Insider Trading—The Market Anonymity Gap in Rule 10b-5

Judith A. Levitt
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IN RULE 10b-5

INTRODUCTION

The use of corporate inside information in securities transactions traditionally has given rise to liability in damages only to the actual purchaser or seller in privity with the insider. Common-law liability for insider trading was predicated upon a principle of indemnification for a breach of duty that arose under a contract. The privity limitation on recovery was a natural outgrowth of the common-law principle in a time, prior to the evolution of the national securities exchanges, when most transactions took place on a face-to-face basis. Absent a contractual breach of duty and direct harm, there could be no recovery. The aim of the law was solely to protect the individual investor's contractual rights.

Section 10(b) of the Securities Exchange Act of 1934 and rule


2. The term "insider" will be used throughout this Comment to include anyone in possession of corporate inside information. It will be unnecessary, in most instances, to distinguish between a common-law or a statutory insider, or between a tipper and tippee.

3. It is beyond the scope of this Comment to set forth an analysis of the duties of an insider that may give rise to liability to a purchaser or seller, or to an issuing corporation. In brief, however, the insider is under little or no duty under common law, absent a showing of fraud, to disclose material inside information to a shareholder. The insider's fiduciary duty to his corporation leads to liability only if the transaction amounted to a usurpation of a corporate opportunity, competition with the corporation, or sale of control. For a detailed analysis of the common-law duties and liabilities, see H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES §§ 235, 239 (2d ed. 1970); 3 Loss 1430-48; Conant, Duties of Disclosure of Corporate Insiders Who Purchase Shares, 46 CORNELL L.Q. 53 (1960); Note, supra note 1; Note, Inside Information as a Corporate Asset, 1970 WIs. L. REV. 576 (1970); 37 FORDHAM L. REV. 477 (1969).

4. 15 U.S.C. § 78j(b) (1970) 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—

(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 regis-
10b-5 promulgated thereunder have effectively preempted the area of insider trading. Contemporaneous with preemption has been a shift in emphasis from indemnification to deterrence. The announced policy behind the Act is to ensure that all investors have equal access to information affecting the sale of securities. That policy includes both the need to encourage the free flow of information in the market and the need to deter the use of inside information which per se gives the insider an unfair advantage in the marketplace. Consequently, a system of liabilities and remedies which reflects both aims has been established under the rule; this system is broader in scope than the

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<td>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,</td>
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<td>(a) To employ any device, scheme, or artifice to defraud,</td>
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<td>(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or</td>
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<td>(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.</td>
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<th>6. Although section 28 of the Securities Exchange Act of 1934 specifically preserves to litigants all rights and remedies available under state law, a plaintiff usually will choose to plead a 10b-5 violation in federal court. The section provides, in part:</th>
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<td>(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages ...</td>
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15 U.S.C. § 78bb (1970). The advantages of the federal rule—the broad expansion of the insider's duty to disclose material information, the relaxation of the element of fraud, the replacement of a strict privity requirement with ordinarily no more than a semblance of privity, and the extraterritorial service of process under the 1934 Act, to name only a few—lead a plaintiff to plead a 10b-5 offense in federal court when a transaction has violated both federal and common law. For a discussion of the advantages of the 10b-5 action over a common-law action, see 3 Loss 1430-74; Comant, supra note 3; Comment, Federal-State Relations Under Rule 10b-5—Procedural Relation, 23 Sw. L.J. 526 (1969); Note, SEC v. Texas Gulf Sulphur Co.: The Inside and Outside of Rule 10b-5, 46 Boston U.L. Rev. 206 (1966); Note, supra note 1.

common law, but not without its limits. The duty owed by the insider has been expanded from a common-law duty arising under a contract, to those in privity with the insider, to a statutory duty to the general investing public. The power to enforce that statutory duty was specifically granted by Congress to the Securities and Exchange Commission in section 21 of the 1934 Act.

Although Congress did not provide for a private right of action under the section, that right has been implied judicially, the courts holding that purchasers and sellers of securities traded on the basis of inside information have standing to sue. The purchaser/seller limitation on standing is essentially a restatement of the concept of privity, but without the requirement of a direct contract between the parties to the trade. Due to the development of the national securities exchanges, anonymity has virtually replaced the face-to-face transaction. There no longer is a contractual relationship between the seller and the ultimate buyer. Privity would be, therefore, an impossible requirement today. The purchaser/seller concept is the natural replacement for privity since it recognizes the anonymity problem and yet limits recovery to those directly harmed by the use of the inside information.

In theory, then, the anonymity of the national securities ex-

   (e) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.
13. The purchaser/seller limitation was first announced in Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), cert. denied, 343 U.S. 956 (1952). For a discussion of the disintegration of the rule, see Lowenfels, *The Demise of the Birnbaum Doctrine*, 54 Va. L. Rev. 268 (1968). Although it has been somewhat eroded, the courts have continually refused to abolish it in damage suits. Boone & McGowan, supra note 1, at 623-29.
changes should not make recovery any more difficult than when trades were made on a face-to-face basis. The situation is quite different in practice, however. No longer does the purchaser or seller know from whom he has bought or to whom he has sold unless he traces the transaction back through the clearinghouse and the exchange. The investor, therefore, must not only discover that the trade was made on the basis of inside information, as was necessary in the face-to-face transaction, he must also discover that he was the purchaser or seller of the shares actually traded on the basis of that inside information. Since it is not routine practice to trace the origins or destinations of traded shares (and it probably would not be economically feasible to require that the middlemen identify the shares in all instances), discovery by an investor that he is the purchaser or seller of such shares normally will be prompted only by an investigation of a specific transaction by an outside source, usually the SEC, and the publicity attendant to the investigation. A public announcement or press release may then alert an astute investor to trace the shares that he actually bought or sold to find out if he was a purchaser or seller of the illegally traded shares. The role of the purchaser/seller as a private enforcer of the Act is thus severely limited by market anonymity.

The SEC, is, in practice, the sole enforcement agency, and it, too, faces obstacles which circumscribe its effectiveness. The physical limitations on its manpower necessitate that it be guided by the size of the transaction. The larger the transaction, the greater is its effect on the market, and therefore, the more worthy it is of investigation by the SEC. Likewise, the larger the transaction, the more noticeable it will be to the investigative eye; size will engender suspicion.

