

# INROADS ON THE NECESSITY FOR A CONSUMMATED PURCHASE OR SALE UNDER RULE 10b-5

*The traditional application of rule 10b-5 has required that there be fraud in connection with the purchase or sale of a security. While the Birnbaum rule that a plaintiff be an actual purchaser or seller has been debilitated and the definition of "purchase or sale" considerably expanded, the necessity for some consummated transaction in securities has remained effectively unchallenged. This note explores the manner in which the "in connection with" language of 10b-5 may be extended to encompass securities frauds in situations involving no consummated purchase or sale transaction.*

**R**ule 10b-5,<sup>1</sup> promulgated by the Securities and Exchange Commission under the authorization of section 10(b) of the Securities Exchange Act of 1934,<sup>2</sup> proscribes fraud in connection with the purchase or sale of securities. Civil claimants<sup>3</sup> under 10b-5, however, have not been subjected to a rigid adherence to the

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<sup>1</sup> 17 C.F.R. § 240.10b-5 (1967) reads as follows: "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in an 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."

<sup>2</sup> 15 U.S.C. § 78j(b) (1964) reads as follows: "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange— . . . (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

<sup>3</sup> Rule 10b-5 did not expressly provide a civil remedy, but in *Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), the court recognized an implied civil remedy. The court based its ruling upon the tort theory that a statute extends a cause of action to those whose interests it was passed to protect. RESTATEMENT (SECOND) OF TORTS § 286 (1964). Section 17 of the Securities Act of 1933, 15 U.S.C. § 77q, is virtually identical in language with Rule 10b-5 except that it only applies to misdeeds in connection with the sale of securities. Since section 17(a) expressly provides for civil liability, recognition of the right to

common law elements of fraud.<sup>4</sup> Depending on the policy sought to be protected,<sup>5</sup> the courts, to varying degrees, have emphasized or minimized such traditional fraud requirements as privity,<sup>6</sup> scienter,<sup>7</sup> and reliance.<sup>8</sup> Certain restraints, however, have been imposed on 10b-5 claimants. One of the most long-lived of these limitations was established in *Birnbaum v. Newport Steel Corp.*,<sup>9</sup> in which the Second Circuit ruled that the claimant must be a "defrauded purchaser or seller"<sup>10</sup> in order to maintain his action under 10b-5. Closely related to the *Birnbaum* purchaser-seller doctrine, but distinct therefrom, is the question of whether a consummated purchase or sale is a prerequisite for 10b-5 relief. This note will examine the "in connection with" language of 10b-5 and the cases which have interpreted that language in order to determine whether 10b-5 is limited by a transactional requirement.

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civil relief under 10b-5 in order to eliminate the disparity between the liability of sellers and purchasers appears to be a logical extension.

<sup>4</sup> *Mut. Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 544 (2d Cir. 1967); *Stevens v. Vowell*, 343 F.2d 374, 379 (10th Cir. 1965). For an examination of the common law elements of fraud see W. PROSSER, *THE LAW OF TORTS* §§ 100-03 (3d ed. 1964) [hereinafter cited as PROSSER]. See also *Cady, Roberts & Co.*, 40 S.E.C. 907, 910 (1961).

<sup>5</sup> A few of the sometime conflicting often unarticulated, policy considerations that might influence a court's decision are (1) the court's concern that business executives seemingly innocent of any intentional wrongdoing not be treated under the federal fraud statutes; (2) the court's hesitance to expand federal corporate law; and (3) the court's desire to give the fullest protection to the investing public.

<sup>6</sup> Compare *Freed v. Szabo Food Serv., Inc.*, CCH FED. SEC. L. REP. ¶ 91,317 (N.D. Ill. 1964) and *Cochran v. Channing Corp.*, 211 F. Supp. 239, 243-44 (S.D.N.Y. 1962), with *Meisel v. North Jersey Trust Co.*, 218 F. Supp. 274 (S.D.N.Y. 1963). See generally 3 L. LOSS, *SECURITIES REGULATION* 1767 (2d ed. 1961) [hereinafter cited as LOSS]; Comment, *Civil Liability Under Section 10B and Rule 10B-5: A Suggestion for Replacing the Doctrine of Privity*, 74 YALE L.J. 658 (1965).

<sup>7</sup> See *SEC v. Van Horn*, 371 F.2d 181 (7th Cir. 1966); *Kohler v. Kohler Co.*, 319 F.2d 634 (7th Cir. 1963); *Ellis v. Carter*, 291 F.2d 270, 274 (9th Cir. 1961); *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); Note, *Proof of Scienter Necessary in a Private Suit Under SEC Anti-Fraud Rule 10b-5*, 63 MICH. L. REV. 1070 (1965). But see *Weber v. C.M.P. Corp.*, 242 F. Supp. 321 (S.D.N.Y. 1965); *Trussell v. United Underwriters, Ltd.*, 228 F. Supp. 757 (D. Colo. 1964); cf. *Dack v. Shanman*, 227 F. Supp. 26 (S.D.N.Y. 1964).

<sup>8</sup> See, e.g., *Speed v. Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951); Ruder, *Civil Liability Under 10b-5: Judicial Revision of Legislative Intent?* 57 NW. U.L. REV. 627, 678 (1963).

<sup>9</sup> 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

<sup>10</sup> 193 F.2d at 464. But see *McManus v. Jessup & Moore Paper Co.*, 5 SEC Jud. Dec. 810 (E.D. Pa. 1948).

*The Birnbaum Purchaser-Seller Doctrine*

The *Birnbaum* doctrine until recently presented a very significant hurdle to 10b-5 claimants seeking to question the existence of a transactional requirement. Indeed, the *Birnbaum* purchaser-seller requirement had been interpreted by later courts as determining the standing of a 10b-5 claimant to bring suit.<sup>11</sup> Under *Birnbaum* only a person who had been defrauded in connection with his own actual purchase or sale of securities was entitled to 10b-5 relief. The *Birnbaum* rule, however, has been significantly emasculated under increasing academic,<sup>12</sup> administrative,<sup>13</sup> and judicial<sup>14</sup> criticism. The Second Circuit itself has hastened the demise of *Birnbaum* by three recent decisions<sup>15</sup> which expanded the more traditional meaning of "purchaser" and "seller." These three decisions led one district court to the conclusion that, even though not explicitly overruled by the Second Circuit, *Birnbaum* no longer

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<sup>11</sup> See, e.g., *Dasho v. Susquehanna Corp.*, 380 F.2d 262, 269-70 (7th Cir.), cert. denied, 389 U.S. 977 (1967); *Greater Iowa Corp. v. McLendon*, 378 F.2d 783, 791 (8th Cir. 1967).

