10b-5 Standing under Birnbaum: The Case of the Missing Remedy

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10b-5 STANDING UNDER BIRNBAUM: THE CASE OF THE MISSING REMEDY

The Birnbaum requirement\textsuperscript{1} that a plaintiff be a purchaser or seller of securities in order to have standing under section 10(b)\textsuperscript{2} of the Securities Exchange Act of 1934 and Rule 10b-5\textsuperscript{3} promulgated thereunder, has been the subject of active debate in recent years.\textsuperscript{4} The

1. In Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), cert. denied, 343 U.S. 956 (1952) the court first enunciated the requirement that a plaintiff in a 10b-5 action, in order to have standing, must be a purchaser or seller of securities. See notes 16-18 and accompanying text infra.

2. Section 10(b) provides in part: “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. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1970).

3. Rule 10b-5 provides: “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 statement made, in light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. Securities Exchange Act of 1934, Rule 10b-5, 17 C.F.R. § 240.10b-5 (1972).

limitation, although nominally followed in almost all federal courts, has undergone gradual and conspicuous change.

The trend away from *Birnbaum* is not the result of dissatisfaction with the theoretical tenets embodied in that decision. Indeed, most courts continue, for a variety of reasons, to view the purchaser-seller requirement as a legitimate limitation of federal jurisdiction in 10b-5 actions. Rather, the trend is the result of growing judicial realization that a person may suffer an injury which deserves redress without actually having purchased or sold securities. In response to this realization, the courts, instead of discarding the purchaser-seller requirement entirely, have taken the middle ground of defining more persons as being "purchasers" or "sellers." Thus, although *Birnbaum* survives in theory, the class of persons who have standing to sue under 10b-5 nonetheless continues to expand.

This article will trace the judicial expansion of the purchaser-seller rule and discuss the theoretical and practical considerations which justify retention of the basic *Birnbaum* framework. It will suggest that the only valid consideration in determining standing under Rule 10b-5 is whether the plaintiff has in fact suffered an injury as the result of fraud in connection with the purchase or sale of securities. Under such an approach, the fact that the plaintiff is himself a purchaser or seller would be only an indication of actual injury, but would not be conclusive on the issue of standing under Rule 10b-5.

**Implied Civil Liability**

The dispute over standing to sue in 10b-5 actions began to be significant only after the federal courts determined that private individuals had the right to sue for violations of the Rule. Both section 10(b) and Rule 10b-5 appear to be criminal in nature,⁵ and the Securities Exchange Act grants a right of action for violation of the section and Rule explicitly to the Securities and Exchange Commission (SEC).⁶ Nonetheless, courts consistently have construed the provisions as implying a private right of action since *Kardon v. National Gypsum Co.*,⁷ and the Supreme Court has recently recognized the im-

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plied right. The Kardon court relied on tort law and statutory interpretation, but the theoretical justification for the recent recognition of the private action is unclear. Apparently the private right is based primarily on the equitable principles embodied in section 286 of the first Restatement of Torts: remedial legislation intended to protect a certain class will give a cause of action to members of that class who are injured by the violation of the enactment. The Supreme Court has

9. The Kardon court first relied on the Restatement of Torts § 286 (1934) which provides that violations of a legislative enactment give rise to civil liability where the purpose of the statute is to protect the particular interest of the person harmed. See note 11 infra. The policy of the Restatement was considered so fundamental that where the right to a civil action in such a situation was "not expressly denied the intention to withhold it should appear very clearly and plainly." 69 F. Supp. at 514. The court rejected the argument that because other sections of the Securities Exchange Act expressly provided civil remedies 10b-5 should not be construed to imply a private remedy.

10. The Kardon court also relied on section 29(b) of the Securities Exchange Act which provides that contracts made in violation of the Act shall be void. "[A] statutory enactment that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it." 69 F. Supp. at 514. Additionally, the court viewed an amendment to section 29 providing a statute of limitations for 29(b) actions as further evidence that Congress intended that the original statute provide civil remedies, either in the form of an action for rescission or a suit for damages. Id.

Reliance on section 29(b) may be valid to justify a civil action where the fraud of the defendant is in connection with the plaintiff's purchase from or sale to the defendant. At one time such privity of contract, or at least a "semblance of privity," was required in all private 10b-5 actions. Joseph v. Farnsworth Radio & Tele. Corp., 99 F. Supp. 701, 706-07 (S.D.N.Y. 1951), aff'd, 198 F.2d 883 (2d Cir. 1952). More recent cases, however, almost unanimously reject the notion that privity must be shown, but instead consider privity as an indication of causation. See Heit v. Weitzen, 402 F.2d 909, 913 (2d Cir. 1968), cert. denied, 395 U.S. 903 (1969); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 353 F. Supp. 264, 274 (S.D. N.Y. 1972); Drake v. Thor Power Tool Co., 282 F. Supp. 94, 104 (N.D. Ill. 1967); New Part Mining Co. v. Cranmer, 225 F. Supp. 261, 266 (S.D.N.Y. 1963). But see Sargent v. Genesco, Inc., 352 F. Supp. 66, 78-79 (M.D. Fla. 1972), appeal docketed, No. 72-3055, 5th Cir., Dec. —, 1972. In actions where the plaintiff and defendant are not in privity, therefore, the Kardon court's section 29(b) rationale would not seem to justify the implied civil action.

11. "The violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for the invasion of an interest of another if: (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and, (b) the interest invaded is one which the enactment is intended to protect; and, (c) where the enactment is intended to protect an interest from a particular hazard, the invasion of the interests results from that hazard; and, (d) the violation is a legal cause of the invasion, and the other has not so conducted himself as to disable himself from maintaining an action." Restatement of Torts § 286 (1934).

It seems apparent that § 286 originally was intended to apply to negligence ac-
stated on several occasions that it will construe securities legislation "not technically and restrictively, but flexibly to effectuate its remedial purposes."\textsuperscript{12} When one of the primary purposes of the legislation is the protection of investors, the court will imply the availability of judicial relief "where necessary to achieve that result."\textsuperscript{13}

The implied right to a private action is not limited to individuals. Since section 10(b) allows the SEC to promulgate rules "in the public interest" as well as "for the protection of investors,"\textsuperscript{14} the private right of action will lie for corporations or for shareholders suing derivatively on behalf of the corporation.\textsuperscript{15}

Recognition of a private right of action under Rule 10b-5 did not, however, answer the question of which persons were entitled to sue.

**Birnbaum Doctrine**

The question of which persons were entitled to sue under 10b-5 was answered in *Birnbaum v. Newport Steel Corp.*\textsuperscript{16} In *Birnbaum*, the Second Circuit set forth two major rules concerning 10b-5 actions, one of which was a standing requirement.\textsuperscript{17} The court held that the

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\textsuperscript{13} J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964) (referring to section 14(a), but equally applicable to section 10(b)).

\textsuperscript{14} See note 2 supra.


\textsuperscript{16} 193 F.2d 461 (2d Cir.), cert. denied, 343 U.S. 956 (1952).

\textsuperscript{17} The second rule of *Birnbaum* dealt with the substantive elements of the plaintiff's 10b-5 action. In deciding what type of actions were cognizable under sec-
SEC's stated purpose in promulgating Rule 10b-5 was to protect purchasers or sellers from fraudulent dealings connected with securities.\textsuperscript{18} Therefore only a plaintiff who could show that he was a purchaser or

\textsuperscript{18} The Birnbaum court, in determining the legislative intent behind 10b-5, used SEC Release No. 3230 (May 21, 1942), which stated that rule 10b-5 was adopted to close this "loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase." The so-called "loophole" referred to in the Release was that inherent in section 17(a), which provides, "(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—(1) to employ any device, scheme, or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." Securities Exchange Act of 1934 § 17(a), 15 U.S.C. § 77q(a) (1970).

Thus, although 17(a) protected a buyer of securities, it did not mention sellers, and apparently they were not within the coverage of the fraud provisions of the Securities Exchange Act.

The statement made by Milton Freeman below also is enlightening in showing the intent of the Commission in promulgating 10b-5. "It was one day in the year 1943, I believe. I was sitting in my office in the S.E.C. building in Philadelphia and I received a call from Jim Treanor who was then the Director of the Trading and Exchange Division. He said, 'I have just been on the telephone with Paul Rowen,' who was then the S.E.C. Regional Administrator in Boston, 'and he has told me about the president of some company in Boston who is going around buying up the stock of his company from his own shareholders at $4.00 a share, and he has been telling them that the company is doing very badly, whereas, in fact, the earnings are going to be quadrupled and will be $2.00 a share for this coming year. Is there anything we can do about it?' So he came upstairs and I called in my secretary and I looked at Section 10(b) and I looked at Section 17, and I put them together, and the only discussion we had there was where 'in connection with the purchase or sale' should be, and we decided it should be at the end." Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967) (general discussion; Milton Freeman, speaker).

There appears to be no serious doubt that the SEC primarily intended to close the section 17(a) "loophole," but from this the Birnbaum court inferred that such was the Commission's exclusive intent. An equally justifiable inference from the expansive language used in 10b-5 is that the SEC intended to extend protection to "any person" defrauded "in connection with" the purchase or sale of securities, and that the Release used by the Birnbaum court was only a statement of motive for promulgating 10b-5 and was not meant to describe the sole purpose of 10b-5.
seller had standing in the federal courts to sue for violations of Rule 10b-5.

During the more than twenty years since Birnbaum was decided, the federal courts have broadened the concepts of purchaser and seller as well as purchase and sale. This trend, which has alarmed some commentators as signaling the judicial creation of a federal law of corporations,\(^{19}\) is the topic to which this article now turns.