It is inherently difficult for an outsider to discover that inside information was the underlying motivation for a securities transaction. Furthermore, the SEC rarely sues for damages under rule 10b-5; rather, it seeks injunctive relief preferring, it would seem, to leave damage

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16. Id.
17. The lack of manpower is noted in Boone & McGowan, supra note 1, at 648. It has also been stated that without private attorneys-general, "the desired deterrent effect of the statute would be left to the vagaries of SEC action . . . ." 48 ST. JOHN'S L. REV. 415, 417 (1973) (footnote omitted).
suits to private litigants. The result is a haphazard pattern of enforcement.

The deterrence policy of the Act is not served by erratic enforcement. The gap created by market anonymity must be closed if rule 10b-5 is to be effective. The means chosen for closing the gap, however, should comport with the system that now exists on paper which reflects the delicate balance between the need to deter insider trading and the need to encourage the free flow of information. Whereas the present gap in 10b-5 serves to weaken the rule as a deterrence measure, imposition of liability beyond what is already sanctioned would inhibit the necessary flow of information, and it certainly should not be imposed before it is determined that the existing degree of liability is not sufficient to deter insider trading. The purpose of this Comment is to suggest a method of compensating for market anonymity, subjecting all offenders to the existing scheme of remedies and liability, while recognizing the balancing of interests which gave rise to those remedies. An examination of the present standing requirements and remedies suggests what means Congress and the judiciary have deemed necessary to protect those interests, and recent federal and common-law decisions indicate the means for giving substance to rule 10b-5.

I. INSIDER TRADING UNDER THE SECURITIES EXCHANGE ACT OF 1934

A. Statutory Distinctions

Insider trading is prohibited by the Securities Exchange Act of 1934 under both section 16 (b) and section 10 (b). The former

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized . . . .

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specifically proscribes speculation by a defined group of insiders resulting in short-swing profits. Legislative history indicates that such short-swing transactions were considered the most flagrant abuse of inside information, the most difficult to regulate, and the least conducive to proof of intent, while the insider was most capable of influencing the market because of his position and sizable holdings. Section 10(b) and rule 10b-5, on the other hand, are considered general, anti-fraud provisions designed to encompass those insiders whose transactions, although not falling within the well-defined limits of section 16(b), run counter to the equal information policy of the Act.

The distinction drawn by Congress in enacting the two provisions presents the first indication that not all forms of insider trading are equally offensive to federal policy. Section 16(b) specifically provides that a suit for damages may be maintained by the issuing corporation against the defined insider, either directly or derivatively, thereby casting the corporation in the role of private attorney general; whereas section 10(b) is silent on the matter of private remedies. As noted above, if no private remedy exists under section 10(b), then action is left to the SEC which, until recently,
could enforce section 10(b) only through its power to seek injunctive relief.\textsuperscript{27} It is apparent from these differences that Congress was more concerned with removing illegal profits from the pockets of the offenders whose conduct was deemed most reprehensible to the policy of the Act than in ensuring that those who had abused inside information short of committing a section 16(b) violation gave up their tainted profits.

Whether or not Congress anticipated that the Securities Exchange Act would preempt common law in the area of insider trading, the distinction drawn above remains valid. Even if section 10(b) had not been judicially interpreted so as to imply a private right of action to a purchaser or seller, state law would have been in force to provide that right. The result would have been that a violation of section 16(b) would have subjected the offender to liability to the issuing corporation under that section and also to liability to the parties in privity under the contract of sale. Abuses of inside information which fell without section 16(b) but within section 10(b) would have subjected the offender to liability only under common law to parties in privity.\textsuperscript{28} Section 16(b) violators would have continued to bear the heavier burden.

B. Judicial Interpretation of Standing Under Section 10(b)

Preemption of the common law by the Securities Exchange Act of 1934 was made certain by the judicial implication of a right of action\textsuperscript{29} in purchasers and sellers\textsuperscript{30} under section 10(b), aided by the fact that the factual transactions involving inside information deemed violative are much broader and easier to prove under rule 10b-5 than under common law.\textsuperscript{31} Yet, the proportionate burden of liability remains the same as that existing prior to the judicial sanction of the

\textsuperscript{28} The common-law liability to purchasers and sellers would be circumscribed, of course, by the limited duty the insider was held to owe to the shareholder, short of a showing of fraud. \textit{See materials cited at note 3 supra.}
\textsuperscript{29} \textit{See} cases cited at note 12 supra.
\textsuperscript{30} \textit{See} materials cited at note 13 supra.
\textsuperscript{31} For a comparison of the duty of disclosure and the elements of a cause of action under the common law and under rule 10b-5, see 3 Loss 1430-74; \textit{Comment, Insider Liability Under Securities Exchange Act Rule 10b-5}, 30 U. Chi. L. Rev. 121 (1962); Conant, \textit{supra} note 3.
implied private right of action. That is, section 16(b) violators are subject to liability under that section to the issuing corporation and, under section 10(b), to the purchasers or sellers involved in the illegal sale. Violators of section 10(b) alone will be liable in damages only to the purchasers or sellers.

C. Abrogation of Purchaser/Seller Requirement: Injunctive Relief

Although the purchaser/seller standing requirement of the rule remains in force for cases in which damages are requested, the courts have set it aside if the issuing corporation sues solely for injunctive relief. As under section 16(b), the corporation is cast in terms of a private attorney general to enforce the Act. Thus, there are three agents who have standing to enforce section 10(b) via injunctive relief—the SEC, the purchasers/sellers, and the issuing corporation; only two, the SEC and the purchasers/sellers, have standing to sue for damages.