<sup>12</sup> See Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for 10b-5*, 54 VA. L. REV. 268 (1968); Comment, *The Purchaser-Seller Limitation to SEC Rule 10b-5*, 53 CORNELL L. REV. 684 (1968). Professor Loss has suggested that the SEC could adopt rules specifically aimed at the elimination of the *Birnbaum* doctrine. 3 Loss at 1469 n.87.

For an analysis of the *Birnbaum* case which suggests that section 10(b) may be read to afford protection for abuses in securities transactions without a limitation of the class of plaintiffs to purchasers or sellers, see Leech, *Transactions in Corporate Control*, 104 U. PA. L. REV. 725, 832-35 (1956).

<sup>13</sup> The SEC, as amicus, in both *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 & n.3 (2d Cir. 1967), and *Vine v. Beneficial Fin. Co.*, 374 F.2d 627, 633 & n.6, 635 (2d Cir. 1967), argued that the *Birnbaum* doctrine was a judicially established limitation not necessarily required by the language of section 10(b).

<sup>14</sup> *Entel v. Allen*, 270 F. Supp. 60 (S.D.N.Y. 1967), noted in 42 N.Y.U.L. REV. 978 (1967). But see *Knauff v. Utah Constr. & Mining Co.*, 408 F.2d 958, 961 (10th Cir. 1969).

<sup>15</sup> *A.T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967) (see note 50 *infra* and accompanying text); *Vine v. Beneficial Fin. Co.*, 374 F.2d 627 (2d Cir. 1967). In *Vine*, the plaintiff was allowed standing to bring his suit under 10b-5 even though he had not participated in a securities transaction. Defendant had acquired 95% of the corporation in which plaintiff was a shareholder. Defendant executed a statutory short-form merger but plaintiff refused defendant's tender. Still holding his shares, plaintiff brought suit alleging a violation of 10b-5 and the court granted him standing on the grounds that plaintiff, in effect, was a "forced seller" of his securities. *Symington Wayne Corp. v. Dresser Indus., Inc.*, 383 F.2d 840 (2d Cir. 1967). In *Symington* the plaintiffs, minority shareholders of Symington-Wayne, sought to enjoin the defendant's tender offer by alleging certain 10b-5 violations. The court ruled on the merits of the plaintiff's claim without consideration of the standing issue. Clearly the plaintiffs were not purchasers or sellers. Disregarding the eventual refusal to enjoin the defendant's activity, importance should be given to the fact that the court decided the issue on its merits, whereas *Birnbaum* gave the court ready basis for summary dismissal.

could be looked upon as restricting the class of 10b-5 claimants to actual purchasers or sellers.<sup>16</sup>

*The Interaction of Sections 3(a) and 3(a)(14) with Rule 10b-5*

Since the decline of *Birnbaum*, the more important consideration in examining the possible limitation of 10b-5 to transactional frauds is the statutory language of sections 3(a)(13)<sup>17</sup> and 3(a)(14).<sup>18</sup> Section 3(a)(13) defines "purchase" to include any *contract* to purchase or acquire, and section 3(a)(14) defines "sale" to include any *contract* to sell or otherwise dispose of. Arguably, when these definitions are read into 10b-5, they require either a binding executory contract for the purchase or sale of securities or a completed purchase or sale before an action is available under the rule. Only a few courts, all at the trial level, have dealt with the question of the necessity of a consummated transaction in 10b-5 actions. In *M.L. Lee & Co. v. American Cardboard & Packing Corp.*,<sup>19</sup> the court upheld the right of a promisee under an executory contract to bring suit under 10b-5 for alleged fraud in connection with an aborted contract whereby the promisor had agreed to buy the promisee's capital stock. Although the court phrased the issue in the case as whether 10b-5 required a *consummated* purchase or sale,<sup>20</sup> the court's resolution of the case made it unnecessary to address this issue since such a transaction was in fact found to be present. Relying on sections 3(a)(13) and 3(a)(14) as providing the statutory basis for the promisee's action, the court found the existence of an executory contract for the purchase and sale of securities which qualified the transaction

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<sup>16</sup> *Entel v. Allen*, 270 F. Supp. 60, 69-70 (S.D.N.Y. 1967).

<sup>17</sup> 15 U.S.C. § 78c(a)(13) (1964) (emphasis added) provides: "The terms 'buy' and 'purchase' each include any *contract* to buy, purchase, or otherwise acquire."

<sup>18</sup> 15 U.S.C. § 78c(a)(14) (1964) (emphasis added) provides: "The terms 'sale' and 'sell' each include any *contract* to sell or otherwise dispose of."

<sup>19</sup> 36 F.R.D. 27 (E.D. Pa. 1964). *Lee* involved an underwriter who loaned money to a corporation pursuant to an agreement between the parties whereby the underwriter agreed to buy the corporation's stock prior to its "going public." The underwriter sued the corporation on the loan and the corporation counterclaimed alleging that the underwriter had violated section 10(b) and rule 10b-5 in that he had refused to perform the contract for the purchase of the corporation's stock. The court's decision is on the plaintiff's motion for dismissal of the counterclaim for failure to state a claim under 10b-5.

<sup>20</sup> The *Lee* court stated the question raised by the case as being the following: "Does Rule 10b-5 require a consummated purchase or sale for a claim to be asserted on the basis of fraud?" 36 F.R.D. at 30.

between the promisee and promisor as a "purchase or sale" within the ambit of the Securities Exchange Act.<sup>21</sup> The significance of the *Lee* case, therefore, lies primarily in the court's recognition of the applicability of 3(a)(13) and 3(a)(14) to section 10(b).