**Expansion of the Purchaser-Seller Concepts**

The federal courts have explicitly recognized that the definitions of purchase and sale for 10b-5 standing purposes transcend the traditional concepts of those terms, as well as that a 10b-5 plaintiff need not be a purchaser or seller in the traditional sense.\(^{20}\) In part this recognition is due to the definitions of those terms within the Securities Exchange Act,\(^{21}\) and in part due to judicial “activism” in cases where the transaction so closely resembles a purchase or sale that it would be patently unfair to disallow the plaintiff an action under 10b-5. The major areas of expansion include: forced sellers, exchanges of shares pursuant to a merger, and the so-called aborted purchasers and sellers.

**Forced Sellers**

The courts have generally allowed an individual standing as a “seller” even though he has not actually parted with his shares, if he can show that in the near future he will be compelled or “forced” to sell because of the fraud of the defendant. This expansion of the concept of seller is based on the rationale that a person who, by virtue of the defendant’s fraud, is faced solely with the alternatives of selling at an economic loss or retaining securities which are worthless, closely resembles an actual seller. Like the actual seller, the forced seller no longer has control over the securities in question, and as a practical matter he will be forced to sell his shares at a loss. A major problem in this area is determining to what extent the defendant’s fraud must limit the plaintiff’s selling alternatives in order for the latter to be con-

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20. See, e.g., Herpich v. Wallace, 430 F.2d 792, 800 (5th Cir. 1970); Hooper v. Mountain States Sec. Corp., 282 F.2d 195, 203 (5th Cir. 1960).

sidered a forced seller. It is suggested that a forced sale should be recognized whenever the defendant has fraudulently eliminated a free market for the sale of plaintiff's shares.

The forced seller expansion was first announced in Vine v. Beneficial Finance Co.22 Vine was a Class A shareholder in Crown Finance, a company which was the target of a merger by Beneficial Finance. He alleged that Beneficial and the officers and directors of Crown fraudulently conspired to bring about the merger. Under the scheme Beneficial first made premium payments to Class B shareholders, who dominated the Crown board of directors. A substantially lower tender offer was then made to Class A shareholders. Although Vine refused the tender offer, 95 percent of the Class A shareholders did sell, thereby allowing Beneficial to effect a statutory short form merger without the approval of the remaining shareholders. After the merger, Vine's alternatives were to sell the stock to Beneficial or to retain stock in a nonexistent company. Thus, "as a practical matter [Vine] must eventually become a party to a 'sale' as that term has always been used."23 The court felt that it would be a "needless formality"24 to require Vine to sell his shares before he sued.

The breadth of the forced sale of Vine remains a question. Consummated mergers25 and liquidations26 which are fraudulently induced represent clear-cut instances where the forced seller doctrine should be applied, as it has been. In such cases the plaintiff is treated as a seller because "the nature of his investment has been fundamentally changed from an interest in a going enterprise into a right solely to a payment of money for his shares."27

On the other end of the spectrum are cases where the defendant's fraudulent attempts to force the plaintiff to sell have not limited plaintiff's selling alternatives by the time he brings his 10b-5 action.28 Although the plaintiff may claim that the value of his shares already has been reduced, he is not yet faced with involuntary alternatives;

23. Id. at 634 (emphasis added).
24. Id.
he may sell to others, or he may retain shares in a going enterprise. Courts have not allowed standing to the plaintiff in such situations because he is not yet a seller, and the economic compulsion to sell is not strong enough to elevate him to forced seller status. Moreover, the plaintiff probably could obtain injunctive relief under the *Mutual Shares Corp. v. Genesco, Inc.* doctrine to halt the defendant's fraudulent conduct.

Between these degrees of compulsion are situations where the plaintiff's shares have not been converted into a claim for cash as the result of merger or liquidation, but where the defendant's fraud has limited the market for the stock and the plaintiff is compelled, in a practical sense, to sell at artificially low rates. In *Travis v. Anthes Imperial Limited* the defendant Molson Industries, purchased 90 percent of Anthes shares by means of a tender offer but fraudulently induced the remaining holders of 10 percent of Anthes shares not to tender in order to force these shareholders to sell later at a lower price. The forced sale situation resulted because Molson's public announcement of the merger produced a circumstance where "[a]n open market for Anthes stock had ceased to exist, and the only possibility for the sale of plaintiffs' stock was to Molson on Molson's terms." The *Travis* case appears to represent the outer limits of the forced seller doctrine: an individual has standing to sue as a seller under Rule 10b-5, even though he has not yet sold, if the defendant's fraud has eliminated plaintiff's freedom of sale in practical effect by foreclosing markets otherwise available.

**Merger**

A shareholder of a target corporation who exchanges his stock pursuant to a merger is at the same time a purchaser of the shares he receives, and a seller of the shares he exchanges. When fraud is employed to consummate the merger and the stockholder is thereby harmed, he has standing to sue under 10b-5. The rationale is that

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29. 384 F.2d 540 (2d Cir. 1967). See notes 107-111 and accompanying text infra.
30. 473 F.2d 515 (8th Cir. 1973).
31. Id. at 522-23.
the Securities Exchange Act defines purchase\textsuperscript{33} to include “otherwise acquiring” shares, and sale\textsuperscript{34} to include “otherwise disposing of” shares. Accordingly, a merger constitutes both a purchase and sale because it involves the disposition and acquisition of shares. Including the exchange of securities pursuant to a merger within the concept of “purchase” and “sale” is logically consistent. If the approval of a merger operates as a fraud upon the stockholders, their rights in securities will be affected in the same manner as if the fraud had been employed to induce them personally to purchase or sell securities.\textsuperscript{35}

However, a stockholder in the “surviving”—as distinguished from the “target” or “disappearing”—corporation does not exchange shares pursuant to the merger. Such a shareholder, it would seem, could not bring an individual 10b-5 action, but would have to sue derivatively on behalf of the surviving corporation, for in such a situation only the corporation is a purchaser or seller. Nonetheless, it is submitted that in the merger situation, the difference in status between shareholders should not be determinative of standing to sue for violations of 10b-5, for either class of shareholders may sustain equal financial injury by virtue of fraud which induces them to consent to the merger. Thus, the test of standing for the surviving as well as disappearing shareholder should be the same: has the shareholder sustained an actual injury as a result of the defendant’s fraud?

It might be argued also that a shareholder in the surviving corporation is a “seller” because the merger decreases his percentage ownership in the corporation. Such an assertion seems unsound as well as unnecessary. Nothing in the wording or history of the Act, nor indeed in its interpretation by the courts, would justify such an ambitious construction of the term “sale.”\textsuperscript{36}

\textsuperscript{33} See note 21 supra.

\textsuperscript{34} Id.

\textsuperscript{35} The Supreme Court has used the following language in expressing the policy rationale behind the recognition of a merger as a purchase and sale: “Whatever 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.” SEC v. National Sec., Inc., 393 U.S. 453, 467 (1969).

\textsuperscript{36} In Coffee v. Permian Corp., 434 F.2d 383, 384 (5th Cir. 1970), the plaintiff sought to be classified as a “purchaser” because the corporation in which he held stock had repurchased some of its outstanding shares and thereby increased the plaintiff’s proportionate percentage ownership of the corporation. The court allowed standing on other grounds, but intimated that it might recognize the plaintiff’s alternative theory of standing by stating that he was “perhaps a purchaser.” Other courts have required that the plaintiff be a direct party to an exchange. See, e.g., Dyer v. Eastern Trust & Banking Co., 336 F. Supp. 890, 912 (N.D. Me. 1971); Superintendent of Ins. v. Bankers Life & Cas. Co., 300 F. Supp. 1083, 1098 (S.D.N.Y. 1969), aff’d,
In the only case found in which a court granted shareholders in the surviving corporation 10b-5 standing, the theory relied on was not that the surviving shareholders were "sellers," but rather that they should be treated equally with shareholders of the target corporation. In Nanfito v. Tekseed Hybrid Co., the plaintiff and all five shareholders of the target corporation were the sole shareholders in the surviving corporation. The exchange ratio allegedly favored the disappearing company, and the plaintiff alleged that the defendants had concealed facts necessary for her to consent intelligently to the merger. The court recognized the difference between the statutory purchaser-seller status of shareholders of a target corporation and the nonpurchaser-seller status of shareholders of a surviving corporation. Nevertheless, the court created an exception to the Birnbaum limitation on the ground that the "purposes and spirit" of the 1934 Act compelled that in the merger situation "shareholders of both the disappearing and the surviving corporations [be given] the same remedies . . . ." Despite the absence of clear authority for the Nanfito decision, the result reached seems entirely desirable as a matter of social policy.

Delayed and Aborted Sellers

The plaintiff who alleges he would have sold his securities at a certain time but for the fraud of the defendant is most often labelled an "aborted seller" by courts and commentators. There are actually two types of plaintiffs who are fraudulently induced not to sell their shares: (1) the "delayed" seller who, subsequent to the fraud, actually does sell his shares; and, (2) the true aborted seller, who still has not sold his shares at the time he sues. For 10b-5 standing purposes, the distinction is significant.

In the case of the delayed seller, the Birnbaum purchaser-seller requirement is met since there has in fact been a sale. There remains the question of whether the fraud of the defendant "caused" the subsequent sale. Some courts have disallowed standing to the delayed

430 F.2d 355 (2d Cir. 1970), rev'd on other grounds, 404 U.S. 6 (1971). The latter view is probably the better interpretation of the meaning of the terms 'purchase' and 'sale' in the Act. If the proportionate increase or decrease in ownership theory is adopted, shareholders in a corporation will be "purchasers" or "sellers" whenever the corporation deals in its own shares. It is difficult to believe that Congress intended those terms to be interpreted so expansively. Such an interpretation involves the courts in a legal fiction which would be unnecessary if Birnbaum were discarded and the plaintiff in a 10b-5 action were not required to be a purchaser or seller in order to have standing.


38. Id. at 238. The plaintiff's action in Nanfito was disallowed on other grounds, and the Eighth Circuit affirmed both the ultimate disposition of the case and the resolution of the standing question. 473 F.2d 537, 541 n.6 (8th Cir. 1973).
seller on this ground, reasoning that the fraud is "in connection with" the inducement not to sell rather than in connection with the later sale. However, the trend in delayed seller situations is for the courts to connect the later sale with the fraud and thereby allow the plaintiff 10b-5 standing.