D. Judicial Interpretation of Rule 10b-5: Damages Versus Injunction

In addition to the distinction established under rule 10b-5 between standing and the relief requested, a further distinction, pivoting around the element of scienter, has been drawn in determining which transactions violative of the rule will warrant the imposition of either damages or an injunction. The initial determination that a transaction is violative of section 16(b) or section 10(b) concurrently determines whether the defendant is potentially liable to both the issuing corporation and the purchasers/sellers, or is liable to the

32. See materials cited at note 13 supra.
34. The courts have reasoned that the action is not for damages, but to deter future violations, therefore ensuring enforcement of rule 10b-5. See, e.g., SEC v. National Sec., Inc., 393 U.S. 453 (1969).
35. For an early discussion of rule 10b-5 and the imposition of liability based on state of mind, see Ruder, Texas Gulf Sulphur—The Second Round, 63 Nw. U.L. Rev. 423 (1968). Ruder suggests that different standards be applied in privity and non-privity cases because of the potential liability attaching to the latter. Id. at 441-42.
purchasers/sellers only. Once a 10b-5 violation is established, the next step is to determine the degree of the defendant's intent, which in turn leads to the choice of the appropriate remedy. The first determination is a congressionally sanctioned distinction based on how repugnant the violation is to the policy of the Securities Exchange Act of 1934; the second is based on how repugnant to that policy are the actions of a particular violator. In terms of the standards applied under 10b-5, injunctive relief is available where mere negligence is present; the recovery of damages is deemed necessary only if something more than negligence, but less than fraud, is found.\(^{36}\)

E. Standing, Enforcement of the Standards, and Market Anonymity

It is clear that the standing requirement and market anonymity join together to create an anomalous result in the enforcement of section 10(b), a result which can serve only to weaken the section as a deterrence measure. By virtue of the corporation's right to seek injunctive relief, greater means are available to police negligent conduct than fraudulent conduct. The more invidious violators of 10b-5 are subject to the more stringent remedy of damages only if the purchasers/sellers are made aware of their cause of action by the chance occurrence of an SEC investigation and its attendant publicity. Whether injunctive relief or the imposition of damages is deemed necessary, either judicially or congressionally, to carry out the policies of the Act, it is imperative that methods of enforcement are available by which all violators may be uniformly subject to the appropriate remedies.

II. Judicial Attempts to Close the Gap

Since 1968, there have been three significant cases, each of which represents an attempt to overcome market anonymity and to prevent violators of rule 10b-5 from retaining their illegal profits. In each case, the court allowed recovery of the insider's profits by the issuing

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36. "Although it is the case that in a private action for damages under § 10(b) some stricter standard of scienter beyond negligence is necessary ... it is also the rule that in an enforcement proceeding for equitable or prophylactic relief ... mere negligence is a sufficient basis for liability." SEC v. Lum's, Inc., 365 F. Supp. 1046, 1057-58 (S.D.N.Y. 1973) (footnotes omitted).

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corporation using the grant of standing to the corporation under sections 16(b) and 10(b) (where injunctive relief is requested) as precedent. In every instance, however, recovery by the corporation either went far beyond compensating for market anonymity, thereby erasing the distinctions in the burden of liability to be borne by section 16(b) and section 10(b) violators, or fell short of filling the gap.

A. Diamond v. Oreamuno

The New York Court of Appeals, in Diamond v. Oreamuno, has reintroduced common law into the regulation of insider trading, dealing a frontal blow to market anonymity. The court held that the issuing corporation could recover damages from the insider on two theories: first, the use of inside information constitutes a breach of fiduciary duty in that illegal sale of shares taints the reputation of a corporation; and second, because 10b-5 is ineffective in removing illegal profits from an insider due to market anonymity, the issuing corporation should be allowed to act as a private attorney general.

The facts of the case constituted a clear 10b-5 violation. As a result of increased expenses, the net earnings of Management Assistance, Inc. (hereinafter referred to as MAI) fell approximately 75 percent from July to August 1966. Defendant officers and directors knew of the decrease in earnings, but prior to public announcement of the revised earnings, Oreamuno, chairman of the board of directors, and Gonzalez, president of the company, sold off a total of 56,500 shares of their MAI stock at the then current market price of $28 per share. After the decline in earnings was made public, the value of the stock dropped from $28 to $11. Plaintiff brought a shareholders' derivative action to compel an accounting for profits acquired by defendants as a result of a breach of fiduciary duty. The supreme court, special term, dismissed the complaint for failure to state a cause of action; the appellate division modified the order.

38. Id. at 499, 248 N.E.2d at 912-13, 301 N.Y.S.2d at 82.
39. Id. at 502-03, 248 N.E.2d at 914-15, 301 N.Y.S.2d at 84-85.
40. Id. at 496-97, 284 N.E.2d at 911, 301 N.Y.S.2d at 79-80.
41. Id. at 496, 248 N.E.2d at 911, 301 N.Y.S.2d at 79.
by reinstating the complaint as against Oreamuno and Gonzalez;\textsuperscript{42} the court of appeals unanimously affirmed the order as modified.\textsuperscript{43}

It is clear that from the outset the court did not intend to allow the defendants to retain profits made pursuant to the illegal sale. It encountered some difficulty in reaching that result, however, since there was no common-law precedent for allowing the corporation to recover those profits unless the corporation had been harmed by a breach of duty and indemnification was being sought for the harm done.\textsuperscript{44} Since the corporate entity suffered no economic damage, support for the sanctioning of the shareholders' derivative action had to be found on other than the traditional common-law grounds.\textsuperscript{45} That support was found in an expanded concept of fiduciary responsibility. For the first time, that responsibility was interpreted to include not only the duty to prevent economic injury to the corporate entity but also to protect the entity's reputation.\textsuperscript{46} By trading on nonpublic inside information, defendants were held to have breached their fiduciary duty by tainting the corporate reputation. Corporate recovery was based, therefore, on the principle of indemnification for harm done;\textsuperscript{47} the derivative suit was allowed to make the corporation whole. The reasoning is consistent with the state's traditional policy of preventing corporate mismanagement.\textsuperscript{48}

The court did not rest its holding solely on breach of fiduciary duty. A second line of reasoning used to support recovery by the