In *Goodman v. H. Hentz & Co.*,<sup>22</sup> the court upheld the right of a customer to sue under 10b-5 for damages suffered when a broker "sold" the customer non-existent securities. Even though there could be no completed transaction in such a case, the court reasoned that 10b-5 proscribed fraud *in connection with* the purchase or sale of securities and that it would unjustly restrict the phrase "in connection with" if this language were to be applied only to *consummated* transactions.<sup>23</sup> Further, reasoning that if the defendant had "perpetrated lesser frauds, such as misrepresentations concerning quality of stocks he recommended . . . or excessive churning of an account to create commissions,"<sup>24</sup> he would have clearly been within the ambit of 10b-5, the court found it inconsistent to deny the plaintiff 10b-5 relief because "the fraud was so substantial that [the] entire transaction . . . amounted to complete conversions of the [plaintiff's] funds."<sup>25</sup> The *Goodman* court, without citing any supporting cases or statutory language other than the "in connection with" language of 10b-5, was willing to overlook the lack of a completed transaction in securities in order to implement the protections accorded the investing public by section 10(b) and rule 10b-5.<sup>26</sup> In contrast to the analysis in the *Lee* case, the *Goodman* holding was not centered around the statutory definition of a purchase or sale under 3(a)(13) and 3(a)(14) although a "contract to purchase" was clearly present. The *Goodman* court apparently found the "in connection with" language of 10b-5<sup>27</sup> to be all that was necessary.

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<sup>21</sup> *Id.* at 31.

<sup>22</sup> 265 F. Supp. 440 (N.D. Ill. 1967).

<sup>23</sup> "The court finds no justification in the legislative history of the [Securities Exchange] Act or in the cases for reading this phrase [the "in connection with" phrase of section 10(b)] as if it read merely 'in the purchase or sale' rather than 'in connection with the purchase or sale.'" 265 F. Supp. at 444.

<sup>24</sup> *Id.* at 445.

<sup>25</sup> *Id.* at 444-45.

<sup>26</sup> See notes 52 & 59 *infra*.

<sup>27</sup> See note 23 *supra*.

Commerce Reporting Co. v. Puretec, Inc. *Undermines the 10b-5 Transactional Requirement*

Most recently the transactional requirement has been examined by the district court for the Southern District of New York in *Commerce Reporting Co. v. Puretec, Inc.*<sup>28</sup> Although an earlier case in the same district had suggested that an aborted contract was an insufficient basis for an action under 10b-5,<sup>29</sup> the *Commerce* court explicitly disavowed the prior decision in holding that it is unnecessary to prove a consummated<sup>30</sup> purchase or sale of securities as a condition to a 10b-5 action for fraud.<sup>31</sup>

<sup>28</sup> 290 F. Supp. 715 (S.D.N.Y. 1968).

<sup>29</sup> *Keers & Co. v. Am. Steel & Pump Corp.*, 234 F. Supp. 201 (S.D.N.Y. 1964). In *Keers*, the plaintiffs were minority stockholders bringing suit as aborted sellers or defrauded offerees for the breach of the majority shareholder's promise not to sell his stock without securing an equally favorable price for the minority shareholders. The promisor died and his executor sold his holdings in breach of the contract. Plaintiffs admitted that, at the time the contract was entered into, the promisor intended to fulfill his promise. Plaintiffs contended that the fraud arose from the executor's intent not to perform the contract. Although the court in *Keers* used language that could be interpreted as establishing the rule that aborted sellers and defrauded offerees had no cause of action under 10b-5 because there was no consummated transaction, see *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715, 718 (S.D.N.Y. 1968), the *Keers* court qualified its ruling: "Where representations are promissory in nature . . . the promisee may not recover unless there is proof that *at the time the promises were made the promisor had no intention of keeping them.*" 234 F. Supp. at 203 (emphasis added). Therefore, the holding in *Keers* is not that aborted sellers have no 10b-5 remedy but rather, in order to come under 10b-5, aborted sellers must allege that there was fraud at the time of entering into the contract. The same restriction as to the necessity of proving fraud at the time of entering into the contract was recognized by the *Commerce* court. 290 F. Supp. at 720.

<sup>30</sup> There may be some question as to exactly what the *Commerce* court meant when it used the term "unconsummated." Did the court merely mean that there was no *closed* transaction—no *actual* transfer of securities—from the seller to the purchaser? If this interpretation is correct an executory contract clearly within the scope of 3(a)(13) and 3(a)(14) as a purchase or sale would come under question as an "unconsummated" transaction. More likely, the court's use of "unconsummated" referred to a transaction where there was not even a section 3(a)(13) and 3(a)(14) mutually binding *contract* for the transfer of securities. Since the *express* statutory definition of "purchase" and "sale" would be met if such a contract were found, in holding that an unconsummated transaction would also suffice the court must have been directing its attention to something less than a mutually binding contract. Also the proposition that there need not be a *closed* transaction has been recognized for some time, as evidenced by several cases cited in A. BROMBERG, *SECURITIES LAW: FRAUD—SEC RULE 10b-5*, § 8.8, at 221-22 & n.98 (1968) [hereinafter cited as BROMBERG], and would not seem subject to question. In this note, therefore, it has been assumed that by "unconsummated" transaction the court meant a transaction that did *not* meet the statutory definition of a purchase or sale contract under 3(a)(13) and 3(a)(14). See note 32 *infra* and accompanying text.

<sup>31</sup> In support of its ruling that a consummated transaction is not needed in order to

*The Facts.* The *Commerce* case involved a claim that Philip and Ronald Purer, principal stockholders of Puretec, Inc., fraudulently entered into an exclusive agency contract<sup>32</sup> with the Commerce Reporting Company for the sale of Puretec's capital stock with no intention of consummating the transaction with the purchaser secured by Commerce if the Purers received a better offer through their own secret negotiations. Commerce secured Granite Equipment Leasing Company as a purchaser assigning to Granite with the agreement of Puretec the purchase right to Puretec's stock. When the Purers refused to sell to Granite and, in fact, actually sold to VTR, Inc., Commerce brought suit seeking 10b-5 relief. The Purers moved for dismissal contending that the plaintiff failed to meet the dual requirements of rule 10b-5 in that it did not allege fraud (1) "in connection with" (2) "the purchase or sale" of any

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maintain a 10b-5 action for fraud, the *Commerce* court cites *Opper v. Hancock Sec. Corp.*, 367 F.2d 157 (2d Cir. 1966), and *Stockwell v. Reynolds & Co.*, 252 F. Supp. 215 (S.D.N.Y. 1965), as well as both *Goodman v. H. Hentz & Co.*, see notes 22-27 *supra* and accompanying text, and *M.L. Lee & Co. v. Am. Cardboard & Packing Corp.*, see notes 18-21 *supra* and accompanying text. *Opper* involved a suit brought by a customer against a brokerage house for failure to carry out the customer's order to sell certain securities while disposing of large amounts of similar stock held by the brokerage firm. The customer eventually sold the securities at a substantial loss. The Second Circuit, in a per curiam decision, stated: "Failure to carry out the order while disposing its own similar stock was not only actionable under the contract but also [was] a violation of the Securities Exchange Act." 367 F.2d at 158. Because of the nature of the Second Circuit's consideration of the issue, it is impossible to say on what basis the action was allowed. However, in view of later cases, it would seem safer to say that the court's ruling stands more for the proposition that there is no requirement under 10b-5 that the plaintiff's transaction be *simultaneous* with the defendant's fraud rather than establishing that no completed transaction was necessary.

