Inc.*, 340 F.2d 457, 462-64 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965). *But see* note 27 *infra* and accompanying text. See generally Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 Nw. U.L. REV. 627, 678-80 (1963).

¹⁰ *Miller v. Bargain City, U.S.A., Inc.*, 229 F. Supp. 33, 37-38 (E.D. Pa. 1964); *Brown v. Bullock*, 194 F. Supp. 207, 229-30 (S.D.N.Y. 1961); see *New Park Mining Co. v. Cranmer*, 225 F. Supp. 261, 266 (S.D.N.Y. 1963); *Cochran v. Channing Corp.*, 211 F. Supp. 239 (S.D.N.Y. 1962); *Texas Continental Life Ins. Co. v. Bankers Bond Co.*, 187 F. Supp. 14 (W.D. Ky. 1960), *rev'd on other grounds sub nom. Texas Continental Life Ins. Co. v. Dunne*, 307 F.2d 242 (6th Cir. 1962); Comment, 59 YALE L.J. 1120, 1137 (1950).

¹¹ See, e.g., *Stockwell v. Reynolds & Co.*, 252 F. Supp. 215 (S.D.N.Y. 1965); *Cooper v. North Jersey Trust Co.*, 226 F. Supp. 972 (S.D.N.Y. 1964); *M. L. Lee & Co. v. American Cardboard & Packaging Corp.*, 36 F.R.D. 27 (E.D. Pa. 1964).

¹² 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

¹³ *Id.* at 463.

¹⁴ See, e.g., *Simon v. New Haven Board & Carton Co.*, 250 F. Supp. 297 (D. Conn. 1966).

¹⁵ See, e.g., *Voegel v. American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965); *H. L. Green Co. v. Childree*, 185 F. Supp. 95 (S.D.N.Y. 1960).

¹⁶ *M. L. Lee & Co. v. American Cardboard & Packaging Corp.*, 36 F.R.D. 27 (E.D. Pa. 1964).

¹⁷ *A. T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967), 1967 DUKE L.J. 894.

¹⁸ *Cooper v. North Jersey Trust Co.*, 226 F. Supp. 972 (S.D.N.Y. 1964).

Even the fraudulently induced deferral of sale followed at a later date by sale at a loss has been determined to be fraud "in connection with a sale" and thus actionable under 10b-5.¹⁹ However, the *Birnbaum* test was given one of its most liberal applications in *Voege v. American Sumatra Tobacco Corp.*²⁰ where, on facts substantially identical to *Vine*, the plaintiff had bought the stock twenty years before the time of trial. When a public tender followed by a short-form merger threatened her with a forced sale, she brought suit under 10b-5. The court found that by Delaware corporate law she had purchased under an implied contract to sell in case of a short-form merger. Since a contract to sell is treated as a sale under the Securities Exchange Act,²¹ plaintiff was a seller.²² Having thus isolated a twenty-year-old contract to sell which could be coupled with the recent fraud, the court then found the requisite reliance in "the justifiable assumption [at the time of purchase] that any merger would deal with her fairly. . . ."²³ Whatever the merits of the *Voege* approach, the district court in *Vine* distinguished it by reasoning that *Vine*, unlike *Voege*, had not exhausted state remedies available to stop the merger.²⁴

In reversing the district court's dismissal of *Vine*'s complaint, the Second Circuit noted the expansive construction the cases have given the "sale" concept and accordingly held that *Vine* was a seller for 10b-5 purposes since the short-form merger and consequent freezing of his assets left him no alternative but sale.²⁵ Moreover, even though reliance may be necessary in some cases, the court regarded it as "unnecessary . . . when no volitional act is required and the result of a forced sale is exactly that intended by the wrongdoer."²⁶ Similarly, the court refused to regard the possible existence of a state remedy as relevant to the availability of a federal right. The SEC, as amicus, had requested the court to go further and to determine that in merger cases such as the instant one, a plaintiff-shareholder may sue under rule 10b-5 irrespective of whether he relinquished his

¹⁹ *Stockwell v. Reynolds & Co.*, 252 F. Supp. 215 (S.D.N.Y. 1965).

²⁰ 241 F. Supp. 369 (D. Del. 1965).

²¹ See 48 Stat. 884 (1934), 15 U.S.C. § 78c(a)(14) (1964).

²² 241 F. Supp. at 374.

²³ *Id.* at 375.

²⁴ 252 F. Supp. 212, 214-15 (S.D.N.Y. 1966).

²⁵ 374 F.2d at 634.

²⁶ *Id.* at 635.

holding "so long as the Rule has been violated and plaintiff's stock lost value as a result," but the court merely noted that the contention was "interesting."²⁷

While the Second Circuit was able to fit *Vine* within the *Birnbaum* standard, a better approach would have been to disregard the buyer/seller shibboleth and to decide the case expressly on the language and policy of section 10 (b) and rule 10b-5. As the *Birnbaum* court observed, 10b-5 was added so that action could be taken against fraudulent buyers as well as fraudulent sellers. However, that interpretation does not necessarily require that *only* defrauded buyers and sellers are allowed private remedies under 10b-5, especially since section 10 (b) and rule 10b-5 did not explicitly contemplate civil liability²⁸ and thus could not have identified precisely those deserving recovery. While the buyer/seller test may have some merit in barring suits alleging no more than a breach of fiduciary duties,²⁹ complex arguments straining to meet the literal language of "buyer" or "seller," detract from a well-formulated overall rule upon which courts and litigants can rely. Further, the *Birnbaum* doctrine directs attention away from the allegations of fraudulent sale or purchase and the causal connection to the plaintiff's loss and instead concentrates on the status of the plaintiff. As an alternative, rule 10b-5 civil liability could be predicated on an investor's loss which is proximately caused by fraud or deceit *in connection with* the purchase or sale of securities.³⁰ This standard would appear to meet the statutory intent of protecting the investing public while still restricting 10b-5 liability to cases directly tied to fraudulent securities transactions.

²⁷ *Id.* at 636.

²⁸ See Ruder, *supra* note 9, at 642-60. Cf. *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964) (approval of civil liability under section 14 (a) Securities Exchange Act).

²⁹ See, e.g., *O'Neill v. Maytag*, 230 F. Supp. 235, 239-40 (S.D.N.Y. 1964) (waste and mismanagement claim not actionable under 10b-5). See generally Comment, 74 *YALE L.J.* 658, 680-82 (1965).

³⁰ See Comment, 74 *YALE L.J.* 658, 671-74 (1965).