\textsuperscript{42} 29 App. Div. 2d 285, 287 N.Y.S.2d 300 (1st Dep't 1968).
\textsuperscript{44} For a brief discussion of the circumstances under which the corporation could bring an action against an insider and authorities listed therein see note 3 supra.
\textsuperscript{45} The court cited Brophy v. Cities Serv. Co., 31 Del. Oh. 241, 70 A.2d 5 (1949), as authority for the principle that a cause of action for breach of fiduciary duty need not include an allegation that the employer suffered a loss. 24 N.Y.2d at 500-01, 248 N.E.2d at 913-14, 301 N.Y.S.2d at 82-83. Brophy, however, held an insider liable to the corporation for profits he made by buying stock when he was aware that the corporation was embarking on a stock repurchase program. Liability, therefore, was premised on the traditional duty of a fiduciary not to compete with the corporation. See 37 FORDHAM L. REV. 477, 479 (1969). See also 3 Loss 1123-24, in which Professor Loss contends that Brophy requires a showing of potential harm to the corporation.
\textsuperscript{46} 24 N.Y.2d at 499, 248 N.E.2d at 912-13, 301 N.Y.S.2d at 82.
\textsuperscript{47} Despite the fact that the court says an allegation of damages is not essential to the cause of action for breach of fiduciary duty (id. at 498, 248 N.E.2d at 912, 301 N.Y.S.2d at 81), because it is not to compensate, but to prevent the wrong that the cause of action exists, the wrong ordinarily prevented would have resulted in economic harm. See 37 FORDHAM L. REV. 477, 479 (1969). By finding damage to the corporate reputation, the court, in essence, perpetuates the idea of compensation.
\textsuperscript{48} 87 HARV. L. REV. 675, 683-84 (1974).
corporation revolved around the court's assertion that the facts alleged constituted a violation of rule 10b-5, with the concomitant statement that the rule provides no effective enforcement measure against violators to insure maintenance of the federal policy that all investors have access to equal information. Potential liability to purchasers under rule 10b-5 was dismissed summarily because of the problem of anonymity in a sale executed on a national exchange. The availability of injunctive relief was deemed insufficient since the defendants would have retained their profits. Thus, to enforce the federal policy, the court reasoned that the issuing corporation certainly had a better claim to the illegal profits than did the violating defendants.

Summary dismissal of the defendants' potential liability to purchasers under rule 10b-5 did not preclude but rather sidestepped the possibility that a purchaser could bring a 10b-5 suit and recover damages from the defendants. The court emphasized the concept of unjust enrichment which implies the disgorging of profits, not liability over and above such profits. The opinion dealt solely with the ineffectiveness of the enforcement methods available under 10b-5 to retrieve illegal profits from violators. The court never alleged that the amount of liability imposed under 10b-5 was insufficient to effectuate the federal policy. By not foreclosing the possibility of liability to the purchasers under 10b-5, the court left defendants subject to multiple liability for a 10b-5 violation theretofore imposed only for the more reprehensible section 16(b) violation.

The intermingling of state and federal concerns in the opinion makes it virtually impossible to distinguish on which ground the court relied to support recovery by the corporation. The lack of certainty is not particularly harmful under the Diamond or similar fact situations, however. It can be argued convincingly that fiduciary duty should encompass protection of the corporate reputation in addition to the corporate pocketbook. The state is left to decide whether the interest is compelling enough to warrant indemnification by de-

50. Id. at 503, 248 N.E.2d at 915, 301 N.Y.S.2d at 85.
51. Id. at 504, 248 N.E.2d at 915, 301 N.Y.S.2d at 86.
52. "The purpose of such an action [for injunctive relief] would appear to be more to establish a principle than to provide a regular method of enforcement." Id. at 502, 248 N.E.2d at 914, 301 N.Y.S.2d at 84.
fendants of both the issuing corporation and 10b-5 purchasers. The state will do so for cases in which the transaction contravenes two discrete policy concerns: the state concern for honest corporate management and the federal interest in maintaining equal access to information in the securities market. If, however, the court in Diamond is interpreted as having expanded the concept of fiduciary duty in order to compensate for the enforcement gap in 10b-5, the failure to preclude the possibility that defendants will be forced to indemnify both the corporation and the purchasers may result in an unjustified encroachment on the congressional distinction between section 16(b) and section 10(b) violations.

B. SEC v. Texas Gulf Sulphur

The next attack on market anonymity took the form of a judicial expansion of the SEC's enforcement powers. In an administrative proceeding under rule 10b-5, the SEC requested relief both in the form of injunctions and damages against the defendants who had bought shares in Texas Gulf Sulphur, Inc. on the basis of nonpublic information. The United States District Court for the Southern District of New York cited Diamond to support the proposition that it is necessary to remove illegal profits from the hands of the defendants in order to effect the deterrence policy of 10b-5. Holding that the SEC has ancillary power to enforce rule 10b-5, in addition to the congressional grant of authority to seek injunctive relief, the court allowed the SEC to recover the defendants' profits. The recovery was to be held in escrow for five years during which time the sellers could seek to enforce their private right of action under 10b-5. Any judgment in favor of the sellers was to be paid out of the amount held in escrow. At the end of the five years, the escrow was to be terminated.

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54. For a detailed description of the facts of the instant case, see SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).
56. Id. at 90-93. See 3 Loss 1827-28; Comment, SEC Enforcement of the Rule 10b-5 Duty to Disclose Material Information, 65 MiCh. L. Rev. 944, 946-48 (1967); Note, Ancillary Relief in SEC Injunction Suits for Violation of Rule 10b-5, 79 HARV. L. REV. 656 (1966).
and any remaining funds to be awarded unconditionally to Texas Gulf Sulphur, the issuing corporation.\textsuperscript{57} The object, as in \textit{Diamond}, was to insure that the violators did not retain their profits.\textsuperscript{58}

Expansion of the SEC's power and the conditional award of the recovery to the issuing corporation do not compensate fully for market anonymity. The numerous private actions brought by sellers against the insiders are illustrative of the fact that the SEC's ancillary power to recover damages many times results in a duplication of effort. Defendants would not have retained their profits in any case. The magnitude of the transactions in question and the publicity given to the oil strike, both before and after the corporation's announcement of the size of the strike, brought the activities to the attention of the SEC. That publicity, in addition to the SEC's subsequent investigation, served to put investors on notice of possible illegal trading so as to trigger their own personal investigations as to whether or not they were sellers within the meaning of 10b-5. The instances in which an SEC investigation does not cause publicity are the only cases in which the SEC's ancillary power is of any use in filling the anonymity gap. In the ordinary situation, the publicity attending an SEC investigation serves to overcome the market anonymity problem. When the SEC is not aware of an illegal transaction or declines to enforce 10b-5 against a known violator, either because of the transaction's lack of impact on the market or because of lack of manpower, the \textit{Texas Gulf} solution is negated.

\textsuperscript{57} 312 F. Supp. at 93.