*Stockwell v. Reynolds & Co.*, 252 F. Supp. 215 (S.D.N.Y. 1965), presented a factual situation very similar to that of *Opper*. In *Stockwell* the court's decision clearly stood for the proposition that "[s]ection 10(b) and . . . Rule 10b-5 do not require that the purchase or sale immediately follow the alleged fraud." 252 F. Supp. at 219. It would seem, therefore, that both *Opper* and *Stockwell* were cited to support a concept that neither court had considered in the resolution of the cases before them.

<sup>32</sup> The contract between Commerce and the Purers involved the granting of a purchase right option by the Purers to Commerce. Commerce was *not* obligated to purchase the stock of Puretec but merely had an option to purchase coupled with an exclusive agency contract. The granting of the purchase right option was probably intended to facilitate Commerce's procurement of a purchaser for the Puretec stock. The purchase right option enabled Commerce to act as both principal and agent in obtaining a purchaser for Puretec. 290 F. Supp. at 717. There was no value, see note 47 *infra*, flowing from Commerce to the Purers for the purchase right option; rather, this option was part of the agency contract. This is not to say that the contract between Commerce and the Purers was illusory. Commerce, as are all exclusive agents, was under an obligation to use its best efforts in obtaining a suitable purchaser for the Puretec stock. See 1 A. CORBIN, CONTRACTS § 144, at pp. 623-24 (1963).

security since the alleged fraudulent agreement was never consummated and therefore amounted to no more than an aborted agreement to sell the stock of Puretec.

*The Commerce Rationale.* In rejecting the defendant's argument,<sup>33</sup> the *Commerce* court looked to the agency transaction between Commerce and the Purers as giving rise to an action for 10b-5 relief.<sup>34</sup> Drawing on the *Goodman* rationale, the court reasoned that to disallow such an action on the original contract between the parties would render meaningless the words "in connection with" and would "artificially restrict the statute to proscription of fraud 'in the purchase or sale' rather than 'in connection with' the purchase or sale of a security."<sup>35</sup> Pointing to the language used in *A.T. Brod & Co. v. Perlow*<sup>36</sup> and *SEC v. Capital Gains Research Bureau, Inc.*,<sup>37</sup> the court reasoned that Congress' purpose in enacting section 10(b) of the Securities Exchange Act was to protect investors by broadly prohibiting "all fraudulent schemes in connection with the purchase or sale of securities."<sup>38</sup>

*The Significance of the Commerce Rationale.* The significance of the *Commerce* decision lies in the court's willingness to uphold a 10b-5 claim founded upon a transaction such as that between Commerce and the Purers, a transaction which involved neither a completed transfer nor a consummated *contract* to transfer securities. Actually the agreement between Commerce and the Purers was merely a purchase right option arrangement and an exclusive agency contract.<sup>39</sup> While in form the assignment of a

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<sup>33</sup> Although the court did not rule in defendants' favor on the question of whether a cause of action had been stated where there was no consummated transaction, it did dismiss the complaint for being "woefully deficient as to form." 290 F. Supp. at 719. The court's objection was that plaintiff's allegations were "too skimpy" to satisfy even the lenient "notice" pleading theory of the Federal Rules of Civil Procedure. 290 F. Supp. at 720. Plaintiff was given leave to amend, however, since the deficiency of the pleading appeared "to be attributable to counsel's oversight rather than his lack of belief in the existence of a factual basis . . ." 290 F. Supp. at 720.

<sup>34</sup> 290 F. Supp. at 718-19.

<sup>35</sup> *Id.* at 718.

<sup>36</sup> 375 F.2d 393 (2d Cir. 1967), noted in 1967 DUKE L.J. 894.

<sup>37</sup> 375 U.S. 180 (1963).

<sup>38</sup> 290 F. Supp. at 718, quoting *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967). The Supreme Court used very similar language and reasoning in *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963) (construing the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq.* (1964)).

<sup>39</sup> See note 32 *supra*.



purchase right to Commerce might be viewed as a contract of sale satisfying the "purchase or sale" definition under 3(a)(13) and 3(a)(14),<sup>40</sup> it was apparently not so treated by the court. If the agency-purchase right contract were itself a statutory purchase or sale, 10b-5 would have been applicable by satisfying the definitional requirements of 3(a)(13) and 3(a)(14) as a contract. The court, however, found it necessary to utilize the *in connection with* language to find a 10b-5 violation in a transaction which took place preliminary to any actual transfer of securities or to the existence of a mutually binding purchase contract.

The *Commerce* decision leads to two rather radical departures from traditional 10b-5 limitations. First, by holding that a *consummated transaction* is unnecessary, and *not* meaning thereby that an executory rather than a completely executed contract will suffice, the *Commerce* court undermines the transactional requirement of 10b-5. Since a contract for the purchase or sale of securities *is* a purchase or sale under the statute, the language "unconsummated transaction" as used by the court must refer to something less than a mutually binding executory contract. By implication, the court's rationale supports the proposition that where a claimant can prove damages,<sup>41</sup> reliance<sup>42</sup> and the defendant's fraudulent intent<sup>43</sup> in connection with dealings<sup>44</sup> between the parties in *contemplation* of the transfer of securities, a 10b-5

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<sup>40</sup> The cases that have considered the question of what sort of contracts come within the purview of 3(a)(13) and (14) are not numerous. *Stevens v. Vowell*, 343 F.2d 374, 379 (10th Cir. 1965) (contract for the distribution of stock of a corporation to be thereafter formed); *Hooper v. Mountain States Sec. Corp.*, 282 F.2d 195, 202-03 (5th Cir. 1960) (contract for the exchange of stock for capital assets held to be a contract to otherwise "dispose of" securities); *H.L. Green Co. v. Childree*, 185 F. Supp. 95, 96 (S.D.N.Y. 1960) (under certain circumstances, a contract for the merger of two corporations might involve a purchase and sale of securities). See also *New Park Mining Co. v. Cranmer*, 225 F. Supp. 261, 267 & n.5 (S.D.N.Y. 1963).