In the case of the true aborted seller, no actual sale has taken place and standing will be denied unless there has been a sale in the statutory sense. As indicated, there is a sale in the statutory sense whenever a shareholder has entered into a contract to sell shares, since section 3(a) of the Securities Exchange Act includes within the definition of "sale" a contract "to sell or otherwise dispose of" shares.

39. In Hirsch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 311 F. Supp. 1283 (S.D.N.Y. 1970), and Baehr v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,227, at 91, 411 (S.D.N.Y. June 29, 1970), the plaintiffs held stock in McDonnell Douglas and alleged that the corporation issued a report indicating earnings of 85 cents per share, when in fact the earnings were lower. The corporation advised Merrill Lynch of the lower earnings, which passed the information on to a select group of customers who sold their shares in Douglas. Days later, Douglas announced publicly the sharp drop in earnings, but by this time the stock had dropped from $87 to $76 per share. The plaintiffs in both cases subsequently sold their shares at a loss, but neither 10b-5 action was allowed on the ground that the defendants' concealment was not "in connection with" the plaintiffs' sales.

40. See notes 44-56 and accompanying text infra.

41. There appears to be only one true "aborted" seller case where the court has allowed the plaintiff standing to maintain a 10b-5 action without requiring that he be a party to a contract to sell. In Neuman v. Electronic Specialty Co., [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,591, at 98,701 (N.D. Ill. Dec. 31, 1969), a tender offer was made by International Controls for the stock of shareholders of Electronic Specialty. The plaintiffs alleged that Electronic made false and misleading statements to its shareholders in an effort to discourage the success of the tender offer. Relying on the advice of the house counsel of Electronic, the plaintiffs attempted to accept the tender offer by telegram. This mode of acceptance was not permitted by the terms of the International offer, and the acceptances were invalid.

The court allowed standing to the class of plaintiffs who relied on the advice of the house counsel and attempted telegraphic acceptance of the tender offer. The court interpreted Mutual Shares Corp. v. Genesco, Inc. (see notes 107-111 and accompanying text infra) as holding that the Birnbaum purchaser-seller requirement was inapplicable in an action for damages where the plaintiff could show "exact proof and measure of damages, and . . . the causal connection between the alleged wrong and plaintiff's loss." [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,591, at 98,703.

One commentator has suggested that the case of A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967) was also an instance where the court allowed standing to a true aborted seller. See Comment, The Decline of the Purchaser-Seller Requirement of Rule 10b-5, 14 Vill. L. Rev. 499, 506 (1969). Actually, the plaintiff in that case, while an aborted seller vis-a-vis the defendant, was an actual seller of securities, and does not fit into the aborted seller category. See notes 80-81 and accompanying text infra.

42. See note 34 supra.
Thus, persons who have standing to sue under 10b-5 are those shareholders who eventually have sold or otherwise disposed of shares, or those who, even though they have not sold, have entered into a contract to sell or otherwise dispose of shares. Failing to recognize the distinction between delayed and aborted sellers, some courts have required the contractual relationship in all cases where the plaintiff has been fraudulently induced to hold his shares, regardless of whether he ultimately sells his shares.\(^\text{43}\)

Though no court has explicitly differentiated between delayed and aborted sellers, it appears that such a distinction has begun to emerge. In *Stockwell v. Reynolds & Co.*,\(^\text{44}\) the plaintiff alleged that he told his stockbroker he desired to sell shares of Alside stock and that the broker actively induced him to refrain from selling for five months by making affirmative misrepresentations concerning Alside's financial status. The court, in allowing the 10b-5 action, stated that the words “in connection with the purchase or sale of any security”... do not require that the purchase or sale immediately follow the alleged fraud.\(^\text{45}\)

In *Opper v. Hancock Securities Corp.*,\(^\text{46}\) the plaintiff gave his broker an order to sell certain shares. The broker did not sell the customer's shares, but instead sold his own holdings in the same company. The plaintiff eventually sold his securities at a loss\(^\text{47}\) and the court allowed him to sue under 10b-5. Although not discussing the purchaser-seller requirement, the court emphasized that the broker obviously “violated its duties under the 1934 Act... and that these violations would be sufficient without more to sustain plaintiff’s suit.”\(^\text{48}\)

In *Silverman v. Bear, Stearns & Co.*,\(^\text{49}\) the plaintiff and his broker agreed that the broker would sell any stocks in the customer's account which incurred a small loss, rather than retain the shares and hope for eventual recovery. The plaintiff alleged that the broker delayed in selling certain warrants and debentures because the defendant had similar holdings and did not wish to cause a further decline in the market.

\(^{43}\) E.g., *Mt. Clemens Indus., Inc. v. Bell*, 464 F.2d 339, 345 (9th Cir. 1972) (dictum). See notes 58-60 and accompanying text infra.


\(^{45}\) Id. at 219.

\(^{46}\) 250 F. Supp. 668 (S.D.N.Y.), aff’d, 367 F.2d 157 (2d Cir. 1966).

\(^{47}\) “Loss,” as that term is used here, does not necessarily mean that the sale price was less than the original purchase price. Rather, loss is measured by the difference between the price at which the plaintiff eventually sells and the price at which he would have sold but for the fraud of the defendant. In *Opper*, the court measured damages as the difference in the price which plaintiff realized on the sale and the market price at the time of the fraud. *Id.* at 676-77.

\(^{48}\) *Id.* at 673-74.

by selling the customer's account. Following Stockwell, the court ruled that the plaintiff had standing to bring a 10b-5 action.

Stockwell, Opper and Silverman, all district court opinions, stand for the proposition that a defendant's fraud need not be concurrent with the sale of securities in order to be considered "in connection with" the sale. Nonetheless, this line of cases has been rationalized by the Ninth Circuit on the basis that in each case there was a contractual relationship "between the parties which elevated the plaintiffs to the status of statutory purchasers or sellers." In Travis v. Anthes Imperial Limited, however, the Eighth Circuit allowed standing to a delayed seller who was not contractually related to the defendant, thus implicitly recognizing that the delayed seller satisfies the Birnbaum requirement because he is an actual, as opposed to a statutory, seller. The Travis plaintiffs, who were U.S. residents, alleged that Molson Industries, a corporation which had made a tender offer to acquire Anthes stock, fraudulently induced them not to sell their shares of Anthes common stock to Molson. After Molson succeeded in acquiring most of the Canadian-held Anthes stock, the plaintiffs sold to Molson, but at terms substantially less favorable than those offered the Canadian holders. The trial court ruled the plaintiffs did not have standing under 10b-5 because they "were not induced to purchase or sell their Anthes shares as a result of defendants' alleged misrepresentations." The fact that the plaintiff later did sell their shares did "not compel a different conclusion."

The Eighth Circuit reversed the trial court, basing its opinion in part on the reasoning of Stockwell. The fact that plaintiffs ultimately sold their shares satisfied the standing requirement, since the sale need not be concurrent with the fraud in order to be "in connection with" it.

50. Mt. Clemens Indus., Inc. v. Bell, 464 F.2d 339, 345 (9th Cir. 1972) (emphasis added).
51. 473 F.2d 515 (8th Cir. 1973).
53. Id.
54. The court also felt the plaintiffs could be allowed standing on the alternative ground that they were "forced sellers" within the doctrine expressed in Vine v. Beneficial Finance Co., 374 F.2d 627 (2d Cir.), cert. denied, 389 U.S. 970 (1967). See notes 22-31 and accompanying text supra.
55. The Birnbaum court, in considering what types of actions were recognized under section 10(b), interpreted the "in connection with" clause rather rigidly and held that the section was aimed at only those fraudulent practices "usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs." 193 F.2d at 464. This consideration differs from the procedural question of who is a purchaser-seller in that it involves the substantive element of the plaintiff's cause of action. The court's interpretation of the "in connection with"
If the plaintiff alleges an injury and shows a sale, the trend seems to be to allow him to prove that the sale was "in connection with" the clause seems to have undergone expansion in two ways, both of which are inherent in the recent Supreme Court case of Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971).

First, actionable fraud is no longer limited to that which is "usually" associated with the purchase or sale of securities, but includes all fraudulent practices, "whether the artifices employed involved a garden type variety of fraud, or present a unique form of deception." A.T. Brod & Co. v. Perlow, 375 F.2d 393, 397 (2d Cir. 1967). Thus, a 10b-5 action by the seller against the purchaser for nonpayment of the purchase price will lie if the seller alleges that the purchaser entered into the transaction with no intention to pay the purchase price. See id.; Richardson v. Salinas, 336 F. Supp. 997 (N.D. Tex. 1972); Pepsico, Inc. v. W.R. Grace & Co., 307 F. Supp. 713 (S.D.N.Y. 1969) (by implication). But see E.L. Aaron & Co. v. Free, [Current Binder] CCH Fed. Sec. L. REP. ¶ 93,598, at 92,755 (S.D.N.Y. Aug. 9, 1972). The major effect of this expansion of the type of fraud cognizable under 10b-5, however, is in the area of corporate fraud. Generally, the courts will no longer dismiss a 10b-5 claim in a derivative action on the ground that it involves only a mismanagement of corporate affairs, if the fraud involved is related to a securities transaction. Bankers Life recognized the basic principle "that Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement." 404 U.S. at 12. The Court, nevertheless, stated, "[D]isregard of trust relationships by those whom the law should regard as fiduciaries, are all a single seamless web along with manipulation, investor's ignorance, and the like." Id. at 6. Moreover, the fraud alleged may be in affirmative acts of misrepresentation, nondisclosure, or the sale of securities by the corporation to an insider for inadequate consideration. See, e.g., Jannes v. Microwave Communication, Inc., 461 F.2d 525 (7th Cir. 1972).