\textsuperscript{58} "[T]here can be no justification for permitting officers and directors, such as the defendants, to retain for themselves profits which . . . they derived solely from exploiting information gained by virtue of their inside position as corporate officials." \textit{Diamond v. Oreamuno}, 24 N.Y.2d 494, 498-99, 248 N.E.2d 910, 912, 301 N.Y.S.2d 78, 81 (1969).

The court in \textit{SEC v. Golconda Mining Co.}, 327 F. Supp. 257 (S.D.N.Y. 1971), fashioned a remedy similar to that in \textit{Texas Gulf}. Pursuant to a consent judgment, defendants deposited with a trustee appointed by the court the amount of their profits realized on the illegal transaction. The trustee was to use his best efforts in locating the purchasers and sellers, and was to pay them stipulated amounts per share and interest out of the deposited sums. The trustee was unable to locate all persons entitled to share in the fund, and certain funds remained in his hands. He then sought a direction by the court as to the disposition of the unclaimed balance. The court refused to return the balance to defendants stating that "[t]o permit the return of the unclaimed funds, a portion of the illicit profits, would impair the full impact of the deterrent force that is essential if adequate enforcement of the securities acts is to be achieved. One requirement of such enforcement is a basic policy that those who have engaged in proscribed conduct surrender all profits flowing therefrom." \textit{Id.} at 259-60 (footnotes omitted). The trustee was directed to deposit the remaining balance in the registry of the court for the benefit of the potential claimants (purchasers and sellers) who had not yet claimed under the judgment. \textit{Id.} at 260.
C. Schein v. Chasen

The 1973 decision in the United States Court of Appeals for the Second Circuit in Schein v. Chasen embodies the most recent judicial attack on market anonymity. Basing its opinion on Diamond, the court held that a tippee who traded on inside information could be held jointly and severally liable with the nontrading tipper-insider to the issuing corporation in a shareholders' derivative suit. The United States District Court for the Southern District of New York dismissed the complaint for failure to state a claim upon which relief could be granted holding that Diamond could not be extended to encompass "extra-corporate conspirators and tippees." The Second Circuit reversed, finding that recovery by the corporation of realized profits, on the basis of Diamond, should extend to such third parties.

In November, 1969, Chasen, president and chief operating officer of Lum's, Inc., announced to a seminar of the securities industry that Lum's earnings for the fiscal year ending July 31, 1970, would be approximately $1.00 to $1.10 per share. About six months thereafter, he learned that Lum's earnings would be closer to $.76 per share. Before the later projection was made public, Chasen conveyed the information to Simon, a registered representative of broker-dealer Lehman Brothers, who was apprised of the fact that the information was confidential. Simon telephoned Sit, allegedly informing him that the information was not yet public, who then called Jundt. Sit and Jundt, portfolio managers for the defendant Mutual Funds, advised the Mutual Funds, on the basis of the lower earnings projection, to sell their entire holdings in Lum's. The Funds subsequently sold a total of 83,000 shares on the New York Stock Exchange at a price of approximately $17.50 per share. Trading on the exchange was halted that day pending release by Lum's of the announcement of the lower projected earnings. When trading resumed the stock closed at $14 per share—$3.50 less than the Funds realized on the sale of their shares.

60. 478 F.2d at 823. Although Lum's is a Florida corporation, there were no Florida decisions in point and the court turned to New York law. Id. at 821.
61. Id. at 822.
63. Id. at 334.
64. 478 F.2d at 823.
65. Id. at 820-21.
In reversing the dismissal order, the Second Circuit initially gave some passing attention to the principles of fiduciary duty enunciated in *Diamond*. Reiterating the interest a corporation has in protecting its reputation, the court held that co-venturers are subject to liability to the corporation in the same manner as if the director himself had traded on the basis of the inside information. Without proof of a co-venture or conspiracy with President Chasen to misuse confidential corporate information, it could not be argued that Lum's reputation had been injured by anyone other than Chasen. It would be assumed, therefore, that Simon and the Mutual Fund defendants would not be liable to the corporation for any damages. However, the court went beyond *Diamond* and effectively found that a joint venture is not necessary to liability, holding that the mere possession of inside information vests the possessor with a fiduciary duty to the corporation.

No prior relationship with the corporation is needed to give rise to that duty. On that basis, the Mutual Funds and Simon, in addition to Chasen, breached their fiduciary duty to the corporation.

The rest of the opinion clarified the court's need to find that a fiduciary duty to the corporation had been breached. As in *Diamond*, the remaining support for the decision was drawn from the federal securities laws and the policies they seek to implement. Addressing itself to the deterrent influence of *Diamond* on insider trading, the court declared that "this cleansing effect ought to reach third parties . . . ." The court took judicial notice of the impracticability of private and administrative rule 10b-5 suits and of the need to prevent violators of the rule from escaping liability in damages. "Preventing those who are privy to confidential inside information from using it to their own advantage has found expression in numerous cases in the federal courts dealing with violations of the federal securities laws." As Judge Irving R. Kaufman noted in his dissenting opinion, the majority, to satisfy their urge to prevent insider trading, held that any

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66. Id. at 823. A joint venture ordinarily consists of "a community of interest in the performance of a common purpose, a joint proprietary interest in the subject matter, a mutual right to control, a right to share in the profits, and a duty to share in any losses which may be sustained." 48 C.J.S. Joint Adventures § 2(a) (1947). The facts of the instant case indicate nothing more than a haphazard series of communications among the defendants, and certainly, none of the essential elements of a joint venture.

67. 478 F.2d at 823.

68. Id. at 823 n.7, 825.

69. Id. at 823.

70. Id. at 825.
person who trades shares on the basis of inside information, having no relationship to the corporation whatsoever, will be liable to the issuing corporation in a shareholders' derivative suit.71

Like the Diamond decision, Schein searched for support for recovery of the insiders' profits in both the common law and the federal securities laws. The expanded concept of fiduciary duty was weak in Diamond and even more tenuous in Schein. The weakness, however, was not detrimental to the holding since the court did not rely solely on the common-law ground. Rather, emphasis was placed on the need to enforce the federal policy of maintaining equal access to material information in the securities market. For the sake of deterrence, not indemnification, the insider must not be permitted to retain his profits. As in Diamond, however, the court's attempt to compensate for market anonymity resulted in liability to the issuing corporation and potential liability to 10b-5 purchasers.