<sup>41</sup> 290 F. Supp. at 720. See note 65 *infra*.

<sup>42</sup> 290 F. Supp. at 720. See note 63 *infra*.

<sup>43</sup> 290 F. Supp. at 720.

<sup>44</sup> While in *Commerce* the pre-purchase dealings between the Purers and Commerce involved an actual purchase right option and agency contract, it is not clear that only negotiations of this formality will fall within the "in connection with" language. The purchase right option-agency contract, classified by the court as any "unconsummated transaction," consisted of *more* than unbinding negotiations but *less* than a mutually binding statutory contract. It remains to be seen whether fraud in preliminary negotiations having no binding effect upon any party will fall within the ambit of 10b-5 proscription.

action will stand regardless of whether any actual transaction in securities has taken place.

Secondly, as a direct corollary to the first concept, the *Commerce* ruling completes the emasculation of the *Birnbaum* purchaser-seller doctrine. Under the Commerce-Purers agreement Commerce was not a purchaser. The Commerce-Purers agreement gave Commerce a "purchase right,"<sup>45</sup> but Commerce at no time received or was obligated to buy Purers stock. The court eschewed the direct approach of finding that the holder of a purchase right was a party to a statutory "contract to purchase" and instead went into the discussion of consummation and the "in connection with" language. Neither did the court treat the transfer of the purchase right from Purers to Commerce as a transfer of "a security,"<sup>46</sup> for under this analysis no discussion of consummation would have been relevant since a completed transfer would have occurred. The court apparently did not utilize this approach because the agreement was in substance only an agency arrangement and perhaps because the transfer was not made "for value."<sup>47</sup> Thus, in allowing Commerce,

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<sup>45</sup> See note 32 *supra*.

<sup>46</sup> Both the 1933 and 1934 acts define a purchase right itself as a security. See 15 U.S.C. 77b(1) (1964); 15 U.S.C. 78c(10) (1964). Arguably the transfer of the purchase right to Commerce would be the sale of a security if this definition were strictly applied. The court, however, did not treat it as such perhaps because it was not given "for value." See note 47 *infra*.

<sup>47</sup> The only definitional reference to "purchase" and "sale" in the Securities Exchange Act of 1934 is contained in 3(a)(13) and 3(a)(14). See notes 17-18 *supra* for the language of this section. On the other hand, the Securities Act of 1933 contains a much longer and more detailed definition of "purchase" and "sale." 15 U.S.C. § 77b(3) (1964) reads in part: "The term 'sale' or 'sell' shall include every contract of sale or disposition of a security or interest in a security, *for value*. The term 'offer to sell,' or 'offer for sale,' or 'offer' shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, *for value*. . . ." (emphasis added). This section evidences Congress' intent to limit the statutory definition of "purchase" and "sale" to situations where meaningful *consideration* flows between the parties to a contract for the transfer of securities. Because of the limited attempt to define "purchase" and "sale" in the 1934 Act, it could be argued that Congress expected the more complete definitional section of the 1933 Act to carry over in the application of the 1934 Act. The Supreme Court in *Tcherepnin v. Knight*, 389 U.S. 332 (1967), indeed recognized that there might be some overlap in the definitional sections of the two acts. Arguably under the 1933 Act definition of purchase and sale the transfer of the purchase right from Purers to Commerce was not given "for value." True, Commerce did promise to use its best efforts in finding a purchaser, but this consideration was given in return for the exclusive agency rather than for the purchase right option which Commerce had no interest in exercising. The purchase right was given merely as a convenience rather than in return for Commerce's efforts as value. While one cannot gratuitously "give" a

a non-purchaser under the court's analysis, to bring this suit, the *Commerce* court clearly disregarded the limiting influence of *Birnbaum*.

Only as an *alternative holding*<sup>48</sup> does the *Commerce* court rely on the existence of the later Commerce-Granite contract as being an actual consummated "purchase or sale" connected with the earlier fraud. The court viewed the contract whereby Commerce assigned the purchase right to Granite<sup>49</sup> as falling within the language of 3(a)(13) and 3(a)(14) as a *contract* for the purchase or sale of securities and, therefore, qualifying as a consummated transaction under the traditional purchase-sale definition. If the court had been relying on the cause of action arising from the *Purers' fraud as an inducement to the Commerce-Granite contract*, the case could have easily been fitted under the approach used by the Second Circuit in *A.T. Brod & Co. v. Perlow*.<sup>50</sup> In *Brod* the

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security as a bonus along with something else that is paid for to take advantage of the "for value" exemption, see H. BLOOMENTHAL, *SECURITIES LAW* 58 (1966), the transaction here was not an attempt to evade the statute but was in substance not a transfer for value at all.

<sup>48</sup> The *Commerce* court stated: "The complaint's allegation of the sale and assignment to Granite of the plaintiffs' contract with Purer provides an *additional basis* for invoking federal jurisdiction based on § 10(b) of the Exchange Act." 290 F. Supp. at 719 (emphasis added).

Several traditional approaches under which the holding of the case might be fitted were available to the court. It chose, however, to utilize the *Brod* method of finding a related fraudulent transaction only in the alternative, and made no use of the fact that the Commerce-Purers transaction might itself be classified as a contract for the purchase and sale of a security, see note 40 *supra* and accompanying text, or of the possibility of treating the assignment of the purchase right from Purers to Commerce as a completed transfer of a security, see note 46 *supra* and accompanying text.

<sup>49</sup> The *Commerce* court described the transaction between Commerce and Granite as an "assignment" of the "purchase right" to Granite, a kind of transfer which when made between the Purers and Commerce was viewed as an unconsummated transaction. See notes 30 & 32 *supra*. The difference here, however, seems to be that incident to the transfer Granite agreed to *exercise* the purchase right by transferring 5,000 shares of its common stock to the Purers, and the Purers *agreed to accept this as consideration* (290 F. Supp. at 717), thus creating a binding contractual arrangement. While this contract was in both form and substance a contract for the purchase or sale of securities, the prior Purers-Commerce transaction was the transfer of a purchase right in form only, while in substance merely an agency arrangement. See note 32 *supra* and accompanying text.