Second, it appears that it is no longer required that the fraud be intrinsic to the immediate securities transaction itself. As expressed by the Stockwell court, "[t]he words 'in connection with the purchase or sale of any security' . . . do not require that the purchase or sale immediately follow the alleged fraud." Stockwell v. Reynolds & Co., 252 F. Supp. 215, 219 (S.D.N.Y. 1965). See, e.g., Drachman v. Harvey, 453 F.2d 722 (2d Cir. 1972).

Drachman involved a shareholder's derivative suit wherein the plaintiff alleged that Harvey, the controlling shareholder of Harvey Aluminum (Aluminum), conspired with Martin Marietta Corp. (Marietta) to give Marietta control over Aluminum. The scheme involved two phases, the first of which was the sale by Harvey to Marietta of 2.9 million shares of Aluminum owned by Harvey at $11.20 per share above the current market value. Harvey, in pursuance of phase two, allegedly convinced the directors of Aluminum to call back its entire issue of 5% convertible debentures at a cost of $6.6 million, even though the issues were not due, and even though Aluminum was concurrently borrowing money for its working capital at a rate as high as 9 percent.

The effect of the recall was to increase Marietta's percentage holdings in Aluminum, and to take away the possibility of conversion of the debentures into common stock, a contingency which would dilute Marietta's percentage holding.

At the original hearing in Drachman the 10b-5 claim was rejected on the ground that the "premium bribe" to Harvey and the recall of the debentures were two isolated transactions. The sale of control by use of the premium bribe did not involve the corporation as a buyer or seller, and though the redemption of the debentures did involve a purchase, there was no fraud connected with this latter transaction. "10(b)
STANDING UNDER BIRNBAUM

fraud. The recognition of this approach in Stockwell, Oppen, Silver-
man and Travis stems from the realization that a “seller is injured as
much when he suffers a loss on the sale of securities which he has been
fraudulently induced to retain as when he is fraudulently induced to
sell them.” When there has been no actual sale, Birnbaum still re-
quires that a plaintiff be a seller in the statutory sense in order to have
standing under 10b-5.

Delayed and Aborted Purchasers

The standing considerations mentioned in the preceding section
regarding delayed and aborted sellers should apply with equal force
where the fraud is in connection with a purchase. Thus, where the
plaintiff alleges he was fraudulently induced to refrain from purchasing
securities, he can be classified as either a “delayed purchaser,” where
subsequent to the fraud he ultimately buys the securities, or an
“aborted purchaser,” where he has not purchased the securities by the
time he sues. The delayed purchaser should be deemed to have stand-
ing as an actual purchaser, but the true aborted purchaser should be
deemed to have standing only when he has entered into a contractual
relationship to purchase or otherwise to acquire shares so that the
transaction fits within the statutory definition of purchase.

It is apparent that many courts since Birnbaum have loosened the causal link re-
quired between the purchase or sale and the alleged fraud. The fraud which induces
the plaintiff to refrain from entering into a securities transaction may very well be
“in connection” with that person’s later entry into the securities market.


57. In similar cases where no subsequent sale was involved, standing has been
Shapiro, 334 F. Supp. 399 (E.D. Mo. 1971); Sanders v. Merrill Lynch, Pierce, Fenner
(S.D.N.Y. June 29, 1970); Keers & Co. v. American Steel & Pump Corp., 234 F.

58. See note 33 supra.
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The principle that a true aborted purchaser must have entered into a contract to buy or otherwise acquire shares was recently affirmed by the Ninth Circuit in *Mt. Clemens Industries, Inc. v. Bell.*

The plaintiff claimed that it was precluded from bidding on and purchasing securities at a sheriff’s auction because of the defendant’s misrepresentations that the securities were worthless. In denying the plaintiff standing, the court stated that aborted purchasers or sellers would be allowed 10b-5 standing only where they were a party to a contract to purchase or otherwise acquire shares.

[The] unifying element [of cases where aborted purchasers have been allowed standing] is the existence of a contractual relationship between the parties which elevated the plaintiffs to the status of statutory purchasers...

Two cases where the plaintiff aborted purchasers met this contractual requirement are *Commerce Reporting Co. v. Puretec, Inc.* and *Goodman v. H. Hentz & Co.* In *Commerce,* the plaintiff entered into a contract with the defendants to purchase all the stock of defendants’ corporation. The agreement was never consummated by actual sale, however, because the defendants’ wrongfully sold to a third party. The court rejected the defendants’ contention that the plaintiffs did not have standing because they had not actually purchased the stock.

Although it has been suggested that an action under §10(b) of the Exchange Act and SEC Rule 10b-5 may not be founded upon an aborted agreement to buy or sell securities...the law in [the Second] Circuit and elsewhere now appears to be established that it is unnecessary to prove a consummated, or closed, purchase or sale as condition to the institution of such a suit.

The court reasoned that because the statute read “in connection with the purchase or sale,” rather than “in the purchase or sale,” it indicated that Congress “intended to protect against fraud in agreements to buy or sell, as well as with respect to completed sales, provided damages could be shown.”

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59. 464 F.2d 339 (9th Cir. 1972).
60. Undoubtedly the court was correct insofar as it was describing cases involving true aborted purchasers and sellers. From the cases cited, however, the court’s opinion makes clear that it was also applying the contractual relationship test to delayed purchasers and sellers—an application which is unwarranted in view of the *Stockwell, Opper, Silverman* and *Travis* decisions. See notes 44-56 and accompanying text supra.
61. 464 F.2d 339, 345 (9th Cir. 1972).
65. Id. (emphasis added).
In *Goodman*, the defendant-broker "sold" the plaintiffs nonexistent securities and falsely represented that he had made certain other purchases which the plaintiff had ordered. Although technically there was no actual purchase or sale, the plaintiffs' 10b-5 action was allowed, for they were "actual parties to transactions which, [but] for the fraud of [the broker], would have been actual purchases or sales . . ." 68

Thus, a contract to purchase will satisfy the *Birnbaum* purchaser-seller requirement, but it is not clear whether something less than an actual contract to purchase will suffice. In *Ashton v. Thornley Realty Co.* 67 the court seemed to answer this question in the affirmative. *Ashton* involved a plaintiff with an irrevocable 90-day option to purchase shares in a cooperative apartment. The plaintiff claimed that he had been induced not to exercise the option within the 90-day period by the misrepresentations contained in the cooperative corporation's prospectus. In allowing the plaintiff standing, the court noted that the "jurisdictional question [was] by no means free from doubt," 68 but,

[T]he fact that Ashton had an irrevocable right, presumably specifically enforceable, to buy shares of the cooperative for a period of 90 days placed him (during the 90 day period) in a status beyond that of a mere aborted purchaser . . . and that his enforceable option to purchase the shares may well constitute a "contract to buy" for the purposes of § 10(b) liability. 69

A similar case where 10b-5 standing was denied, however, is *Manor Drug Stores v. Blue Chip Stamps*. 70 The plaintiffs, retail users of Blue Chip Stamps, were given the right of first refusal to an offering of Blue Chip common stock, pursuant to a court order compelling Blue Chip to reorganize. The plaintiffs did not purchase the new shares, but alleged they had been dissuaded from doing so by statements in the defendant's prospectus which had undervalued its income and net earnings. The court disallowed the action on the ground that the causal relation between the fraud and the alleged injury appeared difficult to prove.

[T]he causal nexus between defendants' alleged misrepresentations and plaintiff's failure to purchase the Blue Chip "units" depends upon a number of highly uncertain factors such as proof that but for defendants' misrepresentations plaintiff would have,

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68. *Id.* at 1299.
69. *Id.* at 1299 n.4. Defendant's summary judgment motion was granted, however, for the misrepresentations alleged by the plaintiff did not constitute actionable fraud under 10b-5.
indeed, purchased the offered "units;" . . . in view of this uncertainty, damages herein appear highly speculative. . . .

The Manor Drug Stores court did not, therefore, consider the issue, presented in Ashton, whether an irrevocable right to purchase securities fits within the statutory definition of "purchase." This issue has not been definitively answered by the courts, but the approach taken by the Ashton court indicates a willingness to expand the term "purchaser" beyond situations where there is either a purchase or a contract to purchase. This willingness is further evidence of the judicial trend to liberalize the Birnbaum rule by including more persons within the classifications of purchaser and seller.

In summary, liberalization of 10b-5 standing requirements in situations where the plaintiff is fraudulently induced to refrain from purchasing securities may take place in the following fashion. Courts will regard a plaintiff who subsequently buys as a delayed purchaser, and recognize that there has been an actual purchase for purposes of Birnbaum. Such a plaintiff is the counterpart of the delayed sellers who were accorded standing in Stockwell, Opper, Silverman and Travis on the theory that the "in connection with the purchase or sale of any security" clause of 10b-5 does "not require that the purchase or sale immediately follow the alleged fraud." A person who does not subsequently buy may still be deemed a purchaser if he is a party to a contract to purchase, and perhaps if he holds an irrevocable right to purchase within a specified period.

Aborted Purchaser Variation: Unsuccessful Contenders for Control

The tender offer is a modern method of corporate acquisition by which an attacking corporation attempts a takeover of a "target" firm by offering to buy shares from the existing shareholders in the target corporation. If the takeover is unsuccessful, the tender offeror may sue under 10b-5, claiming that failure to obtain majority control was caused by the fraud of the target corporation. Whether the tender offeror has standing where the fraud of the target corporation prevents the takeover is, at present, a difficult question due to the seeming irreconciliability of the two major cases on the subject. Adding further complexity to the problem is the fact that some courts are reluctant to enter into battles for corporate control when the competing corporations are equals, and such reluctance may color court decisions on the standing issue. Ultimately, claims of fraud in connection with tender

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71. Id. at 40.
72. See notes 44-56 and accompanying text supra.
offers may be resolved under section 14(e) of the Securities Exchange Act which recently was enacted to deal with tender offer situations. Current case law indicates that the standing requirements under section 14(e) may be less stringent than under 10b-5. Since the case law under 14(e) is relatively undeveloped, however, the present discussion considers only the role of 10b-5 actions in this area.