Unlike Diamond, in which no 10b-5 suits were instituted against the defendants, the SEC brought suit against the Schein defendants for injunctive relief under 10b-5 pursuant to an administrative investigation.72 Furthermore, a class action brought by the alleged purchasers of the shares sold by the Mutual Funds is pending.73 On the basis of the facts found in SEC v. Lum's, Inc., liability of at least the Fund defendants to the purchasers is more than potential.74 In Texas Gulf, corporate recovery was conditional so that defendants' total liability was limited to the amount of their profits. In Schein, however, defendants' liability could be twice the amount of the profits realized on the transaction. The recovery by Lum's is redundant, analogous to the grant of ancillary power to the SEC in Texas Gulf. It imposes an

71. Id.
74. Prior to trial, defendants, Simon, Sit, Jundt, and Investors Diversified Services, Inc., entered into stipulations of settlement with plaintiff SEC, pursuant to which permanent injunctions were entered against them. Of the defendants remaining in the action, Chasen was found to have been at least negligent in conveying the information to Simon (365 F. Supp. at 1066), and Lum's was held to have violated rule 10b-5 on the basis of principles of agency. Id. at 1061. Permanent injunctions were entered against both. Lehman Brothers, however, was held not to have been negligent in supervising Simon, and therefore entitled to the benefit of the "good faith" defense under section 20(a) of the 1934 Act, 15 U.S.C. § 78t(a) (1970). 365 F. Supp. at 1065. The discussion of the facts in the opinion indicates that the Mutual Fund defendants were much more than negligent in acting upon the tip from Simon. The conflicting testimony concerning Simon's actions also suggests that he was more than negligent. Id. at 1050-57.
amount of liability equal to that recoverable for a section 16 (b) violation. As in Diamond, the remedy is overbroad in that it surpasses its intended purpose and encroaches on the federally approved scheme of remedies.

Not only does recovery by the corporation in Schein obliterate the distinction between section 16 (b) and section 10 (b), it also appears to erase the gradations of scienter under 10b-5 which determine whether damages or an injunction is the appropriate remedy for a violation. The court vested all defendants with a fiduciary duty to the corporation on the basis of their possession of inside information, and did not indicate whether negligence or some form of intent will be the standard for deciding if there has been a breach of that duty. It is possible, therefore, that rather than being subject only to an injunction, merely negligent defendants will also be liable to the corporation for the amount of profits realized by the Funds. Willful violators will be subject to an injunction, liable to the purchasers for their damages, and now, additionally liable to the corporation for profits realized on the sale of the shares. This result is untenable when grounded upon the allegation that 10b-5 is not being enforced since violators continue to retain their profits. Furthermore, this result is contrary to the 10b-5 policy against awarding punitive damages. Unreasoned compounding of liability, as exhibited in Schein, runs counter to the federal recognition of the need to maintain equal access to information while not overburdening the free flow of information.

III. The Private Attorney General: Conditional Corporate Recovery

Granting the issuing corporation standing to seek recovery of the insider's illegal profits embodies the concept of the private attorney general. That role, however, should be limited to supplementing the existing enforcement methods. The underlying theory for casting the issuing corporation in the role of attorney general is that the corporation and its shareholders together are more likely to be aware of dubious transactions affecting their own interests than is a single purchaser or seller whose holdings may be small and whose active

75. 478 F.2d 817, 823 (2d Cir. 1973).
interest in the corporation minimal. This theory was borne out in the
Diamond transaction. The difficulty with the grant of standing under
the common law is that it is not qualified so as merely to supplement
the roles of the SEC and the 10b-5 purchasers and sellers.

A. Limiting Corporate Recovery Under Common Law

It is necessary to consider whether recovery by the issuing cor-
portion under common law could be limited, by existing procedural
methods, to the situation in which either no purchaser/seller, or fewer
than all purchasers/sellers, sue the insider for damages under 10b-5.
The Diamond court indicated that interpleader was a possible solu-
tion, and the court in Schein, citing Texas Gulf, stated that since de-
fendants were aware of the 10b-5 actions, they could have protected
themselves from double liability.

The threshold determination to be made by the state courts is
that the expansion of fiduciary duty as enunciated in Diamond and
Schein was meant simply to close the gap in 10b-5 and was not intended
to hold that any person having and using inside information harms
the corporation and must indemnify it for that harm. If that deter-
mination is not made, then the procedural difficulties are moot. No
grounds would exist for denying corporate recovery even if defendants
have already disgorged their profits to purchasers and sellers. A request
to stay the common-law action pending determination of a suit by
10b-5 purchasers or sellers would have to be denied. Assuming, how-
ever, that the state courts acknowledge the expanded fiduciary duty
as camouflage to fill the 10b-5 gap, there remain jurisdictional and
procedural obstacles in the use of a common-law suit as a private at-
torney general to enforce a federal policy.

1. Jurisdictional Obstacles. The initial problem would be juris-
dictional. Once the state court announced that standing was being
given the issuing corporation solely to aid in the enforcement of rule
10b-5, it is likely that state court jurisdiction would be held to fly in
the face of the grant of exclusive jurisdiction given by the Securities

76. Neither the SEC nor any purchaser brought a 10b-5 suit against the Diamond
defendants.

77. 478 F.2d at 825 n.10. Texas Gulf, however, merely provided that the SEC
could seek restitution for private purchasers and sellers in an administrative action
under 10b-5. It did not suggest any method for defendants in a common-law action to
protect themselves from subsequent liability for the same transaction to 10b-5 plaintiffs.
Exchange Act of 1934 to the federal courts to hear 10b-5 actions.\textsuperscript{78} It would be necessary, therefore, for the state courts to retain the \textit{Schein} and \textit{Diamond} concepts of fiduciary duty to escape that conflict. Yet, in order to prevent unconditional recovery by the corporation, it would be imperative for the state courts to recognize that corporate recovery must be subordinate to 10b-5 purchaser/seller recovery.

\textbf{2. Interpleader, Removal and Stay.} Assuming that the exclusive jurisdiction of the federal courts did not present a problem, there still would be procedural obstacles to insuring that corporate recovery would be subordinate to purchaser/seller recovery under 10b-5. Three procedural devices appear to be possible solutions—interpleader, removal to the federal court, and grant of a stay of the state court action pending determination of any 10b-5 suits in the federal courts. The first was suggested by the \textit{Diamond} court and the last by the \textit{Schein} defendants.