<sup>50</sup> 375 F.2d 393 (2d Cir. 1967). In *Brod* the Second Circuit permitted 10b-5 recovery for a broker who purchased securities for a defendant customer who intended to pay for the shares only if the market price increased before the payment was due. The court found the purchaser-seller requirement satisfied by looking solely to the later consummated transaction—the broker's procurement of the ordered securities. The parallels between the facts of *Brod* and *Commerce* raise the question as to why the *Commerce* court varied from

Second Circuit looked to the defendants' fraud as the factor that induced the plaintiff to purchase securities. It was the plaintiff's procurement of the securities from a third party in reliance upon the defendants' fraud rather than the defendants' order that constituted the "purchase" giving rise to the 10b-5 violation. If the *Commerce* court had relied primarily upon this rationale, again there would be no need for its discussion of the non-necessity of a consummated purchase or sale of securities because clearly the binding agreement with Granite satisfied the 3(a)(13) contract requirement.

### *The Implications of the Commerce Rationale*

The *Commerce* court, in choosing to grant the cause of action under the more nebulous "in connection with" language, might have been attempting to keep open the judicial door for future suits brought under 10b-5 in which there was no formal contractual relationship<sup>51</sup> between the parties but where the facts showed that there was sufficient fraudulent activity "in connection with" the unconsummated negotiations to justify 10b-5 relief.

In dealing with the unconsummated purchase or sale, the court is defining the limits of 10b-5 application. To confine 10b-5 actions to situations where there is a binding contract between the parties

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the Second Circuit's rationale in *Brod*. In both cases, the plaintiffs were aborted offerees; in both, the courts looked not to the original negotiations between the plaintiff and the defendant but rather to the plaintiff's subsequent transaction to determine the *measure of damages*. Yet the *Commerce* court did not rely primarily on the subsequent contract between Granite and Commerce as initially giving rise to the 10b-5 violation. The *Brod* court avoided the issue of whether the broker would have had an action if he had not procured the securities ordered by the customers. 375 F.2d at 397 & n.3. The approach of the *Commerce* court would seem to be preferable in that it purports to establish the right of a defrauded party to 10b-5 relief when there is fraud in connection with an unconsummated acquisition or disposition of securities. The existence or non-existence of a subsequent consummated transaction in reliance upon the original representations made between the parties is important only as it goes to prove the damages the plaintiff has suffered. As seen in both the *Lee* and *Goodman* cases, see notes 19-27 *supra* and accompanying text, there may be no subsequent transaction entered into by the plaintiff in reliance on the defendant's fraudulent activity although there is injury. Therefore, it is essential that 10b-5 plaintiffs have an action on the initial fraudulent activity in order to insure their rights to the protection available under 10b-5.

<sup>51</sup> Admittedly the Commerce-Purers transaction involved a kind of formal contractual arrangement, an option to purchase, but it was substantially less than a mutually binding contract necessary to satisfy the 3(a)(13) definition or the court's definition of consummated purchase. See note 32 *supra*.

would unnecessarily exclude factual situations falling in the spirit of 10b-5 investor protection.<sup>52</sup> On the other hand, it could be said that Congress itself has defined the outer limits of section 10(b) by section 3(a)(13) and 3(a)(14),<sup>53</sup> and the courts ought not to extend their jurisdiction to claims not expressly committed to them by Congress. Under this more conservative analysis, 10b-5 is applicable only where the claimant can prove a completed transfer or a mutually binding contractual arrangement for the transfer of securities. When the *Commerce* court departed from the latter view, it broke with the weight of authority in this area.<sup>54</sup>

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<sup>52</sup> Although the presence of a binding contract for the transfer of securities may serve a very valid evidentiary purpose as to the proof of fraudulent activity, the absence of a contract would not seem to affect the policies of investor protection and maintenance of market stability. Public confidence in the stability of the securities market was one of the gravest concerns of Congress in the passage of section 10(b) of the Securities Exchange Act of 1934. "The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation *where the market price reflects as nearly as possible a just price*. Just as artificial manipulation tends to upset the true function of the open market, so the hiding and secreting of important information obstructs the *operation of the markets as indices of real value*." H.R. REP. NO. 1383, 73rd Cong., 2d Sess. 11 (1934) (emphasis added). Why, therefore, limit 10b-5 coverage to those investors who have either closed the transaction or who are under a mutually binding contract for the transfer of securities when there exist other seemingly more valid 10b-5 limitations on the bringing of bogus claims? See notes 62-65 *infra* and accompanying text for a discussion of these other limitations.

<sup>53</sup> The proposition that the Securities Act of 1933 and the Securities Exchange Act of 1934 should be strictly interpreted by the judiciary so as not to expand these acts into a body of judicially contrived federal corporate law has been ably espoused by Professor David S. Ruder in several articles. See Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?* 57 Nw. U.L. REV. 627 (1963); Ruder, *Pitfalls in the Development of a Federal Law of Corporations By Implication through Rule 10b-5*, 59 Nw. U.L. REV. 185 (1964).

<sup>54</sup> Although one of the aims of this note is to point out the seeming inequity of allowing 10b-5 relief to an injured plaintiff who has actually consummated a purchase or sale (i.e., entered into a contract, or actually completed the transfer) in connection with which the defendant used some "fraudulent scheme" but denying that relief to an injured plaintiff who has only contemplated and perhaps taken preliminary steps toward the consummation of a securities transaction, most authority indicates that some completed transaction must have been entered into by the plaintiff before his 10b-5 claim will be recognized. See, e.g., *A.T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967); *Vine v. Beneficial Fin. Corp.*, 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967); *O'Neill v. Maytag*, 339 F.2d 764 (2d Cir. 1964); *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952). The necessity for a completed transaction was expressed in *M.L. Lee & Co. v. American Cardboard & Packing Corp.*, 36 F.R.D. 27 (E.D. Pa. 1964), in which the court recognized the applicability of 3(a)(13) and 3(a)(14) to a situation involving an executory contract for the purchase and sale of securities. The only two cases that question the transactional requirement are *Commerce* and *Goodman*, which are examined in the text.