The first major case on point is *Iroquois Industries, Inc. v. Syracuse China Corp.* where Iroquois made a tender offer to the stockholders of Syracuse China for their shares in that corporation. Iroquois alleged that the officers of Syracuse fraudulently induced the shareholders to retain their shares by misrepresenting the future prospects of Syracuse. The court, reaffirming *Birnbaum*, denied standing to Iroquois. Even though Iroquois had made some purchases of Syracuse stock pursuant to the tender offer, it did not claim that it was misled as to *those* transactions, and therefore was not a purchaser for purposes of *Birnbaum*. Rather, Iroquois claimed that because of the fraud perpetrated on Syracuse shareholders, it was precluded from purchasing *additional* shares. *Iroquois*, then, stands for the proposition that an unsuccessful contender for control cannot maintain a 10b-5 action by relying solely on aborted purchaser status.

In *Crane Co. v. Westinghouse Air Brake Co.*, however, the same court allowed standing to the unsuccessful contender for control in a factual situation resembling *Iroquois*. There, Crane made a tender offer to Air Brake stockholders. Crane alleged that Air Brake and Standard, a company with which Air Brake desired to merge, fraudulently conspired to defeat Crane's tender offer by having Standard purchase Air Brake stock on the open market on the final day Air Brake shareholders could accept Crane's tender offer. The purchases drove the market price of Air Brake stock to a level higher than the Crane offer. As further evidence of the fraudulent scheme, Crane alleged that Standard, on the same day it had purchased the Air Brake stock, secretly sold a substantial portion of these same shares at a heavy loss.

As a result of Standard's fraudulent manipulation of the market, Crane's attempted takeover of Air Brake ended in acquisition of only a minority of the outstanding shares. Crane was allowed standing to sue for the alleged violations of both section 9(a)(2) and Rule 10b-5.

The results reached in *Crane* and *Iroquois*, at first blush, may appear irreconcilable. In each instance the plaintiff was a tender offeror whose attempts to purchase securities had been aborted. The conflicting results seem especially baffling in view of the fact that *Iroquois*

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75. Id. at 967.
was decided only five weeks prior to Crane, by the same Circuit, and a rehearing in Iroquois was denied on the same day Crane was decided.

One possible distinction between the cases is that in Crane the defendants, Air Brake and Standard, completed their merger. Crane, as a minority shareholder in Air Brake, was forced to exchange its Air Brake shares for Standard shares as a result of the merger of Air Brake into Standard. Because Crane and Standard were competitors, Crane was then forced to sell its Standard shares in order to avoid antitrust complications. Thus, although Crane was not allowed standing as an aborted purchaser, it was allowed to maintain a 10b-5 suit as a forced seller.\(^7\)

It is unclear, however, how far the Crane concept extends. Had Crane not been forced to divest itself of Standard shares because of the antitrust laws, would it have been allowed standing as a purchaser or seller because of the merger between Air Brake and Standard? One court has intimated that a merger in such a situation would be enough to elevate an unsuccessful contender for control to "seller" status,\(^7\)\(^8\) and there seems to be no logical reason or policy which compels a different result. Indeed, why not carry the concept one step further and allow the unsuccessful contender for control seller status for 10b-5 purposes if, after the tender offer is defeated, it sells the shares it has bought pursuant to the attempt to gain majority control?

Two problems arise in this context. First, the sale which follows

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77. Though the Crane court spoke of the forced seller concept, it is unclear whether 10b-5 standing was allowed on this ground. Certain language of the court seems to apply the forced seller concept only to the 9(a)(2) action. "Standard's actions had the intended and inevitable effect of inducing Crane to become a forced seller within the meaning of section 9(a)(2) . . . . Standard's failure to disclose its manipulation operated as a fraud or deceit on Crane in connection with the purchase or sale of securities, creating a right to relief in Crane quite apart from Crane's rights as a forced seller under section 9(a)(2)." Id. "The success of Standard's maneuver made Crane a forced seller of the newly issued Standard convertible preferred under threat of a divestiture action to be brought by Standard. . . . Thus, we have here in Crane one induced to sell by Standard's deception and manipulation and so within the protection of section 9(a)(2). Moreover, even if a narrower view were taken of 9(a)(2), it would seem that Standard's conduct would still be actionable under Rule 10b-5(c), condemning conduct which operates as a fraud or deceit 'upon any person.'" Id. at 798.

Confusion on this point shows itself in an action based on the same set of facts. See American Standard, Inc. v. Crane Co., 346 F. Supp. 1153 (S.D.N.Y., 1972). See also H.K. Porter Co. v. Nickolson File Co., 353 F. Supp. 153 (D.R.I. 1972) (supplemental opinion). There seems to be no valid reason, however, to limit the forced seller concept to only one phase of the action, for one who is a forced seller for 9(a)(2) purposes logically should also be a forced seller under 10b-5.

the takeover attempt may not be the true cause for the unsuccessful tender offeror's complaint. That is, the injury to the plaintiff in such a case appears to be caused by the defeat of the tender offer and not by the fact he sold the shares he acquired as a result of the unsuccessful takeover attempt.\textsuperscript{79} Arguably, the fraud is “in connection with” the aborted purchase and not in connection with the later sale of the shares acquired. Nevertheless, this consideration will probably not cause too many courts great difficulty. An analogous situation arose in \textit{A.T. Brod & Co. v. Perlow}\textsuperscript{80} where a broker sued a customer who allegedly gave the broker an order for shares with the intent to consummate the purchase only in the event that the market price of the stock rose. The fraud was thus in connection with the plaintiff's sale of securities. The court stated that plaintiff was “clearly a purchaser of securities,”\textsuperscript{81} since he had had to buy the securities from others in order to sell later to the defendant.

Thus, although in the unsuccessful contender for control situation the defendant's fraud is in connection with the immediate securities transaction—the plaintiff's tender offer—it may also be said to be “in connection with” the plaintiff's later sale of the shares acquired. In terms of causation, the later sale may be viewed as part of a single transaction so that the defendant's fraud “touch[es]” the sale.\textsuperscript{82}

The second problem is more substantial. Where, as in \textit{Crane}, two companies make competing bids for corporate control, the active trading in that stock may raise its market value so that by the time the losing contender is faced with sale of whatever shares he has managed to buy, he could realize a profit on the transaction. For example, Crane's sale of Standard shares because of antitrust considerations produced a profit of several million dollars.\textsuperscript{83} Thus, although Crane might be considered a “seller” and therefore satisfy the \textit{Birnbaum} requirement, the question remains whether it suffered any actual injury. Presumably Crane gladly would have exchanged its profit for corporate control of Air Brake, but the question remains whether the loss of corporate control is a cognizable injury under \textit{10b-5}.\textsuperscript{84}


\textsuperscript{80} 375 F.2d 393 (2d Cir. 1967).

\textsuperscript{81} Id. at 397 n.3.

\textsuperscript{82} See note 55 supra.

\textsuperscript{83} 419 F.2d at 791.

\textsuperscript{84} On remand, Crane claimed damages on five grounds: (1) the difference in value between the Air Brake shares and the Standard shares Crane received in exchange for them due to the merger; (2) similar damages as to the Air Brake stock Crane was prevented from acquiring; (3) the control value of Air Brake; (4) “the
An additional factor to consider in regard to standing in tender offer situations is the fact that most courts are not as willing to "find" a purchase or sale where only corporate entities are involved in the dispute. As stated in one decision,

[T]his Court [has] made it clear that it would not, at the behest of a disappointed contender in a battle for corporate control, necessarily take the same view of the requirements of the securities laws and rules as it does in cases of claimed injury to the average public investor.85

One reason for the reluctance of the courts to enter into battles for corporate control stems from the fact that the purpose of the Exchange Act "is to give the investing public the opportunity to make knowing and intelligent decisions regarding the purchase or sale of securities."86 When two corporations are involved in a battle for control, it is assumed that neither has superior knowledge, and each has readied itself for the onslaught. The policy disfavoring a caveat emptor approach in securities dealings is therefore not as strong here, and the courts may employ the Birnham purchase-seller requirement to avoid involvement in intercorporate disputes.

However, application of the purchaser-seller rule in such a case works an injustice on the corporate shareholders who are injured as a result of the battle, for they probably would have no remedy in such situations under traditional Birnbaum standards. In a situation like Iroquois, for example, where A Corporation offers to buy the shares held by the stockholders in B Corporation, and the officers of B fraudulently induce nontender, it is doubtful that the stockholders, as true aborted sellers, will have independent 10b-5 standing. This is true even though the stockholders suffer an injury to the extent of the difference between the tender offer price and the value of the retained shares when the offer expires. Courts conceivably could remedy this injustice either by allowing the stockholders standing under new section 14(e) which deals specifically with fraud in connection with a tender offer,87 or by discarding the 10b-5 purchaser-seller requirement. It


87. Section 14(e) reads, "It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts
appears probable that the courts will adopt the former approach before they consider the latter.

**Birnbaum as a Limiting Doctrine**

As the preceding sections have shown, the liberalization of the purchaser-seller rule has taken place from *within*. That is, the courts have generally deviated from the rule by *expanding* the definitions of the terms purchaser and seller rather than making external *exceptions* to the rule. The distinction is, for the most part, a semantic one since the result in either case would be the same: an enlarged class of plaintiffs is allowed access to the federal courts for injuries resulting from 10b-5 violations. The expansion of the 10b-5 class of plaintiffs is indicative of a judicial movement away from insistence that the plaintiff actually be a member of a "purchaser or seller class." This movement represents a recognition that persons who are in fact injured by another's fraud in connection with the purchase or sale of securities, ought to have redress.\(^8\)

On the other hand, most courts retain the basic outline of the purchaser-seller requirement both because they feel there are legitimate reasons for its continuation, and because they wish to maintain a degree of control over who will be plaintiffs in 10b-5 actions. This section will focus on the judicial considerations which are used to justify the retention of *Birnbaum*, and will suggest that none of these considerations are relevant to the question of standing to sue.