The suggestion in \textit{Diamond} was that the defendants could take advantage of an interpleader suit.\textsuperscript{79} But since the state court could not have jurisdiction of the 10b-5 suit, defendants could not interplead 10b-5 purchasers or sellers unless the suit by the corporation was brought originally in federal court on the basis of diversity of citizenship.\textsuperscript{80} Surely there is no rational basis for making defendants' ability to protect themselves from double liability dependent upon the fortuitous circumstance of diversity.

The second alternative, removal to the federal courts, is similarly defective. Defendants would be unable to remove the state common-law suit to federal court because of the lack of a federal question.\textsuperscript{81} Even if defendants could interplead the 10b-5 purchasers/sellers un-

\begin{itemize}
  \item \textsuperscript{78} Section 27 of the 1934 Act, 15 U.S.C. § 78aa (1970), provides:
    \begin{quote}
      The district courts of the United States \ldots shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.
    \end{quote}
  \item \textsuperscript{79} 24 N.Y.2d 494, 504, 248 N.E.2d 910, 915, 301 N.Y.S.2d 78, 86 (1969).
  \item \textsuperscript{80} Since \textit{Schein} was brought in the federal court on the basis of diversity jurisdiction, the defendants could have interpleaded the purchasers notwithstanding the difficulty in tracing them. However, it was unlikely that the defendants expected the Second Circuit to decide as it did.
  \item \textsuperscript{81} 28 U.S.C. § 1331 (1970) states in part:
    \begin{quote}
      (a) The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and arises under the Constitution, laws, or treaties of the United States.
    \end{quote}
\end{itemize}
under a state interpleader law, and the state court mistakenly took juris-
diction of it, the interpleader could not be removed to the federal
court since the state court had no valid jurisdiction over it.82

A third alternative was suggested by the defendants in Schein
who requested a stay of the action pending determination of the 10b-
5 suits. Although their request was not reached because of the dismis-
sal in the lower court,83 it was an attempt to subordinate the cor-
porate action to the 10b-5 suits. This solution, too, fails to withstand
scrutiny. If a private 10b-5 suit brought as a class action were to be
found procedurally deficient and consequently dismissed without
prejudice, the question would arise as to when the stay would be
terminated. If it terminated upon dismissal of the federal action, then
it would be possible for the common-law suit to result in a judgment
for the corporation before the 10b-5 complaint could be redrawn
adequately. The alternative would be to continue the stay until the
statute of limitations had run.84 Similarly, if a 10b-5 suit were brought
by an individual purchaser/seller, the stay could not terminate until
the statute of limitations precluded the filing of any further actions.
Even if no 10b-5 suit were pending, the common-law action should
be stayed until the statute of limitations has run on potential 10b-5
suits.

It is clear that the procedural tools available to a defendant to
prevent premature unqualified corporate recovery are unsatisfactory.
What remains is voluntary compliance by the state courts. That com-
pliance necessarily would take a form analogous to the conditional
corporate recovery allowed in Texas Gulf. The difference would be
that the issuing corporation itself, rather than the SEC, would be
seeking the conditional recovery. If any judgment were obtained
thereafter by private 10b-5 plaintiffs, it would be satisfied out of the
amount held in escrow by the issuing corporation.

If such voluntary compliance were to be obtained so as to avoid
the possibility of double liability, the anonymity gap in 10b-5 would

82. See, e.g., General Inv. Co. v. Lake Shore & M.S. Ry., 260 U.S. 261 (1922);
84. Since Congress did not include a statute of limitations in section 10(b), the
federal court must apply the state statute. For an analysis of the resulting lack of
uniformity in the application of a uniform federal statute, see Schulman, Statutes of
Limitation in 10b-5 Actions, 13 WAYNE L. REV. 635 (1967).
be served only nominally; to date, only New York\textsuperscript{85} sanctions corporate recovery. The Securities Exchange Act of 1934 announced a policy to be applied and enforced throughout the states; selective enforcement dependent upon state expansion of common law undercuts the deterrent effect of the statute.

B. Conditional Corporate Recovery Under 10b-5

What is required is a comprehensive federal system sanctioning corporate recovery on a 10b-5 cause of action in those situations in which market anonymity proscribes private 10b-5 recovery.\textsuperscript{86} Incorporation of 10b-5 liabilities into a state's corporate law requires that the corporate structure be specifically intended to prevent the tortfeasor from profiting by the illegal act. The time period over which the information was received determines the measure of liability.

\textsuperscript{85} Diamond v. Oreamuno, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969). The judgment of the Second Circuit in Schein v. Chasen has been vacated by the United States Supreme Court and remanded so that the New York Court of Appeals may consider whether the controlling issue of law should be certified to the Supreme Court of Florida for decision. Lehman Bros. v. Schein, 42 U.S.L.W. 4603 (U.S., Apr. 29, 1974). Therefore, Schein does not represent the state of Florida law.

The Florida certification statute provides:

The supreme court of this state may, by rule of court, provide that, when it shall appear to the supreme court of the United States, to any circuit court of appeals of the United States, or to the court of appeals of the District of Columbia, that there are involved in any proceeding before it questions or propositions of the laws of this state, which are determinative of the said cause, and there are no clear controlling precedents in the decisions of the supreme court of this state, such federal appellate court may certify such questions or propositions of the laws of this state to the supreme court of this state for instructions concerning such questions or propositions of state law, which certificate the supreme court of this state, by written opinion, may answer.


86. Commentators have urged that liability to purchasers and sellers under 10b-5 be eliminated in favor of uniform corporate recovery. \textit{See} Note, \textit{Corporate Recovery for Insider Violations}, 36 \textsc{Brooklyn L. Rev.} 78 (1969); 54 \textsc{Cornell L. Rev.} 306 (1969). The argument is based on the theory that the purpose behind private recovery is not indemnification for actual harm resulting from the transaction. Instead, it is merely the means employed to effectuate the deterrence policy behind the rule—the means for removing violators’ illegal profits. If indemnification were the objective, anyone having purchased or sold shares during the time between the trade on inside information and the public dissemination of the information would be entitled to indemnification. No more reliance was placed by the actual purchasers/sellers in the anonymous transaction on the failure to disclose than by any other purchaser/seller during the same time period. Since recovery is reserved only to the purchasers/sellers in “privity,” it must be merely a method of attempting to limit the monstrous liability which would attach to true indemnification. For a recent decision which abandons privity altogether in favor of liability to all purchasers and sellers, see Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 353 F. Supp. 264 (S.D.N.Y. 1972). \textit{See also} 4 \textsc{Memphis St. L. Rev.} 171 (1973).