Perhaps a hypothetical fact situation could best be used to illustrate the potential reach of the *Commerce* rationale. Suppose a customer places an order with a brokerage house for 1,000 shares of stock which is then selling for twenty-five dollars per share. The broker assigned to handle the transaction fraudulently induces the customer not to purchase the stock. The customer, relying on the broker's misrepresentation, leaves the office without having purchased any stock through the brokerage house and without giving the broker any compensation for his advice.<sup>55</sup> A few months later, the stock is selling for thirty-five dollars per share and the customer brings suit under 10b-5 alleging the above facts.<sup>56</sup> Arguably such a situation could come under the *Commerce* court's interpretation of 10b-5 as extending relief in a situation involving fraud "in connection with" an *unconsummated* purchase or sale.<sup>57</sup> To allow 10b-5 relief only to those investors who have completed a transaction and not to allow the same relief to those investors who have been fraudulently induced not to complete a transaction would seem to be unjustified discrimination as well as a failure to recognize that by the very language of the Act, fraud *in connection*

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<sup>55</sup> For the purposes of this hypothetical, the broker is assumed not to receive any direct compensation for his investment advice, but rather receives compensation only from commissions earned on sales. This assumption is necessary in order to keep the problem outside the coverage of § 2(6) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 (1964) which provides: "It shall be unlawful for any *investment adviser* . . . (1) to employ any device, scheme, or artifice to defraud any client or *prospective client*" (emphasis added). 15 U.S.C. § 80b-2(a)(11), however, provides in part: "[This Act] does not include . . . (c) any *broker* or dealer whose performance of such services [giving investment advice] is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor . . . ." (emphasis added).

<sup>56</sup> Of course the hypothetical plaintiff could have elected to buy the 1,000 shares upon learning of the defendant's fraud and then brought his action within the traditional, transactional fraud claim under 10b-5, alleging that defendant's fraud caused plaintiff to *delay* acquisition of the stock. This alternative, however, would seem to recommend the *Commerce* rationale even more. Why should the defrauded investor have to tie up his capital and subject himself to the risks of the securities market in order to bring a suit where he can prove the elements of fraud "in connection with" the unconsummated purchase or sale of securities? It would seem to be putting form over substance to require parties such as our hypothetical plaintiff to actually purchase the stock. Also, plaintiffs such as the one in the hypothetical most likely would have invested their money in other securities and, therefore, might not have the funds needed to purchase the stock originally sought.

<sup>57</sup> Clearly, the would-be plaintiff in the above hypothetical does not come within the *Birnbaum* doctrine but, as has been pointed out (see notes 12-16 *supra* and accompanying text), this doctrine has been largely eliminated as a limitation not called for under the language of 10b-5.

*with*<sup>58</sup> the purchase or sale rather than fraud *in* the purchase or sale is prohibited. Rule 10b-5 was aimed not only at the prevention of fraud in relation to purchases of securities<sup>59</sup> but also to prevent fraud that affects the stability of the securities market.<sup>60</sup> Arguably, fraud that induces an investor not to transact in securities has just as injurious an effect on the stability of the market as does fraud which induces an investor actually to buy or sell securities. The expansion of 10b-5 to claimants involved in unconsummated transactions would not only provide the fullest measure of investor protection but would increase the number of private actions which operate as a significant economic deterrent to securities fraud.<sup>61</sup>

Of course, the suggestion of this extension of 10b-5 is likely to raise the counter-argument that many non-purchasing investors would seek to benefit *whenever* 10b-5 fraud is uncovered. The opponent of such an extension might point to the innumerable non-purchasers who might bring suit in the aftermath of a successful 10b-5 action in a situation like that presented in *SEC v. Texas Gulf Sulphur Co.*<sup>62</sup> in which certain corporate insiders were found guilty

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<sup>58</sup> The *Commerce* court's reliance on the "in connection with" language to allow a 10b-5 action where no consummated contract existed suggests that this language may be interpreted to refer to activities and negotiations surrounding a contemplated purchase or sale transaction which is never finalized.

<sup>59</sup> Presidential Message, S. REP. NO. 792, 73rd Cong., 2d Sess. 1-2 (1934); see *Cooper v. North Jersey Trust Co.*, 226 F. Supp. 972 (S.D.N.Y. 1964); *New Park Mining Co. v. Cranmer*, 225 F. Supp. 261 (S.D.N.Y. 1963); *Pettit v. Am. Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963).

<sup>60</sup> See note 52 *supra*.

<sup>61</sup> See generally *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964); *Fratt v. Robinson*, 203 F.2d 627, 632 (9th Cir. 1953): "[N]othing . . . would tend more . . . to deter fraudulent practices in security transactions . . . than the right of defrauded sellers or buyers . . . to seek redress in damages in federal courts."

<sup>62</sup> 401 F.2d 833 (2d Cir. 1968). In *TGS* the Second Circuit used language which might have some significant bearing on the transactional requirement of 10b-5. In dealing with the SEC's request for injunctive relief against the corporate defendant's release of public reports containing misrepresentations as to the extent of certain mining discoveries, the court ruled that it was not necessary that the corporation actually transacted in its own securities in order for the court to grant the relief sought. The court stated: "[C]omparisons of Section 10(b) with the antifraud provisions of the Securities Act of 1933 (§ 12(2), 15 U.S.C. § 77i(2)), . . . [offers or] sells a security by means of . . .'; § 17(a), 15 U.S.C. § 77q(a) . . . in the [offer or] sale of any securities to obtain money or property by means of . . .'; [language in brackets was added in 1954 amendments]), and with the 1936 antifraud amendment of Section 15 of the Securities Exchange Act of 1934 (§ 15(c)(1), 15 U.S.C. § 78o(c)(1)) . . . effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security . . .') demonstrate that when Congress intended that there be a

of 10b-5 fraud by withholding and understating information concerning an ore discovery. Numerous claimants might allege that they had contemplated purchase of TGS stock but were induced not to purchase by the unfavorable (and fraudulent) statements released by the company's management. The argument, however, can be met by requiring that claimants in situations involving unconsummated transactions carry the substantial burden of proving reliance,<sup>63</sup> causation,<sup>64</sup> damages<sup>65</sup> and that they belong to

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*participation in a securities transaction as a prerequisite of a violation, it knew how to make that intention clear. . . .*

"Therefore it seems clear from the legislative purpose . . . that Congress when it used the phrase 'in connection with a purchase or sale of any security' intended only that the device employed, whatever it might be, be of a sort that *would* cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities. *There is no indication that Congress intended that the corporations or persons responsible for the issuance of a misleading statement would not violate the section unless they engaged in related securities transactions. . . .*" *Id.* at 860 (emphasis added).