The *Birnbaum* requirement can be termed a "limiting doctrine"

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in that it restricts access to the federal courts. Such restriction is thought to be desirable because, by confining 10b-5 standing within predetermined bounds, a court can protect prospective defendants from nuisance suits, itself from a deluge of 10b-5 litigation, and persons dealing in securities from uncertain and unlimited liability. In addition, some courts go beyond these practical considerations and argue that problems involving separation of powers and federalism mandate a limiting doctrine such as Birnbaum.

Nuisance Suits

The belief is sometimes expressed by the courts that a liberal standing requirement affords no protection against a plaintiff who brings suit with no intention of litigating, in hopes of forcing a well-heeled defendant into a settlement. But at least two arguments militate against using a standing requirement to eliminate nuisance suits.

First, a limiting doctrine which cuts down on the number of all lawsuits brought will have the effect of arbitrarily eliminating legitimate as well as illegitimate claims. For example, a requirement that no left-handed person could bring a 10b-5 action would indeed cut down on the number of fraudulent plaintiffs, but it would also suppress the legitimate claims of left-handed plaintiffs who had suffered injury as a result of another's fraud. Additionally, such arbitrary limitations are underinclusive in that they fail to protect against nuisance suits brought by persons who do have standing. That is, the hypothetical standing limitation in no way would eliminate the fraudulent claims of right-handed persons.

More importantly, it is a distortion of priorities to favor a policy which focuses on reducing the number of actions brought rather than on remedying injuries suffered. Although it is desirable to eliminate sham lawsuits, it is correspondingly undesirable to do so at the expense of persons who are genuinely injured as the result of another's wrongdoing.89

89. The Federal Rules of Civil Procedure, for example, seem to represent an attempt to limit sham suits by deterrence rather than by a method which limits all lawsuits brought. Rule 11 requires that the attorneys sign the pleadings to certify that there is good ground for support of the claim presented. An attorney who wilfully violates Rule 11 “may be subject to appropriate disciplinary action,” which probably means a contempt citation. Rule 23.1 requires the plaintiff in a derivative action to “verify” that the action is not “a collusive one to confer jurisdiction” on the court. Apparently, a false verification could result in a prosecution for perjury.

The deterrent effect of Rules 11 and 23.1, however, may not be strong enough to prevent nuisance suits because the burden of showing that the plaintiff's conduct was wilfully fraudulent often cannot be sustained. Nevertheless, nuisance suits are better eliminated by improved methods of deterrence rather than by limitations on standing.
Floodgates

Some courts seem to approve *Birnbaum*, at least implicitly, because it insulates the federal courts from the flood of litigation which would result if the standing requirement were drastically liberalized. Such a consideration seems irrelevant to the issue of standing; rather, judicial emphasis should be directed at whether, in light of Congressional intent and public policy, a person is a proper party to litigate. If the plaintiff has standing on these bases, a refusal by a federal court to hear the dispute would be an abdication of its duty to adjudicate.

A corollary to this “floodgates” approach is that *Birnbaum* is a competent tool, not necessarily to limit 10b-5 actions in general, but rather to weed out those spurious actions in which the plaintiff attempts to invoke federal jurisdiction over what is basically a state claim. As stated by one court:

> The complaint herein is representative of a growing number of 10b-5 suits brought in this Court on unique, esoteric and implausible legal theories. Innovation is not to be discouraged, nor the imaginative instinct dulled. However, claims cloaked in a tissue of confusion devoid of federal jurisdiction or legal merit, impede rather than foster progress in the field of investor protection.90

The most persuasive reason for not using *Birnbaum* to screen state actions is that it is inappropriate and ineffective for that purpose. Any filtering accomplished by use of *Birnbaum* occurs in a haphazard manner, for there seems to be little correlation between purchaser or seller status and legitimacy of a federal claim. By imposing a pretrial condition applicable to all 10b-5 actions, the courts preclude some parties with legitimate federal grievances from suing, and correspondingly fail to eliminate some actions which seem to be founded on traditional state grounds. An instance of the latter situation occurs when a plaintiff asserts that the defendant contracted to buy securities from him but did not pay for them after delivery. This transaction seems to give rise to no more than a breach of contract action, but if the plaintiff alleges that the defendant entered into the agreement with no intention of paying for the securities, and therefore was fraudulent, 10b-5 standing could be granted under *Birnbaum*.91

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Limitation of Liability

Another purported justification for a strict standing requirement is that the language of Rule 10b-5 is so broad that it can be interpreted to create "an almost completely undefined liability" because it only requires that "someone do something bad" in order to violate it. If some sort of limitation were not imposed, it is argued, persons in business could never be certain when their conduct would subject them to liability. Certainty in business transactions, however, is accomplished by clearly defining what conduct is fraudulent rather than by limiting which persons may sue for injuries suffered. A limitation on standing adds to the certainty of business dealings only in the sense that it defines the class of persons who can be defrauded with impunity, and the attainment of such "certainty" by excluding persons injured by fraudulent dealings in securities exalts certainty over fundamental fairness.

Separation of Powers

Some courts have partially based their refusal to overturn the Birnbaum doctrine on the ground that to do so would involve the courts in the legislative function of Congress. Blau v. Lehman, a Supreme Court case dealing with section 16(b), is frequently cited:

Congress can and might amend §16(b) if the Commission would present to it the policy arguments it has presented to us, but we think that Congress is the proper agency to change an interpretation of the Act unbroken since its passage, if the change is to be made.

This argument ignores two facts: first, the purchaser-seller requirement is itself a court-created doctrine based on an interpretation of legislative intent. Courts can validly reinterpret such a doctrine without engaging in judicial legislation. Second, as discussed earlier, the Birnbaum rule has undergone substantial judicial change, and it is therefore misleading to interject the Blau v. Lehman holding since there the Court was considering an interpretation of section 16(b), which was "unbroken since its passage."

Although Congress may be better equipped to make major changes in securities legislation, the courts are also appropriate instruments to accommodate changing social needs. Courts should not feel

93. Id. citing R. JENNINGS & H. MARSH, SECURITIES REGULATION 961 (2d ed. 1968).
95. 368 U.S. 403, 413 (1962) (emphasis added).
bound by judicial mandates which are out of step with current social conditions.

**Federalism**

Courts unanimously agree that section 10(b) was not intended to regulate fraud which only amounts to internal mismanagement of corporate affairs.\(^9\) Although fraudulent mismanagement conceivably could be federally regulated under the Commerce Clause, regulation traditionally has been a state function. Therefore federal proscriptions regarding corporate mismanagement should not develop judicially under a statute intended for another purpose, but should be the product of specific Congressional mandate. The distinction between breach of corporate fiduciary duty and activities affecting securities, however, has never been clearly delineated. It is frequently said that when the two overlap, the injured party may seek a remedy in either the federal or state courts.\(^9\) For example, where the fraud of the corporate officers causes a shareholder to part with securities, an action will lie under 10b-5 and for breach of fiduciary duty.

However, the courts seem to feel that to discard *Birnbaum*, and to adopt in its place a test similar to that once offered by the SEC—that a person has 10b-5 standing if the fraud of another *influences his judgment* to buy, sell or hold securities\(^9\)—inevitably would involve the courts in the regulation of internal corporate mismanagement.\(^9\) For instance, a stockholder-plaintiff would need only allege that the fraudulent mismanagement of the corporation by its officers, by decreasing the worth of the corporation and correspondingly decreasing the value of the plaintiff's shares, was aimed at forcing him to sell his shares. A 10b-5 action could therefore lie for almost any breach of fiduciary duty, since such breaches usually have the effect of at least indirectly reducing the worth of the corporation. The courts reason that such an expansive test of standing under 10b-5 would encroach into an area traditionally regulated by the states, and one not intended to be covered by section 10(b).

It is submitted that if the plaintiff-stockholder in the above situation can prove that the fraudulent scheme of the corporate officers was

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96. See notes 17 and 55 supra. In *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971), the Supreme Court recognized this principle: "We agree that Congress by 10(b) did not seek to regulate transactions which [amounted] to no more than internal corporate mismanagement."


intended to force him to sell out, he should be afforded 10b-5 standing to halt the practice and recover damages for any injury which he may have suffered. Indeed, the wording of the Rule itself seems to prohibit such conduct. The argument that abandonment of Birnbaum would result in federal judicial regulation of corporate fiduciary duties is actually a fear that some shareholders might bring actions for fraud which is not in connection with a purchase or sale of securities. But a shareholder who can show an actual injury resulting from the defendant's fraud in connection with the purchase or sale of securities should be entitled to sue whether or not the plaintiff is the purchaser or seller.

**The Case for Discarding Birnbaum**

10b-5 Language and the SEC

As noted above, the fact that the language of Rule 10b-5 is very broad seems to militate against a narrow standing requirement. Fraud on "any person" is prohibited, not merely fraud on purchasers and sellers; and the fraud must be "in connection with" the purchase or sale of securities rather than "in the purchase or sale." Indeed, the SEC, which drafted 10b-5, for a number of years has urged that the courts abandon Birnbaum and adopt a test which would be more in line with the expansive language of the Rule and the public policy behind the Securities Exchange Act.\(^{100}\)

The SEC's motive in supporting such a broad interpretation may stem from its own limited power to enforce 10b-5. The SEC may obtain an injunction against fraudulent conduct and may also pass along its investigatory findings to the Attorney General's office for possible prosecution.\(^{101}\) Nevertheless, injunctive relief is not as effective a deterrent as a private action for damages. The former requires only that the party engaged in a fraudulent activity refrain from doing so, whereas an action for damages carries with it the additional "sting" of requiring the defendant to pay for his wrongdoing. Thus, the private action for damages deters the particular defendant from wrongdoing in the future and warns other potential defendants against engaging in similar fraudulent conduct.