Assuming that indemnification is not the objective of private recovery, the conclusion that corporate recovery is the only rational remedy does not necessarily follow.
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poration of corporate recovery into the 10b-5 enforcement system would eliminate any possibility of forum shopping. Moreover, uniform application of 10b-5 by the federal courts would promote consistent standards in the finding of 10b-5 violations and the administration of the appropriate remedies. 87 Finally, because rule 10b-5 greatly enlarged the protection afforded investors from insider trading by expanding the duty of disclosure and abating proof problems faced under common law, 88 it now would be anomalous to revert to the common law to deter insider trading. The present interpretation of 10b-5 intensifies that anomaly by indicating that the rule is being applied to transactions which reflect corporate mismanagement—an area that is traditionally a state concern. 89

A combination of the concepts set forth in Diamond, Texas Gulf, and Schein provides a basis for a uniform system of recovery under 10b-5. Granting the issuing corporation standing to sue succeeds in compensating for market anonymity, while conditional recovery by the corporation prevents the possibility of liability beyond what is sanctioned now for a 10b-5 violation. Once corporate standing and conditional recovery are recognized under 10b-5, administration by the federal courts under the grant of exclusive jurisdiction will eliminate procedural problems in coordinating actions brought by purchasers/sellers and the issuing corporation. Application of the system under 10b-5 could take the following outline: 90

1. If a class action were brought on behalf of the purchasers/sellers, the issuing corporation would be barred from bringing suit, since re-

There must be some attempt to rationalize the remedy allowed with the duty breached. Under the 1934 Act, that duty is owed by the insider to the general investing public who will suffer an economic loss because of the insider's failure to disclose material information. It would seem that that investing public has the higher claim to the violators' profits than the issuing corporation who has suffered no economic injury. Therefore, even if it is not feasible to indemnify all purchasers/sellers who traded during the relevant time period because of the resulting liability to the insider, it would still seem that the purchasers/sellers have a higher claim to the profits than the corporation, even if corporate recovery as the sole remedy would be easier to administer.

87. This would eliminate a repetition of the Schein result, which, by cloaking everyone who obtains possession of inside information with a fiduciary duty and failing to enunciate any standards for the breach of that duty, erased the gradations of scienter under 10b-5.

88. See materials cited at note 6 supra.


90. The suggested form is only a procedural guideline for the coordination of the corporate suit and any action brought by a purchaser/seller. It does not in any way change or attempt to change the substantive elements and standards of a 10b-5 cause of action as they are currently being applied by the federal courts.
covery by the class would necessarily exhaust defendants' profits.\(^1\)

2. If an individual suit were brought by a purchaser/seller, the issuing corporation would have to be joined as a necessary party-plaintiff. The individual plaintiff would be awarded damages not exceeding his losses; the issuing corporation would recover the difference between defendants' profits and the individual plaintiff's recovery. However, the recovery by the corporation would be held in escrow for five years. If, between the signing of judgment and the termination of the escrow agreement, other purchasers/sellers file suit, the prior judgment would be conclusive as against the defendants. The additional plaintiffs need only present proof that they are actual purchasers/sellers, and of their losses. Favorable judgments would be satisfied out of the fund held in escrow by the issuing corporation.\(^2\)

3. If the corporation were to file suit, either directly or derivatively, and no purchaser/seller action were filed at any time prior to judgment, recovery would be in the amount of defendants' profits. Recovery would again be conditional to be held in escrow for five years pending application by actual purchasers/sellers.

4. If a purchaser/seller action and a corporate action were to be filed at approximately the same time, the corporate action would be dismissed upon application by defendants since the corporation would have been joined as a necessary party-plaintiff in the purchaser/seller suit.

5. If the corporate suit were near determination when a purchaser/seller suit is filed, the purchaser/seller action would be stayed pending determination of the corporate action. If judgment were awarded conditionally in favor of the corporation, the purchaser/seller action would consist of no more than proof that the plaintiffs are actual purchasers/sellers and the determination of plaintiffs' damages to be satisfied out of the corporate award. If, however, the judgment were in favor of defendants, or only an injunction issues, the stay of the purchaser/seller action shall terminate and plaintiffs may relitigate the issues.\(^3\)

6. (a) Dismissal on the merits in a suit by the corporation would not bar subsequent suits by purchasers/sellers.

(b) Dismissal on the merits in a purchaser/seller suit would bar all subsequent suits.

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91. If the recovery is not completely claimed by the class, it should be held in escrow for five years pending any late claims, and then the balance unconditionally awarded to the issuing corporation. In no event should the violating defendants be allowed to retain any of their profits.

92. Joining the issuing corporation as a necessary party-plaintiff will facilitate the issuance of a judgment which conditionally awards defendants' profits to the corporation.

93. Each of these provisions, numbers 1-5, is designed to avoid a multiplicity of unnecessary suits and relitigation of identical issues.
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(c) A judgment in favor of either the issuing corporation or a purchaser/seller would act as res judicata in all subsequent suits.\textsuperscript{94}

7. Plaintiffs in a derivative suit on behalf of the issuing corporation would be required to post security for expenses.\textsuperscript{95}

CONCLUSION

The gap in rule 10b-5 created by market anonymity must be closed in order to effectuate the policy articulated by the Securities Exchange Act of 1934. The need cannot be satisfied merely by compounding the liability of those brought into court. Whereas filling the gap would further the deterrence of insider trading thus promoting the federal objective of providing for equal access to material information, duplication of liability would restrict the free flow of information in the securities market. Therefore, use of the issuing corporation as a private attorney general under rule 10b-5 must be limited to compensating for market anonymity. Only a single uniform federal scheme can effectively and efficiently promote the announced federal policy.

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\textsuperscript{94} This author feels that suit by the issuing corporation may not be sufficiently adversarial so as to bar subsequent purchaser/seller suits if the corporation is unsuccessful.

\textsuperscript{95} Although security is not now required in federal derivative actions, it may be necessary in this context to mitigate the possibility of strike suits.
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