The more conservative view of the above quoted language would restrict it to the proposition that a third party—not himself transacting in securities—may incur liability by fraudulent activity which could reasonably be expected to be relied upon to induce others and which in fact does induce others to transact in securities. More broadly construed, the above quoted language might be used to question the necessity of any transaction in securities by anyone where there has been a fraudulent attempt to induce or discourage a purchase or sale. If the defendant engages in fraudulent activity "that *would* cause reasonable investors to rely thereon, . . . and . . . [*would*] cause them to purchase or sell a corporation's securities," 401 F.2d at 860 (emphasis added), then the defendant is liable for any *damages* suffered by a plaintiff whether or not such plaintiff has actually transacted in the security. The emphasis is placed on the word "would"; had the court been requiring a transaction by someone, a better choice of words might have been "that [*does*] cause them to purchase or sell" securities.

It does not necessarily follow under a liberal interpretation of this language that the fraud must be directed toward *inducing* a purchase or sale. It would seem that 10b-5 should likewise be applied to fraud directed at *discouraging* rather than inducing a purchase or sale, since in both situations no consummated transaction is present, yet the same need for investor protection exists. In view of the nature of the TGS ruling (an action for injunctive relief sought by an administrative agency), perhaps too much should not be read into the court's language, but, at least, the court did question the transactional requirement of 10b-5 as related to the liability of the defendant.

<sup>63</sup> Although, as pointed out in note 7 *supra* and accompanying text, reliance has been dispensed with in certain cases (especially those involving non-disclosure transactions where the transfer was made via a national exchange), reliance still remains a vital limitation of 10b-5 actions. Reliance has been thought of as essential in direct-dealing non-disclosure cases. *See, e.g., Kohler v. Kohler*, 208 F. Supp. 808, 823 (E.D. Wis. 1962), *aff'd*, 319 F.2d 634 (7th Cir. 1963). *See BROMBERG* § 8.6, at 209-12; 3 Loss 1765-66.

<sup>64</sup> *Barnet v. Anaconda Co.*, 238 F. Supp. 766 (S.D.N.Y. 1965). *But see Weber v. Bartle*, [1966-1967 Transfer Binder] CCH FED. SEC. L. REP. ¶ 91,910 (S.D.N.Y. Mar. 20, 1967). *See BROMBERG* § 8.7, at 213-20.

<sup>65</sup> The consideration of damages in relation to an action on an unconsummated purchase or



the class meant to be influenced by the defendant's activity.<sup>66</sup> All of these limitations have judicial precedence and could be employed to prevent bogus claims.

Perhaps, in view of the language of 3(a)(13) and 3(a)(14), only a statutory amendment, or continued reliance upon the *Brod* "related transaction" approach, could effectuate the suggested extension of 10b-5 to cover situations involving unconsummated transactions where the parties have not entered into a mutually binding contract. It would not be unreasonable to anticipate, however, that a court presented with the proper fact situation could rely upon *Commerce* and *Goodman* as establishing a right of action under 10b-5 where there has been nothing more than fraud in connection with a contemplated but unconsummated purchase or sale of securities.<sup>67</sup>

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sale of securities is very important. If the courts limit recovery by the so-called federal "out-of-pocket" measure of actual damages, there would be no recovery for a plaintiff such as the one in the hypothetical. He has suffered no out-of-pocket damages. For an examination of this measure of damages, see PROSSER § 105, at 750. Prosser points out, however, that two-thirds of the states recognize a "loss-of-bargain" measure of damages in actions for fraud. *Id.* at 751. The willingness of federal courts to examine all the pertinent circumstances in arriving at a reasonable approximation of the damages suffered by plaintiffs claiming 10b-5 relief seems to lead to the conclusion that the federal courts are not committed to any one concept of damages under 10b-5. Compare *Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527, 533 (10th Cir. 1962), with *Mysel v. Fields*, 386 F.2d 718 (8th Cir. 1967) and *Ross v. Licht*, 263 F. Supp. 395 (S.D.N.Y. 1967). For an examination of the measures of damages under 10b-5, see Ruder, *Texas Gulf Sulphur—The Second Round: Privity and State of Mind in Rule 10b-5 Purchase and Sales Cases*, 63 NW. U.L. REV. 423, 427-29 (1968); Note, *Measurement of Damages in Private Actions Under Rule 10b-5*, 1968 WASH. U.L.Q. 165.

<sup>66</sup> At common law, courts have traditionally limited the class of possible claimants for misrepresentation to those whom the defendant had desired to influence in the manner which had occasioned the damages. See PROSSER § 102, at 717 & n.83. This limitation was imposed on actions in deceit for the obvious reason that the class of persons who may have learned of the misrepresentation and were influenced thereby, would be so enormous as to place a burden of liability on the defendant out of proportion to the fault involved. See Keeton, *The Ambit of a Fraudulent Representor's Responsibility*, 17 TEX. L. REV. 1 (1938).

<sup>67</sup> A fertile area for use of this theory could be in the derivative suit where corporate directors have "fraudulently" discouraged the corporation from making a purchase or sale for their own selfish ends such as maintaining control or purchasing for their own accounts. See Note, *Fiduciary Suits Under Rule 10b-5*, 1968 DUKE L.J. 791.

EPILOGUE: It is interesting to note that in *SEC v. Nat'l Sec., Inc.*, 393 U.S. 453 (1969), the Supreme Court for the first time considered the "purchase and sale" language of 10b-5. The Commission brought suit seeking to unwind a merger between two insurance companies where one company had solicited shareholder approval of the transaction by use of material misrepresentations and omissions in violation of 10b-5. In granting the SEC relief, the Court stated that "[w]hatever the terms 'purchase' and 'sale' may mean in other contexts, here an alleged deception has affected individual shareholders' decisions in a way not at all unlike that involved in a typical cash sale or share exchange. The broad antifraud purposes of the statute and the rule would clearly be furthered by their application to this type of situation." *Id.* at 467.