Moreover, the limited resources of the SEC prevent effective policing of many violations of the Securities Exchange Act, so that enforcement through private damages actions is a necessary supplement to governmental action. In addition, often private individuals are likely to learn of ongoing fraud earlier than the SEC, and the more prompt the

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enforcement, the more likely the prophylactic function of the Act will be effectuated. Although the SEC's purpose in promulgating 10b-5 originally may have been somewhat ambiguous, courts should consider the SEC's current position as persuasive evidence that Birnbaum is at odds with proper enforcement of 10b-5 fraud violations.

Inconsistencies

Although the Birnbaum rule can be faulted because it allows certain types of securities fraud to go unpunished for want of a proper plaintiff, the primary weakness of the rule is that it denies a federal remedy to numerous persons injured by a 10b-5 violation. It is in response to this possibility that the courts have expanded the classes of purchaser and seller in order to allow more persons to sue under 10b-5. Such expansion is laudable, but because it has taken place within the basic Birnbaum framework certain inconsistencies have developed.

For instance, recognition in the merger situation that shareholders in the target corporation are sellers and purchasers when they exchange shares pursuant to a merger is logical, but the same reasoning denies individual 10b-5 standing to shareholders in the surviving corporation since they cannot logically be classified as purchasers or sellers because they have exchanged no shares. As a result, surviving shareholders who may suffer the same type of injury as target shareholders are not allowed an individual action and must sue, if at all, in a derivative capacity.

In the aborted and delayed purchaser-seller cases, the emerging law appears to distinguish between those persons who, subsequent to the inducement not to act, have purchased or sold securities, and those who have not. Persons in the former category are afforded 10b-5 standing on the theory that they are actual purchasers or sellers, while persons in the latter category are denied standing unless they are parties to a contractual relationship which elevates them to the status of purchasers or sellers. The distinction between these two classes is entirely one of form rather than substance. In each instance the injury is a result of the defendant's fraudulent inducement not to act, and in each instance the defrauded party may be injured in the same manner and to the same extent. The fact that a party later purchases or sells securities seems irrelevant to the question of whether he has suffered harm as a result of the defendant's fraud.

Mutual Shares Approach

By employing the Birnbaum rule as a standing requirement, the

102. See notes 35-38 and accompanying text *supra*.
103. See notes 39-73 and accompanying text *supra*.
federal courts have ignored the fact that standing is basically a constitutional case or controversy question.\textsuperscript{104} Except in unusual circumstances,\textsuperscript{105} a person should be allowed standing when he can allege "such a personal stake in the outcome of the controversy as to assure that concrete adverseness which sharpens the presentation of issues."\textsuperscript{106} In the context of 10b-5, a person has a personal stake in the controversy when his interest in securities has been injured or is threatened. In either instance, the issue of 10b-5 fraud is justiciable and standing should be allowed.

This approach apparently was taken by the court in \textit{Mutual Shares Corp. v. Genesco, Inc.}\textsuperscript{107} where the Second Circuit allowed standing to a nonpurchaser or seller who sought injunctive relief. There the plaintiffs were a group of minority shareholders who alleged that the defendants, the controlling shareholders, were forcing them to sell out by keeping dividends low. The court disallowed the claim for damages because the plaintiffs, as nonsellers, had "as yet sustained no monetary injury,"\textsuperscript{108} and therefore could not possibly show that any damages were causally related to the fraud of the defendants. The fact that other shareholders \textit{had} sold at depressed prices did not, in the court's opinion, establish an injury to the plaintiffs. Nonetheless, the court allowed the plaintiffs to sue for injunctive relief under 10b-5 because

\[T]he claim for injunctive relief largely avoids [the issues of present injury and causal connection between injury to others and

\textsuperscript{104} Two courts have suggested that the \textit{Birnbaum} rule is required as a matter of constitutional law. \textit{See Mt. Clemens Indus., Inc. v. Bell, 464 F.2d 339, 343 (9th Cir. 1972); Herpich v. Wallace, 430 F.2d 792, 805-06 (5th Cir. 1970). But the court in \textit{H.K. Porter Co., Inc. v. Nicholson File Co., 353 F. Supp. 153, 166 (D.R.I. 1973) (supplemental opinion), placed the issue in the correct perspective when it stated: "While . . . the requirements of standing under the Constitution may frequently coincide [with the purchaser-seller rule] in particular cases, they are by no means coextensive, in this Court's opinion. The Court has no doubt that plaintiff [who was denied 10b-5 standing because not a purchaser or seller] has standing in the constitutional sense."}\\n
\textsuperscript{105} Ordinary requirements for standing may be altered where Congress specifically limits the class of persons who can sue under a statute it enacts. The standing issue may also be complicated in situations where the plaintiff sues the government or a governmental agency. The test of standing to sue in either case seems to be the two-pronged test announced in \textit{Association of Data Processing Serv., Inc. v. Camp, 397 U.S. 150, 152 (1970): (1) plaintiff must allege an "injury in fact, economic or otherwise," and (2) the court must determine "whether the interest sought to be protected by the complainant is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question." \textit{But see Davis, The Liberalized Law of Standing, 37 U. Chi. L. Rev. 450 (1970) (advocating injury in fact as sole test of standing).}\\n
\textsuperscript{106} \textit{Baker v. Carr, 369 U.S. 186, 204 (1962).}\\n
\textsuperscript{107} 384 F.2d 540 (2d Cir. 1967).\\n
\textsuperscript{108} \textit{Id. at 546.}
injury to the plaintiff], may cure harm suffered by continuing shareholders, and would afford complete relief against the Rule 10b-5 violation for the future.\(^{109}\)

The *Mutual Shares* court apparently did not consider the purchaser-seller limitation to be a per se standing requirement in actions under 10b-5. It did not discuss *Birnbaum*, but mentioned it as one of the “various concepts . . . utilized to limit liability under the sweeping language of . . . Rule [10b-5]”\(^{110}\) and noted that “none [of the limiting concepts were] specifically required by [the Rule].”\(^{111}\)

The approach of the court toward standing has definite merit. The fact that the plaintiff in a damages action has not sold is an *indication* that no injury has been suffered, though nonseller status is not *conclusive* on the standing issue. Where injunctive relief is sought to prevent a threatened injury, whether the plaintiff is a purchaser or seller is even less informative on the issue of whether the alleged wrongdoing threatens him.

### Current Status of Birnbaum

The federal courts seem almost unanimous in their current approval of the expanded purchaser-seller requirement.\(^{112}\) *Mutual Shares* is often reconciled,\(^{113}\) at least in dictum, as announcing the injunctive relief “exception”\(^{114}\) to the purchaser-seller rule, rather than as signifying a different approach to the 10b-5 standing question.\(^{115}\) Nevertheless, courts have failed to apply the purchaser-seller rule from time to time, and there is at least some evidence of a trend to reexamine *Birnbaum*.

109. *Id.* at 547.

110. *Id.* at 543.

111. *Id.* (emphasis added).


114. Since a plaintiff may sue derivatively without personally having purchased or sold, derivative actions could be said to represent a second, well recognized “exception” to *Birnbaum*. Presumably, however, the corporation in such a situation must be a purchaser or seller. See notes 14-15 and accompanying text supra.

115. Failure to realize that the *Mutual Shares* court was approaching standing from a different angle has resulted in a confused body of case law surrounding the
The first court which declined to follow *Birnbaum* was *Entel v. Allen* 118 where shareholders in Atlas Corporation alleged that Atlas sold its interest in another company to Hughes Tool Company (Tooles) without disclosing to the shareholders that Howard Hughes dominated both Atlas and Tooles, and that, therefore, the sale was not negotiated at arm’s length. The court interpreted the Second Circuit decisions of *Vine v. Beneficial Finance Co.* 117 and *A.T. Brod & Co. v. Perlow* 118 as “seriously challeng[ing], if not overrul[ing]” 119 *Birnbaum*, and allowed the shareholders standing even though they were not purchasers or sellers. The court expressed reluctance in allowing the 10b-5 action, but felt compelled to do so:

Although this Court feels that the extension of Section 10(b) and Rule 10b-5 to nonpurchasers-or-sellers . . . would be better left to Congress than to judicial interpretation, it is bound to follow the decisions of this circuit. 120

Actually, neither *Brod* nor *Vine* dealt with the purchaser-seller requirement. As noted earlier, 121 the plaintiff in *Brod* was regarded as a purchaser and the court did not consider the contention of the SEC as amicus curiae that the *Birnbaum* rule should be rejected. 122 Likewise, in *Vine* the SEC suggested that the plaintiff in a 10b-5 action need not be a purchaser or seller in order to have standing so long as

so-called injunctive relief exception. One uncertainty is whether the exception applies in situations, unlike *Mutual Shares*, where there has not been a market manipulation of publicly owned securities. See Hirschleifer v. Fran-Tronics Corp., [Current Binder] CCH Fed. Sec. L. Rep. ¶ 93,681, at 93,028 (S.D.N.Y. Nov. 21, 1972); General Time Corp. v. American Investors Fund, Inc., 283 F. Supp. 400, 403 n.6 (S.D.N.Y. 1968); Puharich v. Borders Electronics Co., Inc., [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,141, at 96,653 (S.D.N.Y. Jan. 24, 1968). Another court has used *Mutual Shares* as authority for holding that the elements of fraud which must be proved are less stringent in an injunctive relief action than in an action for damages, even though the *Mutual Shares* court was concerned only with standing and did not deal with the substantive elements of the alleged fraud. See *Britt v. Cyril Bath Co.*, 417 F.2d 433, 436 (6th Cir. 1969) (plaintiff was a seller so injunctive relief exception was not considered in conjunction with the standing issue).


116. 270 F. Supp. 60 (S.D.N.Y. 1967). Another case in which non-purchasers-or-sellers were allowed 10b-5 standing is *Weitzen v. Kearns*, 271 F. Supp. 616 (S.D.N.Y. 1971) decided by the same district judge who wrote the *Entel* opinion.
118. 375 F.2d 393 (2d Cir. 1967).
119. 270 F. Supp. at 69.
120. Id. at 70.
121. See notes 80-81 and accompanying text supra.
122. 375 F.2d at 397 n.3.
the fraud of the defendant violated the Rule and the plaintiff's holdings lost value as a result.\textsuperscript{123} The court dismissed this assertion as an "interesting contention,"\textsuperscript{124} but one which need not be decided since the court had deemed the plaintiff a seller, albeit a forced one.\textsuperscript{125} Thus, neither \textit{Vine} nor \textit{Brod} reached the question of whether the purchaser-seller requirement should be abandoned. The view of the \textit{Entel} court that these cases seriously challenged \textit{Birnbaum} was, unfortunately, erroneous, and later cases make clear that the Second Circuit continues to adhere to the purchaser-seller requirement.\textsuperscript{126}

Nevertheless, the \textit{Birnbaum} doctrine recently was repudiated by the New Jersey district court in \textit{Tully v. Mott Supermarkets, Inc.}\textsuperscript{127} The plaintiffs, Class A shareholders in Wakefern Corporation, alleged that the directors of Wakefern had shifted the voting control of Wakefern by fraudulently passing a resolution offering a bloc of Class A treasury shares to themselves and other holders of Class B and C shares. The defendant-directors challenged the court's jurisdiction under 10b-5 on the ground that the plaintiffs were neither purchasers nor sellers. The court rejected this argument, stating that "[the defendants seek] to revive the spectre of the \textit{Birnbaum} buyer-seller doctrine at a point in time when both courts and legal scholars are seeking to bury it."\textsuperscript{128} Undoubtedly the court was correct that the weight of law review material on the subject advocates either a very flexible application of \textit{Birnbaum} or its total rejection.\textsuperscript{129} However, the court's assertion that the case law generally seeks to bury \textit{Birnbaum} appears to be somewhat of an overstatement.

First the court invoked language from the recent Supreme Court opinion in \textit{Superintendent of Insurance v. Bankers Life & Casualty Co.},

\begin{footnotes}
\item 123. 374 F.2d at 636.
\item 124. Id.
\item 125. See notes 22-24 and accompanying text supra.
\item 128. Id. at 839.
\end{footnotes}
that “section 10(b) must be read flexibly, not technically and restrictively.” Reliance on the Bankers Life language is misleading because in that case the Court expressly declined to pass on the status of the purchaser-seller rule. The plaintiff in Bankers Life was a seller of bonds, and the succeeding sentence to the Court’s “flexibility” language acknowledged that fact: “Since there was a ‘sale’ of a security and since fraud was used ‘in connection with’ it there is redress under § 10(b). . . .”

Furthermore, reliance on this oft-cited language is of little aid when considering the purchaser-seller requirement since other courts employ the same passage to argue that Birnbaum is still good law. For example, one court has stated:

In our view, there has been no erosion of Birnbaum. Rather, the doctrine formulated therein has been interpreted and applied “flexibly, not technically and restrictively” . . . thus promoting the Congressional purpose in the enactment of this remedial legislation.

The Tully court also relied on Crane Co. v. Westinghouse Air Brake Co. and Kahan v. Rosenstiel as precedents for the rejection of the purchaser-seller requirement. As noted earlier, Crane is most often reconciled within the Birnbaum doctrine as a forced seller case. Moreover, even if Crane is not viewed as a forced seller case, there is no apparent reason to afford greater weight to Crane than to subsequent Second Circuit cases which explicitly affirm Birnbaum’s standing requirement.

The Tully court’s reliance on Kahan as a renunciation of Birnbaum, however, may have been justified. Although the Kahan court was considering only the issue of whether a nonpurchaser-or-seller could maintain a 10b-5 action for injunctive relief, and could therefore be interpreted as adopting the Mutual Shares “exception,” the court’s language suggests that, regardless of the type of relief sought, the 10b-5 plaintiff need be neither a purchaser nor a seller in order to have standing.

Neither the language of § 10(b) and Rule 10b-5 nor the policy they were designed to effectuate mandate adherence to a strict

130. 404 U.S. at 12.
132. 404 U.S. at 12.
133. Mt. Clemens Indus., Inc. v. Bell, 464 F.2d 339, 341 (9th Cir. 1972).
136. See note 79 and accompanying text supra.
137. E.g., Haberman v. Murchison, 468 F.2d 1305, 1311-14 (2d Cir. 1972).
138. See notes 107-11 and accompanying text.
purchaser-seller requirement so as to preclude suits for relief if a plaintiff can establish a causal connection between the violations alleged and the plaintiff's loss.\textsuperscript{139}

Both \textit{Tully} and \textit{Kahan} adopt a causal test for standing. That is, the plaintiff in a 10b-5 action has standing to sue "where there is a causal connection between the purchase or sale of stock, the alleged fraud . . . and plaintiff's loss . . ."\textsuperscript{140} This test obviously disregards the purchaser-seller rule as a 10b-5 standing requirement, and its liberality is encouraging. Other courts have not gone as far, but there appears to be a trend emerging at least to reexamine \textit{Birnbaum}.

For instance, three recent cases which do not reject the purchaser-seller doctrine outright nevertheless appear to indicate dissatisfaction with \textit{Birnbaum}. In \textit{Travis v. Anthes Imperial Limited},\textsuperscript{141} plaintiff was allowed standing on alternative grounds as either a delayed seller or a forced seller. But the Eighth Circuit did not stop there. Instead, in an ambiguously worded dictum, the court responded to the SEC's request to abandon the purchaser-seller requirement as follows:

We decline to do so here, but emphasize that the Securities Exchange Act of 1934 is remedial legislation which should be construed broadly to effectuate its purpose . . . and that "10(b) must be read flexibly, not technically and restrictively."\textsuperscript{142}

By invoking the \textit{Bankers Life} language the court intimated that it would discard \textit{Birnbaum} whenever the court feels that the purchaser-seller requirement fails to effectuate the remedial purposes of the Exchange Act. In essence this may mean that the Eighth Circuit will not follow \textit{Birnbaum} when, in the court's opinion, "justice" is not served by application of the purchaser-seller rule.

In \textit{H.K. Porter Co. v. Nicholson File Co.},\textsuperscript{144} the plaintiff's tender offer for Nicholson stock was defeated when Nicholson sent a series of letters to its shareholders urging them to refrain from tendering. The letters allegedly contained fraudulent representations that Nicholson would soon merge and its shareholders would receive more for their shares than under Porter's tender offer. The facts of the case so closely resembled \textit{Iroquois Industries, Inc. v. Syracuse China Corp.}\textsuperscript{145} that the Rhode Island district court felt compelled to deny standing solely under constraint of that decision. In so doing, however, the

\begin{itemize}
  \item \textsuperscript{139} 424 F.2d at 173.
  \item \textsuperscript{140}  Tully v. Mott Supermarkets, Inc., 337 F. Supp. 834, 842 (D.N.J. 1972).
  \item \textsuperscript{141}  473 F.2d 515 (8th Cir. 1973). See notes 30-31 and 51-55 and accompanying text \textit{supra}.
  \item \textsuperscript{142}  \textit{Id.} at 521 n.9.
  \item \textsuperscript{143}  See notes 130-33 and accompanying text \textit{supra}.
  \item \textsuperscript{144}  353 F. Supp. 153 (D.R.I. 1972).
  \item \textsuperscript{145}  417 F.2d 963 (2d Cir. 1969), \textit{cert. denied}, 399 U.S. 909 (1970). See notes 74-87 and accompanying text \textit{supra}.
\end{itemize}
court engaged in a lengthy discussion of the Second Circuit decisions in *Iroquois* and *Crane Co. v. Westinghouse Air Brake Co.* The court interpreted the latter decision not as a forced seller case but as an enunciation that 10b-5 standing "turned on a showing of a causal connection between the fraud and the damage claim . . . ." The court made clear that it preferred the result in *Crane*, but nevertheless felt bound by *Iroquois* since "subsequent decisions have sought to limit *Crane* and have reaffirmed *Iroquois*.

Similar doubt over the continued validity of *Birnbaum* was manifested by the district court for the southern district of New York in *Competitive Associates, Inc. v. International Health Services, Inc.* There the plaintiff was not a purchaser or seller, but the court refused to deny standing on this ground. Instead, the plaintiff's claim was disallowed because he had failed to allege an actionable injury.

If *Birnbaum* is still good authority . . . then [plaintiff's] complaint must be dismissed. We would prefer however to stand on other or additional and broader grounds for dismissing [plaintiff's] complaint. The complaint does not plead the basis for any injuries suffered by [plaintiff].

The trepidation of the *Travis, Porter* and *Competitive* courts is founded on the general belief that *Birnbaum* might no longer be good authority. In light of the vast majority of cases dealing with 10b-5 standing which accept the purchaser-seller rule, such fear is probably ill-founded. Nevertheless, these three cases, along with *Tully* and *Kahan*, represent an encouraging judicial trend at least to examine very closely the applicability of the *Birnbaum* doctrine.

**Conclusion**

The federal courts have greatly liberalized the *Birnbaum* standing requirement by expanding the terms purchaser and seller to include more persons who are injured as a result of securities fraud. Despite this liberalization, the basic *Birnbaum* framework continues intact and 10b-5 accordingly is not fully effective in remediying injuries suffered by nonpurchasers-or-sellers as the result of fraud in connection with the purchase or sale of securities.

It is suggested that the courts discard *Birnbaum* and adopt a standing test which is more akin to the constitutional case or contro-

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148. Id. at 166 (supplemental opinion).
150. Id. at 92,870.
versy standard and the approach taken in *Mutual Shares Corp. v. Gen-
esco, Inc.* Such a test would require only that the plaintiff allege an injury in fact in a damages action and a threatened injury where injunctive relief is sought. The fact that the plaintiff is neither a purchaser or seller should not be conclusive on the issue of standing, but should serve merely as a factor to be considered in determining whether the plaintiff actually has suffered an injury.

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151. 384 F.2d 540 (2d Cir. 1967). See notes 107-11 and accompanying text supra.

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